

Analysis

## 3 Questions For Tenants And Owners As Subleasing Looms

By [Andrew McIntyre](#)

Law360 (May 29, 2020, 3:00 PM EDT) -- As office and retail tenants continue to have difficulty making rent amid the COVID-19 pandemic, many will look to sublease some or all of their space, and lawyers say the pandemic has ushered in a unique set of sublease questions.

For one, the sheer volume of space that could hit the market later this year could create an unprecedented level of space available for sublease, and one early question is what will the pricing be like for such space this time around.

But the subleasing question is also complex because it's difficult to envision what sort — and amount — of space companies will want or need once the pandemic passes.

"If you're a tenant with excess space, it's very likely you can't just get out of your lease. What choice do you have but to sublease?" said Steve Berkman, a partner at Paul Hastings LLP. "More subleasing space is coming on the market."

Here, Law360 looks at three unknowns about subleasing space amid the pandemic.

What will future needs look like?

While many office and retail tenants, on the one hand, are looking to sublease some or all of their space as they struggle to pay rent, subtenants are not yet lining up en masse to take the space in part because it's still difficult to know what sort of space they might want after the pandemic, experts say.

"There's uncertainty about how many people you can fit within a space. There's huge uncertainty about how many of your employees are coming back to work, and when," Berkman said. "I don't see companies being prepared to take more space yet. They are taking their time. There's not a huge rush. It's not like there are lots of buyers anxiously looking for space."

It's tricky, Berkman said, because working from home has largely been a success, which complicates the calculus of figuring out how much space to have in the future.

And part of the issue is that over the past decade, there's been a move in the office sector toward more open spaces and more collaborative working.

Now, with social distancing top of mind, it's unclear if companies will want that sort of setup, particularly given the unknown about the timeline for finding a vaccine.

"Offices that were built in the last few years with bench seating at a long common desk where people plug in their laptop, are people going to work like that, three or four feet apart?" said Rob Ivanhoe, vice chair of Greenberg Traurig LLP. "Nobody really knows how that equation is going to turn out. There will have to be a balance. It's unknown how many people are going to want to work at home, and how's that going to work. It's going to take awhile. You don't just snap your fingers."

Still, Louis Archambault, a partner at Saul Ewing Arnstein & Lehr LLP, said he expects to see more subleasing activity, particularly in the office sector.

"The question here is, 'Is the space going to be compliant?' You have issues with making sure that workplaces are compliant with the new normal," Archambault said. "What I don't have a clear answer to is if we had a vaccine tomorrow, would your opinion about space change? How much do you think working from home is the new normal versus maintaining what you have?"

How lenient will landlords be?

Landlords generally have significant say over whether or not tenants can sublease space, but given the pandemic, experts expect landlords to exercise some degree of leniency.

But just how lenient landlords will be remains to be seen.

"Professional firms, in general, are going to be rethinking the huge lease expenses that most incur," said Bill Kramer, a partner at Brinkley Morgan. "For that reason, I think landlords need to be a little more flexible in terms of allowing subleases. Maybe thinking about permanently reducing rent somewhat, because if somebody is coming in as a sublessee, they obviously want to be there."

Landlords, Berkman said, will likely end up offering certain concessions. While money is one issue, there are other concessions, like operational concessions. Subtenants may need help with setting spaces up to create necessary social distancing in order to allow workers and customers to return.

And Morris Missry, managing partner of Wachtel Missry LLP, said he expects landlords to be more lenient than they might have been in other instances, since they'd prefer to not have their buildings be half-empty.

"There are many leases that say that the tenant can't enter into a sublease for rents that are lower than what they are paying. In reality, it's done all the time, and many times the landlord consents," Missry said. "Most tenants don't have the unfettered right to sublease without landlord consent."

And while landlords may be flexible in allowing for subleasing, they will likely still exercise caution when it comes to the creditworthiness of a subtenant.

"The most important thing to a landlord is ensure that the proposed sublessee is in as strong or stronger a financial position as the original tenant," Kramer said. "And it's very important on the tenant's part to try to obtain a release from liability. Oftentimes the landlord won't do that."

Still, though, if landlords strictly follow the language in lease documents, they can exercise considerable control, so it remains to be seen just how landlords will act on that point.

"Virtually every lease has a substantial section dealing with subleasing," Kramer said. "Generally, the landlord writes the lease and that section is going to favor the landlord."

What will the sublease pricing market look like?

While amount and type of space needed in the future is one set of unknowns, it's also yet unknown what the sublease market will look like price-wise amid the COVID-19 pandemic.

"We will be trying to figure out the market or the going rate for leases period. New leases or subleases. Subleases tend to be slightly less than market rate or regular lease," Kramer said. "It's unclear as of yet. I think

we have to assume that lease rates will go down."

Berkman said there haven't been enough transactions yet to have a sense of the sublease market.

As one example of a subtenant getting a substantial discount, Kushner Cos. reportedly reached a deal recently to lease space at a trophy office property in Manhattan for roughly \$100 a square foot, roughly half of what tenant Itau Unibanco Holding SA was paying.

"If there are companies that need to get out of their space because not getting out of their space will affect their existence, those companies may be willing to take a bigger discount than others," Missry said. "You'll have to see where available office space trades, and what the absorption rate is going to be in the city," Missry added, speaking of New York City.

And the pricing going forward could favor subtenants, based on massive supply and few subtenants looking for space.

"You may have some subtenants looking for space that they typically couldn't afford. Now they may be able to because the rents will be lower," said Barry Katz, a partner at Saul Ewing. "On a certain level, the subtenants are going to have more leverage and may be able to strike a better deal than they could six months ago. The subtenant space is going to be a lot larger than it was six months ago."

Indeed, the question of how much leverage subtenants will have and where the pricing needle ends up remain to be seen.

"It's sort of an evolving little micro economy, if you will," Missry said. "Everyone seems to think that it's going to be a little more robust than usual because of impaired companies. Both office and retail."

<https://www.law360.com/articles/1270647/3-questions-for-tenants-and-owners-as-subleasing-looms>