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AUSPEX CAPITAL GOES OLD-SCHOOL TO FUND BORDER

▲ Jeff, left, and Lee Engler are brothers and Taco Bell operators, whom Auspex Capital advised for a $263-million financing that kept their real estate separate from their restaurant operations.

Two camps rule in the restaurant business—on one hand, those who think they can get higher returns by selling and leasing back their real estate and deploying the freed capital into more restaurants.

Then there are the Engler brothers, and those like them, on the other, who prefer to retain the real estate because it allows flexibility if, say, a once-promising trade area goes bad.

Brothers Jeff and Lee Engler, who operate Border Foods of Minnesota, "have a very long-term focus," says Chris Kelleher, the partner at Auspex Capital that led a recapitalization deal to follow their wishes. "They've passed this business to their kids, and they wanted to retain their real estate and grow their portfolio. They want to invest in the remodels and then have the growth in sales from the remodels go to them, rather than a landlord."

The problem, as Kelleher and his partner, Naveen Goyal, found, was that financing real estate as part of an overall deal had fallen out of favor post-2008. "So the lenders were basically forcing operators who own their real estate to divest it," Kelleher explains, which is where he and his partner got to work, getting meetings with any bankers who would listen to convince them to finance the restaurant business separately from the real estate.

"We've been pushing on the lending community for several years to look at it a little bit differently, to pull the restaurant business out separately, and then finance the real estate separately," he says. "This allows them to de-leverage the operating company, and put some more amortized debt on the real estate company."

They haven't convinced everyone, Kelleher concedes. "We've gotten a lot of resistance, but we've been very persistent and we've been very analytical, and we're gradually getting the banking community convinced."

Rather than being an innovation, the tactic is actually back to the future, Kelleher says, meaning this was a typical financing method before it fell out of favor. For large operators in legacy brands with heavy remodel requirements, in particular, it's a welcome option, and one that Auspex will keep pushing back into the mainstream.

In fact, that's his lesson learned. "We've got a lot of people that turned us down and they said that's a bad idea. And we've pushed and pushed, and we've gotten some traction," Kelleher says. FT