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If you're looking into financing, here is a general summary of what you can expect.

2008 expectations

What's happening in the finance market?

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Here's what you can expect in the 2008 financing market. It is no secret that all financing has tightened and the amount of time it takes to get a financing deal closed has almost doubled. Interest rates have not been affected; in fact, rates have come down while equity and mezzanine investment returns have remained unchanged and sale/leaseback cap rates have risen.

Please keep in mind that this information is a generalization. Each deal may vary, but the following are general terms and conditions we have observed in the current financing marketplace.

Equity Investment

Even though private equity groups (PEGs) are taking more time to make decisions related to investments, PEGs are still a viable financing option for the franchise community. The following are some general terms for an equity investment:

• **Co-Investment.** PEGs want the owner/operator to co-invest. The idea of "sweat equity" is somewhat on the shelf.

• **Returns.** In terms of an overall return, PEGs are still looking at a 25 percent-plus threshold. We are seeing more and more groups wanting a current return on their investment and they are less willing to wait until the end for a total exit and return.

• **Exit Periods.** Exit periods are still in the five to seven year period.

• **Leverage.** There is less leverage available so more equity is required. In most cases, equity will probably make up 25 percent to 40 percent of a transaction.

• **Investment Form.** The investment is normally a preferred class where the money is paid back to the investor first with a return. There seems to be a trend toward a greater ability to do an early buyout.

• **Buyout (Put).** There is still a put, normally at the sixth anniversary of the investment, where the investor has the right to require the company to redeem their interest.

• **Add-on Funding.** There is normally some provision regarding additional funding and the dilutive effect for future development and acquisitions.

• **Control Rights.** The control rights seem to be loosening because private equity is only investing with the best businesses. PEGs will still have control over all major decisions and corporate structural changes. They additionally will have board seats or observation rights, along with strict financial information reporting, and rights of inspection.

• **Due diligence.** The time period and due diligence required to close an equity transaction in this economy can be two to six months, with a higher degree of due diligence and proforma sensitive analysis.

• **Fees.** The upfront fees will be 1% to 2% of the invested amount, with an annual management fee paid to the equity investor.

Senior Debt

Senior debt is much tighter, and the leverage available is much lower.

• **Leverage.** As to leverage, we are looking at 2.5 to 3.5 times EBITDA (the cash flow of the business). Additionally, lenders are looking at other types of leverage; specifically, what we call "effective leverage" which takes into account capitalized rental payments. This leverage is probably in the neighborhood of 5.5 to 6 times. In terms of debt to equity ratio, we are probably looking at something around 60 to 70 percent debt to equity.

• **Rates.** The interest rates are fairly favorable. With good credit you may be 250 to 300 basis points over LIBOR; or, if it is corresponding to Treasuries, it is possibly 250 to 400 basis points over the Treasuries. This makes many interest rates in the mid to high 6 percent to low 7 percent ranges. Rates, of course, can be fixed, either through buying various hedge products or prepayments at various times during the loan.

• **Collateral.** The collateral positions are very tight. All collateral will be tied up and various cross-collateralizations, leasehold mortgages and tough collateral release provisions will be provided.

• **Personal Guaranties.** Except for low leveraged companies, in most cases there will be some type of personal guaranties. Burn offs can be negotiated.

• **Fees.** Origination fees will range from .5 to 1 percent

• **Prepayments.** For non-floating interest rates, there may be a lock-out period (no ability to pre-pay) for the first few years. Additionally, general prepayment penalties will be imposed on an annual declining basis over the first 3 to 5 years of the loan. Even floating rates may have a prepayment rate of 1 or 2 percent.

• **Fixed Charge Coverage Ratio (FCCR).** A fixed charge coverage ratio (which is cash flow to debt service and other fixed charges) will be in the 1.3 to 1.5 range, depending on the quality of the credit.

• **Use of Funds.** It will be more difficult to take money out through a refinance. Normally lenders look to have their money used for acquisitions, expansion or development purposes. Additionally, distributions, except for tax, may be restricted.

Sale/leaseback

• **In General.** Sale/leaseback money is generally still available. We have seen the cap rates move up in light of concern over the value of real estate. It is clear the likekind exchange market is slowing down, and there are fewer likekind exchange buyers.

• **Closing.** We are seeing a longer period of time to close sale/leaseback transactions.

• **Cap Rates.** Cap rates have a fairly wide range, with the best companies and concepts getting cap rates slightly below or around the 8% range. Companies or concepts with lesser credits are getting in the 9 percent to 10 percent range.

• **Availability.** Sale/leaseback providers depend on debt financing, and even with higher cap rates, the availability of sale/leaseback funding is tight.

• **Different Structures.** Many times the sale/leaseback fund providers are looking at master leases, cross defaults and personal guaranties, all designed to protect against bankruptcy.

In summary, money is still available but tight and slow to close. Please keep the above in mind as you decide which type of financing is best for you. FT