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Money on the Mind

With the recession in the rearview mirror, operators finally have more financing options available to them. Finding those options, though, is another story.

Uncle Maddio's CEO Matt Andrew says he's "cautiously optimistic" that the lending environment once again favors operators. UNCLE MADDIO'S PIZZA JOINT

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Let's talk money.

First, the good news: There is plenty of money available for foodservice operators and brands looking to grow or strengthen their concepts. Stakeholders from across the restaurant financial services spectrum agree on that. U.S. Small Business Administration (SBA) financing is at a five-year high. Hospitality is a hot industry again for private equity firms. Alternative funding options are becoming more common and regulated. And, more importantly, consumer disposable spending is back up.

"There's a huge amount of money in the market," says Ed Prensky, CFO of Plamondon Hospitality Partners, operator of 20 Roy Rogers, "both in equity and lending."

Signs of this abound. GE Capital, Franchise Finance (GEFF), for example, announced in October an initiative targeting "entrepreneurial" multiunit brands and franchisees in the mid-market space. Soon after, GEFF loaned Specialty's Café & Bakery Inc.—a 50-unit, fast-casual bakery/café chain—$37.5 million to refinance existing debt and provide funds for growth. That announcement was followed in January with news of a $7.6 million loan and $2 million revolving credit line granted to Milano's Restaurants International for the development of a new fast-casual pizza concept, Blast 825° Pizza. (GE Capital announced after this story was written that it would sell its finance division.)

Now the bad news: The outlook is not as positive for those new to the industry. Post-recession, banks and investors are more cautious with whom they do business. Unless an operator can demonstrate proven restaurant experience or partner with an established enterprise brand, raising capital in this financial climate is tough—but not impossible.

"It's more challenging for the little guy to get into the restaurant business than it was in the past," says Tom Finn, vice president of franchise development at The Greene Turtle Franchising Corporation. "Bankers are sensitive; they still view the industry as a risky environment. It's hard for the entrepreneurial types to raise capital. But there's more than one solution."

To get a sense of what is possible and what makes sense at which stage of the growth process, we talked to franchisors, franchisees, operators, bankers, and investors about three of the top ways to raise capital—commercial lending, equity investment, and alternative financing.

Working with banks

Matt Andrew, CEO of the 29-unit Uncle Maddio's Pizza Joint, uses phrases such as "cautiously optimistic" when talking about today's commercial lending environment. One can hardly blame him for being reticent. Andrew was president of Moe's Southwest Grill from 2001 to 2006 and started Uncle Maddio's one year after the Great Recession began. He's seen how quickly fortunes and tastes can turn in foodservice.

"I've never seen before—and probably shouldn't—the types of deals we were seeing in 2004–2006," Andrew says. "A fifth-grader could have gotten a $300,000 loan. But it's a new day."

Andrew is referring to increased scrutiny and lending requirements by both federal and banking officials. The bank-financing climate has loosened, but it's still tight compared with pre-2008 levels—especially for emerging brands and new operators. It's no longer enough to have a good idea. Operators hoping to get a capital infusion from a bank also need a good business plan or track record to tell their story.

"Money is there for the right candidates," says Jeff Jackson, president of Billy Sims BBQ, a Tulsa, Oklahoma–based fast-casual franchisor with 44 units. "Banks are looking for personal wealth and experience. They're looking at the concept, too: the training available, the track record, how many units. The franchise has to be solid."

Even with a solid franchise behind them, entrepreneurs new to the foodservice world will find that conventional loans are virtually impossible to secure. That's where SBA loans come in.

Since 2009, the SBA has approved through commercial lenders more than 30,000 general small business, or 7(a), loans in the foodservice space, with an average deal coming in just under $300,000. Last year, 5,784 restaurants received SBA funding, a 9.7 percent year-over-year increase from 2013.

"Our business banking division has seen an increase in SBA lending activity since 2011," says Cristin O'Hara, managing director and Restaurant Finance Group head at Bank of America, the No. 1 lender in the SBA market. "We're working with operators with less than 10 units and $50 million in revenue."

The SBA offers a variety of loan programs for very specific purposes. The four main categories are: general small-business loans, or 7(a); real estate and equipment loans (CDC/504); microloans; and disaster loans. Approval for 7(a) general business loans, the most common type used in foodservice, is weighed against several factors, including a would-be borrower's debt-to-worth ratio, cash flow projections, available capital, collateral, and resource management.

Almost all of Uncle Maddio's 56 franchise groups got their starts with a SBA-backed 7(a) loan, which makes Roger Wagerman, the chain's vice president of sales and development, somewhat of an expert. The process, Wagerman says, has its frustrations—significant paperwork and lengthy processing times, for example—but for many operators and brands, it's the only option.

"Banks are only doing SBA loans for emerging concepts like ours," Wagerman says. "The good news is more banks are opening SBA programs. We get calls all the time from banks trying to get our development business."

The growth opportunities banks see in SBA lending means bankers with expertise like Rebecca Grant, vice president of business development at Ameris Bank, are in high demand. Grant is an almost 30-year veteran in the SBA lending space and has a plethora of advice for operators and brands looking to take advantage of the program.

The first step for a franchisor, she says, is registering the brand on the Franchise Registry to streamline approval. The Franchise Registry lists every SBA-eligible franchise in the U.S. and is run by FRANdata. Registration is free. Eligibility is determined based on franchise's submitted disclosure documents. Inclusion on the list is an indication that a brand's franchise agreement allows an operator to qualify as a small business owner. Participation is voluntary—sort of.

"You have to be registered for most banks to even consider doing an SBA deal with your franchisees," Grant says.

Once registered, smart franchisors should do everything possible to pre-qualify and prepare candidates to expedite the SBA loan process.

"You can't close an SBA loan without a lease in place," Wagerman says as an example of the type of knowledge he shares with franchisees. "You can't have any bankruptcies or felonies on your record. You need to prove bankable assets ... and be able to defend your projections."

Still, strict criteria aside, the dollars for growth are there.

"It's a borrower's market if you're an established brand," says Pierre Panos, founder and CEO of Fresh To Order, a 14-unit fast casual based in Atlanta. "Banks will lend to their good customers and strong operators."

To keep Fresh To Order on the minds of the three to four banks with which it has relationships, Panos sends regular updates on Fresh To Order's performance and growth. "The best thing you can do for your brand is know your bankers," Panos says. "Maintain a connection even when you don't need money. It takes time and work, but it's worth it in the end. Well-managed debt is a great asset."