

Head Leases vs. Subleases

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Head Lease vs. Sublease

Discussion Topics

- Major differences between a head lease and a sublease
- Business advantages to subleasing
- Business disadvantages
- Landlord's consent
- How subtenants can control the risks
- Insurance requirements

Major differences between a head lease and a sublease

- legal differences
 - sublease is predicated on a subset of the tenant's rights under the lease
 - if the head is terminated, the sublease is terminated unless the subtenant has a non-disturbance agreement
 - head lease often excludes the application of renewal or extension rights and pre-emptive rights such as right of first refusals under the head lease in favour of the tenant
 - no direct agreement with the landlord unless granted under a consent agreement or under a non-disturbance agreement

Major differences between a head lease and a sublease (cont'd)

- business issues

- Sub-landlord's cannot create any building value or economic future value: The objective for Sub-landlords is to maximize recoveries.
- Every month a Sublandlord fails to receive recoveries, results in further economic losses and typically further discounts to their premises.
- Most Sub-landlords prefer to discount rates or provide free rent than invest in vacant premises by way providing leasehold improvements.
- The result of items 1-3 above result in discounted rental rates and potential savings to subtenants.
- Length of term plays an important role to the amount of discount a Sub-landlord may have to provide. For example a five year term may see a 15 – 20% discount from head lease rates being achieved in a particular building, however, sublease space with less than eighteen months may see a discount of 65% or greater.

Business advantages to subleasing

- Discounted rate
- Term (typically shorter than required by landlords)
- As is premises with quick possession dates

Business disadvantages

- Risk of insolvency or default by the Sub-landlord
- Extensive consent agreements that bind the Subtenant to the Landlord for arrears and head lease rates in the event of a default by the Sub-landlord
- Inability of the Subtenant to negotiate its lease or make any changes to the lease. This may be a benefit if subleasing from Encana or other major who secures favorable lease terms which the subtenant may piggy back on. However this may be a disadvantage when subleasing from a junior or unsophisticated Sub-landlord.
- Generally bundle of rights are very limited to a subtenant under the lease and in most cases options and rights do not survive an assignment or sublease and do not flow through to the subtenant.
- Subtenant does not have a direct relationship with the Landlord.

Landlord's consent

- Withholding consent
- When must it be granted
- Other issues

How subtenants can control the risks

- Lease provisions to be concerned with
 - consent required
 - clauses in the lease that may need amending at the offer stage and in the head lease or deemed not to apply
 - In no event shall the Tenant sublease or assign its premises for less than the rate contained in the lease herein. This type of wording is very restrictive for example in 2008 the head-lease rate agreed to may have been \$34 psf, 2011 market rate was \$18 and sublease rate required to secure recoveries may have been closer to \$14. However, under this example the landlord does not have to consent and some landlords have used this clause to receive additional payments from Tenants need to sublease their premises.
 - In no event shall the Tenant sublease space for less than the head lease rate quoted by the landlord for vacant premises in the building: Same issue as above. More importantly is to answer the question as to “how does the proposed Sub-landlord receive recoveries especially on premises that my only have a short term available.”

How subtenants can control the risks (cont'd)

- consent agreements and typical provisions
 - waiver of rights under the LRBA
 - non-disturbance at landlord's option
- non-disturbance agreements
 - from head landlord
 - from head landlord's lender
 - from other parties up the chain if a sub-sublease
 - likelihood of getting any of these

Insurance requirements

- Sublease usually requires subtenant to comply with the insurance requirements under the head lease
- Subtenant and sublandlord will want to avoid duplication of coverage
- Head landlord will want proof of insurance showing such coverage

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