

EXERCISING OPTIONS TO RENEW, EXTEND OR CANCEL LEASES: IT'S NOT JUST WHEN BUT HOW YOU DO IT

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Our experiences from negotiating leases confirm that options are valuable to the Tenant and somewhat burdensome to the Landlord.

The Landlord wants the certainty of occupancy and a steady income stream from the property. Conversely, the Tenant wants flexibility to stay, extend, or even relocate for a variety of business reasons: space expansion, space contraction or just a new and perhaps more business-friendly location. It follows then, when a lease contains options, the parties must rely on strict performance of the acts and conditions necessary to exercise such options. As market rents rise, the value of the option to renew at a fixed rent is significant. If, however, rents are slipping, the value of a right to terminate is of great value to the Tenant. Accordingly, if a Tenant should fail to preserve and exercise these option rights, the Landlord will benefit. It follows then that a Landlord will require, and often insist, on strict performance of the acts required of the Tenant to exercise the options, perhaps in order to extinguish the option.

In Illinois, reported cases generally require strict compliance, which is best summarized as follows:

1. *Timely* exercise of the option;
2. In the *manner* required by the lease; and
3. Meeting all of the requirements of exercising the option, such as:

- a. Tenant must be in possession of the space;
- b. Tenant may not be in default of any lease provisions;
- c. Tenant must provide the payment (if applicable) in the amount and manner required by the lease.

The well-advised Tenant should *read the lease* and meet each of the requirements to exercise an option to the letter. In fact, courts have criticized and ruled against tenants who failed to do just what the lease requires.

After the lease is executed, your role as Landlord or Tenant agent does not and should not end. It is both good practice and excellent client relations strategy, *indeed a must*, to identify critical dates for the client, such as lease term commencement date, lease term expiration date, and important deadlines by which options must be exercised. The typical boilerplate phrase, "Time is of the essence," serves as the legal basis for a Landlord to insist on timely exercise of options, and Illinois courts generally agree. Well drawn leases often have exhibits by which the parties stipulate, after completion of tenant improvements, after occupancy, just what these critical dates are, so there is no misunderstanding, and no question

when the time comes for an option to be exercised. As part of basic good practice, brokers should advise their clients of these critical dates, not to mention that the exercise of an option could trigger additional commissions, or the exercise of an option to terminate could generate new leasing or buying opportunities.

We offer the following *guide* for treatment of exercise of options:

1. Is/are these options in the lease, whether to expand, extend, contract, or terminate?
2. Does the lease specify that time is of the essence?
3. Does the lease specify, for purposes of notice, how notice must be given and to whom?

Assuming each of these preliminary questions are answered in the affirmative:

4. Note the critical *deadlines* by which the option(s) must be exercised.
5. Note to whom and in what manner notice must be exercised, often including multiple notices to multiple parties.
6. Note the conditions for exercise of the option (occupancy, payment of a certain fee, and how the fee is paid:

check, cashier's check, wire, etc.) All of this should be done shortly after Tenant occupies the space, when memories are clear and recent, when the parties are in agreement on dates, and of course, when the parties are (hopefully) still in agreement on these points.

7. Mark your calendar for these future events including budgeting ample lead time for warning, consideration, and execution of the required acts. This should include time for you to assist your client with market analysis to determine if options should or should not be exercised, if extension or other lease amendments should be considered and negotiated, or perhaps if new terms should be sought instead. All of this should start well in advance of option exercise deadlines.

Our research and experience reflect that parties should not rely on or expect a court to excuse strict performance of exercise of the options. In a companion article, we will discuss the very few cases where a Tenant has sought and obtained equitable relief when its conduct failed to strictly comply with lease requirements. Those cases are few and far between. Generally, when a Tenant is making a plea for equitable relief due to its failure to strictly comply, that Tenant is tossing the proverbial "Hail Mary" desperation

pass. Almost always, the arguments fail, the option is lost, and Tenant suffers grave financial consequences.

Our best advice to you and to your clients should be:

- A. Know your options;
- B. Preserve your options;
- C. Guard your options; and
- D. Exercise your options timely and in the exact manner required by the lease.

There is no reliable substitute for diligence – options are valuable. You negotiated these terms with great care and effort. Don't waste that effort or squander these assets by failing to guard them well. ▼