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Is "Fair Market Rent" Really that Fair?

By [David Fenrich](#)

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In most commercial leases, "Fair Market Rent" is the standard for the rent payable during a renewal period. While most leases provide some general guidelines for how to determine "Fair Market Rent", they typically do not set out exactly what is to be included or excluded in this determination. It goes with out saying that when the time comes for renewal, the landlord and tenant may have very different ideas on the amount of rent payable during a renewal term.



Most leases attempt to resolve this inherent problem by providing that if the landlord and tenant cannot reach an agreement, the matter will be referred to arbitration. While this sounds like a simple solution, arbitration can be both expensive and unpredictable, especially if the terms of the lease are vague and subject to different interpretations. [Fire Productions Ltd. v. Lauro](#), a recent decision from British Columbia Court of Appeal, is a good example of the risks for both the landlord and the tenant when "Fair Market Rent" is not clearly defined. This case also provides insight on how arbitrators and British Columbia courts will interpret the term "Fair Market Rent" in the future.

The facts in this case are straightforward. Fire Productions leased a 3,100 square foot premises to operate a restaurant and cabaret in Vancouver. The leased premises were in desperate need of improvement, which the tenant paid for and completed. The term of the Lease was renewed once with no concern. It was when the tenant exercised its second option to renew the term for five years that disagreement arose on the rent payable during the second renewal term. In accordance with the provisions of the lease, an arbitrator was appointed to resolve the dispute. At issue in these proceedings was the meaning of "Fair Market Rent".

The arbitrator held that "Fair Market Rent" was based on the value of the premises at the time of renewal, which included all improvements made to the premises by the Tenant. This was because the lease provided that all tenant improvements became the property of the landlord upon completion. The arbitrator set the annual rent payable during the second renewal term at \$19.00 per square foot.

The tenant appealed the arbitrator's decisions to the British Columbia Supreme Court, arguing that the rent should be based on the value of the leased premises, excluding the tenant improvements. The Supreme Court found this argument persuasive and

concluded that annual rent should only be \$13.66 per square foot, a significant reduction. The landlord then appealed to the British Columbia Court of Appeal.

The British Columbia Court of Appeal overturned the decision of the British Columbia Supreme Court and reinstated the decision of the arbitrator. In coming to this conclusion, the court held that use of the word "Market" could only mean that the rent to be paid during the renewal term was the rent that the premises would attract if exposed to the market at the time of the renewal. Thus, because the tenant's improvements became the property of the landlord on completion, it was proper that they were included in the calculation of "Fair Market Rent".

In this decision, the Court of Appeal is essentially saying that unless the lease contains some sort of qualification, "Fair Market Rent" means whatever the open market would pay for the leased premises in question at the time of renewal. It is an objective determination, that does not necessarily have to be "Fair" to the tenant or the landlord.

To get around the unpredictability of what "Fair Market Rent" will be at the time of renewal, it is paramount that the parties set out exactly what should be included in the calculation of "Fair Market Rent", and what should be excluded. For example, if the lease in [Fire Productions Ltd. v. Lauro](#) provided that "Fair Market Rent" would be on the basis of the premises being in the condition before tenant improvements, the arbitrator and the Court of Appeal likely would have set the rent at \$13.66 per square foot, rather than \$19 per square foot.

Clearly, at the time the lease was drafted, the landlord and tenant could have avoided the considerable cost of arbitration and appeals by putting their minds to what should be included in the determination of "Fair Market Rent" and then having this reflected in the lease.

-- [David Fenrich](#)



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