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Restaurant Finance Highlights for the Year

By Dennis Monroe

The year 2015 was not a terribly monumental 12 months for new financing ideas. Instead, it was an overall dynamic market, a continuation of current trends and an acceleration of competition because of the availability of funding.

Below are my thoughts as to key financing highlights of 2015:

1. Competition Among Major Banks and Commercial Finance Companies—In 2015, it seemed every quality credit in the restaurant space that wanted to refinance or get money for an acquisition had a number of major players vying for that company's business.

Players that were particularly aggressive in these strong credits were Bank of America Merrill Lynch, Wells Fargo Restaurant Finance, BMO Harris Bank, Regions Bank, Citizens Restaurant Finance, Cadence Bank and other large financial institutions. The borrower was able to borrow money at very favorable rates and terms. Certainly the loan-to-value and fixed charged coverages (which are the telling ratios as to the availability of credit) were loosened up. Less equity seemed to be required.

2. New Players—Besides the competition among the major financing institutions, there continued to be a number of new players stepping into the market on the lender side. These included smaller regional banks and even community banks. Most of these institutions were not looking at the major large credits but rather at the areas where their rate structure does not face competition from the large institutions.

3. GE Capital Franchise Finance—To touch on another issue in the banking space, GE and the uncertainty as to whether it is in or out of restaurant finance (and who is going to be around at GE) was also a major financing story for 2015. GE was "business as usual" this past year, yet the press stories on many occasions suggested otherwise.

4. Sale-Leaseback Market—The sale/leaseback market is still alive and well. Cap rates were so low, I commented in one of my articles that it was nearly impossible to resist using sale-leaseback financing. There are still a lot of reasons for and against sale-leasebacks, but the point is that they were one of the key financing sources for 2015.

A number of new players stepped in, and some of the cap rates were in the 4% and 5% range for the top credits. In general, the rates were so favorable and the availability of funding was such that it was an interesting time for the operator and user of sale-leaseback financing.

5. Private Equity—Private equity remains active in our restaurant space. It's clear that the big guys are getting bigger and doing major transactions. But because of the competition, private equity groups are also looking at smaller deals.

For example, this past year, KarpReilly LLC made three acquisitions of small companies: Fitlife Foods, Taylor Gourmet and Eureka! Restaurant Group. A number of our clients with two or three units are being courted by private equity. Because the pricing was so high for large transactions, and there was so much activity and competition at auctions, private equity needed to move down the ladder in order to get the type of return they wanted.

6. Activists—It seems the activists—whether it is Famous Dave's or Bob Evans or most recently, Del Frisco—were all of the mindset their investments were underperforming and they should take the necessary actions to bring real value (which includes a lot of management and board seat shuffling). I'm not sure any of these activist transactions in the restaurant space ended up adding much value.

7. Private Placements—More and more restaurants are being financed through private placements. Individuals are looking for alternative investments, i.e., the kind that have a higher return than the market last year, which does not take much. They are looking to use their IRAs and 401(k)s to invest in other things, including restaurants. This definitely creates a much broader source of funding for restaurants than private equity and home offices.

8. Equipment Leasing—Equipment leasing sort of resurrected itself this year with a couple of new entrants into the space and a lot of creative aspects, particularly as to remodel expenses. With the new accounting rules that are in effect for the next year or two, equipment leasing may be even more attractive to operators having to capitalize all leases.

9. Landlords—Landlords were not one of the highlights because there is a shortage of real estate. In order to get these higher rates, landlords are having to do leasehold financing for the prospective tenant. In many ways it was a great idea for 2015, but you always have to be careful not to pay too much for rent just to get leasehold and other types of financing from the landlord.

As you can see, 2015 was a very active year, but didn't necessarily give rise to anything new or novel. There has been a defined amount of opportunity, so consequently 2016 should see more of the same—and maybe GE's staus will be resolved.

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