

RETAIL PROPERTIES

Quarterly

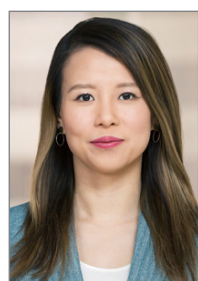
Guaranties

Structuring limited guaranties for retail leases

A retail tenant holding more negotiating power tends to resist providing a full guaranty of its retail lease. This may cause concern for a retail landlord wanting certain assurances of the tenant's financial backing. With some creativity and cooperation, landlords may consider structuring a limited guaranty satisfactory to both parties. Below are some different types of limited guaranties for consideration:

■ **Fixed time guaranty.** The landlord may release a guarantor after a certain amount of time, so long as there are no pre-occurring tenant defaults. The fixed time period is typically a couple of years, but it could also be the initial lease term with a release during any renewal terms. This approach gives the tenant sufficient time to demonstrate its ability to pay rent and perform its obligations under the lease. After the time period has passed without any defaults, the landlord is typically more comfortable with the tenant's future performance without guarantor back up.

■ **Fixed dollar amount guaranty.** The landlord may cap a guarantor's liability to a fixed dollar amount. Although the fixed amount is typically far less than the full risk of loss under the lease, it provides some financial protection to the landlord, while allowing the guarantor to account for the exact amount of its financial exposure. This amount can be calculated based on the landlord's concessions (i.e., tenant improvement allowance, free rent, brokerage commissions, etc.), the anticipated rent amounts for a certain time period, or some other minimum value of the lease. Many landlords will also want to include language providing recovery of enforcement costs, such as legal fees and court costs, in addition to the fixed cap.



Heather Park Meek
Shareholder, Otten Johnson

defaults at the beginning of the fifth year of the lease term, the guarantor would be liable for an amount equal to 12 months of base rent and additional rent payable for the fifth lease year. Since the rent typically increases during the lease term, the guarantor liability amount will increase over the lease term. However, the guarantor will have no further liability beyond the rent for such 12-month period. The time period determines the amount of the guarantor's liability, but the landlord will still need to mitigate its damages if a default occurs.

■ **Burn-down guaranty.** The landlord can mix and match the different guaranty limitations as well. By way of example, the guaranty can be initially capped at \$100,000 with a \$20,000 reduction each lease year conditioned on the non-occurrence of a tenant's default during that lease year. Burn-down guaranties can also either be structured to burn down entirely as of a certain date (like a fixed time guaranty) or burn down to a fixed amount for the remainder of the lease term (like a fixed dollar guaranty). The guaranty can also be unlimited for the initial five years, followed by a rolling 12-month guaranty for the remaining five years, or the rolling 12-month guaranty can remain in effect for the initial term only.

■ **Rolling guaranty.** The landlord may offer a rolling guaranty, which calculates the amount of the guarantor's liability at the time of the tenant's default. For example, if the guarantor signs a 12-month rolling guaranty and the tenant

There are many possibilities for narrowing the scope of the guaranty in a manner that meets the needs of the landlord, the tenant and the guarantor.

■ **Good person guaranty.** The landlord may propose a good person guaranty (also known as a good guy guaranty), which limits the guarantor's liability to monetary defaults up to the date the tenant vacates the premises, so long as the tenant provides advance notice of its vacation and leaves the premises in re-tenantable condition. The tenant remains liable for all of the lease obligations, but the guarantor is relieved from any future liability. This incentivizes the tenant and the guarantor to communicate with the landlord before going dark, and provides an avenue for the landlord to attempt to mitigate its losses by reletting the premises as quickly as possible.

■ **Financial threshold-related release.** If the tenant is a new business, it may be able to grow its business during the lease term. The landlord may be willing to release the guarantor based on the tenant achieving certain financial thresholds, such as a fixed net worth, operating income, or earnings before interest, tax, depreciation and amortization. The tenant delivers to the landlord applicable information showing that these thresholds have been met. The landlord may require a reinstatement of the guaranty if the financial threshold is not maintained for the remainder of the lease term.

■ **Sale-related release.** If the tenant anticipates selling its

business and assigning the lease during the lease term, then the parties may want to negotiate an assignment-related release of the guaranty. Upon a sale, the guarantor would no longer be involved in the operation of the business and would not want to be financially liable on a going forward basis. The landlord typically requires a qualified replacement guarantor and satisfaction of specific release conditions, such as minimum financial strength and relevant business experience.

■ **Multiple limited guaranties.** In most guaranties, multiple guarantors are jointly and severally liable. That means each guarantor is fully responsible for the entire liability of the guaranty, regardless of the contribution by other guarantors. The multiple guarantors may want to limit their liability based on their pro rata share (i.e., three guarantors would each have one-third of the liability) or based on their respective ownership interests in the tenant entity (i.e., a guarantor with 25% ownership would have 25% of the liability). This is sometimes known as "several" liability.

If a retail tenant is unwilling to provide an unlimited guaranty, there are many possibilities for narrowing the scope of the guaranty in a manner that meets the needs of the landlord, the tenant and the guarantor. ▲