



Negotiating a restaurant lease: Tenants have the leverage

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Negotiating the terms of a commercial real estate lease is a complicated endeavor under any circumstances, but for restaurants the challenges can seem especially daunting. Add to that N.Y.'s maze of building codes, an economic downturn and landlords who may not be fully educated on the particulars of today's market, and tenants (and their brokers) have their work cut out for them. But there's no reason to fret. Would-be restaurant tenants have more tools at their disposal now than they have had in many years. Chief among them is leverage.

Economically speaking, the last decade or so in N.Y. was one for the record books. Confident consumers kept commercial vacancies down and property owners fell out of the habit of paying for tenant improvements. But with vacancies on the rise, landlords are becoming increasingly flexible. This is great news for restaurant tenants looking to relocate or open a new flagship because property owners who would never have rejected them outright a year ago have since opened their vacancies to a wider spectrum of retailers.

In spite of such trends, tenant improvements remain a tough sell. That said, landlords will be more inclined to allocate their own funds for such projects under the right circumstances. Consumers are spending less these days, and I often advise landlords that paying for some of the work to make a space more profitable over the course of a long-term lease is money well-spent. Vacancies in "destination areas" and spaces in horrible condition usually do necessitate some such tenant improvements. The same is true of a landlord looking for a specific user or if the restaurateur boasts stellar credit. Basic building work should not be a point of contention. This includes upgrades and maintenance to the electric service, water supply and distribution, gas and waste lines. HVAC improvements and new storefront build-outs are, by contrast, much tougher sells, but it doesn't hurt to ask. The bottom line is that keeping negotiations realistic on the TI front will yield the best results. The most contentious point in negotiations is always related to the terms of the actual assignment or sublet. Consequently, both sides need to be flexible. From the restaurateur's perspective, it is best to enter the discussion with a clear sense of what is negotiable and what is not.

Increased security is one item tenants should remain open to, particularly if they are unfamiliar operators. Another is increased rent, provided that the current figure is below market value. Others include financial requirements for the assignee which may include a guarantor, or specific reasonable use restrictions such as limiting the size of the establishment's bar. By contrast, some of the red flags to be wary of include any use of the misleading term "profit sharing;" unreasonable use restrictions, such as insisting that only sushi be served; increased rent if the deal was done at, or recently increased to, market value; no mechanism to release the guarantor from liability; or a "right to recapture" clause.

It is also useful to enter negotiations mindful of the point of view across the table. First of all, even for tenants with ironclad credit behind the lease, most property owners are leery of entertaining

percentage rent. This is mainly because of compliance and cash flow considerations, but also because it feels a bit like going into business with the tenant.

Demolition clauses have become increasingly common with soaring property values. While it remains to be seen how this will change in light of recent economic developments, it is an issue worth consideration. If a landlord insists on such a clause, the tenant has a right to a significant payout clearly defined in the language of the executed lease. I always tell clients not to see a demolition clause as a deal killer outright. What is important is the payout amount, and the required notification time. A lot of it comes down to common sense. If demolition is a distinct possibility then signing such a lease is rather risky.

Property owners are always nervous when it comes to restaurant deals. Tenants should keep in mind that some degree of worry is well-founded. N.Y.C.'s Landlord-Tenant Court is much more onerous than in many other urban centers, and landlords want to be securitized against all possible eventualities such as free rent, brokerage, renovation and other tenant improvements.

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