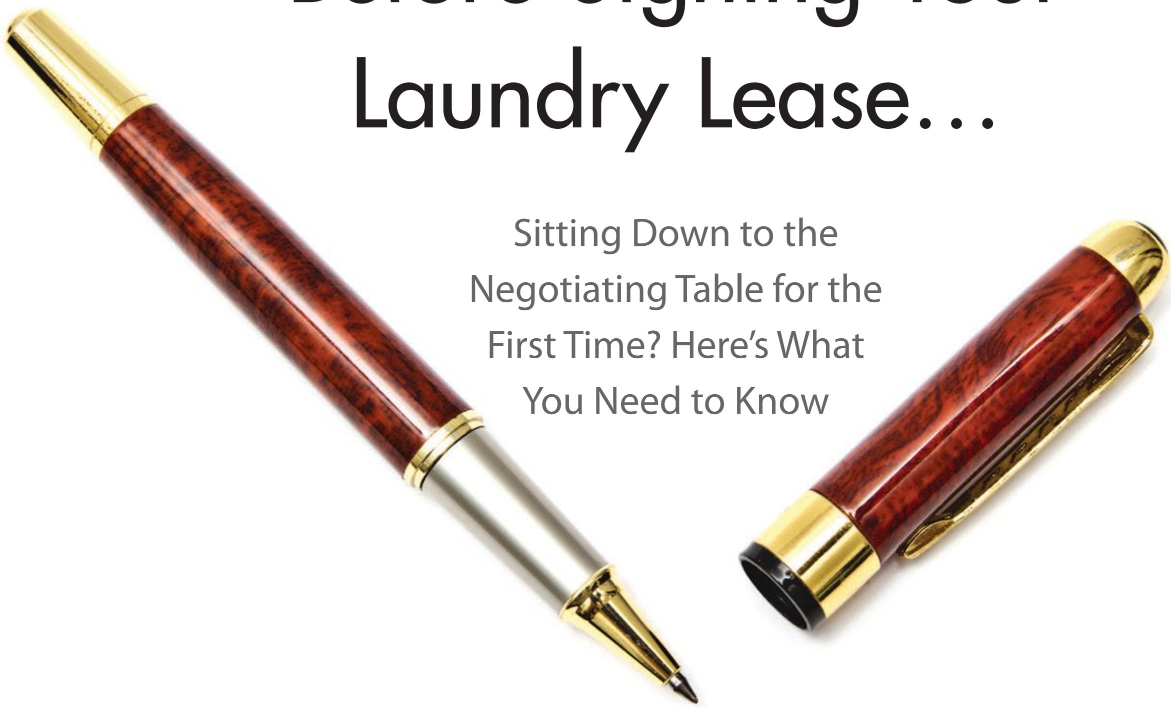
Cary Lipman

Before Signing Your Laundry Lease…



Sitting Down to the Negotiating Table for the First Time? Here's What You Need to Know

Cary Lipman, who lives in Atlanta, has designed, built, owned, and operated seven vended laundries and has been in the industry for more than 30 years. He can be reached at clipman36@aol.com.

First things first… with respect to your laundry lease, the best advice I can offer is be sure you have an experienced commercial real estate attorney by your side to help navigate the page upon page of "legal stuff" you'll be slogging through – and, in the end, agreeing to.

With that disclaimer upfront, my purpose is to highlight, from a vended laundry owner's perspective, some of the more important points that specifically concern a new investor. Hopefully, the only time your lease will become an issue is when you decide to sell your business. Most of the time it should remain in your desk drawer.

At some point during the leasing process, do your best to meet the landlord and speak directly with him or her. There will be occasions where it's advantageous to try to explain some of your concerns face to face and attempt to "sweeten the deal."

Anyone you speak with who has experience in the business will tell you: "The longer the lease, the better." When selling your business, a lease can either be an asset (plenty of time left, with moderate rent increases built in) or a liability (not enough time left for your buyer to recoup his or her investment, make some money and perhaps sell at a profit).

Of course, some landlords think five years is a long time. And it might be fine for a retail business like a women's clothing boutique – but it's definitely not considered "long" or even sufficient for a laundromat.

Once you envision having to move your laundry to another location after five years or trying to sell with no time left to pass on to a buyer, you will become a believer in an absolute minimum of 10 years, with as many five-year extensions (at your option) as possible.

Many landlords will allow extensions in the form of "options." But be careful when looking at the language to renew or extend. Some leases will show the tenant having the option to renew for an additional amount of time after the initial lease period. However, there may not be a dollar amount or percentage increase built in at the time of exercising the option, or you may be required to pay a huge amount in the form of a "kicker" in order to extend the lease. These scenarios are not "options" at all.

Also, the solid working relationship you might have enjoyed with your landlord over the years will be of no use to you at option time if the property has been sold and you have no guaranteed dollar amount built in to your renewal period.

Without having an extension period with a guaranteed dollar amount or percentage increase, the landlord can dictate your fate and raise the rent at the end of the initial lease period to an amount well beyond what you can pay. Your only "option" then would be to move out.

There are inevitable rent increases built into a lease. Some are in the form of a simple dollar amount or percent, such as a 2 percent or 3 percent increase over the previous year. The Consumer Price Index (CPI) is used by some landlords to increase the rent each year. Be sure to negotiate a cap or maximum to protect against an unusually high increases.

Always try to negotiate a flat rent in the beginning years without any increases. This will help you to get on your feet. The obvious logic is that you and your landlord are partners now, and he has a vested interest in your success. If you make money, he gets his rent.

Understand that the base rent commencement date and the lease commencement date will be different, as you will need some time to complete your leasehold improvements. During this time, you will pay no rent. A good landlord understands the scope of the project and should be reasonable with regard to the "free rent" period. A not-so-good landlord will want his rent as soon as possible. Your general contractor and laundry distributor will be helpful in estimating how much time you will need to complete your project.

With regard to that "free rent" period, I've seen everything from one month (which turned out to be a complete disaster) to as long as one year with the landlord contributing $20,000 to the project.

In general, a typical laundromat buildout will take about three to five months to complete, with all of the impact fees, licenses and permits being pulled in advance.

Stick to your guns on this point. If the landlord is particularly tough, your fallback position can be that your objective is to open for business as quickly as possible – but you don't want to get caught in an unforeseen delay, having to pay rent in a yet-to-be-opened store.

Some landlords are afraid you may open early and thus score a couple of months of free rent at their expense. Tell your landlord you'll be glad to begin paying rent as soon as you receive your certificate of occupancy, even if it's before the free-rent period ends. I've done this several times over the years, and it has always worked out best in the long run.

At this point, the next logical question: what should the monthly rent for your laundry business be?

The answer depends on a few factors. The price per square foot is significant because you can only fit so many machines in a given space, and your vend prices on your washers and dryers can only be so high. (For simplicity, I'm purposely not addressing any of the other potential streams of income available in a self-service laundry.)

The best way to compute your rent is by multiplying the square footage of the space by the price per square foot, and then dividing that total by 12 months. For example, a 2,000-square-foot store that's paying $13.50 per square foot would equal $27,000. Divide that annual amount by 12 months, and you can see that the store owner is paying $2,250 per month in rent.

Many leases will be "triple net," which means the laundry owner is responsible for paying a proportionate share of the common area maintenance (or CAM) fees. This is in addition to the rent, in the form of shopping center taxes, insurance, signage, snow removal, trash pickup, parking lot maintenance, landscaping, lighting, and possibly even the depreciation on the roof skin that covers the shopping center. CAM charges can amount to several more dollars per square foot. After adding these charges, you will then have a more accurate picture of your total monthly obligation.

CAM charges can – and probably will – increase each year, and you don't have

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much control over that. Professional shopping center managers will provide an annual compilation of all the charges, and you may get a bill for charges not covered from the previous year (usually taxes).

Clearly, rents will vary widely. There are markets where the rent can be as low as \$3 or \$4 per square foot, and others where is can be as high as \$30 per square foot. By the way, \$30 per square foot is a relatively low rate in New York City, but it's outrageously high for a self-service laundry.

When looking at a site for a new laundry, you first should draw a configuration of the different machines you want in the space, along with their vend prices. This is where your distributor can be extremely helpful.

Next, conservatively project what your revenue and expenses may be for the month, at various turns per day. This will be your pro forma. If the revenue your machines can produce in a week can pay your total monthly rent, you should start to feel a bit more confident about your future prospects.

You very likely will hear that your rent should represent no more than 20 percent to 25 percent of your gross revenue. For example, if your total rent for your 2,000-square-foot store is \$18 per foot, your monthly obligation is \$3,000, or \$36,000 annually. Using the 20 percent calculation, your laundry should be operating at roughly \$180,000 per year. Just be mindful that it will take some time to attain such a figure and that you have other expenses associated with the operation of your business. For this reason, it's critical that you have ample cash on hand while you are ramping up to the "break-even" point.

A standard shopping center lease is lengthy and features hundreds of clauses. (OK, I haven't counted *all* of them, but it sure looks like hundreds to me). Here are a few of the more critical clauses and legal points to look for in your lease:

Use: Being in an ever-changing market, you may want to create various profit centers in your store to increase revenue. Aim to have as few restrictions as possible in the lease, with regard to what you can do.

Assignment: Selling your store is a two-step process – (1) the contract to buy and sell the business and (2) the assignment of the lease to the new owner. Obviously, you can't sell your business if you're unable to transfer your lease to a new buyer. The landlord will definitely have something to say about who may be his new tenant. That's fine, as long as his decision is based on business and is not unreasonably withheld or delayed. The language in the assignment will probably state that you will remain obligated for the remainder of the lease, which will include all option periods and all other assignments to new buyers; in essence, for the rest of your life! Do your best to get off of the lease after a reasonable amount of time – perhaps a year or two.

Non-Compete or Exclusivity: You don't want your landlord renting to a competing business within the same shopping center. Also, ask if he or she owns any other spaces within a mile of your store. If so, ask to include a non-compete clause at that location as well. Then, when the landlord is done laughing, explain the importance of commercial property owners not competing with their own tenants.

Performance: Some leases have a penalty if your business is not grossing a certain amount of money, or the landlord will require a percentage of the store's gross sales. Typically, this type of clause is more likely to be found in shopping mall leases. Don't get caught in this trap.

Common Area Maintenance (CAM): Read this clause carefully because the language can be tricky. Some leases allow the landlord to charge current tenants for stores not rented in the shopping center. Clearly, this is unacceptable.

Rent Due Date: Rent is almost always due on the first of the month, with penalties if it's late. Try to include language stating, "A penalty will be imposed if received after the 15th." You may have to go back and forth with the landlord on this one, but it's important to you from a cash flow perspective.

After all of the key points have been discussed and the wording of crucial clauses has been settled, have your attorney read it over again… *and again!* There is a lot of money at stake – and a second (and smarter) opinion is always welcome.

When you finalize the lease with the landlord, you will be asked to leave a security deposit, the first month's rent, and perhaps a couple of final months' rent payments.

Now… sign that new lease, roll up your sleeves, and start building your brand new laundry business!

[Editor's Note: This article is not intended to provide specific legal advice. Before signing your lease or any legal/business document, it's highly recommended to consult with an attorney or legal professional.]