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Four changes to California law impacting commercial real estate in 2019

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Commercial landlords, tenants and developers as well as purchasers and sellers of real estate should be aware of these four changes to California law, which are effective as of January 1, 2019, and cover the following topics: (1) abandonment of commercial property, (2) disposal of tenant's personal property, (3) limitations on private transfer fees and (4) new code language regarding general releases.

Abandonment of commercial property

The amended law,¹ effective as of January 1, 2019, allows a commercial landlord to serve a tenant with a "Notice of Belief of Abandonment" (the form of which is set forth in the code) after the rent is unpaid for three (3) days (or such longer period required under the terms of the lease for declaring a default), if the landlord reasonably believes the tenant has abandoned the property. Prior to 2019, the code-required minimum period was after rent had been due and unpaid for fourteen (14) consecutive days. The new code section also allows for delivery of the notice by overnight courier service, which was not previously specified under the prior version of the code (which authorized the notice to be served personally or mailed).

Sophisticated California landlords and tenants routinely negotiate specific terms covering abandonment in a commercial lease. Landlords often require tenants to waive the relevant abandonment code sections and agree that the negotiated lease terms control. Nonetheless, both landlords and tenants should be aware of the changes to the code regarding abandonment of commercial property, as it forms the backdrop against which lease specific terms are negotiated.

Disposal of tenant's personal property

The California law that covers the procedures for the disposition of a commercial tenant's personal property— that remains on the premises after a commercial tenancy has terminated and the tenant

¹ See Cal. Civil Code § 1951.35 as an amendment to Cal. Civil Code § 1951.3. Added by Stats.2018, c. 104 (A.B.2847), § 3, eff. Jan. 1, 2019.

has vacated—was amended, effective as of January 1, 2019.² The amended law increases the calculation of the “threshold amount” which allows the landlord to retain the personal property for its own use or dispose of it in any manner if the landlord reasonably believes the resale value of the property is less than the “threshold amount.” Under the prior code the “threshold amount” was the lesser of \$750 or \$1 per square foot of the premises. Under the new law, the “threshold amount” is the greater of \$2,500 or an amount equal to one month’s rent for the premises the tenant occupied.

Sophisticated California landlords routinely negotiate more stringent terms regarding disposal of tenant’s personal property under a commercial lease and require tenants to waive the related code sections and agree that the negotiated lease terms control. Nonetheless, both landlords and tenants should be aware of the changes to the code regarding disposal of personal property under a commercial lease, as it forms the backdrop against which lease specific terms are negotiated.

Limitations on private transfer fees

Private transfer fees are fees that are imposed by a seller of real property and require the buyer and any subsequent purchaser to pay a fee upon the transfer of the real property. The new law³ prohibits owners and developers from creating new covenants, conditions or restrictions on real property that would require subsequent owners to pay specially designated private transfer fees every time the property is transferred, unless such fees provide a “direct benefit” to the property pursuant to federal law. For example, the Federal Housing Finance Agency (FHFA) and the Federal Housing Administration (FHA) are prohibited from dealing in mortgages on properties encumbered by private transfer fee covenants that do not provide a “direct benefit” to the real property. Owners of properties that are encumbered with non-conforming private transfer fee covenants may have difficulty obtaining financing.

Existing transfer fees are not impacted by the new California law, but as of January 1, 2019, no new private transfer fees can be created, except for those that provide a “direct benefit” to the property per federal law. Pursuant to the Code of Federal Regulations, a “direct benefit” means that the fees are used exclusively to support maintenance of and improvements to the encumbered properties. However, a direct benefit also includes cultural, educational, charitable, recreational, environmental, conservation or other similar activities that are conducted in or protect the burdened community or adjacent or contiguous property. (See § 1228.1 of Title 12 of the Code of Federal Regulations regarding “direct benefit.”) The direct benefit threshold is fairly broad; however, it is important to keep in mind that any private transfer fees in California that do not comply with the new California code requirements are void as against public policy.

General release language

Commercial real estate transactions in California between sophisticated parties typically include a release by the buyer of the seller for all known and unknown issues with the property. Savvy buyers will negotiate, with assistance from their legal counsel, various carve outs to the blanket release. The release, along with any carve outs, is usually incorporated into the purchase and sale agreement for the real property. General releases also show up in many other types of agreements related to commercial real estate.

² See Cal. Civil Code § 1993.04 and § 1993.07. Amended by Stats.2018, c. 74 (A.B.2173), § 3, eff. Jan. 1, 2019.

³ See Cal. Civil Code § 1098.6. Added by Stats.2018, c. 306 (A.B.3041), § 1, eff. Jan. 1, 2019.

The provision dealing with the release, whether in a purchase and sale agreement or other document, often directly quotes the California code on general releases, which is contained in Civil Code Section 1542. The language in California Civil Code Section 1542 was recently revised, effective as of January 1, 2019, and now states:

“A general release does not extend to claims that the creditor or releasing party does not know or suspect to exist in his or her favor at the time of executing the release and that, if known by him or her, would have materially affected his or her settlement with the debtor or released party.”⁴

Purchasers and sellers of commercial real estate should be aware of this new code language that is frequently quoted in purchase and sale agreements. Everyone involved with commercial real estate in California should take note of this new code language, as it pertains to many other commercial real estate agreements that include a general release.

Takeaways

Because these recent changes to California law are effective as of January 1, 2019, commercial landlords, tenants and developers, as well as purchasers and sellers of real estate, should keep these items in mind with respect to California real estate transactions in 2019:

- abandonment of commercial property,
- disposal of tenant’s personal property,
- limitations on private transfer fees and
- new general release code language.

Nixon Peabody’s real estate attorneys are available to assist you in navigating these changes in California law. For more information on the content of this alert, please contact your Nixon Peabody attorney, a member of our [Real Estate team](#), or:

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⁴ Cal. Civil Code § 1542. Amended by Stats.2018, c. 157 (S.B.1431), § 2, eff. Jan. 1, 2019.