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Funding Finder

Money doesn't fall from the sky, so how does restaurant financing get done?

Dennis Monroe

IN THE 18 MONTHS I'VE WRITTEN THIS column, I've reviewed approximately 15 new restaurants, so I thought it would be a good time to reflect back and discuss how they found the money to open. Very seldom does the food expert (i.e., the chef or restaurant operator) have the type of funding necessary to open a modern restaurant. There are companies that specialize in going into already existing sites that have been closed down, with the landlord letting them in for a rock-bottom price. As my former partner Phil Roberts of Parasole Restaurants said, "It's like going in and changing the fly paper." But that's rare. In most cases it's a matter of coming up with significant funding to open a restaurant.

There are numerous approaches and philosophies in restaurant funding. Stewart Woodman, chef and culinary expert, has a quote I've used a number of times: "If it was only about food, every good chef would be a millionaire." We know it is not only about food. It's about business, return on investment, controlling costs and making money. But before you can make money, you have to secure financing to get the restaurant open. Financing is a fairly complicated and complex process. Most of the restaurants I reviewed (and ones that are opening in our marketplace) have been financed.

Restaurateurs securing financing for their new locations will look at the following funding sources:

1. Landlord;
2. Senior debt (this is bank debt, either SBA or non-SBA);
3. Private equity (individuals); and
4. City and state financing (such as loans from the St. Paul Port Authority, grants from the city and angel financing from the state).

Here's a glance at each of these funding sources:

Landlord

The most important approach is effectively negotiating a lease with the landlord. Very seldom in today's marketplace does a restaurant owner own the real estate or the building in which the restaurant is located. The first step is to negotiate the rent with the landlord. (It is vital to keep the rent as low as possible and get as much free rent as you can, particularly during the pre-opening stage.) The next issue is what leasehold improvements and leasehold allowances the landlord will provide. (The leasehold allowances include the walls, cabinets, bar and the other items in restaurants that will remain after the restaurateur is gone.) Leasehold allowances can range between $0 and $300 per square foot. In many cases, the buildout costs for a substantial restaurant in a plain-vanilla space are between $200 and $300 per square foot. Thus, if you have a 4,000-square-foot restaurant, it may cost you around $800,000 to build the restaurant and fully equip it with furniture, fixtures and equipment.

Begin with the landlord and get as much as you can from him or her. Make sure the rent does not increase substantially because of higher tenant allowances.

Senior Debt

Banks will tell you they do not lend to restaurants, but in reality they do through SBA loans. If the restaurant is part of a franchise system, it is easier to secure an SBA loan because the SBA has an approved list of franchises to which banks can lend. That being said, it is very important to find a cash-flow lender rather than a collateral lender. As we all know, once restaurant collateral is put in, the restaurant it is not worth much. Bankers tell me the restaurant owner needs to be able to show the cash flow. If you use an SBA loan, you can normally get a higher percentage of the entire cost of the project (normally 80 percent). In almost all instances, the banks will require personal guaranties and possibly outside collateral and a specified level of equity investment in the restaurant.

A number of lenders are restaurant-friendly, particularly some of the small, local and regional banks. The national lenders tend to lend to the franchise restaurant groups.

Private Equity

There are a number of restaurant-friendly private investors in the Twin Cities and Minnesota. Normally, equity is about 25 to 40 percent of the entire cost of the property. The money is raised in increments of usually $50,000 to $100,000 from private individuals who believe in the owner and the concept, and who like to invest in restaurants. The structure varies depending on the previous success of the restaurateur. The more successful the restaurateur is, the less he or she will have to give up in terms of ownership percentage and the preferential return. It is important to retain a securities lawyer for these private equity investments so that everything is structured correctly. The lawyer will prepare the private-placement memorandum and appropriate SEC filings.

City and State Financing

There are a number of niche, smaller dollar programs that can be used, such as the state angel investor grant (which has to be applied for and really is something beneficial) or subordinate loans from the St. Paul Port Authority for energy-efficient appliances, windows (in general, anything that saves energy). Additionally, cities may have unique programs or tax credits from the federal government.

In general, the restaurateurs in the Twin Cities are accustomed to people being willing to invest in their concepts, and Minnesota will continue to be home to very vital and valued sources of financing. FSN

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