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CLIENT ALERT

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New California Law Impacts Leases to Certain Smaller Sized Tenants Including Translation Requirements and Limitations on Pass Through of Operating Expenses

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Beginning on January 1, 2025, landlords of commercial properties – be they office, industrial or retail, will need to develop new procedures when entering into leases with a newly defined class of tenants, identified as "qualified commercial tenants." The new law imposes requirements on leases to this class of tenants that affect rent increases and increased notice periods before a lease can be terminated, as well as restrictions on the pass through of operating expenses. In addition, certain translation requirements are being imposed on leases with qualified commercial tenants that are "substantially negotiated" in one of five named languages. The bill, Senate Bill 1103, was signed by Governor Gavin Newsom over the objections of most California commercial property associations, including the California Business Properties Association, the International Council of Shopping Centers, and the California Chamber of Commerce.

A concise summary of the new set of rules is not easily stated, but the starting point is the definition of this new class of tenants: "qualified commercial tenants" which the Legislature believes needs greater protection in negotiating leases with commercial landlords. The defined class are tenants who meet two requirements: (1) the tenant is a microenterprise, or a restaurant with fewer than 10 employees, or a nonprofit organization with fewer than 20 employees, and (2) the tenant provides the landlord a written notice that states it satisfies the requirements stated above and provides a "self-attestation" regarding the number of employees it has. Microenterprises already exist as a defined category under the Business and Professions Code, and includes a sole proprietorship or business entity that has 5 or fewer part of full time employees, and "generally lacks sufficient access to loans, equity, or other financial capital." Nonprofits are limited to IRS qualified 501(c)(3) organizations. The term "restaurant" is not defined. A qualified commercial tenant has to give the required notice annually, unless the tenancy is for a month to month (or lesser) period, in which case the tenant can provide the notice at any time within the prior 12 months.

Beginning in 2025, the following rules apply to new leases, and where indicated existing leases, entered into with qualified commercial tenants:

(a) New and longer notice requirements for rent increases, including a 90 advance notice for rent increases in excess of 10%, together with "information" on the new statutory requirements (presumably a copy of the applicable Civil Code section will suffice). This requirement applies to all leases with qualified commercial tenants, including existing leases, but it is unclear if this requirement applies to exercises of options to extend in an existing lease.
(b) New and longer notice periods for a termination by a landlord of a month to month tenancy. Specifically, a qualified commercial tenant that has occupied premises under a month to month lease for more than 12 months is entitled to 60 days' prior written notice of nonrenewal/termination of its month to month tenancy. The tenant, still has the right to elect to terminate the month to month tenancy on 30 days' prior notice (even if receives the 60 day written notice from the landlord). This applies to existing leases. A separate notice regarding disposal of personal property must also be given to qualified commercial tenants.
(c) Strict rules on the pass through of operating expenses, including real property taxes (except for assessments levied by a local "business improvement district"), in month to month tenancies, only, including providing "supporting

documentation" (as defined) and limiting permitted operating costs to those incurred for "operation, maintenance and repair," and that are allocated proportionately based on square footage or other substantiated method through supporting documentation provided to the tenant. Significant penalties apply for violations of the requirements, including the ability of a tenant to raise the violation as a defense in any unlawful detainer action and seeking recovery of its attorneys' fees, plus, in cases of oppression, fraud or malice, punitive damages. Local district attorneys are also given enforcement authority of this new requirement. Affected landlords will likely need to change their leasing practices. The new requirements also apply to existing leases that do not contain a provision regarding pass throughs.

(d) The most controversial new requirement relates to providing translation of leases into one of five languages: Spanish, Tagalog, Chinese, Vietnamese or Korean in all new leases entered into on or after January 1, 2025. A landlord who engages in a trade or business and "negotiates primarily," whether orally or in writing, in the course of entering into a lease, must provide a true and correct translation of the contract to the tenant – even if the tenant uses a translator to assist in the negotiation, before the execution of the document. The translation must include "every term and condition in the contract or agreement" (with certain exceptions). Notice of this requirement must be provided to the tenant at the same time. Failure to comply with this requirements entitles the tenant to an ongoing right of rescission. The English version of the contract controls but the translated lease can be admitted into evidence to show "a substantial difference in material terms". Landlords who communicate with prospective tenants in one of the 5 named language will need to implement certain leasing procedures.

There is a belief that the new law will negatively impact leasing to the exact group of small businesses that the law seeks to protect. The ambiguity in certain of the language may also lead to delays in evictions and give rise to other litigation between landlords and tenants. In addition, the provisions on notice requirements for rent increases and the limitation on pass through of operating costs are seen as an initial attempt by the Legislature to impose some form of commercial rent control.

Owners leasing space to qualified commercial tenants are encouraged to call their legal counsel to discuss the significant procedural changes the new law imposes on their leasing practices and what documentation may need to be developed to confirm compliance. As noted, the liability for noncompliance includes rescission, punitive damages and the potential of an enforcement action initiated by a local district attorney.

Please call any of the Buchalter attorneys listed below to discuss your properties and how we can be of assistance.

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