

Franchise REAL ESTATE Insider

BEST PRACTICES FOR GROWING FRANCHISORS

ISSUE 1, VOLUME 1

SITE SELECTION

Bulls-Eye Strategies - by Scott Simcik



Site selection is the single largest contributing factor to the overall success or failure of a franchisee's business. It can also be a complicated time-consuming process regardless of the market size or how "good or bad" the local real estate market is.

Franchisees simply DO NOT possess the same required level of site selection experience (expertise), as the franchisor. Therefore, searching for the best location suited for your new franchisee is the franchisor's highest level of moral and operational responsibility. However, it is more common for new and emerging franchisors to place this critical function into the hands of inexperienced franchisees assigned to outsourced leasing agents and brokers on a market by market basis.

While there may be exceptions to every rule, this outsourcing method of assigning/outsourcing different local brokers in different markets, each with their own site selection strategies, results in a lack of consistent execution. It also means fewer location choices, lower-quality locations and major time delays. It is a major "hit and miss" risk of your franchisee's time and money.



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One Voice - One System





The Inside Story on Site Selection

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A franchisor with three to ten franchisees on the runway, each in different stages of site selection, drifting further and further away from success, can cause growing cultural, financial, operational and potential legal problems, not to mention sluggish royalty revenue ramp-up.

This outsourcing methodology can become a recipe for disaster for the following reasons:

1. Lack of Consistency

Without a franchisor knowing exactly in what cities or states your next 20 franchises will be sold, it is fair to assume the solution would be to identify and interview leasing agents within each market, and assign the agent to your new franchisee. A franchisor will assign 20 different leasing agents, all with varying levels of experience utilizing their own method of site selection practices. Your franchisees do not gain the consistent benefit of a highly standardized site selection strategy with an accountable checklist for systematic and managed execution.

Conversely, one approved Real Estate Management Services firm assigned to

each new franchisee will guarantee a consistent execution of your site selection processes, which will improve on each new assignment and yield better locations, a happier franchisee, and get keys in hand in half the current amount of time that it takes to secure locations.

2. The Financial Loss of Local Market Politics... Is Preventable

Local market politics can work against your franchisee and ultimately you as the franchisor. Operationally, you have turned your franchisee over to local market politics - brokers working for landlords. Generally, local leasing agents negotiate in favor of the local landlords. Your inexperienced franchisee has been assigned to a leasing agent who may be servicing 7-10 other local assignments that are ahead of your franchisee and within competitive industry segments that are also looking for a similar quality type of location.

The most commonly heard phrase is, *“I am waiting for the broker to get back to me,”* as your franchisee waits for weeks only to be positioned out of a location that they were led to believe was possible to secure. Remember that your franchisee is a “single limited as-

signment” to a local broker. This broker knows the flow of money and how he or she will be paid by the landlord based on many years of transactions. Their financial loyalty is first to the landlord, second to the local leasing agent politics, and third to your franchisee.

Knowing the local market should not be confused with the ethical responsibility of first protecting your franchisee’s best interest by shielding them from these friends taking care of friends tactics.

2a. Shortcut Tactics

Site Surveys, “walk-thru’s of properties performed consistently at the right time within the site selection process” represent the best opportunity for franchisees to strengthen their overall financial outcome before and during the early stages of the lease negotiation process. However, “shortcut” tactics by local leasing agents who have not been trained or held accountable on your floor planning, construction and design strategies and costs, combined with enthusiastic new franchisees, can cause major increases in start-up costs, thousands of dollars of loss in financial savings and much higher monthly rental costs.

2b. Bidding Up Is Unfair!

Bidding up your franchisee’s start-up and monthly rental costs is the most frequently abused practice within the dynamics of local market politics. There are varying levels of negotiating expertise.

While it may be an unfair comparison, a car salesman sells a car and a finance manager secures the financial expectations of the buyer while maximizing the profitability of the dealership. If your agent is tied up in local market politics and is an inexperienced negotiator, your franchisee may receive up to 50% less in potential financial savings. This is in addition to making a series of mistakes on the pre-Letter of Intent telephone



The Core-Four Process



conversations, Letter of Intent submission and counter-negotiations of the LOI.

Over 90% of your franchisee's financial savings are based on the level of experience of the leasing agent who is negotiating the term of the Letter of Intent. It is already too late to save your franchisees substantial amounts of money during the final contractual legal review of the landlord's lease. It is a highly suggested best practice to utilize one real estate firm with a centralized Licensed Senior Lease Negotiator who is highly trained on your unit-level economics and systematically negotiates on behalf of 100% of your new franchisees in order to maximize each of the core-four financial quadrants of your franchisee's lease.

2c. Construction and Conditional Use Permits (CUPS)

These permits represent the least amount of concern to the local market politics of landlords and commercial leasing agents. These municipal regulations slow down the negotiation process for leasing agents and landlords who are finalizing and executing leases. Their goal is to get leases executed as quickly as possible so that they can get paid by

the landlords. The less said to your franchisee, the quicker they get paid. It is easier to turn a "blind eye" or tell the franchisee that it is up to the local municipality. They will also be told that the landlord has no obligation to absorb the necessary time to allow your franchisee to pull their permit. This is simply not true, and if you as a franchisor do not have a system to "see and prevent" this from happening, your franchisee will pay rent for consecutive months without being open for business.

Site Selection: STRATEGY

Best Practices

1. It is crucial to recognize the importance of working with one Real Estate Management Services firm which manages and executes your site selection systems as a high performing sub-specialty within the commercial leasing process.
2. It is also important to partner with a firm that accesses and utilizes the most comprehensive demographics and mapping software - combined with a powerful commercial multiple listing database capability.
3. You must be willing to continually improve your current approach to site selection procedures to accelerate the amount of time that it is currently taking to secure locations and to get "keys in hand" for your franchisees.

Site Selection: EXECUTION

Best Practices

Group Zip Codes into Natural Trade Areas and identify the "epicenter" to position your franchisee's location to maximize the marketing and revenue potential within four trade quadrants, (North, South, East and West), avoiding secondary locations within transitional trade areas.

1. Research and maximize up to 15-20 vacancies within two or three natural trade areas depending on the market size.

2. Identify "pocket listings" before they are listed for lease and "ground-up" projects by working with 20 local brokers...not one local broker.

3. Identify "quiet turnover" spaces in fully leased shopping centers which are overlooked and available conversions, relocations, closures, evictions, or terminations.

4. Proactively create equal access to vacancies and utilize national private subscription based commercial multiple-listing databases, which include landlord contact lists, leasing agent and broker bulk emails, planning departments to capture 100% of the available retail inventory.

5. Promote high intensity franchisee "feet in the street" daily searches prior, during and after local searches and market visits are complete in order to capture the daily turnover of new spaces.

It is easy to conclude that outsourcing market by market to local brokers who are representing other landlords and clients in competitive industry segments simultaneously places your site selection strategy and execution into a secondary priority and status category. This critical path of internal systems must be executed consistently and swiftly on each new franchisee assignment, not on the whim of a non-vested broker who varies from market to market.

"It is crucial to recognize the importance of working with one Real Estate Management Services firm."



Lease Negotiation: The Real Truth

You've heard the old phrase "location, location, location." The real truth is **location, condition and cost**. *Location* affects the visibility, customer traffic and gross revenue. The *condition* of the property affects low to high start-up costs and protects budgeted working capital. *Cost* represents the monthly rent as a percentage of revenue and the profit/ loss of your franchisee's business.

Before a franchisor can begin to improve their overall "lease negotiation" systems, there must be an honest appraisal of the current lease negotiation practices. The following two questions will assist you in this appraisal.

1. Do you know in what specific Rural, Medium, Metro or Major Metropolitan Markets your next 20 franchises will be sold? Yes or No?

If the answer is NO, your franchise system will be dependent on 20 different negotiating commercial agents or brokers, each representing a different franchisee on a market by market basis. Regardless of the real estate firm size to represent your local franchisee, it is the individual broker's *experience* that generates the most profitable outcome for

your franchisee. If you as a franchisor have assigned multiple brokers in your past 20 locations, the next question you will need to ask is this:

2. Have these regional or state-by-state brokers been "Navy SEAL" trained on every detail of your industry segment, concept and unit-level business model? This includes site selection, lease negotiation, franchise agreement addendums, landlord legal review, permitting, and construction management process.

If the answer is NO, there is a major "gap" between your franchisor expectations, broker negotiation quality and the desired results that franchisees expect and deserve. Your franchisee doesn't know what they don't know and legitimately assumes that their assigned broker has been highly vetted and interviewed on their level of lease negotiation expertise. In fact, a franchisor may utilize a variety of brokers in different states, with varying experience in negotiations.

Generally, the results of the core-four financial quadrants will be up to 50% less than the franchisors and franchisees potential level of financial savings.

I. Landlord Structural Investment

Commercial leasing agents representing local franchisees will often take "short cuts," because they can, and because the franchisor has not implemented strict guidelines or procedures in the lease negotiation process. Local, regional and institutional landlords are allowed by brokers to sidestep up to 50% of their financial responsibilities in order to pay for demolition, raw, gray, or vanilla shell investments that return the property to a rentable condition.

II. Landlord Tenant Improvement Contribution

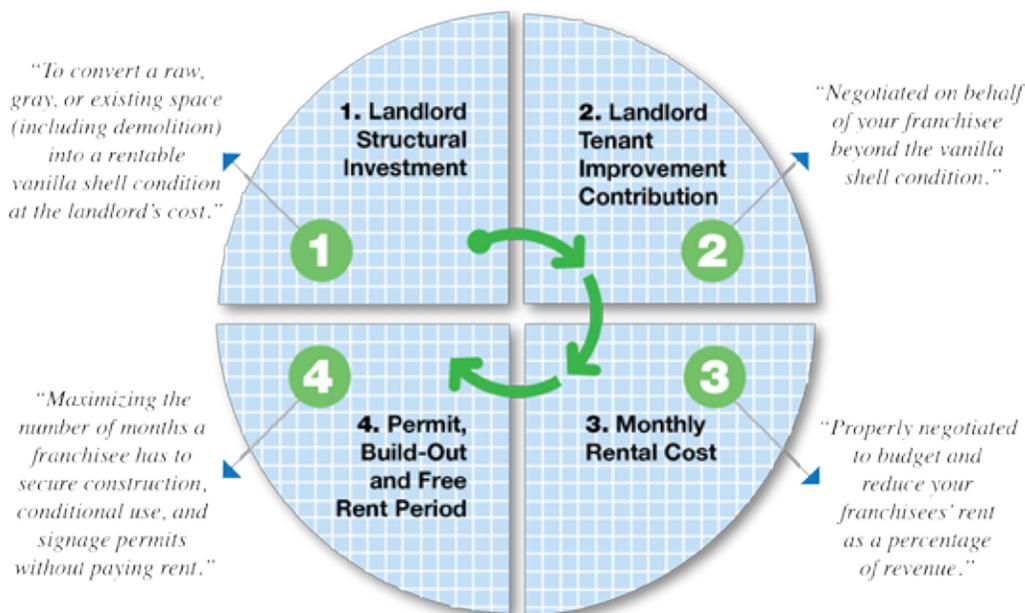
Because of the "short cuts" taken by these brokers, which franchisors and franchisees seldom identify due to the geographical distance, lack of supervision and franchisees' inexperience, tenant improvement dollars are not maximized on behalf of your franchisee. This can cause your franchisees' start-up costs to increase dramatically. If this is multiplied over 20 new franchise locations per year it can represent millions of dollars of additional costs for your franchise system. This creates an overall franchisee experience of investing more than they expected to open up their business. This situation can be avoided by improved lease negotiation techniques, systems and processes that are implemented at the appropriate time for each new franchisee location.

III. Monthly Rental Cost

FGP Commercial Leasing performed a system-wide audit on monthly rent and NNN as a percentage of revenue. We were NOT shocked to find a weighted average of over 15% monthly rent-to-sales ratio. Our audit concluded that there was a series of poor real estate strategies in combination with multiple regional and state by state real estate brokers that were inexperienced and untrained by the franchisor. The franchisor assumed that by outsourcing their real estate sites, they would eliminate these weaker and lower level of lease negotiations.



The Core-Four Lease Negotiation Process



Negotiated Financial Savings:	Average Range		
	Low	Medium	High
1. Landlord Structural Investment:	0 - As is	\$1,000 - \$30,000	\$31,000 - \$100,000
2. Landlord Tenant Improvement Contribution:	\$1,000 - \$10,000	\$11,000 - \$30,000	\$31,000 - \$100,000
3. Monthly Rental Cost: <small>(per-month savings based on 60 mos or 5-yr term)</small>	\$300 - \$18,000	\$500 - \$30,000	\$800 - \$48,000
4. Build-out & Free Rent Period: <small>(based on \$4,000 Rate per Month)</small>	\$8,000 = 2 months	\$16,000 = 4 months	\$24,000 = 6 months
Total Negotiated Savings	\$ 9,300 - \$36,000	\$29,500 - \$106,000	\$86,800 - \$272,000

Lease Provisions

- Lease Term
- Security Deposit (Refundable)
- Rental Abatement
- Permit Contingencies
- Eight (8) Early Termination Clauses
- Broker Commission
- Rental Rates
- Renewal Terms
- Tenant Improvements
- CAM/NNN
- Corporate Signature
- Parking Allowance
- Franchisor Addendum
- Personal Guarantee
- Lease Extension
- Sublease Assignment
- Signage Regulations
- Exclusivity

Franchisee Results: Franchisee benefits by reducing their start-up costs and preserving working capital that might otherwise be used on unforeseen start-up construction, permitting, rental, and asset costs.

FGP Core-Four Lease Negotiation: Requires our FGP Commercial Leasing Brokers to possess a high level of diagnostic reasoning skills and negotiating experience to consult, calculate, and manage the emotional and financial aspects to add the highest financial value to our franchisor and franchisee clients.

IV. Due Diligence, Permitting & Entitlements

The most secretly used strategy utilized by local brokers is harnessing “short cuts” to quickly get leases executed without protecting the franchisor and franchisee. It is necessary to understand the permitting process of local municipalities including time, cost, forms and factors, which contribute to the time it takes to secure the required conditional use permits (CUPS). These broker induced “short cuts” can cause major delays, legal issues and added costs. As a result, franchisees may be paying premature monthly rent over several months even though the business is not yet in operation.

The core-four financial quadrants discussed above each require separate financial goals and high level negotiation skill sets. They are interrelated and will substantially reduce your franchisee’s start-up costs, accelerate the break-even points, protect early working capital and, most importantly result in a monthly rental cost which protects the low and high franchisee revenues and profitability. High-performing locations and operators with a lower rent-to-sales ratio do not feel the financial pain of a poorly negotiated lease.

When negotiating a lease, most franchisees focus on the rent as their primary issue. However, the basic or minimum rent paid by a franchisee is just one of

the many costs and risks under a lease that must be understood and carefully negotiated. In fact, the numerous provisions listed above can exceed the risk and expense of basic rental costs, if they are not properly negotiated at the outset.

A competent real estate broker will be generally knowledgeable with these provisions. However, it is our experience that only the very best can provide a thorough explanation of both the landlord and franchisee considerations when negotiating a commercial lease.

CKO Kickboxing - Grand Opening: *Charlotte, North Carolina*



Bob & Scott,

I was out in Charlotte last weekend and wanted to tell you guys, you hit a home run with Amy & Danny's location.

It's a great space and the market has received our business better than could be expected. They are opening tomorrow morning and to date, they've shattered the company's pre-sale memberships record.

I know how hard Bob has worked on our deals and wanted you to both know it's very much appreciated. Thanks,

Rich Rosso

Chief Operating Officer, CKO Kickboxing

Bob,

As Brenton and I prepare to read and plan out the action items within our executed lease, we would be remiss if we did not send you a note of the deepest thanks and gratitude. From our first meeting all the way to the final signing, you were nothing but the most professional and considerate agent, adviser

and many times a calm voice in an otherwise chaotic situation. I know that I require more time than most on wanting to understand all aspects of the business transaction as well as the desire for continuous follow up. Bob, you truly went above and beyond in this regard. Every phone call, email, text message, the hours worked, the in person meetings and numerous extensive explanations did not go unnoticed and words do not do justice in expressing how grateful we are. In a business where there is at times a lack of service or regard for the actual person and family making such a big decision affecting their entire livelihood moving forward, you are an example of everything that someone in your profession should strive to emulate. We could not have found such an amazing location for our new business or felt fully secure during the negotiation process were it not for you and your utmost skill, attention to detail and genuine care for your client. You are one of a kind, Bob, and we feel blessed to have been able to work with you during this process. We hope to see you at the grand opening of CKO Kickboxing!

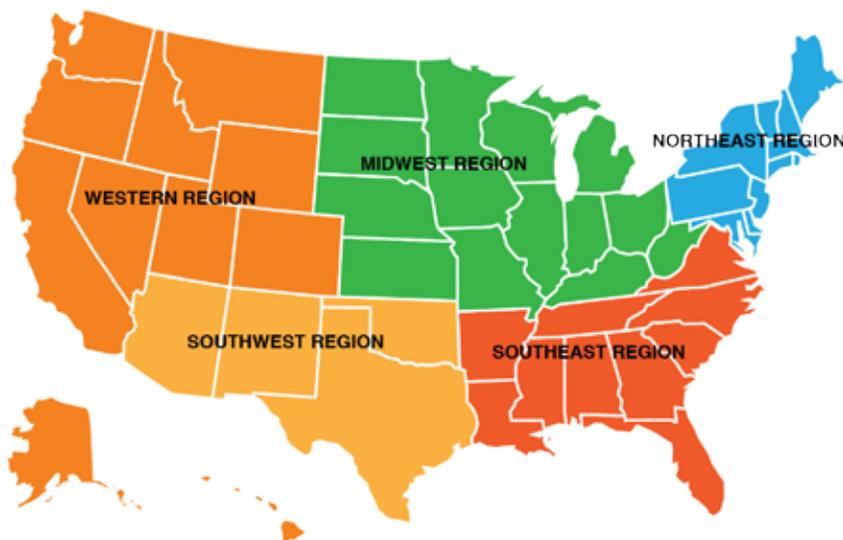
Sincerely,

Brenton & Bonnie Danieli



www.fgpcl.com 800.471.1682

A partnership with FGP Commercial Leasing will allow you to grow your brand in all 50 states with your own Franchise Real Estate team. Successful execution of your Real Estate strategy requires a customized system, a highly trained and unified team operating with “one voice and one system” - delivering standardized Site Selection, Lease Negotiation and Legal Review for each new franchisee location.



THE POWER OF YOUR REAL ESTATE TEAM...ONE VOICE - ONE SYSTEM



Scott Simcik
President | Leasing



Jenna Crain
Executive Assistant



Bob Misko
Senior Vice President | Leasing



Carl Schroeder
Vice President
Market Intelligence



Lloyd Werthheimer
Vice President | Leasing



Linnard Lane
Vice President | Leasing



Cameron Blourchi
Vice President | Leasing



Deborah Kerr
Director | Due Diligence
& Entitlements



Chad Finkelstein
Real Estate Attorney



Steven Eichberg
Real Estate Attorney

OUR REAL ESTATE MANAGEMENT SERVICES & RESOURCES

SITE SELECTION

- Real Estate Strategy
- Mapping & Demographics
- Trade Area Definition
- Location Acquisition

LEASE NEGOTIATION

- Pre-LOI Negotiations
- Letter of Intent
- Tenant/Landlord Work Letter
- Site Survey & Permits/Entitlements

LEGAL REVIEW

- Engagement Letter
- Legal Review
- Franchisor Addendum
- Lease Review Comments

CONSTRUCTION MANAGEMENT

- Planning Stage
- Pre-Construction Stage
- Construction and Delivery Stage
- Close-Out/Certificate of Occupancy





Commercial Leasing
Franchise Real Estate Services



Corporate Headquarters

3625 E. Thousand Oaks Blvd, Suite 228
Westlake Village, CA 91361

Corporate License ID 01906857

**Our Real Estate Management
Services & Resources**

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Your Strategic Partner in Commercial Leasing

FGP Commercial Leasing has revolutionized the Franchise Industry with a simple idea!

We provide comprehensive all-in-one Real Estate Management Services including Site Selection, Lease Negotiation, and Legal Review in all 50 states.

Learn more by scheduling a 1-hour presentation, or speak with a **FGP Commercial Leasing** representative.

■ **Visit www.fgpcl.com for more information**

■ **Call 800.471.1682**

■ **Email info@fgpcl.com**

