BY SARA WYKES

# Space IS THE PLACE

## BREAKING GROUND IS HARD TO DO IN 2017

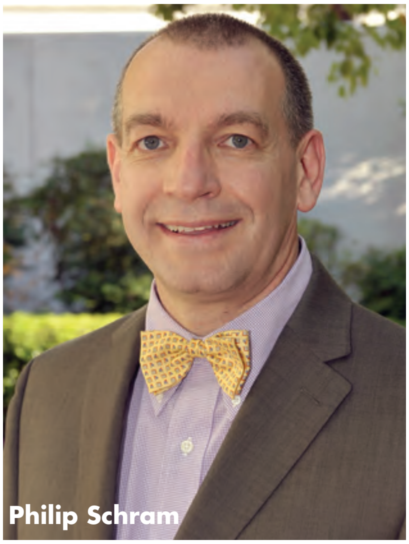
"Real estate development is one of the hardest things for a franchise," says Philip Schram, chief development officer and chair of Buffalo Wings & Rings. Since buying the brand in 2005 with Nader Masadeh and Haytham David, he has helped rejuvenate and rebuild it to 70 locations today. However, changes in the real estate market, construction industry, lending policies, and regulations are slowing him from his goal of adding 75 new locations in the next 5 years.

"In 2009, when the economy collapsed, a lot of people left construction," says Schram. The result was a shortage of qualified contractors and construction workers. As the downturn continued, nobody wanted to be a tenant, he says, and "we developed an excess of real estate." For those willing to sign a lease, it was a buyer's paradise.

But when the economy began to recover and development activity increased, that labor shortage persisted, even worsened, as many contractors had exited the business. Of those who remained, he says, "builders can only go at a certain speed."

Nearly a decade later, fallout from the subprime mortgage crisis also persists, resulting in a real estate and lending market nowhere near as friendly as it had been before the Great Recession.

"Before that," says Schram, "there was much more trust that the money would go to the right person and the job would be done. Now there is less trust and more underwriting, and that takes time. There are new guidelines banks must follow that are more stringent than they were in 2009."



Philip Schram

Robert Thatcher, director of franchise and real estate development for Ben's Soft Pretzels, agrees. "The days of 110 percent financing are long gone," he says. "It takes real equity now." Thatcher says he's also seeing today's higher costs for the most desirable real estate driving an expansion out of core markets into secondary and tertiary markets, where land and rents are more affordable.

### Power shift

The economic recovery that followed the recession also altered the attitude of municipalities toward development. "When things were slow, cities were begging developers to come in," says Schram. "Now they are in a stronger position and are becoming more demanding—and that affects how long it takes to develop a location."

The economy's improving health has

stimulated development, but the law of supply and demand still holds. This has shifted the balance of power, says Dan Burrell, a franchisee and area developer/director with Jersey Mike's Subs. "As more competition in a growing economy fights for space, we are back in a landlord's market," he says. "That reduces tenant improvement terms and other tenant incentives and makes it difficult for single-unit franchisees to compete."

Burrell anticipates additional changes as the real estate market continues to tighten. "I expect landlords to not even offer exclusives, which help protect investments by franchisees. If franchisees want to get in the game, expect slim margins because rent increases continue to require more risk."

The price of land is rising, with competition keenest for prime space in high-traffic, high-visibility corridors—especially for brands with similar footprints and customer demographics, says Schram.

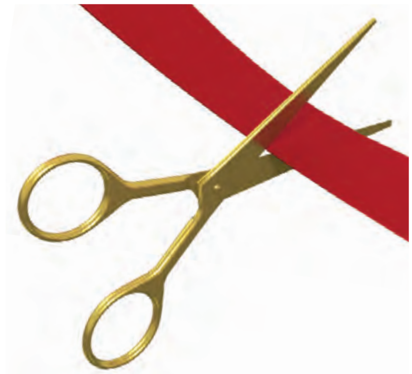
Says Thatcher, "The reality is we have fewer sites that are demographically feasible for new development. Many markets have been overbuilt and we're seeing a trend toward urbanism. Cities want higher and better land use."

### Back to brick-and-mortar

A change few predicted when the dot-com boom began disrupting traditional retail is also affecting the real estate market. Although online sales made shopping from home easier and weakened many retailers, some online businesses are now establishing physical sales outlets, adding to the competition for the best locations. On the other side, many traditional brick-and-mortar stores pressured into adopting digital sales channels are converting some of their real estate into warehouses and distribution centers for their online sales. "All the lines are blurring and coming together, driving the demand and absorption of gross leasable space," says Thatcher.

Mall operators also felt the pinch of the recession and e-commerce, but they are evolving and adapting too. "There has been a shift toward outdoor malls and power centers," says Chris Naylon, net lease advisor for the Sands Investment Group in Sherman Oaks, Calif. He sees the changing tenant and customer mix at malls as an opportunity for franchise brands seeking space, especially those that serve food.

"Customers are looking for an experience beyond just shopping," he says. "I believe restaurants will play a large role in revitalizing tired malls. They play an important part in adding to the overall shopping experience and attracting additional prospective shoppers."



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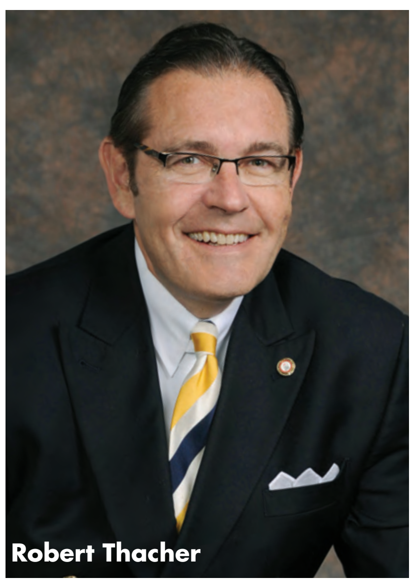


Robert Thacher

### More regulations, more delays

While you can expect new rules and regulations to cause delays with permitting, sometimes the delays stem from a different cause: smaller towns often have only one or two planners on staff, who become overloaded by increased demands from developers. If a region becomes attractive for franchises and other developers, its larger cities might have an adequate number of planners on hand to handle the influx, but the smaller towns around it most likely don't.

"The Orlando DMA in particular is loaded with towns that are simply overwhelmed with requests for new development approvals," says Ray Lauletti, vice president of real estate for Arby's Restaurant Group. And, he says, "As local governments shift more of the work to outside consultants and independent contractors, the store planning process has become even more unpredictable."

Further, as more municipalities feel overwhelmed by commercial development, many are attempting to control it by imposing limits on certain types of businesses, adding another level of competition for the top sites. "Towns like Kissimmee in Florida and Franklin in the Nashville DMA have limited the number of locations they will allow QSRs with drive-thru locations," says Lauletti. "In addition to increasing time to gain approval, those municipal limitations on site supply drive up the price of suitable sites where drive-thrus are allowed."

### What can you do?

Franchise real estate and site selection pros who have dealt with the ups and downs of several economic cycles have learned ways to smooth the path to opening new locations, no matter what the external conditions. As the environment continues to shift around them, their ideas, detailed below, are yet another reminder of the need to continually adapt, and adjust development plans and schedules to fit a changing marketplace.

- **Build in more time.** Regulations at every level of government are in never-ending flux. Ignoring their impact on a project's start-to-finish timeline is a mistake. "We have significantly altered our store planning expectations and added time to our store opening schedule," says Lauletti. "While senior management is not particularly excited by these delays, it pays to be realistic and to communicate early and often about delays in the planning and zoning process." For any new build project anywhere in the country, he says, "We now estimate a minimum of 18 months from site identification to opening. In Florida, we add at least 6 months on top of that."

• **Learn the territory.** Local knowledge is essential for success, especially in new or unfamiliar markets. Thus it is vitally important to set schedule and budget expectations as soon as possible, says Jason Glasrud, development manager for the CBC Real Estate Group in Kansas City. "Most communities have established processes that inform the developer and operator. Drilling down into possible restrictions that can affect a brand's trade dress, drive-thru lanes, and permit, tap, and impact fees is critical in the early stages of a project and allows you to obtain relief when you can."

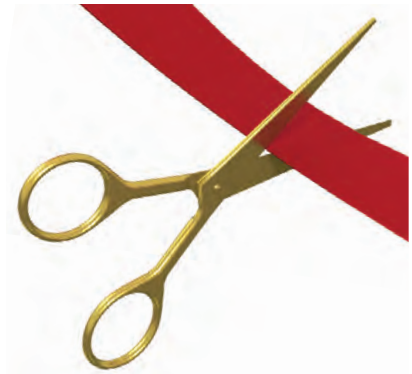
Says Naylon, "Understanding the fundamentals of real estate and the advantages of a particular location becomes increasingly important, even more so in core markets versus secondary or tertiary markets. Poor site selection will lead to poor sales performance in a market where margins are becoming tighter and tighter."

For smaller franchisees or those with minimal experience in real estate and development, it is even more vital in today's competitive market to take advantage of firms with strong local connections, and remain focused on running a successful franchise business.

• **Staff up in advance.** In real estate development today, it's important to have enough dedicated real estate staff on hand, and to hire exclusive brokers to work in specific territories, says John Metz, president of RREMC Restaurants, which operates Denny's and Dairy Queen restaurants, hotels, and real estate. Metz also is the franchisor of Hurricane Grill & Wings, providing another lens for his concerns about finding the best real estate for his brand, as well as for his new fast-casual version, Hurricane BTW (burgers, tacos, wings).

• **Be patient…** "My hope is that the balance of supply and demand is going to balance itself, so my only advice is to be patient," says Schram. "You know what is a good location and what's a bad one, and you must resist the urge to put the wrong franchise in the wrong place." It also matters what you do with the time you spend being patient.

"The smart thing we did in 2010 was not to let go of anybody in the company," says Schram. "We looked at what was working and what was not. We did some rebranding. We worked on training. All of that gave us a better product and a better



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Dan Burrell

company. Some people were tempted to shrink their business. That sends a very bad vibe to your staff."

• **…but don't sit back.** As markets have matured, "The American consumer has become pretty bored with the same enclosed mall concept and the same merchandise from the same retailers," says Thatcher. To compete for prime space in malls nowadays, franchises must distinguish themselves from competitors. "Landlords are seeking products that are fresh and artisanal," he says. "It's about a shopping experience that drives traffic."

For Ben's Soft Pretzels, that means "tinkering and rolling out new product offerings, even on a short-term basis," says Thatcher. "Providing seasonal offerings is hugely important for all retailers. It keeps things fresh." Eleven gourmet dips and sauces support Thatcher's goal of rolling out new options for his customers.

Schram is also seeing the value of adapting, especially for foodservice brands. "More and more people, especially Millennials, are picking up food and eating it at home," he says. "Franchisees may press for smaller spaces, but we've concluded we needed to maintain our size and we're using some of that space for grab-and-go. People need to think about your brand as now having that option."

• **Piggyback to market.** Ben's Pretzels is also taking advantage of an opportunity where another party provides the real estate. "We picked up concessions to sell Ben's at Notre Dame football on Saturdays," says Thatcher. "That introduced 80,000 people to our product, and those same customers may end up at our brick-and-mortar stores." Since then, the brand has picked up more than eight baseball stadiums and other sporting venues. "The concession business has been a clear differentiator," he says. "Now we're getting a lot of interest from the West Coast and hope to grow there soon."

• **Conversions and the need for speed.** In Kansas City, Glasrud and his team at CBC Real Estate have made the competition for prime sites a top priority and have focused on adapting existing structures as a way into trade areas where retail sites are either unavailable or too expensive. Given the demand for prime sites today, says Glasrud, "both developer and operator must move quickly."

Arby's is also concentrating on converting existing structures instead of developing raw land. "We have a variety of such projects in our pipeline" says Lauletti. "We're converting a Pizza Hut in North Canton, Ohio, a former Bojangles' in Greensboro, North Carolina, and a former Hardee's in Jacksonville, Florida." The reason, he says, is simple. "Although many vacant buildings require significant upgrades and come close to the cost of new builds, speed to market is quicker and produces quicker cash flows from operations."

• **Partner with developers.** Finally, make new friends. At Arby's, says Lauletti, "We are pursuing more up-front partnerships with developers who can better navigate the process of raw land and improved pad development." That kind of partnership produced a recent opening in Gainesville, Ga., working with an Atlanta-based developer. That same group, says Lauletti, is now working on development assignments throughout Georgia and Florida.