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FARALLON LAW GROUP NEWSLETTER

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Tenant Lease Renegotiation In a Depressed Market

The current commercial real estate market has seen sustained excess capacity, increased vacancies and drops in rental rates.

Landlords are often competing with existing major tenants with excess space looking for subtenants. As a result, new tenants and subtenants have unusual leverage in negotiating favorable rental rates and other lease terms. Existing tenants/subtenants are also taking advantage of the friendly environment and renegotiating office, retail and industrial leases. If you are a tenant/subtenant seeking to improve your position, there are several approaches to consider, depending on your business goals and negotiating leverage:

➤ **Rent Reductions.** Tenants can approach their landlord and simply request a rent reduction. Landlords may agree to a rent reduction or deferral of a portion of the rentals to the back-end of the lease term. Landlords are more likely to agree if the alternative would be to face insolvent or bankrupt tenant and guarantors and vacant space.

For more solvent tenants, landlords may require a lease term extension in return for a rent reduction/deferral. Rent reductions should commence prior to the start of a lease term extension (resulting in immediate financial relief). If extending the term, tenants should consider negotiating other business terms, such as additional tenant improvements or allowances, renewal options, termination options, release of guarantors, security deposits and letters of credit, expansion or contraction rights.

➤ **Contraction of Premises.** Tenants may consider reducing the size of their premises, if the configuration and demising possibilities permit. Even if the per square rental rate is not reduced, the total rent paid and any pass-through expenses would decrease. Again, landlords would be motivated to do so in return for concessions or to avoid a defunct tenant.

➤ **Assignment/Subletting.** Although challenging in a down market, tenants can attempt to sublease excess space or assign their lease and obtain less expensive alternative space. The disadvantages to this approach are that (i) tenants will nevertheless be responsible for rental shortfalls, (ii) tenants remain fully liable under the lease, and (iii) the transaction costs to effect this approach are higher.

➤ **Lease Termination.** If a tenant is facing insurmountable economic pressures, an early termination of the lease and orderly surrender of the premises to the landlord can often be negotiated. The landlord benefits by avoiding delays and legal costs that follow if the tenant ceased operations. The tenant benefits by obtaining a release of further liability. Landlords may require some payment of accrued rent and/or a termination fee. This approach would require preparing a formal Lease Termination Agreement.

Please feel free to contact Boris Lieberman or Mario Kashou at 415-255-2450 if you have questions or concerns about lease renegotiation.

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