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OUTLOOK

Landlords and Tenants No Closer to Detente

On March 19, I published an article urging restaurant owners to quickly implement a series of financial actions to preserve liquidity. One recommendation I made was to immediately call or send an email to their landlords, telling them they would not be receiving April rent. Mind you, restaurant sales were collapsing around the country, and earlier that day, California's governor had issued a stay-at-home order, the first in the nation. Soon, other states would follow.

That article received more attention than anything I had previously written in 30 years of publishing the Monitor. It was shared on social media. Franchise associations sent it to their members. CEOs sent it to their franchisees.

As the former CFO of a restaurant franchisee, I know all too well the insidious nature of negative working capital. When sales are suddenly cut off in a restaurant business, for whatever reason, payroll and payables are immediately due, and fixed charges continue.

What followed in the latter part of March and early April was surreal. The stay-a-home orders exacerbated a liquidity crisis unseen in the restaurant business. Restaurant operators scrambled for cash. Bank lines of credit were drawn and development and remodeling commitments shelved. Companies that thought they had solid credit lines from hedge and private equity funds were told no mas. Inventories that had not been paid for were donated or thrown out. Most depressing were the mass layoffs of managers and hourly workers, many of whom received little notice.

Not everyone was thrilled with my liquidity preserving ideas. An hour after I hit the send button, I received an email from the CEO of a real estate investment trust upset that I would advise restaurant owners to violate their lease contracts. He was also angry that I told them to disable the auto-pay feature on their bank account. Shame on me.

That some landlords think they would go unscathed from one of the most calamitous events in American history, and one especially devastating to a large number of their retail and restaurant tenants, was wishful thinking. While a landlord's position on the crisis might confound their suffering tenants, it wasn't a surprise to me. I've been on both sides of the landlord and tenant divide and knew landlords would fight hard to keep their rent rolls from collapsing.

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Mark Your Calendar
Restaurant Finance & Development Conference
November 9-11, 2020 • The Wynn, Las Vegas

We're asking you to mark your calendar, not necessarily make a commitment right now. RFDC involves months of planning and that's what we are doing—planning on holding the event, November 9-11 at the Wynn Hotel. We trust you'll decide for yourself whether you want to travel to Las Vegas in November.

RFDC is not a conference that can easily transform itself into a virtual event. While the workshop sessions might work on Zoom, long-time attendees know that dealmaking is the reason most people attend. It's tough to make deals online. In times like these, there is going to be a lot of negotiating and renegotiating going on between operators and bankers and landlords. Plus, opportunities that arise from the economic disruption aren't found online.

We're working with the Wynn Hotel to comply with federal and state requirements for sanitation and social distancing, and the Wynn has published a compendium of their new safety protocol which will be available to attendees. Between now and November, the hotel will be holding hundreds of events and conferences that we and they will learn from. We're lowering the capacity of this year's conference, too. That should help make attendees feel more comfortable given the large amount of space we have booked.

In the next month, we'll offer our subscribers and recent conference attendees an opportunity to reserve a spot at this year's event. Then, we will open up registration online at www.restfinance.com until we reach a safe capacity. If you register and pay, and then decide not to attend for any reason, or if we are forced to cancel given a stay-at-home order or shutdown in air travel, we'll refund every nickel to you, no questions asked.

I hope you will consider attending the conference this year. It will probably be the most important event in the 30 years we have been producing it. Take your time to decide. We've got six months.

—John Hamburger

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Wintrust CEO Built Bank One Location at a Time

Wintrust Bank CEO **Ed Wehmer** recalled his dad asking him in high school, "What're you going to do for your career? Why don't you be a CPA and then you can go around and ask any questions you want about all sorts of businesses?"

And unlike a lot of high school students, he took his dad's advice. When he was with accounting firm Ernst & Young in the late '70s, early '80s, he says, "I acclimated toward banking," as part of the team helping merge banks.

"That was a lot of fun," he said, "but I never wanted to stay in public accounting." So, Wehmer joined a customer's business and became the CFO at a bank where he helped acquire other community banks. And those acquisitions led him to find an opportunity.

"All those banks buying up smaller community banks left a void," he said. Their research showed people really did want a bank that had high-touch service and was also a part of the community. In 1991 he resigned, and along with the other Wintrust founders, put together a business plan "over some beers and cigars," and rented an 1,100-square-foot space in downtown Lake Forest, Ill.

When he showed up his first day, he quickly realized he didn't have a place to sit. "I called my wife and she drove over with a card table and a chair, and off we went," said Wehmer, whose accessible and jocular personality comes through, even over a phone call.

The first location was funded by a group of investors, as were the subsequent branches, each with their own holding company. The banks dotted the Chicago suburbs—different banks with different shareholder groups. In 1996, Wehmer and team brought them under one holding group, Wintrust Bank, and began to acquire other banks, as well. Today, they have 150 locations.

Along the way, "I learned what to do and what not to do," he said. "One thing is don't be too concentrated in one thing. You can't just have commercial real estate. One third of our portfolio is dedicated to niche businesses."

Enter **Sandy McCraren** who has been with the bank for almost 20 years. McCraren ran the Highland Park branch for years, and had a relationship with McDonald's Corp., financing its franchisees.

"Sandy came along with the idea of financing franchised restaurants," said Wehmer. "She had the expertise, so I said 'Let's give it a whirl,' and she began to expand that business." A few years ago, McCraren's team purchased one of GE Capital Franchise Finance's restaurant portfolios as GE exited the finance business, which sent Wintrust on the path to exponentially growing that business.

"We are very flat organizationally, and we like to let people be entrepreneurial," he said. "We set up good guard rails and let people do their own thing." Including all its businesses, Wintrust Bank has grown to $42 billion in assets today. And, it's franchise group is considered a player in today's restaurant finance market.

Today's environment

Like other banks, Wintrust is receiving customer calls about loan deferrals due to the coronavirus, which they are accommodating. "If they ask for it, they get it," he said. When the Monitor talked to Wehmer, Wintrust was offering 30- to 60-day deferrals, "tacking the payments to the end" of the loan.

The CARES Act in April made life for bankers extremely busy. The Act, which included the Payroll Protection Program (PPP), offered small businesses "a loan designed to provide a direct incentive for small businesses to keep their workers on the payroll. The SBA will forgive loans if all employees are kept on the payroll for eight weeks and the money is used for payroll, rent, mortgage interest, or utilities," according to the SBA website.

Bankers across the U.S. put in long hours, seven days a week, as demand for the loans usurped the amount the government earmarked for it. Plus, PPP was confusing, as the SBA changed the rules as banks were processing the loans. "Sandy and her crew processed 227 loans, funding $214 million for their franchise customers," he said. In total, Wintrust processed 11,000 PPP loans during the first round of the program.

Wehmer's direct communication style made it easier for team members to take on the overwhelming task of processing that many applications, said McCraren. "Ed had calls with us every day," she added, which helped build camaraderie throughout the bank. "He's a problem solver. He doesn't wait around for a solution, he creates the solution."

His team put together a system in one week to process the loans, reported Wehmer.

"Everyone across the bank, everyone, was part of this," said McCraren. "I'm so proud of our team."

Wehmer believes the banking system across the U.S. is prepared to weather the crisis, including having more capital available than during the last recession. "In the last recession you had an asset class that went sideways," he said. "In 2006, the circuit breakers were popping. This is totally different. The government is responding appropriately and the regulators are being smart about it this time."

He agrees with economists who say the U.S. will have a U-shaped recovery: a sharp decline, a period of stagnation, and then a healthy rise back to recovery.

Wehmer is optimistic: People "felt good going into this, and I think people will get back to normal—maybe slower, but they'll get back there."

Snow to Head WSFS' Franchise SBA Group

Most would think starting a new job with an SBA lender on March 30 this year would be overwhelming. Banks, especially those that have an SBA group, are inundated with helping business owners access the SBA's Payroll Protection Program (PPP) during the current crisis. But that's not how **Richard Snow** reacted.

"I got to jump in with an amazing team at WSFS Bank right away to support our small business owners during this time of need," said Snow, who joined WSFS as VP/ SBA National Franchise Relationship Manager. "During

my first several weeks with the WSFS SBA team, I was able to help with the PPP loan process within the bank to make sure we were servicing our clients at a high level. It is a core directive at WSFS to relieve some of the financial stress our business owner clients are experiencing due to Covid-19."

Snow joined WSFS to lead the bank's national efforts to provide SBA-guaranteed 7(a) funding to franchises. Before WSFS, Snow was with Benetrends as an SBA Funding Specialist working to fund franchises in the USA and Canada.

His goal is to make WSFS a "go-to" bank in franchise lending, and "execute a flawless process," including efficient closings so customers can open their business faster. It requires a high level of service, he said, and that means understanding the goals of the franchise brand as well. "Which markets will you develop? What are your development goals?" he said.

For Snow, helping entrepreneurs is why he goes to work every day. He even has a personal podcast show, The Smart Start Now, to help inspire minority entrepreneurs on building their own business, and is on the board of the International Franchise Association's Diversity Institute.

"I love the franchise industry," he said. "I love what it can accomplish and how it changes lives by building legacies. I get a rise out of helping entrepreneurs."

And, he believes the franchise industry is learning how to adapt in a Covid-19 world. The franchises that prepare the most will take off once again when it passes and the economy re-opens, he said. While Snow and his team are working with brands to help franchisees access PPP and other programs, "we're still having conversations with brands about funding their franchisees' growth. These clients are still making decisions to open and launch successful brands." You can reach Snow at rsnow@wsfsbank.com, or at (609) 589-1335.

Bohac Joins Franchise Capital Solutions

Larissa Bohac recently joined financial advisory firm **Franchise Capital Solutions** as Business Development Manager. In that role, she will be building and managing relationships with both lenders and franchisee clients.

Bohac has past franchise finance experience with First Franchise Capital, where she worked on conventional financing with customers, and then with Pacific Western Bank where she assisted customers with SBA financing.

"It is nice to have a background in both SBA and conventional," she said. "I can help the franchisee figure out what the best route is for their business."

Bohac grew up on a Nebraska farm family and worked in the ag industry early on in her career, "which made me feel connected to my family," she recalled. "I learned so much about business and relationships there, and it carried over into franchise finance easily."

Lynsay Luchsinger, who founded Franchise Capital Solutions in 2019, met Bohac while they both worked at First Franchise Capital.

"In the short time she has been with us, she's been a great asset," said Luchsinger. "She's bringing bright and fresh new ideas to the table, and she looks at things at all angles" when discussing transactions.

Franchise Capital Solutions works with both larger and smaller franchisees to help them fund their businesses. Recently, both Luchsinger and Bohac have had plenty of conversations with those clients about the current state of the industry during the Covid-19 crisis.

"The franchisees are being pulled in so many different directions and aren't sure which way to go," said Luchsinger, "and they just need to get what they need to continue with their business." Although Franchise Capital Solutions didn't get actively involved with clients trying to access the SBA's Payroll Protection Plan in April, they helped with advice along the way.

"Because of the relationships we have, we were very well versed on the different programs that were available, and we could point them in the direction we were told would be the quickest way to get their funds," Luchsinger said. "All we ever want to do is be here for whatever franchisees need and we were able to do that." You can reach Larissa Bohac at 402-615-0181, or at Larissa@franchisecapitalsolutions.com.

National Franchise Sales Completes Del Taco, Denny's Deals

National Franchise Sales (NFS), a firm that focuses on restaurant mergers and acquisitions, recently closed on the following transactions for clients:

• Completed the sale of multiple Del Taco franchises between existing Del Taco franchisees **Zara Investment, LLC** and buyer **AMB Foods, LLC**.

• Represented the seller of three **Denny's** restaurants and fee properties in Fort Myers, Fla. NFS worked with **Colliers International** on the real estate assets, and negotiated an agreement with Colliers to assist in real estate valuation and its subsequent sale. An existing franchisee purchased all three Denny's and the underlying real estate.

• Executed the sale of a Haagen Dazs unit between seller **Wilsons Away, LLC** and buyer **Tully Creamery, Inc.** who was actively looking for acquisitions, and is new to franchising.

• Completed the sale of nine **Jack in the Box** franchises in the San Diego, Calif. area.

• Sold a Dairy Queen restaurant and real estate in Springfield, Ohio for the seller, **AN Plataniotis, Inc.** The buyer was **Tim & Carla, LLC**, who is new to the Dairy Queen brand.

• Sold for multi-unit franchisee **Downie, Inc.** their IHOP restaurants and fee properties to **MBM Brands**, a private office new to the IHOP brand. MBM is a group of individuals from the investment banking and family office communities with backgrounds in technology, real estate, restaurant development and operations. Current holdings also include Burger King and Jimmy John's restaurants.

For more information, contact National Franchise Sales President **Jerry Thissen** at 949-428-0481 or at jt@nationalfranchisesales.com.

FINANCE SOURCES

Realty Income's April Little Remains Optimistic, Sees Continued Demand for Restaurant Real Estate

April Rochetti Little had an early role model in her grandmother, who was the only female car dealer nationwide for years. And when she was 13, her uncle and mentor, also an entrepreneur, gave her a book on how to accumulate wealth: by owning real estate.

"I grew up in the family business," said Little. "When we would sit around the table, we didn't talk about clothes or shoes," or even about what the neighbors down the street were up to. "We talked about deals, customers."

And she read that book gifted by her uncle. "I knew back then that the car business was not my passion, but I liked the finance part of it. And I also learned I liked real estate."

It's not surprising, then, that Little graduated with a degree in economics and finance from Southern Illinois University. She began her 25-plus year finance career on the debt side of consumer finance before transitioning into the REIT space in 2007. She spent 10 years at Spirit Realty Capital where she became a leader in the net lease space. In 2017, she joined **Realty Income** to serve as vice president of acquisitions. In that role, she works with tenants, investment banks, private equity firms and various real estate brokerage firms in an advisory role to assess current market conditions, capital needs and provide sale-leaseback structures.

That position has kept her busy. Realty Income is one of the largest single-tenant triple net lease REITs in the country with a vast amount of low-cost capital. Its portfolio currently spans more than 6,400 properties across restaurants, retail, and industrial assets among others. The firm completed approximately $3.7 billion in acquisitions last year alone.

Little points to restaurants, QSR in particular, as the "darling" of the net lease sector, as well as an area of focus for Realty Income. "We love the restaurant space. We try to do as much business as we can in the sector, and it continues to be a very important part of our business model," she says.

And as the restaurant world has been turned on its head due to the pandemic, she says that focus on restaurants is not going to change.

"We have a solid balance sheet, and we are very well capitalized," she said. "We are liquid and will continue to be. We consider our tenants our partners and we want to grow with them. In this cycle this is even more important to have those attributes."

And just like other landlords, Realty Income has had tenants ask for rent deferment through the crisis. "We have worked with those who have asked for some type of relief," she said. "We feel very comfortable with our balance sheet and the strength of our tenant base."

Some REITs, Little says, will spend the next few months managing their portfolio because of their tenant mix and cost of capital. "If their tenant mix isn't paying (rent), then they are going to be focused on May, June and July with their tenants," she described. "And then, their cost of debt has increased, because the risk has increased. And that cost of capital is very important." Some REITs will be sitting on the sidelines for a while, she predicts.

"Because we are well capitalized and liquid, we'll be able to continue to acquire."

And for restaurant operators coming out the other side of this, "They knew what their real estate was worth, pre-covid," she said. Little anticipates there will be a change in value, "but it won't be hugely different." She says it will depend on how long the covid shutdown and the reopening will last.

But she remains optimistic. While a pandemic is certainly a struggle like we've never seen, "we've been in tough times before, where businesses were shaken to their core, and worried that they wouldn't survive. This isn't going to be a three-year downward trend. We will have the event early on, and there will be consequences of what happened. We'll work through them, this will pass and we'll get through it together." For more information, contact April at alittle@realtyincome.com or (480) 216-8380.

Advanced Restaurant Sales Closes Popeye's Deal

Restaurant broker **Advanced Restaurant Sales** recently closed a three-unit Popeye's transaction. The restaurants, located in Illinois, were sold to **Gulshan Inc**, a large franchisee with approximately 250 Popeyes. The seller was **Ali Iftikhar Gilani** and company. Gilani is still an active franchisee in the system, with locations in the Northeast and Midwestern United States.

The sale closed during the pandemic, said **Rob Hunziker**, founder of Advanced Restaurant Sales, and still both parties in the transaction are looking for new acquisitions.

Even during this time, "there continues to be equity capital available for acquisitions," he added. "Some lenders are beginning to review new loans, although the Payroll Protection Program is still occupying most of their time." For more information, contact Rob Hunziker at (678) 229-2384 or at rhunziker@arsales.biz.

Auspex Supports Clients Through Covid-19 Crisis

In response to the impact the Covid-19 crisis is having on the restaurant industry, **Auspex Capital** has ramped up its debt restructure and strategic advisory practice.

The investment banking firm is working with clients on their Payroll Protection Program (PPP) application process, developing strategies to maximize PPP loan forgiveness, crafting payment deferral programs with franchisors, lenders, landlords and other vendors, as well as assisting management with the development and continuous refinement of cash flow models to help them navigate through the crisis.

"Auspex has eight senior bankers on its team, all of which have at least 10 years of experience in restaurant finance," said **Chris Kelleher**, managing director with Auspex. "We were all heavily involved helping our restaurant clients successfully navigate through the 2008 to 2010 financial crisis and we are all now fully committed to getting our clients though the current contagion." For more information, contact Chris Kelleher at ckelleher@auspexcapital.com or call (562) 424-2455.

How Do I Come Up With the Money to Reopen My Restaurant?

This seems to be one of those constant questions out there, even though many multi-unit operators and independents have received funding from the Paycheck Protection Program (PPP). These programs were just a way to get employees back to work, and will not provide sufficient funds to reopen restaurants. So what are the funding sources you should be looking at? As you can see, there is no silver bullet, but here are my 12 best ideas:

The first and most important step in the process is to determine what the true cost of opening the restaurant will be, including the cost of new safety requirements. What is the necessary level of working capital to get sales back to a break-even level? These items may seem unknown right now, but they have to be estimated. Once you have these numbers, you are ready to move forward.

Here are some ideas:

1. Landlords: This is as good as any place to start. Your landlord may have deferred your rent and helped you in other ways, but certainly the landlord has a great interest in seeing you succeed. This is so true because new prospective tenants are in short supply. Add to that the inability in many states of the landlord to take legal action if you default on rent. So ask the landlord for help to get open and become viable. Can they provide a loan that can then be paid off over a reasonable period under the lease? Are they willing to look at making certain improvements in your restaurant space, particularly if you have to create new configurations of seating and other items to comply with the new consumer needs such as takeout and delivery? Will they go to a straight percentage rent for several years?

2. Existing investors: If you have existing investors, are they willing to make a loan, or increase their investment? Maybe you could create a preferred class of stock for them, so they get their money back first, with a return. There are many ways to put a structure together that will work for inducing investors. Just ask them what they need.

3. Your existing bank: Banks have been so swamped with PPP loan applications, they haven't been able to consider other credit needs. It is still a potential source of funding that should be pursued, particularly if they have made a PPP loan to you.

4. Mezzanine or subdebt lenders: This is high-priced, but these second-position or unsecured loans are something to consider. Sometimes these funds are provided through small business investment companies (SBICs). Other times they are family office individuals that want a higher return. Nonetheless, it's something worth considering.

5. Friends and family: Friends and family are always an immediate option. You should certainly look at doing this in as much of an arms-length manner as possible, with a formal security offering. It may be friendly unless things don't work out, but they are always a great source if the family has resources.

6. Suppliers: Suppliers have had difficult times, but there are still some who are perhaps willing to sell you goods and services on credit to get you back on your feet.

7. Insurance: Many insurance companies are providing refunds because payrolls have been down and a number of insurance components are tagged to payroll cost. Additionally, if you serve liquor, your dram shop coverage may deserve a refund, since there may have been limited liquor sales.

8. Taxing authorities: As we have said in previous articles, there are always a number of tax items, including the deferral of certain payroll tax and carrybacks for losses, that in the past probably were not available for refunds. There are also certain new tax credits.

9. Crowdfunding: I think this may be one that many restaurants are going to try to use. There are two types of crowdfunding. The first is equity, where you raise money through equity or a simple debt offering. The second, probably more appropriate for reopening, is the Kickstarter or what we call a reward program. It could involve offering special discounts, gift cards or special clubs. In most cases, it requires using a platform and may or may not be effective, but it is something that certainly should be considered.

10. Selling memberships: If you have several restaurants, there is a group of people, particularly one in the Twin Cities who, prior to the pandemic, were able to sell a membership program through which, for a monthly fee, members could dine in the restaurants under certain circumstances and for a certain amount, thus providing upfront funding. This may fit the new price-conscious consumer who wants safety and certainty in their experience.

11. Gift cards: As I stated before, look at gift cards and try to provide some significant discounts, probably more than the normal 20% to 25%. Possibly a higher amount will get consumers back in, which is great, but it will also give you upfront cash.

12. Sale of unique events and private dining: I have seen restaurants where most of their private dining was cancelled, but they've gone out and tried to sell prepaid events and private dining, bringing chefs into people's homes to make meals for a hefty price. It might be a little tricky in light of what we've gone through with our social distancing, but it is something worth a look.

Those are just a few ideas, and while none of them will offer the full solution, all are important to consider. It is going to take a lot of hard work and creativity to get back on our feet.

Dennis Monroe is chair of Monroe Moxness Berg, a law firm which focuses on M&A, taxation and other business matters for multi-unit restaurant businesses. You can reach him at dmonroe@mmblawfirm.com, or at 952-885-5962.

FINANCE INSIDER

Clairvoyant. That's what we would call Wall Street research analyst **Mark Kalinowski's** prediction at the November 2018 **Restaurant Finance & Development Conference**. During Kalinowski's presentation—What could **JAB** or **Roark Capital** buy next?—Kalinowski suggested that based on Roark's publicly stated criteria, the PE firm's most likely next acquisition would be **The Cheesecake Factory**. Fast forward to April 2020 and Roark steps up during the middle of the restaurant shutdowns and makes a $200 million strategic investment in Cheesecake.

Compare that deal and the one **Bloomin' Brands** (Outback Steakhouse and Carrabba's) made with Mr. Market. Both companies raised $200 million each—Bloomin's issued convertible debt, while Cheesecake issued a convertible preferred. What's the difference between the two types of securities? Both stand in front of the common shareholders in a liquidation and both are convertible into common stock. In terms of cash flow, Cheesecake pays a 9.5% coupon to Roark, a non-deductible payment because it is considered equity, while Bloomin' pays its noteholders a deductible 5% coupon. Much better deal for Bloomin'. The dilution that occurs when the security is converted into common tells you how expensive the deal really is. For Bloomin', the conversion premium, that is the price at which you convert the notes into common stock was at $11.89 per share, 25% higher than the price of the stock when the deal was priced. Cheesecake, on the other hand, issued Roark a right to convert the preferred stock into common at $22.23 per share, a 19% premium, and not quite as good as Bloomin'. Neither company wanted to make a deal of this sort, but it seems the market gave Bloomin' a better deal than Cheesecake got from Roark.

Food distribution consultant **Bob Sala** told the Monitor that broadline food distributors, such as **Sysco** and **US Foods**, were running higher gross margins before covid than he had ever seen because of the growing number of independent restaurants. "Now, most distributors would love to have a customer that is open and pays like some of the national and regional QSR brands. The distribution community will continue to consolidate, but at a faster rate given liquidity issues and weak balance sheets," said Sala. For more information, contact Bob Sala at bsala@ceopartners.com.

PE fund **Prometheus Partners** coughed up the equity in a 49-unit **IHOP** franchisee to creditors late last month. The franchisee, **CFRA Holdings** and **CFRA Tri-Cities** (CFRA), had closed all of their locations and filed bankruptcy on May 6, blaming Covid-19. Bank creditors include **Valley National Bank** ($7.8 million) and **Raymond James Bank** ($10.6 million). CFRA operated IHOP restaurants in South Carolina, North Carolina, Tennessee and Virginia. Last year the company had sales of $78 million. **Trinity Capital** is advising CFRA's chief restructuring officer.

Given the disruption in restaurants, **CohnReznick** has created a restaurant realignment and restructuring team. Cohn's hospitality managing partner, **Cindy McLoughlin**, told us the firm has assembled a team from its hospitality and restructuring and dispute resolution practices to help restaurant companies restructure leases, evaluate potential store closures, plan for reopening and provide cash flow and budget modeling. If need be, Cohn's team will also perform a chief restructuring officer role. Cohn's chief strategy and growth officer **Gary Levy** said the firm's goal is to help companies explore opportunistic strategies before things get worse down the road. For more information, contact Cindy McLoughlin at cindy.mcloughlin@cohnreznick.com.

Dine Global Brands CEO **Steve Joyce** must have a lot of time on his hands. The CEO of the coronavirus-challenged Applebee's and IHOP franchise joined the board of publicly traded **RE/MAX Holdings** last month.

That was a quick $100 million frittered away in the March 2018 go-private deal that moved the 110-unit casual-dining brand **Bravo Brio** from the public to the private ranks. And now on to federal bankruptcy court, where the company filed Chapter 11 last month. Swiss private equity fund **Spice Equity**, majority owned by **GP Investments**, wishes they hadn't written that $71 million equity check, while specialty lender **Garrison Capital's** wallet was lightened to the tune of $21 million for a debt advance. Bravo Brio, renamed **FoodFirst Global Restaurants**, was engineered by **Brad Blum**. The former Darden executive's plan to build a "good-food-for-you" version of an Italian restaurant chain, unfortunately ran into the reality of casual dining and two, past-their-prime Italian chains. **Serene Capital** acquired Garrison's $21 million debt position and is hoping someone will come along (Robert Earl is rumored) to pick up the pieces. As of bankruptcy filing date, the company was operating 21 locations for takeout only, while 80 locations were closed. The company has already rejected the leases at 53 locations.

This from attorney **Gary Bubb** with the Boston law firm of **Ruberto, Israel & Weiner** on the Paycheck Protection Program (PPP) loan forgiveness: "Now the IRS has stepped in and helpfully pointed out that, under other tax law principles (specifically, Section 265(a)(1) of the Internal Revenue Code and related regulations), otherwise deductible business expenses are not deductible if they are 'allocable' to a 'class of exempt income' that is excluded from gross income. The IRS reasons that the PPP provision that excludes forgiven amounts from the borrower's gross income is the kind of thing that Section 265(a)(1) is talking about. As a result, deductions for payroll costs, mortgage interest, rent and utilities are prohibited because allowing these expenses as deductible items would constitute a form of double dipping."

The narrative changed immediately after **Shake Shack** returned their $10 million Paycheck Protection loan to the government last month after widespread criticism in the media. **BTIG** analyst **Peter Saleh**, in a note to investment clients on May 5, referred to Shake Shack's $247 million cash balance as a "cash hoard of outsize proportion to historical levels and the company's modest cash burn rate." Why did Shake Shack take a PPP loan again?

Founder and former CEO of Daphne's Greek Cafe, **George Katakalidis**, has joined the restructuring and workout firm **CR3 Partners** as a restaurant industry specialist. Katakalidis, who ran Daphne's for almost 20 years, told the Monitor restaurant stakeholders will be considering all of their restructuring options given the severity of the sales decline due to the coronavirus. For more information, you can contact Katakalidis at george.katakalidis@cr3partners.com.

It took no one by surprise that the 97-unit **Garden Fresh**—Soup Plantation and Sweet Tomatoes—would not reopen its stores. The company, which had annual sales of $250 million and was cash flow positive going into the crisis, couldn't find a path to reopen its buffet restaurants under new social distancing requirements. That, and $2 million per month in rent obligations were reasons enough to permanently shutter the stores and file Chapter 7. Last month the company's PE sponsor **Perpetual Capital Partners**, a Washington, D.C.-based private equity firm, and Garden Fresh management decided not to apply for a loan under PPP. Perpetual paid roughly $90 million (the amount of the outstanding debt) in 2017 to acquire the company, investing $35 million of equity, with the balance of the senior debt held by **Cerberus Capital Management**. Garden Fresh had previously filed Chapter 11 in 2016, 11 years after being acquired by **Sun Capital**, a PE fund.

A sign there may be a resurgence in the restaurant market? **TAGeX Brands** CEO **Neal Sherman** reports traffic to the company's used equipment auction sites is up four fold with more than one million views per month. "First movers are closing locations, redeploying assets, monetizing surplus equipment for cash and value buying in the aftermarket," Sherman told the Monitor.

How do you pay off $33 million in senior and mezzanine debt with only 28 restaurants? You don't, especially when the coronavirus shuts you down in the middle of the busy season. Chapter 11 was the next stop for **TwoJay's Deli**, the Florida family diner, after being acquired in 2018 by PE firms **Branford Castle** and **Brookside Equity Partners**. **Monroe Capital**, a direct private company lender, advanced $26 million to TooJay's, while two of Brookside Mezzanine Funds advanced $7 million. TwoJay's recently borrowed $6.4 million under the PPP, which they said they plan to use on payroll and other expenses, including rent.

A Monitor reader and finance executive went undercover to work as a **Domino's Pizza** driver to understand better why the brand remains the top pizza chain in the U.S., even during a pandemic. His take: Training is key, and strict rules are enforced. Drivers are the only face-to-face contact that delivery customers have and appearance is important. Drivers dress in the logoed shirt and black pants, with no visible tattoos and hair color must be a natural shade. Drivers handle multiple tasks while waiting for the next delivery, including folding boxes, taking phone orders and pulling pizzas from the oven. Many drivers act as store closers and clean up for the next day. Each one clocks in to get into the queue for their next delivery, and logs into the delivery-tracking app so the store can track the exact time each pizza is delivered and when the driver returns to the store. Domino's added new training steps during the pandemic, including wearing a mask while in the store and for each house delivery. Upon return, each pizza bag must be sprayed with disinfectant and the drivers' hands washed in hand sanitizer. Training also includes safety factors like driving speeds and how much cash a driver can carry. Disciplined steps achieve consistent execution and accuracy, down to the detail of how many cups of ranch the customer requested.

Hopdoddy CFO **Todd Wilson** illustrated sales ups and downs during a May 12 webcast hosted by attorney Riley Lagesen of Davis Wright Tremaine. Wilson, who noted 86% of the chain's pre-covid's sales were dine-in, said business tumbled about 70% the week of March 22 but improved by 20 points in April. Then, in May, when Texas allowed dine-in business to resume at 25% capacity, the Austin, Texas-based chain opened "four-to-eight table" patios instead of dining rooms. (Two-thirds of Hopdoddy's 35 units are in the Lone Star state.) Doing so, Wilson claimed, boosted sales another 10%. "When we look at where that 10% improvement has come from," he explained, "we've given up about 5% of our to-go business but then picked up 15% of dine-in business—and the combination of the two is our 10% gain."

Publicly held **Meritage Hospitality** is typical of most franchisees in that it suspended capital expenditures and requested rent relief from landlords and interest-only payments from its bankers. Unlike other franchisees, the 329-unit Wendy's franchisee repaid its PPP loan of $29.1 million.

Sardar Biglari's namesake holding company, Biglari Holdings, which owns **Steak 'n Shake**, acquired **Southern Oil of Louisiana**, an oil and gas company for $51 million in cash last fall. Since then, the price of West Texas crude oil has fallen from roughly $50 to around $25 today, and oil and gas valuations have plummeted.

Valuations among publicly traded restaurant companies have gone wacky, and not in a humorous way. Or so Bloomberg analyst **Michael Halen** believes after calculating that valuations are now 58% above than their 13-year average. "The group's 17.5x enterprise value to 2021 consensus EBITDA compares with the 6.4x forward-EV-to-EBITDA bottom during the Great Recession," he wrote in a May 14 note. Why should this be the case, particularly during a time of great uncertainty? After all, restaurant same-store sales are in the tank and the country, Halen worries, "is headed for a recession marked by unemployment that could rival the Great Depression." The conundrum has left him scratching his head. He cites casual-diner **Cracker Barrel** (CBRL), now trading at 24.4x forward earnings, 38% higher than the peer average. "Typically, lower multiples are assigned when future earnings are uncertain to account for greater risk," he reasons, bleakly adding "the S&P Supercomposite Restaurants index appears to have disconnected from the pandemic-driven industry upheaval."

MARKET SURVEILLANCE

During the Great Recession, a running joke within the restaurant finance community was that few new restaurant loans were being made, but nevertheless, some banks counted "extend and pretend" amendments as new business.

Restaurant companies thought the recessionary hit was bad the last time, but this time, the economic numbers are plain brutal. About 20.5 million people lost their jobs in April, and the unemployment rate is now 14.7%, the highest rate in modern history.

According to the economist, Brian Westbury, during the subprime-mortgage panic of 2008, payrolls declined 8.7 million over a 25-month period and the jobless rate peaked at 10%. "Now, it looks like we lost almost three times as many jobs in just one month."

In 2009, for instance, the money handed out by the government consisted of $600 stimulus checks and a poorly designed "Cash for Clunkers" auto incentive.

In 2020, the year of the Covid-19 panic, there are billions in Paycheck Protection Program loans being funneled to businesses to keep workers employed, stimulus checks have doubled to $1,200 per person, and the unemployed can now receive a $600 weekly supplement until the end of July. Some of that money is going to buy food and beverage at restaurants.

Pizza is killing it. Others are focusing on liquidity and trying to reduce the weekly cash burn. QSR restaurants have at least closed the gap between pre-Covid-19 numbers and the March sales depths, and some are now comping positive. Unfortunately, a significant number of full-service restaurants are likely to close, the result of the new social-distancing mores.

Restaurant operators affected by Covid-19 have relied on their banks, landlords and suppliers for payment deferrals.

On the adjacent chart, we've highlighted some of the comments we heard on their recent quarterly conference calls. Let's just say it is not a pretty picture.

WHAT THE BANKS, REITS AND DISTRIBUTORS ARE SAYING ABOUT THE CONDITION OF THE RESTAURANT BUSINESS	
Atlantic Capital Bancshares (ACBI)	As of March 31, 74% of the $176 million QSR loan portfolio is under deferral. Dunkin' franchisees represent approximately half of the bank's restaurant portfolio.
Bank United (BKU)	A big jump in delinquencies and non-performing loans hammered the bank's $646 million franchise finance portfolio. About $272 million of the loans have been categorized as substandard, or special mention, while 74% of borrowers have been approved for deferrals.
Cadence Bancorporation (CADE)	Cadence pruned its portfolio beginning a few years ago and now has 73% of its sector loans in large multi-unit QSR franchisees, including $110 million in pizza. One other fact: Of 72 clients, 44 asked for payment deferrals.
Citizen's Financial Group (CFG)	Citizen's head of commercial banking, Don McCree, touted the bank's recent acquisition of Trinity Capital, saying the boutique investment firm "happens to be very focused on restaurant restructuring businesses, so we're beginning to see some opportunistic flow there."
First Horizon National Corporation (FHN)	Almost two-thirds of the $1 billion franchised restaurant portfolio consists of QSR loans and 75% of the borrowers have 20 or more locations. The bank said it deferred approximately 40% of its loan balance and that 50% of its franchise finance customers applied for PPP loans.
Four Corners Property Trust (FCPT)	In the REIT, 426 of the 725 properties are leased to a Darden entity, and the good news is Darden is paying rent. For those that need help, there are "short-term rent performance for concessions, including lease extensions and conversion of five-year bumps into annual rent increases."
National Retail Properties (NNN)	NNN said it collected 52% of its rents for April and deferrals represented approximately 37% of its annualized base rent. Deferral terms were one-to-three months of rent to be repaid in late 2020 through late 2021.
Realty Income (O)	All of the investment grade tenants paid their April rent, but casual dining tenants paid at a 52% clip. Thankfully, casual dining represents only 3% of the REIT's 6,525 properties.
Spirit Realty (SRC)	Restaurants make up only 13.1% of the annual rent in a 1,772 real estate portfolio. Spirit says it is keeping deferrals simple: a one-to-three month deferral with a payback in 12 months starting later this year, or beginning of next year and no interest.
STORE Capital (STOR)	STORE said tenants requesting deferrals were made to sign notes with interest, higher lease payments and longer lease terms. New investment is curtailed and the REIT drew down $600 million of its credit line to preserve cash.
Sysco (SY)	Independent restaurants provide the highest margins to food distributors and CEO Kevin Hourican says he expects the independent business to "normalize and return to pre-Covid levels." No firm date was provided by Hourican.
US Foods (USFD)	The broadliner is offering consultations with chefs via Zoom and seeing an increase in business with chains and even independents, but has reserved $170 million for bad debts and has extended customer payment terms.

STATS AND QUOTES

RESEARCH BOUND TO UPEND EXECUTIVE DECISION MAKERS	
Boston Consulting Group's CFO Pulse Check Survey	CFOs are a pessimistic lot. Only 8% of CFOs surveyed by BCG expected a V-shaped recovery, while the majority expected a U-shape one. Liquidity is number one on their minds. Some 66% have stopped or delayed investments, while over half are looking for significant cost savings.
Bank of America's Survey of 1,000 Consumers	The research found 64% of respondents are cooking more at home. When asked if they would feel comfortable dining at a restaurant again, one in five said it wouldn't be until sometime in 2021.
Federal Reserve Bank of St. Louis Analysis of the Stimulus Checks	Adjusting for regional price differences, the researchers found the $600 federal unemployment benefit per week was worth the most in Mississippi ($700) and the least in Hawaii ($506). The states impacted the most from the virus, mainly in the Northeast, saw lower purchasing power.
Federal Reserve Bank of Chicago Survey	In higher-income areas, the researchers saw mobility and restaurant spending dropping before stay-at-home orders began. This suggests higher-income markets may be slower to return to restaurants and retail as the stay-at-home orders are relaxed.
Global Work-from-Home Experience Survey	Some 77% of the workforce say they want to continue to work from home at least weekly when the pandemic is over. That's a 132% increase over those who did pre-virus.
KeyBanc Capital Markets Survey of 1,000 Consumers	The research found 55% of respondents are concerned about the health of themselves and their family, and while 62% said they would avoid cruise ships in the future, only 29% said they would avoid restaurants.
Marketplace-Edison Research Economic Anxiety Survey	How tough is it out there? Researchers found that 60% of respondents said they could not pay an unexpected $1,000 expense, while 41% of respondents could not even pay an unexpected $250 expense.
Piper Sandler's Survey of 440 Consumers	Piper's survey revealed that 55% of respondents have someone in the household now working from home. And, 52% said they would consider working from home "more often" going forward.

INTEREST RATES (%)				
	5/15/20	Last Month	A Year Ago	Trend
Fed Funds Rate	.25	.25	2.50	↓
1-Month Libor	.17	.75	2.43	↓
3-Month Libor	.38	1.13	2.53	↓
1-Year Treasury	.15	.19	2.30	↓
5-Year Treasury	.31	.34	2.15	↓
10-Year Treasury	.64	.63	2.37	↓
30-Year Treasury	1.32	1.27	2.82	↓
Prime Rate	3.25	3.25	5.50	↓

Anticipating the element of surprise is not so easy wrote the late Peter Bernstein, economist, financial historian and author of *Against the Odds—The Remarkable Story of Risk*: "The constant lesson of history is the dominant role played by surprise. Just when we are most comfortable with an environment and come to believe we finally understand it, the ground shifts under our feet."

Smead Capital Management Chief Investment Officer Bill Smead's comments about the economic impact of the coronavirus: "The capital markets are a highly complex system, where perturbations can cause a tidal change. Every business around the world has been affected by Covid-19. For a profitable business anywhere, this is a calamity. For a business that was losing money before this, it's a tombstone."

Hoover Institution economist John Cochrane, author of the Grumpy Economist blog, speaking on a recent podcast: "We sort of have a plan to get us through September with only $4 trillion added to the national debt. The nightmare economic scenario is that it keeps going. It is going to be very hard for the government to stop helping people when its time to stop helping people. Suppose the economy is reopened and the restaurants say 'we want you back to work, Mr. Waiter.' But, Mr. Waiter is making more money on unemployment than he ever did at the restaurants and he is quite happy with the way things are right now. Is the Federal government going to really say 'even though the unemployment rate is 20%, employers want to hire you back again, its time to be a little less general with the unemployment benefits?' I think it's going to be very very hard for the government to stop paying. I suspect we're in for many more trillions of federal spending and money creation."

Warren Buffett speaking at the Berkshire Hathaway Annual Meeting earlier this month: "If you own a shopping center, you've got a bunch of tenants that don't want to pay you right now. And the supply and demand for retail space may change fairly significantly."

Restaurant Sales and Opportunities Post Pandemic: An Expert Weighs In

The Monitor recently asked long-time restaurant broker **Rob Hunziker,** founder of **Advanced Restaurant Sales**, what the world of restaurant M&A will look like after the pandemic.

Q: Will the major restaurant lenders be available post pandemic?

Lenders will participate, but they will first look to their current clients, who are needing to shore up their holdings. If the clients are in a good financial condition, the banks will likely be active lenders for new acquisitions. New customer activity will likely be on the backburner unless they can come up with substantial equity going in the door.

Q: How aggressive will lenders be with new loans?

Interest rates are at historic lows. Reducing principal and interest payments, and consequently keeping fixed charge coverage ratios at lender-required levels will be important. Lenders, in the short term, likely will reduce loan duration (possibly to five years from seven-to-10) and even reduce the turns on EBITDA to three (from 3.5 to 4.5). These actions will reduce risk for lenders, but require buyers to come up with more equity, at least initially.

In the short term, capitalization rates on commercial real estate will likely rise due to a temporary supply-demand imbalance due to massive restaurant, salon and other retail closings.

I am also not sure how lenders are going to calculate EBITDA: Will they will discard the three or so months that restaurants have been operating at coronavirus levels? If so, will they proforma post-virus financials, or go back to the 2019 P&Ls?

My gut is the best way to determine ongoing operations is to use proforma post-virus financials, taking into account prior years.

Q: Is there equity available for acquisitions?

There are dozens of private equity funds and large franchisees with dry powder looking for acquisitions, or partnerships with great operators and good track records prior to the pandemic. Also, individuals looking for a new direction will explore opportunities in the multi-unit restaurant industry.

Mezzanine lenders are available to offer equity in the form of preferred stock, or junior debentures for those operators with good prior track records.

Q: Has the pandemic created any changes in the restaurant industry going forward?

I think the comfort level for people ordering online and having meals delivered has accelerated dramatically, and the restaurant chains that can best take advantage of that trend will see substantial growth going forward.

Growth in pickup and delivery will accelerate. The good news for restaurants is that the cost of delivery, due to increased competition by delivery services such as Uber Eats, Grubhub and numerous new entries, will come down, allowing restaurants to actually generate profits from their delivery orders.

Online restaurant companies utilizing ghost kitchens will be more accepted now that online ordering became a necessity during the pandemic. Sales growth will accelerate in this arena.

Q: What will be the best acquisitions in restaurant companies post pandemic?

Initially, the most popular acquisitions will take place in restaurant companies that have weathered the coronavirus storm the best, such as Sonic, Checkers, Popeye's, Papa John's, Pizza Hut, Domino's and Wingstop. Don't look for any "bargains" in these brands. Many of these operators will have had the advantage of operating at full capacity and getting PPP loans which will be forgiven, in full, as they did not need to reduce staff. They will be in the catbird's seat going forward in terms of valuations.

Checkers, Sonic, and other concepts that remained open and have previously not attracted the mainstream audiences could be particularly interesting. These concepts could show increased sales going forward, as new customers discovered they provide a good product. Look for full-price sales in these concepts in the near term.

The bargains will be in casual dining and sports bars, such as Applebee's and Buffalo Wild Wings. Franchisees likely will need cash infusions, and may want to stay in the game by taking on non-operating equity partners. The upside in these brands is that they have learned to operate more efficiently and will be more profitable at lower sales volumes. Many of these companies will have taken on more debt with the PPP loans, which will not be forgiven in full. This leverage will force some restructuring, Chapter 11 filings or new partnerships with non-operators.

Other QSR and quick casual restaurants that rely more on inside dining such as Moe's, Burger King, Wendy's, McDonald's, KFC and Arby's, should get back to normal fairly quickly. Franchisees in these systems will probably not be sellers until they see sales and cash flows return to 2019 levels. Also, these brands likely have learned to be more efficient and more profitable at lower sales volumes. They took on more debt with PPP loans that will not be entirely forgiven due to the need to close some locations and dramatically reduce staff during the pandemic. Investment in these brands likely will be at or close to pre-pandemic levels. Long-tenured franchisees might be ready to sell having endured one pandemic too many.

Finally, regional concepts focusing on tourism will rebound with a vengeance, once the news cycle stops and the states open up beaches and parks once again.

Rob Hunziker has specialized in multi-unit restaurant business brokerage for over 20 years. You can reach him at rhunziker@arsales.biz.

Off-Premise Operations Rule, So Does Cash

By David Farkas

When you read this, about half of U.S. states will have OK'd the partial re-opening of businesses. Restaurants there can now serve customers in their dining rooms, though within strict guidelines regarding the number of seats, social-distancing and hygiene.

Sales increases at sit-down restaurants should thus be off to a modest start. Just how modest is anyone's guess. An April 28-May 3 survey of adults by the Washington Post and the University of Maryland provided a data point: Only 22% said they'd be comfortable "eating out in a restaurant."

Brian Morrow, CFO for Austin, Tx.-based Hai Hospitality Group expects a sluggish start as the first dining room of the company's eight high-volume restaurants opened at just 25% of capacity on May 13. That's nearly two weeks after the state allowed customers in.

"It will be a slow build and will be built through data as well as through actions we take," he says of sales and guest counts. Actions include requiring employees to wear face masks and gloves — PPE recommended by the state's health department, but not required.

The group meanwhile has established a successful takeout business where none existed. Morrow, who estimated off-premise revenues would add up to roughly $3.5 million, explains how it came about: "We used an Open Table system to come up with a curbside service where guests can reserve their spot in line in advance, and then our team calls them 30 to 45 minutes before their desired time."

"So say you want to eat at seven o'clock," he went on. "Our team calls you at 6:15 and takes the order and our chefs prepare it. You show up at 6:45. We have signs for you to text which [parking] stall you're in and your name. We have contactless delivery, using masks and gloves, and we put the food into the car. We've gotten great reviews."

Shrinking footprints, swelling off-premise

"They could do with one-third of the dining area and one-third of the kitchen and make better use of the real estate," offered Brenna Wadleigh, CEO of N3 Real Estate, referencing restaurants during a Monitor webinar on May 7.

But can smaller footprints with fewer seats, designed to accommodate off-premise sales, perform as well as current 7,000 square-foot boxes? "Ask me that in a couple of months," says Smokey Bones CEO James O'Reilly, who oversees 61 full-service restaurants, when we talked earlier this month. "We have work to do to understand that. But I do see the landscape changing. There could be lots of experimentation."

The veteran executive then describes his chain's recent efforts: "When we rebuilt our team last year, we made off-premise a huge priority, which allowed us to make a significant investment in technology and changes to our asset."

The chain is now bolstering e-commerce and loyalty platforms as well as integrating third-party delivery into the point-of-sale system, he added.

I mentioned these improvements in an email to a private equity executive whose firm has a successful track record in the restaurant space. "For the most part," he writes back, requesting anonymity, "the highest flyers in the last few years already had a substantial off-premise business, with consumer friendly technology and take out/delivery platforms."

Does that mean legacy chains like Smokey Bones are too late to the party? "It's simply harder to do when you have a large installed base or existing footprint. In effect, you are a leopard," he notes. "And for sure you can improve your life going forward, through innovation, shrinking footprints, more technology, etc. But you are still a leopard. And consumers know of you as such."

Restaurant analyst Roger Lipton nonetheless thinks the shift to tech-enhanced off-premise is worth the effort and expense for brands without drive-thrus. He reasons customers who mainly used dining rooms have now grasped off-premise's quality and convenience. As a result, these brands (Lipton cites Chicken Salad Chick) will not only revive dine-in sales as the economy reopens but boost revenues with improved off-premise models. "It's possible, maybe, that that combination will put their sales higher than ever," he predicts.

Meanwhile, some observers have predicted the collapse of the asset-light craze as highly leveraged franchisees beg for relief. Yet at least one investment banker I talked to considered such reports as premature. "Investors love the asset-light model and love the free-cash flow nature of it," he says, also requesting his name not be used.

Pricing deals in a post-pandemic world? Dean Haskell of National Retail Concept Partners describes one of his clients who's worrying about selling a small chain. "'Do I need to burn cash?' That's what's driving his thought process about selling now for asset value and not worrying about the cash burn over next six to 12 months," Haskell explains. "'If I can't sell it, am I going to have to invest in the business and run it? Or do I just shut it down and walk away?' That's his third option."

Navin Nagrani of Hillco thinks now's a great time to have cash. He recommends using it to purchase the property you're renting. "Rather than rent reduction, maybe there's a way you can buy the property from your landlord for a very compelling price," advises the restructuring expert. "As the owner and operator of the building, you can create a new lease and you can, once the market resumes, go out and sell to a REIT or institutional investor and do what I call 'the reverse-engineered sales leaseback.'"

One large landlord assembled a team to help tenants apply for Paycheck Protection loans so they'd have money to pay their rent. Mall tenants were ordered by landlords to pay rent and CAM even though malls were closed. A few restaurant operators told me they tried to reach their landlords, but some wouldn't take their calls.

What I realized most from talking to landlords and tenants over the past eight weeks were that the landlords were just as rattled as their tenants. Many of them recognize they own a lot of properties with impaired business models and too much square footage. It's also likely there will be bankruptcies, downward pressure on lease rates and having to deal with vacant properties that could sit for a long time. Don't just take my word for it: publicly held real estate investment trust stocks have been absolutely battered.

Tenants in troubled retail and restaurant segments want rent abatement, but landlords aren't willing to make those concessions just yet. Tenants should understand their landlords are still processing the potential damage, trying to make sense of what just hit them.

The landlord thinking goes something like this: "Why should I make a long-term change to my scheduled rental income right now? I'll agree to a temporary deferral and see how this plays out." To an operator whose restaurants are closed or operating at reduced capacity, the landlord's position comes off as uncaring of the predicament they are in.

Landlords became suspicious of tenants demanding rent relief before the dust had even settled. Had they abated rents for QSR tenants in late March, they'd realize their mistake in mid-April when sales turned upward.

Landlords are especially dismissive of requests from tenants who are, for now, financially sound. Starbuck's letter to landlords, which was reported in the press, asked for 12-months of rent relief. That brought a smile to one Starbuck's landlord who told me the rent, cam and tax on his lease runs less than 3% of sales. They are also wary of big retail and restaurant chains that often deputize their real estate departments and hire third-party negotiators to reach an overall rent reduction goal.

Landlords with properties leased to "investment-grade" tenants can ignore rent relief requests and just tell the tenants to pay up. Still, many of them negotiated deferrals.

For smaller tenants, especially ones in sit-down dining where their future is suspect, a deferral is just a Band-aid on a deep wound.

If a restaurant remains closed, or must operate at reduced capacity, how can the tenant afford to pay off the deferred amounts in such a short period of time? Isn't that setting up another cash flow crisis late this year or next?

Since the coronavirus crisis began, I've held two webinars on the topic of restaurant lease trends. The questions received during the webinars from landlords and tenants reflect the divide.

"Restaurants are not financially viable at 25% to 50% mandated occupancy," wrote one tenant. "Do landlords want to face a bankruptcy now and sit on a vacant property in the middle of the crisis for another year?" wrote another one. Landlords were just as combative: "I don't see tenants 'partnering' with us when times are great and they are making tons of money," wrote one landlord.

Injured tenants want landlords to share in their pain right now, but landlords say they need more time to assess the damage. Tenants say they would pay percentage rent, but landlords want nothing to do with a variable income stream. Both need predictable income streams to pay their debt obligations and for both of them, that's in jeopardy. Tenants also don't realize landlords are often more leveraged than they are.

St. Louis attorney and restaurant real estate broker David Wright believes the best result will be if tenants and landlords not try to use the situation as a means to out position the other. "The parties should be looking to mitigate the loss and pain and spread it out, versus trying to thrust it on one party," wrote Wright in an email to me.

National tenants with adequate capital and smaller restaurant owners that provided their landlords with a personal guaranty, won't see much more than a deferral for now. Tenants that are in the worst shape financially might actually be in a better position to negotiate an abatement deal.

Unless a restaurant owner is ready to flip the keys to the landlord and file bankruptcy, this cat and mouse game will continue for a quite a while.

—John Hamburger

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