

SMALL BUSINESS: REAL ESTATE

This resource is designed to provide general information for small businesses that rent their space from a landlord and for landlords who rent space to small businesses. This material was drafted in 2024 and we cannot guarantee that all information is current. This resource will not answer all of your questions. It is designed to set out some of the issues you may have to consider, to help you understand the basics about each issue, and to point you in the right direction for help. Much of the information is general, and you may need to contact legal aid organizations or federal, state, city, or county officials to obtain more specific information and advice. This resource was prepared by various law firms, legal aid organizations, and other nonprofit organizations as a free resource. Although the authors hope that it will be helpful by providing background material, we cannot warrant that it is accurate or complete, particularly since circumstances may change. It is not intended to constitute legal advice and should not be relied on as legal advice. Readers should seek tailored advice from their own legal counsel. If you cannot afford to hire a lawyer, you can contact (888) 382-3406 for referral to a nonprofit legal aid organization. If your business may need financial assistance, you should inquire about available programs through the Small Business Administration (SBA).

Commercial Leases

What happens if the building or property that is leased is destroyed? Does the lease automatically terminate? Does the tenant have to continue to pay rent?

Where there is a lease covering this issue. Check your lease to see if there are any specific provisions about what happens if the leased premises are destroyed or damaged. Most commercial leases have something to say about this situation, with definitions distinguishing mere damage from total destruction and provisions about the rights and obligations of the landlord and tenant in both situations. If your lease contains these provisions, the lease will answer these questions. If your lease obligates the landlord to rebuild the premises after a fire or casualty but does not otherwise address the tenant's right to terminate due to the premises being damaged or destroyed, it may mean that the tenant cannot terminate the lease. You should discuss specific situations with an attorney.

Where the lease is silent on this subject or you do not have a written lease. These questions will be answered based on general principles of California law. For example, under California law, unless a lease provides otherwise, the lease automatically terminates when the leased premises are entirely destroyed. Whether the leased premises have been entirely destroyed is a factual determination made on a case-by-case basis.

If the leased premises are not entirely destroyed, but are "substantially damaged," then the tenant has the option to terminate the lease with appropriate notice to the landlord. The leased premises are "substantially damaged" when they are no longer fit for the use for which they were originally leased. This is a factual determination made on a case-by-case basis. The greater the damage, the more likely it will be considered "substantial."

If the landlord can repair the damage to the leased premises in a reasonable period of time, then the leased premises are less likely to be considered substantially damaged and, while there may be a basis for abatement of rent for some period of time, the tenant may not be able to terminate the lease on the basis of that damage. Another factor in determining whether the leased premises were substantially damaged is an understanding of the use for which they were originally leased. For example, if the leased premises are retail stores, damage that results in the leased premises being inaccessible to the public may render the leased premises substantially damaged even if the extent of damage is not that great.

If the lease is terminated, the tenant is relieved of an obligation to pay rent, but the tenant is not entitled to a refund of any prepaid rent. If the lease is not terminated, depending on whether there is a basis for abatement, the tenant must continue to pay rent.

What degree of damage to the leased premises constitutes "partially damaged" or "entirely destroyed" or "substantially damaged"?

The answer depends on specific factual circumstances. To be considered "entirely destroyed" or "substantially damaged," the leased premises must generally cease to be fit for the use for which they were leased. While major fire or flood damage will likely result in the leased premises being entirely destroyed or substantially damaged, limited damage and damage from smoke and light water intrusion may only result in the leased premises being considered "partially damaged." It is important to consider also what constitutes the "leased premises." For example, in the case of a ground lease in which the tenant leases the underlying land and is responsible for all improvements upon the land, the leased premises are the land itself, not the improvements constructed on the land. In that event, the destruction or damage to the improvements will generally not be considered destruction or damage to the leased premises, and the tenant will not

have a right to terminate the lease. If the leased space is a suite within a building or a storefront within a shopping center, then the extent of damage will be determined based on the direct and indirect damage to the specific space and not the damage to the entire building or shopping center.

Is the landlord obligated to rebuild the building?

If there is a lease and it provides for this obligation, the lease controls. Absent an express provision in the lease, while the lease may be terminated or subject to termination, the landlord is not obligated to rebuild the building or leased premises.

If the landlord terminates the lease, is the tenant entitled to a refund of its security deposit?

Yes, unless the express terms of the lease make it non-refundable. According to California law, the landlord must refund the security deposit (less any lawful deductions) within 30 days after the tenant vacates the leased premises.

Is the landlord required to repair and restore the tenant's furniture and equipment?

Generally, the landlord is not required to repair any damage to the tenant's furniture or furnishings or any equipment, improvements, or appurtenances that are removable. This damage may be covered by the tenant's insurance company.

Is the tenant obligated to pay rent during the time the landlord makes repairs on the building?

If the lease is terminated because the premises have been entirely destroyed or substantially damaged, the tenant is relieved of its obligation to pay rent after termination. Under California law, rent reductions for partial damage will be governed by the terms of the lease or, if the lease is silent, on a negotiated resolution with the landlord or through litigation.

Once the landlord completes the restoration of the leased premises, the tenant may still have work to do to repair equipment, phones, office equipment, etc. The tenant will be obligated to pay rent during this period but may be able to cover the cost of that rent from proceeds of the tenant's business interruption insurance policy.

How long can the landlord take to repair the leased premises?

If the landlord elects or is required to repair the premises under the terms of the lease, the landlord must do so in a reasonably expeditious manner, subject to delays due to the adjustment of insurance claims, labor troubles, and causes beyond the landlord's control.

Can the tenant withhold rent if the landlord has failed to timely repair the leased premises after the disaster?

Generally, unless the lease provides otherwise, a tenant remains obligated to pay rent if the leased premises are not entirely destroyed or substantially damaged and remain usable. The requirement to pay rent if the premises remain usable is not generally dependent on whether the landlord makes timely repairs unless the lease permits the tenant to terminate the lease on this basis and the tenant affirmatively does so. Commercial leases usually have specific provisions regarding repairs, and those lease provisions will dictate the rights of the landlord and tenant. Refer to your lease for more information.

If the landlord elects to terminate the lease, is the landlord obligated to help the tenant find alternative space or reimburse the tenant for related costs?

No, unless the lease contains a specific provision that creates this obligation.

Can the landlord rent the leased premises to someone else while the tenant is gone?

No, unless the lease expressly provides otherwise, a landlord cannot rent the leased premises to another party unless the lease has been terminated or the tenant has stopped paying rent or has agreed to a sublet or assignment. The landlord has an obligation to make the leased premises available to the tenant for as long as the lease is in effect. The landlord cannot impair the tenant's right to use the property unless there has been a default by the tenant and the lease has been terminated.

Can the building be condemned?

Yes. Governmental agencies with jurisdiction over a building may condemn it if the building is not suitable for safe occupancy or for other public purpose reasons. Generally, FEMA, public health and safety agencies, or a local building inspection department have jurisdiction to determine that a building cannot safely be occupied.

If the building is condemned, will the property owner be paid for the loss?

When the government condemns property based on a finding that it is no longer habitable or safe for occupancy, the government is not responsible for paying for the loss of the property. Generally, the government is required to pay for condemned property only when the property is taken by the government for public use. Condemnation of property as unsafe is generally not a “taking” for public use. To the extent the owner cannot recover the lost value of the condemned property, the property owner might be able to recover all or part of the value of the property from the owner’s insurance (depending on the terms of that insurance) or obtain financial assistance from FEMA or other relief agencies.