

An emerging property niche to watch: Ghost kitchens

Stephen Hayes | Head of Global Property Securities

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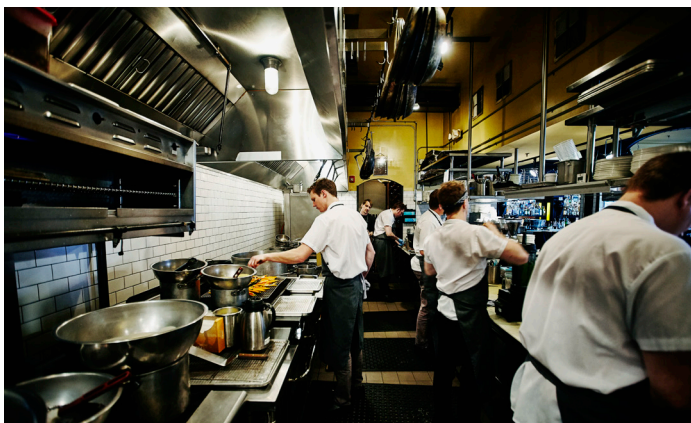
Digital transformation, cost cutting through operational efficiency, scalability and Covid safety. These four themes have been key drivers in almost every industry, which has been reflected in the gravity of changes we have seen as industries have evolved. The hospitality industry is facing disruption from a new consumer trend driving an insurgency of 'ghost kitchens' – and this has implications for property investors.

Underpinned by the movement toward a digitally integrated world we have seen food delivery grow over 300% faster than dine-in over the last 5 years¹, which is predicted to reach \$490 billion USD by 2025². The introduction of various delivery driver providers such as Uber Eats and Door Dash have been followed by a realisation that fast food delivery market demands are far more than just pizza and Chinese cuisine. The emergence of ghost kitchens are effectively betting that the trends we saw accelerate throughout lockdowns are here to stay; new delivery-focused kitchens create a larger and more convenient online marketplace for customers to both browse and source their meals.

The ability to cover the growing demand will inevitably outgrow the productive capacity of restaurants which is why specialised food production facilities taking advantage of economies of scale is an appropriate model for the rapidly growing consumer demand.

What does a ghost kitchen look like?

The idea behind a ghost kitchen is to provide a specialised space that is capable of producing and distributing food to delivery drivers at levels more efficient than a traditional restaurant. These commercial kitchens are built to be efficient, boasting optimised workspaces that are designed to meet peak hour demand. They also substitute a physical store front and dining room area with a digital store front to provide a seamless fulfilment and logistics experience.



The kitchens themselves are specifically built to maximise space. According to 'thekitchenspot'³, designers should consider the following:

- Commercial kitchen needs to be flexible
- Have stand-based countertop equipment
- Plan the positioning of work tables and cooking equipment in advance
- Add a variety of work tables for larger kitchen prep needs
- Choose the right commercial refrigeration
- Consider sink placement – a key factor affecting the success of the kitchen's layout and operation

Alongside the importance of design and layout is the kitchen's location. The key to success lies in areas where both demand and population density are high. In September 2020 there were already around 7,500 ghost kitchens in China, 3,500 in India, 1,500 in the United States and only 750 in the UK⁴. Food brands are realising that operating out of ghost kitchens is a far more effective way to thrive in the food delivery market⁵.

Why ghost kitchens?

Underpinned by the movement toward a digitally integrated world, food delivery is leading to partial disruption in the restaurant industry. Restaurants are reporting losses in their delivery business as margins are being squeezed by third party aggregators. Ghost kitchens have the ability to assist struggling vendors, allowing them to operate on lower lease models rather than prime strips of real estate with street frontage. They will also allow food retailers to access the industry with lower barriers to entry through reductions in legal paperwork and the ability to serve food earlier through visibility on a delivery app.

The strong adoption rates of third party delivery aggregators such as Uber Eats and Deliveroo provoked the shift in the prepared food home delivery market, and it doesn't seem to be slowing down. With the easing of restrictive Covid measures such as state lockdowns, it is likely that society will continue to adopt these technologies and conveniences into the future. Technologically innovative applications that meet consumers' needs – with the right product offering and convenience in mind – will continue to gain market share within the growing prepared food market.

With the business model in its infancy, we expect to see further innovation that could increase the operational efficiencies of ghost kitchens. Some of these areas include the more effective reduction of food wastage, the ability to forecast demand more accurately through harnessing big data, as well as the speed and quality of the food preparation process. Technological advancements will continue to drive greater efficiencies as the business model continues to benefit from greater economies of scale, consequently increasing operating margins as the industry matures and inevitably gaining market share.

New ghost kitchen ventures

With an abundance of interest in the sector it is no surprise there are a number of companies trying to enter the niche. McDonalds and the revered sandwich shop in Los Angeles, Canters, are two examples. With the introduction of their home delivery system, McDonalds witnessed that the in store production demand began to outpace the store utilisation potential. Their solution to cater for this excess demand was to build ghost kitchens solely for deliveries. The adoption of this hybrid food preparation model achieved meeting the increased consumer demand whilst leaving the consumer with a tied sense of familiarity to the product despite there being no tangible point of contact with the consumer.

Companies that don't have the luxury of a recognisable brand or product rely on the creation of virtual brands that have no physical touchpoint with customers other than through their online presence and the finished product delivered to the consumer's door. Dog Haus, a hot dog franchise, employed this strategy throughout Covid. They introduced eight new brands to coexist beside their original hot dog brand. By capturing demand outside of their traditional market they managed not only to beat their Covid-adjusted revenue figures, but beat their pre-Covid expectations.

The third strategy for businesses looking to gain exposure to this growing market segment is the purchase and development of assets that are transformed into a ghost kitchen. This model is best represented by CloudKitchens, an American company founded by Travis Kalanick (Uber Co-founder) who raised 400 million from a Saudi investment fund to launch his new business⁶. CloudKitchens are the leaders in this space, with their mantra being to buy cheap real estate and build shared kitchens for restaurants in the United States, China, India and the UK. They provide a turnkey solution to starting a restaurant, supplying the asset, the technology and a support network to stimulate business.

The future of ghost kitchens

Where are ghost kitchens at in their journey to disruption? Matt Newberg founder of HNGRY.tv predicts that there will only be two types of dining experiences in the future: (1) those on a special occasion; and (2) those had out of convenience, which will be dominated by delivery. Brands will be able to partner up with successful chefs and restaurants to market other industries through a culinary experience. A notion only in its infancy that has the potential to be monetised quickly.

Like any inflow of demand to a sector there will be crowds of hopeful entrants hoping to take their share of the profits. Do these new entrants have the staying power to compete with global brands if they decide to encroach into this space? Could we see a consolidation of food delivery service or will we see a market so saturated that it leads to compressed margins as various dishes become commoditised?

The implications for property investors

Society's increasing adoption of technology and growth in the uptake of the internet is causing rapid societal change. The growth of online prepared food delivery and the increasing popularity of ghost kitchens exemplifies how disruption to the restaurant sector can affect real estate. Whilst retailing is being disrupted, urban infill industrial property is a large beneficiary as ghost kitchen demand drives up market rents and land values. As the institutionalisation of the ghost kitchen industry continues to grow we are expecting the size and scalability of the assets to continue growing alongside it.

Asia in particular is leading the way. Ghost kitchens are increasingly being built and the adoption rates of online delivery and ordering technology have proven to be superior. For example Yum China, China's franchisor of KFC and Pizza Hut, have 300 million people signed up to their online rewards program which serves as a foundation for them to grow their national delivery network⁷. Their long term vision is to have 20,000 ghost kitchens located in mainland China, with 1,000 kitchens in the works for 2021⁸. The FSI Global Property Securities strategies' Asian logistics investments currently have a number of ghost kitchens under development in China and Indonesia.

Conclusion

The continued adoption of technology is leading to rapid societal change, particularly with regard to how we live, work and play. These changes are leading to large re-allocations of capital across global economies with real estate being a major beneficiary. Society's adoption of the conveniences of home delivered prepared meals via online platforms and the subsequent increases in ghost kitchen demand is leading increased investment in real estate in the new age economy.

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End notes

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