

Guaranties of Leases

By Norma J. Williams, Esq.

As protection against tenant defaults, commercial landlords rely primarily on three devices: security deposits, letters of credit and guaranties of the leases. This article will focus primarily on the third, from the perspective of the landlord.

A guaranty is a promise to answer for the debt, default or miscarriage of another (California Civil Code Section 2787). Key considerations with lease guaranties relate to the obligations that are guaranteed; the guarantor parties; and appropriate waivers.

Characterization

A landlord may seek a guaranty of both payment and performance such that the guaranty relates to all obligations of the tenant under the lease in addition to the payment of amounts for which the tenant is obligated. The landlord would not want a guaranty of collection only since the guarantor's obligation would arise in that case only if the landlord is unsuccessful in recovering amounts due from the tenant.

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The guaranty should also be characterized as a *continuing* guaranty such that all of the tenant's present and future rent liability is guaranteed. California case law has held that a continuing guaranty without language that would limit it, extends to obligations under amendments, modifications and extensions of the lease. It would also be prudent to expressly mention these items.

Obligations Guaranteed

A significant area of guaranty negotiation involves the attempt to limit the monetary scope. This may take the form of (1) placing a cap on the total amount guaranteed; (2) limiting the duration of the guaranty; (3) decreasing the amount of the guaranty as the lease term decreases; (4) limiting the guaranty to the tenant's obligations while it is in possession; (5) terminating the guaranty if the tenant meets certain financial benchmarks; or (6) other negotiated limitations.

If a cap is placed on total liability, the landlord should take care that all of its costs in connection with the leasing, and not just rent, are considered. These include upfront leasing expenditures and rent concessions, brokerage commissions, tenant improvement allowances and other initial investments by the landlord that may have been amortized as well as other obligations during the term. Attorneys' fees and other costs of collection should be excluded from the calculation of any capped amount.

Any decrease in the guarantor's liability should require that the tenant not be and never have been in default under the lease at the time that the decrease would be made.

Guarantor Parties

Where an entity, and especially a limited liability entity, is a tenant, the landlord should consider obtaining guaranties from all principals (or those with substantial net worth). The liability of all guarantors should be joint and several. Guarantors may request that the liability of each have a cap, based, for example, on its percentage of ownership of the entity or otherwise.

Care should also be taken that guaranties accurately identify the capacity of the guarantor. Thus, if the guaranty of an individual is sought, the individual should

not sign in a representative capacity for the entity since that would insulate the personal assets to which access is sought. When a guarantor is married, it is always a best practice to obtain the guaranty or consent of the spouse.

Waivers

Since a guarantor is obligated for the debts of another, the law provides a number of protections, most of which are contained in California Civil Code Sections 2787-2855. It is essential that the guaranty contain waivers of these protections, which waivers are enforceable in California as long as they are sufficiently clear and manifest the intent to waive. Significant protections that should be waived in a lease guaranty include: (1) exoneration of the guarantor if the obligation is modified (although good practice would dictate that even with a waiver, the landlord seek a consent from the guarantor to any modifications); (2) right of the guarantor to require that the landlord first pursue the tenant in the event of a default; (3) right of the guarantor to revoke a continuing guaranty; (4) the obligation of the landlord to make demand on the guarantor, to make disclosure; and (5) other protections.

Pre-Leasing Due Diligence

The best advice for a landlord prior to leasing is to understand the financial status of the prospective tenant since these are the best indicators of whether there will be a default or a breach. Thus, landlords should always review the prospective tenant's business plan, credit, financial reserves and rental history prior to entering lease negotiation. In this manner, the landlord can assure itself that it will not need to enforce a guaranty. However, in the event that it does require a guaranty, this article highlights some items that should be considered in its documentation.

Ms. Williams acknowledges the contribution of Kiyana Kiel, Esq. of Williams & Associates to this article. Disclaimer: Nothing in this article shall be construed as giving legal advice. Practitioners are advised to consult with their individual legal advisers as to the legal effect of any item described in this article.