"My lease is expiring soon and I have a renewal option ...should I just accept it?"

I’ve heard this more times than I can remember. In fact, it might be one of the most prevalent commercial real estate questions facing businesses today.

 Usually this question gets answered with a question…often times more than one. “What are the renewal terms” is the obvious question. Often the tenant isn’t aware of what the lease says about renewals. Unlike professional tenant representatives, the business owner facing the renewal is more focused on his/her business and doesn’t make it a habit to read their lease periodically.

It is imperative to fully comprehend all aspects of the renewal option prior to making a decision. My ongoing concern with renewals is two-fold:

1. When the renewal was created
2. Lack of detail in lease language

Let’s discuss my first concern. Most commercial leases are five to ten years in length. That means that you are currently in your fourth or ninth year of the term. That also means that you negotiated the renewal option four or nine years ago. Four years ago the commercial real estate market was healthier than today and I’d bet that the rental rate was higher then. That means you might be paying more now than the market is commanding. Depending on your market, supply of space might very well be outstripping demand, which in turn means that landlords need to be more competitive with their pricing to secure new tenants as well as retain their existing ones.

A lease renewal option written and agreed to four or nine years ago was created in a more robust market and the terms of the renewal most likely do not reflect terms that are offered in the current market. To properly assess the value of your option to renew you should engage a market expert that has the ability to compare and contrast your renewal option to the current real estate market.

My second concern surrounds the lack of detail in most renewal options. The verbiage usually reads like this:

"Provided that the tenant is not in default of this lease, tenant shall have the option to renew/extend this lease for an addition period of five years. Rent during the renewal period shall be negotiated at the time of renewal".
What does this mean? The tenant does in fact have an option to extend their lease...but at what price? For how many years? If you are just going to negotiate the rental rate at time of renewal, is that really an option? Sounds more like the right to have a discussion with your landlord to me. If you approach your landlord and you can't agree on pricing then your option is little more than a permission slip. There is no value in this lease clause and does little more than make the tenant, who most likely isn't a commercial real estate expert, feel as though they are protected. In all reality they are not.

How can this tenant achieve the protection they are seeking? A renewal option (or any option for that matter...including expansion, contraction, and termination options) should be clearly defined and detailed in the lease. I like to see either a set rental amount or a cap. A set rental amount ensures that the tenant in fact does have an option. If the rental amount of the renewal is below the market, then the tenant would most likely benefit by executing the lease extension (assuming they are happy with the space). If the rent is above the market the tenant would be wise to explore and at least consider their opportunities in the market. This does not mean that the tenant has to move. They simply would choose not to accept the lease renewal as outlined in the lease but also indicate to their landlord that they are interested in possibly staying. At that time, negotiations commence to determine a new rental rate. The process of exploring the market helps to inform the tenant of what the new rental rate should be to coincide with the ever-changing commercial real estate market.

It should also be pointed out that even if there is a stated rental amount in the lease, times have changed since that rate was negotiated and the rent may not be in line with the current market.

In addition to the above concerns, it should be noted that there are a myriad of additional factors that contribute to the decision to extend a lease, such as changes to your business since you signed the lease (both internal and external), your spatial requirements, etc. I simply highlighted a couple of very common concerns. Your tenant representative should discuss all of these items with you.

If your lease is expiring it would behoove you to engage an experienced tenant representative to assist you with this process. Commercial real estate can be a very complicated business so it is nice to have an advocate on your side that is an expert in this field.