



Real Estate Roundtable 2020

Office Subleasing: A Landlord's Perspective

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COWBOY JIM'S SUBLEASE OPPORTUNITY

Travel Corp., a travel agency that leases office space in Cowboy Jim's mixed use development, has fallen upon hard times recently. The Covid-19 pandemic has slowed Travel Corp.'s business dramatically and the associated uptick in working from home has significantly lessened its office space needs. In a bid to cut costs, Travel Corp. has been exploring its subleasing options and has discovered that, Mask Corp., the corporate offices of a face mask manufacturer and one of Travel Corp.'s fellow tenants in Cowboy Jim's development, has seen its business significantly increase during the pandemic. Travel Corp. and Mask Corp. ultimately come to an agreement whereby Mask Corp. will sublease a third of Travel Corp.'s premises for the purposes of storing some excess chemicals required in the manufacture of Mask Corp.'s face masks, as well as for various other administrative purposes. [CONTINUED]

COWBOY JIM'S SUBLEASE OPPORTUNITY

[CONTINUED] To Travel Corp.'s delight, Mask Corp. is so desperate for space that they offer to pay a premium of \$5 per square foot above and beyond the base rent stipulated in Travel Corp.'s lease. Mask Corp. also anticipates having to complete substantial renovations to the sublet premises in order to accommodate its intended use. The sublease agreement is conditional upon obtaining the landlord's consent, but the parties are confident, as the lease provides this consent is not to be unreasonably withheld. The parties approach Cowboy Jim to dispense with what they view as the formality of landlord consent. Cowboy Jim reviews the proposed sublease, head lease and various amending agreements, and determines he isn't as comfortable with this proposed sublease as the parties imagined he would be. Cowboy Jim reaches out to his lawyer for their input on the Mask Corp. sublease.

ISSUES TO CONSIDER

- 1) Key factors to consider in determining whether to consent
- 2) Significance of change of use
- 3) Who is entitled to the profits
- 4) Importance of ancillary documentation
- 5) Renovation in the sublease context
- 6) Right of recapture

1: Look to Head Lease for Guidance

- a) Cowboy Jim's consent "not to be unreasonably withheld"
- b) Any further qualifications in head lease?
 - a) Examples where it would be reasonable to withhold consent
 - b) Information re subtenant to be provided
 - c) Timing of consent
 - d) Other qualifiers for landlord's obligation to consent

Examples where it would be reasonable to withhold consent?

- a) Where tenant is in default under head lease
- b) Request made shortly after commencement of term of head lease
- c) Little term left remaining in the head lease
- d) Consideration of change in use
- e) Where a right of recapture exists under the head lease

What is the tenant required to disclose regarding the proposed subtenant?

- a) Does the head lease require disclosure regarding the proposed subtenant's business and/or financial status or experience level?
- b) Implied disclosure obligation even if not explicitly stated

Timing of Landlord's Consent

- a) Is there any provision addressing timing of the landlord's consent?
- b) **Sample Clause:** *Any purported sublease is subject to the Landlord's approval. If the Landlord fails to grant or withhold its consent within 10 days of the Tenant's request therefor, the Landlord will be deemed to have consented to the sublease.*

Other Standards of Landlord Consent

a) Unfettered discretion

a) Leverage in negotiations

b) Landlord consent not required

a) Often applicable where there are pre-authorized rights of transfer (to franchisees, affiliates, etc)

How does this impact Cowboy Jim?

- a) Not a lot of information re: term of the head lease or financial strength/corporate structure of the proposed subtenant.
- b) Such knowledge may already be available to Cowboy Jim as Mask Corp. is an existing tenant
- c) Proposed change of use a key factor to consider

2) Significance of change of use

- a) Current permitted use – travel agency
- b) Any general language expanding scope?
- c) Storage of excess chemicals
 - a) Environmental concerns
 - b) Acceptable under zoning/regulations
 - c) Insurance
 - d) Exclusivity clauses of other tenants

3) Who is entitled to the profits?

- a) Any provision in head lease regarding capture of sublease profits
- b) **Sample Clause:** *In the event of any Transfer which is a subletting of the Premises by the Tenant by virtue of which the Tenant receives a rent in the form of cash, goods or services from the Transferee which is greater than the Rent payable hereunder to the Landlord, the Tenant will pay any such excess to the Landlord in addition to all Rent payable under this Lease, and such excess rent shall be deemed to be further Additional Rent.*

4) Importance of Ancillary Documentation

- a) Subtenant gets no greater interest than under head lease
- b) Landlord to review form of sublease to ensure terms of amending agreements and other ancillary documents are properly captured
- c) Drafting tips:
 - a) Ensure subtenant is to perform all obligations of tenant
 - b) Sublease to expire 1 day prior to term of head lease
 - c) Description of subleased space

5) Renovation in the sublease context

- a) Sublease subject to head lease
 - a) Landlord consent to renovations is typical
- b) If consent not in head lease, negotiate
 - a) Include provisions regarding:
 - a) Adherence to plans reviewed and approved
 - b) Insurance
 - c) Quality control
 - d) Ownership of improvements

6) Right of Recapture

- a) Does the head lease contain a right of recapture provision?
- b) **Sample Clause:** *The Landlord may, within thirty (30) days after submission of Tenant's written request for Landlord's consent to a proposed assignment of this Lease, cancel this Lease (or, as to a subletting, cancel as to the portion of the Premises proposed to be sublet) as of the date the proposed subletting or assignment was to be effective. If Landlord cancels this Lease as to any portion of the Premises, then this Lease shall cease for such portion of the Premises and Tenant shall pay to Landlord all Rent accrued through the cancellation date relating to the portion of the Premises covered by the proposed subletting or assignment. Thereafter, Landlord may lease such portion of the Premises to the prospective transferee (or to any other person) without liability to Tenant.*
- c) Note tenant may have right to rescind request

Summing Up

- a) Careful review of the head lease and any ancillary documents to understand the process to be followed for obtaining the Landlord's consent to the proposed sublease, and understanding the extent of the Landlord's discretion in making the determination – does the Landlord have a recapture right, providing it with an alternative to granting or refusing its consent?
- b) Where the Landlord is required to act reasonably, has it been provided with sufficient information to make an informed decision? Do the circumstances at hand potentially allow the Landlord to reasonably withhold its consent?
- c) To the extent possible, and keeping in mind any constraints on the Landlord's discretion, seek to address concerns with the proposed sublease arrangement / gaps in the head lease



THANK YOU FOR LISTENING



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