A Reprint from *Tierra Grande*

TENANT-MADE IMPROVEMENTS

Is Landlord Liable?

by Judon Fambrough

A nagging question in the back of every landlord's mind, especially in the case of long-term leases, concerns potential liability for improvements made to property by tenants.

For example, if hunters drill a water well on a deer lease to supply water to the cabin or if commercial tenants install an elevator to make upper levels of a building more accessible to customers, what happens when the lease expires? If the tenant leaves unpaid debt on the improvements, is the landlord liable?

Improvements made with the landlord's knowledge and consent, but at the tenant's expense, cannot be grounds for increasing rent because the tenant owns the improvements. The consent must be definite and certain. Tenants may remove the improvements when the lease terminates, assuming it can be done without damaging the property.

Improvements made without the landlord's knowledge and consent cannot be removed when the lease terminates and create no personal liability for the landlord. But is the land subject to a valid mechanics lien for the unpaid debt? Only three Texas appellate cases have addressed the issue.

In 1965, the Austin Court of Appeals ruled that neither the land nor the landlord is responsible for the debt. A tenant cannot encumber the landlord's title to land by making unauthorized repairs or improvements.

In 1955, the El Paso Court of Appeals held a tenant may encumber the tenant's title with a debt but not the landlord's leasehold estate. Without the landlord's consent, a contract with the tenant to furnish material and labor grants a contractor or supplier rights against the tenant's estate but not against the landlord or the owner's title to the land.

The third case, a 1965 opinion by the Austin Court of Appeals, explored the possible creation of an agency agreement

in the rent contract authorizing the tenant to make repairs on the landlord's behalf to the Driskill Hotel.

The tenant contracted for improvements to the property and then defaulted on the contract. The contractor attempted to place a mechanic's lien on the property. The owner protested.

The contractor maintained that the tenant had express and implied authority to make the improvements based on language in the lease. The lease stated the tenant had the responsibility to renovate the property "in a satisfying and workmanlike manner" that will "maintain and perpetuate the tradition, historical significance and aesthetic qualities of the old Driskill."

The appellate court disagreed. The contract language set standards to be applied if improvements were made, the court maintained, but did not authorize the tenant to act as the landlord's agent to contract for improvements.

While landlords may not be liable for the costs of improvements, they may be liable for delinquent property taxes on the improvements. In a 2000 opinion rendered by the First District of the Houston Court of Appeals, the landlord (Franz) had a ground lease (one including an agreement that the lessee build or improve a structure on the property) with a tenant to operate a restaurant. The landlord had the option of terminating the lease and claiming all improvements if the tenant did not pay the taxes or insure the property. During the lease term, property taxes were assessed separately on the tenant's improvements.

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The tenant defaulted on payment of taxes from 1987 until 1995, at which time the landlord terminated the lease. Katy ISD placed a delinquent tax lien on the landlord's real property even though the landlord did not own the improvements at the time the taxes became delinquent. The landlord contended that, because the property taxes had been assessed separately, a lien on the improvements could not be placed on the underlying property. The court did not address this issue.

"Regardless of whether a lien on improvements could have attached to the underlying real property anyway," the court ruled, "we hold Franz (the landlord) responsible for the delinquent taxes assessed on the improvements on his land because the two estates merged."

The ruling went on to say that "the doctrine of merger is based on six elements:

- the existence of a greater and lesser estate,
- both estates must unite in the same owner,
- both estates must be owned in the same right,
- no intervening estate must exist,
- merger must not be contrary to the intention of the owner of the two estates and
- merger must not be disadvantageous to the owner of the two estates."

The court did not detail how the six elements applied to this case except to say "the merger was not disadvantageous to him (the landlord), delinquent taxes notwithstanding."

In its conclusion, the court noted that the issue of whether the tax lien would attach to the underlying property even if the improvements were demolished was not argued on appeal and was waived. The question remains unanswered.

The case challenges those who draft leases to develop language that addresses the consequences of delinquent tax liens on improvements when the lease terminates. One possible solution is to have title to the improvements revert to a corporation owned by the landlord when the lease terminates. While this avoids merger, the corporation may still be liable for the delinquent taxes.

Fambrough (judon@recenter.tamu.edu) is a member of the State Bar of Texas and a lawyer with the Real Estate Center at Texas A&M University.

MAYS BUSINESS SCHOOL

Texas A&M University
2115 TAMU
College Station, TX 77843-2115

http://recenter.tamu.edu
979-845-2031
800-244-2144 orders only

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Tierra Grande (ISSN 1070-0234), formerly *Real Estate Center Journal*, is published quarterly by the Real Estate Center at Texas A&M University, College Station, Texas 77843-2115. Subscriptions are free to Texas real estate licensees. Other subscribers, $20 per year.

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