

Your Lease Matters

In this exclusive report we discuss the nuances in the typical landlord's option wording that **WILL** cost you money and increase your risk needlessly.

Renewal & Extension Options



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Term Options

What is the Option?

Depending on the specific wording used, the option allows the tenant to either lease the space again for a further term, often under the landlord's then standard lease; or extend the existing lease contract for a further period. To best understand the difference, consider that the word "lease" is both a verb and a noun. As a noun, it refers to the lease agreement, or contract. As a verb, it is the act of leasing the space irrespective of the contract.

Often the heading will read "Renewal Option" when the subsequent wording is actually an option to extend the current contract. This is not a subtle difference.

An option to renew the Lease allows the tenant to once again lease the space they occupy. Implicit in that wording is that the current lease contract has ended, and a new contract must be entered into after negotiation, some times. Often the landlord's wording in this case states only that the tenant will sign the 'the Landlord's then standard lease form'. This wording takes away the ability to negotiate better terms and the tenant is forced into signing the new agreement which is beneficial to the landlord.

An option to extend the Lease means the existing contract continues for a specific length of time. If the initial contract is not rigorously negotiated, then (once again) the tenant is locked into a document that is very landlord friendly.

As you can see, in either situation, the tenant can really hurt their business in the future if the lease is not negotiated properly at the very beginning.

On the next page we discuss when the tenant can exercise their option.

When Can the Option Be Exercised?

Almost all option clauses contain wording that gives the tenant a defined, and somewhat narrow, window in which to inform the landlord the tenant wishes to exercise the option.

It is important to note two things here:

1. The tenant must proactively notify the landlord that they wish to exercise their option otherwise the tenant loses it, and
2. The window noted above occurs well in advance of the lease expiration.

Why these matter:

Sam owned a very successful location. One day, Sam received a call from his landlord advising him that the landlord would not renew the lease as they had leased Sam's space (and a few other spaces nearby) to another, larger tenant.

Sam was shocked because he had several options to renew, and his lease was not set to expire for another 6 months. The landlord informed him that the window in which Sam had to notify the landlord of his intention to exercise his renewal option expired the day before. Sam did not exercise his option on time, so it was null and void the next day, when the landlord called. Sam had simply forgot about the deadline while he was consumed with the day to day operation of his very successful business.

This cost Sam his business and hundreds of thousands of dollars in capital costs, lost sales and profit.

Typically, the ability to exercise the option and inform the landlord of the intent to continue in the space is 6- 12 months before the lease expiration. Many leases state that the tenant can only exercise the option between two dates, such as: not earlier than 12 months and not later than 9 months prior to the lease expiration.

Therefore, there are several critical dates the tenant must keep in mind and actively manage from the very start of the lease. These include: When did the lease actually start? When does it expire? When is the window to exercise?

However, bear in mind this time management is done at the beginning of the lease - many years prior to the lease expiration and the window we've mentioned. Therefore, the Greenstead Consulting Group uses our Lease Management System to confirm and track these dates for you. You get notifications well in advance of the last day to exercise your option. It is a simple one-time investment based on the length of the term, or terms, in question. Contact us to learn more so you can avoid a fate similar to Sam.

Occasionally, the landlord may have a 'negative option' clause pertaining to the tenant's right to renew or extend the lease. In this case, the lease is automatically renewed unless the tenant advises the landlord that it doesn't wish to renew by a certain date. A major issue with this type of clause is if the tenant does NOT wish to renew and misses the deadline to tell the landlord. The tenant is then locked into a further term that could be many years long. Negotiating the tenant's way out of this situation is very expensive. This too is a type of date we track on behalf of our clients.

How Does the Tenant Exercise its Option?

The tenant must be careful to adhere to the proper notification protocol in the lease because the tenant can lose its option if proper notification is not followed. In some cases, the notification may need to go to several different people/addresses or entities. Missing any of those could result in a forfeiture of the option.

It is also important to know how it is to be sent. If the lease states it must be in writing and sent by certified or registered mail or overnight courier, the tenant **cannot** send it by email, or hand deliver it, for example.

It is always important to obtain written confirmation of receipt by the landlord of the tenant's notification.

Let's Talk Rent

How good is your crystal ball? One of the important topics about the option period is rent, of course. There are three common ways of determining what the rent will be for each option period.

Pre-negotiated Rent

When the lease is first negotiated and long before it even starts you may have a negotiation as to what the rent will be for each option period. In this case the rent will be defined in the lease and the parties will have to live with what has been negotiated many years before.

While this may be convenient, there are certainly pitfalls. What if the property is not as good as you originally thought? That pre-negotiated rent may not be worth it. What if market rents decline and you are now locked into above market rents?

Conversely, if the property is in an up-and-coming area, or rents have historically climbed quickly, this may be a good way to deal with the question of rent.

Fair Market Rent (FMR)

In this case the landlord and tenant agree to discuss a renewal based on the market rents of comparable leases at the time of exercising the renewal. The big question for our company is how one defines market rent? To illustrate this, consider that the landlord presents comparable rent examples for around \$25.00 per square foot each year for 5 years, but you discover that in exchange the tenant received incentives equal to \$25.00 per square foot. On renewal, the landlord is not offering incentives, so is the comparable of \$25.00 really comparable? We'd argue it is closer to \$20.00 per square foot per year after deducting the tenant's repayment of the incentive – because landlords never give anything away, and it is built back into the rent.

Also consider what happens if the two sides can't agree on what Fair Market Rent is to be during those discussions. How will the impasse be resolved? The common solution

is to have one or more third parties judge the legitimacy of Fair Market Rent. This can be expensive.

A Formula for Determining Rent

There are many different formulas a landlord can use. If the tenant pays percentage rent in addition to the base rent, the formula may include a portion (or all) the percentage rent paid in the last year or two of the preceding term.

It may be that the new rent will be a percentage increase over the last rent payable, which could be a negotiated amount (eg: 2%) or the rise in inflation.

Or it could be a combination of the other two calculations, such as 'the greater of' Fair Market Rent and \$XXX per square foot per year. And to be cheekier, it may increase even further by either a negotiated amount or a percentage.

Bear in mind the landlord will never want to accept less rent than you paid previously, so it takes a skilled negotiator to convince the landlord otherwise and protect the risks you may face.

A Catch-22

A Catch-22 is a dilemma or difficult circumstance from which there is no escape because of mutually conflicting or dependent conditions.

Often, the landlord requires the tenant to exercise their option and be contractually obligated for the option term without knowing what the rent will be if it is based on Fair Market Value or a calculated amount using future unspecified data, such as the rate of inflation many years from now. The landlord does this to gain leverage in the negotiation because the tenant can't simply walk away if the tenant doesn't like the rent. The tenant has already obligated itself to the further term.

There is a simple way around this that we insert into the clause, if needed.

An Option is What We Call a **TBC**[™].

TBC is our acronym for Tenant Benefit Clause[™]. A TBC is a clause inserted into the negotiation and ultimately the lease, that only benefits the tenant. Landlord's hate these, so they place very high hurdles around them. You get the appearance of having the TBC, but the landlord inserts words to take the TBC back (called a claw back provision). Importantly, the claw back provisions may not be in the section of the lease that they relate to. We ferret those out when we review the lease.

When it comes to Options, not only does the landlord require the notification to exercise the option be well in advance of the lease expiration – hoping you miss it like Sam did – or gaining leverage in the rent, as noted above, the landlord may also include some or all the following:

- a) The option is personal to the tenant who signed the lease, and is clawed back on assignment, or subletting. This means that the option is null and void if the lease is assigned, or a sublease is entered into due to a sale of your business, for example. This can and has killed many a business sale.
- b) The tenant can never be in default of the lease at any time to exercise the option. If the tenant has ever been in default, the option is clawed back and goes away. This is understandable since the landlord doesn't want to be forced into continuing a relationship with a bad tenant. So, it looks innocuous on the surface. However, there are many kinds of defaults. For example, let's say the landlord receives the rent one day late due to a postal interruption. That is a default the landlord can use to remove the option. In another real world example, the tenant was responsible for replacing broken glass. Due to issues with the supplier the glass could not be replaced within the timeframe specified in the lease, even though the tenant took immediate action and was pushing for the repair. The tenant lost the option.
- c) The tenant doesn't achieve a pre-negotiated sales volume prior to exercising their option. Again, that volume may have been negotiated well before the location first opened and no one knows with 100% certainty the sales volume many years later would be achievable.

As you have discovered:

- i. Words matter in a Lease and even a seemingly subtle difference can have a large impact on your business;
- ii. Dates matter, as you can lose an option by missing the exercise day by as little as 1 day;
- iii. The Lease wording ALWAYS works to the landlord's benefit;
- iv. The landlord provided lease is never fair to the tenant; and
- v. You only get what you expertly negotiate at the very beginning.

Your real estate agent may have negotiated that you get one or more options to remain in your space, should you wish; but it is the actual leasing wording detail that determine what you really get, what risks there are and what that option may cost you.

We know all this from thousands of leases covering millions of square feet working for both landlords and tenants. We know what landlords want, and what they will concede. We know how to present your position to make it easy for the landlord to make the lease more tenant friendly.

This is just one clause. Imagine what the rest of the lease holds and what you must negotiate to protect your interests. That is where we come in. Contact us today for a no obligation quote, to work in YOUR interests.



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