

Option to Renew v. Option to Extend

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It is common in commercial lease agreements to contain an option for the tenant to continue its occupancy of the premises beyond the initial term. When that kind of option is granted, the landlord and tenant should pay careful attention to whether the lease provides the tenant with either a right to renew or extend the lease, because those terms provide for distinctly different rights and obligations in the resulting lease agreements after the tenant has exercised its option.



Under a lease renewal, there is a “legal instant in time” between the expiration of the original term and the commencement of the renewal term of the lease agreement. Due to this brief cessation of a leasing relationship between the parties, a lease renewal legally creates a new lease agreement between the parties. However, unlike a lease renewal, exercising an option to extend the lease is considered to be a continuation of the original lease, without interruption, and no new agreement is entered into by the parties.

This key difference in treatment of the resulting lease agreement could cause a number of unintended consequences by the tenant and landlord. Two key issues that may arise concern the treatment of the tenant’s personal rights, and the liability of the original tenant following an assignment of the lease agreement.

(a) Continuation of Personal Rights:

When determining which option is appropriate, the parties should consider whether or not the personal rights of the tenant contained in the lease agreement should continue to exist during the additional term(s). Personal rights are contractual rights which are personal to the tenant and do not create an interest in the land, and include, for example, exclusivity rights and rights of first offer to purchase the property.

Absent express language to the contrary in the lease or renewal documentation, personal rights and covenants that benefit the tenant under a lease cease to exist when a right to renew is exercised. A lease extension, however, automatically continues all personal rights under the lease agreement.

Tenants should be particularly mindful of this distinction, as inadvertently losing the

protections of an exclusivity provision, or the ability to purchase the property from the landlord, could be a very costly mistake. Conversely, landlords should be mindful of this difference, as they may be extending, unintentionally, benefits to the tenant that were to expire after the initial term of the lease.

(b) Continued Liability following Lease Assignment:

Another important distinction between a renewal and an extension arises in situations where the original tenant has assigned its interest in a lease agreement to a third party. In these circumstances, it is common for the original tenant to remain legally bound to the landlord for the performance of the new tenant's covenants and obligations in the lease. If, following the lease assignment, the new tenant extends the term of the lease agreement, the original tenant will continue to remain legally bound to the landlord for the tenant's obligations during such extended term.

However, if the new tenant exercises a right to renew, the renewal creates a new lease solely between the landlord and the new tenant. Accordingly, the original tenant is no longer liable for the performance of the covenants of the new tenant under the lease during the renewal term (unless all of the parties have expressly agreed otherwise).

Conclusion

During the negotiations of a lease agreement and during the renewals or extensions thereof, it is important for both tenant and landlord to consider the differences between an option to renew, and an option to extend, a lease agreement. Once the parties have agreed on an approach, whether such option is to renew or extend, express language with respect to which rights or liabilities are to continue during the additional lease term(s) is the most effective way to ensure the intentions of the parties are honoured.

If you have any questions or require further assistance with lease agreements, please do not hesitate to contact the writer directly at dcs@tdslaw.com or (204) 934-2335

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