

## Underwriting Supermarkets

Christina Szczepanski, TRF  
Denise Dukette, United Bank

January 15, 2013  
Winter Webinar Series

# Winter Webinar Series

- Nurture the growing healthy food financing sector
- Provide webinars to CDFIs and CDFI partners interested in healthy food financing



**MetLife  
Foundation**

# Today's Webinar Topic

- Provide an introduction to food retail formats
- Learn about key questions to ask potential borrowers
- Develop tools for the 'nuts and bolts' of underwriting supermarkets

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Nurturing Healthy Food Financing

OPPORTUNITYFINANCE NETWORK 

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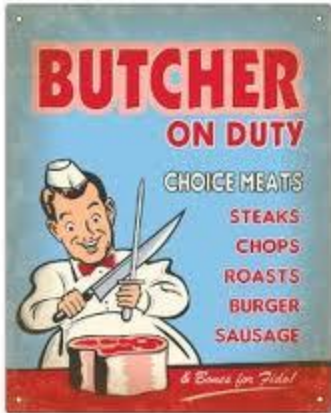
# Agenda

1. Introduction
2. Underwriting Supermarkets
  - Retail Store Formats
  - Underwriting Tips
  - Critical Underwriting Factors
  - Next Steps
  - Q & A

# Where do you shop for groceries?

## Why do you shop there?

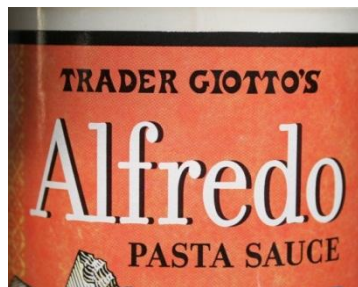
Convenience, Price, Selection, Service, Brands, Perishables





# How Your Grocer Thinks about the Business

- High volume, very low prices
- High service, moderate pricing
- Convenience, Limited SKUs
- High private label
- High brand name SKUs



# Retail Store Formats

Conventional/Traditional

Limited Assortment/Discount

Superettes

# Conventional or Traditional Supermarkets

- Full-line, self-service grocery store with annual sales of \$2 million or more
- Carry between 15,000 and 60,000 SKUs including private label and brand name products
- Multiple service departments
- Stores range between 20,000 SF to 65,000+ SF
- National Chains (Kroger, Safeway); Independents & Regional Players (IGA's, Shoprite)
- May have cooperative marketing/purchasing arrangement

# Conventional or Traditional Supermarkets

- Highly competitive pricing, use of coupons and store courtesy cards to maintain customer base
- Significant marketing approach and early adopter of new technological innovations (i.e. self scan)
- May cluster or group with like store types
- High infrastructure needs – parking, technology, security

# Limited Assortment/Discount Supermarket

- Limited selection of items (4,000 SKUs or less) in a reduced number of categories
- Tend to carry more private label products
- Few (if any) service departments
- Typically offer every day low pricing
- Store sizes vary from 13,000 SF to 25,000 SF

# Superettes

- Annual sales of less than \$2 million
- Typically under 13,000 SF
- Carries a basic, narrow selection of SKUs, primarily food items; may have deli counter but limited services, small quantity of any type of item
- Limited private label SKUs
- Limited storage requires high product turnover
- Highly localized customer base; walking distance or on mass transit. Limited, if any, parking.
- Offer services like check cashing, money orders, phone cards, bill payment

# Superettes

- May have ethnic foods to support local neighborhood requirements
- Limited marketing; demand is dictated by local consumers who are not comparison shopping
- May have supplier issues to obtain product mix, frequent deliveries, small order size



# Underwriting Tips

# Underwriting Tips

- Limit the amount of due diligence you do until there is a signed lease or a high probability of a signed lease.
  - High probability = draft / lease negotiations ongoing
- Review lease terms / Site control must be confirmed.
  - If no location, difficult to assess probable success.
- Vendor relationships must be defined.
  - Can't operate a store without product.
- Resumes and background on key employees is necessary to ensure that critical business skills are in place.
- There could be collateral conflicts. Know about them ahead of time.
  - Supplier liens, Landlord acknowledgements, Equipment Leases

# Underwriting Tips

## *Understand type of supermarket concept*

- How will that concept fit the location?
  - Conventional/Traditional supermarkets in urban settings require store space as well as parking capacity
  - Corner Stores/Bodegas fit well in urban settings but less successful in rural locations with less regular customer flow
- How will that concept fit with existing stores?
  - Anchor store in market or smaller niche store filling in gaps

# Underwriting Tips

## *Understand type of supermarket concept*

- What is demographic base? How does concept fit with local needs/requirements?
  - Income levels
  - Diversity; ethnic groups; does operator have control over merchandising? Ability to cater to local tastes?
- How can location be accessed?
  - Driving access with easy parking
  - Mass Transit
  - Walking

# Underwriting Tips

Each concept has its own dominant risk factors. Analyze in the context of the concept.

- ***Access***: parking vs. mass transit vs. walking distance
- ***Value Added Sales***: pharmacy/clinic, bakery, prepared foods, alcohol, financial services, floral
- ***SKU Diversity***: wide array of SKUs or small number of high turn items
- ***Quality of Financials***: audits vs. tax returns, quality and depth of interim financial data including YOY

# Critical Underwriting Factors

- Location & Competition
- Management Experience
- Profit Margin (variable costs, controllable costs)
- Product Mix
- Capital Investment (fixed costs, core costs)
- Cash flow drains – theft, shrink, waste, spoilage

*Have to analyze each aspect to understand store risk*

# Location & Competition

# Location & Competition

## *Determine Potential Demand*

- Market studies
- Wholesaler/supplier knowledge and experience
- Cooperative buying group – analysis resource, data and trend analysis
- Food hubs – access local products, support marketing effort, create competitive specialty



# Location & Competition

## *Determine Potential Demand*

- PolicyMap for market leakage and demand analysis
- State/Municipal or other group market studies
- Peer Groups – provide metrics and data mining for analytical purposes
- Tap into CDFIs with relevant expertise

# Location & Competition

## *Market analysis of demographics*

- Customer draw area (Trade area)
  - How will customers get to the store?
- Competition in area
  - Current
  - Potential (vacant spaces)
- What is unmet demand / need?
- What is saturation in the market?

# Management Experience

# Management Experience

## *Scale of Store influences critical experience needs*

- Multi-Department stores require specific expertise to manage individual department and to manage the store.
  - Can't learn on the job
  - Certain departments may require specific skills & credentials (pharmacy, prepared foods, etc.)
- Superettes/Bodegas require less specialized expertise but long hours and stringent oversight

# Management Experience

## *Critical experience needs:*

- Vendor Negotiation
  - Which are appropriate vendors for needed products
  - Delivery frequency and minimum order size
- Personnel Management
  - Skilled department managers are critical
  - High employee turnover is common and thus, training costs are high
  - Employee theft can be a critical cost

# Management Experience

## *Critical experience needs:*

- Financial/Legal/Insurance Knowledge and Resources
  - Appropriate insurance coverage (including liability for slip & fall, business interruption for spoilage)
  - Legal support for landlord & vendor negotiations
  - Financial relationship for cash management/cash delivery; merchant services; any financial products offered

# Management Experience

## *Critical experience needs:*

- Marketing
  - Wholesale rebates / placement fees
  - Coupons
  - Courtesy Cards
  - Competitive actions / trends

# Management Experience

## *Critical experience needs:*

- Technology
  - Inventory data capture / inventory audits
  - Input pricing into IT system (including sale items)
  - Financial reporting off data system
  - Courtesy card / customer activity tracking



# Profit Margin

# Profit Margin

## *Key Income Statement Metrics*

- Industry language – Know it:
  - Weekly Sales
  - Gross Margin
- Seasonality is the norm
  - Use Year over Year (YOY) comparison
- Wholesaler rebate
  - Where to account for it

# Profit Margin

## *Key Income Statement Metrics*

- Major Expense Items
  - Personnel
  - Utilities
  - Insurance (liability, hazard, business interruption)
  - IT/Technology investment
- Generally, Grocery Stores are low margin.
  - Understanding profit margin by product/department is critical; need for volume to cover overhead.

# Profit Margin

***Margin analysis*** is critical to store success

- Data capture to:
  - Analyze margin by SKU, by department
  - Analyze trends – weekly and YOY
  - Monitor shrink (critical controllable cost)
    - Theft
    - Spoilage/Waste
  - Monitor SKU turn over time
    - Remove low margin, slow turn products
    - Add new products & monitor performance

# Profit Margin

***Margin analysis*** is critical to store success

- Pricing Strategies
  - Use of loss leaders to draw customers (formula, bananas)
  - Use of coupons / weekly sales
  - Shelf placement fees / rebates to improve margin
  - Specialty products to improve margin
    - Local specialty demand; ethnic foods
    - Seasonal/holiday items, changing the product offerings

# Profit Margin

***Margin analysis*** is critical to store success

- Product Turn vs. Shelf Stability
  - Manage each department's ordering based on its product shelf life
    - Seafoods; deli, produce, dairy, bakery, meats all have different time frames for quality and salability
    - Spoilage from having aged product = direct cost
    - Monitoring of product expiration dates for shelf stable items

# Profit Margin

***Margin analysis*** is critical to store success

- Product Turn vs. Shelf Stability
  - High cost products with low margin are most critical to monitor and control
  - Low cost products with high margin are least critical to monitor and control
  - Short shelf life products are most critical to control
  - Shelf stable items are least critical to control
    - Need good inventory management and reporting to monitor cost, margin and turnover

# Product Mix



# Product Mix

## *Mix of Goods and Services*

- Products
  - Fresh and shelf stable foods
  - Prepared Foods
- Services
  - Financial Services
  - Pharmacy/Clinics
- Other (Alcohol, Lottery, Cigarettes, etc.)

# Product Mix

## *Analysis of Mix*

- Determine contribution and trending of each
- Synergistic mix
- Each product/service needs to contribute to bottom line
- Weak / low value products and services should be reduced or discontinued
- Consideration of new products/services which may add more value, create more demand and customer draw

# Product Mix

## *Product Accessibility*

- Optimal Store layout
  - Access/Egress
  - Manager's view – able to monitor customer activity
  - Customer flow
  - Product placement
    - Visibility
    - Accessibility
    - Infrastructure (built-ins, coolers, counters)

# Capital Investment & Infrastructure

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# Capital Investment & Infrastructure

## *Core required investments for functional store*

- Coolers/Freezers (consider utility costs)
- Shelving/Counters
- IT/Technology requirements
- Product delivery and storage capacity
- Maintenance costs – parking lots, flooring, carts/baskets
- Secure cash storage / safe

# Capital Investment & Infrastructure

## *Specific Data & Technology Needs:*

- Point of Sale (POS) system
- Accept electronic payment (incl. SNAP & WIC)
- Inventory tracking system
- Data mining for trend, product and margin analysis
- Courtesy Card technology
- Security system (cameras and alarms, theft monitoring)

# Cash Flow Drains

# Cash Flow Drains

- Common Cash Flow Drains
  - Product Theft (customers & employees)
  - Cash theft (employees)
  - Waste/Spoilage
  - Excessive utility costs
  - Minimum product orders which are too large for store volume/activity



# Ongoing Monitoring

# Ongoing Monitoring

## *Store success is an ongoing event.*

- Have clearly defined financial reporting requirements
  - Monthly reports with year to date and YOY performance (quarterly or annually once stabilized)
  - Well performing areas and underperforming areas
  - Margin!!
- Monitor trends, not just points in time

# Ongoing Monitoring

## *Store success is an ongoing event.*

- Ensure that management addresses any changes timely:
  - Personnel issues
  - Accounts payable / vendor relationships
  - Product & service mix (will change over time)
  - Demographic changes (in market area)
  - Required capital expenditures & maintenance

# Ongoing Monitoring

***Store success is an ongoing event.***

- Monitor competition
  - Who is entering market?
  - What space is available for new competitors?
- Are there areas of need?
  - Products
  - Services
  - Education

# Now What?

# Now What?

## *Analyzing potential borrowers:*

- What is borrower's probable success? Are they knowledgeable and prepared?
- What are the target market's needs?
- How will borrower meet those needs?
- Does borrower have costs properly identified?
- Is there adequate capital to properly finance project?

# Now What?

## *Analyzing potential borrowers:*

- Is site selection appropriate and is the site secured?
- Are vendors properly identified and are terms appropriate?
- Does borrower understand time and resource commitment necessary to success?
- Will the proposed store serve its community well?
  - Healthy foods / locally produced if possible
  - Accessible by target customer / market

## Q & A



## **Additional Resources**

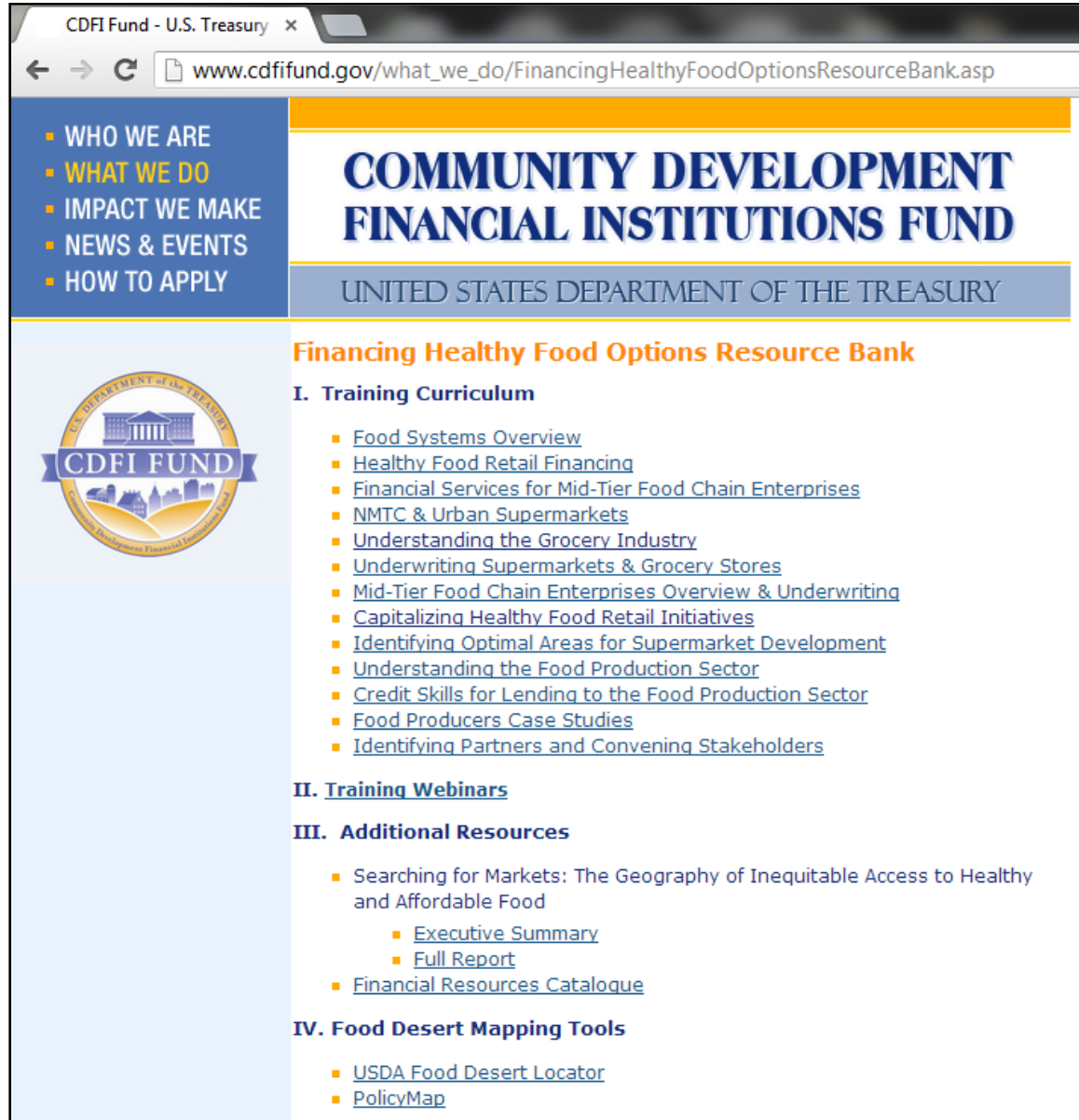
# Upcoming Winter Webinars

- **CDFIs and Public Health**
  - January 24, 2013 @ 1pm ET
- **Energy Efficiency and Healthy Food Retail**
  - January 30, 2013 @ 2 pm ET

To register: [opportunityfinance.net/fhfowebinars](http://opportunityfinance.net/fhfowebinars)

# CDFI Fund – Virtual Resource Bank

[http://www.cdfifund.gov/what\\_we\\_do/FinancingHealthyFoodOptionsResourceBank.asp](http://www.cdfifund.gov/what_we_do/FinancingHealthyFoodOptionsResourceBank.asp)



The screenshot shows a web browser window with the URL [www.cdfifund.gov/what\\_we\\_do/FinancingHealthyFoodOptionsResourceBank.asp](http://www.cdfifund.gov/what_we_do/FinancingHealthyFoodOptionsResourceBank.asp). The page features a blue navigation menu on the left with the following items: WHO WE ARE, WHAT WE DO, IMPACT WE MAKE, NEWS & EVENTS, and HOW TO APPLY. The main content area has a yellow header with the text "COMMUNITY DEVELOPMENT FINANCIAL INSTITUTIONS FUND" and "UNITED STATES DEPARTMENT OF THE TREASURY". Below this is the "Financing Healthy Food Options Resource Bank" section, which includes a list of training curriculum topics, training webinars, additional resources, and food desert mapping tools. The CDFI Fund logo is visible on the left side of the page.

**WHO WE ARE**

**WHAT WE DO**

**IMPACT WE MAKE**

**NEWS & EVENTS**

**HOW TO APPLY**

## COMMUNITY DEVELOPMENT FINANCIAL INSTITUTIONS FUND

UNITED STATES DEPARTMENT OF THE TREASURY

### Financing Healthy Food Options Resource Bank

#### I. Training Curriculum

- [Food Systems Overview](#)
- [Healthy Food Retail Financing](#)
- [Financial Services for Mid-Tier Food Chain Enterprises](#)
- [NMTC & Urban Supermarkets](#)
- [Understanding the Grocery Industry](#)
- [Underwriting Supermarkets & Grocery Stores](#)
- [Mid-Tier Food Chain Enterprises Overview & Underwriting](#)
- [Capitalizing Healthy Food Retail Initiatives](#)
- [Identifying Optimal Areas for Supermarket Development](#)
- [Understanding the Food Production Sector](#)
- [Credit Skills for Lending to the Food Production Sector](#)
- [Food Producers Case Studies](#)
- [Identifying Partners and Convening Stakeholders](#)

#### II. Training Webinars

#### III. Additional Resources

- Searching for Markets: The Geography of Inequitable Access to Healthy and Affordable Food
  - [Executive Summary](#)
  - [Full Report](#)
- [Financial Resources Catalogue](#)

#### IV. Food Desert Mapping Tools

- [USDA Food Desert Locator](#)
- [PolicyMap](#)

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## How to Apply

OFN welcomes all CDFIs that are committed to performance to apply for Membership. Our standards for Membership are different and generally higher than the CDFI Fund's requirements for CDFI certification. Not all OFN Members are CDFI Fund-certified and not all CDFI Fund-certified CDFIs qualify to be OFN Members.

To apply please complete OFN's new [online membership application](#). You will be able to provide all necessary attachments when completing the application. If you want to work on the membership application prior to submitting it online please download a [practice copy](#). We recognize that not all CDFIs are ready for or interested in OFN Membership. We invite these CDFIs, as well as non-CDFI organizations and individuals who support OFN's mission, to become [OFN Allies](#).

Do you want more information?

- [Download our Membership Guidelines.](#)
- [Read our Membership FAQs.](#)
- [Contact our Membership Department at \[membership@opportunityfinance.net\]\(mailto:membership@opportunityfinance.net\).](#)



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OFN Allies actively support OFN's mission and the important work that OFN does on behalf of the opportunity finance industry. CDFIs—including those that do not currently meet OFN's Membership requirements—as well as individuals and organizations that are not CDFIs, are invited to become OFN Allies.

Ally benefits include:

- Participation in OFN's policy and advocacy efforts on behalf of the opportunity finance industry.
- Policy Action Alerts at key times in the legislative process when your participation in advocacy can make a real difference.
- Regular policy updates and analysis.
- Free participation in Quarterly Ally Calls led by OFN's policy team.
- The Member discount to attend OFN Regional meetings.
- Subscription to OFN's E-newsletter, quarterly *CDFI Market Conditions Report*, and a complimentary copy of the annual *Opportunity Finance Institutions Side by Side* publication.
- Recognition on OFN's Web site list of Allies.
- Allies that aspire to become OFN Members are invited to participate in Member Staying Connected calls, a valuable peer learning opportunity for any CDFI.

Annual Ally dues are \$75 for individuals and \$250 for organizations.

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# Contact OFN

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## Become a Member or Ally

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