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### Commercial Lease Renegotiations: Tips for Landlords and Tenants

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There's a new power struggle underway in the commercial real estate leasing marketplace right. Debt is scarce and more expensive, and cap rates are rising, thereby driving down commercial property values. Simultaneously, corporate bankruptcies and massive employee downsizing are driving up commercial vacancy rates, leaving landlords scrambling to retain existing tenants and employing every effort to attract new ones. Tenants are now seeking to capitalize on this economic chaos by renegotiating existing commercial leases - in some cases, as a last ditch effort to stave off bankruptcy.

Clearly, it's a new playing field for commercial landlords and tenants. Landlords and tenants should consider key factors in renegotiating a commercial lease.

#### **Under what circumstances should a tenant expect to be able to renegotiate its lease?**

- 1. If the lease is going to expire within the next two years.** If the lease is going to expire within the next two years, the landlord will likely entertain extension discussions, assuming the tenant has been a good one. If the current market rent is lower than the current rent under the lease, it's an opportunity to renegotiate the rental rate and perhaps other terms.
- 2. To avoid bankruptcy.** If a tenant faces near certain bankruptcy, then a landlord will likely entertain a rent reduction request as part of a global cost cutting strategy. Of course, the more important the tenant, the more likely it is that the landlord will respond favorably. For example, the anchor in a retail mall would have more leverage to renegotiate a rent reduction than would a smaller, less significant tenant. That said, given the adverse effect that empty storefronts have on malls even during affluent economies, a landlord will likely entertain any renegotiation request if necessary to maintain tenancy. The prudent tenant should also demonstrate that a proposed rent adjustment is part of an across-the-board cost cutting; otherwise, the landlord may not be cooperative. Landlords should not be asked to be the only party to bear the burden of a tenant's financial troubles. A savvy landlord should require the tenant to disclose its financials and to show evidence of other substantial cost cutting in the company.
- 3. If have leverage or something to offer to Landlord.** As explained below, if a tenant has a valuable right, it may choose to relinquish that

right in return for a rent reduction or other concession.

### **What bargaining positions may help a commercial tenant to renegotiate a lease?**

1. **Expansion rights.** A commercial lease may contain “expansion rights,” which the tenant may waive in return for restructuring the lease. For example, the lease may permit the tenant to expand its premises into a parking area or other adjoining retail or office space. Waiving such may provide value to Landlord.

2. **Claims related to ongoing disputes.** Tenant might also waive claims related to ongoing disputes in return for renegotiating the lease. For example, if the original lease contained a co-tenancy clause and an anchor tenant has departed the premises, the tenant may have an ability to terminate the lease, thereby providing leverage to restructure the original lease. Also, in light of the Massachusetts Supreme Judicial Court’s decision in *Wesson v. Leone*, 437 Mass. 708, 774 N.E. 2d 611 (2002), a tenant may have a termination right in the event the landlord fails to perform a significant obligation under the lease, assuming that obligation was a substantial inducement to tenant entering into the lease. Prior case law made it virtually impossible for a tenant to terminate a lease for failure on the part of landlord to perform an obligation under the lease unless it resulted in a constructive eviction (*i.e.*, the premises could not actually or effectively be used). But the Court in the *Wesson* case permitted a tenant to terminate for a chronic leak in the roof that the landlord failed to repair. Based on this relatively new change in the law, a tenant may choose to waive a termination right in return for a lease restructuring.

3. **A “kick-out” clause.** If the lease contains a “kick-out” clause (*i.e.*, a right to terminate if sales do not reach a certain volume), the tenant may have a termination right, thereby creating leverage for a tenant for a restructuring. is entitled to terminate its lease unilaterally.

### **Alternatives**

1. **Reassign or sublet the lease.** For some tenants struggling in this economy, the best option is to simply seek to assign their lease or sublet the premises to another tenant. Many commercial leases contain specific provisions detailing the circumstances under which a tenant may avail itself of these options, and the procedural prerequisites. Generally, tenants are not permitted to sublet or assign leases without commercial landlord’s consent but, more often, the lease provides that the landlord may not unreasonably withhold its consent.

2. **Lease termination payment.** If none of the above options are available, and a tenant elects not to file for bankruptcy protection, the tenant can usually reach a monetary settlement with a landlord, taking into account the likely vacancy period and the costs of re-letting.

3. **Bankruptcy.** If all other efforts fail or are not viable, bankruptcy is the remaining option for a tenant. After filing a bankruptcy, tenant can reject its lease and thereby terminate it or it can accept the lease, in which case it must perform under the original terms.

### **Conclusion**

Renegotiating leases in the current market presents a challenge to landlords and tenants. The parties who understand their leverage and the issues that are important to both sides can achieve the best results with the most efficiency and the least amount of conflict.

***This article is intended to serve as a summary of the issues outlined herein. While it may include some***

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