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So you Say You're Subleasing

Key issues to consider when subleasing office space



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WITH THE CURRENT ECONOMY With the current economy, subleasing has been on the rise. Subleasing gives a tenant currently occupying space (the sublandlord) a way to get rid of excess space, and the rent associated with it. There are several key issues, however, that both parties need to be aware of.

- **Consent Requirements** – A lease typically provides the details as to (i) when landlord's consent is required, (ii) if the prime landlord must be reasonable in its decision, and (iii) the procedures for requesting the consent. In addition, the lease may let the landlord take back (recapture) the proposed sublease space, instead of letting the tenant sublease the space. If the landlord recaptures, then the tenant is relieved from rent for the space the landlord takes back.

Before entering into any proposed sublease, or letter of intent for one, the tenant should review the lease's language on consent and recapture.

- **Rent & Term** – Usually the tenant and subtenant can negotiate the sublease rent as they see fit, though if it's higher than the rent under the lease, profit sharing may apply (see below). The term of the sublease cannot exceed the term remaining under the lease. Extension rights are a different story, however. Extension rights in leases often provide that only the original tenant can extend the lease (but not any subtenant).
- **Costs** – Typically the subtenant pays its share of the taxes, insurance and maintenance (CAM) charges under the lease. Whatever the terms of the parties' deal are – the amount of subtenant's share, whether a base year applies, whether the subtenant pays estimates, etc. – they should be clearly spelled out in both the letter of intent and the sublease.



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- **Profit Sharing** – Leases typically permit the landlord to keep 50% (sometimes all) of any profits the tenant makes by subleasing. Some leases make it clear that certain costs (e.g., brokers fees) are excluded from what constitutes “profit” but others do not address the issue. If there is any sale of furniture or equipment between the parties, it should be documented clearly to avoid an argument that the landlord gets a share of those proceeds as well.
- **Alterations** – Any changes made to the subleased space must comply with the provisions of the lease dealing with alterations, including often having landlord consent. The tenant should also see if the lease requires such alterations to be removed at the end of the term.
- **Rights under the Prime Lease** - Unless the lease restricts a provision to the original named tenant (like an extension option), the subtenant gets the benefit of all landlord obligations under the lease, and generally, all of the tenant’s rights (like parking) as well. If the tenant wishes to retain certain rights, such as an extension option, expansion option or parking rights, it should clearly state that in the sublease.
- **Direct Relationship** - Even though the subtenant receives the benefits of landlord obligations (like janitorial services), because the lease is between the landlord and tenant, the subtenant does not have a direct relationship with the landlord. This means it cannot sue the landlord for landlord defaults under the lease (like landlord’s failure to maintain the building). Because of this, the subtenant should make sure the tenant agrees to use reasonable efforts to make the landlord perform its obligations under the prime lease.
- **Obligations under the Prime Lease** - Typically the subtenant is stepping into the shoes of the tenant under the lease and must perform whatever the tenant was obligated to do under the lease.



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- **Obligations under the Prime Lease** (*continued*) - That means, for example, the subtenant must carry all required insurance, perform all required tenant-maintenance, etc. The subtenant should make sure it knows all tenant obligations under in the lease. If there are any tenant obligations the subtenant doesn't expect to perform, it should clearly state that in the sublease.
- **Clean Bill of Health; Future Defaults** - Ideally the subtenant should confirm that there are no outstanding defaults under the lease, and the sublease should provide that both parties get copies of all future notices of default sent by the landlord.
- **Non-Disturbance** - During the term of the sublease, if the tenant defaults under the lease, the subtenant could be evicted by the landlord (even if the subtenant is not in default under the sublease). For subleases of large space (5,000 sf or more), for a fair market rate, the subtenant may be able to negotiate a protective agreement with the building owner, a non-disturbance agreement. This lets subtenants stay in their space if the tenant defaults (for reasons unrelated to the subtenant's actions). Subtenants leasing small sites, or getting below market terms from their sublandlord, may find landlords unwilling to enter such an agreement, however. Though the subtenant would have a right to go after the tenant if the tenant caused the lease default.
- **Final Thoughts** - These are only some points which may apply to your transaction. An experienced team focused on your business is the best defense against subleasing headaches.



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