ADVANCED PROPERTY SYSTEM
2021.08.02

The Developer's Playbook is an essential guide to property development. Like a sports coach would collect their favourite strategies in a binder, we have assembled a 'playbook' of property strategies that will teach you industry secrets and provide a framework for leading you and your team to a winning development It contains vital information, that has been summarized into five fundamental 'rules' to finding success in real estate projects.

3.1 DEVELOPMENT SKILLS
Your development skill level depends on you gaining expertise and mastering the property disciplines. Rate your skills according to the following criteria. You can access the online form here:

Project identification. This includes securing off-market properties, site analysis and prospecting.

1. Basic	2. Average	3. Fair	4. Good	5. Excellent

Development Design and Visioning. This refers to putting together a vision and marketing it to potential customers and investors.

1. Basic	2. Average	3. Fair	4. Good	5. Excellent

Development Management (Project/Site Administration). This refers to the execution and day-to-day management of the professional team, financial management and supervision of the building contractor.

1. Basic	2. Average	3. Fair	4. Good	5. Excellent

Financing. What is your capacity for project feasibilities and financial management of a project?

1. Basic	2. Average	3. Fair	4. Good	5. Excellent

Sales and Marketing. How well can you package a product for sale and convert buyers?

1. Basic	2. Average	3. Fair	4. Good	5. Excellent

3.2 FIVE FRAMEWORK RULES

First, we must learn some of the basic rules followed by property developers, which have been condensed into five crucial points. They are called Five Framework Rules.

3.3 RULE 1: FOCUS ON YOUR STRENGTHS

It is very important to know and accept your role in your property development. No one can be everything to everyone, and successful developers know how to best use their unique skillset to their advantage. I remember the first development that I worked on, I was running frantically between designing the building, coming up with the feasibility, doing project management and running to the bank to raise the funding. Soon, I realised I was on a trajectory that would lead to burn-out or that I would end up making a critical mistake because my eyes were on too many balls. Fortunately, I realized early on that it is impossible to do everything, and I started looking for the right people to help.

So, are you the kind of developer that is brilliant at finding an opportunity, but struggles with the day-to-day execution of tasks? Or are you talented at unlocking project finance, but lack creativity when it comes to fine-tuning the design of apartments? Knowing your own strengths and being able to see the strengths of others is not only an essential skill in property development, but it will also help you to surrounding yourself with the right people when assembling your Property-A-Team.

<u>The A-Team</u>

Every project needs a competent professional team, and experienced developers know to surround themselves with experts of their field. There is the architect, who understands the influence that design has on cost and creating an attractive product. The quantity surveyor, who knows how to balance the feasibility with enough profit to attract investors, but with enough budget to deliver a high-quality outcome. Engineers help to safeguard the building end-user and can achieve dramatic manipulations of the laws of nature. Your town planner will help you navigate the complexities of urban planning regulations and help position your property to attain the strategic rights it needs for development. The sales team will tap into the minds and culture of your audience and help you to achieve pre-sales to support your development funding. Below is a breakdown of the core professionals that form part of the team, and a summary of their project scope and deliverables.

Project Team		
Discipline	**Deliverables**	**Comments**
Architect	Architectural & Interior Design services includes space planning, design development, selection of finishes & fixtures, services coordination, submission to local authority, project coordination & contract administration.	Lead consultant (Principle Agent) and client interface. Advise the client on the appointment of consultants and other specialist service providers including: -H&S Consultant -Council runner (risk of council not fully operational) -Acoustic consultant -Structural engineer -Assembly of project team Agree a procurement strategy in consultation with the client - Agree a Project Program -Determine Method of Contracting -Lead consultants and client interface

Project Manager	Project, Contract: Managing the project construction programme, reporting, specifications and project budget & providing the site management resources to manage subcontractors and hand over the installation of the fit-out within the agreed timeframes.	Help establish project brief, project procurement policy, project team structure, prepare agreements for consultant and service provider appointments for sign-off by client.
Quantity Surveyor	The overall cost management and reporting of the project budget throughout the project duration. Developing a detailed cost estimate based on the designs of the professional team. Managing the procurement and tender process and financial administration of the contract.	Can also advise developer on: -Project cost deliverables -Development Cashflow (NB) -Value Engineering -Achieving profit targets -Sales roll-out and tax strategy.
Structural Engineer	Review and comment on the design development drawings and sign-off council submission layouts for submission to the local council. Assist in the design of any specialised structural engineering systems and conduct site visits to ensure the implementation is accordance with the structural design intent and SANS 10400 structural codes.	Provides useful information on economical structures that can reduce development cost. Can also help avoid costly development decisions, in particular on structure, retaining walls and basement construction.
Mechanical Engineer	The design and supply of all mechanical services and systems, including coordination of services across the disciplines and site supervision throughout the duration of the project.	Advisory services include preparation of base-build specifications that form part of development product. For example, what is the type of A/C the purchaser is getting?
Electrical Engineer	The design and supply of all electrical services, including coordination of services across the disciplines and site supervision Fit-out Area: throughout the duration of the project.	Also provides important base-build specifications relating to purchaser such as: -Electrical loading/unit calc. -Bulk services supply -Specification per unit
Fire Engineer	The design and supply of all fire services and systems, including coordination of services across the disciplines and site supervision throughout the duration of the project.	A rational design can save considerably on development cost.
Information Communication Technology (ICT)	Design, procurement and commissioning of IT network infrastructure, telephony, audio visual and access control.	Useful value-adds to end-user of a development in terms of access control, connectivity and futureproofing.

3.4 RULE 2: PLAN YOUR EXIT BEFORE YOU ENTER

Arguably one of the most important rules in any development is having a clear exit-strategy at every crucial point in the project. Most projects fail when developers are pushed into a corner and left with no choice other than to give up and sell out at a big discount. It saddens me to say this, but there are many people in the industry that are on the lookout for just such an opportunity, and prey on unfortunate development entrepreneurs that didn't foresee a critical stumbling block until it was too late. During the visioning stages of a project, we run the risk of being overly optimistic in our pursuits. So, how do we prevent an unfortunate end to our project? Does having an exit strategy really make such a big difference? It sounds simple enough, but you would be surprised by how many developers blindly start building a project without any clear exit in mind. Many projects start construction without knowing anyone on the team having clear certainty that if all else fails they have an end-game strategy safely tucked away in a 'break-in-case-of-emergency' box. Having a secure financial landing spot may mean the difference between basic survival, unbelievable success, and perilous disaster. Why is it so important? Because when the pressure builds to breaking point, we are highly susceptible to renegotiation and stresses can become unbearable.

<u>Exit Here</u>

In the life of a project, there are several opportunities to plan a graceful exit. Your exit strategy should be planned and orderly. The metaphor I like to think about is like cashing out of a casino when you're at the top of a winning streak. You want to avoid feeling like you're franticly reaching for the chord of your parachute as you plunge uncontrollably to the earth, unsure of where you're going to land. By undertaking a development, you are adding value to the project from day one, and it's important to remember this when contemplating the price of your exit. Here are five examples of possible exit points during a project.

<u>Exit 1 - Land Improvement</u>

If you were successful with changing the rights of a specific property, say from a single dwelling residential use to a high-density commercial office use, that is a significant and valuable action. Many developers focus on this simple improvement and exit once the new land rights have been secured at up to ten times the value of their initial investment. The valuation is usually proportional to the amount of time and energy spent on unlocking these rights, and the timing of market demand.

<u>Exit 2 - Packaged to Go</u>

The next exit could be after the change in land use, but before the physical commencement of a development. Many investors look for opportunities where the development has been fully unlocked and is ready to go. This is referred to as a packaged development, and typically means the following.

- New rights have been approved and proclaimed
- Town Planning restrictions have been removed or resolved
- Professional team has been briefed and assembled
- Development feasibility has been prepared.

By carefully positioning your development cater for a sector that is in demand, a profitable exit can be planned for, once the whole package has been put together.
(Story of Standard Bank, Rosebank)

<u>Exit 3 – Turnkey</u>

The third exit level follows the packaged development and is called a turnkey development. In this scenario, you have prepared the property with all the necessary improvements and rights and gone one step further to find an investor. This investor is not a developer but is willing to rely on your skills to build the project and they are prepared to pay it once completed. It is therefore possible for you to conclude a deal with your investor and use this agreement to raise capital to develop the project yourself. Turn-key projects are typically 'closed-book' developments, because the total development cost is lower than the sales price for the completed project, which generates a development profit. This makes sense, because you are the one taking development risk and so understandably should earn a profit at the end. Fortunately for you, the risk is mostly limited to the time-based deliverables and construction cost variations, which can be captured and allowed for in the feasibility and agreement with the builder.

<u>Exit 4 - Sales Exit</u>
One exit, that is probably one of the most common development strategies, is the gradual process of selling parts of the development as you go. In a residential or commercial project, this gradual sales exit can be achieved by setting up your project as a Sectional Title development. In this way, you can legally pre-sell your units, start construction when you achieve the bank's required pre-sales, and continue to market and sell units throughout the construction process. On completion of the building, an occupancy certificate is issued and the Sectional Title scheme is registered, and the units are transferred. Sectional Title development is a highly specialised process and should only be undertaken with the advice of an experienced lawyer.

<u>Exit 5 - Pre-let Exit</u>
Another exit could be planned on the completion of the construction, based on a certain number of units or square meters that have been pre-let. This form of exit is quite a common approach for large, listed real-estate funds that are looking for property stock but don't want to get involved in the development. They are, however, also concerned with the long-term rentability of their investment, which means that it is your responsibility as developer to ensure that the project can be successfully rented out. One way to add a sweetener to entice the investor is to offer them a rental guarantee for the first year of operation following the completion of the development. This may sound like a risky move on your part at first but can easily be planned for as a contingency in the development feasibility. When calculated, the actual amount needed to subsidize the rentals is fairly nominal when operating in good market conditions with a product that is in reasonable demand.

3.5 RULE 3: WHEN IN TROUBLE, CREATE A THIRD OPTION

One thing to remember is that the most successful developers know that in every difficult situation there is always time to step away and consider your options. People opposing you would like to convince you that your options are limited to the extreme choices. They normally sound something like this. 'Either you come up with the extra funding or you will have to dilute your share.' Another one could be 'If you can't get the next three sales, we will have to cancel the project and sell your land.' The good news is that there is always a third option – one that must be shaped from whatever limited resources are at your disposal – and you must always choose this option or risk falling into someone's carefully laid trap. What do I mean by this? Well, usually in a critical moment, we tend see the world in black and white, especially when we have been pushed into a corner and someone is asking us to make a rushed decision. Developers that survive these situations can remain calm and renegotiate by coming up with a magical third option that the other parties have likely not considered. For example, say you enter into a finance agreement for your project with a bank based on certain sales hurdle rates. You have drawn down on a loan that is earning interest every month, and you need to achieve certain numbers of property sales to keep the bank happy. You have been spending this money on building roads and infrastructure for your project, but then something happens, and your sales dry up. What do you do? The bank starts getting worried because you're not getting sales and so the interest bill starts racking up. This is a very common scenario for many developers building multi-unit estate projects, and unfortunately can lead to financial disaster. In a difficult situation like this, you have very little negotiating power, and the bank can act out their contractual rights to call on your guarantees. If you aren't in a financially liquid position, they may decide to take your land or worse, force you into insolvency.

One such unfortunate situation played out with a developer who was building a housing estate in Cape Town. He had party financed the land and used a large portion of his development finance on building infrastructure to serve the development. The interest on his loans started to climb out of control, and when he no longer could achieve his sales targets, the bank called on his guarantees. This is a vicious cycle that is extremely difficult to get out of and can lead to the financier diluting your stake in a development or offsetting the outstanding loans against collateral in the development such as the land.
All of this can be avoided by having a predetermined exit-strategy for this exact situation. You could, for instance, structure the terms of your funding in a way that, should the sales stagnate for any reason, you are given a 6-month interest-free period in which to ramp up your marketing, refocus your feasibility and re-launch your project. You could also build a buffer in your feasibility – say, a lump sum of money which represents a small portion of your profit, but in the event of financial stress can be sacrificed to save the project.

3.6 RULE 4: BUILD A STRONG BUSINESS CASE

Before property investors and banks fund a new project, they usually make the developer and his team jump through some hoops to convince them that you have indeed brought along a project worthy of their time and hard-earned capital. This should come as no surprise, especially when considering the potential risk that a purely financial investor must convince their investment committee, board of directors and even themselves to take. As a developer you should always be clear about the risk vs. reward offered by your project. When it comes to putting together your proposal, try to eliminate all the risks on paper, and if this is not possible, you need to plan robust contingencies for each obstacle that may come your way. By closing out every possible loophole in your business case, you will be amazing by the favourable response from investors and funders alike.

To a banker, there is nothing more noticeable than a developer that is well prepared and can answer every question in a presentation meeting with confidence. Remember, these institutions are conservative and risk-adverse by nature, and it is of paramount importance that you calm any of their fears that may arise. It is worthwhile mentioning that banks see hundreds of applications from developers and regularly turn down new projects because of five key points.

1. Property valuation is poor (The wrong property in the wrong location)
2. Lack of development experience
3. Insufficient Equity relative to the loan (Gearing too high)
4. Guarantees not sufficient (This is based on your balance sheet)
5. Lacking bank-qualified pre-sales

As a developer starting out, it is very difficult to satisfy most of these points. Nevertheless, I will show you how to overcome these obstacles and build a case for your development that will wow any bank or investor.

<u>Valuation</u>

Firstly, it is very important to get a favourable valuation done on the property well before the time of the first financial meeting or presentation. Should you hire a third-party valuer? In many cases, banks are prepared to perform a free valuation to win your business, but I find it useful to bring in an independent valuer as you have more control of the way in which the valuation is structured and presented. During this program, I will also help you prepare a detailed property report that lists all the positive aspects of your development site. This can be an extremely valuable document to allow your property to be seen in the best possible light. I find it helpful to imagine that the investor or customer that you are presenting your property to has never heard of you, has never seen the property, and has never heard of the context or location that your project is in. If you present your proposal thoroughly, you can be sure that they are on the same page and see the incredible potential of your unique deal. When it comes to a rezoning property, you should always try and have at least a letter of approval of your new rights in hand when presenting it to an investor. This is advantageous, because in all likelihood, the purchaser or investor will be appointing a valuer who will take the new rights into account when calculating the land opportunity cost.

<u>Experience</u>
The next point is development experience. How is it possible to demonstrate expertise on your first project? In this case, it may be wise to hire a development manager or a property developer that is known by the bank, with credible experience in the market. An added bonus of this is that they will be familiar with the bank's requirements and be able to help you select a good team. Referring back to the selection of your 'A-Team' discussed in Rule 1, it is possible to hire the right team of experts led by a Development Manager that you trust, to carry out the development on your behalf. In this instance, you can help to determine the primary goals of the project, and be involved throughout the process, but rely more heavily on your professional team to resolve the day-to-day project challenges. Another option to consider is if you are in a financially strong position, you may want to consider a turn-key development, which isolates you from construction risk and establishes you as the end-user or purchaser of the development. This leaves the problems of financing the project to the turn-key developer, who is acting independently from you, the property investor.

<u>Equity</u>
The next challenge is proving that you have enough money (equity) to match the funding criteria (gearing). Again, how do you produce additional equity when, for example, you have just invested capital in purchasing the land? In this case, you may have to consider bringing in a financial partner or equity investor to support the requirements of your project. Another idea would be to think about doing a phased development. If you are the owner of the property, this also means that the value of your property may be used as equity in the development, provided that you register a bond over the land in favour of the bank.
Entering a deal with the right balance of equity-to-loan is a fundamental point in real-estate development. By increasing the ratio of equity in the project, you effectively limit your exposure to loans and running interest. This can safeguard your investment and reduce development risk. Banks or other Private Equity lenders will typically consider a 70:30 loan-to-equity ratio, which is otherwise referred to as a 70% 'gearing'. Although this may be considered by many as an industry standard, your financial standing with the bank could mean a higher gearing such as 75:25 or even 80:20. Your discretion can be applied here because a higher gearing may give you the opportunity to do a bigger development relative to the same amount of equity, but it also increases the risk. It is worthwhile mentioning that one way of increasing the equity in the deal is by getting a partner on board. Many financial investors are regularly seeking partnerships with experienced developers of projects in strategic locations. This may be the crucial ingredient that you need to unlock your development, as a financial investor will have a limited involvement in the development process, as long as the project is delivered on time and within the agreed parameters of cost and profit.

Guarantees
Along with the equity requirements put forward by your lender, they may (and likely will) require guarantees to be in place for the development. These guarantees typically are designed to protect the lender's exposure on the loan amount and can be in the form of collateral such as other real estate, assets or cash. Often, banks may look to the developer's balance sheet as a form of guarantee.

Pre-sales
When it comes to reducing development risk, the most beneficial aid to any development's financial application is having bank-approved pre-sales. These pre-sales can sometimes rank as strongly as an equity investment in a project depending, of course, on the means by which they have been qualified. Your project financing will always be linked to pre-sales in one form or another. For example, if you are doing a residential development, your funding may be calculated on a 120% sales-to-loan ratio. This means that you need to achieve R120 million in pre-sales for the bank to release R100 million to your development. For pre-sales in a Sectional Title development to be considered bankable, the purchaser usually needs to have completed the following.

- Signed a binding Offer to Purchase
- Paid a Deposit (deposit 1 can be, say 10% of the purchase price)
- Provided adequate guarantees on the balance of the purchase price

In a commercial (office) project, the funder may agree to provide the full financing to you on the strength of a lease with a long-term tenant. This is an ideal situation for a bank, especially if the tenant is considered to be of a high grade or 'blue-chip' d the lease term exceeds 5-7 years. In this case, they are protected from risk in the event that you are unable to deliver the project. Using the lease a security, the bank can step in and complete the development with their in-house team, or substitute you with another developer and still recover from a project in distress.

3.7 RULE 5: TIMING IS EVERYTHING

Successful property development is extremely sensitive to timing. Your ability to deliver a project is dependant on external conditions that are largely out of your control. As a developer, you therefore need to plan for and react to these factors in a responsive way.

Timing the Market
An important consideration in development is market timing. As a developer, you should be aware of economic factors that impact the supply and demand in the area of your project. Although the effects of market timing can be widely distributed (such as a global pandemic), it is prudent to start with the local factors that may impact your scheme. Some considerations include the following.

- What is the market demand for your product?
- Which other competing developments exist, or are planned in the near future?
- What is the political environment, is there stability?
- What are the projected interest rates? How are these likely to influence my development loan?
- What are building prices doing? Are there any planned escalations, say, in steel prices?

Project Plan
One way to be proactive with planning is to create a development project plan. This plan is essentially a list of deliverables, or outcomes, with associated dates next to each item. It doesn't have to be complicated – in fact, the initial development plan should be quite high-level and give a comprehensive 'bigger-picture' view of the milestones and critical dates.

When planning this program, it is vital to describe your exit strategy both in terms of outcome and critical delivery dates.

Count the Stages

A useful guideline to establishing a project plan is looking at the workstages contained in the PROCSA Development Manager edition. This document refers to seven key project work stages in every development as follows.

Stage 0 – Project Initiation
Stage 1 – Inception
Stage 2 – Concept and Viability
Stage 3 – Design Development
Stage 4 – Documentation and Procurement
Stage 5 – Construction
Stage 6 – Close-out

When planning your project, you can monitor your progress by consistently asking yourself at which stage you are in the overall program. The PROCSA document conveniently outlines the project scope (services) and deliverables of each workstage. These can act as a guide to your tasks as development manager, and you can even go so far as to cross out each stage as you complete it.

Exercise: Five Framework Rules

Complete the following questions based on the five framework rules.
You can find a link to the online questionnaire here.

Rule 1: Focus on your Strengths

Based on your answers to the Development Skills questionnaire, what would you say is your one main strength and skill in a development?

Rule 2: Plan your Exit

Choose an exit strategy from the five examples provided, and describe how it can be used to reduce your project risk?

Rule 3: When in trouble, create a third option

Picture the following scenario. You are midway through your development and have been drawing down payments from your development loan. Your capital has been spent on upgrading services and building the concrete structure of your first block of flats. Your sales have stagnated, the bank has placed a hold on any further drawdowns and has proposed bringing in another developer by diluting your equity stake from 100% to 20%. Prepare a counterproposal and explain your recovery.

Rule 4: Build a Strong Business case

In terms of your new development, which one of the five business case points would you say is the weakest? How can you improve the business case of this aspect of your project?

Rule 5: Timing is Everything

Using the PROCSA scope of services as a guide, assign a duration (in months) to each work-stage and prepare a high-level project program for your development. This can be in the format of a list, table or diagram.