More About Development…

Real estate development is a multifaceted business, encompassing activities that range from the renovation and re-lease of existing buildings to the purchase of raw land and the sale of improved parcels to others. Developers are the coordinators of those activities, converting ideas on paper into real property. Developers take the greatest risks in the creation or renovation of real estate--and receive the greatest rewards. Typically, developers purchase a tract of land, determine the target market, develop the building program, obtain the necessary approvals and financing, build the structure, and lease, manage, and ultimately sell it.

Development is a detail business. Successful developers know that the clause overlooked in a title policy or the soils test skipped can come back to haunt them. They also know that they are ultimately responsible for any omissions and mistakes. Even if someone else is negligent, developers must deal with the consequences. Developers know that it is best to double-check everything.

A developer must always be responsive to events as they occur--a good developer is ready for the unexpected, flexible, and prepared to shift strategy quickly. During the approval process, for example, a developer often must negotiate with neighborhood groups that seek major changes in a proposed project. If the developer is not willing to compromise, the group could have the power to kill the project altogether. A developer must be able to address citizens' concerns without compromising the project's economic viability.

Managing the development process requires special talents--not the least of which is common sense. Developers must have a clear vision of what they want to do; they must also provide strong leadership along with that clear vision. Developers by nature have strong egos and opinions, but they must be good listeners; developers cannot possibly be authorities on all the many different fields of expertise involved in a project.

Developers work with a variety of people: building professionals including architects, planners, contractors, and consultants; people in the construction trades; tenants and customers; attorneys, bankers, and investors; city officials, city staff members, inspectors, and citizens' groups; homeowners' associations; and community organizers. They must know at least something about dozens of subjects, from managing people to managing buildings. No developer is an expert in all areas. Success comes from knowing the questions to ask and of whom to ask them, what the common practices and rules of thumb are, and how to identify worthwhile advice and information.

The spark of creativity--in design, financing, and marketing--often separates successful developers from the rest of the field. Like any creative or artistic endeavor, managing the creative process and people can be extremely difficult. Too much guidance may stifle creativity; too little may lead to unmanageable results. Obtaining creative, exciting work from the team without exceeding the budget is one of the fundamental challenges of management.

Real estate development is an organic, evolutionary process. No two developments are exactly alike, and circumstances within a development change constantly. For beginners, development often appears easier than it is. Most beginning developers have to work twice as hard as seasoned professionals to keep events moving in the right direction. At some point in almost every deal, developers wish they had not become involved; at this point developers discover how badly they want the deal.

Solving problems as they occur is the essence of day-to-day development, but learning to expect the unexpected and never leaving anything to chance may allow for fewer problems, less stress, and more satisfaction in one's career. Laying the necessary groundwork before an important meeting, arranging an introduction to the best prospective lender, creating the best possible setting for negotiations, and knowing as much as possible about the prospective tenant's or lender's needs and concerns before meeting with them, helps to ensure success for a developer.

Requirements for Success

Developers take risks. At the low extreme, developers may work for a fee, simply managing the development process as agents for other investors. They might incur a small degree of risk from investing some of their own money in the venture. At the other extreme, developers might be fully at risk, investing the first money in the project, taking the last money out, and accepting full personal liability. Failure could mean bankruptcy.

Beginning developers usually must accept greater risk than experienced developers do, because beginners lack a strong bargaining position to transfer risk to others. They often must begin with projects that, for whatever reason, more experienced developers have passed over.

Many people are attracted to development because they see or hear about the wealth and glamour of the most successful developers. They read about black-tie openings and visit high-rise office buildings and regional shopping centers that mark the major leagues of real estate. To be sure, development offers enormous rewards, tangible and intangible, and the feeling of accomplishment that comes from seeing the result of several years' effort is worth the trouble and sleepless nights along the way.

Development's tremendous risks, however, require a certain kind of personality. Individuals must be able to wait a very long time for rewards. Three or more years often pass before the developer sees the initial risk money again, not to mention profit. As a rule, rather than the exception, two or three times during the course of development developers risk losing everything. Developers live with uncertainty. Events almost never go as planned, especially for beginning developers, and projects almost always seem to take twice as long and cost twice as much as initially expected.

Development also can be extremely frustrating. Developers depend on many other people to get things done, and many events, such as public approvals, are not under the developer's control.

Even the smallest projects today typically require $50,000 to $100,000 cash upfront just to determine whether or not the developer can obtain a construction or development loan. A developer never should begin a project without at least twice as much cash available as seems necessary to get the project to the point where other funding is available. The upfront cash is only part of the total cash equity that a developer will need to complete a project. Most lenders today require a developer to invest cash equity to cover 20 to 30 percent of the total project cost. The total cash equity need not be in hand or even sufficient to purchase the land, but it should carry the project through to a point at which the developer can raise other funds from investors or lenders.

Expecting the unexpected is one lesson every person must learn en route to becoming a developer. Fortunately, the development process becomes easier as developers gain

experience and undertake successive projects. Instead of waiting for a bank to provide a loan, developers may discover that lenders are calling them to offer to do business.

Nevertheless, the most difficult project is the first one. If it is not successful, a beginning developer may not get another chance. Thus, selecting a project that will not cause bankruptcy if it fails is imperative. Because of increasing difficulty in obtaining public approvals and financing, a developer should not be surprised if five or more projects are attempted before one gets underway. John Dawson, a real estate representative with McDonald's Corporation, says that out of 100 sites that he looked at recently, he signed earnest money contracts and paid for feasibility studies on five. None of the sites proved to be developable.