Demystifying the Corporate Real Estate Process: The Retailer's Perspective

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INTRODUCTION

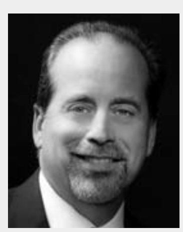
Although in many circles retail real estate has lost its luster, opportunities for knowledgeable practitioners still exist. This article is intended to inform the reader as to how to review real estate opportunities from the retailer's perspective and use this insight to become a more effective practitioner. In order to convey this in a useful manner, the following items are discussed: the typical corporate real estate organization; understanding the decision-making process; site selection methodology; the real estate committee approval process; and building a corporate retail real estate business.

THE CORPORATE REAL ESTATE ORGANIZATION

The structure of a corporate retail real estate organization varies from company to company and is dependent upon the importance of real estate to senior management. For example, if selecting the right location and making the "best" real estate deal is considered a core competency of the company and is paramount to its financial existence, real estate will be given much attention and have a significant position in the corporate hierarchy. If, on the other hand, real estate is more of an administrative function within an organization, it is given less weight and carries less influence. Most corporate retail real estate organizations fall somewhere in between these two types. Consequently, the first order of business for the real estate practitioner is to determine the importance of real estate within an organization. No point spending considerable time, energy and resources on real estate opportunities with a company that does not consider real estate a priority.

For obvious reasons, retailers usually consider real estate a very important element of their survival and success. Therefore they will organize their business around identifying, selecting and finalizing the best real estate transactions. Typically, the better operators or merchants integrate the real estate function with operations or sales forecasts to accomplish the overall objectives of the company and get everyone on the same page. This approach will often require the input and approval of multiple disciplines within a company. The real estate practitioner is advised to learn how this structure operates to avoid submitting sites or locations destined for unsuccessful results. The following organizational chart is common to retail real estate organizations (see Figure 1).

Location research, financial planning and asset management functions may be separate or incorporated into



About the Author

Anthony A. Colavolpe, CRE, FRICS, *is managing principal of The Citron Group, LLC, an international real estate and advisory services group based New Haven, Conn. Colavolpe has more than 37 years of experience in the development and ownership of real estate. Prior to establishing The Citron Group, he spent 14 years as senior vice president of real estate for the Stop & Shop and Giant supermarket chains, both wholly owned subsidiaries of Royal Ahold. In this capacity, Colavolpe was responsible for all real estate-related activities, including location research, new store development and asset management throughout the northeastern United States from Maine to Virginia. He also managed a multi-million dollar annual capital expenditure budget and served on the company executive and operating committees.*

Figure 1. Some organizations combine real estate, planning and construction functions within one group, thereby vertically integrating the entire process. This often leads to a more expedited decision-making process. Other organizations will separate real estate from construction and planning. Depending upon the company's objectives, the latter type of structure could extend the internal timeline for company approvals. As a general rule, the more people involved in the process, the longer it takes to move things through the pipeline.

Figure 1

President or CEO

CFO or EVP of Real Estate.

SVP of Real Estate and/or Construction/Facilities

VP of Real Estate and/or Construction/Facilities

Real Estate and/or Construction Representatives

UNDERSTANDING THE DECISION-MAKING PROCESS

Understanding the decision-making process in corporate real estate can often mean the difference between success and failure. In order for a developer, investor, financial institution or real estate practitioner to spend time and resources on a potential retail project, they need an understanding of potential tenants. The terms, conditions, income stream and development costs relating to these tenants frame the overall financial results for the project. If the expectation is that a particular tenant will anchor a project, pay a certain rent and accept a pre-determined site plan, and then many months later these factors change, the project may no longer be viable. This is likely to happen when the person submitting an opportunity to a retailer is a novice or simply does not understand the corporate decision-making process. Of course the process differs among organizations. Depending on such factors as company size, level of senior management involvement, the marketplace in which a property is located ("barriers to entry"), the company's storing strategy and capital expenditure budget, it could take anywhere from 30 days to several years or more to receive a firm decision. If it's the shorter time frame, you are in good shape. If, however, you cannot get a decision for several years, you may want to think about finding another prospect. In an era where the world of retail and finance changes almost daily, a quick "No" is better than waiting a long time to be told "we are no longer interested."

Most corporate retail organizations make their decisions based upon some common elements. The first element of the decision process is typically centered on the company's storing objectives. Companies regularly need to forecast sales whether those sales are from their existing fleet, future stores or acquisitions. This is often accomplished by developing a one-, three- and five-year storing strategy for the company. Storing strategies are modified regularly to reflect overall market conditions, entitlement impediments, competitive influences, consumer trends and any other changes affecting buying power. The amount of capital a company has budgeted for store development will influence how many units, and within what time frame, stores will be delivered and opened. Retailers commonly allocate a percentage of sales to capital expenditures. Companies, especially those listed on a stock exchange, will include this type of information in their annual report.

Once the retailer has vetted its storing strategy, the real estate department within the organization is empowered to achieve the required results. Locations falling within the approved strategy will receive priority treatment. Those that do not are either rejected outright or receive much less attention. Although the strategy itself would, in all probability, be considered proprietary in nature, certain milestones will be shared with the real estate community, and it is incumbent upon the real estate practitioner to gain some insight on the parameters driving the strategy. Why is this important? For example, if a retailer has already reached its approved allocation of stores or capital expenditure budget for a given year and your project needs a decision now, you are probably out of luck. If, on the other hand, timing is not necessarily an issue, getting a firm commitment for another fiscal year might work for your project.

Once you have a handle on the strategy, you need to understand the retailer's other important considerations: the amount of sales a retailer can generate within a trade area, whether the prototype can be accommodated, and the financial metrics—sometimes referred to as hurdle rates—needed for a positive decision. Forecasting sales volumes is discussed under the heading of the Site Selection Methodology. Likewise, financial metrics are reviewed briefly under the heading of The Real Estate Committee Approval Process.

The retailer's prototype often changes with the ebb and flow of the market. The best advice in this regard is to regularly ask the retailer for its prototypical guidelines. Sending a retailer a half-acre site for consideration when the prototype requires five or six acres to complete a store development not only is a waste of time, but negatively impacts the credibility of the person submitting the location. It demonstrates a lack of knowledge, or worse, the impression that the retailer's needs are not important.

To recap:

- Determine the length of time needed to obtain a firm decision from the retailer;
- Determine the number of stores a retailer intends to complete within a given fiscal year. General rule: a company needs approximately 50 percent more projects in the pipeline than the stated objective in order to accomplish its strategy. Permitting requirements, financial conditions and property control may influence this number;
- Determine a company's capital improvement budget. Dividing that number by the typical investment to be made by the retailer on a per-store basis should line up with the number of stores the retailer intends to open in a given year;
- Keep abreast of the retailer's current prototypical building or space requirement standards. Do not waste time submitting locations that differ significantly from the stated criteria.

SITE SELECTION METHODOLOGY

Site selection can be viewed both as a science and an art. Critical to selecting the right site is forecasting the amount of sales volume a retailer will generate from a particular location. The sales volume estimate is a major factor in the corporate decision-making process. Two recognized approaches used in formulating a sales volume forecast are analogs and gravity models. The latter is a form of regression analysis. The analog approach mimics the characteristics of similar operating locations. This assumes if one or more sites with reasonably similar characteristics produce a particular result, the subject location, if comparable, can or will experience a similar level of activity and profitability. Gravity models are more sophisticated and therefore require a higher level of expertise and knowledge in order to arrive at a creditable conclusion. The gravity model also measures the retail tenant's ability to draw customers over distance. Each of the foregoing approaches is best left up to professionals well-versed in forecasting methodologies.

The real estate practitioner, however, can provide critical support and information to the forecast professional. The first step in developing a sales volume forecast is the delineation of the trade area. Unlike the common approach of simply drawing one-, two- and five-mile rings around a site, determining the demographics for each of these areas and submitting the "package" to a retailer, the trade area as defined by a retailer will encompass many variables. The end product resembles more of an amoeba than a circle. It takes into consideration natural barriers, traveled routes and the location of nearby competition or "sister" stores. A well-defined trade area is that area from which a retailer expects to draw 80 percent or more of its business. In the case of locations where a retailer already may have a presence, the customers' origins are often known. When dealing with a virgin location, however, the practitioner's assistance is always welcomed. Within these trade areas, demographics specific to the retailer's preferred or target customer are generated, analyzed and then compared to a set of predetermined criteria.

This section began by saying site selection methodology can be viewed both as a science and an art. The scientific elements have been briefly described above. The art takes the form of a "gut" reaction to a location. Occasionally, notwithstanding the results generated by analogs or gravity models, a retailer will either accept or reject a site based upon intuition. Seasoned merchants and operators often have a "sixth sense" when it comes to picking the right location for a store. This intuition can sometimes override the scientific analyses.

Once the trade area has been defined and a sales volume forecast estimated, it is not uncommon for a retailer to visit a location and its environs before making a final site selection decision. Assuming economics and other details need refining, this decision, although important, gets someone only to the next level. Decisions of this nature will often involve members of the retailer's real estate team or senior management driving the defined trade area in order to understand how customers will get to and from a site. The time it takes to drive to a location and determine the amount of "friction" encountered will weigh on the retailer's ultimate decision. The quality and quantity of the retailer's competition will also be a factor. The competitors' store size, age, condition, sales volume, offering and price points are generally given consideration when evaluating a site. A retailer's own stores within a given market or trade area will also affect the decision. For example, if a new store in a market already occupied by a retailer will not generate sufficient new or incremental sales dollars to justify another store, in all probability the retailer will reject the site. Building too many stores in one trade area is known as cannibalization and is not a popular business strategy in today's financial climate.

The real estate practitioner can assist the retailer and/or the sales forecasting expert by being extremely knowledgeable about the physical and locational characteristics of a site or location. Knowing a competitor's sales volume is also helpful but not mandatory. Having this information and product knowledge at one's fingertips is one of the hallmarks of a successful investor, developer or real estate practitioner. Relationships between the retailer and the real estate community often begin by nurturing these fundamentals. Lastly, the real estate practitioner can assist in formulating a well-conceived site visit for the retailer. In this regard, drive the market or trade area first and make sure you know the details as well as, if not better than, the retailer.

Suggested reading:

- *Site Selection* by John S. Thompson;
- *Market Research for Shopping Centers,* edited by Ruben A. Roca.

THE REAL ESTATE COMMITTEE APPROVAL PROCESS

In all probability, when all is said and done, without the approval of the retailer's real estate committee or satisfaction of other company requirements, the site, location or potential transaction submitted to the retailer will not move forward. Once the sales volume has been forecasted, a site visit has been conducted and the retailer's prototypical facility can be accommodated, the last step involves the determination of economics, as well as the terms and conditions of a proposed transaction. Most corporate retail real estate operations have an internal set of financial guidelines or policies used in making a decision. Each company relies on some benchmark rate of return, the time it takes to receive back its investment, the projected profitability of the opportunity and its impact on a balance sheet or profit-and-loss statement, as well as accounting, capital and human resources. The complexity of this process, the time it takes to assemble the right information, put it on an agenda and get an approval, varies from company to company. If the retailer is owned by an absentee international owner, the process may be extended by the parent company's own approval process.

In many organizations, a member of the real estate department or senior management will present the submission to the real estate committee and answer questions about the property, location or transaction. The submission often will include the following:

- An executive summary, including a comparison of the target criteria against the indicated results of the proposed transaction;
- Background information;
- An overview of the proposed transaction and its relationship, if any, to the company's storing objectives;
- A financial analysis, which may also include a store-related pro forma;
- Sales volume forecast and rationale generated from the location research analysis;
- A conceptual site plan;
- Other visual or factual items needed to assist in making a decision;
- A recommendation.

Assuming the opportunity has received the necessary internal approvals, and depending upon the protocol of a company, someone from the retailer's organization is usually empowered to go forth and negotiate the transaction. The real estate committee approvals and the economics or conditions specified therein will be used as a guideline for these negotiations. While the specifics may not be readily known to the real estate practitioner, understanding the financial criteria used by the retailer, its position in similar transactions and knowing the "deal-breakers" are helpful. In this regard, reading through documents related to similar transactions executed by the retailer, as well as speaking with developers, investors and financial institutions can generate some valuable insight.

To recap and add a few details:

- Determine what internal approvals are needed and the timing associated therewith;
- If possible, determine the financial criteria used by the retailer and how it fits within the economic parameters of the proposed transaction;
- Understand the accounting treatment or rules for retail transactions and the submission itself;

- Understand the body of information needed by a retailer and assist in the compilation of this material;
- Determine who, within an organization, will be making a presentation to the real estate committee or senior management;
- Read leases, contracts and other transaction documents to gain a better understanding of what a retailer will or will not do to complete a transaction. Speak with other informed individuals about the same things, particularly those who have consummated a transaction with the retailer.

BUILDING A CORPORATE RETAIL BUSINESS

For the real estate practitioner, there are three main factors in the building of a corporate retail business. Networking is probably a fourth, but the three other factors are much more important. The first is product knowledge, the second is credibility and the third is control of the product.

Knowing the marketplace "cold" is one of the things that separates a true professional from the "wannabes." Someone who knows every piece of real estate within a market or trade area, including those occupied by a competitor, as well as the strengths and weaknesses associated therewith, can save a retailer valuable time and resources. Sharing this kind of information with a retailer's real estate representatives helps them look good—a sure-fire way to build relationships. Help them also to know in advance the likelihood of getting requisite land use permits, and to understand transaction-related pricing levels and similar data. Retailers depend upon receiving quality information. This gets to the next point—credibility. If the information supplied by the practitioner is wrong, misleading or less than complete, the relationship will suffer. Instead of helping the retailer's real estate representatives look good, the opposite may occur. Not a good thing for building a business. Therefore, make certain whatever information or material you are disseminating is reliable, current and reflective of the marketplace.

Lastly, controlling the product typically means you have some influence over the end result. If you as a practitioner do not have some form of ball control and either another retailer or developer does, not only is your credibility negatively affected, so is your remuneration. Simply put: no deal, no money. Therefore, make sure you have secured a binding contractual relationship before submitting a site or location to a retailer. Under the broad banner of control is also confidentiality. One way to lose a deal is to tell the world about it prematurely. Retailers do not want to telegraph their moves; neither should you.

It is also advisable to quantify on some basis the likelihood of success, particularly if entitlements or permitting issues are prevalent. Some suggested reading in this regard is offered below. If expectations are not properly managed, the retailer may make costly decisions based upon the wrong set of assumptions.

Suggested reading:

- *The Complete Guide to Zoning* by Dwight Merriam, Esquire, CRE, ACIP;
- *Nimby Wars, The Politics of Land U*se, co-authored by P. Michael Saint, Robert J. Flavell and Patrick F. Fox.

CONCLUSION

Corporate retail real estate in today's economic environment is a difficult proposition. Notwithstanding these difficulties, opportunities still exist for seasoned and competent professionals. The often discussed future wave of toxic

Figure 2

Corporate Retail Real Estate Decision-Making

Create a Real Estate Storing Strategy
Empower Real Estate Team to Implement Strategy
Identify Real Estate Opportunities
Compile Site/Location Specific Information
Develop Concept Site Plan
Define Trade Area
Forecast Sales Volume
Conduct Site Visitation with Decision Makers
Complete Financial Analyses
Prepare Real Estate Commission Submission
Present to Real Estate Committee
Obtain Requisite Internal Approvals
Empower Real Estate Team to Negotiate Transaction
Secure Site/Location and Place in Queue

commercial real estate loans may, or may not, materialize. If it does, investors and developers will compete aggressively for these assets. However, other situations such as corporate downsizing, expense reduction initiatives and limited internal resources favor real estate practitioners with proven track records in asset management or advisory services. Financial institutions, investors or developers with limited or flawed expertise may also be a source of business for real estate practitioners.

Being on top of your game and constantly searching for good opportunities will give you an edge over your counterparts. Figure 2 outlines in summary form each of the steps discussed in this article. This illustration reflects the corporate decision-making process in many retail organizations. Understanding this sequence of events and the associated timing can be a beneficial tool to the real estate practitioner. ■