

Limit Tenants' Special Rights

The high rents that owners are able to command for commercial space these days make it an owners' market. But tenants paying nearly record-high rents are likely to try to get more for their money by demanding special rights that may prevent owners from maximizing their profits. Commercial property owners and their managers should know how to negotiate compromises that satisfy potential tenants and safeguard owners' interests.

Among the rights a tenant most often requests is the option to expand the space it occupies within the commercial property owner's building at a set rate, says Carole Laude Pechi, founding partner of an Illinois-based commercial real estate law firm.

"Their hope is that if the market takes off, they'll be able to get more space at a below-market rate," Pechi says. "For an owner, the danger is the potential loss of revenue. However, a tenant that can afford today's rates is a bird in the hand," she adds.

Tenants also often want expansion rights because the more rights they have to offer a subtenant, the more marketable the tenant's leased space is.

"How can I assign or sublet? That's what tenants are thinking. How tenants can get out of the lease is often foremost in tenants' minds when they're negotiating their lease's terms," Pechi says.

Negotiating Termination Rights

The freedom to open and close its doors at whim is another right that makes retail tenants' space more marketable. But that is a right that tenants rarely secure, according to Pechi, because owners are interested in drawing traffic into the space, she says. Closed stores don't further that end.

"The bigger the tenancy, the more likely an

owner is to give you that right," Pechi says, adding that there are, of course, exceptions, depending on the marketplace and the negotiating power of the tenant.

Stores that aren't doing well don't generate traffic either. That's why it may make sense for owners to grant retail tenants another right they often request: the right to terminate the lease if the tenant's sales don't reach an agreed-upon mark by an agreed-upon date.

"If a tenant is not doing well in a certain commercial space, it's not helping the owner and it's not helping itself," Pechi says. "So it might not be such a bad thing to concede that right, as long as the tenant's sales number is realistic."

Get Personal

If a desirable tenant insists on a certain right, commercial property owners sometimes try to mitigate the potential losses by insisting that the lease language make the right personal. That is, the owner would state in the lease that the right belongs to the tenant and the tenant alone, explains Harvey Habner, a partner at Toronto-based Goldman Sloan Nash & Haber LLP.

"If a tenant wants some type of concession, you can say, 'OK, I'm going to give it to you, but not to any of your assignees or subtenants, or anyone else, just to you—so long as you're in possession, you're acting in good faith, and you're up to date on your rent,'" Habner says.

However, it's difficult to get tenants to agree to that, Pechi says, for the same reason commercial property tenants want special rights in the first place: Flexibility makes them attractive to subtenants. Making special tenant rights personal to the particular tenant with whom you're negotiating would defeat that purpose.

To smooth the negotiation process, Susan Fowler McNally, a partner at Gilchrist & Rutter in Santa Monica, Calif., suggests the following compromises:

- If the tenant balks at the idea of making a right personal, compromise by having the lease provide that only the original tenant's affiliates or successor may exercise the right;
- Condition the exercise of the option or other right on the tenant's not being in default on the exercise date or the effective date. Compromise by allowing the tenant to exercise the right if it is not in default after it has been notified and before the applicable cure period has lapsed; and
- Require tenants to exercise their right in advance of the effective date to allow the owner to plan accordingly. For example, retail tenants usually have to apprise owners of their renewal plans 12 months in advance. Office tenants typically need to give six to nine months' notice.

Insider Sources

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