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The Law Office of Kevin F. Jursinski & Associates, P.A.
COMMERCIAL LEASE NEWSLETTER

PRACTICAL TIPS FOR COMMERCIAL LANDLORDS AND TENANTS
IN IDENTIFYING THE REALITIES OF PROSPECTIVE LEASE DEFAULTS
“KICK-OUT” CLAUSE

In today's uncertain economic times, many commercial landlords are finding it difficult to have tenants sign long-term leases. Many commercial tenants are reluctant to commit to long-term leases, especially when they are being asked to personally guaranty these leases, especially in light of the fact that it is hard to predict, for both the commercial landlord and tenant, future economic expectations. This results in many commercial landlords being unable to effectively capture tenants on long-term leases and leaves tenants weary of these leases, all of which results in a stagnant market place. Here are some suggestions to break the road blocks starting with this month's suggestion of a “kick-out” clause.

As indicated above, many tenants are reluctant to commit to a three (3) to five (5) year or longer lease term because of their inability to project out issues relating to the economy and where they will be at in the next several years. The answer: a “kick-out” clause.

“Kick-Out Clause” - A “kick-out” clause is a provision in a commercial lease which allows a tenant to reduce their financial risk of a long-term lease while at the same time allows the landlord a vehicle to entice tenants to enter into the lease and some incentive on the back end in regard to the “kick-out” clause such as a payment option for the tenant exercising the lease.

Essentially a “kick-out” clause will work as follows:

A tenant is interested in accepting a commercial premises and the landlord is interested in having a tenant commit to a five (5) year lease. The Landlord may be advancing certain monies to the tenant for build-out which the landlord wants to recapture.

The tenant does not want to be stuck in a lease in the event they are unable to perform. As such, the parties can create a “kick-out” clause which identifies the fact that the tenant could exercise a right to vacate the premises after a certain period of time based upon factors such as:

- (a) tenant is unable to meet certain expectations as far as sales or productivity;
- (b) the tenant simply cannot continue operations because of an economic downturn; and
- (c) the landlord and tenant can identify a time period in which, at the very least, the landlord's resold improvements will be amortized before the kick-out; or alternatively, there will be a provision in which the landlord can recapture the tenant build-out based upon a provision in which the tenant has to pay a certain amount for a restructure and right to the "kick-out" clause.

An example of restructuring is a five (5) year lease in which the tenant has a right, after meeting all obligations under the lease for a period of two (2) years (or three (3) years) to notify the landlord that it intends to vacate the premises predicated on (a) the tenant not meeting certain financial goals in its sales (this is applicable to a retail establishment and must be also accompanied by verification of gross sales provided for in the lease) or (b) the tenant simply not being able to continue on in operations for a whole host of economic reasons.

The landlord and tenant would structure the "kick-out" clause so that if the landlord advanced tenant improvements which it intended to recapture that, at such time as he exercised the unamortized portion of the tenant improvement, would be a payment made by the tenant to the landlord for recapture of the premises.

Example of "kick-out" clause on a five (5) year lease - An example of this is a five (5) year lease in which the landlord and tenant agree that the tenant improvements will be amortized in the lease and after the third year, those advanced expenses will have been recaptured by the landlord. Assuming expenses of \$30,000 for the build-out and the expenses would be recaptured at \$10,000 a year. Tenant would be given the right, after two years of faithful performance of the lease, (the lease not otherwise being in default) to exercise its right within a period of time from 60 days prior to the end of the two (2) year period to notify the landlord of its intent to cancel the lease. The tenant would have to provide the landlord with notification prior to the tenant vacating the premises. Tenant would have to vacate the premises in accordance with the terms and conditions of the lease would have to have all payments made under the lease current at the time of vacation and the tenant would have to then pay any unamortized portion of the tenant improvements.

Using our example of a three (3) year recapture for tenant improvements of \$30,000 at \$10,000 per year and the tenant electing to exercise its option to vacate the premises at the end of the second year, the tenant would need to provide appropriate notification to the landlord prior to the end of the two (2) year lease and also make sure that all other obligations under the lease were met, no defaults existed, the premises were surrendered to the landlord in the same condition they were received less normal wear and tear, and lastly, that the remaining unamortized tenant improvement amount, which in our scenario was \$10,000, was paid to the landlord as the "kick-out" clause payment obligation.

“Kick-out clauses” have been successfully utilized by major national tenants. It’s harder for a smaller tenant to utilize a “kick-out” clause in normal economic times. However, in current economic times when the market is soft for rentals, many landlords may now be more receptive and apt to consider a “kick-out” clause for a smaller tenant based upon logical business like terms and conditions as outlined hereinabove. This is one factor that many tenants should consider in evaluating their rights and duties.

Both the commercial landlord and commercial tenant should be aware of this provision and seek the assistance of a qualified real estate attorney experienced in commercial leasing to assist them in addressing the particulars of a “kick-out” clause so that there would be no uncertainty, the clause would be clear and ambiguous, and as importantly, if there are any disputes over the “kick-out” clause, a third party trier of fact; i.e., the Court, could easily identify the terms and conditions of the “kick-out” clause, the factors allowing for the exercise of the “kick-out” clause and whether there was appropriate compliance by the landlord and tenant so that the party seeking to enforce the “kick-out” clause would be in a position to do so without significant problems.

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