

Survival of the Fittest

CORFAC brokers discuss micro trends in restaurant real estate

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An economic downturn has a way of providing clarity. When people have fewer dollars to spend, they become more discerning about where they choose where to spend them. Nowhere is that more apparent than in the restaurant industry. The recession revealed weaknesses in many ill-conceived restaurant concepts and knock-off franchises, while well-branded restaurant chains with solid business plans have expanded since the 2008 downturn.

As an example of a concept that continues to grow, International House of Pancakes (IHOP) has added restaurants throughout the Northeast in recent years, and the company has taken advantage of lower rents by improving some of its store locations. Subway grew too and recently overtook McDonald's as the largest restaurant chain worldwide based on store count. By comparison, Subway competitors have under-performed and closed stores in multiple Northeastern cities.

The recession also created opportunities for restaurant operators because of lower rents and greater flexibility by landlords that had previously shunned restaurant tenants. This was particularly true in New York City with national companies such as Chipotle Mexican Grill adding stores in the last couple of years. The company now has 25 restaurants in New York City. Other restaurants did the same: Qdoba Mexican Grill added stores in New York City, Massachusetts, and throughout the Philadelphia metropolitan area. Pret A Manger, the U.K.-based sandwich, salad and soup shop, is opening its 28th store in Manhattan this May. Pret has added stores in New York City every year since opening in the U.S. in 2000. Starbucks also expanded opportunistically during the recession.

Meanwhile, non-franchise restaurants characterized as "upscale casual" continue to open in locations where the demographics can support them. Food quality and price points must be in line with contemporary preferences, tastes and budgets. For example, brothers Michael and Stephen Lucey will soon open a second restaurant in Wilmington, Delaware, that will serve \$8 to \$10 lunches and \$14 to \$22 dinners. The brothers leased 4,725 square feet in the Regency Centers' Shoppes at Graylyn. They also own Six Paupers Tavern & Restaurant located in historic Hockessin, Delaware, and have been in the restaurant business since 1997, when they opened Dead Presidents Pub.

Just got the name of the restaurant. It's probably too late but it is "the Ulysses, an American Gastro pub"

Sent from my iPhone

On Apr 15, 2011

On the other end of the spectrum, some restaurants are closing and selling for just the fixed assets. Restaurant operators that either want to retire or did not succeed with their restaurants are selling their businesses in greater numbers, and often at deep discounts. In many cases, they just want to get the value of their equipment back. In Delaware and southern Pennsylvania, restaurant businesses (excluding leaseholds and real estate, if it is owned) are selling from \$60,000 to \$250,000.

For the concepts that are surviving — and some even thriving — there are a few trends emerging.

Burgers, burgers, burgers!

There is little doubt that the hamburger is America's most popular food. Burger joints are opening everywhere and all the time.

Smashburger, the franchise operator based in Colorado, is opening throughout the Northeast and said to be looking in Manhattan. Smashburger likes 1,600- to 2,000-square-foot stores in major metro areas with traffic counts of 50,000 cars per day and will open in secondary markets with 30,000 cars per day passing by prospective locations.

Five Guys, the burger franchising company based in Virginia, is also adding restaurants with store sizes that range from 2,000 to 3,000 square feet. The restaurant chain serves a variety of burgers and hot dogs.

Shake Shack, the kiosk concept featuring the Shackburger, hotdog and frozen custard, was started by noted chef Danny Meyer's Union Square Hospitality Group in 2004 with its first location opposite Madison Square Park. The concept has expanded in New York City with restaurants on Columbus Avenue and on 86th Street between Third Avenue and Lexington Avenue, selecting real estate that has a lot of foot traffic near subways and bus stops with dense retail and residential areas. Shake Shack also has new eateries in Saratoga Springs, New York; Westport, Connecticut; Miami; and Washington, D.C.

Jake's Wayback Burgers, which started as a regional restaurant chain in Wilmington, Delaware, in 1991 and is now based in Cheshire, Connecticut, expanded throughout the East Coast in recent years and is accelerating its growth. Jake's website lists 28 "coming soon" locations, including four in Connecticut, two in Delaware, three in New Jersey, six in New York, seven in Pennsylvania, and one in Massachusetts.

The burger-based restaurants have gained significant traction with consumers because of higher quality ingredients and the limited menus with quick service. They are also quite popular for families with kids and the atmosphere is a step above the average fast food restaurant.

New York City: A Food Incubator

New York continues to be an incubator for new and interesting food concepts. Besides being the ultimate melting pot of humanity and source of richly flavored ethnic foods, the city turns out new food concepts in part because pro formas for national restaurant companies normally don't work in New York City — especially in Manhattan with its big rents and costly operating expenses.

One of the more interesting food trends started a few years ago when a Sex in the City episode featured cupcakes from the West Village's Magnolia Bakery. That triggered a veritable cupcake war and there are now at least half a dozen New York City bakeries promoting little cakes. A few of the latest "incubator" restaurants that are opening multiple locations include Cosi, where patrons choose their own meats and condiments for flatbread sandwiches; Chick Peas, with a Middle Eastern twist featuring pita bread; and HealthyKitchen, which offers low-fat, vegan, curried vegetables with brown rice. Regardless of the food concept, Manhattan restaurants share a few things in common: in order to survive, the food must be of good quality with comparable value and sold in above-average volumes.

A Tale of Two Pubs

Some older pubs are closing while there has been a noticeable increase in the number of new neighborhood pubs throughout Delaware, Pennsylvania and other Northeast areas. While some pubs are closing because owners are retiring, new pubs are thriving because they are adapting to serve a new demographic. In the old days, bar customers munched on a hot dog that had been in the warmer for a few hours. Younger customers today want better quality food, including appetizers, noshes and small plates with healthier ingredients.

Lease and Sale Rates

During the recession, a lot of restaurants got temporary rent relief and in some cases permanent rent restructuring. New tenants received aggressive offers from landlords. For example, in one regional shopping center in Wilmington, Delaware, where the rents were \$20 to \$25 per square foot, a restaurant took vacant space with rent pegged at \$16 per square foot with 3 percent annual increases.

In New York, base retail rents fell to an all-time low with deals done in highly trafficked pockets of the boroughs in the mid-\$50s per square foot annually compared with more recent (and typical) transactions with rents at \$100 per square foot. Deals in Manhattan were done at 30 to 40 percent less than all-time highs but the market has roared back with fierce competition for the best locations and rents have recovered 20 percent or greater in most locations. Leases on side streets for food tenants can still be done below \$100 per square foot. However, on prime avenues, rents for food tenants can go as high as \$250 per square foot, especially for small space users looking for 300 to 800 square feet in heavily trafficked, high-profile areas in Manhattan. Tenants must do tremendous volume to pay those rents, and for large users, rents must be significantly less and space often is multi-level. Also, more landlords want some upside in their restaurant tenants'

businesses, with some leases done on a rent plus percentage of revenue basis — especially if the tenant is sophisticated enough to have audited revenue reports. By comparison, Manhattan’s more famous locations for general retail space, such as Fifth Avenue (between 50th and Central Park) still command as much as \$2,500 per square foot annually.

One benefit of the recession for upscale restaurant operators is that they were able to secure anchor locations in ground-floor locations in office buildings and residential towers. For example, Rockefeller Center added Bill’s Bar & Burger recently and will soon have a Del Frisco’s Grille. In general, however, landlords are very selective about putting restaurants in the ground floors of their buildings.

Looking Forward

Consumers are certainly more willing to dine out in places where good value can be had — and feel good about it — than they were 18 months ago. The restaurant industry should continue pumping out fast-casual and fast-innovative restaurants, shops and kiosks based on consumer acceptance and preference for the types of food, atmosphere and price points these restaurant operators are able to provide. Fine dining will likely continue to struggle except in major metro markets.

Rents have firmed faster in Manhattan than other areas of the country with a 20 to 30 percent bounce from the depths of recession. Rents should continue climbing in the next year as the competition for favorable space keeps rising. In suburban markets, rents in prime areas have recovered slightly but there are good-to-great deals available in secondary locations and older malls.

Financing has improved both on the real estate and capital equipment sides of the equation. However, banks continue to exert greater scrutiny to prospective borrowers’ business plans and professional backgrounds so restaurant financing remains difficult. For a variety of reasons, lending institutions are likely to remain cautious toward restaurant operators for the foreseeable future.

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