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Revisiting the Convenience of Community Banks

By Dennis Monroe

Recently I spoke at a conference to lawyers on the current status of community banking, and it got me thinking about how much things have changed on that front for the restaurant industry.

The federal regulations primarily directed at larger banks have trickled down to affect small community banks. As a consequence, these banks have had a hard time attracting commercial loans. And yet, they need more profit, which means more performing loans, so community banks are anxious to make loans—even those in the restaurant industry.

Community banks usually prefer local commercial loan opportunities, and restaurant loans may provide better interest rates than certain other loans, such as real estate loans, which historically community banks have made.

Also, community banks love the cash deposits restaurants make, and many smaller banks can provide electronic cash management.

Below are 10 things to consider when approaching a community bank for restaurant financing:

1. Location: Community banks like to touch their collateral and see their borrowers. They do not like to stray far from their stated trade area; in fact, in many cases they are prohibited from doing so by regulation. If your restaurants are in different states, or you are planning development in multiple areas, the community bank may still be an option if the restaurant company's headquarters are near the bank. A Hardee's operator with whom I have worked did most of his financing through banks located near the restaurants he was opening. This was a successful strategy for him for many years.

2. Management: Lead with a discussion of who runs the company and who is on the management team. Community banks, like investors, are in essence lending to key individuals. In the world of loans, it's not only who you know, but who they know is running the company.

3. Cash Flow: Be prepared to explain the cash-flow nature of the restaurant business. If you are a franchise, show other comparable stores or exemplary financials from the Franchise Disclosure Document (FDD). It is crucial community bank officers understand restaurants are cash-flow businesses and not hard collateral. Also, you may need to explain how restaurants are valued. There are several resources online where you can find this information.

4. Financials: Expect to be asked to provide historical financials in GAAP format. The following are crucial items that will need to be explained: personal expenses that are run through the company; variations from GAAP; extraordinary non-recurring expenses; depreciation vs. expensing policies; and accounting for gift cards, employee meals, deferred revenues and accruals.

5. Balance Sheet: Your balance sheet is one of the key documents for the bank, with your equity account of particular interest. In many cases, restaurants have negative equity accounts because of accelerated depreciation or a buyout of shareholders or cash distributions, including tax payments. This needs to be fully explained with historic accounting on how the capital account got to a negative position or why the capital account is small even though the restaurants have been profitable for years. Also, all intercompany accounts and loans to shareholders or loans from shareholders need to be accounted for. Loans from shareholders should be reclassified as equity to shore things up.

6. Concept: One way to attract a community bank's interest is to get the bank officers excited about your concept, whether it is a proprietary concept, an existing concept, or a franchise. It is important your banker understands your concept and why it will be successful (or will work), and recognizes that you have figured out the business proposition, labor and food costs and ROI. Be convincing. Practice giving your presentation several times before showing up at the bank. It can be tricky, particularly if this is your first restaurant.

7. Franchise Financial Evaluation: If you are a franchisee, ask your franchisor if they have a financial evaluation by FRANdata that can be presented to the bank to show the strength of the system. Most franchisors have them, and it speeds up the process when dealing with community banks.

8. Personal Guaranties: Know that you will have to provide personal guaranties. Be prepared to bring in personal financial statements for all of the partners in your organization.

9. Corporate Structure: If you are a multi-unit operator, you will need to explain your other operations, how they have been financed, how the bank can segregate its collateral and what other inter-creditor issues need to be addressed. In general, you will need to work through your corporate structure with the bank—the simpler, the better.

10. Individualize Your Lender: It is important to find a loan officer at your community bank who is at a senior level and is fairly sophisticated. In many cases, you can talk directly to the president of the bank. Another benefit of community banks is you probably can get to know some of the individuals on the credit committee. Have as many people from the bank as possible over to your restaurant or deliver food to them. The key is to develop a personal relationship so the community bank wants to be your bank of record.

Good luck—but you may not need it if you keep community banks in mind.

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