Ep #53: The Hidden Costs Behind "Turnkey" Restaurant Listings

Full Episode Transcript

With Your Hosts

Patrick Totah and Andy Mirabell

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Welcome to *Restaurant Deal Making EXPOSED!*, the only show that equips you with everything you need to know about restaurant transactions. In this show, we tell you all about how to make the sale or purchase of your restaurant not just possible, but successful. Now, here are your hosts, ex-restaurateurs, and seasoned brokers, Patrick Totah and Andy Mirabell.

Andy Mirabell: Welcome back to another episode of *Restaurant Deal Making EXPOSED!* I'm Andy. I'm here with Patrick, and today we are discussing turnkey. Really?

turnkey is one of the most overused phrases in restaurant real estate. Many listings advertise turnkey, but the reality can be very different once a buyer or tenant begins due diligence. Often, the term is used loosely by brokers who may not fully understand restaurant operations, permitting, or health department requirements.

In this episode, Patrick and I will discuss the often misleading habit of labeling a restaurant business listing as turnkey and highlight some of the factors that can cost a buyer significantly if proper due diligence or inspections are not done. So buyer beware because turnkey can be grossly misleading.

Patrick Totah: All right. Yeah, I think turnkey is kind of misleading, and I have kind of gone away from that term, and maybe go with like second-generation restaurant. One of the things that I think about for someone who wants to bring their own concept, whether it's a chef or someone who has other locations, it's turnkey in that it has restaurant infrastructure. It has a hood, it may have a walk-in, it has floor drains. So it has the infrastructure, and I think that's what we mean by second-generation. And so you don't have to spend all your money on these big-ticket items.

However, what does it really mean when someone says turnkey? Because most of the time, when you get in there, they have to still change the aesthetics to fit their concept. Depending on how old the restaurant space is, you know, turnkey—let's say you're selling a business that's been in business for 20 or 30

years. Most likely, you're going to have to put new handwashing sinks in and FRP and maybe make some other changes to modernize the space.

Andy: Yeah. I mean, again, turnkey just literally refers to low startup cost, few changes would have to be made, minimal upfront costs or construction needs, things like that. And I just think it's kind of used way too lackluster. Yeah. Sorry, it's used way too easily these days.

Patrick: Have you ever sold a restaurant space that your client could literally walk in, turn the lights on, and start business tomorrow?

Andy: No, no. And again, I don't want to over put too much weight, more weight than need be. There's always going to be little things that need to get done. But I think it's the surprises we're talking about when someone says it's turnkey. And absolutely no, there's very, very few times you can slap a coat of paint on it and just get your health permit and press go.

Yeah. Right? So, there are some steps that come along with the change of ownership with, you know, each county's health department that really can undermine or alter the trajectory of what your client, buyer, or new tenant is getting into when they think it's turnkey. So, the biggest elephant in the room for me, anyways, here and for me to set expectations with my clients is that is the pending change of ownership inspection for each location.

This is way different than a typical health inspection. You know, they're dropping in on a business that's already operating and making sure that you have good food handling practices and your sanitation buckets are there and things are clean and chicken's not sitting over veggies, all those things, right?

This is different. A change of ownership inspection is vital in each of these transactions. And oftentimes, we have our client—we suggest that our client pays for or requests to have the health department out to provide them with a change of ownership inspection report during their due diligence so there are fewer surprises along the way with this transaction. Because the change of ownership inspection is revolves around code and current code. It may require

big changes to a space that you don't typically see, maybe when you're walking through initially.

Patrick: Yeah, can I clarify on that? So, a lot of times, I think it's really important that a seller of a business could be in 100% in compliance and you go to sell a business and you do the change of ownership inspection and the health inspector may require, like I said earlier, a new handwashing sink or some other changes. Now, that doesn't mean that the seller is not in compliance. It's the health department taking an opportunity right now to say, hey, the business is selling, and so because of that, we want these changes to kind of make it more current with where we are today.

Andy: It triggers them saying we need to bring this space to code.

Patrick: Yeah. But it's, I mean, I think that's misleading a little bit, Andy, because it's already to code because they're not getting this labeled on their prior inspections as if they're not in code. But I think they're just basically looking for the new buyer to modernize the space a little bit. And they're using this as an opportunity to do that. And furthermore, there's there's counties that are a little bit more extra with this than other counties, right? Like, I mean, we won't name any names and all, but like there are a couple counties that are way more intense with this process.

Andy: I'll name names. Yeah, no, there's tougher counties, and that is what it is. I have a really tough time in Alameda County in the East Bay. I have some very—they can be very challenging, very intensive, very in-depth reports. And that's, you know, just one example.

But maybe I'll ask you this, too, but let me share an example. I've had transactions that this has brought up massive, massive requirements that cost these buyers a lot of money. So, I remember getting a change of ownership inspection during escrow after we've removed contingencies for a buyer who was moving into a space in Oakland. And I just recall getting back a list that had nearly 48 items on it. And these weren't small-ticket items.

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These were now changing the FRP, the wipeable paneling in the kitchen and food prep areas, not only just to go up to eight feet or whatever it was, to go floor to ceiling in this high-ceiling space. They had just done the FRP a couple years before. So, that was a major ticket item. How about coving? How about removing all the tile in the kitchen on the floor and getting coved tiles so they're moppable at the edges, things like that? If the tile is not in good condition or the right kind of tile. These are expensive ticket items.

Patrick: I've had similar issues. So, like in Alameda, I sold a pizza restaurant at one point, and there's this back area where they make the dough, and the health inspector wanted the entire back area, it's about 500 square feet, to be retiled. I looked at the tile, and to my eye, was it the most new tile in the world? No, but it didn't have any cracks. It had the grout. I could not figure out for one second why they wanted this to be retiled. So we had to do it.

I had another county in San Francisco, I was selling this business for the second time in about a year, and they wanted this new sale to have a new water heater because they said the pressure wasn't strong enough. Well, I looked back because I had sold the business about a year prior, it was the same inspector, and they had said at that time to put in a brand-new water heater for a different reason. And so I went back to her, and I said, hey, we just put this water heater in last year per your spec. And now here we are a year later, and she wouldn't let up. I mean, she said basically, the pressure when I did this right now didn't meet our standards, and we have to put a new water heater in. And I'm like, so, these are things that I would say were unforeseen. Obviously, there are a lot of things when you go into a restaurant that will immediately stick out. And every now and then there are some things that…

Patrick: Yeah.

Andy: Yeah, I actually had a similar situation where they required two water heaters, not one, because the space was small but did quite a bit of volume. Yeah, it was it was lovely. Another one that could be a trigger, and I don't want to get too off tangent on this, but when someone's upgrading a space, I've had a lot of—I've had multiple occasions where they have to install a grease trap if one

didn't exist. And you can't just use the out-of-ground grease trap in the back where they transport used oil from the kitchen in a buckets back to that. They want an in one installed in-ground if you're going to upgrade the space. And that's a big ticket item.

On a smaller level here, even moving around equipment can require a new plan check or health department review. So if you, as a buyer, go into a space and you don't want that oven in the same place the past the seller had it in or you want to change the fryer for something else, you actually got to resubmit plans and specs for all your equipment. You know, you can open up a can of worms on that sometimes.

Patrick: You can. Yeah, I mean, I always tell my clients that they should, you know, either obtain their health permit and then if they want to make changes, they can work with the health department to make those changes, right? The other big misconception that I always find is that people think that as part of the health inspection, that they're going to check ADA regulation. And ADA has nothing to do with the health inspection. If you're buying an operating business and you're getting a change of ownership inspection, and there are ADA issues, that is not going to stop you from operating the business or getting a health inspection. Andy, I'm sure you could talk more about this.

Andy: You know, I can. I actually was going to ask you about that in a minute because you've dealt with it a lot. We actually do often times refer specialists to our buyers to go in and I guess either create a casp report or ADA report in order to know where there are where there's risk or where you may have to upgrade something to be ADA compliant. There's a lot of fear around ADA lawsuits. And that's a whole other story. But it's a big risk for restaurateurs and business owners.

Patrick: But I mean, it doesn't mean that you can't operate. However, it doesn't mean that you don't have liability. The time in which an ADA inspection comes around is if you did permitted work, and as part of that permitted work, then they're going to require you to bring the bathrooms to the most current spec on ADA. So, what I tell all my clients is if you have any concerns regarding ADA

compliance, you should get a CASp inspection because we're not—that's not what we do. I mean, obviously, there are some low-hanging fruit that most people are going to know or, hey, that does not look to me like ADA, but there are specialists for this.

Andy: Sure. Yeah, we can generally point out door width or angle of a walkway or slants, you know, all those things. But again, we're not going to hang our hat on that. We want you to talk to a specialist, right?

Patrick: Yeah, absolutely.

Andy: Another thing that can come up is that buyers don't, or brokers are not advising their buyers to get maintenance records for major equipment. And if you're not seeing the equipment service records, maintenance records, repair records, things like this for the major equipment, whether it be refrigeration, your hood, your grease trap, this really can bite you in the rear end later. The equipment could conk out on you a month after you take over, and it really could cause a lot of financial stress on people. So I do think it's really important that buyers get in there and inspect hoods, refrigerators, grease traps, HVAC, electrical, take a look at plumbing, things like that. It's important.

Patrick: Absolutely. And you know, these are things that you want, you know, as your agent to help your buyer request and inspect, right? I mean, you know, like major systems like the hood or the walk-in, you want to know, like, you know, was for the walk-in, when was the last time the compressor was changed? Or has there been service on it on a regular basis to make sure that it's, you know, cleaned and the filters are clean and because all that stuff does put stress on a on these on these equipment. And so, and I think a lot of times, in the restaurant industry, we get so caught up with everything that, you know, all the other things that a restaurant can bring for, you know, stress and everything. Like, are these people who are operating restaurants doing maintenance on their equipment on a regular basis? Sometimes, sometimes not, right?

Andy: Yeah, totally, totally.

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Patrick: As an agent, some of the things that we do ask our buyers to request are maintenance records like you said a second ago, health inspection prior reports. You want to also look at plumbing potentially. Sometimes you can stick a camera down there to make sure there's not going to be some major issue down the road that you don't know about.

Andy: Checking the plumbing in a business is very important because grease buildup, other buildup, linens, towels, all these things, main-line plumbing has actually been a major, major issue and cost a lot of buyers who haven't had that inspected some money, for sure.

And I think most experienced buyers know that if they're going to go into a business and they're going to pull their own permits, do their own design, things like that, turnkey is not necessarily a term that really resonates or is important to them, right? We really want to focus on, you know, it's just highlighting that turnkey should mean that you have relatively little work in order for you to get your doors open, relatively little work. But that term's thrown around, and it really can, in conclusion, you know, turnkey can really not be turnkey. And there's a lot of other factors involved that could cost a buyer or a new tenant a lot of money in order to get their doors open for their own concept. So, buyer beware, as we say, right?

Patrick: Yep. Absolutely.

Andy: So, anything else, Patrick? I was going to ask you kind of an interesting question about your own experience.

Patrick: Okay, what's that?

Andy: Yeah. Did you have any surprises when you bought your first SF restaurant? In kind of in this regard, things that were unexpected or maybe that you didn't necessarily do or were advised to do during due diligence that kind of cost you some money or stress?

Patrick: Yeah, yeah, that's funny. I remember coming in on a Monday morning, and the hot water wasn't working. And, you know, this was like probably several

weeks after we, you know, closed escrow. And also, when I bought the business, the general manager who was there was taking a vacation. So we were kind of there without the head manager. He was going back to England to see his family. And so we, me and my partner, kind of had to run the business with just the employees. And so what happened was, it was the water heater. And but we didn't even know where the water heater was. Like it was—this was in the bottom of an office building, and I guess during the due diligence process, it was never brought up, and I thought maybe the water heater was part of the building. I never because I didn't I couldn't have seen where it was.

Well, what happened was, there was this these double doors on our front line where the chalkboard with our menu was hanging on, and I didn't realize that there was like a little room back there.

Andy: You just thought it was a menu display board the whole time, right?

Patrick: And so we opened that door, and that's where the water heater was. And also, there was like some other things that the room needed some cleaning, we'll call it, right? It was kind of a big disaster that I didn't even like look into. And then to top it all off, we had someone come to replace the water heater. Well, we had this like really expensive water heater. It was like a 100-gallon water heater, and it cost, like, you know, like over a thousand dollars. It wasn't just like an ordinary water heater. And I was just like, it was like this thing that happened, and, you know, obviously it was not a big, big deal, but it was a major surprise, and I was like, how did we not ask about the water heater? You know?

Andy: The things, the things we overlook when we're young and getting into a restaurant location, right? Yeah. No, thanks for sharing. I appreciate it.

All right, guys. Well, thanks for listening about our subject, turnkey, and its use. We will see you next time for another episode of Restaurant Deal Making Exposed. Thanks for listening.

Thank you all for listening to this week's episode of *Restaurant Deal Making EXPOSED!* If you're considering selling your business and would like a free

consultation, reach out to patrickAndAndy@therestaurantsalesbroker.com or visit TheRestaurantSalesBroker.com to learn more.