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Alert | Real Estate

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New Statute Affects Small Business Leases in California

Go-To Guide

- California Senate Bill 1103 (SB 1103) introduces changes to commercial leases, offering enhanced protections for small business tenants.
- Tenants that meet the "5/10/20 rule" and provide written notice of their qualified status can seek the benefits of these new protections.
- Landlords must translate leases into the tenant's primary language for qualified commercial tenants.
- Leases with qualified commercial tenants automatically renew unless landlords provide timely nonrenewal notices, aligning commercial tenancy practices more closely with residential standards.
- Rent increases for short-term leases require advance notice, and any fees for building operating costs must be proportionate and documented.

Effective Jan. 1, 2025, SB 1103 makes four principal changes to commercial tenancy law:

1. increased notice periods for rental increases on short term tenancies (month-to-month or shorter);
2. a new requirement for translating the lease into other languages;
3. automatic renewal of the tenancy unless the landlord objects in a timely manner; and

4. limitations on rental increases based on building operating costs. The law provides additional leasing protections to small business commercial tenants who meet the definition of "qualified commercial tenants."

Commercial landlords should be aware of all the related changes and should build these new requirements into their form leases, tenant notices, and operating procedures. More generally, landlords should be aware that like the protections for small commercial tenants enacted during COVID-19, these new leasing regulations indicate a legislative policy towards treating small businesses more like residential tenancies, as opposed to traditional commercial leases with larger commercial tenants.

Definition of 'Qualified Commercial Tenant'

Businesses must meet two elements of the qualified commercial tenant definition to qualify for these new protections.

First, a business must be a "microenterprise," a restaurant with fewer than 10 employees, or a nonprofit with fewer than 20 employees. A microenterprise is defined in Business & Professions Code section 18000 as a sole proprietorship, partnership, LLC, or corporation with five or fewer employees (including the owner), who may be full or part-time, and which generally lacks sufficient access to loans, equity, or other financial capital. A convenient way to remember this definition is the "5/10/20 rule," based on the number of employees.

Second, the tenant must have provided to the landlord, within the previous 12 months, written notice that the tenant is a qualified commercial tenant and a self-attestation regarding the number of employees the tenant employs before or upon the lease's execution and annually thereafter. In other words, the law's provisions are not self-executing – the tenant must give notice first. The rental rates, the premises' square footage, and the tenant's income or wealth are not considered when determining qualified status.

With these definitions in mind, here are the four principal changes SB 1103 makes to commercial tenancy law.

The Four New Tenant Protections

1. Notice of Rent Increase for Short Term Rentals

Existing Civil Code Section 827 provides that for short term residential leases, namely month-to-month or a shorter period, the landlord must give prior notice of a rent increase. The amount of notice required depends on how much the rent will increase.

SB-1103 extends this notice requirement to qualified commercial tenant leases. If the increase is 10% or less of the prior year's rent, the notice mut be given at least 30 days before the increase date, and if it is greater than 10%, then the notice must be given at least 90 days prior. The notice itself must advise the qualified commercial tenant of the requirements of this amended statute.

It is unclear how relevant this provision would be to most small businesses. Unlike short term residential tenancies such as residence hotels, a commercial business is not likely to be a month-to-month tenancy unless it is a holdover from a longer fixed lease. Due to an apparently unresolved inconsistency in the Senate and Assembly versions of this section, however, its protections may extend beyond month-to-month leases. Landlords may assume this provision applies to rental increases for all commercial real property leases by a qualified commercial tenant.

Violation of this provision does not entitle the qualified commercial tenant to civil penalties, but qualified commercial tenants may be eligible for restitution of overpaid rent or an injunction to prevent further violations.

2. Translation of Lease

Existing law in Civil Code Section 1632 requires a business to deliver a translation of a contract from English to the primary language in which the agreement was negotiated, specifically in Spanish, Chinese, Tagalog, Vietnamese, or Korean (translation requirement) but provides an exception if the other party uses their own interpreter (interpreter exception).

SB 1103 expands this requirement to a landlord leasing to a qualified commercial tenant for leases negotiated on or after Jan. 1, 2025. It requires the landlord to comply with the translation requirement but does not grant the landlord the interpreter exception. In other words, the landlord must always comply with the translation requirement.

If the landlord fails to comply with this requirement, the qualified commercial tenant (but not the landlord) is entitled to rescind the lease.

3. Automatic Renewal

Existing Civil Code Section 1946.1 provides that a residential lease is deemed renewed unless the landlord gives 30 to 60 days' notice of nonrenewal prior to termination, depending on whether the lease was for less than one year.

SB 1103 expands this protection to qualified commercial tenant leases and requires the landlord to give notice of the provisions of this section in the notice to a qualified commercial tenant. Qualified commercial tenants who believe their landlord has violated this section's notice requirement can file a complaint with local housing authorities or pursue legal action.

4. Limitation On Building Cost Charges

Existing Civil Code Section 1950.8 prohibits a landlord from demanding an extra fee to continue or renew a lease unless the amount is stated in the lease, but this requirement does not apply if the increase is for building operating costs incurred on behalf of the tenant and the basis for calculation is established in the lease.

SB 1103 adds a new law, Civil Code Section 1950.9, that applies to leases executed or renewed on or after Jan. 1, 2025. The section prohibits a landlord from charging a qualified commercial tenant a fee to recover building operating costs unless the costs are allocated proportionately, the costs were incurred in the prior 18 months or are reasonably expected to be incurred in the next 12 months, and the landlord provides a prospective tenant notice that the tenant may inspect the cost documentation.

There are some substantial enforcement teeth in this particular provision, including actual damages, attorneys' fees and costs, and in the case of willful, oppressive, fraudulent, or malicious violations, treble damages, and punitive damages. The tenant can also raise this section as a defense to eviction.

Application

SB 113 applies to all commercial tenancies in California where the tenant is a qualified commercial tenant. Obvious applications are shopping malls, strip malls, and other buildings where a variety of small

business are collected. Some commercial landlords, for example the owner of a large commercial office building leased to large businesses, might think the statute is not relevant to them, but smaller tenants such as a café or gift shop in the lobby may be covered.

Unanswered Questions

Unanswered questions remain, such as the case of subleases, where the tenant might not be a qualified commercial tenant, but the subtenant might qualify under SB 1103. Similarly, it remains to be seen how and when a landlord could challenge the tenant's self-attestation of qualified status, particularly if that status changes during the tenancy.

Consult With Counsel

This GT Alert is a general description of SB 1103 and is not intended as legal advice. There are numerous definitions, limitations, and qualifications in the existing statutes and in the law itself that would affect its the application. Landlords should consult with counsel before acting in response to SB 1103.

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