

The Advisor

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Renewal Options in a Lease: Tips and Traps for Landlords and Tenants



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Whether you are a landlord or a tenant, one of the crucial terms to consider when negotiating a lease is the renewal clause. The renewal clause grants the tenant an option, or several consecutive options, to renew the lease for a set term or several set terms after the expiry of the initial term of the lease. It is important for a landlord to ensure that the renewal clause is drafted to maximize the rent payable during the renewal term, and to deny a troublesome tenant the ability to exercise the option to renew. Conversely, a tenant wants to ensure that the renewal rent can be fairly negotiated or determined, and that the option to renew cannot be revoked for minor infractions under the lease.

It is common for a renewal term to be continued on the same terms and conditions of the lease, with the exception of rent, any financial incentives offered to the tenant for the initial term (such as a tenant's improvement allowance) - and the renewal clause itself. It is very important for the landlord to exclude the renewal clause from the "continued" terms, otherwise the lease would allow the tenant the right to renew the lease in perpetuity.

The rent during a renewal term is often based on "market rent" at the time of renewal, or simply determined by negotiation between the parties based on a minimum rent set in the renewal clause. "Market rent," from a landlord's perspective, should be defined by using language such as 'similarly improved premises in the market,' while a tenant would prefer 'unimproved premises in the market,' for obvious reasons. From the tenant's perspective, if rent is to be negotiated, the lease should allow for arbitration if the parties cannot reach an agreement - or, alternatively, state that the negotiated rent must be satisfactory to the landlord. A strong term for the landlord to insert in the renewal clause is that the rent cannot in any case be lower than the maximum monthly rent that was payable during the initial term.

The renewal clause should set a specific time frame for the tenant to give notice that it is exercising an option to renew. A typical time frame is no earlier than 12 months, and no later than 6 months, prior to the expiration of the initial term. During that period, negotiation of the rent payable, and any other items to be determined, must take place.

Most renewal rights are contingent on the tenant not being in default at the time the option to renew can be exercised, or having never defaulted under the terms of the lease at any time during the initial term. In the latter case, the landlord should always remember to give written notice of any default to the tenant, and set out in the notice that the option to renew has been forfeited due to the breach. If the landlord does not do so, and the tenant subsequently remedies the breach, the tenant could later argue that the landlord cannot rely on the prior breach to prevent the exercise of the option. A landlord can also place other conditions on the option to renew - for example, in a retail setting, a landlord could require a substantial renovation of the leased premises in a certain year as a prerequisite to exercising the option to renew in the last year of the lease.

Finally, if you are planning to assume an existing lease, it is crucial to obtain confirmation in writing from the landlord that the existing tenant is not, and has never been, in default under the terms of the lease, and that any right or rights to renew are still valid and exercisable by the tenant. Otherwise, you may be assuming a lease in which the right to renew has already been forfeited by a prior default of the existing tenant.

For advice and assistance in negotiating or enforcing lease provisions, please contact Field Law's **Real Estate Group**.

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