

**BUSI 331**

**Answer Guide 3**

**LESSON 3: Introduction to Leasing**

---

1. Answer: 1  
Situation A illustrates an escalator clause where the Delicious Hamburger House Restaurant must pay the increase in taxes and/or operating expenses above the base year. The other statements are false. Situation B illustrates a sublease where Pete and Walt are the sublessors and Terry is the sublessee. Situation C is not an example of a net lease. It is an example of a percentage lease where the tenant is required to pay a specified percentage of gross or net sales made upon the premises. A net lease is a lease where the tenant pays a base rent plus his or her pro rata share of the property taxes, utilities, heating, repairs, maintenance costs, etc. Situation D illustrates a gross lease where the owner or lessor pays the taxes, insurance, maintenance, services, operating costs, etc.

2. Answer: 4  
Option (4) is false. Rent can be paid at any time on the day it is due; it is not in arrears until after midnight.

3. Answer: 4  
All of the statements are true.

Comparing the two-year-old lease on Floor 3 with the new lease on Floor 4 indicates a compounded growth rate of 7% per year. After credit premiums are applied to Floors 1 and 5 and renewal rates are calculated at 7% per annum, compounded annually, the following rental rates are produced.  
Current Market Rent =  $\$152,000 \div 8,000 = \$19$

Floor 1:	current,	$\$19 \times 1.15$	= \$21.85/sq. ft.
	in Year 4,	$\$21.85 \times 1.07^3$	= \$26.77/sq. ft.
Floor 2:	current,		= \$19/sq. ft.
	In Year 4,	$\$19.00 \times 1.07^3$	= \$23.28/sq. ft.
Floor 3:	5-year lease,		= flat at \$152,000 per year
Floor 4:	renewal in Year 4,		= \$23.28/sq. ft.
Floor 5:	current,	$\$19 \times 1.10$	= \$20.90/sq. ft.
	Renewal in Year 4,	$\$19 \times 1.10 \times 1.07^3$	= \$25.60/sq. ft.

4. Answer: 3  
Five-year income expectation

<u>Floor</u>	<u>Year 1</u>	<u>Year 2</u>	<u>Year 3</u>	<u>Year 4</u>	<u>Year 5</u>
1	174,800	174,800	174,800	214,160	214,160
2	152,000	152,000	152,000	186,240	186,240
3	152,000	152,000	152,000	152,000	152,000
4	128,000	128,000	128,000	186,240	186,240
5	<u>167,200</u>	<u>167,200</u>	<u>167,200</u>	<u>204,800</u>	<u>204,800</u>
Total	\$774,000	\$774,000	\$774,000	\$943,440	\$943,440

---

5. Answer: 2

If the subject property was a proposed building, all rents would be set at market level. The only floor affected by this assumption is Floor 4, which in the previous question was subject to a lease that started two years ago. Year one's gross potential income expectation is calculated as follows:

<u>Floor</u>	<u>Year 1</u>
1	174,800
2	152,000
3	152,000
4	152,000
5	<u>167,200</u>
Total	\$798,000

6. Answer: 2

Gross Potential Income	
Scheduled rent (Floor 3 & 4)	\$280,000
Escalation income (Floor 4)	8,000
Market rent (Floor 1, 2 & 5)	494,000
Other income from concessions	<u>20,000</u>
Total Gross Potential Income	\$802,000
Vacancy and Collection Loss (@ 6%)	<u>- 48,120</u>
Effective Gross Income	\$753,880
-Operating Expenses	
Fixed	70,000
Variable	<u>120,000</u>
Total Operating Expenses	\$190,000
Net Operating Income	\$563,880
-Replacement Allowance	20,000
NOI After Replacement Allowance	\$543,880
-Mortgage Debt Service	<u>- 33,900</u>
Pre-Tax Cash Flow (Equity Dividend)	\$509,980

7. Answer: 3

Option (2) is false as more space is rented, more income will be scheduled and less will be estimated at market levels. Options (1), (3), and (4) are true.

8. Answer: 1

Option (1) is true. Option (2) is false as the value of the goods may exceed the rent amount so long as any goods or funds remaining after payment are returned to the tenants. Option (3) is false as distraint is available only to commercial tenancy situations. Option (4) is false as only lodgers or boarders are afforded this right.

9. Answer: 2

Statements B and C are true. Statement A is false. Rent is usually payable in money, but may be payable as a share of the profits from land, or even by services. Statement D is false. When a lease is assigned, the original tenant has transferred all of his or her interest to the assignee and no longer has a reversion or any interest in the land. In this case, there is a legal ground for the landlord to bring actions against the assignee.

10. Answer: 2  
Scenario A represents a water lot lease because it provides the leaseholder with access up to navigable waters (water used for business or transportation) on tidal rivers and ocean fronts; including the water and the land beneath the water. Scenario B represents an air rights lease that allows the leaseholder to use the air space above a freehold owner's land. Scenario C represents a water lot lease that provides Milly the right to use the area of water adjacent to ocean frontage: to build an erosion control structure with a dock. As an upland owner, her riparian rights allow her access to the water. Therefore, Option (2) is the correct answer.
11. Answer: 1  
Option (1) is correct as frustration occurs when parties to a contract are unable to perform their obligations due to the occurrence of events that are beyond their control. Option (2) is incorrect as surrender requires the tenant to yield their lease to the landlord so that their interests are aligned with the landlord's reversion and all legal rights of the contract are forfeited. Option (3) is incorrect as injunction is an action taken by one party to prevent the other party from committing a contractual breach. Option (4) is incorrect as distraintment is the act of seizing a tenant's goods to compensate the landlord for the tenant's failure to pay rent.
12. Answer: 1  
In a semi-gross or modified gross lease, a tenant pays base or contract rent and some of the landlord's proportional costs, such as insurance, repairs and maintenance. The landlord assumes all other costs including property taxes, utilities, and management expense. There is no standard for the degree of "net" in this case and each lease will be different.
13. Answer: 2  
Option (1) is false as the tenant's right to "quiet enjoyment" assures the tenant of the use and enjoyment of the premises for all usual purposes without physical interference from the landlord. Option (3) is false as a landlord must only make sure the premises are fit for human habitation and occupation if the premises being leased are furnished. The landlord has no obligation to repair unfurnished premises. Option (2) is true.
14. Answer: 1  
There is an implied covenant that the tenant will deliver up the premises as he or she found them, except for "reasonable wear and tear". That expression is used to describe the aging process that all buildings necessarily suffer from the elements and ordinary usage. However, this covenant does not oblige the tenant to leave the premises in a better state than it was in when he or she assumed possession: (see the British Columbia case of *Nixon Automotive Ltd. v. Nikolai Plastics Ltd.* 1978.) Paint peeling is generally considered wear and tear and since the peeling had already begun when Jenny moved in, repainting the wall would leave the premises in a better state than it was when she assumed possession; therefore, she is not responsible.
-

15. Answer: 3  
At common law, the doctrine of frustration does not apply to the commercial landlord-tenant relationship. This has been altered in some provinces' commercial tenancy legislation, by providing that the provincial Frustrated Contracts Act is applicable to commercial tenancies. A lease may be frustrated due to destruction, substantial damage to the premises by fire, or, more commonly, by the landlord's inability to deliver new building premises to the lessee by a specific date. Frustration relieves a tenant of the liability of paying rent, or may be cause for termination of the lease. However, if the damage is not substantial, or the delay in delivery of the building is minor, the courts may determine that the lease was not frustrated and there are options (e.g., landlord's repairs) for both parties to continue in accordance with the terms of the lease. In Bill's case, the delay of four months is not minor considering the three-year lease and the competitive restaurant industry.
16. Answer: 2  
The right to distrain (seize) the goods of a tenant for non-payment of rent is an important remedy available only to landlords in respect of commercial tenancies. This is known as a distress.
17. Answer: 4  
The right to assign or sublet, a going dark provision, a purchase option, and a renewal option are all clauses beneficial to the tenant and could be offered by a landlord to secure tenancy.
18. Answer: 3  
Commercial fixed term tenancies automatically expire at the end of term. No notice is required. If a tenant stays on and the landlord accepts rent, it becomes a periodic tenancy. The period length depends on original term.
19. Answer: 2  
All of the options are true except for Option (2). A flat rental lease is the most common form of commercial lease for office and light industrial space.
20. Answer 4  
A revaluation lease provides for rent reviews at specific points in the lease term. A common example is a long-term land or ground lease with a term of 40 years where the rent is reviewed and adjusted every 5 years based on the prevailing market rent.
-