cedardeangroup

THE IMPACT OF ROCKETING RESTAURANT RENTS ON LONDON LEISURE OPERATORS

2018 REPORT

INTRODUCTION

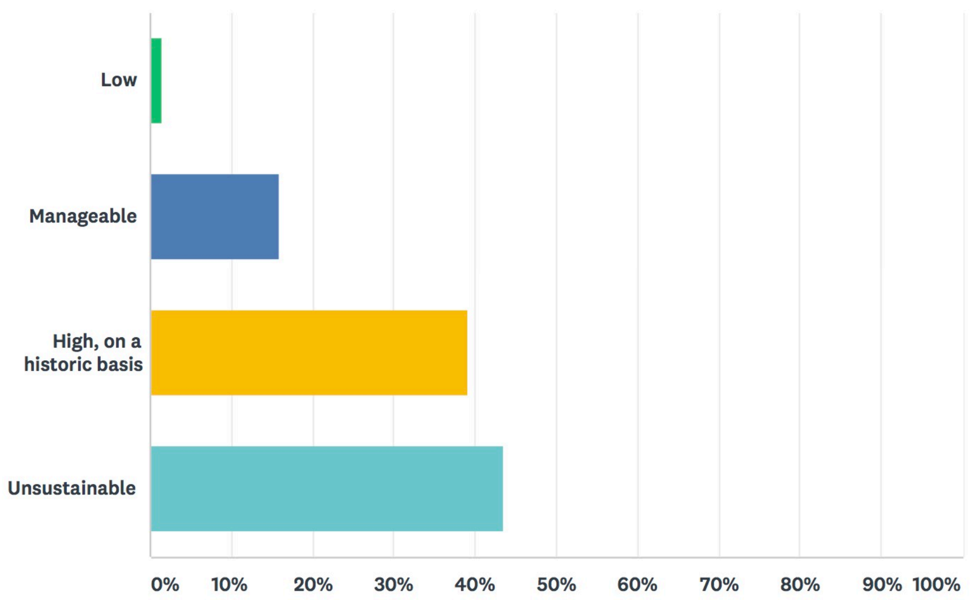
This report examines the effect rocketing rents and rates are having on restaurants in London. Cedar Dean Group has gathered data from operators, representing around 600 restaurants, pubs and bars across the leisure industry and presented its findings on the key challenges affecting these businesses today.

The report also sets out CDG's recommendations for landlords and key policy makers, bolstered by additional commentary from high profile restaurants and the public sector.

THE PROBLEM

Restaurateurs are being squeezed by rocketing rents

Current costs for operators



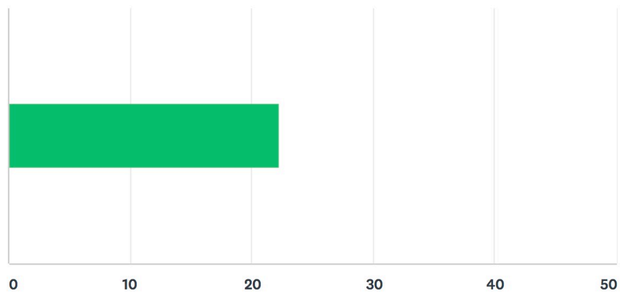
Of surveyed restaurateurs, 84% have described their current rents and rate costs as High or Unsustainable – 70% of those asked are based in central London.

Rents paid by leisure operators in prime Central London are rising at rates far beyond inflation. Some rents in the W1, WC2 and E1 postcodes have more than doubled in the past year. While some coming up to their five-year rent review face an average increase in rent of 50%.

> *"There is clearly a need for substantial reform to both the commercial leases that are applied to restaurants and the rent review process. The reviews are upwards only and can be further influenced by any provisions that are put in within the lease agreement. It isn't sufficiently regulated or sufficiently transparent."*
>
> **Leonid Shutov, Bob Bob Ricard**

The current situation is unsustainable

Average % of operator turnover spent on rent

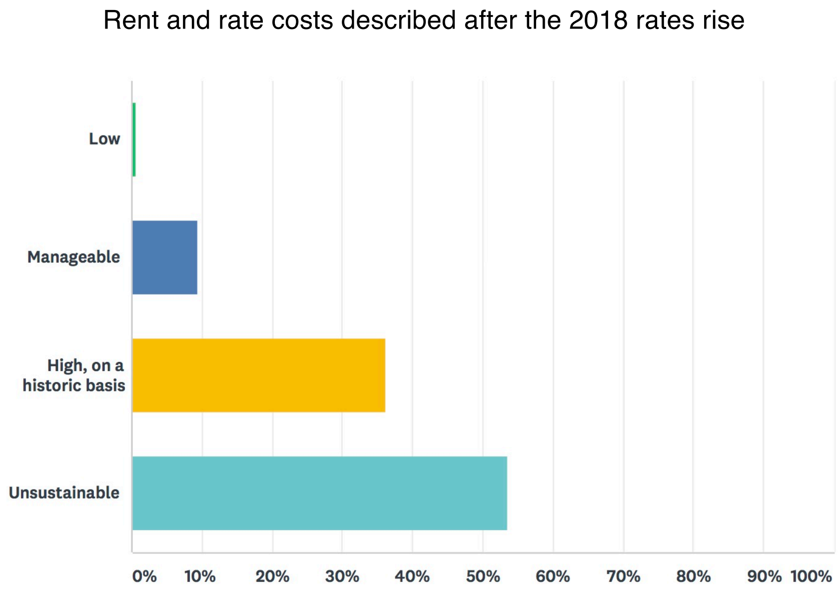


We have reached a tipping point with restaurants now spending more than they can afford on rent. Restaurants are spending an average of 21% turnover on rent, up from 16% last year. This is already up from CDG's forecast that operators will be paying an average of 20% of turnover in rent by 2021. Historically, 12% of turnover is the maximum businesses can afford.

The percentage of turnover spent on rent has risen by 70% over the last five years and 140% over the past decade.

> *"A number of restaurants are in serious trouble at the moment, predominately related to the rents and not assisted by legislation. Historically, the most successful rents have been under 12% of turnover and as restaurants have needed to expand, landlords have taken advantage and rents have crept up because of demand."*
>
> **Roger Payne, CEO, Camden Dining Group**

The review of business rates is looming

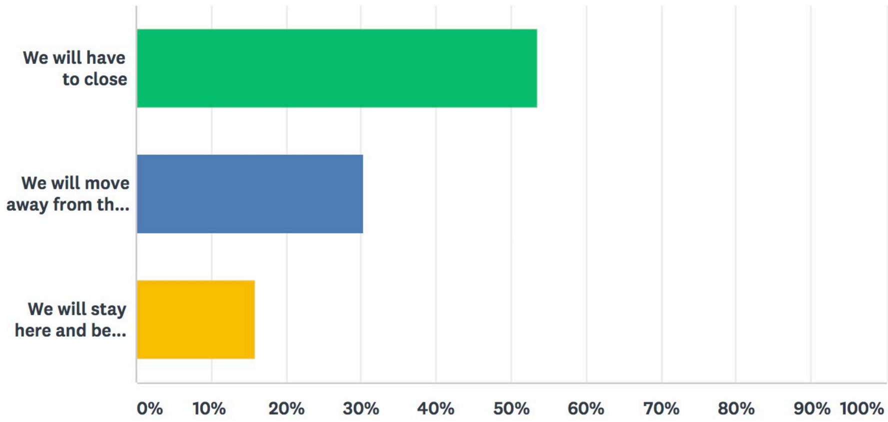


90% described the forecast increase in rents and rates as High or Unsustainably High.

This is up from 60% in last year's report. Industry veterans polled by CDG forecast rise by at least 20% in rent after their next rent review. The business rates review will see the rates paid by restaurateurs rise to reflect the current rent bubble.

Most restaurants will have to close down or move away from London

If rents and rates continue increasing as forecast, what is next for the business



Just 16% of restaurateurs were confident that they will be able to carry on with business as usual if the rents and rates trends carry on as forecast.

While 84% of restaurants said they would have to close or move away from central London.

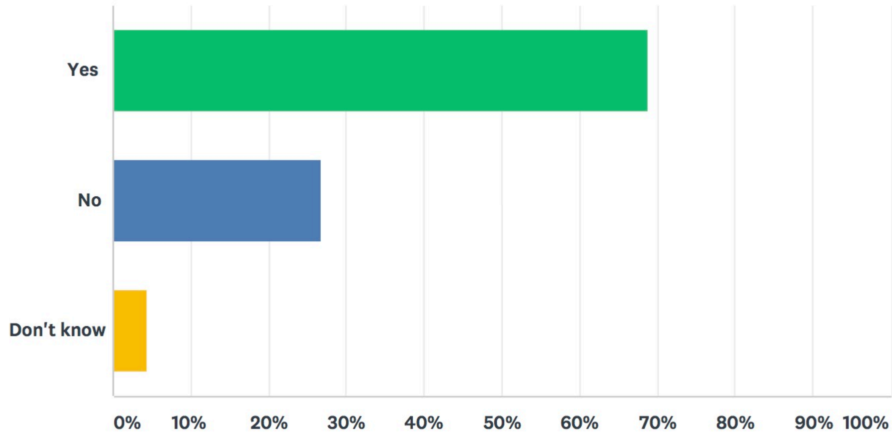
Even Supertraders are feeling the strain

Last year, it could be argued that the aggressive expansion strategies of Supertrader brands – such as Five Guys and Shake Shack – were temporarily pushing up market rents. New chains are paying huge premiums to secure desirable sites and expand to increase aggressive valuations. This is distorting market rates: when assessing how much rent a restaurant should be paying at the time of a rent review, landlords use the highest recent rent paid in the close vicinity of the restaurant being assessed as their benchmark.

But this year, several high-profile closures including Jamie's Italian, Prezzo and Byron show that even successful companies are feeling the strain of high rents.

More landlords are not playing fair by their tenants.

Does your lease fall within the Landlord & Tenant Act 1954 (i.e. do you have renewal rights)?



Tenant security is diminishing, making it harder for restaurateurs to hold-on to their coveted central locations. Landlords are bypassing the 1954 Landlord & Tenant Act which includes a statutory code governing business tenancies and gives business tenants a degree of security of tenure by giving them the right to have a renewable lease on the same terms as the original lease granted. However, more than a quarter of leases now don't fall under the Act.

> *"Leases within the act shouldn't be optional or at the discretion of the landlord. The average leaseholder today has no protection whatsoever; they can't rely on the Act. If landlords are unwilling to offer a lease within the Act, they have no choice.*
>
> *"There is also clearly an issue with the fact you can withhold information in the land registry about the details of the lease and rent. This is appalling, and favours landlords. Restaurants are small organisations; many of them are one-off independents. It is much more difficult for them to have the inside knowledge to find this information and not having a transparent system sets them up for failure"*
>
> ***Leonid Shutov, Bob Bob Ricard***

WHAT HAPPENS IF NOTHING CHANGES?

Remote central kitchens will become more prevalent

Restaurateurs within expensive Central London will create centralised preparation hubs on the cheaper outskirts, reducing the space needed for food preparation on site and allowing more space for diners. We are seeing this with Deliveroo's invention the

"Roobox". But this may have a knock-on effect on the quality of food produced as well as overall dining experience.

Reverse premiums will rise

As Central London rents become increasingly unaffordable, there is a risk that reverse premiums could become common-place, i.e. businesses tied to the lease of a building may be forced to pay new tenants to take a lease off their hands.

> *"We will see more failures in the hospitality sector due to rates and minimum wage policy and rent portfolios which are too expensive. People are almost happy to just give premises away because they are in trouble, rather than trying to sell them. As landlords start to experience increasing voids rents will come down over time as they will have to offer their premises at a cheaper rate.*
>
> *"Both the business rates issue and the government policy regarding minimum wages have had a significant impact on profitability and sustainability within our sector. Policy makers have completely misread the viability and again the situation will lead to a quantum of less income from rates as businesses close. This will have the same effect on government as inflated rents will to the landlord sector – ultimately resulting in less revenue for the public and the private sector."*
>
> **Roger Payne, CEO, Camden Dining Group**

An exodus from London will benefit regional cities – but at the expense of the capital

The leisure industry in cities like Bristol, Leeds, and Manchester is flourishing, with concepts struggling in the overheated London market, finding a foothold in the regions. While restaurateurs will have a solution to London's rental crisis – this is bad for London. The leisure scene in London is a world-renowned asset which generates revenue from locals and tourists alike. These amenities will no longer be available if nothing is done.

PROPOSED SOLUTIONS

In order to get some real traction in the campaign to make costs fairer for operators, we need the government, landlords and leaders in the industry to adopt certain measures which we have recommended below.

Joined-up approach needed from landlords, government, agents and tenants

CDG believes the Government, landlords and tenants must all work together to implement successful changes to slow the decline of the independent and historic restaurant sector.

Landlords to subscribe to an “affordability statement” which ensures rents and rates of an operator do not exceed 25% of turnover

CDG’s affordability statement suggests that prior to a new lease or rent review being finalised, the operator is to demonstrate that their combined rent and rates do not exceed 25% of net turnover. It is understood that if rent and rates exceed this level of turnover then the business will be potentially loss-making and unsustainable.

In the event that the rent and rates combined do exceed this 25% level, the landlord would consider giving the tenant a rent concession during which the lease cannot be assigned until arrears are made up. This could mean a headline rent was still being maintained for open market purposes but would also assist a tenant during a time where the turnover and property costs are not aligned. In addition, during this period, the landlord would be open to a review strategy where they are able to consider taking a surrender of the lease and putting a new tenant in who may be able to get the costs versus turnover ratio in proportion.

Landlords to be responsible for rates payable

Landlords should be ultimately responsible for the rates payable and, upon a new lease, give tenants a fixed price which includes rents and rates. This would ensure more transparency for tenants as to what their overall cost is.

Pressure on landlords to adhere to the Landlord and Tenant Act 1954 part (ii) and allow tenants their occupational rights

We also want to see greater pressure on landlords to make use of the Landlord & Tenant Act 1954. For example, when a lease comes to being within five years of expiry automatic renewal rights should apply in order to give tenants the opportunity to reinvest in a business needing refurbishment.

But legislative change could be counterproductive by encouraging landlords to take on only the commercial tenants whom they feel most certain will pay the highest rents.

‘Naming and shaming’ landlords who do not abide by the 1954 Act would place public and political pressure on landlords, if not to abide by the letter of the Act, at least to abide by its spirit (by offering their commercial tenants greater security of tenure), so that they have some way of justifying their position.

A more positive incentive would be to allow landlords in the capital who do abide by the Landlord & Tenant Act to qualify for deductions on certain taxes.

More innovation and transparency needed from restaurateurs

Business owners also have a part to play; they must have the confidence and flexibility to adapt their business models to increase profits. For example, ‘all-day dining’ models that increase the servings to 21 meals a week can drastically increase the number of covers a restaurant can process, helping to drive higher profits. Improved dialogue between tenants and their landlords about turnover and business performance is also needed.

DAVID ABRAMSON, CEO of Cedar Dean Group, comments:

“We always knew that the upward only rent review system created a cliff edge ending for operators but these latest statistics are must worse than what we saw a year ago, with the average rents comprising 21% of turnover of and average rent and rates together at around 30%.

“There simply isn’t enough profit in the mix for hardworking operators. The reasons for the rental increases are partially due to a small number of very exceptional supertraders who can simply pay rents that others can’t.

“In the London market, we see that premises with rents above £250,000 are struggling to change hands a bit akin to the high-end residential market as there is a fear to generate, the levels of turnover needed due to consumer volatility.

“With these statistics showing 84% of operators currently see their rent and rates as unsustainable, we turned to the Westminster Property Association for help and for them to consider their Corporate Social Responsibility in lobbying landlords for affordable rents.

“Our suggestion was to urge landlords to take turnover into account when giving new leases or executing rent reviews – rather than the historic application of a pounds per square foot basis which has put so many operators out of business. Their response was that such an affordability statement could reduce footfall and undermine successful operators - something we fundamentally disagree with.

“One thing the last few months has shown is that high rent and rates are not just affecting businesses that need to improve but also operators that invest substantial sums in the capital city including the likes of Ripley’s, Believe it or Not, Jamie’s Italian and Byron.

“We are already seeing a lot of the innovation going to the east and south of London where levels are more affordable.

“It is plain and simple the numbers just don’t add up. Without intervention, the restaurants will be forced to close their doors and by the time landlords wake up it will be too late.”