COVID-19 Leads to More Subleasing

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The need for commercial real estate, especially office and retail space, has been significantly impacted by the pandemic. COVID-19 continues to keep employees working from home, with the likelihood some employees will continue indefinitely to work from home after the pandemic due to increased productivity and higher employee morale. In addition, some industries that had to reduce workforces may be slow to rebound. As a result, large portions of office and retail space will remain empty for the foreseeable future. In order to fill these spaces and thus continue the flow of rent payments, landlords are increasingly allowing tenants to enter into subleases. Tenants are considering this option in order to reduce costs or as a means of retaining their existing locations until their business resumes pre-COVID levels. For subleases to work for all parties involved, various factors should be considered before deciding to sublease.

Tenants must first determine whether its lease allows for subleasing and what requirements are involved in obtaining the landlord's consent. This includes any information that the landlord may need, such as financial or other qualifications that may be required for a prospective subtenant. In the event that the primary lease does not allow for subleasing, the tenant must request it and likely negotiate terms with the landlord. It is likely that most landlords will be more receptive to subleasing than they may have been pre-pandemic, since they will want to ensure a steady flow of rent payments.

Even if subleasing is permitted, the original tenant will remain obligated to the landlord for rent and other costs in the event that the subtenant defaults. The original tenant may also be responsible for maintenance and returning the space to its original condition upon termination of the lease. In order to reduce these risks, the tenant should properly vet prospective subtenants regarding their financial condition and reputation. The tenant should also include adequate indemnification requirements of the subtenant and security for the subtenant's obligations under the sublease. A sublease should also be clear as to whether the tenant or the subtenant is responsible for utilities, insurance and other costs under the lease.

Although it may seem that subleasing would provide the most benefit to a tenant, it can be a good option for the landlord as well, especially in the current leasing climate. If a tenant is unable to pay the rent, the landlord would likely opt for a sublease over a rent reduction or deferment. Most landlords would also prefer not to have to terminate leases to avoid facing the costs and inconvenience of finding a new tenant and negotiating a new lease. Also, due to reduced demand in the current market, it is likely the fair market rent for a new lease would be less than the rent that the current tenant is paying.

A landlord should also thoroughly vet a subtenant and make sure that it can assume the tenant's responsibilities for the length of the sublease agreement. Also, and stated above, landlords will typically keep the original tenant responsible for all liabilities in the event that the subtenant defaults.

Although landlords are not typically parties to a sublease, a landlord may want to be a party and thus deal directly with the subtenant. This will ensure timely payments from and communications with the subtenant, and avoid the possibility of the tenant withholding a subtenant's rent from the landlord.

Subtenants can also benefit from subleasing. Those who may not qualify for or have the financial ability to enter into long-term leases can benefit from a subleasing opportunity. Subleasing provides a business with the ability to try out a new location or have access to space that it may not otherwise be able to afford as a primary tenant. It also allows for minimum commitment if the sublease is for a short term.

The biggest challenge for subtenants is they are entirely dependent on the primary lease signed by the tenant. Since subtenants are not parties to the primary lease, they have no rights in the event of the tenant's default. This is the case even if a subtenant is current on its payments to the tenant. If the tenant defaults, the landlord could terminate the primary lease (and therefore the sublease) and take back all of the space. Also, if the tenant does not wish to renew the lease and the subtenant does, the sublease will still end upon the termination of the primary lease. As a result, subtenants should be completely familiar with the terms of the primary lease and its effects on the subtenant. Key items include permitted use of the space, requirements for the landlord's consent to sublet, conditions for renewal, and default and termination provisions.

Finally, it may also benefit the subtenant if the sub-tenant and the landlord deal with each other directly. First, this provides certainty for the subtenant that the landlord is receiving the subtenant's payments. Also, if the subtenant and landlord communicate directly, then the subtenant will be aware of any defaults or issues with the main tenant that may arise. In such circumstances, the subtenant may be able to quickly negotiate with the landlord as to a continuation of the sublease or a transfer of the primary lease to the subtenant.

The commercial real estate market continues to feel the consequences of these uncertain times. With careful planning, subleasing presents a viable short term option for all parties until business owners and commercial property owners understand the long term effects of these unprecedented times.

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