

# COMMERCIAL LEASING

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SMALL BUSINESS  
DEVELOPMENT PROJECT –  
BET TZEDEK

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- The following information is intended to assist in spotting legal issues relevant to small businesses in the State of California. There are many factors to be considered in determining which actions and decisions would be most appropriate to any specific situation. This presentation only discusses some of the more important factors. It is not intended to substitute for legal advice.
  - The attorney presenting today are not providing legal advice or entering into an attorney-client relationship with any attendee. We are here to provide information only, and nothing said during this presentation is confidential. You should decide which course of action is best after discussing it thoroughly with an attorney.

# TOPICS TO BE COVERED

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1. Commercial Leasing Overview
2. Key Terms of a Lease
3. Commercial Leasing and COVID-19



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# PART ONE: COMMERCIAL LEASING OVERVIEW



# COMMERCIAL LEASING OVERVIEW: COMMERCIAL VERSUS RESIDENTIAL LEASES

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- Commercial
  - Uses include retail, office or industrial leases
  - A commercial tenant's rights are governed almost entirely by the lease
- Residential
  - Use is just for residential purposes
  - Residential tenants enjoy significant protections under law
    - E.g. The right to have repairs made by the landlord and requiring the landlord to provide heat
- All leases should be in writing
- Residential tenants are afforded different protections under law than commercial tenants, including different protections under the COVID-19 regulations
- Today's presentation will focus on commercial leases

# COMMERCIAL LEASING OVERVIEW: ORDER OF EVENTS

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1. Consult a Professional
2. Identify Space
3. Submit an offer (aka letter of intent) to lease the space
4. Negotiate and enter into a lease



# COMMERCIAL LEASING OVERVIEW: CONSULT A PROFESSIONAL

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- Real Estate Broker
- Attorney
- Insurance Broker



# COMMERCIAL LEASING OVERVIEW: IDENTIFY SPACE

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- Identify space needs for your use
  - Size
  - Location
  - Timing
  - Budget
  - Parking
  - Other Amenities such as gym





# COMMERCIAL LEASING OVERVIEW: LETTER OF INTENT/TERM SHEET

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- Many times landlords and tenants negotiate key business terms through a letter of intent. The letter of intent is a non-binding agreement.
- Some Basic Business Terms Include:
  - Rent (and rent abatements)
  - Length of Lease Term
  - Premises
  - Condition of the Premises (e.g. as-is)
  - Any tenant improvement allowances
  - Options to Renew
  - Security Deposit

# COMMERCIAL LEASING OVERVIEW: TENANT ENTITY

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- Type of Business Entity: Sole Proprietorship, Partnership, Corporation, Limited Liability Company
- Impact on Exit Strategy: This may impact the exit strategy by insulating the business from personal liability and by making it easier to sell the business
- Creditworthiness of the Tenant Entity: Note that the landlord may require a lease guaranty based on this query

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# PART TWO: KEY TERMS OF A LEASE



# KEY TERMS OF A LEASE: BASIC TERMS

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- Lease Term (and any renewal thereof)
- Permitted Use
- Rent
- Security Deposit
- Repair and Maintenance Obligations
- Insurance
- Alterations
- Signage
- Continuous Use Covenants
- Assignment and Subletting Rights
- Default
- Surrender

# KEY TERMS OF A LEASE: TERM OF LEASE & PERMITTED USE

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- Initial Term/Renewal Option
  - Start-up business may want a shorter initial term with renewal options to allow for an easier exit
  - Renewal options allow flexibility and limit obligations if a business fails
  - Under a renewal option period, there will be a timeframe on when a tenant can exercise its election
  - Think about option rent – it is typically either FMV or continued rent increases
- Permitted Use
  - Landlords often limit use of the space to a very specific purpose — this can be fatal to an exit strategy
  - Tenants should keep the permitted use general to allow for (1) a change in the business model (e.g. in case of a COVID-19 lockdown), or (2) sublet or assignment to a variety of businesses
  - If a tenant's use requires professional certifications and licenses then landlords will want evidence of these (e.g. therapy licensees/certifications)

# KEY TERMS OF A LEASE: RENT

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- Fixed Rent
  - Typically due at the beginning of each month
  - Tenants can negotiate for an abatement of rent
  - Typically first month's rent is due at lease execution
  - Rent can be structured in 2 ways:  
Gross vs. NNN
    - NNN: Operating Expenses, Taxes, & Insurance
- Other: Percentage Rent
- Additional Rent
  - Operating Expenses, Taxes, Insurance
    - Operating Expenses: e.g. maintenance of common areas
    - Taxes: e.g. property taxes
    - Landlord's insurance: e.g. general commercial liability
    - Where there is more than one tenant in the center/building, Tenant pays Tenant's share of these costs
  - Utilities
    - Separately Metered
    - Common Share
  - Additional Services
    - Overtime HVAC (hours of operation)
    - Janitorial/cleaning services

# KEY TERMS OF A LEASE: SECURITY DEPOSIT

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- Can either be a cash deposit or in the form of a letter of credit
- A cash deposit is typically 1-2 months rent
- Typically due at lease execution
- Tenants can negotiate a reduction in the security deposit during the term
- If any rent is overdue, Landlord can deduct the overdue amount from the security deposit
- If used, landlord can require tenant to restore the security deposit.
- Tenants typically waive California Civil Code 1950.7 which provides that if a security deposit in a commercial lease exceeds the first and last month's rent and is used to cover only defaults in the payment of rent, the portion of the deposit in excess of the amount equal to one month's rent shall be returned to the tenant within two weeks after the landlord receives possession of the premises with the remainder to be returned or accounted for within thirty days after the landlord receives possession of the premises

# KEY TERMS OF A LEASE: BUILD OUT OF SPACE

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Typically, landlords lease the space out to tenants in an “as-is” condition. This means that a tenant takes the space in the condition the space is as of the execution of the lease. Tenants should ensure that landlord delivers the space free and clear of any prior tenants and prior tenant’s personal property.

## **Tenant’s Work**

- A tenant can then do its own build-out of the space subject to landlord’s approval and applicable law.
- Typically, tenants pay for this work. However, tenants can negotiate an allowance from landlord for this work.
- Tenants can negotiate a separate, later rent commencement date to give them time to build out the space without paying rent.

## **Landlord’s Work**

- In some circumstances, and if negotiated, a landlord agrees to do the work to get the space ready for tenant.
- This is typically paid for by landlord.
- The timing of completion is important - ideal for landlord to have this work completed before tenant moves in/the commencement date.
- Landlord may carve out a tenant delay, meaning if landlord is delayed in completing the work and therefore delayed in delivering the space to tenant, and the delay is but for tenant’s delay (e.g. if tenant has approval rights), then landlord is not penalized for the delay.



# KEY TERMS OF A LEASE: REPAIRS AND MAINTENANCE

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- There is no “implied” duty to repair in commercial leases; it must be written
- Tenant is typically responsible to maintain its premises – and in a restaurant context landlords will require tenants to maintain the premises up to health code and maintain grease traps etc.
- Landlords typically responsible to maintain and repair the structure of the building (including the foundation and roof), building systems, lobby and common areas
- Tenants can try to minimize business interferences by requiring repairs to be made after hours
- Tenants can request rent abatements and/or termination rights for circumstances in which the landlord fails to repair or maintain the premises for an extended period of time



# KEY TERMS OF A LEASE: TENANT'S INSURANCE

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- The lease will require, at minimum, coverage for casualty (property damage) and liability (damage to persons or property of others)
- Ask your insurance agent to review the insurance provisions in the lease and to regularly review the policy to ensure compliance
- Obtain a certificate of insurance as proof of the current coverage (and do not allow coverage to lapse)
- Make sure any additional insureds are covered (e.g. landlord)



# KEY TERMS OF A LEASE: ALTERATIONS

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- Alterations are improvements tenant makes to the premises during the lease term after the initial improvements/build out of the space
- Landlords typically want consent rights
- As a tenant, consider negotiating for no landlord consent when an alteration is cosmetic in nature and small in value.

# KEY TERMS OF A LEASE: SIGNAGE

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- Businesses must have the right to use interior and exterior signs
- Typically landlords have consent rights over exterior signage
- Signage restrictions may hinder the types of use or exit strategy
- If there is an exterior sign or awning, make sure that the landlord cannot erect scaffolding or otherwise cover it for an extended period of time
- Note that landlord may require tenant to remove its signage upon expiration of the term of lease so budget for this!

# KEY TERMS OF A LEASE: OPERATING/CONTINUOUS USE COVENANT

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- A continuous use covenant requires a business to remain open
- Covenant typically in retail shopping centers
- Be weary if your business shuts down at certain times of the year
- If you operate a seasonal business, specify when the business is allowed to close
- If the landlord insists upon a continuous use covenant, a tenant should carve out exceptions for closure for events like renovations, casualty, or inventory count

# KEY TERMS OF A LEASE: SUBLEASE AND ASSIGNMENT

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- Useful as an exit strategy to get out of the lease or permit someone else to use the space
- Landlords typically have consent rights over who tenant can sublease the space/assign the lease to
- Things a tenant can negotiate for:
  - No landlord consent in the event of a transfer to an affiliate under common control as the original tenant or a transfer to a franchisee or a merger, consolidation, or reorganization of the tenant
  - If landlord has a net worth test as condition of landlord's consent, limit this
  - Limit the ability of landlord to share in profits (i.e. transfer premium) and make sure you get your costs back
  - Replace the old guarantor for a new guarantor in the event of a sublet or assignment
- Some landlords negotiate for a recapture right. This typically means that a landlord can take the space back and terminate the lease upon tenant's request to sublease/assign. This may be a good thing for a tenant trying to exit!

# KEY TERMS OF A LEASE: DEFAULT

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## Tenant Default

- Notice of Default and Cure Period
  - Monetary Default (failure to pay rent)
  - Non-Monetary Default (failure to perform obligation)
- Landlord Remedies
  - Application of the Security Deposit
  - Landlord Self-Help
  - Terminate the Lease and Sue for Damages
  - Re-let the Premises and Collect Leasing Costs and Deficiency
  - Keep the Lease in Place and Sue for Full Rent When Due (Civil Code 1951.4)
  - Landlord May Sue Guarantor for Damages
- Tenants want to avoid Accelerated Rent
- Include Waiver of Consequential Damages

## Landlord Default

- A tenant can negotiate for interruption of services
- A tenant can negotiate for rent abatement
- There is no warranty of habitability in commercial leases
- Tenant Self-Help Rights
- Other Remedies
  - Suit Against Landlord
  - Claim for Constructive Eviction

# KEY TERMS OF A LEASE: SURRENDER

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- Removal Obligations: What can a tenant take with it upon expiration or earlier termination of the lease term? Usually a tenant is entitled to take its personal property (movable personal property like tables and chairs, massage beds) and trade fixtures. Fixtures (e.g. bar counters, fixed tables, cash registers) typically become landlord's property. Tenants should specify what items it wants to take with it upon expiration of the lease to avoid any confusion!
- Does the tenant need to remove its signage?
- What happens if the tenant does not surrender and vacate the premises in time? This triggers the holdover provision, which typically is a higher amount of rent from the period that tenant is holding over in the premises until tenant vacates.
- What happens if a tenant leaves the premises without its personal property? The personal property may be considered abandoned and sometimes a landlord can dispose of it at the tenant's cost.
- Surrender obligations may get costly so know your surrender obligations before entering into a lease!



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# PART THREE: COMMERCIAL LEASING AND COVID-19



# COMMERCIAL LEASING AND COVID-19: CERTAIN RELATED PROVISIONS/DOCTRINES

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- **Force Majeure:** relieves the parties from performing their contractual obligations when certain circumstances beyond their control arise, making performance inadvisable, commercially impracticable, illegal, or impossible.
  - Tenants should negotiate adding a Force Majeure provision that (1) does not carve out non-payment of rent, and (2) includes key terms like “pandemic,” “COVID-19,” “acts of God” . . . etc.
- **Casualty:** prevailing view is the pandemic is not a casualty but rather a single incident like fire
- **Condemnation:** the acquisition or taking by a public entity of private property for a public purpose; an argument for tenant when government mandated shutdowns for non-essential business
- Both of the below doctrines allow for the argument that a default is excusable under circumstances that were unforeseeable to the parties at the time of the contract's formation.
  - **Doctrine of Impossibility:** looks at whether the underlying action to be performed in a contract was possible under the circumstances
  - **Frustration of Purpose:** analyzes whether the parties can achieve the stated or implied purpose of the contract

# COMMERCIAL LEASING AND COVID-19: LA COUNTY TENANT PROTECTIONS RESOLUTION

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- Tenant Protections Resolution (formerly the LA County Eviction Moratorium): effective March 4, 2020, through **December 31, 2022**, unless repealed or further extended by the Los Angeles County Board of Supervisors and extends certain protections to residential and commercial Tenants affected by the COVID-19 pandemic in Los Angeles County.
- **As of February 1, 2022**, commercial tenants are no longer protected from eviction due to **nonpayment of rent**.
- Commercial tenants will have the following time to repay past due rent from March 2020-January 2022:
  - Twelve (12) months for those with 0-9 employees
  - Six (6) months for those with 10-100 employees
- Tenants with 9 or fewer employees: Prohibiting enforcement of personal guarantees for rent incurred on or before 1/31/22

# COMMERCIAL LEASING AND COVID-19: CITY OF LA EVICTION MORATORIUM

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The City of Los Angeles enacted Ordinance Nos. 186606 & 186585 providing commercial tenants with specific protections:

- **Main Protection**: During the period beginning on March 4, 2020 to three months after the end of the local emergency as declared by the Mayor of LA, no evictions for non-payment of rent during the period beginning on March 4, 2020 to the end of the local emergency as declared by the Mayor of LA if the **inability to pay rent is due to circumstances related to the COVID-19 pandemic**, including:
  - Loss of business income due to a COVID-19 related workplace closure;
  - Child care expenditures due to school closures;
  - COVID-19 related health care expenses; and
  - Reasonable expenditures that stem from government-ordered emergency measures.
- **Applicability**: Applies to commercial leaseholds located in the City of Los Angeles except for commercial real property leased by a multi-national company, a publicly traded company, or a company that employs more than 500 employees.
- **Rent Deferral NOT Rent Abatement**: Tenants shall have up to three months following the expiration of the Local Emergency Period to repay any rent deferred during the Local Emergency Period.
- **No landlord shall charge interest or a late fee for such unpaid rent due to circumstances relate to COVID-19.**

# Q&A

## GOOD LUCK AND STAY STAFE!

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Thank you

