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FOOD

Is New York Too Expensive for Restaurateurs? We Do the Math

By KAREN STABINER OCT. 25, 2016

The New York City restaurateur's perennial lament — that staying afloat is tougher here than anywhere else in the country — grows louder each time another restaurant closes. Rents are astronomical, the complaint goes; wages are rising, regulations are byzantine, and don't even talk about the price of fresh produce.

But is it true? Is New York any less hospitable to independently owned restaurants than other big cities?

Recent figures suggest that it may be: The number of independent restaurants in the city fell 3 percent from March 2015 to March 2016, slightly more than the 2.7 percent drop nationwide, according to the NPD Group, a market research firm that tracks consumer spending.

Finding more conclusive evidence, though, isn't easy. Privately owned restaurants don't have to divulge what they spend. Lease terms are guarded like the contents of national security briefings.

One thing we do know: There is a rigid formula for survival. Whether a restaurant opens in hypercompetitive Manhattan or in California's gold-rush dining scene, it has to make the same equation work: The costs of real estate, labor and food should add up to about 75 percent of its projected sales, leaving a profit margin of roughly 10 percent once smaller expenses are figured in.

A large restaurant group or chain may be able to skate below 10 percent because its volume is so high, but a chef who opens a starter full-service restaurant can end up in trouble if profits dip below that threshold.

To further break down the formula, a healthy restaurant aims to spend about 10 percent of its sales revenue on rent, utilities and other occupancy costs; 30 to 40 percent on labor, including payroll taxes and benefits; and 30 percent on food and beverages.

Because those three expenses account for most of a restaurant's costs, we sought the best numbers we could find and compared them for three vibrant dining cities: New York, which has the nation's largest roster of independent restaurants; Los Angeles, where the number of independents is growing; and San Francisco, a smaller, volatile market that has responded to restaurant closings with a real estate plan that enables start-ups to hedge their bets.

Here's how the cities stack up, cost by cost.

Real Estate

Space in Manhattan and parts of Brooklyn can cost twice as much as in Los Angeles or San Francisco.

CoStar, the nation's largest source of commercial real estate data, tracks more than 980,000 listings. Though they are not broken down by use, Joseph Sollazzo, an economist with the firm, created a rough category of "restaurant friendly" spaces for us: listings from 2,000 to 5,000 square feet, a popular range for independent full-service restaurants, that met criteria like "available for all uses" and "ventilation."

At the end of June, the average asking price for such a space in Manhattan and a handful of Brooklyn neighborhoods was $120 a square foot, a 6 percent increase over March 2008. In West Los Angeles, that city's priciest area, the average was $52, an 11 percent increase in the same period. The average rent in San Francisco's central business district was only $45, despite a 19 percent increase since 2008.

"We've seen stronger rent growth over the cycle outside of Manhattan," Mr. Sollazzo said. "Yet rents here are more than double what they are in the other markets, indicating that there's still a long way to go before it is as expensive to rent restaurant space as it is in Manhattan."

Garrick Brown, vice president for retail research at the commercial real estate firm Cushman & Wakefield, produced restaurant-space listings that confirm the price gap: The company's asking prices currently run from $120 to $180 a square foot in Manhattan, from $60 to $80 in Los Angeles, and from $60 to $100 in San Francisco.

Some San Francisco landlords offer promising but unproven tenants a bit of help known as a percentage deal. If a restaurant performs below an agreed-upon level of sales, the tenant pays only the base rent. If it takes in more than the stipulated amount, the landlord collects an additional percentage, which can double the monthly rent.

Mr. Brown says he sees signs that the Manhattan market is starting to soften, as landlords begin to lower asking prices and become more willing to negotiate; he expects the trend to continue through the end of 2017.

He is less certain that they will embrace percentage rents, which are not widely available in New York, but could become more popular if long-term vacancies make landlords, as he put it, "feel the heat."

Most of them don't, yet. He has heard of New York tenants paying as much as 13 percent for occupancy costs, which he considers a danger zone. "You get past 15 percent and you get into trouble," he said.

Labor

It's cheaper to staff a restaurant in Los Angeles than in New York or San Francisco, though New York still benefits from a tipped minimum wage.

The federal Bureau of Labor Statistics reports that annual mean restaurant wages in New York City in 2015 were about $49,000 for a head chef, $28,580 for a cook and $29,290 for a server. In San Francisco's much smaller labor force, pay was about the same for a head chef, $31,120 for a cook and $32,040 for a server. Wages were lower in Los Angeles: $40,740 for a head chef, $25,300 for a cook and $27,570 for a server.

In all three cities, restaurants pay more than the federally mandated minimum hourly wage of $7.25, and each city plans an increase to $15 over the next few years. New York businesses with more than 10 employees will reach $15 in December 2018, up from the current $9; smaller businesses, a year later. San Francisco will increase its minimum wage from the current $13 in July 2018, but Los Angeles will not reach $15 an hour until 2020 or 2021, depending on staff size.

New York State allows employers to pay a lower minimum wage for tipped front-of-house employees, while California is one of seven states that have abandoned the so-called tipped minimum wage — so a New York restaurateur pays those staff members less than a California owner does.

But New York State's tipped minimum wage is going up as well, from a current rate of $7.50 an hour to $9 or $10 by the end of 2018, depending on the number of employees.

A small number of New York restaurants have abolished tipping and raised menu prices to absorb their added labor costs; an alternative, tacking a service charge onto bills, has run into legal challenges. Whether this new approach will raise or lower labor costs in the long run is still a matter of debate; advocates argue that higher pay will be offset to some extent by lower hiring and retraining costs.

Whichever path restaurateurs take, labor costs are on the rise. Overtime expenses around the country will increase on Dec. 1, when new federal Department of Labor guidelines make more salaried employees eligible if they work over 40 hours a week. And while individual restaurateurs may endorse higher wages in a traditionally underpaid field, they must still make the basic math work to survive.

The payroll increases are “a punch in the gut” for owners, because they mean more money out of pocket, said Richard Coraine, a 35-year industry veteran and the chief development officer of Danny Meyer’s Union Square Hospitality Group, which is gradually rolling out a no-tipping system at its restaurants.

While an established group like his may seem immune to cost concerns, Mr. Coraine said that everyone worries about increased outlay. The single-unit owners simply risk “backing up against the wall” more rapidly, he said, because there are fewer dollars in their 10 percent profit margin.

Food

Ingredients cost more on the East Coast than on the West Coast, and the gap grows when California produce is in season.

Baldor Specialty Foods is a major restaurant supplier for the East Coast, and West Central Produce is a major source on the West Coast. Their prices fluctuate on seasonal produce, and they give a price break to restaurants that buy across multiple categories like dairy, produce, dry goods and protein.

We asked West Central to price an order for fruits and vegetables from a 65-seat Manhattan restaurant that uses Baldor as a major supplier. A week’s produce order of 30 items cost $543 from Baldor and $423 from West Central, a difference of just over $6,200 a year.

Doing business in an agricultural wonderland further lowers costs. Michael McCarty, the owner of Michael’s in Midtown Manhattan and its older sibling in Santa Monica, Calif., pays $29.90 for a flat of farmers’ market tomatoes in Manhattan, while a double flat costs only $6.10 more in Santa Monica. Market strawberries are $65 a flat in New York and $36 out West.

Even red meat, chicken and some fish are cheaper in the West. Mr. McCarty said a dry-aged strip steak costs almost twice as much in Manhattan as in Los

Angeles; a six-ounce portion of lamb rack is $24.95 in Midtown and $8.85 in Los Angeles.

The price difference, combined with lower rents in Los Angeles and San Francisco, helps offset labor cost increases and eases the pressure to raise menu prices.

The Bottom Line

It’s harder for an independent restaurant to thrive in New York, and harder everywhere than it used to be.

Traffic growth for all types of restaurants has flatlined at 1 percent since March, according to the NPD Group, which considers the number of visits a more reliable indicator of industry health than sales figures. The group’s projections through 2022 anticipate only a half-percent increase per year; before the Great Recession, from the 1990s until December 2007, normal growth was 2 to 3 percent.

William Wheaton, an economics professor at the Massachusetts Institute of Technology, says restaurants are fighting for a share of a finite consumer budget. Americans, he said, exhibit “an incredible regularity in what they spend on eating out: $1,200 to $1,400 per person” annually. And they tend to visit restaurants of any type, from fast food to fine dining, about 190 times a year, said Bonnie Riggs, a restaurant-industry analyst for NPD’s food service division.

If restaurants raise menu prices to reflect higher costs, they risk losing customers who still want to dine out as often without spending more than they’re used to — and fewer people at higher prices isn’t progress.

The customer base for full-service restaurants across the country started to shrink in 2007, Ms. Riggs said, as the recession led defecting customers to look for faster, cheaper food. Visits to quick-service restaurants — a catchall category that runs from markets with prepared foods to fast food and chains like Sweetgreen — grew to 80 percent of all restaurant visits by June 2016.

Less expensive options like those “have to be stealing from someone,” Ms. Riggs said. “Chains are growing and independents are closing, with the steepest decline in New York City,” where margins are so tight.

It’s culinary Darwinism: In what Mr. Wheaton calls an “intensely dynamic and competitive industry,” there’s one more sobering New York number. New York, New Jersey and Connecticut have more restaurants than anywhere else in the country — 16.9 per 10,000 people as of spring 2016. (The greater Los Angeles area runs second, with 12.1 restaurants per 10,000 people.)

In a saturated market like New York’s, a chain’s advantage — greater financial resources — can spell the difference between survival and failure

“Let’s say you’re in some part of Manhattan that has 50 restaurants,” Mr. Wheaton said. “As costs rise, the guys with deep pockets hang in there for a while, and the others close up. If you’re a total go-it-alone-er without a patron to back you, you’re one of the first to go.”

Mr. Wheaton refers to the “exits and entries” cycle, an economic phenomenon that pertains to any competitive business: “The worse things are, the more casualties,” he said. “The more casualties, the better things get for the survivors, at which point competitors feel encouraged to open more restaurants. They whittle the sales volume of the existing restaurants down lower, to the point where they’re having trouble covering fixed costs, and too much competition leads to another cycle of closures.”

New York restaurateurs bemoan other enduring frustrations, including a complicated permit process and a two-tiered liquor license system that can take months to navigate. The city’s Department of Small Business Services recently announced the creation of the NYC Food & Beverage Hospitality Council, a group of over 30 industry representatives committed to improving the industry’s long-term health.

West Coast restaurateurs have their own set of complaints, including caps on the number of liquor licenses, which can drive up the price of acquiring one in a busy neighborhood, and the same skilled-labor shortage that New York faces.

None of it matters unless the basic numbers work.

Mr. Coraine says that in New York, they don’t. He believes the city has already forfeited its culinary supremacy, a casualty of costs. “People are leaving to find their dreams elsewhere,” he said.

When ambitious young chefs come to him for advice, his answer is terse: “Los Angeles,” is what he tells them. “And I’m not kidding.”

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