

## SUBLEASING AS AN EXTREME SPORT: SUBLEASE DUE DILIGENCE

**Presented by:**

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When a Tenant and Subtenant enter into a Sublease, the Prime Landlord, Tenant and Subtenant (should) all perform due diligence. The purpose of this presentation is to summarize each party's considerations when entering into a sublease.

### A. Subtenant

#### 1. Due Diligence Generally

- a. The Subtenant's due diligence is necessarily the most involved
- b. However, the level of due diligence depends on several factors

- i. Importance of space to Subtenant's business
- ii. Size of space (one floor rule of thumb)
- iii. Length of term (three year rule of thumb)

#### b. Categories of Due Diligence

- i. Lease file
- ii. Physical condition
- iii. Operational issues
- iv. Financial Strength
- v. Status of ownership

#### 2. Lease File

##### a. Prime Lease

- i. Entire document is relevant: address issues by way of . . .
  - (a) Exclusions in Sublease
  - (b) Amendment (what if sublease only part of premises)
  - (c) Consent
  - (d) Also address cost and responsibility of obtaining consent/amendment if necessary

- ii. However, most important provisions:
  - (a) Transfer
    - (i) Sublease itself
    - (ii) Further transfers
  - (b) Use
  - (c) Alterations
  - (d) Term (require option exercise?)
  - (e) Retail: exclusives, % rent, continuous operation, signage
  
- iii. Transfer: Better to address in Prime Lease
  - (a) Consent required?
  - (b) Recapture permitted?
  - (c) Procedure
    - (i) Information required to be submitted
    - (ii) Conditions to be satisfied (e.g., language that must be included in sublease)
    - (iii) Timing: what must you submit to start clock ticking?
    - (iv) Financials required?
    - (v) "Fine Print": Cannot be a tenant in the building/rent cannot be less than what Prime Landlord charges/etc.
  
- b. Other Documents in Lease File
  - i. Commencement date agreement
  - ii. Amendments and letter agreements
  - iii. Assignments, subleases and consents
  - iv. SNDA
  - v. Estoppels
  - vi. Other correspondence
    - (a) Approval of alterations (and any removal requirements at end of term)
    - (b) Exercise/waiver of ROFO, renewal, expansion options
    - (c) Default notices
    - (d) Operating expense correspondence (reconciliations, copies of tax bills, settlement of disputes, etc.)

3. Physical Condition
  - a. Existing conditions
    - i. Wiring
    - ii. Electrical capacity
    - iii. Telecommunications equipment/risers
    - iv. HVAC
    - v. Plumbing
    - vi. Security
    - vii. Personal property
  - b. Required alterations
    - i. Whose responsibility (e.g., new shared corridor)
    - ii. Permitted under Prime Lease?
    - iii. Affect grandfathered status of building/premises?
    - iv. Removal at end of lease term?
  - c. Compliance with laws
    - i. Zoning report (zoning, land use, building codes, parking)
    - ii. Property condition report
      - (a) ADA compliance
      - (b) Certificate of occupancy compliance
    - iii. Environmental report
      - (a) Phase I
      - (b) Indoor air quality
4. Operational Issues
  - a. Independent systems (e.g., supplemental HVAC, security)
    - i. Who maintains them?
    - ii. Any service contracts in place with respect to them?
    - iii. Prime Lease service contract requirements
      - (a) Consider in whose name they should be held
      - (b) Assignable?

- iv. Any warranties and guaranties to be transferred? If not, obligation for Tenant to enforce?
  - b. Shared facilities (e.g., common restrooms, conference rooms)
    - i. Maintenance
    - ii. Scheduling
    - iii. Security
  - c. Rules
    - i. Rules and regulations attached to lease? Supplemented?
    - ii. Construction rules and regulations
    - iii. Freight elevator hours, charges, rules
    - iv. Cleaning specs
    - v. Schedule of additional services available, costs
    - vi. After hours HVAC
- 4. Financial Strength
  - a. Parties to consider
    - i. Landlord
    - ii. Prime Landlord
  - b. Sources to consult
    - i. D&B reports
    - ii. Credit reports
    - iii. Financial statements
- 5. Status of ownership
  - a. Title report
    - i. Prime Landlord has fee or leasehold interest?
    - ii. Loans and liens
  - b. UCC Search: especially if Tenant conveying personal property

B. Tenant

- 1. Transfer provision (mostly same considerations as Subtenant)
- 2. Financial strength of Subtenant
- 3. Ability to make representations regarding Prime Lease
- 4. Subtenant activities that might cause a default under Prime Lease

- a. Use
- b. Alterations
- c. Hours of operation
- d. Density
- e. Load limit

C. Prime Landlord

- 1. Transfer provision
  - a. Withhold consent?
  - b. Recapture?
  - c. Timing
  - d. Profits
  - e. Reimbursement for costs
- 2. Financial strength
  - a. Tenant
  - b. Subtenant
- 3. Ability to make representations
- 4. Compliance with zoning/land use
  - a. Use
  - b. Parking
  - c. Alterations
- 5. What happens to Subtenant if Prime Lease terminates?