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Due diligence: What you need to know in negotiating a retail lease in New York City

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There are several factors that go into the analysis and negotiations of a retail lease. One of the most important aspects is your client's intended use and the actual permitted use of the property. When surveying a property, it is important to review the most recent certificate of occupancy (CO). This can easily be done on the New York City department of buildings (DOB) website. The CO will tell you what the permitted use of the space is and will be as specific as stating "office," "retail," "restaurant," etc. If the property is not zoned for what your client intends on using it for then the prospective tenant should retain an architect to determine if the space can be converted for such use. Also if possible, the CO would need to be amended to reflect this change and it will need to be determined at the outset whose responsibility it would be to cover the expense of changing the CO.

Once due diligence is completed on the space and the rent has been agreed upon, the tenant should focus on negotiating the main business terms: rights to assign the lease, landlord's contribution for build-out costs and items to remain in the space post-lease termination. There are two main reasons to negotiate for an assignment of lease provision in a retail lease. First, many businesses go out of business prior to the expiration of their lease. The ability to assign the lease to another operator can help the tenant to mitigate the risk of a potential default or utilization of a personal guarantee (if any). On the other hand, if the business is successful, the tenant may want to sell the business and, concurrently therewith, would need to assign the lease to the buyer. In this scenario, it may be necessary to negotiate whether the landlord will be entitled to share in the profits of the sale.

In a retail space, the design concept is very critical for its success, it is important to know the nature and extent of client's alteration plans, the estimated hard and soft costs of the same, and whether the landlord is willing to contribute towards these costs. Depending on the location, type of space and the negotiation of the terms of the lease, landlords are sometimes willing to contribute a fixed sum of money towards a tenant's renovation costs since the renovation will likely enhance the value of the property. Under certain circumstances, the landlord may require the tenant to leave and not remove certain built-ins and other improvements upon expiration of the lease. Further, since the tenant is not operating its business and receiving any cash flow during the build-out period, it is essential to negotiate a free rent period in addition to or as an alternative to landlord's contribution towards the cost of renovations. It is prudent to have the tenant's renovation plans and specifications pre-approved by the landlord prior to execution of the lease and to attach the same as an exhibit to the lease.

Regardless of whether a landlord contributes to these costs or not, the lease may state that upon expiration of the term, the tenant is permitted to remove only its trade fixtures and personal property. All other decorations, built-ins, improvements, etc., must be surrendered together with the property and would subsequently become the landlord's property. If the tenant desires to have the option to remove any such items at the expiration of the lease, the lease must explicitly provide for this right - otherwise, those items will belong to the landlord.

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