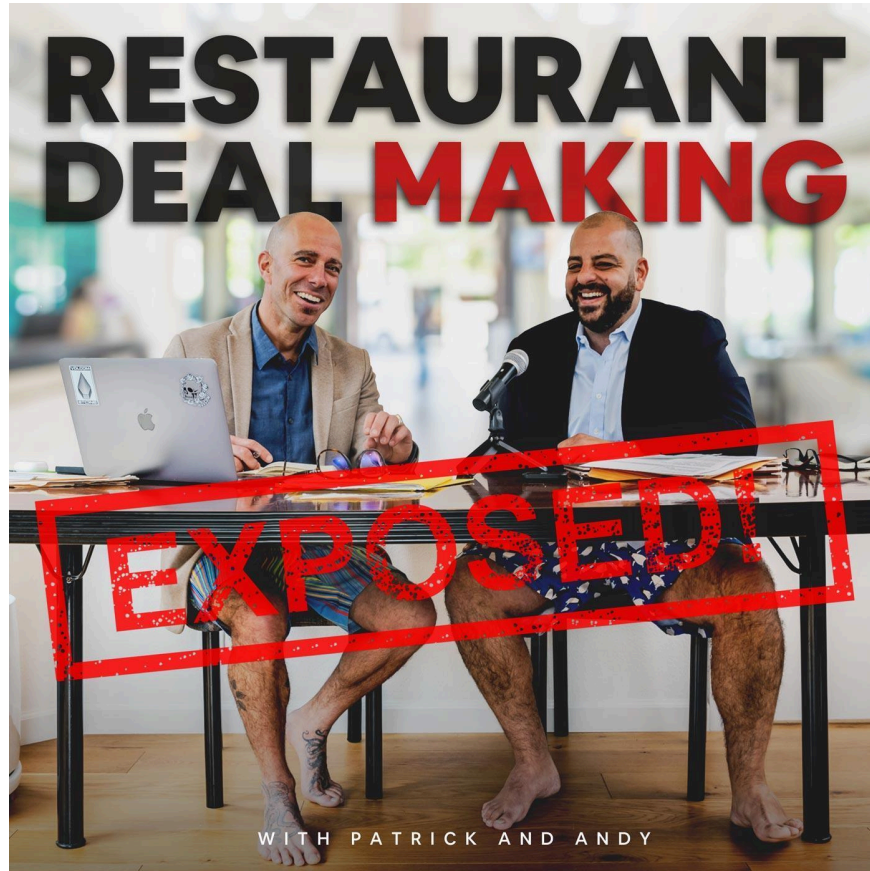


**Ep #32: Why Restaurant Deals Fall Apart  
and How To Save Them  
with Steve Zimmerman | The Restaurant Dealmaker Show**



**Full Episode Transcript**

**With Your Hosts**

**Patrick Totah and Andy Mirabell**

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## **Ep #32: Why Restaurant Deals Fall Apart and How To Save Them with Steve Zimmerman | The Restaurant Dealmaker Show**

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.

Steve Zimmerman: Welcome. My co-hosts today are Patrick Totah and Andy Mirabell, two of RRC's top agents who were former restaurant owners and operators, and then they were former clients before joining Restaurant Realty. I now have the opportunity to introduce Patrick, who will give you a little bit of his story. So, Patrick, welcome.

Patrick Totah: Hey, everyone. I grew up in the restaurant industry. I was a part of my, I call it Deli Daycare. My dad used to take me to work every day, and grew up beside him there. And later in life, I started working for some larger companies like Jamba Juice and Starbucks. I previously owned two restaurants in San Francisco before joining Restaurant Realty in 2018.

Steve Zimmerman: Thank you. And we had the opportunity of selling Patrick those restaurants. So that was a nice experience and a nice introduction to Patrick. So Andy, please.

Andy Mirabell: Hey, thanks for having me on, Steve.

Steve Zimmerman: You're a pleasure.

Andy Mirabell: I've had a, it's been an absolute pleasure working at Restaurant Realty, and if we go back 25 years, I worked my way through college as in bars, restaurants, and managing bars and restaurants in LA, and studied so hard to be a teacher, but didn't quite use that and just stuck with the industry.

So I've had multiple locations of my concept previously and wanted to segue out of brick-and-mortar operations and to do something exciting like this. And when I crossed paths with Steve and some of his top agents in the past, it seemed like

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a fantastic fit, and I'm very thankful to have been here since 2018 with Restaurant Realty.

Steve Zimmerman: Well, we've been very grateful to have you, both of you. And I would also add, when I first met Andy, how old were you, 25 years ago?

Andy Mirabell: I mean, I think I had hair, a partial mohawk, and yes, I think it was at Blowfish Sushi in San Francisco. I was probably 24 or 25.

Steve Zimmerman: Yeah, Blowfish, on what avenue was that?

Andy Mirabell: Bryant and 21st.

Steve Zimmerman: Bryant. Way out on the Mission.

Andy Mirabell: Yeah. Nearly a three-decade run. And then I remember you coming back to my restaurant when I had my own restaurant in San Francisco, and five or six years in, I had you in to sit down and talk about the potential of selling. And we didn't quite get there at that point, but RRC helped me sell my second restaurant in Sacramento a few years later, and I came on board with you.

Steve Zimmerman: Right. Well, we're grateful that you did come aboard. So, our topic today is going to be why restaurant deals fall apart and how to save them. And we're very qualified to discuss this topic because all of us have done many deals, and we've learned from our ups and downs of doing these deals. So, our format is that we're going to be asking questions. I'll be asking some questions, Patrick will be asking questions, and Andy will be asking questions.

So I'm going to start off by asking the first set of questions, which is number one, what are the top two or three reasons restaurant deals tend to fall apart while in contract, while in escrow? So, gentlemen, who wants to go first?

Andy Mirabell: Gosh, I mean, I think there are two big elephants in the room on this one. I'm going to throw one out there, Patrick, and you can support it or not,

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but time is the one that kills a lot of the deals. If there are delays due to either buyer or seller delays, landlord delays, delays in lien clearances, and such, time can often whittle down the patience of a buyer in particular. And there are times where they've had enough, and we can only extend the contingency period so many times before they say, "You know what? I'm going to move on to a different opportunity."

Patrick Totah: I think that's a huge one. I think we're going to end up talking about the lease, which I think is really important later on, but I think another really big reason is the buyer or seller not being flexible or reasonable. Both sides, I think, have to be very patient. They have to work with each other. They have to be reasonable and flexible with each other. And I think when you don't have that, it just adds another element or a challenge to getting a deal done. And I always work with both my buyer and seller to try and make sure that they're both being flexible and reasonable.

Andy Mirabell: Yeah, and you brought up the point of landlords and leases, which we'll probably dive into later. I know we, once in a while, as agents, tongue-in-cheek say, "Oh, the landlord can be a deal killer because they're not approving our qualified buyer." But that is part of the game and part of the transaction. So if a buyer is not up to the standards of the landlord, they can kibosh the assignment of the lease or lease tenant approvals at that point, and that essentially kills the deal. So that's a big one.

Another one I deal with a lot, especially in particular counties in Northern California, is change of ownership inspections with the health department. When the business is changing hands from one owner to the next, it has to go through quite rigorous inspections. And sometimes those inspections can bring up tasks for the buyer and/or seller to complete before the close of escrow or after that can be quite prohibitive financially. So when you have an inspection in hand and it's more than a buyer expected, that really can kill a deal because they can back out at that point if it's not something they want to proceed from there.

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Steve Zimmerman: And you had mentioned initially that one of the big potential deal breakers is time. And you very recently orchestrated a deal in the East Bay with a lot of extraordinary time. What were the, what was the philosophy or the mechanisms that you used to keep that deal on track? Because obviously, there was a lot of diplomacy involved, or that deal could have fallen apart many times. So how did you do that?

Andy Mirabell: Yeah, it really went on to be one of the longest transactions I've been a part of. Of course, as a broker, we want to facilitate getting things to each stage and the final finish line sooner than later, so other things can't come up. This deal really got delayed for a couple of key reasons. The top one was that we were trying to have the buyer assume the large existing EIDL SBA loan from the pandemic. That process can take three to four months and it's a very low success rate. So that killed quite a bit, that actually just took a lot of the transaction here and we kept extending, and we didn't get a positive outcome on that.

Thankfully, the way we wrote the asset purchase agreement was that we had Plan A and Plan B. If Plan A didn't work out, we moved to Plan B. So that wasted a few months. Also, the back-and-forth between the buyer and the landlord went, I think, far beyond what the initial agreement with the LOI and terms that were agreed on. It went too far beyond that, and the request kept coming from the buyer's side, which greatly delayed the transaction, and it added to some frazzled nerves on both sides, too. But in the end, we did get the transaction done, but it was nearly 13 months. That's a long one.

Patrick Totah: You hit on something there. It is another reason or challenge to getting a deal done right now, and how it has been since we got out of the pandemic, and that being the EIDL loan and what that's added to getting a transaction done. These loans have liens attached to the business, and that's been another challenge in getting deals done because sellers do not want to pay back the loan, given that it's a 30-year loan with really favorable terms. And

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having that discussion with sellers early on is really important in trying to get the deal done.

Andy Mirabell: It is. And the attempt to try to assign it, recollateralize the assets, the success rate is very low, and it takes a lot of time and effort. It takes a really motivated seller to work with the SBA to get these clearances or resubordination, whatever it may be. But in the end, the seller should be paying off this EIDL loan in order to close escrow.

Steve Zimmerman: And there are no prepayment penalties on those EIDL loans, right?

Patrick Totah: And the government wants their money back.

Steve Zimmerman: Oh, sure, 3% plus interest rate, understood. So occasionally, gentlemen, as we know, sometimes buyers and sellers remove contingencies, which means basically they sign off that the inspection contingencies, the review of books and records, the landlord contingency, whatever contingencies are outstanding have been removed. The buyer usually increases their deposit to a minimum of 10% of the purchase price. And occasionally, one of the parties, either buyer or seller, tries to cancel the deal after that has occurred. So, could you tell us what are the ramifications of either a buyer and/or seller trying to cancel an escrow after contingencies have been removed?

Patrick Totah: Yeah, I mean, that's a pretty rare thing, at least in my experience so far, but it has happened a few times. I think it's incredibly challenging because you're trying to unravel a deal. You've already gone through the whole bulk sale publication in order clearances, and so you have to cancel that whole thing. You also, the buyer and seller have to agree in order to cancel a deal. So it's not just as simple as the buyer saying I want to cancel. Both the buyer and seller have to agree, and if they can't come to terms on what's going to happen with the deposit, that creates a whole other challenge as well.



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Andy Mirabell: There's a lot of damage that can be done at that juncture, too. If we've removed contingencies and hung an ABC transfer poster in the window, informed staff, informed their customer base, there's damage, and it's hard to quantify that, but it's there and it's real. So a lot of the times in these rare situations, then the buyer and seller should be moving into mediation and try to figure out how to come to some sort of agreement on either to close this escrow or move on.

Patrick Totah: But you know, mediation is non-binding. So just because that person says, "Hey, this is what I think you should do," both the buyer or seller don't have to, Steve, and maybe you can speak to this a little bit more, they don't have to agree with that. Is that correct?

Steve Zimmerman: That is correct. Unless an agreement is reached in mediation and they both sign off on that agreement with the mediator, they've both come to an agreement through the mediation that they've agreed. But again, if they don't agree, then it's non-binding, obviously. But if they put an agreement in writing signed by both parties, then I believe it is enforceable.

But going back to this situation, this scenario, we do have a liquidated damages clause in our contract, which addresses buyer's primarily, buyer's failure to basically move forward, try to cancel the deal after they have removed contingencies. And what it states basically is that their deposits, whatever they amount to, stay, do not get returned. They lose them. And the broker participates in part of those deposits, and any excess goes to the seller.

Now, as far as recourse for the seller, if the seller breaches, cancels, rather, then there's no specific language in regards to that, but mediation is the normal route that is taken if, in fact, that happens. We have that actually happening in a situation in Southern California where there was early possession and the buyer backed out and had all their money in escrow. And this is over a year ago, and it's taken us a year to get into mediation, which we have next month. But anyway.

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Andy Mirabell: I think we all, if we've been as a broker, if you've been through early possession, I've been through early possession as the seller of the business, and I've also engaged in participating in that with my clients in a couple transactions, and it's a very precarious situation. So there's a lot of risk involved.

Steve Zimmerman: We do not recommend early possession, only if there's a dire situation like the seller's on the verge of being evicted or has a health issue and just can no longer continue to operate. There are always some extenuating circumstances because we're dealing with humans.

So, next question. When deals fail, is it more often due to actual due diligence or is it more in regards to emotional reasons?

Andy Mirabell: Gosh, I think due diligence has a huge part in that. We oftentimes share, I think our brokerage is quite transparent with financials and what we have on file, as long as you've signed the NDA, for interested parties and buyers to learn as much as they can about the business before they actually move to drafting an offer or proceeding into contract. But once you get into contract and you start asking some more hard questions, whether it be about financials, whether it be how you've maintained the major pieces of equipment in your restaurant, hood, grease traps, whatever it may be, things start to come out. So if I think due diligence is a big factor on why a deal can fall apart.

Obviously, there's emotional reasons. I have buyers, I have had buyers in the past that, yes, they're so they love their business, they're emotionally tied to it and the team. If they don't think the party coming in is going to take good care of their team or something as they get to know them, I've had sellers start to get a little weary about the deal proceeding. I've had sellers prepare the business for sale and then kind of fallen back in love with their business as they prepared it for sale and close of escrow. And that, that shows emotional ties.

Steve Zimmerman: How often does that happen? Because that doesn't happen to me very often.



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Andy Mirabell: It's rare, but it's actually happening to me right now, and you know, again, as an, as a broker and agent to them, we need to keep their mindset on the prize and the end game of this too. So it's not common, but it can happen.

Patrick Totah: Yeah. I also believe it's more about the due diligence and digging in a little bit more, and when you start to find out like let's say your, you've given them all the financials up front and everything looked really good. And then you get into the due diligence, and all of a sudden, you start looking at that year-to-date trend, and things are going down instead of going up or staying the same. I think then all of a sudden you start, the perception is that the business is kind of on a downward trend, and then you start to become a little bit more weary about everything else.

But I have had deals fall apart because of emotional situations where, you know, the buyer is being fairly reasonable and the seller is very emotional. And as you start to dig in, it starts to get even more emotional for the seller. And I would say that I've had fairly reasonable sellers that have gotten emotional, which has been a little bit surprising at times. And so I think it could happen to the best of the folks that I've worked with. But I think it's more often due diligence and numbers and inspections and letting that kind of tell the story on whether you're going to do the deal or not.

Steve Zimmerman: One thing I'd like to bring up from the seller's side is that the seller, before they list the business, should meet with their accountants to determine what the tax ramifications are going to be. Because I have been in a couple of situations, actually it was a large resort, it was a \$10 million transaction, and there were a couple partners. One of the partners actually was advised by their son in structuring the deal originally, and the son was an investment advisor.

Well, lo and behold, we got a full price offer and after they got the offer, they drilled down and they found out that the after-tax proceeds would not be enough to support these two soon to be hopefully retiring families. So it's very important

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that they do consult with their, the sellers do consult with their advisor to find out what the after-tax consequence is going to be. This is assuming we're selling a going-concern business. When they're selling an asset sale, they just want to get the hell out of there. They could care less. Taxes are not on their radar.

Patrick Totah: That's a lesson I learned early on when I had a listing and, you know, I won't name any names or anything, but it was roughly around \$4 million and as the seller who's owned these businesses for a very long time, so their depreciated value is probably fairly low. There was no, you know, higher basis or anything like that. And when he started talking to his accountant, and he started to understand what he was going to walk away with, it just didn't make sense for them. So I think that's a conversation you probably want to have up front.

Steve Zimmerman: Oh, yes. I think definitely before you take the listing actually, if it's if you're something you perceive is got, you know, great value and is, you know, appreciated dramatically since they started the business. So my next topic for discussion is, how vital is it for buyers and sellers to be reasonable and have some level of flexibility during a transaction?

Patrick Totah: Yeah, I think this was one of my first things that I talked about today. So I think it's very important. I try to have that conversation with my buyers and sellers up front, and I know that it can be emotional. I have been both a buyer, a seller, and also the broker on a deal. So I've been in every single shoe of this particular transaction. So I know how it feels to be in all of those. So I know that it can be emotional, and so you have to kind of set expectations up front and just make sure everybody understands that being reasonable and flexible like I said earlier is extremely important. You just don't need an extra challenge into getting a deal done. There's so many other real challenges in getting these things done that you just want to take this off the table.

Andy Mirabell: Yeah, and haggling over small things can be an issue in our transactions. However, again, kind of reminding a buyer or a seller that we're talking about a very small amount of money if something comes up in the transaction. An example may be legal fees or lease assignment fees that the

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landlord passes back to the seller or assigner of the lease. And it may come as a surprise after the legal dollars add up to a couple thousand dollars, but in the end, keeping the buyer and seller's vision on the end goal is important.

Steve Zimmerman: And either next question's yours.

Andy Mirabell: Does buyer's remorse ever come into play? That's kind of this phrase that we throw around a lot, buyer's remorse for any transaction, a car or whatnot, but is that a reality in our world?

Patrick Totah: I've had buyer's remorse after I did a transaction.

Steve Zimmerman: Really? Which transaction was that?

Patrick Totah: The second place that I purchased from Restaurant Realty.

Steve Zimmerman: Oh, okay. The one in the marginal location. You had remorse that you sold that business?

Patrick Totah: No, I had, I'm sorry, I had buyer's remorse after I bought it. Yes.

Steve Zimmerman: Oh, okay. Seller's remorse after you bought it. Not buyer's remorse. You were delighted to get rid of that place. Especially that was just pre-COVID.

Patrick Totah : No, I had buyer's remorse when I bought it at the time.

Andy Mirabell: You know, buyer's remorse can come into play. We brought up early possession earlier and although that's rare that we use that in a transaction, once a buyer is in a space operating a business with the team and all the nuances and seeing it in real time every day, yet they don't own the business yet because escrow hasn't closed, I've had buyers go, "Oh my God, I didn't see all this." I'm like, "Well, no, you didn't, because you weren't the owner yet." And so that's something that could really accelerate buyer's remorse if

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you're in early possession as a buyer and you see things that you were unprivy to as an observing buyer or even customer.

Patrick Totah: Also, training, you know, like doing training before you close escrow. I try to stay away from that because you're basically putting the buyer in the store before we close, which is slightly close to early possession, and they're going to see what's really happening in there. And if for some reason they had any doubts and something just triggers them, who knows what could happen? And so I really try to make training really outside of escrow. I think it's really important.

Andy Mirabell: Have you seen much buyer's remorse, Steve?

Steve Zimmerman: Well, not much, but just to play a little bit further about what Patrick just said about having training done before the close of escrow. The other complications there is that if the staff knows that this is the buyer, he has sometimes confusion as to who does he owe his loyalties to, the buyer who's become the new owner or the former owner? So it can get a little dicey there as to, you know, chain of authority for following up with, you know, between the employee and the landlord.

But in rare occasions, it may work very well. I recently sold a German restaurant to a Korean, and they wanted to continue the restaurant as German. So needless to say, the Koreans did not have any experience in German food, but they have a very successful track record of owning two or three other restaurants. They were Japanese sushi teriyaki type restaurants, and they had substantial financial wherewithal, and they wanted to continue to run this business. And so they asked to have training two months before the close of escrow. At first, I was really taken by that, but when I drilled down and I saw their backgrounds and I saw their financial strength, they were also, by the way, buying the building as well as the business. So it was a two and a half million dollar transaction.

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And the seller was very forthright, you know, with the employees before they came in and said, "These are, you know, professional restaurant people, they know how to deal with people, and they know how to operate." And it worked out extremely well, which was very unique, but you know.

Patrick Totah: Was your seller open to that?

Steve Zimmerman: It was part of the deal because they knew it would take them quite some time to learn about all the intricacies of a totally different food that they had no experience with. But I agree with what Patrick originally said. I try to avoid that. Have training, it's specifically stated in our purchase contract, training begins at the close of escrow. So it's clear as to what the relationships are between the employees and the new owner, etc., and again, minimizes the buyer backing out because he sees little things that are going to get him off track.

Andy Mirabell: Previously we brought up as why certain deals can fall apart, and I think I alluded to this a bit. But what role does the landlord play in each deal, and why do we sometimes tongue-in-cheek call them the deal killer?

Steve Zimmerman: Yes. Well, I think that there's no question the landlord makes or breaks the deal. You know, it could be a combination of the base rent, the triple net expenses, the guarantor, you know, if it's a personal guarantee, is there going to be a burnoff of the guarantee, or is the guarantee going to go on for an infinitum? Other little gotchas, like frequently, options are personal to the seller and are not transferable. So that's a mechanism for the landlord to be able to renegotiate the whole deal. So, you know, they're definitely the landlord plays a major role in making or breaking a deal.

Patrick Totah: Sure. And then like as you said, the other little gotchas in there with the like, a consideration clause or a termination clause. You know, I always tell people when we're going into deals, you know, unlike a commercial, you know, commercial building or a home that you've purchased and everybody's gone through a transaction like that, it's really a buyer and seller and there's no

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third party. Going into a business transaction and having that third party who's really not privy to the contract between the buyer and seller, so they really have no interest in this deal other than having to work to get you a lease, and I think that is always the big challenge, right? To get the landlord to be excited about having to do that.

Andy Mirabell: Yeah, and that's our job, and also to create an appealing tenant package that is that the landlord can review and get excited about. But you're right. I mean, a landlord if they have a tenant in hand and it's been a good, steady tenant, what is their what's the sense of urgency to approve someone else?

Patrick Totah: I say it's always part of their job as being landlords.

Andy Mirabell: True. Very political of you.

Patrick Totah: It's a good problem to have.

Andy Mirabell: So I guess this kind of leads, begs the question, how do we manage this risk in particular with a landlord or some of the others we've talked about early on in a transaction, so we don't run into these roadblocks?

Steve Zimmerman: Yeah, well, I think what needs to be done is you've got to anticipate, which means you've got to vet the buyer up front, operationally and financially. Whenever I get a listing, I review the physical plant for defects to see if there's going to be a major hurdle with change of ownership in Northern California, or it's because physical defects could be tremendous. Air conditioners need to be replaced, compressors, ADA needs to be put into place, the thing is totally out of whack as far as meeting the criteria of change of ownership.

I definitely scrutinize that up front. And if I see there's a problem with a lot of change of ownership issues, I will tell the owner to have a change of ownership done even before we list it. Price it out and find out what we're talking about as



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cost. And you have to build that in the pricing because if he expects to net, let's say \$250,000 and there's \$50,000 of corrective work, then you do the corrective work up front or you're going to have to sell it as is and take a big discount on the price or change the price to offset the cost to bring it up to speed. And again, if it's a going concern, most buyers don't want to deal with that because they want to maintain the momentum of the cash flow.

I know recently sold a pizza place, and they were buying goodwill and a going concern. They had to close the kitchen for two days to replace the kitchen floor, and the buyer said, "Uh-uh, I'm not doing it. I don't care if I get a discount on the price. I want the continuity of the cash flow and the momentum starting off, so you, Mr. Seller, are going to have to do that work and get the change of ownership signed off before we close escrow." So that's always very important. And obviously, reviewing the lease very thoroughly to discuss some of the gotchas we just talked about is essential.

Patrick Totah: I really have nothing to add to that. I think Steve covered everything.

Steve Zimmerman: Okay. Next question is yours, Patrick.

Patrick Totah: Alright, yeah, so when in your experience, do you know a deal is in trouble, and how do you step in to get it back on track?

Steve Zimmerman: I'll let Andy go first on this one.

Andy Mirabell: Yeah. I mean, when a deal is in trouble, it's hard to refute hard financials that are on paper, on the books and so on. So if a buyer doesn't like what they see as they dig in deeper during due diligence, that's hard to change their mind. We're not here to sell them on the product. We're here to help them with the transaction.

But a deal can be in trouble if the buyer and seller maybe are not getting along as well or don't necessarily have mutual respect for each other. That can start to

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derail things pretty quickly if they think one party or the other is not being reasonable or not conceding to any sort of compromise in certain terms. That can be a tough one.

I just think one of the biggest things we can do and as years go on being a restaurant broker, we learn a lot of lessons through all the transactions we do. And sometimes you learn it the hard way, but it's always a learning experience to make the next transaction and better serve our clients in the future. And managing expectations ahead of time is paramount. And we keep saying that kind of phrase over and over again. But from the onset of drafting an offer, we need to let buyer and seller know the timelines as specifically as we can. Those timelines very often change.

We should let each party know what their financial liability outside of purchase prices, and we want to get them prepared for certain milestones in the transaction too. A big one being having their proforma, their financials, their credit reports, their description of self for the landlord so they can get approved. So I think really, us managing expectations is key and being as transparent as possible and clear as possible with each of our clients so they know what to expect, because these deals change quickly and often.

Steve Zimmerman: And as far as getting a deal back on track that gets into trouble, there are some reasons. The basic reasons are the financials don't pan out to be what they were originally represented to be, in which case, the remedy for that is adjusting the price, you know, assuming the seller is amicable to that. Or sometimes the landlord is tougher than to anticipate, and that sometimes can be difficult because you get some real stubborn landlords that it's my way or the highway, in which case, you're going to reach an impasse probably. But if you have a landlord that's trying to be reasonable, you know, try to mitigate the issues between the prospective new buyer and the landlord.

And of course, physical defects, that, you know, that's always a one that can definitely, you know, take a deal south. And so it's important again to, you know,

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check out that a good broker will check out the physical plant to see what little gotchas there may be there. That's critical.

Patrick Totah: Have you guys dealt with, this has happened to me a few times, like where a landlord, it's usually typically an older landlord, "I only like to give out three-year leases," or "I like to give out a lease that's no longer than five years." That, I've been successful some of the time in talking them into going, you know, to a five and a five or longer, but sometimes they're just dead stubborn on not doing something that they've always done and don't understand why.

Andy Mirabell: Yeah. And I'm not going to say this in a derogatory way, but it's hard to teach an old dog new tricks, especially if they're, you know, been in the business for a long time. This is comfortable for that landlord because they know they'll have the opportunity to get someone better or a higher rent in the future. I just think it goes back to us trying to be as thorough with what our job is and presenting them with the reasons why a longer term is going to get you a better tenant. It's going to protect their investment. They're going to be a happier, you know, you have a longer relationship. And also, you know, I think there's security in a longer term, especially if we vet the tenant ahead of time very well with the landlord.

Steve Zimmerman: You know, I think one of the rationales for an older landlord to perhaps want more of a short-term lease is for estate planning. He may feel that there's more upside to be able to sell the building if he can sell the building empty, because it could be marketed to an owner user, which will generally pay more for a building than just, you know, being a tenant and or selling the building to, you know, it precludes that owner user that wants to actually own the building and run the business in that building. So I think that's part of the rationale. I'm not saying it's right, but that I think is part of it.

But the way I present it to a landlord is very simply, you know, you, Mr. Landlord, if you make an investment, you want to get a return of your investment, and you want to get a return on your investment. And in order to accomplish those two

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goals, you need time. And similarly, with a buyer of your of this business, you know, they're going to be incurring a lot of risk, investment of their time, their money, they need enough time again to get a return of their investment and return on their investment.

So I don't get involved in deals, at least that they have to have a minimum of five years, minimally. And with some upside that maybe you can negotiate a first right of option to buy the building, you know, so it doesn't tie up the landlord's hand if they want to go to the market after they talk to the tenant first and give him the right to buy the building, then they don't have to come back to the tenant like they do in a first right of refusal. So, you know, there are different mechanisms that you can negotiate.

Patrick Totah: We've talked a lot about these deals falling apart, and do you have an example of a deal that you thought would fall apart and you were able to save it?

Andy Mirabell: What do you think? Oh, yeah. Every deal. No, I'm kidding.

Patrick Totah: They all have that point where it could happen, right?

Andy Mirabell: Yeah, yeah, really. I feel like I'm beating a little bit of a dead horse with the early possession, and a deal that falls apart after early possession is going to be a nightmare. So I'm going to leave that out. I think I kind of already talked about one of the longer ones we've dealt with. Both buyer and seller were very frustrated with the timelines or perceived stubbornness of the landlord, or perceived lack of flexibility between buyer and seller.

Patience on my end really did pay off, trying to be an ear for them to talk to, and they can say what they're feeling and their opinions are. You know, at times we joke that we are a little bit of a therapist in these deals, which is fine, and we want to let each party get out what they need to get out. But I also think kind of letting cooler minds prevail in some of these disagreements or frustrations does

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allow the deal to stay on track, in addition to us trying to offer supporting evidence.

Steve Zimmerman: Yeah, I think, you know, I once I get into most of my deals, they it's either it happens or it doesn't happen, but it's not something that, you know, generally fails because of the ebb and flows of the business. It's usually just the business doesn't meet the criteria in the due diligence. So most of my deals, once we've gone through the due diligence, they close.

Patrick Totah: I have to bring up the time that I was on the other side of the deal with you and when I bought my first restaurant, and I thought the deal had, you know, was basically done. And we got off the phone, and then about a week later, we started talking again, and I really thought the deal was dead. And then it came back out of nowhere. And so, as a buyer, that felt, that was a very scary moment for a second there.

Steve Zimmerman: Yeah, remind me, I said I remember that, but what were the issues, the particular issues? Landlord issues, wasn't it?

Patrick Totah: It was price. After digging in on due diligence, you know, I had come back and, you know, to your defense, I probably came in pretty low with my, you know, I said, "Look, I can continue to do this deal, but it would have to be, you know, at X price." And you were like, "Well, they're not going to do that." And I said, "Okay, well," you know, and I didn't want to, but it was one of those moments where I kind of had to like dig in.

And then we hung up, and then you called me back about a week later, and you said the seller had agreed. And I was like, "Oh my God." I was flabbergasted. I thought the deal was done. And we had been working on it for quite a bit. And that was my first business purchase. So I was, you know, it's like the time that my dad took me to buy a car for the first time, you know, it was,

Andy Mirabell: Steve had to make you sweat on that one, Patrick. He was intentional for sure.

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Steve Zimmerman: You were a very shrewd buyer. I was very impressed with your negotiating acumen, considering this was the first business that you had purchased, but you just had a good sense of negotiation, you know, and that has obviously served you very well in your career here, you know, as a restaurant broker.

Patrick Totah: Thank you very much, Steve.

Steve Zimmerman: Yeah. Yeah.

Patrick Totah: All right. I think I'll turn it back over to Steve here for the next set of questions.

Steve Zimmerman: Okay. Do you have an example of a deal that you thought would fall apart, and you were able to save it?

Patrick Totah: Oh no, we just asked that.

Steve Zimmerman: Oh, we did ask that. Okay. Then I didn't give you my full answer. Because I did have a specific deal. It was a very large deal, it was the Fisherman's Grotto deal, Number Nine, which is the largest deal I've done as far as, without real estate. And it was because it was not financable because the financials couldn't support an SBA loan or any kind of bank loan. It took a lot of negotiations for the seller to agree to carry back a serious carry-back.

And the sellers were obviously very reluctant to do a carry-back, and so I suggested, well, you know, this buyer has a substantial amount of real estate. Why don't we secure the note with equity, first note or second note, I can't remember what it was, but it was a note that had no greater than about a 50% loan to value with the existing financing and the seller carry-back financing. So they agreed to that. So we carried a note secured by the buyer's piece of property. That was one issue.

The second issue was, it's an old historical business that had been in business for 75, 80 years, and there was a lot of history, a lot of photos of the family and



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all kind of artifacts in the restaurant and the buyer wanted to keep that history because he was going to keep it as Fisherman's Grotto, make it better, but wanted to keep the old tradition. So he wanted all the original photos, and he wanted the artifacts.

So in order to mitigate that concern, what we did is we had photos taken of the photos, real high-quality photos, so that the owners could keep the original photos and then copies of the photos would go back on the wall in their place. And then we had some artifacts that were replicated. So it still had the feeling of being the real, you know, historical experience of the family, you know, operating it for 75 years.

So that was one thing. And then they, you know, they wanted also, there was another issue, let's see, the landlord wanted a, which was the Port of San Francisco, wanted a personal guarantee and the buyer said, "You know, I've got a substantial net worth, there should be no reason for a personal guarantee." And so we negotiated a cap on that personal guarantee.

Andy Mirabell: Wow. This is why Steve is the big dog here, because I'm not going to even share my deal that almost fell off track because it was some little cafe down... no, I'm kidding. This is why Steve is who he is.

Patrick Totah: A picture of a picture. I like that.

Steve Zimmerman: Okay, that's cool. All right. All right. Okay, so it's my turn. Our next subject matter is what is the truth about restaurant valuations and what is your business really worth? And needless to say, most sellers think that their business is worth a lot more, a hell of a lot more than what the market will support.

So my first question to you, gentlemen, is how often does a seller's idea of their restaurant's value line up with the reality of the market or with your broker opinion of value? And maybe you want to explain to the benefit of the group, what is a broker opinion of value?

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Andy Mirabell: Yeah, Patrick, do you want to take that?

Patrick Totah: Yeah, a broker opinion of value is, we don't call them valuations because we're not appraisers. So we, we take your financials, we do a weighted average for the last three years, and based on the adjusted net income, we use a multiplier to find out what we believe, you know, your business is worth. And we use comps from, you know, relevant, you know, close to your restaurant or, you know, a similar type of restaurant to get that multiplier. So that's what a broker opinion of value is.

Regarding a seller, whether or not they think that their restaurant is worth what we provide them, that does happen time to time. And, you know, I don't think there's any, you know, a seller has been there for, you know, however many years, they put their blood, sweat, and tears into it.

It can be a very emotional thing because you have to kind of line that up with what your life has been about for the last, you know, 20 or 30 years that you've been doing that. And, you know, a lot of times it's about, you know, what they believe the restaurant could be doing versus what it actually is doing. I think I get that a lot. It's like, oh, there's a lot of opportunity here.

Andy Mirabell: Yeah, which is not what we're selling. I mean,

Patrick Totah: Yeah, but we have to do it based off of what it's actually doing or has been doing for the last, you know, two to three years, right? And I think that's probably the disconnect that I've come around a lot. Yeah.

Steve Zimmerman: And if I could interject just for a minute on that, about what it is doing versus what it could be doing. You know, we tell the seller very simply, the buyer is going to pay what it's doing, not what it could be doing. Their motivation for buying it is what it can do, but for what it can do, they're going to have to invest their money and their time, and there's no guarantee that the restaurant will do what it can do. They're going to pay for what it does do. That is

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the reality. Their motivation to buy it is again, part partly what they think they can take it to the next level.

Patrick Totah: Yeah.

Andy Mirabell: Yeah, I think, I'm going to give credit to a lot of the sellers out there that most sellers who are ready to sell, do really put their trust in our hands, and we'd go through review of what is shared and provide them with a broker opinion of value. And I want to say most are very reasonable and understanding. But there are those out there that are putting value on what it could do, even though the business may not be making money currently or revenue is low. And that's a hard conversation to have because I don't want to discount the, like Patrick said, the blood, sweat, and tears that went into them operating this business for so many years.

I had a really nice conversation, one of my friends and accountant, restaurant accountant, I think both of you know them, obviously, Dan Engel Accounting, and Steve's talked to them across paths with them, but we brought up this exact question with them weeks back, and he had a good chuckle with me and said, "You know, he thought that our brokerage and us as agents really are realistic about the values we've been putting on businesses," the ones that he's privy to because he's a restaurant accountant and deals with a lot of sellers that we work with too.

But he brought up the fact that a lot of CPAs and accountants, if they're, if the owner goes to a CPA or accountant and asks, "What's the value of my business?" He brought up that a lot of these CPAs and accountants are putting balance sheet valuations, using balance sheet valuations to come up with the value. And it's essentially the assets on the books, the liabilities, and the equity equals the value of the business. And from our standpoint, that is not an equation that works because it's not based in reality or what the market will bear.

Steve Zimmerman: You know what I say typically to a seller that says, "Well, my accountant tells me that my business is worth X," and that X is unrealistic from

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my perspective, what I respond is very simply, "How many restaurants has your accountant sold?" You know, it's one thing to be theoretical, it's the other to be practical, and we have the practical input because we've been there and done it, and that's what we do is we re, you know, we do a serious broker opinion of value based upon our history of sales comps.

And one of the things we do in recasting financials, that means, you know, doing adjustments to the financials, the primarily we work off tax returns. The current year, we work off the most current year-to-date P&L. But we, we add things back, and sometimes we subtract things back. So, can you explain, gentlemen, what that concept is about doing add-backs or doing negative add-backs, doing adjustments, negative adjustments, let's say, please?

Andy Mirabell: Yeah, obviously, a lot of people who've been, you know, their profession is running their own restaurant or restaurants, they run a lot of personal expenses through the business. And these personal expenses are not necessarily that's, it's not necessarily going to apply to a buyer coming in operating the business under their own management or ownership.

So what we can do is take these personal expenses and add them back to the bottom to figure out what the seller discretionary earnings or true profit is of the business. Some of these are approved add-backs by a lender or an SBA lender. They're the more major ones like owner's, one working owner salary plus payroll taxes, amortization, depreciation, and major owner expenses that aren't related to the business, such as auto or things like that, automobile expenses and things like that. But when we add these back and recast it, it can give us a reflection of what the true profit would be if a new owner was not running these things through the business and had it all on their books to show on their tax returns at the end of the year.

Patrick Totah: Yeah, and then there's, on top of that, I think what Steve was talking about as well is like negative ad backs. Sometimes, like for instance, I have a business that I'm doing right now where the owner has his dad come in there and he works, you know, 20 or 30 hours a week, and he's not on payroll.

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And so, you know, I have to do a negative adjustment to offset that as a normal employee, right? So I have to do, take an average wage of what a normal employee would be by 30 hours and do a negative adjustment.

Also, I've got another deal I'm working on where the landlord is the seller and they're not paying themselves market rent. They're paying themselves, you know, slightly lower than market rent. And so I have to do, you know, whatever the landlord's paying themselves, I do on top of that a negative adjustment for whatever the difference is going to be for what, you know, market or what the landlord is hoping or, you know, to get for that lease. So there are some cases where we have to do these negative adjustments to normalize everything.

Andy Mirabell: Yeah, a really simple example is if it's a chef-owner operator, the buyer that's coming is not a chef, they may be able to offset some of the front of house labor to an extent, but if you have to hire a full-time chef, it's going to cost you a pretty penny to do that. So we have to account for that when we, you know, are recasting the profits.

Or some there are some cases where the owner, the seller is a working owner and he's, you know, working 50, 60 hours a week, and the buyer doesn't plan to be the working owner. So again, you're going to have to do a negative adjustment for what the costs are to replace the work that the seller-owner, so just to re-amplify with what Patrick discussed.

Andy Mirabell: There's times when we're talking about add backs, though, where there are certain owners and operators that will just be running everything through the business, you know, their food for home or whatever it may be, travel, all these things. So are there things that we as brokers don't add back, you know, to the bottom line, or more importantly, are there things that lenders absolutely don't add back?

Steve Zimmerman: Do you want to go first, Patrick, on that one?

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Patrick Totah: Yeah, you know, I always tell my sellers, you know, I've had some that, you know, really go in depth on the things that they're writing out to their business. I try to draw the line, but, you know, as long as we can justify and we can show, you know, some sort of records, and really, you know, because it's really about the perception to the buyer, right?

So if we can really disclose all of those and really pull them to the top and show it to the buyer, but the problem is like you said earlier, the SBA loan, if we have a business that we want to get pre-approved, there are certain things that the SBA are not going to allow you to add back. And so if you're trying to sell a business and get that SBA pre-approval, you know, adding back all these extra things are going to be very difficult, and that's going to bring down your value of the business, basically.

Andy Mirabell: Yeah, you can't have your cake and eat it, too. So the owner has to choose whether they're going to show all their profits on their tax returns and pay the related taxes associated with it. The business could be worth more on paper if you're doing that year in and year out, versus someone who's just running every expense through the business to lower their tax liability each year and show less profits or negative profits on their tax returns.

Are there common expenses that even, you know, sellers or their advisors forget to add back?

Steve Zimmerman: I have found that occasionally there's some extraordinary accounting, legal, or legal, let's say if they've had a lawsuit and they've had a lot of extraordinary legal, they haven't taken that consideration. A good broker will pick it up, but they should contract the legal expense from the previous years, and all of a sudden, say they see a big jump in legal, and they should ask the seller, "Well, why is that?" "Oh, I had a lawsuit." Okay. But in some cases, and that could also occur in accounting, for example, accounting, you know, expense goes up dramatically. "Well, there was an audit, and we had to get our accountant involved with it. And/or we had a sales tax audit or any kind of an audit," which necessitated extra expense.



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Andy Mirabell: What about a large one-time expense? A sewer main line that you're going to have to replace for \$50,000, but will be good for the next 30 years.

Steve Zimmerman: Yeah, typically that should be, you know, that should be capitalized on the balance sheet and added to depreciation, not expensed. So if it is expensed, we usually do an adjustment, and it's usually an add-back because it's, they're obviously trying to reduce their taxable income, but those kinds of things do occur.

And so you know, it always it's very beneficial for a prospective client to deal with an experienced, you know, broker agent like the three of us to really do the proper adjustments to make sure that the seller's discretionary earnings, which is the reconciled amount of the adjustments is right and is bonifiable and will be believable by the buyer, which will enhance, you know, getting the deal done.

Andy Mirabell: To kind of move into another topic here, what makes a restaurant worth more than the number on the tax return? So, obviously, we try for going concerns, we want to use a multiplier of SDE or profits to come up with the value of the business. But what are some other items that could actually add value in our opinion?

Steve Zimmerman: I think, yeah, the goodwill of the business and goodwill is usually the reputation of the business, and some businesses have a very unique reputation because of their past history like, for example, Fisherman's Grotto Number Nine, although it was not making a lot of money, the buyer could see that it was an institution and it had a phenomenal location and had a lot of upside.

So that would be an example of one, or like another business I sold was like Tommy's Joint, which is again, a historical business, key location prior to COVID, but it's still a very strong corner location. And again, the real estate went with it.

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Generally speaking, if real estate goes with a business, I have found personally that the buyer, the seller can get usually a 10% premium on the value of the business if the real estate goes with it. You know, he buys the real estate at market price, but he can usually get a 10% premium on the market value of the business if he can buy the two together, because there aren't that many opportunities where sellers actually own the real estate. And most buyers would love that kind of opportunity, but those kind of opportunities are far and few between. I mean, for example, we, Restaurant Realty, has sold over 1600 businesses, of which only 75 had buildings with them we don't, because it's just not that prevalent for a seller to own the building because real estate is so expensive in California and most parts of the state.

So, also if they have a unique situation like a liquor license, like, for example, in Venice, Southern California, you know, they aren't issuing any more hard liquor licenses there. So your liquor license can go for half a million dollars in Venice because they just aren't available, period, and they're not, they aren't issuing any more.

So if you have a long-term, let's say below-market lease, and if you present value discount that lease, that's got X amount of value, and that lease is fully assumable. But more likely than not, you don't see those many situations, and if you do, the landlord just says, "Hey, I don't care if it's assumable or not, I'm not doing this deal until I get a new market lease." So anyway, that's enough on that. Patrick, any thoughts for that?

Patrick Totah: Yeah, I mean, the two things that I said was goodwill, which institution type business, right? Like those, you're, you know, I would slightly overpay for something like that because they don't come around often. They probably have, you know, very few owners that have ever owned it. And if they're very profitable and, you know, have really strong revenue, I mean, those just don't come around a lot.

And then lease, that's one of the more major things because that's something that you're going to be paying the entire time, and you know, your landlord is

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almost like your partner, and you don't want to be overpaying for 10 years, 20 years, you know, so I think if you can get a below market or a very reasonable lease, I think that's going to always be a huge value.

Steve Zimmerman: Right. Yeah, unfortunately, gentlemen, because of time constraints, we're reaching our time limit, and we have another subject to discuss, and perhaps we'll have to have another get-together, which is for our future viewers, turning a losing business into a winning opportunity.

And I think that's a good segue for us to sort of end here and sort of entice the audience to, you know, hopefully join us again in covering that subject. But I want to thank both you, Patrick and Andy for the very informative information you shared with us today. And if anyone wants to contact you, Patrick, what's the best way to get you?

Patrick Totah: [patrick@restaurantrealty.com](mailto:patrick@restaurantrealty.com).

Steve Zimmerman: Okay. And Andy?

Andy Mirabell: I'm [andy@restaurantrealty.com](mailto:andy@restaurantrealty.com). And I, too, said the next two topics coming up, we'd love to talk about it more. There's some really exciting stuff, and wanted to thank you, Steve, for having us on.

Steve Zimmerman: Oh, it's a pleasure. Thank you very much, Andy and Patrick for adding a lot of flavor into today's episode. And I want to thank everyone for joining us. And if you want to get in touch with me, you can email me at [steve@restaurantrealty.com](mailto:steve@restaurantrealty.com), or I can be reached toll free at 888-995-9701. Take care of yourself, take care of others, and thank you for joining us today. Thank you, gentlemen.

Patrick Totah: Thank you.

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