Financing Challenges For F&B Operators

- Restaurants are considered high risk by most investors and lenders, hence the cost of capital is usually higher
- Restaurants are often an afterthought in certain types of hotel operations, therefore funding/budgets are limited for restaurants
- Venture capitalists tend to focus more on projects that are tangible

Sources of Capital For F & B Operations

- Economic Development Agencies
- Small Business Administration
- FHA
- International Investors
- Long Term Debt
- Private Individuals
- Pension Funds
- Insurance Companies
- Investment Banks
- Private Wealth
- Venture Capitalists
- Limited Partnerships
- REIT’s
- Corporation Formation
  - S-corps
  - C-corps
  - L.L.C.
Economic Development Agencies

- Local development agencies (city, county, state)
- U.S. Department of Commerce
- Utility Companies
- Parking Authorities
- Transportation Authorities
- All of these entities are sources for partial financing, payments in kind or special allowances
- Project typically has to further specific agency interests

Small Business Administration

- Current/past focus on minority investments, preference given to female business owners
- Agency provides 90% loan amount guarantee to commercial lender
- Application process is fairly complex and time consuming
- Loan origination and application fees can be considerable and drive up the cost of capital

Farm/Home Administration

- Used to re-structure debt
- Works well for re-financing of projects
- Conversion of short-term debt to longer terms
Long-Term Debt

- Refers to traditional business loans
- Current window for restaurants averages 10-15 years as a maximum
- Appraisal process examines the lease-hold improvements, may require payment of difference upon appraisal completion of construction phase
- More difficult to obtain, dependent on lending institution’s philosophy and loan factors

Private Individuals

- Family, friends, business associates are often sources of capital or payment in kind
- Personal relationships can hinder operational efficiencies
- Risk level of investment has to be clearly communicated!
- May require shorter loan period or higher rate of return

Pension Funds

- Union pension funds invest in larger projects or projects that will benefit their membership
- Las Vegas hotels and restaurant projects are an example of this
- Usually comes with contractual requirement to use union labor throughout construction phase
- May dictate that union labor is used for all line level positions (closed shop provision)
Insurance Companies

- Prefer to invest in projects with real estate collateral
- Tend to finance mixed-use developments
- Usually require higher rate of return
- Funding levels tend to follow economic cycles

Investment Banks

- Refers to international network of commercial lenders who pool transaction earnings, not deposits.
- Work with the World Bank to foster economic development strategies
- Source for large and multi-unit development

Private Wealth

- Refers to funding from wealthy individuals, e.g., sheiks, real estate developers, petro-chemical owners, entertainment and sports figures, technology leaders
- Name recognition can assist with efforts to secure additional financing
- Contractual relations can be developed to assist with opening activities, and on-going efforts to promote and market establishment
- Negative publicity can destroy the restaurant’s bank of goodwill, AKA “guilt by association”
Venture Capitalists

- Tendency to invest in new start-ups that have multi-unit/franchising potential
- Like to work on mixed-use projects
- Typical strategy is to develop real estate location, assist with financing, then sell off assets as soon as financial targets are met
- American Trading Real Estate, Rouse Associates are good examples
- Often require substantial share of profits and/or ownership, possible first refusal on any IPO

Limited Partnerships and Corporation Formation

- Business structure is often dependent on tax situation of potential partners
- “S” corporations offer certain tax advantages concerning treatment of income and losses
- “C” corporations can offer more protection of owner’s assets, often negated due to loan collateral pledges
- “C” corporations require significant amount of record keeping and often raises the overall start-up costs due to higher application and filing fees.
- Sole proprietorships are very common in single-unit operations