

Understanding a lease

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For the past few months we've looked at the issues of determining the types of location that are right for your business and how to find that perfect location. This month, we will examine some of the economic terms commonly found in a commercial lease.

For many new franchisees, their franchisor will likely provide them with hands on assistance in understanding or negotiating a lease. Others may provide training programs on site selection and lease negotiations while many prepare for their franchisees an addendum of terms that should or must be included in any lease a franchisee signs. Before you enter into negotiations with your landlord, it makes sense to check with your franchisor and determine what assistance and guidance they can provide you. They've done this before and their experience can save you not only money, but time and possibly even help you avoid losing that perfect space.

Once you have found your location, most franchisors are going to ask you to complete a site review package. Depending on your franchise system, it may require demographic information, photographs of the exterior and interior of the space as well as photographs of the surrounding area. There will be questions concerning traffic counts, other tenants in the center, the size of the space available as well as the condition of the space and the work required to bring it up to your franchisor's standards. In most instances, you will need the approval of the franchisor on the site before you are able to execute any leases.

Regardless of the assistance provided by your franchisor, hiring a good real estate attorney to work with you in evaluating the lease and assisting you in negotiations will be important. Whether working with your franchisor or your attorney, a basic understanding of the terms in a lease will be important so that you can make an informed decision.

Your focus should be on the total cost of the location. While often you will find that larger locations have a smaller cost per square foot, if you do not need the extra space, there is really no reason to incur the extra expense.

Base rent: The base rent is typically stated as a square foot cost. For example, an annual gross rent of \$36,000 for a 2,000 square foot location will usually be stated as a base rent of \$18.00 per square foot.

In addition to the base rent, there are other charges and methods of calculation you should be aware of.

Percentage rent: In addition to your base rent, many centers will charge you an additional amount based upon a percentage of your gross sales. Typically, the percentage rent can be calculated as a fee over and above a projected minimum sales volume. If you can avoid a

percentage rent altogether or if you can negotiate a high sales point above which the percentage rent would be calculated, this should be your goal in negotiating your lease.

Cost of living escalator: In times of inflation, many landlords will try to limit their risks associated with rising costs by increasing your rent. This increase in rent is based upon some formula such as the Consumer Price Index. For many years now, with inflation low, this has not been a major problem for most tenants. But, you should not ignore the possibility of a return to higher inflation in the future and if possible, limit the amount of any cost of living escalator your landlord may require.

Common-area maintenance: The composition of these costs will vary from location to location but they typically include the costs of items shared by all of the tenants including, parking lot maintenance, snow removal, common signage, security, exterior lighting, general maintenance and repairs. Landlords typically allocate these expenses based upon the size of your location as a percentage of the total center size, but you should be careful on how this is calculated. We will discuss leased vs. leaseable later.

Merchants association: While usually only found in mall locations, Merchants Association fees are used to pay for the mall's general advertising and promotion. As with common area maintenance your charges are usually based on the size of your location.

Real estate taxes: As with common area maintenance and the merchants association, you will typically be charged with your percentage of the total real estate bill on the center.

We've covered most of the more common additional costs. However, how those costs are calculated can have a dramatic impact on your overall occupancy expense.

Leaseable vs. leased: Landlords prefer to charge you the additional expenses based upon the amount of space they currently have leased in your center. In this way, they do not have to incur the additional expense for locations that are vacant. For example, assume that you are in a center that has 500,000 available feet of retail space but that only 400,000 square feet are currently leased. The size of your location is 2,000 square feet. If your lease provides for you to share common expenses based upon leaseable square feet in the center, you would pay $\frac{4}{10}$ th of one percent (.004) of the common expense (2,000/500,000). However, if your lease provides for you to pay based upon the total space currently leased then your share would be $\frac{5}{10}$ th of one percent (.005) (2,000/400,000) or 25% percent higher than under the leaseable calculation. It is always in your best interest to negotiate your additional lease contributions based upon a leased formula rather than the leaseable formula as the later typically benefits the landlord.

Remember, having a low square foot rent does not necessarily mean that your overall rent will be low. You should be concerned with your total occupancy and that means having an understanding of the additional costs and how those costs are calculated. An experienced franchisor or real estate attorney can help you make the right decision.