# Exit Strategies:

## Negotiating early lease termination provisions and what to do if you have excess space

Getting into a lease is easy. Getting out…not so easy. Exit strategies anticipate the "what-if" scenarios businesses should contemplate when leasing commercial space.

Commonly referred to as "early termination rights", these provisions allow for the cancellation of a lease prior to its expiration date and establish a formula designed to limit the financial exposure of a business. Think of them as escape clauses for companies that may need to right-size during the lease term and for professional practices where the death or disability of the principal(s) effectively closes the business.

This discussion sets forth pre-emptive actions forward-looking tenants should consider and address *before* signing a lease; as well as remedies available to those businesses that did not foresee changes in their space requirements.

### PRE-SIGNING NEGOTIATIONS

Anyone who has ever had excess space on their hands can attest that verbal assurances from the landlord or property manager to "help you dispose of unneeded space", while polite gestures, are vague and unenforceable promises. Your objective is to reduce to writing and incorporate within the lease agreement, the time periods and costs involved in the event you must cancel the lease. Therefore, include your request for specific early termination rights within the initial Letter of Intent.

The property owner has two concerns when faced with an early termination proposal: to have a reasonable amount of time to re-tenant the space and to be made financially whole. I suggest the landlord be given 90 to 180 days prior written notice of the tenant's intent to vacate the premises.

Becoming whole means the landlord is able to recoup its out-of-pocket costs, which include administrative expenses associated with the lease, as well as the unamortized portion of certain tenant improvements and leasing commissions. As some improvements will have reasonable value to the next tenant (i.e., "second generation" value) these costs should be excluded from amounts to be remunerated. In the event the property owner tries to assess interest charges on the pay-back amount, these charges should never exceed the market rate for borrowing funds.

Many landlords also request reimbursement for all incentives connected to the lease, including any free rent period, cash payments used to defray moving costs and the like. Where space is delivered in a largely "as-is" condition and with few incentives, I suggest limiting the early termination fee to the amount of unamortized commissions. When the reason for vacating is tied to needing a lesser or greater amount of space, I suggest that penalties not be assessed if the landlord of a multi-tenant building cannot accommodate the tenant's requirements within 90 to 180 days of receiving written notice.

Closely related to the discussion of early termination rights is the tenant's ability to sublet the premises, which will be discussed later in this article. Prior to signing the lease, be certain the landlord cannot unreasonably withhold its consent for either assigning or subletting the space. Consult with your legal advisor for expanded language to protect yourself in these and other areas.

### POST-SIGNING REMEDIES

Without clearly defined early termination provisions, the property owner will likely hold your feet to the fire and enforce the terms of the lease. This is its right under the lease. However, the tenant with unneeded space can take several proactive courses of action to mitigate potential losses.

First, as soon as you are aware that you may need to vacate all or a portion of the premises, so advise the property owner, verbally *and in writing*. And ask for their assistance in marketing the space to others. You never know if other tenants in the building have inquired about additional space and/or if there is a waiting list to lease your space. If your rental rate is lower than the landlord's perception of the current market rate, they may be willing to terminate your lease in hopes of leasing the space at higher rates. In this instance, any termination fee should be minimal.

Next, prepare a simple flyer describing the space and canvass other tenants in the building, especially those businesses immediately adjacent to your suite, to see if they need additional space and/or have the right to expand into your space if should it become available.

Finally, you may wish to lease the space to others, i.e., *sublease* the space. Space being offered for sublease falls into two categories: 1. the tenant has too much space and wishes to share a portion of it for the balance of the lease term, or 2. the tenant chooses to vacate the space for some reason. In either case, you, as the sublessor, are now competing for tenants with your landlord, as well as with every other landlord.

Tenants wishing to rid themselves of excess space generally advertise in the newspaper; on the property itself; or on web-based listing services, including: CoStar (www.costar.com), Loopnet (www.loopnet.com), City Feet (www.cityfeet.com) and Craig's List (www.craigslist.com). All but CoStar are accessible by the general public at no charge.

In the alternative, space may be listed with a real estate brokerage firm that, as part of its due diligence, should advertise the sublease on their website, in print ads, on the above mentioned service sites and on all available CIE (Commercial Information Exchange) and MLS (Multiple Listing Service) sites. Note that brokers typically charge a 5% to 8% commission for this service.

Businesses needing to sublease space should accept the fact that they have all of the responsibilities of a landlord with none of the benefits…and will probably need to subsidize any transaction.

### FINAL THOUGHTS

I've talked about WHY exit strategies are important, WHEN they should be negotiated, WHAT should be included and HOW to go about the process. All that remains is WHO should you trust.

Few real estate agents have the expertise required to anticipate and negotiate early termination rights. So, if you have a relative, colleague, or golfing buddy with a real estate license who scratch their heads when you bring up the subject…head for the door. This is not the time for on-the-job training. Instead, seek out a competent real estate advisor – *and do so before you sign the lease.*

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