

Kimball, Tirey & St. John LLP

Commercial Tenant Improvements: Who Owns What?

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When a tenant leases commercial space, it may be in “shell” condition – an empty space without improvements, waiting for the tenant to customize to meet the tenant’s unique business needs.

When the tenancy ends, the landlord and tenant may have different expectations regarding the required condition of the premises. The tenant may intend to remove all of the improvements the tenant made. Alternatively, the tenant may intend to remove none of the improvements. Unless the parties specifically address this issue in their lease, the tenant and landlord may have different expectations. The law establishes “default” rules that will apply to fixtures in the absence of a specific agreement by the landlord and tenant.

Fixtures Defined

Generally, fixtures are items attached to real property so they become a part of the property. Examples of fixtures are hot water heaters, air conditioners, sinks, lighting and built-in furniture.

When determining whether an item is a fixture, California courts will consider:

1. How the item is affixed to the property¹;
2. The item’s adaptability to the use and purpose for which the property is used;
3. The intention of the party attaching the item (When the improvement is made by a tenant, the court will presume that the tenant intended to retain the ability to remove the item);
4. The difficulty of removal of the item;
5. The damage caused by removal; and
6. The relationship between the parties.

Tenant Removal of Fixtures

California Civil Code §1019 allows a tenant to remove from leased premises “anything affixed [to it] for purposes of trade, manufacture, ornament, or domestic use, if the removal can be effected without injury to the premises, unless the thing has, by the manner in which it is affixed, become an integral part of the premises”, if the tenant removes those items during the lease term.

If fixtures are not removed before the landlord regains possession of the property, the fixtures will become the landlord’s property.

The courts’ presumptions generally favor the tenant when determining if an item has “become an integral part of the premises” and whether “removal can be effected without injury to the premises”. Most items can be removed without permanently damaging the premises (electrical lines and pipes can be capped, holes in drywall can be patched, etc.). Removal is prohibited

¹ California Civil Code §660 reads, “A thing is deemed to be affixed to land when it is attached to it by roots, as in the case of trees, vines, or shrubs; or embedded in it, as in the case of walls; or permanently resting on it, as in the case of buildings; or permanently attached to what is thus permanent, as by means of cement, plaster, nails, bolts or screws.”

only when the injury to the leased premises caused by a fixture's removal cannot be repaired or money damages would not compensate the landlord for the loss.

When applying these rules, the courts balance the equities. To develop business on leased premises, a tenant must be able to improve the property and remove his or her improvements when the tenancy terminates. On the other hand, a landlord is entitled to the return of the premises at the end of the lease term in substantially the same condition that it was at the beginning of the tenancy, subject to depreciation for the reasonable use of the property by the tenant.

Summary

Generally, in California, tenants may remove improvements they have made to the property, if they do so before they return possession of the property to the landlord. When removing a fixture, the tenant must repair or compensate the landlord to return the premises to its pre-improvement condition. However, California tenants may not remove improvements if the lease prohibits removal, if removal of the fixture would cause irreparable or uncompensable damage to the premises, or if they fail to remove it before they return possession of the premises to the landlord.

Avoiding Fixture Disputes

If landlords don't want the "default" rules to apply, or if they want the lease to specifically state that the tenant is required to remove tenant-installed improvements before vacating, they should address these issues in the lease.

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