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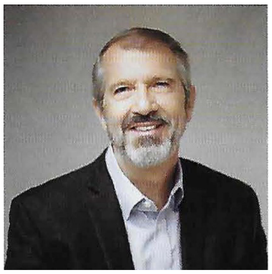

THE GREAT FOOD HALL RACE

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Food halls seem to be sprouting across the U.S. like dandelions on a spring lawn, fertilized by the nation's ever expanding food culture, millennials' taste for variety and retailers' slow-roll discovery of the extent food and beverage can contribute to enhancing the retail experience.

Starting with Harrods' first foray in to comestibles in 1902, food halls have been a long-standing retail amenity. Over the years came Macy's Cellar, Joe Baum's Big Kitchen in the World Trade Center and the omnipresent fast-food courts in shopping malls, first appearing in the 1980s. In fits and starts, they have lurched into the future, holding out the promise of assorted combinations of variety, convenience and enjoyment. The newest generation of food halls, many connected to celebrity chefs, are a far cry from the national franchise-dominated food courts. Rather, the current prototype is a theme on some variant of ethnic, local or artisanal producers, blending a-la-minute quick casual and retail operations. They function as much as destinations as conveniences, driving traffic as well as sustaining it.

The number of major halls, sized 10,000 to 50,000 square feet, is expected to triple from over 100 to 300 by the end of 2020. And the rate of growth for smaller halls is even higher. The press touts them as win-wins for all parties concerned, i.e., the consumer, the operator and the developer. There are plenty of good reasons behind the enthusiasm: for consumers, these halls provide many contemporary food choices and enliven the experience. For the operator, there are reduced start-up costs and heightened volume . The developer benefits from enhanced brand appeal for the properties, as well as the prospects of higher rents and ameliorated risks of failure. Arguably, all is true—almost too good to be true.

Never mind that the impact of food halls on the brick-and-mortar restaurants in their areas, in an industry with fierce competition in every category and segment, stands to accelerate the number of failed operations. The proliferation of the halls compounds the principal weakness of the industry—there are too many restaurants for the population they serve, and they are growing faster than that same population. One must wonder if the growth is being driven by consumers or by developers. Either way, the claim has been made that food halls mark an evolutionary step in the development of the industry, and it may well be a case of survival of the fittest. Time will tell whether this proves true.

My experience in this space, and that of our team at Heyer Performance, tells us that many of the very same mistakes restaurant entrepreneurs make are being repeated in the planning and design of food halls. It is a familiar litany: failure to research and size the market; overzealous revenue projections; poor offering curation; failure to create a compelling and differentiated story; and finally, squeezing productive capacity. Industry history dictates that anyone of these shortcomings may jeopardize the success of a project. Several can be disastrous. The inevitable conclusion is that food halls may not be the Silver bullet that the industry rides on to the next stage.

Our involvement in the planning stages of several halls reveals that the initial developer-tenant deal parameters are the crucible out of which long-term success is born. Too often, the financial structure of a developer's project drives an optimistic assessment of revenue potential, independent of realistic research on the market size and competitive landscape. That inflated revenue projection subsequently drives the lease terms. The terms we have seen run the gamut from build-to-suit to limited TI allowances counterpoised by rental demands spanning a combination of fixed-variable to a straight percentage of sales, peppered with varying CAM charges, central credit card processing and strict operational obligations.

Given the many combinations of lease terms and the market revenue potential, the path to success for all stakeholders can be narrow. Vendors, regardless of development assistance, face a chance of not recouping their investments. Worse, they may at best be buying a job. While the landlord invariably has the upper hand in these transactions, they risk dark space(s) in the hall that diminishes the energy level and dampens guest appeal. They may be also delivering a rent roll that is inadequate to their financing obligations.

It has been our belief at Heyer Performance that long-term success depends on the thoughtful blend of owner objectives, guest experience, operational efficiency and financial performance. Our experience counseling food hall developers leads us to promote winwin landlord-tenant deal parameters based on realistic and diligently researched revenue potential.