

What Commercial Tenants Should Know About Personal Guaranties

Article

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A business owner may form a corporation or limited liability company to separate business obligations from personal assets. Then, while negotiating a lease for office, retail, industrial or other commercial space, the landlord may ask the business owner to sign a personal guaranty. With a few words and a signature, much of that separation can disappear for one of the company's largest and longest-term obligations.

Landlords have legitimate reasons to request guaranties. A new or thinly capitalized tenant may have little credit history, few assets and no payment history. Even an established operating company may hold most of its assets in affiliated companies. The landlord is committing valuable space and may also be paying a brokerage commission, funding tenant improvements or granting free rent. A guaranty provides another source of repayment if the tenant defaults.

A prospective tenant should not, however, sign the landlord's form without negotiation. A guaranty can often protect the landlord during the period of greatest risk without exposing the guarantor indefinitely to every liability under the lease.

Start with the Letter of Intent

The guaranty should be addressed in the letter of intent, not raised after lease negotiations begin. At a minimum, the letter of intent should identify the guarantor and state whether the guaranty will be unlimited, capped, or reduced or released over time. If the landlord expects a personal guaranty and the tenant expects none, that disagreement can be a deal killer. It is better to discover it before both sides spend time and money preparing lease documents.

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Identify the Guarantor(s)

If the business owner, who is also the prospective guarantor, is married, some assets may be jointly owned with their spouse. This will limit recovery if the spouse does not sign because only the assets owned by the signing spouse may be available to satisfy the guarantor's obligations. A spouse involved in the business may be willing to join the guaranty, while one who is not may be unwilling to sign. If a spouse does join, the guaranty should recite that the spouse's joinder is a material inducement for the landlord to enter into the lease, and that the lease confers benefits on the tenant that are considered adequate consideration for the spouse to sign the guaranty.

Know What Is Being Guaranteed

A guaranty may cover only rent or every tenant obligation under the lease, including operating expenses, repair and restoration obligations, indemnities, attorneys' fees, accelerated rent and damages after the tenant leaves. It may also survive the lease's expiration or termination.

Florida's statute of frauds generally requires a promise to answer for another party's debt or default to be in writing and signed by the guarantor. The fact that a guaranty may appear as a short exhibit or a few paragraphs at the end of the lease does not make it unimportant. The guarantor should read the lease and guaranty together because both documents determine the amount at risk.

Ways to Limit a Personal Guaranty

The appropriate limitation depends on the tenant's financial strength, the landlord's investment, the lease term and the parties' bargaining power. Common approaches include:

- **Cap the liability.** The guarantor's maximum exposure can be limited to a stated amount or a specified number of months of base rent and operating expenses. The provision should say whether attorneys' fees, repair costs and indemnity claims fall within the cap.
- **Provide for a burn-off.** The guaranty can terminate after the tenant pays rent and performs its obligations for an agreed period, such as two or three years. A landlord may require that no uncured default exist when the release occurs. The tenant should avoid language under which a minor or cured default permanently prevents the burn-off.
- **Reduce the exposure over time.** The cap can decrease as the landlord recovers its initial costs and the tenant establishes a payment history. This may be a fair compromise when the landlord has funded substantial improvements or other concessions.
- **Negotiate a surrender or "good-guy" guaranty.** The guarantor remains liable until the tenant gives advance notice, pays all amounts due through the surrender date, vacates and returns the premises in the condition required by the lease. If those conditions are met, the guarantor is off the hook for rent remaining on the lease term. However, if the business stops paying rent but continues to occupy the space, the landlord can pursue the guarantor's personal assets to collect the rent. The required notice, payment and surrender conditions should be precise. Otherwise, disagreement over a repair or removal obligation may prevent the release.
- **Limit the covered obligations.** The guaranty can cover base rent and recurring operating expenses but exclude consequential damages, unperformed construction obligations, environmental liabilities not caused by the guarantor or tenant, and other extraordinary claims. Any exclusions should be coordinated with the lease's default and indemnity provisions.

- **Tie the guaranty to the landlord's remaining investment.** If the landlord's principal concern is recovering a tenant improvement allowance, brokerage commission or free-rent concession, the guaranty can be limited to the unamortized amount of those costs, with the balance declining monthly over the initial term.

Do Not Overlook Future Changes

A guaranty often continues despite amendments, renewals, expansions, assignments or other lease changes, sometimes without notice to the guarantor. A guarantor who approves a five-year lease for a particular space may not intend to guarantee a renewal term, an expansion or materially increased obligations negotiated later.

A prospective guarantor should consider requiring written consent before the guaranty applies to a material amendment or extension beyond the initial term. The guaranty should also address permitted assignments. If the landlord approves a financially responsible replacement tenant and receives a replacement guaranty or other security, the original tenant and guarantor should seek an express release.

Notice and Cure Rights Matter

A guarantor may not be involved in the tenant's daily operations and may not know that a default has occurred. Requiring the landlord to send default notices to the guarantor gives the guarantor an opportunity to cause the tenant to cure. The guarantor should receive at least the same notice provided to the tenant and, when practical, a short additional cure period. The guaranty should state that notices must be sent to a current address or email address and explain how that information can be updated.

Consider Alternatives

If a personal guaranty is unacceptable, the tenant may offer other credit support, such as a larger security deposit, letter of credit, prepaid rent, guaranty from a stronger parent company or financial reporting demonstrating the tenant's ability to perform. These alternatives have their own costs and risks but may preserve the owner's personal liability protection.

If multiple owners are asked to sign, they should determine whether each is liable for the entire amount or only a stated share. A landlord will usually prefer joint and several liability, which permits recovery of the full amount from any one guarantor. The owners may instead seek separate caps based on their ownership percentages or another agreed allocation.

The Bottom Line

A personal guaranty is not merely a signature page attached to the lease. It is a separate credit decision that can expose a business owner's personal assets long after a new location opens. Prospective tenants should address the guaranty early, understand what it covers and negotiate limitations that reflect the landlord's actual risk. These issues are best addressed before the letter of intent is signed and the landlord's lease form becomes the assumed framework for the deal.

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