New England Restaurant Broker

Seller financing is crucial in selling restaurants

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Most buyers and sellers realize that traditional banking institutions avoid financing restaurants like the plague. The SBA has programs for that purpose but the applicant has to have demonstrated management experience, collateral, a minimum of a 10% cash down payment, and the business being purchased must show enough profitability to provide a level of comfort that the business can meet the debt service.

The problem arises, for both the buyer and seller, where the buyer sees the business through rose-colored glasses and the seller can only provide tax returns that consistently show annual losses and mediocre profits to avoid paying income taxes.

Subsequently, 99% of the sale of independent food and liquor businesses require some level of seller financing. Today, the norm seems to be 30% - 50% by the seller with a negotiated interest rate in the 6% range, amortized over 3 - 5 years. In larger deals, where monthly occupancy cost may be perceived as already onerous, a seller may be convinced that it may be in his best interest to amortize his loan over 8 or 10 years with a balloon at the end of 5 years. This scenario many times provides a win-win aspect to a marginal deal.

However, what typically happens if the new owner is late on payments or stops payments? Most sellers would not like to take the business back, and I would assume most buyers do not want to put up personal collateral.

The seller holds a Note and a UCC (Uniform Commercial Code) that specifies that the business assets are the primary security. While these notes are generally signed for personally and corporately by the buyer, they usually do not have personal assets pledged. Plus the fact is, should it get to the point where the buyer isn't paying the seller, it's unlikely that they (the buyer) have any assets at all to cover the loan regardless of having signed personally.

If the buyer simply cannot pay the loan, and the note is secured by the business assets, then yes, the seller can take the business back. Unfortunately, the business is usually not in anywhere near the shape it was in prior to being sold. It usually resembles a house that has been in disrepair for quite some time. Nevertheless, this is generally the mechanics of what transpires.

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