

# Commercial Leasing Bulletin:

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## Determining Rent When Renewing/Extending a Lease Term

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When a tenant is leasing commercial space, it may wish to reserve the right to secure its tenure beyond the initial term of the lease. Typically, this is achieved by the landlord providing the tenant with an option to renew or extend the lease (“Renewal Option”).

### Enforceability of Renewal Options

For a Renewal Option to be enforceable, it must provide for all essential terms being:

- (i) parties;
- (ii) the length of the term (“Renewal Term”);
- (iii) premises;
- (iv) rent (“Renewal Rent”); and
- (v) any other essential terms.

Failing agreement on those elements, the Renewal Option would be an “agreement to agree” and not enforceable.

Accordingly, to be enforceable, the Renewal Rent must be fixed or objectively ascertainable. To be ascertainable, it is common that the Renewal Rent, if not fixed, be based upon “fair market rent for comparable premises in the same market area as the leased premises to be agreed upon between the parties.” Note there are two elements, being (i) the “fair market rent”; and (ii) to be agreed upon between the parties.

Typically, such a Renewal Option provides that the lease would be renewed for a fixed term on the same terms as the lease (which would satisfy all of the requirements listed above except for the Renewal Rent).

If Renewal Rent is not fixed or objectively ascertainable, there is not an enforceable Renewal Option. An uncertain Renewal Option will not give the tenant an enforceable right to renew/extend

the lease, and will merely create the obligation on the landlord to negotiate a renewal/extension with the tenant in good faith.<sup>1</sup>

In addition to agreeing on the basis for ascertaining the amount of the Renewal Rent, what happens if the parties fail to agree on the amount of the Renewal Rent? Frequently, in cases where the Renewal Rent is not fixed, Renewal Options provide for the Renewal Rent to be determined by arbitration. Arbitration is time-consuming and costly. An alternative for relatively small premises is to have the Renewal Rent decided by an independent, third-party expert.

## Elements for Establishing Renewal Rent

There are two elements for establishing the Renewal Rent, being (i) the basis for determining the amount (e.g., market rate); and (ii) the method of determining such amount if the parties do not agree (e.g., arbitrator).

As an example, say that the parties agreed that the rent in the extension term will be fair market rent at the start of the extension term. But what is “fair market rent”? The landlord may claim \$20.00 per square foot is fair market rent and the tenant may claim, with competitive analysis, rent in similar space is \$5.00 per square foot. Ideally, they will meet somewhere in the middle before the term ends. However, sometimes they cannot reach an agreement on what price is fair market rent. If they cannot agree, they need to agree on who will set that price, such as a third-party expert.

As long as the parties have agreed upon the basis for establishing the Renewal Rent but have failed to agree upon the method of determining the same (such as arbitration or expert), it was, until recently, unclear as to how the Renewal Rent would be set. This called into question the enforceability of the Renewal Option.

We have long been of the opinion that a Renewal Option would be enforceable if (i) the basis for establishing the amount of the Renewal Rent was agreed to (such as market rate) but (ii) the method of determining the amount of the Renewal Rent was not agreed (who should set that rate failing an agreement between landlord and tenant). It was our view that a Court would either decide the amount of the Renewal Rent or delegate that authority to another Court officer or independent third party on a reference. Our speculation has now been confirmed by the recent Ontario Court of Appeal decision in [2501306 Ontario Inc. v. Country Garden Academy Inc.](#) (“Country Garden”).<sup>2</sup> This case confirmed that where (i) the basis for determining the amount of the Renewal Rent was agreed but (ii) the method for determining the same was not agreed, the Court would enforce the Renewal Option and would determine the Renewal Rent.

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<sup>1</sup> [Narwhal International Limited v. Teda International Realty Inc., 2021 ONCA 659.](#)

<sup>2</sup> [2501306 Ontario Inc. v. Country Garden Academy Inc., 2020 ONCA 177.](#)

## ***Country Garden Decision***

In *Country Garden*, the rental rate during the Renewal Term was “to be based on prevailing market rates at the time of renewal for comparable premises” and determined by negotiation between the parties no later than 90 days prior to the commencement of the Renewal Term. The clause did not outline what would occur if the Renewal Rent was not agreed to by the deadline. Following a dispute on fair market rent, the landlord applied to the Court under Rule 14.05(3)(d) of the *Rules of Civil Procedure (Ontario)* for a determination of the appropriate Renewal Rent payable by the tenant during the Renewal Term. The application was granted by the Court and confirmed by the Court of Appeal.

The application Judge determined the amount of the Renewal Rent based on expert evidence and the Court’s interpretation of “prevailing market rate” and “comparable premises”. The Court of Appeal upheld the determination of the application Judge and its method for determining Renewal Rent payable in the Renewal Term. In supporting the determination of the application Judge, the Court of Appeal summarized the lower court’s process as follows: “The application Judge’s decision concerning the Minimum Rent for the renewal period was based on evidence concerning the terms of the lease, the nature of the property and expert evidence concerning prevailing market rates for comparable premises.”<sup>3</sup>

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<sup>3</sup> *Ibid*, at para 19.



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