Underwriting 101: Getting Deals Done

How to evaluate risk and basic project feasibility.

How to structure the key elements of your capital stack.

Public-Private Partnerships, Structured Seller Financing & JV's with Land Owners.

Financing Infrastructure via Value-Recapture Models.

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Definition: **Risk** implies future uncertainty about deviation from expected earnings or expected outcome

Understanding Real Estate Risk, and How Risk Management Affects the Cost of Capital

The Five Major Risk Categories in Brownfield Development

1. Financial Risk
2. Entitlement Risk
3. Environmental Risk
4. Construction Risk
5. Market Risk

How Experienced Developers Manage The Four Development Risk Areas That Impact Financial Risk:

1. Entitlement Risk
2. Environmental Risk
3. Construction Risk
4. Market Risk

Entitlement (Zoning) Risk

1. Local Knowledge – Zoning Book & Map

2. Political Connections – Get Involved

3. Contingencies for Zoning Approvals in Land Acquisition Contracts

4. Community Consensus Building- “Give the people what they want.”

Environmental Risk Management

The Process of Reducing Environmental Risk

1. Phase I – History of Uses & Records Search PA / ESA = Innocent Purchaser Defense
2. Phase II – Site Investigation - Buildings, Soil, & Water Testing
3. Phase III – Remedial Action Work Plan – SOW – RFP
4. Remedial Action Report and RAO = Liability Relief & Re-Opener Protection

Construction Risk

1. Design Team (A, E, MEP) ***must*** include Construction Manager

2. Design Development + Value Engineering = Budget Certainty

3. GMP Contracts with Completion Guarantee (Bonded)

Market Risk

1. Research! Shop the Market Yourself or Commission a Market Study & Appraisal
2. Know The Competitive Market Area & Product Environment
3. Supply Forecast = Identify Demand Niches
4. Pre-Sales = Certainty
5. Phase Projects (Zoning Implications)
6. Valuation – Appraisal Metrics

Four Ways Developers Manage Financial Risk

"Capital Stack": Total Project Cost = Land + Soft + Hard Costs

1. "Leverage" Equity with Debt

Total Revenue	=	**130%**
Profit Projection	=	30%

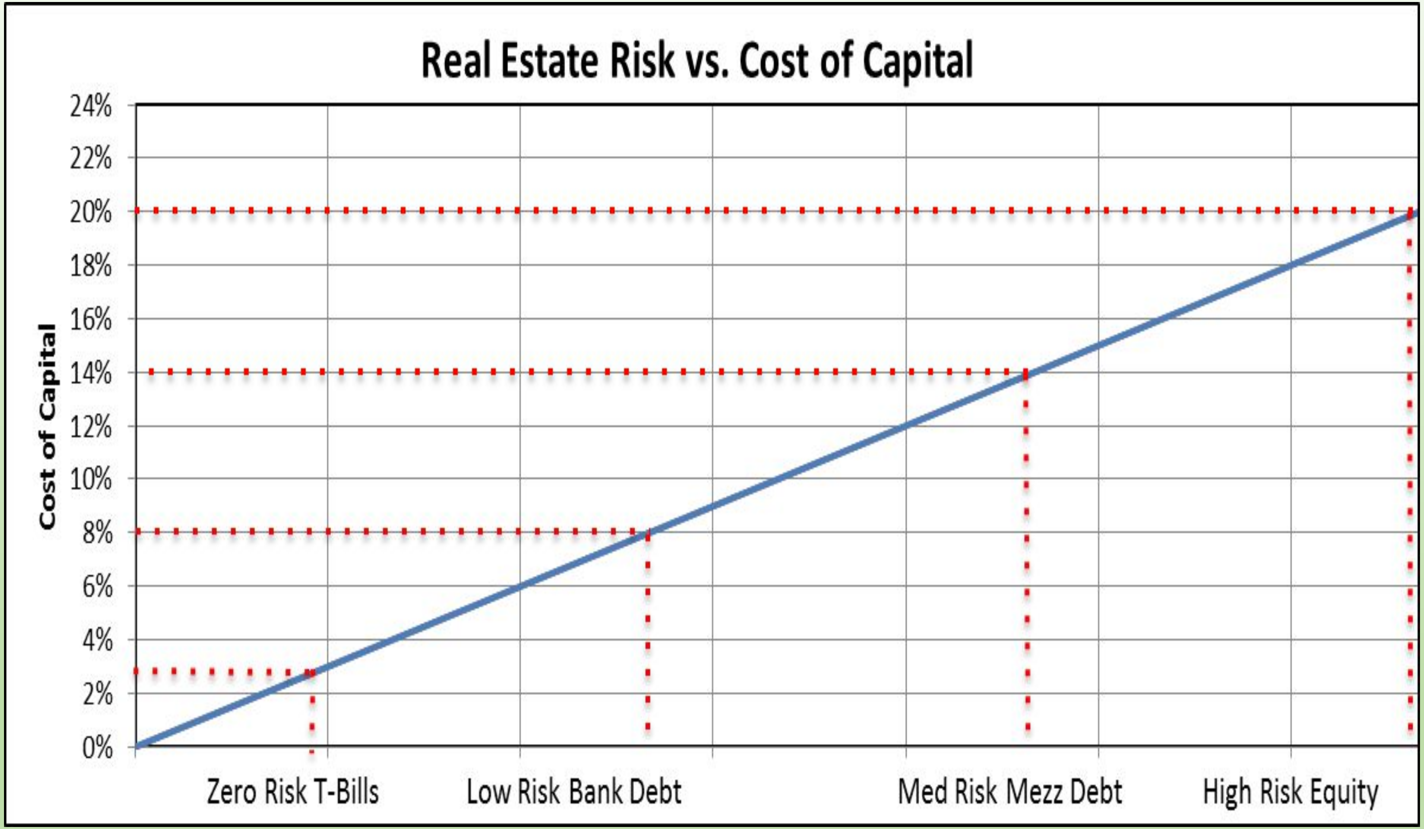
Capital Stack:

a. Total Project Cost*	=	100%
b. Sponsor Equity	=	1%
c. Investor Equity	=	9%
d. Mezzanine Debt	=	15%
e. Bank Debt	=	75%

2. Invest in Prime Locations

3. Preferred Returns = Developer's "profit deductible"

4. Waterfall Distributions = "Hurdle Rates & Promotes"


Real Estate Risk vs. Cost of Capital
Cost of Capital
24%
22%
20%
18%
16%
14%
12%
10%
8%
6%
4%
2%
0%
Zero Risk T-Bills
Low Risk Bank Debt
Med Risk Mezz Debt
High Risk Equity

Capital Stack & Pricing Model

A. Cost of Bank Loans

1. Commitment Fees 1-3%
2. Broker Fees 1-3%
3. Interest Rates –
   a. Prime Rate + 1-5%
   b. Libor Rate + 1-5%
   c. T-Bill Rate + 1-5%

B. Mezzanine loans

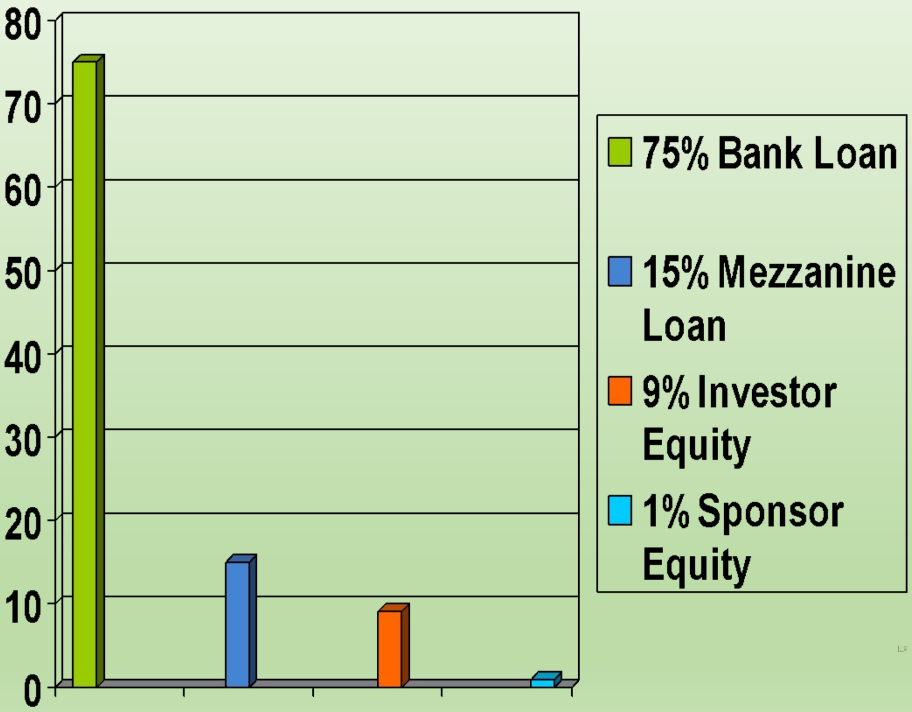
1. Commitment fees 1-3%
2. Broker Fees 1-3%
3. Interest Rates 10-20%

C. Investor Equity

1. Preferred ROE 8-20% +
2. Profit Share 10-90%

D. Sponsor Equity
(After A+B+C Paid in Full)

1. Preferred ROE 8-20% +
2. Profit Share 90-10%



Creative Financing Strategies Using: Structured Seller Financing & Joint Ventures With Land Owners

Working with Land Sellers: When to offer more than the asking price?

(Hint: Time to reduce risk = money!)

- Higher Risk = Lower probability of Investing and if they do invest, they increased the "Risk Premium" (++Cost of Capital)
- The cost of capital over time is the largest line item in a project Budget.
- Having a Seller give the Buyer time to reduce risk = Higher Land Value and cheaper Cost of Capital
- Share that Higher Land Value with the Seller

Working with Sellers to Reduce Risk & Increase Value

1. **A full Joint Venture**
2. **A sale contract with Seller Mezzanine financing (Get Creative!)**
3. **A sale contract with Seller secured Junior financing**
4. **A sale contract with Seller Senior secured mortgage financing.**
5. **Option to Purchase in Phases**
6. **Sale contract with a phased take down**
7. **Option to purchase the entirety**
8. **Sale contract with extended time to close with contingencies and a formula sale price**
9. **Sale Contract with a "Responsible Party" who prefers to remediate itself prior to transfer of title.**
10. **All cash, no contingencies, quick close contract (the Maxwell formula)**

Public Private Partnerships
Municipal Tools To Aid Redevelopment

1. Giving Developer <u>time</u> to perform risk management process
2. The Power of Zoning;
   a) Redevelopment Areas
   b) Density Bonus & Value Recapture
   c) Expedite approvals / permits
3. Tax Incentives – Abatements / Pilots
4. Financing the Land Sale
5. Financing Infrastructure - RAD Bonds & SIDs
6. Shared Parking Garages
   a) Mass Transit Commuters Park during the day
   b) Residents & Neighborhood Park at Night & Weekends

Value Re-Capture Techniques to Finance Infrastructure

- New land development
- Joint development
- Land-value taxes
- Transportation utility fees
- Anchor institution partnerships (with nonprofit or private entities)
- Corridor-level parking
- Land banking
- District energy systems .

The key to success:
Structure the deal so everybody wins.

(Hint: Leave some money on the table)

- The Community
- The Environment
- The Political Leaders
- The Investors

Trust is the grease that gets deals done!

It takes years to build a great reputation, and just minutes to ruin it.

What’s the objective?

Creating great places where people want to live, work, and play.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