



The commercial classroom: Lease termination clauses - Part 1

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A lease is a contract between a landlord and tenant that defines which party is responsible for what and who pays for what in a building. The "term" indicates the length of the lease. But what if the tenant wants to end the lease before the end of the term? Leases may or may not have clauses to allow the tenant to do so.

The most common release clause is the right to sub-lease. This clause allows the tenant to rent out part or all of their space. It requires the landlord's consent and approval. Language in the lease generally states, "...such approval cannot be unreasonably withheld."

When this is done a second lease is constructed between the tenant, now referred to as the master tenant, and the sub-tenant. There is no direct contractual relationship between the sub-tenant and the landlord. The sub-tenant pays their rent to the master tenant who in turn pays the landlord.

The original tenant is liable under the lease for all rent due. If the amount of money collected from the sub-tenant is not sufficient to pay the obligation to the landlord, the original tenant must pay the difference.

Sub-leasing space in a down market can be a real challenge. A 10 year lease was signed five years ago with annual rent that is now \$70,000. Presently rents are down 25%; competitive space today is being rented for \$54,000 a year. The tenant may be able to find a sub-tenant but may have to subsidize the rent by \$16,000 a year to meet their leasehold obligation.

But what if a profit can be made from the sub-tenancy? Often the lease will indicate that if a profit is made the profit goes to the landlord or is split between the landlord and the original tenant.

Assignment Clause - A lease may allow the tenant to assign the lease to another party, subject to landlord approval. Here the assignee takes over the lease and has a direct relationship with the landlord. They must abide by all the terms and conditions of the lease. However the original tenant continues to have a liability for the leasehold obligation. If the assignee does not pay the rent or in any other way breaches the lease the original tenant is responsible.

Assignments of leases often result from the sale of a tenant's business and consequent desire by the tenant to be completely removed from the lease responsibilities. The tenant who is assigning a lease generally desires to be released from any further liability; typically accompanying the assignment clause will be a release of liability clause. This requires the original tenant to pay a substantial penalty (perhaps six months rent or more) to be released from the lease.

Next month we will explore early termination or "bail out" clauses and "good guy" clauses.

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