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# HOW TO OPEN YOUR OWN RESTAURANT

*By Kevin Moll, President, Restaurant Consulting Services, Inc.*

Hungry to get into your own restaurant? Maybe you've looked at a couple locations, contacted a few brokers, and have toured some restaurants for sale… but you still need a little direction and clarity. This is normal, as buyers simply need to know all of the options available to them. I'm happy to share this information to help you make a wise and informed decision about how to best secure a site for your own restaurant business.

*Kevin Moll*

This article presumes that you have researched the industry, have a good concept idea in mind, understand that there are inherent risks associated with the restaurant business and that you have the experience and skills you'll need…or you have the resources to hire the talent that will be needed to open and run a successful restaurant. It also presumes that you have some substantial funding already available.

"Money fuels projects" is a common term around our office, as underfunded and/or unplanned ventures are rarely successful. In fact, our experience has shown that the number one reason for restaurant failures is the lack of having a solid business plan in advance of entering into a lease. Having a business plan that is written by restaurant professionals is significantly to the advantage of the new business owner when compared to an "out of the box" plan or a plan written by someone that does not have restaurant business acumen. Some key questions that a good business plan will answer are: What will my projected sales be? How much will this venture cost? Is there enough operating capital? What should rent cost and can the concept handle it? What size should the premise be? What will labor, food, occupancy, operating and other expenses be? Is the projected amount of profit worth it considering the cost? A good set of business plan financial projections will show not only dollar figures, but also percentages that should all be in line with, or better than industry averages.

***Nothing can replace the value of an accurate set of cost estimates and financial projections based around the concept to be opened***

Knowing what the entire project will cost and how much rent the business can handle before entering into a lease is of paramount importance from the very beginning. Many operators that do not have a business plan find themselves constantly short of adequate operating capital and they find that the rent is too high for the business. Unfortunately, once you're signed on the lease, it's too late to backtrack and do it correctly.

At this point, let's presume that you have substantial knowledge about the industry, and you're armed with a great business plan. Now all you need is the perfect location right? Well, before pulling the trigger on the first site you find, let's examine the best way for you to invest your capital.

First of all, it’s important that you understand the concept of, “The highest and best use” which is a term that commercial realtors refer to when evaluating commercial space. Quite literally it means what is the maximum result you could expect for the least possible expenditure in a specific space.

Here’s an example of “The highest and best use.” You and I both own a one acre parcel of land. I decide to build a donut shop and lease it out. I’ll enjoy monthly rental income of $3500.00. You on the other hand decided to build a 15-story building, with office tenants on the upper floors and retail tenants on the main level. As the owner and landlord, you’ll enjoy a monthly income of $35,000.00. See the difference? We both started with the same size parcel, but you made a much wiser decision then I did relative to maximizing available space on the parcel. This same “highest and best use” technique applies when determining the best path forward when opening your own restaurant. For many, once the capital dollars are spent, they’re gone, so the intent is to spend wisely and do this correctly the first time. Let’s look at some of the options available to you below.

**<u>OPTIONS FOR GETTING INTO YOUR OWN LOCATION</u>**

*These are high-level overviews of various methods of securing a restaurant space. Every transaction is unique, with buyers and sellers all having specific needs and desires. Prior to moving forward with any of the following methods, you will want your restaurant accountant and restaurant attorney identified. Before signing any final documents, wise buyers will always obtain the approval of their legal counsel.*

**FIND A BUSINESS OWNER WHO IS RETIRING**

This method takes some footwork, but if you can find a business owner that’s ready to retire, you may be in luck if you can strike a deal with minimal money down. Perhaps you can work for him/her as a manager for a period of time in order to prove your value. After closing the deal, the owner will take comfort knowing that you have the experience to run the restaurant and can make the payments out of the business. These deals are hard to find, but certainly worth exploring if your available funding is minimal but you have a solid resume. A well-written agreement is also required for this type of transaction.

**FIND AN EXISTING OPEN LOCATION. BUY OUT/RELOCATE THE CURRENT TENANT SO YOU CAN SECURE THAT PRIME LOCATION AND ITS ASSETS**

A great location that you can afford is everything in this business, and, handled discreetly, almost everything is for sale. The basic premise of this method includes:

- Initial meeting to discuss potential interest in selling the assets of the business.
- Next, the Letter of Intent (LOI) details the price, down payment, monthly payments and other matters, along with contingencies such as: due diligence period, sale subject to the successful transfer of the lease, passing plumbing, mechanical and building inspections, and successful issuance or transfer of the liquor license.
- The Asset Purchase Agreement or Stock Sale Agreement is crafted. (note that your attorney will likely have a strong opinion about which option is appropriate for you, as a stock sale transaction commonly will expose a buyer to additional, and sometimes unnecessary risks and liability).
- Lease and Agreement reviewed by your attorney.
- Closing and possession.

In many cases, having an interested party approach the seller with a buyout or buyout/relocation offer is quite a surprise. Unless you have extensive experience negotiating transactions like this, you may wish to engage a restaurant consulting firm that can professionally and confidentially represent your interests. If successful with this method, you'll have a great location, immediate cash flow and you can slowly convert the business into your own concept while enjoying income at the same time.

**FIND A DEVELOPER WHO IS LOOKING FOR A GREAT TENANT**

Real estate developers commonly seek restaurant tenants suitable for their large projects. If you can find a developer that finds your concept to be complimentary to their complex, they will usually work hard to make the match fit. The reason for this is that developer's rarely run good operations of their own, preferring to have a tenant instead. In this case, you'll want to have your business plan and pitch deck specifically tailored with an emphasis on the benefits for the developer. This type of leasing method is not very common, but it's one that you should certainly consider, especially if you are interested in expanding into multiple locations in the future. A great relationship with a developer might be the only landlord connection you'll ever need!

**GROUND UP LOCATION**

This is almost always the most expensive route to take, but for well-heeled ventures that require specific building features and trade dress, this is the route that will allow you to differentiate your brand while providing you with the amenities (such as a drive-thru window) that you may require. The basic premise of this method includes:

- Site location work
- Feasibility study to validate the location
- Business plan creation to evaluate costs/revenues
- Secure the location contingent upon city approvals and zoning
- Architectural design, construction drawings, general contractor and construction
- Completion of the 400 tasks that will be required in order to open properly. This includes the design of menus, equipment, marketing, hiring and training, promotion, systems creation and much more.

**EXISTING CLOSED LOCATION**

This type of space is referred to as, "Second generation space" because it previously housed a restaurant type of tenant. As such, the electrical, plumbing and HVAC is most likely sufficient for your needs. This site may or may not have furniture, fixtures or equipment (FF&E). In addition, you'll want to make sure that this location has a grease interceptor (trap) and a hood system. The goal with this type of site is to minimize your investment into a premise that does not belong to you. Why would you spend money to improve the landlord's building? Strange to us too, but it happens all the time.

I recently met a gentleman who, as a tenant with a five-year lease (no extension option), spent over $600,000.00 in building improvements in order to get his restaurant/tavern open. What a tremendous and unnecessary waste…you just know that the Landlord loved this tenant! If he was a client of ours, we could have saved him hundreds of thousands of dollars in costs and he would have had a busier restaurant with longer term security in the site as well. Anyway, in this type of existing/closed situation, you may be dealing with the building owner or his/her representative and as you as the new prospective tenant are not represented here, be very cautious. The general steps in this type of transaction include:

- Initial meeting to discuss site specifics, features, rent, landlord allowances and other items.
- Second site visit with general contractor, restaurant equipment dealer, designer and any others that you wish. This is a good time to provide these people with the information they'll need to provide you with quotes on any remodeling, decorating, furnishing or replacement of equipment.
- Letter of intent (LOI) created that features lease term/lease price, along with contingencies such as: due diligence period, sale subject to the successful issuance of the lease, passing a plumbing/mechanical/building inspection, and successful issuance/transfer of the liquor license.
- Lease and any other terms reviewed by your attorney.
- Closing and possession.
- You must then begin on the 400 item checklist of things to accomplish prior to opening.
- Final inspections prior to opening, then soft and grand opening.

**RESTAURANT / COMMERCIAL BUSINESS BROKERS**

In these situations, the restaurant is almost always open and the seller has determined to he/she no longer wants the business. The seller has hired a broker to promote the sale of the business and to represent the interests of the seller. As a prospective buyer, you will want to engage for someone to protect your interests – and with all due respect, many accountants and attorneys simply are not seasoned in the way of restaurant purchases. Especially if this is your first restaurant purchase, you may not know what to look for prior, so be sure to limit your financial exposure. The seller and broker have already set to the selling price, but is it a fair price? Restaurant valuations are based on many factors, but the primary three are:

1. Condition of the physical premise, including furniture, fixtures and equipment. Poor quality conditions diminish the value by 1/3rd.
2. The lease – terms, amount, other charges (common area maintenance – CAM) and other factors including transferability to the new owner, renewal options and restrictions on use. A poor or expensive lease diminishes the value by 1/3rd.
3. Proven profitability. If there is no proven profit, the value diminishes by 1/3rd.
4. Other factors to consider in the overall value include: Is there a guest database? How are the social media reviews? What is the "blue sky" potential? Can you turn around a failing business?

The takeaway here is that just because a seller determines the asking price, it's only a starting point for negotiation. Rarely does a seller achieve the full asking price. When working with a restaurant broker (or brokerage) or a commercial business broker, the general steps in this type of situation include:

- Initial meeting to discuss site specifics, building and business features, rent, lease terms, profitability, employees, operating history, liquor license – if any, and the reason for selling.
- Letter of intent (LOI) created that features lease term/lease price, along with contingencies such as: due diligence period, sale subject to the successful issuance or transfer of the lease, passing plumbing, mechanical, and building inspections, and successful issuance or transfer of the liquor license if there is one.
- Lease and any other terms reviewed by your attorney.
- Creation of Asset Purchase Agreement or Stock Purchase Agreement.
- Closing and possession. You as the new business owner then take over the business operation. Hopefully in the Purchase Agreement you included a seller "training period" to help introduce you to your new guests and the day-to-day matters of running the restaurant.

**MANAGEMENT CONTRACT WITH OPTION TO PURCHASE AT A PREDETERMINED PRICE**

If you find a restaurant with what appears to be "good bones" to it, but are not sure that it's affordable, or maybe there's a bit of uncertainty on your part that can justify an outright purchase, entering into a management contract with an option to purchase at a predetermined price may be the ideal answer for you. Note that in some states, it is illegal to operate a liquor-licensed premise under the terms of a management contract, so you'll want to investigate this prior to moving forward. A management contract type of acquisition includes a minimal out of pocket investment, immediate cash flow, and assurance of a future if you're successful under the terms of the contract. The general manner in which this type of transaction commonly takes place looks like:

- Discussion with the owner to evaluate price, property specifics, terms, what the owner wishes to achieve and to convince the owner that you're the party he/she should consider handing the business over to.
- Terms of the discussion detailed in a Letter of Intent (LOI).
- Possible due diligence period and plumbing, HVAC and building inspections.
- Management Agreement (MA) crafted that protects the interests of both parties, details the responsibilities of costs/expenses, details of the operating responsibilities, management fees and distribution of profits, along with the purchase price and clearly outlined terms and costs. This is a document that you'll want your attorney to create and then carefully review it with hospitality industry professionals as well.
- Signing of the MA, introductions to staff, ongoing operation (and hopefully improvement) of the existing business. Should you be happy operating the business, at a point sometime in the future, you may elect to either purchase the business or simply walk away and look for another deal.

In conclusion, the above methods are not all-inclusive…we've even seen a case where a long term employee become the owner of the very restaurant he started in! The goal here is obvious: a great location that's suitable for your concept, that you like, that you can afford, that will help insure a successful business. If we can assist, please give us a call.

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