Potential Property Pitfalls at Lease Renewal Time
About to sign a new lease? Avoid unnecessary headaches and expense with these tips

July 15, 2013
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Most leases are complicated with numerous provisions that will impact operations. If you’re about to renew your lease or are working with a new real estate management agent, look out for these lease provisions that might cause issues or problems. While no two situations are the same, remember that in the existing market most landlords have great incentive to keep an existing tenant.

Do You Want to Stay?

The threshold question for a facilities manager/ownership is whether you want to renew. The answer to this question involves a combination of factors:

1. Do you need less or more space?
2. Have any improvements paid by the tenant been significantly depreciated?
3. What are the costs of moving your company to another location?
4. What is the availability of other leasing options in the target geographic area?

While your landlord should be motivated to keep an existing tenant, other competing landlords will also grant incentives to lure a new tenant.

Term and Rent

Make sure the lease reflects the business deal as stated to you. Double-check the commencement and expiration dates and the stated rent, particularly annual rent increases.

Option to Extend Term

The notice of renewal must be delivered in a timely manner, as this is a date that you do not want to miss. In addition, the lease will have specific provisions as to how notice of renewal needs to be delivered; usually by certified mail or by personal delivery. These provisions are strictly interpreted by courts. It is important to pay attention to these provisions. For example, several years ago this author became aware of a tenant that thought it needed to give notice of renewal no later than six months prior to expiration of the lease when it turned out that 270 days (nine months) advance written notice was required. The landlord used this mistake to renegotiate some of the business terms of the renewal.

Security Deposit

If you are about to renew your lease, review this provision to protect what often is a large sum of money. Focus on where the security deposit is held (for example, a segregated bank account would be better than granting the landlord the right to comingle the security deposit with other funds) and what occurs upon the sale of the property. Make sure that the landlord is not released from the obligation to return the security deposit until such time as the new owner acknowledges receipt of the security deposit. If your security deposit is a cash deposit, take steps to protect your investment if the landlord files bankruptcy or if the building is foreclosed upon by a lender. For example, one client provided a $100,000 security deposit and the landlord filed for bankruptcy protection. A California bankruptcy court ruled that the tenant was an unsecured creditor, which meant at best it would receive pennies from the bankruptcy
estate. The court also ruled that the lender that foreclosed upon the lease did not have to return the security deposit since the successor physically never had possession of the earnest money. The lease should provide that in the event of a bankruptcy or foreclosure any subsequent owner of the property will be required to recognize the deposit, regardless of possession of the funds. A good alternative would be to consider using a letter of credit, which cannot be collected so long as there is no tenant default. With a letter of credit, the risk of loss of a large sum of money is diminished in the event of the sale of the property.

**Condition of Premises**

If you are about to renew your lease, focus on maintenance and repair, particularly in areas where you have been spending more money than anticipated. You may want to check if under the lease the landlord has met certain warranties and representations: for example, in many leases, the landlord will represent that the roof, structure, HVAC, plumbing and electrical systems are in good working condition and repair, and that the premises are in compliance with applicable building code. If so, make sure these warranties are still true.

For example, a client was approaching a renewal deadline and was concerned about the physical condition of a 60,000 square foot industrial warehouse with some office space. I suggested a professional inspection. For a small cost, the inspector identified issues with the roof, the HVAC system, poor weatherproofing, potholes in the parking lot, and a crack in one of the floors. Since these problems were brought to the attention of landlord before the lease was renewed, repairs were made a condition to my client exercising the renewal of the lease. Thousands of dollars of repairs that otherwise would have been the responsibility of tenant were passed on to the landlord.

Another client of mine learned this lesson the hard way. Several months after renewal of a lease for an industrial property, the roof started leaking. Since under the lease repair of the roof was the responsibility of the tenant, the cost to tenant in this case was over $50,000.

**Environmental**

As a facilities manager this is an area where constant vigilance is required. Almost every lease prohibits the tenant from the use of hazardous materials, except for those specifically related to tenant’s use and approved by landlord, and those hazardous materials will need to be properly handled and stored.

**Insurance**

This is an area that can fall through the cracks. Make sure that you work with your insurance manager to determine that the type and amount of required insurance is up to date and adequately insures your property and liability exposure.

**Damage to Premises**

Review the lease to make sure that in the event of a major casualty the landlord has to give notice of its intent to rebuild and restore the premises within a specific time period and that rent abates during this period of time.

**Operating Expenses**

A manager of a building in an industrial park where the tenant pays a proportionate share of real estate taxes and operating expenses should focus upon whether those taxes and operating expenses charged by landlord are reasonable and consistent with expectations. Review the taxes and operating expenses which are charged to make sure the landlord is not trying to capture costs unrelated to the specific operation of the industrial park or buildings or specifically related to leases of other tenants. The lease may have an “audit” provision giving the tenant the right to audit landlord’s statement of operating
expenses and to be reimbursed for the cost of the audit if there is a discrepancy over a certain percentage (say 3%).

Pay particular attention to the real estate tax component of any expenses being passed along to the tenant particularly if the property has been sold during the time the tenant has occupied the premises. Often the sale of the property will trigger the local taxing authorities to reexamine the assessed valuation of the property and, if the property was sold by the previous owner at a profit, real estate taxes might increase.

While over the last five years sales at a profit are rare, this author recently had a client that is a tenant in a property that sold for more than a 50% profit which will trigger a significant increase in the real estate taxes that the tenant will be required to pay under the existing terms of the lease. As it so happens, the lease is up for renewal in a year and I renegotiated the base year of the lease so that the tenant will only pay increases in the taxes above the reassessed valuation of the property.

**Repair and Maintenance**

If you are about to renew your lease, you should take inventory of what areas of repair and maintenance have exceeded your budget and are necessary. If these costs are excessive, at the time of renewal make it a condition of renewal to shift responsibility for areas of repair that are historically costly to you. In most leases a landlord imposes virtually all expenses of operating, maintaining and repairing the premises upon a tenant, including the responsibility to repair and maintain the HVAC, electrical and plumbing systems, all fixtures and equipment, and replacement of light bulbs. As a rule of thumb, the longer the lease, the more responsibility a tenant has for repair and maintenance.

Attempt to limit your repair and maintenance responsibility to systems (electrical and plumbing) within the premises. Also, request that landlord be responsible for major repair or replacement of the HVAC system (such as the need for a new compressor).

**Sublease**

Depending upon your space needs, this may be the time to consider the possibility of subleasing a portion of the premises. Typically, a lease provides for consent of the landlord prior to sublease to a third party. These provisions will have specific notice provisions with the need to provide specific information for the subtenant. Be familiar with this provision so as to not waive any rights.

**Tenant Improvements Prior to Commencement of Renewal of the Lease**

If you’ve been in premises for an initial term of 5-10 years or more, do not be hesitant to request improvements before exercise of a renewal. Even cosmetic improvements such as repainting office areas and warehouses, new ceiling tiles and carpet, etc. can pass along a positive impression to
employees and guests. Make sure to receive a warranty for the work for a one to two year period after the commencement of the renewal term.

**Use Your Attorney**

Finally, prior to renewal of a lease contact your attorney and request a thorough review of the lease. Ask your attorney to identify which party – landlord or tenant – pays for specific items of repair and maintenance. There are many items that may not be addressed in a lease or improperly shift the responsibility for costs upon the tenant that should be a landlord’s responsibility.

This author was involved in such a situation recently. A sewer pipe located outside the premises leased by a client, but serving the premises, burst and required immediate repair. The lease was silent on which party should pay, the result being landlord and tenant may need to litigate the issue. Meanwhile, the tenant needed a working sewer pipe and was forced to spend over $50,000 to repair the problem. Use the renewal of a lease as an opportunity to anticipate potential issues and clarify costs and responsibility.