ADVANCED PROPERTY SYSTEM
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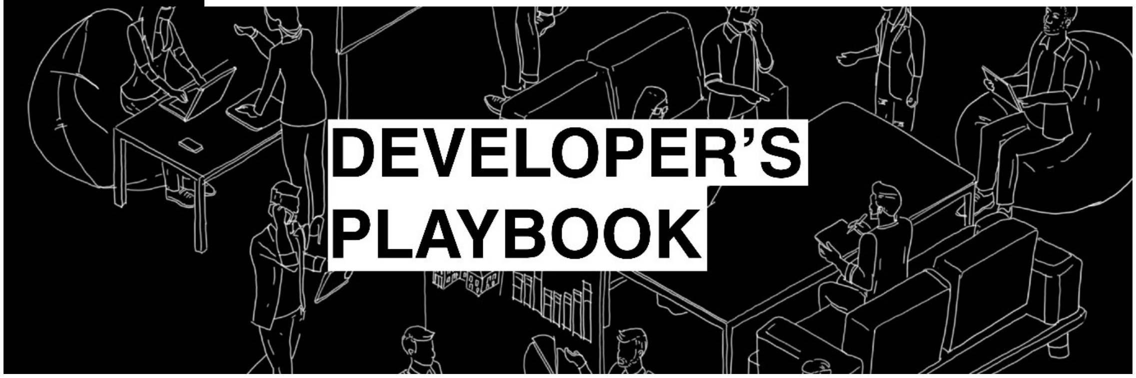

2.1 PROFILE OF A DEVELOPER

Your unique background and skillset make up your profile as a developer. Your character, education, and experiences all work together determine your unique approach to thinking about property and naturally make up your strengths and weaknesses. Like a fingerprint, your personality leaves a mark on each project you work on. This applies to all areas of your work, from the way you come up with a new project idea to the way you put the funding together. Your individual style is what makes you unique in the industry and should be seen as a strength – something to build on.

One of my colleagues and friends, Anthony Orelowitz, started his professional career as a banker in the property finance division of a bank. It was here that he gained valuable insight into structured project finance, the imperatives of budgetary controls, and accountability towards development clients. His passion for architecture led him to found Paragon architects, and to become involved in property developments through his development company, Alchemy Properties. In his property projects, he uses architectural experience to design the development in a specific way that talks to the financial aspects that project financiers and banks are looking for. In this way, he can deliver cleverly designed buildings that make use of creative development structures, like the corporate offices called Sasol Place, in Johannesburg. Like my own story, this is an example of someone that transitioned from a background in architecture and design into property development. Anthony used the skills, learnings and experiences of his past to inform his future as a property developer.

2.2 PERSONALITY CHECK

There are a lot of considerations before getting started in real estate, and in this program, we hope to establish your profile in a way that tailors your experience to suit your personality. There is a part of your background that has attracted you to the property industry in the first place, and this gives us a clue as to your individual development style.

For instance, when you think about setting up a project plan for a new development, do you have a more business-minded approach? Perhaps you come from a financial or project management background. Your thinking suggests that you are a good manager but perhaps need a little creative support from a project partner or a strong project architect.

Do you rely on your instincts and to push on with a clear vision of your end goals, or do you prefer a more cautious approach based on market research and careful analysis of the pros and cons? Your answer could be helpful in determining your risk profile, and the degree of financial exposure that you are comfortable with.

2.3 SIZE AND SCALE

Part of understanding your development profile is finding the size and type of developments that you aspire to take on and matching your ambitions with your means in terms of skills and financial capacity. The scale of the development that you can undertake can be broken down into three key principles.

- Your borrowing capacity
- Your personal project goals, and
- How much risk you are willing to take in the development

Each one of these principles investigate fundamental characteristics of your capabilities as a developer. If you find that you are lacking some depth in one or more of these areas, don't be discouraged. Nobody is perfect, and there are many tools available to you to support your development process in a more wholistic way.

2.4 BORROWING CAPACITY

Your ability to raise capital for your project depends on two things. Firstly, you have to consider how much *equity* you have available to allocate towards your project. Equity refers to capital in the form of cash, or land (the project site is considered as a form of equity) and in some cases includes unconditional financial guarantees. The second consideration is the loan amount that you can borrow for the development. This is commonly referred to as *senior debt* and can be raised either from the bank, a partner, or an investor. The amount of money raised relative to available equity is known as the Loan to Value Ratio. Most banks offer an LTV ratio for development projects of approximately 70%. This is also dependant on your financial records and can be linked to your balance sheet.

<u>Example: Calculating your LTV</u>

The Loan to Value is the magical ratio that dictates your equity split in a development. If it is 70:30, then for every R300 of equity you put towards the development, your funder will contribute R700. Here is an example of a typical development loan at work. Say, for instance, the Total Development Cost of your project is R100 million. The bank has expressed an interest in providing funding for the scheme at an LTV of 75%. How much equity do you require?

The bank's financed portion is calculated as R100 million X 75% = R75 million. The balance of the development cost will be made up in equity on your end. R100 million X 25% = R25 million. Armed with this information, it is possible to approximate your borrowing capacity and find a project scale that suits your affordability.

Tip: A bank may typically require that you draw down from equity until the full contribution has been made towards the project. Only then will the loan drawdowns from the bank commence. This protects them as a lender against some of the upfront risk and should be a warning to us as developer to ensure that our scheme is financially sound before we sink all of our hard-earned into it. We will look at *gearing* and how you can improve the LTV again in the *Finance Secrets* portion of the program.

2.5 PROJECT GOALS

Having clear project goals allows you to remain focussed on adding value to your project. This applies to all areas of the development from your property rezoning (town planning permissions), to obtaining development approval and especially applies to the delivering a completed product during the construction phase. It is also worthwhile to keep the value of your development in your mind at all times. By setting financial goals for various stages of your project, you can plan a value-based exit strategy at numerous points along the way.

Here are some important questions that will help guide you when setting your project goals.

- What is the value of a property with development rights compared to the same property that has not been rezoned?
- What is the development potential based on the property location and amenities?
- Have there been any recent improvements made (infrastructure upgrades, nearby 'feeder' developments, etc) or is there a potential for improvements in the near future?
- What are the local demographics in terms of employment numbers, affordability of users and other market pressures?
- What are the real estate economics in the area? These include supply and demand numbers of similar products as well as competition.

Tip: To find out more information on the development potential of your property, it may be worth commissioning a Market Research Study.

Exercise: Development Visioning
To take a closer look at your personal project goals, we will complete a basic development visioning exercise as follows. Answer the following six questions about your personal project aspirations.

Q1: What is most important outcome of your development?

a. Making a decent profit	b. Being recognised as a legitimate developer
c. Earning enough money to go on to the next development	

Q2: To you, what is the most important part of the project?

a. Managing the professional team	b. Building a unique, quality project
c. Having a great feasibility with good funding	

Q3: What makes for a good start to a development, in your opinion?

a. You have the perfect site location	b. You have access to project capital
c. You have built the perfect product for your customer	

Q4: How do you know you are ready to start the project construction?

a. You have achieved your funding	b. You have had good market pre-sales
c. Your development team is confident that the time is right	

Q5: Name 3 of your favourite property developments in the surrounding area, and what you admire about each one.

	Development	**What inspires you**
1		
2		
3		

Q6: Prepare a concept sketch of your development. This can be a rough diagram and does not have to be accurate. Look to other examples from developments that you know for reference. If possible, ask an architect or designer for assistance with scale.

Include the following basic information.

- Concept Building Blocks (Massing)
- Count the total number of units
- Estimate the typical unit size
- Total Development Area

Q7: Complete the following Development Data table for your project.

Development Data		
Item		**Description**
Use	What is the building use? e.g. Residential, Offices, Retail etc.	
Units	If a residential project, what is the total number of units?	
Phases	Is the project phased? If yes, how many phases are there?	
	If residential, what is the maximum unit roll-out per phase?	
Area	What is the Estimated Total Development Area (m²)?*	
Total Development Cost	What is the total, all-inclusive estimated development cost?**	
Disposal	How will the project be taken to market? e.g. Sales or Rentals?	
	If Rental, what is net annual income?***	
	If Rental, what is hurdle rate? Year 1 return?$	
Equity	What is the total equity limit – the maximum equity available?	
Cashflow	What is the cashflow limit – the maximum monthly exposure?	
Risk	What is the main down-side risk?	

*Total Development Area = No. of Units X $55m^2$ X 1,2 (add 20% circulation)
**Total Development Cost = Area X R25,000/m^2 (this is a rate allowance)
***Net Annual Income = Units X Average Rental/mo X 75% X 12 (deduct 25% op's costs)
$Year 1 return = Total Net Annual Income/Total Development Cost = %Yield.

2.6 RISK PROFILE

What is an appropriate amount of risk in a typical development, and how do you begin to calculate the relationship between risk and reward? Real estate development risk may lie in different areas depending on the type of development as well as your individual risk tolerance.

In the context of a property development, one way to assess risk would be according to the following risk matrix table. Which category best describes your level of risk?

Risk Category	Definition	Type of Development
Aggressive	Accepts a high level of risk	Highly Speculative developments. High-return growth-Assets. New build projects in unproven/untested markets.
Moderate	Allows some risk	Mixture of new development and investing in already-built products, with the option to convert existing.
Conservative	Avoids risk	Low-return investor in Defensive-Assets. Prefer built stock with proven income and listed property investments (REIT's and securitized listed property funds)

Knowing your appetite for risk is a good first step towards considering the scale of project you are ready to tackle. Thinking specifically about a property project you have in mind, how would you classify your risk profile?

1.Risk-adverse	2.Cautious	3. Average	4.Confident	5.Fearless

2.7 DEVELOPER PROFILES IN THE MARKET

<u>MNT's turn-key strategy.</u>

The well-known developer Irene Tsai has come up with a clever strategy for the delivery of turn-key projects to investors. It is a type of turn-key development strategy, which makes it easy for her company, MNT developments, to unlock bank funding upfront. Before starting the project, Irene signs a development agreement with a customer. Her customer agrees to purchase the development at a fixed price on completion, and Tsai is able to raise development finance based on the balance sheet of her customer, instead of relying on her own financial strength.

This is an interesting position, because in the event of a problem with the development, the bank can take over as developer, carry out the development and still get paid in honour of the agreement. Naturally the bank looks to Irene Tsai and her company's development experience in determining whether she qualifies for funding, but typically this strategy allows her to build hundreds of residential units using little to no capital of her own. To sweeten the development agreement with the customer, MNT may further offer a rental guarantee that guarantees the income of the development during the first year of ownership and occupation.

This is a big incentive for the purchaser, who now has a guaranteed first year return, but is also a very manageable promise on the end of the developer. Since she is aware of the market demand for the development, Tsai can manage the risk of the guarantee by simply topping up on the rental vacancies with cash from her own development profit or project contingency.

Waterfall's Land Strategy

The Waterfall Development company has established arguably the best development strategy in the country for using land to unlock developments. As was the case with their 2,200 hectare (22 million square meters) in Midrand, Waterfall's Werner van Ryn used the inherent value of raw land as a means unlock many developments without capital.

It started with a lease agreement between the Waterfall's DevCo and Mia family, the landowners. The deal was that a percentage of every development that Van Ryn could unlock on their land would be paid back to the family. All he had to do was to unlock the development rights. Werner then went on to market the property to office tenants, residential buyers and retail operators as a prime development midway between the country's capital cities Johannesburg and Pretoria. The sales pitch worked, and purchasers began signing leases that allowed Waterfall DevCo to develop land which they don't own, and raise money based on the strength of their buyers or tenants.

In this ingenious strategy, more than R16 billion worth of developments has been unlocked, using no more than the power of land and the leverage one can generate from its intrinsic value.

2.8 STAY ON PROGRAM

Write down the five most valuable outcomes that you hope to gain from this program.

	Outcome
	Example: I want to learn how to do my first commercial office development.
1	
2	
3	
4	
5	