# TAKE THE MONEY AND **run your restaurant**

**by ethel hammer**

Like a demanding mistress, the business of restaurants is notoriously expensive and undeniably risky, no matter how captivating. The truth is, well more than half of all restaurants fail within the first three years, so it's no surprise that financing for eateries carries little charm with investors, especially traditional money lenders such as banks. Instead, most restaurant operators have to look toward unorthodox sources of capital, which are often a jumble of options including Small Business Administration (SBA) loans, financing from local and state government economic development agencies, microloans based on projected credit card revenues, various partnership and/or investor plans, tax credits, personal funds or equity, landlord lease deals, leasing arrangements, barter and more.

"Be sure to read the fine print about the payback." —claude solliard

In their quest to open, expand, or upgrade their restaurants, owners may use one or more of these resources. But they should do so with care, caution the experts. "Many people are in total denial when it comes to money," says Michael Staub, an ex-chef with an MBA who is now a restaurant consultant with Group M, Inc., in Cambridge, Massachusetts. Staub has helped some 35 restaurants—including high-profile places such as Olives, the Elephant Walk, and Icarus—write pro forma statements for borrowing, negotiate purchases and leases, and get funds from the SBA, private investors, and commercial banks. According to Staub, most people don't understand the percentages involved in restaurant success. For instance, he notes, "You'll go out of business, unable to cover expenses and give back to your investors, if you don't have one and a half to two times your investment in gross sales by your third year." When it comes to borrowing, he adds, "You don't pay dollars, you pay percentages."

## MICROMANAGING

Playing percentages has helped Claude Solliard stay in the restaurant game. The chef-owner of Seppia's, a white-tablecoth restaurant in midtown Manhattan, Solliard has found quick operating money through Internet-based microloans, which are formulated on the ability of merchants (in this case, a restaurant) to sell a percentage of their future credit card sales for present-valued capital. "When I have had equipment problems or some slow times at the restaurant," the chef explains, "I have borrowed from American Microloan. It's been very good for me, especially because I am from Switzerland . . . I don't have the collateral or the cosigners here that banks require for traditional loans."

Some lenders call microloans a new kind of cash advance or the buying of future receivables. But whichever label is applied, charges for this type of borrowing generally range from 10 percent to 35 percent of the loan amount, depending on the microloan company and/or the risk of the transaction. Loan amounts are based on receivables, and repayment is made automatically by withholding a certain percentage—15 percent is standard for American Microloan—of the restaurant's daily or weekly credit card revenue for six months (though terms and time may vary with each lender). From application to the receipt of funds, the microloan process typically takes a week or less, which is another reason these loans are appealing to restaurateurs with a sudden cash-flow crunch.

Although Solliard's experience has been very satisfactory, he warns, "Be sure to read the fine print about the payback. Other microloan companies have approached me about lending options, but their percentages and other fees were higher." Solliard also appreciates that he now has a relationship with Woochae Chung, the managing director of American Microloan. Although the chef's first transaction with the company was over the Internet, Solliard reports, "Now that I have borrowed several times from them, I can call Woochae to discuss any financing. I started out with a $20,000 loan. But now I can borrow as as much as $100,000—and get the money quicker. The company is very flexible, and I feel that they're really there to help me." Howard Chernin, vice president of American Microloan, agrees: "I don't want to put a restaurant at risk by charging an exorbitant rate . . . after all, we're in this business for the long term, not the short term." Founded a little more than two years ago, his company has lent funds to about 100 restaurants, many of which have returned for subsequent loans.

## DID IT THEIR WAY

Microloans and other types of funding are rarely available for restaurant start-ups, especially when the would-be owners have no track record in the business. Chris Jones and Bert Goldfinger faced this catch-22 when trying to open the Red Barn, their American bistro with a French accent in New York's Hudson Valley. Although not the quintessential mom-and-pop restaurant owners, they do, exemplify do-it-yourself American dreamers.

Goldfinger, the chef, is also a New York City dentist; his wife and partner, Jones, does marketing sales for a New York design firm. Together they opened the Red Barn in 2001 using their own funds from savings, a mortgage on the building, and a separate note to finance equipment. But both partners still work four days a week at their "real jobs" and three days a week at the restaurant, which is a two-hour drive from the city. "We've been working seven days a week for five years," Jones says.

Before opening the restaurant, Goldfinger worked days and went to cooking school at night, attending the nine-month degree program at the French Culinary Institute to hone his craft. He also did a *stag* at Le Cirque with Jacques Torres.

Now the couple has their dream, they claim, although with lots of "buts." According to Jones, "There is no money for extras. We haven't done anything else of consequence . . . no improvements to the house, no gratuitous shopping. We're risking it all." The couple hopes to eventually quit their white-collar jobs, but money is still tight. The refrigeration at the Red Barn broke down shortly after they opened, so they've replaced all the equipment with the exception of a working 1957 ice-cream maker. The restaurant also recently closed because of a broken pump. Managing the available teenage workforce in the area is no picnic either. "People have no idea what it means to live your dream," Jones says. Not to mention finance it. She agrees with consultant Jerry Vincent, principle of Vincent & Associates Food Service Consultants in Paola, Kansas, whose rule of thumb is: Never put up your house as collateral for a loan on a restaurant. It's risky, and you're really just paying to lend money to yourself.

## GET BY WITH A LITTLE HELP

"We were three people with a dream and no money," says Peter Drohomyrecky, a partner in Spring and Green Zebra restaurants in Chicago. Almost five years ago, Drohomyrecky, who was then a country club manager, went into business with his wife, Sue Kim, a front-of-the-house professional, and Chef Shawn McClain to open Spring, an American seafood restaurant with Asian influences. Half of the start-up financing came from a bank loan backed by the SBA. The other half came from family, friends, and a few businesspeople.

When Spring became a critical success, Drohomyrecky went back to the SBA to finance the group's second venture, Green Zebra. "I'm forever grateful. I would recommend the SBA for anyone who needs it. It's a difficult procedure, but when nobody else will lend you the money, you do whatever it takes."

Commercial bank loans are hard to get for first-time restaurateurs without hard assets to back them up. But SBA's 7(a) Loan Program backs up to 75 percent of a maximum $2 million loan from a commercial lender. Loans up to $150,000 are backed up to 85 percent and more than $150,000, up to 75 percent. SBA Express Loans offer a maximum SBA exposure of 50 percent.

## TENANT TERMS

With $10,000 in his pocket to open a restaurant, Steve Soble, president of Spare Time, Inc., in Chicago, encountered a creative landlord who suggested a unique financing deal. "He offered me a lower base rent for three years to get 20 percent of the profits." After three years of success, Soble renegotiated a higher base rent with no profit sharing. Now Soble has a mini-empire of nine Chicago restaurants and counting.

Don't hesitate to ask your landlord for tenant improvements, Soble says. "In my most recent deal, the landlord put in the heating, ventilation, and air conditioning (HVAC) [and] the elevator, upgraded the electric, and brought in a new water service." Landlords typically get that money back through a higher base rent.

Soble owns buildings, too, using the real estate equity to fund the restaurant build-out, which raises the property's value. Through the creation of two separate entities, he (as the restaurateur)

## PERSISTENCE PAYS

Funds and financial know-how are available to restaurateurs who do the homework. Start smart with some of the following resources:

**National Business Administration** Private organization that promotes the growth of small enterprises, helping members obtain government, commercial, and education loans. (800) 456-0440, nationalbusiness.org

**National Restaurant Association** The NRA Information Service and Library offers a listing of many current books on the subject of restaurant financing. restaurant.org

**Small Business Administration** Government agency dedicated to promoting and assisting small business development; offers various loan arrangements. 202-205-7064, sba.gov pays a higher rent (to himself, as the building owner), permitting the funding of a higher mortgage. "At the end of the day, if the restaurant fails, I still have the real estate," he says.

Soble and his father also own a property in Richmond, Virginia, which they are now converting to rental apartments with a restaurant downstairs. Because the building is in a historical district, it's eligible for tax credits. "For every dollar you put in, you get 20 percent back in federal tax credits and 25 percent back in state tax credits," Soble says, adding that he found a company that buys his tax credits, which they, in turn, sell to clients. "I wind up getting 80 cents back on the dollar for the tax credits. I use that money to do the restaurant."

"I'm forever grateful. I would recommend the SBA for anyone who needs it." —peter drohomyrecky

Soble also raises money through limited partnerships in which investors cannot lose more money than they put in. But whether he's working with investors or working partners, Soble keeps control. "I never go below 51 percent ownership," he remarks.

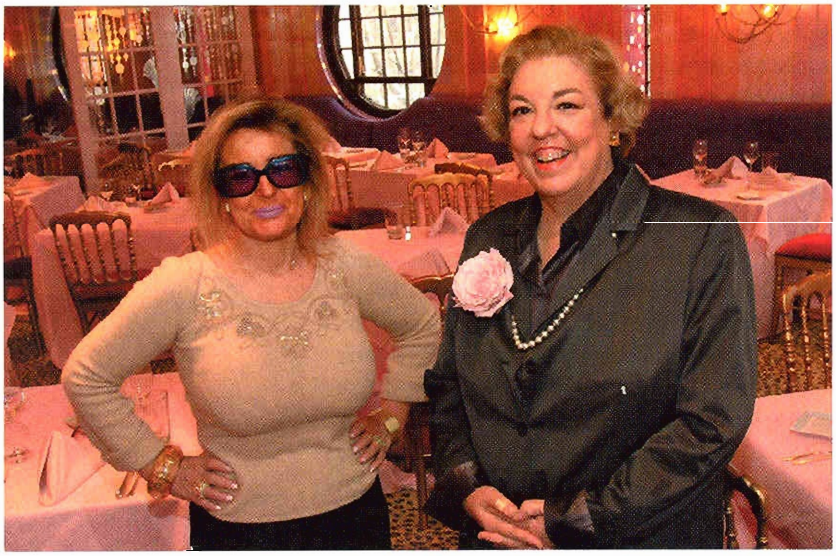
## PROFITABLE PARTNERSHIPS

In 1991, Howard Davis, a Chicago attorney and CPA, went into partnership with Jerry Kleiner, a restaurant designer. "Jerry had the design talent, and I did the business," Davis said, noting that he and Kleiner opened six restaurants together, selling two. The remaining four—Gioco, Opera, Red Light, and Marche, in which Davis and Kleiner are still partners—are all thriving. In 2004, Davis branched out on his own, opening Le Lan, an award-winning French-Vietnamese restaurant. For his new partners, he chose two well-established Chicago celebrity chefs: French Chef Roland Liccioni and Thai Chef Arun Samparathvivat.

"Well-written contracts can protect you," Davis says, "but the best agreement in the world is not going to help you with a partner you cannot trust." Good partnerships require the right personalities, complementary, and non-competing skill sets, and the ability to trust. "First you need a good chef," Davis says. "Second, you need someone who understands the business component. Finally, you need someone who is a good manager."

His typical restaurant deal structures equity on a flip basis, Davis explains. Equity holders, for example, might invest $1 million in exchange for one-third ownership. Typically they might receive two-thirds of the cash distribution until they get their $1 million back, at which time they flip back to getting one-third of the distribution. "In restaurants, you decrease risk by giving preferred payback," Davis says. Chefs, he adds, put in "sweat equity" and don't need to invest cash.

An investor might also get a preferred return on top of an accelerated payback, that is, 6 percent interest on their investment, for example, until the $1 million is paid back. "A great payback would be one to two years," Davis says, but four to five is "still okay." After equity is secured, additional funds can be added through bank debt and tenant improvement allowances.



Restaurateurs Deborah Hughes (left) and Mary Catherine Deibel ignored warnings about going into business with friends.

## FRIENDS AS FINANCERS

The old adage "Never go into business with friends" is disproved daily by Cambridge, Massachusetts, restaurateurs Mary Catherine Deibel and Deborah Hughes, best buddies for 35 years. Deibel functions as the highly visible social arm of the business; Hughes, a trained chef, does the restaurant design. To expand their first restaurant, Upstairs at the Pudding, Deibel and Hughes brought in 15 investors . . . "all wonderful customers, lawyers, doctors—members of our wine dinner group." These investors were paid back partly in dinners, parties, and events and partly in profit. "We call our investors the Monday Club," Deibel comments.

When Deibel and Hughes moved to their current restaurant, Upstairs on the Square, their original investors increased this network by bringing in their friends as investors. In both instances, Deibel and Hughes maintained complete operational control and more than 50 percent ownership. As for the return on investment for their sponsors, "Seven to 8 percent is really great," Deibel claims. "People who buy in to small restaurants do it for the love." Restaurateurs looking for money should keep in mind the special value of what they're offering investors, she adds. "You're selling fun and a network of interesting people." And such social commodities may be priceless for some investors.