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COMMERCIAL LEASE LAW insider

Practical Tools for Owners, Managers, Attorneys, and Other Real Estate Professionals

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FEATURE

DEPARTMENTS

Managing Vacancies: Collect Rent from Small Tenant While Searching for Big Tenant

Put 10 protections in your landlord termination option.

Finding a big tenant is generally the paramount objective for the owner of an office building, shopping center, or other commercial facility that's rife with vacancies. But as you search for that big tenant, one or more of your current small tenants might be interested in leasing some of that vacant space. This creates a dilemma. Every day the space remains vacant you lose money. But while taking the little bird in hand will increase your short-term rental income, it might end up costing you the chance to land that big bird in the bush that you need to make it in the long run.

The ideal solution would be to let the current tenant lease the vacant space for now while agreeing to give it up if and when you find a major tenant who wants to lease it.

MAKE COMPENSATION CONTINGENT ON YOUR ACTUAL EXERCISE OF THE TERMINATION OPTION.

Sound too good to be true? It's not, according to a New Jersey landlord's attorney whose clients have used this arrangement effectively in many different settings. The leasing strategy is simple: Establish a landlord termination option just the way many tenants demand their own lease termination option. The attorney says that tenants will generally agree to such a provision as long as the terms are fair and the landlord provides some form of compensation.

Get 10 Legal Protections

Here's how to negotiate and draft a landlord termination option provision that includes the 10 legal protections you need, along with a *Model Lease Clause* that you can adapt for your own circumstances.

1. Make tenant acknowledge landlord's option to terminate. The first thing you need is the tenant's express acknowledgment of your right to terminate the lease. Specify that termination takes effect on the day you decide to terminate the lease (the "termination date"), which may occur at any point before the lease expires. The New Jersey attorney recommends picking a termination date that falls on the last day of a calendar month so that you get the full rent for that particular month [Clause, pars. a(i) & a(ii)].

2. Provide for limited advance notice of termination. Agree to provide the tenant written notice in advance of the termination date, but try to keep the advance notice period as short as possible. The attorney suggests proposing 30 days while expecting tenants to push back by demanding up to 90 days. "They might contend that 30 days isn't enough time to move out and find new space." You may have to compromise by picking a notification period that falls somewhere in the middle between 30 and 90 days [Clause, par. a(iii)].

3. Provide tenant compensation for exercising termination option. A tenant will likely demand compensa-

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tion in consideration for granting you a termination option. Be prepared to meet that demand but not simply for *having* the option. Instead, make compensation contingent on your actual *exercise* of the option. Also specify that compensation is payable only if the tenant vacates the space on time so as to deter a potentially costly holdover [Clause, par. c].

4. Tie tenant's compensation to month option is exercised. How and how much should you pay tenants for an early termination option? The New Jersey attorney says that many tenants in this position want a fixed cash "buyout" payment that's typically equal to some multiple of the tenant's monthly rent. That multiple may be as high as 12 times the monthly rent.

Strategy: If you agree to this formula, tie the compensation amount to a monthly minimum rent for the month during which you send the termination notice rather than a future month. That should keep the buyout payment down to the extent that monthly rent typically increases as the lease runs on. However, a savvy tenant may insist that you calculate the payment using the minimum monthly rent charged on the date termination actually occurs because the rent may be higher on that later date [Clause, pars. c(i) & c(ii)].

IF THE HOLDOVER FEE IS TOO HIGH, A COURT MAY DETERMINE THAT IT'S AN UNENFORCEABLE PENALTY.

5. End tenant's lease rights on termination date. Clearly state that after the termination date occurs, the tenant will have no further rights under the lease or interest in the space other than those that the lease says will survive the end of the lease. The tenant should be prepared to treat your exercise of the termination option as if the lease had expired naturally [Clause, par. a(iv)].

6. Keep tenant on hook for outstanding obligations. Ensure that the tenant understands that your actions to end the lease prematurely by exercising the termination option don't relieve it of liability for its outstanding lease obligations, including the obligations that survive the lease. For example, the tenant is still responsible for paying minimum rent, additional rent, and any other charges accruing up to the termination date. Without this language, a tenant may claim that all of its outstanding lease obligations will be immediately extinguished once you terminate the lease [Clause, par. a(v)].

7. Set three conditions for surrender of space. When and if you exercise the termination option, you want the tenant to surrender the space on or before the termination date to ensure that it's available to the big tenant you've just lined up. Require the tenant to meet three conditions to satisfy its surrender obligations:

- The tenant must cure all outstanding lease violations;
- The tenant must give you possession of the space; and
- The tenant must clean and remove any remaining occupants and property from the space.

State that you have "sole and absolute discretion" to determine whether the tenant has fulfilled these conditions [Clause, par. b(ii)].

8. Charge tenant holdover fee for not surrendering space on time. To further ensure a smooth transition, require the tenant to pay a special holdover fee if it doesn't surrender the space on or before the termination date. This special holdover fee is different from the holdover rent you charge under the standard holdover rent clause of the lease, the New Jersey attorney explains. It essentially replaces the standard holdover rent clause to establish special rules for holdovers that occur after you exercise your termination option.

As with standard holdover rent, it's important to get the special holdover rent amount right. The rent must be high enough to give the tenant an incentive to surrender the space on time; but if it's too high, a court may determine that it's an unenforceable penalty. Recommendation: Charge a special holdover fee that's a multiple of the tenant's monthly minimum rent then due prorated for each day the holdover lasts until the tenant surrenders the space. All things being equal, double the minimum monthly rent should be an appropriate multiple, the New Jersey attorney suggests [Clause, b(i)].

9. Require tenant to indemnify you from third-party claims. If the small tenant holds over, the incoming big tenant won't be able to move in on time. That could not only cause the deal to fall through but also expose you to risk of being sued by the big tenant for failure to deliver timely possession. So, in addition to paying a holdover fee, require the small tenant to indemnify, i.e., defend and hold you harmless from, all damages, costs, claims, and expenses you incur from third parties as a result of its failure to surrender the premises on time [Clause, par. b(iii)].

10. Reserve all legal remedies to get tenant to leave by termination date. To dispel any possible doubt, spell out that the tenant doesn't have your permission to stay in the space after the termination date. And expressly reserve your right to use any and all available legal remedies to regain possession of the space if the tenant doesn't leave [Clause, par. b(iv)].

MODEL LEASE CLAUSE

Get Right to Take Back Space from Small Tenant

Getting an early lease termination option gives landlords flexibility to lease vacant space to a smaller tenant while continuing to pursue big tenants to occupy it for the long haul. However, tenants will demand compensation for agreeing to let you terminate them to make way for the larger tenant. So, it's essential to create a special lease clause that's fair and provides legal protections for both sides. Here's a Model Lease Clause created and used successfully by a veteran New Jersey landlord attorney that you, with the help of counsel, can adapt for your own needs and situation.

LANDLORD'S TERMINATION OPTION

a. Termination Option. Landlord and Tenant acknowledge and agree that:

(i) Landlord shall have the option to terminate this Lease effective as of the Termination Date (as that term is defined below);

(ii) For purposes of this Clause, the "Termination Date" means the last day of any calendar month within the Term (or any extension thereof) as selected by Landlord, in its sole and absolute discretion;

(iii) To exercise its termination option, Landlord shall give Tenant written notice of the Termination Date (the "Termination Notice") at least [*insert #, e.g., 30*] days prior to the Termination Date;

(iv) Effective as of the Termination Date, Tenant's interest in and to the Premises shall be wholly extinguished and this Lease shall expire in the same manner and with the same effect as if the Termination Date were the Expiration Date; and

(v) Landlord's exercise of its termination option shall not constitute a release or discharge of Tenant with respect to any outstanding, and unsatisfied, or continuing obligations or liabilities, whether unbilled or calculated, accrued or incurred, applicable to the Premises, such as, but not limited to, Rent and other charges payable by Tenant up to and including the Termination Date, and Tenant's obligation to indemnify Landlord under Clause [*insert lease section #*] hereof.

b. Surrender of Premises. Landlord and Tenant further acknowledge and agree that:

(i) In the event that the Actual Surrender Date (as defined below) fails to occur on or before the Termination Date, Tenant, rather than paying the Holdover Rent required under [*insert lease section # of standard holdover rent clause*] hereof, shall pay [*insert multiple, e.g., double*] the Minimum Rent applicable to the Premises for each day between the Termination Date and the Actual Surrender Date;

(ii) For purposes of this Clause, the "Actual Surrender Date" means the first day on which all of the following three conditions are fully satisfied, as determined by Landlord in its sole and absolute discretion:

(A) Tenant has cured all outstanding defaults, if any, under this Lease;

(B) Tenant has quit, surrendered, and delivered to Landlord actual and exclusive possession of the Premises; and

(C) The Premises are empty, vacant, broom clean, in good condition and order, and free of all occupants, liens, and property required to be removed under this Lease at the end of the Term or any extension thereof;

(iii) Tenant understands that on the Termination Date, all or a part of the Premises may be subject to certain rights of occupancy held by other parties and that any retention of possession by Tenant after the Termination Date may cause significant hardship to Landlord and to such other occupants. In connection with the foregoing, Tenant shall defend, indemnify, and hold Landlord harmless against all liabilities, damages, costs, claims, and expenses incurred by reason of any such retention of possession;

LANDLORD'S TERMINATION OPTION (CONTINUED)

(iv) Nothing contained in this Clause shall be construed as a consent by Landlord to the occupancy or possession by Tenant of the Premises beyond the Termination Date. Landlord, upon the Termination Date, shall be entitled to consequential damages and to the benefit of all legal remedies that now may be in force or may be hereafter enacted that enable Landlord to regain possession of the Premises.

c. Compensation from Landlord. In the event that the Actual Surrender Date occurs on or before the Termination Date, then, Landlord shall give Tenant within [*insert #, e.g., 30*] days after the Actual Surrender Date, a check equal to the product of:

(i) [*insert #, e.g., 12*]; and

(ii) The monthly installment of Minimum Rent due on the first day of the month in which Landlord gives Tenant the Notice.

DRAFTING TIPS

Get 5 Lease Protections When Granting Free Rent to Tenants

State in a clear and precise way exactly what the concession does and doesn't cover.

Offering free rent is often part of the price landlords must pay to get a substantial tenant to sign a long-term lease for a significant amount of space. As with any other business arrangement, free rent deals must be incorporated into the lease. But experts suggest that the lease drafting isn't always commensurate with the deal making. "The typical free rent clauses that I see in the marketplace are fraught with peril and plagued with ambiguity," laments a veteran New York City commercial landlord attorney. So, he developed his own provision that addresses five crucial issues that standard clauses leave unanswered.

FREE RENT CLAUSES TYPICALLY FAIL TO ADDRESS ARREARAGES.

1. What Rent the Free Rent Waiver Covers

Problem: Standard clauses don't say what the free rent waiver covers—that is, whether it includes just the fixed rent or also extends to additional rent such as taxes, operating costs, CAM, insurance, and electrical charges.

Solution: Our Model Lease Clause specifies that the free rent waiver covers only the fixed rent [Clause, par. a].

2. Whether the Free Rent Waiver Covers Arrearages

Problem: Free rent clauses typically fail to address arrearages. Thus, if rent is waived for a two-month period, say Nov. 1, 2025, to Dec. 31, 2025, does that mean that any arrearages that continue to be due from before Nov. 1, 2025, but that continue to be due during the two-month period are waived too?

Solution: Our Model Lease Clause lists the start and end dates of the free rent waiver period and clarifies that the waiver covers only the fixed rent attributable to that period [Clause, par. a].

3. Consequences of Pre-Free Rent Period Breach

Problem: Landlords typically want to be able to nullify or recapture free rent if the tenant violates the lease. But free rent clauses typically fail to provide for these rights.

Solution: The Model Lease Clause addresses the consequences of breaches, starting with clarification that breaches committed before the free rent period begins nullify the free rent waiver and that the breaching tenant must pay all of the waived rent due during that period [Clause, par. b].

4. Consequences of Breaches Committed During Free Rent Period

Problem: Free rent clauses should but often don't give the landlord recourse against tenants that breach the lease during the free rent period.

Solution: The Model Lease Clause requires tenants that commit such breaches to:

- Pay the landlord, upon demand, an amount equal to the rent it would have had to pay had the free rent waiver never existed; and
- Pay the rent that would have been due after the breach occurred had the waiver never existed [Clause, par. c].

5. Consequences of Breaches Committed After Free Rent Period

Problem: Standard free rent clauses have no mechanism to hold tenants that enjoy the benefits of free rent accountable for the breaches they commit after the free rent period ends.

Solution: The Model Lease Clause gives the landlord the right to demand that tenants that commit such defaults pay a sum equal to the full amount of rent waived during the free rent period. Tenants also have to repay the free rent they enjoyed if the lease ends early for any reason, such as condemnation, default by either party, consensual written agreement, etc. The rationale for this, the New York attorney explains, is that the landlord will no longer receive the rent stream that it anticipated for the originally scheduled full duration of the lease term. In light of that, the free rent period would no longer represent the same proportionate share of the lease term if the lease term were to be shortened. [Clause, par. d].

MODEL LEASE CLAUSE

Ensure Free Rent Lease Clauses Give You Adequate Protection

When granting free rent can't be avoided, be sure to document the business arrangement in a clear and precise way that explains what the concession does and doesn't cover. The lease clause should also give you some recourse to nullify or recapture free rent if tenants breach their lease before, during, or after the free rent period. Here's a Model Lease Clause that you and your attorney can adapt for your own use. As acknowledged by the New York City attorney who wrote it, the Clause addresses the issues in a "Landlord-friendly manner" that you might have to tweak when dealing with a strong tenant.

FREE RENT

a. Free Fixed Rent Period. Subject to the remaining balance of this Section, Fixed Rent only that is attributable solely to the period November 1, 2025, through December 31, 2025 ("Free Fixed Rent Period"), and no arrearages that arose prior to the Free Fixed Rent Period shall be waived.

b. Breaches before Free Fixed Rent Period. If any breach of the Lease by Tenant occurs before November 1, 2025, then Fixed Rent shall be due for the entire Free Fixed Rent Period and the foregoing waiver shall be null and void.

c. Breaches during Free Fixed Rent Period. If a breach of the Lease by Tenant occurs on the first day of, during, or on the last day of the Free Fixed Rent Period, then:

(i) with regard to the Fixed Rent waiver that Tenant already enjoyed, Tenant shall pay Landlord a sum on Landlord's demand equal to the amount of such waived Free Rent as if the foregoing waiver had never been granted; and

(ii) with regard to that portion of the Free Fixed Rent Period that occurs on or after the date on which the breach has occurred, Fixed Rent shall be due as if the waiver had never been given.

d. Breaches after Free Fixed Rent Period. If a breach of the Lease by Tenant has occurred after the Free Fixed Rent Period or if after the Free Fixed Rent Period the Lease terminates or expires early for any reason whatsoever, Tenant shall pay Landlord upon Landlord's demand a sum equal to the amount of Fixed Rent that was waived for the Free Fixed Rent Period.

e. Survival of Obligations & Remedies. All obligations of Tenant under this Section shall survive the expiration or earlier termination of the Lease and shall be in addition to the rights or remedies of Landlord at law, in equity, and under the Lease.

RECENT COURT RULINGS

Guarantor's Liability Ends When Tenant Surrenders, Not When Landlord Accepts Surrender

What Happened: An investment advisor tenant stopped paying utilities in March 2020; it stopped paying rent in June; and it surrendered the office in November. The landlord sued the tenant and the corporate officer who signed a good guy guaranty on its behalf. After years of ping ponging around in litigation, the court ruled that the tenant and guarantor were jointly and severally liable for rent both before and after the tenant vacated, citing language in the guaranty releasing the guarantor upon the tenant's surrender "pursuant to the terms of the Lease." One of those terms was that the landlord accept the tenant's surrender in writing. And since the tenant didn't get the landlord's written acceptance, the guarantor was on the hook. One failed appeal later, the guarantor took its case to the state's highest court.

Ruling: The New York Court of Appeals reversed, finding that the guarantor wasn't liable for post-surrender rent.

Reasoning: The guarantor's liability ended when the tenant surrendered the premises, even though the landlord didn't actually accept the surrender in writing. While the guaranty covered all of the tenant's monetary obligations until the date of surrender, it didn't define "surrender," leaving the door open for the Court to look at the entire context. The whole point of structuring the arrangement as a good guy guaranty was to limit the guarantor's liability to the tenant's actions. After all, as an officer, the guarantor had some level of control over the tenant. By contrast, it had no control over the landlord's actions. Tethering the guarantor's liability to the landlord's acceptance of the surrender would defeat the purpose and render much of the guaranty language superfluous, the Court reasoned. "We have long and consistently ruled against any construction which would render a contractual provision meaningless or without force or effect."

- 1995 CAM LLC v. West Side Advisors, LLC, 2025 N.Y. LEXIS 1771, 2025 NY Slip Op 05782, 2025 LX 436241

Subtenant That Vacates on Time Need Not Pay Holdover Rent to Tenant

What Happened: Best Buy subleased retail property to Factory Direct on the condition that it return the premises in a "condition and repair equal to the condition and repair thereof at the commencement of said term" and pay 150 percent of the fixed rent if it held over. Factory Direct vacated before the sublease term expired but didn't restore the property to its original condition, leaving behind damage and alterations that Best Buy had to rectify at its own expense. Best Buy sued Factory Direct for compensatory damages, which it argued should be the 150 percent holdover rent for the three months it took to restore the property. It's as if Factory Direct had occupied the space during that time, it contended.

Ruling: The New Jersey federal court ruled that Best Buy didn't have a valid claim for holdover rent and tossed the case without a trial.

Reasoning: The point of holdover rent is to compensate the landlord for the losses it incurs when a tenant *remains* in the property after the lease terminates. But Factory Direct didn't overstay the sublease term. While its condition wasn't what it would have liked, Best Buy still had possession and control over the property the day the sublease expired. Nor did the sublease agreement contain any language purporting to link Factory Direct's holdover rent obligations to the property's post-termination condition. In addition, the court noted, Best Buy's own senior director stated in a pre-trial deposition that the company had already decided before the sublease expired to move out of the space but temporarily postponed the move for reasons unrelated to the property's post-termination condition.

- Best Buy Stores, L.P. v. Factory Direct of Secaucus, LLC, 2025 U.S. Dist. LEXIS 203617, 2025 LX 461738, 2025 WL 2918884