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Landlords and tenants: Beware of recapture clauses

As the local commercial real estate market continues to prosper, I have seen a relatively significant increase in the amount of leases I am negotiating — for both landlords and tenants.

It is obvious that the vast majority of Chicago business owners, at one time or another, are in a position where they need to negotiate or renegotiate the commercial lease for the premises in which they operate their day-to-day businesses. It is during these times of relative real estate prosperity that not only do savvy tenants need to properly analyze and negotiate the more basic terms and conditions of their lease agreement, but also more complex concepts contained in those leases — such as recapture clauses. This column serves as a refresher for both sides of the table on the intent and utility of recapture provisions.

In short, a recapture clause in a commercial lease allows a landlord, upon the occurrence of certain events, to terminate the lease and take back — or “recapture” — the leased premises. There are a few variations of this right. For example, such a provision may be found in a shopping center lease whereby the landlord has the right to recapture the premises in the event the tenant does not maintain a specified minimum amount of business. However, the most common location for such a clause is within the assignment and sublet provisions of the lease.

Generically, a lease will often provide that the tenant is not allowed to assign or sublet the premises without the landlord's approval, and that such approval shall not be unreasonably withheld, conditioned or delayed. In the event of such assignment or sublet request from a tenant, the inclusion of a recapture clause

gives the landlord an additional option of recapturing the entire premises in response to the tenant's assignment or sublet request.

For obvious reasons, such a provision requires careful contemplation and negotiation from both landlords and tenants during lease negotiations.

The landlord's perspective

Often, the tenant's attorney will simply attempt to delete such recapture provisions from a lease in a wholesale fashion, as if the provision is patently unfair to the tenant. This is not necessarily a reasonable or realistic position to take.

As noted, if the landlord is required to be reasonable in its response to a request by the tenant to assign or sublet a premises pursuant to the lease provisions, there is the potential that, without the inclusion of a recapture provision, the landlord could end up in the position of arguing whether a future requested assignee or sublessee is reasonably acceptable to the landlord or not.

One way to solve this potential problem is to spell out all of the reasons that a landlord may reasonably reject a potential assignee or sublessee (e.g., the inclusion of

net worth requirements or restrictions on particular permitted uses for potential assignees or sublessees, and so forth); however, such additional provisions can sometimes be cumbersome or, worse yet, incomplete at the time of the signing of the lease.

What may seem like an unrea-

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sonable reason to reject a potential assignee or sublessee at the time of the drafting of the lease may be completely reasonable two or three or more years in the future.

Furthermore, particularly during prosperous times in the real estate market, a tenant's request to assign or sublet may be primarily motivated by profit potential to the tenant.

Without a recapture clause or other protective provisions for the

landlord, the tenant may be able to sublet or assign the premises for a higher rental rate than that tenant's lease rate with the landlord — while pocketing the profit.

The tenant's perspective

While the inclusion of a recapture provision is mostly a one-sided benefit in favor of the land-

lord, the tenant should understand the landlord's rationale for its inclusion and, therefore, move to narrow the triggering events for the effectiveness of such a provision, or by negotiating a share of potential future profits from an assignment or sublease so that both landlord and tenant may benefit.

If a landlord requires the inclusion of such a recapture provision, a savvy tenant may insist that the provision is triggered only upon the tenant's request for assignment or sublet of more than 50 percent of the premises. This prevents the landlord from invoking the recapture right of the entire premises if the tenant only needs to sublet a small portion of space for its particular purposes.

Alternatively, in exchange for requiring a landlord to delete the recapture right altogether, a tenant may agree to allocate a percentage of all profits from an assignment or sublet to the landlord (for example, such profits may be split between landlord and tenant).

At a minimum, if the landlord insists on a recapture provision, the tenant should be allowed the right to withdraw its assignment or sublet request in the event that the landlord notifies the tenant of its intent to recapture the premises. In such case, the current lease would simply continue under its current terms and conditions.

The bottom line is the when negotiating recapture provisions — from either the landlord's or the tenant's perspective — it is very important to consult with an experienced commercial real estate attorney to ensure that your interests are properly protected.

Leases can be extremely long-term commitments so taking the extra time at the onset to make sure your lease document accurately reflects your intent is well worth the investment.

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