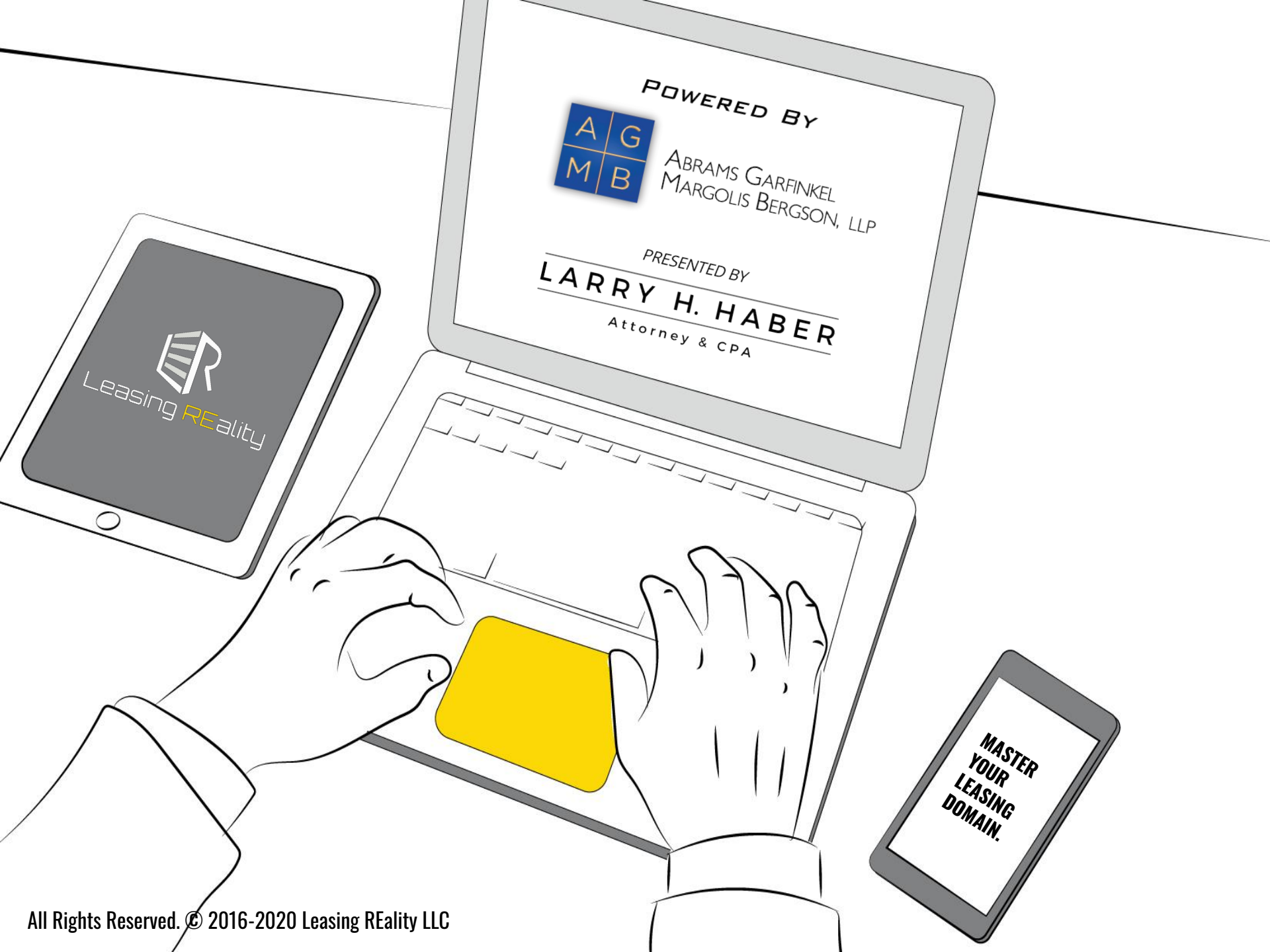


Good Guy Guarantees and Security Deposits

Short and Long Term Risk Mitigation Strategies for Landlords and
How Tenants Can Counteract Those Strategies





POWERED BY

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Test Your Knowledge

Check Your Understanding with sample Good Guy Guarantee and Security Deposit questions from Leasing REality's Certificate Programs at the end of slides.

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TAKE A TEST RUN

Explore Leasing REality's 32-Hour and 48-Hour Certificate Programs Course Lessons.

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What is a “Basic” Good Guy Guaranty (“GGG”)?

A **good guy guaranty (“GGG”)** in its basic form was originally intended to incentivize a “corporate” tenant to be a “good guy” and give back its space if it was (or was on the verge of becoming) a non-paying tenant.



What is a “Basic” Good Guy Guaranty (“GGG”)? (continued)

Guarantor of a Tenant’s Covenant to Pay Rent:

- For the payment of base rent and additional rent while a corporate tenant is in occupancy of its space
- The GGG Guarantor generally owns and controls the “corporate” tenant

The Basic GGG Will No Longer Be in Effect If:

- Tenant or Guarantor delivers the required prior written notice (i.e., 30, 60, 90 days) of its intent to vacate the premises prior to lease expiration
- Space is given to the landlord broom clean and vacant
- Rent is paid through the date of surrender

“GGG” and Security Deposits: How Much Protection is Enough?

Landlords:

Channel the one and only Zen Master, 11-time NBA Champion Phil Jackson, and ask yourself the Zen-like question, “How much is enough?”

Tenants:

Embody Pete Townshend of The Who’s hit song “A Little is Enough” when deciding upon:

- How much **security deposit** you’re willing to give a landlord?
- How many or few steroid-laced legal and business points you’re willing agree to in the **GGG**?

The Leasing REality

On a **10-year/10,000 RSF** office lease renting at a **\$60 PSF** (i.e., **\$600,000** annual rent) with a **\$60** tenant improvement allowance (landlord contribution) (i.e., **\$600,000**) and **6 months** of free rent (i.e., **\$300,000**), and with brokers on both sides of the transaction, which in many markets will require a **100% commission to the tenant's agent** (roughly **\$200,000** in NYC) and a **50% override commission to the landlord's agent** (roughly **\$100,000** in NYC), a landlord within the **first 6 to 12 months** of lease execution very well will be incurring roughly **\$1,200,000 million in costs** (not including legal, architectural, engineering and building department filing fees).



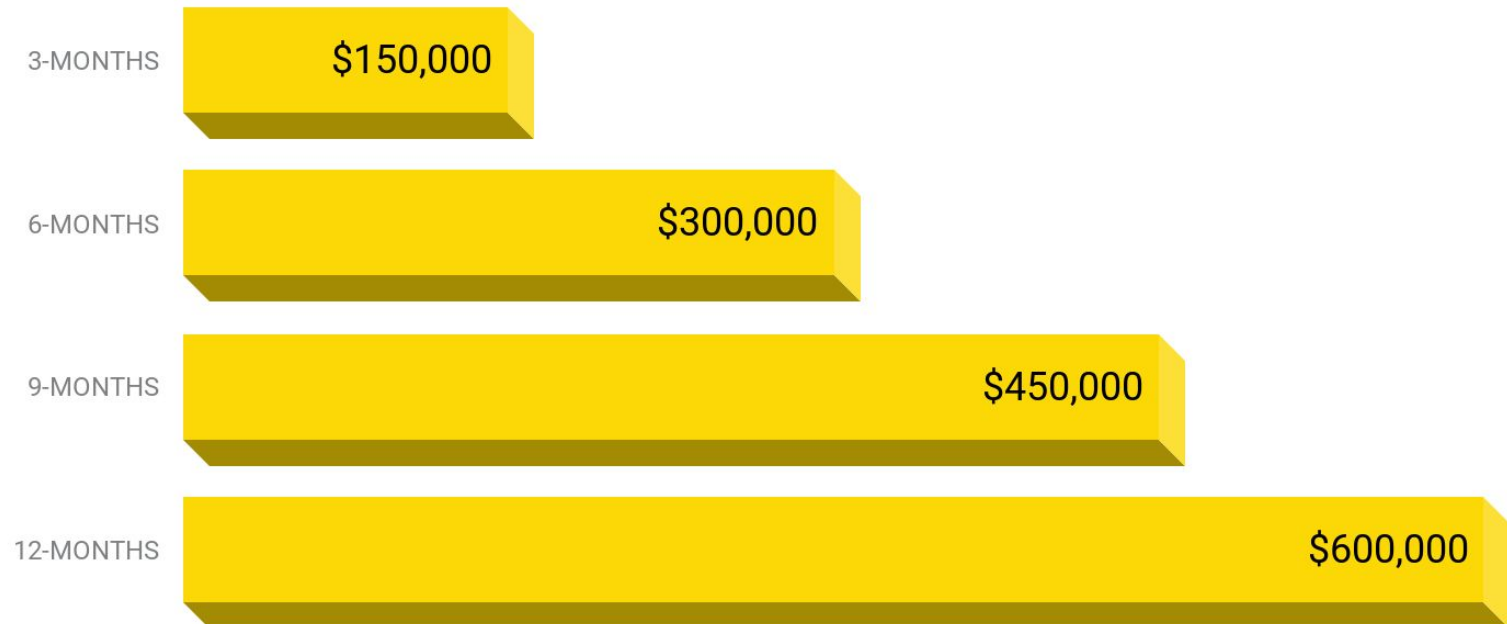
The Leasing REality (continued)

Short of the tenant being a nationally or regionally recognized tenant, given the aforementioned **short term \$1,200,000 in costs** the landlord will incur, how the landlord underwrites the deal and the risks associated with it will go a long way in determining whether it will require **3, 6, 9 or even 12 months** of security deposit from the tenant (and a GGG containing significant dosage of “steroid laced” business and legal protections from a tenant’s guarantor) at lease execution!



The Leasing REality (continued)

The \$600,000 Annual Rent Scales of Security Deposit Justice or Injustice



Financial & Non-Financial Security Deposit Determining Factors

Sweet 16 List

1. The strength of tenant's (and its principal's) profit and loss statement
2. The strength of tenant's (and its principal's) balance sheet
3. Tenant's historical track record
4. Is it office or retail? "Think" more outlay by a landlord on office deal and more "skin in the game" by a tenant on a retail deal.
5. Lease term length (the shorter term, the smaller the "tenant concession cocktail" and the larger the security deposit required)

Financial & Non-Financial Security Deposit Determining Factors (continued)

Sweet 16 List

6. Amount of tenant concessions and allowances
7. Whether tenant is a non-profit or trade association. If so, “think” more security deposit given there will be no GGG.
8. Is tenant a newly created shell entity? If so, “think” more security deposit given the risk.
9. Is the tenant’s parent a foreign entity? If so, the named tenant will likely be a newly created shell entity (thus think more security deposit).

Financial & Non-Financial Security Deposit Determining Factors

(continued)

Sweet 16 List

10. How much “skin” does tenant have in the game? Retail tenants generally have “more skin” at risk, as they (a) often receive little or no landlord TIA contribution, and (b) all or the majority of their free rent period is consumed by performing improvements to the space (and consequently, unlike many office tenants receiving a “turnkey buildout,” the free rent granted cannot be redirected to offset moving, furniture, IT and other costs.
11. Are the brokerage commission payments and free rent concessions being spread out over the 1st year, or paid (or granted) upfront?

Financial & Non-Financial Security Deposit Determining Factors

(continued)

Sweet 16 List

12. Is the security deposit based on the 1st year, last year, or average base rent amount?
13. Is tenant requesting a reduction “burndown” of its security deposit?
14. Is the security deposit in the form of a letter of credit or cash (which due to bankruptcy laws, the latter generally equates to significantly greater risk to landlord)?

Financial & Non-Financial Security Deposit Determining Factors

(continued)

Sweet 16 List

15. Will the tenant channel Eric Clapton's song "Let It Grow" and agree to deposit additional security as the base rent increases annually?
16. Will the tenant agree to allow landlord, if permissible by law, to co-mingle the security deposit?



Financial & Non-Financial Security Deposit Determining Factors

(continued)

Conclusion: The **greater** the concessions requested, the **shorter** the lease term for a landlord to recoup the concessions granted, the **higher** the risk to landlord and the **worse** the financials and track record of the tenant, along with the **absence** of a business and steroid laced good guy guaranty, the **larger** the security deposit will be.





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Check Your Understanding #1

True or False?

In a commercial lease, security deposits and good guy guarantees are often used by landlords to manage short-term and long-term financial risks.

Find correct answer and explanation at the end of slides.



Check Your Understanding #2

True or False?

As a consequence of bankruptcy laws, it is beneficial for landlords to require tenants to have security deposits in the form of a letter of credit over cash.

Find correct answer and explanation at the end of slides.



Check Your Understanding #3

True or False?

In deciding the amount of security deposit to require from its tenant, a landlord will, among other things, evaluate its initial costs (such as how much landlord is providing its tenant in the form of free rent, a tenant improvement allowance contribution and landlord's work, in addition to the brokerage commission amount) and review the tenant's and its principal's financial statements, historical track record and business plan.

Find correct answer and explanation at the end of slides.



Check Your Understanding #4

True or False?

The following factors will increase the amount of security deposit a landlord will require from the tenant: (i) the tenant being a shell corporation; (ii) the tenant putting little or no money into the space; and (iii) there being no good guy guaranty.

Find correct answer and explanation at the end of slides.



Check Your Understanding #5

True or False?

It is generally safer and more secure for a tenant to have its security deposit held by its landlord in the form of cash rather than a letter of credit?

Find correct answer and explanation at the end of slides.



Check Your Understanding #1-#3 Answers

True or False?

1. **The correct answer is True.** Especially given a landlord's upfront costs in the form of landlord's work, tenant improvement allowances, free rent concession and brokerage commissions – not to mention legal, architectural and Department of Building filing fees, security deposits and good guy guarantees allows landlords to manage their short-term and long-term financial risk by covering as much of a landlord's costs as possible and motivating the tenant to give back their space if they stop paying rent.
2. **The correct answer is True.** A letter of credit is not considered part of a bankrupt tenant's estate, whereas a cash deposit is. Thus, upon a tenant's filing for bankruptcy protection, a landlord would have to hold the cash security deposit for the benefit of tenant's estate and ultimately transfer same to the trustee and stand side by side with unsecured creditors, whereas, with a letter of credit, landlord can draw down and retain the entire amount.
3. **The correct answer is True.** The landlord wants to minimize its risk of losing (and otherwise feel comfortable that it won't lose) its initial outlay of money spent performing work to prepare the premises for a tenant, paying a brokerage commission and foregoing rent for the first three (3) months by requiring tenant to post a significant security deposit and have reasonably satisfactory financials.

Check Your Understanding #4-#5 Answers

True or False?

4. **The correct answer is True.** A landlord would want a larger security deposit if (i) tenant was a shell entity which has no assets to go after in the event of tenant's default, (ii) the tenant does not invest much money in the premises thus not having much "skin in the game" making it less painful for tenant to walk away, and (iii) there is no good guy guaranty whereby an individual would personally guarantee the obligations up to the time tenant surrendered the premises in the condition required under the terms of the lease.
5. **The correct answer is False.** From the tenant's perspective, when it comes to a cash security deposit, if you lock up a large amount of cash, you're potentially restricting yourself by not having that cash at your disposal, and you're receiving a de minimis rate of return on it. In addition, in the event the mortgage of a tenant's landlord is foreclosed on, unless the cash security the landlord holds is delivered to its mortgagee, the mortgagee or purchaser of the loan will have no obligation to return it to the tenant! As a result, all tenants should explore the annual administrative cost that a bank will charge you for having a LOC. The other side of the coin is, if you're given the option as a tenant between the landlord holding your money or a bank holding your money – not that you particularly love either one – but the bank over the landlord is a safer, more secure option.

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