

Basic Real Estate Development

Tuesday, October 28

2:00 p.m. – 4:00 p.m.

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The ULI Mission

The mission of the Urban Land Institute is to provide leadership in the responsible use of land and in creating and sustaining thriving communities worldwide.

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THE BASIC REAL ESTATE DEVELOPMENT PROCESS

Introduction to the Process – Preliminaries:
What Is Real Estate Development?

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WHAT IS A DEVELOPER?

- Creative people
- Problem-solvers
- Deal-makers
- Detail-oriented
- Work-a-holics and overachievers
- Coordinators who convert ideas into reality
- Risk-takers
- Reward-oriented

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WHAT DOES A DEVELOPER DO?

- Acquires the land
- Identifies the market segment(s)
- Coordinates the team
- Develops the program
- Obtains entitlements and approvals
- Arranges financing
- Manages the process
- Approves leasing/selling strategy
- Oversees property management
- Earns a profit (hopefully)

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DEVELOPER RESPONSIBILITIES

- Omissions, commissions, and mistakes
- Everything that occurs in the process
- The unexpected, unforeseeable, and unknowable
- Flexibility/inflexibility (when to hold 'em, when to fold 'em)
- Proper preparation or lack thereof
- Possessing necessary people skills
- Negotiating skills
- Financial liability
- The ultimate consequences

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PROCESS & TEAM PLAYERS

Stage Of Development	Team Players
Site Selection	Brokers, title company, surveyors, marketers, appraisers
Approvals	Land use lawyers/consultants, market analysts, economists, architects, planners, lobbyists
Feasibility	Market analysts, economists, cost estimators
Design	Architects, surveyors, engineers, enviro, planning, landscape, parking consultants, market analysts
Financing	Mortgage brokers, bankers, const. & permanent lenders, title companies, market analysts, appraisers




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PROCESS & TEAM PLAYERS

Stage Of Development	Team Players
Construction	Architects, market consultants, general & sub contractors, appraisers
Marketing	Brokers, PR firms, ad agencies, graphic artists
Operations	Property/asset managers, consultants
Sale/Leasing	Brokers, appraisers, asset managers, advisors
Entire Process	Lawyers, accountants, investment advisors



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- ### PITFALLS
- Overpaying for the land
 - Don't understand your market data
 - Inexperienced developer
 - Inexperienced team players
 - Unreliable market studies and/or appraisals
 - Inadequate financial skills
 - Out of touch with market pricing
 - Failure to account for all expenses
 - Non-marketable concept
 - Unrealistic time-line
 - Poor record keeping skills
 - Poor quality controls
- 


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BOTTOMLINE

In other words, Real Estate Development is the most:

- **risk intensive,**
- **stress-inducing,**
- **capital gobbling,**
- **thankless career known!**




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Introduction to the Process – Initial Considerations




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The Generic Development Process

Definition:


- Real estate development is the continual reconfiguration of the built environment to meet society's needs.
- Real estate development is a complex, entrepreneurial, high-risk, capital intensive, long-term, multidisciplinary endeavor. It involves exposure of large amounts of capital to continually changing market forces over a lengthy period of time.




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Who Are the Players in the Process?



- Real estate developers are the central actors in the development process because their actions determine the why, when and for whom of development:
 - what land will be considered for development;
 - when improvements will begin; and
 - for whom the project will be developed.

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Other Players in the Process



- Public Sector
 - State
 - Local
 - Regional
- Community Interests
- Consultants and other professionals
- Lenders
- Transaction Parties
- Co-Workers

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Economic Cycles & Risk

- Length of time + economic cycles = “possibility of loss or injury”
- Types of Risk:
 - Investment risk
 - Market risk
 - Total risk
 - Financial risk
 - Business risk
 - Interest rate risk
 - Operating Risk



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Risk (continued)


- Managing Risk – some techniques:
 - correctly recognizing and assessing it
 - have a realistic cash cushion at all times
 - use non-recourse financing
 - push the risk onto other players
 - obtain a binding lender commitment
 - use an option to purchase
 - use rolling options
 - obtain builders’, buyers’ or tenants’ predevelopment commitments

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Establishing Strategy & Criteria


Goals:

- Minimize risk
- Maximize opportunity for return of capital and return on capital.

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Introduction to the Process – Individual Phases of Development

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EXAMPLE: CHRONOLOGY OF THE REAL ESTATE DEVELOPMENT PROCESS

Preliminaries Pre-Development Development Post-Development

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Market Analysis: Go/No Go Decision #1

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What Is A Market Analysis?

- Examination of subject property/area in context of broader market trends
- Analysis of supply and demand factors
- Market-driven recommendations and programming

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Functions of Market Analysis

- It addresses 3 questions:
 - Is there a market?
 - What is the velocity of absorption?
 - What is the optimal marketing
- Additionally: determining who needs space – potential buyers or tenants – and what type of space they need is the starting point for all development projects.
- The initial market analysis should define the gaps in the market and the product or products that will fill them.

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Feasibility Study vs. Market Analysis

- Feasibility Study* is an analysis of the *physical*, *market*, and *financial* components of a given project. It culminates in the production of a formal development plan. The financial component determines whether the project will yield sufficient return on capital to justify it.
- Market Study* analyzes the present and future *supply* and *demand* characteristics for a particular land use and relates these factors to the marketability of a specific use or site.

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Uses for a Market Study

- Verify existing product program/plans
- Third-party project financing
- Provide economic reality to land planning and revitalization efforts
- Highest and best use
- Long-term site planning
- Achievable
- Reposition existing developments

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All Development Is Driven By Demand


Demand factors include:


- employment growth in basic industries
- employment growth in service industries
- percentage of growth expected to occur in the submarket
- demographics, such as population, age, income distribution, education
- psychographic considerations


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Identifying the Market Area

- The market area is the geographical region from which the majority of demand originates (and in which the majority of the competitors are located).





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Product Identification

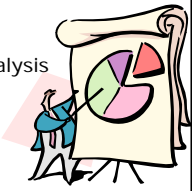
Maximizing velocity of product absorption by accurately identifying the product mix in terms of:


- uses,
- type,
- square footage,
- style,
- price range, and
- amenitization.


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Financial Analysis


- Financial feasibility: Determining whether the proposed project can achieve the desired financial objectives.
 - Involves discounted cash flow analysis




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Site Selection

- Choosing a specific property in order to maximize opportunities for market demand and product absorption while minimizing market risk.


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Negotiating/Structuring Acquisitions – The Art of the Deal

- Creating a win-win situation that meets both the Seller's needs and the Buyer's needs.
- Negotiate a realistic Due Diligence period!!!!
- Caveat: negotiation occurs at all stages of the development process – consultants, vendors, partners, public officials, community interests, etc.



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Due Diligence: Go/No Go Decision #2

- The careful and complete analysis of the site and all of its geographical, regulatory, environmental, ecological, geological, topographical and historical characteristics to minimize the prospect that the desired product cannot be developed on the site as intended.

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Is There Such A Thing As Undue Diligence???



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MARKETING REAL ESTATE

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Strategic Marketing - Planning


- Establishing an identity for the project that can be expressed through its design and reinforced through promotional materials and on-site merchandising (i.e., branding).
 - Branding adds value to future projects
- Differentiating your development or product
- Sales centers as a marketing tool
- Developer subsidies - cost and disclosure.
- Preferred Builder programs – protecting your investment.
- Discounting initial sales to builders to create momentum

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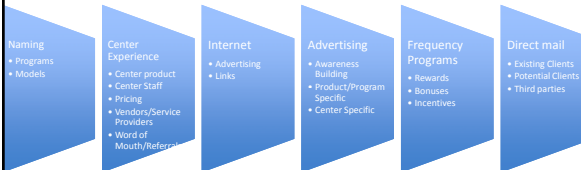
Strategic Marketing - Purpose


DEVELOPERS are first and foremost MARKETERS.

The primary objective of marketing is to identify needs in the marketplace and then to implement a successful plan to fill those needs. Failure to provide the precise needs of the marketplace will result in a failed “field of dreams” – build it and they will not come.

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Strategic Marketing: Creating The Project's Image




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Create by Susan W. Moore, NewHeight Group, Miami, Florida

Strategic Marketing

- *Marketing* is all about delivering qualified traffic to the Sales/Leasing Center

CAVEAT: prospects shop by the process of Exclusion NOT Inclusion



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Strategic Marketing

- *Marketing* is no longer limited to general shotgun procedures and results - *targeted* customers can now be accurately located, directly communicated with, closely traced, and guided to a purchase decision.
- *Marketing* - through the advances of technology - is now capable of more precisely identifying and controlling *targeted* buyers and users.



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Strategic Marketing

Marketing Defined:

- Marketing is communicating and giving target market customers what they want, when they want it, where they want it, and at a price they are willing and able to pay for it

OR (better yet)

- Selling or leasing the greatest amount of space in the shortest period of time at the optimal price.



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Acquisition Financing

- Institutional financing usually is not a significant factor at this stage because raw land generates no income stream to secure repayment of the loan.
- Techniques
 - Seller Financing
 - Joint Ventures
 - Creative Structuring
 - Private Investment Sources
 - Options
 - Leases





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The Closing Process

- Acquiring title to the real property from the current owner (Seller).






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The Closing Process

- Tips:
 - Don't close on the last day of the work week
 - Don't allow negotiations to be opened at the table
 - Have the other party's decision-maker present
 - Close in your attorney/title company's office



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Entitlements

- Obtaining the government approvals necessary for the project to proceed.
 - Understand the role of the public sector
 - Consider the use of development or developer agreements
 - Understand growth management laws and LDRs – current and pending



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Entitlements: Growth Management

- *Force #1: Organized Activism*
- *Force # 2: Demographics*
- *Force # 3: Zoning and Code Updates*
- *Force # 4: Affordable Housing*
- *Force # 5: Environmental Awareness*



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Entitlements: Jurisdictional Levels


Tiered Structure:


- Federal Permitting Requirements
- State Permitting & Growth Management
- Local and Regional Authority

Interactivity

- Each level can prevent a project from going forward
- Not all reviewing agencies share the same perspective on approval criteria – resulting in a disjointed and non-linear process

Sequential






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Entitlements: Local Government Processes

- **Comprehensive Plan** – Primary long-range growth management tool of local governments – Plans for future and responds to changing conditions – Usually includes both map and text
- **Land Development Codes & Regulations** – Detailed regulations implementing the Comprehensive Plan
- **Zoning (Right-to-Use)** – Specific use, density, intensity, height, setbacks and mid-range issues consistent with Comprehensive Plan
- **Planned Development Approvals** – More flexible zoning technique at first, but usually requires another post-approval process to tie down details




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Entitlements: Local Governmental Processes

- **Subdivision / Plat Approvals** – Requirements of dividing land – Impact fees, exactions and other government requirements are imposed here
- **Development Orders & Engineering Approvals** – Final plans which detail civil engineering or related requirements – Necessary to build horizontal improvements
- **Building Permits** – Official document or certification that authorizes construction, alteration, enlargement or the like, of a building or structure



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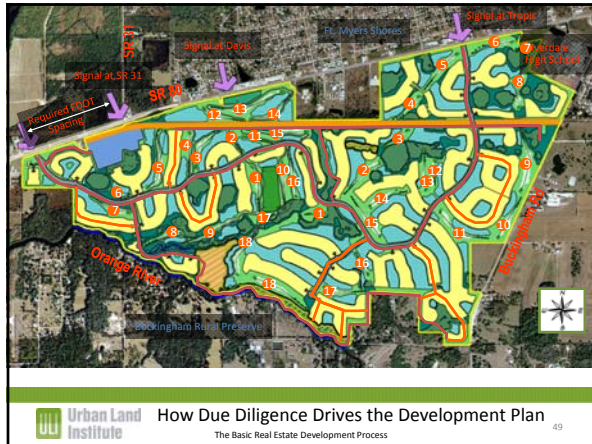
Planning & Design

- Master-planning the development
- Planning for specific sites
 - The goal of site planning is to maximize the value of the developed property subject to market absorption and regulatory constraints
- Place-making
- Creating a sense of community
- Creating “experiences”



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Development Financing

- Sources /Structures/Types:
 - Construction Loans
 - Bridge Loans
 - Permanent Loans
 - Mezzanine Structures
 - Equity
- Tips:
 - Consider structuring as a revolving line of credit
 - Don't forget release provisions

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Infrastructure & Construction



• Rough grading and installing roads, water, sewer, and utilities for the development.

■ Constructing horizontal and vertical improvements to the land.

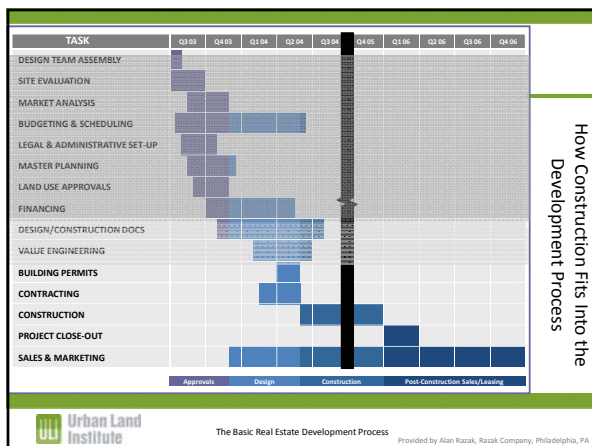


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CAVEAT: Overburdened infrastructure has led to a variety of devices designed to finance improvements as an alternative to moratoria. These include:

- *Municipal bonds* repayable from general property tax revenues
- *Impact fees* payable by the developer at the time of platting or application for permits
- *User fees* imposed on those served by the improvements
- *Assessment districts*
- *Special districts* which have separate governing bodies and impose taxes on the residents within the district
- *Tax Increment Financing (TIF)* which uses taxes based on the increases in assessed value resulting from the improvements to pay for those improvements
- *Exactions* of money or land from developers to be used for municipal purposes in exchange for entitlements

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Construction Process

- Design Process
- Contracting
- Permits
- Commencement
- Payments (Draws)
- Completion
- Occupancy

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The Players

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Owner

- Developer
- User

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A + E Team

- Architect
- Engineers
- Specialty Consultants

Contractually, includes almost all design professionals involved in project

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Public

- Municipal Inspectors
- Conservation District
- Health Inspectors
- Life Safety Inspectors

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Contractor

- General Contractor
- Construction Manager
- Subcontractors
- Owner's Contractors

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Delivery Methods

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Project Management

```

graph TD
    Owner[Owner] --- PM[Project Manager]
    PM --- Architect[Architect]
    PM --- CM[CM / General Contractor]
        
```

- Primarily associated with project values of \$25M or less
- Typically low complexity

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Construction Management

```

graph TD
    Owner[Owner] --- Architect[Architect]
    Owner --- CM[Construction Manager]
    Architect --- EC[Engineering Consultants]
    CM --- CMFS[CM Field Staff]
    CMFS --- Trades[Trades]
        
```

- Typically higher complexity with project values of \$25M or >
- A professional service applying effective management techniques to the planning, design and construction of project, to control time, cost and quality.
- The Construction Manager is the appointed agent of the client and acts for him to ensure that a viable and cost effective design is produced.
- As the Owner's representative, the Construction Manager is responsible for developing and implementing a project management plan that will achieve the goals of the owner

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Construction Management

- The Construction Manager provides CM services to the Owner for a fee
- Owner holds the construction contracts
- No GMP is provided

```

graph TD
    Owner[Owner] --- Architect[Architect]
    Owner --- CM[Construction Manager]
    CM --- STC[Sub/Trade Contractor]
        
```

Construction Management Agency

- Construction Manager, prior to commencement of construction, guarantees price of the project
- CM generally holds the construction contracts
- Assumes the risk and obligations of a general contractor

```

graph TD
    Owner[Owner] --- Architect[Architect]
    Owner --- CM[Construction Manager]
    CM --- STC[Sub/Trade Contractor]
        
```

Construction Management At-Risk

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Modified CM / CM At-Risk

```

graph TD
    Owner[Owner] --- CM[Construction Manager]
    CM --- Architect[Architect]
    CM --- CMFS[CM Field Staff]
    Architect --- EC[Engineering Consultants]
    CMFS --- Trades[Trades]
        
```

- The CM commits to deliver the project for a specified price, thus it is in its best interest to complete the construction as soon as possible, which also serves the owner's interest
- Owners with less experience and those lacking in-house construction management capabilities benefit from CM expertise.
- The skills of the CM should permit the project team to fast track the project or to employ multiple prime contractors

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CM Multi-Prime

```

graph TD
    Owner[Owner] --- Architect[Architect]
    Owner --- CM[Construction Manager]
    CM --- MPC[Multiple Prime Contractors]
        
```

- The CM commits to deliver the project for a specified price, thus it is in its best interest to complete the construction as soon as possible, which also serves the owner's interest
- Owners with less experience and those lacking in-house construction management capabilities benefit from CM expertise.
- The skills of the CM should permit the project team to fast track the project or to employ multiple prime contractors

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Program Management

```

graph TD
    Owner[Owner] --- PM[Program Manager]
    PM --- P1[Project 1]
    PM --- P2[Project 2]
    P1 --- Architect1[Architect]
    P1 --- CM1[CM / General Contractor]
    P2 --- Architect2[Architect]
    P2 --- CM2[CM / General Contractor]
        
```

- Primarily Public Sector clientele
- Prioritization of projects
- Establishing realistic goals for schedule and scope
- Use funding quickly and effectively
- Outreach to small and local contractors and vendors
- Minimize the impact on the educational environment
- Address all fire/life-safety/accessibility and health department issues

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The Contracting Process

- Contract Documents
- Contract Specifications
- Contract Types



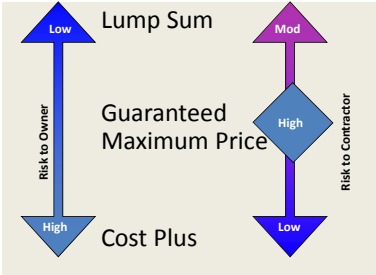
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Contract Documents

- Agreement
- General Conditions
- Drawings
- Specifications
- Clarifications and Changes

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Contract Types



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Elements of GMP

Total Estimated Cost
+ Allowances
+ Contingency

Guaranteed Maximum Price

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Contracts Specify:

- Who
- What
- When
- How Much
- Allocation of Risk
 - What's my Exposure?

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Sales/Leasing

- Merchandising the finished product, including the sense of community and the "experience", if applicable.
- Considerations include use of in-house staff or outside brokerage firm, central sales versus builder sales

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Governance & Stewardship


- Creating a proper set of mechanisms and processes to provide for the development's long-term governance and maintenance.




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Governance Structures

- Homeowners' Associations
- Condominium Associations
- Tenant Associations


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Asset Management

- The transition from development stage to operating stage by transferring operations to the property/asset manager or owners' association.




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The Functions of Asset Management

- Leasing
- Property Management
- Project Management
- Risk Management
- Team Leadership
- Radar
- Special Ops
- Measuring and Reporting Investment Returns


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POSTSCRIPT

Exit Strategies

- Think of these as American Express cards. You can't use them until you've come home without one!
- In other words, you need one or more exit strategies at every stage in the development process.





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POSTSCRIPT

Driving Forces in the Industry

- Consolidation
- Securitization
- Globalization
- Technology
- Development Issues:
 - Regulatory & Environmental Issues
 - Sources and costs of capital
 - Escalating Costs
 - Rampant Speculation
 - Failing Infrastructure
 - Erosion of Development Rights
 - Transportation Issues


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POSTSCRIPT

Emerging Trends

- Demographics
 - ◆ Boomers
 - ◆ X'ers
 - ◆ Y'ers
- Psychographics
 - ◆ Boomers
 - ◆ X'ers
 - ◆ Y'ers

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POSTSCRIPT

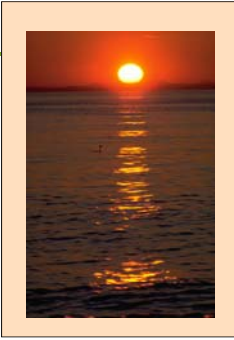
Creating Profit in Real Estate

- ◆ Waiting (Patience)
- ◆ Entitling (Adding Value)
- ◆ Squatting (Obstructionism)
- ◆ Structuring

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Wrap Up

- Questions & Answers
- Clarifications



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