

Special Issue

Leasing in a Down Economy

Don't Give Rent Relief Without Any Strings Attached

By Glenn I. Becker

In today's economic slowdown marked by slumping sales, many retail tenants are increasingly asking for rent concessions, and, in an effort to retain tenants, landlords are acquiescing to such requests. There are several different types of rent relief, ranging from an all inclusive "gross" rent, to a temporary reduction in base rent, or converting the economic terms of the lease from fixed rent payments to a "percent in lieu" deal, where the tenant's rental obligation is based on a percentage of gross sales generated at the premises. The duration of the rent reduction (referred to herein as the "Relief Period") typically lasts only one or two years. All too often, however, rent relief and other incentives designed to keep a tenant in place are given without any strings attached, thereby denying the landlord some flexibility should market forces swing back more favorably in the landlord's direction.

In the current market, landlords have little choice but to give breaks to what may have historically been strong tenants. Chances are that landlords are going to work with their good tenants to get them through these bad times, because a landlord would usually rather have a leased space, even at reduced rent, rather than another empty space. What follows are some concepts and language that, from a landlord's perspective, should be included in all rent relief amendments.

INCLUDE A LANDLORD RECAPTURE RIGHT

Whenever a landlord grants rent relief, the landlord should insist on expressly retaining the right to recapture the space, which, if exercised by the landlord, can be negated by the tenant's agreeing to revert to the full contract rent. While in

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today's business climate it is unlikely for the landlord to exercise its recapture right, such a right can come in handy if the economy and rental rates suddenly improve. The theory behind retaining such a right is that a tenant should only be entitled to the rent relief as an accommodation when times are "bad," and it should not be entitled to reap a windfall economic benefit when times get better.

A landlord's recapture right in a rent-relief scenario is really no different from a landlord's recapture right that may already be contained in the lease. What *is* different, however, is that the tenant may negate the recapture by agreeing once again to pay the rent that would have otherwise been due under the lease but for the temporary rent reduction. The following is an example of such a recapture right:

At any time during the Relief Period, Landlord shall have the right, in its sole discretion, to terminate the Lease and recapture the Premises upon sixty (60) days' prior written notice to Tenant (the "Landlord's Termination Notice"). Tenant may nullify and void Landlord's termination by (i) sending written notice to Landlord within fifteen (15) days of receipt of Landlord's Termination Notice stating that Tenant will immediately resume paying the full Fixed Minimum Rent, Percentage Rent and Additional Rent (collectively, the "Full Contract Rent") otherwise due under the terms and provisions of the Lease but for the relief granted by this Amendment (the "Tenant's Nullifying Notice"), and (ii) Tenant in fact resumes paying the Full Contract

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Rent due under the terms and provisions of the Lease within fifteen (15) days after Tenant's Nullifying Notice. If Landlord exercises the foregoing termination right and Tenant does not send Tenant's Nullifying Notice and/or Tenant does not resume paying the Full Contract Rent in accordance with the preceding sentence, then the Lease shall be terminated ...

While some tenants may balk at the above language, it is actually a fair and reasonable compromise. It provides the landlord the flexibility to recapture the space and lease it to a "stronger" tenant if the economy gets better and the market justifies higher rents. Yet the language is fair to the tenant who was granted the rent relief; if the market changes and the tenant is again able to afford the full contract rent, the tenant can simply nullify the landlord's recapture. If, however, the tenant is still unable to pay the original rent, then the lease is simply terminated and the parties go their separate ways. It is a win-win scenario for both the landlord and the tenant — the landlord has the chance to re-lease the space to a tenant who is willing to pay the then-market-rental rate, and the original tenant is no longer saddled with rent payments it still cannot afford.

CONDITION RENT RELIEF ON TENANT'S NOT BEING IN DEFAULT

Any rent-relief document should expressly state that the granted relief automatically terminates and the tenant reverts to paying the full contract rent if the tenant defaults under the lease or the amendment. Such a concept should not be objectionable to a tenant because it should not be entitled to take advantage of financial breaks unless it is otherwise in full compliance with the remaining terms and provisions of the lease. Here is an example of language that landlords should include in the document:

Tenant shall be entitled to the temporary rent relief granted by this Amendment only so long as:

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(a) Tenant does not commit an Event of Default (as defined in the Lease); and

(b) Tenant timely makes all payments of Substitute Rent as set forth in this Amendment.

Landlord is entitled to terminate the Relief Period and the rent relief granted hereby immediately upon written notice to Tenant if Tenant's entitlement to rent relief ends pursuant to a breach of either of the above conditions, in which event Tenant shall resume paying the Full Contract Rent (as defined above) due under the terms and provisions of the Lease.

Perhaps it goes without saying that the landlord should not be required to give rent relief and then have to suffer tenant defaults, but surprisingly, many rent-relief documents are silent on this issue. The above language not only protects the landlord by preventing a defaulting tenant from continuing to enjoy the relief, but it also provides the landlord with an additional right and remedy short of defaulting the tenant and exercising the remedies under the original lease. Due to the time and expense involved, a landlord initially may not want to resort to the remedies under the lease, so as an additional right on account of a tenant default, the above language allows the landlord simply to void the rent relief and immediately start billing the tenant for the full contract rent.

REQUIRE TENANT TO BE CONTINUOUSLY OPEN IN 'PERCENT IN LIEU' SITUATIONS

If the rent concession granted is in the form of a percentage of gross sales in lieu of fixed rent, the landlord must be sure to add language to the document that conditions the relief on the tenant's being continuously open and operating during the entire Relief Period. The tenant should not be entitled to pay "percent in lieu" rent if it is not open during standard shopping center hours or if it has gone dark. Language

along the following lines should be included as an additional condition in the percent in lieu situation:

Tenant shall be entitled to the temporary rent relief granted by this Amendment only so long as Tenant is continuously open to the public and operates its business at the Premises during all days and for the same hours required under the Lease, with levels of inventory and staffing sufficient to maximize the Gross Sales at the Premises.

The foregoing language protects the landlord by not allowing the tenant to take advantage of the rent break if it temporarily or permanently closes its store.

GROSS RENT OR PERCENTAGE RENT IN LIEU SITUATIONS

Where the rent relief is in the form of "gross rent" or "percent in lieu" rent (either being referred to herein as "Substitute Rent"), it is important for the landlord to retain the flexibility to apply and allocate the Substitute Rent to any item which is included in the broad definition of "Rent," such as common area charges, taxes, insurance and any other items of "Additional Rent." Language that addresses this concept could read as follows:

Landlord may, at Landlord's election, allocate some or all of the Substitute Rent among (i) Tenant's Pro Rata Share of Common Area Costs, (ii) Tenant's Pro Rata Share of Landlord's Insurance, (iii) Tenant's Pro Rata Share of Real Estate Taxes, (iii) the Promotion Fund Charge, or (vi) any other items of Additional Rent set forth in the Lease, provided that no such allocation shall result in any increase in the total amount due from Tenant hereunder.

Why is this language important? Because it gives the landlord the freedom to allocate funds to such items as marketing and promotion where the landlord may need a certain participation level in order to require participation by other tenants. It also allows the landlord to allocate amounts to rent compo-

nents which may require specified funding levels under the landlord's loan documents. This language should be acceptable to the tenant, as it does not change the amount the tenant pays, but gives the landlord the option to apply the payments in a way that is the most beneficial to the landlord's overall leasing and financing strategy.

DO NOT DELAY THE RENT BUMPS

When drafting a rent relief document, landlords should include language stating that the rent relief does not delay previously scheduled rent bumps, nor does it excuse the payment of other amounts (such as direct billed utilities, refuse removal charges, and the like, if those charges are not intended to be included in the relief package). The language to be employed can be as straightforward as the following:

Except as otherwise provided, nothing contained herein shall be construed as relieving Tenant of the duty to pay all other charges or sums due in accordance with the Lease. The Full Contract Rent which will become due for all months subsequent to the Relief Period shall be as set forth in the Lease, and any increases in Rent which are scheduled to occur pursuant to the Lease during the Relief Period shall not be reduced or delayed hereby.

Remember, the rent relief should be viewed as a temporary accommodation to the tenant, and there is no reason that the negotiated rent increases should be deferred by the Relief Period. Once the Relief Period expires, the rent should increase (if applicable) according to the previously negotiated schedule so that the landlord still receives some of the benefits of its original deal. Landlords may also try to go one step further by reciting that in the event any sums or credits are due a tenant for or during the Relief Period on account of adjustments or reconciliations to additional rent, the amount thereof shall be retained

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by landlord as rent and the amount of rent relieved shall be reduced by a like amount.

ADD ESTOPPEL AND RELEASE LANGUAGE IN FAVOR OF THE LANDLORD

Landlords should attempt to use the rent-relief document to obtain representations and a release that run in its favor. Such representations are similar to statements one might seek to obtain in a tenant estoppel certificate, but in an abbreviated form. For instance, landlords should consider adding the following language (or some form thereof) to the amendment:

Tenant hereby represents and warrants that: (i) no default under the Lease by Landlord exists; (ii) no state of facts exists which with the passage of time or the giving of notice or both would constitute a default by Landlord, and (iii) no sums or credits are due Tenant from Landlord except adjustments, if any, of estimated rents and charges for the current calendar year in accordance with the Lease and this Amendment.

Such language would prevent a tenant from coming back to the landlord down the road, claiming that it was owed money or a rent

credit at or prior to the time the relief was granted. Similarly, landlords should attempt to obtain an express acknowledgment by the tenant that: 1) the tenant accepts the premises in its then current "As-Is, Where Is" condition; and 2) the landlord is not obligated to perform any work whatsoever with regard to the premises. Finally, if at all possible, landlords should strive to secure a release from the tenant regarding matters that accrue up through the execution of the document. Such a release can be as simple as the following:

Tenant hereby releases Landlord and its partners, members, shareholders, directors, officers, employees, agents and contractors from any and all claims, liabilities, damages and costs arising out of or in connection with the Lease or Tenant's use and occupancy of the Premises and the Shopping Center through the time of the full execution and delivery of this Amendment by both parties hereto.

Be prepared for some tenants, particularly ones with a great degree of clout, to reject this language, as many are loathe to release landlords from unknown or undiscovered claims. Nevertheless, attempting to secure such a release, especially in a rent relief situation, is definitely worth the effort, particularly when a landlord is giving up some of its previously agreed upon economic benefits.

ADD A CONFIDENTIALITY PROVISION

Landlords should also include a standard confidentiality provision in their rent relief document. Let's face it, tenants, especially retail tenants, talk to one another. If a landlord grants concessions to one particular tenant, and other tenants in the same shopping center find out, then soon those other tenants will clamor for the same type of rent relief. Landlords must be careful in drafting their rent relief documents so as to ensure strict confidentiality and discourage (and perhaps even penalize) the tenant from talking to other tenants about the economics of any breaks the landlord has conferred.

CONCLUSION

While no landlord enjoys granting rent relief, it is often preferable to the alternative of more vacant space. However, just because a landlord wants to retain tenants does not mean that the landlord should give away the proverbial "kitchen sink." There should be protections built into every rent relief document, not only to protect the landlord's interests, but to provide some freedom and flexibility to the landlord when the relief is no longer warranted and/or when the economic conditions take a favorable turn.

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