

## Get Protections When Filling Space with Short-Term Charity Tenant

If a space in your office building isn't attractive to potential tenants—say, because it's irregularly shaped or subject to another tenant's expansion right—consider leasing that space to a charity tenant, suggests Santa Monica attorney Susan Fowler McNally. Charity tenants tend not to be fussy about the space in which they house their administrative staff, as long as it's cheap. And they're usually willing to lease space for a short time—for instance, one to five years. So although you'll probably have to settle for a below market rent, a charity tenant could be a great short-term solution for a problem space. You'll fill dark space and take in enough rent to cover some of your operating costs, notes McNally.

But filling space short-term with a charity tenant is only helpful if everything goes smoothly and without extra expense. With McNally's help, we'll give you a checklist of five protections to include in your lease with a charity tenant. And we'll give you Model Lease Language to help you add these protections to your lease.

Our protections and language assume that the document you'll sign will be a lease. But they can be easily adapted to a license agreement. (There's a box on p. 6 to help you decide whether you're better off signing a license agreement or a lease with a charity tenant.)

### FIVE PROTECTIONS FOR CHARITY TENANT'S LEASE

#### Dramatically Increase Rent to Deter Holdovers

Set a high holdover rent that the charity tenant must pay if it doesn't move out of the space when it's supposed to. You want to deter the charity tenant from holding over in the space. This will be especially important if another tenant has an expansion option

for the space and is attempting to exercise it when the charity tenant's lease is ending. You don't want to be stuck getting below market rent longer than you expected.

But don't set the holdover rent too high, or else a court could deem it an unenforceable penalty. McNally suggests saying in the lease that the holdover rent will be set at whichever of the following amounts is greater: 1) a set dollar amount (which should be 150 percent to 200 percent of the minimum rent and additional rent that the tenant with the expansion right was required to pay); or 2) twice the fair market value rent for the space (which you determine based on recent lease renewals for similar space), she notes.

Also say that if the charity tenant holds over in its space, it will become a month-to-month tenant and that its lease won't be renewed or extended, advises McNally.

To do this, add the following language to your lease's holdover clause (you'll need to define "Fair Market Value" elsewhere in the lease):

#### **Model Lease Language**

If Tenant holds over after the expiration or sooner termination of the Lease Term, without the express written consent of Landlord, such tenancy shall be from month-to-month only, and shall not constitute a renewal or extension of the Lease, and in such case Rent shall be payable at a monthly rate equal to the greater of (a) \$[insert amount] or (b) twice the Fair Market Value rent obtained by Landlord for similar space in recent lease renewal transactions.

#### Require Charity to Indemnify You if It Holds Over

Require the charity tenant to indemnify—that is, defend and reimburse—you for claims by a third party (such as a tenant who's trying to expand into the charity tenant's space) that are made because the char-

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ity tenant is holding over, says McNally. Otherwise, you could be severely hurt—especially if you’ve relet the space. Also require the charity tenant to pay you any profits you’ve lost because it held over, she adds.

**Model Lease Language**

If Tenant fails to surrender the Premises upon the termination or expiration of this Lease in accordance with Clause [insert # of surrender clause] hereof, in addition to any other liabilities to Landlord accruing therefrom, Tenant shall protect, defend, indemnify, and hold Landlord harmless from all loss, costs (including reasonable attorney’s fees), and liability resulting from such failure, including, without limiting the generality of the foregoing, any claims made by any succeeding tenant founded upon such failure to surrender, and any lost profits to Landlord resulting therefrom.

**Require Charity to Accept Space ‘As Is’**

Require the charity tenant to accept the space “as is,” says McNally. Also, bar the charity tenant from making any alterations to the space without your prior written consent so you don’t have to worry about undoing those alterations at the end of the lease, she adds. You don’t want to spend money on a tenant that will be in its space for only a short time and is paying

**License Agreement or Lease?**

You’ll have to decide whether to sign a license agreement or a lease with the charity tenant. Which is better? There are two schools of thought on that, but the experts we spoke to say neither is wrong.

A license agreement can make it easier to oust the charity if you need to take back its space—or “license area”—quickly, says Santa Monica attorney Susan Fowler McNally. As a “licensee”—the license agreement’s equivalent of a tenant—the charity has no “leasehold interest” in a space. So you can revoke the charity’s right to use the space at any time, with little or no notice, McNally explains.

If you sign a lease with the charity for space in the building and the charity violates the lease and fails to cure—that is, correct—the violation, you must take legal steps needed to terminate the tenancy and get back possession of the space, says McNally. That could take a long time, she warns. But a lease may be better for financing purposes, since lenders consider it more favorably. Also, many experts agree that if a license agreement looks too much like a lease and the charity argues that it’s a lease, a court will interpret it as a lease, and you’ll lose your quick termination right.

McNally has noticed that owners tend to sign license agreements if they expect the charity to spend less than one year in the space. And they tend to sign leases if they expect the charity to stay in the space one year or more.

below market rent, she explains. (Make sure you define “Fixtures” elsewhere in the lease.)

**Model Lease Language**

Tenant hereby accepts the Premises in an “as is” physical condition, without any warranty, credit, agreement, or allowance from Landlord with respect to the condition or improvement thereof. Tenant shall not make or permit any alterations, improvements, or modifications in or to the Premises or the Fixtures, without Landlord’s prior written consent.

**Restrict Assignments/Sublets and Get Profit**

Require the charity tenant to get your consent before it assigns its lease or sublets its space to another party. After all, you made a sweetheart deal with this charity—and you may not want the benefits of that deal transferred to another charity or a for-profit organization.

Also, add that if you give your consent to an assignment or sublet, you’re entitled to additional compensation, says McNally. You should get a better payback than the reduced rent the charity tenant has been paying and it might even discourage assignments and sublets, she explains. You could, for example, use one of the following two options, says McNally:

**Option #1: Raise rent.** Raise the rent to the fair market value rent for the space, says McNally.

To do this, add the following language to your lease’s assignment/sublet clause:

**Model Lease Language**

If Landlord consents to an assignment or sublet, as a condition thereto, which the parties hereby agree is reasonable, the Rent for the Premises shall automatically increase to Fair Market Value.

**Option #2: Demand ‘transfer premium.’** Alternatively, demand that the charity tenant pay you all or most of the profit it makes on the assignment or sublet (known as a “transfer premium”), says McNally. You gave a rent break to a struggling, not-for-profit charity. And you don’t want it taking advantage of your generosity by turning its lease into a profit-making enterprise.

**Model Lease Language**

- a. If Landlord consents to an assignment or sublet, as a condition thereto, which the parties hereby agree is reasonable, Tenant shall pay to Landlord [insert amount, e.g., 100] percent of any “Transfer Premium,” (as defined in Paragraph b hereof) received by Tenant from such Transferee.
- b. For purposes of this Paragraph a hereof, “Transfer Premium” shall mean [insert percent, e.g., 100 percent] of the amount resulting from the following calculation:

- (i) All compensation received by Tenant for an assignment or sublet, less the costs reasonably incurred by Tenant with unaffiliated third parties in connection with such assignment or sublet (i.e., brokerage commissions and tenant finish work), minus
- (ii) The Rent allocable to the portion of the Premises subject to such assignment or sublet.

## ☐ Relocate Charity if Another Tenant Wants Space

Keep the right to relocate the charity tenant to another part of your building, McNally says. You'll need this right if another tenant on the floor wishes to expand into the space before the charity tenant's lease ends or if you find a higher-paying tenant, she explains. Make sure you can relocate the charity tenant quickly—say, with only 30 days' advance notice, she advises.

### **Model Lease Language**

Tenant acknowledges and agrees that the Rent is considerably lower than the fair market value rental rate for the Premises because [choose one: of the irregular [size/shape] of the Premises or Tenant's rights with respect to the Premises are subject to the expansion rights of [insert name of tenant with expansion right]; consequently, in addition to, and without limitation, Landlord's rights pursuant to Clause [insert # of relocation clause], hereof, if [choose one: Landlord finds a tenant or occupant that will pay at least a fair market value rental rate for the Premises or [insert name of tenant with expansion right] notifies Landlord of its desire to expand into the Premises], Landlord may relocate Tenant to other space in the Building with improvements comparable to those in the Premises upon not less than [insert #, e.g. 30] days' prior written notice.

You may want more flexibility in case a higher-paying tenant or a tenant with an expansion right wants to move into the space when the end of the charity tenant's lease is near—say, within nine months away. So consider getting the right to either relocate the charity tenant or terminate the charity tenant's lease, suggests McNally. At that point, the costs and hassles of relocating the charity tenant may not be worth it. Also, expect the charity tenant to demand a right to terminate the lease if it doesn't like its relocated space. You'll have to negotiate that point with the tenant.

**PRACTICAL POINTER:** You may also want to require the charity tenant to sign a "confession of judgment," says McNally. With a confession of judgment, the charity tenant agrees that if it defaults under the lease—for example, it fails to pay its rent—it agrees in advance that you're entitled to a court judgment against it, says McNally. The judgment permits you to recover possession of the space and get money damages equal to the unpaid rent, plus any attorney's fees and costs you incur, she explains. This way, you can avoid a lengthy court battle with the charity tenant and get paid (and recover possession of the space) quickly. Note that some states don't permit confessions of judgment, McNally points out. s

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### **CLLI SOURCE**

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