

# COMMERCIAL RENTAL ISSUES

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

One problem with downtown Oakland is the scarcity of African American owners of office buildings and commercial buildings. That scarcity might speak to the relative wealth of the local black populace, or it might speak more toward the viability of the Oakland office and commercial real estate markets. For whatever combination of reasons, the overwhelming majority of black businesspeople who are occupants in Oakland buildings are renters (quite different downtown from forty years ago, when African Americans were not accepted as tenants).

Whether you are a landlord or a tenant, it is beneficial to have some basic knowledge of the financial and legal motivations of the other side. This article will briefly examine five issues (of the 30) that are addressed in typical office and commercial leases, to examine the same issue from the two perspectives of the landlord and the tenant.

**Power Plays** A basic understanding is that the entire lease negotiation is a test of power. The question is who wants the other the most. In a period of low vacancies, the landlord has the power and will attempt to dictate terms. In periods of high vacancies, the tenant has the leverage.

Other factors also come into play, the most important of which is "Location, Location, Location." However, location is relevant to the tenant if the public normally thinks of the tenant's type of business at that location, generally not an office located in a commercial strip or an attempt to locate a store in an industrial zone. If location is relevant, the landlord will have the advantage. Another location issue is the quality of the building for the intended use. Office buildings are rated "A" for a rather new multi-story office building that is thoroughly earthquakeed, through "B" for an older multi-story office building where age is the only fault, to "C" for a steel frame building that, although comfortable and quite functional, is old and was not designed with modern seismic retrofitting in mind. The closer to "A" the more to be paid per square foot.

In the tenant's favor on any building is the fact that the building is there to be used. Every month of unrented space is a loss to the owner - and to the management company that is being judged and paid by the owner.

**Parties** The tenant will want to incorporate or form a limited liability company (LLC) to be the tenant in the lease. That way the corporation (or LLC) will start to build a credit history for future use. The landlord, however, will want a warm body to be the tenant, and will least of all want a newly-formed corporation as a tenant because of its worthlessness in the event of a default. As the tenant argues in favor of the corporation, the tenant may be required to sign on the lease as a guarantor, with the corporation (or LLC) being the tenant. Alternatively, the landlord might allow the corporation to participate only if the human will join the transaction as a co-signer. Both ways, the corporation builds a credit history.

**Term** The tenant should beware of entering long leases. Ten years is a long time and should not be expected. The landlord, however, would benefit by "locking-in" a long term lease at high and increasing rental rates. That will allow the landlord to obtain more money from a sale or a refinance loan on the building; the philosophy being that a leased building is worth more than an empty one and long term leases are guaranteed future money that has a present day value.

Three years is about average (depending on the type of business), five years is common and tenant options to renew for the same or fewer years as the initial term is the norm. Beware on options that the landlord has no rights in the renewal process (that is, unless you are a landlord). If the lease's wording merely sounds like the lease may be renewed, the landlord will be empowered to veto the renewal. It is common for the amount of the rent to be left open for future agreement for the renewal period when the lease is first entered, the landlord not knowing how the market will be so far in the future and not wanting to be locked-in with a bad rate.

**Assignment and Subleasing** Most leases allow for assignments and subleasing with the landlord's consent "which will not be unreasonably withheld." The landlord has a very reasonable basis for withholding consent: economics. But first, the difference between assignment and subleasing is the difference between the tenant turning over to some new person all of the tenant's rights and obligations (an assignment) compared to giving the new person some of the tenant's rights (a sublease). In the sublease, the tenant actually becomes a landlord to the sublessee.

From the actual landlord's standpoint, however, this new person may not have the credit history of the actual tenant, or this new person may possibly intend to run a different type of business in the leased premises than that of the actual tenant. These two possibilities alone create risks for which the landlord had not bargained when the actual tenant's negotiations were underway. Therefore, it could be held to be unfair to allow the tenant to unilaterally subject the landlord to new risks without paying him/her with additional rent in compensation for such risks.

Although the landlord's hands are not tied if a richer new person with superior credit than the actual tenant or the same type of business is proposed, it does make it harder for the landlord to convince a court that s/he is being reasonable turning down the new person. However, an assignment being such a change in parties from the actual tenant who was before the landlord in negotiations, it might still be hard for the tenant assignor to prevail on the unreasonableness issue.

The conclusion: it is still the landlord's building and the act of leasing is an economic risk being taken. The tenant will not be allowed to change those risks unilaterally. However, the landlord will not be allowed to unreasonably ossify the rental relationship.

**Default** The term "default" has a distinct legal meaning that should be described in the lease. A default is not necessarily a late payment; it might not be doing something that is forbidden in the lease. However, after a period to cure and after notices that might be required in the lease for the landlord to give the tenant in writing, a default can be declared if the violation is not "cured" within the period specified in the lease. No notice is usually needed to inform the tenant that the cure period has elapsed.

Upon default, the landlord can exercise the legal procedures to get rid of (evict) the tenant. However, no matter how blatant the default, the landlord has no right to physically evict a tenant. The county sheriff's department is organized to be the strong arm of the landlord. However, these two paragraphs only scratch the surface on default, especially on default in rent payments. It doesn't even attempt to be authoritative.

In conclusion, this whole article only scratches the surface of the diametrically opposed positions of landlord and tenant in leases. There will be more later. However, nothing is adequate short of hiring an attorney to work with the landlord or tenant, but not both simultaneously.