21 September 2015

Click here for the latest articles on EB-5 Financing.

The Global Hospitality Group® is best known for its expertise in connection with hotels and resorts. We also have an active restaurant practice, and like a hotel, a restaurant is an operating business integrally intertwined with special purpose real estate. We frequently advise restaurant owners and operators on labor and employment, ADA, management, and finance and licensing issues, and we have a particular expertise relating to celebrity chef deals.

Senior Global Hospitality Group® member David Sudeck recently participated in a roundtable discussion about the food and beverage industry in Los Angeles, published in the Los Angeles Business Journal. The following discussion about licensing issues, EB-5 and crowdfunding investment in restaurant projects, gift card and loyalty programs and tax planning strategies is based on the roundtable and includes some clarifications and updates.

The Food & Beverage Industry in Los Angeles: A Roundtable Discussion
Supplement to the Los Angeles Business Journal

The food and beverage industry is unique in many ways. And here in Los Angeles, where we have some of the best dining and food-for-purchase options in the nation, there may be an even more finely tuned set of rules for success. Stir in an unpredictable economy and you've got a sector of Southern California business that continues to evolve faster than most. To make some sense of this exciting and unpredictable realm, the Los Angeles Business Journal turned to some of the leading experts in the region – from the financial, legal and business perspectives – to get their diverse insights and assessments regarding the current state of the industry that Angelenos most certainly couldn't live without!

What are some of the factors for success that uniquely apply to the food and beverage industry?

DAVID SUDECK: It is important for the chef/manager to understand food and labor costs and deliver a consistent experience to the customer. I have seen many of our restaurant clients drive big revenue numbers but the restaurants have not succeeded because there were not adequate cost controls. A successful restaurant must maintain a balance of style, value and service while controlling these costs.

Are there any licensing issues specific to California that out-of-state restaurant owner/operators need to be aware of?

SUDECK: Before signing a lease or buying a restaurant property, a potential owner should see if there is any applicable conditional use permit (CUP) and understand the implication of full compliance with its stated conditions. These conditions can have a significant impact on the property's operations and often result in a delay in opening. Also, when remodeling a restaurant, the owner should determine what activity will trigger (or avoid) a health department plan check and new ADA/local accessibility law compliance issues.
What are some of the newest consumer trends affecting the industry today?

SUDECK: My clients are using social media effectively and carefully monitoring review sites (like Yelp) to build loyalty and a sense of community.

What will be the major issues facing the food and beverage industry in the next 3-5 years?

SUDECK: The increase in minimum wage has been a repeated concern of our restaurant clients. Rising insurance costs, employment claims, and accessibility and other lawsuits have also made it increasingly difficult to maintain profit margins.

What are some of the best ways for a food and beverage company to build its brand and elevate itself from the competition?

SUDECK: Some of my most successful clients are effectively using merchandising and packaged food products as additional ways to generate revenue and build brand recognition.

What advice would you offer to an early-stage restaurant company seeking growth capital?

SUDECK: Most early stage restaurant endeavors are funded through “friends and family.” However, after developing a successful formula, many are now starting to look to EB-5 for financing to fund expansion of new locations, particularly where new construction is involved. EB-5 funding and crowdfunding are two of the hottest trends in financing.

How might EB-5 financing fit into a restaurant’s financing plan?

SUDECK: For experienced developers and operators, we are handling an increasing number of raises involving, at least in part, EB-5 financing (immigration-based investment – typically with the inbound investment dollars coming from China to fund a loan or preferred equity). EB-5 financing may be a low-cost, source of capital – particularly when the restaurant is part of a hotel or a larger mixed-use project, as it tends to be easier to find investors for larger projects.

What are some ways that restaurant owners can ensure the success of EB-5 funding, if they choose to pursue it?

SUDECK: It is helpful if the sponsorship includes at least one partner with a successful track record, or a well-known chef or celebrity backing. EB-5 investors typically have little or no voting rights, which allows the sponsor to maintain greater control over the restaurant’s operations. Note, however, that the typical investment period for EB-5 financing is 5 years, so the sponsor will need to show how the international investor/lender will be repaid as of the end of that period. For more detailed information on EB-5 financing, you can visit: https://hotellaw.jmbm.com/category/eb-5-financing.

Explain a little about how crowdfunding works.

SUDECK: A number of our restaurant clients are looking at raising funds through “crowdfunding.” Recent changes in securities regulations now permit the general solicitation of accredited investors under certain circumstances. I expect that we will see at least a few new restaurants funded this way. Many of the same qualities that attract international EB-5
investment will likely be important in attracting investors in a crowdfunding context.

**How important is it to train restaurant managers on workplace legal matters before they become lawsuits—for example, Americans with Disabilities Act issues?**

**SUDECK:** The best way to avoid unnecessary lawsuits and claims is to provide your team with proper training. For example, the restaurant’s management team should understand the basics of compliance on a range of key issues ranging from discrimination to accessibility laws (including the ADA). Also every front-of-the house employee should be familiar with the rules on “service animals,” communicating with individuals with disabilities, and how to provide accommodations to those individuals. The restaurant’s website should also be reviewed for accessibility. While the ADA does not yet include technical specifications for website compliance, we recommend that our clients conform to current WCAG requirements.

It is also important to have an updated employment handbook and to make sure that the managers have read the handbook. Wage and hour claims are rampant and expensive to deal with (as they are typically not covered by insurance), so proper compliance training in this area is also critical.

**Can anything be done to expedite liquor licensing procedures?**

**SUDECK:** The liquor licensing process requires patience and attention to detail. Frankly, most delays that we see relate to the issuance (or renewal) of a required conditional use permit. However, we also see delays in the routine processing of liquor license applications as a result of incomplete or improperly signed forms (>). I rarely see the application process take less than two months regardless of how careful our client is, but the process can extend beyond that due to lack of care.

Most of our clients in Los Angeles County acquire a Type 47 or 48 license on the open market rather than through a lottery. A temporary license is typically available if the license was issued to the same premises where a new restaurant will be opened, but a temporary license will not be available when transferring a license from one premises to another.

**Gift cards provide a significant source of revenue to restaurants. What are the most important issues associated with launching a gift card program (legal, accounting, etc.)?**

**SUDECK:** Gift card and loyalty programs have spawned a lot of lawsuits. There are a number of California state and federal consumer protection laws governing gift cards and gift certificates. The California Department of Consumer Affairs provides good general information in this regard. Some general tips for California law compliance: (1) do not include an expiration date on gift certificates or gift cards that are sold to consumers, and do not charge a fee after a certain “dormancy” period; (2) certificates and cards with a cash value of less than $10 must be redeemable for its cash value; and (3) none of these rules may be waived. Under certain (limited) circumstances, unredeemed gift certificates also escheat to the state. There are a number of additional rules and exceptions to the rules, so it is best to consult with an experienced attorney in the area to make sure your program complies with applicable law. For your information, the California laws associated with gift certificates may be found at Civil Code Sections 1749.45-1749.6. Happy reading!

**What are the top sources of revenue growth for food and beverage companies this year?**

**SUDECK:** My clients are focusing on catering, special events (including off-site pop-ups) and film shoots to drive additional revenue, attract media coverage, and support brand recognition.
What tax planning strategies are available to the food and beverage industry?

SUDECK: Initially, it is important to choose the right type of entity to conduct the business, and the entity selected can result in significant tax differences. C-Corporations are subject to double taxation (a tax first on corporate profit and then another tax on dividends to shareholders as income), so it is rarely the entity of choice for a non-public restaurant company. To avoid this double tax, S-Corporations or limited liability companies (LLCs) are often used. Both S-Corporations and LLCs are required to pay an annual minimum franchise tax of $800 in California. However, LLCs are also subject to a gross receipts tax on gross revenues (which ramps up to over $11,000 per year at $5,000,000 or more of revenue). S-Corporations, on the other hand, are taxed at a rate of 1.5% of net income. Therefore, a business with high revenues and low profits may benefit from organizing as an S-Corporation. Nonetheless, we often find our clients prefer to use LLCs as a result of the greater flexibility in terms of entity governance, and allocations and distributions of profits. A tip from one of my clients – be careful when estimating future sales when obtaining your seller’s permit, as the estimated sales will be used to calculate the deposit required by the California State Board of Equalization!

David Sudeck is a senior member of JMBM’s Global Hospitality Group® and JMBM’s real estate department. He is a seasoned real estate attorney with extensive legal experience involving all types of residential and commercial properties. David’s practice primarily involves the complex issues associated with hotels, resorts, vacation ownership properties (including clubs, timeshares, fractionals and private residence clubs), restaurants, golf courses and spas. David represents clients in the purchase and sale, development, construction, financing, leasing, and sale-leaseback of properties, and advises them on their operations, including management and ADA compliance issues. Contact David at 310.201.3518 or DSudeck@jmbm.com.

This is Jim Butler, author of www.HotelLawBlog.com and hotel lawyer, signing off. Why don’t you give us a call (or send an email) and let us know what you working on? We would like to see if our experience might help you create value or avoid unnecessary pitfalls. Who’s your hotel lawyer?

Our Perspective. We represent hotel owners, developers and investors. We have helped our clients find business and legal solutions for more than $71 billion of hotel transactions, involving more than 3,800 properties all over the world. We bring this experience to any hotel project — big or small. Let’s explore how it might work for you. For more information, please contact Jim Butler at jbutler@jmbm.com or +1 (310) 201-3526.

Jim Butler is a founding partner of JMBM, and Chairman of its Global Hospitality Group® and Chinese Investment Group™. Jim is one of the top hospitality attorneys in the world. GOOGLE “hotel lawyer” and you will see why. Jim and his team are more than “just” great hotel lawyers. They are also hospitality consultants and business advisors. They are deal makers. They can help find the right operator or capital provider. They know who to call and how to reach them.