

## Unit 17: Leases

### **LECTURE OUTLINE**

#### I. Leasing Real Estate

##### A. Definition—lease

1. A contract between owner of real estate (lessor) and tenant (lessee) to transfer rights of exclusive possession and use in exchange for the payment of rent and other obligations.
2. The owner retains the reversionary right to possession.

##### B. Statute of Frauds (Consult your local laws)

1. In most states, to be enforceable, a lease for more than one year must be in writing.
2. A lease that can be performed in a lesser period of time is usually enforceable in court even if it is oral.

##### C. In Practice: The best practice for the protection of all parties is to use a written lease, signed by both lessor and lessee.

#### II. Leasehold Estates (see Figure 17.1)

##### A. Estate (tenancy) for years

1. Continues for a definite period of time, regardless of how long.
2. Specific beginning and ending dates.
3. No notice is required to terminate.
4. Does not automatically renew but the written agreement may provide for an option to renew.

##### B. Estate (tenancy) from period to period

1. Exists for a fixed period of time but automatically renews.
2. The payment and acceptance of the rent extends the lease for another period.
3. Proper notice must be given to terminate the lease.
4. Holdover tenancy
  - a. Created when tenant with estate for years remains in possession.
  - b. Landlord may evict or treat holdover tenant as one who has periodic tenancy.

C. Estate (tenancy) at will

1. Exists with the consent of the landlord.
2. Usually informal and oral.
3. Indefinite in length.
4. Proper notice must be given to terminate.
5. Automatically terminates at the death of either party.

D. Estate (tenancy) at sufferance

1. Created when the tenant who legally obtained possession of the property now illegally remains in possession.
2. Exists without the consent of the landlord.
3. Example—tenant whose lease has expired but refuses to move out.

III. Lease Agreements

A. Requirements of a valid lease

1. Capacity to contract—all parties must be legally competent.
2. Legal objectives—intent of the contract must be legal.
3. Offer and acceptance—meeting of the minds of the parties.
4. Consideration—usually rent but can be labor or other services.

B. A complete description of the premises should be clearly stated; preprinted lease agreements better suited for residential property; commercial lease more complex, legal counsel should be consulted.

C. Possession of premises

1. The covenant of quiet enjoyment for the tenant is implied by law regardless of whether addressed in the lease.
2. Conditions under which the landlord is allowed to enter property without tenant's permission are stated.

D. Use of premises—if the use is to be limited in any manner, that use must be specifically stated in the lease.

E. Term of lease—dates should be stated precisely.

F. Security deposit (consult your local laws)

1. Held by the landlord during the lease.
2. Applied to unpaid rent or repairs.

3. State or local law may set maximums.
  4. In Practice: The lease should specify whether such funds are security deposits or advance payments of rent.
- G. Improvements
1. Generally, neither party is required to make improvements.
  2. The tenant may make improvements with permission.
  3. Any trade fixtures should be identified in the lease.
- H. Accessibility—federal Fair Housing Act (see Unit 18) makes it illegal to discriminate on basis of physical disability. Tenants may make reasonable modifications to property but must restore at end of lease term.
- I. Maintenance of premises
1. Historically, the landlord is not obligated to make repairs.
  2. Under current landlord-tenant laws, most jurisdictions require landlords to make repairs on residential units to keep them in habitable condition and maintain the common areas.
  3. The tenant must return the premises in the same condition as received, except for ordinary wear and tear.
- J. Destruction of premises
1. The tenant is obligated to pay rent if the improvements are damaged or destroyed when the tenant has constructed buildings on leased land, often agricultural or industrial land.
  2. If part of a building is destroyed, the tenant is usually not required to continue to pay rent for that part.
- K. Assignment and subleasing
1. Can be prohibited by the terms of the lease.
  2. Assignment is the transfer of all of the tenant's interest.
  3. Subleasing is the transfer of part of the tenant's interest.
  4. Either may require the lessor's consent.
  5. The original tenant/sublessor's interest in a sublease is known as a sandwich lease.
  6. Lease terms or local laws may govern short-term rentals through online rental services.
- L. Recording a lease—varies according to state laws and the length of the lease; leases of three years or longer generally are recorded

M. Nondisturbance clause—mortgage clause that states a mortgagee who forecloses agrees not to terminate the tenancies of lessees who pay their rent.

N. Options

1. The privilege of renewing or extending the lease or purchasing the property at a predetermined price and time.
2. The tenant must give notice of intention to exercise the option.
3. The lease is the primary consideration, the option is secondary.

IV. Types of Leases (see Figure 17.2)

A. Gross lease

1. The tenant pays a fixed rental amount.
2. The landlord pays all of the property charges, such as taxes and utilities.
3. Most often used for residential and commercial office space rentals (may differ by local custom).

B. Net lease

1. The tenant pays a fixed rental amount.
2. The tenant also pays some or all of the property charges.
3. Generally used for large commercial or industrial leases

C. Percentage lease

1. The tenant pays a fixed amount of rent plus a percentage of the gross income of the business. A gross lease or net lease may also be a percentage lease.
2. The percentage and basis agreed to between the parties.
3. Most commonly used in retail businesses.
4. Specifics vary with the type of business and its location.

D. Variable lease—provides for increases in rent during the lease period

1. Graduated lease—provides for increases in rent at set future dates in specified amounts
2. Index lease—periodic increase or decrease in rent based on changes in some economic index

E. Other lease types

1. Ground lease

- a. Usually involves separate ownership of land and buildings.
- b. Allows the tenant to construct a building on land that the tenant does not own.
- c. Generally set up as a net lease.
- d. Typically for terms of 50 to 99 years.

2. Oil and gas lease

- a. The owner receives cash for transferring exploration rights.
- b. If oil or gas is found, the owner usually receives a percentage of its value as a royalty.

3. Lease purchase

- a. The tenant leases the property with part of the rent applied toward the purchase price.
- b. The purchase is the primary consideration, the lease is secondary.

4. Sale-and-leaseback

- a. Owner sells the property and then leases it back for an agreed period and rental.
- b. Often used when extra capital is needed on a construction project.

V. Discharge of a Lease

A. Termination

- 1. No notice is required to terminate a tenancy for years.
- 2. The parties can mutually agree to cancel the lease.
- 3. The tenant may surrender the leasehold interest if the landlord is willing to accept it.
- 4. A tenant who abandons the property is still liable for the terms of the lease, including rent payments.
- 5. When the owner of leased property dies or the property is sold, the lease does not terminate except for the following:

- a. A lease from the owner of a life estate ends on the death of the person on whose life the estate is measured.
    - b. The death of either party to a tenancy at will.
    - c. A sale clause in the lease.
  6. A lease may be terminated by operation of law, as in a bankruptcy.
- B. Breach of lease—rights and responsibilities of landlord and tenant are governed by state law.
  1. If the tenant breaches the lease, the landlord may sue for overdue rent, damages to the premises, or other defaults. If landlord breaches any lease provision, the tenant is entitled to certain remedies.
  2. Suit for possession—actual eviction
    - a. The landlord must serve notice to the tenant; the number of days varies according to law.
    - b. If the tenant does not leave peacefully, the court may have the tenant and the tenant's possessions forcibly removed.
  3. Tenants' remedies—constructive eviction
    - a. If the landlord breaches the lease, the tenant has the right to sue for damages.
    - b. The tenant may abandon the premises if:
      - i. The landlord's conscious neglect has rendered the premises uninhabitable
      - ii. It is the responsibility of the tenant to leave because of the premises not being usable.
- C. Protenant legislation—Uniform Residential Landlord and Tenant Act
  1. The result of consumer awareness.
  2. Parts or all adopted by most states.
  3. Provides that both parties have certain obligations.
  4. Provides state-specific remedies for both parties.
- D. Fair Housing and Civil Rights Laws (See Unit 18)
  1. To ensure that all persons have access to housing of their choice, including rentals, within their ability to pay, without differentiation in terms and conditions, because of their race, color, religion, sex, familial status, disability, or national origin (consult local laws for additional protected classes)

2. Changes in 1988 had significant impact on rental practices, with
  - a. Protection for people with disabilities.
  - b. Protection for families with children.
3. Examples:
  - a. Cannot segregate individuals in sections of a complex.
  - b. Must allow people with disabilities to alter the premises.
  - c. Cannot charge different amounts of rent or security deposit