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Leisure property trends: Is it the end for multiplex anchors?

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Abstract

Closure of four multiplex cinemas in the UK during 2001 fuelled market speculation that the UK cinema sector is facing 'meltdown'. Such a scenario has potentially disastrous consequences for leisure park investments, for which multiplexes have so far been the only realistic anchor tenant. This paper examines recently published data to assess whether these fears are indeed justified. The current situation is examined within the context of long-term trends in consumer demand and the evolution of multiplex development together with published forecasts of cinema visits and screens up to 2005.

INTRODUCTION

Cinema analysts Dodona begin their 2001 assessment of the UK market with the statement, 'There is now near universal consent that the long-awaited meltdown of the UK [cinema] exhibition market has arrived'.¹ Dodona are not alone in expressing these sentiments, which have been repeated both in the property press² and (in a milder form) by Sayce *et al.* in this journal.³ The closure of four multiplex cinemas in the first half of 2001 (Dundee, Romford and two in Manchester) provided evidence to many that a market meltdown had indeed begun, and fuelled further adverse sentiment about the leisure property sector.

Undoubtedly, a severe downturn in the cinema market could have very adverse consequences for the leisure property market. First, multiplex cinemas have been the principal source of anchor tenants for new developments. A cut-back in new site requirements will leave many schemes that already have planning permission looking for alternative anchors.⁴ Any decline in new lettings, clearly, will also limit the amount of market evidence available for rent reviews.

Secondly, the lease formula that secured the acceptability of leisure property as an institutional investment asset depends implicitly on sustained expansion of the cinema sector, in terms of both new site requirements and growth in cinema turnover. A sustained decline in the economic performance of the cinema market would almost certainly damage investment returns from leisure property. As Sayce *et al.* point out, the 'new' leisure leases, in which values are assessed on a floor area rather than a profits basis, combined with lease agreements that provide for guaranteed

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increases in rent, could lead to a situation in which the rent that occupiers are paying is rising faster than their income, and faster than rents achievable on the open market. If this is, indeed, the case then the economic viability of individual sites may be undermined and there is a risk that tenants might default and/or that over-renting would damage investment yields.⁵

Although people like to think of markets as rational, the property market is highly susceptible to disproportionate swings in sentiment. Simply the idea that cinema markets will decline may be enough to hit investor sentiment and thus yields, and falling performance then becomes a self-fulfilling prophecy. The history of other 'new' markets — business parks and retail warehousing, for example — shows that overoptimism in growth phases, and undue pessimism in downturns, can produce significant mispricing of property assets and lost opportunities for investors.⁶ So far, there has been much speculation about cinema markets in the property press, but little hard evidence has been presented to support considered debate.

To help inform the debate about a multiplex 'meltdown', this paper draws together published indicators for the cinema market and highlights where more analysis is required to be able properly to assess risks to investment performance. The paper looks first at UK trends in consumer demand for cinema visiting, then at trends in multiplex development. This provides the context for a discussion of possible scenarios of oversupply, using crude industry rules of thumb about cinema viability. Drawing on published forecasts of cinema spending and new screens, the paper then speculates on how market conditions might evolve over the next few years.

DATA RELIABILITY

Before looking at trends in cinema visiting, it is worth inserting a health warning about data. Although coverage of the cinema market in official statistics and consultants' published reports is better than for many of the other leisure sectors, figures tend to be revised frequently, and consultants produce differing estimates of even the current situation.⁷

In its September 2001 statistical release, for example, the Office for National Statistics (ONS) made significant downward revisions to its box-office figures for 1999 and 2000 when compared to data released in the spring. For both 1999 and 2000, figures for consumer expenditure at the UK box office (in current prices) were reduced by more than £100m in each year, which was equivalent to an 18 per cent lower value for 2000 than had previously been estimated.⁸

Moreover, many consultants make their own judgments about official statistics based on specialist knowledge, and adjust their box-office estimates accordingly. Thus, for any single year, a range of estimates is available from published reports, and the differences

between them can be very significant. Dodona's *Cinemagoing 9* report, for example, which was published in March 2001,⁹ indicated box-office takings in 2000 at £581m, as compared to the ONS March figure of £748m and the revised September figure of £614m.

One could ask, why does any of this matter? The simple fact is that any judgments made about the viability of the cinema market are inevitably made against partial, and shifting, benchmarks. Critically, data revisions can often be much larger in scale than the underlying growth trends they are supposed to be revealing. It is therefore important to avoid looking at snapshots of the market (for example, only one or two years' data), but to look at the current situation in the context of long-term trends and to cross-reference data from different sources wherever possible.

Subject to these health warnings, the remainder of the paper seeks to illuminate where cinema trends are heading, and their implications for leisure property.

THE CINEMA VISITOR MARKET

Reversal of a long-term decline in UK cinema audiences following the introduction of the multiplex product (improved cinema environment plus more entertaining films) from 1985 onwards is well documented.¹⁰ According to figures collated by the British Film Institute (BFI), UK cinema admissions in 2000 were at their highest level for 15 years, at 142.5 million visits.¹¹ Although year-on-year admissions and box-office takings are notoriously volatile — driven as they are by the appeal of individual films — the long-term trend since the mid-1980s has clearly been upward, and driven strongly by the development of new screens (Figures 1 and 2).

Figure 1: Long-term trend in visits and box office

Figure 2: Multiplex screens and total cinema admissions

- The average trend since 1985 has been for visits to increase by 4.7 per cent each year.
- Over the same period, above-inflationary rises in average ticket prices meant that consumer spending at the box office rose by 5.4 per cent per annum on average in real terms (or 11.5 per cent per annum in current prices, ie including inflation).
- On average over these 15 years, cinema spending rose faster than consumer expenditure in the aggregate (which increased at 3.2 per cent per annum, in real terms).

Slowing growth of box office takings

It also appears to be true, however, that growth in box-office takings has slowed over the last two to three years, to well below the post-1985 trend. Between 1997 and 2000, visits grew at an average rate of only 0.8 per cent per annum, and box-office takings increased by 4.6 per cent per annum (at current prices), even though multiplex supply continued to expand and consumer spending overall has been buoyant. A continuing shift in the balance of provision in favour of multiplexes, at which average ticket prices are higher,¹² has helped box-office takings to increase faster than audiences.

This is not the first time that the cinema market has endured a slow-down. The first burst of multiplex development in the late 1980s, and the accompanying boom in visits, were followed by a period of much weaker growth between 1991 and 1995. The annual increase in visits fell from an average of 4.7 million per year (1985–1991) to 3.6 million (1991–1995) and the rate of growth in box office expenditure slowed by almost two-thirds.

The difference today is, arguably, that much more is at stake for investors than in the early 1990s, with much wider institutional

ownership and potentially greater knock-on consequences of a cinema downturn on confidence in leisure property generally. Whether the latest slow-down amounts to a 'meltdown' — at least on the consumer side of the equation — remains questionable, however.

A key question is whether recently weak average growth in box-office visits and revenues is the start of a new trend which signals that the market has reached the limits of consumers' appetite for cinema. Alternatively, is it simply a short-term — or cyclical — dip, or does it represent the start of a period of consolidation as the large number of screens built recently 'bed down' and build new audiences?

Looking more closely, recent data are not conclusive. Box-office expenditure, for example, grew more strongly than consumer spending overall in both 1997 and 1999. In 1998 and 2000, it was weaker (incidentally, both years in which there were major international football tournaments, which have previously been blamed for depressing admissions in those years). Even including these two poor years, however, the average five-year growth trend since 1995 has been close to the long-term average for visits, and above trend for box offices. Clearly, it matters over which years one chooses to identify the 'trends'.

A market *not* in decline

Whether or not recent patterns mark a break in trend, it is clear that the cinema-visiting market is *not* in decline. Visits and spending are growing year on year and, critically, box-office turnover *in the aggregate* has grown faster than the typical rental guarantee provided to landlords, even during the most recent slow-down. The real problem for cinema investors is not the consumer market, but the development market, which has expanded so fast that it has diluted the spending gains that have been made by attracting bigger audiences.

MULTIPLEX DEVELOPMENT

Cinema analysts Dodona monitor the opening of new multiplex sites and screens.¹³ These data illustrate various distinct periods of multiplex building in the UK, following the opening of the country's first multiplex in Milton Keynes in 1985 (Figure 3).

- 1988–1991 — first wave of expansion, during which an average of 14 sites per year opened, and which was halted by the early 1990s' recession.
- 1992–1995 — a period of consolidation during the slow economic recovery of the early 1990s, with an average of six sites opened each year.
- 1996–2000 — a development boom fuelled by operators' willingness to shift to conventional 25-year property leases, with guaranteed rental increases, in order to secure funding and sites from institutional investors. Thirteen sites opened in 1996: openings rose to an average of 25 new multiplexes in each of the last three years.

Figure 3: Impact of multiplex development on visits per screen

The Dodona figures confirm just how substantial the recent multiplex development boom has been. Since 1995, 1,150 new multiplex screens have opened, which is equivalent to an increase in screens of 159 per cent. An average of 230 extra multiplex screens per year over the period 1995–2000 compares to 85 per year from 1985 to 1991 and only around 50 per year in the mid-1990s.

‘Race for space’

Not all operators have been equally involved in this ‘race for space’, however. Warner Village, UGC (formerly Virgin) and Cine UK have been the main protagonists, adding between 175 and 200 new screens each to their estates since 1996 (according to data published by Dodona).¹⁴ The other major operators — Odeon, UCI and National Amusements (Showcase) — have proceeded more cautiously, the latter two adding a net 80–90 screens each.

Similarly, not all towns have attracted equal interest. New development has spread unevenly across the country, with intense operator competition for markets in the largest towns and cities and more patchy coverage of other towns. Unpublished research by Property Market Analysis shows that there are now ten cities in the UK with 50 or more multiplex screens inside a 15–20-minute drive of the city centre, while there remain a sizeable number of fairly large towns (over 100,000 population) with no provision at all.¹⁵

IMPACT ON VIABILITY

Cut-backs in cinema operators’ plans over the last year or so¹⁶ suggest that they are finding it increasingly difficult to make sites viable, or at least to support large development programmes and remain profitable. There is, however, little hard evidence available

An oversupplied market?

— at least to the property market — that sheds light on precisely by how much, and where, the cinema market is ‘saturated’, ‘oversupplied’ or even ‘in meltdown’.

Taking some crude indicators for the period since 1995 (from the data above) suggests that growth in cinema visits has not kept pace with the net addition of screens to the market (plus 24 per cent and plus 47 per cent, respectively).¹⁷ However, box-office turnover (in nominal but not real terms) did grow faster (plus 77 per cent at current prices; plus 39 per cent at constant prices).¹⁸ Does this necessarily mean, however, that the cinema market is oversupplied, in the sense that not all screens can be supported viably by the amount of consumer spend available?

Various industry ‘rules of thumb’ concerning cinema viability are cited in published research and surveys. Using these, and the data above, it is possible to calculate a very crude estimate of whether the UK cinema market *on average* is oversupplied (Table 1). In its 1996 review of the UK market, Dodona indicated that a viable cinema would need to attract between 320 and 400 visits per seat per year (or roughly one visit per seat per day).¹⁹ In their 2000 report, *Screen Wars*, King Sturge suggested that large cinemas were attracting 250 visits per seat per year, but the author speculated that this would be insufficient to cover operating costs.²⁰

In reality, an average of 205 visits per seat was achieved across all UK cinemas in 2000.²¹ The crude estimates in Table 1 therefore suggest that the UK market *on average* is indeed oversupplied, unless operators can run cinemas profitably at substantially lower visit per seat ratios — of under 200 per year, perhaps. An alternative interpretation of Table 1 might be that sufficient visits are currently generated to support the multiplex sector, but the cost would be the disappearance of nearly all other cinema screens (or around 1,000 screens in total). These cinemas have so far been the primary victims of the multiplex expansion, with the loss of 280 screens already since 1996.²²

A similar picture emerges using an alternative ‘rule of thumb’ — of 50,000 visits per screen — mentioned in the King Sturge report.²³ According to the Dodona data,²⁴ visits per screen have been falling since 1997, and dipped below the 50,000 threshold during 2000 (Figure 4).

Table 1: ‘Required’ and actual cinema visits in the UK, 2000

	Multiplex only	All cinemas
Screens	1,875	2,954
Seats per screen	227	235
Total UK seats	426,319	695,615
UK admissions ‘required’ @ 320 visits per seat pa	136,422,080	222,596,800
UK admissions ‘required’ @ 400 visits per seat pa	170,527,600	278,246,000
Actual visits in 2000		142,500,000

Note: Figures in *italic* are calculated, all other data taken from Dodona

Source: Based on data in Dodona, *Cinemagoing 9*

Figure 4: New multiplex screens opened

OUTLOOK

Looking forward, consultants' forecasts from the spring and summer of 2001 suggest that the cinema-visiting market will continue to expand. Aggregate box-office takings are predicted to increase over the five years to 2005, at rates above inflation. The range of predictions is, though, wide — from an additional £130m (Dodona) to £500m of box-office spend (Leisure Industries Research Centre) at current prices.²⁵ At the lower end of the predictions, the growth trend would be slightly weaker than in the consolidation period of the mid-1990s; at the upper end of the forecasts, growth would be only slightly behind the long-term trend from 1985.

These forecasts will no doubt be revised in the light of the economic fall-out of the terrorist attacks on the USA. At the time of writing (three weeks on) the ramifications for the UK cinema market are, literally, unpredictable. The brief history of the UK multiplex market provides few clues as to how cinema consumers might respond to a sharp slow-down in the UK economy. During the last recession in the early 1990s, for example, the rising box-office trend continued almost uninterrupted throughout (see Figure 1).

Even if cinema visiting holds up, the principal problem remains that box-office spend will continue to be spread ever more thinly, at least for the next few years. Although a sharp cut-back in multiplex building is certain, many screens are already in development. Indeed, Dodona's research reveals nearly 600 new multiplex screens due to open during 2001–2002. Allowing for closure of other screens, Dodona predict that nearly 450 (net) new screens will be

added to the current stock by 2005, taking the UK total to 3,400 screens.²⁶

If these forecasts are realised, then visits per screen, *on average across the UK, and for all types of cinema*, are likely to remain around 10 per cent below the 50,000 per screen 'viability' benchmark mentioned above throughout the next five years. Predictions for income per screen are slightly more optimistic. Dodona show box-office income per screen beginning to grow once more after 2002, at rates similar to the last five years, as development of new screens is cut off.²⁷ The more optimistic spending forecasts from other consultants imply no further decline in box-office income per screen after 2000.

IMPLICATIONS FOR LEISURE PROPERTY MARKETS

The data presented in this paper appear to support the idea that the UK cinema market, at least in the aggregate, is oversupplied and will continue to be so for at least the next two or three years. Whether the data support the 'meltdown' theory, however, is less conclusive.

Certainly, on the basis of crude benchmarks, it appears that there are too many cinema screens in the UK to be supported by current or even predicted future audiences. Also certain is that the box-office income of individual cinemas, *on average*, has not increased since 1996, and may well fall slightly over the next few years as more multiplex screens come on stream. There is also a risk that income per cinema will rise more slowly than the guaranteed rents provided for in a majority of multiplex leases, confirming the threats to investment returns previously identified by Sayce *et al.*²⁸

None of these predictions, however, amounts to a 'meltdown' (subject to the caveat that some revision — of yet undetermined scale — is probable in the wake of the US attacks). Continuing growth in aggregate visits and box-office spending is predicted, albeit at lower rates than during the recent past. Spend per screen is expected to start rising once more after 2002 as development is cut back.

Furthermore, the average picture begs a number of very important questions.

- Which types of cinema are losing audiences? There are, for example, still over 1,000 non-multiplex screens in the UK (some 40 per cent of the total). Is there enough income available from cannibalisation of older screens to protect multiplexes?
- Are the 'viability' benchmarks used above appropriate? To what degree, and for how long, can operators sustain lower average visiting ratios than are assumed in these benchmarks?
- Is oversupply universal, or confined to those places where competition for cinema audiences has been greatest? Towns that have only one multiplex may, for example, have avoided the income dilution suggested by the national picture.

- To what extent can operators compensate for slower audience growth, or lower visiting ratios, by raising ticket prices? What are the factors that determine their ability to do this?
- How do all of these factors combine to affect the income of any individual cinema, and how does this impact on the ability of the operator to pay higher rents?

The most probable outcome is that more cinemas will close — but many of these may not be multiplexes. Some multiplex cinemas will struggle to generate increases in turnover — but possibly only those in the most competitive local markets. Lease guarantees will mean that rents for some cinemas will rise faster than tenants' income — but some situations might equally support quite large increases in rent. As the wave of cinemas built during the late 1990s reach their first rent reviews it will become increasingly important for landlords to look again at what occupiers can afford in specific local situations — not simply rely on the apparent protection of rental guarantees.

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