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KEVIN F. JURSIANSKI, ESQ.
COMMERCIAL LEASE NEWSLETTER

**THE LEASE GUARANTY
ISSUES FOR BOTH COMMERCIAL LANDLORD
AND COMMERCIAL TENANT**

This month's article will address varying types of lease guaranties and the impact and effect a lease guaranty will have both on the Landlord and the Tenant. In general, a guaranty is a written obligation undertaken by a third party who guaranties the performance, in whole or part, of the commercial Tenant's obligations under the lease agreement. Guaranties have been significant to both the commercial Landlord and Tenant, especially in today's real estate market when defaults are occurring.

This article will address the impact and effect on both the Landlord and Tenant as to the varying types of guaranties and will provide information which can be utilized by both Landlord and Tenant to craft protections in reference to a commercial lease.

**COMMERCIAL LANDLORD: REASONS WHY A GUARANTY IS NEEDED BY
A COMMERCIAL LANDLORD**

In the situation where a Tenant is a single asset LLC, Corporation, etc, a Landlord will be well served by having a guaranty of the lease issued by a financially responsible person or entity. A company may be set up by a shell corporation to act as a lessee. Setting up such a company as a single asset entity for the purpose of being a Tenant does not violate Florida Law and does not create liability for the principals of such company. Geigo Properties, LLP v. R. J. Gators Real Estate Group, Inc. 28 Fla. Weekly D1443 (4 DCA 2003).

Many Landlords are accepting leases and not requiring the principals of a tenant's entity to be personally liable under the lease. These actions by the Landlord might encourage some Tenants to sign a long term lease, but it raises a number of problems for the Landlord as to the enforceability of the lease.

Unfortunately, even sophisticated (but ill advised) Landlords in our area engage in leases with commercial Tenant entities when they have no personal guaranty from a financially

responsible individual or entity. This proves to have a twofold negative impact upon the Landlord in the event of default.

In the event of a default, the Landlord will be able to look only to the Tenant. If the Tenant is a single asset entity, with the only assets that the Tenant has being the leasehold estate, the collectability against the Tenant will be extremely poor. In the event the Landlord initiates a suit against the Tenant, the Tenant may also file a counterclaim against the Landlord for whatever causes of action the Tenant may have, which could include various claims such as fraud in the inducement, breach of the lease and constructive eviction. In such a case, the unwary Landlord who was naive enough to sign a lease without a guaranty by a financially responsible person will find itself enmeshed in a lawsuit that needs to be taken through to trial with the unfortunate result being that:

- a. If the Landlord wins, they will spend attorney fees and costs and will not have any source of recovery if the lease is not guaranteed by a financially responsible person, and the Tenant proves to have no assets;
- b. If the Landlord loses, it will again pay its own attorney fees, those attorney fees of the opposing party as well as suffer a damage claim in the event that the Tenant happens to have a viable cause of action.

Even worse is the naive Landlord in this situation who believed it could extricate itself from the lawsuit by simply dismissing its own cause but eventually realize that the counterclaim would remain viable and pending until it was dismissed, discharged or tried to a final conclusion. As such, the Landlord is in for a long term lawsuit when it has no real opportunity to recover any monies.

It is certainly a “lose-lose” situation for our naive the Landlord if they do not obtain a guaranty.

One other item that could negatively impact the Landlord is the fact that the Tenant might not even own the personal property kept on the premises. The property might in fact be owned by a financially responsible person who could remove his equipment or personal property from the premises, without such personal property being subject to the Florida Landlord’s Lien under Florida Statute §83.08. Another black eye for our naive Landlord.

IMPACT AND EFFECT OF GUARANTY ON TENANT

Many Tenants unwittingly assume that they have to guaranty 100% of the obligations of their company as to the lease agreement after being requested to do so by the Landlord. Further, many unsophisticated Tenants assume that this undertaking is not significant since it is “only a lease”. Take for example a small 1500 square foot store which has rent as \$12.00 a square foot and CAM at \$5.00 a square foot with a five (5) year term. While a Tenant would assume that this is “only a lease” the guaranty of this lease from the onset of the lease commencement, could expose the guarantor to liability in an amount in excess of \$125,000.00 plus attorney fees and costs in the event of a breach. This is based

upon sixty (60) months at base rent, plus sixty (60) months as CAM, plus tax, as well as potential attorney fees and court costs. As such, even though it is “only a lease”, as you can see from this example, even a small location can expose the guarantor to a six figure damage claim.

TYPES OF GUARANTIES

There are several types of guaranties. Knowing the types of guaranties can assist both the Landlord and the Tenant in their negotiations. A structured guaranty can be entered into to satisfy both the Landlord’s need to have some security for its lease, as well as the Tenant’s individual requirement not to be exposed to a significant damage claim in the event of a default. Here are the types of guaranties and their applicability:

UNCONDITIONAL LEASE GUARANTY GUARANTYING PAYMENT: In this situation, the guarantor usually obligates himself or herself to all damages that the Landlord could suffer as a result of the breach of a lease by the Tenant. These damages could include not only the damages resulting from the non payment of the actual rental, but also any damages which could be caused by the Tenant’s misuse of the property (for example a causality loss caused by the Tenant). Additionally the damages could include any other losses that are available to the Landlord as a remedy under the lease agreement, inclusive of the recovery of attorney fees, costs, potentially additional damages in the form of late charges, interest, and potential failure to pay or liquidate damages for non operation by the Tenant.

GUARANTY OF COLLECTION: This guaranty of collection is significantly different from the guarantee of payment inasmuch as the guarantor stands responsible for only the amount due to the Landlord after the Landlord exhausts its remedies against the Tenant. The Landlord must first seek to recovery damage against the Tenant, execute against the Tenant which would be in the form of potentially offsetting rentals, making good faith efforts to re-let the premises. Deducting from the damages and personal property, the Landlord could receive by enforcing its distress for rent writ or other remedies which would minimize and mitigate damages for the Landlord. Then and only then, would the guarantor be responsible for the balance due to the Landlord after the Landlord attempts collection efforts against the Tenant.

The distinction of guaranty of payment versus guaranty of collection is even more pronounced in a situation in which a guarantor would guaranty payment of a mortgage for in that particular instance, the unconditional guaranty of payment versus a guaranty of collection could result in the guarantor being sued for 100% of the outstanding amount due on the mortgage note without the lender having recourse to foreclose against its collateral. Although not as onerous as an unconditional guaranty of payment for a mortgage note, an unconditional guaranty of payment versus a guaranty of collection on a lease nonetheless still can have a negative effect upon the Guarantor.

GUARANTY OF SPECIFIC RENTAL PAYMENTS VERSUS GUARANTY OF ALL LEASE OBLIGATIONS: There is also a distinction on the guaranty for the

guarantor to limit its liability to either only rental payments or alternatively guaranty only a certain portion of the rental payment.

Using an example of a five year lease, the guarantor could indicate that it would guaranty only the first two (2) year years of actual lease payments to be made by the Tenant and if the Tenant was not otherwise in default and had made its first two years of lease payments, the guarantor would be released of all further obligations.

A guarantor could put a “cap” on the obligations of the guarantor as to only the specific lease payment obligations that are due during the first twenty four (24) months of the lease (or the negotiated guaranty period).

Further, by guarantying only the “lease payments” the guarantor not only limits its guaranty to a specified sum during a specified period of time in the lease, but also avoids having exposure in the event of a casualty loss or other damages that could be occasion to the Landlord by the Tenant’s occupancy. For example: in the event of a major casualty created by the Tenant or one of Tenant’s agents, employees or invitees, the guarantor might be responsible for the lease payments and would not be responsible for those damages occasioned by the Tenant’s occupancy. Another striking example would be in the event that a Tenant damaged or destroyed the premises, which exceeded insurance coverage or alternatively the insurance company was subrogated to the rights of the Landlord as against the Tenant for damages caused by the Tenant under the Tenant’s direction or control or through one of its representatives.

Both the commercial Landlord and commercial Tenant needs to be aware of the various types of guaranties they can structure the appropriate guaranty which would protect the interest of the Landlord in the event of a default, but at the same time, place a limit upon the ultimate exposure of the Tenant for the leasehold obligations. Unfortunately, many sophisticated Landlords as well as knowledgeable Tenants, fail to explore the various options in a guaranty since sometimes a lease guaranty is simply looked as “take it or leave it” situation which is simply not the case. The knowledge of these various guaranties can give both the commercial Landlord and the commercial Tenant a number of options they can utilize in lease negotiations.

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