

Renegotiating Your Leases (With Form)



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Know what to do when the tenant calls.

IN THE PAST FEW YEARS, tenants of all kinds have suffered a dramatic shrinkage of their revenues and profits. Even a tenant whose revenues remain level can have reduced profitability as a result of increased costs or, in the case of a retailer, lower profit margins on its inventory. Many major law firms have dissolved or dramatically reduced their space requirements. A tenant that signed a lease just a few years ago may find itself struggling to compete with tenants that have more recent — and lower — rental rates. Consequently, tenants are making difficult calls to their landlords — and landlords should not be surprised to get them.

In the not-too-distant past, a troubled tenant was easily replaced with one of the many eagerly waiting tenants. A security deposit might have been forfeited and a few months' rent might have been paid, but the termination was nearly painless for the landlord and tenant. Today there are fewer tenants and replacement is much more difficult and costly. A landlord that has suffered the loss of an important tenant or several important tenants may face loan defaults or, in the retail context, breach of a co-tenancy provision with the risk of very substantial vacancy.

THE TENANT'S RIGHTS • When a tenant finds itself in need of rent relief or other concessions from its landlord, an assessment of its rights and obligations under the

lease is the first priority. Particular emphasis should be given to its right to sublease or assign if there is a realistic prospect of finding a replacement. A retail tenant with a continuous operation covenant must consider whether it will be specifically enforced by a court, and whether there are monetary damages for a failure to operate. A careful lease review may reveal defaults by the landlord that give the tenant some negotiating strength when it meets with its landlord. Before meeting with its landlord, a tenant should put together a story justifying the rent relief or concessions that it would like. For example, has it lost a major account or gone through a round of layoffs or lost a revenue-generating partner? The tenant should assemble financial statements to substantiate its story and, if it wishes to give back space, a space plan indicating what it wishes to surrender and how its remaining space would be used. The tenant must formulate a realistic business plan that shows what it must do to stay in business and how rent relief or other concessions fit in the plan.

When the landlord meets with the tenant, it must evaluate whether it is better off with or without the tenant (if the landlord believes that its refusal to grant any concessions will lead to a default and lease termination); what are its mitigation duties; what can be recovered in a lawsuit; and whether, when and what it can get from a new tenant with due consideration to the time to re-let and the transactional costs such as brokers' fees and a tenant improvement allowance. The landlord must ask itself whether the tenant has a chance of surviving if the concessions are made and what concessions are necessary in order to assure the tenant's survival. In other words, is the problem the tenant or the economy?

The landlord may conclude that it is better off terminating the lease, getting as much money as it can, and looking for a replacement tenant. Often the landlord asks for a termination payment to be made by a third party such as a guarantor (whom the tenant then owes) instead of the tenant in or-

der to avoid a preference claim in an ensuing bankruptcy. As an alternative, the landlord may make the effective date of the termination 91 days after the termination payment is received or it may add a condition subsequent that annuls the agreement if a bankruptcy is filed; the condition subsequent approach may be ignored by a bankruptcy judge (although the tenant would presumably reject the lease anyway), and the risk may be tolerable if the landlord has a new tenant. In a retail lease, the landlord must be careful not to breach any other leases' co-tenancy provisions if it considers a lease termination.

If the landlord and tenant have concluded that rent concessions are appropriate, they will next consider what sort of agreement they should fashion. One variation has become known as a "blend-extend" in which the lease is extended at a blended rental rate of the existing lease rate and lower market rate. When this sort of agreement is employed, the landlord and tenant should be clear whether the extended term is considered a tenant's exercise of an extension option (if it has one) or whether the tenant's existing extension options remain intact.

STRUCTURING RENT RELIEF • There are several ways in which rent relief can be structured. The base rent can simply be reduced and the requirement of percentage rent can be reduced or eliminated. The ways in which base rent can be reduced are numerous. The rent reductions can coincide with the tenant's business cycle so that it pays less rent when its revenue is least (if, for example, the tenant's revenues are seasonal). The rent can be abated temporarily or permanently. Some rent relief is spread over the term so that, for example, the base rent in January, February, and March is less than the rent in the other months of the year. Of course, rent relief can include (or be limited to) a waiver of past-due amounts, and that waiver may be conditioned upon no further event of default occurring for the balance of the term. Some landlords

feel that abated rent should be made up in a later part of the term. Although this seems attractive, it may have the unintended effect of forcing a replay of the rent relief discussion when the tenant is unable to pay the deferred rent plus the base rent. The duration of a rent concession may be tied to the tenant's revenue so that the rent reverts to what it was before the rent concession when revenue returns to the point that can support the prior rent.

In any event, the tenant must continue to pay operating or common area expenses. When rent relief is given, the lease must be reviewed for consistency (or conforming changes) such as the breakpoint (if dollar amounts are used instead of a formula), renewal rent (if, for example, the renewal base rent is 110 percent of the base rent for the last month of the term and that base rent has been reduced for what the landlord hopes is a short time), or sharing ratio of expenses (if space has been surrendered).

For the landlord, the discussion of rent relief or other concessions is a time to ask that the tenant give up some of its advantageous rights. Although this may seem as though the landlord is taking advantage of the tenant's weakness, in fact, the landlord is simply taking back rights that it gave the tenant in anticipation of the tenant's performance of its obligations under the lease. Among the rights that a landlord might reconsider are:

- Renewal rights;
- Expansion rights;
- Rights of first refusal or rights of first offer;
- Kick-out rights in a retail lease (which in any event should be amended to reduce the threshold or to postpone the time at which the kick-out rights can be exercised);
- Co-tenancy rights, although the loss of a co-tenant may be the tenant's doom;
- Termination rights;
- Signage rights, for example, reduction of a tenant's prominence on a monument sign from all of it to half of it;
- Exclusive uses, although this may harm the tenant if it faces competition; or
- A broad use clause, which might be narrowed in order to allow the landlord to give new tenants exclusive uses that it otherwise could not.

The landlord may also consider several sorts of amendments to the lease. For example, it may wish:

- More frequent reporting of gross sales;
- A larger security deposit;
- Additional or expanded guarantees to cover at least the abated rent or other assurances of payments such as a letter of credit, which admittedly may be difficult for a struggling tenant to get but could be delivered by the tenant's owners;
- To take the security deposit and have one of the tenant's principals guaranty the lease to the extent of the security deposit in order to avoid risks in the event of a tenant's bankruptcy;
- The right to show the premises and terminate the lease if it finds a replacement tenant. The tenant may balk at this suggestion even though the landlord explains that this is nothing more than the landlord's success in finding an assignee of the lease on the tenant's behalf and what the landlord would have done if the tenant had defaulted. The tenant may offer to override the landlord's termination right by resumption of its obligations under the lease before the rent relief or other concessions were made. This, of course, requires the landlord's evaluation of the likelihood of the tenant's success under the lease without rent relief or concessions and whether the rent relief discussion will be replayed in a few months. A variation requires the tenant to repay abated rent as a condition of overriding the landlord's termination right;
- A relocation right so that it can amalgamate the tenant's premises with other vacant space for a larger tenant; or

- Standards of fiscal responsibility for the tenant. For example, it may prohibit the tenant from making loans, making investments except in its business at the premises, guarantying the obligations of anyone else, making distributions to its principals (except in amounts sufficient for them to pay their income taxes), and increasing salaries or giving bonuses to management personnel. Of course the landlord will surely prohibit an assignment or sublease of the lease given the attractive concessions it has made for the tenant's benefit and not for anyone else's.
- The consent of any lender that encumbers the premises;
- An estoppel statement from the tenant to the effect that it has no claims against the landlord or defenses to the performance of its obligation under the lease including the payment of rent;
- Recovery of its out-of-pocket costs in preparing the lease amendment such as those incurred for attorneys' fees; and
- A promise of confidentiality by the tenant so that the landlord's willingness to grant rent relief or other concessions does not become commonly known among its other tenants.

If the original lease or a memorandum of it was recorded, the landlord and tenant will want to record an appropriate amendatory instrument.

The landlord would be ill-advised to enter into any amendment of the lease without:

- A confirmation of any guarantors of the lease;

A tenant will also want to be sure it does not need the landlord's lender's consent pursuant to a subordination, non-disturbance and attornment agreement or the lease.

APPENDIX

Basic Form Amendment To Grant Rent Relief Or Other Concessions

_____ AMENDMENT TO LEASE

THIS _____ AMENDMENT TO LEASE is made as of _____, 20____, between _____
_____ (“Landlord”) and _____
_____ (“Tenant”).

Landlord and Tenant have entered into the Lease dated _____, _____ (the “Lease”) which they wish to amend. Accordingly, they agree:

1. Defined Terms; Recitals. Terms used but not defined in this _____ Amendment have their meanings in the Lease. The recitals are incorporated into this _____ Amendment as though set forth in full in it.

2. Abated Rent. From _____, to _____, inclusive (the “Abatement Period”), the Base Rent will be reduced from \$_____ per month to \$_____ per month. The difference is the “Abated Base Rent.” The Abated Base Rent will not be forgiven but rather deferred and payable in accordance with this _____ Amendment. Tenant will continue to pay all other Rent according to the Lease.

3. Termination of the Abatement Period. The Abatement Period will end immediately without notice or cure rights if:

- a. Tenant fails to pay Rent in accordance with the Lease;
- b. Tenant otherwise defaults under the Lease;
- c. Tenant or any officer, director, principal shareholder, employee, or agent of Tenant or any associate or affiliate of Tenant either directly or indirectly discloses the terms of this _____ Amendment, except as required by law or for banking purposes, it being acknowledged by Tenant that the terms of this _____ Amendment and the concessions granted by this _____ Amendment to Tenant are of a highly confidential nature;
- d. Tenant directly or indirectly lends money to, guarantees the debts or obligations of, invests money in, or offers financial assistance to any person or entity;
- e. Tenant makes any distributions or payments (whether by way of dividends, bonuses, or otherwise) to any of its shareholders, officers, or directors;
- f. Tenant increases the salary or other remuneration of any of its shareholders, officers, or directors;
- g. Tenant assigns or attempts to assign the Lease (or any interest in it) or subleases or attempts to sublease all or part of the Premises;
- h. The Lease is terminated.

If the Abatement Period ends pursuant to this Paragraph 3, the Abated Base Rent (plus interest accrued at the Default Rate from the time the Abated Base Rent was otherwise due until it is paid in full) will become due and payable immediately upon receipt of an invoice and Landlord will be entitled to exercise all of its rights and remedies with respect to the Abated Base Rent (plus such interest) as though this _____ Amendment had not been agreed.

4. Landlord's Rights Upon a Proposed Assignment or Sublease. Landlord will be entitled to withhold its consent arbitrarily and unreasonably to a proposed assignment of the Lease (or any interest in it) or sublease of all or part of the Premises during the Abatement Period.

5. Termination of Certain Rights. Tenant will not have any option to renew or extend the Term of the Lease.

6. Landlord's Termination Rights

- a. Landlord may terminate the Lease during the Abatement Period upon giving Tenant at least thirty (30) days' prior written notice of its election to do so. In that event:
 - i. The Lease will end on the termination date in Landlord's notice and Tenant will surrender the Premises in accordance with the Lease on or before the termination date without payment or compensation of any kind from Landlord;
 - ii. Tenant will pay all Rent as provided in the Lease up to the termination date;
 - iii. neither Landlord nor Tenant will have any further liability or obligation to the other after the termination date except for obligations that accrue before the termination date or survive the Lease by its terms or by law.

b. Tenant will have the right to nullify the termination notice by repaying to Landlord all Abated Base Rent no later than fifteen (15) days after the receipt of Landlord's termination notice and resuming payment of Base Rent in accordance with the Lease.

7. Confirmation of Guaranty and Consent of Lender. This _____ Amendment will not be effective unless _____ confirms its guaranty of the Lease, and Landlord's lender _____ gives any required consent to this _____ Amendment.

8. Confirmation. Landlord and Tenant confirm the Lease. Tenant has no claims against Landlord and no defense to the Lease and no offsets or abatements to the Rent (except as set forth in this _____ Amendment). Tenant represents that there are no defaults by Landlord under the Lease and no circumstances that would be such a default after the giving of notice or the passage of time or both.

9. Landlord's Costs. Within ten (10) days after its receipt of an invoice, Tenant will reimburse the out-of-pocket costs incurred by Landlord in the preparation and negotiation of this _____ Amendment.

10. Miscellaneous. This _____ Amendment constitutes the entire understanding and agreement of Landlord and Tenant with respect to the matters covered by it and supersedes all prior agreements and understandings, written or oral, between Landlord and Tenant with respect to such matters. This _____ Amendment will supersede any inconsistent provisions of the Lease. This _____ Amendment cannot be modified or amended, nor can any term or provision be waived or discharged, except in a writing signed by Landlord and Tenant. The waiver of any breach of any provision of this _____ Amendment will not constitute or operate as a waiver of any other breach of that provision or of any other provision, nor will any failure to enforce any provision operate as a waiver of that provision or any other provision. This _____ Amendment will be construed in accordance with, and be governed by, the laws of the State of _____. In the event of litigation arising out of this _____ Amendment, the prevailing litigant will be entitled to an award of reasonable attorneys' fees and costs incurred in the litigation. This _____ Amendment may be executed in counterparts, in which case all such counterparts will constitute one and the same agreement; however, this _____ Amendment will not become binding unless and until executed and exchanged (whether or not in counterpart) by Landlord and Tenant. Telecopy or facsimile signatures will be regarded as valid and binding signatures. This _____ Amendment will benefit and be binding upon Landlord and Tenant and their respective heirs, representatives, successors and assigns.

Landlord and Tenant have executed this _____ Amendment as of its date.

[Signatures]