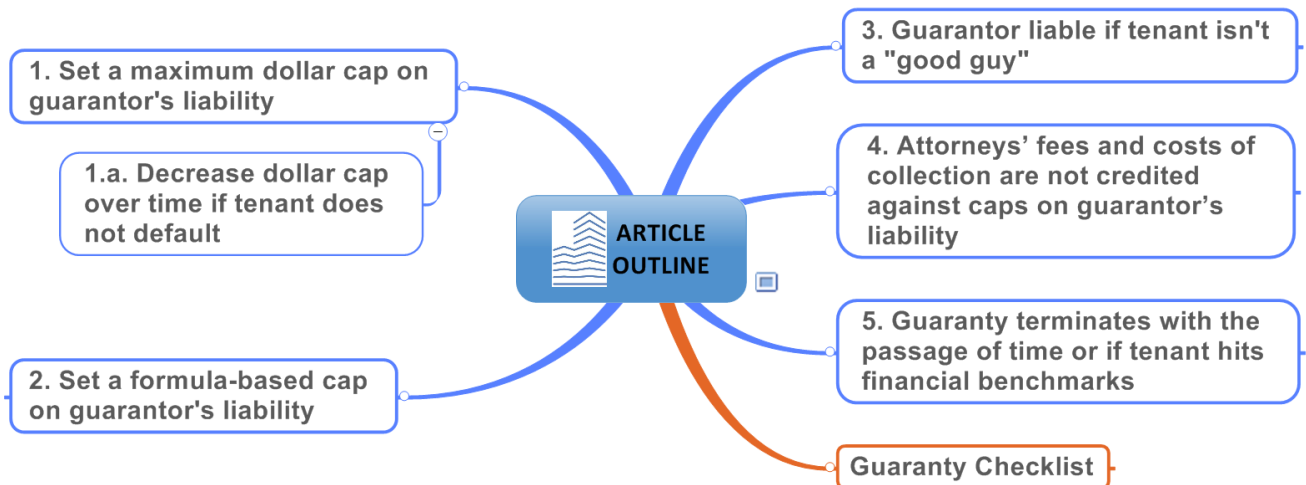




# Negotiating a Lease Guaranty 5 Bottom-Line Issues

Landlords often require a personal or corporate lease guaranty. The lease guaranty, a separate document executed simultaneously with the lease, makes the guarantor liable for the tenant’s defaults under the lease. The conflicting interests between landlord and guarantor are obvious: landlords want an unconditional and unlimited guaranty, while guarantors want a conditional and limited guaranty. Below are five bottom-line issues to consider and a checklist to review when negotiating a lease guaranty.



## 1. Set a maximum dollar cap on guarantor’s liability.

The parties can set a maximum dollar cap on the guarantor’s liability. For example, the landlord can agree to cap the guarantor’s liability at \$100,000, \$500,000, or any other amount. The dollar amount of the cap generally bears some relationship to the landlord’s potential losses and the tenant’s creditworthiness, or lack thereof.

### a. Decrease dollar cap over time if tenant does not default.

If the tenant performs without default under the lease for a period of time, the risk to the landlord presumably decreases. Using this rationale, guarantors argue that the maximum liability should decrease as time passes without a

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tenant default. For example, if the guarantor's maximum liability is set at \$120,000 for a ten year lease, the parties can agree that the guarantor's maximum liability will decrease by 1/10<sup>th</sup> (or by \$12,000) with the passage of each default-free year. Similarly, the parties could agree that the maximum liability will decrease by 1/120<sup>th</sup> (or by \$1,000) with the passage of each default-free month. Potential formulae are only limited by one's creativity.

## 2. Set a formula-based cap on guarantor's liability.

Another way to look at limiting guarantor's liability is to set a cap based upon a formula that will cover landlord's likely losses in the event of a tenant default. Common categories of losses include lost rent, the amount of the unamortized tenant improvement allowance and brokerage fees, and attorneys' fees and costs incurred in evicting the tenant. Unlike a set dollar cap, with a formula-based cap the guarantor does not know the exact dollar amount of his financial exposure when the lease is executed.

If, for example, the landlord estimates a maximum of one year as the time required to lease the premises following the termination of the tenant's lease, the Guarantor's maximum liability could be set by the following formula:

$$\begin{aligned} & \text{12 months rent and common area expenses} \\ + & \text{ unamortized tenant improvement allowance and brokerage commissions} \\ + & \text{ attorney fees and costs incurred in evicting the tenant} \\ = & \text{ Guarantor's Maximum Liability} \end{aligned}$$

Of course, the business needs of the parties should govern the terms of the formula and the above sample formula should be modified accordingly.

## 3. Guarantor liable if tenant isn't a "good guy."

The tenant is a good guy if it turns over possession of the premises to landlord as soon as possible following its default under the lease. A good guy guaranty makes the guarantor liable for (i) the cost of evicting the tenant from the premises, (ii) rent from the date of tenant's default thru the date on which tenant surrenders possession of the premises to landlord, and (iii) damage caused when tenant vacates the premises. Since the guarantor is liable until the tenant vacates the premises, a good guy guaranty creates motivation for the guarantor to exert influence over the tenant to vacate the premises and deliver possession to landlord ASAP.

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A good guy guaranty does not cover all of the losses that a landlord may suffer as a result of a tenant's default and is often used in conjunction with a dollar or formula-based cap on the guarantor's liability. If this is the case, specific language must be added to the guaranty that (i) sets forth the terms of the good guy guaranty, and (ii) excludes the guarantor's liability under the good guy guaranty from the dollar or formula-based cap.

#### **4. Attorneys' fees and costs of collection are not credited against caps on guarantor's liability.**

Attorneys' fees and other costs of collecting from the guarantor are generally not credited against an agreed upon cap on guarantor's liability. If this were not the case, a landlord could find itself spending more in collection costs than the guarantor is obligated to pay.

#### **5. Guaranty terminates with the passage of time or if tenant hits financial benchmarks.**

The reason for a guaranty is that the landlord believes that the tenant does not have the financial wherewithal to support the monetary obligations under the lease. If the tenant either performs without default for a period of time or if the tenant's financial condition improves during the term, the rationale for requiring a guaranty may evaporate.

**Guaranty terminates at a point in time.** Under this approach, the guaranty terminates at a point in time if tenant has not defaulted. For example, if the lease is for five years, the parties can agree that the guaranty will terminate at the end of the third year if the tenant has not been in default at any time during the first three years. Or, as another example, if the lease has a five year term, the parties can agree that the guaranty will terminate if the tenant has not been in default for 24 consecutive months.

**Guaranty terminates if tenant hits financial benchmarks.** Landlords often agree that the guaranty will terminate if the tenant reaches certain financial benchmarks. For example, the parties can agree that the guaranty will terminate if the tenant obtains (i) an agreed-upon net worth, (ii) an agreed-upon level of gross sales, or (iii) any other agreed-upon financial target the parties establish.

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While this article provides a framework for landlords and guarantors to negotiate material financial provisions of a guaranty, there are many other financial considerations and legal nuances that are beyond the scope of this discussion. For example, this article does not cover important financial issues such as joint and several liability (and potential limitations on such liability) and the release and substitution of guarantors (which may arise upon an assignment of the lease or the removal and replacement of partners). It also does not cover many inherent legal issues such as defenses against enforcement, subrogation, bankruptcy, local law issues, etc., that should be considered and addressed by landlords and guarantors before entering into any guaranty.

**GUARANTY CHECKLIST:** For your convenience, below is a summary checklist of key issues for landlords and guarantors to negotiate.

### Lease Guaranty Checklist:

1. Guaranty can be (i) unlimited, or (ii) limited.
2. If the guaranty is limited, establish guarantor's liability:
  - a. Cap guaranty (choose one)
    - i. Dollar cap - Dollar cap can decrease if tenant does not default for specified period of time
    - ii. Formula-based cap
  - b. Good guy guaranty
3. Terminate an unlimited or limited guaranty if tenant (i) does not default for a specified period of time, or (ii) reaches financial benchmarks.
4. Attorney's fees and costs incurred in pursuing guarantor are not credited against or subject to limitations on guarantor's liability.

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