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## Why Are More Banks Getting Into Restaurant And Franchise Lending?

By Dennis Monroe

Last month we discussed why sophisticated investors like to invest in restaurants. This month, with the help of my partner Randy Evans, we are asking the question, "Why are more commercial banks getting into the restaurant franchise lending business?"

Some notable banks have in the recent past expanded into restaurant franchise lending. A few examples are: (a) BMO Harris Bank; (b) Bank United, through its subsidiary United Capital Business Lending; (c) Fifth Third Bank; (d) Highland Park Bank & Trust; (e) TD Bank; (f) Huntington Bank, and (g) more recently, M&T Bank has been exploring the possibility of getting into the space. In light of these new entrants, we thought it would be helpful to interview a couple of veteran restaurant lenders to gain further insight into why commercial banks are continuing to enter. We spoke to Rick Meiklejohn at BMO and Bill Wildman at United Capital Business Lending.

Historically, banks have been adverse to lending money for restaurants. This obviously has changed, and one of the reasons is the distinction between the restaurant world in general and the franchise restaurant world. Yet the distinction notwithstanding, it is still restaurant lending. After speaking with Bill and Rick, the following appear to be some of the reasons why:

**1. Market in General.** The market, in general, according to Rick Meiklejohn, has become more sophisticated. The available market data has also become more abundant and sophisticated, allowing the national, regional and local commercial banks to do more effective underwriting. Bill Wildman spoke about the diversification of bank lending after 2008. This started with the process of cleaning up their balance sheets, and then, once things were good, moving forward to look for new opportunities such as franchised restaurants.

**2. Relationships.** A loan to a franchise restaurant company can provide for a broader relationship (particularly depository, cash management, wealth and investment management) because restaurants have need for cash management, credit services and wealth management for the owners. This broader relationship allows the banks to make significant fee income so their return is not just interest income on the loans.

**3. Demand.** There always seems to be a demand in the restaurant finance world for senior debt. The reasons are:

A. Franchisees are constantly developing and opening new stores.

B. Franchisees are required to frequently remodel.

C. There are frequent consolidation transactions where a larger franchisee buys out smaller franchisees.

D. Franchisees often buy and sell real estate.

The franchise restaurant industry is a dynamic one, where there is always need for senior debt, unlike in certain manufacturing industries or high tech industries. The consolidation and continued development of the franchise restaurant industry has always been driven by the availability of debt.

**4. Rate Structure.** Bill Wildman emphasized that while there is pressure on lower rates in today's market, the prevalent view is the restaurant industry is not as rate-sensitive as other industries. Rick Meiklejohn acknowledged rate compression but pointed out that banks can deal with rate compression because, as stated above, they can provide other services to the borrower which can then provide an overall favorable return.

**5. Franchisor Safety Net.** Both interviewees stressed the importance of the franchisor relationship, which provides a significant backstop for loan issues. The analysis performed by lenders on the franchisor systems is an extremely important factor here. There are particularly sophisticated tools that evaluate the systems, which then makes the underwriting process a great deal easier because the economic viability of the franchise system is clearly understood.

**6. Sale of GE.** Both interviewees spoke of the pending sale of GE Capital Franchise Finance and its impact. The market niche GE had, particularly in the middle market space, is now going to be available for other lenders. Wildman and Meiklejohn both though GE's sale would be a plus for their lending groups.

Also, unless GE is sold as a stand alone entity, it has a number of talented employees with strong customer relationships who are going to be looking for new opportunities. These people will be available to those banks that want to expand or start a new lending group.

**7. Consumers.** With consumers now spending more money on food outside of the home than inside the home, there is certainly consumer demand that allows for development and

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growth of new concepts. With private equity involved in this industry, an equity cushion is provided. This all plays into the ability of the lenders to feel like they have a good credit position for restaurant lending.

**8. Non-Franchise Restaurants.** There are some impressive companies who have 10 to 20 multi-concepts within their restaurant portfolio. To name a few: Talk of the Town in Orlando, Parasole Restaurants in Minneapolis, Starr Restaurants in Philadelphia, Cameron Mitchell Restaurants in Columbus, Ohio; Fox Restaurant Concepts in Phoenix, and Lettuce Entertain You in Chicago. These types of companies have and will continue to attract the attention of national investors and lenders. The tough area for lenders is still the small, early-stage restaurant company. For those concepts, the SBA will always be the best option.

It is clear that restaurant lending is still alive and well, and banks still see this as an opportunity. Most commercial banks and national lenders are looking for clear niches that have enough demand and borrowers for relationships to be established.

In the next issue we will complete the discussion of restaurant lending when we discuss the in-between financing stratum (which we call mezzanine financing).

–Dennis Monroe, Chair
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