

COMMERCIAL
REAL
ESTATE

REVIEW

August 28 to September 1, 1999

AN IRVINE SPECTRUM NEWS
ADVERTISING SUPPLEMENT

Tenants Rights in a Lease

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In this article we have taken four topics, common to commercial real estate leases and briefly described either a) rights that a tenant typically has in relation to the landlord or b) suggestions you may wish to make on behalf of your tenant client. Because this synopsis cannot address the intricacies of your specific transaction and lease law varies between states, we recommend that you consult with legal counsel before making a binding commitment.

Offset Rights - If a landlord does not perform his obligations in the agreement, can the tenant perform the obligations and if credit any cost incurred against rent due under the lease? Can the tenant cancel the lease? The ability, perceived or real, for the tenant to utilize it's rights to "self help" in this circum-

stance is one of the greatest threats to a landlord. Even if the tenant does not have the contractual rights to self help, he will often have a difficult task of convincing a judge of his case against the tenant if the landlord has not complied with his obligations.

Unlike contract law, which usually states that one party does not have to perform under the agreement if the other party does not perform, most states have said that the parties must abide by the terms outlined in the lease. In most area of the U.S. where residential tenants have been provided self help rights, those rights have not been extended to commercial leases. If commercial tenants are not provided with these rights, what can they do if their landlord does not fulfill his obligations? In some states, the courts have said that if the landlord is not meeting his commitments, that he has effectively evicted the tenant. This allows the tenant to be relieved from the

lease and move elsewhere. If the tenant stays in possession, he must pay rent. This does not help much for those tenants that would incur great expense in a relocation or just do not wish to move.

Some states have allowed "self help" provisions. If you want the tenant to have greater recourse in this type of circumstance, clearly state in the lease that the tenant has the right to fulfill the landlords obligations if they are not met within an agreed upon time frame in according in an acceptable manner. We suggest that the lease specifically state that the tenant's obligation to pay rent is a covenant dependant (among other things) upon the landlord's permitting the tenant quaint enjoyment of the premises.

Capital Expenditures - On occasion, near the end of the lease term, the landlord may notify the tenant that he plans to make modifications to the property as is allowed in the

agreement. The lease will often allow, or even require, that the landlord maintain the roof, building exterior, parking lot and common areas. What is stated to be routine maintenance is often a thinly veiled excuse to renovate the property, at the tenant's expense, so that the building is attractive to prospective tenants after the existing term expires. Landlord's that have re-roofed, re-painted the building, re-surfaced the parking lot, or renovated the landscaping and subsequently billed the departing tenant for the cost, have motivated the revision of many leases around the country during the last few years. A tenant's advisor can help mitigate this dilemma by including language that spreads out the obligation to pay for these expenses over the expected useful life of each upgrade. Sample language you may wish to include in your document is as follows... "_____."

□ **RIGHTS**, see page A11

□ **Rights**, from A10

What if the capital expenditure is government mandated? If they are due to a specific use of the tenant, typically the entire cost is borne by the tenant (you can always attempt to have the landlord pay for the share of the cost that is equal to the percentage of the improvement that is likely to have reversionary value to the landlord). Usually these requirements are not due to a specific use, but instead are for items such as compliance with the ADA (i.e. elevator installation), natural hazard mitigation (i.e. seismic modifications), energy efficiency, etc. Rather than attempting to place the entire cost on the landlord, sharing the cost burden in the same fashion as in the paragraph above is a good alternative. If these mandated upgrades are near the end of the term, the landlord should have the right to terminate the agreement if the cost is too burdensome and the tenant should have the right to a) terminate the lease if the landlord does not pay his share or b) pay for landlord's share and offset that cost against rent due. A similar approach can be used with other cost sharing issues such as the remediation of environmental contamination that is not caused by either party or damage due to natural hazards (i.e. ice storms, earthquakes, wind, etc.)

Right of 1st Refusal - Typically tenants will want a right to either acquire the property

or take additional space during the term. As a rule, the first right is entirely in the tenant's favor as it limits the landlord's ability to sell or relocate tenant's with the property. Often, it will take a concession of this type to secure the tenant and so the provision is given. The most critical item is that the language be precisely constructed to mitigate misunderstanding. The tenant should attempt to obtain an "ongoing" right of first refusal which will provide the alternative throughout the term. If the right is "one time" the tenant may face an opportunity to purchase or expand early in the term when he or she is still getting established in the property and may not have the need to grow or the capacity to buy. If the tenant is limited to the one occasion, it defeats the intended purpose of the right. As first right provisions typically require the tenant to pay a fair market rate or price, the landlord is not clearly harmed (constrained yes) by providing the right throughout the term.

In addition, be clear as to the party that has the first right. It may be that the tenant is on the lease, the tenant is the logical party to want the expansion right, but it is the principals in the company that often would elect to buy the property and to be on title, not the tenant's business. As an owner of a business obtaining a first right, address before the lease how the rights would be effected if your partnership dissolved and the company remained, there was a divorce, etc.

In rights to purchase, landlord's typically

must fully negotiate the terms to a sale, then provide notice of the terms to the tenant, provide a period for the tenant to match those terms (typically 1-3 weeks) and if the tenant does not respond within the allotted period, the landlord may proceed with the initial sale. With expansion, the landlord should notify the tenant at least 30 days in advance of the pending availability of t

SNDA's - Tenant's on occasion request and receive a Subordination, Non Disturbance and Attornment agreement from the landlord's lender, in the hope that the tenant's lease will not be voided in the event of foreclosure on the property. Each state differs in its handling of this issue, but California uses a "race notice" system which establishes priorities between interests in real estate. Typically, the party which attaches first in time takes priority over later attaching interests (so long as the later attaching interests have notice of the prior interest). In this system, the foreclosure of a senior deed of trust can terminate junior interests (i.e. a lease agreement) in the property.

Is a lease automatically extinguished when a) the lease is executed after the deed of trust was placed against the property (which is typical with property encumbered with a loan), even though the tenant was successful in obtaining an attornment provision and b) the deed of trust was subsequently foreclosed upon by the property's lender. Can the lender in that circumstance void the lease

even if the tenant is in full compliance of all terms with his or her agreement?

In California, a 1997 decision in the case of *Miscione v. Barton Development Company* held that the lease was not extinguished. Because a) the attornment provision was in the agreement and b) following the foreclosure, the foreclosure purchaser accepted rent from the tenant, the court held that the attornment provision overrode the priority of the deed of trust. The Court held that the Attornment provision had the same effect as a subordination clause.

While obtaining a SNDA from the property lender as a part of your lease agreement may be time consuming and is often difficult, the existence of a SNDA in your contract can provide a good degree of comfort to the tenant that he or she may be able to retain quiet enjoyment of the property for the duration of the term, so long as the tenant complies with the obligations of the lease,regardless of a change of ownership. * Remember that a change in title may result in a change in the assessed value of the property and the corresponding property tax obligation, in some states.

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