Better Together: Why Private Development and Public Interests are not Parallel Universes.

Creating Community: Cultivating and Sustaining Neighborhood Identity February 16, 2019
Presenters

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The mission of the Urban Land Institute is to provide leadership in the responsible use of land and in creating and sustaining thriving communities worldwide.

About ULI

ULI—the Urban Land Institute is a 501(c) (3) nonprofit research and education organization supported by its members. Founded in 1936, the institute now has more than 40,000 members in over 90 countries representing the entire spectrum of land use and real estate development disciplines, working in private enterprise and public service.

As the preeminent, multidisciplinary real estate forum, ULI facilitates the open exchange of ideas, information and experience among local, national and international industry leaders and policy makers dedicated to creating better places.
Presentation Topics

- Public & Private Objectives for Development
- Public & Private Steps in the Development Process
  - The Business of Real Estate
- The Importance of an Integrated Planning Process
  - How to Work More Effectively Together
Public
- Transparency
- Feasibility
- Cost effectiveness

Common
- Certainty/ No surprises
- Honesty
- Fairness
- Policies, regulations and staff resources that support good development
- No public controversy

Private
- Simplicity
- Flexibility
- Efficiency
PRIVATE PROCESS
- Business Concept
- Site Selection /Market Study
- Secure Financing
- Due Diligence/real estate purchase

PUBLIC PROCESS
- Comprehensive plan
- Zoning entitlement
PRIVATE PROCESS

- Business Concept
- Site Selection /Market Study
- Secure Financing
- Due Diligence/real estate purchase
- Site engineering
- Architectural design
- Preliminary Bids
- Pre-sales/leasing
- Construction Management

PUBLIC PROCESS

- Comprehensive plan
- Zoning entitlement
- Subdivision plat
- Infrastructure
- Building plan review
- Inspections
- Certificate of Occupancy
And now Bob’s back of the napkin analysis. More artfully known as…. “the real estate deal”
Conceptual Development
Project Assumptions

Property Size: 7.95 acres

Price: $85,000/acre - $$$/lot

Development Assumption

• 24 residential lots (3.0 du/acre)

Price Assumptions

• Home Price = $$$
• Lot Sale Price = 25% of home price or $$$
Project Cost Assumptions

Planning, Engineering & Entitlement Costs = $$$/lot

Site Development Costs = $$$/lot

Off-site Costs = $$$

Soft Costs

- General & Administration
- Marketing
- Closing Costs
- Legal Costs
- Taxes
- Financing Costs
### Base Scenario Proforma

<table>
<thead>
<tr>
<th></th>
<th>Yr1 Q1, Q2</th>
<th>Yr1 Q3, Q4</th>
<th>Yr 2 Q1, Q2</th>
<th>Yr 2 Q3, Q4</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Lot Sales (2/Mo.)</strong></td>
<td>-</td>
<td>-</td>
<td>10</td>
<td>14</td>
<td>24</td>
</tr>
<tr>
<td><strong>Total Revenue</strong></td>
<td>-</td>
<td>-</td>
<td>$$$</td>
<td>$$$</td>
<td>$$$</td>
</tr>
<tr>
<td><strong>Planning, Engineering</strong></td>
<td>$$</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>$$</td>
</tr>
<tr>
<td><strong>Entitlement Costs</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Site Development</strong></td>
<td>-</td>
<td>$$</td>
<td>$$</td>
<td>-</td>
<td>$$</td>
</tr>
<tr>
<td><strong>Offsite Costs</strong></td>
<td>-</td>
<td>$$</td>
<td>-</td>
<td>-</td>
<td>$$</td>
</tr>
<tr>
<td><strong>Land Acquisition</strong></td>
<td>$$</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>$$</td>
</tr>
<tr>
<td><strong>Operating Costs</strong></td>
<td>$$</td>
<td>$$</td>
<td>$$</td>
<td>$$</td>
<td>$$</td>
</tr>
<tr>
<td><strong>Total Costs</strong></td>
<td>$$</td>
<td>$$</td>
<td>$$</td>
<td>$$</td>
<td>$$</td>
</tr>
<tr>
<td><strong>Net Cash Flow</strong></td>
<td>($$$)</td>
<td>($$$)</td>
<td>$$</td>
<td>$$$</td>
<td>$$$</td>
</tr>
<tr>
<td><strong>Cumulative</strong></td>
<td>($$$)</td>
<td>($$$)</td>
<td>($$$)</td>
<td>$$$</td>
<td>$$$</td>
</tr>
</tbody>
</table>

Internal Rate of Return = 16.24%
Analyzing Returns

**Internal Rates of Return (IRR)**
Equivalent to the interest rate paid on a bank account with the same up-front money (total costs) in order to get the same return (net cash) in the same amount of time.

**Example:** $1 million invested at 10%/year for 5 years will return the investor’s money plus $100,000 per year for a total of $1.5 million returned at the end of 5 years.

- The TOTAL RETURNS to the investor are $1.5 million (50% on his/her money) BUT IT IS ONLY EQUIVALENT TO A 10% INTEREST RATE

**Time** is one of the biggest factors impacting returns

**Up-Front Costs** also have big impacts
What is the “Right” Return?

**HIGHER RISK = HIGHER IRR Required**

- Real Estate Development is the HIGHEST RISK investment class

10-Year Treasury Bills are paying ~2.71%

- Virtually NO risk (Backed by the US Government)

**Home Mortgage Rates ~4.57%**

Developer of Project Requires 15%+ IRR

- The difference between 15% and 2.71% is **RISK**
- Each developer will require a different return depending on the risk associated with the project

*Because prices and costs can’t be controlled – reducing risk is the focus of developers*
## Impacts on Returns

Developer requires 15% IRR to move forward

<table>
<thead>
<tr>
<th>Impact</th>
<th>IRR</th>
<th>Result</th>
</tr>
</thead>
<tbody>
<tr>
<td>Proforma calculation</td>
<td>16.24%</td>
<td>Passed</td>
</tr>
<tr>
<td>Reduce lot density from 3.0 to 2.75 du/ac</td>
<td>13.38%</td>
<td>Failed</td>
</tr>
<tr>
<td>Increase site costs by 10%</td>
<td>12.70%</td>
<td>Failed</td>
</tr>
<tr>
<td>Reduce finished lot prices by 10%</td>
<td>11.02%</td>
<td>Failed</td>
</tr>
<tr>
<td>Add 6 months to entitlement</td>
<td>11.45%</td>
<td>Failed</td>
</tr>
</tbody>
</table>
Overall Risks

- Absorption Period
- Entitlements
- Rate Environment
- Construction Process
- Market Conditions/Demand
Such a risky business requires...

- Large profit margins
- Significant liquidity for “what if” scenarios
- Vast experience by all professions
- Available capital
The Real Estate Cycle (2018)
Factors that impact development - beyond the control of the developer

Controlled by the public agency:
- Process timing
- Application fees
- Public agency resources
- Policies and regulations

Other factors:
- Local and national economy
- Market for development
- Financing
- Labor
Steps in the Development Process

- **Zoning**
  - Sets framework for development
  - First regulatory step

- **Use permit**
  - Allow for review of certain uses that may have impacts on surrounding uses

- **Subdivision**
  - Creates the way for property to be bought and sold
  - Ensures adequate public facilities and buildable area

- **Site & design plans**
  - Ensures compliance with that specific development standards

Less Discretion
Zoning

Issues decided at previous step

• Comprehensive Plan land use and policies
• Existing zoning
• Zoning of other properties in the area

Issues on the Table

• Consistency with Comprehensive Plan
• Zoning category proposed
• Site suitability
• Impact on services
# Subdivision

## Issues decided at previous step

- Consistency with the Comprehensive Plan
- Land use
- Density
- Setbacks
- Height limits
- Parking requirements
- Landscaping requirements
- Impacts from land use
- Compatibility with adjacent uses
- Balance of uses city-wide
- Market for use

## Issues on the Table

- Compliance with the Zoning regulations
- Adequacy of infrastructure and services
- Subdivision design
- Title to property
- Compliance with Plat requirements
Special Use Permits

Issues decided at previous step

- Consistency with the Comprehensive Plan
- Allowance for use in the District
- Standards to be used in evaluating the use
- Density
- Setbacks
- Height limits
- Parking requirements
- Landscaping requirements

Issues on the Table

- Use allowed by zoning ordinance
- Compliance with specific standards for use
- Suitability of property for use
- Conditions
# Site and Design Plans

<table>
<thead>
<tr>
<th>Issues decided at previous step</th>
<th>Issues on the Table</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Consistency with the Comprehensive Plan</td>
<td>• Compliance with zoning</td>
</tr>
<tr>
<td>• Allowance for use in the District</td>
<td>• Building layout and orientation</td>
</tr>
<tr>
<td>• Balance of uses city-wide</td>
<td>• Landscaping</td>
</tr>
<tr>
<td>• Market for use</td>
<td>• Site triangle</td>
</tr>
<tr>
<td>• Compatibility with adjacent land uses</td>
<td>• Drainage</td>
</tr>
<tr>
<td>• Development standards</td>
<td>• Buffer areas</td>
</tr>
<tr>
<td>• Density</td>
<td>• Screening</td>
</tr>
<tr>
<td>• Setbacks</td>
<td>• Walkways and pedestrian ways</td>
</tr>
<tr>
<td>• Height limits</td>
<td>• Access points and internal circulation</td>
</tr>
<tr>
<td>• Parking requirements</td>
<td>• Public improvements</td>
</tr>
<tr>
<td>• Landscaping requirements</td>
<td>• Architectural treatment</td>
</tr>
<tr>
<td>• Availability of services</td>
<td>• On site circulation and parking</td>
</tr>
<tr>
<td>• Traffic impacts</td>
<td>• Building scale and design</td>
</tr>
<tr>
<td>• Drainage impacts</td>
<td>• Open space</td>
</tr>
<tr>
<td></td>
<td>• Vicinity considerations</td>
</tr>
</tbody>
</table>
IT DOESN'T WORK BUT IT SURE IS IMPRESSIVE
How to Work Effectively Together

1. Understand the risks
2. Be clear
3. Identify shared goals
4. Maintain respect
5. Recognize mutual needs
Questions
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