

CLARK HILL Journal

Lease Guaranties, Security Interests & Letters of Credit: How Good Are They To The Landlord?*

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Lease Guaranties

Personal guaranties are the most common tool to secure performance of a lease.

While standard, multi-page forms are superior, a guaranty can be created by a simple sentence stating that "Guarantor absolutely, unconditionally and irrevocably guarantees the full and timely performance of all of tenant's obligations pursuant to the lease."

While a guaranty may create a contractual obligation for the guarantor to meet all of the tenant's obligation under a lease, from a practical perspective most guarantors do not have the means to meet those obligations. Therefore, guaranties usually result in some sort of a compromised settlement. Guaranties are more effective when provided by both spouses, allowing marital assets to be targeted during collections. Personal guaranties have become less effective since the crash in values in the residential housing market because the risk that a bankruptcy filing would result in the sale of the guarantor's home in order to distribute equity to creditors is no longer as realistic.

While a guarantor does not enjoy a possessory interest in the real estate, guarantors should be served with default notices and included as parties in eviction lawsuits that seek to obtain money judgments.



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Security Interests

A security interest is the right to compel performance by creating a collateral interest in a specific property. A security interest is created by a contract. A security interest is perfected by filing paperwork that notifies the public of the secured party's interest in the property. A security interest in real estate is a mortgage that is filed with the County Register of Deeds. A security interest in personal property is perfected by filing a UCC Financing Statement with the State of Michigan. To the extent that the personal property is affixed to real estate (such as a rooftop air conditioner unit or a stove's hood vent), the UCC Financing Statement is also

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filed with the County Register of Deeds.

While it is not typical for landlords to obtain security interests in personal property, it is common. However, while commercial leases sometime provide landlords with security interests, landlords frequently fail to perfect those security interests by filing the necessary forms. If the security interest is not perfected when the lease is executed, it can be later perfected by filing the necessary paperwork, however, the security interest will be secondary to any new secured parties such as lenders who won the race to file the paperwork.

Landlords that provide assets for use in the tenant's

business (such as a liquor license or equipment left behind by a prior tenant) should always obtain a security interest in those assets.

Landlords will typically not be able to obtain a viable security interest to the extent that the tenant obtains a commercial loan to build out or operate its business because the bank will demand the first secured position.

Letters of Credit

A letter of credit is a promise by a third-party, generally a bank, that it will pay a certain amount to the landlord if the tenant defaults.

Obtaining a letter of credit is rare. A letter of credit will generally only be feasible for

a large, creditworthy, national tenant with an extensive banking arrangement. This type of tenant generally only defaults in a bankruptcy situation where the value of the letter of credit may be deemed as an asset of the estate. In the current marketplace, few landlords will have the necessary leverage to compel such a tenant to provide a letter of credit. In order for a small tenant to obtain a letter of credit, it would likely have to deposit the amount of the letter of credit with the bank, which for the tenant would be the cashflow equivalent of paying the money as a security deposit.

Stephon B. Bagne has specialized in representing property owners involved in condemnation proceedings during his entire career. His expertise in representing property owners in condemnation cases is widely recognized. Stephon has represented all types of property owners in a variety of situations including vacant and improved property, partial and total takings, easement and fee acquisitions, involving commercial and residential properties. Stephon has successfully challenged the necessity of takings and negotiated less onerous acquisitions in partial taking matters. He regularly speaks and writes about eminent domain and other real estate law issues for a variety of professional organizations. **Contact him at: sbagne@clarkhill.com or 313-965-8897**

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