

What To Know When Acquiring Multi-Unit Real Estate Sites

By **Dennis Monroe**

As we all know, franchise restaurant companies are dynamic and constantly selling and buying multi-units, sometimes in fairly significant numbers. I'd like to highlight the key points related to the acquisition of specific real estate sites.

After the buyer has made a financial decision to acquire a group of stores, the next step in the process is to understand the issues related to individual sites. If the real estate is a seller-fee-owned site, it's pretty straightforward. You need to check the title and any potential encroachments or easements, and then agree on a lease (if you're going to lease it) or focus on the allocation of the price to that specific piece of real estate (if you are buying the site). If you're going to acquire an existing third-party lease site from the seller, then you have to go through a number of issues, which vary based on the types of properties that you're acquiring.

Here are a few things to keep in mind:

1. What does the title look like? It's almost essential to get a report from a title company (title commitment) to understand the legal characteristics of a site. This will tell you who the current owner is (and it may be different than the name on the lease); whether the landlord has a mortgage or deed of trust filed against the site that may have an interest superior than that of the lease interest; or if there are easements benefitting or burdening the site. Not all buyers also get surveys: Decision factors include the length of the lease.

2. Physical characteristics of the property. A key element in assessing a site is the legal right to use the physical attributes of it. The legal right to access and entry are the most common property right issues we run into. For example, if the drive-thru exits to the neighboring property, is there a legal easement benefitting the site allowing that access point? Is the dumpster on the correct site?

3. Basic terms of the lease. The lease should have a term (including options) that matches the term of the franchise agreement or, in the case of a non-franchise concept, enough term to support the price of the asset. The base rent on build-to-suit leases is often a factor of the construction costs, so

it may not be clear from the lease itself. The use clause of the lease should match the existing use; also look to see if there are other permitted uses (i.e. another restaurant, any lawful use, or only XYZ concept).

4. Financeability. Is there a provision in the lease that grants a lien by the landlord on the FF&E? Some states have statutory landlord liens, but those liens are seldom perfected. Nevertheless in order to finance the deal, a waiver or subordination from the landlord might be required. A lender taking only an interest in the FF&E will not be as concerned about the other terms of the lease; but a lender taking a leasehold mortgage may focus on flexibility of the site itself (i.e., what are the use restrictions, physical attributes and limitations and quality of the surrounding property).

5. How much does it cost? This will be a factor of the base rent, taxes and insurance. The title documents may also reveal further charges such as common area charges, additional insurance and costs. Multi-unit leases are often triple net to the landlord. The landlord is not responsible for repair or replacement of the building, including roof, structure, parking, HVAC systems and other improvements. In acquiring a site, the buyer needs to evaluate if there are capital expenditures in the near future or if a reserve should be established.

6. Exit strategy. Understanding how to get out of a lease can be as important as knowing how to enter into one. See if there is an obligation to continuously occupy the premises, i.e., if a landlord could call the lease into default if the tenant fails to operate. It might be better economically to shut down the restaurant and pay rent, taxes and insurance and keep the restaurant secure rather than to operate (note that there are often continuous occupancy clauses where the lease requires the payment of percentage rent). As suggested above, see what use and assignments are permissible to find out if there is another user that could take over the tenancy. Look at the default clause and see if there is a duty to mitigate by the landlord; and review the state law provisions to determine if the jurisdiction prohibits rent acceleration. Even if the lease allows for rent acceleration, if there is a clause requiring reduction of the

rent to present value and offset by market rent for the same period, it might be an acceptable loss.

7. Finding success in working with the landlord.

Communication with the landlords is of great importance. Normally the seller will not want to inform the landlord of a potential transaction until the buyer has waived most of its contingencies. Since that's done near closing, the time frame to obtain the documents from a landlord is compressed. So it's important to review the leases and title documents in advance. If there are example agreements attached to the lease, use those agreements for that landlord. If the consent of the landlord is contingent on the assignee having a certain level of operating experience, include that information. In approaching the landlord, the current tenant should prepare a letter outlining the basic parameters of the transaction and introducing the assignee. The assignee should also provide a letter outlining the experience and financial strength of the

new tenant and providing as much financial information as possible. A typical landlord package includes any necessary consent (including a copy of the assignment document is helpful, so that the landlord can see the full assumption of the lease obligations by the assignee).

Remember that a real estate site is often the most important asset of a restaurant, so an effective due diligence and acquisition process are key.

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