Demand for Restaurant Space in California Off to Slowest Start Since 2020

Restaurant Move-Outs Rise 20% in the First Five Months of 2024

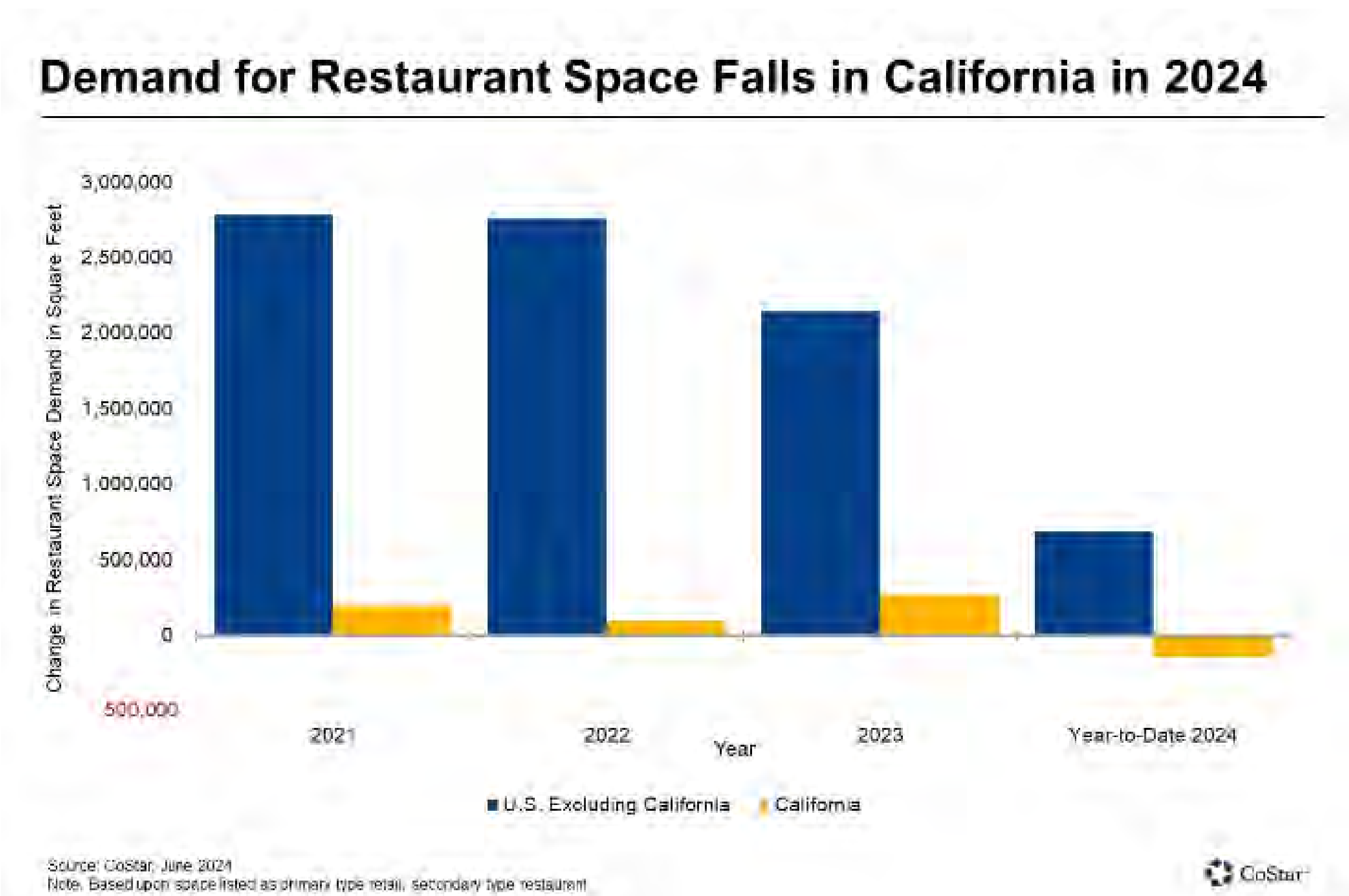
By Brandon Svec

After three consecutive years of record spending at bars and restaurants, fast food and casual dining and beverage establishments are facing tough decisions as operating costs rise and sales growth moderates.

And while demand for restaurant space has cooled nationally, pressure from compressing profit margins is especially evident in California, which in part may be due to a $20 minimum wage for most fast-food workers throughout the Golden State that took effect April 1.

Market analysts warned the new law would lead to restaurant closings and job losses, and months after the law's enactment it appears from recent store closing data that the effect is starting to be felt in the market.

The new labor law was intended to shield smaller mom-and-pop restaurants by exempting them. It only covers employees working at chains with at least 60 units or more nationwide. However, many



smaller franchisees are forced to meet the new wage minimums even when they own only a handful of restaurants due to the much larger footprints of their franchisers. In addition, all operators including the smaller mom-and-pop restaurants compete with the higher wage floor for the same labor pool.

The combination of higher operating costs and sluggish restaurant sales has tilted the balance of demand for restaurant space downward in California. While the full impact of the new labor law on restaurant space demand across California may not be felt for some time, early signs appear to be worrisome. Demand for food and beverage service space across the State of California is off to its slowest start to a year since 2020, declining by over 140,000 square feet through May.

Higher Costs

Declining demand for space is evident in both a pullback in the number of new restaurants opened and an increase in restaurant closings. The most recent casualty is Rubio's Coastal Grill, which closed 48 locations across California at the end of May. The brand noted that the action was taken because of the "rising cost of doing business" in the state. After the shutdowns, Rubio's will continue to operate 86 units, primarily in Arizona and Nevada.

The pullback in demand for food and beverage space is primarily limited to California, as most markets throughout the country continue to record demand gains. Restaurants and beverage shops accounted for more than 19.1% of all retail leasing activity across the U.S. over the past year, the highest level for any sector on record and 2.2% higher than the sector's annual average during the five years preceding the pandemic.

Vigorous leasing activity resulted in a 680,000-square-foot increase in demand for restaurant space across the rest of the country since the start of the year.

Although the full impact of the new law is likely to be debated, restaurant operators across California are already experiencing its effects, and if early signs accurately indicate a larger trend, we may expect to see more restaurant closings occur throughout the state.