Multifamily Development 101
What you need to know to get started

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What is the most profitable development deal?

Any deal that results in a more robust legally approved land use.

Example: taking a property used as a surface parking lot and receiving entitlements to build an 8 story apartment building.

The surface parking lot has 50 spots each paying $100 per month for a total annual revenue of $60,000. An 8 story building can likely yield at least 100 apartments with an average $3000 monthly rent resulting in a gross potential annual revenue of $3,600,000. Of course, there are additional operating expenses and the cost to build the apartment building, but at the end of the day, the residual land value has gone up significantly with the entitlements for the apartment building

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How to find a development deal?

It takes outreach to brokers and property owners to find development deals. Development deals are typically found in one of the ways described below:

- A marketed deal that goes out to a small group of developers with a proven track record
- Engaging a broker that specializes in sourcing development deals
- Writing unsolicited letters to property owners describing your interest in purchasing their property for development.
- Calling Architects and other folks in the design and construction trades that work on development projects
- Driving around looking for construction projects that appear to be understaffed based on the activity on site. In these cases, find out who the lender is and call them to let them know what is going on. If the borrower can't afford to pay the debt service, you may have an opportunity to buy the note if the borrower goes into default.
- Call commercial leasing brokers that are engaged to lease space on a property that appears to be underutilized and ask them about submitting an offer to buy the site. They will get a commission if the deal closes so they are usually happy to help
- There are many ways to find deals. The best way to attract deals is to be active in the community you are interested in and opportunities will appear. The more you give to the community you want to serve, the more you will get back
- A broadly marketed deal, while possible, does not typically result in a deal

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What are the financial return requirements necessary to attract outside capital?

- Yield on cost - This is the net operating income divided by the project budget based on today's rents. The yield on cost generally needs to be at least 1.5% higher than the projected exit cap rate
- IRR – Development deals require a 20% return to the investor
- Equity Multiple – a 2x is projected to be earned by the investor

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Negotiating the Purchase and Sale Agreement

- A long closing period – Development approvals are granted by government entities and are out of your direct control. This is the biggest risk in development because it relies on government action. An approval can get significantly delayed for a host of reasons. With that in mind, negotiate for a close of escrow after receipt of entitlements and after all appeal periods have lapsed at a minimum.
- Property owner cooperation in signing applications for development approvals. The city will require the property owner's signature which is needed since the property is still under contract.
- Site access is required for you and your consultants to complete due diligence.
- Assignable PSA – This is an important one because you want the flexibility to assign the contract after you have created value in the entitlements.

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You have just executed the PSA...Congratulations! You're off to the races. Below are the items and consultants you will likely need during your 30-90 day investigation period. There may be others but this is a good start.

- Review the zoning code to understand what can be built on the site today and have an architect and land use attorney review as well. You may find that you can develop more robust project than originally projected.
- Architect yield study
- Environmental review Phase I
- Environmental Phase II if needed
- Civil Engineering Feasibility Study
- Topographic/Boundary Survey
- ALTA Survey
- Geotech Study - to evaluate the liquefaction potential of the soils underlying the site and to provide soil data that can be used to estimate soil strength and compressibility.
- Transaction attorney to draft LOI and PSA.
- 3rd party market study
- Property Manager to validate your projected rents and expenses. In addition, they can also validate the required amenities and finish level needed to achieve the projected rents.
- Capital Broker if money is needed to pay for project costs.
- Contractor opinion of construction costs

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Due Diligence confirms you have a feasible project. Now its time to work with your design team and create a project that will create a project that adds significant value to the land. Here is a list of folks you will need to work with:

- Architect
- Landscape Architect
- Structural
- Civil Engineer
- Arborist
- Green Building Consultant
- CEQA (California Environmental Quality Act) Consultant
- City Application Fees
- Dry utility Engineer
- Land Use attorney
- Other Misc. costs

Congratulations! City Council has approved your project and it is now passed the appeal period. You have two options...

- Assign the contract with the rights to the entitled site and make $$
- Advance the architecture through design development, construction documents, and submit to the building department for plan check to get permits, build it, lease it up and then sell it for $$$$$$$, assuming rents stay the same.

Of course this is oversimplified. There will be many setbacks and you will find a way to be resilient and power through. However, this is the business of real estate development and there will be curveballs along the way. Hey, if it was easy everyone would do it! Good Luck!

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