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Food & Beverage Looms Large in Retail Real Estate

New Report Outlines How This Sector Can Make a Difference in Center Operations

Introduction

The global retail and leisure landscape is undergoing **fundamental change**–lasting and structural, driven by macro demographic trends, technological advancements and ever-evolving consumer expectations. These combined trends and expectations are having a *huge impact on both the retail and foodservice sectors globally*, in terms of consumer spending patterns and space allocation, according to a study just released by ICSC, *The Successful Integration of Food & Beverage Within Retail Real Estate.* * Across most countries, consumer spending on foodservice has been outpacing grocery spending (and indeed all retail spending) in recent years. Furthermore, as spend shifts from transactional to experiential food offers, *food and beverage (F&B) is growing in importance to retail real estate*. For example, in some regions of the U.K., Canada and U.S., the amount of space in properties dedicated to F&B is forecast to reach up to 20% or more of total space by 2025 (and it could surpass 30% in Asia). Implemented correctly, foodservice drives shopper traffic, dwell time, spend and overall sales growth—the "halo effect." To be sure, more restaurants and bars do not necessarily equate to success for shopping centers, as this huge expansion in space allocation comes with opportunities (e.g., increased shopper traffic and sales) but also risks (e.g., oversupply). But overall, F&B can now act as an anchor.

Foodservice Operators Differ From Retailers

- Foodservice differs in important ways from retail. *Using a comprehensive foodservice categorization model, landlords and restaurant operators can better understand the industry through eight segments*, each with distinct trading periods, dwell times and trade area characteristics, as well as location, unit and seating sizes, and technical requirements.
- Landlords need to better comprehend *how foodservice business models differ not only from traditional retailers, but between foodservice categories*. Specifically, landlords need to understand what operators bring to their customers, what they sell, when they sell it and how much they sell it for.
- The *"rental gap" is generally closing between foodservice and traditional retail*; as with retail, however, affordability varies by F&B category/operator. A new mindset and skillset is required to deal with foodservice, as more risk is usually attached to a restaurant operator opening in a shopping center than a traditional retailer.
- A *general global shortening of lease lengths benefits both operators and landlords*. The landlord gains the opportunity to replace poorly performing and "out-of-fashion" operators with fresh, new concepts. The operators avoid committing to long lease agreements.

No "Blanket Approach" to Leasing, Managing, Appraising and Investing in F&B

- *There is no "one size fits all" when it comes to creating the right foodservice space and concept* for a particular center; customization and in-depth knowledge of customer base, trade area and competition are key to creating the right blend of local, national and international tenants. Incorporating pop-up spaces and new restaurant concepts, for instance, can also inject dynamism into centers.
- In general, retail real estate needs to *take a more strategic approach to getting the foodservice concept and mix right*. This would involve matching the foodservice offer to the center type and trade area, as well as investing in foodservice people. Asset managers need to encourage movement and interaction between foodservice and retail during the day to maximize cross promotion. In addition, the foodservice offer should be successfully and seamlessly integrated with the broader leisure offer (where appropriate).
- A *partnership approach may lead to better understanding of foodservice operators' business models*. This can involve either landlords taking ownership stakes in their own food tenants, or through percentage rent, an

*After an RFP process, ICSC commissioned JLL last July to study F&B from a global perspective, in order to provide ICSC members with practical insights into the sector.

increasingly accepted feature for the foodservice sector that has an impact on valuations.

- A *growing foodservice offer can impact shopping center cost and complexity* through, for instance, increased parking demand, opening hours/evening economy, service charges, and other operational challenges. However, all of this is outweighed by the benefits of longer hours for the entire center.
- *When marketing a property lacking an attractive foodservice offer, vendors and their advisors often make this part of the "sales story*," focusing on the significant asset management opportunity that it provides.
- *Investors in and appraisers of shopping centers need to become foodservice and retail specialists*, and understand retail and foodservice operators and their business models—specifically, how well the foodservice offer caters to a specific consumer base, the number of covers and how the seating arrangements work. Also crucial is fully appreciating the difference between sales and profit, and the value/cost/benefit that foodservice brings to retail real estate.
- A *modern and well-executed foodservice offer is now considered crucial for a shopping center to obtain "core status*," in the eyes of an investor.
- Investors are increasingly attributing actual upside potential value to the opportunity to improve a shopping center's foodservice offer, and *some even incorporate this upside into their internal underwriting when considering an investment.*
- *Operators with a prior healthy financial history—i.e., "credit tenants"—remain crucial*; while strong guarantors are desirable, foodservice "done properly" increases dwell time and shopper traffic and ultimately drives retail sales.

Direct and Indirect Benefits of F&B

- *Direct benefits* of an appropriate F&B offer to shopping centers (e.g., higher tenant sales, lower vacancy levels) offset any slowing potential demand from other sectors. Effective means to assess the performance of an operator include sales productivity, sales per seat and average transaction per customer.
- *The rent-to-sales ratio is a particularly important measure as it indicates operators' rental affordability and can assist landlords in flagging tenants in financial difficulty*. A rent-to-sales ratio of 5%-10% (excluding other costs such as business rates and service charges) is considered to be indicative of healthy sales and affordability in mature markets, with high labor costs. Typically, "impulse" and "refuel and relax" operators can afford slightly higher ratios of 10%-14%, due to the higher margin achievable from their more simple menus; "casual dining" and "fine dining" operator ratios are more likely to be around 5%-8% for Europe (or, in the U.S., 5%-9% for both).
- *Indirect benefits* of the foodservice offer—the so-called "halo effect"—may involve greater shopper traffic and dwell time (and, ultimately, sales at other tenants) at a property level; destination appeal and "social glue"; and symbiotic relationships with retailers and leisure operators. Foodservice is one of the most effective ways of incorporating experience, diversity and vitality into retail places.
- *Industry benchmarks must be developed* to quantify these direct and indirect benefits. This could soon be obtained through, for instance, new datasets stemming from mobile phones and social media. New indicators/ performance measures such as "linked trips" measuring the relationship between food and leisure and retail offers will also emerge.

Successfully Integrating F&B Into Center Types

- Landlords in *large destination shopping centers* should focus on securing an F&B tenant with enough critical mass to act as a standalone anchor and cater to longer dwell-time customers; on presenting a breadth of offer; and on locating several focal points (food courts, food halls, markets), plus other operators spread throughout the center. A site-wide, comprehensive approach is essential; successful integration of food means planning the "estate," not just filling gaps or holes.
- *Smaller neighborhood centers* may benefit more proportionally from F&B than larger destinations as a result of

ownership and connections. These centers service the local population, strongly differentiated by quality tenants from the same area.

- Requirements for *mixed-use properties* resemble large destination properties, in terms of creating destinational appeal. However, landlords must ensure that linkages and marketing to other use-classes are maximized. In addition, their social spaces support and benefit from foodservice.
- *Upgrades and redevelopments should balance "too much or too little*," ensuring that new elements fit seamlessly with the existing offer.

Future Outlook: The Beginning of a Transformational Journey

- *Technology is acting as a foodservice enabler and disruptor in three areas: production, services, and ordering/ payment processes*. These involve improving operational efficiency (including staffing/labor); offering "hyper-personalized" experiences through advanced analytics and pushed by social media, virtual reality and robotics; but also altering logistics and consumer demand through online delivery systems and takeaway services.
- *The main "tech risk" for restaurants and their landlords is transparency*: i.e., the possibility that the consumer will not continue to patronize the café, restaurant or bar in a given property. Greater access to information through mobile technology makes it easier to visit another place nearby.
- The retail real estate industry must also keep in mind *the risks of a restaurant "bubble" arising from private equity-backed overexpansion of F&B space, and of customer fatigue ("boredom") as consumers constantly seek the "next best thing" in foodservice. Moreover, labor costs are also rising*. At individual centers, these risks can be mitigated by minimizing overlapping F&B uses; focusing on quality, authenticity and experience; and striving for creativity as a point of differentiation for particular markets.

Conclusion

Nevertheless, the main drivers behind the shift to greater foodservice space in retail real estate in general and shopping centers in particular are *likely to remain as relevant, if not more so, in 10 or 20 years' time as they are now*. A maturing sector requires greater rigor and science to successfully plan and execute foodservice strategies. As arguably a new asset class, foodservice calls for **a new range of skills, capabilities and people** to deliver real value to the industry.