

FOR TENANTS THAT MAY EXPAND LATER, THERE ARE OPTIONS

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Business is slow, uncertainty prevails and your lease is expiring.

The last thing that you want to do is commit to a new long-term lease or rent more space, even though you may soon need it.

However, you may be able to lease less space now or commit to a shorter lease term and still plan for growth.

Here are a few important tools that tenants can use to lay the groundwork for growth:

RIGHT TO RENEW

An option to renew is the right to extend the term of your lease for a given time period, often five years. All of your lease terms will stay in effect, except the rent.

But what is the new rent going to be?

Some renewal options provide that your new rent will be at fair market value (FMV) or, often, at 95 percent of FMV.

FMV generally means you will be paying the same rent that prevails in new leases at the time that your renewal term starts.

For example, if your renewal term starts in 2008 and markets rents are \$40 per foot for comparable space, then you will be paying \$40 a foot as well or \$38 a foot if you have a "95 percent of FMV" option. If market rents skyrocket, so does your rent.

One of several better alternatives is an option to renew at a fixed rent (such as \$30 a foot). If rents have increased significantly, you achieve instant, automatic savings.

NEGOTIATE A NEW LEASE

But what if rents have gone down?

Wouldn't you have been better off with a fair market option?

No. If rents have gone down, then the market for space is, by definition, soft.

Forget your option and negotiate a new lease with your landlord, who is probably happy to have you.

Remember, options to renew are generally protection against rising rents. You don't need protection against falling rents.

However, an option to renew at a fixed rent will expose your landlord to the risk that you will renew your lease at a below-market rent. So, aside from exerting brute bargaining power, which on any given day you or your landlord may have, compromise may be required.

One notable compromise is fair-market rent with a maximum and minimum.

For example, your lease could provide that your renewal rent would be equal to the fair market rent, but would not, in any event, exceed \$35 a foot or be less than 110 percent of the rent in effect during the last year of the original term.

There are countless other concerns that may affect the value of an option to renew your lease.

The bottom line is that it is important to obtain the right to renew your lease in a way that protects you against significant rent increases in the future.

EXPANSION RIGHTS

Tenants should also protect their growth potential with the right to lease more space.

The best such right is an option to expand. This option obligates the landlord to provide additional space regardless of availability, essentially reserving space for future growth.

It is important to determine what rental and other terms will apply to your lease of additional space.

Both parties may agree that the same per-square-foot rent



applies to the expansion space. Or the landlord may insist on fair-market rent for the expansion space.

Understand, though, that each tenant right creates a landlord obligation.

An option to expand certainly provides the tenant with a valuable right to grow, but it also requires the landlord to reserve space for you.

As with the reservation of anything else (except plane seats, which don't seem to limit the airlines at all), the landlord can't hold the space for you and still lease it to someone else.

As a counter, your landlord may agree to a right-of-first-refusal or a right-of-first-offer.

A right-of-first-refusal requires your landlord to lease available space to you on the same terms and conditions as available to anyone else.

Under the right-of-first-refusal, the tenant gains a potential, but not guaranteed, opportunity to expand.

AVOID A RIGHT OF "FIRST OFFER"

Your landlord may suggest a right-of-first-offer on available space.

Under this right, you would only get a notice from your landlord that says certain space is available and you can make an offer on the space.

You don't get any guaranty of availability or price protection.

The most important reason to know about a right-of-first-offer is to make sure that you get something better, like a right-of-first-refusal.

ASSIGNMENT AND SUBLETTING RIGHTS

In addition to renewal and expansion rights, your ability to assign and sublet can enhance future growth opportunities.

The right to assign and sublet essentially enables you to lease part or all of your space to another business, helping you plan for growth in at least two significant ways.

First, if you don't take enough space now, you might need to move later. A right to assign and sublet may give you greater comfort in leasing less space now because you can move when you grow (without paying rent on two spaces).

Second, the right to assign and sublet may give you greater comfort in leasing more space than you need today because you can sublet extra space to others. As you grow, you will take over the space that you previously sublet.

Today's economic uncertainty may give you pause in expanding or committing to a long-term lease.

The silver lining is that this same uncertainty represents a marketwide softness that gives you the opportunity to negotiate with your landlord.

With knowledge of your rights, you can obtain the ability to grow your business in the future.



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Jack Garson's practice focuses on Real Estate, Construction and Business law. He serves as a legal advisor for numerous local, regional and national companies. In his role as legal counsel, Jack also serves as a strategic advisor and lead negotiator. Further, Jack provides guidance on the structure of complex transactions, the resolution of business disputes, the growth and sale of companies, and the management of issues such as liability and risk reduction, employment practices, and enhancing profitability.

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In the past two years, we've grown by 50% through expansions in New York City and, most recently, Charlotte, North Carolina. This growth has provided immense value to our clients and attorneys.

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