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Leisure property trends: What is driving occupier demand?

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Abstract

Continuing shifts in the structure and direction of leisure operator markets are causing considerable turbulence in the occupational demand for leisure property. It is argued here that 'leisure' is not one easy-to-read sector but comprises several specialised markets. The situation is made even more difficult for property investors by the constantly changing corporate landscape in leisure, as operators juggle their portfolios in order to meet City expectations for larger and more focused companies. Equally, though, the fast-moving, fashion-driven nature of leisure continues to create demand for new space and formats. The paper reviews current trends in key occupier markets and discusses emerging evidence on leisure rental growth in the light of these trends.

INTRODUCTION

Investors in leisure property have undergone a steep learning curve about the nature of occupational requirements in the leisure sector. At the start of the recent leisure property boom around five years ago the property industry optimistically, and perhaps naively, focused on the idea of a 'fits-all' leisure box.¹ This was a formula that had worked for investors in the newly established retail warehouse market, and many saw the growing demand from leisure operators for large units on out-of-town sites as a similar opportunity.

What experienced leisure surveyors already knew, however, and the rest of the market has belatedly realised, is that the idea of a single 'leisure occupier market' is somewhat misleading. In reality, the demand for large units on leisure parks comes from a number of distinct entertainment industries which are selling differentiated leisure experiences to distinct consumer bases. Individually, these entertainment markets are relatively small in terms of the volume of consumer demand and the number of occupiers in each sector.

Moreover, consumer fashions in leisure tend to change rapidly and operators have to be ready to respond with new entertainment offers. The properties they occupy need to be sufficiently flexible to allow operators to change size, layout or even location as markets evolve.²

Over the short life of the leisure parks market there have, too,

**Not a single leisure
market**

Rapid change

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been significant changes in the corporate make-up of individual occupier sectors, which have implications for the covenant exposure of leisure landlords.

While guaranteed rental uplifts on the majority of the first wave of leisure parks provide considerable protection for landlords against swings in individual occupier markets, the combination of specialised, fast evolving and sparsely populated occupier markets has significant implications for the medium- to longer-term investment performance of leisure property.

Sayce *et al.*,³ for example, argues that the lock-in of occupiers to standard units on rental terms unrelated to either their ability to pay or exposure to consumer fashions creates an investment 'paradox' that stores up problems for the future. These problems are likely to emerge in relation to rent review settlements, assignment or re-letting of outmoded units, or managing tenant mix to enhance investment returns. In their assessment of the future for UK leisure property, in the first issue of the *Journal of Leisure Property*, Morley and Evans also conclude that the property industry will need to develop 'greater understanding of operators' businesses and needs'.⁴

This paper provides an introduction to some of the structural issues relating to leisure occupier markets, reviews significant changes in the occupier landscape in recent years, highlights a number of key trends of significance for the near future and looks at how these are beginning to be reflected in rents.

THE STRUCTURE OF LEISURE OCCUPIER MARKETS

Occupiers on leisure parks

Whereas town-centre retail property markets are largely driven by fashion goods markets, and retail warehousing is driven by household goods and electrical retailers, leisure property is driven by a diverse collection of entertainment industries. These various leisure industries have limited operational features in common beyond a shared requirement for large, available, sites in car-accessible locations in large towns.⁵

Of the broad spread of pursuits that are typically described as leisure activities⁶, commercial leisure property has attracted only a limited range as occupiers. Multiplex cinemas have clearly been the most aggressive in their recent expansion, and were, indeed, the principal catalyst behind the development of institutionally acceptable leisure parks.⁷ Ten-pin bowling, bingo, nightclubs and, more recently, health and fitness are the other industries that have been attracted to commercial leisure developments — first to leisure parks and, increasingly, to shopping centres and town-centre leisure schemes. Recent research by Property Market Analysis shows that around 85 per cent of demand on leisure parks is from these industries, the remainder being principally catering.⁸

Although operators in these industries have so far been happy to

Need to understand operators' businesses

Leisure park occupiers

Table 1 Site requirements of commercial leisure operators

	Floor space in sq ft (sq m)	Catchment (population)	Location	Trading periods
Bingo club	25,000 to 35,000 (2,300 to 3,250)	50,000 to 70,000	Retail parks/major roads; town-centre conversions	Midday to 11pm daily. Peak Thurs–Sun evenings
Health and fitness club	35,000 to 60,000 (3,250 to 5,580)	90,000 ABC consumers in 15-minute drive	Stand-alone or business, leisure or retail parks	6am to 11.30pm; peak Mon–Wed 6pm to 8.30pm
Multiplex cinema	35,000 to 100,000 (3,250 to 9,290)	100,000 (small site) to 200,000+ (large)	Out-of-town leisure park/shopping mall	10am to 1am; peak Fri–Sun 7pm to 10.30pm
Nightclub	18,000 to 30,000 (1,860 to 2,800)	100,000+ towns	Edge town, major road or town centre	Wed–Sat 8pm to 2am; peak 10.30pm to 2am Fri/Sat
Ten-pin bowling centre	25,000 to 45,000 (2,300 to 4,200)	150,000+	Edge town centre on major road	10am to midnight; peak 6.30pm to 9pm and weekends

Source: Information derived from *A Guide to Site Criteria for Commercial Leisure*, Business in Sport and Leisure, 1997. Multiplex catchment information from King Sturge Screen Wars.

occupy standard 20,000–40,000 square foot ‘boxes’ on parks or in shopping centres, ideal requirements vary between sectors. Data from a Business in Sport and Leisure survey in 1997⁹ (summarised in Table 1) shows how required unit sizes differ between typical occupiers found on leisure parks.

Catering occupiers in town centres

Catering demand in town and city centres — from restaurant chains and the new ‘super pubs’ — has driven the emergence of commercial ‘leisure pitches’ in many town and city centres, and provided new tenants for institutionally owned high-street units.

Town centre demand

High-street leisure demand tends to be more broadly based than that for leisure park units, with both larger numbers of occupiers and offers available to fill town-centre units. The BISL study, for example, suggested a similar range of size and building requirements across town-centre catering and pub operations (although, inevitably, differences in licensing requirements).¹⁰ This clearly is more advantageous to landlords than the situation on leisure parks, as it provides some security against changes in consumer fashions and/or failure of tenants.

Changing occupier requirements

Significantly for landlords, the nature of occupier requirements has changed even over the short life of institutionally owned leisure property. In general, occupier requirements have increased in size and technological demands have increased. In the cinema market, for example, data from Dodona show that while the number of small cinemas has declined, the number of sites with ten or more screens has increased significantly (Table 2).¹¹ A similar trend towards larger-sized units is reported for town-centre bar and restaurant outlets.¹²

Occupier requirements

Table 2 Growth in demand for larger cinemas

Cinema size	Sites in 1996	Sites in 1999	% change
5 or under screens	638	510	-20
6–10 screens	78	126	62
Over 10 screens	19	56	195
All cinemas	735	692	-6

Source: Dodona, *Cinemagoing*, 1996 and 1999

Similarly, entertainment technologies are changing rapidly and will need to be accommodated in the next generation of leisure buildings. Future multiplexes, for example, will begin to embrace digital projection technologies; bingo clubs are already using network IT to deliver linked-club bingo games; and nightclubs are using sophisticated sound/projection systems to create and change their atmosphere. Rapidly evolving occupier requirements introduce the risk that early leisure parks' units will become obsolete over a far shorter time-span than the leases agreed on them.

A small occupier pool

Building obsolescence is a particular worry in a market like leisure, in which the pool of alternative occupiers is small. In addition to the obsolescence risk, Sayce *et al.*¹³ argues that a lack of alternative users for large leisure units could adversely affect rent reviews by restricting the amount of open market evidence, or deter assignment where occupiers of equal financial standing cannot be found.

Market domination

A handful of operators dominates each of the occupier sectors found on leisure parks, and the number of units they occupy is small in comparison with retail property markets. For example:

- the UK multiplex market comprises six main operators (Odeon/ABC, Warner Village, UGC, UCI, Cine UK and National Amusements), which together operate a total of 286 sites¹⁴
- the largest operator in the ten-pin bowling sector is Allied Leisure with 54 sites, and only two other operators have more than six sites each (AMF and Bass)¹⁵
- two operators dominate the bingo market, Rank (Mecca) and Gala
- the nightclub sector has one dominant occupier, Luminar, and only two others with more than 20 sites each¹⁶
- the rapidly expanding health and fitness market is slightly more broadly based, having eight operators with more than 20 sites each.¹⁷

In the retail sector, by contrast, Marks and Spencer alone operates 299 stores and WH Smith has 500. The out-of-town relative newcomer to the retail market, Matalan, operates 24 standalone sites and 99 sites altogether.¹⁸

The restaurant and bars markets are more diverse, with both a

larger number of occupiers capable of occupying similar units and more occupiers in each sector. In a recent survey of the UK pubs market, for example, Mintel identified nine leisure companies which operate more than 1,500 pubs each.¹⁹ The leisure groups that grew out of the large brewing companies — Whitbread, Bass and Scottish & Newcastle — each operate several high-street restaurant/bar formats. Given that the big operators' offers are pitched at different customer segments, several formats from the same operator can often be found in one location. This would, of course, be unimaginable for cinemas, or the other activities occupying leisure parks.

RECENT LEISURE INDUSTRY CONSOLIDATION

Leisure industry trends in the last few years have favoured corporate consolidation and specialisation. Whereas in 1997 a number of diversified leisure conglomerates existed — such as First Leisure, Rank and Vardon — today only a few leisure companies operate in more than one sector, and some of the largest operators are seeking to focus their activities even further.

Reflecting concerns in the City about the ability of diversified leisure companies to deliver value to shareholders, a number of such companies transformed themselves into single-sector leisure operations. First Leisure, for example, once had interests that spanned bingo, bowling, nightclubs, bars and health and fitness, but by 2000 it had become a pure health and fitness operator, renamed as Esporta.²⁰ Similarly, Vardon disposed of its former theme parks and tourist attractions to become a dedicated health and fitness operation, known as Cannons.

Other operators have undertaken significant acquisitions in order to refocus their businesses. Prominent among these have been hotel and health and fitness acquisitions by the big brewery chains, and further concentration of outlets in the hands of market leaders in bingo, bowling and nightclubs. Table 3 identifies some of the more significant acquisitions in the last few years.

Where does this leave landlords? To date, the changing operator landscape has had largely positive consequences for leisure investments. The move into the health and fitness market of large leisure companies with financial track records has, in particular, produced viable new occupiers for institutionally owned leisure space. On the other hand, the number of institutionally attractive covenants in some sectors — such as bingo, nightclubs and bowling — has been reduced, and could well create future problems for the first generation of leisure parks.

CURRENT OCCUPIER TRENDS

Given that individual operators' space requirements are changing rapidly, corporate composition of individual sectors is in flux and individual operators are themselves constantly evolving, what trends can be identified that will shape leisure property demand in the near future?

Corporate consolidation

Impact on covenants

Table 3 Recent significant acquisitions and disposals by leisure companies

Year	Event	Sector
1998	Bass sold bingo division to a management buy-out (MBO)	Bingo
	First Leisure sold its bingo division	Bingo
	Holmes Place acquired Broadgate Clubs from British Land	Health and Fitness
	Vardon sold leisure attractions business to focus on health and fitness, as Cannons	Health and Fitness
1999	Gala acquired Jarglen Group	Bingo
	First Leisure sold FEC/bowling business to Allied Leisure	Bowling
	Allied Leisure acquired European Leisure against competition from Waterfall	Bowling/nightclubs
	Rank sold Odeon cinemas to Cinven	Cinema
	French cinema chain UGC acquired Virgin Cinemas	Cinema
	Pinnacle Leisure acquired by Cannons	Health and Fitness
	Whitbread acquired Racquets and Healthtrack Group	Health and Fitness
	Whitbread acquired Swallow Hotels	Hotels
	Bass acquired Southern Pacific Hotels Group	Hotels
	Rank sold nightclub division to Northern Leisure	Nightclubs
	Allied Leisure sold ex-European Leisure nightclubs to Luminar	Nightclubs
	First Leisure sold its nightclubs division to an MBO	Nightclubs
	Wolverhampton and Dudley took over Marston Thompson and Eversheds	Pubs
	Punch and Bass acquired entire Allied Domecq pub estate in competition with interest from Whitbread	Pubs
	Scottish and Newcastle acquired Greenalls' pub, restaurant and lodge division	Pubs
2000	Gala acquired Riva bingo (formerly part of First Leisure)	Bingo
	Allied Leisure acquired Waterfall	Bowling
	Allied Leisure taken over by start-up company Georgica	Bowling
	Mazaran merged with Springhealth	Health and Fitness
	Virgin considered acquisition of failed Healthland but did not proceed	Health and Fitness
	Fitness First acquired Healthland's Australian sites	Health and Fitness
	Esporta bought two of the UK Healthland sites	Health and Fitness
	Crown Sports mounted takeover bid for Dragons. Not resolved by end 2000	Health and Fitness
	Luminar took over Northern Leisure	Nightclubs
	Slug and Lettuce sold to SFI	Pubs

Source: Leisure trade press (*Leisure Week*, *Leisure Management*, *Leisure Opportunities*) and *Financial Times*

Cut back in multiplex plans

The end of the multiplex boom

Multiplexes have been, and remain, the key anchor tenants on major leisure schemes. A record number of multiplex screens are likely to have opened during 2000, according to Dodona.²¹

According to King Sturge, 17 multiplexes providing 211 new screens opened between June and November 2000 inclusive.²² The King Sturge data confirm agents' views that Cine-UK remains the most aggressively expanding operator, with 69 new screens opened over the period.

For some time, however, the cinema industry has been anticipating a cutback in operator plans in response to emerging evidence of overcapacity in the market. The withdrawal of Village Roadshow/Warner Village from major schemes in Sheffield and Barnsley in summer 2000, and Greenwich and High Wycombe in the winter, provided confirmation that the major operators are reassessing their plans. Other evidence of overcapacity came from decisions during the last year by overseas entrants Hoyts and Ster Century to withdraw from the UK cinema market.

Although cinema analysts Dodona expect multiplex openings in 2001 to be only slightly below the level in 2000, this reflects the completion of already agreed sites. While Cine-UK is still reported to be looking for new sites, other operators such as UGC have

stated that they will cut back expansion in the near future.²³ This leaves developers looking to other sectors for anchors, and raises important issues for investors at a time when the wave of multiplexes signed up in 1996–1997 approach their first rent review.

Health club trends

The health and fitness revolution

The current buoyancy of occupation demand from the health and fitness sector has, at least in part, provided an alternative to dwindling occupier demand in the cinema, bowling and bingo industries. A recent report by On-Line Leisure,²⁴ which documents trends in health clubs with more than 500 members, shows that the number of such clubs grew by 29 per cent between 1999 and 2000. Even greater numbers are anticipated; the 519 clubs described by On-Line as ‘in planning’ is more than 50 per cent higher than at the same time in 1999.

Failure of the South African backed company Healthland was the only contrary event in an otherwise expanding health and fitness market during 2000. Others in the market attributed Healthland’s failure to its low-cost membership sales strategy rather than any fundamental problems in the health club market itself.

Indeed, the consensus in health club and property industries alike is that more capacity exists in the UK health and fitness market.²⁵ Current views are based on the idea that UK memberships can head towards US levels, where the market is more mature. There, around 10 per cent of the population are members of health clubs. Estimates for the UK vary, but are of a similar order to the On-Line Leisure estimate of 4.1 per cent of the UK population. This confidence is shared by leading operators — such as Esporta, Holmes Place, Fitness First and Cannons — which have intentions to take their number of sites to around double the present level.²⁶

Future capacity

Similar UK-US comparisons were being made in the multiplex market only three years ago, but these expectations have not been fulfilled. UK cinema visiting rates remain well below US levels in spite of the recent increase in provision. A key difference in the health clubs market, however, may be an opportunity to create different offers for distinct consumer segments, thus broadening the market. Clearer differentiation of clubs by price point is seen as a key future trend by City analysts Granville Baird, as is corporate consolidation within the health and fitness industry.²⁷

Further pub divestment by major leisure companies

Pub sales by the major brewers following the competition review of the brewing industry at the end of the 1980s kick-started the development of branded and themed pubs. As well as rolling out chains of branded bars since then, the major brewing groups (Whitbread, Bass and Scottish & Newcastle) have moved into leisure markets which are perceived to have higher growth potential. Acquisitions over the last few years include interests in health clubs, hotels and branded restaurants.

Pub sales

A new wave of pub sales is currently under way as the major operators continue to refocus their businesses on growth markets — health and fitness and hotels, in particular. Allied Domecq disposed of its entire pub estate in late 1999; Whitbread has announced the sale of its 3,000-strong pubs and bars division as well as disposal of a large number of restaurants; Bass announced the sale of 900 pubs at the beginning of December 2000; and Scottish & Newcastle is to review its operations and is expected to sell more than the 250 pubs that it put on the market in September 2000.

In addition, Whitbread and Bass also both ended their association with brewing during the last year, selling their entire brewing operations to Interbrew.

These pub disposals will create acquisition opportunities for fast-expanding independent chains such as JD Wetherspoon, but they also signal growing concerns about saturation of branded outlets in the town centre catering market. Independent operator Yates has also announced a slowdown in its expansion plans for 2001. However, the major operators have stated that they will continue to roll out newer brands, such as Whitbread's Costa coffee chain and Scottish & Newcastle's Bar38.

More demand for budget hotels

At the same time as they have been downsizing their pub estates, the major operators have targeted hotels for expansion, focusing on the budget hotel sector. One recent report indicated that the number of budget hotels in the UK has increased at the rate of 18 per cent per year since 1992.²⁸ Growth is being fuelled not only by increasing consumer demand but also by cannibalisation of trade from the three-star hotel market.

Focus on budget hotels

Recent events confirm operators' confidence in budget hotels. Scottish & Newcastle, for example, acquired the Premier lodge chain as part of its acquisition of Greenalls' pubs in late 1999. Whitbread announced a joint venture with Punch in the summer of 2000 to develop Travel Inns on 50 sites adjacent to Punch pubs. Granada is expected to retain its Travelodge chain even though the remainder of its hotel estate is on the market.²⁹

Strong future demand from operators for budget hotel sites can be anticipated. Consultants Deloitte and Touche, for example, predict a further 700 budget hotels over the next three to five years.³⁰ The leading operators all have ambitious expansion plans, with Travel Inn alone set to double in size by 2003,³¹ and other operators (such as Accor and Marriott) have announced intentions to target the UK budget sector.

In their *Commercial Leisure Survey*, property agents FPD Savills³² say that budget hotel expansion is being enhanced by the introduction of institutionally acceptable leases. Having thus found institutional acceptability, budget hotels have emerged as a new occupier sector for commercial leisure developments. Their

representation on mixed-use and leisure schemes is set to grow further as new developments come forward.

IMPLICATIONS FOR LEISURE RENTS

Are trends in occupier demand being reflected in rental performance of leisure properties? Although the published evidence remains scant, the FPD Savills *Commercial Leisure Survey* usefully documents emerging rental trends across leisure sectors. Their report provides quarterly rental figures from the beginning of 1998 for each of the cinema, health and fitness and food and beverage sectors.

Falling cinema rents

As would be expected against a background of softening occupier demand and expanding supply, Savills indicate that cinema rents outside London have been falling since the third quarter of 1999. Sayce *et al.*³³ similarly indicates a fall of between 3.6 per cent and 15.5 per cent in cinema rents between 1998 and 2000. Savills suggest that cinema rents in the third quarter of 2000 were £24 per square foot in London and ranged between £10 and £16 per square foot elsewhere.

By contrast, strong demand in the health club sector continues to drive up rents, especially in London. Savills suggest that rents in this market may have increased by as much as 25 per cent over the last three years, pushing health club rents to £14 per square foot in London and £9.50–£10.50 per square foot in provincial towns.

Rents for food and beverage units continue to rise in London but appear to have plateaued in major provincial locations during 2000 at around £25 per square foot, according to Savills.

OCCUPIERS NEED FLEXIBILITY

This review of recent developments in leisure operator markets has attempted to show why investors need to keep abreast of trends that affect the underlying occupier base for leisure property. Clearly, although leisure occupiers have some features in common — their desire for large out-of-town sites especially — they are subject to a host of idiosyncratic factors and trends that are specific to their own operating markets. Operators in the various occupier sectors are exposed to different consumer drivers, leisure fashions, property supply situations and corporate strategies, and these drivers have the capacity to change very quickly.

Challenge of rapid market evolution

Given that the pool of occupiers in each sector is small, and investors cannot rely on there being a large number of competing uses to sustain rental growth, it makes sense to develop an understanding of the factors that drive leisure operators' businesses. Over the next few years, investors will be protected from the full vagaries of current occupier markets by the terms secured in the early leisure leases. However, this will only postpone the time when the property industry has to face up to the fact that leisure occupier markets are more complex than was first imagined, and that buildings and occupational terms will need to deliver flexibility to satisfy the fast-moving needs of operators.

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