The Dos and Don’ts of Leasing Property Owned by a Municipality

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Foster Swift Municipal Law News
August 15, 2018

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Most municipalities own at least some real property and often such property is underutilized. An effective way for a municipality to monetize that asset, and raise extra revenue, is to lease the property to a tenant. However, the successful completion of a municipal lease—like any commercial lease—requires that municipalities think carefully, and negotiate thoroughly, regarding a number of legal issues.

1. Written Lease Agreement

“Get it in writing.” You’ve undoubtedly heard this advice countless times, and for good reason—it is critical to spell out with specificity the rights and obligations of each party in a written lease agreement. While a lease agreement does not necessarily need to be in writing to be enforceable by a court, having a well-defined lease in place with your tenant is a good way to avoid having to go to court in the first place. As with any business relationship, things will go wrong, mistakes will be made, and misunderstandings will happen in the course of a landlord/tenant relationship. Having a comprehensive lease in place, which covers issues such as how much rent is due and when, who is responsible for damages and repairs, and how long a lease term lasts, along with a host of other issues, can help municipalities ensure beneficial and amicable relationships with tenants.

2. Term

Every lease agreement should clearly define the length of the lease, as well as specific start and end dates. Depending on the terms of a lease deal struck by a municipality and tenant, a lease agreement may have several start dates, including when a tenant can enter the premises to set up, when rent is due, when the tenant must secure insurance, and when business may commence. In addition, the lease agreement should identify under what conditions the parties may terminate the lease, and the parties’ respective rights and obligations upon lease termination. Events of default, triggering the rights of a party to terminate the lease, as well as any opportunities to cure defaults,

should also be spelled out in the lease.

3. Insurance

To the extent a municipality becomes a landlord, it should ensure, and require documentation in the lease agreement, that its tenant has sufficient insurance for its business. Once a municipality allows another party to operate on its property, it must concern itself with the types of activities that the tenant is engaging in, and whether such activities put the property or people at risk. As discussed below, in a typical lease scenario, risks are divided between landlord and tenant for repairs, maintenance, and damages to the property. If a municipal landlord doesn't require coverage, it may have to bear the full cost of repairs. Further, requiring insurance is simply good business. If a tenant doesn't have sufficient insurance for its business, it may choose to use its next rent payment for an expense, such as damage or an accident that would otherwise have been covered by insurance.

4. Use Clause

To the extent that a municipality is concerned about how a tenant may use its leased property, it should include a "use clause" that limits and defines permitted activities in the space. The limitations can be broad or narrow, and should be tailored based on concerns related to risks of liability related to certain kinds of businesses, and/or if the municipality has an aversion to certain kinds of business activities.

5. Taxes

While property owned by a municipality for a "public purpose" may be exempt from taxes, if such property is leased to a for-profit business for a non-public purpose, such exemption does not apply. Specifically, MCL 211.181(1) provides:

Except as provided in this section, if real property exempt for any reason from ad valorem property taxation is leased, loaned, or otherwise made available to and used by a private individual, association, or corporation in connection with a business conducted for profit, the lessee or user of the real property is subject to taxation in the same amount and to the same extent as though the lessee or user owned the real property.

Accordingly, a lease agreement should make clear that a tenant is responsible for all taxes and should be listed on the tax rolls as the taxpayer.

6. Repairs, Maintenance, and Improvements

A lease agreement should identify whether the municipal landlord or tenant is responsible for major and minor repairs and maintenance for the leased building or space within a building. Typically, tenants are also responsible for paying a proportionate share of common area maintenance within a building. In addition, a lease should address the parties' agreement about any improvements that the tenant intends to make to the space, including who is responsible for the work, when it must get done, and who must pay for it.

7. Miscellaneous Expenses and Obligations

Many other issues can and should be addressed in a lease agreement between a municipality and a tenant. For example, the agreement should document who is responsible for procuring and paying for janitorial services, how utilities should be apportioned in a multi-tenant building, who is responsible for exterior maintenance such as landscaping and snow plowing, and what dedicated parking, if any, is available to the tenant.

These issues must also be considered when a municipality leases space from a private landlord or a municipal landlord.

In sum, municipalities that intend to lease space to tenants should not simply rely on a "boilerplate" lease agreement when negotiating and memorializing terms with a tenant. Each term of the lease must be carefully considered and reduced to a written agreement. By working with experienced legal counsel to craft an agreement, municipalities can avoid hidden, onerous traps that can result in expensive and time-consuming litigation.

If you are thinking of leasing space to tenants or leasing space from others, and have questions about what should be included in the lease agreement, contact Scott Hogan at 616.726.2207 or shogan@fosterswift.com.