# CRUCIAL GUIDE TO LEASING A RESTAURANT

Read this guide to make a smarter, more informed decision among the many restaurants available to lease

# RESTAURANT INDUSTRY

The restaurant industry is a $825 billion dollar industry according to the National Restaurant Association.

The Association?s 2018 State of the Industry Report states there are over one million restaurant locations currently in the United States employing over 15.1 million people.

There are over one million restaurant locations in the United States and that number continues to frow.

Average unit sales recently reported by the National Restaurant Association indicate sales averaged $992,000 at full service restaurants and $861,000 per yea rat quick service restaurants.

The restaurant industry equals four percent of the U.S. gross domestic product and it's employees make up ten percent of the overall workforce in the United States.

Restaurants are the nation?s second-largest private sector employer. The industry is a job creator that is vital to the nation?s employment.  Sales for restaurants in 2018 reached $800 billion.

This vital industry is also a microcosm of the small business owner in America.

More than 7 in 10 restaurants are single-unit operations.

More than 9 in 10 restaurants have fewer than 50 employees. These are truly mom-and-pop business opportunities producing a legacy and lifestyle  for their families.

It's an amazing industry filled with opportunity but when leasing your first space, there are a few things to know.

This guidebeook will show you:

- Why the Landlord is Not your Friend
- Who the Leasing Agent is working for and why it matters.
- The most common lease mistakes
- Landlord "math" basics
- Why Free Tenant Improvement money is never free

# THE LANDLORD IS NOT YOUR FRIEND

## Don't forget this!

The landlord/tenant relationship shares a lot in common with a marriage. Both parties go in with the best of intentions and there's a lot of love on both sides.

However, if the relationship ends in a break up (roughly 50% of all U.S. marriages end in divorce), things get a little rocky on the back end and usually no one remains friends.

We never recommend negotiating a lease on your own with a landlord. The landlord (or his leasing agent) has done this hundreds of times. For you, it may be the first time.

Before you pick up the phone and call on that vacant restaurant space, consider the following reasons why that landlord is not your friend

The landlord drafts the lease document. You should assume that the lease will be landlord friendly, meaning unfavorable to the tenant, in most cases.

That's not to say it can't be modified but make sure you have someone on your side that's familiar with the language of the document so you can get the best business terms going into the lease.

# THE LANDLORD TEAM

Don't assume the friendly voice on the phone works for you. He or she doesn't.

The person answering the phone from the sign on a lease property doesn't represent you.

The person handling the restaurant space works for the landlord. He has one goal and one goal only: lease this space for the landlord. The only properties he shows you are from the person that pays his salary.

If a better location for your concept is a quarter mile away and he doesn't represent that space, he will not tell you about it.

# YOUR OWN BROKER

Using your own broker for negotiations has only upside and no downside for you as a tenant for a restaurant property.

## No Fees (usually) for Tenant Representation

The landlord has already predetermined commission on the space.

If you aren't represented by a broker, the commission is the same amount except the landlord's leasing agent gets 100%.

The landlord's leasing agent would rather work directly with you but your cost remains the same either way. His earnings do not.

As a caveat, be sure and ask any broker you work with if there are any fees. We Sell Restaurants does not typically charge to represent leasing tenants.

## The landlord’s Rep Doesn’t specialize in Restaurants

The landlord’s representative is not a restaurant specialist. He may not purposely hide information, but he may not know that the HVAC unit is right-sized for retail but dramatically undersized for a restaurant operation.  Once you move in and begin operating your restaurant/sauna and customers are passing out from the heat, added HVAC capacity is up to you.

The term of your lease, personal guaranty and the options to renew all need to be negotiated up front.  Don't attempt this on your own or with the landlord's resource.

## Negotiating Power

A strong broker working on your behalf knows what comparable rates are for the market.

They can tell you whether the rate being quoted is in line or should be negotiated.

## Industry Knowledge

A restaurant broker can advise you on restaurant-specific infrastructure. Items like the grease trap, HVAC, and hood system are exclusive to the industry, and only someone familiar with the business knows this.

# LANDLORD MATH

## Understanding the Basics

There are three components to the formula for lease space.

- Square footage
- Base Rent
- CAMS, Taxes and Insurance

### Restaurant Lease Formula

The standard formula for a restaurant lease is quoted as a price per square foot plus CAMS, Taxes and Insurance.

This is the total cost of the lease for a year. Divided by the twelve months in a year, it equals the monthly lease rate.

**Example**

1200 square feet

$32.00 per square foot

7.85 CAMS, Taxes & Insurance

1200 X 39.85 = $47,820

$47,820/12 months =

$3985.00 per month

# LEASE ESCALATIONS

With standard Base Rent escalations of around 3% per year, here's how the math works on a 5-year lease with a five- year option.  This assumes 3% annual increase on the example just provided.

NOTE:  In this example, we do not show increaes to CAMS, Taxes & Insurance.  These would typically  increase over time.

| | Base | CAMS/TI | Annual | Monthly |
|---|---|---|---|---|
| Year 1 | $32.00 | 7.85 | $47,820 | $3,985 |
| Year 2 | $32.96 | 7.85 | $48,972 | $4,081 |
| Year 3 | $33.95 | 7.85 | $50,159 | $4,180 |
| Year 4 | $34.97 | 7.85 | $51,381 | $4,282 |
| Year 5 | $36.02 | 7.85 | $52,640 | $4,387 |

# CAMS & TRIPLE NET

## Explaining the Components of Landlord Math

CAM is an acronym for “Common Area Maintenance.” Landlords typically charge base rent plus CAMS, Taxes and Insurance.

Common area maintenance refers to expenses for the common good of the shopping center which are distributed among those who benefit on a square footage basis.

CAMS can include anything from garbage pickup to landscape and exterior lighting. They are calculated on a pro-rata basis or “in proportion” to the square footage.

Taxes and Insurance are typically (in shopping centers) charged on the exterior of the building and a tenant is still responsible for taxes on personal property and insurance within his four walls.

## Triple Net Lease

A Triple Net Lease is also known as Net, Net, Net Lease or NNN Lease. This is often associated with a free standing building and refers to the fact that the tenant pays all or part of the taxes, insurance, and maintenance associated with use of the property.

The fees are paid in addition to the tenant's regular monthly rent.

## Reconciliation

The landlord will "true up" or send a reconcilation of the CAMS, Taxes & Insurance once a year to adjust the amount based on the actual maintenance, taxes and insurance charges. This resets the rent payment for the next year

## Negotiating CAMS

It is typically not possible to negotiate the amount of CAMS paid as this is a pass through expense from the landlord. We do sometimes successfully cap the CAMS charge or cap the percentage amount it may increase for a period of time on a new lease.

# MOST COMMON MISTAKES

## No Exit Strategy

The most common error in negotiating a lease is the failure to plan for an exit strategy. No one enters business expecting to fail, but it happens. Partners get sick or walk out of partnerships.

Couples divorce, or liquor licenses get pulled. On the flip side, businesses sell. You get an offer you can't refuse. There are many reasons why a business owner will need to get out of the lease. We recommend you have an exit strategy as you enter into a lease. Generally, this will not be found in the initial version of the landlord's lease and the broker needs to fight for these terms.

To avoid these common lease mistakes, negotiate on these five elements before signing a long term document.

# NEGOTIATE THIS UP FRONT

To avoid this common lease mistake of failing to consider an exit strategy, negotiate on these five elements before signing a long term document.

## Lease Transfer

Lease transfer is the single most contentious issue in the sale of a business and kills more deals than anything else. Your only power in this negotiation is at the outset of the lease, not when you're ready to sell. Make sure the terms of the lease spell out how it will transfer it to another party.

## Experience Clauses

You may enter into a lease with a landlord with lots of experience, but always think in terms of selling the store at a later date. Plenty of successful individuals enter the restaurant industry without experience, but that doesn't preclude their eventual success.

Landlords often will try to sneak language into the lease that requires restaurant experience, even for franchise operators and it can severely limit the pool of buyers for your business later on.

## Confidentiality

The landlord should be held to confidentiality on the terms of any future sale of your restaurant.

Landlords like to talk. If they have the right to request the purhase agreement, they should be enjoined from sharing it.

# NEGOTIATE THIS

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## Transfer Charge

Determine up front what the amount of the transfer charge will be. Don’t agree to loose language like “reasonable attorney fees” as you have no idea what the cost will be. Identify the amount you’ll pay in a transfer so you know what it is and insure that it’s minimal ($500 to $1500 is appropriate).

## Transfer Time

Try to force a time period on the transfer, such as “transfer shall occur within thirty days of submission of a formal request.” Landlords are famous for dragging out deals. When you’re negotiating the original lease, you’re in the driver’s seat. When you want to transfer it later on, you’re no longer a priority.

# How Much Should You Pay for Occupancy Costs?

# OCCUPANY COSTS

## How much should you pay?

### Questions to Ask

HOW MUCH WILL I BENEFIT FROM THIS LOCATION TO JUSTIFY THE RENT?

Occupancy is the sum total of Rent, CAMS, Taxes and Insurance – all the costs associated with the lease. In major metropolitan markets, the CAMS, Taxes and Insurance can be as much as 30% of the base rent price so the calculation for rent on its own is incomplete without the addition of these costs.

Physical location is very important to the restaurant owner. The length and value of the lease and its costs as a percent to total sales is a fixed expense that continues whether you have a single dollar of sales.

Competition to be in the most desirable part of the dining scene can drive rents to very high levels. A restaurant tenant should focus on how much space he actually needs before signing up for a large recurring expense. Carefully look at the cost of a lease in terms of the total occupancy expense.

# CALCULATING OCCUPANCY

You should strive for total occupancy costs that equate to 8% to 10% of the total sales of the restaurant. That is becoming mor eand more difficult to achieve in today's competitive leasing environment.

Rent is a fixed expense and one of the most difficult to overcome. One word of caution when looking at second generation or empty restaurant space. Often a restaurant operator will base his or her forecast on the prior operator’s sales.

Remember that every dollar you do not pay in rent becomes additional income to the restaurant.

Your forecast should be based on your menu, average ticket sales and gross sales rather than a prior operator that may have had a radically different concept.

**Questions to Ask**

UNDER MY MOST CONSERVATIVE FORECAST, WHAT WILL MY OCCUPANCY COST BE AS A PERCENT OF SALES?


# Tenant Improvement Money

# IT'S NOT FREE

A Tenant Improvement Allowance, commonly referred to as the "TI" allowance, is the amount of money offered by a landlord to the tenant for improvement to the space. The funds are generally offered one of two ways: dollars per square foot of the leased premises or set dollar amount. These funds are to be used strictly for the improvements to the leased space. They cannot be used for the purchase of equipment or inventory for your restaurant.

Here are of the little known details about TI money you should know. First, the money is not advanced to the restaurant owner. Typically, both the tenant and landlord meet to agree upon the plans or design and then the tenant pays the contractor for the expenses. The landlord later reimburses the tenant based on a fully accounting.

Sometimes the landlord will add language that if the project is not completed within a certain amount of time than the TI money is not reimbursed. Sometimes he will only repay funds if he chooses the contractor. Make sure you have control over who does the work and what you're paying. Secondly, tenant improvement money is expected to supplement the expense for build out. It does not cover the entire cost. The landlord's contribution is for long term improvements to his property. He wants to see you invest as well and fully expects your contribution to the project at least match his.

This is a word of warning to the would-be tenant. Tenant improvement money, or TI, is not free money. You will be paying this back in the rent amount at some ridiculous rate of interest that's never clearly calculated for you. It's all part of the landlord's top secret formula for arriving at a square footage price. It may seem like a huge amount of money when a landlord is offering up $20 a square foot for a 2000 square foot space or $40,000 of "free" money. However, a typical build out of a restaurant will be much more than that. Average expenses range from $15,000 for a grease trap (in ground 1500 gallon) to $1000.00 per linear foot for a hood (average 12-14 foot or $12,000 to $15,000). Installation of mechanical, electrical and plumbing can easily run another $40,000 before you build any walls, add flooring, put in a bar or purchase any equipment.

That's why a "second generation" space or even the purchase of an asset sale is often less expensive and less work.

# LANDLORD CONCESSIONS

Concessions from the landlord are never a sure thing in the negotiations on a lease. A landlord is going to look at the new tenant along with their credit history and experience. He or she will also look at what the new tenant is investing in the property.


## Free Rent

When building out a new space or an empty location, it is usually possible to obtain a few months of free rent.  However, it usually does no toccur on a transfer since there is already a lease and tenant in place paying the rent.

On a new lease, expect free rent for the time it will take to get your concept open or structure to receive free rent until you obtain a vertifiecate of ocuvpancy

You will usually need to pay CAMS, taxes and insurance even if base rent is abated.

# TENANT PACKAGE

A landlord is going to want to see a full package on you as a tenant as well as the concept. Skipping this step will limit your changes of negotiating for the space. A strong restaurant broker can help you prepare a complete package which includes.

## Menu

The landlord will want to make sure your concept is no tcompetitive with others in the center or may even have non-compete clauses.

He will also want to know you have a full developed concept ready to go.

## Business Plan

A full business plan, even if it's a short one, goes a long way toward demonstrating your concept. This should include your menu , marketing plan, and background and experience.

"Always put your best foot forward because you never know where your next step may lead you."

- Stephan Labossiere

# TENANT PACKAGE

## Full Financial Package

It is critical that you be in a position to put forward a full financial pacakge on the listing for the landlord.  You will also need to be sure you and any guarantors have good credit.

### Financial Statement

The landlord will require both a personal and if you have an existing concept, th business financial statement before approving the space or a transfer. This will be for all parties to the lease and wives are typically rquired to sign the lease.

### Tax Returns

Most landlords will require at least two years of tax filings for you personally and on your business.  If you don't want to share this level of financial detail, you will probably not be approved.

# PERSONAL GUARANTEE

Almost every landlord expects a personal guarantee on the lease. That means that you are personally guaranteeing or pledging your personal assets on behalf of your company. If the business fails and you bankrupt the company, you can still be personally liable for the remaining term of the lease.

Before you or your attorney consent to the personal guarantee, remember that there are many forms a personal guarantee can take to minimize your risk. You should attempt each of these strategies before you blindly sign the personal guarantee that your landlord (who is not your friend) wants. Think carefully before you ask a family member to sign up for this as well, as it can bankrupt him to answer a judgment or lien from a landlord if you go under. Here are just a few strategies to lower that risk.

D**iminishing Personal Guarantee**

The gurantee "burns up" or diminishes as you make monthly payments on time.

**Fixed Personal Guarantee**

You and the landlord agree up front that you gurantee will not exceed some number, i.e . $100,000

**Removal of Personal Guarantee at the end of the initial Term**

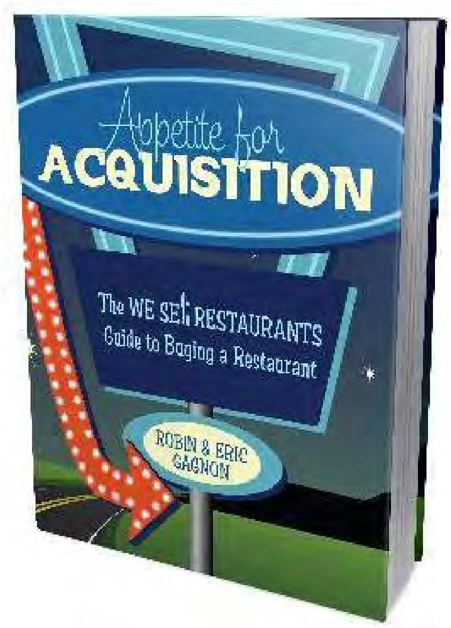
You should always request that your gurantee last no longer than the initial term. You don't want to be on the hook for option years.

**Removal of Personal Guarantee at any Point in the Term that the Lease is Transferred with Landlord consent**

Request that your gurantee be replaced by any new tenant. If you decide to sell the restaurant, you do not want to be responsible for someone ele's performance.

One last note. Most landlord require a personal guarantee of both the wife and the husband. Do not be surprised to find a spousal commitment to the lease and personal guarantee even if you attempt to shield or keep her out of the transaction.

# ABOUT THE AUTHOR

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She teaches the nation's only Certified Restaurant Broker curriculum.

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