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## Lease exit strategy subleases

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Who needs an exit strategy? In this economy, most of us are aware of tenants facing difficulties in meeting their lease obligations. If we weren't thinking about it front and center, it was brought front and center when Borders declared bankruptcy, closing hundreds of stores.

The realization that Borders is now unable to make its lease payments raises the question in every retailer's mind: *What happens if my business, my location, and my lease aren't viable in the future?* You need an exit strategy.

The exit strategy is negotiated when you are signing or extending your lease.

**What are the most typical exit strategies?** From best to worst, they are:

1. A sublease provision that provides maximum flexibility.
2. A right to terminate in exchange for a payment.
3. A shorter term lease, with options to extend.
4. A corporate lease, without any personal guarantees.

**Sublease provisions.** The best exit strategy is to find a subtenant to take over your space at or close to your rental rate. That solution will not be free of costs, because you will probably incur broker fees and attorney fees, there will probably be fees payable to the landlord and its attorney, and there may be construction or alteration costs. In many situations, the monthly rent payable by a subtenant will be less than your rental obligation. And there are risks. If the subtenant doesn't pay, damages the property or defaults in some other way, or doesn't move out at the end of the term, you remain liable.

Despite these risks, a sublease is generally a tenant's best option. It is not a default under the lease, it doesn't affect the tenant's credit rating or reputation, and even with all of its costs and risks, it's generally less expensive than the other options.

Most leases say that a tenant cannot sublease without the landlord's consent, and that the landlord's consent cannot be unreasonably withheld.

**Reasonableness.** The lease will often say that the landlord is not being unreasonable if it denies consent for specified reasons. Some reasons for denial of consent that the lease says are “not unreasonable” could unreasonably interfere with the tenant’s ability to sublease. Examples are provisions that say:

- a. The tenant cannot sublease to an existing tenant at the shopping center. The landlord does not want to compete with its tenants in leasing space. However, the most likely candidate to take your space is another tenant already in the same center. To compromise, you might agree that you won’t lease to an existing tenant only if the landlord has comparable space available.
- b. The tenant cannot sublease to any affiliate of an existing tenant or cannot sublease to a tenant that the landlord is leasing to in another location. Those are aggressive positions that should be resisted.
- c. The tenant cannot sublease to a party that the landlord is negotiating with or has negotiated with in the past. That should be limited to active negotiations and in the case of past negotiations, those that have occurred in the last three months.
- d. The subtenant must be creditworthy. The standard for testing creditworthiness should be reasonable, and a suggested standard is that the subtenant’s creditworthiness is sufficient to pay the remaining obligations under the lease.
- e. The subtenant’s use must be the same as the tenant’s use. The landlord wants to maintain control over the tenant and product mix. The landlord may also have non-compete agreements with certain of its tenants that restricts its ability to allow certain uses in the center. You may be able to achieve some flexibility by restricting a new use to no more than a specified percentage of the subtenant’s revenue.
- f. There may be additional restrictions on use, such as not allowing a sublease if it results in increased traffic, usage of facilities, or increased parking usage.

**Timing.** Because subtenants need to move quickly, tenants often ask a landlord to agree to respond to a request for a sublease within 15 days. If landlords agree to a time frame at all, it is generally 30 days. It’s best if the landlord will agree to a deemed consent if it fails to respond within the required time period, but that’s very difficult to get.

**Remedies.** The lease will often say that the tenant’s only remedy if the landlord is not reasonable in granting consent is to go to court and get a judge to order the landlord to be reasonable. That’s not a real remedy, since by that time, the subtenant has found substitute space. A tenant should try to retain the right to get monetary damages from the landlord if the landlord has unreasonably withheld its consent.

**Costs.** The lease will almost certainly include fees payable to the landlord for its time in reviewing the sublease and negotiating the form of consent. There will also be a provision for paying the fees of the landlord’s attorneys. Fees should be “reasonable” and, if possible, include a monetary cap.

**Profit sharing.** If you are in an under market deal, and rents go up, you may make money on your sublease. It is considered “market” for a landlord to say it should get 50% of the amount that the subtenant pays that exceeds what the tenant pays. The excess rents should be calculated after deduction for costs of subleasing, including brokers fees, attorney fees, costs of improvements, fees paid to the landlord and its attorneys, and other out of pocket costs. These costs should be deducted up front, before any profit is determined and shared, and the landlord should be paid its share of the profit as and when collected by the tenant after the tenant has recouped its initial costs.

The time to make sure you have a good degree of flexibility for subleases is before you sign the lease. That’s the time to push back against language that could make it difficult to sublease, which is a legitimate concern in this economy.

*Sandra Gold Slon is a real estate partner at TroyGould, specializing in representing tenants in their lease negotiations. She represents major international firms with locations all over the country, as well as smaller companies with multiple locations and single-location office and retail users. She works well with start-up companies and major corporations, taking into account their different approaches and needs.*

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