

## **Operational Issues in Restaurant Leasing: Eat Your Fill but Clean the Grill!**

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Offices are generally squeaky clean, quiet, dry, and odorless. Restaurants are usually loud (even when the ambience says “quiet!”), water gets slopped all over the kitchen floors, greasy smoke rises upward, grease flows downward, vermin love them, and they generate lots of garbage and trash. They are also very expensive to outfit and have a high failure rate. Their saving grace is that they also pay higher rents, which is why many landlords love them. For all these reasons, restaurant leasing is a different animal than office leasing.

Any landlord leasing to a restaurant and any tenant leasing space for a restaurant, particularly in a mixed use building, needs to understand the challenges the restaurant will pose to the building systems and to the occupancies of the other tenants.

This checklist below focuses on operational issues that can and should be dealt with in a lease for a restaurant. Shopping center landlords and restaurant chains have facilities teams that have a thorough understanding of the requirements and challenges of restaurant operations. Owners of mixed use buildings dominated by residential or office tenancies may not have a very clear understanding of the issues involved (and their lawyers may not either); and individual restaurateurs, even ones with a very sophisticated operation, may not fully understand the operational and legal challenges.

Accordingly, the following checklist focuses on restaurant leasing in mixed use buildings in a non-shopping center context. The author’s article “To Eat or Be Eaten: An Introduction to Restaurant Leasing (with Due Diligence Checklist)” attached as Exhibit A.

### CHECKLIST

#### **Legal Due Diligence**

- Determine if there are any zoning issues with the proposed use.
- Engage the Architects and Code Compliance Consultants – Buildings Dept./Permitting Process.
- Certificate of Occupancy (NYC issue)
  - Constructing a restaurant in a building that doesn’t have a Certificate of Occupancy (CO) may require an amendment to the CO or issuance of a CO, which potentially triggers a variety of Code compliance issues (including possible requirements to upgrade building systems outside the restaurant premises).
    - Can a CO be obtained just for the restaurant?
    - Are there other existing violations against the building and do they have to be discharged? Who discharges? Is it practical to discharge the violations

- (e.g., is the cooperation of another tenant required to discharge a building violation).
    - Are there open alteration applications affecting the building and do they affect the tenant's ability to obtain a CO for the restaurant?
    - An architect/code compliance expert needs to be consulted.
- Liquor License –
  - Some states permit licenses to be transferred and other states require that a new liquor license be obtained.
  - Many liquor ordinances limit the location of establishments selling liquor (not proximate to schools, churches, etc.).
  - Consider local approvals (NYC Community Boards).
  - Background checks are frequently required
    - Landlord
    - Tenant
  - *Sources of funding*
  - Consider if you should engage a liquor law attorney
  - Lease requirements
    - The lease should require that the landlord cooperate in obtaining the license.
    - The tenant should be required to diligently prosecute getting a license.
    - There should be representations by each party that its principals do not have a criminal record and would not otherwise be disqualified from holding a liquor license.
  - There are two approaches to obtaining the liquor license:
    - Pre-lease due diligence
    - Lease can be signed with a contingency. If contingency is used:
      - What rent should be payable before the liquor license is obtained?
      - Should there be a termination payment?
      - When can construction start?
      - When is the security deposit paid?
      - Include cooperation/due diligence/landlord and tenant representations.
- Consider other permits and licenses:
  - Business license
  - Food service license
  - Music license
  - Health permit
  - Sales tax permit

### **Physical Plant Due Diligence and Operational Issues**

- Electric, Water, Gas, Steam
  - What utilities are required to operate the restaurant?
  - Is service already available to the restaurant?
    - Is the service adequate?
    - What is the condition of the conduit and equipment?
  - If service is not already existing at the premises:

- Who is responsible for providing the service?
    - To what point must the service be brought (e.g. to perimeter of premises, to edge of pad site or to a location designated by tenant in its plans)?
    - What are the specifications for service?
    - Are there any moratoriums in effect on added utility service?
    - If tenant is installing service, are there any tap in fees, impact fees or deposits to be paid?
  - Capacity – It is important to consider:
    - the service available to restaurant
    - the service available to building
    - the cost of bringing in additional service (to space and to building)
    - the lease should also address future needs for additional service – tenant needs to ensure that tenant can expand service at tenant’s cost; with landlord to cooperate
  - Cost/Metering
    - Is utility directly metered or submetered?
    - If the utility is submetered, is tenant billed at Landlord’s out-of-pocket cost?
    - If there are not separate meter(s), who installs them and at whose cost?
    - If the premises are already metered, do existing meters measure only the usage in the tenant’s space?
- HVAC
  - Usually tenant installs its own HVAC system because:
    - Building heat may be unreliable
    - Tenant may operate the restaurant outside of normal building HVAC hours
  - Where do the compressors go?
    - Roof? Backyard? Roof setback?
    - Does the tenant have the right to install lines running to the compressors through building common areas?
    - What are landlord relocation rights?
  - Sound/vibration insulation is important for some restaurants
  - Landlord may require tenant to maintain a service contract for maintenance of the system
- Refrigeration units (which often require compressors)
  - The issues are similar to the issues with HVAC
- Hot water
  - Tenant should be required to heat its own water – a restaurant tenant’s hot water needs will outstrip the needs of office and residential tenants.
- Exhaust systems
  - It is important to consult with architect about the proposed exhaust system.
  - Multiple stacks may be required for different exhaust sources.
  - Cost (generally very expensive) – Who shoulders the cost of installing stacks or repairing existing stacks?

- Location: Where can the stacks be installed? Landlord consent should be required if stacks will be in common areas. Stacks may have to run through tenanted areas, which may present issues.
- Right of Access: Tenant should have right to access common areas to install, maintain, repair and replace stacks.
- *Existing stacks: Landlord consent to exclusive use*
- Service Contract: Landlord may require tenant to maintain a service contract for periodic cleaning of stacks.
- Relocation: Landlord should negotiate for a relocation right.
- Grease is a major issue with restaurant tenants. (Drain lines, main building lines, grease interceptors)
  - There should be a careful due diligence investigation about the proposed grease traps.
  - A grease trap is essential.
  - Tenant should be responsible for maintaining:
    - Grease traps
    - Drain lines from restaurant to main building line
    - Who's responsible for main building line? Who else is using it? Is tenant the prime user and, if so, should the tenant assume responsibility for the main line?
    - Service contract – A contract with a reliable plumbing company can be useful.
- Waterproofing Floors
  - Kitchens generally suffer a lot of spillage.
  - Landlord may insist on, or tenant may wish to install, waterproofing under the flooring and pitch floor so that all fluids flow to a drain. This would be especially important if there is any sensitive equipment stored below the restaurant kitchen.
  - Malls may require flood testing of floors, especially for 2<sup>nd</sup> and 3<sup>rd</sup> floor restaurants.
- Sprinklers
  - Are there additional requirements for a restaurant?
  - Who installs and who pays the cost?
- Signs – The tenant generally believes that bigger and brighter is better.
  - Where will the tenant's sign be installed?
  - Can the tenant install a lighted sign? This is generally not a good idea in a mixed use building with residential tenants.
  - Sign installation and maintenance should be addressed, including:
    - Landlord approval of sign
    - Compliance with laws, including permit requirements
    - Maintenance of signs in good and safe condition
    - Removal at end of lease term
    - Landlord right to remove temporarily for repairs and alterations.
  - There should be a removal requirement at end of lease terms.
- Satellite Dishes and Antennas
  - Where can dishes and antennas be located?
  - What other limitations are placed on dishes and antennas (size, visibility, etc.)?

- Include provision to comply with roof warranty requirements.
  - Determine if the original roof contractor must be used for installation.
  - Tenant should be required to pay for repairs.
- There should be removal requirement at the end of the lease term.
- Outdoor Seating
  - Outdoor seating is generally structured as a revocable license.
  - If a mixed use building, landlord should consider impact on other tenants.
  - The tenant should be responsible for cleaning.
  - Noise and disturbances from outdoor activity should be addressed.
  - Complaints
    - The tenant should be responsible for removing trash.
    - In a shopping center, landlord should consider impact on traffic flow patterns.
- Sidewalk Sheds/Building Scaffolding
  - Sidewalk sheds and scaffolding can be very bad for a tenant.
  - Sidewalk sheds/building scaffolding are erected for:
    - Owner repairs/alterations
    - Adjacent property owner repairs/alterations
    - Legal requirement
  - Possible Tenant Protections
    - Double height
    - Lighting
    - Signage
    - “Cool” shed design
    - Reasonably regulate how long the scaffolding may remain in place including:
      - Cannot be erected more than 30 days in advance of construction.
      - Complete work expeditiously.
      - Take down shed as soon as legal requirements permit.
  - Rent abatement
    - What if shed installed by adjacent property owner rather than landlord?
    - When does abatement commence?
    - How much is the abatement?
      - Tenant should prove demonstrable damages.
      - Cap amount of concession.
      - See sample clause attached.
- Quality of Life Issues/Nuisance
  - Noise, vibration, odor, security should be addressed.
    - Prevention is key (Control over Alterations)
      - Sound proofing
      - Review of tenant’s plans by an acoustic engineer
      - Exhaust
    - Enforcement
      - The landlord should have a right to cure.
      - The tenant should provide an indemnification against lawsuits by other tenants.
    - No broadcast of music or sound outside or for limited hours.

- Limit activities generating excessive noise (e.g. hiring a band or playing music).
  - The tenant should be responsible for pest control.
  - Garbage, trash pickups, and dumpsters should be addressed, including:
    - Frequency of pickup – usually daily.
    - Trash removal paths should be established.
    - Where should trash and garbage be stored until pickup?
    - When can trash/garbage be placed outside for pickup?
    - Can the tenant have a dumpster? Where can it be placed? How often emptied?
  - General appearance issues should be addressed:
    - Who is responsible for removal of graffiti?
    - Cleanliness is next to godliness should be the philosophy.
    - Tenant should keep all glass clean and in good condition
    - *Refurbishment/redcoration requirements.*
- Sidewalks
  - Who is responsible to keep sidewalks clean, unobstructed, and free of signs?
  - Tenant should be responsible for curb and sidewalk damage caused by trucks unloading goods and beverages (proof issues – videotape helpful).
- Deliveries
  - Who has use of loading docks?
  - If no loading docks, where can deliveries be made? Back of building? Front of building? Will local authorities designate a loading zone?
  - Set times of delivery. While it is generally preferable that deliveries be made late night or early morning to avoid traffic congestion, this can also be an issue for residential project.
- Hours of Operation of tenant’s business
  - What does landlord expect?
  - What hours does tenant expect to be open?
  - In case of percentage rent, landlord will insist on a minimum number of operating hours.
  - Does tenant have a “go dark” right (triggering possible recapture rights with possible landlord reimbursement of tenant’s investment)?
  - What are landlord’s and tenant rights when there are temporary closures for casualty, repairs, remodeling, or inventory?

## SAMPLE SIDEWALK SHED CLAUSE

(a) Owner may install, or permit to be installed, a sidewalk bridge and/or scaffolding on or about the building. Except as hereinafter expressly provided, Tenant shall not be entitled to any abatement of rent by reason of such bridge and/or scaffolding, and Owner shall have no liability to Tenant with respect thereto. Owner shall not unreasonably withhold its consent to Tenant's installation, in common with other building tenants and the scaffolding and construction company, of appropriate signage identifying Tenant on any sidewalk bridge installed in front of the demised premises. If the sidewalk bridge is installed in front of the demised premises in connection with repairs, improvements, additions, or alterations being made by Owner, Owner shall endeavor to complete the underlying work for which the sidewalk bridge is installed with reasonable expedition and to remove the sidewalk bridge with reasonable expedition, without being under any obligation in either case to engage workers or contractors at premium or overtime rates. Such sidewalk bridge and scaffolding shall not prevent access to the demised premises by Tenant's customers. If the sidewalk bridge is installed in front of the demised premises in connection with repairs, improvements, additions, or alterations being made by Owner and if Owner gives Tenant written notice of the proposed installation of such sidewalk bridge at least 5 business days prior to the actual installation thereof, and Tenant requests installation of a "double height" sidewalk bridge over the area directly in front of (and contiguous with) the demised premises, Owner shall install such sidewalk bridge at "double height" in front of the demised premises at Tenant's sole cost and expense, and Tenant shall reimburse Owner for the additional cost incurred by Owner to install the sidewalk bridge at "double height" in front of the demised premises (instead of normal height), as additional rent, within twenty (20) days after Tenant is billed therefor. If the sidewalk bridge is installed in front of the demised premises in connection with repairs, improvements, additions, or alterations being made by Owner and if Owner fails to give Tenant written notice of the proposed installation of such sidewalk bridge at least 5 business days prior to the actual installation thereof and Tenant thereafter requests that Owner raise the sidewalk bridge to "double height" in front of the demised premises, Owner shall raise the portion of the sidewalk bridge in front of the demised premises to "double height" at Owner's sole cost and expense; provided Tenant makes such request by the earlier of the date 20 days after (i) the date Owner gives Tenant written notice of the proposed installation of the sidewalk bridge or (ii) the date the sidewalk bridge is installed. The parties agree that a sidewalk bridge is raised to "double height" if it is raised to a level just above the top of Tenant's storefront sign.

(b) Notwithstanding the foregoing, if a sidewalk bridge is installed in front of the demised premises the following shall apply:

i. If such sidewalk bridge is installed in front of the demised premises in connection with repairs, improvements, additions, or alterations being made by Owner to the Building, then from and after the date four (4) months after the date such sidewalk bridge is installed (the "**Initial Abatement Date**") through the date such sidewalk bridge is removed (the "**Abatement Period**"), the base rent shall be reduced by the Percentage Reduction (which shall be determined as hereinafter provided). Notwithstanding the foregoing, the Initial Abatement Date shall be reasonably extended to reflect delays caused by strike, labor trouble, accident, government action, hurricane, civil disorder, Tenant's actions or other cause beyond Owner's reasonable control. The Percent Reduction shall equal the lesser of (i) the percentage reduction in gross sales at the demised premises during the Abatement Period to the extent reasonably attributable to the impact of the sidewalk bridge on gross sales at the demised premises, and (ii) 25%. In determining whether a decline in gross sales is reasonably attributable to the installation of the sidewalk bridge, the parties shall consider whether or not the other stores operating under Tenant's brand in Manhattan (the "**Other Manhattan Stores**") did (or did not) suffer similar declines and any other relevant factors. For example, if the gross sales at the demised premises declined by 10%, and the average gross sales at the Other Manhattan Stores declined by 5%, the Percentage

Reduction might be reasonably determined to be 5% (10% - 5%), absent other relevant factors. The abatement granted Tenant under this subparagraph (i) (the “**Abatement**”) shall be implemented as follows and shall not be effected or implemented automatically or on a self-help basis (except as herein expressly provided). Tenant shall give notice to Owner of its determination of the appropriate Percentage Reduction for the Abatement Period and its determination of the Abatement within six (6) months after the sidewalk bridge is removed from the front of the demised premises, which notice shall be accompanied by reasonable evidence of the gross sales at the demised premises and at the Other Manhattan Stores, broken down on a monthly basis, for the calendar year(s) in which the Abatement Period occurred and for the preceding two (2) calendar years, which sales figures shall be certified under oath by Tenant’s chief financial officer. If Tenant fails to timely give such notice and deliver such sales information, Tenant shall be deemed to have waived its right to any Abatement. If Owner disputes Tenant’s determination of the appropriate Percentage Reduction and/or Abatement, Owner shall give Tenant notice thereof within thirty (30) calendar days after Owner receives Tenant’s notice, together with the required certified gross sales information. Notwithstanding any dispute, Tenant shall continue to pay the full base rent, without prejudice to its position, until there is final, non-appealable judgment by a court having jurisdiction in either party’s favor. If there is a final, non-appealable judgment as to the amount of the Abatement, Owner shall promptly pay the adjudicated Abatement amount to Tenant, failing which Tenant may offset the adjudicated Abatement amount against the base rent and additional rent next coming due under this lease. For purposes of clarification, there shall be no Abatement granted pursuant to this subparagraph (i) (1) if the sidewalk bridge is removed prior to the Initial Abatement Date (as same may be extended as provided above) or (2) with respect to a sidewalk bridge, scaffolding or other protection installed, or caused to be installed by, the owner or tenant of any other building or property.

ii. If such sidewalk bridge is installed in front of the demised premises in connection with repairs, improvements, construction, demolition, additions, or alterations being made to an adjacent parcel of land by the owner or ground lessee of such adjacent parcel, then from and after the date six (6) months after the date such sidewalk bridge is installed (the “**Adjacent Parcel Initial Abatement Date**”) through the date such sidewalk bridge is removed (the “**Adjacent Parcel Abatement Period**”), the base rent shall be reduced by the Adjacent Parcel Percentage Reduction (which shall be determined as hereinafter provided). Notwithstanding the foregoing, the Adjacent Parcel Initial Abatement Date shall be reasonably extended to reflect delays caused by strike, labor trouble, accident, government action, hurricane, civil disorder, Tenant’s actions or other cause beyond the adjacent parcel owner/ground lessee’s reasonable control. The Adjacent Parcel Percent Reduction shall equal the lesser of (i) the percentage reduction in gross sales at the demised premises during the Adjacent Parcel Abatement Period to the extent reasonably attributable to the impact of the sidewalk bridge on gross sales at the demised premises, and (ii) 10%. In determining whether a decline in gross sales is reasonably attributable to the installation of the sidewalk bridge, the parties shall consider whether or not the other stores operating under Tenant’s brand in Manhattan (the “**Other Manhattan Stores**”) did (or did not) suffer similar declines and any other relevant factors. For example, if the gross sales at the demised premises declined by 10%, and the average gross sales at the Other Manhattan Stores declined by 5%, the Adjacent Parcel Percentage Reduction might be reasonably determined to be 5% (10% - 5%), absent other relevant factors. The abatement granted Tenant under this subparagraph (ii) (the “**Adjacent Parcel Abatement**”) shall be implemented as follows and shall not be effected or implemented automatically or on a self-help basis (except as herein expressly provided). Tenant shall give notice to Owner of

its determination of the appropriate Adjacent Parcel Percentage Reduction for the Adjacent Parcel Abatement Period and its determination of the Adjacent Parcel Abatement within six (6) months after the sidewalk bridge is removed from the front of the demised premises, which notice shall be accompanied by reasonable evidence of the gross sales at the demised premises and at the Other Manhattan Stores, broken down on a monthly basis, for the calendar year(s) in which the Adjacent Parcel Abatement Period occurred and for the preceding two (2) calendar years, which sales figures shall be certified under oath by Tenant's chief financial officer. If Tenant fails to timely give such notice and deliver such sales information, Tenant shall be deemed to have waived its right to any Adjacent Parcel Abatement. If Owner disputes Tenant's determination of the appropriate Adjacent Parcel Percentage Reduction and/or Adjacent Parcel Abatement, Owner shall give Tenant notice thereof within thirty (30) calendar days after Owner receives Tenant's notice, together with the required certified gross sales information. Notwithstanding any dispute, Tenant shall continue to pay the full base rent, without prejudice to its position, until there is final, non-appealable judgment by a court having jurisdiction in either party's favor. If there is a final, non-appealable judgment as to the amount of the Adjacent Parcel Abatement, Owner shall promptly pay the adjudicated Adjacent Parcel Abatement amount to Tenant, failing which Tenant may offset the adjudicated Adjacent Parcel Abatement amount against the base rent and additional rent next coming due under this lease. For purposes of clarification, there shall be no Adjacent Parcel Abatement granted pursuant to this subparagraph (ii) (1) if the sidewalk bridge is removed prior to the Adjacent Parcel Initial Abatement Date (as same may be extended as provided above) or (2) with respect to a sidewalk bridge, scaffolding or other protection installed, or caused to be installed by Owner in connection with repairs, improvements, additions, or alterations being made by Owner to the Building.