

LEASE

Rent *review*

Steven Crea, principal of Crea Legal, a franchising and leasing legal practice in Melbourne, and **Warren Billet**, leasing manager of Retail Food Groups which includes Brumby's Bakeries, bb's Cafes, Big Dad's Pies Donut King and Michel's Patisserie, respond to questions about retail leasing for franchisees.

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What is the franchisee's greatest concern over leasing now?

Steven Crea

Obviously getting stuck with a lease which is debilitating to the business is the major concern due to such things as a poor location or expensive rent. Failure to achieve a lease renewal (at all or on reasonable terms) at the expiry of the term is also a major concern. These things can have a serious impact on the value of the business.

Warren Billet

The greatest concern for our franchisees surrounds the asking rents at lease renewal time. Our franchisees would argue that the traffic flow in the centres are not increasing as the lessor leasing executives are saying, and our stores are increasing their sales mainly

can afford to pay, in other words occupancy cost. There needs to be some legislated regulation in this country for a lessor to justify (with written evidence) rental increases they try to seek.

Our franchisees are grateful that we (RFG) have a healthy relationship with most lessors and our leasing team is very experienced in this area.

How can incoming franchisees reassure themselves that the lease they are taking on is financially workable?

Steven Crea

There is no substitute for thorough analysis of the proposed franchised business including sound financial projections. They should then look at the gross rent as a percentage of

hold their own lease has the full responsibility of the lease on themselves.

A few years ago the ACCC stated it encouraged retailers to share information and try to even the apparent disadvantage we have compared to the lessors with regard to lease information. With more than 1100 stores, we are better positioned than most to be able to cross-check comparative leases for the benefit of our franchisees.

With all the uncertainty over the economy and retailing, who holds the balance of power now in the franchisee, franchisor and landlord triangle?

Warren Billet

Let's not kid ourselves; the institutional lessors always hold the balance of power in retail leasing, even in recent times where rents should be decreasing. New players in the market are particularly vulnerable.

In talking with other large franchisor property managers, we agree in most cases if the retail leasing executives are not digging a line in the sand and not giving in to unreasonable rent increases, the franchisees' profitability can be affected by the rent for the premises.

Steven Crea

As sites have been harder to lease and premium rents harder to achieve, we have seen a minor softening of rents over the last year and slightly more inclination for landlords to be open and

As lessee, our head office shares the liability of the lease with our franchisees whereas a franchisee that is asked by its franchisor to hold their own lease has the full responsibility of the lease on themselves

due to the excellent work of our RFG marketing department driving higher average sales to our stores.

The rent increases are not justified in most cases; but that is always the crux of the relationship between lessee and lessor. A retailer should not be punished by the lessor at lease expiry for doing a great job over many years to have a successful and profitable business.

We all know in leasing that rents are supposed to be driven by market forces, and not by how much a retailer

estimated sales and it must be within a range that is common for other profitable franchises in that particular franchise system.

Warren Billet

At RFG, we hold all our head leases. As lessee, we use all the information available to us to determine the viability of the commercial terms of the lease. As lessee, our head office shares the liability of the lease with our franchisees whereas a franchisee that is asked by its franchisor to

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accommodating to tenants' circumstances through fear of empty shops if they don't take note. But the good space still commands big dollars and the landlords will always reign supreme in these situations.

As between franchisee and franchisor, franchises are much more difficult to sell

Obviously getting stuck with a lease which is debilitating to the business is the major concern due to such things as a poor location or expensive rent

in this market therefore the lease deal on offer must be sharper than before and the franchisee has experienced a shift of power to them in this sense.

How easy is it for the franchisee to plan for lease increases over the term of their agreement?

Steven Crea

In a retail lease, very easy as the rent reviews tend to be fixed percentage increases. Therefore, the amount payable

each year over the lease term can be easily calculated. If CPI is used (whether alone or in combination with fixed increases) this will be more difficult and require an estimate to be made. Where market reviews apply, it can be very difficult and depends on market rent fluctuations.

Warren Billet

Assuming a lease term is shorter than a franchise term, it is easy enough to plan what the annual increases are with a flat percentage increase each year. As franchisor and lessee, we would always argue there is no justifiable reason whatsoever for any lessor to charge a CPI plus two per cent increase each year. That has to change. The greatest unknown for a franchisee is, of course, at lease expiry, and how reasonable the

lessor is with accepting a commercially sensible renewal rent.

How does a franchisee go about lease renewals to ensure an equitable result?

Steven Crea

Franchisees should have a good understanding of retail leasing and ask the franchisor to give them visibility into the process of site selection and negotiation of lease terms. Conducting their own due diligence on the site and the area and the market rents is important, and that includes talking to other businesses in the area and asking them what their concerns are.

Make sure the franchisor is exclusively motivated by securing the best possible site at the best possible money and is not acting on some other agenda, such as a broader scheme of arrangement with the landlord involving other sites, or being driven by strategic decisions involving competitors and network development. ■

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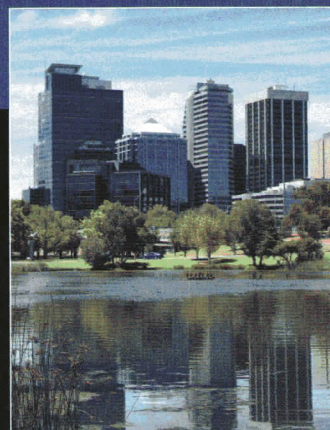
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