

There Ain't No Such Thing as Free Rent

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Commercial tenants sometimes bargain for “free rent” periods from landlords as part of the lease negotiation process, and both tenants and landlords may view free rent periods as a “concession” by the landlord in lease negotiations. But is free rent really “free?”

An astute landlord will set the rental rate at an amount which allows the landlord to recover the so-called free rent by amortizing it over the term of the lease at some reasonable rate of return, so that the tenant is paying slightly higher rent during the months in which rent is actually paid. This puts the landlord in the same financial position at the end of the lease term that would be the case if there was no free rent period.

Consider also that a landlord’s offer to pay for tenant improvements or to give the tenant an improvement allowance should result in the same situation. The landlord will probably increase the rent over the term of the lease in order to recoup those costs.

A tenant who is offered a free rent period and/or a tenant improvement allowance should respond by asking the landlord what the monthly rent would be over the term of the lease if there was no such “concessions.” Presumably it would be less, which may be more attractive to the tenant.

If the lease contains an option to renew or extend the lease term, a tenant should consider that the amortized cost of the free rent and tenant improvement allowance is built into the rent for the initial term of the lease. Accordingly, should the tenant’s rental rate during the renewal or extension period include the same components again? If so, the tenant is overpaying the landlord for these concessions. Theoretically (and in an ideal world), those components have been paid back to the landlord by the end of the initial term of the lease, so the rental rate after that should be adjusted downward to account for that, before adjusting it upward to account for inflation and other market conditions. Obviously, it is a safe bet that the rent will not actually down after the initial term of the lease, but these are valid arguments for the tenant to make to the landlord in order to justify a claim that rental increases during a renewal or extension period should not be as great as the landlord may think are appropriate.

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