

If you have not reviewed your lease in detail, you need to do it now!

We just completed the sale of a small manufacturing company whose 10,000 sq. ft. lease was about to expire, and the rent was increasing from \$6.00 per sq. ft. to \$13.50 per sq. ft. **The annual base rent increased by \$75,000 and the value of the business dropped by almost \$400,000.**

When someone is looking to buy or start a business, they are looking for three things:

1. Sustainability
2. Profitability
3. Growth

When selling a business that operates under a lease agreement there are many critical considerations that both the buyer and the seller should be aware of. When reviewing your lease, there are several key points to look for:

- **Expiry date:** How much time is left on the lease? If the time to expiry is relatively short, it may affect the value of the business. Most buyers will want an assurance of sustainability and do not want to renegotiate a lease or relocate the business.
- **Right to extend or renew:** Are there any lease renewal options in the current lease? Most buyers want an assurance of a minimum of 5 to 7 years.
- **Reasonable “right to assign”:** Does the lease allow for assignability to the buyer with the same terms? Does the landlord have the right to approve or reject the buyer? Will the seller remain on the lease, effectively as a guarantor of future payments?
- **Costs to renew:** Are there any renewal fees?
- **Uses of the property.** As our world changes, so do businesses and perhaps your lease contains usage permissions. If your business is changing, you need to be sure that the business use in the future is permitted by the lease.
- **Demolition clause:** A demolition clause gives a landlord the right to evict a tenant if they decide to demolish, redevelop, or renovate the space being rented. Demolition clauses are included in many leases. They are showing up in almost all lease renewals and extensions across the nation.

A lease also plays an important role in bank financing. Banks will only extend financing to the extent the business has unfettered occupancy. The standard for lease renewals that banks feel comfortable with is a term of 5 to 7 years or longer.

For example, if you have a 10-year lease, but a demolition clause can be invoked after 3 to 5 years, the bank may only consider a portion of the 10-year term to be sustainable. Therefore, they may only finance a portion of the appraised value. As such, the seller is often expected or required to provide financing subordinated to the bank's financing.

We had another client with a ten-year lease that was about to expire and the landlord wanted to sell the property. The client had invested over \$3,000,000 in leasehold improvements to the 15,000 sq. ft. space over the past ten years. According to the terms of the lease, these improvements were non-transferable and cannot be moved by the tenant. They must remain with the property once the lease expires. The price the landlord wanted for the real estate was \$1,500,000 over an independent appraiser's value. We were able to negotiate a new 5-year lease with only a 35% rental increase. The rule here is: **if you need to spend excessively on leasehold improvements, then buy the building!**

If the lease terms are pending or immediate (within the next 2 years) the business owner needs to approach the landlord to ensure a new lease or options are available for a new owner to allow a smooth transition of the business.

Bottom Line

When developing an exit strategy, the owner needs to put themselves in the buyers' position and think about:

- Can the buyer do with the business what he'd like to do?
- Can the buyer work within the terms of the lease?
- Is that going to be acceptable to a buyer?

These are reasons why you need to start thinking about your exit at least 3 to 5 years in advance. This should provide sufficient time to put the lease in a favourable position, or to consider moving to new premises with a long-term lease, or better still, even buying a property. *I have always maintained that if you can afford the rent, you can most likely afford to pay the mortgage.*

About the Author



Doug Robbins, President & Founder of Robbinex Inc.

Doug is an internationally renowned Canadian Business Intermediary and Business Broker. He is a seasoned businessman having completed more than 1,500 assignments relating to advising clients on Mergers and Acquisitions (M&A); valuations; transferring businesses to the next generation; partnership resolutions; refinancing; along with numerous other consulting activities.

Doug has always actively supported the M&A profession through investing significant time and energy by way of memberships, lecturing, and presenting workshops for numerous M&A organizations.

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