

An owners perspective on lease breaks during downturn

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Clairvoyants aside, no one signing a lease at the height of the commercial leasing market several years ago could have predicted the collapse of that market, let alone the collapse of the economy.

Because of this, many landlords now have commercial tenants who cannot cover the rents they believed they could cover at the inception of their leases.

The question then arises — how should a building owner approach a commercial tenant's request to break its lease before expiration?

In answering this question, the first consideration for an owner should be obvious: does the owner want the space?

At the market's peak, owners almost always wanted to take back their commercial units because potential tenants were knocking down the doors with offers of hundreds of dollars per square foot. Those were the times when owners were offering substantial buyouts to tenants that held leases with rents below the market rates.

Now, pockets do not open so easily, prospective tenants are not so eager, and an owner's deliberation over whether to let a tenant go has become more nuanced.

If an owner believes that it could re-let the premises for more rent or to a superior tenant, or if the owner has any other reason to want the space, then



the owner has reason to work with a tenant who wants to break its lease. However, many owners have good reasons not to want their commercial tenants to vacate prematurely.

For instance, an owner may believe that the retaken space may sit vacant for too long. Or, the inducements necessary to draw a new tenant, such as cash for build-outs or months of free rent, might not be justifiable in light of battered cash-flows during this economic downturn.

So too, an owner may be reluctant to see a higher class of tenant, such as a national franchise, go when the replacement tenant may not provide the same guaranty of rent payment that the owner's lenders value in the context of refinancing or even maintaining existing mortgages.

So, while the question of whether an owner wants a tenant out may be obvious, the answer may not be so simple.

Once an owner has determined its desire for a tenant's space, the owner must next determine the circumstances under which it would permit the tenant to break.

When an owner does not want its tenant to leave, the owner possesses distinct

negotiating advantages. Commercial leases typically contain provisions that accelerate the remaining rent due under a lease when a tenant vacates early. This means that, by leaving early without the owner's consent, a tenant would incur a significant liability depending on the amount of time left on the lease.

While acceleration clauses provide owners with a leg-up in any lease break negotiation, the advantage is particularly powerful when an owner does not want the tenant to break because the owner can leverage the tenant's liability to its advantage and demand a cash payment for the tenant's departure. Of

course, the current economic climate complicates matters because a tenant that wants to break its lease likely cannot pay its rent and likely lacks the ready cash for a buyout.

The point endures though: an owner reluctant to see its space vacant can use the lease to its advantage. Such an owner can present an inquiring lease-breaker with options that might salvage the interests of all parties.

One scenario would be a proposal that the tenant either pay a buyout amount or remain as a tenant at a lower rent or with some rent deferred until the tenant is more solvent. A tenant could

very well go along with such proposal when the owner's concession is more attractive than either paying a buyout or incurring an acceleration clause liability.

When an owner would rather retake the tenant's leasehold than retain the tenant, a would-be lease-breaker sits at a friendlier negotiating table. Under these circumstances, the owner still holds the

lease term and any acceleration clause as a bargaining chip but can afford to be more accommodating in light of the common goal. Here, the owner must ask what it is willing to give up to get the tenant's leasehold.

The answer is situation specific but

may result in the tenant paying a buyout or the owner simply permitting the tenant to walk without consequence.

This analysis has endless permutations considering the unique circumstances of each owner and tenant in every lease break situation. However, with an objective approach and reasoned analysis, owners can achieve a desirable resolution for what may be a tenant's undesirable departure.

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