Will Build to Suit

Rising construction costs bring new thinking about ROI, brands, expansion and more.

By **Scott Hume**, Executive Managing Editor

A construction-industry adage is that when money is cheap and plentiful, building materials are neither. That's certainly the scenario facing every restaurateur and chain operator seeking to capitalize on the upswing in food-away-from-home spending. There's money to be made operating new restaurants—if you don't run out of money trying to build them.

The war in Iraq and Hurricane Katrina's wake in the Gulf Coast region siphon materials and manpower, but that's just the beginning. The industrial revolution in China and a building boom in the Middle East (especially in hyperactive economies such as Dubai) both deepen domestic scarcities and boost prices. Demand for steel, plastic, drywall and lumber exceeds supplies in many areas and prices for all those basic building materials have soared.

Thinking of wiring that new restaurant? China is buying up as much copper as the marketplace can produce, sending prices for wiring skyward (at $2.55 a pound in early April, copper was up 51% over year-earlier levels). Other core metals that are basic building materials, including aluminum (up 27% over a year ago) and zinc (up 71%), tell the same bad news.

And if you can find and afford to pay the premium prices for necessary building materials, who's going to assemble them into a restaurant, especially if you plan to build (as many chains do) in growing markets such as Florida? Many site contractors there are tied up building condos or have moved to Mississippi to capitalize on post-Katrina construction needs. Contractors themselves have trouble meeting manpower needs since most members of Gen Y who aren't in uniform don't seem as keen on entering the building trades as their parents were.

What we have here, says Marc Buehler, vice president of marketing for Dallas-based Tony Roma's, is "a perfect storm of negative factors coming together."

New Metrics

The predictable result of this storm? Shock and awe.

Few operators have scrapped expansion plans in light of > 70

Tony Roma's downsized full-service prototype in McAllen, Texas, is more cost-efficient to build and operate.

MAY 1, 2006

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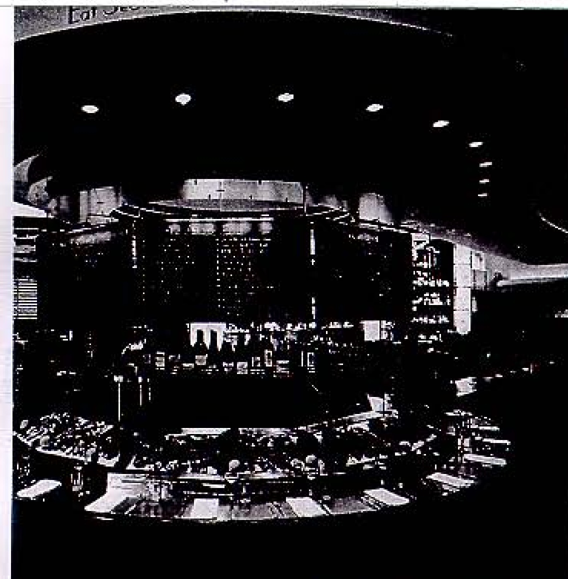
$130 Increase in the world export price per tonne for hot-rolled steel coils over just a two-week period in March 2006. (World Steel Dynamics/*The Economic Times Online*)



Long-term partnerships with vendors keep building costs in check for The Oceanaire Seafood Room.

< 69 cost increases (though building in markets where material and labor shortages are most acute may be postponed), construction-industry sources report. Instead, restaurateurs are rethinking their needs and expectations. Square footage may be reduced or less-expensive, more plentiful materials may be substituted.

Curbing enthusiasm for new ventures isn't always an easy task. "Anything that costs anything is too much for restaurateurs," says Bruce Russo, president of Dallas-based Techcon, which designs and builds restaurants primarily for independents, although it does some chain projects. "That's because they remember the last time they bought materials 10 years ago and they cost less then. Operators don't live in reality, but we know that."

That resistance to higher prices is largely a result of restaurateurs' commitment to excellence rather than their penury, Russo adds. They don't like to compromise on quality or risk cheapening a brand. But they're coming to grips with the new reality, which asks the question, "What does the brand really require?"

"All norms are being broken since Hurricane Katrina," Russo says of the building trades. "Can you still build a restaurant for $300 a square foot? Maybe not. It may be that $350 to $400 a square foot is the real world now, and restaurateurs are becoming more open-minded about that."

"We like to say, 'It's not what it costs; it's what you can buy it for.' And that's very true right now," says Brian Stys, vice president for restaurants at Boston-based Shawmut Design and Construction. "You might have a $200,000 electrical job, but if manpower's tight, it might cost $240,000 to get it done."

Subdividing the Concept

If the alternative is slow or no expansion due to higher costs, then thinking and planning smaller can benefit—not diminish—a brand, says Tony Roma's Buehler. The casual-dining rib concept already has done what many of its competitors likely also will do: subdivide the brand to maximize location opportunities and minimize construction commitments.

Most of the 230 Tony Roma's restaurants opened since the chain began in 1972 have been standard full-service, full-size operations that average 6,850 square feet. Last year, in McAllen, Texa a new prototype opened, smaller but more cost-efficient. The design—averag ing 5,200 square feet—is no less a Ton Roma's and more appealing to current and prospective franchisees (who account for 90% of system sales). With about 250 seats, the McAllen prototype can do the same business as the previous standard.

For in-line, food-court, airport or overseas locations where an even smaller (750 to 1,000 square feet) operation is most feasible, the chain has developed i Tony Roma's Express concept. It was an overseas franchisee who convinced the chain of the compact model's viability.

"We have an operator in Venezuela who pioneered it," Buehler says. "It was very successful, though you're looking a a completely different P&L model. The sales aren't nearly as high, but you're looking at a build out of maybe $200,000 versus the $4 million a full-scale Tony Roma's may require."

Can ribs, the concept's signature dish be cooked and served in a 1,000-squar foot quick-service format? Prep changes to hold cooked ribs with caramelized sauce were developed "because speed i the name of the game in that context. You have turn a ticket in three to four minutes." But the company is quite >

Tips From the Trades

Brian Stys, vice president at Boston-based Shawmut Design and Construction, advises that operators take these steps to counter building-cost increases.

- **Plan early with an expert who knows the market because regional differences in availabilities, prices and codes can be huge. "Just because you built there eight years ago doesn't mean the situation is the same today."**
- **Identify the most-expensive framing or décor materials (such as lighting) and order them as early as possible.**
- **Consider a restaurant's life expectancy. "You want a building to last, but you don't have to build a nuclear power plant."**
- **Research possible materials substitutions from the beginning. "What you don't want to do is be half pregnant when you discover you need to make changes or cut costs."**
- **Have a construction expert review leases to spot potential problems a lawyer may miss.**

< 70 happy with the express concept's first site in Honolulu's Ala Moana mall, Buehler says.

Satisfied enough, in fact, to prepare its boldest gamble: Tony Roma's Fast & Casual. As the name suggests, this is a fast-casual rendition of its ribs concept, sized between full- and quick-service prototypes at 2,200 to 2,800 square feet, with seating for 80 to 100. The first fast-casual unit will open next month in Wellington, Fla. The limited menu of 25 to 30 items also niches between full (50 items) and quick service (12 to 15).

And the challenges of building in Florida have reinforced the necessity for smaller, more-efficient structures. "Just getting three bids for the electrical work was difficult," Buehler says. "The trades are stretched too thin. Everyone's busy, and they'd rather build condos than restaurants."

The Rising Cost of Building

Producer Price Indexes for key building components show the sharp increases over the past two years. This year (2006 numbers are for preliminary figures for February) shows no signs of relief.

Source: U.S. Department of Labor, 1982=100.

Substitutions Allowed

New realities require new thinking. Restaurateurs have had to come to grips with "value engineering"—substituting less expensive or more readily available materials—when necessary, says Philip Bourizk, an architect with Columbus, Ohio-based WD Partners, which works with many restaurant chains, especially on new-prototype development.

Clients set budgets "but when you're ready to begin building a year later, prices have gone up," he says. Increases can be absorbed or restaurateurs must "decide what's worth investing in." Choosing décor elements with a similar look but lower price than originally planned is a common solution.

Panelized interiors that can be pre-assembled and installed rather than built on site are cost-effective and gaining favor, Bourizk says.

For upscale concepts such Minneapolis-based The Oceanaire Seafood Room, value engineering isn't an acceptable response, however. Terry Ryan, president of Oceanaire, which has three units under construction, says the higher costs for construction have pushed his concept not only to plan better but also to plan further into the future.

"Building one restaurant is always more expensive than building several, and we try to leverage our plans with vendors," he says. Economies of scale can bring down prices. "We try to plan a blend of units in expensive and less-expensive markets, but we also partner with vendors. There's a company that does millwork for us and they know we're going to be doing four or five restaurants a year. If a general contractor knows he's going to be doing multiple locations over the next several years, you have a partnership."

Passing on higher costs by raising menu prices—as construction executives say some of their clients are doing—isn't an answer for Oceanaire, Ryan says.

"You can never lose focus on why customers come to your restaurant. You can't put up plywood and stain it. It's easy to say a location cost X% more than expected and try to pass it through to customers. But guests won't accept it if a restaurant they've gone to for 25 years menued steak for $8 and now it's asking $10."

Shawmut's Stys doesn't expect construction costs to return to levels of a few years ago but thinks increases will at least level off. Techcon's Russo is less optimistic, suggesting it could take 15 years to complete recovery from Katrina, keeping prices high.

That's not all bad news, however, says Russo, because restaurateurs have been forced to face efficiency lessons that will pay off long term. "They wouldn't have believed it, but many find they can make dining rooms and kitchens smaller and more efficient and the revenues can be the same," he says. "You reduce the bar from 16 feet to 12 and you can have one bartender instead of two, which cuts labor costs.

"Huge dining rooms are tough to give up, but if you lay out the numbers for them, operators catch on." R&I

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