

Leasing Retail and Restaurant Space

Frank Raeon

Author, **The ABC's of Site Selection: How To Pick Winners and Avoid Losers**
Principal, *Location Decision Advisors* - www.locationdecisionadvisors.com

The following information, minus exhibits, will provide you with a comprehensive overview of what to look for when you make the decision to lease retail or restaurant space. The first part identifies an actual Letter of Intent (LOI), otherwise known as a Proposal, which was drafted by Frank Raeon. The second part provides a description of important lease terms.

Typically, either a commercial realtor or landlord representative will prepare a Letter of Intent. In addition, both parties may fill in the blanks or add language to a standardized lease agreement which has been prepared by a real estate attorney. While the review services of a real estate attorney are not necessary at the LOI stage it is wise to consult legal counsel when it comes time to review and comment on a lease agreement.

Part A: Letter of Intent

July __, 20__

The following Letter of Intent has been prepared for _____, the Cincinnati area franchisee for _____. The proposed Premises consists of end cap space in the Graeter's Building in The Pointe mini lifestyle center located on the southwest corner of Cox Lane and University Drive in West Chester Township, Butler County, Ohio.

LEASE SPACE: Approximately 2,276 square feet of primarily rectangular shaped space.

BUSINESS USE: A boulangerie selling artisan, made from scratch, breads which are baked daily on premise. Educational baking classes may, from time to time, be offered. In addition, the ancillary sale of oils, jams and jellies, cutting boards, and gift baskets will be offered. Furthermore, Lessor will consent to the incidental sale of wines and cheeses.

BASE TERM RENTS: Years 1-4: \$25.00 psf (\$56,900.00 annually)
Years 5-7: \$27.00 psf (\$61,452.00 annually)

CAM CHARGES: Estimated monthly pro rata costs for first year real estate taxes, insurance, and maintenance are \$4.75 per square foot (\$900.92 per month).

OPTION TERMS: Lessor agrees to grant Lessee two (2) consecutive five (5) year renewal options. During each option period rents will be increased by 10%.

POSSESSION: Lessor will provide Lessee with possession of Vanilla Box space approximately 120 days after lease execution.

START OF RENT: Lessee's rent obligation will commence 45 days after possession or when tenant opens for business, whichever occurs first.

BUILD OUT: Please see the attached construction exhibit describing Lessor's build out.

SIGNING: Lessee will have the right to display fascia mounted signing above its storefront as well as on the building wall facing University Drive. If permitted by West Chester Township, Lessee will also be permitted to display signing on the front building wall facing Cox Lane. All proposed signing must be approved by Lessor, and, must comply with local zoning and building code regulations.

BUSINESS HOURS: Lessee will be required to be open for business 6 days a week for not less than a total of 60 hours.

PERCENTAGE RENT: Upon the conclusion of the third year of Lessee's base term, Lessee agrees to pay Lessor, as additional rent, 3% of any and all sales exceeding \$796,600. Said additional rent shall not exceed \$2 per square foot per annum and shall be payable to Lessor on or before February 1st of the following calendar year.

SECURITY DEPOSIT: Lessee will be required to provide Lessor with one month's security deposit (\$4,741.67)

FINANCIALS: Lessee agrees to provide Lessor with a current financial statement upon Lessor's execution of this Letter of Intent.

CREDIT CHECK: Lessee agrees to provide Lessor with information required to run a credit check.

GUARANTEE: Lessee will be required to sign a personal guarantee as an assurance to Lessor that all of its financial obligations will be honored during the base term and all subsequent option periods of the lease agreement.

BROKER: The owners of University Pointe will be responsible for paying _____ a real estate fee based upon a previously signed commission agreement.

UNDERSTANDING: It is understood that this Letter of Intent is not intended to create any legal rights or obligations. Rather, its purpose is to provide a summary of basic business terms. All of the legal rights and obligations of the parties will be set forth in a lease agreement which Lessor agrees to provide to Lessee within 10 days of the execution of this Letter of Intent. Furthermore, no such rights or obligations shall take effect until a lease document has been fully executed by both parties.

This Letter of intent shall remain open for acceptance until Noon on Wednesday, _____, 20__.

AGREED BY LESSEE:

Name

Date

AGREED BY LESSOR:

Name

Date

Part B: Important Lease Terms

A lease agreement is a very detailed, complex document that spells out the terms under which a Tenant (Lessee) agrees to enter into a business relationship to rent space from a Landlord (Lessor). It can be, especially for the neophyte, a somewhat intimidating document. Because it is a legal contract it should definitely be reviewed by your real estate attorney before being executed.

Cotenancy. This important term refers to a lease clause which can be very influential with respect to sustaining customer traffic and preventing a decline in sales revenues. This is one instance where you are definitely advised to seek legal counsel.

The longevity and prosperity of one or more anchors or major tenants in the shopping center or building where your business is located is crucial to the longevity and prosperity of your business. As such, you want to make sure that if an anchor or major tenant leaves (otherwise known as going dark) or occupancy levels fall below a certain percentage or square footage you are entitled to some form of rent relief, or, can break your lease.

Credit Scores and Financial Statements. These constitute the litmus test for most landlords who lease space to small and start-up businesses. They are looking for high credit scores and financial statements which show that you have little debt and an attractive net worth. The combination of these important factors will automatically elevate not only landlord interest levels but also your ability to negotiate better terms for yourself with respect to rent, build out, and/or tenant improvement allowance.

Early Termination/Escape/Kick Out Clause. If you decide to rent space, having your attorney incorporate an early termination provision into your lease agreement is the best way to protect the substantial investment you are making. Simply stated, such a clause allows you to terminate your lease obligations prior to the conclusion of either your base term or option term if there is some compelling reason to do so. An example might be a loss of business due to the closing of one or more anchors. Another might be a substantial increase in the amount of vacant space.

Other reasons for invoking this type of protective clause might be attributable to the continued postponement of needed capital improvements such as roof

replacement and parking lot repairs and resurfacing or common area maintenance problems such as continuous delays in snow removal and the replacement of burned out parking lot lighting. Such problems can result in fewer customers.

Having such a clause in your lease can also provide you with a platform for requesting temporary rent relief—something that most good landlords will consider if you have a history of being current with your rent.

Similarly, you need to make sure that you can invoke such a lease clause if your landlord wishes to relocate you to lease space which may not contain the same types of amenities that your present space has—things like substantially similar visibility, store frontage, signing, windows, convenient as well as sufficient parking, building improvements, and interior finishes. In such instances, be careful not to overlook the potential for loss of business due to the lack of synergy or compatibility with one or more adjoining or nearby tenants.

Holdover Clause. This is an important lease clause that your attorney can help you with. It enables you to temporarily remain in your space for a short period of time (anywhere from a week to two or more months) once your lease has expired. However, in order to invoke this important privilege you will be obligated to pay your landlord a rent premium. Accordingly, count on your holdover rent to increase by as little as 10 - 15 % or as much as 20 - 25%.

Percentage Rent. While scorned by most small businesses, percentage rent is looked upon as a value enhancement by owners of malls and lifestyle centers throughout the United States. Consequently, it is a common lease requirement for retailer and restaurant companies who wish to occupy prime real estate.

The “bonus” theory behind paying percentage or overage rent is that landlords should be rewarded financially for establishing a synergistic tenant mix—a feature which, if done correctly, should account for higher sales levels. In such situations, in addition to paying a base rent, tenants pay their landlords a percentage of their sales beyond a certain predetermined figure.

For example, a retailer may be required to pay a landlord anywhere from 2–7 percent of annual sales revenues exceeding \$1,000,000. In instances where said retailer produces annual sales of \$1,250,000 and is bound by a percentage rent requirement of 5 percent, the landlord will end up receiving an additional \$12,500 in annual rents.

Most tenants who end up paying their landlord's percentage rent don't do so grudgingly because they are happy to make what is usually either a very good or an excellent return on their investment.

Tenant Build Out. Most landlords typically provide tenants with two kinds of rental space. For new space, the standard is a “vanilla” box finish. This typically includes the basics: Unpainted drywall, concrete floor, one restroom, ceiling, lighting, electrical outlets, HVAC, and a hot water heater. For restaurants, upgrades in plumbing, restrooms, electrical outlets, and HVAC will all be required—how much depends upon the type of restaurant use.

In certain instances, a landlord may agree to deliver unfinished space or “cold, dark shell” space while providing a build-out allowance to the tenant who will then assume responsibility for completing the build-out. This removes the landlord from the space planning and building permit processes as well as from bidding the job and hiring one or more contractors—a situation many landlords welcome.

Older or second generation space is usually delivered to tenants in either “as is” condition or with some minor improvements. Such improvements might include freshly painted walls, new flooring, new ceiling tiles, etc. Alternatively, some landlords will be happy to simply provide a new tenant with some form of free rent in exchange for the tenant coming “out of pocket” to refurbish the subject space.

Tenant Improvement Allowance. Landlords will consider providing a desirable tenant who has good credit and good financials with some form of build-out allowance. Build-out is the key—landlords don't want to spend money for things like furniture, fixture, and equipment. Nor will they consider providing money for decorative items.

Upgrading the HVAC, electrical, and plumbing systems are likely candidates for improvement dollars. Adding glass wrap or an outdoor patio represents other possibilities. These are improvements that ultimately add value to a property. Remember that landlords want tenants to have “skin in the game.” In other words, they want to see tenants come out of pocket for a long list of improvements items starting with flooring, lighting, and painting.

Triple Net Rents. Most shopping center owners charge their tenants what is known as a triple net rent. Sometimes referred to as pass through costs, triple net rents require a tenant to pay his or her pro rata share of real estate taxes, insurance, and common area maintenance.

Vanilla Box Space. Developers and landlords typically deliver space to tenants to complete with walls, ceilings, lighting, HVAC, and one or more restrooms. The tenant is then expected to decorate the walls and provide floor coverings. Extras such as additional HVAC, electrical, and plumbing systems, along with improvements such as outdoor patios, awnings, signs, and additional glass, are typically paid for by the tenant.

Frank Raeon has been helping clients find high volume retail and restaurant locations for more than twenty-five years. Examples of national, regional, and local market leading companies he has helped include Blockbuster, Buffalo Wild Wings, Dewey's Pizza, Donatos, First Watch, Graeter's Ice Cream, Izzy's, McDonald's, Pier 1 Imports, Servatii's Bakery, Subway, United Dairy Farmer's, Walgreen's, and Wendy's.

Frank is also the principal of ***Location Decision Advisors***, a Cincinnati based real estate advisory company which helps small retail and restaurant companies and franchise organizations better understand how to pick winners and avoid losers. He is currently working on his second book: **Inside Site Selection**. It is based upon interviews he is conducting with people from throughout the United States who are responsible for making retail and restaurant location decisions.

You can **contact** Frank regarding the provision of advisory services, including site selection coaching, at (513) 271-0300 or via email at frank.raeon@gmail.com.