The World of a Developer: Moving an Idea to Reality

This information is provided by GrowSmart Maine as a result of feedback from the public at the June 2016 Forum: **Growth in Portland: Can Public Process Help Bridge the Divide?**

What makes a developer tick? How do they choose projects and neighborhoods? What is the best way for the public to offer suggestions? What makes a "good" development? And, behind the curtain, how do the finances work?

These were all questions asked by the attendees at GrowSmart Maine's 2016 forum on *Growth in Portland.* It is our hope that the answers to these questions this will lead to more effective conversations between the public and developers, and ultimately, to developments that create more livable and enjoyable neighborhoods all over Maine.

What makes a developer tick? Obviously, different things for different people, but all want to create a project they can be proud of. For many, innovation and contributing to the neighborhood in some way is key. This can mean anything from making a statement with an esthetically pleasing building, to creating much-needed affordable housing, to building a space that builds community and makes the neighborhood livelier. A developer is a businessperson, and this is their livelihood, so the project needs to pay off in the end. But this is not the only measure of success.

What is the role of a developer? A developer is the person who has the vision, finds the site, works with the neighborhood to adapt the design and the city or town to follow or adapt the rules, finds the financing, and hires the building crew. Often the developer also rents or sells the finished product. The developer is the first one in, and the last one out. The developer also takes the financial risk, usually making money, sometimes breaking even, occasionally losing money. A developer needs to have 20% of expertise in about 20 different areas and know how to assemble a team to tie it all together.

Step 1: Finding a site. Every developer has ten sites they'd love to get their hands on, due to location, the existing building, or local amenities (some combination of utilities, sidewalks, stores, parks, trails, views). For example, a developer gets a call on a site that is up for sale. First step, take a quick look at Google Maps. Say it's in a neighborhood that is of interest…the developer thinks it's up and coming, it already has good amenities, or perhaps the developer just sees possibilities that no one else has yet seen.

The developer's first step is to investigate. Important items to consider include:

- Land: is it in a flood zone? Are there any water issues?

- Soil and Environmental issues: What was there before or what is there now? Is there likely to be contamination? Is there likely to be ledge (blasting expense) or clay/sand (the expense of driving piles for stability).
- Neighborhood: How does the public feel about the site being developed? What concerns do they have that will affect the use, look or number of units in the development. Are they concerned about height, traffic, gentrification? How can these concerns be alleviated?
- Zoning and Regulation: Will a zone change be needed? How different from the zoning that is currently in place? If so, how likely is the municipality to grant one?
- Title: Is everything in place, or will an investment need to be made to legally clear the title before a closing.
- Tax Credits: Is it a historic building or neighborhood so that tax credits could be used? Does it make sense to do so?
- Placemaking: What is the neighborhood like? Could the development add to it and make it better? What's in it for the neighborhood? *This is a critical component to success.*
- Amenities: Is natural gas available? Is public transportation nearby? Bike paths? What other amenities already here could affect marketability of the units? What could this development do to increase the overall attractiveness of the neighborhood?
- Market feasibility: Can we rent or sell these units for more than the cost of construction? If we build it, will they come?

Step 2: To Take the Plunge…or Not. Now it's time to move out of the "back of the napkin" stage. The developer will be able to answer some of the above questions with existing information and a certain level of intuition, but to find out enough to seriously crunch numbers, experts need to be brought in. These likely include an architect, environmental engineers to assess the soil – because that affects construction costs – perhaps a lawyer. This process will take several weeks. It generally costs about $20,000 just to kick the tires, so to speak. It is during this phase when a set of basic cost numbers are developed:

- Cost of land
- Cost of preconstruction/soft costs (taxes, fees)
- Cost of construction (actual building)
- Cost of loan (interest cost and fees over the life of the project)
- Stabilization costs (keeping the project funded during the time it takes to be fully sold or rented)

These are all balanced against:

- Potential income (Estimated rent or sale price)

During this time period, the developer should be meeting with the neighborhood to take into account concerns and ideas, and adapt the building as needed. Here is also

where developers take a good hard look at what could go wrong: what could cost more, take longer, or affect the rental or sales market by the time the building is completed.

Once all this is pulled together, the developer makes a decision. Will the project pay off? Does it fit into his/her vision? Should he/she move ahead?

Step 3: Moving to Pre-Construction. If the leap is taken, then the next steps are to get a design and plan on paper and start putting bids out to contractors. Detailed geotechnical work may be needed. The developer will now begin to contact banks about this specific project. Until the bids come in, conversations with banks are by necessity somewhat preliminary. Typically, a developer talks to more than one bank, because getting a good rate and as long a guarantee on the rate as possible is key to success. (Five years? Eight years? Ten years?) Bids often come in higher than expected, so once they arrive, there is usually a period of what is called value engineering, or finding places to reduce construction costs that don't reduce the overall value of the project. This step can take some time.

Finally, once the construction bids and other contractor bids are solid, the bank deal is firmed up (including an appraisal that is high enough to warrant the loan) any needed zoning changes are approved, the neighborhood is reasonably happy with the project, and no lawsuits are in sight, the developer will usually step back and take one final look at the numbers. If things look tight, he/she can assess the market: have rents or sales prices moved? Now that closing is imminent, where are rates? And finally, adjusting those numbers, where is the return? Is it still sufficient to move ahead? If the answer is yes, the developer moves ahead to buy the land, hire the construction team and break ground.

Step 4: Construction. Anyone who has ever built a house, garage or maybe even a shed knows that nothing ever goes according to plan. But not going according to plan is part of life for anyone in the building business. From a developer's perspective, having the building ready to live in by April or August – when people in Maine tend to move – is a goal. Since that goal is often not met (see note on stabilization cost above), this is one more variable. Other challenges, especially in Southern Maine, are lack of available workers when they are needed. Again, these are all standard issues in the building trades, not particular for a developer.

Neighborhood Interaction: Good developers interact with a neighborhood early and often. (See GrowSmart Maine's *Neighborhood Meetings That Build Support for Your Project*.) As a resident who cares about the neighborhood, it is your responsibility to attend these meetings and talk with the developer early, before too much is invested. Suggestions that could have easily been adopted early in the process are much less likely to be implemented towards the end. It's up to you to talk about your vision for the neighborhood and be a part of the process. Your neighborhood will benefit – and so will you!

SAMPLE Construction Cost Analysis
(numbers for illustration purposes only – do not represent real costs)

Original Estimate:

Cost of land, preconstruction, building
Cost of loan
Estimated stabilization costs
$5 million

Revisions:

Architect changes to initial design	+ .2 million
Geotechnical analysis: need to drive piles	+ 1 million
New total	6.2 million

Actual Bid Cost:	$7.5 million
Value Engineering	- $4 million
New total	$6.9 million

Developer then evaluates new square foot cost and assesses any revisions to original assumptions on rent or sale cost, debt service, and length of need for stabilization cost. Can any of these be adjusted to make the numbers work? This is the point at which the developer must make the final decision to build or not to build.

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