REAL ESTATE DEVELOPER...WHO & WHAT IS IT?

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To better understand the job of a Developer, this paper will first begin by describing the iterative tasks a Developer must follow throughout the development process. The paper will end with a discussion of some of the overall issues one must consider when developing real estate.

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I. INTRODUCTION

There is no good definition of the word "Developer" because a Developer does more than just merely develop a piece of property. It is difficult to describe a set of tasks which best defines what one does to be (or become) a Developer. There are no set criteria, let alone ground rules or even a curriculum one can undertake to become experienced in either the multitude of development oriented tasks one incurs as a Developer or to obtain an understanding of how one develops. There are no college curriculums or MBA programs to learn about development. So, how does one become a Developer?

I am writing this paper to provide some insight into my career and experience as a Developer. The following will provide an overview of the functions and major tasks of a Developer. It will also discuss some of the major issues one must understand before one can complete a real estate development. The primary focus of this paper is towards the Shopping Center Industry; however, it can be utilized for any facet of real estate development.

II. THE ROLE OF THE DEVELOPER

For the purposes of this document, it will be assumed that the end product of the Developer's work will be a shopping center. The process by which the Developer undertakes his varied tasks does differ from product type to product type e.g., shopping center vs. residential, etc. The entitlement (approval process), may be similar between product types however, the nuances e.g., socio-political conditions, legal agreements, documentation, design of the end product, job and (sales and property) tax revenue generation are very different.

The Developer is an individual or company who assumes, for himself and others, a position of trust and confidence between the land seller, lender, city, tenants, consultants and owner of the property/shopping center. The Developer may develop for his own account, with or without investors (Self Development), or for another Owner (Fee Development). Regardless of development type, the Developer assumes the same level of trust, authority and responsibility for the end product.

The Developer typically covenants to furnish the requisite skills and judgments to complete a project. By the mere nature of what a Developer does, it is imperative that he be multi-faceted because the Developer must be able to fully understand the socio-political processes needed to complete the project. In addition, one must be fully capable of understanding all of the requisite financial, technical and legal processes to complete a project. Brokerage and leasing represent but one small portion of a Developer's job.

The Developer must understand the entire process. It begins with the initial evaluation of the proposed site through completion. This starts with a comprehensive market survey, followed by a demographic analysis and a market study of existing vs. future tenant needs, as well as the needs and desires of the community. One then turns one's attention towards the city's documentation, general and specific plans, and the project's technical specifications, development and design criteria. The city's development, design rules and regulations are an important part of the total process; however, they only represent guidelines and rules by which one must proceed with the proposed development. Further, the City's rules also represent just one of the many issues that must be factored into the final development product. As important as the above may be for the "processing" of a project, it is imperative for the Developer to consider critical items, such as competition both, within the primary trade area as well as among the project's tenants. Most critical of all is the project's Return on Investment (ROI), which, in today's financial climate should be equal to at least a 10% to12% unleveraged Return on Investment. This is computed by determining the Net Operating Income (Gross Income less management fees, structural reserves and vacancy factors) divided by Total Cost for the entire Project. If the project presents less than a 10% ROI, the financing becomes extremely difficult because the "risk" and equity requirements increase dramatically.

Thus, the Developer must be able to assimilate everything into a project's proposal that meets the desires, requirements, needs and criteria of the city, community, tenants, owner, lenders and the neighbors. Neighbors include surrounding residents and other prospective tenants within and outside of the shopping center. This being said, the Developer appears to be a "jack-of-all-trades" with regards to the work one must undertake. Yes, this is, in fact, the case because the Developer truly works from the inception of an idea through tenant move-in and management of the Center.

- <u>Functions and Tasks of Development</u>

  The functions and tasks that a Developer follows are many. They are each inter-connected and iterative i.e., they cycle (and re-cycle) through the process and continue until consensus is derived or the tasks are completed. The typical pre-development process, including normal public hearings, is about 6-to-12 months in duration. The typical construction, including design, at minimum, is an additional 9 months.

There is much, which must be considered during these processes. The real estate industry is cognizant of the "outside" pressures and the political climate for any type of development. Once again, the Developer must be involved with the local neighborhood, community, city and state politics to understand the importance of these items. That being said, the following presents a simplified overview representation of the tasks, which a Developer must undertake throughout a development process. Again, each of these items represents an overview of work, which, in and of themselves, includes numerous detailed sub-tasks.

One can ideally break development into six (6) time, phases, i.e., processing phases, each of which has a series of go and no-go decision points:

1. Pre-Development Phase:

   This is the initial phase of development within which the Developer begins his analysis for the viability of the site and to determine the project's preliminary concept. The evaluation typically begins with an economic analysis of the U.S., State, City and Community. The importance of this detailed economic analysis cannot be over-emphasized in that it becomes the base from which a project (any project) must be evaluated. For example, one may have the ideal tenant for a potential site; however, the timing may be all wrong for either that city or tenant; or the current economic concepts may focus upon a particular business sector or product type, such as value concepts or entertainment etc. Each of these concepts will lead one towards a very different development scenario.

   Once this is done, the Developer will focus towards the economics and viability of a particular site. Market research will continue throughout this entire phase i.e., it never stops. Detailed site evaluation and land use analyses continue. Financial arrangements begin for the land acquisition, as does the due diligence for the title and every ongoing aspect of the proposed project. Architectural selection begins as does initial site planning and some design concepts. Environmental analyses begin for the site. Meetings begin with the homeowners groups, city departments, other governmental agencies, utility company's etc. The initial project's proforma will be completed and initial anchor/major tenant contacts begin.

   Go, no-go decisions are made throughout this process.

2. Development Phase:

The site plans are continuously reviewed, changed, re-evaluated and new proformas are prepared. Site plans are redesigned with new tenant and city/community inputs. The Letters of Intent or other legal documents are begun with the major and non-major tenants. Analyses of any existing tenants, surrounding tenants and those within a five-mile radius are undertaken to determine the strategic / initial tenant mix for the proposed project. Lease negotiations begin with anchor and other major tenants.

Initial meetings begin with prospective construction lender(s). Legal reviews continue for all facets of the project. Governmental reviews and multiple city/agency meetings occur with each of the entitling agencies.

Architectural changes continue with ever changing conditions and requirements. Proformas are updated. The Developer begins detailed discussions with the prospective venture partners / lenders etc. In that construction issues for financing are now becoming firm, (based upon latest project and city criteria), negotiations for construction and take-out financing should become finalized.

Land loans or other financing vehicles are completed and land is purchased.

The tenant-leasing program continues.

3. Construction and Design Phase:

In this phase, the Developer begins working drawings. The Developer meets with and selects the general contractor(s) who will be bidding on the project. A detailed bidding and contractor selection process begins and contracts are negotiated.

Proformas are once again re-evaluated and adjusted to reflect the latest information so a "final" proforma can be determined. Detailed construction and construction management procedures are also finalized.

The construction loan is put in place and lender procedures are finalized. Legal, accounting and reporting procedures are coordinated with all parties. Governmental releases and approvals are obtained for the proposed project.

A project change order and construction management system is implemented. Tenant improvements and construction requirements are implemented as construction begins. Interaction between the city, tenant, Developer and lender continues as the project continues to completion. Finalized checklists and contractor approvals continue until the tenant moves into their space. The leasing program continues.

4. Tenant Move-In Phase:

This is a critical phase wherein the Developer assists the tenants with their move into their space. Obviously, this entails obtaining all requisite Governmental releases, tenant releases and legal notices to various parties.

The Developer begins the pre-management phase of coordinating and managing the completion of the project while each tenant takes occupancy of his or her space.

5. Loan Closing Phase:

The Developer begins the closeout of the work by meeting with the lender, general contractor and Governmental agencies to obtain all requisite estoppel certificates, etc.

6. Operational Phase:

The Developer has now completed all of the "development" tasks and must turn his or her attention towards the ongoing and very critical operation of the completed project. Many specialty consultants will be hired to assist with this process; however, the Developer must effectively convert from his construction and development phase of thinking and focus towards the property management phase of the business. All required accounting and maintenance procedures are developed and implemented into an ongoing program.

In addition to the above, the grand openings, merchant associations, promotional programs, etc. are now implemented.

III. DEVELOPMENT ISSUES:

In addition to the typical development tasks, as briefly noted above, the Developer is continually challenged with meeting numerous technical, political and social issues. The following represents some of the current issues with which the Developer (and owner) is faced on a day-to-day basis. These are neither industry specific nor representative of just State of California activities. In fact, they represent ongoing issues and problems facing all real property development throughout the Country.

- LEGISLATIVE ACTIVITIES IN CALIFORNIA:

The State of California is one of the most dramatic states within the U.S. in that it contains more shopping centers and diversity than any other State. By way of example if one draws a sixty- (60) mile ring around downtown Los Angeles, one will be provided with an area within which the Gross Product Produced makes this, approximate 1,400 square miles, equal to the 6th largest nation in the world! That being said, one can assume that California's legislative process is also over-burdened to handle this diversity. In fact, there are over 5,000 pieces of legislation introduced into each session in Sacramento. Approximately, 10% to 20% directly and continuously affects the real estate community.

California's real estate industry's lobby group, located in Sacramento, is the California Business Properties Association, ("CBPA"). CBPA is the industry's legislative advocate and represents virtually every real estate sector located within and outside of the State. CBPA's role is to follow; support or draft changes to these Legislative Bills and thus, it becomes the unified voice for the entire real estate industry.

The reason for the above comment is to illustrate just one (more) complexity which overlays the job of the Developer. The legislative issues with which we are faced are many. Three of these areas currently include such items as:

- Taxation and Over-Regulation: Many of the elected legislators we select to represent our communities today are being very creative to find more ways for government to create more programs and agencies which tend to micro-manage business and people. In many instances this is done through a form of taxation, which the cities and legal bodies will call "fees". They represent another very real expense to anyone who owns property or decides to develop or re-develop their property. The residential sector of the real estate community has, in the past (on virtually an annual basis), tried to promote a "split-roll" taxation wherein the commercial / retail / industrial sectors will pay a disproportionately higher amount of tax to the city, county and state than will the residential sector.

- Multi-Layered Growth Management: There are many elected community and state leaders who are now demanding additional approval authority over development projects that are created within their areas. For example, some state leaders are continuously attempting to add new, multiple, regional and community layers of planning approvals for projects. This occurs even if the activity only occurs at a local level. In addition, there is a movement within many communities to add; yet another layer of neighborhood approvals, which are in addition to the usual city based approval processes.

- Anti-Development – No Growth Movement: This type of legislation continues to occur as the poor economic times begin to improve. For example, the battle appears to cover many local venues e.g., the Coastal Commission's authority vs. the future growth within California. This dynamic process will continue because there seems to be a difference of opinion between those factions who only want to sustain themselves vs. those who want "reasonable" growth vs. those special interest groups who have their own (normally no-growth) type of private agendas.

- WHAT IS REAL ESTATE:

  Real Estate is an industry made up of many parts. These include housing, apartments, shopping centers, office buildings, casinos, hotels, industrial buildings, commercial buildings, farms, retailing buildings and vacant land. Real estate is a very powerful "engine" that helps drive a thriving California (and National) economy, both in-to and out-of recession. The decision process of exactly how one develops a specific type of project, is, thus, dramatically impacted by a number of variable factors.

- THE CONCEPT OF SPRAWL:

  At any point in time, the Developer must concern himself with knowledge of the state, local and political environment within which he works. In fact, as noted above there are always between 250-to-500 active real estate focused bills being processed in Sacramento at any point in time. The Developer needs to understand the content and purpose of these Bills. Some, for example, are concerned with the latest concepts of "Sprawl", which is getting much press at all industry levels.

What is Sprawl? There is no clear definition for the word. It is now getting much national attention and emotionally affects our daily lives. Sprawl is typically focused towards the ever-expanding city limits on an outward growth basis. Thus, it appears to be taking growth away from the urban (inner city/downtown areas) and moving out towards the suburbs. It is associated with the loss of open space to new residential growth, which is followed by retail, commercial and industrial growth. It is viewed by some as the opposite of good growth in that it appears to some as a poorly planned and automobile oriented development. Also, to some, all development is "sprawl". But one must put growth management in perspective with the "project(s)" being developed, "where" it is being developed, and placed in relationship with "what" uses are already surrounding the proposed project.

Sprawl has become a "buzz-word", used by many individuals and politicians who want to make a statement. In fact, in the November 1999 elections, the voters appeared to be partial to this concept because 70% of the 240 state and local ballot initiatives on sprawl were passed. We continue in today's poor economic times to continually deal with the issues of sprawl towards the suburbs vs urban development. In that retail development usually follows residential development, one may be able to state that retail is not "responsible" for the sprawl. Regardless, the Developer must be intimately familiar with the politics within one's own area(s) and become a part of the solution to these growth management issues. Added to this, of course, are the development's normal environmental concerns?

- <u>WHAT IS A SHOPPING CENTER:</u>

The Shopping Center portion of this industry is, in and of itself, only about 70 years old. A Shopping Center means different things to many people. Country Club Plaza, the first true Shopping Center, was developed in Kansas City by California's Janss Corporation. Janss developed the Plaza for J. C. Nichols Company. This represented the first architecturally integrated shopping experience wherein parking, along with many types of retail and office tenants was brought together into a meaningful whole. In years that followed, Janss Company replicated the Kansas City model and designed one of California's first shopping environments, i.e., Westwood Village. Though, Westwood today is quite different than originally designed, it brings to mind the concept of why shopping environments must continually change with time, the changing shopping habits of customers and the ever changing business plans of the tenant.

Thus, a shopping center is a compilation of shopping experiences, which meets the needs of specific community criteria as well as the requirements and focus of specific tenants. Many tenants are public companies and are thus driven by Earnings per Share; all tenants are in business to sell products or provide a service and, of course, to make money! The job of the Developer is to mix and match the needs and requirements of the tenants, city, community, owner and investor as correlated with various technical, economic and financial criteria. One cannot overlook the socio-political concerns and the realities of a specific community to bring about a proper tenant and use mix. The results are usually melded together into a viable shopping center.

- IMPACT OF SHOPPING CENTERS WITHIN CALIFORNIA:

It is interesting to note that when one takes into account the total of all U.S. shopping centers, exclusive of tourism and automotive workers, the Shopping Center industry represents the largest employer, both within California and the U.S. For example, according to the National Research Bureau and International Council of Shopping Centers, the total of all sales from all shopping centers within the U.S. is over $1 Trillion Dollars. This revenue is generated from a U.S. total of approximately 45,000 shopping centers (of all sizes).

California contains about 14% of all shopping centers built within the U.S. Specifically, there are about 6,000 shopping centers within California, which produces over $112 Billion Dollars in retail sales. The State's sales taxes equate to about $5 Billion Dollars, from which $1 Billion Dollars of the State's sales taxes are placed back into the local Cities and communities. Shopping centers within just California have a statewide employment base of over a million jobs. This includes neither the part time jobs nor the construction jobs created with each new center.

The Developer's end product (a viable shopping center) produces about 2 new jobs for every 1,000 square feet of Gross Leasable Area ("GLA") built. An equal number of construction jobs are created during the 9-18 months of construction. Each square foot of leased GLA on average produces annual sales revenues of $200-$500, of which, one (1%) percent typically accrues to the local community as a rebate of State's sales tax. This represents some of the statistics regarding why shopping centers are viewed differently than other real estate products within a city. They generate a very meaningful amount of sales tax, new employment and they also revitalize a local community. They usually generate an additional property tax increment, as well.

In summary, the Developer is not unlike a Chief Executive Officer of a company wherein the CEO is responsible for all decisions. Numerous quantitative tasks, qualitative tasks and responsibilities also fall onto the shoulder of the Developer. In reality, each development is an entrepreneurial activity. Conceptually the development of a new project is not unlike the entrepreneur who begins a new manufacturing company.

The start-up of a non-real estate project requires the creation of a business plan, acquisition of the land, construction / purchase of the building and creation of a staff to run and operate the company. The shopping center requires the same functions and when completed, each shopping center becomes an ongoing business, which is subject to the same market and economic pressures as any other business. In fact, each neighborhood shopping center (about 10 acres in size) will: cost, on average, about $15 to $25 million dollars to build (subject to amenities). They each create about 200 to 250 new jobs (plus an equal number of part-time jobs); produce, on average, about $25 to $40 million dollars in retail sales (of which one (1%) percent accrues to the local city / community as tax revenue) and will provide goods and service to the surrounding neighborhood.

The results of good and quality development cannot be over-emphasized. If done with forethought, it will be win-win for all parties.