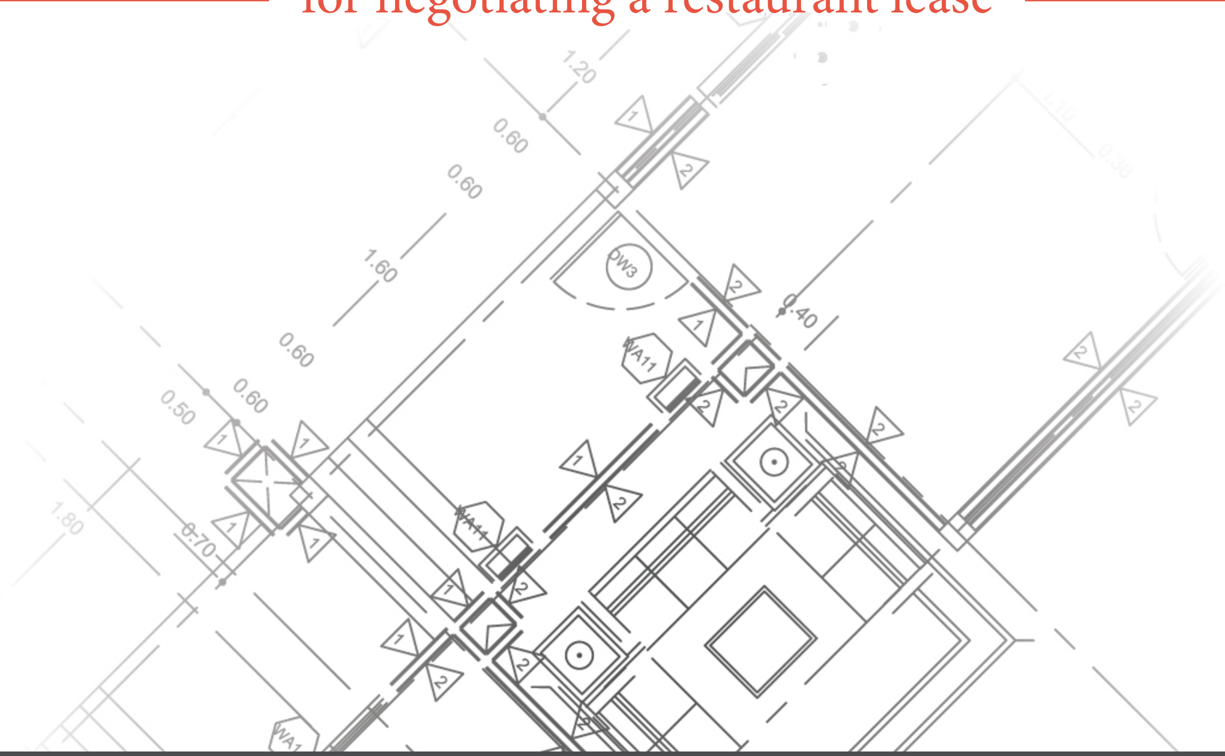
MOSES
SINGER

MENU

for negotiating a restaurant lease



APPETIZERS

CONSTRUCTION COSTS

Prior to executing a restaurant lease, the potential tenant should obtain an estimate from an architect and contractor, as applicable, of the estimated costs and timeline to build-out the restaurant for tenant's initial occupancy. This is especially important considering recent supply-chain issues, inflation concerns, and rising borrowing costs.

ZONING

It is important for tenant to make sure the proposed space meets all legal and zoning requirements for the intended use. If this information is not confirmed prior to lease signing, or if tenant will be required to obtain approvals prior to occupancy and opening for business, then tenant should make sure that the lease commencement is contingent upon receipt by tenant of all such approvals and fulfillment of all such requirements. In light of the recent pandemic, a tenant may want to investigate the potential for outdoor seating in the event of future shutdowns.

TENANT IMPROVEMENT ALLOWANCE

Tenant should negotiate for a "Tenant Improvement Allowance" to help defray the costs of tenant's initial build-out of the restaurant. Tenant should have the landlord approve its conceptual renderings or plans, if available, before signing the lease which will avoid delays in starting its build-out of the restaurant and ultimately, in operating its business. If tenant is to receive an "improvement allowance" to complete its initial renovation work, tenant should try to negotiate for any unused portion of the allowance to be credited to future rent payments rather than being forfeited to the landlord.

TERM

While committing to a long-term lease (e.g., 10 years or more) may result in a lower annual rent, being locked into a long-term lease could prove risky in the restaurant business which can have a high failure rate. A preferable arrangement would be a shorter term (e.g., 5 years) with one or more renewal options (e.g., 5 years each). The lease should provide a clear structure for setting the rent during the renewal periods, or if that is not possible, then clarifying the "prevailing market rate" language with an arbitration provision for resolving potential deadlocks.

LIQUOR LICENSE CONTINGENCY

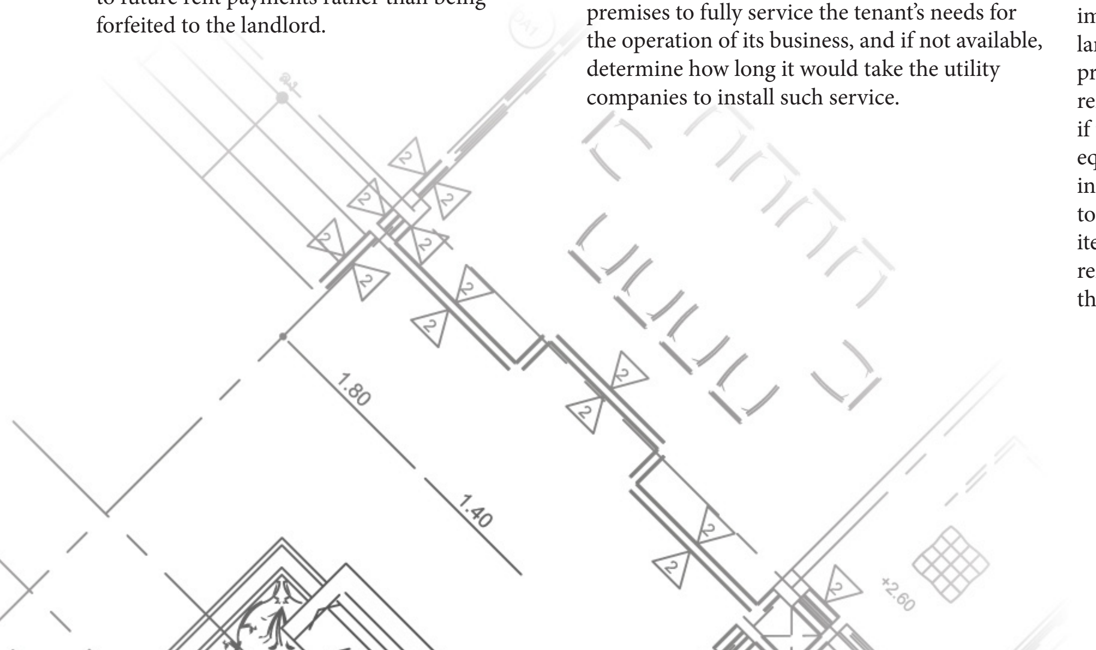
The sale of alcohol is typically vital to the successful operation of a restaurant. If this is the case, then it is very important that tenant be aware of the requirements for, and that the lease be contingent upon, tenant obtaining a liquor license within a specified time period, failing which tenant, at its election, will have the option of terminating the lease.

OPERATING HOURS

Tenants prefer more flexibility with respect to required hours of operation, so the lease should be consistent with the tenant's business plan. If the space is part of a retail project, tenant would want the same operating hours as other restaurants in the project, provided they are consistent with the specific business plan for the restaurant (e.g., if breakfast hours are needed or not).

UTILITIES

Tenant should make sure that all utilities (such as gas, water, and electricity) are available at the premises to fully service the tenant's needs for the operation of its business, and if not available, determine how long it would take the utility companies to install such service.



SIGNAGE

The lease should specify tenant's rights to signage that would be outside the premises, in any building directory, and if the space is part of a larger retail project, on monument signs and pylons. The lease should outline the specific location and size of its sign and, if feasible, include a conceptual rendering to attach to the lease as an exhibit.

IT COMMUNICATIONS

Many restaurants have one or more TV sets and provide amenities, such as free internet through Wi-Fi connectivity. Tenant should consider its needs with respect to roof rights for installation of a TV antenna or access for other IT equipment. Special provisions will need to be included in the lease to provide roof access to tenant and enable tenant to install the necessary equipment.

SUBORDINATION AND NON-DISTURBANCE

In order to protect its investment, tenant should obtain a nondisturbance agreement from the landlord's lender under a mortgage or from the landlord's ground lessor under a ground lease as a condition to the effectiveness of the lease, so that the lease cannot be terminated in the event of a mortgage foreclosure or ground lease termination. Smaller tenants may not have the leverage to require the landlord to obtain a nondisturbance agreement, but should at least request it from the landlord at the outset of negotiations.

END OF TERM

Leases often provide that costly tenant improvements, fixtures, and installations, at landlord's option, either become landlord's property at the end of the term or must be removed by tenant at tenant's cost. However, if the costs of these items (such as kitchen equipment, HVAC, and grease traps) were initially incurred by tenant, tenant may want to give itself the option to either remove these items at the end of the term or allow them to remain on the premises at no additional cost to the tenant.

MAIN COURSES

RENT COMMENCEMENT DATE

If work is to be done to prepare the space for occupancy (either by landlord or tenant), a period of free rent should be provided by landlord to tenant so that rent will not commence until after the conclusion of a sufficient time period for the work to be done and tenant to begin to operate in its space.

INITIAL CONSTRUCTION

If landlord is performing the initial renovation work in the space or other construction of the retail project, tenant may want to consider imposing an outside delivery date by which landlord's work must be completed and providing tenant with a remedy of receiving additional rent credits or, in the event of an extended delay, the right to terminate the lease. Tenant should not be required to wait without any available remedy or recourse for an unlimited period of time as a result of delays in landlord completing its work. In addition, if tenant's business is impacted by a particular time of the year, tenant may also want to negotiate the right to delay its opening (e.g., an ice cream store not opening in December in New York City).

RENT AND ADDITIONAL RENT

Most restaurant leases are "net" leases, which means the tenant is responsible for all monthly fixed rent and its proportionate share of the relevant expenses of the property, such as real estate taxes, insurance expenses, and common area maintenance ("CAM") charges. An alternative rent structure would be the "gross" lease whereby tenant's fixed rental payment would include its proportionate share of real estate taxes, insurance expenses, and CAM charges during a "base year," which is typically the first year of the lease term. Thereafter, tenant would only be responsible for its proportionate share of these costs to the extent they are in excess of the amount of the corresponding costs during the "base year." The "net" lease has a lower fixed rent because it does not include the base year costs, but CAM charges will be higher than in a gross lease. In either case, the lease should specify which expenses are being passed through to tenant and tenant should make sure the expenses being passed through do not include unnecessary and uncontrollable expenses, such as discretionary capital improvements that the landlord may elect to perform in order to upgrade or beautify its property. The lease should also provide the calculation for tenant's "proportionate share," which is typically the ratio of tenant's space to the entire building. If the space is part of a larger retail project or a newly constructed or renovated building, the "gross" lease will need to address the situation in which the project is not fully occupied or "fully assessed" during the base year. In that scenario, since costs are not fully incurred during the "base year" due to the lack of full occupancy, tenant could be exposed to very large increases when the project is later fully occupied and assessed. This issue is solved by landlord "grossing up" the real estate taxes, insurance expenses, and CAM charges during the base year as if the project was fully occupied or assessed. Tenant may try to cap annual CAM charge increases at a percentage of the prior year's actual CAM charges (excluding certain costs like insurance which are not controllable by landlord). Tenant can also try to cap CAM increases which later prove to be materially in excess of landlord's initial estimate at lease execution.

PERCENTAGE RENT

It is fairly common that once tenant's sales hit a certain level (the "breakpoint"), tenant must pay a percentage of gross sales over the breakpoint as "additional rent." The breakpoint is a target for gross sales from the premises. A lease will then contain negotiated exclusions from gross sales for transactions not truly subject to percentage rent and the landlord will want requirements for the tenant to provide monthly, quarterly, and/or annual sales statements and for landlord to be able to audit such statements. Percentage rent clauses are usually accompanied by landlord-protective provisions such as that tenant continuously operate at the premises and radius restrictions that prevent tenant from opening another location within a certain radius of the premises, which could decrease revenue at the premises. Of course, the inclusion of this "additional rent" could serve to lower the fixed rent in the lease, which would be beneficial for any tenant, but especially for a tenant opening a new business.

ASSIGNMENT AND SUBLETTING

Due to the high risk nature of the restaurant business, tenant should fight for favorable assignment and subletting provisions that can provide a safety net should a tenant require an early exit of the lease. While tenant would want the lease to either include a broad use clause or permit a change of the permitted use to allow the use that will be conducted by the assignee or subtenant, this right may be tightly controlled in a shopping center project where a landlord is trying to establish a particularly desired tenant mix. Additional flexibility would include the ability for tenant to assign the lease without landlord's consent in connection with a sale of the business, provided the surviving entity meets certain financial criteria and that the sale is not merely for the purpose of assigning the lease. In any event, tenant should try to obtain a provision that landlord will not "unreasonably withhold, condition, or delay" its consent to general assignments and subleases, but it may find landlord resistance where the premises has high visibility and percentage rent is an important factor.

SECURITY DEPOSIT

Landlords may require a larger than normal security deposit due to the high failure rate in the restaurant industry. One way to make this more palatable to the tenant is to include a "burn-down" provision to provide for periodic returns of portions of the security to tenant at designated milestones during the lease term provided that tenant has not defaulted under the lease. Principals of the tenant who have a high net worth could also provide a "good guy" guaranty or full personal guaranty in order to incentivize the landlord to require a lower security deposit.

EXCLUSIVITY PROVISION

If the space is part of a larger retail project, a tenant may want an "exclusive use" provision whereby the landlord would be prohibited from leasing other space in the project to a competing restaurant or would be required to prohibit another tenant from serving this tenant's signature dishes or style of cuisine. A landlord may seek to limit what would be considered a competing use or may push to carve out a key tenant, or a then existing tenant, from the exclusive. Remedies for landlord's violation of the exclusivity provision could include entitling tenant to a reduced rent and/or a termination option for extended violations.

CO-TENANCY PROVISION

If the space is part of a larger retail project with an anchor tenant (or in a shopping center project where there has not yet been a "grand opening" and there are substantial vacancies), tenant should negotiate for remedies in the event there is a delay in the signing of a lease for an anchor tenant, in the opening of the anchor tenant's business, or in the opening of the shopping center, or if the anchor tenant ceases its business operations during the term. Some potential remedies could include a reduction in the rent, the conversion of the monthly rent to rent in the amount of a percentage of sales only, tenant ceasing operations until the anchor tenant opens (or the space is re-let), or termination of the lease. These rights may be conditioned on a decrease in tenant's gross sales (after the first year) that occur despite tenant being open and operating for business.

EARLY TERMINATION RIGHT

For an even more flexible safety net, tenant can try to negotiate a termination right at some point prior to the expiration date, especially if the tenant's principal was required to provide either a full guaranty or "good guy" guaranty. Typically, such a termination requires payment of landlord's then unamortized upfront costs (e.g., brokerage fees and tenant improvements) and a number of months worth of rent. A more aggressive termination right would be one that would enable tenant to terminate the lease in the event tenant is open and operating for business, but sales are not as expected. That option typically would be accompanied by a termination payment to landlord as noted above. From the landlord's perspective, landlord may try to negotiate either its own "kick out" clause, allowing the landlord to terminate the lease if sales fall below a certain level, or a relocation provision if landlord finds a more profitable tenant for the space.

GUARANTY

If landlord requires tenant to provide a guaranty from one of its affiliates or principals, then tenant should try to limit it to a so-called "Good Guy Guaranty" which would release the guarantor from liability to landlord to the extent accruing after the premises is promptly and properly surrendered to the landlord by the tenant after tenant is in default. In addition, if a guaranty is provided to landlord in connection with the lease, the tenant and guarantor should negotiate for a release or substitution of the guarantor in the event of an assignment of the lease to a third party, so that the initial guarantor will not remain liable to the landlord after such assignment.

FUTURE SHUTDOWNS

As a result of the recent pandemic, tenants should request a rent abatement provision to address future shutdowns which prohibit or limit indoor dining. Generally, landlords will likely be unwilling to accept the risk of a circumstance over which they have no more control than the tenant. A potential compromise could be a proportionate rent reduction based upon government mandated occupancy limits.

FORCE MAJEURE

An additional method to use for addressing the effects of a pandemic is the force majeure provision. A force majeure clause addresses a circumstance in which a party's performance under the lease is delayed or prevented because of an event that such party does not control or could not have anticipated. The extent of the excused breach will depend on the express terms of the lease. Tenant should try to include "pandemics", "epidemics", "diseases", and "government mandates" in the list of covered events in the force majeure provision, but, as previously mentioned, it is unlikely that landlords would be willing to shoulder this risk alone. Moreover, force majeure clauses are typically drafted to delay performance of tenant's lease obligations with an express exclusion for the payment of rent. It is likely that only a tenant in a very advantageous bargaining position would be able to move a landlord from that established position.

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For more recipes, menu items, and orders, please contact the head chef, Nahum M. Palefski, or any of the other well-seasoned attorneys in the Moses Singer Real Estate practice group.