

COMMERCIAL RENTAL ISSUES

An Article by William A. Taylor One of the Business Lawyers

When last we spoke, I was entertaining on the subject of lease issues, taking no side (landlord or tenant) and providing some legal insights on five of the score of issues that separate landlord and tenant. That activity will be continued in this article, concentrating in brief on the following five issues.

Utilities and the Triple Net Lease Every landlord has a choice in regards to utilities, property taxes, common area maintenance. Either s/he can leave such items to the tenants to pay (a "net/net/net lease" otherwise known as a "triple net lease") or the landlord can raise the rents on new rentals to provide for such expenses and use that money to pay the expenses for the entire building.

For a variety of reasons, the landlord may want the tenants to pay all of the expenses of running the building, leaving to himself or herself only the capital expenses, e.g., roof replacement. In the case where the tenant pays, those tenants should concern themselves with the questions of what percentage of the whole is that tenant's square footage and what is that tenant's exact percent of a particular expense. A tenant's concern should be to not pay for some other tenant's portion of the expense. Additionally, if the building is not fully leased, the tenant should expect the landlord to pay the percentage of expense actually caused by the vacant premises.

The landlord, on the other hand, though not wanting to cheat tenants by misallocating expenses, may not want to open his/her books to prove to a requesting tenant that the percentage being applied is correct. The tenant does have the right to an inspection of certain information to assure accuracy in the allocation of percentages of the building.

Where the tenant is "miraculously" spared having to pay the expenses of running the building, its lease rates probably already contain the landlord's best estimate of the tenant's share of such expenses plus a profit. In a market that is not price-sensitive, a tenant would not be expected to notice the higher rent.

Subordination All leases longer than two pages have a paragraph entitled "subordination." The paragraph usually refers to the fact that a lease, aside from being a contract, is also evidence of the creation of an interest in real property. Interests in real property are able to be recorded, and such recordings have the capacity of "clouding" the title of the property owner. Most leases require the tenant to not record the lease on pain of default.

The contract aspect of a lease causes the tenant to promise to subordinate the lease, i.e., to sign any documents required to cause the priority of the lease to be less than, below or subordinate to any mortgages, deeds of trust or other real property interests that the land owner decides or is required to record. Since tenants can't be trusted to sign abstruse, fine-print legal documents at a landlord's immediate order while s/he is waiting, leases with subordination clauses usually give the landlord the right to be tenant's attorney-in-fact (similar to a specific power of attorney) to sign such documents for the tenant.

Insurance Policies Insurance is one thing that is consciously doubled-up on each tenancy. The tenant obviously has an insurable interest in the premises being rented. The tenant is probably the only person (entity) known to the customer/invitee (person invited to the leased premises to do business). However, the customer/invitee's lawyer is more interested in who is the property owner. Therefore, the landlord will also have an insurable interest in the same building.

The insurance policy of the landlord will have differences from that of the tenant, but in respect to the issues of premises liability, their interests will be approximately the same. The tenant's insurance policy will be required to name the landlord as "additionally insured," meaning that the tenant's insurance policy will actually indemnify (provide coverage for) the landlord as though the landlord had bought the policy. The landlord's policy, however, will not refer to the tenant.

The amount of coverage is an insurance issue that is partially determined by jury awards for certain incidents. Policies that contain million dollar coverage for each occurrence are to be expected.

Damage to the Premises In the event of fire or some other cause of destruction of the premises in whole or part, the landlord is worrying about the building, the tenant is worrying about the business and the rent requirement. Most leases require the landlord to determine quickly if the building is damaged in a percentage so great as to cancel the leases because of inability of repair the building within a reasonable time. Upon determination of a 50% or 60% loss, the tenant will be notified in writing that the lease will be prematurely terminated as of the date of loss of the building and no further rent will be due from tenant. The tenant had best find a new building.

A less destructive incident might cause the building to be shut down for repairs and be unavailable for tenant and occupy to do business. During that period of inaccessibility to the tenant, the rent requirement will be stopped. The issue of insurance then becomes important. If the damage is covered by landlord's insurance, the terms of the policy will control. If the damage is not covered, the tenant will usually have the right to make the repairs to landlord's building without expecting any reimbursement from the landlord. Such a situation arises when the specific location is required by an insured tenant and if the landlord is underinsured.

The condition of the premises prior to the damaging event becomes a prime concern during any repair and rebuilding. Having the premises inspected by a contractor or building inspector at the commencement of a lease term would provide the baseline standard up to which any repair would not be expected to exceed. However, such an inspection is seldom done. An "As Is" tenancy especially needs documentation of condition prior to the commencement of a tenancy. Otherwise, the repair will exceed the quality of the tenancy that was rented - all to the landlord's benefit.

Alterations In a discussion similar to that in the damages or destruction section (above), the issue of a tenant altering the leased building revolves around the fact that the landlord owns the building. In spite of the fact that all of the public might identify the building with the tenant's business, the tenant usually (by lease) has no right to alter the building in any significant way.

"Fixtures" is a legal term that refers to improvements by the tenant that are relatively permanently attached to the building being rented. The issue is who owns the attached improvement? If the improvement can be detached from the building and carted away by the retreating tenant or the tenant's creditors without significantly damaging the building, it will not be termed a fixture. If it does become a part of the building, because of the nature of its installation or its location, the improvement becomes a fixture and the tenant has made a gift to the landlord.

The detachment of any improvements from the building needs to be done as damage-free as possible. That fat security deposit, so painfully gathered when the lease was entered, is at stake. The landlord has a right to receive the building in as good a shape as when the tenant entered the premises, reasonable wear and tear excepted. Patching holes in the wall and minor painting of high-wear areas is advised to reduce arguments over security deposits.

In conclusion, this article only scratches the surface of the diametrically opposed positions of the landlord and tenant in leases. There are at least a score of such issues in each lease; this article and the one immediately preceding this, only lightly addressed ten. Please be informed.