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BUYING A FRANCHISE IN THE MIDST OF A PANDEMIC – EVALUATING RISK & REWARD

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You might not believe it, but *right now* just may be the perfect time to invest in a franchised business! But buying a business – including a franchised business – is not without risk. Note, however, that the Covid-19 pandemic is changing how consumers engage with all aspects of business. As such, it is necessary for a prospective franchisee to consider how current conditions may impact the purchase of the franchise and whether current (and possibly future) conditions may require the prospect to consider not only whether they want to invest, but also the type of business to invest in. For example, you may want to consider the short-term impact of your state's coronavirus policies and executive orders on your future business. These important considerations should be discussed with your attorney, franchise broker, and/or CPA as part of your due diligence process.

What is key to understand is this pandemic will, eventually, pass – and, right now, it is fair to say we are in a buyer's market. While it is certainly true the current pandemic is unique in its impact across all sectors, it is also true that we have seen uncertain economic times before and weathered them. 9/11, the Great Recession, even more localized events such as hurricanes and other natural disasters – we have been through them before and come out the other side. What was true during all of these events remains true today: there is, potentially, a lot of opportunity to make money by investing in a new business. This is underscored by two, key factors not typically present when the economy falters: (1) the Small Business Administration (SBA) and banks are loaning money and (2) home equity has (so far) not been affected.

The United States Congress, through the SBA, has put in place a number of extremely helpful tools and programs for small business owners to take advantage of, including new (or expanded) SBA-backed loans programs and payroll assistance. In particular, the CARES Act increased the availability of EIDL disaster loans to qualified borrowers and borrowing itself has been streamlined. Additionally, existing 7(a) and 504 loans (and those written through September 27, 2020) will have their fees paid for by the SBA, and no fees will be generated on new loans through that date under these programs – a substantial savings to borrowers. These programs may be enhanced further if a third round of stimulus is approved by Congress in the coming weeks.

In other words, buyers have the opportunity to borrow SBA-backed funds and learn to operate their businesses while SBA handles the loan payments. Moreover, banks are looking to lend money for business acquisitions, and interest rates are all-time lows. Likewise, the CARES Act includes concessions for borrowing against your 401(k), making it less expensive to use those funds for investment opportunities (although the distribution still remains taxable). Simply put, there are many opportunities out there right now for qualified buyers to borrow.

In this positive borrowing environment, it is important that prospective franchisees understand, and position themselves to take advantage of, the current market conditions before they change. For example, your purchase of a franchise now may mean you are able to secure advantageous concessions from your franchisor that might not normally be available. That is, franchisors may incentivize your purchase with, or you may have greater leverage to negotiate, reduced royalties, reduced franchise fees, and other valuable concessions. This may lead to real savings, which translates to money in your pocket, as your business grows and thrives in the post-COVID-19 era.

COVID-19 has caused significant business disruptions across many sectors, including the retail leasing market – many businesses are closing, and commercial landlords are staring at vacant storefronts. As a result, we are in a rare tenant's market. Landlords may be more willing to reduce rent – or offer more valuable concessions for buildouts – than they might under normal market conditions. Lower rent and other incentives may drastically reduce COGIB and/or your monthly expenses, a significant advantage going forward. Ultimately, savvy buyers may have more money to reinvest in their business or save against a future need.

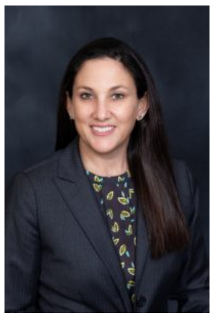
All this said, potential franchisees should use the additional free time they may have to really do their due diligence on their prospective franchisors. Under the Federal Trade Commission's Franchise Rule, as well as several states' franchise laws, franchisors are obligated to amend their franchise disclosure document ("FDD") to reflect material changes to the information contained in that document. This is critical because, due to the current pandemic and the economic fallout from it, many businesses are forced to close their doors or reevaluate their growth strategies. Because franchising is not immune to this phenomenon, it is necessary for a prospective franchisee to have up-to-date information about the health of the franchise system that s/he is interested in investing in.

Some questions to ask:

- Is this franchise an "essential business?"
- Is the information in Item 20, concerning permanent franchise unit closures, current?
- Does the franchisor have a plan to alter or amend its system to address the ongoing health and safety needs of franchisees and the public they serve?
- Can the business model be temporarily adapted to address the prospective franchisee's state government's restrictions on business, travel, and social distancing?
- Are the financial performance representations in Item 19 (if the franchisor provides that information) accurate and up to date? If not, when is the most recently reported information from?
- Is historical information going to give the prospective franchisee any valuable insight into future performance in light of the current pandemic-affected economy?
- Does this franchisor have a plan or policy to address royalties and other recurring fees in light of the pandemic, or, if not, will it negotiate with you before signing a franchise agreement?

In addition, it is even more important during these challenging times to speak with as many current franchisees as possible.

Finally, while investigating franchising opportunities, do not forget to speak with a qualified attorney who specializes in franchising. The FDD and your franchise agreement are complex legal documents drafted by the franchisor: they need to be carefully and critically reviewed by a qualified professional to ensure your rights are properly protected and that the disclosures and/or agreement do not violate any federal or state laws which might affect your business. Please contact us by phone at 732.747.7100 or by email info@marksklein.com to discuss these issues and/or if we can assist in any way.



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