



SUTHERLAND

# The Ins and Outs of Leasing

**David F. Reid, Esq.**  
**Sutherland Asbill & Brennan LLP**  
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## The Ins and Outs of Leasing - Overview

- Why have a lease?
- Common lease provisions of concern.
- Issues relevant to unfavorable economic conditions.
- Other issues specific to non-profit organizations.

## Why have a lease?

- Main reason: to protect the tenant's expectations.
- Written evidence of the parties' agreement and intent.
- Basis for allocating obligations between the parties.
- Contracts involving real property are subject to special rules often requiring an agreement to be in writing to be enforceable.

## Tenant Protection – From Landlord

- Some non-profits operate in donated space. As the use is “free,” the non-profit may not realize that a written agreement is necessary.
- A good written lease identifies the premises, the term, and the rental, if any.
- Written lease prevents the landlord from later changing his mind about any of the above items by:
  - renting the space to a third party
  - taking the space back before the non-profit expects it
  - changing the terms of the rent.

## Tenant Protection – From Third Parties

- Sale of property by Landlord:
  - A purchaser is required to investigate the property before purchasing.
  - If a party is in possession by virtue of a written lease, then the purchaser will be required to respect the terms of the lease.
  - If the agreement between landlord and tenant is unwritten, eviction could happen 60 days after purchase!

## Tenant Protection – From Third Parties

- Mortgage of Property by Landlord:
  - If mortgage precedes lease: No protection of tenant, regardless of written lease (unless lender has agreed to respect the lease).
  - If lease precedes mortgage:
    - If lease is unwritten, tenant can be evicted upon foreclosure.
    - If lease is written, tenant may be able to remain in the premises regardless of foreclosure.

## Tenant Protection – Allocation of Obligations

- A written lease allocates the landlord's and tenant's respective obligations.
- Explicit allocations avoid disputes later.

## Tenant Protection – Allocation of Obligations

- Common obligations allocated by a lease:
  - Maintenance of fixtures, equipment and common areas.
  - Payment of taxes, insurance and utilities.
  - Who assumes liabilities, such as injury to people within the premises?
  - Term: When and how must the premises be surrendered to the landlord?

## Common Provisions of Concern

- Commercial leases can be long and complicated documents.
- Often, on property owner's "form" lease, which contains provisions beneficial to the landlord that a tenant might not identify as problematic.
- The following is a summary of a few basic important lease terms that this discussion will cover.

## Common Provisions of Concern

- Identity of Landlord
- Definition of Premises
- Term
- Financial Aspects
  - Rent
  - Insurance
  - Taxes
  - CAM
  - Utilities
- Use Issues
  - Permitted Use
  - Prohibited Uses
- Repair and Maintenance
- Alterations
- Defaults and Remedies

## Provisions of Concern – Identity of Landlord

- Party signing lease as landlord must in fact be the same party that currently owns the property.
- Title search to verify ownership.
- Ask the landlord for copy of recorded deed vesting title in landlord.
- Seek representation in lease from landlord that landlord is owner of the property, and that any title information that landlord has provided is true, correct and complete.

## Provisions of Concern – Premises Definition

- Specific description of location of property and premises is required for lease to be enforceable.
  - Legal description
  - Street address
  - Accurate depiction of the property, including location and dimensions

## Provisions of Concern – Premises Definition

- The more specificity the better
  - Identify the location of the building
  - Depiction of the leased space is better than “Suite 108”
  - Does the leased premises include parking spaces?
- Note that case law in Georgia suggests that undimensioned site plans may not be a legally valid description of the premises.

## Provisions of Concern – Term of Lease

### ➤ Basics:

- When does the lease begin?
  - Upon execution?
  - Specific date in future?
- When does the lease end?
  - When is the landlord entitled to retake the property?

## Provisions of Concern – Term of Lease

- Commencement vs. Rent Commencement
  - Commencement = the time that the lease term begins and tenant is permitted to occupy the space
  - Rent commencement = when rental begins to accrue. May be simultaneous with or after commencement.
  - If space is not ready for use by tenant upon execution (tenant must “build out”), rent commencement should begin when space is ready for use.

## Provisions of Concern – Term of Lease

### ➤ Extension/Renewal

- Tenant may have option to extend lease term for a fixed period of time.
- To be enforceable, all terms and conditions of renewal must be present in the lease itself
  - Method of exercising option
  - Length of extended term
  - Rental – must be fixed or capable of being fixed by reference to outside source (CPI) or binding arbitration

## Provisions of Concern – Financial Aspects

### ➤ Rent

- Usually fixed amount per square foot
  - Specify total square footage and total rent in lease.
  - If not known, specify method for determining square footage
- Agree when rent is due (usually first of each month)
- For clarity, specify both monthly and annual amounts of rent

## Provisions of Concern – Financial Aspects

### ➤ Rent (continued)

- Gross lease: Tenant pays only fixed rent; landlord responsible for all other costs (taxes, insurance, operating costs). Uncommon in commercial context.
- Net lease: Tenant pays fixed rent plus taxes, insurance and operating expenses.
- Net lease, multiple tenants in building: pro rata share
  - Each tenant responsible for its pro rata share of expenses.
  - Carefully review how pro rata share is determined.
  - Based on square footage of tenants?
  - Does the calculation include vacant space?

## Provisions of Concern – Financial Aspects

### ➤ Insurance

- Under net leases, tenants pay pro rata share of the property insurance on the building.
- Tenants should also consider (and landlords may require) purchasing:
  - insurance covering the tenant's property within the premises
  - commercial general liability insurance

## Provisions of Concern – Financial Aspects

### ➤ Taxes

- Under net leases, tenants pay pro rata share of real property taxes levied on the building and land.
- **Caution!** Developments may contain multiple tax parcels, each assessed differently. Be sure tenant is only paying a portion of the taxes on the tax parcel containing tenant's premises.
- Definition of "taxes":
  - Broad vs. narrow
  - Exclusion of taxes on landlord's profits

## Provisions of Concern – Financial Aspects

- Taxes (continued): “Rental taxes”
  - Tax gross rental paid under lease
  - Exist in at least 2 states (but not Georgia), and some jurisdictions within states have enacted them.
  - Concern over future enactment of rental taxes:
    - If lease is silent, party specified by future law would have to pay rental taxes.
    - Landlord will want to make tenant pay these
    - Tenant should try to exclude rental taxes from definition of “taxes.”

## Provisions of Concern – Financial Aspects

### ➤ CAM

- Customary term used for “common area maintenance.”
- Maintenance of areas outside of tenants’ space but within the building or development that must be maintained.
- Examples: parking lot; roof; exterior walls; plumbing; HVAC; shared hallways; security; elevators.

## Provisions of Concern – Financial Aspects

### ➤ CAM (continued)

- Tenants derive benefits from common areas, so landlord seeks to pass costs on to tenants.
- Usually each tenant pays pro rata share.
- “Fixed CAM” may be negotiated.
  - Fixed amount payable towards CAM, regardless of actual costs of CAM or tenant’s pro rata share.

## Provisions of Concern – Financial Aspects

- CAM (continued): Administrative fees
  - “Administrative fee” in CAM is the cost of managing the common areas.
  - Often equals surcharge of 10% of CAM
  - **Caution!** Watch out for “double-dipping”:
    - management expenses plus administrative fee within CAM
    - administrative fee within CAM plus a separate administrative fee outside of CAM

## Provisions of Concern – Financial Aspects

- Utilities used by tenant:
  - Who pays?
  - Submetering for multi-tenant building.
  - **Caution!** Pro rata share of building's utilities may not be a good idea; tenants' use of utilities often not proportionate to square footage.
  - **Caution!** If landlord pays utilities and tenant reimburses landlord, include protections allowing verification.

# Provisions of Concern – Use of Premises

## ➤ General

- Very important in retail context.
- Less important in office, industrial contexts.
- Must be reviewed in all cases.
  - If tenant's contemplated use isn't allowed, the lease is worthless to the tenant.
  - Restrictions on use can limit ability to assign lease.

## Provisions of Concern – Use of Premises

### ➤ Permitted Use

- Narrow: specific use. Favored by landlords.
- Broad: “any lawful use.” Favored by tenants.
- Even if permitted use is broad, still will be subject to certain prohibited uses, rules and regulations.
- Be sure permitted use includes all contemplated uses.
  - “General office use”: does this include providing services to non-profit’s customers or beneficiaries?

## Provisions of Concern – Use of Premises

### ➤ Exclusive Use Provisions

- Common only in retail context
- Ask landlord if any exclusive uses exist for benefit of other tenants – be sure your use doesn't violate them.

### ➤ Prohibited Uses

- Uses generally viewed as undesirable in the type of commercial development.
- Specified in lease.
- Be sure tenant's contemplated uses are not on list.

## Provisions of Concern – Use of Premises

### ➤ Use Restrictions in Title Information

- Restrictive covenants placed on the property by former or current owners.
- Identified by title search.
- Ask landlord for title information.
- Representation from landlord that all title information and use restrictions of record have been disclosed.
- Representation from landlord that permitted use does not violate restrictive covenants placed on the property or the terms of any other tenants' leases.

# Provisions of Concern – Use of Premises

## ➤ Rules and Regulations

- Common for multi-tenant buildings/developments.
- May be in lease, exhibit in lease, or incorporated by reference.
- Designed to coordinate administrative matters, such as hours of operation, elevator service, signage rules.
- Landlord will want flexibility to change rules. If so, changes should:
  - Be reasonable.
  - Not conflict with the tenant's contemplated use of the premises.
  - Apply uniformly throughout the building or development.

## Provisions of Concern – Maintenance

- Specify what items each of tenant and landlord is responsible for maintaining.
- No “customary” allocation; depends on expectations of parties.
- Any obligation to repair and maintain the premises which is not expressly assigned to Landlord is likely to be borne by Tenant.

## Provisions of Concern – Maintenance

- Landlord often responsible for structural repairs (roof, foundation, exterior walls), and repairs to building utility systems and common areas.
- Tenant is often responsible for interior, non-structural repairs.
- If landlord is responsible for fixing items inside premises, specify landlord's access rights.

## Provisions of Concern – Alterations

- Common law rights favor tenants' right to alter premises.
- Landlords thus impose restrictions in lease.
- Usually consent required for “structural” alterations.
- More lenient towards “non-structural alterations.”
- Often no bright line, so landlords impose limits on non-structural alterations, too.

## Provisions of Concern – Defaults, Remedies

- Default: any violation of a party's lease obligations.
- Notice and cure rights:
  - Party must give notice to other party of default and allow opportunity to cure default before exercising remedies.
  - Prevents “gotcha” violations.
  - Allows chance to fix problem without incurring severe penalties.
  - May be limited to non-monetary defaults.

## Provisions of Concern – Defaults, Remedies

- Remedies available to tenant:
  - Offsetting or abating rent not generally allowed unless specified in lease.
  - Constructive eviction: requires tenant to move out before being able to claim this defense.
  - Otherwise, limited to court action (i) to force landlord to comply, or (ii) to terminate lease and seek damages.

## Provisions of Concern – Defaults, Remedies

- Remedies available to landlord:
  - Must be specified in lease, or only remedy is to sue for eviction.
  - Common remedies in leases:
    - Terminate lease, recover damages from tenant.
    - Re-entry/termination of right of possession without termination of lease.
    - Dispossessory action.
  - **Caution!** No duty to mitigate damages unless lease is terminated.

## Issues Relevant to Unfavorable Economic Conditions – Subleasing and Assigning

### ➤ General:

- Tough times lead to downsized operations.
- Selling part or all of tenant's interest in lease may be attractive as leased space isn't needed or is too expensive.

### ➤ Definitions

- Assignment: Selling all of remaining rights in a lease to a third party.
- Sublease: Selling a portion of remaining rights in a lease to a third party.
  - Portion of premises
  - Portion of lease term

## Issues Relevant to Unfavorable Economic Conditions – Subleasing and Assigning

### ➤ Landlord's Consent

- Leases are generally freely assignable without contrary provision requiring consent.
- Most landlords thus impose consent requirements.
- Specify consent standard: reasonable vs. sole discretion.
- Include general exception from the consent requirement for assignments or subleases to affiliates, or in connection with mergers.

## Issues Relevant to Unfavorable Economic Conditions – Subleasing and Assigning

### ➤ Sharing of Profit

- Sublease or Assignment may result in higher rent being paid to original tenant.
- Lease may specify that “profits” be shared.
- Landlord may use consent right to try to obtain a share of the profits.

### ➤ Use Clauses.

- Permitted uses, prohibited uses affect what parties can take a sublease or assignment of lease.

## Issues Relevant to Unfavorable Economic Conditions – Renegotiating Terms

- Rent reductions: common request of landlords currently.
- Be prepared to offer concrete evidence justifying need for lower rent.
- Landlord concern over tenant bankruptcy.
- Be creative:
  - Additional guarantor
  - Offer to change other terms that landlord may desire.

## Issues Relevant to Unfavorable Economic Conditions – Renegotiating Terms

- **Caution!** Rent reduction cannot be treated as a charitable contribution. Do not offer this “bonus” to landlord.
- **Caution!** Properly document agreed upon changes with signed written instruments.

## Other Lease Issues Specific to Non-Profits

- Lease guaranties:
  - No legal problem with an affiliate, a director or officer, or a benefactor guaranteeing tenant's performance of obligations under a lease.
  - Consult tax counsel before claiming any tax deductions.
- Landlord's donation of space:
  - Not tax-deductible unless the landlord donates the property permanently.
  - Reversion after lease disqualifies donation as tax deduction.

## For More Information:

If you would like more information about the services of Pro Bono Partnership of Atlanta, contact us at:

Phone: 404-407-5088

Fax: 404-853-8806

Info@pbpatl.org

www.pbpatl.org