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Hill District Grocery: The Long (and Getting Longer) Sad Tale

Where's the beef? Where is the chicken, the bread, the canned soup, the detergent, or the coffee? Not in a Hill District grocery store that's for sure. And since the early 1980s that has been the story. Aldi's made overtures about building a store in 2005 but was rebuffed because the store did not offer a full service grocery.

In 2008, the Hill House Association began a renewed effort to attract a major grocery store using money from a variety of sources to fund the construction and equipping of the facility. The original plan called for an $8.5 million project that would find a grocery chain to ante up significant private capital and operate the facility. They asked for proposals and initially opted to go with Kuhn's, rejecting a bid by the Sav A Lot chain that would have built a far less expensive, basic grocery store.

Kuhn's was unable or unwilling to meet the requirements imposed by the Association and eventually withdrew in late 2009. In mid-2010, the owner of Shop n Save stores stepped forward with an offer of $1 million to become the grocery store owner/operator. A ballyhooed ground breaking took place in April 2011 with promises the store would be finished by year's end. It's October 2012 and still no store and no work on one.

In September 2011 the Pittsburgh Courier, in a report on the store's progress, repeated that the cost of the project would be $8.5 million. Then in June 2012, with still no construction underway, the spokesperson for the project revealed that the cost had jumped to $10 million because of a change in the management team. As a result it would be necessary to find $2 million more in funding. More rounds with funding partners were anticipated. Adding to the store project's woes, it was recently announced that in just four months other unforeseen cost increases have pushed the new total funding requirement to $11.6 million, leaving the project $3.9 million short of the amount needed to begin work.

Bear in mind that when the price tag reached $10 million several developers and construction managers said that was too steep for such a development. Will more developers now join the ranks of those who were concerned about the $10 million price tag? This is beginning to sound like the stadium and convention center escalating costs and is close to the North Shore Connector cost explosion.

The big problem with the current plan is the lack of private risk capital. Only $1 million in risk capital has been pledged—9 percent of the total cost. Why is there so little private investment?

Questions must be asked if taxpayers and charitable groups are going to fund most of this store. At $11.6 million a minimal rate of return on capital of 5 percent would require net profits, after all expenses, to be roughly $600,000 per year. Given the razor thin profit margins in grocery retail, it will likely require roughly $30 million per year in sales. Of course, since there is no significant level of private risk capital, the project organizers are probably not concerned about any profits.

Has the group putting the project together ever estimated what the annual sales would be? Or is that of no concern? The operator will certainly be concerned about that number. Even though he will not have to generate a return on the full $11.6 million, he will have to produce enough revenue to pay for keeping the store up and running and fully stocked. What will it cost him to fully stock the store before customers are allowed in? With over 40,000 items typically sold at a store this size, it could be a big investment in inventory, perhaps a million dollars or more. Then he has to pay the help. According to newspaper accounts it is estimated that as many as 100 people will be needed to maintain full service (with almost a guarantee they will be unionized). Then there is all the other overhead, power, water, insurance, heating and cooling, advertising, security, restocking and maintenance as well as loss allowance for theft and spoilage.

Let's look at a scenario for the store. Statistics from the Food Marketing Institute show that, on average, supermarkets have $172,000 in sales per worker and have a gross price margin of 40 percent over costs of goods with cost of goods equal to around 71 percent of sales. Labor costs are about 14.5 percent and other operating costs are 12 percent of sales. Since a large fraction of grocery employees are part time, the labor compensation will be around $2.5 million and, if sales come in at the industry average per worker, annual sales would have to be $17.2 million. Using a national average markup of 40 percent, the store's cost of goods sold would be 71.5 percent of sales or $12.3 million. Total operating costs are around 26.5 percent of sales on average so those expenses would come to $4.5 million. Either way net margin would be 2.0 cents profit per dollar of sales or $344,000 in total profits. All this assumes national average performance can be achieved and sales reach $172,000 per worker.

The question is: what is a reasonable forecast of sales? The absence of grocery chains willing to put up a substantial fraction, say 70 percent of the project cost, indicates that most operators are fairly certain that upward of $20 million and certainly $30 million in sales per year are not likely. The fact that the project team has not sought bank loans to fill in the gap in funding could be interpreted to mean they assume the project will not produce nearly enough revenue to cover operating cost and bank loan payments. Or perhaps they have approached banks and been denied because the probable sales and profit margins are just too low for the bank to take the risk.

If the project is completed and sales are well below $15 million a year (about the national supermarket average) the store will likely become a losing proposition unless it can strenuously control costs and maintain exceptionally high price to cost margins. At numbers below $10 million in sales, the store might not be viable as a full service supermarket with all the bells and whistles because of the inherent difficulty of lowering costs proportionally with sales.

At the very least, the organizations pushing this project need to provide taxpayers and other funders with a reasonable and credible forecast of sales and operating costs.

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