



8 Hidden Dangers in Restaurant Lease Agreements

1. Net Charges and Common Area Maintenance (NNN/ CAM)

Commercial properties including, shopping centers and free standing restaurants typically require the Tenant to pay a portion or all of the properties expenses as "Additional Rent". The charges may include maintenance and repairs of the common walkways and parking lots, security, property management and utilities for common areas. The Tenant will also pay their share of property taxes and property insurance. NNN charges for each year are estimated and paid monthly with your rent payment. These charges are usually defined on a monthly or yearly price per square foot similar to rents. For Example, a property may be offered at \$2.00 per square foot with net charges (NNN) estimated at \$.50 per square foot. Your "Pro Rata" share of expenses is calculated by dividing the size of your store by the total square footage of the property. For example 1,000 square feet divided by 10,000 square feet equals ten percent (10%). If you are the only occupant you will pay 100%. At the end of each year, the actual expenses are reconciled and you will either owe the Landlord additional money for underpayment or receive a credit for overpayment.

WARNING! NNN expenses can increase dramatically. It's important to understand which expenses can spiral out of control. For example, Property Taxes can often double when an older property has sold. An experienced real estate agent or attorney specializing in restaurant leasing can guide you through this minefield and protect you from unexpected expenses.

2. Condition of Premises/Landlords Work

The Lease agreement between Landlord and Tenant will specify what is included with the "Premises" and what type of condition the Premises will be delivered. Tenant's and Landlord's often have much different expectations of what is included and the condition of the Premises upon delivery of the keys from Landlord to Tenant. You will either lease a space in an existing property that has been occupied by another business in the past or in the case of a new development a space that has never been occupied and under construction. It is extremely important for you to clarify what is and is not included and what type of condition the premises will be delivered. A complete description of the Landlord's work and delivery conditions should be negotiated and become an exhibit to the lease. With new construction it is very important to clearly specify what is included as part of Landlord's work. Will the Landlord provided electrical systems include subpanels and distribution within the Premises or only a conduit to a main panel? The devil is in the details when negotiating Landlord's work description. Items that should be addressed include, but are not limited to size and capacity of the HVAC system, capacity of the electrical system and who is responsible for making modifications to fire sprinklers or ADA accessibility.

3. Exclusive Use

One of the attractions of operating in a shopping center is increased traffic generated by your neighboring tenants. This benefit can quickly become a disadvantage if an unscrupulous Landlord allows too many competing uses within the same center. An "Exclusive Use" clause provides you with protection that the landlord will not allow a current or future tenant to sell similar merchandise now or in the future. For example, if you sell pizza and the landlord allows other restaurants in the center to sell pizza as well, your business may suffer. It's important to craft very specific language in the lease to protect yourself against future competition. Without this protection a future tenant or existing tenant that expands their product line, may impact your sales.

4. Assignment

Assignment is the transfer to another party all of the Tenant's interest in the lease for the remainder of the lease term. Assignment rights are one of the most important terms to understand and negotiate. An assignment provides the ability to get out of a lease early or to sell your business. Most assignment clauses contain many conditions that must be approved by the landlord, and some give the landlord the sole decision to approve or disapprove the assignment. Furthermore, some assignments do not release you from your lease obligation. A properly drafted assignment provision provides an exit strategy and can make a huge difference in the valuation of your business if you plan to sell.



5. Contingency

A contingency is safeguard to cancel the lease in the event you are unable to open for business. For example, if you are planning to build a restaurant, you may be required to pass many inspections and secure permits from various agencies including Planning Department, Public Works and Health Department. It's important to understand the many factors that may delay your opening for business and have a plan to deal with such delays. A properly drafted contingency clause can protect you from paying rent until you are able to open for business and provides the right to cancel the lease if you are unable to receive all permits needed to open for business.

6. Lease Commencement/ Rent Commencement

Many leases include a Lease Commencement and Rent Commencement date. Both terms are used when the date the tenant begins paying rent is different than the date the lease is signed. For example, if the lease is signed January 1st "Lease Commencement" and the first rent payment is not due until three months later, the "Rent Commencement" date is March 1st. Rent Commencement is typically determined by how much "Free Rent" or "Rent Abatement" is provided to the tenant. For many tenants and restaurants in particular, it's important to connect the "Rent Commencement Date" to the receipt of permits. For example, Rent shall commence 120 days after tenant receives all necessary permits to start construction or Rent shall commence 30 days after tenant receives all permits including Health Department and Certificate of Occupancy.

7. Options to Extend

Having the right to extend the term of your lease is an important factor for most business owners. Although many tenants fight hard for the right to extend their lease and the amount of rent to be paid during the option terms, most tenants are unaware of the key deal points when negotiating options to extend. Most commercial leases state that Options are personal to tenant. This has the effect of cancelling the right to exercise your option if you assign the lease. If you plan to sell your business having the right to extend your lease can make or break the sale of your business and the price you receive. Another key issue is the effect of defaults on your option to extend. Many leases will state that upon certain defaults, the Options shall become void. Negotiating precise language maintaining your rights so long as you cure such defaults is an important step in preserving your options.

8. Personal Guaranty

A personal guaranty is a security instrument whereby the person signing the guaranty "Guarantor" remains liable for the monetary obligations of the business. If you operate your business as a corporation or limited liability company and wish to lease commercial real estate, the property owner will often require a personal guaranty. A personal guaranty will typically remain in effect for the entire term of the lease and any options if exercised. With typical lease terms of 3 to 10 years, you can remain liable years into the future for a business you no longer own. There are numerous strategies to limit your liability when signing a personal guaranty. One strategy is to limit the amount of time you remain liable. If you are signing a five year lease, limit the personal guaranty to the first 24 or 36 months.

8 Hidden Dangers in Restaurant Leases provides an overview of some of the key lease provisions to be aware of. An experienced real estate agent or attorney specializing in restaurant leasing can guide you through this minefield and protect you from unexpected liabilities and expenses.

About The Author

Mark Chase is licensed real estate broker in the state of California and president of Restaurant Real Estate Advisors specializing in real estate for restaurants. Mark's more than 23 years experience representing both landlords and tenants provides a rare combination of knowledge and experience from "both ends of the negotiating table." Mark has negotiated with most national retailers and restaurants and has also secured new sites and negotiated hundreds of leases on behalf of regional and national chains such as Quiznos Subs, Domino's Pizza, Golden Spoon Frozen Yogurt, Subway and Little Caesars Pizza. In addition to his transactional experience, Mark has been featured as an expert on real estate by Business 2.0, Los Angeles Times, Los Angeles Business Journal, Daily News, California Real Estate Journal, Estates Gazette (UK) and KFWB Noon Business Hour. *Professional affiliations have included American Industrial Real Estate (AIR) Association, Association of Corporate Real Estate Executives and International Council of Shopping Centers (ICSC).*

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