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## Doron F. Eghbali Real Estate Law

### [Fundamentals of Retail Leases](#)

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Retail leases present their own dilemmas and challenges to landlords and tenants. Retail leases entail rather rarefied provisions which could constitute a trap for the unwary. In this article, we explore SOME of the issues involved in negotiating and consummating a retail lease in a free-standing building (not a shopping center). Such issues revolve around the following: term of the lease, minimum payment, percentage payment, continuous operation of the business, utilities and taxes, and repair and maintenance.

#### **1. TERM OF THE LEASE**

The date of commencement of the lease and duration of the lease could create quandaries for both landlord and tenant. The term of the lease is often fixed with the proviso that during the fixed term there is a minimum payment.

In addition to fixed term, most retail leases often entail an option to extend the lease term for a designated time. Invariably, tenant's right to exercise the option is contingent upon tenant not being in default, as defined and described in the lease.

This is imperative, from practical and transactional perspectives, to ensure the lease expressly and clearly states the time requirement needed for tenant to exercise such option by giving notice i.e., whether extension is effective upon sending the notice or receiving it.



## **2. MINIMUM RENT REQUIRED IN PERCENTAGE LEASE**

Minimum rent is required in percentage leases. The amount of minimum rent is often a matter of negotiation depending upon relative strength and weaknesses of the parties involved. Nonetheless, minimum rent in a percentage lease is often relatively lower than the current rental fair market value of the leased property.

This is critical to note paying the minimum rent is in addition to paying for taxes, insurance, and utilities, among other things as required by the lease and agreed by the parties.

Landlord might require, in any instance, for the minimum rent to at least cover taxes, insurance, utilities and loan payment. Landlords, to incentivize tenants, might agree to relatively lower minimum rent payments especially at the beginning of the lease for the tenant business to build up its business. In such situations, often, minimum rent might gradually increase.

### **GRADUATED INCREASE IN MINIMUM RENT BASED ON CONSUMER PRICE INDEX**

Not surprisingly, landlords, by and large, demand increase in minimum rent payment in proportionate and commensurate with Consumer Price Index (CPI). Nonetheless, such proportionate relative increase could prove problematic as to accurate method of calculation. Most probably, the most common standard is the CPI published monthly by the Bureau of Labor Statistics of the US Department of Labor.

## **3. PERCENTAGE RENT**

Percentage rent provision is found in many retail leases. Such provision refers to tenant paying on top of the minimum rent a portion of the gross sales to the landlord. Such mechanism could be advantageous to both tenant and landlord. Landlord would receive a windfall when the tenant's business is flourishing and Tenant receives a break when the business is facing serious headwinds and is in a downturn.

Among the issues to be considered in Percentage Rent provisions, the following might warrant serious attention:

- **DEFINITION AND SCOPE OF PERCENTAGE RENT:** Essentially, one of the major questions arising in such provisions is the definition of Gross Sales and exclusions from Gross Sales. Often, the Definition section of the Retail Lease seeks to define Gross Sales as encompassing as imagined virtually encompassing whatever the tenant or its affiliates earn. Nonetheless, there should be exclusions to the Gross Sales definition. Such exclusion should include the money returned to customers in one form or another and some taxes such as sales taxes and excise taxes.



- **CALCULATION OF GROSS SALES:** Gross Sales could be calculated several ways. One of the methods to calculate Gross Sales is to pay the difference (in a specified percentage), if any, between the Minimum Rent paid for the year and Gross Sales for the year. For illustrative purposes only, if the business has paid \$100,000 in Minimum Rent and its Gross Sales is \$400,000. Then, the business might have paid a specified percentage of the \$300,000 difference on top of the Minimum Rent to landlord. Accordingly, the retail lease often requires maintaining all the books and records for such purposes. Hence, it is incumbent upon the tenant's counsel to seek to negotiate a provision which provides all the books and records are confidential and to be used ONLY for Gross Sales purposes and NOT for any other purposes, including disclosure to any actual or potential customer or competitor of the tenant.
- **TIME OF CALCULATION AND PAYMENT OF GROSS SALES:** Tenant should often negotiate paying Gross Sales on an annual basis. Such timing often ensures that sales during peak seasons are offset by relatively lower sales in other months. Not surprisingly, landlord prefers calculating Gross Sales on a monthly basis to take advantage of peak seasons and obtain a greater percentage of the sales while eschewing an offset by relatively lesser stellar months of the year.

#### **4. CONTINUOUS OPERATION OF THE BUSINESS**

Generally, absent a covenant or provision, no implied covenant is inferred for the tenant to operate the business continuously. Nonetheless, in percentage leases, since the landlord's rent is partly or rather largely bankrolled by Gross Sales, such provision is provided. There is even case law to the effect that even if there is no such lease in a Percentage Lease, such continuous operation of business is implied.

#### **5. UTILITIES & TAXES**

Generally, in freestanding buildings, tenant is obligated to pay for utilities. In multi-tenant buildings, tenant often pays a proportionate share of utilities.

In terms of taxes, absent any express provision, landlord is generally obligated to pay all pertinent taxes with one exception. Tenant is often obligated to pay for taxes on improvements constructed by the tenant when the tenant is permitted to remove such improvements.

#### **6. REPAIR & MAINTENANCE**

Generally, landlord is obligated to repair and maintain the structural elements of the leased building and the tenant is obligated for non-structural elements including all other parts of the building such as plate glass and improvements.

Tenant should be careful in undertaking the repair and maintenance of areas other people have access to such common areas, heating, ventilation and air conditioning. In addition, tenant should be cognizant of a trap which requires acceptance the premises in the present condition as usually



there are other provisions in the contract which state the leased premises have no problems. Certainly, even new buildings have problems.

## **DISCLAIMER**

This article NEITHER supplants NOR supplements the breadth or depth of such esoteric topic. In fact, this article ONLY provides a rather rudimentary synopsis of such rarefied subject matter.

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