

Expansive matters

Protecting the right to grow in leases **By Bill Ehret**

In most instances, the most difficult thing for companies to protect is the right to grow their businesses in a given location. For companies that lease space, this may be the No. 1 concern when entering into leases that are greater than three to five years in length.

The following, in order of preference for a tenant/lessee, are the three common ways a company can incorporate language in the lease document that will protect its right to grow.

- Option to expand
- Right of refusal
- Right of first offer

Option to expand

An option to expand is the most favorable choice for the tenant and the least desirable for a landlord, because it is a unilateral agreement in favor of the tenant. An option gives the tenant rights to a specific space at a specific time some time in the future.

The landlord must be able to deliver this space if the tenant exercises its rights to the space. This can effectively take space off the market and tie the landlord's hands for future leasing, so it is not the first choice for landlords to grant such an option.

Complicated options to expand will include specific notice periods for exercising or waiving rights to the space and delivery of the space, and may include language related to a formula for determining rental rates and tenant improvement dollars.

Right of refusal

The right of refusal is the first attempt to level the playing field in the landlord/tenant relationship. Whereas options tend to more firmly tie up the space, a right of refusal provides a mechanism by which the landlord can continue to market vacant space to a third party, while the existing tenant has the last look. As the name implies, it gives an existing tenant the right to accept or refuse the lease terms on space that may be appropriate for future growth.

The biggest difference between an option to expand and the right of refusal is timing.



Whereas the option has a defined time window when space must be made available to the tenant, the right of refusal may be an ongoing matter that could surface 30 days after you move into new space or three years down the road, when a third party tenant is willing to enter into a lease for the space.

There are distinctions between ongoing rights of refusals and one-time rights. Ongoing rights continue throughout the initial lease term; with one-time rights, the first time the space is offered and passed on because expansion is not necessary, the rights to the space no longer exist.

There can also be multiple levels where companies may fall in line, with one company having the right of first refusal and a second company having a right of second refusal.

Right of first offer

The right of first offer simply requires the landlord to offer vacant space to a tenant before it is offered to any other party. This is particularly important in buildings that have higher occupancy rates or growth tenants competing for space that may become available from time to time.

Unlike the option to expand, the right of first offer is specifically controlled by events unrelated to the tenant and can be difficult to plan around.

The right of first offer should not be dis-

missed as a normal event that suggests a landlord will offer space to a growing tenant, and it is a concession by the landlord. This provision requires the landlord to communicate with the tenant about space availabilities and helps both parties to plan for future growth.

These three mechanisms give some comfort for planning and protecting a company's right to grow in a specific location. The level of comfort becomes a negotiated issue, and the complexity of the language should be handled by experienced real estate attorneys and negotiated in the context of the current market conditions for the type of space.

Any combination of these provisions can occur in a lease and all will come with critical notice of exercise dates. It is important that the tenant occupant be aware of these dates as they approach and develop a strategy to take proper advantage.

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