



Spring 2008 Newsletter

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This article is part two of understanding what's involved in a tenant personally guaranteeing a lease. This part reviews how a tenant can minimize their exposure to the guarantee.

How to reduce your exposure to the Personal Guarantee of the Lease

Now as scary as providing a personal guarantee may be there is not all bad news in both how you approach the subject with your prospective landlord and how you can NEGOTIATE a better guarantee for yourself. Lastly you also need to understand the "law" in your local jurisdiction, which could mean State, County, City laws.

This is why it is essential for you to have legal representation in any real estate transaction.

In many jurisdictions landlords are required to "mitigate" their losses. What this means is before they can cash in what you put up to guarantee the lease the landlord has to do a few things first.

Firstly they CAN use your security deposit right away. No questions asked.

Secondly, they must make every effort to re-lease the premises in a timely manner. This means they can't sit around waiting for the next tenant to arrive on their doorstep. They must actively market the space. Once a replacement tenant has been found and secured and only then will your loss or the amount you will be paying as a result of your guarantee be calculated.

The landlord will calculate the number of months of not receiving rent. They will add to this the marketing costs, legal fees, renovation costs and commissions associated with the loss mitigation.

They will in most cases be entitled to interest on the outstanding amount owed for mitigation period. So unless you are near the end of your lease the amount of actual exposure can be significantly reduced. However, if market conditions are unfavorable or the economy is not good this can work against you as it may take a landlord longer to find a replacement.

The following are some pointers of reducing your personal exposure under the personal guarantee.

1. You can try and limit the amount of time you will guarantee the lease term. Perhaps you can have language that says "that after 2 years in the space, provided the tenant has not been in any default and has been in good standing with the landlord" the personal guarantee goes away or reduced by certain amount of time" You can also try to tie the time limit to your business doing a certain amount of gross sales which you can substantiate to the landlord and if you achieve that level of sales for a certain amount of continuous time the guarantee goes away or is drastically reduced.
2. You can try a have a "liquidated damages" clause which means you are willing to lose a preset and mutually agreed upon amount of money to settle any default. Be cautious as this may mean a substantial amount compared to going the mitigation route.
3. You should require language that absolutely requires the landlord to mitigate its loss, just in case there are no hard and fast laws in your jurisdiction.

4. You can try and have a co-signor or co-guarantor who has better financials, but be careful as its usually a relative and you all know how that can play out if your business falters.
5. Try can have a shorter term lease, is reduces the total amount. For example if you were thinking of a 5 year lease term, think about a 3 year term with an option to renew for 2 years. Your exposure would be only 3 years. Please note however, the shorter term lease may cost more because the landlord wants the security of knowing they won't have to re-lease the space sooner. Also be aware, if in the event you are having interior improvements done by the landlord and the cost is being rolled into the lease payments, this can cost you more for a shorter term since the payments will be based on the length of the initial term. Lastly, if you get a business loan for whatever reason the lender will require you to have a lease term that is the same or greater than the loan term.

Other than these tips you should be prepared to have to sign a personal guarantee.

The only exemption might be if you are going to lease property in a run down, economically stressed area, then a landlord should be happy to see you and your business and not require a personal guarantee.

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