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## Ways in which the tenant's space may grow (or shrink), or become its own

*EDITOR'S NOTE: This article is part of a continuing series designed to acquaint nonlawyers with basic legal issues and considerations involved in leasing commercial property. It should not be considered a substitute for specific legal advice.*

Many tenants want their leases to allow for maximum flexibility for growth and expansion, as well as to hedge against the need for contraction.

As discussed in an earlier article, tenants may plan for these possible eventualities when dealing with the term of the lease — options to extend, options to terminate early, etc. Another way to deal with these potential scenarios is dealing with them in terms of the space under lease — that is, provisions through which they may increase or decrease the square footage under lease. With respect to all such rights, the mechanics of how these rights must be extended and accepted should be specified.

■ **Options to expand (lease additional space).** Tenants who anticipate a need to expand the leased area sometime in the future or as the need arises may negotiate an option to expand the leased premises into contiguous space or even to take additional space in the building, shopping center or other project regardless of whether it is contiguous.

As with any option, the terms of the lease for the expansion space and the time and manner for exercise of the option

should be definite and certain. The tenant will want to ensure that the premises to which the option attaches will be so situated that the tenant can make effective use of the additional space should it exercise the option. Before granting the tenant an option to expand, the landlord should be certain that the expansion space actually will be available on the option dates and that no conflicts exist with rights of other tenants (for example, that the existing tenant in the proposed expansion space has an option to renew or another tenant has a right to expand into the same space). On a practical note, the landlord should also consider how the exercise of the option to expand would affect future plans for building use.

■ **Right of first refusal; right of first offer.** If the landlord is reluctant to commit to giving the tenant an outright right to expand, it may be willing to grant to the tenant a right of first refusal or a right of first offer with respect to the space the tenant would like to possibly occupy in the future.

A right of first refusal gives the tenant, should a third party make an offer to lease the space in question, the right to lease the space on the same terms and conditions as the third party is willing to do. Time limits and other details about how this right is to be exercised must be clearly spelled out. A right of first offer, on the other hand, requires the landlord to first offer the space in question

to the tenant before marketing it generally. This right, too, must be clearly spelled out to avoid disputes.

■ **Option to reduce leased space.** Similar to the right to terminate early, a right to reduce the amount of space leased usually will cost the tenant something, such as payment of an amount to compensate the landlord for unamortized leasehold improvements and leasing expenses such as commissions paid, the cost of dividing the space, and the loss of part of the landlord's rental stream.

A tenant subject to swings in its industry may be willing to pay for this option, however. As with options to expand, issues such as triggers for exercise of the right, deadlines and lease amendments should be spelled out.

■ **Option to purchase.** Leases sometimes grant to the tenant an option to purchase the property during or at the expiration of the term, most commonly when the tenant occupies the entire building.

A true option is an irrevocable offer by the landlord to sell the property that can be accepted by the tenant's exercise of the option. Therefore, the option must contain the complete terms of purchase with certainty; the best practice is to embody all of the terms and conditions of the sale in a form of purchase-and-sale contract that is made an exhibit to the lease. An option to purchase upon terms "to be agreed

upon" is probably too uncertain to be enforceable, unless there is an objective mechanism for setting the price and other essential terms in the event that the parties cannot agree. Most commonly, an option is exercisable only if the tenant is not in default, and must be exercised strictly within the time and in the manner specified in the lease, or it will be lost.

■ **Right of first refusal to purchase.** Rather than an option, a lease might give the tenant a right of first refusal to purchase the property. In such a case, the tenant only has the conditional right to acquire the property, which right is triggered at the time that a third party makes a bona fide offer to purchase the property. Usually the price and terms of the purchase will be determined by the offer by a third party, which the tenant must meet in order to exercise the right. However, one Colorado Supreme Court upheld a right of first refusal with a prenegotiated specified price for the holder of the option.

■ **Right of first offer to purchase.** A right of first offer given to a tenant requires the owner, should it determine that it wishes to sell the property, to first inform the tenant of his intention to sell, allowing the tenant to make the first offer, before the owner may offer the property for sale to third parties.▲