

2023 Real Property Law Health & Wellness Retreat



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Whose Space is it Anyway?: Top Issues in Subleasing in a Post-Pandemic World

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Speakers

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Agenda

I. Introduction: Timing/Complexity

- difference between assignment & sublease
- Permitted Transfers [No landlord consent required]

II. Top Issues

- Risks of subtenancy
- Due diligence
- Review of master lease
- Subtenant's negotiation points
- Master landlord consent

III. Concluding Thoughts

Assignment vs. Sublease

Definitions

- **Assignment** – all of Tenant’s rights under the master lease are transferred to the assignee; following the assignment, Assignee is in privity with Master Landlord (a direct relationship).
- **Sublease** – Subtenant receives a portion of Tenant’s rights under the Master Lease; there is NO privity between Subtenant and Master Landlord; this means that Subtenant has to “go through” Sublandlord for requests of Master Landlord.



Assignment vs. Sublease

Courts will look to the terms of the agreement and not just the title of the document – if there is a full transfer of Tenant’s rights under the lease, that is an assignment even if the parties label it a sublease.



Change in Control of Tenant; Permitted Transfers

Most commercial leases contain a provision that states that any change in control of Tenant constitutes an assignment of the lease requiring landlord's consent.

- Tenants will require some exemptions from this requirement

Permitted Transfer: No landlord consent for assignment of lease in connection with:

- (i) merger or acquisition
 - (ii) sale of tenant's business
- net worth requirement

Risks of Subtenancy

- Loss of tenancy due to Sublandlord default/bankruptcy
- No privity with master landlord (so have to go through sublandlord for everything)
- Other issues if it is a sub-sublease
- Transaction costs/length of time to review
- Experience of counsel involved in negotiating sublease



Due diligence/Sublease Negotiations



- Parties (both subtenant and sublandlord)
- Condition of premises
 - Industry sector: retail, office, industrial, life science
 - Is there any pre-delivery sublandlord work required? E.g., do the premises have to be demised?
 - Is any FF&E included?
 - If yes, will FF&E transfer to subtenant or remain with sublandlord
 - Security system/internet
- Permitted Use
 - Is proposed use consistent with use set forth in master lease?
- Historical records of OpEx
 - Prop C (in San Francisco)[Subtenant usually pays] – double taxation [Laura]
- Disparate base year

Due diligence/Sublease Negotiations



- Are the subleased premises *ALL* of master premises or a portion
- Holdover [consequences for Subtenant holdover]
- Subtenant not in privity with master landlord (consequences for both subtenant and sublandlord)
- Sublandlord needs to understand they are now in the landlord business

Due diligence/Sublease Negotiations



Sublease term/surrender obligations

- Subtenant should not have master tenant surrender obligations
- Sublease term should end before master lease term (even if only 1 day)
 - Sublandlord to determine its time for de-commissioning of premises and sublease term should terminate so that Sublandlord has time to perform its surrender work
 - Subtenant to determine time for its de-commissioning of premises on surrender

Review of Master Lease

Incorporation

Exclusion

Is the sublease for all or just a portion of the premises?

Sublandlord v. landlord obligations

Are any modifications of the master lease necessary

- Pre-approval of alterations
- Pre-approval of signage
- Any new rights

Incorporation of Terms of Master Lease Into Sublease

So, you read the master lease:

- Substitute “Sublandlord” for “Landlord”
- Substitute “Subtenant” for “Tenant”
- Substitute “Subleased Premises” for “Premises”
- **Ask – when I make these substitutions – do these provisions make sense in the context of the sublease?**

Incorporation of Terms of Master Lease Into Sublease

A number of provisions are typically Excluded from the sublease:

- Base rent
- Holdover
- Tenant right to audit CAM
- Security deposit
 - Because these are all replaced by terms set forth the sublease
- Work letter

Some provisions typically included:

- Tenant's insurance obligations
- Tenant's repair obligations
- Landlord remedies

Incorporation of Terms of Master Lease Into Sublease

A number of provisions the term “Landlord” means “Landlord” and not sublandlord:

- Landlord’s insurance obligations
- Landlord’s maintenance obligations
- Limitation of Landlord’s liability
 - Because these are all items that should remain the obligations of Landlord

A number of provisions the term “Landlord” should be read to mean “Landlord and Sublandlord”:

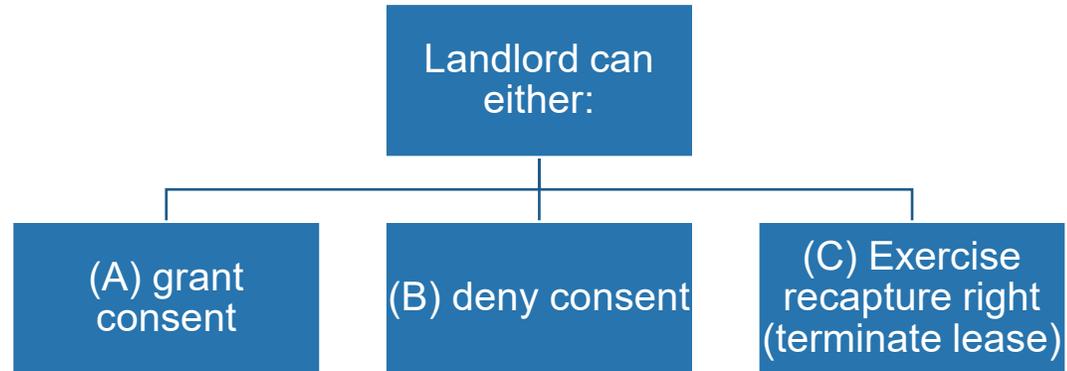
- Alterations – so if subtenant wants to make alterations to the premises, then consent of Landlord and sublandlord is required
- Assignment/sublease – so if subtenant wants to assign the sublease or sub-sublet, then consent of Landlord and sublandlord is required

Subtenant Negotiation Points

- Loss of tenancy risks
- Non-disturbance
- Cure periods; Subtenant cure rights of Tenant defaults
- Sublandlord obligations to perform its obligations under the master lease
- Sublandlord agreeing not to terminate master lease or amend in a way that adversely affects Subtenant's rights to subleased premises
- Sublandlord indemnification – losses incurred by subtenant for sublandlord's default under the master lease
- Service interruption – if rent abates under master lease, rent should abate under sublease - In such circumstances, Sublandlord shall use commercially reasonable efforts to promptly obtain all available abatement under the Master Lease.
- Sublandlord will exercise audit right at Subtenant's request



Sublease – Landlord Consent



Landlord Consent – Reasonableness Standard -2

– CA Civil Code §1995.250



A restriction on transfer of a Tenant's interest in a lease may require the Landlord's consent for transfer subject to any express standard or condition for giving or withholding consent, including, but not limited to, either of the following:

- (a) The landlord's consent may not be unreasonably withheld.
- (b) The landlord's consent may be withheld subject to express standards or conditions.

If any of the conditions to a transfer are unreasonable, or if the lease prohibits transfers altogether, the landlord loses its remedy under Civil Code §1951.4



Landlord Consent – Recent Case Law – Reasonableness

Longs Drug Stores Cal. v. DS Westgate,
2022 Cal. App. Unpub. LEXIS 529, 2022
WL 260641

Sublease – Landlord Consent



- What are terms of master lease regarding process for obtaining Landlord's consent?
 - Timing
 - Documents and information that Tenant is required to provide to Landlord
- Landlord representations regarding status of lease
- Cost of Landlord expense to prepare consent
- Will the parties want to include any modifications to the lease in the consent?
- Does Landlord have a recapture right?
- Is there sublease profit and how is it calculated?

Master Landlord Consent



Non-disturbance

Additional time following termination of master lease for subtenant to vacate

Is there a deemed consent provision in the master lease?

Does Landlord have a recapture right?

is lender consent required?

Conclusion

1

Make sure you understand who your client is and their role in the transaction:

- Sublease: Master Landlord, Sublandlord, Subtenant

2

Make sure you have carefully reviewed the master lease and determined which provisions are applicable to your client and which should be excluded from the sublease

3

Make sure you understand the process of and standards for obtaining Landlord's consent

THANK YOU!

Feel free to contact us with any questions

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