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## **Subleasing basics: Protecting the unwary subtenant's interests in its premises - by Matthew Zangwill**

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A sublease might seem a simple transaction since the hard work of negotiating the master lease is done and its terms will be incorporated into the sublease by reference. However, the existence of the master lease may be the cause for often overlooked details that can harm the subtenant.

The master lease can be viewed as a snapshot in time representative of the market for the particular type of leased space. If executed during a frenetic leasing market, certain provisions of the master lease such as the surrender obligations of the tenant, cure periods, tenant's alteration rights and ability to assign and sublease may reflect an imbalance of the parties' bargaining power. A full and thorough review and accounting of the master lease is advised to identify unwanted obligations or limitations that should be shifted away from the subtenant.

A critical subleasing issue is the consequence of a termination of the master lease prior to the expiration of the term of the sublease. What happens if a sublandlord defaults on its obligations under the master lease or rejects the master lease in its bankruptcy? With few exceptions, a sublease will not survive termination of the master lease and as the landlord has no direct relationship with a subtenant, it is not obligated to recognize a subtenant's right under the sublease to remain in possession. Compounding such a dilemma, consider the subtenant's position if the subtenant made capital improvements to the subleased premises only to find that its interest has been extinguished. Consider further if the rent under the master lease is below market at the time of a default. The convergence of such events might provide the landlord with ample motivation to seek to terminate the master lease following a tenant default, leaving the subtenant's fate in the hands of the landlord.

There is no simple solution to shoe horn into a sublease that will satisfy the concerns of all parties. Since the rent payable under the sublease is often less than the rent payable under the master lease, the subtenant should carefully evaluate the financial strength of the tenant to quantify the risk of a master lease default.

A best case scenario for the subtenant would be a recognition agreement from the landlord wherein the landlord agrees not to disturb the subtenant's possession and recognize the sublease as a direct lease between the landlord and subtenant in the event the master lease is terminated through no fault of the subtenant. However, recognition agreements are often met with heavy resistance or outright rejection. If, as mentioned above, the subtenant's rent is less than that in the master lease, the landlord may insist that the rent be increased to match the master lease – or even higher if the rent payable under the master lease is also undervalued.

If the landlord will not deliver the subtenant a recognition agreement, other subtenant protections can be baked into the sublease. These include covenants from sublandlord that it shall:

- Fully and faithfully perform the terms and conditions of the master lease on its part to be performed.
- Not surrender, voluntarily terminate or amend the master lease.

- Send subtenant copies of all default notices received from or sent to landlord.
- Permit subtenant to cure any default under the master lease to prevent a termination of the master lease, with reimbursement of any expenses incurred by subtenant to be paid by sublandlord or offset against next installments of rent due until all sums have been recovered.

Additionally, if the master lease allows the sublandlord to terminate the master lease following a fire or other casualty, the sublease should prohibit the sublandlord from making such determination and transfer decision making power to the subtenant.

A landlord can also pose an existential threat to the continued existence of the master lease if the landlord defaults on a mortgage encumbering the subleased premises. If a mortgagee forecloses, an after-executed sublease will be at risk of termination. A solution is to obtain from the mortgagee a non-disturbance agreement that will permit the subtenant to remain in occupancy pursuant to the terms of the sublease, provided there is no default by subtenant.

Since a subtenant lacks a contractual relationship with the landlord, its rights are limited in an instance where the landlord fails to perform its obligations under the master lease (e.g., provide building services). Accordingly, the sublease should give the subtenant the right to bring an action against the landlord in the sublandlord's name to compel landlord's performance.

A subtenant may view a sublease transaction solely from the vantage point of lower rents. However, as highlighted herein, oft-ignored sublease issues can have adverse consequences to an unsuspecting subtenant. While the existence of the master lease is paramount, there is more than one avenue to successfully protect a subtenant's interest in its subleased premises.

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