

## MPC Financial Management Tips from the Masters:<sup>1</sup>

- Land Search and Site Selection
  - Multi location developer: "Generally we are focused on primary housing opportunities in our existing markets (predominantly southern and western US) although we are exploring second home/resort opportunities on a selected basis . . . We like projects that include a mix of residential product as well as commercial zoning."
  - Multi location developer: "Perform extensive market research and understand dynamics of all competitive projects (current and proposed)."
  - Multi location developer: "Desirable size: 300 – 2,000 acres (greater if phasing or options available)."
  - Multi location developer: "Geographical and market preferences:
    - SMSA > a minimum of 500,000 population base
    - Future job growth projected at or above national average.
    - Variety of industry with no one industry dominating the market
    - Reasonable transportation systems in place or planned for the near future
    - Competitive school system with good academic recognition
    - Overall perceived quality of life for target market
    - Population base is sufficient to produce a sales rate that will justify the investment and additionally allow the project to enjoy an "earned" market share (e.g., residents moving into the project because it is more attractive than other housing opportunities available).
    - Site is within a 40-minute drive from broad based employment opportunities.
    - No more than 10 minute to major transit arterials (i.e., freeways)
    - Good access to and visibility of the project
    - Product can either offer, or is in close proximity to, significant recreational and educational opportunities.

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<sup>1</sup> Consolidated notes for conference participants from Mark Fine, Kathy Perkinson, Derek Thomas, Rich Sonntag and Ehud Mouchly; added to notes from the ULI MPC Boulder Conference (2001) by Randy Johnson, LaDonna Monsees, Rick Mork, Ehud Mouchly, Marc Scroggins and Bob Williams.

- Land Acquisition Criteria
  - Multi location developer: "Generally we will only acquire entitled land with vested approvals. Alternatively, we will option un-entitled land and take through the entitlement process with the landowner."
  - Multi location developer: "In new markets, or areas within existing markets where we have more limited development experience, we require significant soils testing and engineering to be completed during the diligence period."
  - Multi location developer: "Thoroughly understand the status of all required approvals before development can commence. In situations where significant discretion still exists, we try to delay acquisition until those issues are resolved."
  - Multi location developer: "All major discretionary approvals on hand; California – tentative map or its equivalent in other states."
  - Multi location developer: "Geological, social, endangered species, botanical, toxic waste, proposed freeway construction and significant political constraints or other risks that may affect the project are thoroughly analyzed and proven acceptable."
- Joint Venturing
  - Multi location developer: "In some cases, we have joint ventured the vertical construction (homes and office buildings) with other developers/builders."
  - Multi location developer: "Try as hard as you can to make the land owner your joint venture partner by contributing the land into the JV; As a fall-back position, try to get the land owner to provide long-term [subordinated] seller financing."
- Often-missed Profit Opportunities
  - Multi location developer: "We are exploring opportunities to capture profits by offering bundled services to homeowners within our communities."
  - Primary single location developer: "Generate early cash by selling bulk parcels that are not integral to the MPC core."
- Predevelopment and Initial Development Financing
  - Multi location developer: "In most cases we will be willing to put some money at risk fairly early to allow extra time to complete diligence."
  - Multi location developer: "If you can find alternative financing sources for infrastructure, be aware that special/assessment district financing can be prohibitively expensive. However, if you play your cards right, you can pass the costs on to your builder buyers and end-users."
  - Primary single location developer: "You're pretty much on your own regarding predevelopment financing. But then I couldn't have moved forward if I didn't have the Mello-Roos (community facilities district) available for initial infrastructure."

- Assessment districts can be terribly expensive, but they may be the only show in town.”
- Primary single location developer: “Get the [infrastructure] general contractors or even the unions – if you must – finance their own work.”
  - Underwriting
    - Multi location developer: “Stand fast and don’t fall in love with the project, like the other visionaries around you.”
    - Multi location developer: “We take an extremely conservative approach to third party development financing and in most cases, underwrite our assets on an un-leveraged basis, with a leverage scenario as an upside case. In situations where we do lever the assets, leverage rarely exceeds 50% of asset value.”
    - Multi location developer:
      - “We target returns exceeding 20% although longer term projects or new market opportunities will require returns exceeding 30%;
      - Investment payback or breakeven in less than 5 years;
      - Aggregate profits equal to or exceeding invested capital.”
    - Multi location developer:
      - Project IRR: > 24%
      - Return on Capital with 5 years.”
    - Primary single location developer: “Avoid evaluating a project in a vacuum, i.e., always consider alternative opportunities – it colors your opinion of the project at hand.”
    - Primary single location developer: “Easily overlooked questions as you prepare your proforma:
      - Is our implied market capture realistic?
      - Do initial pricing assumptions realistically reflect what will be required as incentive to kick off a project, especially relative to extent of amenities in place?
      - Consider the relationship between discount rate and overall aggressiveness of various assumptions. Higher or lower rate may be appropriate depending on changing assumptions vs. leverage, inflation, absorption.
      - At the other end of the scale, be careful about sandbagging.
        - Operating people are notorious for this, e.g., generous contingencies in line items and a generous basket contingency. Too much [of this] and we’re wasting our time; the deal will never get done.

- This of course is often our own fault; it's the financial mind's natural tendency to reward people if they come in big-time under budget, but crucify them if they are a few % points over.
  - The CFO has to foster an environment where people are encouraged to be realistic about risks."
- Financial Structuring
    - Multi location developer: "Where possible, we try to joint venture with the landowner in order to minimize our capital investment and reduce our breakeven period."
    - Multi location developer: "We seek to minimize capital investment through the use of municipal financing where available and accepted in the marketplace."
    - Multi location developer: "Land Acquisition structured and major up-front infrastructure minimized to protect cash flows and IRR's."
    - Primary single location developer: "Watch the capital structure. Don't mix your long [land and infrastructure] assets with short [short fuse debt and equity] liabilities. If you can't find long money, perhaps you'd better sit this one out."
  - Product Segmentation, Positioning and Pricing
    - Multi location developer: "Thoroughly understand supply and demand at each price point planned for the community and the relative price/value ratios of each."
    - Multi location developer: "Clearly define the 'big idea' or unique selling proposition for the community that differentiates your product from the competition."
    - Multi location developer: "Clearly understand the amenity package needed to effectively market the residential product."
  - Financial Management:
    - Primary single location developer: "I extensively use entity cash forecasts that help me color our project pro formas. As capital becomes relatively more or less scarce, it affects how I look at any single project's economics."
    - Primary single location developer: "Watch your phasing, and particularly your first phase. Plan your phases so that they can't stand on their own. Don't plan phases that will take longer than 3-5 years to absorb."
    - Primary single location developer: "Avoid temptation to use only today's balance sheet in evaluating leverage capabilities, in order to contrast future possible capital requirements with today's."
    - Primary single location developer: "Never count on money from reimbursement agreements in your projections. Think of it as a possible, though not certain, gift for your grandkids."

- Primary single location developer: “[We need to measure] What is our flexibility in [in a down market. We produce] downside scenarios to [measure the impact of] extended time [requirements] for peak capital.”
- Multi location developer: “If your organization is vertically-integrated (i.e., from raw land to finished vertical structures) be certain to segregate your teams to account for your multiple profit (and cost) centers: e.g., you need to create a transfer price mechanism for a finished lot between the land developer and the home builder inside your company. This should reflect market pricing for the product and properly allocated cost-center costs. Don’t camouflage potential cross-subsidies.”
- Quick DOs and DON'Ts
  - Do take equity over debt
  - Don’t commit to pay preferred return currently
  
  - Do keep debt below 50% to 60%
  - Don’t leverage land until its fully entitled and ready to go
  
  - Do choose lenders carefully
  - Don’t cross-collateralize your projects
  
  - Do keep your lender fully informed
  - Don’t work with a lender with no track record or experience in MPC financing
  
  - Do utilize municipal bond financing
  - Don’t provide credit enhancement unless you are 100% in control
  
  - Do use non-recourse seller financing
  - Don’t pay cash for land!