

# CHAPTER 16

## FINANCING PROJECT DEVELOPMENT

### Importance of Market and Feasibility Analysis

- Studies provide market participants with specialized market information.
- Studies represent the principal source of information for design-related questions.
- A market analysis is included in the loan submission package for commercial loans.

### Types of Market Studies

- **Site-Specific Market Studies**
  - **Highest and best use**
    - Determine how to best use a particular site
    - Of vacant site: to determine value of land
    - Of improved property: to determine improvement rent and values

### Types of Market Studies

- **Site-Specific Market Studies**
  - **Pre-determined use studies**
    - Determine demand and supply of a particular use
  - **Marketability studies**
    - Determine how to best market a project

### Types of Market Studies

- **Feasibility studies**
  - Broader in scope than other market studies
  - Determine whether a proposed project will meet the objectives of the developer/ investor.
  - Typically includes:
    - Market analysis: (e.g. analysis of supply and demand)
    - \*Financial analysis: (e.g. forecasts of expected cash flows, development and financing costs, IRR and NPV estimates)

### Real Estate Development

- **Development and Construction Business**
  - Land development: (Horizontal development) is the process of changing raw land into a usable building site. This is not always a physical process; legal entitlements could suffice.
  - Building development: (Vertical development) is the process of constructing improvements on a developed site
  - Rehabilitation: this group is ignored by the book but is increasingly an important group
- Whenever possible developers specialize by either property type or location.

## How to Determine the Real Developer?

### Developer Adds Value:

- Equity:
  - Must have money at risk
- Ownership:
  - Must have control of site
- Financing:
  - Must have financial capability to complete project
- Tenant / User:
  - Must have tenant or capacity to attract tenant/users



## The Development Team

### Standard Development:

- Engineers, Architects, Appraisers, Market Analyst, Real Estate Brokers, Attorneys, Mortgage Brokers, Tenants/Users, Lenders, Planners, etc.
- Instead of listing everyone, sometimes it helps to think of the following three groups.

## The Development Team Group 1

### Suppliers of Financial Capital:

- Equity Partners
- Joint Venture Partners
- Construction Financing Lenders
- Permanent Financing Lenders

## The Development Team Group 2

### Consulting Professionals:

- Lawyers
- Architects
- Engineers
- Marketing Agents
- Market Analysts
- Environmental

## The Development Team Group 3

### The General Contractor (GC):

- The general contractor oversees all aspects of the construction of the project.
- Subcontractors are hired by the general contractor to complete specific tasks such as plumbing, painting, and electrical.

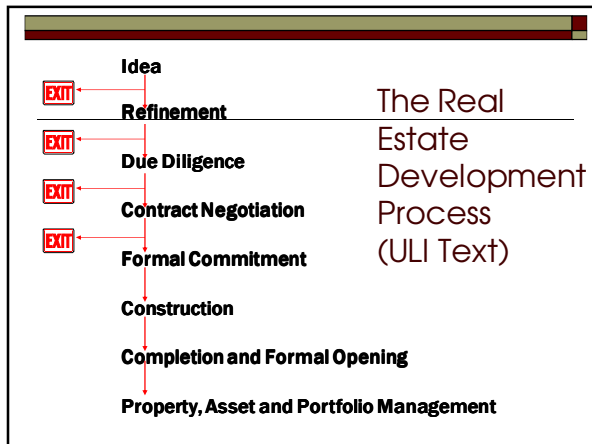
### The Construction Manager:

- The construction manager serves as the developer's on-site agent.

## The Role(s) of the Developer The "Other" Group



In a nutshell, the development team is always very small. It could easily be one person.



- ### The Development Process
- Stage 1: The Idea
  - Stage 2: Land Acquisition
  - Stage 3: Project Feasibility
  - Stage 4: The Contracts and Permits
  - Stage 5: The Improvements and Construction
  - Stage 6: Project Completion and Occupancy
  - Stage 7: Management or Sale

- ### Financing Phases
- In general, development has three phases of financing.
- 1: Land Acquisition
  - 2: Construction Financing
  - 3: Permanent Financing

- ### Project Costs
- There are three general cost groups:
- Land costs
    - Site improvements, air rights, riparian rights
  - Hard costs
    - Blue collar labor related, materials, equipment, contractor fees, shell costs of existing structure in rehab projects, and developer fees
  - Soft costs
    - White collar labor related, real estate taxes, operating reserves, insurance, financing, title, interest, architectural, legal

- ### Project Financing
- Short term financing
  - Long term financing
  - Mini-perm
  - Take out commitment
  - Stand by commitment

- ### The Construction Loan Major Components
- Methods of disbursement
    - Monthly Draw: mostly used in larger scale projects with large loans
  - Interest rates and fees
    - Usually based on short term indexes
  - Assignment and commitment letter
  - Tri-party buy/sell agreement

## The Construction Draw

□ Funds are Drawn Down from Future Advances after a construction loan is signed. The lender verifies physical construction before disbursing each Draw

Month	New Draw	Current Accrued Interest 8%	New Loan Balance
1	\$500,000	\$3,333.33	\$503,333.33
2	\$750,000	\$8355.55	\$1,261,688.88
3	\$1,500,000	\$18,411.26	\$2,780,100.14
4	And so on..	-	-

## Choosing a Lender

- **Visibility**
  - Local or national? Is the lender prominent in the industry?
- **Professionalism**
  - Does the lender understand what the developer is trying to accomplish? A good lender has seen thousands of loan situations, they can assist the developer in many ways.

## Choosing a Lender Continued

- **Service**
  - Does the lender have a reputation for fast, efficient service before and after loan closing? Time is always against the developer "Time is money"
- **Flexibility**
  - Real estate is an imprecise industry with infinite variations of structure, a good lender understands this.

## Choosing a Lender Continued

- **Reliability**
  - Can a lender be counted on to work with the developer if things don't work out as expected?
  - It is in a traditional lenders best interest to do this
  - Today developers can access much broader pools of financing and many of these newer sources lack real estate lending experience. Certain avenues of inexperienced lenders can later pose a problem

## General Requirements for a Loan Submission Package

- **Project information:**
  - Project description
  - Site plan
  - Plans and specs
  - Development team

## General Requirements Continued

- **Market and Financial Data:**
  - Financial statements
  - Projections
  - Cost breakdown
  - Lease commitments (if any)
  - Market study and appraisal
  - Loan requests
  - Equity partners

## General Requirements Continued

- Government and Regulatory Info
  - Zoning
  - Property Taxes
  - Permits

## General Requirements Continued

- Legal Documents
  - Legal entity
  - Land cost
  - Deed restrictions
  - Subordination agreements
  - Force majeure provisions

## Loan Information Interim Loan

- Permanent and standby commitment
- Plans and specs
- Cost breakdown
- Interim and permanent lender closing requirements

## Contingencies in Lending Commitments

- The maximum period of time to acquire the construction loan
- The completion date for the phase
- Minimum rent-up requirement and approval of all major leases
- Provisions for gap financing
- Expiration dates
- Approval of design changes

## Example: Cost of Office Project

<u>Item</u>	<u>Cost Totals</u>
Land	\$1,951,600
Plus: Hard costs	\$6,657,700
Plus: Soft costs	\$5,471,900
Total Construction Costs	\$14,081,200
Less: NOI during lease-up	\$2,055,900
Development Costs	\$12,025,300