CHAPTER 1

Overview of the Development Process

Where does the real estate development process begin? It begins with an idea. It does not begin with crunching numbers. It does not necessarily begin with a site. It begins with an idea. Real estate development is a highly creative endeavor, as the reader will see. Frankly, those in the creative arts, such as movie or television production, often do very well transitioning into the real estate development industry.

ECONOMIC PERSPECTIVE

Before we delve too deeply into the development process, it is important to gain a perspective on its role in the U.S. economy. (Do not focus on the absolute numbers in the list below; instead, focus on the relative magnitude of the numbers as you read them.)

Real Estate Development[1]

- Is more than a US$5 trillion U.S. market segment
- Generates about a third of U.S. GDP
- Creates jobs for more than 9 million Americans
- Is responsible for nearly 70 percent of local property tax revenue, which pays for schools, roads, police, and other essential public services

Clearly, the real estate industry has a major impact on the U.S. economy, and on the world economy as well. I cannot think of any business or

[1]While these numbers are statistics from the United States, similar numbers and percentages proportionally exist for many other countries as well.

activity that does not directly or indirectly use real estate or is not a supplier of the real estate industry. Most important, focus on that last bullet point. If a municipality gets 70 percent of its revenue from property taxes, it is logical and true that municipalities are in favor of real estate development, that is, real estate development improves values and hence the tax base and thus generates increased property tax revenues. Therefore, municipalities inherently are positively inclined toward new property development and regeneration. Yes, there are municipalities that say they do not want new development, but eventually they all come around because property tax revenue has such a significant impact.

I mentioned earlier that the real estate industry has a major impact on the U.S. and world economy. Every business, every person, uses a building

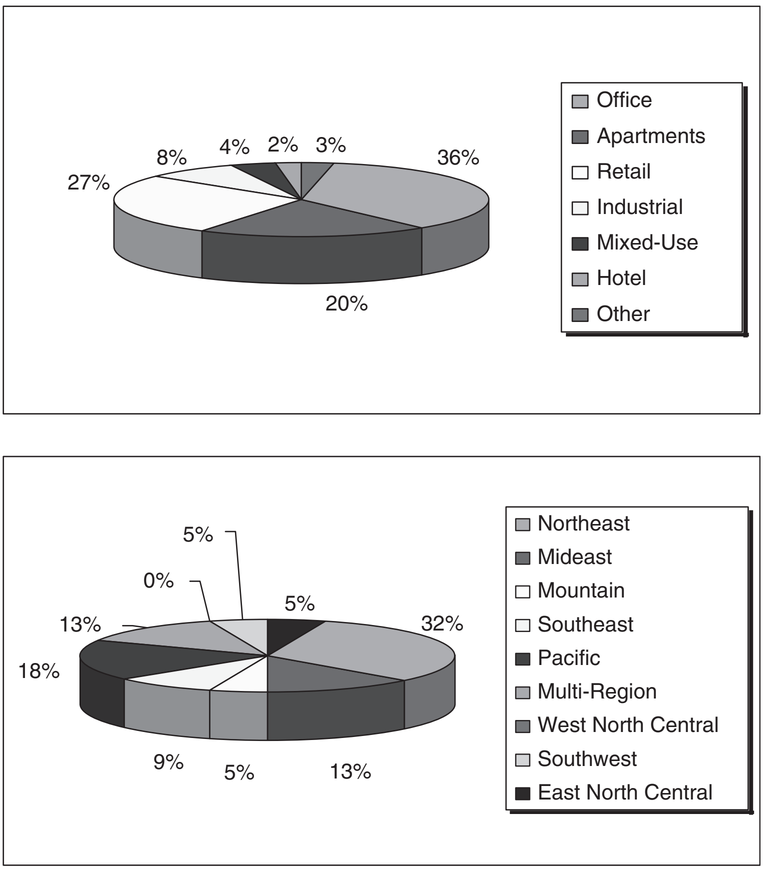

Figure 1.1a 200X REIT Transactions: Total Acquisitions US$9.7 Billion

or real estate every day. Even the homeless person sitting in a cardboard box has his piece of real estate. Hence, the balance sheet of every company and every person in this world has real estate as a major line item. Municipalities know this. Hence, over the years, governments have provided many financial and legal subsidies to enable additional real estate development and investment.

Let's look at Figures 1.1a and 1.1b.

Figures 1.1a and 1.1b were derived from information from public real estate investment trusts (REITs). The information is labeled as coming from 200X because the specific year is not important for this discussion. In Figure 1.1a, we see that REITs acquired US$9.7 billion of property. (The top pie charts indicate distribution of property types, and the bottom pie charts indicate geographic distribution.) In Figure 1.1b, we see that REITs

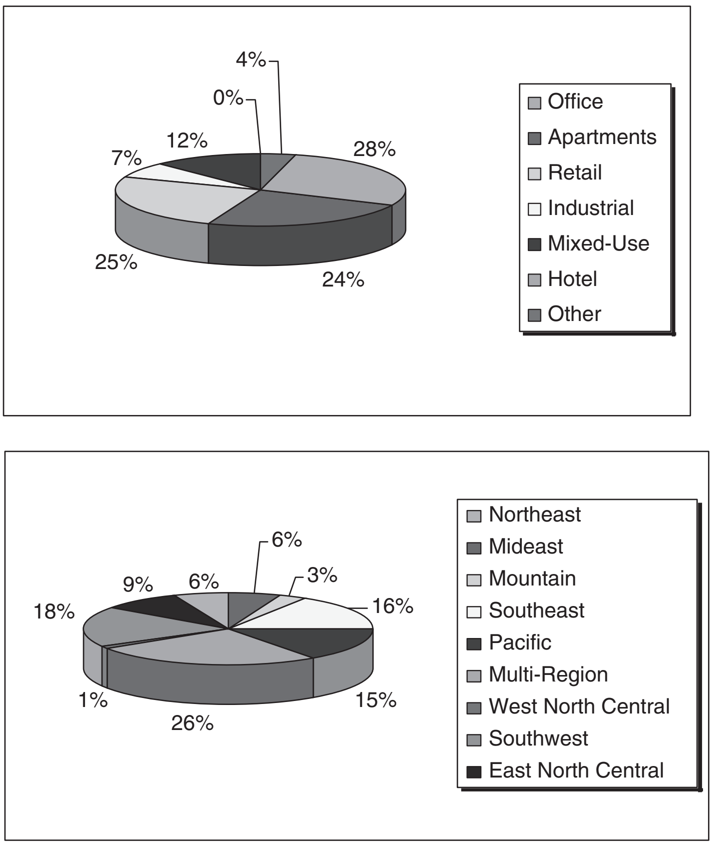

Figure 1.1b 200X REIT Transactions: Total Dispositions US$3.8 Billion

in this year disposed of or sold US$3.8 billion of property. So, what do we learn by studying these pie charts? Well, we see that the REITs in this year are net holders of property. We see that the REITs concentrated their preferences in property type and concentrated their geography where the properties are located. So again, what do we learn from these pie charts? The correct answer is, as a developer, nothing; the information is useless. It is interesting but useless. Some might say that the information would be better presented as a trend over several years. Again, I would still say the information is useless to a developer. Primarily, when was this information gathered and presented? The data is from the end of a year. It probably took several weeks to compile the information into these nice pie charts. So, the information is outdated. A development project takes on average three to five years before construction begins, maybe another year or two for construction to finish, and perhaps another year before the building is fully occupied. So if a developer had a site today and started planning, before a building is completed and operating, five years or more will pass. What will the markets be like in five years? What will be the demands of any particular city or town five years from now? No one knows. So performing a trend analysis is barely a beginning. What a developer needs to do is establish the *trend beyond the trend*. Once a trend has been determined, the trend is old and common. A developer cannot gain an advantage by using known trend information. To be successful, a developer needs to perceive what is next to come. Now this is not easy to do, but this skill distinguishes successful developers from *very* successful developers.

Consider a group I worked with several years ago. The group presented an idea to me for creating a suite hotel project in New York City, seeking an opinion. The central idea was that the project would attract families. Currently, families had to secure multiple rooms to accommodate family members. A suite hotel would contain individual hotel rooms, but each room would contain two bedrooms, a sofa bed, and perhaps a folding cot. The group's concept included a children's museum on the ground floor, open to nonguests, and provided child care, should parents want to attend a Broadway show or go to dinner some evening. I thought this was a good idea. The next day, I received an e-mail newsletter that highlighted the fact that the concept was already being used in Germany. A week letter, I received another e-mail newsletter with an article discussing the concept in use in South Africa. Ideas, good ideas, are everywhere. Just because a developer has an idea rarely means he or she is the only person with that idea. There are many people in this world with good ideas. The key is to act quickly or to devise an idea that is the next step, or the trend beyond the trend.

A useful tip in trying to determine the trend beyond the trend is to look for the negative in a circumstance. That is, what is it that is not happening?

You will find that focusing on what is not happening is far easier than focusing on what is happening. Consider this example: Imagine you are with a friend, colleague, or spouse. There often comes a point when you might be a little hungry. So, what does one person say to the other? ''I'm hungry. Where do you want to go to grab a bite?'' What does the other person say? ''I don't know. Where do you want to go?'' And this questioning goes back and forth without immediate resolution. On the other hand, imagine if the dialogue went as follows: ''I'm hungry. Where *don't* you want to go?'' The answer usually comes quickly. ''Well, I don't want Italian food because I just had Italian food last evening'' (and so on). It is far easier to determine the negative because most people have definite ideas of the negative. A developer should do the same. Don't ask a city, ''How about we build a shopping center here?'' A developer should instead ask what the city does not want built. The answer often comes quickly.

Essentially, we are following demographic—that is, people—trends when we plan a real estate development. What are the population trends? What regional population or development shifts are occurring? Are there any specific city development trends discernible? In short, real estate development is about people. What is it that people are doing or, more important, not doing? If a developer becomes a student of people and how people go about their daily lives, that developer will become adept at formulating the trend beyond the trend.

The State of New Jersey created a number of years ago the Blueprint for Intelligent Growth (B.I.G.) Map. The color-coded map indicated where in the state the government would encourage development or regeneration, where in the state the government would discourage development or regeneration, and where in the state the government would be open to argument. These areas were depicted by the use of three colors: green, red, and yellow, respectively. (If you would like to look at the B.I.G. map, then go to the New Jersey Department of Environmental Protection web site.) To my knowledge, this is the only map of its kind created by any state in the country. It is a very creative and progressive effort for a state to exercise control on a statewide basis.

If you look closely at the B.I.G. Map, you will see a clear concentration of the green-colored areas. They are located across from the major cities of New York and Philadelphia. So why did New Jersey concentrate on these areas to encourage development? Well, what is physically in these areas? What is the condition of those improvements? The areas are built-up, but old. Infrastructure is inadequate and in need of repair. The state, in essence, has unproductive assets in these green areas. Unproductive assets from the government's viewpoint are assets that have low or nonexistent value for tax purposes. (Remember, 70 percent of property tax revenue supports the local municipality's efforts at maintaining roads, schools, and the like.) Therefore, it is easy to picture that where there is a concentration of non-productive assets, the government would like new development or regeneration. Conversely, the red-colored areas are already built, but the state would like to promote the preservation of open, green space and hence discourages additional development.

As I said, this is a creative and progressive effort. However, as of the writing of this book, the B.I.G. Map has been tabled indefinitely. That is, the purpose and execution of the B.I.G. Map will not be pursued for the foreseeable future. This is not to say that the concept was stopped. What happened? Well, what do you think would happen to elected officials in the red areas of the map? They would lose political power. How would this happen? Since new development would be discouraged in the red areas, the population would probably move to areas where they would find newer development (buildings). Thus the population in the red areas would probably decline. Along with reduced population and older buildings, property tax revenues would decline. With reduced property tax revenues, the town's basic and essential services would not be funded. Without the funding, politicians such as the mayor would initially be without purpose and eventually not have a town to govern.

In addition, New York and Pennsylvania were not too happy with the B.I.G. Map. The two states clearly understand that they would lose population to adjacent, newly rebuilt towns across the rivers in New Jersey, and as a result, the two states would lose tax revenue to New Jersey.

So, developers have to always address two factors when pursuing a development anywhere: What political changes will occur, and what property tax revenue changes will occur as a result of new development? Every town will ask this question, so be prepared with a logical answer.

RELEVANCY OF UNIVERSAL KNOWLEDGE

Everything you see, everything you hear, and everything you read is relevant to real estate development. Let me offer a couple of scenarios and take you through the thinking process of why universal knowledge is so important. Gasoline prices seem to be going higher, for a time they seemed to be going lower, but no one really knows what the trend is going to be. Recently, gasoline prices were at historically high prices, placing pressures on the population. What kind of pressures am I speaking about? Well, consider people who drive 30 minutes or more to get to their workplace or to a local train station to get to their workplace. When gasoline prices doubled or more, personal budgets were extended to pay for gasoline. These people who drive in many cases do not have a choice about driving because public commuter services are limited or nonexistent in the areas in which they live. Thus, they had to pay the higher gasoline prices. While many of these people were willing to bear the higher cost of gasoline, other expenses, particularly discretionary expenses, were reduced or eliminated. Perhaps people have become frustrated as a result of having to cut back on their luxuries or even their necessities of life as a result of the high gasoline prices. So what might be a commonsense solution? I suppose one possible solution might mean moving closer to the workplace or to the urban center. Very well; if people start moving closer to or into the city, what do they need? Where is the opportunity for a real estate developer? Well, the answer is quite simple. More housing has to be built in these urban centers.

One day you read in the newspaper that a foreign car manufacturer is moving into a southern U.S. state. What does that foreign car manufacturer need? Some argue that the foreign car manufacturer needs to move to a specific location that has a job pool of qualified employees for the manufacturing plant. Extending this thought, that means that perhaps new housing needs to be built to house the new employees. In addition to the new housing, perhaps some retail of various types has to be developed to service the people who are moving into the area. And of course, the foreign car manufacturer needs a building to establish the plant. Does this building exist currently? Does this building have to be built? On what site? If this building has to be built, what are the foreign car manufacturer's requirements? Again, another opportunity for a real estate developer.

Universal knowledge is critical. Always be aware of everything that is going on around you, whether you read about it in a newspaper, hear it on the radio, see it on television, or catch it on the Internet. This universal knowledge is an application of what I referred to earlier as the trend beyond the trend. If you, as a real estate developer, want to be successful, you will be aware of everything and be thinking about what opportunity is presenting itself to you.

> ***"Don't forget nothing."***
>
> **—Rogers' Standing Orders for Rangers, 1739**

So, what is the development process? Let me offer a comprehensive, and somewhat lengthy, definition of the development process:

The improvement of raw land or property through the development process is a highly creative process in which physical ingredients such as land and buildings are effectively combined with financial and marketing resources to create an environment in which people live, work, and play.

Let's dissect this definition, so you have a thorough understanding of what the development process is really about.

The improvement of raw land or property. As a real estate developer, you improve things, whether you are starting a development from the ground up or renovating an existing property. When we say we are improving raw land or property, what we really are saying is that we are creating value. Many people who get involved with real estate development think they want to get involved to make money. The reality is that a real estate developer cannot make money without first creating value. Once value is created, then money or profit can be made. This is a basic concept that I will refer to many times: The main goal of a real estate developer is to create value.

A highly creative process. One characteristic that attracts many people to real estate development is that it is highly creative. In my experience, some of the most successful people transitioning to real estate development are those who come from the creative industries, such as film and television production and the like. Frankly, I have learned that film and television production is actually very similar in its processes to real estate development. The only thing that's really different is the jargon. As a real estate developer, you can do just about anything you wish to do. Of course, you have limitations such as zoning, and you must meet all of the building codes and other requirements. However, you can build or design anything you wish. Your imagination and the imagination of your project team are your limitations.

Physical ingredients such as land and buildings are effectively combined. The fact that real estate development involves physicality is very attractive to many people. People can actually see and touch what it is that they do. They can point out to friends and relatives a building that they themselves built. At one point in my career, I was a commercial banker. When I was a real estate banker, and I lent, say, US$100 million to a developer, I could see how the US$100 million was used. I could touch a foundation, touch a wall, or touch windows. Later in my career as a banker, I lent to major corporations. I would lend, say, US$100 million to a Fortune 100 company. Where did that money go? Did it go to pay payroll? Was it used to pay administrative expenses? Could I touch something that the US$100 million was used to pay for? Most likely not. As a banker, I had a lot of confidence lending money to a developer because I knew I could see how the money was being spent. My consultants would tell me whether work was in place. When I was a corporate banker, I could only rely on auditors to tell me that the money was spent appropriately.

Financial and marketing resources. These two resources are essential to real estate developers. Clearly, financial resources are needed; otherwise, the developer would not have the money to build. But as this book explains, marketing and market research and the resources associated with the real estate development process are both essential.

Now, there are two things that I want everyone reading this book to adopt into their psyche. If there is nothing else that you learn by reading this book, there are two things that you must understand. The first is the last phrase in the definition of the development process: "to create an environment in which people live, work, and play." Some people new to the real estate development business still think that real estate is an anomaly. Some people think real estate is something that is highly specialized and doesn't involve the majority of people in the world. Well, think about it. Where are you now? Perhaps you are at home, at work, at school, in a park? All of these things involve real estate development. Perhaps they are buildings. Perhaps they are green space. All were created by a real estate developer. Everything that you do as a developer involves people and how they live, work, and play. When you go before a city board or a community group and they ask you, inevitably, "Why are you doing this development?" your answer should be immediate: "I am creating an environment by which people live, work, and play." If you say, as some inexperienced developers say, "I am here to make some money," you *will* fail to obtain the necessary approvals. Everyone knows that you would not, as a developer, be doing a development unless you made money. But you shouldn't be so crass as to say that's your sole purpose. The reality is that you are creating an environment by which people live, work, and play.

The second thing that is essential to your understanding of real estate development is the *enterprise concept*, as summarized by Jim Grasskamp of the University of Wisconsin at Madison. The enterprise concept portrays real estate development and its operations as a business, and it requires active, aggressive management. Consider, what is a business? A business has revenues, expenses, income, employees, and taxes. What does a real estate project have? A real estate project has revenues, expenses, income, employees, and taxes. They are essentially the same thing. What do both require to succeed and create value? They both require active and aggressive management. If you decide to passively monitor your business or real estate project, it will fail or, at the very least, be mediocre. So it is essential for a real estate developer to follow the enterprise concept.

Grasskamp said that you should perpetually ask yourself four questions:

1. **What is it that we are doing?** What are you building? A hotel, a multifamily building, an office building, a retail complex? How big or small? How will it be designed? If real estate developers do not have a clear vision of what the market needs and what exactly they are building for the market, they will have difficulty.
2. **For whom are we doing it?** Why is a real estate developer building a building? A developer doesn't build the building just for fun. A developer builds a building for a specific target market. Constantly ask yourself, For whom am I building this building? In reality, it doesn't matter what you think. What matters is what your target market thinks because it is your target market that is actually going to buy or lease space in your building.
3. **To whom are we doing it (whom are we affecting)?** The reality is that a real estate developer who builds a building is causing change. That change could be increased traffic, noise, odors, or just the reality that something has changed. If a developer does not think about and identify those groups or individuals who will be affected by the real estate development, those groups or individuals will become that developer's NIMBYs (Not in My Backyard people).
4. **Will it economically fly?** Is your project financially feasible? Note that the financial analysis is the fourth thing that Grasskamp asked about, not the first thing, as many people think. While it's true that financial feasibility is important, as far as a real estate development project is concerned, it is clearly not the first consideration and can be irrelevant if the first three questions are not sufficiently answered.

If real estate developers do not know what they are doing, if real estate developers do not know for whom they are building, if real estate developers do not know whom their project is affecting, then the financial feasibility is absolutely useless information. I have interacted with a number of real estate developers who have proudly announced that their project has a projected return on investment of 50 percent or more but really did not understand the ideal or desired project they should be building for their target market or how the surrounding community and government would be affected by their new real estate development. Unfortunately, in many cases, developers do not ask themselves these four questions. They do not apply the enterprise concept, and as a result, they have mediocre projects. Oftentimes, they wonder why their project is not leasing or selling. The answer is simple: They did not apply the enterprise concept.

Grasskamp goes on to talk about the highest and best use versus the most fitting use and the highest and best use versus the most fitting use versus the most probable use. What does this mean? Let me offer a hypothetical situation. Let's say that you have acquired a strip of land between a light industrial area and a residential single-family home area. The concept of highest and best use would argue that you should build another industrial plant—a property type that likely creates the highest value for the site in this situation. Do you think the single-family homeowners would appreciate having an industrial plant in their backyard? If you built single-family homes on the strip of land, would anybody buy these homes next to an industrial plant? You could build a retail building. Single-family homeowners would probably appreciate having retail and similar services close by. But would the single-family homeowners appreciate the delivery trucks coming and going at 6:30 in the morning? So what should be built? Try to answer the first three questions that Grasskamp says you should be asking yourself in this hypothetical.

Grasskamp further said that there are three types of development approaches or concepts: the traditional development concept, the idealistic development concept, and the pragmatic development concept.

The traditional development concept is quite successfully used every day by many people. Under the traditional development concept, a developer finds a site, comes up with an idea, pulls together a team, signs contracts, builds the building, leases it, and sells it. Again, the traditional development concept is used every day by many developers, and there is absolutely nothing wrong with the approach.

The idealistic development concept is perhaps what you the reader will be using. The idealistic approach suggests optimization of consumer satisfaction. That is, you know the target market's needs and wants, and you, as a developer, try to maximize the satisfaction of your target market's needs and wants. Next, you try to minimize your cost of production, you try to minimize the impact on third parties (NIMBYs), and last, you try to maximize the profit to the investors (including your profit).

But Grasskamp said that a developer is likely to use the pragmatic development concept. The pragmatic development concept says that a real estate development results in having less than the most fitting use, which is constrained by political factors, short-term solvency, and the state of real estate technology. Let's look at each one of these individual aspects of the definition of pragmatic development concept. Let's consider these point by point:

Less than most fitting use. It often arises when a site is available but cannot have the maximum highest and best use because of the needs and wants of the surrounding neighbors, as in the hypothetical of a strip of land between a light industrial park and a single-family housing development.

Constrained by political factors. What is one of the most common political factors that constrains real estate? It is zoning. Zoning requires a developer to include certain aspects and elements into his future project. There are many other political constraints, such as political elections, but zoning is the most common.

Short-term solvency. Short-term solvency is probably the most important aspect of development. Short-term solvency asks whether you have the money to bring the development project to fruition, where fruition is defined as the point at which you are able to get a construction loan for your project. For example, do you have the money to pay for attorneys, accountants, soil-testing consultants, environmental testing consultants, and so on? Short-term solvency is very much like the old adage about investing in the stock market, spend only the money that you can afford to lose. Until you reach the point that you actually are able to get a construction loan for your project, all the money that you spend will come out of your own personal savings account. Perhaps you will be able to raise money from friends and family, but it is still money that comes from your own savings or out of your own pocket. There is no standard for how much a developer will spend on a proposed project to bring it to the point of obtaining a construction loan. It could be a small amount because the developer has a lot of experience in building a particular type of property in a particular location. It could be a large amount because of various difficulties or the sheer scale of the project. I mentioned that the time to bring a project to the point of obtaining a construction loan could be 2 to 3 years or could be 10, 15, 20, or 30 years. A rough, rough rule of thumb I often use is that the predevelopment costs (the amount of money that will be spent before a construction loan is obtained) is about 3 percent of the eventual total development cost for the project. With that in mind, I often use the amount of US$200,000 to US$300,000 given the size of projects I have worked on. (The amount could be lower or significantly higher.) Short-term solvency asks whether you as the developer have US$200,000 to US$300,000 readily available to spend on the predevelopment costs of a proposed project, money that you can afford to lose and not have a significant change in your lifestyle if you cannot bring the project to fruition. Many beginning developers have a simple answer to this question: no. So a developer who thought of building a US$30 million office building in the suburbs somewhere is often forced to revise the plan to renovating a two-story walk-up building in the city.

The state of real estate technology. This is not about technology as in computers. I am addressing building technology, design technology, and the like. With all due respect to design architects, they often design a building that cannot be built. Thus the question here is what technology will allow the efficient and cost-effective construction of a building that is attractively designed by your design architects?

All of this is the concept of pragmatic development. Pragmatic development is more than likely the approach that you and everyone else will use toward the development of a new project.

I like Figure 1.2 because of its simplicity, yet the simplicity quite effectively shows how a developer brings together a variety of resources to create

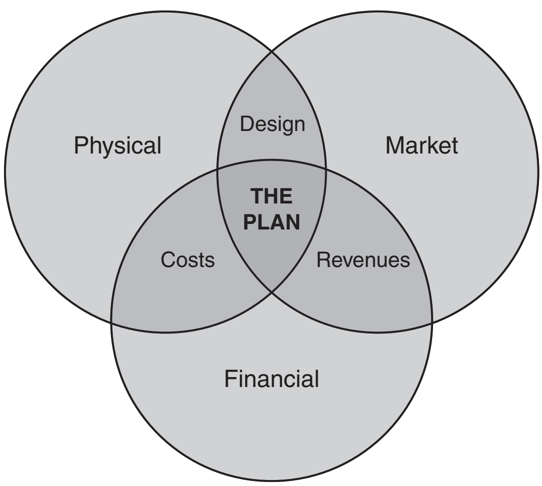

Figure 1.2 The Development Process

a development plan. For example, when a developer takes the universe of physical things and combines it with the universe of the market, the developer has the design of the project. When the developer takes the universe of physical things and combines it with the financial tools, the developer has the costs of the project. When the developer takes market information and resources and combines it with the financial resources, the developer has the revenues for the project. When all three things are combined—physical, market, financial—then the developer has created the development plan.

GROUND-UP DEVELOPMENT VERSUS REDEVELOPMENT

There are three basic types of development: greenfield development, brownfield development, and grayfield development.

Greenfield development takes place on a site where nothing has ever been built previously. The sites may be old farmland or forest areas. Greenfield development once was the most common type of development, as suburbanization continued out from the central business districts (CBDs). Today, greenfield development is probably the most difficult type of property development to execute.

Brownfield development has two definitions. The first, or technical, definition is a site that has environmental contamination. The common or day-to-day definition of brownfield development is basically a site that has been built on before. The site could be improved with a structure or structures or the site could be vacant. So, for example, this could be an abandoned industrial plant or manufacturing site. Brownfield development sites are of high interest to most municipalities because they are nonproductive assets; that is, they produce little or no property tax revenue. As a result, municipalities welcome developers and their efforts toward renovating or reclaiming brownfield sites.

> *"Education is all you have left when all the facts are gone."*
> **—Brigadier General Daniel Kaufman, Dean, U.S. Military Academy**

Grayfield development is a relatively new term that is being used more frequently today. There is nothing really wrong with a grayfield site. It is often improved with a building, the building is fully leased, and the property is cash flowing; that is, there is sufficient cash flow for the property to pay all of its expenses, taxes, and the like. What distinguishes a grayfield property is that it is in need of renovation or is currently being physically underutilized. So, for example, let's say we have a 10,000-square-foot convenience center. The convenience center is fully leased with the typical tenants of a dry cleaner, video store, take-out food, and so on and pays all of its expenses and taxes. However, the 10,000-square-foot convenience center is located on 100 acres of land. Clearly, the property is being underutilized. The property could be greatly expanded to create higher value through highest and best use. Most developers acquire grayfield properties. Without question, all beginning developers should focus all of their efforts toward acquiring grayfield properties. Why?

It is not unusual that a new developer who acquires a grayfield property begins a redevelopment effort. Somewhere during the process, the new developer perhaps feels overwhelmed, perhaps thinks that he or she has gotten involved in something that is beyond his or her capabilities. Frustrated and frightened, the new developer decides to sell the grayfield property. Can a sale be made? Absolutely. The property is cash flowing, has value, and can be readily sold to another party. Let's say the new developer decides to help his community by purchasing a brownfield property. Again, somewhere in the process, the new developer feels overwhelmed. Can the developer sell the brownfield site? Sure. But when? How much is the property worth? The biggest distinction between a brownfield development site and a grayfield development site is that the grayfield development site has cash flow.

THE SIX PHASES OF DEVELOPMENT

Throughout the development process, you will be involved in a variety of development activities:

Site acquisition	Cost planning and control
Market/program planning	Financial
Leasing	Project timing and scheduling
Property management/operations	Community approval/zoning
Architecture/engineering/construction	Documentation
	And so on

To keep yourself organized and on track, you need a plan. That plan is the six phases to the development process:

1. Study phase
2. Feasibility phase

3. Preconstruction phase
4. Construction phase
5. Initial occupancy phase
6. Occupancy and investment management phase

Simplistically, in the study phase, you do some basic analysis and investigation, perhaps focusing on a city, neighborhood, or even a site or two. Once you are reasonably confident about a particular site, you proceed into the feasibility phase, in which your goal is a feasibility report. (A feasibility report is a business plan for a project, as discussed at length in a later chapter.) See Figures 1.3a through 1.3d. After completing your feasibility study and deciding to move forward, you enter the preconstruction phase. In this phase, you are preparing for physical construction. You will be acquiring the site, obtaining government approvals, and signing contracts for the physical construction of the project. The construction phase is the construction of your project, including construction management. The initial occupancy phase includes the move-in of tenants and tenant improvement work. The last phase, the occupancy and investment management phase, includes the move-in of the remaining tenants and the continuous analysis and management of the newly built or renovated building through and including the

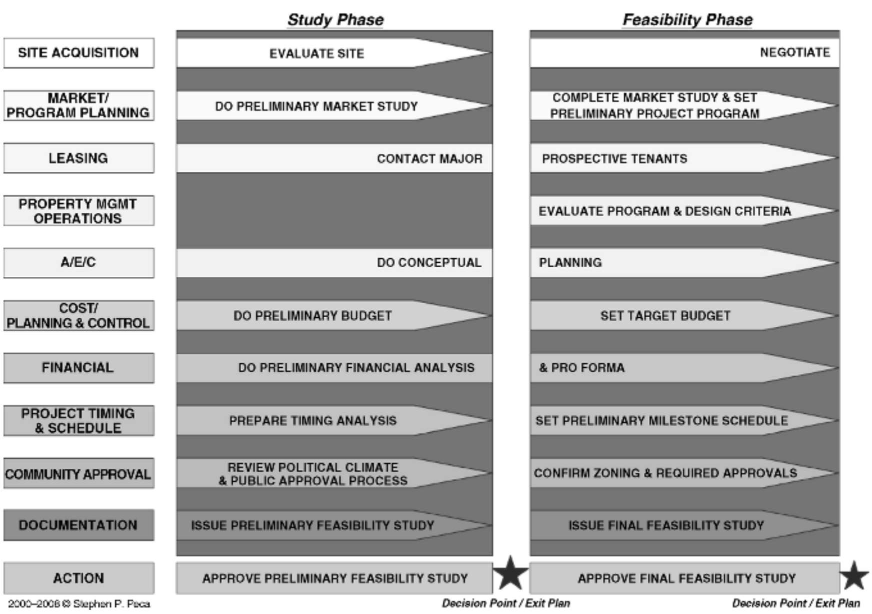

Figure 1.3a Predevelopment Process

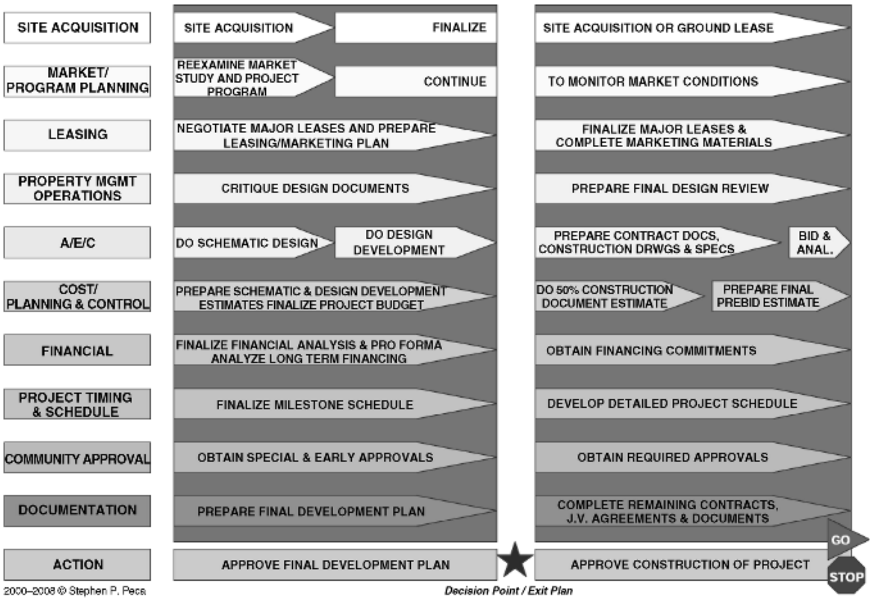

Figure 1.3b Development Process: Preconstruction Phase

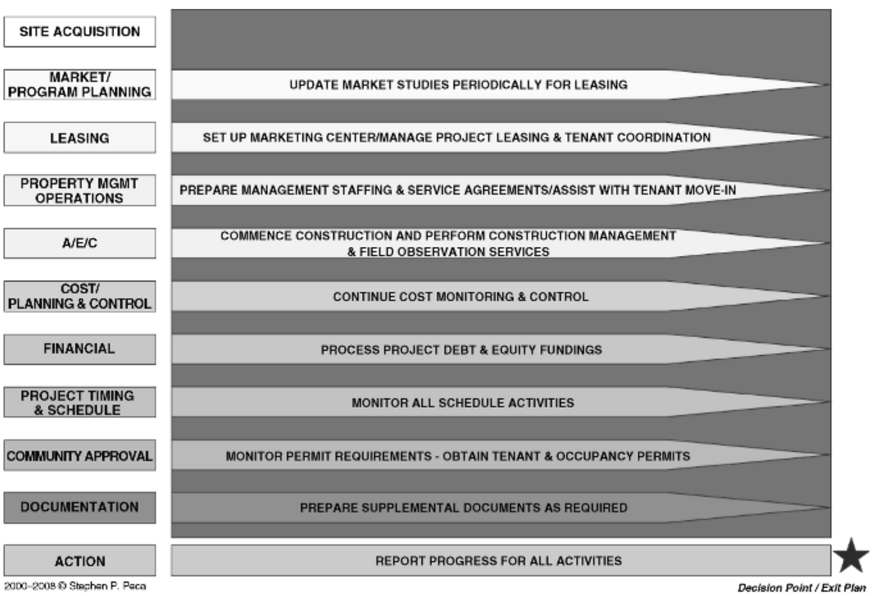

Figure 1.3c Development Process: Construction Phase and Initial Occupancy Phase

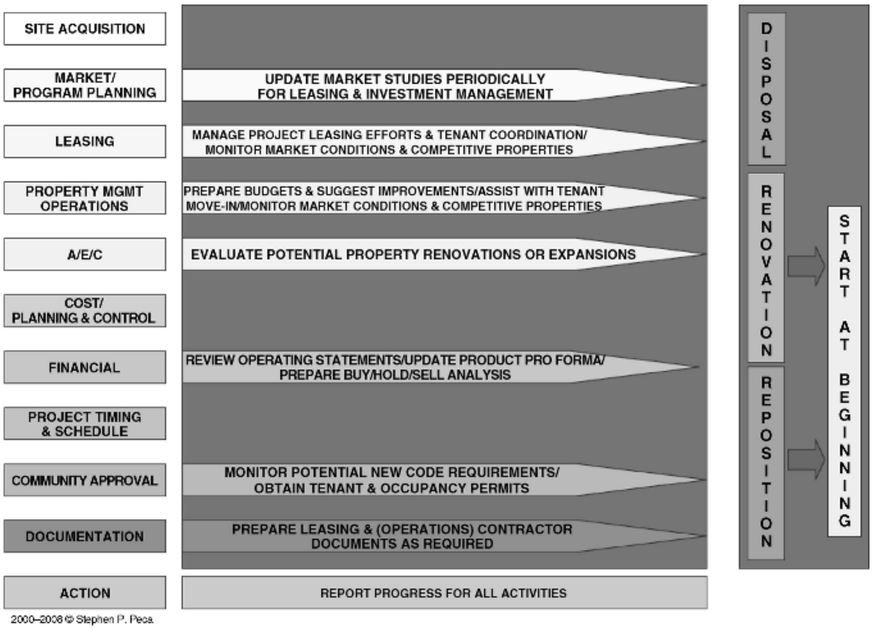

Figure 1.3d Development Process: Occupancy and Investment Management Phase

eventual sale of the property. The remainder of the book speaks to the details in each phase.

Figures 1.3a through 1.3d outline the development process graphically. They show the various activities that a developer will be involved in throughout the development process. While the charts do not address every activity, they address the major and most common activities. Notice the star between each phase. The stars represent decision points. At the end of each phase, you should stop and reflect on your progress and consciously decide whether to move forward into the next phase. Of course, this means that you should be crafting an exit plan for each decision point. The exit plan asks, How do I stop the process? How do I recover my costs to date? What can I do? Many developers I know—even large developers—have exit plans, but interestingly, these developers have exit plans only after the occupancy phase. That is, their exit plan is to sell the project. Brilliant! But what is your exit plan should you need to exit the project in the middle of the construction phase? What do you do? Many developers have not thought about this situation. You *must* have an exit plan for each phase in the development process. When thinking about each exit plan—and for that matter, as you progress through each phase—you should ask yourself, Have I created value? If you have created value, you have something to sell; this is the ideal. As a corollary, do not spend any money unless you can say to yourself, If I spend this money, I will be creating value. For example, to spend money on a market analysis report in the study phase does not typically create value. At this phase, your idea is probably not fully thought out. Hence, the market analysis report would be generic, not useful to anyone else, and thus of no or very little value to anyone else. On the other hand, if you obtain a phase 1 environmental assessment on a particular site, you will know at the conclusion of the assessment whether the particular site has environment contamination. This knowledge clearly establishes value (or detracts from it) for that particular site.

The charts outlined in Figures 1.3a through 1.3d are clear, comprehensive, and simple to understand. However, there is one reality that the charts do not recognize: The development process will never happen this way. The development process will occur in an apparently haphazard way, totally different from what is outlined on the chart. Still, you must perform all of the activities outlined on the chart; otherwise, your development process or plan will be incomplete and thus either fail, be fraught with numerous problems, or be mediocre at best.

Let me offer an example of why the development process will never occur as outlined. Let's say you are offered a prime piece of property. From existing knowledge, you know the property is fully occupied, cash flowing, and in good physical shape. It is being offered to you at a substantial discount. Most people in the real estate industry acknowledge that if the sales price of a property is less than the replacement cost of the property, you should buy the property. This means that you will have acquired the property well before the study phase begins instead of sometime during the feasibility phase, as outlined on the chart. This situation is not an unusual circumstance. However, after acquiring the property, you must perform all of the activities outlined; otherwise, you will suffer endless problems and perhaps fail in your efforts. The development process includes many functional activities; *all* must be performed.

So given what we have discussed in this chapter, what is the role of a developer? The developer is a visionary. The developer is a manager and coordinator of people. Accordingly, the developer is a team builder who persuades the team to embrace her or his vision and leadership toward the ultimate goal of the creation of a building and the creation of value. The developer is a problem solver. I would say that the majority of a developer's time will be spent on solving a variety of minor and major problems. Many of these problems can be anticipated. Many of these problems occur without notice or unexpectedly. A developer is also a public spokesperson who will need to constantly talk about the project and sell the need for the project to each of the constituencies.

So, is a specific education or specific knowledge needed to be a developer? No, not really. Anyone can be a developer, but anyone can fail as a developer, too. I think there are three areas that a developer should be comfortable with to be successful. The first is accounting and finance. You do not have to be an accountant or a CPA. You should just be comfortable with numbers, since you will be faced with them every day. The second is knowledge of the law, specifically contract law. Everything you do in development involves a contract, so you should be comfortable reading and interpreting contracts. The third is public speaking and/or public relations. You will be making many, many presentations to groups of people and sometimes to just a single person. You should be comfortable making these presentations and dealing with people who disagree or heckle you.

LEARNING POINTS FROM THIS CHAPTER

After reading this chapter, I should:

- Understand the distinction between construction and development.
- Know the definition of *development* and specifically three words that always define development.
- Understand the enterprise concept.
- Know the six phases of development and the importance of an exit plan at the end of each phase.