



### I'll Have Another: Lease Renewal Options

Renewal options are frequently included in Leases; however, they are frequently drafted without thought to the business and monetary value to either the Landlord or Tenant and lumped in with fill-in the blank provisions that brokers and bad lawyers like to call "boilerplate". But good lawyers know that options serve different purposes for each party and have different value to each party, and when drafted without thought and can greatly favor one party or the other in a way that was not intended.

Tenants want flexibility and a "good deal" that hedges against steep increases in rent. Landlord's want long term stability, top dollar rents, and an overall good tenant. There are real costs for a Tenant that fails to renew its Lease, including for moving, printing new business materials, loss of good will associated with its current location, and improvements to a new space, to name of few. Similarly, the loss of a Tenant means that a Landlord has to pay new leasing commissions, tenant improvement allowances, carry the common area costs, and suffer the blight of an empty space.

How can the competing interests of Landlord and Tenant be reconciled, and what is "fair"? The devil is always in the details and the salient points should be flushed out at the outset of a relationship, to ensure a clear understanding of the key terms surrounding the option right.

- **Rental Rate** - Tenants typically like to have the renewal rate based on a fixed amount. Approaches vary from fixed increases in the rent per square foot (i.e., .50 cent per foot per year) to a fixed percentage of the total rent (i.e., 3-5% annual increases). That way, when the time comes Tenant knows exactly what it has to compare against other offers. Landlords benefit from having the option term at "market rate." After all, who knows what the future will bring? Market rent provisions can vary from either the market rent being whatever the landlord says it is, to more complex terms that give the tenant the right to challenge a landlord's proposed market rent. How this is determined can be tricky, and should be carefully described (for example, with expert resolution involving qualified brokers representing each party). Similar issues arise in determining what is the "market"? Is it the building, the entire project, a few mile radius, or an entire MSA? Just like when ordering off of a menu without prices, parties should be wary when a lease says no more than the renewal rent will be "market rates."
- **Upside & Downside** - Tenants like lease options which control against increasing rental prices. Landlords want to make sure they are receiving top dollar rents and maximizing revenues. Parties sometimes agree to provisions that incentivize renewal, but control for extreme increases and decreases in rental rates. Common lease provisions provide that rent during the renewal term cannot be less than the rent paid during the preceding term. Similarly, even in cases where renewal rent is to be based on the-then current market, sometimes a ceiling is included, so that rent cannot increase by more than a fixed percentage of the prior rent. These provisions may convince a Tenant to renew, and not shop around, and allow Landlord and Tenant to take advantage of the lower transaction costs associated with a lease renewal.
- **Timing** - Landlords will want an option triggered as early out as possible. Often as early as twelve months before the expiration of the Lease, but no later than nine (9) months prior to the expiration of the Lease. This short window for exercise and advanced notice allows Landlord ample time to find a new tenant, if needed. Conversely, Tenant wants a larger window to exercise any option, and doesn't want to have to commit until near the end of the current lease term. Solutions will vary depending on the needs of each party, the type of property involved and what is current seen in the marketplace. In any event, the Lease should clearly state when and how the option must be exercised.
- **Other Terms** - There are many seemingly innocuous provisions that can also cause problems when not carefully thought-out. For example, Landlord and Tenant each must consider what terms are being renewed and which, if any, are not being re-granted. Check your lease, does it provide that "all of the same terms shall apply during the option period?" If so, Landlord may have unintentionally obligated itself to pay a new improvement allowance or again allow for a rental abatement period originally granted during the initial term. Likewise, Leases often include conditions on Tenant's right to exercise the renewal option, which may include whether Tenant is currently in default, or, in some cases, if it has ever been in default. Finally, the parties should consider whether the option should be personal to the named tenant, or if it should be available to assignees, as well. Each of these variables deserves careful consideration. Options, after all, extend the length of relationship and it is never pleasant

for there to be bad blood when you're only half way down a long road.

We represent both landlords and tenants, giving us the advantage of knowing the market place and the unspoken requirements and desires of each party.

For more information please call (480) 889-8948, send an email to [info@steinlawplc.com](mailto:info@steinlawplc.com) or visit [www.SteinLawPLC.com](http://www.SteinLawPLC.com)

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