



## NYC BUSINESS SOLUTIONS

Presents

### COMMERCIAL LEASES: LEASE STRATEGIES FOR TOUGH TIMES . . . OR ANY TIME

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Welcome to *Commercial Leases: Strategies for Tough Times...or Any Time!*  
This packet is a supplement to the presentation and provides additional detailed information on the issues discussed.

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## **I. ISSUES TO RESOLVE PRIOR TO NEGOTIATING THE LEASE**

1. *Select a Location:* Depending on your company's needs, client base, programs, budget, the zoning rules, etc. Also make sure to take into account the location of potential competitors and the level of pedestrian traffic at the locale. A real estate broker can be useful in your search. Generally, they are paid by the landlord.
2. *Assemble Advisors:* Including real estate broker; attorney; contractor or architect; trade association; lenders; small business assistance groups; development agencies; government agencies.
3. *Determine Space and Facilities Needs:* Including number of offices or cubicles; waiting room and reception area; restrooms; conference space; library; kitchen; associated spaces; lighting; ventilation; security; accessibility for people with disabilities; telephones and computer systems. Building and other codes may dictate some of these matters.
4. *Determine Operating Costs; Develop a Budget:* What your organization or business can afford to spend up-front for relocation costs, building-out the space, and insurance, and on an ongoing basis for rent, utilities and location-related operating expenses. Are you being asked to pay a share of the operating expenses for the building? If so, find out the owner's operating costs and confirm how they are calculating the tenant's share. Is the landlord offering free rent or contributing to tenant's initial improvement costs?
5. *Investigate Ownership of the Building:* To find out the ownership history of the building, and to review deeds, mortgages, mortgage satisfactions and financing statements, go to the on-line City Register at: <http://www.nyc.gov/acris>. Click on the hyper-link called "Begin using ACRIS" and follow the instructions.
6. *Verify Applicable Zoning Restrictions:* You must verify that your intended use of the space is acceptable under the applicable zoning rules. Zoning resolutions for every neighborhood in the five boroughs may be found at:  
<http://www.ci.nyc.ny.us/html/dcp/html/zone/zmapintr.html>
7. *Determine the amount of property tax due on the building:* Most commercial tenants are required to pay a share of the property tax due on the building. Go to the New York City Department of Finance website, select "Property Taxes by Address" and find out the amount

of tax due. <http://www.nyc.gov/html/dof/html/home/home.shtml>. You may also check this information at <http://www.propertyshark.com>. Make sure that you verify the taxes due for an entire tax year. Again, confirm how landlord is determining tenant's share. Is the passthrough on a net basis (i.e., tenant pays its share of the entire property tax bill) or gross basis (i.e., tenant pays its share of the property tax bill over a base year).

## **II. IMPORTANT DIFFERENCES BETWEEN COMMERCIAL AND RESIDENTIAL TENANCIES**

### *1. Generally:*

- a. A commercial tenant's rights basically are limited to the rights set forth in the lease. Most leases are drafted by landlords and contain terms favorable to the landlord.
- b. Don't confuse commercial and residential tenancies. Residential tenants have numerous rights guaranteed by law. Commercial tenants generally have few rights. In the commercial context, if a right or obligation is not in the lease, it is likely not enforceable.

### *2. Warranty of Habitability:*

- a. Residential: By law, tenants are entitled to a decent, safe and sanitary apartment.
- b. Commercial: There is no commercial warranty of habitability. Unless required by the lease, the Landlord does not have an obligation to maintain or repair your premises, or to maintain the common areas. While commercial landlords must comply with codes and laws with respect to the building generally, commercial tenants usually take the premises "as is." However, the Landlord does have an obligation to repair structural conditions that substantially impact the use and occupation of the premises. Ex: If the premises do not have heat or hot water for an extended period of time, the Landlord cannot collect rent during such time

### *3. Duty to Mitigate:*

- a. Residential: If a tenant leaves a leased space before the term of the lease expires, a residential landlord has an obligation to make an effort to lease the space to a new tenant.

- b. Commercial: A commercial landlord does not have a duty to mitigate. A commercial landlord can collect the rent for the remaining part of the lease term from the tenant who vacated the space.

4. *Rent Regulation:*

- a. Residential: Some residential buildings are rent controlled and there is a ceiling on the amount of rent a Landlord can charge.
- b. Commercial: There is no rent regulation in commercial spaces. Thus, once your lease expires, there is no limit on the rent the landlord can charge you, nor does the landlord have any obligation to offer you a lease renewal, if such an obligation is not written in the lease.

### **III. NEGOTIATING THE LEASE**

1. Prepare a term sheet or letter reviewing the landlord's proposed lease, and proposing revisions. The final term sheet is a summary of the fundamental lease terms agreed to by both landlord and tenant. (Please see the sample term sheet, distributed at today's workshop)
2. Remember: the written terms of the lease will govern any dispute between the tenant and the landlord. If the landlord makes you a promise, insist that he or she include it in writing in the terms of the lease. Any oral agreements or promises made by the landlord will not be binding if they are not expressly included in the signed lease agreement.
3. Carefully review the lease. Consult your attorney and have them review the proposed lease before you sign it. You have no negotiating leverage after you have signed it. A review of the important provisions of a standard store lease follows below in Section IV.

### **IV. REVIEW OF THE LEASE TERMS**

1. *Description of the Space You are Renting:*
  - a. Your lease will include a description of the space that you are renting. Usually the street address is sufficient. But if there is more than one space at the address, the lease must specifically state which space you are getting. Often a diagram of the space is attached to the lease.

- b. The lease must list any additional space that is included (for example storage, bathrooms, etc.).

## 2. *Amount of the Rent*

- a. The amount of the rent is totally negotiable. You and the landlord will sit down and work it out. There is no commercial rent regulation. The landlord may ask for as much rent as he or she wants. In this respect, a broker would be invaluable to the tenant as they are a source of market knowledge and would assist tenant in determining whether the asking rent is representative of the market.
- b. The rent usually goes up by a set amount every year during the lease term. The amount of the increase is stated in the lease.
- c. The landlord will ask for a security deposit. A typical deposit is two or three months rent but may be much more depending on the credit quality of the tenant. It is fair to ask for reductions in the amount of security deposit tied to your performance (e.g., no missed or late payments for a period) at specified times during the term of the lease.
- d. Often, landlords will grant the tenant a "free rent" period while the tenant is making renovations to the space and readying it for occupancy. The length of the "free rent " period is fully negotiable, but is typically between 2 and 6 months. For retail leases, landlords typically try to further limit the free rent period by tying it to the opening of the tenant's business.

## 3. *Term of the Lease and Option to Renew*

- a. A typical commercial lease runs for 3 to 5 years. For retail leases, the term typically runs for 5 to 10 years because location is such an essential component of a retail tenant's success.
- b. Make sure that the lease term is long enough for the needs of your business. Does it give you enough time to establish your business and grow?
- c. You have no right to a lease renewal unless it is included in your lease. If you want the right to renew your lease after it expires, you must put the right to renew in writing, and make it part of your lease. You should specify in the renewal provision what the amount of the rent will be upon renewal of the lease (either a fixed rental rate or a percentage of the fair market value at the expiration of the lease). Otherwise, your landlord may ask you to leave at the end of your lease term without giving you any

reason at all, or the landlord may offer to renew your lease at a much higher rent.

#### 4. *Termination of the Lease*

- a. Be careful. Your lease probably has language that gives your landlord the right to terminate your tenancy if the landlord decides to sell, demolish or rehabilitate the building. Usually the landlord must give you at least 3 to 6 months notice before requiring you to move. Sometimes the landlord will also give you money to compensate you for having to move out before the end of the lease term.

#### 5. *Permissible Uses of Your Space*

- a. This is the part of the lease that says what you are allowed to do in your space. It is very important, because you have no legal right to sell or do anything that is not permitted by the lease. All of your business activities must be written in your lease.
- b. In a retail space it will also cover what type of signage you will be able to erect (lighted, awnings, in-window, notice of sales or of a going-out-of business sale). There are also city regulations and permit requirements for signage that you need to comply with.
- c. If possible, use the following language: "Tenant may use and occupy the premises for all lawful purposes." If the landlord will not agree to this, then attempt to phrase your business activities in the most broad and inclusive way possible.

#### 6. *Alterations of Your Space*

- a. You must obtain your landlord's consent, in writing, before you make any alterations to your space. If possible, get the landlord's permission to make your intended alterations before you sign your lease.
- b. If possible, add language to your lease that the landlord "shall not unreasonably withhold or delay" consent to alterations.
- c. Decorations are technically alterations. Try to get the landlord to agree that its consent is not required for mere decorations.

## 7. *Repairs*

- a. Repairs in the leased space are usually the tenant's responsibility. This is not like a residential apartment where your landlord has the responsibility to make all repairs. The landlord is usually responsible only for maintaining the public spaces and the exterior of the building.
- b. Walk through your space before you sign the lease to see if the space is in satisfactory condition. If not, ask the landlord to make repairs before you move in. The landlord may insist that you take the space in "as-is" condition.

## 8. *Insurance*

- a. Most leases require the tenant to carry casualty (damage to property) and liability insurance. You should also consider insurance that covers the replacement value of the items in your store, and business interruption insurance.
- b. Speak to an insurance broker about the insurance that you will need and what it will cost. Make sure that the insurance broker reviews your insurance obligations under the terms of the lease.

## 9. *Assignment or Subleases of the Premises*

- a. If you decide to move out before the lease is over, you may want to have another person or company take over your lease. This is called an "assignment".
- b. If you decide to let someone else use a portion or all of your space, but you retain control over the space, this is called a "sublease".
- c. Your lease will probably say that you do not have the right to assign or sublease your space without the permission of the landlord.
- d. If possible, add to your lease that your landlord "shall not unreasonably withhold" permission to assign or sublease your space.
- e. The restriction on assigning or subleasing also applies to someone who wants to buy your business and take over your space. You do not have the right to permit someone who buys your business to move into your space. Get the landlord's permission first!
- f. These provisions are very important to review and negotiate carefully so that you have flexibility

## 10. *Additional Rent*

- a. This is money that you will owe your landlord that is not included in the rent stated on the first page of your lease. It may include real estate taxes, charges for maintenance of the building and garbage removal, etc.
- b. The tenant's additional rent is usually a percentage which is equal to the proportionate share of the tenant's space in the building. For example, if there are 10 units in the building, the tenant's share of additional rent may be 10%. You should include in the lease that you have the right to receive a copy of or inspect the property tax bill each quarter to insure that you are not being charged more than your proportionate share of the taxes.

11. *Defaults in Terms of the Lease*

- a. Defaults in the terms of the lease include failure to timely pay fixed rent or other charges or failure to perform obligations that you are required to do under the lease. You should always try to get notice and a period of time to cure a default before the landlord can exercise its right to terminate your lease because of the default
- b. If you receive a notice from your landlord stating that you have violated the terms of your lease then you must correct the violation in a short period of time (usually ten to 15 days). Consult your lawyer and send your lawyer a copy of the notice.
- c. If you need a little extra time to correct the violation, then you must go to Supreme Court before the period expires and ask a judge for more time. If the violation exists, and you do not go to Supreme Court on time, the Landlord will likely be able to bring an action to evict you.
- d. Your landlord cannot "lock you out."

12. *Notices Given to the Landlord or the Tenant*

- a. Your lease will tell you how to communicate with your landlord and how your landlord must communicate with you.
- b. Usually, leases require that notices must be given in writing, which must be sent by certified or registered mail to an address stated in the lease.
- c. Any notice that is not given in the form required by the lease will have no legal force or effect.

13. *Services Provided by the Landlord*

- a. Any services that you expect your landlord to provide must be stated in writing in the lease. For example, if heat, hot water, bathrooms and elevator service are to be included, this must be stated in the lease.
- b. If a service is not listed in the lease, your landlord is under no obligation to provide it to you. For example, if there is no electric meter in the space, the tenant will be responsible for the price of installation and the cost of service.

## **V. RECORDING THE LEASE**

1. There is no legal requirement that a lease be recorded with the New York City Register. The purpose of recording a lease is to provide notice of the lease to future landlords. If the lease is recorded, the new landlord is bound by the terms of the lease.
2. New York considers a lease with a term of more than 3 years to be a conveyance. You should consider recording a lease that has a term of over 3 years. If you change the lease, the terms of that change should also be recorded. Note, however, that many landlords will either expressly prohibit or will object to your recording the lease or a memorandum of lease. In that case, a tenant in actual possession of the space puts any new landlord on "constructive" notice (landlord is deemed to know) that you are a tenant and regarding the rights you have under your lease.
3. The entire lease (or amendment) does not have to be recorded. Recording a "Memorandum of Lease" that sets forth the basic terms of the lease is sufficient to give a successor Landlord notice of the lease.
4. Once you have recorded the lease, you must record all amendments or modifications to the lease. An unrecorded modification is void against a new landlord.
5. The New York City Register files and maintain records concerning all property-related transfers and encumbrances. For more information on recording a lease, and to calculate the exact fee for recording the lease (\$32.00 + \$5.00 per page) visit [http://www.nyc.gov/html/dof/html/property/property\\_rec\\_property.shtml](http://www.nyc.gov/html/dof/html/property/property_rec_property.shtml)

## VI. TYPES OF CLAIMS LANDLORD MAY BRING

1. *Jurisdiction*: Actions under a commercial lease can be brought in both the New York Civil Court or the New York Supreme Court. Jurisdiction of the New York Civil Court is generally limited to cases in which the amount sought to be recovered does not exceed \$25,000.
2. A *Non-Payment Claim* is exactly what it sounds like, a claim that Tenant has not paid moneys due under the lease.
3. Landlord must give Tenant notice, called a "*Rent Demand*."
  - a. The Rent Demand gives Tenant notice of the default so that Tenant can cure before any legal proceedings begin. Under New York law the minimum curative period is 3 days.
  - b. The Rent Demand can be written or oral. A lease may require that Rent Demand be given in writing. A lease cannot waive the requirement of a Rent Demand.
  - c. Rent Demand must state a "good faith" approximation of the rent due, the ways Tenant can pay, and the consequences of non-compliance (e.g., the landlord exercising its right to terminate or charge additional interest on the amount of rent due).
4. Possible grounds for a *Holdover Claim* include:
  - a. The Tenant is staying beyond the lease term without permission.
  - b. Landlord may terminate the lease before the agreed upon expiration date when there has been a significant breach of a "substantial obligation."
    - i. Breach of a "substantial obligation" includes using the premises for illegal purposes, uses not permitted under the "use" clause, or committing or permitting a nuisance.
    - ii. Under New York law, in order for the breach to be significant, there must be "actual harm, damage or a substantial injury."
    - iii. If the lease states that a certain violation is a "substantial obligation," courts will usually enforce such agreement.
  - c. Notice:
    - i. In most circumstances, Landlord must give tenant notice of the claim. The Landlord does not have to give notice if the lease expires on its own terms.
    - ii. Notice must state the nature of the violation, time period cure, and consequences of failure to take such action.

- iii. If, after the lease expires, the Landlord accepts rent, in order to commence proceedings the Landlord must give the Tenant thirty (30) days notice.

## **VII. COMMERCIAL TENANT COUNTERCLAIMS AND DEFENSES**

### *1. Counterclaims Against Landlord:*

- a. Unless Tenant waived this right in the lease, upon being sued by the Landlord the Tenant may interpose an answer which may contain a counterclaim. If the Landlord sues the Tenant for nonpayment, and Tenant has waived the right to counterclaim, Tenant cannot counterclaim for any cost or repair of the premises. The Tenant must bring a separate action to recover for this cost.
- b. The court might sever the Tenant's counterclaim from the Landlord's claim (which means the matters will be decided separately) in order to obtain a speedy decision regarding the Landlord's claim. The counterclaim will not be severed if it is so intertwined with Tenant's defense as to become part and parcel of the case.
- c. A commercial tenant's counterclaims can include a breach of any of Landlord's covenants in the lease.

### *2. Defenses:*

- a. Actual Eviction of Tenant. This defense is applicable to situations in which the Landlord wrongfully expels the Tenant from the premises i.e., "locks you out." There must be physical expulsion in order for this to be a viable defense. This suspends the Tenant's obligation to pay rent and is a complete defense to a Non-payment Proceeding.
- b. Constructive Eviction of Tenant. This defense does not require physical expulsion. Instead, the Landlord's wrongful acts substantially and materially deprive the Tenant of the beneficial use and enjoyment of the property. Tenant must abandon the premises in order to use this defense.
- c. Apportionment Under Casualty Provision. Most leases provide that in the event the premises are partially or entirely damaged by fire or other casualty and rendered unusable, repairs will be paid for by Landlord and rent will be reduced for an amount equal to the portion of the property that is unusable. See Section 9(a) of the Standard Form of Office Lease and Section 9(a) of the Standard Form of Store Lease.
- d. Improper Service of Process.

- i. Landlord is required by law to arrange for personal delivery of the court papers to the tenant.
- ii. If personal delivery is not possible the landlord may deliver (or "serve") the court papers upon the tenant by arranging to have the papers posted at the entrance to the tenant's space (known as the "premises") and by mailing the court papers to the tenant.
  - 1. The legal term for delivery of the court papers by the landlord to the tenant is "service of process". This is the term you will hear in court.
- iii. It is important for a tenant to check the lease, which may contain additional requirements concerning how legal notices are to be given. The landlord's failure to follow these requirements may give the tenant a good "improper service of process" defense.
- iv. An improper service of process defense is nearly always raised in the tenant's answer to the landlord's claims. If the defense is not raised in the tenant's answer, or in a pre-answer motion by the tenant to dismiss the landlord's case, then the defense is "waived", meaning that the tenant may not raise it later on.

### 3. *Yellowstone Injunction:*

- a. After the Landlord serves a notice of default, the Tenant can file for a "Yellowstone" Injunction in Supreme Court.
- b. The purpose of a Yellowstone injunction is to avoid termination of the lease by tolling (temporarily stopping) the time period during which the tenant must cure a default. The law recognizes many commercial tenants invested time and money in their leased space and therefore the injunction affords the Tenant an opportunity to obtain a judicial determination of whether or not you are in breach and what would be required for you to cure the breach.
- c. The Tenant is entitled to a Yellowstone injunction upon showing that:
  - i. Tenant has a valuable interest in a commercial lease;
  - ii. Tenant has received from the landlord a notice of a default under the lease, a notice to cure such default, or a threat of termination of the lease;

- iii. Tenant has requested the injunctive relief prior to termination of the lease; and
- iv. Tenant has the desire and ability+ to cure the alleged default by any means short of vacating the premises.
- d. In granting a Yellowstone injunction, a court may impose conditions, such as posting of a bond in an amount related to damages the Landlord might suffer if the court later determines that relief should not have been granted.
- e. Even when the Yellowstone injunction is granted, the Landlord may still draw upon an irrevocable letter of credit or other security deposits under the lease.

### **VIII. BANKRUPTCY**

1. Upon the filing of a bankruptcy petition by the Tenant, bankruptcy law enacts an "automatic stay" that precludes all creditors from collecting debts.
2. Whether the automatic stay precludes the Landlord from collecting rent or evicting the tenant depends upon whether the lease is considered part of the debtor's estate.
  - a. If the lease expires before the filing of the bankruptcy petition or expires while the bankruptcy case is pending, then the lease is not considered part of the debtor's estate. This means the Landlord is not subject to the automatic stay and can continue to collect rent and can take action to evict the Tenant.
  - b. If the lease does not expire, then the lease is considered part of the debtor's estate and automatic stay applies (see below).
  - c. Under most standard leases, the Landlord has the option to cancel the lease after the Tenant files for bankruptcy. These provisions are generally unenforceable under the bankruptcy law as currently in effect.
3. If the lease is considered part of the debtor's estate:
  - a. The automatic stay applies.
  - b. The Landlord is precluded from taking any steps to enforce the terms of the lease.
  - c. The security deposit is "frozen" and the Landlord cannot use any cash security deposit to offset unpaid rent. If the security deposit is in the form of a letter of credit, the law is not entirely clear if the Landlord can use proceeds from the letter of credit to pay unpaid rent.

- d. If the Tenant has defaulted under the lease, in order to evict the Tenant and regain possession of the premises the Landlord must obtain a court order.