

HABITAT

APRIL 2004 HABITAT

COMMERCIAL LEASES

Looking for Leverage

When it comes to the relationship between co-op or condo owners and commercial tenants, what boards sometimes don't understand about their commercial tenants' rights and their leases can often hurt them. If they fail to set parameters for what is "noxious use," they will soon discover the meaning of the phrase after that swanky new restaurant moves in and its excessive noise and pervasive kitchen smells keep resident-owners up at night.

Call it an inherent conflict of interest. "The commercial tenant wants to stay open as late as possible, play music as loud as possible, have as many people coming into the space as possible," observes attorney James Samson, a partner at Bangser Klein Rocca & Blum, while the residential owner just wants to be able to enjoy his or her home as peacefully as possible.

We're talking about leases and leverage – about what to do when the sponsor holds the rights to your commercial space and you think you're powerless, about what to do when a store's music is too loud, a restaurant's food is too smelly, or a garage's rent is long overdue. We're talking about commercial lease power and how to find it – and use it effectively.

What should a board be looking for when it goes to review its commercial lease? Any kind of quality-of-life obligations, regarding the cosmetic appearance of the space, as well as "escalators" – rent-increase clauses that allow the building to charge more future rent. There are five such clauses, and most commercial leases have at least two of them. These clauses are among the most overlooked portions of a lease, and boards that fail to bill their tenants based on these built-in increases can be cheating themselves of hundreds of thousands of dollars.

The tax-increase escalator, the porter-wage escalator, and the Consumer Price Index escalator are all built-in rent increases tied to upticks in property taxes, union wages, or cost-of-living increases. The "pass-through" escalator, one of the most common, creates a formula for passing on a portion of the building's operating expenses to the commercial tenant, based on the square footage it rents in the building – a key clause most buildings forget to charge. The last is the most straightforward: the "general escalator," a bump in rent every x number of years.

If the tenant is paying rent on time, and with the proper escalations, the board has other avenues of negotiation, such as holding up repairs on the commercial space until the tenant agrees to keep the sidewalk swept and have the garbage removed in a timely manner.

It may seem like dirty pool to the tenant, but commercial tenants often have quality-of-life obligations that boards fail to enforce, points out Samson. "The first thing you have to do is look at the lease to see if they are paying rent on time." Then ask, "What obligations does the tenant have that he's not performing?" What rights does the board have when it comes to alterations in the space or signs on the building's facade?

Recently, says Samson, he represented a co-op board on Broadway that was able to successfully negotiate a quid pro quo with a difficult sponsor who held the lease on a commercial space. The sponsor had planted an enormous air conditioning unit in the co-op's backyard, without asking permission, and the board was angry. When the sponsor then tried to get the board to sign off the building permits he needed to make alterations to his space, the directors held their ground: no signature until the A/C was taken away. A deal was struck.

Attorney Andrew Brucker, a partner in Schechter & Brucker, says that, more often than not, boards aren't even making certain that they are passing on the tenant's share of expenses to the commercial leaseholder. "I can't tell you how many of my co-ops don't bill the sponsors for their share of taxes or water or whatever. I had a situation on the Upper East Side where the commercial tenant was simply paying the wrong amount continuously."

After the board finally reviewed the lease, it was too late to recoup the money. There is a six-year statute of limitations.

What happens if the co-op board has combed through the lease again and again and can't find any provision that the commercial tenant has violated? What's a board to do if it looks like they have no room to negotiate?

In rare instances, the property can apply for relief under the Condominium and Cooperative Abuse Relief Act, passed in 1980, which in limited instances allows a board to terminate a sponsor's pre-conversion sweetheart lease. Unfortunately, it is unusual for a court to allow a lease termination, because the owners knew about the lease – or should have read it – before they moved into the building. "That's why the attorney general or the courts won't say, 'These people are getting screwed, let's rewrite the lease.' As onerous as it may sound, you may really be stuck with a sponsor's commercial lease," notes Brucker.

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That's when boards have to get really creative with a difficult tenant, such as being willing to extend a lease at favorable terms in exchange for a guarantee that the tenant won't put in a nightclub or a bar. Still, boards need to think carefully about what they want to trade and whether an immediate gain is worth a future loss.

Take the example of a co-op on Central Park West, which 15 years ago wanted to raise money to pay for a major renovation, but didn't want to take out a high-interest loan. The board sold the building's commercial space to three tenants, turning these medical providers into shareholders with a limited proprietary lease. While the sale guaranteed a steady stream of income for the property, and an immediate infusion of cash, over the years, one director acknowledges, the board has at times sorely regretted the loss of rental income in a hot commercial market.

Another problem can arise when the building changes managing agents. "It's very rare for the new manager to look at the lease," warns Brucker. "What they look at is how much was billed in the past and then continue to bill it. That happens all the time. We have more than one co-op where the commercial lease says capital improvements are paid by one party, while repairs are paid by the other party and nobody ever passed through the cost of the repair to the tenant."

In the end, a building should have its attorney look at the lease, make sure everything is in order, and summarize it for the board. If you don't, you could be getting less than you are owed – and more than you bargained for.

—Ruth Ford