

COMMERCIAL REAL ESTATE

Some extension rights you should consider when negotiating a lease

Recently, we received a call from a longtime client. When we constructed his lease seven years ago, the owner was unwilling to grant our client any extension rights.

When we viewed the deal in its totality, the lack of extension rights was outmanned by the other good things the deal had to offer: rate, term, tenant improvements, abated rent, etc. So, we proceeded.

Then, WHAM! The owner decided to sell the building to a company that gave our clients the heave ho, and we were looking for another location.

An extension occurs at the expiration of your commercial real estate lease but is agreed upon when you sign a lease. So, you are truly leasing commercial real estate in the future. Unlike a residential lease, you the occupant are not guaranteed you can stay past the lease expiration. There are nasty little creatures called “holdover provisions” which allow an owner to jack your rent way up if you stay —



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or worse — and cause you to move.

With this experience as a backdrop, and guided by the definition, I will discuss the various extension rights you should consider when negotiating a commercial real estate lease.

An option to renew or extend: The occupant is allowed to stay in a building after the conclusion of a lease at a pre-determined set of deal points — such as the

rent to be paid and the increases in rent on an annual basis. Typically, in a down market, owners will be willing to grant an option to extend at a fixed-rent amount.

When markets are more robust — like today — the extension will be based upon prevailing market forces in the future. In essence, you will have an agreement to agree: the owner won't give you the boot but also won't commit to a rent figure.

Generally, options to renew will carry certain rules of engagement such as the timeframe under which you can exercise the option, the method by which you give the

owner notice, and exactly who must exercise the option. Also, you must have faithfully paid your rent on time or the option to extend may be at risk. If any of these boxes go unchecked, your option could be lost — so pay attention!

A right of first refusal to lease: Simply, if you have no option to extend, a right of first refusal allows you to match or exceed another occupant's offer to lease the building. Rights of first refusal to lease occur most often with adjacent or expansion space and are rare as a means to renew a lease. We commonly see rights of first refusals to purchase.

A right of first offer to lease: The owner comes to you and says “I'm willing to allow you to stay past the expiration of your lease. Make me an offer.” Akin to a right of first refusal, these generally are a purchase right vs. a lease extension — but we occasionally see them with leases.

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