

COMMERCIAL TENANTS LEASE RENEWAL – THINGS TO CONSIDER

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Whether negotiating for a lease renewal or exercising an option to renew, there are several things to consider to ensure the best possible result. In order of importance, the first three things to consider are (1) start early, (2) start early, and (3) start early. Negotiating a renewal is a game of strategy and leverage. A lack of sufficient time benefits the Landlord.

Just because the Tenant has a good relationship with the Landlord does not mean that the Landlord will offer the best renewal terms. The Landlord will assume that the Tenant does not want to bear the cost and hassle of moving. Therefore, the Landlord's first offer will likely be worse than the current terms and worse than the best deal available, but not quite bad enough to make the Tenant want to move. This is the start of a delicate negotiation to get the renewal terms down to a fair level. Here are a few reminders and tips for such a negotiation.

Start Early: The single most important factor is to begin early. The Tenant must open negotiations with the Landlord early in order to properly plan for renewal, understand the market dynamics, and maintain a plausible position with the Landlord that moving is a viable option if reasonable terms are not forthcoming. What constitutes early depends upon the circumstances, but as a general rule one year in advance of the expiration date is reasonable. For larger spaces or tighter markets, eighteen to twenty-four months in advance is reasonable.

If negotiations do not begin early enough, the Tenant will lose leverage because the Landlord will know that despite Tenant's protestations to the contrary, a move is not possible before the expiration date of the lease. This loss of leverage will lead to less than the best available renewal terms.

Know What Vacancy Means to the Landlord: As a corollary the Tenant's loss of leverage for commencing renewal too late is the Landlord's cost of vacancy if the Tenant elects to move. Do not be shy about reminding the Landlord that she will incur significant costs for loss of revenue, brokerage commissions, Tenant improvements, demolition, and promotion if Tenant moves out.

This point ties into why a fair renewal rate should be 90%-95% of fair market rent for the premises. The fair market rent is an all inclusive figure based upon average brokerage commissions, Tenant concessions, demolition, advertising, and other costs associated with Landlord attracting a new Tenant. Since the Landlord is not incurring any of these costs in a renewal, the renewal rate should reflect an appropriate discount off of the fair market rate. Understanding the Landlord's vacancy costs and reminding her of them can help swing leverage back to the Tenant.

Seek Concessions: A Tenant that has been occupying space for the past 5, 10, or more years has unique knowledge of how well or poorly the Landlord maintains and operates the building. Lease renewal is the best time to address shortfalls in maintenance or problems with the building systems.

Address Lease Issues: Similar to seeking concessions, lease renewal is the appropriate time to address problems in the lease. For example, if the Tenant realized during the term that operating expenses were above average for the market, but there is no right to review or audit operating expenses in the lease, then renewal is the time to obtain a right to audit.

This is a double-edged sword, so use caution. Once the Tenant opens negotiations beyond the basic terms of a renewal, e.g., base rent, term, further renewal options, the Landlord will feel comfortable in taking the same approach and inserting changes to provisions in the lease that the Landlord does not like. To open negotiations on non-renewal specific terms of a lease (like inserting audit rights) should be considered carefully after an analysis of the lease and the history of the relationship between Tenant and Landlord.

Renewal Options and Pre-Negotiated Renewal Rates: All of the foregoing applies equally to renewals of leases with and without renewal options. A renewal option without an agreed to renewal rate in the lease still requires agreement on the renewal base rent figure. There is a lot of misunderstanding about how a renewal with a previously agreed to rental rate should be handled. If handled properly it can be a great win for Tenant.

As with all renewals, starting early to maintain leverage is important. Tenant should conduct a thorough analysis of the market rates for the premises. If the fixed renewal rates set forth in the lease are higher than 90% of market, then this is an opportunity to open negotiations with the Landlord under threat of moving to more reasonably priced space. If the fixed renewal rates set forth in the lease are lower than the market rate, then exercising will give the Tenant a below market fixed rent for the renewal term.

Conclusion: Begin negotiations early to maintain leverage. Knowledge of the market is power during the negotiation. Look at alternative space and do not be afraid to move if the Landlord is not negotiating in good faith or offering reasonable renewal rates. Without the credible threat of moving, the Tenant has little leverage to negotiate the best renewal deal.

Gary O'Brien is an experienced commercial tenant attorney representing small and large businesses alike. As former in-house real estate counsel for Siemens Corporation and former big law firm attorney, Gary O'Brien has the expertise to represent all commercial tenants.