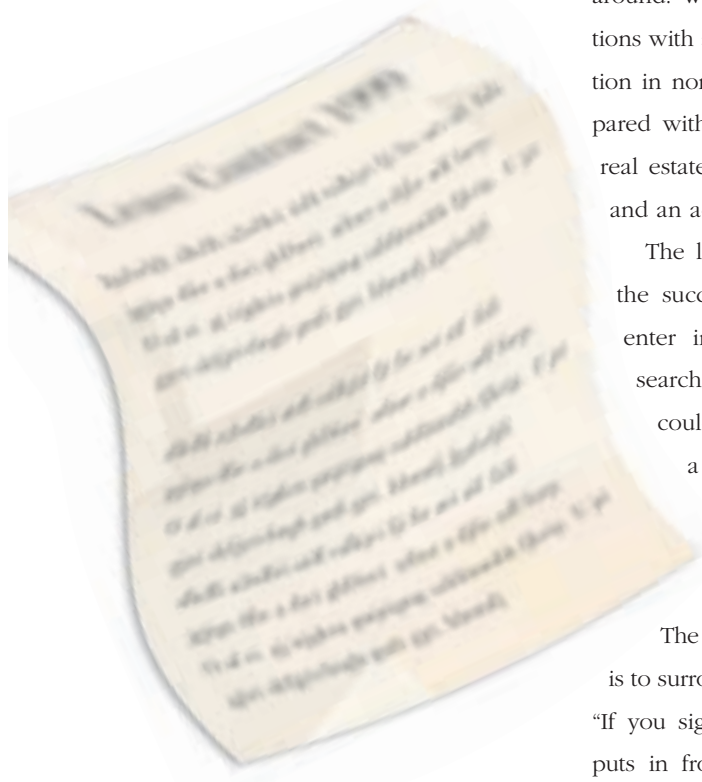


BEFORE YOU SIGN, PART II

*How well you negotiate the lease will
determine your future prosperity.*

BY **A n d r e a S e r c u**

Seven years ago, Katinka Allan, owner of Natural Beauty in Santa Clarita, California, showed up alone at the bargaining table to close the lease on a piece of property for her spa. She had assumed a lease in her first space and figured that her experience—with a little last-minute advice from her accountant—was all she needed to secure a longterm home for her spa. But the landlord of the strip mall ended up declaring bankruptcy and the center's grounds went largely to seed. A real estate agent might have foreseen the problem before the lease was signed.



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Allan played it smart the second time around: When she entered into negotiations with a major development corporation in north Los Angeles, she was prepared with the advice of a commercial real estate agent, a real estate attorney and an accountant.

The lease that you sign will affect the success of your day spa. If you enter into negotiations without researching basic lease options, you could end up stuck for years with a lease that will drain the profits out of your business.

THE RIGHT ADVICE

The first step in lease negotiations is to surround yourself with expert help. “If you sign the lease that the landlord puts in front of you without obtaining proper legal advice, you’re putting your business in jeopardy because the lease will be completely one-sided—I guarantee it,” says Charlie Slater, president of Spa Central Spa Planning & Development in Bloomington, Minnesota.

According to Slater, a typical lease will contain 40 to 100 questionable points that will need to be negotiated by both parties. “These points might include something seemingly small, like a clause that the tenant will pay taxes and insurance based on the occupancy of the building or center, but you may get stuck with huge payments if the adjacent properties go vacant.”

Slater recommends negotiating the finer points such as parking and signage by yourself, then allowing an attorney to read the fine print and counsel you on the broader, more significant issues. He also suggests raising objections on a few minor points as “negotiating coins” that can be sacrificed to gain advantage on

issues that are more important to you.

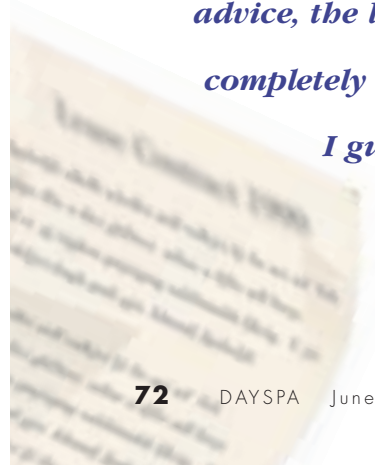
One of the most challenging issues you’ll face is determining the length of your lease. Most consultants recommend a five-year lease with options for renewal, but others advise standing firm for a lease that covers no fewer than 10 years. “In our business, plumbing costs so much that you have to have a long lease,” says Richard Calcasola, president of Maximus Salons/Day Spas in New York City. “It will take a new spa three years to really make money, and you’ll want to roll with it for a while. Ten years is good; 15 years is better.”

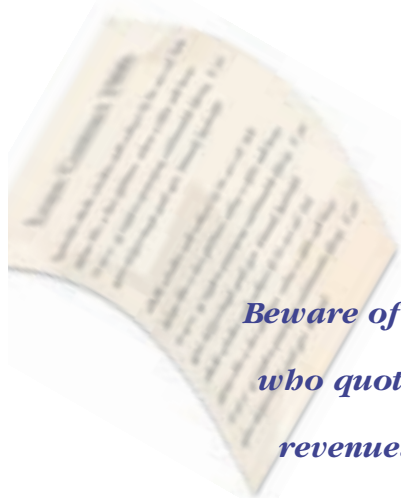
Peter de Caprio, owner of Noëlle spa in Stamford, Connecticut, suggests getting as many options to renew the lease at the end of the term as possible. He negotiated a 10-year lease with four five-year options for Noëlle, and notes that options can sometimes give you better bargaining power with a landlord because they demonstrate a desire to stay in the space long term.

Michael Coe, co-owner and vice-president of Gene Juarez Salons & Spas, Seattle, Washington, is always thinking of expansion possibilities when he negotiates regional mall space. He often takes options on adjacent space within a 10-year lease, and can sometimes influence the landlord to write shorter leases on neighboring tenants.

THE RIGHT PRICE

As a rule, the larger the space and the longer the lease term, the less you’ll pay per square foot. If you lease 500 square feet in a regional mall, for example, you could pay as much as \$40 per square foot. By leasing 5,000 square feet in the same mall, you may be able to decrease that rate to \$28, says Coe. Allan believes






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that proposing a 10-year lease with a five-year option prompted the management company to take her more seriously, allowing her more free initial rent, tenant improvement dollars and a lower rent on her 4,000-square-foot space.

The market and the location will largely dictate your rent. A good real estate appraiser can help you determine a price that's fair, or you can talk with other tenants to find out how much they're paying. Slater suggests comparing the amount you expect to make per square foot with the amount you'll pay in rent to ensure you'll make money in your location.



When researching a location's cost, beware of landlords who quote possible revenues for your spa based on figures from retail tenants. "If a landlord quotes you \$20 a square foot for rent, saying that everyone else in the center is doing \$100 a square foot in revenue, he's comparing apples to oranges," says Mark Donovan, president of Annex Salon Consulting Group in Guilford, Connecticut. "Spas aren't retail stores; your income isn't based on how much inventory you can cram into your space."

Check your lease carefully for rent increase language, says Donovan. An increase during the term is usually adjusted to the Consumer Price Index and can hit you with an unexpected rate hike. He advises fixing the price for the life of the lease. Douglas Preston of Preston Wynne Success Systems in Saratoga, California, agrees, noting that you might suggest a fair increase at the time of renewal—perhaps 5% or 7%, to follow the inflation rate.

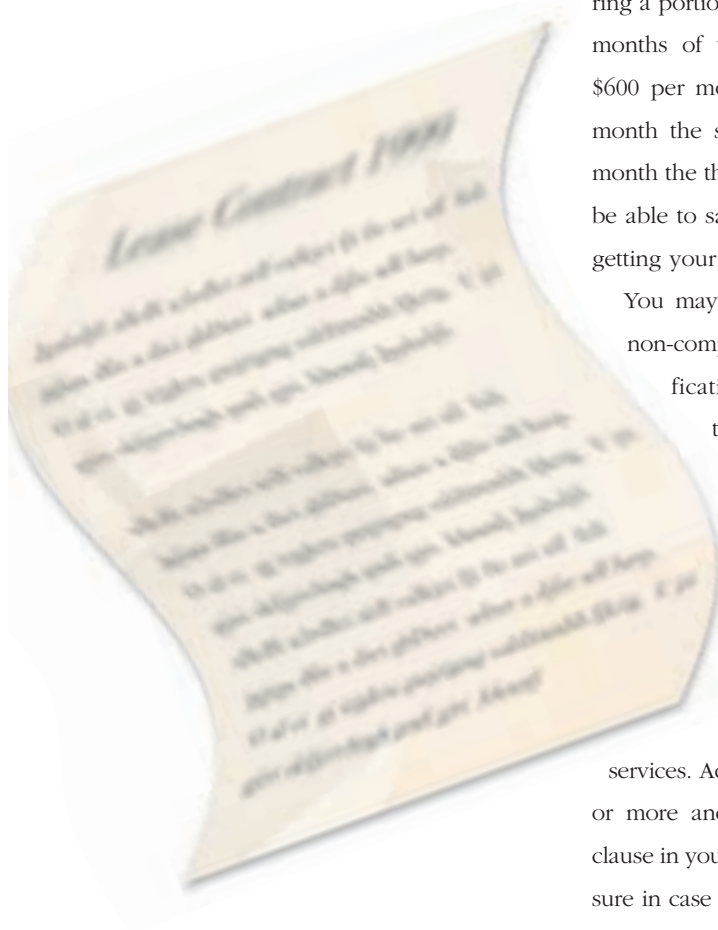
There are additional costs you must be aware of before signing a lease. Regional mall space

and high-demand markets, such as Beverly Hills and Manhattan, are among the most expensive locations because landlords typically charge a percentage of your gross revenue—anywhere from 6% to 12% after your business has cleared a specified profit. For instance, your lease may stipulate that you owe \$10 per square foot initially, but after you've made \$300,000 in gross sales, you'll owe 6% of every revenue dollar or \$10 per square foot—whichever is higher. Unfortunately, this means that just as your business begins to make money, the landlord will take a bigger cut. Landlords often justify gross percentage rates by citing the added wear on their property and the role they've played in your success by bringing anchor businesses to the center. "It turns a fixed cost into a variable, which isn't good for your business," says Donovan.

There are ways to counter a gross percentage rate. Slater suggests raising the break-even point at which the percentage kicks in, explaining to the landlord that your business thrives on services with lower gross profit yields than retail. You can also try to lower the percentage; if the landlord balks, stress your long-term stability. "You want the highest threshold before the gross percentage starts, saving you hundreds of thousands of dollars over the term of the lease," he says.

On top of percentage rent, regional mall landlords often charge Triple Net expenses, which include common area maintenance (CAM) charges, taxes and insurance. Some landlords will agree to pay for water—a bonus for a spa business—but usually this charge falls under the Triple Net payments. CAM charges cover grounds-keeping expenses such as snow removal and landscaping and can

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range from a few dollars per square foot to \$30 or more, with no cap.

Some high-end markets, such as Beverly Hills' Rodeo Drive, may charge additional "key money," a gratuity that can run as high as \$250,000. This fee basically gives precedence to the tenant to lease space that's in high demand.

MAKING ALLOWANCES

Landlords can and do make allowances, especially to businesses they perceive as long-term, stable renters. You may be able to ask for several months of free or deferred rent, says Donovan. By deferring a portion of your rent to the last few months of your lease—you might pay \$600 per month the first year, \$800 per month the second year and \$1,000 per month the third year, for example—you'll be able to save more working capital for getting your business started.

You may also be able to negotiate a non-compete clause and advance notification of a sale of the property. Slater suggests spelling out the terms of a non-compete clause to prohibit the landlord from leasing neighboring spots to businesses that derive more than 20% of revenue from competing products or services. Advance notification of 90 days or more and an escape or transference clause in your lease can help remove pressure in case of financial duress.

In newer strip malls where the space is basically a plain shell, landlords are particularly open to building out the property for prospective spa tenants. Plumbing, one of the most expensive areas to finance, is a great place to focus, says Woody Yowler of Spa Visions in Swedesboro, New Jersey.

You should insist when you negotiate your lease, however, that the landlord cover any necessary code upgrades, such as Americans With Disabilities remodeling and asbestos removal.

Tenant improvement (TI) money is key to building out a new location and expanding an existing one. TI dollars can range from an average of \$25 per square foot to as high as \$120 per square foot, although, according to Preston, many landlords who allow TI dollars will require a longer lease term and will sometimes raise the rent. Occasionally, a landlord will offer rent credit in lieu of TI money, but rent credit is cheaper for the landlord, so you may want to negotiate an increase in the amount of rent credit offered.

TI dollars are usually used for expenses such as new wall construction, ceilings, doors and plumbing or electrical work. Calcosola suggests using TI money only for construction and improvement purposes. "You don't want to ask for TI money for decorative stuff, like marble and gold leaf. A landlord won't understand the importance of these things to a spa," he explains.

If your lease includes options, you should negotiate new TI dollars when it's time to renew. "An option is basically a second lease, so you should ask for another remodeling allowance," says Slater. "Opportunities get missed because so many people forget to ask for that money."

Savvy consultants and day spa owners also insist that landlords pick up the tab on large utility equipment. Coe believes that it's the landlord's responsibility to bring utilities to the space, although he notes that the point may be easier to make if you're paying a gross percentage rate. In his last lease negotiation, Coe demanded that the landlord pay for a

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heating, ventilation and air-conditioning (HVAC) system while the spa paid the much smaller ducting bill.

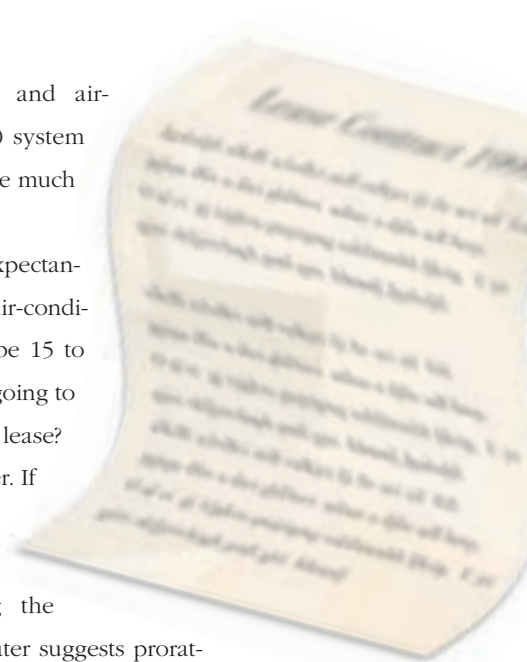
“What’s the life expectancy of a heating and air-conditioning system? Maybe 15 to 20 years. But who’s going to sign a 15- or 20-year lease? Not many,” says Slater. If a large utility should break and need replacement during the

course of a lease, Slater suggests prorating the cost by dividing the life expectancy of the equipment by the remaining years on the lease.

Protection for yourself and your business is an important consideration. Calcasola highly recommends demanding that you be named as a tenant on the landlord’s liability insurance to protect your business in the event a client slips and falls outside your spa. The landlord will probably require the same protection from you for anything that may happen inside your walls, short of the roof falling in.

Calcasola also suggests avoiding personal liability by signing the lease as a corporation to prevent the landlord from attacking your personal assets if there’s a problem—a likely event if you’re a new spa owner because most landlords prefer first-time business owners to use their personal assets as a guarantee. You can prove you’re a good risk by showing demographic studies and architectural renderings, explaining your familiarity with the location and business.

If that doesn’t work, try to negotiate partial liability, making you personally responsible only for the lease’s first year, says Calcasola. “Save this piece of negotiation until all the other issues have been resolved,” he says. “After the landlord has negotiated this far with you, he’ll be more inclined to go along with this request.” And in the end, you’re not only shopping for a property; you’re shopping for a landlord who will work with you to help your business succeed. ♣



Andrea Sercu is a *DAYSPA* contributing editor.