BlueRockPartners
Commercial Real Estate Advisors

NEWSLETTER
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Hawaii's Great Chicken War of 2020

Okay, the title is a bit overstated for effect, but what is true is both the fact that there is a Chicken War taking place in Hawaii from which the market is reeling. The contenders are Chick-fil-A and Raising Canes and the battlefield is the State of Hawaii.

Our state has often lagged behind the U.S. mainland when it comes to the hottest brands in the county finding their ways to our shores. In fact there are entire retail categories that have never made it to Hawaii - the universe of Mexican food chains completely missed us.

As for the two heavyweights in the chicken category, they are hot across the country and this time Hawaii is earlier in the cycle. It is an exciting time for the consumer, the construction industry and landlords throughout the state. As these two brands race to gain first position in trade areas, ancillary impacts are rippling all around them.

One of the most influential of these impacts is the submarket of pad sites both free-standing and in shopping centers. The pad site market is primarily driven by the "Three F's": Finance, Fuel & Food. 90% of the pad sites in Hawaii are occupied by users in these three categories.

Traditionally, the financial institutions have been known to set the market with their obvious access to capital, unique approach to underwriting and very patient money. In recent years, the evolution of the fuel players to get away from repair shops in favor of convenience stores has allowed them to pay significantly higher rates and compete with the finance players.

As if the market hasn't been driven up enough by those two categories, we now have the food category heating up ala the Chicken Wars. Not only are they pushing the upper limits of value, but their prolific expansion in all of the major trade areas has the pad market frenzied.

It was not that many years ago that pad sites in quality locations would occasionally breach the $250,000/year mark. There weren't many but the comps were out there. In the past three years, there are no shortage of pad deals well in excess of $200,000/year and several current comps are over $300,000/year.

Perhaps the most astounding aspect of this meteoric climb is that some of the comps on the high end now include food users - Raising Canes and Chick-fil-A being central figures and protagonists.

For a number of years our firm did a fairly large quantity of pad deals and we continue to be relatively active in that arena. In aiding our clients with underwriting these deals, there were industry-standard rates of return which were predominantly impacted by land costs, construction costs contrasted against sales volume. Many of the other operational items for Quick Serve Restaurants ("QSR's") do not vary much one from another.

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With the backdrop of exceedingly high pricing for both real estate and construction, it really comes down to either being able to push volume or compress returns. With traditional rates of return, QSR's need to generate $5M-$6M/year in sales, and there are only a few QSR concepts that have demonstrated that level of capacity.

That narrows things down to shaving returns but with high stakes dollar amounts like these it is reminiscent of the 2006 bull market where investments were on thin rates of return with unrealistic and or extremely aggressive expectations of continued growth or value creation. A thin margin game that didn't work then and, in the case of these pad deals, may not work now. Remember, pad deals are almost always 20 years of fixed, known lease term with built in escalations to mirror CPI, so these deals begin thin and hold that trajectory for a couple of decades.

It will take some time to see if the volumes of the new chicken players (or other QSR's chasing them) are sufficient to sustain these lofty pad values, but in the meantime, the Chicken Wars wage on across the state pressing all of us into unprecedented realms.

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