THE BOSTON
RESTAURANT
GROUP, INC.

Impact of the Pandemic on Restaurant Leases and Valuations

In the past a "good" lease was always considered the most valuable asset of a restaurant.
Post Covid-19 it has become the restaurant's greatest liability.

I realize how difficult the past few months have been for everyone in the restaurant industry and I just wanted to share with you my observations, based upon my personal experience as a commercial real estate broker specializing in the sale, leasing and appraising of restaurant businesses.

INDUSTRY OVERVIEW

Of the 16,000 restaurants currently operating in the State of Massachusetts, the Massachusetts Restaurant Association predicts that as many as 3,600 restaurants, approximately 23 percent, will close as a result of the coronavirus pandemic, the major contributing factor being the restaurants' inability to meet their rent obligations, given the lack of revenue. *Source: The Boston Globe, June 20, 2020*

STATUS REPORT

A recent webinar put restaurants into three categories:

Doing Well
Fast Food and Take-Out operations, especially with drive-thru and delivery programs.

Wounded But Will Survive
Well capitalized with established relationships with lenders, landlords and suppliers.

Wounded and Will Not Survive
Those that are undercapitalized. Some underperforming Franchises. Many independents whose sales are not sufficient in regards to paying rent and occupancy costs.

LANDLORDS

Initially everyone looked at the landlord as a source of relief. Unfortunately many landlords are leveraged with mortgages which may restrict lease modifications and rent reductions, and have their own financial obligations to contend with. Many have deferred rent payments, some have abated and/or discounted rent and others have demanded rent payments, in full, effective the first of July. Some of the stronger, multi-unit restaurant operators have been successful in having the landlord agree to rent payments based upon a percentage of sales, with any shortfall being spread out over the remaining years of the lease. Others have not been so fortunate.

LEASE TERMS

For any experienced buyer or tenant to enter into a new lease today, there needs to be some significant concessions from the landlord and perhaps a greater focus by both parties on reducing tenant improvement or TI expenditures. Should the landlord be either unable or unwilling to negotiate, the property will probably be vacant for an extended period of time:

- Rent payments need to be reduced until 100 percent occupancy can be allowed, especially if enhanced takeout is not feasible. How much and for how long needs to be negotiated on an individual basis.
- Should the restaurant need to shut down again at a future date there should be an agreement as to rent deferment or reduction for that period of time.
- Any personal guaranty should be as limited as possible.

OCCUPANCY COSTS

Restaurants think of rent as a percentage of sales, as opposed to a cost per square foot. The reason being that a restaurant requires a significant investment in leasehold improvements (kitchen, grill exhaust, etc.) as opposed to that required for an office or retail store. The target for total occupancy costs, in a major city today, in 8 percent of sales. This includes base or fixed rent and such NNN charges as Real Estate taxes, Common Area Maintenance, Condo fees and any percentage rent.

For the near future, base rent should be fixed for each 5-year term [with a modest escalation for the cost of living]. Given the amount of competition in the industry, many restaurants have been experiencing declining sales in the past few years, yet rents were increasing at the rate of 3 percent. Note the decline in same store sales, in 2019, for some of the National restaurant chains currently operating in the state of Massachusetts: Yard House (11.4%), Chili's (11.4%), TGI Fridays (13.1%)(*Source: Nation's Restaurant News, 07/13/2020*)

VALUATION

An Industry Benchmark is that the restaurants typically sell for a multiple of from 25% to 35% of the prior year's sales and/or from 2 to 3 times EBITDA. The differential being dependent upon the terms of the lease, the condition of the improvements and the potential for future growth. Most restaurant sales are for the value of the assets only, not the stock, As a majority of buyers change the name of the business and renovate the space in their own concept. Of over 700 restaurant sales with which we have been involved, less than 4% of the buyers have kept the same name (28/700).

TODAY'S PURCHASE PRICE

There are two values for a restaurant business today. One is what it is actually worth. The other is what it will actually sell for in the current economy. The key is the landlord's being willing and able to work with the new buyer or tenant so that a rent payment schedule can be negotiated to allow a new business to get established. We are in uncharted waters and the days of escalating rent payments and personal guaranties are going to be a thing of the past. From my perspective, it is very much a buyer's/tenant's market.

SUMMARY

Hopefully, when things stabilize and people feel more confident that the virus is under control, we should start seeing some activity, as we continue to receive requests for information from people looking to get into the industry: chefs, managers, investors, etc. Also, as a majority of our buyers are restaurant owners, until such time as they get their own affairs in order, they are not in a position to take on a new responsibility.