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A TENANT'S GUIDE TO LANDLORD DEFAULT

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Economic instability and looming debt in the commercial real estate sector can leave tenants uncertain about existing leases or potential new spaces.

Nearly $1.5 trillion in commercial real estate debt is forecasted to mature by 2025, the highest volume since the financial crisis of 2008–09. This, coupled with a decline in office values and rising interest rates, can put tenants in a precarious position, as office, retail and multifamily properties comprise the majority of defaulted CMBS debt transfers.

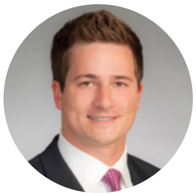
First and foremost, tenants can proactively mitigate risk – today and before signing a future lease – through careful due diligence and a thorough evaluation of a landlord's financial stability, cash position, debt structure, fundraising abilities and investment strategy. In addition, here are 15 other important aspects tenants should consider if a landlord is at risk of default or when evaluating new locations.

1. **SNDA:** Ensure a Subordination, Non-Disturbance, and Attornment Agreement is in place with the current lender and building owner. This protects your occupancy rights in the event of a foreclosure. It is also important that your lease requires SNDAs from future lenders — if it's only the current lender, the initial SNDA is worthless as soon as the building trades or is refinanced.
2. **Ground Lease Recognition Agreements:** While ground leases are not as common as mortgages, many large properties are subject to ground leases. If there is a ground lease, make sure that you have a recognition agreement from the ground lessor so your lease won't terminate if the ground lease terminates.
3. **Subleasing:** If planning to sublet, bear in mind that the absence of an SNDA can deter subtenants due to the associated risks. If you are entering into a sublease, ask the sublessor about the status of its SNDA.
4. **Rent Obligations:** Even if ownership changes, your duty to pay rent continues.
5. **Building Maintenance:** Pay attention to building maintenance and notify the landlord of significant changes which could justify constructive lease termination. Also, be sure to require self-help rights in your lease.
6. **The Lender:** If a larger bank is the lender, they are likely to continue funding maintenance in the event of a landlord default. If the bank is at risk of failure, then your risks are much higher.
7. **Your Occupancy:** The larger your occupancy share of the building or loan portfolio, the more leverage you have in renegotiating lease terms.
8. **Sale Negotiations:** If the building is being sold, there could be an opportunity to negotiate terms with the new owner.
9. **Lease Buyouts:** Early lease buyouts need lender approval. Proceed cautiously to avoid potential fraud.
10. **Lease Security:** It is unlikely a landlord would let a paying tenant out of a lease; however, understand the building's stacking plan as other tenants could have expansion plans.

11. **Landlord Concessions:** Utilize or escrow any outstanding concessions from the landlord. Require the right to offset tenant improvement allowances in your rent if your landlord fails to pay the tenant improvement allowance.
12. **Lease Audit:** Regularly review your lease for possible renegotiation points or potential issues and expense reconciliations.
13. **Backup Documentation:** Keep a record of all communications, notices and agreements with your landlord. This documentation can be crucial in resolving any disputes that arise from a potential default.
14. **Tenant Associations:** Consider joining or forming a tenants' association. By banding together, tenants may have more leverage to negotiate with landlords or potential new owners.
15. **New Leases and Contingency Planning:** Prepare for every possible scenario. Negotiate rent abatement or termination clauses should the landlord fail to maintain the building's quality or promised improvements. For smaller buildings, tenants might negotiate a Right of First Refusal (ROFR) to purchase the building. Prior to signing, request access to the landlord's credit rating and financials and closely monitor the Debt Service Coverage Ratio (DSCR) for any CMBS debt. A DSCR less than 1 could indicate financial trouble.

Informed, strategic decisions are vital to secure your tenancy, and we are experts at developing tenant strategies that mitigate risk and dispose/buyout of unused space. If you have questions about your real estate strategy or would like to better understand the financial health of your landlord, please reach out.

For more information:



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Chase is a commercial real estate broker who excels at delivering integrated account management services to real estate occupiers, including strategic planning, portfolio/lease administration, transaction management, project management and workplace strategy.

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Adam is a real estate attorney who has represented multinational consulting companies, Fortune 500 consumer brands, national medical clinics, global third-party logistics companies, and other real estate tenants occupying a wide variety of product types.