Franchise Times®

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Study closely

How creative franchises are securing 'situational financing'

By Dennis Monroe

In today's tight financing market for franchise businesses, it is key for us to share our success stories and help each other find financing.

This column discusses three actual situations where a franchise business was able to secure financing.

Case Study 1

The first case study is a fairly straightforward approach, but does have a number of unique twists. A franchise concept desired to locate on an end cap of a strip center. The space was previously occupied by a national concept that had decided to pull out of the area. The franchise concept was new to the city so they wanted a strong visible location. For purpose of visibility, as soon as construction began, this concept put up a creative, clever pylon sign, which elicited a lot of consumer interest prior to the store's opening.

As to the financing, the landlord was unwilling to provide any leasehold allowances because it did not have the resources and had issues with its bank. The franchise concept effectively negotiated a very low rent rate that included a reasonable percentage rent at high volumes. The percentage rent was 5 percent of gross sales over a level where the franchisee would generate a substantial operating profit. Also negotiated in the lease was a ceiling on common area maintenance costs, a right to additional space, as well as construction of certain outside signage.

The financing was a combination of three elements:

A. Because the rent was so low, the company was able to secure $1 million of bank financing with a bank that was located close to the site and was familiar with the neighborhood. The financing did require personal guaranties. The bank was willing to do the financing, in part, because there was a 30-month amortization so the loan would be paid off quickly. The proformas given to the bank reflected a reasonably strong fixed charge coverage ratio.

B. The franchisees secured an equipment-leasing package for the furniture, fixtures and equipment (FF&E) which also utilized a fast 30-month pay off.

C. The owners had a reasonable (but not excessive) amount of equity in the transaction that covered the start up and soft costs for the project.

If you can secure low occupancy costs, this opens the door for other financing and provides a cash flow cushion and the ability to use fast pay downs.

Case Study 2

This case study is the exact opposite of the first case study. This franchise concept was capital intensive and required a very high level of leasehold improvements. The concept also required a substantial amount of FF&E. The site was very high profile and the owner of the property was anxious to get this concept into the space because the landlord knew it would drive other potential retail tenants to the center.

The franchisee negotiated a significant leasehold allowance and, in addition, secured a $2 million leasehold improvement loan from the landlord. The loan provided for a 10-year amortization with a fairly low interest rate. Also, there was rent reduction for a period of two years. However, the landlord's contribution was not enough to get the project completed. There was a need for FF&E financing which was done through a traditional equipment lease utilizing a bank leasing company with lower rates than a normal third party leasing company. Again, the lease was on a fairly short-term basis (48 months).

Additionally, the operator supplied approximately $500,000 of equity and a private individual investor provided $1 million of capital needs under a high yield loan. The loan was at 12 percent interest, with a two-year interest only and then a six-year amortization. What made this deal so attractive to the outside investor was the concept's incredible high volume, high cash flow and a demonstrated strong fixed charge coverage.

As to the investor debt and equipment leasing, there were personal guaranties by the franchisee. There were no personal guaranties on the lease.

It should be noted this concept is doing

> **"In this market, sharing success stories is key."**

extremely well. Cash flow and sales are exceeding what was projected.

Case Study 3

This case study is about a franchise concept that went into an urban strip center. The vacant site was a restaurant site for 20 years and had not been improved for at least 10 years. The center was owned by a prominent family, and this family was interested in securing a strong, national concept for the space.

The first thing that was negotiated was the lease with, again, a fairly low rent factor. There was a $400,000 leasehold allowance and a $600,000 leasehold loan. The loan provided for payment based on cash flow from the business.

A related party to the landlord approached the franchisee with a desire to invest equity under a joint venture. The joint venture provided that the investor would put in 60 percent of the required equity and the franchisee put in the remaining 40 percent. The franchisee received 60 percent of the profits and the investor received 40 percent of the profits. The franchisee was able to charge a 5 percent management fee.

There was also a $450,000 FF&E package which was secured through a leasing company. Guaranties were provided by the franchisee ownership group. What made the financing so strong was the substantial amount of equity in the project.

This plan required a great deal more paperwork, but it turned out to be a very successful project and returns have been substantial.

What can we take from these three case studies?

1. In today's market, financing is situational. Each location requires an assessment of all of the available options.

2. Your tool box of available financing has to be a big tool box that includes everything from low rate rent, to leasehold loans, to equipment loans, to investor contributions, to high priced debt, to bank financing, to supplier financing, to any type of financing you can dream up. It truly is an environment that requires creativity and a lot of mix and match. FT

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