

Whitepaper

Handling commercial real estate disputes and future-proofing your commercial real estate business



BORNSTEIN LAW
BAY AREA REAL ESTATE ATTORNEYS



Never in our professional careers have we fielded calls for such an astronomical amount of rent debt due to the pandemic.

It's sad. At Bornstein Law, we don't have to walk far from our office on Polk Street in San Francisco to see shuttered, graffitied storefronts and other detritus left in the wake of the pandemic.

Offices have empty seats and many shops, restaurants and cafes have not been able to survive the exodus of workers who are now working remotely.

We are encouraged to see that new businesses have sprouted up and tourism is on the rise, but there have been many casualties. Commercial landlords have been put in a precarious position but our office can assist.

Since commercial tenants are seen as being more sophisticated than residential tenants in the eyes of the law, businesses and organizations are afforded fewer protections and rights than those who rent residential units.

Unlike residential tenancies, evictions are not limited to "just cause" reasons but rather, we need to look at which terms of the lease the tenant has breached.

Failure to pay rent accounts for most of the commercial eviction actions we handle at Bornstein Law, but this is a course that should be taken with careful thought and only be used as a last resort, especially if the business enjoys goodwill with the public.



What is the value of a commercial tenant and how quickly can a vacancy be filled?

Generally speaking, it is relatively easy to re-rent a vacant apartment if the unit is priced right and is in good condition. It is not so easy to fill a vacancy in a commercial space.

Prospective tenants willing to move into an empty storefront or office are harder to come by, especially with a glut of inventory. We don't expect it to get any easier; as the hybridization of office work continues, more and more companies are either moving from core urban areas or downsizing their square footage.

When endeavoring to evict tenants, then, commercial property owners run the risk that the space will languish on the market for months or years on end with no clear path to rental income. Worse yet, the underutilized property may be subject to a vacancy tax.

Bornstein Law will gladly have a dialogue with you to weigh the costs and benefits of evicting the tenant, with a strong preference to negotiate a mutually agreeable deal to keep our client's cash flowing after differences are ironed out.

We have always said that litigation is not like a Warriors or a Giants game where one side wins and the other side loses.

Our goal is to never elongate a dispute, but to resolve the matter as cheaply, quickly, and efficiently as possible, taking into account time, risk, and attorneys' fees.

The California commercial eviction process at a glance

As the first step, we'll have to ascertain whether there is a legal reason to evict the tenant. Aside from non-payment of rent, disputes arise when the tenant engages in unacceptable use of the property. Alterations, damage, or unauthorized subletting are common transgressions. Our office will carefully review the terms and conditions of the lease and any penalties for breaching the contract.

If the tenant has failed to pay rent, we'll have to peel back the books and take a hard look at the numbers.

Under the California Code of Civil Procedure (CCP) §1161.1, the landlord is allowed to prepare a document called "an estimated rent demand." This differs from residential tenancies, where an estimation of rent owed is defective and will surely tank an unlawful detainer action because a precise dollar amount must be used.

However, this ballpark number must be reasonable and if in fact the rent demanded is an estimate, it must be clearly communicated to the commercial tenant. Now is not the time to exaggerate the actual rent amount that is owed; an inflated amount will come back to bite the landlord.

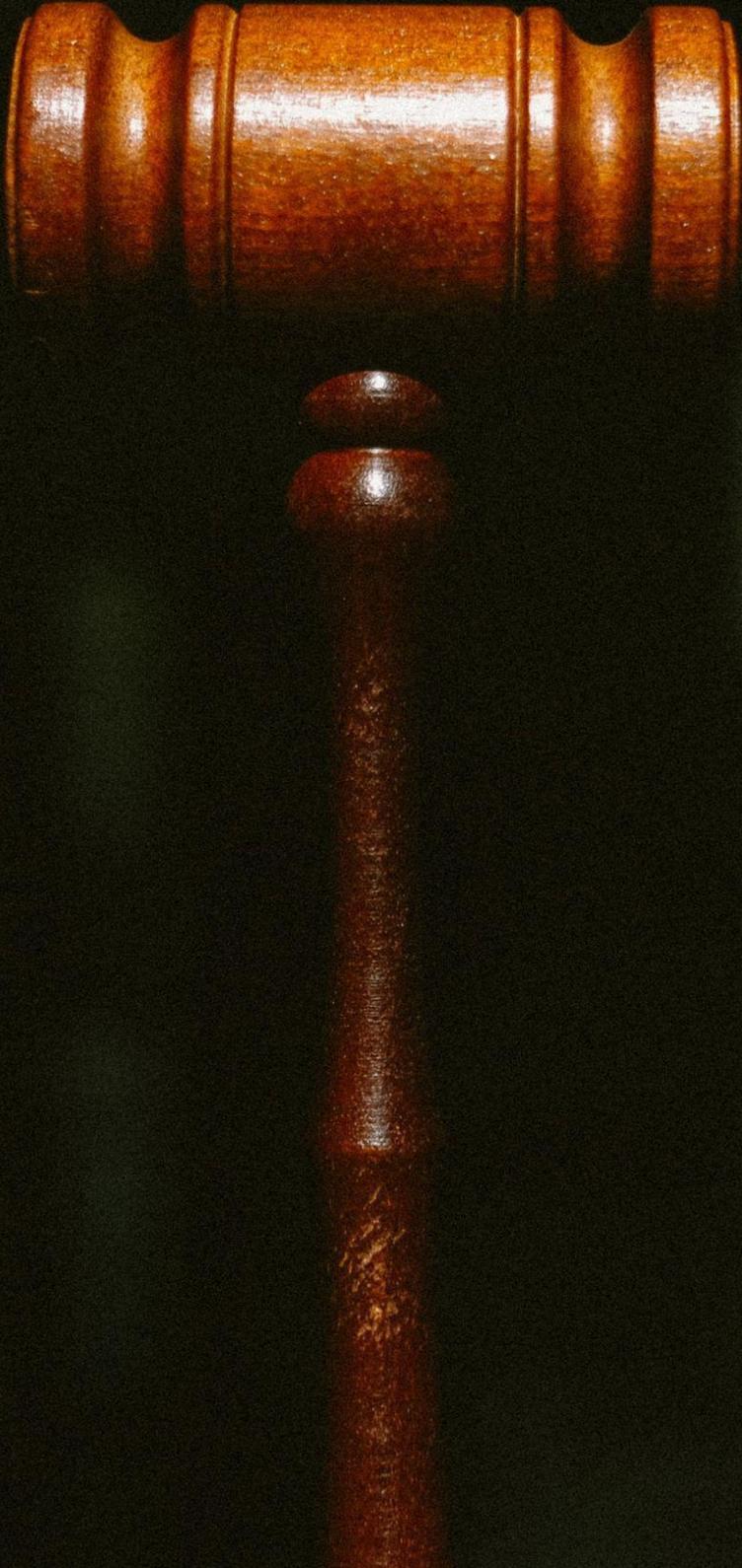
If we find that the commercial tenant is indeed violating the lease and no easy, amicable solution can be found, Bornstein Law can prepare a 3-day notice.

If the theory for eviction is non-payment of rent, it is common that a cash-strapped business will offer a partial payment. Landlords can accept a partial payment and, with our assistance, still move forward with recovering the full amount owed.

The landlord should be cautious before accepting a partial payment of rent after serving the 3-day notice. The tenant must have been properly notified that by taking payments in installments, the landlord is not waiving the right to pursue an unlawful detainer action to recover possession of the property. Actual notice to the tenant must be given prior to the acceptance of the partial payment or the landlord runs the risk that his nonwaiver notice will be invalid and the landlord may lose the unlawful detainer action (*Woodman Partners v. Sofa U Love*, (2002) 94 Cal.App.4th 766).

Since the manner of communicating nonwaiver notice in Section 1161.1(c) does not prescribe any particular manner in which notice of a commercial landlord's nonwaiver of rights must be communicated to the tenant, it may also be given in a three-day notice or the lease. Bornstein Law can help commercial landlords prepare a lease that will comply with CCP § Section 1161.1(c) before the issue of whether a landlord properly gave tenant a nonwaiver notice before accepting partial payment of the rent, even arises.

If the landlord accepts a partial payment of rent after serving the 3-day notice, the tenant must be properly notified that by taking payments in installments, the landlord is not waiving the right to pursue an unlawful detainer action to recover possession of the property.



Assuming the notice is properly served, the landlord is not quite done yet.

A "Proof of Service" form must be completed. After you've checked all of the boxes with your lawyer's advice, the tenant has 3 days (excluding weekends and court holidays) to remedy the situation, keeping in mind that a partial rent payment does not exempt the tenant from eviction proceedings, but will receive credit for the payment.

Hopefully, the tenant pays the rent or cures the underlying behavior, but if not, you have perfected your right to file an unlawful detainer complaint. To commence this action, our office will need a bit of documentation.

Once the lawsuit is in motion, the tenant will be served a summons, and the onus is on them to do one of two things. The tenant can elect to vacate the property within 5 days if the document is delivered in person, although they may buy some time if served in a different manner.

More likely, they will respond to the summons and contest the eviction, but if the tenant does nothing at all, Bornstein Law will ask for a default judgment from the court.



If the matter is enlarged, a trial date will be set and the biggest determinant of our success is which attorney the defendant retains and how hard they fight. If our client prevails, they will be awarded unpaid rent and any other damages specified in the lease agreement.

At this point, we can now reach out to the Sheriff to serve a 5-day Notice to Vacate, carry out the eviction, and change the locks. By law, the tenant can claim any remaining possessions within a specified time. For anything that goes unclaimed, the landlord must dispose of items in accordance with the law. Rest assured, it is not finders keepers.

The difference between the big fish and the little fish

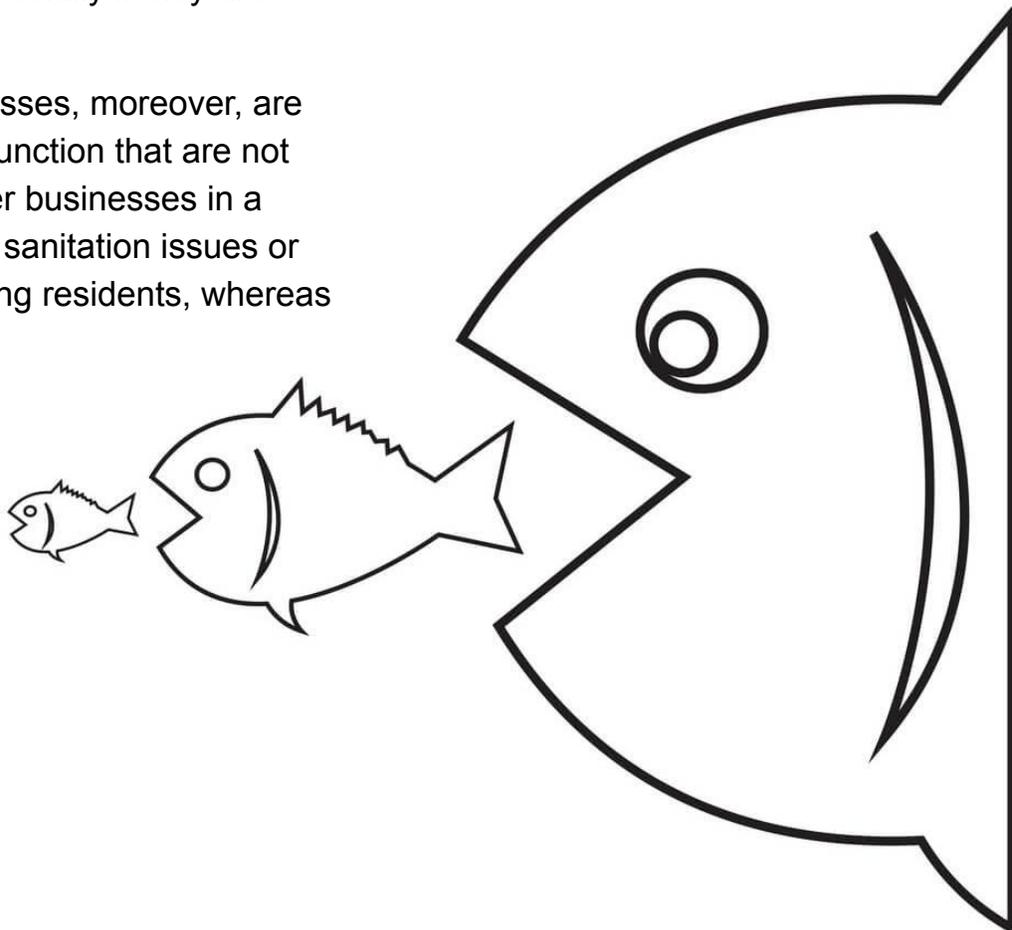
Some commercial tenants have more legal muscle. We are differentiating between a large restaurant chain, for example, and Joe's Hole In The Wall Diner which has five employees.

Large, mid-sized businesses and chains generally have more leverage in negotiating leases and if something goes astray in the rental relationship, they tend to have a phalanx of attorneys and staff able to address disputes. Oftentimes, when eviction actions are not going in their favor, larger businesses will throw in the towel and just pay off the rent debt.

By comparison, small businesses have less bargaining room in negotiating leases and not as many resources to stave off eviction.

Any drop in income can be catastrophic - the prospect of recovering rent debt from these small businesses can be dismal, especially if they are insolvent.

Smaller, mom-and-pop businesses, moreover, are more prone to pockets of dysfunction that are not normally encountered by larger businesses in a huge strip mall,- For example, sanitation issues or noise complaints by neighboring residents, whereas chains run a tighter ship.





Glossary of terms

When drafting, negotiating, or reviewing commercial leases, it is vital to seek informed guidance from an attorney. Yet owners of commercial properties should understand some key terms and clauses and consider in which condition the space can be delivered to the tenant.

Sublease Clause

This is an important clause in the lease agreement that governs whether or not a commercial tenant can lease out space to another tenant. Not uncommonly, businesses would like to lease out the entire premises or underutilized space to subtenants to realize additional income or the ability to vacate the premises if need be.

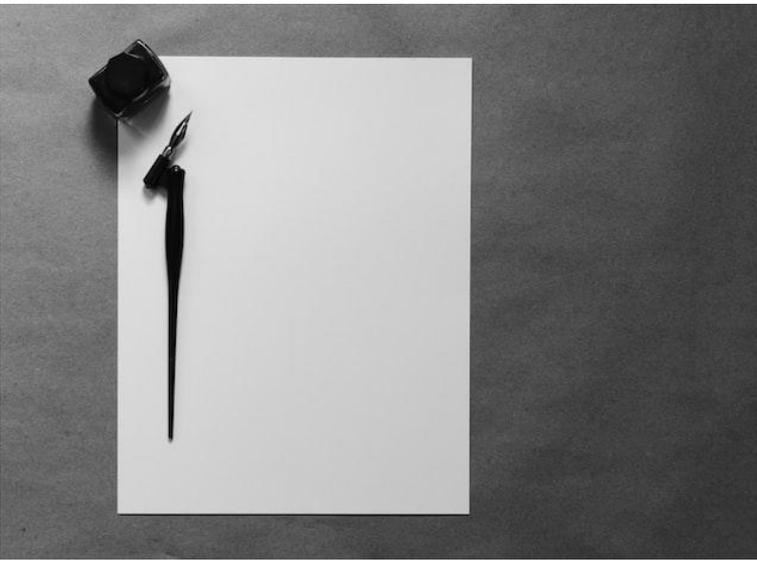
Exclusive Right Clause

Most commonly seen with retail businesses, this exclusivity clause can also be applied to any industry and gives the tenant the right to be the only business that sells a certain product or service in their respective field at the same property. A nail salon, for example, would not want a competing nail salon in the same strip mall.

Rent Escalation Clause

Commercial rent can be increased on an annual basis or during any renewal options, and this clause spells out how much of an increase a tenant will be subject to.





Common lease structures in a commercial tenancy

Unlike residential tenancies that must conform to California state laws and local rules in rent-controlled jurisdictions, there is wide latitude given to landlords and tenants when negotiating commercial leases.

Commercial spaces can be delivered in a whole host of conditions. It can be presented to the tenant gift-wrapped with a bow, or the physical space can be a disaster zone and everything in between.

Let's go over some common lease structures.

Triple Net (NNN)

A triple net lease, also called a net lease, is one of the most common lease structures that require the tenant to pay base rent, as well as fulfill the three nets. They are:

- Property taxes
- Building insurance
- Common area maintenance (CAM)

Under this structure, the tenant is responsible for all expenses related to the property, but the landlord has responsibilities of his or her own.

Maintaining the structural components like the roof, structural walls, and foundation is an obligation that falls squarely in the lap of the landlord.

In an "absolute triple net lease," however, the landlord is completely off the hook, as the tenant is responsible for the structural components of the building.



Calculating rent for a NNN lease:

Take estimated annual expenses, add this number to the price per square foot and multiply this by the rentable square footage of the space.

Full-service gross lease

Under this structure, the tenant is responsible for paying a base rent and the landlord is on the hook for all expenses related to the property.

From a tenant's perspective, this sounds very attractive, because they know exactly what they are paying each month. Ye the landlord will likely increase base rent with a full-service gross lease as a means of risk mitigation for the owner - it is preferable to be as insulated as possible from any unexpected expenses that arise.

Calculating rent for a full-service gross release: multiply the price square foot by the square footage.

Modified Gross lease

This structure requires tenants to pay a base rent and a portion of operating expenses such as electric.



Calculating rent for a Modified Gross Lease:

This is nearly identical to finding full-service gross rent. That is, the price per square foot is multiplied by the square footage of the space. The tenant then adds this number to the amount of expenses that they will incur on top of rent.

Cold Dark Shell

As its name implies, the landlord delivers the space in a condition that needs a lot of TLC. It could be down to the studs of the building without electricity, plumbing, etc.

Clearly, the build-out costs are high for the tenant. In turn for the tenant absorbing these costs, the landlord can offer a lower rent and a higher tenant improvement allowance (TIA), meaning the landlord gives money to the tenant to help pay for improvements to a space or a rent grace period while the space is built out. This negotiable allowance is generally referred to in dollars per square foot.

Because TIA typically does not have to be paid back, it can be a huge incentive for a tenant to ink a lease and can be a critical negotiating point when attracting new tenants.

Second-Generation or "hand-me-downs"

The appeal to rent these spaces is that there can be little or no build-out costs, depending on the type of business and the past tenant.

As an example, when a tenant is seeking space for a restaurant, it may be ideal to rent a space where the previous tenant was also a restaurant. The space is likely to be outfitted with proper ventilation, plumbing, fire suppression, and everything else needed for a kitchen. Commercial stoves and refrigerators can be included, to boot.

In these hand-me-down spaces, a fresh coat of paint, new flooring, and a signage change may be all that the tenant needs to do to open their doors to business.

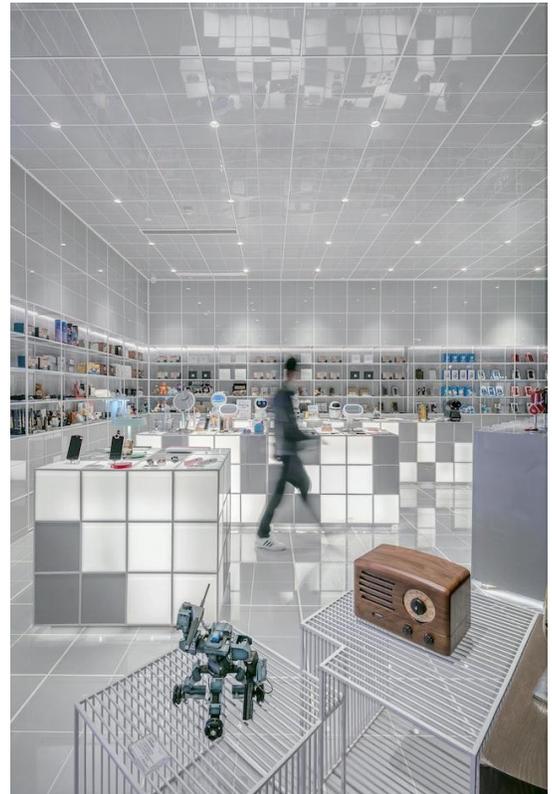
As a word of caution for landlords who have a vacancy previously rented by a long-term tenant, the space may not be up to code. With maddening regulations in the Bay Area, it can be a harrowing experience to make the property code-compliant, including accessibility for persons with disabilities.

Take, for instance, the harrowing story of a couple who took over a small restaurant in order to serve their renowned ramen to 10 guests a night, three times a week. Even the most tenacious entrepreneurs were no match for a maddening bureaucracy, with the couple racking up over \$100K in expenses in order to open up shop, [as this San Francisco article reports](#).

Parting thoughts

From the cradle to the grave, our firm can provide informed advice on a myriad of legal issues facing commercial property owners and their agents, from the inception of the rental relationship to the removal of tenants, and offer sound guidance if any quandaries arise along the way.

Negotiating desired lease terms, drafting the lease, and resolving disputes in commercial tenancies require the assistance of a law firm that manages landlord-tenant law on a daily basis. Our reputation precedes us as the Bay Area's foremost practitioners in this niche area of law.



If the rental relationship collapses, the court and the defendant's attorney in an unlawful detainer action will scrutinize notices and there is no room for error. If there are any flaws in the 3-day notice or if it was not properly served, the tenant who is in breach of the lease can nonetheless prevail.

A recurring theme in our practice is landlords or their agents using bad notices or not properly serving them but these cardinal sins can be avoided by tethering yourself to a law firm that handles eviction actions and complex real estate litigation all the time.

Helping you think smartly and strategically about your real estate investments. For informed advice, contact the firm built for rental property owners and the professionals who serve them.

Bornstein Law is dedicated to helping you powering through your real estate challenges and resolving thorny landlord-tenant disputes as quickly, efficiently, and cost-effectively as possible, taking into account time, risk, and attorneys' fees.

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