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## Franchisees-Is Now The Time To Sell Your Real Estate?

The American economy is currently seeing high prices for acquiring operating franchise units and real property interest rates are low. Is this the time to hang on to your real property assets or is it time to turn those real property assets into available cash? This is a question that many franchisees are facing. The prospect of cashing out those real property assets is enticing.

Maybe not. Here are a few reasons not to sell:

- Real Property Appreciation – A fast food franchise usually has a life of 20 years. At the end of the 20 years, the franchise ends, unless a new term is approved by the franchisor. The closer you get to the end of the 20 years, the less valuable your franchise is to a prospective buyer. However, the real property upon which the operating franchise sits historically increases in value by 2% to 3% each year. So, for the successful franchisee, the operating franchise business is essentially a “cash machine” allowing the franchisee to live the lifestyle he/she wants to live (the more franchise locations the more cash flow generated). As debt is paid down on the real property each year and the value of the real property increases, at the end of the 20-year franchise life, it will have become substantially more

valuable and the debt will have been retired. The value of the real property creates generational wealth that is attractive to many.

- Flexibility – Any given franchise concept’s popularity tends to rise and fall over time. If a franchisee leases its real property from a third party, the rent will be set forth in the lease. When times are tough for the franchise concept, the franchisee will have a difficult time negotiating new terms with its landlord. However, if the franchisee or a related entity owns the real property, it can easily adjust the amount of rent to reduce the rental burden on the operating entity during periods of time when the franchise concept might be struggling. If the franchisee is charged rent of 8.5% by its related landlord and the related landlord borrowed money at 6%, the related landlord can afford to reduce the rent while the concept is struggling (in this example by 2.5%) and still be able to make payments to its lender. This rent reduction will be very helpful to the operating franchisee.
- Financing Leverage – Conventional lenders like real property. While there are many active conventional lenders in the franchise world today, if the franchisee/borrower has real property to pledge as collateral and is not looking for financing primarily based on cash flow alone, it makes it much easier to obtain credit, and the credit will be available on better terms than if cash flow is the only source of repayment (as opposed to having the real property as collateral too). When real property is available, lenders will consider generous development lines which is likely to make it easier for a franchisee to continue expansion. If business is good and there is excess cash flow, the franchisee/borrower can utilize the extra cash flow to pay down the real property loans faster or use the cash as additional revenue sources for expansion.
- Franchisee Leverage – Franchise agreements are drafted in favor of the franchisor, not the franchisee. Franchisee ownership of its real property in

many cases will provide leverage over a franchisor that is acting unreasonably.