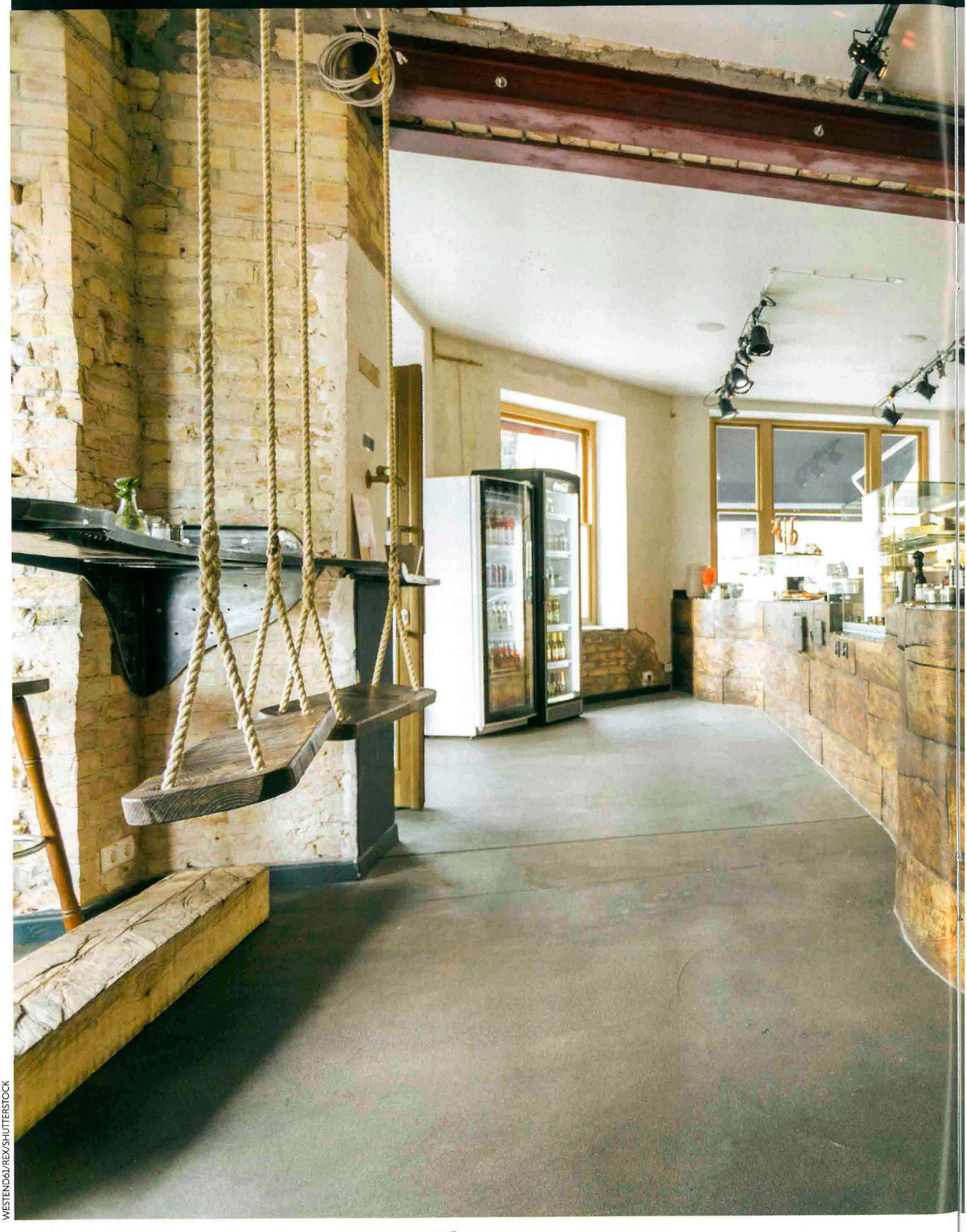

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FACTORING IN THE FICKLE

In the leisure market, today's trend can be tomorrow's discard, while tenant profits and covenants can be ephemeral. So what five problems must landlords and investors consider?

Nothing is harder to value than the future. Future turnover, future profit, even the future of the business itself are all as clear as mud in a leisure sector that depends on discretionary spending and the latest fads.

So how do you make the leaps of faith necessary to value leisure property correctly? The answer is: with very great care, because even the safest of bets can turn out to be tricky. Remember, the explosive growth of the budget hotel sector wasn't enough to prevent Travelodge undergoing a financial restructure in 2012. The consensus is that until a market is mature, the valuation test will be profit, not property fundamentals.

John Maddison, partner at Quadrant Estates, says: "Covenant is the key, but nine times out of 10 the cool new brands don't have much record, so you are buying a story."

If that story depends on phenomenal first-year turnover and exponential growth, be even more careful, warns Quadrant colleague and partner Vanessa Buchan. "New brands can have great turnover when they are new and trendy, then the novelty wears off after three years and you can't value on that basis," she says.

If rents begin to rise just as the successful but immature business makes a slapdash transition to maturity, then the result is potentially disastrous.

No investor is going to drive value if they sign up – then overvalue – a series of short-lived leisure ventures. And yet the chance that leisure property assets are undervalued is what drives a certain amount of investor interest.

Here are the *EG* panel's top tips for getting leisure values right – or less wrong.

The problem of residual value

You never know how things will work out, so residual property value matters. Andrew McGregor, partner at Knight Frank, says the prospects for reletting are better today than ever.

"Five years ago I would have been scratching my head to replace a 20,000 sq ft nightclub with an alternative use. Today there are options," he says.

GVA senior director Gavin Brent says: "Knowing that leisure deals contain an element of risk chips a bit off the price of leisure assets – though to some extent that is already factored into yields, which are typically higher than other property asset classes. But even a leisure deal with a poor covenant in London may get a sharp yield simply because it is in London, and alternative uses for the site are more plausible."

London pub yields of 2-4% are a case in point, says Brent, even given the unhappy record of London pub closures.

"Outside London, investors will want a blue-chip leisure tenant," he says.

Risk pricing

You can create shadow profit and loss accounts and determine rental as a proportion of EBITDA or you can light candles and pray, but in the end, new leisure ventures – and even old leisure ventures – involve risk. This is particularly true of those scaling up from a metro market (the top 10 UK cities) to the wide expanses of


SARAH GINN/PYMCA/REX/SHUTTERSTOCK

Nightclubs are now relettable assets


OLIVER DIXON/REX/SHUTTERSTOCK

Trampoline centres are the new craze

> *"Five years ago I would have been scratching my head to replace a 20,000 sq ft nightclub with an alternative use. Today there are options"* Andrew McGregor | Knight Frank

The lessons of bingo

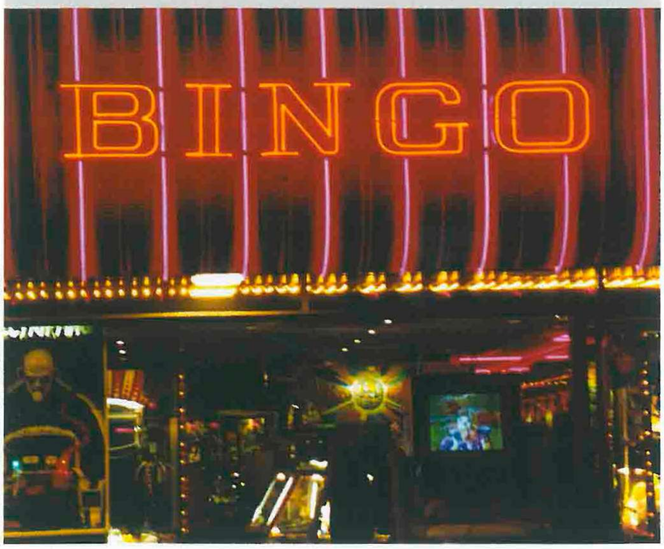
Today's hot leisure trend is tomorrow's funny story, and nothing makes the point better than bingo, says CBRE's David Batchelor.

"Leisure concepts are vulnerable to prompting over-excitement about values. That leads to over-expansion, rents rocket, then it all goes wrong – look at the bingo market, which did this 25 years ago. There was a big move onto leisure parks – they came out of old cinemas and moved into new units next to cinemas on leisure parks. Rents went from £8 per sq ft to £20 per sq ft, then five years later the market returned to normal."

For those with very long-dated bingo leases sitting on their leisure parks, this is nothing but good news – although it may not be for some bingo operators, which face any number of challenges that were not even dreamed about in the mid-1990s.

Quadrant's Tom Hatfield says: "Operators such as Gala signed 25-year leases and landlords are still happy to get the income, but today it's a lot easier to play bingo online – something you can't say about trampolining or crazy golf – and the smoking ban hurt bingo, too."

So be warned.



PETRA MEDLEY/PYMCA/REX/SHUTTERSTOCK

mainstream (everywhere else).

"Travelodge's problems in 2012, the Fitness First CVA in 2012 – these are the names at the back of investors' minds," says Brent. "The more secure the business, the more secure the rental prospect, the sharper the yield.

"The yield gap narrows with better understanding and when it does you get a yield shift. Though some leisure sectors, like crazy golf, will never be a sufficiently large market for strong institutional appeal, which will affect yields."

In some sectors this is still all theory. For instance, the market has yet to see any trampoline-based leisure investments change hands, so pricing evidence is unavailable. Unless you know differently, of course.

From propco to opco

One way to get a firm grip on the problem of leisure value is to become your own operating company – or, at least, to employ it or own it.

Aprirose, the UK-based real estate investment company, has become the poster child for this approach following its £525m acquisition of the QHotel business from Bain Capital Credit and Canyon Partners. The portfolio includes 26 five- and four-star regional hotels, with 3,680 bedrooms, in cities including Leeds, Manchester and Glasgow.

Redefine/BDH Hotels will run the operation for Aprirose, following previous opco roles with the firm at the Hampton by Hilton London Docklands and Mercure Bristol Holland House and Spa.

NewRiver retail is also heading in the same direction following its acquisition of a 202-pub portfolio from Marstons in 2015.

CBRE director David Batchelor says: "A fully operational pub might sell for yields of 10-15%, but from a real estate-only point of view, it would be 4-5% – two different views on pricing – and the investor who can span them both has opportunities for enhanced returns."

Health clubs: feel a pulse?

John Griffin, head of investment at Lunson Mitchenall, says long-dated index-linked leisure income can be too good to be true. "The risk if the covenant fails is that you don't have many viable alternative uses for the property. If you own a health club in the middle of nowhere let on artificially high rents that then inflate, then you have to watch out.

"The trouble is that there is an element of fumbling around in valuing assets like this. There is no historic evidence to back up yields."

David Thame