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Move in on new territory: learn to negotiate better leases

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As the economy springs back to life, restaurants are again expanding and new entrepreneurs are getting involved in the industry.

But the right real estate strategy is critical to the viability of any new venture. It can make the difference between success and failure.

When negotiating a lease, many restaurant operators who lease their space mistakenly focus on only the most basic aspects, such as rent and availability. And it is easy to overlook other important factors that can have a big impact on profitability. The following negotiation tips are four examples of lease provisions that often do not get the attention they deserve:

Missing your opening date.

Restaurateurs usually sign their leases well in advance of an opening so they can build out and equip their restaurants. But landlords generally require a deadline by which the restaurant will open. So what happens if a tenant, because of unforeseen events, misses the opening deadline? The restaurateur's objective should be to avoid for as long as possible termination of the lease by the landlord if the restaurant has not opened by the prescribed date.

On most leases, a missed opening date is treated in the same way as any other tenant default would be: the landlord is allowed to terminate the lease and sue for damages. A restaurant tenant should negotiate into the lease a payment schedule that allows for the payment of

rent for a specified period, such as 120 days, before risking the loss of the lease. Paying rent before opening is almost always preferable to losing the location.

Calculating percentage rent. Restaurant leases often require tenants to pay a percentage of sales, but restaurateurs have an often-overlooked chance to save money by negotiating what is defined as "sales." The restaurateur's objective should be to avoid paying a percentage of sales that are extraneous to the main business.

Here are examples of sales on which the tenant should not pay percentage rent:

- * Discounted sales to employees
- * Tips added to credit card sales
- * Sales of gift certificates where the certificates are redeemed at a different location
- * The discounted portion of sales paid partially with coupons
- * Sales from off-premises catering
- * Sales from vending machines
- * Fees collected for using automatic teller machines or pay phones

In addition, restaurateurs can try to partially offset credit-card costs by excluding from the definition of "sales" a percentage of credit card receipts, since card issuers' charges reduce profit on credit card sales.

Negotiating exclusive rights.

Restaurateurs in multitenant locations always should consider negotiating for some exclusive rights. The restaurateur's

objectives should be first to accurately define what exclusive rights he or she is getting, and secondly, be able to enforce those rights without having to prove damages for a violation.

Defining exclusive rights requires some give-and-take. For example, a steakhouse in a shopping center likely would not get the exclusive right to sell steak; this would unduly restrict the landlord in attracting other restaurant tenants. The steakhouse might, however, ask for the exclusive right of having a menu that is composed of more than 50 percent meat items. You must then, however, define how you measure menu items. For instance, you do not want a competitor to claim it has less than 50 percent meat items on its menu by including all beverages and desserts or single nonmeat items that have multiple menu listings for various preparations. Instead of a general exclusive, a restaurateur can try to protect a particular menu item by indicating that a particular item is the restaurant's "signature" dish.

The restaurateur also must ask for the specific right to enforce this exclusivity. Otherwise, if the landlord breaches the exclusive, the tenant might be relegated to suing for damages. But that is costly and speculative, and would require the tenant to prove the damage caused by a competitor's presence.

Timing payment of construction allowance.

Landlords often help pay for a restaurant's build-out costs by giving an "improvement allowance," in which the landlord reimburses the tenant only after the work is complete and paid for by the tenant. The restaurateur's objective should be to avoid advancing any money and then having to wait for the landlord's reimbursement.

At a time of critical cash-flow issues, tenants advance large progress payments

to cover build-out expenses, but they do not receive reimbursement until the work is complete. A restaurateur should, therefore, negotiate for the landlord to pay the contractor directly as bills become due. If the landlord is paying for only a portion of the build-out, then he or she should pay the pro rata share of progress payments as bills become due. Not only does this help the restaurateur budget funds, it also assures timely reimbursement that is not contingent on factors determined by the landlord.

The articles on this page do not necessarily reflect the opinions of the editors and management at Nation's Restaurant News.

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