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COMMERCIAL LEASE NEWSLETTER

What steps should a commercial landlord take when a tenant stops paying rent?

What is the business and pragmatic approach to address a commercial tenant that defaults on their loan and threatens to vacate the premises voluntarily or involuntarily?

The above questions are often asked by commercial landlords and property managers, certainly more often over the last several years. Regardless of the fact that our current economy is weak, a situation involving a commercial tenant who defaults on their lease will always be present. Therefore, it is a question that should be answered by the commercial landlord and tenant facing the reality most commercial landlords and tenants are, or will be dealing with as to their commercial property.

Initial steps in regard to default. The initial business and pragmatic approach is to address the issue squarely with the commercial tenant. Ideally this would be during an in person meeting with the commercial landlord, property manager and the tenant. Making this even better would be to have a specific witness to the discussion. Regardless, the discussion should focus on the business approach to resolving the issue. Whether it is consideration of rental abatement, temporary agreement of reduction, modification of the term or another way to remediate the problem, those topics should be addressed.

The first step of course would be to identify the problem, which in most instances would be the tenant's inability to make payments. If problems exist in regard to the condition of the premises (and the claim is that such condition is a landlord obligation), those problems should be specifically addressed as they could lead to constructive eviction. See Newsletter dated September 2009 regarding constructive eviction.

Regardless of the outcome, the commercial landlord should never (at the meeting) make a representation to specific terms and conditions to modify the lease without indicating that any such modification of the lease agreement or proposed terms and conditions must first be specified in writing. Further, they should be identified in a specific lease proposal and lease amendment.

Regardless of what takes place at that meeting, the commercial landlord should prepare written notes of the meeting made contemporaneous with the meeting and follow up that meeting with a short letter, e-mail or memo to the commercial tenant indicating what discussions took place. Further, landlord and tenant should reaffirm that the discussions were made in an attempt to address the tenants' concerns but should not be binding upon any of the parties unless and until a specific agreement was entered into, signed by both landlord and tenant as well as being witnessed by two (2) witnesses. See Newsletter dated July 2010.

Notwithstanding the fact that in order for a lease to be amended, such amendment should be in writing, the landlord wants to avoid the tenant (in any prospective discussion and or litigation) to assert that there was some type of representations made upon which the tenant and relied. This would allow for an estoppel defense to be asserted against the landlord or alternatively that there was some type of oral modification made to the lease agreement. A specific contractual case on point (see below) indicates that parole evidence could be allowed if a modification was made to a written agreement after the agreement was entered into and upon which the parties relied and/or partly did rely, potentially to its detriment based upon fraud.

The specific case which indicates that notwithstanding the fact that contracts involving conveyances with real estate interest (Florida Statute 689.071) which encompasses a lease for more than one (1) year) cannot generally be modified by oral conversations, parole evidence (oral testimony) would be considered by the Court. ***"A written contract may be modified by an oral agreement if the parties have accepted and acted upon the oral agreement in a manner that would work a fraud on either party to refuse to enforce it."*** Arvilla Motel v. Shriver 889 So 2d. 887 (2DCA 2004)

As such, the first and foremost point to be discussed with the commercial landlord and commercial property manager in regard to this matter is to process the conversation between the parties and follow up the conversations with a written e-mail, letter or memo and stress that the only changes to the lease are required to be in writing signed by Landlord and Tenant.

What happens in the event that the tenant indicates it is unable to maintain monthly payments? One way that the landlord can obtain temporary relief is to take the security deposit at the premises and apply it to the rent. This gives short term relief to the tenant while at the same time affords the landlord with some protection that if the tenant files bankruptcy, there would be no claim against the deposit by the bankruptcy trustee.

Oftentimes landlords are disappointed when they find that the tenant is in default, is failing to pay ongoing rents, and vacates and potentially files a Chapter 7 or Chapter 11. This problem becomes more exacerbated when the landlord finds that the landlord has to repay the bankruptcy trustee for the deposit the commercial landlord has under the lease, which most likely the commercial landlord has already allocated and spent.

Notwithstanding the application of the deposit, the landlord still has to in order to address the fact that the lease payments are not being made.

If no resolutions can be made to the defaulted rent, any offset of the deposit needs to be accompanied by a demand that the deposit ultimately be replenished, and a formalized demand pursuant to the lease agreement. This may not necessarily be the form of a three (3) day notice pursuant to Florida Statute 83.20 (or longer notice if such is contained in the Lease), the demand for deposit should nonetheless be made in writing and served upon the Tenant. At the least, arguably the Landlord would have the claim that the Lease would be in breach for failure to reinstate such deposit.

Once this takes place, negotiations should continue with the landlord to see if there is a way to salvage the lease arrangement.

Information and Strategy is Key. A commercial landlord should also have as much information as possible on the tenant. Obviously, at the default stage, the tenant is going to be reluctant to provide any financial information so the landlord should at least have, in his possession, the financial and credit information in regard to the tenant when the lease commenced. Secondly, the landlord should obtain a UCC1 search and a judgment search. If the tenant has an outstanding UCC1 on its assets which was put in place prior to the lease coming into effect (or unfortunately the landlord waived its landlord's lien or subordinated the lien to a Lender) then in such event the landlord will not have priority as against the tenant's personal property and equipment found around the premises and the landlord will not be in a position to exert its right to pursue a claim against the tenant's personal property. A landlord's lien and UCC1 search are significant factors which give the landlord some leverage and it is easy to find out this information which can determine the landlord's strategy.

The concept is for the commercial landlord to have a strategy in place which gives the landlord as much strategic information as possible so he or she can make an educated and not a stressful decision when facing a commercial tenant's default.

Next month, what is the landlord legally entitled to do if a pragmatic and business approach is not achieved?