



Valbridge
PROPERTY ADVISORS

3Q 2023
MARKET ANALYSIS
FULL-SERVICE RESTAURANTS



VALBRIDGE PROPERTY ADVISORS | TAMPA

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FULL-SERVICE SEGMENT OVERVIEW

The full-service segment of the restaurant industry includes chain and franchised restaurants that offer table-waiting service. While some of the real estate assets are owner-occupied, most are leased to franchisees.

HISTORICAL PERFORMANCE

The Covid-19 Pandemic had a significant adverse effect on the full-service restaurant sector in 2020. Even with 2021 and 2022's aggressive recovery, long-term growth was mitigated. From 2018 to 2022, chain restaurant revenue expanded at a 1.5% to \$571 billion. In recent years, industry participants have faced shifting consumer preferences and a saturated food service environment. Revenue growth was stunted in 2020 by challenges related to the Covid-19 Pandemic, namely supply chain issues, rising input costs, and fluctuations in demand. In 2022, the FSR industry generated \$55.7 billion in revenue and annual profit growth over the past five years has been approximately 0.3%.

The following data was taken from IBIS World.

Year	Revenue (\$m)	IVA (\$m)	Establishments (Units)	Enterprises (Units)	Employment (Units)	Exports (\$m)	Imports (\$m)	Wages (\$m)	Domestic Demand (\$m)	Consumer Spending (\$b)
2014	47,747	19,669	36,891	296	745,703	N/A	N/A	16,327	N/A	11,515
2015	51,055	21,153	37,298	301	769,995	N/A	N/A	17,579	N/A	11,893
2016	51,284	22,116	36,828	305	768,304	N/A	N/A	18,014	N/A	12,188
2017	51,297	21,687	36,555	310	757,675	N/A	N/A	17,737	N/A	12,478
2018	52,877	22,134	37,099	316	765,709	N/A	N/A	18,327	N/A	12,837
2019	54,527	23,106	37,537	319	768,487	N/A	N/A	19,294	N/A	13,092
2020	40,367	17,156	36,892	315	556,199	N/A	N/A	14,320	N/A	12,701
2021	48,997	21,642	37,298	318	637,133	N/A	N/A	18,360	N/A	13,754
2022	55,705	24,013	39,377	335	694,749	N/A	N/A	20,191	N/A	14,091
2023	57,090	24,499	39,959	340	706,333	N/A	N/A	20,561	N/A	14,139

INDUSTRY OUTLOOK

After facing challenges in recent years related to the Covid-19 pandemic, the full-service industry has not fully recovered. 2021 saw a revenue rebound that surpassed pre-Covid levels. Revenue is projected to increase by approximately 1.5% in 2023. The growth rate between 2023 and 2028 is projected at 1.3%, notably lower than the 2.5% growth rate from 2018 to 2023. The increase in interest rates that have been pushed by the Federal Reserve in 2022 is expected to push prices down as the cost to borrow funds becomes more expensive. Industry competition is expected to keep prices low, which will cut into overall revenue growth.

TOP 50 BRANDS

FSR Magazine ranks the top 50 FSR brands based on market share and revenue and discusses each brand's recent and projected growth. The top 50 brands according to the report are presented in the following table.

1. Olive Garden	11. The Cheesecake Factory	21. Ruth's Chris Steak House	31. First Watch	41. Cooper's Hawk Winery
2. Applebee's	12. LongHorn Steakhouse	22. Cheddar's Scratch Kitchen	32. The Capital Grill	42. On the Border
3. Buffalo Wild Wings	13. Red Robin	23. Ruby Tuesday	33. Miller's Ale House	43. Pappadeaux Seafood Kitchen
4. Chili's	14. Golden Corral	24. Carrabba's Italian Grill	34. Chuy's	44. Village Inn
5. IHOP	15. Waffle House	25. California Pizza Kitchen	35. O'Charley's	45. Black Bear Diner
6. Texas Roadhouse	16. BJ's Restaurant	26. Yard House	36. Maggiano's Little Italy	46. Famous Dave's
7. Denny's	17. TGI Fridays	27. Perkins	37. Mellow Mushroom	47. Brio Tuscan Grill
8. Outback Steakhouse	18. Hooters	28. Bonefish Grill	38. Fogo de Chao	48. Ninety Nine Restaurants
9. Cracker Barrel	19. P.F. Chang's	29. Dave & Buster's	39. Texas de Brazil Churrascaria	49. Fleming's Prime Steakhouse
10. Red Lobster	20. Bob Evans	30. Logan's Roadhouse	40. Twin Peaks	50. Saltgrass Steakhouse

Source: FSR Magazine

FSR REAL ESTATE SECTOR OVERVIEW

Full-service restaurants (FSRs) are attractive real estate investments for a variety of reasons including favorable lease terms, availability of market data, limited property management required, and because they are considered a primary essential service that is less impacted by changes in the economy and/or Pandemic disruptions.

LEASE TYPE AND TERMS

Most FSR leases have original lease terms from 10 to 20 years with moderate rent increases, as well as 10 to 25 years of renewal options. Most FSR leases consist of triple-net, absolute net, or ground leases, where the tenant is responsible for all maintenance and expenses. This limits any significant property management required by the landlord.

LOCATION

Many FSRs have average to excellent location appeal. FSRs are typically located along major traffic arterials or in desirable areas with good visibility and access. The location of many FSRs makes them easier to backfill if the tenant were to vacate the property. The layouts of most FSR improvements are reasonably similar, meaning the renovations of another FSR tenant are generally cosmetic and relatively inexpensive.

SALE-LEASEBACK

The low cap rate environment for FSRs has made sale-leaseback transactions attractive to franchise operators. In turn, franchisees can liquidate value for their real estate to allow for development of additional stores, existing store remodeling, or restructuring of the balance sheet. Many franchisee operators develop new stores in the fee simple estate and operate the store until the gross sales revenue is stabilized. Leases are often drafted 6 to 18 months after opening the store by the franchisee operator based upon market rent, which is typically within a range of 6.50% to 8.50% of gross sales. The properties are then taken to market to liquidate the real estate investment. The franchisee operator then remains at the property as a tenant with a long-term lease in place. Due to the attractiveness of the market for sale-leaseback transactions, the supply of properties in the FSR sector has increased over the past several years.

NATIONAL FSR REAL ESTATE SALE METRICS BY BRAND

The data presented in the tables below includes 14 national FSR brands and provides a general overview of the most recent real estate market for the asset type. The following sale transactions occurred between January 1, 2023, and June 30, 2023.

3Q 2023 AVERAGE NATIONAL SALES INDICATIONS - FULL SERVICE

Brand	# Sales	Sale Price	Year Built	Bldg SF	Land Size	LTB Ratio	Sale Price \$PSF	Annual Rent	Rent \$ PSF	Cap Rate
Applebee's	6	\$2,534,549	1996	4,811 SF	50,714 SF	10.53	\$527.67	\$173,123	\$36.01	6.80%
Carrabba's	0	-	-	-	-	-	-	-	-	-
Cheddar's	2	\$3,192,397	2010	8,232 SF	82,546 SF	10.03	\$381.99	\$187,794	\$22.45	5.75%
Chili's	2	\$2,130,000	2006	5,737 SF	62,944 SF	11.25	\$378.12	\$134,325	\$23.84	6.38%
Denny's	5	\$1,648,600	1985	4,674 SF	44,954 SF	9.47	\$354.07	\$107,128	\$23.10	6.59%
Hooters	1	\$3,600,000	2005	5,144 SF	80,150 SF	15.58	\$699.84	\$217,800	\$42.34	6.05%
IHOP	4	\$1,670,250	1985	3,670 SF	28,532 SF	7.99	\$464.66	\$95,599	\$26.37	5.71%
LongHorn Steakhouse	0	-	-	-	-	-	-	-	-	-
Olive Garden	2	\$3,846,000	2014	9,719 SF	93,589 SF	10.04	\$422.72	\$166,270	\$18.11	4.33%
Outback Steakhouse	1	\$2,109,000	1993	6,220 SF	72,745 SF	11.70	\$339.07	\$131,602	\$21.16	6.24%
Red Lobster	8	\$3,784,502	1992	6,951 SF	70,712 SF	10.12	\$553.51	\$231,658	\$34.06	6.16%
Red Robin	2	\$2,800,000	1997	5,118 SF	80,150 SF	15.66	\$547.09	\$149,800	\$29.27	6.18%
Ruby Tuesday	1	\$2,800,000	1997	5,118 SF	80,150 SF	15.66	\$547.09	\$149,800	\$29.27	5.35%
Texas Roadhouse	6	\$2,633,610	2015	7,734 SF	98,438 SF	12.96	\$341.83	\$137,251	\$17.94	5.24%
Total	40									
Indications										
Minimum - By Brand	-	\$1,648,600	1985	3,670 SF	28,532 SF	7.99	\$339.07	\$95,599	\$17.94	4.33%
Average - By Brand	-	\$2,729,076	1999	6,094 SF	70,469 SF	11.75	\$463.14	\$156,846	\$26.99	5.90%
Median - By Brand	-	\$2,716,805	1997	5,441 SF	76,448 SF	10.89	\$443.69	\$149,800	\$25.10	6.11%
Maximum - By Brand	-	\$3,846,000	2015	9,719 SF	98,438 SF	15.66	\$699.84	\$231,658	\$42.34	6.80%

Source: CoStar & Valbridge Research

2022 AVERAGE NATIONAL SALES INDICATIONS - FULL SERVICE

Brand	Sale Price	Year Built	Bldg SF	Land Size	LTB Ratio	Sale Price \$PSF	Annual Rent	Rent \$ PSF	Cap Rate
Minimum - By Brand	\$1,925,000	1990	4,417 SF	41,558 SF	7.65	\$331.78	\$87,450	\$14.65	4.63%
Average - By Brand	\$3,126,580	2002	6,406 SF	84,034 SF	13.26	\$504.35	\$165,668	\$26.83	5.32%
Median - By Brand	\$3,003,066	2001	6,258 SF	61,797 SF	9.50	\$495.17	\$157,792	\$25.68	5.28%
Maximum - By Brand	\$5,662,223	2018	8,422 SF	379,734 SF	57.65	\$710.32	\$325,378	\$40.81	6.46%

Source: CoStar & Valbridge Research



NATIONAL FSR REAL ESTATE CAPITALIZATION RATES - 6-YEAR HISTORY

Brand	2018	2019	2020	2021	2022	3Q 2023
Applebee's	6.82%	5.99%	6.93%	6.99%	6.46%	6.80%
Carrabba's	-	6.47%	5.63%	5.58%	5.23%	-
Cheddar's	5.25%	5.36%	-	5.46%	4.86%	5.75%
Chili's	6.05%	5.82%	5.83%	6.07%	5.28%	6.38%
Denny's	6.05%	6.24%	6.02%	6.11%	5.34%	6.59%
Hooters	7.73%	6.50%	6.52%	6.59%	6.11%	6.05%
IHOP	6.16%	6.07%	6.47%	6.13%	5.28%	5.71%
LongHorn Steakhouse	5.35%	5.90%	5.92%	5.90%	4.68%	-
Olive Garden	5.36%	6.04%	-	5.51%	4.71%	4.33%
Outback Steakhouse	5.58%	5.16%	5.83%	5.67%	5.29%	6.24%
Red Lobster	6.02%	6.09%	6.03%	6.00%	5.75%	6.16%
Red Robin	5.71%	5.97%	-	6.34%	5.95%	6.18%
Ruby Tuesday	6.01%	6.64%	6.67%	7.11%	4.95%	5.35%
Texas Roadhouse	5.19%	5.28%	5.51%	5.13%	4.63%	5.24%
Average	5.94%	5.97%	6.17%	6.04%	5.32%	5.90%

Source: CoStar & Valbridge Research

Overall capitalization rates were generally stable from 2018 through 2021, with the average cap rate remaining between 5.94% and 6.17% (23 basis points). The capitalization rate for 2022 decreased significantly with an average of 5.32%, indicating a 72-basis point drop or 12% compression. The average cap rate for the first half of 2023 began to recover, returning to the general market pattern of 2018-2021, currently at 5.90%.

REAL ESTATE SALE PRICE TRENDS

The average sale price by brand decreased 12.7% from 2022 to 3Q 2023 (\$3,126,580 to \$2,729,076) and the median sale price decreased by 9.5% (\$3,003,066 to \$2,716,805), signaling decreased demand for FSRs.

SALE PRICE PER SQUARE FOOT OF GBA TRENDS

As with the sale price trend, the sale price per square foot of GBA average also decreased over the past year. The average price PSF of GBA decreased from 2022 to 3Q 2023 by 8.1% (\$504.35 to \$463.14) and the median decreased by 10.4% (\$495.17 to \$443.69).

RENT TRENDS

The average rent from the selected data set decreased by 5.3% from \$165,668 in 2022 to \$156,846 in 3Q 2023. The decrease in rent is only a reflection of this specific data set and not the market overall. In general, most leases are negotiated with rent increasing between 2% and 3% annually, or by 10% to 15% every 5 years.

CAP RATES AND EXPENSES

In extracting cap rates, the market typically does not deduct any vacancy or collection loss from the NOI for FSRs if they are encumbered by a long-term lease with a credit-worthy tenant.

CONCLUSION

The FSR sector will continue to be popular amongst real estate investors. The affordable price point, d favorable lease terms (i.e. rent escalations and renewal options), and limited management responsibility of this asset type will continue to attract private investors. REITs and institutional investors will seek portfolios of FSRs via sale-leaseback transactions with significant size franchisees.



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Knowing the true value of something is more important than ever, but it can be difficult to discern—especially in today’s highly scrutinized regulatory environment. The experts at Valbridge Property Advisors are here to help.

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