

Real Estate Issues for Franchisors

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**Collaborative. Accountable. Authentic.
Legal Solutions for Business Objectives.**





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Today's Topics

- Key Lease Provisions of Interest to Franchisors
- The Franchise Agreement and the Franchisor's Lease Rider
- Enforcement of Franchisor Rights/Lender Considerations

Key Lease Provisions of Interest to Franchisors

Use Clause

- Broad – “the premises may be used for any use permitted by applicable law”
- Narrow – “the premises may be used only and exclusively for the sale of red shoes.”
- Franchisor typically prefers a narrow use clause while franchisee may want something with more flexibility
- Be careful not to be overly restrictive - “including such products or services that are being offered by the franchise system from time to time”
- Continuous Operations – Franchisor and Landlord want continuous operations clause (subject to temporary closures) to maximize traffic to the site and center
- Avoid “go dark” clauses

Radius Restrictions

- Purpose – avoid nearby alternatives diluting business
- Important to Landlord where percentage rent involved
- What's the right distance?
- How is a violation defined – Same concept? Same owner?
- Maintain flexibility for Franchisor and franchised system

Exclusive Use

- Helps franchise to avoid competition in the center
- Concept specific – the only insurance company or financial institution in the center
- Product specific – list products no one else can sell
 - Be careful to allow for product expansion
- Beware of existing prohibited uses
- Remedies for landlord's breach of exclusive use clause

Trade Marks, Signage, Improvements

- Landlord Approvals
- Center limitations
- Governmental Approvals

Rights to Remodel

- Future Improvements pre-approved or clear process
- Match up with Franchise Agreement requirements
- Landlord Perspective – review and approval rights, but won't unreasonably withhold consent if consistent with improvements of similar franchised locations

Other significant provisions

- Term of the Lease
- Nondisturbance
- Lease Amendments
- Site Selection

The Franchise Agreement and the Franchisor's Lease Rider

The Franchise Agreement

- The triangulation of Landlord, Franchisee and Franchisor – balancing act
- Approval of Real Estate (lease and its term, other tenants, the Site and its parking, traffic patterns, visibility, access) – consistent expirations, different processes for review
- Development Timeline and Opening – be specific, but realistic
- Cross Default with Lease – a breach of the lease is a breach of both agreements / franchisor's remedies (if franchisor is the landlord, note the state relationship laws)
- No Guarantees of Franchisor of Success or Revenue – we approve the site, but...
- Same Legal Entities: franchisee and tenant, especially when the franchisor is the landlord
- Related Issues – approved vendors (e.g., construction, real estate broker, lawyer), local zoning issues, signage permits, and obtain lien waivers from contractors and subs

“The Franchisee is responsible for the development and construction of the Premises, and for opening the business at the Premises.”

Franchisor's Lease Rider

- Franchisor's Approval of the Lease Agreement – thus, this Rider!
- The Delivery Date - Specific Requirements and Deadline
- The Delivery Date's sibling: the Rent Commencement Date – starting the clock, avoid hard dates
- Repairs and Maintenance Obligations – obligations apart from CAM of structural elements, foundation, floor slab, roof structure and roof membrane
- Franchisor's Notice and Cure Rights – optional, receive notice, additional cure period, turf war
- “Approved” Assignment to Franchisor (and Future Franchisees) – cost? approval / consent? release? assist the landlord find tenant
- Assumption Upon the Expiration or Termination of the Franchise Agreement – notice and option to assume if strong site
- Access During and After the Term – ensure compliance with franchise agreement, protect the system, remove trade dress + equipment (e.g., Coke fountain), and surrender (no welding!)
- The Rider Trumps the Lease Agreement – or, “organ transplant”

“The Delivery Date is the date of this Lease [or the Commencement Date].”

Enforcement of Franchisor Rights/ Lender Considerations

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- Simultaneous default notice requirements
 - Consider requiring both Landlord and Franchisee to provide written notice of a tenant-default
- Additional days to cure and simultaneous tolling of cure periods
 - Tenants typically have 0-5 days to cure monetary defaults and 30 days to cure non-monetary defaults
- Franchisor entry rights; de-imaging the premises
- Franchise Agreement assignment requirements and permitted assignment rights in the Lease
 - Right of first refusal to assume the lease (Franchise Agreement); Permitted assignment to Franchisor (Lease)
 - Be cautious of assuming past liabilities and ongoing tenant obligations; partial performance
- Landlord is NOT a party to the Franchise Agreement; Franchisee as a landlord
- Franchisor as Landlord and cross-default

Enforcement of Franchisor Rights/Lender Considerations

- Landlord lien rights to franchisee-tenant's goods, equipment, fixtures, etc.
 - State-specific statutory rights
- Franchisee-tenant lending agreements
 - Security interests in franchisee-tenant's leasehold estate; assignment of leases
 - Priority rights
- Landlord's lien v. Franchisor's lien v. Franchisee's lender's lien
 - Importance of subordination

Q&A

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