

## Beware of 'good deals' through sublease contracts

BY NORMAN GELFAND

SPECIAL TO THE AUSTIN BUSINESS JOURNAL

Volatile. Turbulent. Insecure.

These words often are used in reference to the stock market. These same words reflect the current Austin-area real estate market. Economic conditions in Austin have motivated business owners and/or new entrepreneurs to find "good deals" on office space by subleasing — instead of committing to a direct long-term lease with the building owner.

One of the most critical decisions business owners can make is the one regarding one of their largest overhead costs — the business facility. This decision should be made after careful investigation of the facility, evaluation of the lease terms and conditions, and consideration of the impact of these terms and conditions on business and personal obligations and liabilities. A decision to lease property based on price alone can adversely affect the future growth of the business by elevating risks that could place the business in jeopardy.

In a normal lease transaction, the primary tenant has the opportunity to negotiate favorable business terms and conditions. Typical subleases require the secondary tenant to be bound by the existing lease between the primary tenant and the landlord. Before the business owner makes a decision about subleasing space from the primary tenant, it is critical to evaluate the existing lease in terms of the secondary tenant's business needs. It would be prudent for the secondary tenant to have a keen understanding and thorough evaluation of the terms of the existing lease and its effect, prior to entering into a sublease contract.

### The good

Most sublease opportunities are priced below normal market rates and provide the secondary tenant an opportunity to gain an affordable short-term lease that allows for flexibility and growth. Credit requirements are minimal as the landlord retains the primary tenant's credit guarantee and may not require credit guarantees from the secondary tenant. Unimpeded lines of credit and conservation of working capital reserves permit rapid growth and business development.

Portions of the 3 million square foot sublease space inventory in Austin is available with suitable office configurations, furniture, phone systems and cabling in place. The existing infrastructure allows for lower initial investment and immediate occupancy, and it conserves working capital.

### The bad

There may be limitations on the tenant's rights to sell company stock to outside investors.

Also, the tenant may not be able to lease or purchase equipment and inventory or incur debt without the landlord's approval. Other disadvantages include:

- the lease may force the tenant to pay contested claims;
- the landlord may have the right to relocate the secondary tenant without compensation;
- the landlord's capital improvements are not amortized and are passed through to the tenant in a lump sum; and
- the conditions of non-monetary default may trigger an acceleration of payments and force the secondary tenant out of business.

### The ultimate ugly

Consider the following scenarios, which can happen when subleasing. Without much advance notice, the primary tenant files for bankruptcy or defaults, leaving the secondary tenant no other option but to vacate the leased space. The situation trickles down further if the secondary tenant has subleased a portion of the primary tenant's facility. Now there are two tenants suddenly left without office space.

When subleasing, remember that the secondary tenant is bound by terms and conditions that exist in the primary tenant's lease. There is no "standard" lease contract; no two leases are alike. The needs of the tenant and each sublease vary, and the lease contract should be considered with that in mind.

While there are opportunities that result in a win-win situation, there are numerous risks involved in subleasing. When contemplating the sublease option the tenant is best served by engaging a leasing specialist. Typically, there is no fee to the tenant as the landlord's representative shares his or her fee with the tenant's representative.

An experienced tenant representative can provide invaluable professional guidance in the successful navigation of the turbulent waters of Austin's economy. Knowing where the "rocks" are can make the difference between a successful subleasing experience and a "shipwreck."

**NORMAN GELFAND** is president of Gelfand Group in Austin. He can be reached by email at ([norman@gelfandgroup.com](mailto:norman@gelfandgroup.com)).