

Franchising: The Property Aspects



Wright, Johnston & Mackenzie LLP -
The Place for Practical Advice



Franchising – The Property Aspects

Once you have made the decision to buy a Franchise the next step will be finding suitable premises, particularly where a “high street” location is necessary.

In the vast majority of cases, this will be on the basis of you taking a Lease or Sub Lease. It's important to remember this will be a major financial commitment and must be taken into account when assessing the total cost of a Franchise. It will also be the next big contract you enter into after the Franchise Agreement itself.

Finding Your Premises

Every Franchise is different and some Franchisors are far more closely involved than others when it comes to choosing premises for the new outlet.

At one end of the scale, you may only be told the geographical area you are allowed to operate your Franchise from and, from there, you are left to find the premises on your own. In this situation, it would be a sensible idea to engage the services of a Surveyor who will search the area to find premises that are suitable and available and then negotiate the best terms on your behalf.

At the other end of the scale (and which is generally the case for larger scale Franchises operating in the high street) the Franchisor may want to be in control - choosing the premises, agreeing the terms and taking a Lease in their own name. They would then simply grant you a Sub-Lease that would mirror the terms of their own Lease.

Lease Or Sub-Lease?

So, you could find yourself entering into either a Lease with the owner of the premises (the Landlords) or a Sub Lease with the Franchisor – but what difference does this make to you?

Lease from the Landlords

If you enter into a Lease with the Landlords, you will have a direct contractual relationship with them and will be obliged to pay rent and other outgoing costs directly to them and to comply with all other obligations contained within the Lease.

Bear in mind that your Franchisor may want to approve both the terms you have agreed with the Landlord and the wording of the Lease itself before you sign it. There could also be specific clauses you need to have in the Lease, which are set out in your Franchise Agreement. Although a more common occurrence in England than in Scotland, the Franchisor may also look for a Deed of Option to be entered into between the Franchisor and the Franchisee, giving the Franchisor the ability to take over the Lease in a default situation.

As you are just starting out in your new business, the Landlords may have concerns over whether you are financially able to meet the Tenant's obligations under the Lease and could ask for a rent deposit (for example 6 months rent) which would be held by them until such time as you have demonstrated you are a reliable Tenant. If you have set up your own company they may also ask for personal guarantees.

Sub Lease from the Franchisor

The Franchisor may be keen to keep a degree of control over the Franchise and will want to take a Lease of the premises in their own name. Once they have done this they will then grant you a Sub Lease – making the Franchisor your immediate Landlord. In this situation you will still need to perform all of the obligations that a Tenant under a Lease would have but the rent and other costs would be paid to the Franchisor who in turn would pay the rent and other costs to the Owner of the premises (their Landlord) in terms of their Lease. This method suits the Franchisor as, if you don't carry out your obligations under either the Lease or where the Franchise Agreement comes to an end for whatever reason, they have the option of either (a) remedying any breaches themselves to ensure that their Lease with the Landlord is not breached (and pursuing you for the costs incurred by them for doing so) or (b) terminating the Sub Lease with you and continuing to trade from the premises on their own (or granting a Sub Lease to a new Franchisee).

The terms and conditions of any Lease or Sub Lease must be carefully reviewed, as you will be contractually bound to comply with these.

In particular, it is important to ensure that your obligations under the Lease or Sub Lease will terminate at the same time as the Franchise Agreement. This is usually not a problem, as the Franchisor naturally wants to ensure that on termination of the Franchise Agreement the Franchisee has to vacate the Franchise premises.

At WJM we will examine the lease documentation on your behalf, discuss with you its contents and the financial and other obligations it will place upon you and then try and get the best deal we can for you.

What Are Your Obligations?

When you are a Tenant under a Lease you are basically expected (and obliged) to step into the shoes of the Landlord and care for the premises as if you were the owner. Commercial Leases are granted on a FRI basis (full repairing and insuring) which means you have to accept the premises as being in good and tenable condition from day one and throughout the duration of the Lease, you must maintain and repair and renew the premises to ensure it is in the same condition at the end of the Lease. The Landlord will insure the premises but the Tenant must pay the cost of the premium.

In return you will have the right to occupy the premises and will have rights to carry out alterations to the premises and to assign or sub-let your interest to a third party (which rights are generally subject to the Landlord's approval). FRI Leases will normally run for 10 to 15 years with rent reviews every 5 years. At the end of the Lease your final obligation is to vacate the premises, remove any alterations you have made and, depending on the terms of the Lease, leave the premises in either the same or better condition than you found it in at the date of entry.

Fitting Out Your Premises

The Franchisee will be expected to pay for the initial fitting out of the premises and will inevitably have continuing financial obligations under the Lease or Sub Lease in respect of the cost of maintenance and repair of the premises. A particular Franchise may have a standard fit out which the Franchisor requires in all of their Franchised premises. You will often find that

the Franchisee has to give the Franchisor money up front to cover the total cost of the fit out. The Franchisor then arranges for their own contractors to come in and do the work. This means the Franchisee has very little involvement in this side of things. It is very important to “high street” Franchisors that all premises trading under their name are identical to ensure their customers receive the same service and experience no matter which Franchised business they go to.

Depending on the state of the premises, the cost of your initial fit out could be high. It is important you fully investigate this as soon as possible as it is an unavoidable cost - which must be paid out before your business is up and running.

Consider All The Costs!

So far as the property side of your Franchise is concerned there are a number of costs you will need to bear in mind: -

- Legal and Surveyors Fees (sometimes including the Franchisors costs of the Lease and Sub-Lease as well your own)
- Rent (plus VAT)
- Insurance
- Service Charge (if your premises are within a larger area which is maintained on behalf of all the Tenants by the Landlord)
- The Fit Out
- Ongoing cost of maintenance and repair of the premises
- Decorating Obligations
- Reinstatement costs upon expiry of the Lease or Sub Lease
- Stamp Duty Land Tax
- Registration Dues

Property issues are often a significant part of the start up costs for a Franchise. WJM's Franchise team can advise you on the likely costs and guide you through the complex process of obtaining your premises.

More information from:

Gillian Cowie: gzc@wjm.co.uk

Joanne Ockrim: jo@wjm.co.uk

www.wjm.co.uk

Edinburgh
0131 225 5660

Glasgow
0141 248 3434

Inverness
01463 250 011



The information contained in this newsletter is for general guidance only and represents our understanding of relevant law and practice as at February 2012. Wright, Johnston & Mackenzie LLP cannot be held responsible for any action taken or not taken in reliance upon the contents. Specific advice should be taken on any individual matter. Transmissions to or from our email system and calls to or from our offices may be monitored and/or recorded for regulatory purposes. Authorised and regulated by the Financial Services Authority. Registered office: 302 St Vincent Street, Glasgow, G2 5RZ. A limited liability partnership registered in Scotland, number SO 300336