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Challenges of restaurant valuation for appraisers - by John Nitz

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Appraising restaurants can be challenging for several reasons, including

- 1.) Factoring current economic trends;
- 2.) Examining the property rights appraised;
- 3.) Recognizing key locational factors;
- 4.) Adjusting for parking and seating capacity; and
- 5.) Extracting non-realty items such as FF&E, furniture, fixtures, and equipment potentially included in the sale.

During the 2020-21 COVID Pandemic, the restaurant industry struggled with at least 600 Connecticut restaurants failing during this time period, per the Connecticut Restaurant Association. As the Pandemic ended, restaurants in Connecticut began to flourish once again, despite facing other obstacles such as rising product and operation costs and staff shortages.

In valuing restaurants, an appraiser must recognize the property rights conveyed, i.e. leased fee versus fee simple interest. A franchise restaurant, like Burger King, subject to a long-term triple net lease can be quite different in value from a vacated Burger King restaurant without a lease in place. The income capitalization approach via either the direct capitalization technique or discounted cash flow analysis are instrumental techniques in valuing leased fee interests. According to brokers at Horvath & Tremblay, one of the top net lease brokers in the country, market activity has softened since the increase in interest rates two years ago, which has seen capitalization rates escalate from 4.5% to 6.5% for triple net leased restaurant franchises. The appraisal of owner-operated restaurants typically involves the sales comparison approach; whereas, the cost approach also could be reliable for newly constructed restaurants. The income capitalization approach can be developed in valuing an owner-operated restaurant on a stabilized occupancy perspective, serving as support of the sales comparison approach.

In Hartford County which encompasses 29 towns and cities in Central Connecticut, restaurant sales activity has been consistent over the past three years. In 2022, the County had 26 restaurant sales, including 17 pure restaurants and nine mixed-use properties with a restaurant use. The sale of a Sonic restaurant at 90 Buckland St., Manchester, CT represented the highest restaurant sale in 2022 at \$2.3 million or \$1,241 per s/f. In 2023, there were 27 restaurant sales, including 22 pure restaurants and five mixed-use sales including a restaurant use. The highest sale was 1444 Farmington Ave., Bristol, CT, a new Chipotle and Starbucks near the Farmington town line, which sold for \$5.12 million or \$1,040 per s/f. Thus far in 2024, Hartford County has had 11 restaurant sales, including five pure restaurant sales. The highest sale was a vacant Starbucks restaurant on .48 of an acre of land at 613 Queen St., Southington, CT, which sold in February 2024 for \$1.5 million or \$1,347 per s/f.

Recognizing locational factors is another challenge for an accurate restaurant appraisal. Factors include demographics, traffic counts, visibility, exposure, proximity to a major interchange, neighboring land uses, and competition. More intricate locational factors include panoramic views, including water and mountain views and location within a resort or tourist area. The high-priced restaurant sales noted above are all well-located properties with high traffic counts. With respect to location, appraisers also must recognize significant new residential growth in the area, which is occurring throughout Connecticut with new apartment development.

Other characteristics such as seating capacity, outside dining areas, and parking availability are additional key factors that must be recognized in restaurant valuation. Lastly, appraisers must confirm restaurant sales with participants involved in the sale to recognize whether FF&E has been included with the sale and its contributory value. The value of the FF&E can represent 15-25% of the cost of a new restaurant; consequently, extracting its contributory value is critical especially in valuing an owner-operated restaurant.

The valuation of restaurants oftentimes is challenging for appraisers, given all the variables mentioned in this article. Those interested in an accurate restaurant appraisal should consider MAI appraisers with years of experience.

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