

Leasing Retail Stores in New York City

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Introduction New York City is a fascinating and dynamic retail market. It is also one of the most competitive and challenging, requiring a careful and methodical approach to leasing to avoid potential commercial and legal pitfalls. This article addresses some salient commercial and legal considerations for retailers leasing stores in New York City. **Retail Team** At the outset of each lease transaction a retailer should select a team of professionals, including a real estate broker, attorney, architect, engineer, general contractor, and other consultants to assist with successful lease negotiations. To avoid potential commercial and legal problems, it is important to work with only one real estate broker when searching for the right store location. The selected broker should execute a letter agreement to look solely and exclusively to the landlord for the payment of any commission. Landlords generally pay one real estate brokerage commission, which is split between the landlord's broker and the tenant's broker. Engaging more than one broker to act on behalf of a retailer can destroy a retail store transaction because if multiple brokers submit lease offers to the same landlord on behalf of the retailer, a dispute may arise as to which is the procuring broker entitled to payment of a brokerage commission by the landlord. Once a retail location is selected, it is advisable to have the tenant's professional consultants conduct inspections (including an asbestos inspection test) and due diligence on the premises to verify use, condition, and feasibility of establishing a retail store. Depending on the results of the due diligence assessments and any special tenant circumstances (e.g., electrical, HVAC, etc.), it may be necessary to negotiate additional concessions such as the landlord agreeing to perform certain construction and renovations to ready the premises for tenant's occupancy. Conducting these due diligence investigations upfront will avoid potential problems and misunderstandings when the parties proceed to negotiate a comprehensive lease agreement. **Lease Negotiations** Typically, a lease term sheet is used to memorialize the basic financial and commercial terms of the lease transaction negotiated between the parties. The lease terms are then incorporated into the actual lease agreement typically prepared by landlord's counsel. Below is a discussion of several key lease points that require special attention during lease

negotiations:

- **Term:** Most retail leases in New York City are for a five- or 10-year term. If possible, it is advantageous to negotiate a renewal option, which provides for an agreed-upon rent during the renewal term, as part of the initial lease agreement.
- **Demised Space:** New York City landlords generally use the term "rentable square feet" in setting the amount of space a tenant is leasing. However, the landlord's determination of rentable square footage can be arbitrary and may include space that is neither usable nor includable in the demised premises such as columns, a portion of the elevator banks, janitor's closets, lobbies, stairways etc. Rentable square footage in most instances is not the same as "usable square footage" which is the actual floor or carpetable square footage of the premises. The difference between a premise's rentable and usable square footage is referred to as the "loss factor." Typically, New York City retail leases may have loss factors of between 15 and 25 percent. In other words, 2,000 rentable square feet may actually be only 1,700 or 1,500 usable or carpetable square feet. Retailers must be cognizant of this distinction when entering into lease negotiations since the loss factor can have an adverse effect on the retail store's actual size, selling area, and profitability.
- **Rent:** The rent payable under a lease normally consists of fixed rent and additional rent. Fixed rent is payable monthly and frequently calculated based on a certain dollar amount per "rentable square foot" of the store premises. Fixed rent may also include electrical charges. In certain instances, it may be advantageous for a retailer to submeter the electricity and pay charges directly to the local utility. Additional rent typically includes tenant's proportionate share (e.g., the ratio that the rentable square footage of the premises bears to the total rentable square footage of the building) of yearly increases in real estate taxes and building operating expenses over an agreed-upon base year.
 - Free Rent/ Rent Abatement: The amount of any free rent is completely negotiable between the parties. However, the free rent period should commence from the date the landlord completes its work and delivers possession of the premises to the tenant. In some instances, landlords agree to reimburse tenants for the costs of the tenant's buildout of the premises instead of granting the tenant free rent under the lease.
 - Security Deposit: Depending on the prospective tenant's financial security, the amount of any security deposit may be six months or more of fixed rent to be secured by a letter of credit. In some instances, landlords will require both a security deposit and a corporate guaranty of the lease.
 - Commercial Rent Tax: Certain areas of Manhattan currently require retailers to pay commercial rent tax to the City of New York at the effective rate of 3.9 percent of their yearly rent if the annualized rent paid by the retailer is \$250,000 or more, subject to applicable deductions and tax credits.

- **Use:** When negotiating the use clause in a lease it is important to verify, in advance, the permissible uses under local zoning ordinances and the Certificate of Occupancy for the building where the store is located. Special care should be taken to draft as broad a use clause as possible to cover all of the retailer's intended retail store uses. For example, a use clause that covers the retail sale of clothing and accessories may not cover the sale of perfume, cologne, or jewelry.
- **Tenant's Alterations:** Most retail leases provide that the tenant will accept the store premises in its current "as is" condition. Consequently, unless there is a special agreement with the landlord as part of the lease negotiations, most landlords will not do any work to ready the premises for a retailer's occupancy. Consider preparing and submitting to the landlord full construction plans and drawings, including signage and storefront designs, for prior approval and incorporation into the lease. This will eliminate uncertainty at a later date as to whether the landlord will approve the tenant's storefront design and plans for the retail store's construction.
- **Sublet and Assignment:** Landlords generally will not permit tenants to assign or sublet their store premises without the landlord's prior written consent and approval. Retailers should try to obtain a lease provision whereby the landlord will not unreasonably withhold, delay, or condition its consent to any subletting or assignment. Absent the foregoing language, the landlord can arbitrarily withhold or delay its consent to any proposed subletting or assignment.

Conclusion The foregoing describes some pitfalls and issues to consider when negotiating and entering into retail store leases in New York City. Careful attention to these and other lease issues will help avoid costly and time-consuming errors and insure your retail store's successful operation.

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