**Urban Land
Institute**

Chapter 1:Introduction to the
Real Estate Development Process

Professionl Real Estate Development

The third edition of Professional Real Estate Development explains the nuts and bolts of the real estate

development industry. The book describes the details of land development and how to develop and manage

four types of income-producing real estate products: residential, office, industrial, and retail. Focusing on

small-scale projects, the authors offer practical methods for developing each major type of real estate,

covering feasibility analysis, design and construction, financing, marketing, and management. Photos,

diagrams, spreadsheets, and case studies provide examples of actual projects and how the process works.

Information is specific and detailed, with costs, rents, and financing information included by product type.

Introduction to the Real Estate Development Process

Real estate development is the continual reconfiguration of the *built environment* to meet society's needs. The creation of roads, sewer systems, housing, office buildings, and shopping centers requires much work. Someone must initiate and then manage the creation, maintenance, and eventual re-creation of the spaces in which we live, work, and play. The need for development is constant as population increases, technologies evolve, and tastes continue to change.

Both public and private participants have compelling reasons to understand the development process. The goal of *private sector* participants is to minimize risk while maximizing personal or institutional objectives—typically profit, but often nonmonetary objectives as well. Fortunes have been made and lost in real estate development. Few business ventures are as heavily *leveraged* as traditional real estate development projects, magnifying the risk of ruin but also the potential for high returns to investors. The *public sector*'s goals are to ensure public safety, to manage the impacts of real estate development on the community and the environment, and to promote smart development that is consistent with community's interests. These goals

require balancing the market's need for constructed space against the public sector's responsibility to provide services, improve the quality of life, and limit environmental harm. A key tenet of this book is that all participants enjoy a higher probability of achieving their goals if they understand the nuances of how the development process works, who the key players are, how their objectives are interwoven, and why it is important to achieve consensus.

DEFINING REAL ESTATE DEVELOPMENT

Real estate development is the process of bringing built space to fruition. It starts with an idea and ends when consumers—tenants or owner-occupants—occupy the physical space put in place by the *development team*. Each real estate project is in essence a separate business entity employing the three factors of production—land, labor, and capital—to create a product. To transform an idea into reality, these factors are coordinated by entrepreneurial management and delivered by teams. *Value* is created by providing space to meet the needs of society. Although the definition of real estate development remains simple, the process grows more and more complex

as municipalities, financial markets, and consumer tastes evolve.

Developments do not happen without financial backing, which often requires multiple agreements negotiated by multiple players. The developer works with public sector officials on approvals, zoning changes, exactions, building codes, and the provision of *infrastructure*. Community and special-interest groups play increasingly important roles. The time needed to conduct public outreach, negotiate with the public sector, and obtain financing must thus be factored into the equation when evaluating a potential project. Only after these functions are organized can the team of designers, engineers, and construction workers begin the physical development. The project is completed with the leasing or selling of the space to users. This final phase requires the expertise of marketing professionals, graphic artists, salespeople, website developers, and other specialists. The developer tries to ensure that every element in the process is properly executed on schedule and within budget.

Today, development requires more knowledge than ever about the specifics of prospective markets, patterns of urban growth, neighborhood associations, traffic patterns, legal requirements, local regulations, contracts, building design, site development, construction techniques, environmental issues, infrastructure, financing, *risk control*, and time management. Ever-increasing complexities in each arena have led to increased specialization within the development team. As more affiliated professionals work with developers, the size of the team has expanded and the roles of some members have changed. As development has become more complex, it has generated the need for better-educated developers.

THE EIGHT-STAGE MODEL OF REAL ESTATE DEVELOPMENT

Despite the growing complexity, developers still follow a standard sequence of steps from the moment they conceive a project through the time they begin ongoing *asset management* and/or sell the finished product. Although some may delineate the sequence of steps slightly differently, the essence does not vary significantly from the eight-stage model shown in figure 1-1.
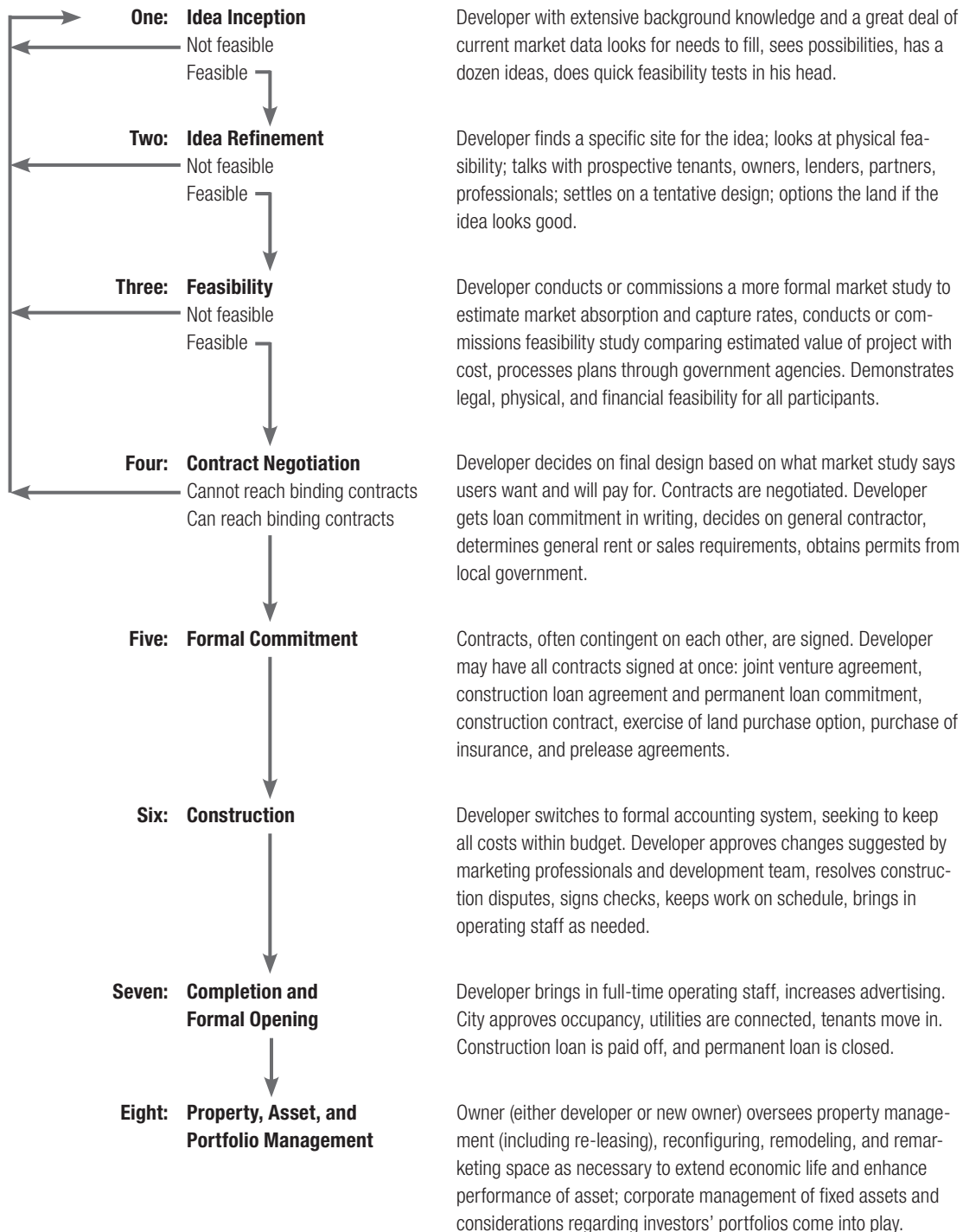
The eight-stage model also applies to the redevelopment of projects, which requires most of the same steps as new development. In very large development projects, individual components can be nested within a larger development plan and may each be at different stages at a given time.

Before proceeding further with the model, a few points should be emphasized. First, the development process is neither straightforward nor linear. The flow chart shown in figure 1-1 can identify the discrete steps and guide an understanding of development, but no chart can capture the constant repositioning that occurs in the developer's mind or the nearly constant renegotiation that occurs between the developer and the other participants.

Second, real estate development is an art. It is creative and complex, partly logical and partly intuitive. Studying the components of development can help all players make the most of their chances for success. What cannot be taught are two personal qualities essential to success: creativity and drive.

Third, at each stage of the process, developers should consider all the remaining stages. Developers should make current decisions fully aware of their implications not only for the immediate next step, but also for the life of the project. The development process requires managing the interaction among the functions (design, construction, finance, management, marketing, and government relations) in each of the eight stages as well as over time.

The developer should recognize the importance of asset management and property management after the project is built by providing for those functions during design and construction. For example, operating a sophisticated building with advanced technological systems may require skills beyond those of most property managers in a particular market. Or, maintaining a particular material may require greater expense than would a different product.

Figure 1-1   **The Eight-Stage Model of Real Estate Development**

One: Idea Inception
Not feasible
Feasible ⌐

Developer with extensive background knowledge and a great deal of current market data looks for needs to fill, sees possibilities, has a dozen ideas, does quick feasibility tests in his head.

Two: Idea Refinement
Not feasible
Feasible ⌐

Developer finds a specific site for the idea; looks at physical feasibility; talks with prospective tenants, owners, lenders, partners, professionals; settles on a tentative design; options the land if the idea looks good.

Three: Feasibility
Not feasible
Feasible ⌐

Developer conducts or commissions a more formal market study to estimate market absorption and capture rates, conducts or commissions feasibility study comparing estimated value of project with cost, processes plans through government agencies. Demonstrates legal, physical, and financial feasibility for all participants.

Four: Contract Negotiation
Cannot reach binding contracts
Can reach binding contracts

Developer decides on final design based on what market study says users want and will pay for. Contracts are negotiated. Developer gets loan commitment in writing, decides on general contractor, determines general rent or sales requirements, obtains permits from local government.

Five: Formal Commitment

Contracts, often contingent on each other, are signed. Developer may have all contracts signed at once: joint venture agreement, construction loan agreement and permanent loan commitment, construction contract, exercise of land purchase option, purchase of insurance, and prelease agreements.

Six: Construction

Developer switches to formal accounting system, seeking to keep all costs within budget. Developer approves changes suggested by marketing professionals and development team, resolves construction disputes, signs checks, keeps work on schedule, brings in operating staff as needed.

**Seven: Completion and
          Formal Opening**

Developer brings in full-time operating staff, increases advertising. City approves occupancy, utilities are connected, tenants move in. Construction loan is paid off, and permanent loan is closed.

**Eight: Property, Asset, and
          Portfolio Management**

Owner (either developer or new owner) oversees property management (including re-leasing), reconfiguring, remodeling, and remarketing space as necessary to extend economic life and enhance performance of asset; corporate management of fixed assets and considerations regarding investors' portfolios come into play.

Furthermore, to keep a space competitive in an ever-evolving market, asset managers need to remarket it continually and to upgrade or remodel it periodically. *Institutional investors* and corporate owners are keenly aware of the periodic need for and cost of major remodeling to prolong a building's economic life. Careful planning during stages one through seven should enable developers to find ways to minimize the frequency and cost of retrofitting, while respecting the original concepts. Whether or not developers manage a property for the long term, they are responsible for considerations that affect asset management during the first seven stages. Given that developers' decisions help determine future *operating costs* and that such costs represent a significant part of the project's value (i.e., what it will sell for), developers typically focus sharply on making building operations cost-efficient.

Fourth, although the model for development is grounded in reality, it represents an ideal version of the process. The model assumes a well-informed developer, a thorough analysis of the market, accurate assessments of the construction costs, and so on. Real estate development is full of stories of people whose intuition has led them to success. The stages described here do not account for the lucky, intuitive person who had a gut feeling and used unconventional means to get a project built. Still, it is better to be skilled and lucky than just lucky.

Fifth, the development process is inherently *interdisciplinary* and dynamic. It is a complex process that demands attention to all aspects of creating the built environment. The developer must be conversant in many disciplines, in order to make informed decisions and balance competing goals. Furthermore, many of the components of this interdisciplinary world are changing rapidly, and the interfaces between disciplines are constantly in flux.

Finally, real estate development is a global industry. Financing sources are sometimes global, major tenants have international connections, and real estate service companies operate and compete globally. Most important, global factors are spurring changes in lifestyle preferences that are changing what people want in the built environment.

CHARACTERIZING DEVELOPERS

Developers are like movie producers; they promote and finance a project, assemble a team of specialists, and then manage that team to make sure that the project is realized. Developers are proactive; they make things happen. As discussed in later chapters, a great deal of uncertainty is associated with the development process, just as with the introduction of any new product. However, unlike many other industries that make new products which have limited lives, real estate development involves long-term commitments because buildings last for decades. Thus, the cost of making a mistake is extraordinarily high. The amount of related risk the developer assumes personally is an important issue that commands significant attention throughout this book. Regardless of which risk control devices the developer finds appropriate for a particular project, the developer ultimately is responsible for managing all aspects of that project. Clearly, successful developers must be able to handle (and thrive under) intense pressure and considerable uncertainty.

Developers are not all alike. Some develop only one type of property such as single-family homes; others develop a wide range of product types. Some carve out a niche in one city; others work regionally, nationally, or internationally. Some run extremely lean organizations, hiring outside expertise for every function from design to leasing; others maintain needed expertise in house. Some operate as publicly traded companies, such as real estate investment trusts (REITs), while others stay private, forgoing certain capital market advantages to avoid the short-term pressure of quarterly earnings. In between are many gradations. As in most professions, developers range from those who put reputation above profit to those who fail to respect even the letter of the law. Likewise, in ego and visibility, they vary enormously. Some name buildings for themselves, while others cherish anonymity.

Private developers must balance an extraordinary number of requirements for completing a project against the needs of diverse consumers of the product. First, as figure 1-2 shows, developers need

CASE STUDY Shortbread Lofts Summary

THE DEVELOPER

Larry Short/Shortbread Lofts LLC

PROJECT LOCATION

Shortbread Lofts is located in downtown Chapel Hill, North Carolina, within a short walk of the University of North Carolina. It sits along a bus route that runs throughout the town. Prime development sites such as this one are scarce, and approvals are painstakingly difficult to obtain, making this site a rare development opportunity in a market with limited competition.

LAND

The total land area is 1.28 acres on two sites. The primary site is 1.08 acres, level, and rectangular, with 313 feet of frontage on W. Rosemary Street, a commercial corridor. The secondary site, across the street, is 0.2 acre and is used for additional surface parking. The property was rezoned TC-3 (Town Center 3) for the development of Shortbread Lofts.

BUILDING

A seven-story podium construction building contains 85 units (271 bedrooms) of student housing. The six stories of residential units sit above a ground level that contains a leasing office, 6,459 square feet of retail space, and a parking garage. The residential units are two-, three-, and four-bedroom units, with a bath for each bedroom. The garage has 121 parking spaces that are leased to residents.

INITIAL CHRONOLOGY

Rezoning approved	February 2012
Construction began	January 2013
Leasing began	December 2013
Project completed	August 2014

DEVELOPER BACKGROUND

Larry Short moved to Chapel Hill in 1979, when the prime rate hit 18 percent. He had been in Chicago, earning an MBA at Northwestern University, working first as a CPA at Arthur Anderson, then doing real estate makeovers. He started developing single-family units while in school and eventually moved to developing small apartments full-time. His deals were usually owner-financed. When he hit Chapel Hill he couldn't write a $10,000 check.

Short avoids publicity. He hires the right people to work on his developments, people who have the right local connections. Before his first major development, the Warehouse, and the Shortbread project, he had rehabbed several small condominiums in Chapel Hill; he acquired the units, upgraded them, and resold them to new users.

CASE STUDY Irvine Tech Center Summary

THE DEVELOPER

Greenlaw Partners in single-purpose partnership with Guggenheim Plus Leveraged LLC

PROJECT LOCATION

Irvine Tech Center (ITC) is located in the Irvine Business Complex, a 2,700-acre planning area rapidly transitioning from relatively low-density industrial and office properties to mixed-use and residential development. The transformation is driven by proximity to Orange County's principal airport and to the University of California at Irvine, and by underlying shifts in the county's economy. The site sits at the intersection of two major arterials. One connects the airport to the university campus, and the other connects Orange County coastal cities to two major interstate highways and to inland job and residential areas.

LAND

The site was acquired in three phases:
ITC I, 10 acres and five buildings
ITC II, 8.9 acres and seven buildings
ITC III, 4.2 acres and one building
The project is divided by a collector street that separates ITC I from ITC II and ITC III. The existing tilt-up buildings provided interim income during the entitlement period.

DEVELOPMENT STRATEGY

Acquisition of vehicle trip allocations from other parcels in the IBC to support the density proposed for the ITC site.

INITIAL CHRONOLOGY

Acquisition of ITC I and II	2005
Initial entitlement application	2006
Acquisition of trip allocation units	2005–09
First purchase offer	2006
Entitlement application withdrawn and project reconceived	2009
Entitlements reinitiated under Irvine Vision Plan	2010
Acquisition of ITC III	2012
Sale of ITC I closed	2013
ITC II and III under contract for 2015 close	2014

DEVELOPER BACKGROUND

Wilbur (Wil) Smith came to Los Angeles to attend the graduate program in real estate development at the University of Southern California. Having an extensive family background in real estate, Smith had worked construction, leased and managed properties, and made acquisitions. After graduating, he joined Maker

This case study was written by John Brady, (retired) Guggenheim Real Estate, San Francisco.

Irvine Tech Center *Continued from page 7*

Properties, a private firm in Orange County engaged in residential, mixed-use, hospitality, and commercial developments.

In 2003, Smith formed Greenlaw Partners and began an acquisition program focused on office, industrial, and other income properties. He joins with institutional financing sources to identify opportunities where the highest risk-adjusted returns can be obtained "on the buy" by purchasing properties at or below replacement cost. He then creates and implements a business plan to increase cash flow or base asset value and to optimize the equity multiple and the internal rate of return (IRR).

the blessing of local government and often of neighbors around the site. In many cases, to obtain public approval, developers must redesign a project. Thus, appropriate flexibility is one of a developer's most crucial traits. Second, developers need to be able to find tenants or buyers (users) who will pay for space and associated services over time. Third, developers must lead an internal team of specialists who depend on the developer for their livelihoods and recruit external players whose businesses contract with developers. Fourth, developers need to demonstrate the project's feasibility to the *capital markets* and pay interest or offer *equity* positions in return for funding. In each of these areas, developers use various forms of risk management, initiating and managing a complex web of relationships from day one through the completion of the development process.

This book refers many times to the "development team" that assists the developer in the design and construction of an idea. It is worth noting that only a small proportion of the people in real estate development are developers—the *entrepreneurs* who initiate and execute a project. The bulk of the players come from a wide range of professionals, support staff, and building tradespeople who are indispensable to the process. Clearly, challenging work abounds in real estate development for many participants, not just for the developer. In fact, most developers start their real estate careers in one of the supporting professional trades.

The developer's job description includes shifting roles as visionary, promoter, negotiator, manager, leader, risk manager, and investor—a much more complex job than merely buying low to sell high. Developers are more akin to entrepreneurial innovators (like Bill Gates or Elon Musk)—people who realize an idea in the marketplace—than to pure traders skilled primarily at arbitrage.
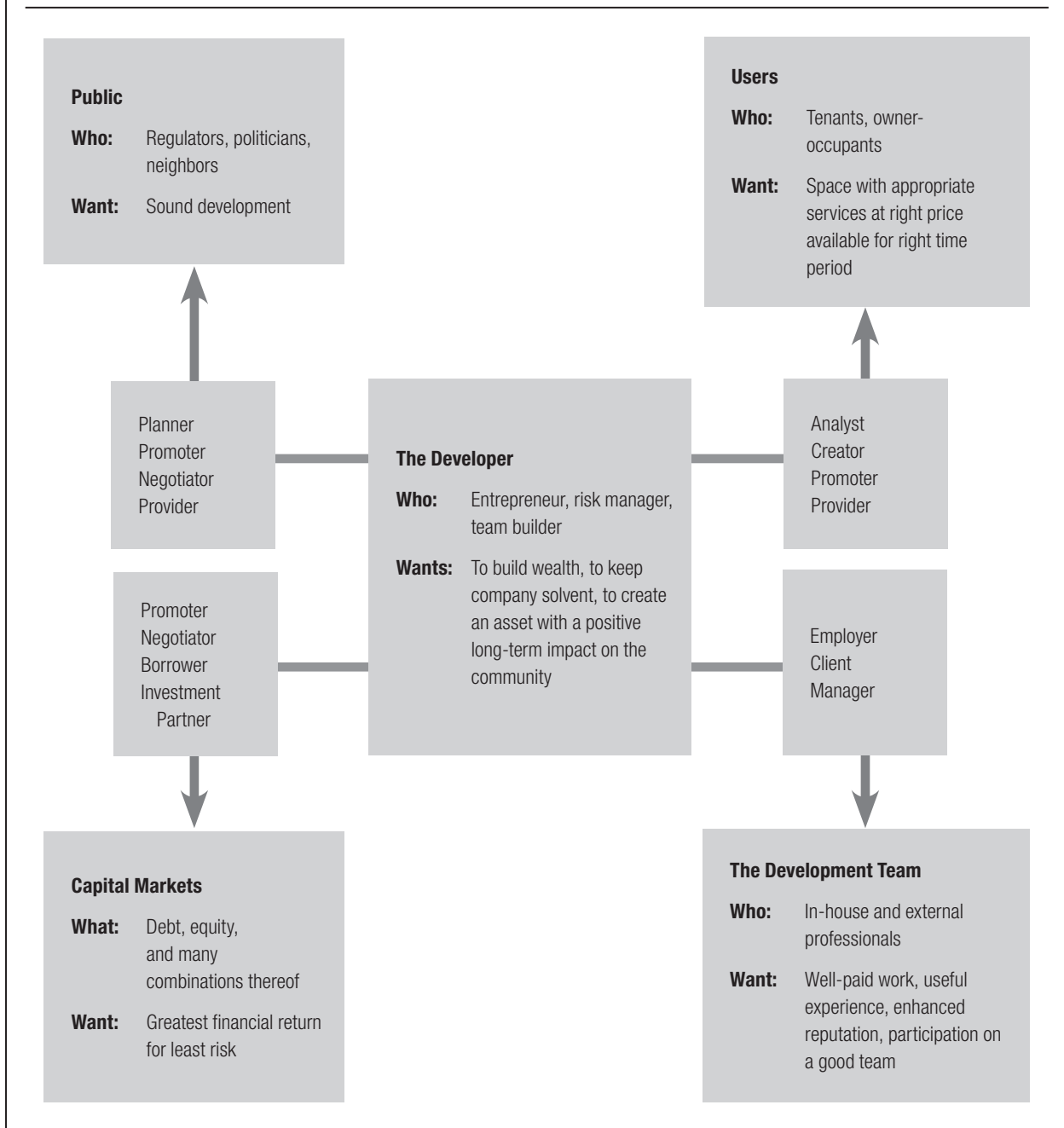
Balancing these roles is an art that is mastered through experience. Equally important as that mastery is a goal-oriented disposition to overcome problems and obstacles. Developers must be highly focused on success with the ability to negotiate, compromise, and shape a project to meet the demands of stakeholders. Without the drive of a developer, few developments would occur because the potential roadblocks are numerous.

REPUTATION OF THE INDUSTRY

By definition, developers are agents of change. As in any profession, some are models of ethical behavior, making innovative and attractive contributions to the community, while others exhibit little sensitivity to community standards. But unlike other consumer goods that can remain in a showroom, the developer's product is clearly manifested in the built environment. It is there for everyone to see and judge. It is extremely difficult to communicate the qualities of a project before it is completed. Thus the developer's public persona can be as much a part of a project as the product itself, making developers easy scapegoats for everything from more traffic to higher taxes or crime rates.

As growth infringes on communities, the appearance of NIMBYism ("not in my backyard") is inevitable. Without even knowing the individual or the firm, many people are wary of a developer's involvement in a project in their neighborhood. Neighbors await bulldozers with trepidation. In the face of growing animosity, developers, city planners, elected officials, and others involved in community growth have learned the hard way about the necessity of involving the broader community in guiding development. Chapter 8 discusses how a developer

Figure 1-2   **The Developer's Many Roles and Interactions**

Public

Who: Regulators, politicians, neighbors

Want: Sound development

Users

Who: Tenants, owner-occupants

Want: Space with appropriate services at right price available for right time period

Planner
Promoter
Negotiator
Provider

The Developer

Who: Entrepreneur, risk manager, team builder

Wants: To build wealth, to keep company solvent, to create an asset with a positive long-term impact on the community

Analyst
Creator
Promoter
Provider

Promoter
Negotiator
Borrower
Investment
Partner

Employer
Client
Manager

Capital Markets

What: Debt, equity, and many combinations thereof

Want: Greatest financial return for least risk

The Development Team

Who: In-house and external professionals

Want: Well-paid work, useful experience, enhanced reputation, participation on a good team

can address these challenges. Communities will always change, with or without developers. A good developer can manage change with vision and sensitivity, and thus have a positive effect on a community.

THE DEVELOPMENT TEAM

The developer is the leader of a development team. He coordinates people and helps realize a vision. That vision may be his own, that of the community, one that is shaped by the team, or a blend of all

of these. Developers seldom work in isolation. To design, finance, build, lease or sell their products, developers must engage the services of many other experts—public and private—some of them specialized professionals, others entrepreneurs like themselves. Chapter 3 describes the typical array of team members in detail.

With each project, developers must shape and sell an idea to secure commitments from others. Thus, they are first and foremost promoters. Like any team leader, they must also motivate players, often with incentives beyond money—with pride in the project, with the hope of future work, and with fear of the consequences of nonperformance. Knowing when and with whom to use different incentives is a key leadership skill for developers.

THE PUBLIC SECTOR: ALWAYS A PARTNER

The public sector is involved—as a stakeholder or a partner—in every real estate project. Real estate development is highly regulated, and the legal and regulatory environment surrounds the entire development process. Developers usually work hand in hand with local governments and the community, giving them the same respect and attention they would give any other partner. Chapters 7 and 8 discuss the public sector's involvement in depth.

MARKET AND FEASIBILITY STUDIES

Developers rely on *market research* to make decisions throughout the development process. Textbooks on marketing and market research seldom cover real estate in great detail. Likewise, real estate textbooks often fail to connect market research to broader marketing principles. Yet the connection is critical. Developers, planners, public officials, lenders, and investors need to apply the fundamental concepts of marketing to make better-informed decisions and control risks. That means they must gather information—and information carries a cost. The cost of a market study depends on what the level of detail is, who performs the analysis, and how much rigor a developer wants (or is required) to pay for. As with

all risk control techniques, the developer must weigh the cost in relation to the magnitude of the risk.

Developers look for indications of the kind of space that will satisfy the market's needs over a project's long expected life. The future is not just the one year or five years that it takes to develop a project; it is the entire useful life of the project, which may last 50 or 100 years. Although the market analyst scrupulously examines past performance and is exacting in determining current market conditions, it is what the analyst has to say about the future that matters most. No one can fully anticipate the future, but the developer's challenge is to be at least a few steps ahead of the pack.

A feasibility study completes the analysis (see chapter 13 for details). Simply put, the project is feasible if its estimated value exceeds its estimated costs. Value is a function of projected cash flow and a market-derived capitalization or discount rate (defined in chapter 11).

DESIGN: NEVER AN AFTERTHOUGHT

Good design has never been more important than it is today. Serious attention to the market—the people who will use the project—can show developers and their architects and planners how to capture market share from competitors or how to build for a new niche.

Design is a tool for connecting with and discriminating between specific market segments. Building designs convey direct messages, and architects have had to become proficient in creating appropriate ones. It is important to remember that for some uses and certain tenants, the appropriate message is pure functionality—that is, the most functional bay sizes and core elements, covered with a skin whose operating costs are low.

Each player in the development process brings some expectation of how a completed project will look and function. For example, stakeholders who want to maintain a town's character are concerned about continuity, context, preservation of a way of life, and interactions with surrounding areas. The developer brings her own aesthetic preferences and

In Portland, Oregon, the Brewery Blocks is a mixed-use urban community encompassing seven buildings on five contiguous blocks. The project transformed a deteriorated warehouse district into a thriving neighborhood.

her vision for the project. Financial sources may be reluctant to depart from proven designs—and market successes—of analogous projects. The developer charges the architect and design team with resolving the diversity of expectations into a single, coherent image. Still, the ultimate responsibility for a suitable design rests with the developer.

Design is about far more than aesthetics. Architect Louis Sullivan coined the phrase "form follows function" in the late 1800s, and today it is truer than ever. Sustainable design that is softer on the environment and more energy-efficient and cost-effective to manage over time wins out over beautiful but less functional design. Today's architects, landscape architects, and other designers take a holistic approach, considering a host of factors when designing a new project or redevelopment. Their goals include making the most of the site and

location, minimizing energy consumption, using the most environmentally friendly materials, conserving water, enhancing indoor air quality, and optimizing long-term operational practices.[1]

EVOLUTIONARY CHANGES IN THE DEVELOPMENT PROCESS

Evolutionary changes in the process in recent years have required adjustments to the time-honored eight-stage model. These changes are noted here and illustrated in later chapters.

Availability of Data

Good developers have always relied on a great deal of background information gleaned over a lifetime of conversation, observation, and reading—newsletters, newspapers, academic journals, websites, and the

like. Data are fundamental to sophisticated players in the marketplace. More accurately, the ability to turn raw data into useful information often makes the difference between profit and loss.

Throughout the discussion of the eight-stage model, this book refers to a host of traditional information sources. What is new is the extent and delivery capacity of the information available today. Technology now makes vast databases easily accessible to the development community through the internet. Companies such as SNL Financial provide real-time information on the financial condition of publicly traded real estate companies. CoStar provides a sophisticated online commercial-property equivalent of a residential multiple-listing service. Websites such as GlobeSt.com and crenews.com send out daily market summaries that focus on national and regional news in commercial real estate. Most cities have local business journals that maintain websites that contain real estate sections. Moreover, it is easier than ever to find property listings and potential prices through websites such as LoopNet.com, Zillow.com, Trulia.com, and many others. And many more websites and resources continue to come online. The result is that the internet continues to make more local, national, and international market information ever more accessible, leading to better educated investors, developers, owners, tenants, and residents.

Technology and Social Media

The rise of technology and social media has had a profound impact on the evolution of real estate. As technology continues to improve, so do construction practices. New building techniques accelerate the pace of construction as well as boost its safety. The way that property owners and tenants interact with real estate is changing drastically from just a few years ago. People can now monitor their utility consumption and set certain preferences through online portals and smartphone applications. Rent can be paid online, and expense tracking systems can provide minute-by-minute analysis. These continuing technological advancements change the way people

live in and use their built environment. "Smart" homes and office buildings are becoming the norm.

Social media, in particular, have grown in importance. Most property management firms have websites that include a messaging component or Facebook groups for their properties through which residents can communicate about upcoming events and happenings at a development. Twitter provides almost instantaneous news on transactions and other activities. Websites and smartphone applications such as Flickr and Instagram enable users to share pictures of their apartments or the hotels they visit. These changes in the way people interact provide a convenient medium for reaching a larger audience with more information. There is no doubt that advances in technology and the spread of social media will affect the evolution of how people select and interact with real estate. Most important, the new technological possibilities will influence what consumers want in their built environment.

Sustainability

A few years ago, sustainability and green building methods were interesting buzzwords. Now sustainable and green development is often a legal requirement, as detailed in chapters 7 and 8. Many professional organizations now offer resources and services related to sustainable and green building techniques, as well as education on the value of sustainable practices to developers and investors. Groups such as the Rocky Mountain Institute provide comprehensive guides like, "How to Calculate and Present Deep Retrofit Value for Owner Occupants," which focuses on demonstrating the creation of value through sustainability.[2] The U.S. Green Building Council has created its LEED (Leadership in Energy and Environmental Design) rating system, which offers building owners and operators a framework for identifying and implementing practical, measurable solutions for green building design, construction, operations, and maintenance. It is heavily used by local jurisdictions for project approvals.[3] Going forward, sustainability and green building will be staples of the real estate development process.

A Much Longer Venture Capital Period

Chapters 10 and 11 cover the traditional financing cycle, which moves from land acquisition financing to land development financing to construction financing to permanent financing. This sequence still holds, but the time required to move from the early stages to the closing of the construction financing has lengthened. Why? Because building sites in infill locations are more complex and negotiations are more difficult as ever more participants enter the development process. Why does this matter? Because the cost of funds is considerably higher in the early stages of the development process. A lender putting up money for hard construction has relatively high-quality collateral. A lender or investor putting up the capital needed to carry out planning work and political negotiations over a period of many years before construction can start does not have good collateral. In fact, at this stage, financing is much like the financing that a venture capital company would extend to a new small business. If the business fails, not much is there to liquidate and sell. The longer time period before construction means a longer venture capital period and thus a longer need for expensive financing. This issue significantly affects how relationships among the development team are structured throughout the first five stages of the development process.

Feasibility from Another Perspective

It has always been important to understand the feasibility of a project as well as the feasibility of continued participation by all members of the development team. As the process grows more complex and the venture capital period lengthens, it becomes more important to focus on feasibility for the individual members of the team, sometimes called "level two" feasibility. As the timing of a project gets extended, everyone has to worry about how they personally are able to manage their finances and careers during what could be a long period with little or no cash inflow. As discussed throughout this book, it is the developer's responsibility to consider the viability of the venture for each member of the development team.

Wall Street (and Related Avenues)

During the 1990s, securitization became much more important in real estate investment. As will be explained in the chapters on finance, few large, publicly traded real estate companies existed before 1990. In fact, the market value of all REITs then was less than $10 billion. Today, with an equity market capitalization of more than $650 billion, REITs are included in numerous stock market indexes, such as the S&P 500.[4]

This change has had two obvious impacts on the development environment. First, it created a new level of reporting and thus made information more available. The Securities and Exchange Commission requires public companies to report their financial status, and Wall Street analysts provide considerable commentary on these public companies. Second, the investment banker mentality has hit real estate development because the major investment banks are now actively involved. In addition, large private equity firms such as KKR (of *Barbarians at the Gate* fame), Apollo, Blackstone, TPG, and the Carlyle Group now have extensive investments in real estate. Wall Street moves to a different beat than the commercial banks, insurance companies, and wealthy families that have traditionally financed development. To find the right investment partner, today's developer must contend with a faster-moving and often harsher world.

Increased Pressure on the Public Sector

A primary theme of this book is that the public sector is always a kind of partner in the development process. The evolution of community planning, environmental safeguards, hazardous waste cleanup, and other concerns has produced a more complex approvals environment. Government officials at all levels are under tremendous pressure to perform better (often with fewer resources) and to deal more rapidly with this more complex environment.

SUMMARY

As the book moves forward with the introductory framework in chapters 2 and 3, it is important to keep the following concepts in mind:

- Everyone is in some way connected to the development process. Consequently, the developer should see the public sector as a partner.
- The developer ultimately is responsible for creating buildings and spaces with appropriate associated services that meet society's needs over time.
- Because the decision-making environment of the development period is complex and interactive, a model is useful for evaluating the future ramifications of current decisions.
- Real estate development is an art that requires drive and creativity coupled with appropriate flexibility and risk management.
- Development of the built environment is a long-term activity that justifies considerable planning. Early consideration of future operational management needs should be a critical element of such planning.

Few people have the background needed to connect all the aspects of the development process. Readers of this book should skim the areas where they have the background to make the connections and focus their attention on the areas where they are less proficient.

TERMS

The following terms are introduced in this chapter:

- Asset management
- Built environment
- Capital markets
- Development team
- Entrepreneur
- Equity
- Feasibility studies
- Infrastructure
- Institutional investors
- Interdisciplinary
- Leverage
- Market research
- Operating costs
- Private sector
- Public sector
- Risk control
- Value

REVIEW QUESTIONS

1.1 What is real estate development?

1.2 Why does every real estate development project involve both the public and the private sectors?

1.3 What is the role of the developer in the development process?

1.4 What are the eight stages of development as delineated in this textbook?

1.5 What are the advantages of using such a model? What are the pitfalls?

1.6 Why is real estate development inherently an interdisciplinary process?

1.7 Why and how do developers use market research and feasibility studies?

1.8 Discuss the importance of good design in development.

1.9 Discuss the many roles a developer must play.

1.10 What role does time play in the real estate development process?

NOTES

1 www.gsa.gov
2 www.rmi.org/retrofit_depot_deepretrofitvalue
3 www.usbc.org/articles/about-leed
4 www.reit.com/REIT/REITbytheNumbers.aspx