

The commercial classroom: Lease termination clauses - Part 2

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Last month we looked at the most common lease termination clauses: subleasing and assignment. Remember leases may or may not have clauses to allow the tenant to terminate the lease.

Other Clauses to Release

a Tenant from a Lease

Different owners refer to clauses that release tenants with various terminologies. What one clause means to one owner or attorney may mean something different to another. Be sure to clarify in detail when someone speaks of any of the following.

Early Termination or "Bail Out" Clause - This is often requested by national retailers; if they open in a new location they hope their store will do very well and if so they would want to remain at that location for a long time. But if their market research in selecting that location was wrong and the store was not doing well they would want to terminate the lease.

They may request a lease with a five-year term and four five-year options, allowing them to stay there for 25 years if the store continues to perform well. But they may also request a Bail Out Clause after three years, to protect them if the store fails.

Why would a landlord even consider doing this? Obviously, they hope to have a national tenant stay in their building for a long time. But to offer an early termination clause, the landlord would require a significant penalty if it were exercised, typically one year's rent. This would give them sufficient time to replace the tenant without any interruption to their cash flow.

"Good Guy Clause" - This clause may take several forms. A landlord may simply agree to release a tenant if requested. The clause states: in the event that the tenant has to break the lease, the tenant will notify the landlord, pay their rent up until the date they vacate the space, vacate the space and return the keys.

Sometimes the landlord agrees to release the tenant provided all the rent is paid up to date and there is no damage to the premises, however they also impose a financial penalty for doing so.

In another form of good guy clause the landlord may agree to release a tenant if the tenant can find a replacement tenant willing to pay equal or greater rent than they are paying. The landlord will need to approve this new tenant, their concern being that the new tenant's financial strength or "credit worthiness" is equal to or greater than the current tenant. This puts the burden on the current tenant to find a replacement.

In this case the tenant may employ a real estate broker to help find a new tenant, and the tenant would be responsible to pay the real estate commission.

Lease Buy Out - Generally this is not a clause in the lease But, it may come up during the term of the lease, that the tenant wants to terminate the lease and is willing to pay to do so. Lease buy outs are expensive and the "Main Street Tenant" cannot usually afford to do so. Typically a landlord will

consider discounting the obligation based on the present value of money, but that may effectively be only a 10% discount or less. Most negotiated buy outs usually end up with 50% to 75% of the obligation being paid.

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Smith has been writing and teaching commercial continuing education courses for over twelve years. He has authored seven commercial continuing education courses. He has written three textbooks on commercial and investment real estate with instructor training materials used to teach commercial courses throughout the United States. He has also written "The Commercial Classroom: Lessons in Commercial and Investment Brokerage," and most recently, "Buy the Numbers: Investing in Real Estate."

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