

Managing Tenant Default Process

I. KNOW YOUR TENANTS

A. Watch for signs of tenant distress

1. Reductions in numbers of employees
2. Changes in level of activity at Premises
3. Changes in rent payment patterns
4. News articles about tenant businesses
5. Notices of Bankruptcy
6. Requests for subleases or assignments

B. Stay in touch with tenants frequently to encourage communication about problems

C. Stay on top of rental defaults

D. Ask for tenant estoppel certificates if permitted by the lease

E. Get updated tenant financials - especially if the

tenant wants concessions from the Landlord

II. WHAT TO DO WHEN THERE IS A DEFAULT

A. Send out default notices right away – don't allow arrearages to build-up

1. Demand strict compliance with Lease

2. Follow notice provisions of Lease exactly - failure to do so can be very costly

3. Make sure any guarantors (including predecessor tenants) are notified every time

B. Meet with tenants personally if possible to discuss payment

C. Apply security deposits immediately and demand that tenant restore

D. Get alternative security in the context of a workout agreement

1. Personal guarantees

2. Promissory Notes

3. Settlement Agreements with Consent

Judgments

4. Letters of Credit

5. Additional Cash Security Deposits

E. Consider terminating the lease if it looks like the tenant is headed for bankruptcy

F. Get the space back - don't allow tenants who don't pay to stay in the space

1. Dispossessory processes vary by state

2. Usually a quick way to get a judgment for rent against tenants

3. Allows landlord to release space to tenant who will pay

III. WHAT TO DO WHEN THE TENANT IS IN BANKRUPTCY

A. In most cases, if the lease was terminated prior to the bankruptcy filing, the lease is not a part of the bankruptcy estate and can't be assigned

1. Still need relief from the automatic stay to evict the tenant if they are still in the space

2. Landlord usually gets control of the space much more quickly

3. Claims for past due rent are unsecured, low priority claims in bankruptcy

B. If lease is not terminated prior to the filing of a bankruptcy action, the lease is part of the tenant's bankruptcy estate

1. Automatic stay prevents Landlord from taking any actions against the tenant (including demand letters)

2. Bankruptcy court decides whether to reject or assume lease - process can last from 60 days to much longer depending upon complexity of case, but landlord can ask for acceleration of process in the event of hardship

3. In order for lease to be assumed, any default must be cured and adequate assurances of ability to perform under the lease in the future given

4. Court can assign the lease to another party without the consent of the landlord; however, assignment could be a good thing for the landlord because lease will be assigned to party with ability to pay the rent

C. Landlord is entitled to certain damages in

bankruptcy actions

- 1. Claim for administrative rent for period from filing of the bankruptcy action until lease is rejected - high priority claim**
- 2. Unsecured, low-priority claim for pre-petition debt**
- 3. Damages claim pursuant to bankruptcy code for lease rejection damages - greater of (i) rent for one year or (ii) 15% of the remaining rent under the lease (not to exceed three years' rent) - 11 U.S.C. § 502(b)(6) - low-priority claim**
- 4. Usually claims are only paid pennies on the dollar**

D. Stay on top of notices from bankruptcy court - must file timely proofs of claims

E. Contact landlord's counsel whenever there is a tenant bankruptcy - especially if the tenant or the tenant's property is in the space

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NOTE: This site includes a summary of certain legal issues facing landlords today. This site does not, and is not intended to, give legal advice. Reference should be made to full

text of the statutes, regulations and legal documents for complete analysis. Consultation with competent counsel is strongly recommended.

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