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The Law Office of Kevin F. Jursinski & Associates, P.A.
COMMERCIAL LEASE NEWSLETTER

STRUCTURED GUARANTIES TO LIMIT LIABILITY OF THE COMMERCIAL TENANT

GUARANTY OF COLLECTION v. PAYMENT; LIMITATION ON LENGTH OF GUARANTY

In today's uncertain economic times, many commercial landlords are finding it difficult to have tenants sign long-term leases. Many commercial tenants are reluctant to commit to long-term leases, especially when they are being asked to personally guaranty these leases, in light of the fact that it is hard to predict, for both the commercial landlord and tenant, future economic expectations. This results in many commercial landlords being unable to effectively capture tenants on long-term leases.

In addition to the ability to do a "kick-out" clause, tenants may also be able to convince a landlord to allow them to vacate the premises prior to the end of the lease. Such is the case when the landlord insists on a personal guaranty of the tenant. The tenant can always request that either:

(a) the guaranty of the lease is the guaranty of collection rather than payment which can minimize and mitigate some of the expenses of the personal guarantor of the lease; and

(b) in conjunction with, or in the alternative to a guaranty of payment, rather than an absolute guaranty, the commercial tenant can also ask for a limited time period for a guaranty of the debt liability. Let's look at the differences between the two.

The Guaranty of Collection v. Absolute Guaranty

Certainly the landlord wants to have a right to have protection in the event he is not able to collect the rent against the tenant, especially when it is a single asset LLC or Corporation whose only assets may be those assets contained at the premises.

In such case, a landlord is going to want to have a specific guaranty by a principal with credit worthiness. The principal, however, does not want to be on the hook for the full and absolute guaranty especially given the fact that, under Florida law, Florida does not have the Single Action Rule in effect as many states do. What the single action rule indicates is that a guarantor may face direct liability on the guaranty with no offsets, or assets of the company, or the ability of the landlord to collect, etc. A scenario in which this would result is where there is a commercial five (5) year lease which, for simplification purposes, requires payments of $50,000 per year. At the end of the second year, the tenant defaults. The guarantor of this lease signing an absolute guaranty might find himself or herself in a position, if they are financially well off, for the landlord simply to take steps to sue the guarantor on the guaranty in conjunction with the suit on the lease for $200,000 (four (4) years at $50,000 per year) seeking to collect against the guarantor for the accelerated balance of the rent based upon the damages under the lease before taking any steps to liquidate his damages against the assets of the company or seek to collect against the company. In such circumstances, the guarantors would be jointly and severally liable for the full amount due under the lease and the landlord would not have had to take any efforts to collect against the tenant.

Oftentimes in a commercial or retail setting, there is an offset to the landlord's damages by the landlord exercising its rights under Florida Statute 83.08 to exercise distress for rent written levy on a tenant's personal property which would be offset against the amount due under the lease. A condition under the lease agreement and/or by Florida Law, a commercial landlord may, upon breach, retake possession of the premises for the account of the tenant, and if so, to take commercially reasonable steps to re-let the premises and provide the tenant with a credit against any re-letting of the premises. The case law is not clear that a commercial landlord has to extend the same duty to a guarantor, but even assuming arguendo it does, the guarantor still is liable for the full debt on the lease with no obligation on the landlord's part to effectuate collection. The solution to this is to have a limited guaranty of collection v. payment. This guaranty of collection would require the landlord to first exhaust its remedies and liquidate its claims against the tenant and its property before pursuing collection of the guaranty for the balance due.

Limited Duration of Guaranty - Alternatively, there can be an agreement made that for a period of time during the lease, the guarantor will be absolutely liable for lease payment obligations due and owing under the lease and after a certain specific time, the guarantor's obligations under the lease would be extinguished. It is important to note that most guaranties guarantee the obligation of the tenant for "all rights, duties and obligations under the lease". This means that a guarantor signing an absolute guaranty guaranties not only the payments due under the lease but all performance obligations such as repair, maintenance, damages, injury, casualty losses and the like. This is far in excess of what generally most guarantors anticipate or believe is their obligation.

Therefore, carving out a guaranty that identifies only a guaranty of the specific payments, and better yet, guarantying not only the payments, but guarantying the payments only after the landlord exercises duty to collect against the tenant and exercises his rights to offset, minimize and mitigate his damages. Then and in such event, the guarantor's obligations would either be eliminated or would be reduced is preferable.

For example, at the end of two (2) years, the guarantor's liability could be eliminated; or alternatively, it would then decrease so that the maximum liability of the tenant would be reduced to an agreed upon remaining balance of months for payment obligations only. The limitation of the guaranty; or alternatively, the restructuring of the guaranty from an absolute guaranty to a guaranty of payment is yet another way for the commercial tenant to structure a lease in today's uncertain economic times.

Sometimes, the diminishing guaranty is also construed as an "evergreen guaranty" which provides the tenant will personally guaranty a set number of months or years commencing upon default by a tenant. This could mean that for the first three (3) years of the lease, the guarantor would agree to provide a guaranty of monthly lease payments for twelve (12) months after the default or some other format which tries to cap the exposure to the guarantor. Many tenants fail to realize that a guaranty of a five (5) year lease calling for a $50,000 per year annual lease could mean that the guaranty is for a guaranty in excess of $250,000 which includes not only rent, taxes, insurance, maintenance, re-letting costs, attorneys' fees, additional court costs and expert fees, all of which could be sought as against the guarantor. Therefore, the fact that the lease only calls for rent of $4,000 per month should not be looked upon as the exposure, rather the exposure should be the full balance due under the lease, which as indicated above,, on a five (5) year lease, could be well in excess of $300,000 on a monthly lease payment that only calls for $4,000 a month.

Again, in structuring these guaranties, limitations of guaranties, evergreen guaranties, etc., a qualified real estate attorney's advice should be sought to assist the commercial tenant accordingly, as well as the commercial landlord in structuring a fair and reasonable lease, especially given the fact that most commercial landlords have to engage in such activities based upon market realities.