

Capital Options for a post-Covid-19 World?

By Dennis Monroe

We will emerge from this crisis. Restaurants will reopen. The public is hungry for a return to normalcy and restaurant dining. Let's discuss some options for reopening your restaurant. With the help of my partners, Chris Mumm and Matt Duffy, who have been focusing on the issues involving Covid-19, here is guidance regarding the future.

From a financial standpoint, what are your options when the restaurant reopens? The most significant will be the SBA Payroll Protection Program loans. While it's still in its infancy, it may be one of your best capital sources. Also, many states provide emergency small business loans. I am aware that many restaurant owners already have submitted applications to the extent they can.

Also, proactively approach your existing lenders. Put together a conservative pro forma, then ask for an extension of existing credit, and additional credit in order to re-open your business. Your successful reopening is your lender's best chance at repayment in the long run.

Also, I believe there will be investors who will step up, particularly with the return on their public equity accounts. Private investors might provide slightly above-market loans that are probably not convertible into equity, but amortizable. These loans will likely include interest in the neighborhood of 8%-9%, with interest-only payments for probably six months, and then ideally, a five-year amortization. These are estimates, but should be a good approximation if we emerge from this crisis in the relative near term. These types of loans represent a good opportunity for investors, particularly with capable restaurant owners.

Another capital source may be franchisors. In the past, franchisors had special investment offerings to raise funds for their franchisees, or obtain special lines of credit for the benefit of franchisees. We believe franchisors will use creativity for the long-term benefit of their brands and in an effort to provide alternatives for their franchisees.

Sources of funding we typically rely on when a new concept is growing should be revisited. They include options such as private placements, crowd funding (both equity and rewards approach), landlord assistance and friends and family.

Restaurant operators often rely on suppliers to help them manage short-term cash flow, but suppliers will be less predictable now. They may not be able to extend credit

in the short-term, but the larger ones, particularly the national food and broadline suppliers, might access public credit markets to provide funding. When it comes to back payments owed to suppliers, they might need to provide payment terms, possibly including loans repaid through future purchases.

We expect there may also be other development companies, and possibly some non-profits, that step up in light of these unique circumstances to provide working capital funding to restaurants, particularly in more distressed areas.

What can you expect from your landlord once you reopen? Not all landlords are in the same financial position. Some are highly leveraged and need to make mortgage payments to their lenders—they're in a similar position as you.

Other landlords have more flexibility because they own their buildings outright. We've seen flexibility from lenders, which helps to ease the immediate burden on landlords and restaurant owners. And, an increasing number of landlords are cooperative and flexible on rent payments. That said, they will want to get back to normal as soon as possible and will expect you to repay any rent deferrals. You may be able to offer to extend your lease term, or provide personal guarantees if they aren't already a part of the lease. Also, look at percentage rents, particularly on the low side and then on the upside, so landlords can obtain some recovery.

Your landlord may have funds available to support capital improvements and might spend money on advertising, all with the goal of retaining a long-term tenant. Don't be afraid to ask for what your business needs.

Is business interruption insurance applicable? Beth Ewen's article on page 10 suggests there might be. Generally, it requires a triggering event resulting in a "physical loss" (e.g. fire, storm, flood, etc.), making coverage for Covid-19 unlikely. Since there are differences in policies, you should review yours with a lawyer to confirm if a triggering event has occurred. Also, some states are exploring legislative changes to insurance policies, including business interruption insurance, making pandemics a triggering event.

We're also fielding questions about back taxes. In Minnesota, sales tax has been deferred for at least a month. While things like payroll, sales and other taxes may not be forgiven, I'm hopeful that payment plans, interest and penalty abatement will be. There may even be some forgiveness. The government

will be overwhelmed with these requests, so they will need to put some fixed guidelines in place.

Employees are your lifeblood. They're on the front lines and feeling the impact of the economic decline. They may be cautious moving forward, and to win them back, consider a new model: more profit sharing. As your restaurant improves financially, employees can share in the success. In this model, management will be a smaller group with a flatter structure. Profit sharing can take many forms—discuss this idea with your attorney and accountant.

My final thought concerns tipping. Many restaurants have had problems with the traditional tipping model as it doesn't provide a broad base for paying staff, particularly the back of the house. The solution appears to be a straight service

charge/gratuity, which would be owned by the restaurant and then divided by the management as they see fit to adequately compensate their workers. This is subject to state and local law, and some courts have even ruled on this issue.

Those are just a few initial thoughts. We need to have an open forum, so if you have any suggestions or creative ideas, email them to me, and we'll work as a clearinghouse for some of these important ideas that will surely emerge as a result of this crisis.

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