



Gold Book

Research Series

Your Guide to Laundry Excellence

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The Laundry Owner's Guide to Leases

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The Laundry Owner's Guide to Leases

A self-service laundry is a unique type of enterprise with a unique set of requirements.

Most other retail businesses are highly portable, requiring only a "plain vanilla" space with few specific mechanical alterations. A laundry, on the other hand, requires specific and costly mechanical accommodations, permits specific to the site, and placement of costly equipment.

Within this context, a laundry's lease becomes a consideration of primary importance. The following pages explore some of the key elements that laundry owners must consider, both when entering a lease and managing the document throughout the life of the laundry.

1. Characteristics

Why are laundromat leases different from other commercial leases?

A number of key conditions require self-service laundry leases to be markedly different from leases for most other retail enterprises.

PERMANENCE. Commercial laundry equipment is bolted to the floor. Floors have been cut to allow for drains, ceilings and roofs opened to accommodate venting, and half-walls and bulkheads built to hook up equipment. Once a laundry is in, it is in for the long haul.

INVESTMENT SIZE. A laundry operator who enters into a lease is not merely renting space. He or she is entering into a lease as part of a larger venture that includes buying or installing tens or hundreds of thousands of dollars worth of capital equipment, the future earning capacity of which is inextricably tied to the leased location. A laundry operator is not free to simply move capital equipment and stock to another space. Portability is effectively nonexistent. The terms of the lease, therefore, play an oversized role in dictating the financial future of the enterprise. One overlooked bit of fine print in the lease has the potential to make or break the business, and produce substantial financial losses.

DEMOGRAPHICS. A laundry's business is tied to a specific space in a specific neighborhood, and its revenues rely on a customer base with a rather narrowly defined demographic profile. Additionally, factors such as an alteration in the direction of traffic flows, or changes affecting nearby multifamily housing—such as demolition or gentrification of housing—can diminish profits and force a laundry into the red.

As a result of these overarching factors, laundromat leases are different from other retail leases in several significant ways.

LENGTH. Laundries require initial and ongoing investment in costly capital equipment. Those investments typically entail years of debt service, which eat into profits. For that reason, a laundry lease must be long enough to pay off such investments, and guarantee the operator sufficient time to recoup those costs and enjoy a period of higher profits. Consequently, while other kinds of businesses may be content to lock in leases by the year, laundry owners typically think in five- and 10-year blocks. A laundry tenant also must be more conscientious than other kinds of businesses in *tracking option deadlines* and *negotiating and exercising new options* to ensure that there is sufficient time to pay off any new capital investments that occur over the normal course of business.

VALUATION. A lease is one of the most important factors in the valuation of a laundry. The earning potential of a laundry is directly proportionate to the amount of time left on a lease, and so has a significant impact on the asking price of a laundry at the time of its purchase or sale. A laundry that contains the latest equipment, but which occupies a space secured only by a five-year lease and no options, is essentially not much more than a room full of equipment from the point of view of a prospective buyer.

COST. A laundry lease typically is priced lower than leases for other kinds of retail tenants, simply because a laundry tenant is a dependable, long-term tenant, and the rented space will not be rotating tenants as frequently as if it were rented to most other kinds of retail businesses.

TIMING. While laundry rents may run cheaper than many other retail enterprises, a landlord has a built-in advantage in negotiating with a business that cannot pick up and move. Because the laundry is physically tied to the site, it is crucial for a tenant to negotiate and nail down rent increase amounts as far in advance as possible; ideally, this should occur during initial negotiations and before the lease is signed. In general, the less time left on the lease, the more leverage the landlord has to demand a higher rent.

2 Negotiating

What are some successful lease negotiation techniques?

Lease negotiating techniques can be influenced by variety of factors. Different combinations of techniques will have varying degrees of efficacy depending on whether one is building a new store, purchasing an existing laundry, negotiating an existing lease as a tenant, negotiating with a corporate landlord, or negotiating with a local mom-and-pop owner.

Moreover, since no two leases are alike, tactics that may work in one situation may not apply to or work in another. However, there are some key things to know going in.

GENERAL CONSIDERATIONS

CREATE A CONNECTION. Whenever possible, try to negotiate at least in part through in-person meetings. Establishing a face-to-face personal connection often can provide the critical edge in working through various sticking points in the lease negotiation process.

CONNECT. LEARN. GROW.

SEE BOTH SIDES. As with any negotiations, it works to one's benefit to stand in the other party's shoes to better understand his or her point of view. When it comes to laundry leases, this may be of particular value in the case of mom-and-pop landlords, especially in helping to bolster one's ability to convey to them that one completely understands their concerns as small business owners.

DON'T ACT DESPERATE. There is a difference between appearing earnest and appearing overeager. An earnest manner shows a serious approach to negotiations, while an overeager attitude may embolden a landlord to up the ante. Conversely, while it can work to one's advantage to convey the impression that one is capable of walking away from a deal, one does not want to appear too casual. Consequently, one needs to balance the appearance of being both fully engaged in negotiations, yet prudent enough to reject a one-sided deal.

BE HONEST. As with all business transactions, being clear and honest in lease negotiations not only can help ease the process, but also lay the groundwork for a positive landlord-tenant relationship after the lease is executed. One can be open and honest and still execute a shrewd deal.

STAY UNDER THE RADAR. An existing tenant who has been a good actor—one who pays rent on time, keeps the space clean and well-maintained, and makes no unreasonable demands on the landlord—may well enhance their chances of winning more favorable terms when it comes time to renegotiate. That may also be the time to point to recent tenant improvements and, in the case of a store in a shopping center, point to customer growth that benefits the center's other businesses.

START EARLY. The earlier in the process one initiates lease negotiations, the more time one has to work out favorable terms. And once one has entered a lease, one should always stay aware of the dates and deadlines related to exercising lease options, as well as the lease's notification requirements, which can vary widely from lease to lease.

SEEK COUNSEL. There is no such thing as a standard lease. They are long and complicated, and all of them start out as documents drawn up for the benefit of the landlord. The wording of a simple clause buried in the back of lease can come back to haunt the tenant years after his or her signature on the document has dried.

One can scarcely enter or negotiate a lease well if one does not understand it well. Because the typical laundry owner is not a legal or real estate professional, it is essential to seek guidance from someone familiar with leases—particularly those specific to laundries. It may be a laundry broker, or a distributor who has helped set up laundries. These experts can and do provide much of the assistance with leases that laundry owners require.

At the same time, one needs to acknowledge that a commercial real estate attorney, especially one with expertise in laundries, is most completely "in the business" of reviewing leases. Moreover, in addition to providing counsel, an attorney often can help lead negotiations, especially in the case of large corporate landlords, simply because they speak from a position of legal expertise which the buyer does not have.

DO RESEARCH. This is part of being prepared. Prospective tenants—particularly those who are about to

enter a lease spanning as much as 20 years or more—are well advised to know about the person or entity they are leasing from, and about the property, center and area where they are leasing. This research may include:

Other tenants/properties. That means talking to the landlord’s other tenants, and finding out what some of the landlord’s other properties are, if any. It means finding out if the landlord leases to other laundries, and if so, speaking to those tenants. If the site is in a center, one also should note any vacancies.

Rents. To aid in negotiation, one also should research rents—both the market rate for local retail rents, and the rents the landlord charges other tenants.

Landlord’s standing. It also does no harm to research a landlord’s own financial and legal status, much as the landlord demands of the tenant, to ensure the landlord is in good legal standing.

Surrounding area. Research should include using official sources, as well as one’s eyeballs, to determine what is going on in the community surrounding the laundry. This includes tapping into local law enforcement for crime data, and driving around the area to identify any negative signs, such as vacant housing or businesses, graffiti and other signs of decline.

CORPORATE VS. ‘MOM AND POP’ LANDLORDS

Corporate owners and “mom-and-pop” owners share an interest in wanting to generate the best possible income from their holdings. But like large and small businesses in any sector, these two types of landlords generally differ in terms of their other priorities, and in how they approach business decisions and negotiations.

CORPORATE. In the case of corporate owners, a property manager generally provides the “face” of the landlord. The manager acts as middleman between the landlord and tenant. In fact, tenants often will never meet the actual landlord. As the landlord’s representative, a property manager is paid based on the rent that is being charged—as well as on any increases. Consequently, he or she has a strong incentive to negotiate for the highest possible rent.

MOM-AND-POP. Like other landlords, mom-and-pop landlords also want to lease their spaces at the highest possible rent. But they also tend to have a greater interest in having a good tenant in their building or center. On the plus side, because the laundry owner deals directly with the landlord, there is a better shot at negotiating a decent rent through face-to-face negotiations—something that is harder to do in dealing with a property manager. On the minus side, some mom-and-pop owners, whose income may be more closely tied to a rental space, may have an inflated perception of its value, and/or refuse to enter long-term leases out of fears they may be shortchanged if the market changes and rents rise.

BUILDING A NEW STORE

Building a brand new laundry from the ground up also generally means building a brand new lease. And

all the “moving parts” of both the laundry and lease must be carefully chosen, examined and approved to ensure success when the owner turns the key and gets the business moving.

When someone assumes an existing lease, that lease has already been shaped by concessions and compromises on the part of the tenant and landlord, permissions that have been granted or denied, and conditions and responsibilities that have been negotiated and agreed to. However, for someone who is building a new store—and entering a new lease—all those things remain yet to be done.

That is why the prospective tenant's first task is to do a stellar job of selling his or her proposition to the landlord in order to gain the best possible terms in the lease.

DOCUMENTS. The prospective lessee should assemble a complete package of documents outlining the proposed enterprise. It should include a *business and marketing plan*, a professionally produced *floor plan of the facility*, itemized *construction and equipment costs*, and *details on other improvements* to the rented space. One also needs to document one's net worth, as well as one's financial ability to sustain the business and continue to pay rent in the event of an economic downturn—as evidenced by *credit reports and financial statements*. Assembling and presenting this information in a clear and forthright fashion demonstrates business sense and professionalism, and communicates one's determination to launch a successful venture.

BENEFITS. The tenant-to-be should be prepared to emphasize benefits—the fact that the laundry brings the landlord a long-term tenant in a dependable line of business. If the location is in a shopping center, one should emphasize the benefits a laundry brings as a destination business capable of drawing customers who will frequent other businesses in the center. In the case of a center with a grocery store whose rent is tied to a percentage of sales, for example, a prospective laundry operator could argue that the dependable stream of additional traffic brought in by the laundry will enhance the landlord's rental income from that grocery store.

CONCESSIONS. While concessions may play some role in all lease negotiations, they loom large when negotiating a new lease. One needs to enter negotiations understanding that the final lease must satisfy the needs of both the landlord and the tenant. This will mean a give and take on the part of each. One needs to go into talks already knowing which points one is prepared to concede and which are non-negotiable, and then stick to that plan. A couple of possible concessions on the part of the landlord specific to building a new laundry that the tenant may wish to pursue include:

Free rent during the construction period. Stressing that one is establishing a long-term commitment to the property, a tenant may want to ask for 120 to 180 days of free rent—a lease condition known as “rent abatement”—during the time the facility is being outfitted and finished. A reasonable final agreement might specify free rent for either a maximum of 120 days or until the laundry opens, whichever comes first.

Lower negotiated rent in light of investment. A tenant may succeed in negotiating a lower rent based on the fact that the tenant has made a significant investment in the property.

BUYING AN EXISTING STORE

Buyers of existing stores who attempt to renegotiate an existing lease may find they have less leeway in dictating terms than those building a new one, particularly if the prior laundry owner has been paying rent on time, and otherwise acting as a good tenant.

At the same time, one may be able to gain leverage in negotiating rent in the case of a laundry that is not in good condition. A buyer of such a laundry likely is doing so with the intent of rebuilding the business. In that case, a buyer could default to the same lease negotiation stance used when building a new store—demonstrating to the landlord how one plans to overhaul the existing business through investments in new equipment, tenant improvements, better marketing and signage, and so on.

3 Key elements

What are some of the most important elements of any laundry lease?

Because a lease is a lengthy and complicated document, nearly any element in the lease—should it contain terms unfavorable to the tenant—could be characterized as the “the most important element” if it comes back to haunt the tenant.

That said, there are a number of key elements that emerge as top-line concerns in laundry leases.

DURATION

The rule here is simple—the longer, the better. The lease, whether a single long-term lease or one divided into tenant renewal options—five-year options, for example—needs to cover a length of time to accommodate three main concerns. A lease should be long enough to:

- Exceed the length of the laundry operator’s debt service;
- Provide a subsequent period of debt-free improved cash flow; and
- Maintain a duration that is attractive for the purpose of selling the store.

Most industry experts would recommend maintaining a lease so that, with options, it spans a period of 20 or even 25 years. Owners need to be conscientious about tracking existing options and negotiating new ones to preserve that time horizon. This may be a challenge should a landlord not want to lock in additional options—all the more reason to make sure that there is sufficient buffer time in the lease to react to such a situation.

In terms of the structure of a new lease, a 20-year lease consisting of an initial 10-year term with two five-year options is common. In a situation where there is significant debt service, as in the case of an owner building a new laundry or totally rebuilding an existing one, a laundry operator may want an even longer lease—perhaps 10 years with three or more five-year options.

In any event, whether the lease negotiations are for building a store, buying an existing one, or renegotiating as a current tenant, one always aims for a long-term lease with clearly defined options.

COST

A business’s rent must fall within a “comfort range” in terms of its expense ratio. In the self-service laundry

business, most operators are comfortable with a rent that is somewhere in the range of 20 percent to 25 percent of gross sales. While sales revenues can be fluid, operators must do all they can to ensure that they know what their rent will be over a given period of time.

GROSS LEASE. Under this sort of lease, the landlord pays all the costs of the space, including utilities, and the tenant pays a flat rent. Under a *modified gross lease*, the landlord pays all costs excluding utilities. A mom-and-pop landlord may prefer this kind of lease.

TRIPLE NET LEASE. Landlords who rent space in the shopping centers where many laundries are located recoup the costs associated with operating the entire property by passing a share of those costs through to tenants by means of a triple net lease. These charges are assessed in addition to base rent. The charge is based on a monthly estimate, and once a year is reconciled to reflect actual expenses, with the tenant responsible for any shortage at that time. In some cases, a landlord may reconcile the charges on a quarterly basis.

The triple net charge associated with these leases consists of three main elements—(1) *common area maintenance*, also known as CAM; (2) *taxes* and (3) *insurance*. Each tenant is billed a share of the triple net charge on a prorated basis, calculated to the square foot of space. For example, if a tenant rents 1/10 of the space in the center, the tenant pays 1/10 of the center's total triple net charges. In some cases, a landlord—particularly a large corporate one—may layer in other charges, in effect creating a “quadruple net” charge that includes not only the triple net costs, but also a property management fee. (*Note that the term CAM is sometimes used interchangeably with the term “triple net,” although it is but one element of the triple net charge.*)

Of the three main charges—CAM, taxes and insurance—it is CAM that must be monitored most closely by the tenant. Taxes and insurance are set and easily verified, but common area maintenance may include a range of charges that may or may not be justifiable or legitimate—for example, charges for snow removal services assessed for a period in which no snow fell. A tenant should make sure that the lease ensures a full, verifiable accounting of all costs associated with the CAM charge.

KEY CLAUSES AND FINE PRINT

As a rule, every word and phrase in a lease is there for a specific purpose, and that purpose is to support the interests of the landlord. In the broadest sense, the lease is all “fine print.”

The fact is that little traps are set throughout most leases, which if not caught and modified before the tenant signs, could trigger a range of unfortunate consequences. These consequences can be more significant for laundries, which are fixed to the site, and therefore can be significantly affected by lease language that restricts the use or alteration of the site's physical infrastructure, or that assigns the tenant responsibilities and financial obligations triggered by certain conditions or events affecting the site.

When push comes to shove, these nuances are best understood by legal and real estate professionals who specialize in commercial properties. This is not to discount the expertise of business brokers and distributors, who also have deep and valuable knowledge about leases specific to laundries. It is up to the laundry operator to tap the knowledge base best suited to his or her particular needs. At the same time, in the case

of an operator who is spending hundreds of thousands of dollars to build or gut and rebuild a laundry, it would seem negligent not to have the lease document vetted by a qualified commercial real estate attorney.

There are a number of key words and phrases that a vigilant lessee should be aware of.

WORDS AND PHRASES

REASONABLE. This is a word that favors the tenant, and can be used to modify troublesome terms and conditions. “Costs” can be transformed into “reasonable costs,” or “fair and reasonable costs” which, in the case of a disagreement, leaves the amount of those costs up to a court rather than the landlord. As another example, landlords prefer to assign themselves “sole discretion” over various terms of the lease or rights of approval. In every case, the prospective renter should amend that to “reasonable discretion.”

PERSONAL. As in “personal to the tenant.” This phrase is used to restrict some rights or aspects of a lease to apply only to the tenant. If a tenant’s options to extend the lease are personal to the tenant, should that tenant attempt to sell the laundry, the buyer would not receive those options because the current owner has no right to convey them to another tenant. This would severely affect the selling price and marketability of the business.

UNREASONABLY WITHHELD. Like “reasonable,” this phrase can be used to amend one-sided conditions that the landlord attempts to impose on the tenant. This often comes up in terms of lease assignment—a tenant’s transfer of the entire lease, and primary liability for the lease, to an assignee such as a buyer. Landlords, who typically place a range of conditions on buyers to ensure they are financially viable as tenants, may however impose conditions so strict as to harm a tenant’s ability to sell the business. It behooves a laundry owner to make certain there is language in the document specifying that lease assignment may not be “unreasonably withheld, conditioned or delayed” by such restrictions.

KEY CLAUSES

USE CLAUSE. This clause identifies the ways the tenant may use the leased premises. These “permitted uses,” described elsewhere in this paper, typically include laundry, drycleaning and related services. If the site is located in a shopping center, the clause usually specifies *the tenant’s right to offer those services on an exclusive basis*.

ASSIGNMENT CLAUSE. An assignment clause specifies whether a tenant can transfer the lease to a third party, in this case a buyer of the laundry business. Leases typically specify that the tenant has no right to assign or sublet the leased property to another party. Unless this language is modified to provide these rights to the tenant, the laundry owner will be at the mercy of the landlord, and will find it difficult or impossible to sell the business.

MAINTENANCE CLAUSE. Leases may contain very broad maintenance clauses that may hold the tenant responsible not only for keeping the property maintained and in good repair, but also for returning the property to the same condition if it is damaged or even totally destroyed—regardless of the cause.

REPAIR CLAUSE. One should ensure that a lease’s repair clause limits the tenant’s obligation to making

non-structural interior repairs only, otherwise one may find oneself responsible for major structural and exterior repairs.

TERMINATION CLAUSE. Leases often grant landlords rights to terminate a tenant's lease under a broad range of circumstances, such as damages to the premises (in the case of a shopping center, that damage may or may not include the laundry space). With hundreds of thousands of dollars in embedded equipment, one must make sure one is protected from such termination, either by amending the terms of the lease, or by obtaining appropriate insurance protection against the financial impact caused by it.

CONDEMNATION CLAUSE. Condemnation clauses in leases typically protect only the landlord. A tenant must ensure the lease contains a provision that specifies if the property is condemned or taken over by an authority through eminent domain, the authority must pay the laundry the full value of the business.

See more below under *Basic Lease Terms and Definitions*.

4 Rent

What are some of the most common methods used for setting and increasing rents?

Landlords employ a wide range of rent-setting methods, and the choice of which one to employ often depends on the characteristics of the property and the circumstances of the landlord. The concerns of a corporate landlord that owns multiple shopping centers, for example, are far different from those of a mom-and-pop landlord who owns a single building.

BASE RENT. A base rent is a fixed amount, based on the square footage of the rented space, that is used as a minimum rent in a lease, and which may be used as a component of another rent-setting method, such as triple net rent, described below. Base rent may remain the same for a period of years, or be increased each year over the term of the lease.

TRIPLE NET RENT. As discussed earlier, triple net rent includes base rent, plus taxes and insurance and common area maintenance (CAM) fees. Triple net rents are commonly found in shopping centers, where landlords wish to pass through charges associated the total property.

PERCENTAGE RENT. Almost all triple-net leases have a clause regarding percentage rent, which is typically based on 10 percent of the gross income of the business. Under this clause, if 10 percent of the laundry's gross income is higher than the rent, the tenant pays that amount instead of the normal rent amount—a consequence that can be particularly costly for high-grossing laundries. A prospective tenant must seek to have this clause stricken from the lease if at all possible.

The vast majority of the time, getting this clause stricken is easy to do. There are revenue "thresholds" that have to be met before this clause applies, and a self-service laundry does not typically reach those thresholds.

MARKET RENT. A market rent is the rental income that a similar space in a given area would command on

the open market, based on the rents that other landlords currently are getting in recent lease transactions. When a landlord and tenant agree to a market rent, it is critical for both parties to agree on how that market rate will be determined, as well as to agree to a method for settling any disputes, such as arbitration through a mutually acceptable appraiser. The lease should contain language that spells out these mechanisms.

INCREASES

Lessees must pay close attention to language that specifies how rent increases are calculated and imposed over the term of the lease. For example, will they increase yearly, or only when an option is exercised? What may appear reasonable in print may be costly in practice.

FIXED PERCENTAGE. While a fixed percentage increase may seem clear-cut on its face, it is critical to understand how those percentage increases will be calculated. For example, the lease could be written to calculate 2 percent annual rent increases either by using the *original base rent*, or by *compounding based* on the prior year's rent. The difference can be substantial over the course of a 20-year lease.

COST OF LIVING. A lease also may tie rent increases to variances in the cost of living, as measured by the Consumer Price Index, a statistic which is calculated based on the cost of a "basket" of goods and services purchased by wage-earners. Rent increases tied to such indexes provide an extra measure of protection to the landlord, while introducing a variable where a tenant might prefer a set value.

If they are used, cost-of-living increases should be tied to a local index and should not exceed the rate of inflation. Additionally, the tenant should ensure that the lease specifies that the rent will not increase if the cost-of-living index remains unchanged, and that any increases be capped at an agreed-upon percentage. A lease also could be negotiated to the tenant's advantage to specify that an increase at a given juncture will be a certain fixed percentage, such as 2 percent, or the increase in the CPI, whichever is lower.

As with fixed percentage increases, rent increases based on cost of living which are compounded from year to year can cause rents to increase more quickly over the term of the lease.

5 Tapping expertise

How does one find an expert to help write, review and negotiate a laundry lease?

A laundry owner who puts in the time and effort can recover from almost any mistake he or she has made in establishing and operating a laundry. The owner, for example, can revamp a business or marketing plan, extend financing or adjust the laundry's equipment mix.

But if the owner is trapped by a lease that is too short or costly—or if the owner is caught up in the lease's fine print—it can mean losing the business altogether.

In short, the lease is a laundry owner's most important document. And, as noted above, negotiating a lease

is not a do-it-yourself endeavor. One needs to seek the counsel of professionals who are deeply involved in the laundry business, and who review laundry leases as a key part of their normal business activity.

Such experts will be familiar with the common leasing pitfalls that can most affect self-service laundries. They also will be knowledgeable about aspects of leases that are of particular importance to laundries, such as those regarding utilities, air conditioning and venting, and permits.

For those reasons, one does not want to engage a general attorney, a real estate agent with limited commercial leasing experience, or a "friend of a friend" who knows something about laundries to review a lease.

Luckily, there are a range of true experts who can help guide laundry owners through the process of reviewing, amending and negotiating laundry leases. These include laundry consultants, equipment distributors, business brokers, commercial real estate professionals and commercial real estate attorneys.

There are numerous ways to locate these skilled specialists.

PROFESSIONAL ORGANIZATIONS. The most obvious resources are professional organizations keyed to the laundry business. In this case, the Coin Laundry Association and its affiliates clearly stand out as the most valuable resources for locating people with extensive experience in the self-service laundry industry. Members include professionals from the disciplines listed above, and the organization provides owners with access to a range of educational resources and professional expertise.

NETWORKING. The CLA, as well as other organizations and industries involved in the self-service laundry business, provide the opportunity—through member services, industry events and web forums—to network with professionals who can help with the leasing process, and to communicate with others in various parts of the industry who can provide advice and references regarding qualified lease experts.

OTHER OWNERS. Other laundry owners, particularly those with long-term success in the business, can be a valuable source of information in identifying the most experienced and knowledgeable lease experts.

DISTRIBUTORS AND BROKERS. Distributors and brokers often have the deepest initial involvement—and in the case of distributors, ongoing involvement—with laundry owners. These professionals not only can offer valuable counsel concerning leases, but also can point laundry owners to other professionals—such as commercial real estate attorneys—who are knowledgeable in self-service laundry leases.

ONLINE RESEARCH. In addition to tapping into the web-based services offered by laundry-focused organizations such as the CLA, those seeking expertise also can find commercial lease specialists through websites maintained by organizations that serve commercial real estate attorneys, commercial real estate agents, business brokers and others.

In the best of scenarios, an owner would identify, access and coordinate the expertise of a combination of

experts—a distributor, a real estate professional and an attorney, for example—in his or her effort to hammer out the best possible lease with the most favorable terms.

And with all that is at stake, there is no reason not to make every effort to do so.

6 Reading the landlord

What does a landlord want or need from a tenant or prospective tenant?

A landlord is exactly that, the lord of the land.

While a landlord may make concessions during lease negotiations, once the lease is signed and in effect, the landlord reasonably expects things to go smoothly, with few or no departures from the agreement.

Landlord expectations may vary somewhat depending on whether the property being leased is managed by a hands-on, local mom-and-pop owner, or overseen in a more or less hands-off manner by a property manager in the employ of a corporate landlord.

In the case of property that is not owned clear of debt, what a landlord “wants” from a tenant also may be further defined by the landlord’s own financing terms, and by the demands of the landlord’s own bank.

But in most cases, certain expectations apply across the board. From the point of view of most landlords, the list of characteristics of a good tenant reads like characteristics of a good scout: A good tenant is thrifty, clean, prompt and honest.

TIMELINESS. Most of all, the landlord wants the rent. The rent is the whole point of the landlord’s business, and the landlord therefore wants it to arrive on time. The landlord’s own financial viability and ability to pay bills relies on the timely payment of rent, so there is almost nothing that raises a red flag more quickly than a late rent payment.

FINANCIAL SECURITY. The possibility of late rents or business failure are the reasons landlords demand that prospective tenants—particularly long-term ones such as laundries—provide such a high degree of evidence of fiscal soundness and successful business management. They want to be secure in the knowledge that a tenant will have the ability to pay the rent in good times and bad. Landlords want tenants with respectable net worth, decent income and a good credit rating.

MAINTENANCE. The laundry owns the business and equipment, but the landlord owns the property. As such, the landlord wants the property to be well maintained. At minimum, the landlord desires the leased space to be maintained in the condition in which it was rented, and maintained according to the terms of the lease. In the best scenario, a landlord wants the property not only to be maintained, but also improved.

CLEANLINESS. The last thing a landlord wants is a property that becomes an eyesore, either inside or out.

Landlords want tenants who keep the inside of the business clean and neat—interior spaces dusted, swept and mopped, and walls and any windows washed—and who keep the storefront tidy and clean.

PASSION. Landlords want tenants who demonstrate a dedication to running an efficient and profitable enterprise. Such tenants not only keep their businesses clean and well maintained, as noted above, but also update and fine-tune marketing, replace equipment on schedule, and seek new ways to draw additional customers into the laundry.

COMMUNICATION. While landlords do not want tenants who communicate every small complaint, they do want tenants who apprise them of major issues as quickly as possible. While a landlord may not want to hear that a tenant is going to miss a rent payment, the landlord would prefer to hear that news as soon as possible in order to work out some arrangement in advance of the problem.

7 Basic terms and definitions

What are some of the most commonly used lease terms?

The lease is at the heart of any self-service laundry venture, so it benefits an owner to become familiar with the many terms such leases employ. Laundry operators can profit from obtaining one of the many available desktop legal and real estate dictionaries that serve as handy resources for those seeking clarification of lease terminology.

While far from exhaustive, the following list contains some of the most common terms an owner should become familiar with.

Abatement—Free or reduced rent for a fixed period of time.

Anchor tenant—The major tenant in a shopping center or building.

Appraisal—An estimation and reporting of the value of a property based upon an analysis by a qualified professional.

Assignment—A transfer by a lessee of the lessee's entire interest in a property.

Attorn—A tenant's agreement to recognize a new owner as the new landlord, and to pay rent and otherwise perform under the existing lease.

Base rent—A set amount, used as a minimum rent in a lease, which may remain the same or be increased each year over the term of the lease.

Base year—The initial year of a lease agreement, which is used as the baseline for determining rent increases.

Build out—The cost of reconfiguring and finishing new or released space in accordance with a tenant's specifications.

Common area—Those areas available for common use by all tenants or groups of tenants and their invitees.

Concessions—Cash or cash equivalents expended by a landlord to influence or persuade a tenant to sign a lease.

Condemnation—The taking of private property, without the consent of the owner, by a governmental agency for public use through the power of eminent domain.

Consumer Price Index (CPI)—A measure of inflation in relation to the change in the price of a fixed market basket of goods and services purchased by a specific population.

Default—Failure to perform a promised task or to pay an obligation when due, such as the failure to make on-time payment of rent, or failure to perform any terms of a lease.

Demising walls—Boundaries that separate a tenant's space from another tenant's space and from a public area.

Early possession—Access to a space prior to the commencement date of the lease, during a construction period, for example, without consuming time from the term of the lease.

Escalation clause—A clause in a lease that provides for rent to be increased to reflect changes in expenses paid by the landlord, such as real estate taxes and operating costs.

Fair market value—The sale price at which a property would change hands between a willing buyer and willing seller.

Force majeure—A force that cannot be controlled or resisted, including "acts of God," such as natural catastrophes; and acts of man, such as riots and strikes.

Grantee/Lessee/Tenant/Buyer—One to whom a grant of property or property rights is made. In the case of a lease, this is the tenant.

Grantor/Lessor/Landlord/Seller—One who grants a property right. In the case of a lease, this the landlord.

Gross lease—A lease in which the landlord pays all expenses of the leased property, including taxes, insurance, maintenance and utilities.

Lease commencement date—The date on which occupancy commences and the legal terms of the lease go into effect.

Leasehold improvements—Improvements made to leased premises for the benefit of the tenant, which may be paid for by the landlord or the tenant.

Letter of attornment—A letter from a landlord to a tenant stating that the property has been sold and directing rent to be paid to the new owner.

Letter of intent—A formal method through which a prospective tenant or buyer expresses interest in a property.

Long-term lease—A lease whose term exceeds 10 years.

Market rent—The rental income that a property would command on the open market with a landlord and a tenant ready and willing to consummate a lease in the ordinary course of business; indicated by the rents that landlords were willing to accept and tenants were willing to pay in recent lease transactions for comparable space.

Net lease—A lease in which the tenant pays, in addition to base rent, certain associated costs such as property taxes, insurance premiums, repairs, utilities and maintenance.

Pass throughs—A tenant's pro rata share of operating expenses (such as taxes, utilities and repairs) paid in addition to the base rent.

Percentage lease—A provision of the lease calling for the landlord to be paid a percentage of the tenant's gross sales as a component of rent, usually added to a base rent.

Renewal option—The right of a tenant to renew and extend the terms a lease for a stated period of time and rent.

Rent commencement date—The date on which a tenant begins paying rent, which may be on or after the lease commencement date, but never before the lease commencement date.

Rentable square footage—The usable square feet of the space, plus a pro rata share of common areas.

Trade fixtures—A tenant's personal property that is attached to a structure and used in the business.

Triple net lease—A lease in which the tenant pays base rent, plus taxes and insurance and common area maintenance (CAM) fees.

Usable square footage—The specific square feet of space the tenant will occupy to do business.

8 Pitfalls

What are the most common mistakes an owner needs to avoid?

Many of the actions that a tenant takes to void or mitigate the effects of certain terms of a lease involve modifying or taking out what is already in the lease, often language found in the pre-printed boilerplate common to most leases.

Failing to eliminate or alter these provisions—which include the assignment, maintenance, repair and termination clauses discussed earlier—may later present the tenant with major financial and operational problems.

But other costly oversights often involve provisions tenants failed to add to the agreement, other agreements related to the lease that they failed to execute, or activities they neglected to perform as part of due diligence. Failing to address any of the major factors detailed below can turn out to be a major mistake.

EXCULPATION OF PERSONAL GUARANTY. When one sells a car, one does not expect to continue to gas it up after the sale. And when one sells one's laundry, one does not expect to continue to be liable for the rent. But a landlord may in fact hold a former tenant liable for the projected rent for the lease term if that tenant failed to secure as part of the lease an "exculpation of personal guaranty," which excuses the tenant from further liability upon assignment of the lease to the new tenant—the buyer.

DARK CLAUSE. A tenant who occupies space in a shopping center whose traffic relies on one or more large anchor tenants—such as a grocery or "big box" store—must ensure that the lease contains language allowing the laundry to request a proportionate reduction in rent should those businesses pull out and their spaces "go dark."

NON-DISTURBANCE AGREEMENT. The lease isn't the only document to consider in guaranteeing the ongoing viability of the lease. Under certain circumstances, a lease can become worthless without another kind of agreement—a non-disturbance agreement with the mortgagee—which protects the tenant if the landlord is foreclosed upon. In the event of foreclosure, the agreement allows the tenant to remain in possession of the leased property and pay rent directly to the bank.

ASSIGNMENT OF LEASE AS COLLATERAL SECURITY. This document is required by most lending institutions. In the event of a loan default by the tenant, the document gives the lender the right to step into the shoes of the tenant and appoint a new tenant, or "appointee." If a landlord does not execute a finance company's collateral assignment of lease document at the time of the lease signing, the landlord may not agree to do it at a later time. Moreover, the landlord may also charge the tenant a fee to pay an attorney to review the document.

SUBORDINATION AGREEMENT. When a laundry with active financing on equipment enters a lease, it should work to have the landlord sign an agreement that subordinates the landlord's claims to the claims of the finance company in the event the tenant fails to make payment on the equipment.

UNIFORM COMMERCIAL CODE FINANCING STATEMENT, OR UCC-1. This is a legal form that a creditor files to give notice that it has or may have an interest in the personal property of a debtor (a person who owes a debt to the creditor as typically specified in the agreement creating the debt). This form is filed in order to "perfect" a creditor's security interest by giving public notice that there is a right to take possession of and sell certain assets for repayment of a specific debt with a certain priority. Such notices of sale are often found in the local newspapers. Once the form has been filed, the creditor establishes a relative priority with other creditors of the debtor. This process is also called "perfecting the security interest" in the property, and this type of loan is a secured loan. A financing statement may also be filed in the real estate records by a lessor of fixtures to establish the priority of the lessor's rights against a holder of a mortgage or other lien on the real property. The creditor's rights against the debtor and the lessor's rights against the lessee are based on the credit documents and the lease, respectively, and not the financing statement.

The financing statement is generally filed with the office of the state secretary of state, in the state where the debtor is located – for an individual, the state where the debtor resides, for most kinds of business organizations the state of incorporation or organization. Many states have a state agency that operates under the secretary of state, which is tasked with overseeing business organizations and activities, including receipt of financing statements.

In the case of a loan secured by personal property collateral, the filing of a financing statement gives notice of a lien against the property so that other lenders or buyers of the personal property will know of the security interest. In the case of a filing of a financing statement by a lessor of fixtures, the filing of the financing statement gives notice of the lessor's interests to others who acquire an interest in the real property and related fixtures. The financing statement does not create a lien nor does it create any additional rights against a lessee in favor of a lessor, the filing of a financing statement just gives notice of whatever rights the creditor or lessor have under their loan documents or lease, respectively.

WATER AND SEWER. A tenant may pay for water as part of additional rent, but a failure of the landlord to pay the bill could result in a water shut-off that halts the laundry's business. A better situation is for the laundry to pay for water directly to the municipality under the terms of the lease. If one pays the bill through the landlord, one should ensure the landlord provides proof of payment at the time of payment. Moreover, a laundry should have its own dedicated water meter separate from adjacent businesses to ensure it pays only for the water it uses.

LEGAL REVIEW. As noted earlier, prospective tenants can tap any number of resources for counsel in negotiating a lease. However, before committing pen to paper to sign an agreement whose options typically span an entire generation, one would be negligent not to submit it first to a qualified commercial real estate attorney for final review.

VIOLATIONS/LITIGATION. As part of legal due diligence, a representing attorney should do a public records search to look for building violations, as well as a litigation search focusing on the landlord. Few prospective tenants would wish to enter a lease in a building that is under an existing stop work order, or one with a landlord whose property is in foreclosure.

TAX STOP CLAUSE. A tax stop clause is language in a lease that halts the escalation of tax expenses for either the landlord or the tenant. A lessee is advised to have a tenant tax stop in order to put an upper limit on the taxes the tenant must reimburse to a landlord under a net lease or triple-net lease. This can be of particular concern in the case of a landlord who makes improvements to the property that sharply increases the taxes on the rented space.

PERMITTING PERIOD. Obtaining required permits can take many months. Similar to agreeing on rent abatement (free rent) during a construction period, likewise a new laundry entering a lease needs to try to negotiate a long enough period of rent abatement—typically a period to follow receipt of all permits—to account for the time that has been spent waiting for all permits to be granted and received.

COST OF INFRASTRUCTURE OR STRUCTURAL BUILD-OUT. Failing to accurately verify the cost of making

major changes to the premises before signing a lease can prove fatal if the actual costs of the planned work, discovered after signing, prove to be too high. A laundry that plans major construction going into the venture should ensure that the lease contains a contingency clause that allows the tenant to get out of the lease if the cost of the proposed work is later found to be excessive.

OTHER CONSIDERATIONS. There are many other potential expenses to which a tenant might suddenly be exposed and/or for which the tenant might be held liable. A renter will want to make sure to be protected under the terms of the lease from any such unforeseen events or circumstances. Possible questions a tenant might want to explore prior to entering a lease include:

What happens if access to the business is obstructed, or parking space is suddenly restricted?

What happens if the premises are found to contain hazardous materials?

Who pays for accessibility alterations to the premises if the facility is found not to meet the requirements the under the Americans with Disabilities Act?

Language added to a lease can address these concerns. For example, prior to signing a lease, a tenant may want the landlord to include a specification in the lease attesting to the fact the property is ADA-compliant.

9 Options and extensions

What does one need to know about options and extensions?

An option to extend a lease is about more than both sides agreeing to extend the term of the occupant's tenancy. It is about the costs and conditions that apply to that extension. Considerations include:

NOTIFICATION

A lease should contain *clear deadlines for executing options, and for notification of intent to exercise an option*. A tenant should notify a landlord as far as possible in advance of his or her intention to exercise an option—and do so in writing via registered letter, rather than through a phone call or email, so the tenant has documentation that the landlord was notified in a timely manner.

TIMING

As has been discussed, it is important to nail down the terms of additional lease options as far ahead of time as possible to avoid surrendering one's negotiating leverage to the landlord. As an example, if the deadline to exercise a five-year option were approaching, one might want to begin negotiating an additional option at that time in order to keep 20 years on a lease.

ASSIGNABILITY

As noted earlier under Key Clauses, a prospective tenant must ensure that a lease is assignable in its entirety

to a third party in the event of a sale. As such, neither the lease nor any of its options must be “personal to the tenant,” that is, restricted to being exercised by the tenant alone. The laundry owner must have the right to convey all lease options to a new owner. (This is discussed more fully in the Assignment section below.)

INCREASES

Tenants typically aim for options with *prenegotiated* rents and increases, which serve them well as long as area rents are low, stable or rising, but which can be problematic should area rents fall. Landlords, on the other hand, are more likely to want to grant options that set rents at the *fair market value* that prevails at the time the option is exercised.

As noted in the **Rents** section of this paper, close attention must be paid to how increases are structured, both when negotiating the initial lease, and when hammering out new options as old ones are exercised. In the case of options, one has the advantage of a 10-, 15- or 20-year horizon at the time new options are negotiated either to come to a satisfactory agreement on future ones, or to make other arrangements.

10 Permitted uses

What is the preferred approach to permitted uses?

The simplest answer is: Go for broke. Go into negotiations asking for exclusive rights to any service one could reasonably—if even remotely—expect to offer. Then let the landlord take up the task of striking them out.

First-tier permitted uses would include:

- Self-service laundry
- Wash-dry-fold service
- Drop-off and full-service drycleaning
- Shoe repair (possibly).
- Detergent sales
- Snack and drink machines

Second-tier uses might include:

- Other vended products
- Automatic teller machines
- Video games
- Kiddie rides
- Game rooms/play rooms
- Exercise areas

Other permitted uses that a laundry may wish to press for include those which might also require rights to

sublet a portion of the leased space as kiosks for the provision of other services geared to the laundry's target demographic, which may comprise for example, a large foreign-born community. These might include:

- Check cashing
- Money orders
- Phone cards
- Tax preparation

Some laundries also have shared a laundry's leased space for things such as beauty salon services.

Of course, in the case of the many laundries located in shopping centers, the existence of competing co-tenants such as convenience stores, banks and arcades may preclude a landlord from approving some of these permitted uses, or at least exclusive rights to them. But it is nonetheless up to the landlord to strike these uses from the laundry's proposed lease, rather than the other way around.

OTHER CONSIDERATIONS

Aside for permitted uses, other things a laundry might ask for during the initial lease negotiation could include:

- Permission to operate on a 24-hour basis.
- Right of first refusal on spaces next to them, and the right to expand into that space.
- Dedicated parking if available.
- Specification forbidding rental of adjacent space to certain businesses such as bars, gyms, beauty parlors, whose business peaks during a laundry's peak after-work business hours.

11 Assignment

What does one need to know about lease transfer and assignment?

As has been discussed, in order to market and sell a laundry successfully and at a fair price, a laundry must have a lease that grants the tenant the right to transfer and assign the lease and all its options to the buyer.

But because laundries are bolted-down businesses which typically operate under long-term leases, landlords tend to attach a variety of qualifications to laundry leases to ensure that if the laundry is sold to a new owner, rent payments will continue unabated for the remaining term of the lease.

Many of those attached strings may complicate and slow the sale of the business, and make it more difficult for the original tenant to obtain a full release from obligations under the lease even after its assignment to the new owner.

LIABILITY

Generally, a standard lease contains language that specifies that when a tenant sells the business on the property, the seller is still contingently liable under the lease for continued payment of rent and other obligations.

As noted under the *Pitfalls* section above, the seller's way out is to obtain an *exculpation of personal guaranty* from the landlord which excuses the original tenant from liability once the lease is assigned to the new tenant. Such a provision—if agreed upon by the tenant and landlord—also may be written to grant the release of the lessee as guarantor only after the new tenant has paid the rent on time for a given period of time—two years, for example.

LANDLORD APPROVAL

Landlords typically include provisions that restrict the rights of a laundry owner to sell the business unless the landlord has approved the sale. These rights of approval generally are founded on some measure of the buyer's financial health.

For example, a lease provision may specify that the prospective buyer must have a net worth that is greater or equal to that of the tenant; or that it meet a certain threshold, such as \$500,000; and/or that the buyer must have a certain credit score.

For that reason, it is necessary for the tenant, on agreeing to such as lease, to ensure that the lease also contains language specifying that if those thresholds are met by the buyer, the landlord *may not unreasonably withhold* consent and impose other conditions.

OTHER CONDITIONS OF SALE

One emerging trend to beware of in leases is one under which the landlord include a clause which specifies that, upon assignment, the landlord will receive a *percentage of the seller's net proceeds as additional rent*.

Landlords also may impose *fees to assign or negotiate a new lease* at market rent that run into the thousands of dollars.

12 Value and selling price

How do lease terms affect the value of a laundry?

There is one main reason to care about the value of laundry—the price one can get when selling it to a buyer.

That's why one needs to go into a lease not only with an eye to operating the laundry profitably, but also with an eye to selling it at a fair price. For that reason, the terms of a lease should align with an exit strategy as well as an operating strategy. That means keeping the lease in attractive condition, and working to keep rents at a reasonable level.

THE BASIC PREMISE

As has been stressed throughout this paper, a self-service laundry literally is bolted to the floor. The cost of other investments in the business—such as leasehold improvements and hook-up fees—are already sunk into the property secured by the lease.

That's why long leases generally are preferred. A long lease assures a prospective buyer will have enough time to recoup his or her investment. Provided other factors are positive, the longer a buyer is guaranteed of earning income, the more valuable the laundry is. For that reason, most experts agree that the length and terms of the seller's lease—and how it compares to an industry standard lease—have an outsize influence on a laundry's value.

But valuation is still the sum of its parts. The importance of the lease in valuation must be weighed in relation to the other characteristics of the laundry. While it's probably the most important factor in calculating the *intrinsic value* of a laundry—which also includes equipment and the aforementioned leasehold improvements and hook-up fees—valuing by intrinsic value will result in a lower valuation than other methods that consider factors such as sales, income and return on investment.

KEY FACTORS

REMAINING LENGTH OF LEASE. The amount of time remaining on a lease, provided the lease can be conveyed from one leaseholder to another, typically is one of the more valuable assets of a laundry, particularly in areas with higher rents and greater competition.

But the importance of a long-term lease can be moderated by other factors. For example, a 20-year lease may be the gold standard, but it will have more value in a market with stable or improving customer demographics than in an area that is losing renters and/or undergoing gentrification, or in which a buyer might face growing competition from new laundries.

Nonetheless, a long lease provides a measure of certainty around which long-term plans can be laid for a business that is inextricably tied to a single location. For that reason, if nothing else, more than one industry veteran consulted for this paper indicated that “the lease is everything.”

BEST SCENARIO. Most industry experts would agree that for a laundry to be considered a marketable property, its lease should have a bare minimum of 10 or 12 years remaining, be assignable to the buyer, and feature options to renew at reasonable terms.

A well-priced lease with 15 or 20 years or more assignable years remaining will result in a higher valuation provided other valuation factors are positive as well. A laundry with a long-term lease also is more valuable in municipalities where permitting and constructing new laundries is limited by statute and/or very costly. A successful laundry with a long-term lease might command a premium in certain areas where hook-up fees are extremely high, for example.

On the other hand, leases shorter than 10 years may contribute little or even no value to the valuation—especially if the lease lacks other terms that are attractive to a prospective buyer.

RENT. The amount of rent a laundry pays—and the increases written into the lease—factor heavily into how much a seller can get for a laundry.

That's because in the resale market, cash flow is the key consideration in setting the purchase price. If a seller's rent is too high, it will reduce the laundry's cash flow and the sale price will be lower.

For example, one commonly used valuation scheme —*profit multiple* method—is based on the annual net income a laundry generates times a certain multiple. Depending on the market, the multiple used to set a laundry selling price may range from 3.5 to 5.5 times yearly net income. Because it accounts for expenses—including rent—this valuation method does a good job of reflecting the performance of a specific store. Clearly, a high rent that is over market rate can severely reduce a laundry's selling price that is calculated using this method.

OTHER FACTORS. As noted, considerations such as net income, age and condition of equipment, demographics and other factors are all critical to how much a laundry is worth. But their importance to value—and the laundry's ability to generate future income—may recede if the length, cost, terms and conditions of the lease are unsatisfactory. A bad lease can sink the enterprise, no matter how stellar the other characteristics are.

BOTTOM LINE

For all of these reasons, a laundry operator—from the time of the original lease negotiation through each successive exercised option—should negotiate with an eye to selling the business, even if there is no foreseeable intention to do so.

By maintaining the lease in good condition, one can enhance the possibility of selling the business more quickly if it becomes necessary to do so, and thereby help insulate oneself from unexpected events, such as an unanticipated change in finances, health or some other circumstance.

Conclusion

As has been demonstrated here, a well-negotiated, fairly priced lease is a foundational element of a successful laundry. It is a factor which in a wide range of circumstances has the ability to trump the importance of any other aspect of the business.

A good lease is critical to launching a successful laundry, maintaining its profitability throughout ownership, and establishing a good selling price when the time comes for an owner to move on.

That's the reason that a laundry owner never regrets having spent too much time examining, negotiating and maintaining a lease—only not spending enough time doing so.

[Editor's Note: The suggestions and guidelines within this white paper may or may not apply to your particular business situation. Therefore, it is strongly suggested that you consult your attorney before signing your lease or any other legally binding documents.]

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