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# Promises, Promises: What If A Commercial Tenant Doesn't Perform?

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Commercial leases require tenants to pay rent. That requirement is, however, just the beginning. Tenants also agree to contribute to real estate taxes. They agree to maintain insurance. They agree to keep the space clean and in decent condition. They agree to report certain information to the property owner. They agree not to put junk on the sidewalk or ugly signs in the windows. In short, they promise to do all kinds of things beyond simply paying rent. Many tenants do what they promise, but some don't. In that case, what can a property owner do?

If you read any commercial lease, you will see that the property owner can terminate a lease if the tenant doesn't perform its promises. The lease also says that if the tenant defaults, the owner can go into the space and remove the tenant and its belongings. The owner also has the right to change the locks or turn off the utilities. The owner might need to give the tenant a warning and a grace period to clean up its act, but eventually a tenant default entitles the landlord to exercise all kinds of draconian

remedies. Many commercial leases also say that, in the event of a default, the property owner can draw down on the tenant's security deposit and demand that the tenant replenish it, claw back free rent permitted during the tenant's initial buildout, and accelerate the rent through the end of the lease. Yes, if you read a commercial lease it lays out a lot of scary things that can happen to a tenant.

Not so fast! The courts will often stand in the way of a property owner that wants to terminate a lease or take other draconian actions. The courts will conclude that the tenant's sins weren't bad enough to justify termination or similar actions. The tenant will often promise to do better. The court will often believe the tenant and give them another chance, and a third chance, and a fourth. To top it all off, this process will often happen at an excruciatingly slow pace, at least in New York City, because the courts are so overwhelmed with landlord-tenant disputes and other claims.

The net result is that property owners shouldn't believe they actually have the right to terminate a lease or exercise other extreme rights for a tenant's default, especially if it's a default that the tenant can argue is immaterial. A bit of unpaid rent might be immaterial. Many months of unpaid rent probably would not be, but the court would probably still give the tenant more time. It would still take quite a while to get to that decision. A torn awning might be an immaterial violation of the tenant's covenant to maintain the space as a class "A" restaurant, but failure to maintain insurance as the lease requires may not be. That is up to the judge. Many judges seem to think that property owners just own property and get money, have accumulated massive cash reserves over the years, and ought to be able to suck it up – none of which is typically true.

In response, property owners ought to think about building into their leases the ability to respond to tenant defaults in ways that are less

dramatic than terminating the lease or removing the tenant from the leased space.

Interest and late charges on unpaid rent are the first and most obvious weapons that any property owner ought to build into its lease. It is astonishing to see how many leases, particularly older ones, don't provide for those payments. Courts will usually enforce them, although it may take a while. If a tenant realizes it will eventually be on the hook for default interest at a high rate and late charges, that just might create enough of an incentive to pay on time. If the tenant is short on money, an owner will want the tenant to have an incentive to pay rent before other obligations.



Tenants also assume many meaningful obligations beyond the obligation to pay rent. A concerned property owner might try to build monetary measures into the lease in order to respond to certain defaults. For example, if a tenant promises to stay open certain hours, then a court probably won't allow the owner to terminate the lease if the tenant violates its promise, but a court might very well enforce a formulaic payment for every hour the tenant is closed when they agreed to stay open. It helps for the property owner to include language explaining why the payment is reasonable and why it's important for the tenant to stay open.

Many other lease-related issues could also be converted into payment obligations. As another example, instead of prohibiting the tenant from selling their lease or subleasing the space to someone else, maybe the lease could automatically allow certain transactions of those types but also require a rent adjustment if they occur. It doesn't need to be a binary or "yes/no" situation.

If the lease has a guarantor and the property owner cares that the guarantor maintain a certain financial strength, a court would probably not allow the property owner to terminate the lease if the guarantor falls below the required financial standard. The lease might instead, however, call for a rent increase to compensate the owner for taking more risk than anticipated.

If the tenant allows garbage to pile up in the wrong places or at the wrong times, any lease will often allow the property owner to clean up the mess at the tenant's expense. It might make more sense to simply impose a charge for making the mess, again with an explanation for why it's important that such messes shouldn't happen and why the charge is reasonable.

In short, any property owner should try to give itself an arsenal of weapons both large and small to use against a defaulting tenant. Those weapons can include lease termination, but they should also include lesser measures that will give the owner a practical remedy for any default, given that courts won't readily terminate leases.

The key here is to create smaller and more immediate consequences for bad behavior. Small and immediate consequences may be more painful than larger ones, which are unlikely to survive a court's scrutiny. If the property owner can and does accelerate all of the rent due under the last seven years of a lease and the tenant suddenly owes six or seven figures of accelerated rent, then many tenants will just give up. That usually

means camping out in the space without paying rent, and operating the tenant's business until the marshal or sheriff arrives.

Draconian rights of the property owner can leave the tenant with no hope. Therefore, the tenant often stops trying. Smaller consequences might suffice, at least sometimes, to train a tenant that the property owner should not always be the last to get paid after payroll, suppliers, and distributions to the tenant's owners. The property owner is not the tenant's partner! On the other hand, if the tenant is the property owner's de facto partner, then the owner wants to be able to take small but serious actions to inspire the tenant to take that partnership seriously.



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I help buyers, sellers, borrowers, lenders, tenants, property owners, and other commercial real estate market participants identify and achieve their business goals. To do that, I need to understand risk, security, numbers, value, financeability, flexibility, and exit strategy. Some legal issues matter a lot and many don't. It's important to know the difference. I write extensively on commercial real estate law and practice – over 300 articles and five books on leasing, lending, and other areas, with some emphasis on ground leases. I occasionally serve as an arbitrator or expert witness in complex real estate disputes. That lets me see how transactions go wrong. Often, the problems could have been avoided by keeping it simple and following the money, but everyone got sidetracked. As a Forbes contributor, I try to tell stories that teach worthwhile lessons for real estate deals. **Read Less**