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Ask the Experts column

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“As a new franchisee, what do I need to know about commercial leasing?”

Site selection and lease negotiations are among the most critical tasks facing the new franchisee. While the franchisor often selects the site, the franchisee is typically required to accept the choice and the risk that the location will perform well. Where the franchisee selects the site, it must do so quickly or risk the expiry of the franchise offer. In addition to these pressures, the franchisee must also negotiate (or accept) a complex lease or sublease. The following summarizes some of the key issues:

- i. **Lease structure:** Will you lease directly from the landlord or sublease the premises through the franchisor? In the latter case, the landlord may be in a position to obtain better rent, lower common area maintenance charges (“CAM”), and exclusivity in the complex for your business. However, consider that some franchisors may “bump” the rent somewhat in excess of their payments under the head lease. If you lease directly, the franchisor will require you to give them the option to assume your lease if you default under your franchise agreement.
- ii. **Site selection:** You should conduct your own site due diligence. Review traffic flows, inspect the site, consider demographics and neighbouring retail stores, parking capacity, site access, environmental concerns and restrictive covenants.
- iii. **Design:** Ensure that the landlord has approved the site design plan. Consider whether there exist any lease restrictions on signage, trade-marks and functional buildouts. Confirm that rent is not payable until the premises are completed. If the franchisor is building a turnkey operation, ensure that there are no hidden costs.
- iv. **Permitted Use:** Confirm whether the sale of certain products or services is prohibited by the lease. (ex. A landlord may grant the exclusive right to sell hamburgers to only one restaurant in a mall.)
- v. **Rent:** Is rent under the initial and renewal terms at market rates? What is the CAM? Are they at market? Is there a cap on annual CAM and CAM increases? Is additional rent payable?
- vi. **Lease/sublease term:** Ensure that your obligations under the lease/sublease do not exceed the term of your franchise agreement. Consider your risk if the franchise terminates prior to the end of the lease/sublease. Is the maximum term of the franchise agreement equal to the maximum term of the lease/sublease?
- vii. **Renewal:** What are the conditions of lease renewal? Can you force the landlord to renew? Ensure that conditions of renewal are reasonable.

- viii. **Repair and Maintenance:** Ensure that you are not liable for any structural repairs or maintenance expenses not related to the interior of your leased premises.
- ix. **Assignment:** The landlord may restrict your right to assign your lease. Ensure that consent to an assignment cannot be unreasonably withheld. The franchisor may also restrict your right to assign the lease to a competitor if it elects not to assume the lease.
- x. **Abatement:** The franchisee will want the right to a credit against its rent where it is required to remedy lease defaults (such as failure to maintain the premises) and termination rights where such defaults continue unremedied.
- xi. **Default Provisions:** Are they reasonable? Do you have a reasonable right to cure?
- xii. **Relocation:** Ensure that the landlord does not have the right to relocate or terminate you upon the occurrence of certain conditions. If there is a right to relocate, make sure that the relocated premises are to be substantially the same in size and layout as the original premises. If the franchise agreement is terminated, do you have the right to maintain the lease? If so, can you operate a competing business from that location?

The foregoing is a rough guide to location and lease issues. A franchisee should consult qualified legal counsel prior to entering into any franchise or lease agreement.

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