



## GUIDE TO COMMERCIAL LEASES



**This publication provides general guidance only and should not be construed as legal advice.** The law on the topics discussed in this publication is highly context-specific. If your organization needs legal assistance, or if you have further questions about these topics, please contact Public Counsel's **Community Development Project** at (213) 385- 2977, ext. 200. The Community Development Project builds strong foundations for healthy, vibrant and economically stable communities through its comprehensive legal and capacity building services for nonprofits that assist low income neighborhoods in Los Angeles County. [www.publiccounsel.org/practice\\_areas/community\\_development](http://www.publiccounsel.org/practice_areas/community_development).

## Table of Contents

I. INTRODUCTION AND PRACTICAL TIPS .....	1
II. THE BASICS OF A COMMERCIAL LEASE .....	1
III. TYPES OF COMMERCIAL LEASES .....	1
a. Net.....	1
b. Gross .....	2
IV. HOW TO ACQUIRE A COMMERCIAL LEASE .....	2
V. TERMS OF COMMERCIAL LEASES .....	3
a. Basic Terms .....	3
b. Additional Terms .....	5
i. Late Payments .....	5
ii. Assignment and Subletting .....	5
iii. Use Clauses.....	5
iv. Security Deposits .....	6
v. Legal Requirements .....	6
vi. Common Areas .....	6
vii. Repairs and Maintenance.....	7
viii. Insurance.....	8
ix. Defaults and Remedies .....	8
x. Eviction.....	9
xi. Landlord’s Obligations .....	9
xii. Indemnification and Exculpation.....	10
xiii. Surrender and Holding Over.....	10
xiv. Alterations to the Leased Property.....	11
xv. Attorneys’ Fees .....	11
xvi. Entry by Landlord.....	11
xvii. Tax Consequences of Leases .....	11
xviii. Estoppel Certificate .....	12
xix. Subordination, Nondisturbance, and Attornment (“SNDA”) .....	12
xx. Guaranty.....	13
xxi. ADA Disclosure.....	13
xxii. Parking.....	13

## I. Introduction and Practical Tips

The Guide contains a general introduction to the typical provisions in a lease of commercial space and discusses issues that a business or nonprofit organization should consider when entering into a lease of space for use in its business or nonprofit activities.

When entering into a lease, a tenant should keep in mind the issues discussed in this Guide and remember the following general practice tips:

- Virtually every part of a commercial lease is negotiable and is usually dependent on market conditions. A tenant should keep this in mind when negotiating its lease and should not be afraid to ask for what it wants regarding every term that is important to the tenant.
- The lease should be read completely from front to back. While often long, the written terms of the lease control the agreement. The terms can come back to haunt a tenant if the tenant has not completely read and fully understood the lease contents.
- A tenant should always make sure the person the tenant thinks owns the property does in fact own the property. If necessary, the county records can be consulted to verify ownership.

## II. The Basics of a Commercial Lease

A commercial lease is a written, detailed agreement between (i) a person or entity (i.e., a sole proprietorship, partnership, corporation, limited liability company, trust, etc.) that rents a property and (ii) the property's owner. The owner is referred to as the **landlord** or **lessor** and the renter as the **tenant** or **lessee**. The lease describes and controls the rights and obligations of the landlord and the tenant. During the time in which the lease is in effect (the **lease term**), the landlord is transferring an interest in the leased property to the tenant. This interest allows the tenant to have possession of the property for the lease term, while the landlord retains legal ownership (or **title**) to the property.

The lease should clearly describe the property, also referred to as the **premises**, so that the landlord and the tenant are certain that they have entered into a lease relating to the same piece of property. If the property is not described in the lease, or if the property cannot be determined from the description in the lease, the lease will probably be legally invalid and therefore ineffective. The tenant should also decide on and specifically include in the lease any additional rights that he or she will need (e.g., storage space, parking).

## III. Types of Commercial Leases

Commercial leases may be categorized by their payment terms. There are two basic categories of payment terms:

- a. **Net:** Under a net lease, not only does the tenant pay the agreed-upon fixed amount of rent, but the tenant also pays (or reimburses the landlord for) some of the costs associated with owning the property, generally consisting of three categories: taxes,

insurance and maintenance. (When all three of these categories are included in the tenant's obligations, the lease may be referred to as a **triple-net lease**, or **NNN lease** – the three N's referring to the three general categories of expenses.)

- b. **Gross:** Under a gross lease, the tenant pays the agreed-upon rent, and the landlord is responsible for the costs associated with owning the property.

An easy way to remember the difference between these two categories is to think in terms of how the landlord views the rent being collected from the tenant. If it's a net lease, the rent is net to the landlord. In theory, the landlord keeps all of that rent. If it's a gross lease, the rent is gross to the landlord. From the rent, the landlord must pay its costs of owning the property, and the landlord only gets to keep what's left over.

True gross leases are relatively rare in commercial leasing. (Gross leases are much more frequently utilized in the residential context.) However, many commercial leases are nevertheless characterized as **gross** because they do contain some elements of a gross lease. These leases may be further identified as **modified gross** or **base year** leases. In that type of lease, the landlord is responsible for the costs of owning the property during the initial part of the lease term – usually the first (or **base**) year – and the tenant only pays a portion of the amount by which those costs over time exceed the costs applicable to the base year. Therefore, as the operating costs of the property increase, the tenant in a base year lease will be responsible for paying its share of such increases.

There are other ways in which the lease may have aspects of both net and gross leases. For example, a lease may obligate the tenant to pay its share of only one or two categories of expenses. These leases are sometimes referred to as **modified net** or simply **net** (as distinguished from **triple net**) leases.

Because these provisions have material economic significance, it is important to understand what is and isn't intended to be included in the tenant's financial obligations when terms like **net** and **gross** are being bandied about.

#### IV. How to Acquire a Commercial Lease

Commercial properties for lease are usually found through real estate listings and commercial property brokers.

A broker will represent at least one of the parties to a commercial lease, and he or she receives a commission for bringing the parties together and assisting in the lease transaction. That commission is typically paid by the landlord. It is not necessary that a tenant use a broker, but his or her expertise in the market may be helpful. Sometimes a broker will seek to represent both parties in a lease transaction. Neither party has to agree to such an arrangement, as the broker will have inherent conflicts of interest when representing both sides of a transaction. In other words, the broker will be juggling the competing interests of both the landlord and the tenant, as terms that are favorable to the tenant may not be favorable to the landlord, and vice versa. Such competing interests are further described in this publication.

Research (or *due diligence*) is just as important for someone seeking to lease a property as it is for someone seeking to buy a property, such as a house or land. Either before or during the negotiation of the lease, the tenant should investigate the property to make certain that it is suitable for the tenant's needs. In addition to independently confirming that the landlord does in fact own the property, the tenant should also, at a minimum, confirm (i) that the roof is in acceptable condition, (ii) that the property's building systems are in acceptable operating condition, and (iii) that the tenant's use complies with the property's zoning requirements. The tenant should also confirm that the information the landlord and the broker have provided is accurate. A tenant should not rely on oral promises or representations, as lease agreements often provide that only written representations and disclosures may be relied upon.

Before entering into a lease, the parties usually negotiate a *letter of intent* (sometimes referred to as a *lease proposal* or a *term sheet*). The letter of intent identifies the basic terms of the transaction before the parties begin spending time and money negotiating the details of the actual lease. These terms will include, among other things, the identities of the landlord and the tenant, the premises, the length of the lease, the rent to be paid (including whether that rent is net or gross or some variation of the two), the permitted use of the premises, and the security deposit, if applicable. After the parties have finalized the letter of intent, one party (usually the landlord) prepares an initial draft of the lease. Most letters of intent include a provision that states the terms of the letter are not binding on the landlord and the tenant, so even though both parties may have signed the letter of intent, they are usually not bound to one another until an actual lease is signed.

## V. Terms of Commercial Leases

### a. Basic Terms

Two of the most basic provisions to be negotiated in any lease are the *term* (the length of time for the lease) and the *rent*. The tenant's payment of rent in exchange for use of the commercial property is the essence of the landlord-tenant relationship. Rent is the *consideration* (something given in exchange for something else) that the tenant pays for the right to use the landlord's property during the term of the lease.

Rent is usually money that the tenant pays the landlord. The lease must set forth either the amount of rent due or a formula by which rent is to be calculated. Although there are many varieties of rent, they usually fall into one of the following three categories: (1) *base rent* (in certain types of leases, sometimes referred to as *minimum rent*), which is the monthly payment of a fixed amount by the tenant; (2) *additional rent*, which is usually comprised of the tenant's contribution toward the cost of operating the property and is frequently not a fixed amount; and (3) *percentage rent* (found in some retail leases), which is the landlord's right to receive a portion of the tenant's sales or profit arising from the lease of the premises. The lease may provide for one or more of these categories of rent. The base rent provision should be as simple and unambiguous as possible. Landlords will typically include a provision in the lease that increases the base rent during the lease term to keep pace with inflation or rising market conditions.

Provisions dealing with the term of a lease should include the date the tenant can take possession of the property, the date the tenant must begin payment of rent, and the date the tenant must return possession to the landlord. Some leases will provide the tenant with one or more options to extend the term of the lease and, if so, will identify the deadline for delivering notice of the tenant's exercise of each such option. These deadlines are critical, as a failure to timely provide notice will usually constitute a forfeiture of the option and prevent the tenant from extending the term.

There are various pros and cons to be considered when determining whether the term of the lease should be short or long. Short-term leases work well for tenants who only need the property for a limited period of time or who are just starting out their businesses and are not sure whether they will succeed. A short-term lease also gives the tenant an opportunity to renegotiate more favorable terms if market conditions change in favor of tenants (lower rent, more beneficial clauses, etc.). However, the tenant has no assurance that the landlord will make the property available to the tenant at the end of the term. For that matter, there is the possibility that market conditions will have changed in favor of landlords. Long-term leases ensure the availability of the property and provide some certainty, but they involve commitment on the part of the tenant to the longer term. (The use of options to extend the term can sometimes help bridge the gap.) Each situation will be different and will need to be evaluated carefully.

Another key provision is the condition the premises are to be in when the tenant takes possession. Sometimes property is leased in its *as-is* condition. That means the tenant either uses the property the way it is or takes responsibility for making the changes necessary for the property to be used. (These changes are referred to as *leasehold improvements*.) Other leases may provide for the landlord to make those improvements before delivering possession of the property to the tenant, either at the expense of the tenant or the landlord. If the landlord undertakes responsibility for making the leasehold improvements at its entire expense that is frequently referred to as a *turn-key* lease. Sometimes the cost of the improvements to be performed by the landlord will be shared by the tenant and the landlord, with the landlord providing what is known as an *allowance* and the tenant paying the cost over the allowance. The terms governing construction of the leasehold improvements may be embedded in the lease itself, but are more typically incorporated in an attachment to the lease referred to as a *work letter* or *tenant improvement agreement*.

If the landlord is performing the leasehold improvements at the tenant's expense – whether the entire expense or only the expense in excess of an allowance – it is important to make sure that the lease gives the tenant some ability to approve that expense in advance and, if necessary, to adjust the plans to cause the work to conform to the tenant's budget. If the tenant will be performing the leasehold improvements, the date that the tenant must begin payment of rent is especially important for the tenant as the tenant must ensure that any construction it needs to perform is timely completed and the tenant is ready to open for business once its obligations to pay rent begin. Otherwise, the tenant could find itself paying rent before it can even use the property. Therefore, tenants will often carefully estimate how long it will take them to construct necessary leasehold improvements and negotiate a period of time in which the tenant can access the property to complete the leasehold improvements before its obligations to pay rent begin.

## **b. Additional Terms**

### **i. Late Payments**

Most commercial leases contain late charge and interest clauses that apply when a tenant fails to make rent payments on time. Such clauses compensate the landlord for late rent payments without requiring the termination of the lease. Tenants are often able to negotiate a grace period or, even better, the right to notice and a grace period before the imposition of a late charge.

### **ii. Assignment and Subletting**

The tenant's interest in a commercial lease is the tenant's right to possess the property. A *sublease* is the tenant's transfer of less than the entire interest it owns in the property, while an *assignment* is a transfer of the tenant's entire interest. In the case of a sublease, the tenant allows another (the *subtenant*) to occupy some or all of the property. The subtenant pays rent to the tenant, and the tenant pays rent to the landlord. If the subtenant breaches the sublease, the tenant will have the right to re-take possession of the portion of the property that was subleased. In the case of an assignment, the tenant transfers to another (the *assignee*) its entire interest in the property. Unless the lease expressly forbids such actions, the tenant will have the right to assign the lease or to sublet. However, most leases do contain restrictions against such transactions, the most common being that no sublease or assignment may be concluded without the landlord's prior consent, which consent is not to be unreasonably withheld.

In the case of a sublease, the tenant remains liable for its obligations under the lease. For example, whether or not the tenant receives rent from the subtenant, the tenant will continue to be responsible for the payment of rent to the landlord. Likewise, except in rare instances where the lease provides otherwise, the tenant also retains liability for its obligations under the lease after an assignment. The original tenant is deemed to be what is known as a *surety* for the obligations of the assignee. If the assignee breaches the lease, the original tenant will be liable.

### **iii. Use Clauses**

To avoid conflicts between the tenant and the landlord over what the tenant is permitted and not permitted to do on the property, or conflicts among multiple tenants regarding appropriate uses, landlords generally prefer that the lease contain a specific, limited use clause, which forbids any use other than what is specifically authorized. Tenants, on the other hand, generally prefer to have permitted uses stated in broad terms, giving tenants flexibility in their operations and making it easier to attract prospective subtenants or assignees if that need should arise. If a specific use is important to the tenant, the tenant should make sure the lease contains a clear provision that such use is permissible. A tenant can also insist that it be the only tenant allowed to operate a certain, specific business at the property. Such provisions are generally legal and enforceable if they are reasonable in their breadth and length.

#### iv. Security Deposits

Most leases require the tenant to deliver to the landlord a security deposit, usually in the form of cash, though occasionally parties will opt for a letter of credit. The purpose of the security deposit is to provide the landlord with a source of funds to reimburse the landlord for losses incurred by the landlord for a **default** (failure to perform an obligation) on the part of the tenant. Unless the lease otherwise specifically so provides (and this is rare), the landlord is not obligated to keep the security deposit in a separate bank account or to have interest accrue on the deposit. The landlord will be obligated to return any unused portion of the security deposit within a specified period of time following the end of the lease term.

#### v. Legal Requirements

Unless the lease provides otherwise, the landlord is usually obligated to ensure that the property complies with legal requirements. The tenant is not required to change the property to make certain it complies with applicable laws and regulations, unless the tenant has specifically agreed to make such alterations.

One area of law that typically raises concerns is environmental protection. The federal government and many state governments have enacted laws and regulations placing the duty of complying with the various environmental laws on the owner or user of property. For example, the Comprehensive Environmental Liability Response Act of 1980 holds both the tenant and the landlord **jointly and severally liable** (both together and separately legally responsible) for contamination of a property when a harmful hazardous substance is present on the property during the term of the lease. It is therefore crucial that the landlord and the tenant decide on their respective responsibilities for work associated with environmental cleanup laws. Typically, leases will allocate responsibility depending on when the hazardous substance was brought onto the property and by whom. Most leases will restrict the tenant from bringing hazardous substances onto the property other than typical cleaning and office supplies. If the tenant's business requires the use of other hazardous materials, the landlord and the tenant must agree upon the types of hazardous materials that the tenant can use on the property.

Tenants, especially those involved in industrial, chemical or manufacturing uses, should be aware that the landlord is likely to push for various clauses protecting the landlord from liability if environmental hazards occur during the tenant's use. Such protections are likely to include, for example: (1) requiring the tenant to **indemnify** the landlord (paying back the landlord's costs involved in hazardous-materials clean-up, along with all penalties and other losses suffered by the landlord), (2) requiring the tenant to inform the landlord if a governmental agency contacts the tenant regarding environmental matters, and (3) requiring the tenant to be responsible for remedial work and environmental clean up, meaning the tenant itself will be responsible for the physical clean up.

#### vi. Common Areas

If the property being leased is a portion of a building or a portion of a larger project, the tenant will normally be granted rights to use portions of the building or project in common with others. These may include, for example, the building lobby, elevators and stairs, hallways and



restrooms, and parking lots and walkways. These are called **common areas**. These rights should be expressly granted in the lease. Landlords generally seek to reserve the right to make changes to the common areas. It is prudent for a tenant to seek to have the lease specify that such changes won't interfere with the tenant's use and access to the property. In a retail lease, where visibility and customer parking are particularly important, the tenant may also wish to incorporate additional protections in the lease to ensure that such visibility and customer parking are not materially and adversely affected by such changes.

## **vii. Repairs and Maintenance**

The lease should clearly allocate the responsibility of the parties for maintenance of the property. Unless the tenant is leasing an entire building, the landlord will typically have the obligation to maintain the common areas, the structure, the exterior and the building systems (electrical, plumbing, HVAC to the point that it enters the premises, etc.). Maintenance of the interior is usually the tenant's obligation. Note, however, that this is not mandatory, and the lease will need to be reviewed carefully to determine who is responsible for what. In a typical net lease of a multitenant building or project, the tenant will be obligated to pay certain of the costs incurred by the landlord with respect to that building or project, including the cost of maintaining the common areas. These costs are sometimes referred to as **CAM** (short for **common area maintenance**). They can also be referred to by other terms such as **operating expenses**. The tenant's share of CAM (or whatever other term is used in the lease) is usually calculated by dividing the square footage of the tenant's premises by the entire square footage of the building or project. It is important for the tenant to understand how CAM charges are billed in the lease and what types of expenses are covered by the CAM charges. It is sensible to speak with an attorney about the various types of expenses that should be excluded from CAM charges as such charges are likely to be very nuanced and differ across all properties.

Unlike the situation with residential leases, in which the tenant has a statutory right, under certain circumstances, to perform maintenance that the landlord has failed to perform and take a credit against rent (what are known as **self-help** and **offset** rights, respectively), tenants under commercial leases will not have the ability to do either unless such rights are spelled out expressly under in the lease. Although a tenant can attempt to negotiate for self-help rights in a commercial lease, it is unlikely that a tenant will be able to secure self-help rights. Landlords resist giving these rights, and tenants are frequently left only with the ability to pursue claims against the landlord in court or via arbitration. In that case, the tenant still must continue paying the full amount of rent or run the risk of being evicted. The reason for this is that the payment of rent is considered an independent covenant, not conditioned on the landlord complying with its obligations. There is an exception to this rule, but it is one to be considered carefully (with the assistance of counsel): Under California law, the tenant could claim that the landlord's conduct or failure to act has rendered the property unfit for the purposes for which the property was leased and that a **constructive eviction** (where the landlord's conduct has made it necessary for the tenant to leave the property even though the landlord does not expressly initiate the eviction process) has occurred. To assert such a claim, the tenant must actually vacate the premises, and the tenant thereafter runs the risk that a court or arbitrator will determine that the actions or inactions of the landlord did not rise to the level of constructive eviction.

### **viii. Insurance**

A lease will generally require that the tenant obtain insurance covering liability for personal injury and damage to the tenant's property. (Some, but not all, leases will require the landlord to maintain insurance covering its own liability and damage to the building.) Those insurance requirements should be reviewed by the tenant's insurance broker before the lease is signed to ensure that the coverages are reasonably available. Maintaining the insurance is very important, and this is not only because failure to do so would be a breach of the lease. Most commercial leases expressly disclaim any liability on the part of the landlord for damage to the tenant or its property, even if that damage is the result of the landlord's negligence, and they require that the tenant rely on its own insurance. (It can come as quite a surprise to some tenants when damage occurs – say from a bursting pipe or a leaking roof – and it turns out that the landlord has no responsibility for reimbursing the tenant.)

At the risk of being somewhat technical, there is a very important item that commercial tenants need to understand. It is something known as ***waiver of subrogation***, and failure to ensure that such a waiver is contained in the lease can have serious consequences. The word ***subrogation*** essentially means stepping into the shoes of another and enforcing claims that the other may have. It applies in circumstances where the person seeking to subrogate has had to incur costs on behalf of the other person. Here's how it works with insurance: If an insurance company has to pay a claim on behalf of the insured (i.e., its customer), the insurance company then has the right to pursue claims against whoever caused the situation that made payment of that claim necessary. What this means is that, if the tenant, through its inadvertent negligence, were to cause significant damage to the landlord's building, the insurance company could, after paying to restore the landlord's building, take the tenant to court and recover the amounts the insurance company had to pay. While the insurance company couldn't sue its customer (the landlord), as that would clearly defeat the purpose of insurance, it could sue the tenant, even though the tenant may have, through its payment of CAM, been contributing to the cost of that insurance. The tenant's liability policy may cover a portion of that claim, but most policies contain strict limitations on the amount that can be applied to damage caused to leased property. Consequently, it is essential that the tenant's lease contain a waiver of subrogation, by the terms of which the landlord waives, for itself and its insurance company, claims against the tenant to the extent covered by the landlord's insurance. This waiver is usually mutual, with the tenant making a similar waiver for damage to its property.

### **ix. Defaults and Remedies**

A default and remedies provision should do the following: (1) specifically define the meaning of a ***default*** (generally, a failure to perform an obligation) under the lease; (2) identify the appropriate notice to be given in case of default; (3) provide for the defaulting party to have an opportunity to cure the default after notice; (4) identify and limit the remedies available on the occurrence of a default; and (5) set forth any other consequences of a default.

Depending on the terms of the lease, the tenant can default in a number of ways, including its failure to (1) pay rent; (2) pay the real estate taxes and assessments; (3) maintain adequate casualty and liability insurance; (4) maintain the property; (5) prevent a wasting of the property or improvements constructed on the property; (6) operate its business at the property; or

(7) maintain its legal existence and financial strength. Assigning the lease or subletting the property can be an event of default if the terms of the lease prohibit such actions.

Most leases permit the landlord to terminate the lease in the event a default has occurred, and they may provide the landlord with the opportunity to waive the default either temporarily or permanently. In addition, the lease may give the landlord the right to **cure** (to fix) the default and seek reimbursement plus interest for the costs it incurs. The tenant may be able to secure the right to cure a monetary default within 3-5 days after receiving notice from the Landlord and the right to cure a non-monetary default within 30 days after receiving notice from the Landlord. The lease may also give the landlord the right to sue the tenant for damages resulting from the default or nonpayment of rent.

Once the lease is actually terminated, it usually cannot be reinstated. However, the tenant's obligations to the landlord do not end with the termination of the lease or the tenant's eviction. The tenant will continue to be liable for the unpaid rent that accrued before termination of the lease. Moreover, depending on the lease's terms, the tenant may also be required to continue paying rent until such time as the landlord is able to re-lease the property. And, if the landlord is unable to collect at least as much rent from the new tenant as the rent that would have been payable by the original tenant under its now-terminated lease, the landlord may recover the difference. In addition, the costs incurred by the landlord in re-leasing and any other losses caused to the landlord by the default may be subject to recovery.

#### **x. Eviction**

In the event the landlord moves to evict the tenant, an attorney can help the tenant navigate the eviction process. Typically, the eviction process begins with the landlord delivering a 3-day notice to the tenant requiring the tenant to pay past due rent or perform an outstanding obligation under the lease. After 3 days, the landlord will likely file a complaint and serve the tenant with the same. Then, the tenant has 5 days to respond to the landlord's complaint. Once the tenant responds to the landlord's complaint the court will set a court date within 20 days after the tenant's response. If the court rules in favor of the landlord the court will issue a **writ of possession**, which the landlord will then deliver to the local Sheriff. The Sheriff will inform the tenant that it has a short period of time to leave the property. If the tenant has not moved out within such period of time the Sheriff will remove the tenant from the property. Again, there are many nuances to the eviction process and an attorney can help the tenant understand the additional details of the process.

#### **xi. Landlord's Obligations**

Generally, under a commercial lease, neither the landlord nor the tenant has any significant obligation to the other party that is not described in the lease. It is therefore important that both parties make certain that everything they thought the other party promised is written in the lease and that each party's obligations are described specifically and without ambiguity. For example, the commercial landlord is not usually required to provide any services to the property or for the tenants other than making the leased property available. Accordingly, it is important for the tenant to make certain that the lease describes any services it believes the landlord agreed

to be required to perform. Services to the property will typically include providing heat, air-conditioning, water, plumbing, cleaning, repairs, elevators, and other similar services.

To protect itself from the effect of conditions that arise during the lease term over which it has no control, a landlord is likely to include in the lease a ***force majeure clause***. Such a provision precludes the tenant from terminating the lease or reducing its rent if certain events arise, which are usually described in a force majeure clause to include, strikes, national emergencies, war, tornadoes, hurricanes, acts of God, or other natural disasters.

A force majeure clause is included in commercial leases to protect the landlord. The idea behind such a clause is that the landlord should not be penalized for events over which it has no control, cannot prevent, and is unable to stop. Although the landlord benefits from a force majeure clause by the tenant being unable to terminate the lease while the landlord is unable to provide some portion of the services it was supposed to perform, the tenant is unable to utilize the property it has leased and requires for its business. The force majeure clause is a weighing of fairness – the landlord will argue that without it, the tenant has an unfair and unforeseen advantage by being able to terminate the lease because of a situation over which the landlord has no control.

Many leases will make the force majeure clause mutual, but will expressly exclude from force majeure the obligation of the tenant to pay its rent (as opposed to the tenant's other obligations under the lease, such as maintaining the property or operating its business on the property). One way the tenant can protect itself from the effects of force majeure is to carry business interruption insurance.

## **xii. Indemnification and Exculpation**

The landlord and the tenant may attempt to limit their liability under the lease pursuant to indemnification and exculpation clauses. These clauses formalize the parties' agreement as to who will be responsible for any injury, damage, or death that occurs on the property, regardless of whose fault caused the accident. In an ***indemnification*** provision, one party agrees to be responsible for any injury, damage, or death that occurs on the property regardless of whose negligence was involved. However, one party should not agree to be responsible for another party's gross negligence or willful misconduct. In an ***exculpation*** provision, one party waives any personal liability against the other party regardless of the cause of that liability. These provisions are frequently negotiated, and an attorney can help determine the tenant's responsibility for damage, injury or death that occurs on the property.

## **xiii. Surrender and Holding Over**

To protect the rights of both the landlord and the tenant, the lease should provide for what is to happen when the lease ends. A surrender and holding over clause usually provides for the following: (1) that the lease will terminate and the tenant will give up possession of the property to the landlord at the end of the lease – and the lease should indicate the manner in which this is to be done – and the required condition of the leased property on the termination of the lease; and (2) the landlord's rights if the tenant decides to ***hold over*** (i.e., refuses to leave the property when

the lease terminates). Landlords commonly include provisions to reserve their rights to collect any and all damages and rent equal to 150% to 200% of the rent in effect during the lease if a tenant holds over. Understanding the requirements for condition of the property at surrender is important, as many leases give the landlord the right to require the tenant to remove improvements and alterations at the end of the term and restore the property to the same configuration as it was in at the beginning of the lease. (The parties are free to negotiate whether and to what extent that restoration obligation applies.) The tenant should likewise understand the language of the hold-over clause because landlords typically include significant penalties for a tenant that remains in possession of the premises after the lease ends.

#### **xiv. Alterations to the Leased Property**

Both the landlord and the tenant are usually concerned about their rights and obligations to make alterations and improvements to the leased property, and they often negotiate extensively regarding this subject. The lease should set forth these rights and obligations expressly and without ambiguity. Unless the lease provides the tenant with specific authority, a tenant is not permitted to alter the leased property without the landlord's consent. Typically, the tenant should have the right to repair or alter the property if the alterations are non-structural in nature, will not affect the building systems, and cost less than a reasonable threshold amount (sometimes around double the rent).

#### **xv. Attorneys' Fees**

A commercial lease may provide for the prevailing party to recover attorneys' fees from the losing party in the event of a lawsuit or arbitration. This is a beneficial provision to both the landlord and the tenant because it will help deter both parties from initiating frivolous lawsuits.

#### **xvi. Entry by Landlord**

The entry by landlord provision permits the landlord to inspect the property at reasonable times to make certain the property is in good condition or to allow purchasers and future tenants to view the property. The tenant should require that the landlord provide notice (24-48 hours) before entering the premises (except in emergencies) to ensure that the tenant is prepared for the landlord's entry. Some tenants may have particular sensitivity with respect to portions of the property, including tenants with government contracts that require limitations on access by third parties. In those cases, provisions may be added to the lease requiring the landlord to be accompanied by a tenant representative. However, nearly every commercial lease will allow immediate entry in the event of a bona fide emergency.

#### **xvii. Tax Consequences of Leases**

Leasing real property can result in significant tax consequences for both the landlord and the tenant. A lease is the right to use a specific piece of property for a limited period of time. If the parties are not careful in structuring their relationship, however, a lease can also be considered, for tax and financial purposes, a sale of property or a financing arrangement. The treatment of a lease as a sale or a financing arrangement may have disastrous tax consequences for both parties and should be avoided, unless that is the intention. The tenant may want to

consult with an accountant or lawyer with appropriate expertise to avoid such an outcome, especially if such tenant will be a party to a long-term lease.

### **xviii. Estoppel Certificate**

Most landlords' commercial lease forms include a clause requiring the tenant to provide, on request, an *estoppel certificate* stating the current status of the lease. The purpose of an estoppel certificate is to: (1) confirm that the lease is in full force and effect; (2) clarify whether the lease has been amended, extended, or assigned, or whether any defaults exist; and (3) confirm the essential terms of the lease. Estoppel certificates are often required during a refinance or sale of the building to confirm the essential terms of a tenant's lease. The lease, with all of its amendments, is usually attached as an exhibit to the estoppel certificate when the certificate is executed. Care should be taken by the tenant when completing and signing an estoppel certificate, because, in the event of an inadvertent error or omission, the tenant will nevertheless be estopped (prevented from taking a contrary position) from asserting anything inconsistent with the contents of the estoppel.

### **xix. Subordination, Nondisturbance, and Attornment ("SNDA")**

As a condition to making a loan to the landlord with the landlord's property as collateral, most *lenders* require that their *liens* (the right to take the property of a debtor as payment for a debt) be senior and superior to all other claims on the real property, including leases. When a lien is senior and superior to another lien, it means that the more senior lien will have priority to obtain the property if the borrower goes into default. *Subordination* is the act of a tenant agreeing to give up its statutory priority (i.e., the right given to it by law to have its claim on the property come first) and to give the lender lien priority in the event the landlord loses its interest in the property due to failure to comply with the terms and conditions of the mortgage (also known as *foreclosure*). The legal effect of that is the elimination of the tenant's leasehold. To avoid that possibility, tenants often insist, in exchange for the agreement to subordinate the tenant's interest in the leased property to the lender's lien, that the lender agree not to disturb the tenant's occupancy of the leased property in case of a foreclosure (typically known as a *nondisturbance* clause or agreement) as long as the tenant is not in default under its lease obligations. Lenders also typically require that tenants *attorn* to the lender (i.e., acknowledge the lender as the new landlord) if the lender steps into the landlord's shoes. The concepts of subordination, nondisturbance, and attornment are memorialized in a separate legal document called an *SNDA*. The landlord will usually include a provision in the lease that requires the tenant to execute an SNDA upon the landlord's request. The most important element for the tenant in all of this is the nondisturbance. This protects the tenant from loss of its lease in the event there is a foreclosure. Not only is that important from a business continuity standpoint, but it becomes even more critical if the tenant has invested money improving the property with the expectation that it will have possession of the property through the entire term.

**xx. Guaranty**

The landlord can secure its investment in the premises, and protect itself against a tenant default, by having a third party execute a lease guaranty making that third party liable for the tenant's obligations under the lease.

**xxi. ADA Disclosure**

Under California law, every landlord is required to advise the tenant whether the property has been inspected by a Certified Access Specialist (**CASp**), and, if so, the landlord is required to provide the tenant with any report generated as a result of that inspection. A Clasp is a professional that has been certified by the State of California to have the knowledge required to adequately assess a property's compliance with state and federal construction-related accessibility standards, including the Americans with Disabilities Act ("ADA"). The tenant should expect the landlord to deliver the leased property in compliance with all accessibility standards. Moreover, as a best practice the tenant should make sure the lease addresses whether the landlord or the tenant will be liable for any ongoing costs of ADA compliance.

**xxii. Parking**

The tenant needs to understand its parking rights to ensure that its business will have adequate parking. The landlord may reserve rights with respect to parking to ensure that it can make necessary repairs to the premises. The lease should clearly state these rights of the landlord and the tenant.