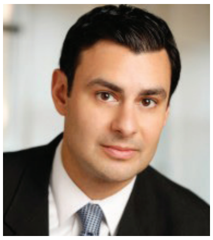
Risks of Subleasing Commercial Spaces

By: Pierre E. Dabbas, Esq. and Peter I. Reiter, Esq.



Pierre E. Dabbas

Peter I. Reiter

This article will address the different risks that may arise in subleasing commercial office and retail spaces and the effects upon the sublandlord and subtenant.

Sublandlord's Risks:
(i) When subleasing for a short term (i.e. approximately two years or less), the sublandlord needs to ensure that the subtenant will have the ability and financial resources to remain in the sublease space for the entire sublease term. If the subtenant defaults or vacates the subleased premises prior to the end of the sublease term, it may be extremely difficult to find a short-term replacement subtenant for a term less than 12 months, leaving the sublandlord with the entire financial obligation until the expiration of the master lease. Sublandlord may have already incurred costs and provided incentives to the original subtenant (i.e. a free rent period, cash allowance for construction/alterations and incurred payment of brokerage fees/commissions).

(ii) If there is a holdover penalty for rent under the master lease and the subtenant does not vacate upon the expiration of the sublease term, the sublandlord may incur up to two or three times the rent as holdover rent charges plus additional penalties (i.e. pay for damages for an incoming tenant who may be delayed due to the subtenant not vacating on time), which may not be entirely covered by the sublease security deposit;

(iii) If subtenant has agreed to return the sublease space in a "particular condition" upon the sublease expiration, by removing all of the furniture, fixtures and equipment (and specialty alterations, if any), sublandlord may have to restore the subleased premises and deliver it vacant and broom clean;

Subtenant's Risks:
(i) Subtenant's primary concern is that the sublandlord does not default under the master lease which may cause the termination of the sublease, i.e. by sublandlord paying the rent to the master landlord or breaching any other terms or conditions of the master lease where the sublandlord still retains other space under the master lease. Ideally, the subtenant would like the master landlord to recognize the subtenant under the same terms and conditions of the sublease, especially if the sublease rent that the sublandlord is paying the master landlord is lower than the rent under the master lease. The subtenant would like to be directly held responsible by the master landlord and be recognized as a direct tenant of the master landlord under the sublease's terms and conditions. However, most landlord's "consent agreements" provide that the landlord has the right to terminate the sublease or if the landlord is willing to retain the subtenant. The subtenant is required to pay the rent owed under the master lease. Needless to say, if the sublease rent is at a higher rent than under the master lease, the landlord will more readily accept the subtenant and not terminate the sublease.

(ii) If the sublandlord dissolves or liquidates and the landlord recognizes the subtenant pursuant to the master lease, the subtenant may incur additional potential liabilities in sublandlord's absence. Examples include restoration and removal of sublandlord's furniture, fixtures and equipment, additional rent charges of real estate taxes and operating expenses charges under the master lease, all of which may not have necessarily been included under the sublease.

Pierre E. Dabbas, Esq.
Romer Dabbas, LLP
275 Madison Avenue, Suite 801
New York, NY 10016
(P) 212-888-3100
(C) 646-599-6994
(F) 212-888-3201
PDebbas@romerdebbas.com
www.romerdebbas.com

Peter I. Reiter, Esq.
Romer Dabbas, LLP
275 Madison Avenue, Suite 801
New York, NY 10016
PReiter@romerdebbas.com
www.romerdebbas.com