Development Process Map

Presentation Narrative

INTRODUCTION

The development process often feels chaotic, haphazard, and arbitrary, especially for new participants or outsiders. It often seems "more difficult than it should be," a process where you take "one step forward, and two steps back. This dynamic is not only frustrating, but it can compound the challenges that are already inherent in the development process if stakeholders – especially interested local residents and local leaders – interpret what can be "natural" fluctuations as evidence of bad faith or poor capacity. Yet, unscrupulous developers can take advantage of this confusion when local stakeholders and officials do not have some core understanding of the process allowing them to hold developers accountable.

To help counteract these concerns and to empower local communities, we have developed the Development Process Map to help stakeholders, local officials, and grassroots organizations better understand the process.

The Development Process Map provides an overview of the development process. At a high level, the process map is a simple matrix. The "columns," moving left to right, follow a project through typical "stages," from forming the concept, to testing its feasibility, putting the deal together, actually building it, and eventually into an operations or sale phase. Key "go/no go" decision points mark the end of each stage. If a solid "go" decision cannot be reached, the circular nature of development comes into view as earlier stages must be updated, reconsidered, or changed altogether to (re-)form a viable development concept that can move toward fruition.

At the same time, development is an interdisciplinary exercise, involving a range of perspectives and professionals. In general, the "rows" or "channels" in the matrix follow the progression of key disciplines or issue areas. These include market, site, design, construction, finance, and project management. In some cases, the channels made "overlap" into each other as a project progresses. For example, design eventually transitions to construction, and market evolves from assessment, to testing, to marketing, and eventually into ongoing property management.

Forming the Development Concept

The initial phases of the development process are often the most amorphous. Community-based organizations rarely start with the primary goal of becoming real estate developers. Instead, development is usually the means to an end. An organization may be concerned about youth in the community, the need for more or better greenspace, improving the health of the community, serving the needs of homeless or other special needs populations, or improving the look and feel of their neighborhood. The decision to become involved in development often evolves from the underlying purpose and goals of the organization.

We begin with Forming the Development Concept. At some point, when approaching either a site or a community need that the "private market" has not been able to address "on its own," community groups often find themselves asking "If not us, then who? If not now, then when?" And they begin to explore how they can help move an idea from concept to reality. At this early stage, there are several channels of information coming together and interacting with one another.

MARKETING

When starting from a given site, the first step in the market channel will be to begin testing alternative uses for the site. We know *where* we want to do something, now we have to figure out *what* we want to do. Which community needs might be addressed by developing this site in a given way? What do local stakeholders and leaders "want" to see? What is possible?

DESIGN

For a given *use* (the what) we can begin to define the type of site we need. How big must the property be? What characteristics must it have (or must it not have)? For example, many retail/franchise chains have very specific formulas for site selection, identifying specific minimum and maximum acreage standards, requirements for daily traffic counts on nearby roads, proximity to other complementary or competing uses, etc.

When working from a given *site*, however, as potential uses are explored and tested against market information and perspectives, assessing the physical aspects of the site help inform the choices that might be made. Are there specific architectural or engineering constraints – like the presence of wetlands that might limit the size or placement of structures? Are there legal considerations that must be accounted for? This might range from zoning requirements that allow certain potential uses and not others to liability concerns resulting from prior uses of the site.

Whatever the starting point, the market and design channels eventually come together to identify a specific use for a specific site. When the *what* and *where* have been married together, a more specific market goal can be established and initial conceptual plans for how the buildings on the site might be laid out – given physical and legal limitations – can be developed.

FINANCE

If a development concept is going to move beyond the idea stage and become an actual project, it must be financially feasible. Early on, much of the focus is going to be on estimating a rough cost. As the specific site and building plan start to come into focus, experts can begin to develop "back of the envelope" projections on cost. These are often based on very general industry standards like a total cost

per square foot for commercial construction or initial information about items like the asking price for a given property or prior estimates that were done to quantify potential environmental remediation costs.

As greater specificity is provided by the design team, rough cost estimates can be refined further taking into account early projections of the size and type of buildings, special construction issues driven by site characteristics, and the like. In turn, this allows the development of an initial financing plan, where commonly available sources of financing are "penciled into" a project in an effort to determine its feasibility.

For most projects undertaken by community-based organizations (or those promoted by local government) there will be an initial gap between initial cost projections and commercially available sources of financing. This is where various forms of public or philanthropic financing come into play, ranging from below-market financing to tax credits to grants to soft loans or other forms of direct financing. It is just as important to gauge the realistic likelihood of receiving such funding as evaluating the financing that may be commercially available. Specific uses also have access to specific funding sources. Affordable housing and other types of economic development projects often can take advantage of special pots of money.

As the development concept comes together, an initial financial plan can be assembled identifying the estimated and likely sources and uses for the project. While much can change later, this provides an initial roadmap that will be supplemented later with much more specific information.

PROJECT MANAGEMENT

This is a critical part of the process and deserves us spending a little time walking through it. It will help you and your community get a sense of who's doing what and what everyone's responsibilities should be.

The idea of a development process presumes the presence of a developer. In a "normal" project, the developer is at once the playwright and the director. She dreams up the story, writes the script, and will lead the interdisciplinary team that turns the written play into a full-blown performance, one that, if successful, will attract throngs of theatre goers.

For many community-driven projects, however, the process is somewhat different. Community stakeholders, whether nonprofit organizations or local officials, may have identified a need, determined that sufficient demand exists to put on a play, and selected the script. But for many reasons ranging from a lack of capacity to risk aversion to their own sense of the organization's appropriate role, they may not be in the position to direct the play. In such cases, the community stakeholders may determine that their role should be limited to that a patron or sponsor – helping to support the project development concept by recruiting a director, offering up the venue (i.e. donating or selling the site), helping bankroll the initial investment needed to hire actors and build the set, or even contributing to the "audience" by pre-purchasing tickets (i.e. agreeing to lease a portion of the project upon completion).

Once the developer has been identified, however, the execution is ultimately her responsibility. A myriad of decisions will be made along the way that will affect the ultimate performance. At this stage, the developer will engage a team of professionals – the development team – to assist in the project. As with most plays, there will be major and minor characters. Key roles include the *market analyst*, someone highly skilled in evaluating the business climate for the proposed use of the site, assessing the likely

demand for the product being offered, and providing insights to help refine and shape the product to maximize value. The *architect* is responsible for taking the initial ideas about what to build and fleshing them out into detailed plans and specifications, telling the *builder* (or general contractor) exactly how to build the structures. In most cases the architect will be supported by various engineering disciplines including civil and structural engineers and others such as landscape architects or interior designers.

Experience *legal counsel* is vital and must be engaged early in the process. Not only will they have input on contracts with development team members, but projects that are community driven often involve complex development agreements with various public entities that may be contributing to the project in one way or another.

Depending on the skill and experience of the developer, other consultants who specialize in obtaining financing, especially from public funders, or layering multiple funding sources together for complex projects may be employed.

Finally, while the project is still at the conceptual phase and may be years away from completion, engaging *marketing* (leasing/sales) and/or *property management* professionals early on is common too. For residential real estate in particular, the realtors or marketing agents who will ultimately be showing the property to potential residents and the property management company that will have day-to-day oversight of multifamily properties (including condominiums) often have valuable insights about how to design and build a project to make ongoing operations more effective, efficient, and attractive to potential clients.

To effectively manage the development team, the developer will need to clearly articulate roles and responsibilities, carefully select the development team — ensuring that team members not only have the necessary specialty skills but also function effectively together (to use the metaphor of the play, many productions have been plagued by a diva-like star who does not know how to play well with others) – and develop a system or process for overall project management.

This may, in relatively small projects, be as simple as developing good “to do” lists and holding regular team meetings to track progress. But in many cases, more complex project management systems, which can include software packages, include Gannt chart approaches, outlining relative timelines between steps and critical path perspectives, highlighting inter-relationships between different quasi-independent paths will be necessary.

Feasibility

As a project moves from the conceptual stages toward establishing feasibility, a developer will begin to expend funds. Because development is a risky proposition, however, the development process tends to proceed in ways that allow at-risk funds to be expended incrementally, constantly testing the waters before wading in deeper.

The point of feasibility review is to drill down, moving from general rules to thumb to project-specific projections, and making sure the developer can, as much as possible, identify all the details and justify

projections with supporting data. If, on closer review, the development concept is not likely to be feasible, the process starts over.

To use a different analogy, forming the development concept is like dating. You may go through a lot of first dates to find someone who matches what you're looking for and for whom you are a fit. Feasibility is about really getting to know each other, flaws and all. In some cases, this phase ends with a breakup and re-entry in the dating pool. But when the development concept proves to be sound and attractive, by the end of the feasibility phase, you're engaged. The future direction is clear, but you're not married just yet.

MARKETING

When designing the development concept, some level of attention to the market for the project was paid. At the early stage, the market data being used tends to be that which is readily available – census data, government data on regional economic activity, information from past community planning initiatives, etc. – but once a specific use at a specific site have been identified, the developer must begin collecting more rigorous market data that tests the viability of the proposed project.

In some cases, if a specific user (i.e., tenant) is known, this may be as simple as beginning discussions about the needs and desires for project and the budget for ongoing leasing and/or ownership costs. But in most cases where a project may need to serve a mix of potential tenants (or buyers) many of which may not yet be known, more formal market analysis may be needed.

SITE

As one developer properly puts it, "without site control, all you have is an idea." In many cases, the goal is to redevelop a given site, often one that is locally important but challenging, maybe one that is publicly owned. But whether in public or private hands, once the development concept has been deemed worth pursuing, the developer must obtain control of the site. Usually, this is done through a "purchase option" that gives the developer an exclusive right to purchase the property at a given price for some period of time but does obligate the developer to complete the purchase. Usually, an option includes a nonrefundable payment to the seller to compensate for holding the property off the market while the developer works to put the full transaction together. But by not obligating the developer to complete the purchase, the developer can choose to "cut bait" if further due diligence reveals that the development concept is not feasible and unable to proceed.

DESIGN

At the conceptual stage, the architect likely focused on rough footprints for where structures might be placed on the site. It was not yet necessary to get into great detail about what exactly the building would look like, how the interior space would lay out, etc. And by not getting "too far ahead" the developer could limit her costs by not doing more than necessary when the project was still just an idea. Progressing into the feasibility determination phase of the development process, it is necessary to take the design beyond "generic boxes" and begin developing initial schematics that include elevations (i.e. drawings showing the face of the building(s) from different directions) and initial floorplans that lay out in general form how different spaces (e.g. residential units or commercial storefronts) are likely to fit together in the overall building.

FINANCE

For purposes of forming the development concept, initial economic viability was roughly calculated using "back of the envelope" industry norms and high level assumptions, as the developer moves into the feasibility stage, more refined projections are needed. A detailed proforma will be developed and will be informed by the project-specific due diligence being conducted in the market, site, and design channels already discussed.

The total development cost is now being updated based on site-specific information and investigations. For example, environmental testing results allow the developer to make more accurate projections of remediation and cleanup costs, and specific design decisions being made, influenced by zoning and other local requirements, similarly inform more precise construction cost estimates. A "gap" between total costs and commercially available financing exists in many projects undertaken or promoted by community-based organizations and local stakeholders.

Quantifying that gap allows the developer to begin approaching public sources (e.g. various tax credits/incentives, public financing/grants/cost sharing, etc.) or private philanthropic sources like foundations, angel investors, and the like. At the same time, the developer will begin discussing the specific project with commercial lenders in an effort to find the best financing package available and beginning to negotiate transaction terms. Throughout this period, the project's proforma will be constantly updated with refined projections, and often the developer will use different "what if" scenarios to test the impact of various financing options, design choices, and more or less aggressive (optimistic) revenue projections.

PROJECT MANAGEMENT

When forming the development concept, the developer began to recruit and select her team of professionals. But like a sports team working its way through the preseason, it may be that certain core team members – the star quarterback and his primary receiver – are clearly "on the team" but other role players have not yet been selected or are effectively still "trying out." By the end of the feasibility stage, the need for specific role players – like a specialized environmental consultant – should be clear and those members should be selected.

Intermission: Questions to Consider

1. What's been the outreach strategy to engage community residents in this process? Has the community provided ideas to the development team on how to achieve turnout at community meetings?

2. Does the community know the development team? Has the due diligence been done on the projects they've previously completed? Were they receptive to community input?

3. How well does the community know each other? Are community members on the same page? Or are there differing opinions that need to be discussed?

4. Does the community — residents, neighborhood organizations, elected officials — have to reconcile potential differences between what the data says and what the community experiences? At times there may be a gap.

5. Are there financing gaps that will not allow the project as envisioned by the community to go forward? How does the community plan to prioritize?

6. Successful projects can be catalysts for broader neighborhood improvements. How does the community plan to contribute to those broader neighborhood improvements?

7. Is there a plan for ongoing communications and cooperation with the owners and operators of the building? How can community members welcome new residents and/or businesses to their neighborhood?

Dealmaking: Planning & Financing

If the end of the feasibility stage is like getting engaged, the dealmaking phase will culminate in the wedding. But this stage involves a great deal of planning and negotiating. No detail is too small – whether that means working out the seating chart so Uncle Joe has a good seat but isn't likely to run into his least favorite brother-in-law or, in the case of development, picking out the carpet colors, plumbing fixtures, and maybe even the furniture. And while love may be in the air, it is also when we work out an iron-clad prenup. Of course, in the case of development, there is not just one agreement but a whole series of interrelated agreements that bind the parties together. As with relationships, the closer one gets to closing the deal, the higher the cost of walking away, but until that the point things can still fall apart leaving someone jilted at the altar.

MARKETING

"If you build it, they will come" may have been a memorable movie line, but that does not work in real estate. To obtain financing – especially for commercial buildings or for-sale housing – lenders often require that some portion of a project be pre-leased or pre-sold. So now is the time to start implementing the marketing strategy.

By time this phase ends and the transaction closes, the marketing effort will start to merge with the eventual "property management" plan. The plan includes clear benchmarks for the handoff of control of the building(s) when construction is complete, and how day-to-day issues like landscaping, snow removal, and maintenance will be handled.

SITE

As the project moves closer to the final *go/no go* point of closing, the developer will submit formal applications for needed government approvals. This usually involves various zoning reviews, site plan approvals, and the like. Depending on the project and the area, this may involve a series of other approvals, often from multiple layers of government. For example, zoning and site plan may be under the purview of the City and its planning commission, while various incentives or public financing approvals

may come from quasi-independent boards or authorities. Regional infrastructure authorities or utility companies may have to sign off on the project before it can access needed utilities. Other public funding approvals may come from state or even federal agencies. Projects on environmentally sensitive or waterfront sites may be subject to a host of other reviews and approvals on issues ranging from storm water, wetland, and flooding concerns to protections for native or endangered species.

DESIGN

From rough "boxes" placed to specific elevation and floor plan schematics, in the dealmaking phase design moves on to construction drawings (i.e. blueprints) and the development of specifications. Instead of just giving a look at the finished product, construction drawings provide details needed to build the project, down to instructions about where to place electrical outlets and heating/cooling vents and what type of carpet to install in common hallways. These will be used not only to obtain building permits and potentially other public approvals, but they provide the basis for obtaining firm construction pricing.

FINANCE

We continue to revise and refine the project's proforma. Back of the envelope rough numbers gave way to professionally informed project-specific estimates, and now as dealmaking progresses actual contracted amounts can be filled in based on pre-leasing activity, firm bids for construction, and the like. The budget should still have contingencies built in — a pot of money "just in case" — because no project ever performs exactly as projected. Despite the numbers not being guaranteed perfect, the level of expected "deviation" gets smaller.

This can be a delicate stage, especially for projects with complex financing plans involving multiple "layers" of conventional and public funding. The developer will need to navigate overlapping and sometimes contradictory starting expectations from different funders and ensure that discrepancies are resolved. Because most funders do not "lock in" certain financial terms (especially interest rates) until the very last minute, small shifts in the broader financial markets can require last minute adjustments to the "deal" and, in extreme cases, lead to a project's failure to proceed.

Specific applications are made for all forms of financing, public and private, and specific deal terms are negotiated. Many projects will require that developers, or in some cases other parties, put up equity (at risk cash that ensures the developer has "skin in the game") and/or a variety of financial guarantees, promising to put up additional funding to ensure construction completion in the case of cost overruns or to fund operating deficits if actual lease-up rates prove lower than expected once construction is complete.

PROJECT MANAGEMENT

The dealmaking phase can be exhausting for the developer. The process is highly interdependent, and many factors are beyond the control of the developer. For example, a freak power outage that delays a City Council meeting at which a tax incentive was going to be approved might lead a project to miss an application deadline for below-market rate financing from a state government agency. The delay while waiting for the next application cycle, in turn, leads to changes in the interest rate for the primary financing

and increased construction costs as revised construction timeline involves building through the winter or a rainy season.

In general, the developer's role is to hold the contracted professionals accountable for producing their contributions to the overall effort and for choreographing the complicated dance between all the different "channels" and outside parties that must converge for a closing to take place. Throughout this phase, the developer will be negotiating – usually in multiple rounds – seeking to reconcile different expectations from different parties to the overall effort. This can include not just the funding sources involved, but ensuring that the design team incorporates last minute changes requested by the planning commission, for example, and that those same changes are communicated to the contractor and reflected in the pricing.

Project Construction

Closing is a major milestone, and one that like a wedding is often the cause for celebration. The development project is definitively real, and barring a catastrophic situation there is no backing out now. Despite euphoria of the honeymoon period immediately following closing, there is still much to do in the construction phase and a great deal to coordinate to ensure that relationships now cemented remain strong.

MARKETING AND PROPERTY MANAGEMENT

At or immediately following closing, the developer is likely to sign contracts with the marketing and property management team. In some projects these duties may be split, with a real estate agent responsible for sales (e.g. of condominiums) or leasing (for residential and/or commercial tenants) and a property management company eventually taking day-to-day control of activities like maintenance, janitorial or landscaping, etc. For multifamily rental projects, the same company may be responsible for all marketing, leasing, and property management duties. And, of course, it is common for the developer, often through a related-party entity, to keep these responsibilities "in house."

In commercial projects, the marketing and property management team will help coordinate communication between tenants who have preleased spaces and the construction team, making sure that any changes to the timeline are clear to all concerned and that any "tenant buildout" activities included in the construction contract are properly communicated.

FINANCE

From a finance standpoint, the construction phase is largely about drawing down funding sources when needed to ensure the contractor and other costs (interim insurance, property taxes, marketing cost, etc.) can be paid when due. Communication will be key, as many funders – especially public funders – have detailed reporting requirements that must be met to access funds, and even conventional lenders require substantial paperwork be submitted to track actual progress against the draw schedule and various other requirements. If delays, cost overruns, or other construction issues affect the draw schedule or create gaps in the overall project budget, it is critical to address them as early and directly as possible with a project's funders. So constantly tracking the impact of any changes on the proforma.

PROJECT MANAGEMENT

As the director of a complicated and dynamic "live performance," the developer continues to coordinate, communicate, cajole, and encourage the various "actors" throughout the construction period. The spotlight is on construction, and in some projects the developer will hire a specific construction manager to represent her interests and keep that portion of the process moving. But as noted early, the marketing and property management team needs to be engaged, and funders need to be informed of the project's progress, any hiccups, and how issues are being addressed. As the process progresses, a smart developer will make a concerted effort to keep the neighboring residents informed of how the project is moving along. As the building nears completion, the developer usually plans a grand opening or other similar event. This serves at least two distinct purposes – publicizing the availability of the project to the public thereby helping to ensure the project's economic success by attracting additional tenants or buyers or customers for the commercial tenants in the building and recognizing the efforts of the many partners and stakeholders in taking the project from concept to reality.

Operations or Sale

Following construction completion, most projects move on to an interim phase of lease-up and stabilization, meaning there are relatively certain operating expenses and income. The day the contractor turns over the building, it is ready for occupancy but not yet occupied. Financially this means there is little to no revenue coming in from tenants, but operating expenses are already going out. If the building was pre-leased, then this period may be short, but in many cases even with key pre-leases in place there may be spaces that still need to be marketed in order to reach a point of stabilized operations. After that point, ongoing attention will be needed to sustain that stability and manage future changes as tenants turnover, markets change, and the building ages and requires increasing maintenance and eventually infusions of new capital. For-sale projects may not have the same timeline, at least for the developer, but few projects are fully pre-sold and even those that are will need to actually close.

MARKET OR MANAGEMENT

Once the development is stabilization, the property management team will be responsible for the day-to-day operation of the project, keeping tenants happy and managing turnover as original tenants move out and new tenants are identified to move in. They need to develop and track annual budgets, adjusting to "conditions on the ground" and ensuring that the project is meeting its financial obligations in the short term, hopefully without sacrificing long-term success of the project (the tracking of which brings an *asset management* perspective into play).

DESIGN AND CONSTRUCTION

During stabilization and even for the first year following construction completion, the design team and contractor may have some responsibilities. Mostly this will entail any warranty repairs from the contractor for items that were not apparent at final inspection.

FINANCE

Until now, most projects are operating on "construction financing." Once a project is stabilized, it can close on its permanent financing, which usually offers lower rates and long-term amortizations. If a project has not met its economic benchmarks, the developer may have to infuse cash to the project, defer the receipt of developer fees, or otherwise restructure the financing to ensure it is viable – as defined by the lender – in order to close, payoff the construction loan, and otherwise move into the operations phase. Following closing, many projects will be required to submit ongoing annual financial audits and performance reporting to its investors – especially if there are public funding sources involved or equity investors who may be due a defined share of operating profits.

PROJECT MANAGEMENT

If development projects are like children, each one unique but usually progressing through a series of predictable milestones on a general schedule within a normal range of variance, then construction completion could be seen to represent a project's birth. The job of the parent (i.e. the developer and now the owner) is by no means complete, it is only just starting. The "team" of people supporting the developer may be smaller with ongoing reliance on the in-laws, babysitters, and some close friends and neighbors but no longer needing the obstetrician.

The owner must still manage the team, making sure the development is properly managed and maintained, bills (especially the mortgage) are paid on time, and that proper reporting to all concerned is submitted.

Conclusion

For more information on how to prepare communities for the real estate development process and other helpful tools, visit www.groundworkusa.org/development.