A New Approach to Best Practices in Real Estate Planning and Site Selection

By Jim Stone

Part I: Toward a Winning Approach

How Do They Do It?

We all want to believe that there are best practices in our industry. Life would be so much simpler if all we had to do is find the best way to pick markets, layout a network of stores, and choose the best sites. Read the manual, follow the recipe, make money every time.

Just do what McDonald's does. How does Walgreen's end up with such good locations? Hire their research director and their VP Real Estate. What are we waiting for?

Research directors and VPs of Real Estate move around, but they don't always replicate their success. Maybe it's the predictive model? Do we need customer data? Did we do site surveys?

Could it be the real estate brokers? Are we seeing the best deals soon enough? Is their broker better than our broker? Is our CFO too cheap to pay rent for good sites? Do we make decisions too slowly?

Right Tool for the Job

There are best practices in farming, manufacturing, and cooking. That's because some tasks have consistent, repeatable elements that can be practiced until the best method is learned. But what happens when the subject is complex, which means that there are many moving parts with constantly changing states and relationships?

Chain store real estate planning and site selection is not like farming or cooking. The retail marketplace is complex and dynamic. Using exactly the same formula for real estate decisions would be like picking horse number 3 in every race. Even a broken clock tells the right time twice a day. But those aren't winning odds in the chain store real estate game.

How do we approach decision making in complex situations? Is it really just luck, or are there ways to be much more successful than average?

Chain Stores and Fighter Pilots

Most people have never heard of John Boyd. He has been called "the fighter pilot who changed the art of air warfare." His nickname was "40 second Boyd" because he had a standing offer to all pilots that if he could not defeat them in simulated air-to-air combat in under 40 seconds, he would pay them $40. He never lost.

Boyd spent his career studying and documenting winning military strategy and tactics.   One classic example is his analysis of kill ratios of two fighter planes in the Korean War. The Russian MiG-15 was superior to the USAF F-86 in many areas, yet the F-86 ended up having a 10-1 kill ratio versus MiGs in combat. On further examination, Boyd determined the F-86 gained an advantage from the fact that it had a bubble canopy, affording the pilot an unobstructed 360 degree view. In addition, its fully hydraulic flight control system (lacking in the MiG) gave it greater quickness in transitioning from one maneuver to another. Although the MiG was quicker and tighter in most maneuvers once initiated, the F-86 pilot had better visibility and could get his plane into and out of any given maneuver more quickly due to better hydraulics.

The F-86 dominated because the pilot could observe the situation, quickly identify the best action, and count on his plane to respond when he made the decision. If the enemy countered, he could repeat the process as many times as necessary to gain the advantage and win the fight.

Chain store real estate decisions certainly don't happen at the same speed as air combat, but there are many similarities. The "pilot" is the investment committee that reviews the data about a site and decides whether to approve it based on an estimate of performance. The decision must be made before another chain store secures the site. **Investment committees can gain the same advantage as fighter pilots if they can observe the situation, quickly identify the best action, and count on their people to execute quickly. If conditions change, the process can be repeated**.

Investment committees often review "standard" packages of information about sites including maps, reports, aerials, sales forecasts, and proforma financials. Although the package may have a standard format, the "situation" is never the same. The variations in trade area demographics, competitor position and strength, site characteristics, and sister store presence are not only significant, but they change over time (sometimes getting better, sometimes worse). It may take months or years for a store to reach a stabilized level of sales, and even that is hard to interpret because of differences in the quality of store managers and employees.

How can a chain store company maximize its success when the market is this complex?

Pattern Recognition: The Key to Winning

How do experts make decisions in complex situations under time pressure? Firefighters, EMTs, and military commanders often have to make split-second judgment calls in life and death situations, and they usually make good decisions. They are clearly **NOT** following the classical decision making process:

analyze the problem, list the alternatives, rank them on weighted criteria, and select the one with the best score.

Gary Klein, a pioneer and thought leader in the area of intuitive decision making, describes the pattern-recognition process in his book Intuition at Work (Random House, 2003). When faced with a situation that requires a decision, such as approving a site for a new store, experienced real estate professionals will see certain "cues" that call to mind a "pattern" that they have seen before. The more situations they have seen, the more patterns they have to draw upon to apply to the current situation.
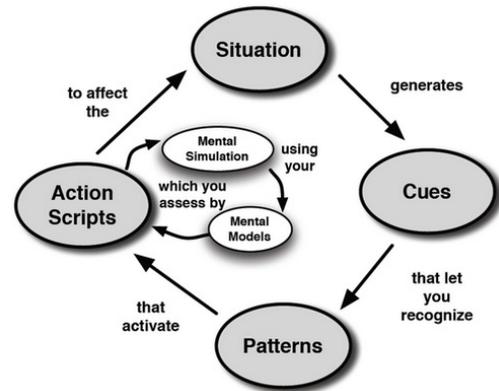
Here's an example of a comment that an experienced real estate manager might make: "The last time we put a store in a big shopping center we had to close it because no one could find us. It was a great center in a great trade area, but we only had 1,200 square feet and got lost in the noise."

For some retailers, this site might be perfect. But for others, maybe those with a less well-known brand, the retail synergy and population density don't translate into sales.

After we recognize a pattern, we know what factors to focus on and begin to set expectations. The patterns also include "scripts" for action that will have certain outcomes based on our experience. We might need to make adjustments to adapt the pattern we recall to the current situation, but the similarities will guide us in the right direction.

Klein sums up the process:

> "**Intuition is the way we translate our experiences into judgments and decisions. It's the ability to make decisions by using patterns to recognize what's going on in a situation and to recognize the typical action script with which to react. Once experienced intuitive decision makers see the pattern, any decision they have to make is usually obvious**." (Intuition at Work, p. 13).

You might be thinking, "This sounds a lot like using analog stores." Indeed it does. It's no surprise that analog store sales are still the most popular source of guidance in estimating future performance of chain stores.

Analogs offer a nice blend of art and science in estimating store sales. The factors used in comparison can include a wide range of variables including trade area statistics, site characteristics, competitive presence, proximity of analogs and market characteristics. The significance of different factors can be derived using statistical methods or managerial judgment. And it gets even better when a team of people work together, bringing many years of experience and patterns to compare the subject store to the analogs and adjust the sales estimate for the differences.

Analytics: Don't Try This at Home

Now we are ready to talk about analytics. In case you thought we were abandoning research, statistics, and predictive models, fear not. It was important to establish the fact that PEOPLE make decisions, not computers or mathematical models. Just as weather data and charts help the meteorologist make better forecasts, analytics can improve real estate decisions.

We are blessed with many tools to support real estate decisions today. We have powerful computers, user-friendly software, rich data with geographic references, and modeling techniques that simulate the choices that shoppers make based on millions of transaction records. However, chain store analytics is not and never will be as simple as getting a hot cup of coffee from a vending machine (impressive as that may be).

It's not that hard to create a "push button" predictive model for most chain stores that will be +/- 20% accurate 60% of the time ("push button" means enter the site address and get the result). That's not saying much because many chains only have that much variance from their average unit volume (ie, if they used their average unit volume as the estimate every time, they might be +/- 20% 60% of the time). If that's the best you can get from a model, save your money and use average unit volume as the estimate.

What if you'd like to increase your confidence to 70%? 80%? Many think a model that's +/- 20% accurate only 70% of the time is useless. To make the point, if a model predicts that a store will do $1 million, and you can only be 70% confident that the actual sales will be between $800,000 and $1,200,000, you probably need to do a lot more work to get comfortable with the deal before approving it.

The same model might be 90% reliable if you relax the range of error. Unfortunately, to be 90% reliable it might require the sales range to be +/- 35%, ie between $650,000 and $1,350,000. This is still not good enough for most companies to consider a valuable tool.

What if we add a human analyst to the process? Rather than let the model create the trade area for the store, let the analyst look at the road network, retail districts, competitors, and socioeconomic barriers to define the primary trade area. Rather than assume that the probability of capturing a customer declines at a standard rate as you move away from the store, let the analyst modify the capture rate using the same map, experience, and common sense. Rather than assume that the primary trade area will generate 80% of sales, let the analyst examine the area beyond the primary trade area and determine what the sales from those neighborhoods (or mountain ranges or deserts) might be.

There are many companies who use exactly this approach. They also claim that their sales estimates are +/- 15% or better 90% of the time. THIS is the power of art and science working together.

Before you invest in a "push button" sales forecast, you might want to ask yourself what level of reliability is good enough.

Part II: Success Starts With Leadership and Culture

The most enlightened real estate analyst or even VP of Real Estate cannot succeed in an organization that does not embrace the power of intuition, teamwork, and analytics.

In the past month I had a couple of interesting conversations with senior people in two different public chain store companies. What can you learn about these companies from the comments of their leaders?

#1: "We have a predictive model in place and we use it on every deal. We are a public company and we need standardized ways of doing things. We do a lot of research on the sites, but at the end of the day the number is the number and we go by it."

#2: "I'm new to the company and we have field people begging me to use a model that was created for sales estimates (before me). I know that it's not good enough, so I don't give it to them. It doesn't even take site characteristics into account. I finally asked them: do you think the sales will be different for a store that's in a Wal-mart anchored center or in a little strip center a mile from the Wal-mart? "Of course!" they replied. After I told them that the model couldn't tell the difference they didn't want it anymore."

Comment #1 suggests an attempt to minimize risk by maximizing the objectivity of the sales forecasting process. Ironically, this is probably the riskiest approach because it places too much reliance on the predictive model and leaves little incentive for the people with experience and local market knowledge to dig up important facts and share them in the review process. I used to jokingly say that "the predictive model should have a seat at the table of the Investment Committee." These guys are actually doing it, and seating the model at the head of the table!

Comment #2 is the voice of a seasoned veteran with the patience to build a decision making process that integrates "art and science." The model will be used when it's ready, but only as a tool in the hands of people who have a commitment to one another to do the best possible job of picking good locations. They will ultimately use their intuition to make decisions, but only after assessing the situation of each site and finding the cues that unlock patterns they've seen before. The value of the model is not just the "answer" that it generates; it's also in the many "cues" it provides that help focus the different research priorities of each site.

How's Your OODA Loop?

My what? Jumping back to John Boyd, the Air Force fighter pilot, the OODA Loop is the name that he gave to the process of making decisions in complex situations that are always changing. OODA is an acronym for Observe, Orient, Decide, Act. It's a loop because in a complex situation our learning continues after we make a decision. Did things come out as we expected? If not, why? How can that help me make a better decision the next time I'm in a similar situation?

A detailed description of the OODA Loop is beyond the scope of this paper, but you should check out a book by one of John Boyd's "disciples" named Chet Richards called Certain To Win (Xlibris Corp, 2004). Richards provides a guide to applying Boyd's principles of leadership and the OODA Loop to businesses.

One of the best (maybe only) applications of the OODA Loop to chain store real estate has been developed by John Breitinger of re-lytics. John has been in the retail real estate business for longer than he wants to admit as a shopping center developer, asset manager, broker and architect of information systems. In the past few years he has built a leasing services company grounded in the use of research and teamwork (with the client and among the leasing agents) that has thrived, even in the most difficult market conditions in years. Here is a schematic of their "Planning/Decision Loop:"
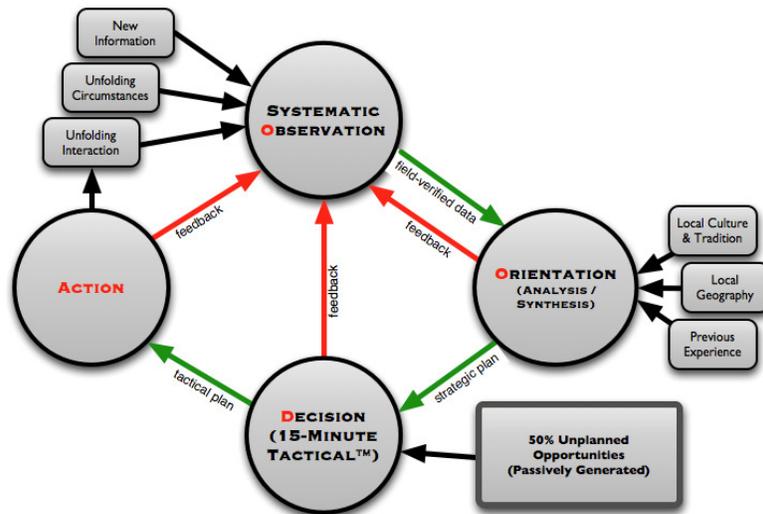
The "loop" begins with "Systematic Observation," which is the hard labor of creating an ongoing inventory of the businesses in the market that influence chain store performance as well as retail vacancies. These data are maintained in an information system that includes mapping, demographic reporting, and other tools for maintaining an accurate picture of current market conditions.

"Orientation" includes spending time with the property owner to understand their objectives, details of the property, background information on current and former tenants, and a dialog about the local market that will set the expectations for the leasing program.

The "Decision" step consists of a brief weekly meeting that sets the game plan based on a combination of the targeted prospects and any inbound opportunities from word-of-mouth or advertising. The brokers execute this plan and work the deals, paying careful attention to new information that they gather in discussions with prospects and observing activity in the market.

The process is repeated every week, with a conscious effort to use the new learnings from the previous cycle in the next cycle. Many chain store companies and brokers would say that their process looks like this. The big difference is the **feedback** and the flexibility to change the tactics based on the feedback. Without the feedback, it's not a loop; it's an assignment that consists of chasing the same prospects with the same pitch until the space is leased or everyone gives up.

Is this a "best practice?" A best practice is a method or technique. The methods and techniques used by Cushman and Wakefield/Northmarq (the business unit where re-lytics is utilized) are unique to their organization and would require revisions to fit the culture, management style, and information systems of another organization. It would be more accurate to call this a "best approach."

The re-lytics approach highlights one of the most important aspects of successful chain store real estate planning and site selection: the need for local market knowledge. Almost every chain store operator uses local brokers to find available real estate. The question is, how many of them actually "partner" with the brokers and have a process like the re-lytics planning/decision loop to ensure that they are seeing the right opportunities? Many companies develop a set of criteria for new stores and "throw it over the wall" to the brokers to find deals. The criteria are pretty general because they have to cover a wide range of deal types (shopping center formats, urban/suburban, competitive profile), so the brokers have to use their imagination to screen deals or inundate their client with site packages. A modest investment of time in collaboration could yield a more streamlined deal flow and much better outcomes.

This Is Not For Everyone

If we accept the approach of the "OODA Loop," what is the profile of an organization that can use this approach?

Given the importance of intuition and teamwork, the only way that this approach can work is if there is a high degree of trust and mutual respect among the people involved. Everyone must feel confident about contributing ideas and information to the process. The leadership sets the tone by being engaged, encouraging participation in planning and progress review sessions, and allowing subordinates to do their jobs without being micro-managed.

Think about the wide range of players in the real estate planning and site selection process for a typical chain store operator:

Title	Job Description
CFO	Senior executive on the Investment Committee
VP Real Estate	Responsible for all new store development, lease renewals, relocations
Field Real Estate Reps	Regional responsibility for finding and executing deals under supervision of VP Real Estate
Director of Research	Maintains location databases, performs analysis, prepares site packages for Investment Committee meetings
Analyst	Assists Director of Research in site analysis
VP Operations	Manages store operations
VP Marketing	Manages all marketing programs
Broker Partners	Local market responsibility for finding deals and executing transactions under supervision of Field Real Estate Reps

This cast of characters can vary dramatically from company to company, but it will always be a mix of seniority, experience, specific skills, and areas of responsibility.

Each organization must find its own version of the OODA Loop. This table is a list of management styles and values that are supportive of this approach and those that are not:

Supportive	Not Supportive
Open sharing of ideas	Rigid hierarchy of authority
Mentoring and Training	Learn by survival
Constant communication	Infrequent, formal meetings
Flexibility to change plans	Aversion to plan revisions
Focus on local market	Assumption that markets are mostly similar
Rewards innovation	Rewards following procedures

The most successful companies will have cultures and business processes that support intuitive decision making, teamwork, and solid analytics. The initiatives that lead to a supportive environment must come from the top of the organization. When the right leadership is in place, the organization can only become effective if it promotes people who support this culture and removes those who do not.

Part III: Arming the Troops

Given a healthy organizational climate, hiring and retaining the best people is the most important success factor for any company. The next question is, how well-equipped are they to maximize their productivity and reach their potential?

Real estate is physical, but real estate decision making is intellectual. The Planning/Decision Loop for chain store operators is supported by three integrated components: Systems, Analytics, and Data.

Information: the Fuel of Knowledge

When we talk about systems, we mean information systems, and specifically:

- Maps – the ability to visualize a market, existing stores, competitors, traffic generators, demographic data distributions, trade areas, proposed sites, aerial imagery, and more
- Reports – demographic profiles of trade areas, lists of locations around a site with field notes, photos, and more
- Databases that allow authorized users to update and maintain locations and their associated data such as stores, competitors, and proposed sites
- Multiple devices for using the information including computers running Windows or web browsers and mobile devices such as iPads.
- Analytic tools such as market screening and optimization models, sales forecasting models, analog retrieval systems, and ad hoc analysis and reporting tools.

There are many vendors who provide some or all of these capabilities. Every organization has different requirements and budgets, and there is no single vendor who is right for all companies. However, here is a checklist of factors to consider in developing the requirements for a system:

1. Data management – can information about locations (stores, competitors, proposed sites) be updated by people in the field and synchronized for all users quickly and easily?
2. Availability – can field users generate their own maps and reports and attach pictures and notes while looking at properties and surveying markets?
3. Do the trade area demographic reports generate the same numbers whether they are run on a desktop, web browser, or iPad?
4. Can access to different system components be controlled by permission settings for each user so that analysts, field reps, and broker partners only see what's appropriate for their job?
5. Does the system have the ability to print presentation quality maps including large format (e.g. 24" by 36") maps (many web-based systems struggle with this challenge).
6. Can maps and reports be customized with modest effort and expense (or easily by the user)?
7. Can the system support a wide variety of data sources including different demographic sources, business locations, customer data, and custom geographies (e.g. territories or trade areas)?

Analytics: Where Art Meets Science

After spending 20 years using and developing commercial real estate analytics, I have learned that most people don't spend enough time analyzing their requirements and constraints before plunging into it.

Virtually every company can benefit from the use of analytics, but the best approach varies dramatically. **The goal is to find the point of diminishing returns ("PDR") where additional analytics will no longer contribute significantly to better decisions, especially in light of the cost in time and money.**

Convenience and demographic profiles are important factors in chain store analytics. Imagine a glass table covered with iron filings. If you have a couple of magnets, you can place them under the table and the filings will move toward the magnets. If you knew the friction of the filings on the glass and the power of the magnets, you could create a mathematical model that would very accurately estimate the number of iron filings in different sections of the glass. If this was a site model, you would be assuming the following:

1. All customers (iron filings) had the same amount of money and desire to shop at the stores (magnets)
2. The attractiveness of the stores could be accurately measured and had the same influence over each customer.
3. The travel patterns (friction) of the customers were perfectly uniform across all points on the glass.

We know that the retail marketplace cannot be modeled with this level of accuracy. However, some chains can be modeled more accurately than others. Here are some factors to consider when looking for the PDR in model reliability:

- **Store size** – a 1,200 square foot store typically commands a small share of the customer's wallet, has many competitors, and is heavily influenced by the traffic generated from retail activity around it. As a result, the patterns of patronage are difficult to estimate and predictive models will usually not be very reliable, even if large amounts of customer data are available. Conversely, big box retailers and grocers have larger trade areas and/or frequency of visits that make it possible to create more reliable models.
- **Customer data** – customer transaction data can greatly enhance the quality of predictive models. Some chains, such as restaurants, have a hard time capturing customer data, and the PDR will come sooner for them.
- **Customer profile** – some chain stores cater to a very narrow customer profile, such as teenage girls or families with small children. It is easier to identify the presence of these groups around a store, and other things being equal, their models will be more reliable.
- **Shopping center format** – Mall-based retailers (inline) discovered long ago that their success is primarily based on the traffic in the mall and that analyzing the trade area around the mall will produce weak results. Freestanding stores have a stronger and more consistent identity than inline strip center stores, and as a result, can be modeled more accurately.

Regardless of the PDR for a given company, the management culture is often the most important factor in the use of analytics. Some management teams are obsessed with analytics and will push their organizations to implement analytics that are well beyond the PDR. This makes them cumbersome and slower to react to opportunities, giving them a competitive disadvantage. They are often frustrated with the level of reliability of their analytics causing stress and disappointment for those who provide the results.

On the other end of the spectrum there are management teams who distrust the use of analytics and invest well short of the PDR. They suffer from the pain of mistakes that could have been prevented by knowledge that could have been gained if the analytics were in place.

Many companies swing like a pendulum on both sides of the PDR, changing their level of investment and replacing personnel and vendors to fit the latest viewpoint!

Whatever the appropriate level of analytics may be, here are some guidelines for getting the most from them:

1. **Start simple.** Beware the PDR! Correlation analysis of sales against trade area variables such as population, income, age by income, and daytime population will give you a sense of how much help you will get from models.
2. **Avoid "Push Button" sales forecasts**. Most companies feel that a sales forecasting model is useful if it is +/- 15% in at least 85% of a sample of stores. Everyone would love to have a "push button" model (ie enter an address and get a sales forecast). If someone tells you that they can build you a "push button" model with this level of accuracy, don't ask how. Don't say "prove it." Just turn and run the other way until you lose audio contact.
3. **Art and Science**. Chain store analytics MUST BE a blend of art and science, which means analyst and tools. Predictive models can work and there are many success stories to prove it. However, the ones that work have the analyst involved in scrubbing the data, adjusting trade areas, studying aerials, auditing the detailed calculations, poring over the competitive landscape, and carefully considering site characteristics before accepting the final forecast as useful guidance. Any attempt to shortcut the role of the analyst will result in disappointment, maybe not the first time, but it will always catch up with you.
4. **Use Your Brains!** Many companies do their analytics in the headquarters and ask field reps to simply provide anecdotal evidence to support their lofty models. **The best modeling tools in the company are probably the brains of the field reps**. Give them access to maps rich with data and visualization tools so that they can explore what they can't see through the windshield and synthesize the maps and demographics with their experience and judgment. I'll take a 20 year field rep with a simple mapping and demographic program over a fancy mathematical model that hasn't been to the site any day. Given the choice, I'll take both!

Data: Garbage In, Garbage Out

The best data are captured in the field and entered into your system. However, you will need to use a lot of other data that are purchased from third parties that might include demographics, shopping centers, business locations, maps, and traffic counts. There are choices and they are not all equal in scope or quality. They are also not the same price. That means that you will need to do some "value

engineering" to make sure that you're getting data that are "good enough" at a price that you can justify.

After you select a demographic data provider, you can't really change the data in your system because you can't verify it. You can verify location data (points) in the field, and indeed you must do this if you hope to make good decisions. It's impossible to verify a national data set of competitors at once, but it is reasonable to verify the data when you are working in a specific market or evaluating a site. This is why your information system should make it easy to make changes.

Part IV: What Now?

This paper has covered a lot of ground. Depending on your experience, the material may be familiar or not. If any of these ideas has motivated you to take action, consider the following:

1. No matter what your company is like or what job you do, trust your intuition and find a way to use it in your decision making. If you need to support it with more facts or science, do it.
2. If you are a senior executive, ask yourself whether the company culture promotes the kind of "loops" that lead to good decision making in the complex retail marketplace. If yes, think of ways to make it better. If no, figure out how to change it or find a company where you can work with a team that strives to reach its potential.
3. As you consider the tools that you need to support your decisions, take the time to develop a list of requirements that is appropriate for your business and team. Even if your "wish list" can't be found from existing vendors or built in-house, you can see how to adapt to the missing pieces and assess the trade-offs of the vendors' capabilities.