Top 5 Issues Every Real Estate Broker Should Be Aware Of In Negotiating A Restaurant Lease

By Pierre E. Debbas, Esq. and Guy Arad, Esq., Romer Debbas LLP

Negotiation of a restaurant lease is significantly different from that of a standard retail or office lease. In addition to negotiating the monthly rent and the term of the lease, brokers should be aware of the following issues which are quintessential when negotiating any restaurant lease:

1) **Certificate of Occupancy:** Whenever 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 Dept. of Buildings ("DOB") website. The CO will tell you what the permitted use of the space is. If it is currently zoned for a restaurant / food service establishment, then that alleviates several concerns. However, if it is not zoned as a restaurant, the prospective tenant should retain an architect to determine if the space can be converted for use as a restaurant. 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. The major structural items to take into consideration if the space can legally be used as a restaurant are the adequate means of ingress to and egress from the space and potentially the basement, the ventilation system and the utilities servicing the space.

2) **Liquor License and Community Board Approval:** Most restaurants rely on the sale of alcohol for a significant portion of their revenue. It is therefore imperative to have a built-in due diligence period in the lease which allows for the tenant to cancel the lease if in fact a liquor license or community board approval are not granted within a specified period of time. Liquor licenses are issued by the State Liquor Authority ("SLA"). The SLA reviews the number of restaurants and those that already sell alcohol in the specific area your space is and determines if it will approve the liquor license application. If the landlord will not agree to a liquor contingency, then the tenant must arrange to appear before the community board prior to executing the lease.

3) **Assignment of Lease:** There are two main reasons to negotiate for an assignment of lease provision in a restaurant lease. First, many restaurants go out of business prior to the expiration of their lease. The ability to assign the lease to another operator (whether for the same use or otherwise) 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 restaurant 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.

4) **Build-Out Costs and Landlord's Contribution:** Since the design concept of a restaurant has become so 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 (see point 5 below for further analysis on this issue). 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.

5) **Items Remaining in the Space Post-Lease Termination:** As you can imagine, renovation costs for restaurants in Manhattan are extremely expensive. 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 take 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.

As you can see, each of the five terms listed above have an economic impact on a tenant and are terms which affect the operation of the tenant's business. It is important that these terms are agreed upon at the term sheet stage. It is also necessary to retain an experienced real estate attorney to review the lease and ensure that these terms (among others) are accurately depicted in the lease and that the lease accurately reflects the business deal between the landlord and tenant.

Pierre E. Debbas, Esq.
Guy Arad, Esq.
Romer Debbas, LLP
183 Madison Avenue Suite 904
New York, NY 10016
Tel: 212-888-3100
PDebbas@romerdebbas.com
www.romerdebbas.com