

Why You Should Never Exercise Your Renewal Option

Authors: Seth Travis, Collier Leatherman & Jeff Miller, Davis Moore
September 2024

Introduction & Executive Summary

Imagine your practice has been operating successfully from the same location for over a decade. As the end of the lease approaches, you face a simple choice: sign the renewal notice or explore other options. With future rents already defined in the lease, renewing the lease might seem like the easiest and most straightforward choice. However, this seemingly simple decision can be more costly than anticipated.

This paper explores what is at stake, common concerns, and proposes a competitive process to significantly improve outcomes.

What is at Stake?

Lenders typically require building owners to escrow funds for tenant improvement allowances (TIAs), vacancies, and other expenses to protect the bank against potential loan defaults. These reserves can amount to multiple years' worth of rent. The building owner's profits balloon if you renew a lease without accessing these funds, which could show up in the form of rent reduction, TIA, free rent, lower annual increases, or many other variations.

Common Concerns

- **"I Have No Other Option Than My Renewal Option."**
Perhaps you believe the cost to move is too high or are uninspired by available alternative facilities.
- **"It Seems Like a Lot of Trouble."**
You are already overloaded. How could you possibly add this to your schedule?
- **"I Like My Landlord and Don't Want to Jeopardize the Relationship."**
Maintaining a good relationship with your landlord is important.
- **"I Don't Need a Broker Because I'm Not Moving."**
Why would you need a broker if the renewal rights are spelled out in the lease?

The Value of a Competitive Process

Whether or not you intend to actually relocate, you can improve upon your renewal rights. The path to accessing escrowed funds is not complicated but requires diligence and skill. To begin, 18 to 24 months before your lease expires, you can:

- Conduct a comprehensive review of your current needs – many times practices realize their needs have changed substantially since the time the facility was built; is there too much space, not enough, or not enough of the right type of space?

- Refresh yourself on lease extension options and notice dates – whether you exercise a renewal or not, best practice to maximize your negotiating leverage is to implement a decision before the renewal notice date.
- Explore potentially suitable alternative properties – whether these options appear better than your current situation is almost irrelevant. At this point, you are simply putting the market on notice of the upcoming competition for your tenancy.
- Obtain proposals from competing locations – building owners routinely surprise themselves in how aggressive they become in a competitive environment; you may find the perceived cost barrier to relocation has been eliminated.

While this process is simple attending to the details will achieve 20%+ better outcomes.

Revisiting the Common Concerns

- **"I Have No Other Option Than My Renewal Option."**
What if you could transform your layout to maximize revenue production? A once insurmountable barrier to moving could be erased by concessions from a hungry building owner and improved operational margin.
- **"It Seems Like a Lot of Trouble."**
Consider allowing a talented professional to carry most of the load on your behalf. A six-to-twelve-month process could be condensed to a thirty-minute meeting once a month.
- **"I Like My Landlord and Don't Want to Jeopardize the Relationship."**
Who says negotiations have to be adversarial? A well-managed process can benefit both parties, fostering a positive ongoing relationship.
- **"I Don't Need a Broker Because I'm Not Moving."**
Even if you intend to stay, your building owner will provide more favorable renewal terms – lower rent, more TIA, signage, etc. – if they must fight to keep you.

Case Studies and Examples

Raleigh Neurology was on the verge of renewing their lease when it decided to run a competitive process. The result was average annual savings of \$40,000 for the practice.

Duke Health Wake Forest used the best practices process to generate a 16% base rent reduction, 2 months free rent, and a \$300,000 Tenant Improvement Allowance.

Zitel Chiropractic, a smaller tenant in a large office building, benefited from the process, achieving savings of \$40 per square foot on its lease extension.

Prisma Health System has saved \$30 million over the last 3 years without relocating a single practice.

Conclusion

Don't let fear or lack of time overcome you. Take control of your situation. More often than not you will be surprised by favorable results well within your reach.