QSR®
Limited-Service, Unlimited Possibilities

PLUS: Winners of the 2008 QSR/FPI Foodservice Packaging Awards

7-Eleven Takes on Quick-Service

Get used to seeing this brand in your customers' hands as 7-Eleven ramps up its fresh food offerings.

NOVEMBER'S
FRESH IDEAS:
KID-FRIENDLY SNACKS

INDUSTRY WATCH

FINANCE

Leasing Terms

The slowing economy has made landlords more willing to put incentives in play.

By Deborah Cohen

Hans Hess, founder and chief executive of the budding organic hamburger chain Elevation Burger, is preparing to open his second store—a 2,000-square-foot location in a premium spot at National Harbor, the newly developed retail and convention center overlooking the Potomac River outside Washington, D.C. In addition to several months of free rent, the landlord provided more than $150,000 in funds for interior and exterior improvements, enticements once unheard of for start-ups.

"When I first began looking for real estate back in 2004, definitely the shoe was on the other foot," Hess says. "I'd say the marketplace has changed completely now."

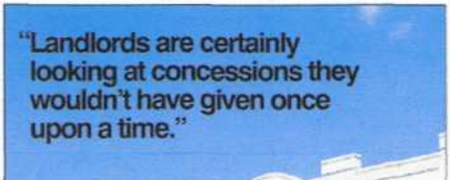
Indeed, incentives such as these—one of the unlikely upsides of a down economy—are becoming common in today's market. Real estate experts say there has been a shift toward more favorable terms for commercial tenants as previously fat-cat landlords show greater flexibility to secure commitments for vacant or overdeveloped properties.

Starbucks Coffee Co. and other large restaurant chains are closing stores and curbing growth amid rising commodity and energy costs and a slowdown in consumer spending.

Boston-based Property & Portfolio Research, which tracks the commercial real estate sector, expects total retail store closings for 2008 to reach 6,000, up from 4,600 last year. Overall, landlords are expected to give back the 1.7 percent growth in rents they enjoyed last year. It adds up to opportunities for savvy operators looking to expand.

"Definitely it's a buyer's market, the same way it is with houses," says Steven Delaney, a commercial broker with Indianapolis-based Sitehawk Retail Real Estate. "Landlords are certainly looking at concessions they wouldn't have given once upon a time."

The trick is to take an informed approach to lease negotiations, says David T. Denney, a Dallas-based attorney specializing in restaurant transactions. Whether you're a national player, a regional chain, or an independent, be careful not to overlook provisions that can save thousands of dollars over the life of your contract.



First off, make full use of your regional broker. Commercial real estate brokers are often the most informed about the performance of a local market, including going rates and the terms secured by rival restaurants.

"Don't just use the broker to come up with what the rent is going to be," Denney says. "What can you ask for and what are other people doing? They know that."

Landlords typically request a base rent as well as a requirement calling for a percentage above and beyond projected annual sales—commonly 6 percent. For example, you agree to a base rent of $20 per square foot on a 4,000-square-foot space for a total of $80,000 a year. That annual base rent represents 6 percent of roughly $1.3 million. Once you exceed a breaking point of $1.3 million in sales, the landlord collects 6 percent of your revenue on top of the base rent.

In today's market, says Denney, landlords are more flexible on this percentage; you might be able to negotiate terms below the 6 percent standard. Alternatively, both parties might agree to a higher flat rate per square foot.

Make sure when defining applicable sales in your lease (landlords using percentage-based rents want to see monthly sales reports) that you and your attorney identify exclusions for items such as tips, delivery fees, and revenue collected from offsite events such as festivals where food is not being prepared on the rented property. Even catering dollars may be up for discussion, Denney says.

Many other provisions can be brought to the bargaining table, provided you have the wherewithal to ask. For instance, you might be able to prevent the landlord from reconfiguring the parking lot to the detriment of your restaurant. Or you could stipulate that a handful of spaces are assigned only for your patrons and prevent valets from parking vehicles belonging to diners at competing restaurants in front of your store.

Be mindful of your opening date and ensure that if construction or improvements are being done to a new or converted space that your contractor gives a definitive time line for the work. It's not unusual to negotiate for 120 days of occupancy before paying rent, Denney says. Several months of free rent after opening or extra tenant improvement dollars for refurbishment projects might also be within your grasp.

Mathew Mabel, president of Surrender Inc., a Dallas-based development consultancy for growing restaurant companies, cautions his clients not to fall in love with a particular site or a specific landlord. All too often would-be tenants, especially new operators with little experience, approach site selection with blinders on.

"Be prepared to wait until the right deal comes along," Mabel says, noting the availability of research to provide demographic, psychographic, and traffic information on potential sites. "You have to be ready to walk away."

He also stresses caution about personal guarantees, which are often required for first-time tenants or unproven concepts. Instead of signing such a guarantee for the full life of the lease spanning 10 years or more, push for a shorter time frame, such as two years. Such a provision could prevent you from putting too much skin in the game, Mabel says, adding that it's often possible to negotiate a reduction in a personal guarantee as the rent is paid down.

"We like to see the guarantee burn off," he says. "As you pay rent, we like to see you get part of the guarantee back."

Mabel also likes to see a clause that allows his client to reassign a lease to someone else, in the event of a sale or other transfer of the business.

There's often room for compromise on additional fees such as maintenance. Under the standard commercial covenant known as the triple net lease, the tenant pays taxes, insurance, and maintenance expenses that arise from use of the property. But a frugal operator willing to mow his own lawn might be able to reduce monthly maintenance fees or get similar concessions.

The full breadth of terms up for negotiation is, of course, too large to cover. The important thing, say the experts, is to be ready for a healthy give-and-take.

"You're not going to get a concession on every point," Mabel says. "You always want to have multiple issues in play."