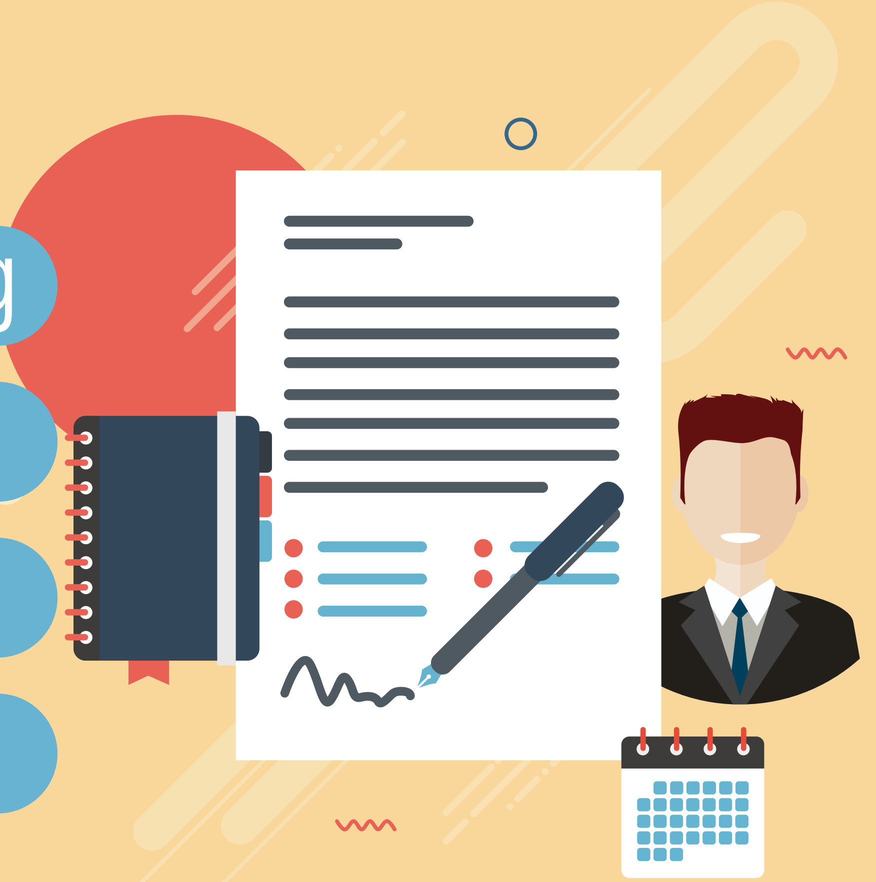
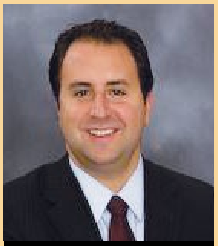
Renegotiating Your Lease Is Always an Option





by Justin M. Klein, Esq.

A common misconception amongst commercial tenants is that because there is remaining term or options available on their lease, there is no need or opportunity to renegotiate it.

In today's rocky real estate market, tenants need to stay on top of their leases more than ever. Centers are constantly redeveloping, repurposing and, in short order, closing. The leverage, in many cases, has shifted to the tenant. Landlords need certainty of occupancy more so than usual, with loans issued in past (better) real estate cycles coming due.

One such avenue where leverage exists is near-term expirations or options. Tenants who can time negotiations of lease extensions/renewals properly can usually get favorable concessions. Unfortunately, many tenants believe that options are the best result rather than the fallback. Simply put, the idea of exercising an option or letting a lease collect dust mid-term without a thorough lease review and negotiation may just be the single biggest mistake commercial tenants can make. Options are, by nature, tenant-friendly and are one of the few cases where a tenant has leverage over a landlord. Even leases without options and with term remaining have value that can be extracted or, at a minimum, explored.

Commercial tenants frequently believe that the option is limited to the terms stated in the lease and is simply a "yes, we will exercise" or "no, we will not exercise" proposition. A tenant has an opportunity to change economic and non-economic lease terms by proactively engaging in discussions with his or her landlord and timing it correctly. If done correctly, this can substantially improve the terms of the lease and the value of the business in a sale.

In reviewing options and term, the first question is always "Do you want to stay past your natural lease expiration?" The next question always needs to revolve around economics in both the short and long term. This includes rent, CAM and taxes in addition to business forecasting and other operational considerations. This creates the long-term occupancy cost (all-in rent as a percentage of sales) analysis. Questions like, "If I stay, what rent can I live with? Do I need a rent reduction to stay?" (This plays into timing, which will be discussed later.), need to be answered before any negotiation commences.

The next step is determining whether you can improve economics based on a term you are willing to accept. This involves questions such as, "Can I better my terms in exchange for exercising early or for longer than the option period?" Depending on the tenant, a 10-year term could present an opportunity for a landlord to refinance or sell a property, fill other vacancies, etc. Even in the case of smaller tenants, an early exercise of an option or extension of a lease helps owners by creating long-term stability.

A critical point to consider and evaluate along with lease extension is how much term remains on the franchise agreement. This is important because it is imperative to line up as best as possible the lease term and the franchise agreement term. Moreover, whether you can or will renew your franchise agreement is also important to consider in connection with the mid-term lease review. That is, if you have locked up additional time on your franchise agreement or know a renewal is impending or already approved, this can also be leverage with a landlord who should appreciate the procurement of a longer term tied to the obligations of operating the franchise for the term in the franchise agreement.

With few exceptions, successfully negotiating an early extension or exercise of an option in exchange for concessions is a matter of finding a win/win scenario with ownership. Andrew R. Margolick, president of ARM Consulting, LLC, a seasoned negotiator who has successfully negotiated over 4,000 leases for retailers, franchisors and franchisees, notes in this regard, "Contrary to popular belief, there is not a retail apocalypse and landlords aren't handing out concessions like Halloween candy.

"Thoroughly reviewing almost any lease will flush out opportunities to negotiate and will allow for an understanding of leverage points for landlords that a tenant will want to amend," Margolick added.

In many instances, the opportunity to change any combination of term, rent, percentage rent, use clause, radius, etc., is readily available if done correctly. The key lies in not only the timing of negotiations, but in understanding both your needs and the owner's needs. With respect to timing, a tenant should work to protect good locations early and wait to negotiate marginal ones in need of large concessions.

Commercial tenants should consider:

• Hiring a third-party lease negotiator. Negotiating a renewal or extension of an existing lease can be much different than negotiating a new deal. A third party with specialized experience in this area can be objective and ask the right questions.

• Understanding the value (both good and bad) of various lease terms, including, but not limited to:

a. Exclusives in their lease. Many leases, particularly older ones, have exclusives that might prevent a landlord from leasing space, thus creating leverage for the tenant in a negotiation.

b. Use clause. Many tenants' uses get tweaked throughout the term. A gym may add a smoothie bar, a coffee shop might add food, etc. These ancillary items could make or break a tenant, so reviewing and tweaking the language as necessary is important.

c. Radius restrictions. Trade areas are constantly evolving. A large radius restriction could prevent brand growth and allow for competitors to enter the market more easily.

d. Relocation provisions. Some leases allow landlords to relocate tenants for any reason and, in some cases, at the tenant's cost. Work to eliminate or limit a landlord's ability to relocate you.

e. Co-tenancy clauses. Centers are constantly evolving, redeveloping, etc. Tenants who depend on another tenant to drive traffic can find that they are "stuck" in a long-term lease with no options to terminate and no alternate rent structure.

f. Personal or corporate guaranty. While these are usually crucial to landlords on an initial lease, landlords will have made money or broken even on a space by the time the initial lease term ends. If a tenant has not been in default of the lease, they should work to limit the guaranty moving forward.

• Understand the center you occupy. Are you the anchor tenant? Are there vacancies within the center? Is the center owned by a REIT or an individual, and what are their long-term investment plans with respect to the center?

• Know your franchise agreement and how the provisions of that agreement may be implicated by decisions you make with your lease.

Having the right terms in your lease is a critical component to long-term success of a business. It is imperative to be diligent in ensuring that your lease works for you not only at the outset of the business relationship, but also during and throughout the term.

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