

Chicago Daily Law Bulletin®

Volume 157, No. 1

Monday, January 3, 2011

Lawyers see more redoing of office leases

By Jerry Crimmins
Law Bulletin staff writer

Base rents for commercial office space in Chicago may be stabilizing, but there is a “major uptick in subleasing and lease modification,” according to Harold S. Dembo, vice chair of the real estate group at Much, Shelist, Denenberg, Ament & Rubenstein P.C.

“I believe we’re bottomed out” on rents, said Dembo, who has been doing real estate law for 30 years.

“The stress on landlords and tenants in 2008 and 2009” during the economic downturn, “was the worst it’s ever been,” he said. “I think we’re slowly coming out of that.”

Theodore I. Yi, a real estate lawyer and co-managing partner of the Chicago office of Quarles & Brady LLP, said, “I see signs of coming out of the downturn. ... At least toward the end of last year, 2010, my sense is there is new activity.”

Michael S. Friman, partner in McCormick, Braun, Friman LLC, and Dembo both said that for real estate lawyers, much of the current activity is in renegotiating leases, lease renewals or extensions and subletting, as opposed to new leases.

“Even my law firm found a sublease a more attractive vehicle than a direct lease in these economic times,” Friman said. “In this economy, landlords are definitely showing more flexibility in allowing tenants to sublease.”

Subletting commercial space, although common now, creates a host of legal pitfalls, Friman said. It involves “lengthy negotiations between the subtenant and the tenant and then the landlord,” he said.

Dembo said in the area of renegotiating leases, both landlords and tenants can seek advantages in the current economic climate.

Even a lease that still has three years to run may be negotiable, in Dembo’s opinion.

“If you have three years to run, it may make sense to engage a broker to analyze it ... to get a flavor, a feel for what economic package you could bring to the landlord,” including lower rent, he said.

“We can certainly help strategize the overall package” for either a landlord or a tenant.

“The landlord can also get certain things” out of a renegotiated lease, Dembo said, such as a larger security deposit from larger tenants, or, from smaller tenants, a personal guarantee where the tenant puts personal assets on the line.

Or the landlord might want to delete a provision in the current lease if it’s renegotiated, such as a guarantee of exclusivity that had been given the tenant prohibiting a similar business at that location.

“Landlords are amenable” to renegotiating some leases, Dembo said, if they get a longer lease. Then “they don’t have to build out their space. They don’t have to pay a broker maybe” to find a new tenant, “so on balance, both sides come out ahead.”

“Despite what you might think, it’s easier for a tenant who is in good standing to renegotiate than a tenant who is already in default” in a commercial lease, Friman said.

“That’s obviously in contradiction to the residential mortgage market,” where a

homeowner generally needs to be in a default situation in order to enter into a mortgage modification or a short sale.

Friman said in his experience a lease may be easier to renegotiate if it is expiring in two years.

Friman said landlords should examine the financial strength of the tenant to see if it’s worth the investment to renegotiate the lease. “You don’t want to go through the process ... if the tenant is still not going to be able to meet their rent and default,” he said. “In most commercial leases, the landlord has the right to request financial statements from the tenant throughout the terms of the lease.”

Yi said in his practice, he saw “a fair amount of tenants seeking to reduce their space “or trying to reduce their rent burden” in 2009 and in part of 2010.

“I saw less of that toward the end of 2010.” The end of 2010 saw some new commercial leasing activity, Yi said, a hopeful sign.

He said he has seen “a small amount of new activity in the central business district of Chicago.”

Yi saw more new activity in the mid-Atlantic area, where he also has clients, “in the District of Columbia and in northern Virginia because the government is expanding and people who want to do business with the government need to open an office near DC.”

A real comeback in the real estate market depends on increased employment, Yi said.

“You need office space to house more workers. If the employee base is not expanding, you don’t need more space.”