







Real Estate Development Basics

Course Curriculum



DTAP DEVELOPERS TECHNICAL ASSISTANCE PROGRAM







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Community Planning & Economic Development Developers Technical Assistance Program (DTAP)

Developed by:



www.varrorealestate.com

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Table of Contents

CHAPTER 1: INTRODUCTION	5
CHAPTER 2: GETTING STARTED	8
I. DEVELOPMENT PROCESS OVERVIEW	8
II. Small Scale Development & Skills Assessment	11
Activity A: Small Developer Skills Inventory	15
III. DETERMINING YOUR BUSINESS MODEL	17
Activity B: Model Participant Activity	24
CHAPTER 3: SITE SELECTION & OPPORTUNITY IDENTIFICATION	25
I. WHAT TO CONSIDER WHEN SELECTING A SITE	25
II. RESOURCES FOR SITE SELECTION	35
III. INVENTORY COMPARISON	39
Activity C: Site Selection Research	40
CHAPTER 4: ACQUISITION, DUE DILIGENCE, AND ENTITLEMENTS	41
I. Pre-Acquisition	41
II. ACQUISITION PROCESS	42
III. DUE DILIGENCE CHECKLIST	44
IV. ENTITLEMENTS	46
Activity D: Zoning Research	53
CHAPTER 5: DESIGN & CONSTRUCTION	54
I. INITIAL CONSIDERATIONS	54
II. Design	57
III. CONSTRUCTION	65
Activity E: Buildable Area Analysis	74
CHAPTER 6: INTRODUCTION TO FINANCIAL FEASIBILITY	75
I. REAL ESTATE IS A BUSINESS	75
II. SINGLE YEAR FINANCIAL ANALYSIS	77
Activity F: Develop & Sell Financial Feasibility	84
Activity G: Single Year Financial Feasibility	85
III. Сар Rate	86
IV. FINANCIAL "GAP"	88
CHAPTER 7: FINANCING	91
I. FINANCING OVERVIEW	91
II. FINANCING OPTIONS	92
III. Debt Financing / Mortgages	95
	100

	GAP FINANCING AND ECONOMIC DEVELOPMENT FINANCING	
VI.	LENDING FOR SMALL SCALE DEVELOPMENT	
СНАРТ	ER 8: DETAILED FINANCIAL FEASIBILITY	
١.	Pro Forma Structure	
١١.	DIFFERENCES IN THE RESIDENTIAL AND COMMERCIAL PRO FORMAS	
III.	Sample 10 Year Pro Forma – Residential	
IV.	Sample 10 Year Pro Forma – Commercial	
А	ctivity H: Developing a Pro Forma	
СНАРТ	ER 9: LEASE UP AND PROPERTY MANAGEMENT	
CHAPT	TER 9: LEASE UP AND PROPERTY MANAGEMENT	
СНАР1 I. II.	TER 9: LEASE UP AND PROPERTY MANAGEMENT Lease up Property Management	
CHAP1 I. II. APPEN	TER 9: LEASE UP AND PROPERTY MANAGEMENT LEASE UP PROPERTY MANAGEMENT IDIX A: GLOSSARY – PRO FORMA TERMS	
CHAPT I. II. APPEN APPEN	TER 9: LEASE UP AND PROPERTY MANAGEMENT LEASE UP PROPERTY MANAGEMENT IDIX A: GLOSSARY – PRO FORMA TERMS IDIX B: MINNEAPOLIS ZONING CODE - SELECT SECTIONS	

Chapter 1: Introduction

Purpose of Course

Developing and investing in real estate can be an exciting and rewarding experience. lt provides the opportunity to get deeply involved in vour community working with area residents, businesses, and government. Real estate requires developing strong relationships with community leaders, architects and engineers, contractors, brokers, lawyers, financers, and potential



tenants. It also will challenge you to partner and think creatively to solve problems, tap into your sense of good design, understand building construction, draft smart legal agreements, and analyze financials. Done well, at the end of all of this, you will have a product that is not just visible to you, but will change the landscape of the community, provide value to residents and businesses, and deliver a decent financial return to you and your investors.

Despite the upside, real estate can be a scary and risky business. In fact, the complexity that ultimately makes real estate so fulfilling can also make it intimidating, particularly for those who are new to the industry. While any investment should be carefully considered, real estate does not need to be out of reach for the average investor. There are many opportunities for wealthy individuals and corporations to create multimillion dollar developments. Yet every day, there are average individuals who buy, build, and redevelop small residential and commercial properties that individually and collectively make a tremendous impact on their communities and provide personal fulfillment.

No book nor course can teach everything there is to know about real estate investing and development. Yet, having a basic understanding of the process, concepts, and key resources can be an invaluable way to start in real estate and help minimize initial hesitancy. The purpose of this course is to provide some initial material to help aspiring, novice, and perhaps even some experienced developers, with the knowledge and tools to build their confidence and enable greater success in their real estate ventures. The City of Minneapolis Developers Technical Assistance Program (DTAP) has four primary objectives:

- Support community wealth building through real estate development
- Diversify the pool of real estate developers in Minneapolis
- Increase local ownership of residential and commercial property
- Build capacity for developers doing small and mid-sized projects

To support those overarching program objectives, this course is intended to provide you with knowledge and tools to:

- 1. Navigate the real estate development process
- 2. Evaluate and manage the risks of development
- 3. Work on projects in Minneapolis

While many books and courses are available that help individuals gain knowledge about real estate acquisition and development, they often are targeted to large scale opportunities. In every neighborhood in Minneapolis, there are small and medium size opportunities to enhance the built environment, improve the community, and earn a profit. This guide intends to provide you, the real estate visionaries in our community, with some resources to take your next step in advancing the real estate opportunity that is right for you. While much of the guidance provided in this text applies to development regardless of location, the intended audience are those who intend to develop in the City of Minneapolis. As such the processes, rules, resources, etc. are focused on Minneapolis and may not be the same nor directly applicable outside of Minneapolis. Furthermore, it is up to you as the developer to verify any information provided in this guide that may impact your success as a developer, regardless of whether your project is located in Minneapolis or elsewhere.

The Missing Middle

One of the stated objectives of this course is to build capacity for developers doing small and mid-sized projects. When it comes to housing, we are quite familiar these days with construction of single-family homes and large (50+ unit) apartment buildings. However, there are numerous other styles of housing that were common prior to the end of



World War II. These housing styles create higher density than single family homes but

are not as dense, nor as tall as larger, multi-story apartment buildings. Dubbed "the missing middle," these styles include duplexes, triplexes and fourplexes; courtyard apartments; row houses and townhomes; and multi-plex apartments. Planners tout the benefits of the missing middle as providing more housing options for different

"Missing Middle" A range of multi-unit or clustered housing types compatible in scale with single-family homes that help meet the growing demand for walkable urban living. Source: Opticos Design types of households, improved density that supports walkable communities, and options to make housing more affordable. While developing housing in the missing middle is less prevalent than it was

before the end of World War II, developers, city planners, and residents recognize the value. Understanding the missing middle is important for small developers, as it may offer income producing opportunities at a manageable investment level. While the missing middle is re-emerging as an option for both builders and buyers, it still has some challenges. Some communities continue to resist mid-scale residential, formally through zoning and lawsuits or informally by vocalizing their objections, even when it is designed to be compatible with neighboring single-family homes. In addition, if land and/or labor costs are too high, it may not be financially feasible to finance and develop mid-scale housing; higher density may be necessary to make the economics work. Nonetheless, in some locations, the missing middle, built to accommodate today's needs, can be a desirable alternative for those looking for housing that supports dense, walkable communities at a human scale. It is the City's goal that as more emerging developers become successful the volume of this critical missing middle housing in Minneapolis will grow.



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Chapter 2: Getting Started

Key Concepts

- Despite its complexity, with the right skills and partnerships, it is possible to be highly successful in real estate. This course provides many basic real estate concepts to help residents and others in the Minneapolis community take those initial steps to create small and medium scale developments in their neighborhood.
- This course is organized into six general phases of development: Site Selection & Opportunity Identification; Acquisition, Due Diligence, and Entitlements; Financial Feasibility; Financing; Design & Construction; and Lease Up & Property Management
- Real estate requires a huge array of capabilities including people skills, financial acumen, negotiating ability, and technical knowledge. Understanding what is needed during each stage is important. Further, knowing your own abilities and limitations, and when to bring on external help will be critical to your success.
- There are many choices a real estate investor must make about his or her focus in real estate. These choices include Acquisition, Term, Asset, Financing, Tenant, and Geography. Where, and how narrowly, you focus in each of these areas will collectively make up your business model. Your business model will depend on your interests, capabilities, risk tolerance, and external opportunities.
- For a development to succeed, a developer must bring together four critical elements: site, tenant, money, and knowledge. You may only have one of these four elements to start but can acquire the others either directly yourself, or by establishing partnership with others. One such partnership is that of the capital partner and the operating partner.

I. Development Process Overview

Real estate development is far from a straight path from A to B. In fact, it may often feel like riding both a merry-go-round and a roller coaster simultaneously. Many things must be brought together at the same time to make a development succeed. Despite these multiple parallel paths, there are still various phases in the development process that must occur. The material in this course is organized into six different phases of development, which loosely occur during the development process in the order presented here.

Site Selection & Opportunity Identification

You don't have a development if you don't have a site. Even if you begin with an idea or a tenant first, at some point early in your process you will need to identify a site for

development. Initially, finding the right opportunity can be overwhelming. But knowing what to look for during your preliminary search, how to quickly filter out properties, and resources for easily gathering critical upfront information can make this part of the process much more manageable. (Chapter 3)

Acquisition, Due Diligence, & Entitlements

Once you have identified a property for acquisition or development you must buy it and get all approvals necessary to build and operate it in the way you intend. Getting a property "under contract" (signed purchase agreement) is a big step, but in reality, it is when the real work begins. Due diligence, the process of investigating the property, getting financing, and making sure the property will work for you, can be fairly involved, especially if the property is going to be developed or redeveloped. If changes are going to be made to the property, the entitlement process is a substantial and critical step. (Chapter 4)

Design & Construction

Design and construction are the most visible and sometimes the most exciting parts of the entire development process (perhaps even more exciting than getting your first rent check!) Understanding the design process will be helpful, and having good partners can be the difference between making a development work (effective design, lower cost, necessary approvals) or not. Construction is exciting because it is visible, but it is also exciting because it marks a milestone – you have purchased the property, secured financing and all entitlements, and may even have a tenant lined up. However, construction can still be a scary time because you will be signing checks on a regular basis without seeing any income from tenants yet. Construction can also present unknown costs, so knowing what to look for and having good partners is critical. (Chapter 5)

Financial Feasibility

The reality is that financial feasibility will commence from the point you begin to consider an opportunity to the moment your last lease is signed. Because an opportunity must "pencil" (i.e., make sense financially) for it to succeed, you must regularly be updating your analysis and adjusting (or getting out) as necessary. As you proceed through the development process, your revenue, cost, and other inputs will change, and assumptions will be continuously refined. Your financial feasibility analysis should shift from a "back of the envelope" calculation early on to a detailed financial pro forma later in the process. (Chapters 6 and 8)



Financing

Though some individuals may have piles of cash in their mattress that they can use to acquire a property, build a structure, and initially operate their development, most real estate investors will need to seek partnerships with outside parties —in the form of equity, debt, or both. Even a great vision on the ideal site will not succeed if it cannot be financed; often when developments fail, financing (or lack thereof) is the cause. Understanding the financing process and what lenders want from you can help mitigate the financing risk and make you more comfortable. (Chapter 7)

Lease Up & Property Management

Once the last wall is painted and the sod is laid, you have reached another major milestone. Yet, like other milestones, this is not a time to be complacent. Quality property management – keeping the property in good condition, maintaining strong relationships with your tenants, and ensuring tight accounting – will impact the long-term viability of your property.

It may be somewhat misleading to place "lease up" as the last phase given that it often may need to start well before construction begins. The earlier you can secure a tenant or tenants, the lower your risk. Nonetheless, if your building is not full at opening, or whenever a tenant vacates, you will need to focus on leasing the empty space. Understanding how best to lease your space, including deciding whether to do this on your own or through a broker or property manager, is an important part of property management. (Chapter 9)

Applying This to You!

Looking at the six phases of development, which are the areas that are most exciting to you? Which phases do you feel the most confident? Which are the phases that are most intimidating to you?

	Score: 1=Low, 5=High	
Phase	Exciting	Confidence
Site Selection & Opportunity Identification		
Acquisition, Due Diligence, & Entitlements		
Financial Feasibility		
Financing		
Design & Construction		
Lease Up & Property Management		

II. Small Scale Development & Skills Assessment

Small scale differences, risks, and rewards

While the overall process generally applies for all developments, whether a small duplex or a 40-story office tower, there are some differences in small scale versus large scale.

Location-based – Small developers often start because they have a connection to a specific property in their community. In fact, while big developers may have access to talent, money, and connections, the small developer advantage may be deep insight in a particular neighborhood. A small developer that knows a local market intimately can turn that knowledge into an opportunity that others who are focused more broadly do not see.

Start-up mentality – Much like a cost conscience start-up who scrapes together card tables for desks and paints his own office, having a start-up mentality can allow you to make otherwise costly investments workable with a lot of sweat equity. An individual, or a small team, will often take on many of the tasks required in development to save money, such as finding and negotiating a deal and performing property upgrades.

Financing – Assuming you have a solid project and demonstrate competence, securing reasonable terms from a local bank for a loan should be doable. However, getting equity, if more is needed than just your own, may require a bit of digging. Larger projects will seek out capital from larger institutional investors or smaller, locally managed funds. Smaller developments may fall below the radar of these sources. In many cases, capital for small developments will need to come from a tight ring of friends, family, and other close relationships that the developer has pulled together.

Steady growth – A small developer is not likely to be able to retire after developing and selling off a single property. Even if the return is good, the size of the profit will be commensurate with the small project size. While small scale developers do look to make money, it is typically a steady stream of acquisitions and developments that, over time, create an impressive portfolio. It is the passion and value created in other ways that drives small developers forward.

Skills needed at each stage of development

Perhaps one of the most interesting aspects of real estate is the broad set of skills that it requires to pull a development together. Even more, this means that individuals with different personalities and talents still have an opportunity to find their niche and do well in real estate. Someone who is detail-oriented may find herself focusing more on the financial modeling or legal contracts, while a person who is outgoing and enjoys working with people may lean more to developing tenant relationships. Each phase of development has certain skills that play an important role. Many of these are described below.

Phase 1: Site Selection and Opportunity Identification

- Intelligence gathering Talking to people who know an area most intimately, like neighbors, local business owners, and on-the-ground workers to understand what is happening with properties, owners, tenants, and overall trends.
- Market analysis Identifying niches or needs to fill, and comparing opportunities
- **Understanding zoning** Knowing at a high level what can and cannot be built on a site
- Process familiarity Understanding what will be involved in getting from opportunity identification to project completion to anticipate opportunities and challenges
- Visionary thinking Creativity; Imagining what could be and a passion for making it a reality

Phase 2: Acquisition, Due Diligence, and Entitlements

- **Contract language** Understanding legal language and contract drafting that will ensure flexibility and buyer protection during the purchase process
- Engineering expertise Assessing environmental, soil, stormwater, and utility conditions and limitations
- **Building construction** Identification of concerns with existing structure and preliminary cost estimates
- **Navigating approvals** Familiarity with the development approval processes, including stakeholders (i.e., partners, administrators, approvers) as well as time and submittal requirements
- Schematic Design Conceptualizing an "approvable" design that will be functional, cost effective, aesthetically pleasing, and timeless

Phase 3: Financial Feasibility

- **Basic math and spreadsheets** Conducting simple calculations to estimate cash flow and returns
- Forecasting and estimating Familiarity with market rents and construction and operating costs to incorporate realistic assumptions
- **Balance** Maintaining a realistic financial model not muddied by wishful thinking, yet not so conservative that it paralyzes any action

Phase 4: Financing

- **Financial relationships** Having or establishing strong relationships with equity partners and/or lenders who can provide funds
- **Trust and competence** Well organized, demonstrating aptitude and an ability to get things done, to instill faith in your financial partners

Phase 5: Design & Construction

- **Design sense** Making good decisions about materials, layouts, features, and trade-offs that influence your building's sale or rental value
- **Construction and management skills** Hiring many skilled tradespeople and coordinating their work; keeping your project on time and on budget
- Engineering & technical drawings Designing a building that is structurally sound
- Knowledge of building code and regulations Ensuring construction is safe and performed appropriately

Phase 6: Lease Up & Property Management

- Marketing and people skills Attracting good tenants and maintaining a good brand image for your development
- **Negotiation skills** Negotiate financial and other lease terms to ensure a strong lease, but also a good ongoing tenant relationship
- **Conflict resolution** Handling any tenancy issues professionally
- **Building maintenance** Looking after major heating and cooling, plumbing, landscaping and building exterior elements

Filling gaps through personal and professional partnerships

While it is beneficial to have a somewhat varied and adaptable skill set, to be productive in real estate does not mean you must excel in all areas. Every skill needed at every stage along the way can be obtained through partnerships and/or by hiring talent. In fact, the only notable skill some of the most successful real estate developers have is an ability to identify good talent and bring those individuals together into an effective team.

Some of the most common partners that a developer will bring on his team and the main areas they support are:

• **Real estate broker** – Market intelligence, site identification, lease up, negotiation of business terms

- **Attorney** Assist with contracts (purchase agreements, leases) and navigating the entitlement process
- Architect/Designer Site and building design; supporting the entitlement process
- Engineers (civil, environmental, structural) Preliminary site inspections, site and building design, and supporting the entitlement process
- General Contractor/Construction Project Manager Preliminary site and building inspections, design support, construction management
- **Market Analyst** Independent perspective on market rates, potential for tenants and income
- **Financial Partners (equity and debt)** Provide ownership capital and/or loans for acquisition and construction
- Financial Analyst Run financials/create pro formas to determine feasibility
- **Property Manager** Day-to-day property operations, maintenance, tenant relationships, and lease up

Depending on your situation, you may choose to hire all, some, or none of these partners. Clearly, the more you do yourself, the less out of pocket cost you will have. Buying a small, neighborhood retail building, painting the exterior, and improving the landscaping may not require much more than your own time and vision. Larger or more complicated properties may justify a bigger, sophisticated team. The important thing is to find the right balance that makes sense for you and the situation. Saving money in the short term can ultimately cost you more money and time overall from unforeseen conditions, poorly structured deals, legal challenges, inadequate design, and shoddy construction. Part of the thrill of real estate is increasing your own knowledge with each new deal. Nonetheless, be smart and partner right.

Activity A: Small Developer Skills Inventory

H = Have L = Will Learn O = Outsource			
Phase 1: Site Selection and Opportunity Identification	Н	L	0
Intelligence gathering – Talking to people who know an area most intimately to understand what is happening with properties, owners, tenants, and overall trends			
Market analysis – Identifying niches or needs to fill and comparing opportunities			
Understanding zoning – Knowing at a high level what can and cannot be built on a site			
Process familiarity – Understanding what will be involved in getting from opportunity identification to project completion to anticipate opportunities and challenges			
Visionary thinking – Creativity; Imagining what could be and a passion for making it a reality			
NOTES:			
Phase 2: Acquisition, Due Diligence, and Entitlements	Н	L	0
Contract language – Understanding legal language and contract drafting that will ensure flexibility and buyer protection during purchase process			
Engineering expertise – Assessing environmental, soil, stormwater, and utility conditions and limitations			
Building construction – Identification of concerns with existing structure and preliminary cost estimates			
Navigating approvals – Familiarity with the development approval processes, including stakeholders (i.e., partners, administrators, approvers) as well as time and submittal requirements			
Schematic Design – Conceptualizing an "approvable" design that will be functional, cost effective, aesthetically pleasing, and timeless			
NOTES:			
Phase 3: Financial Feasibility	Н	L	0
Basic math and spreadsheets – Conducting simple calculations to estimate cash flow and returns			
Forecasting and estimating – Familiarity with market rents and construction and operating costs to incorporate realistic assumptions			

H = Have L = Will Learn O = Outsource			
Phase 3: Financial Feasibility (continued)	Н	L	0
Balance – Maintaining a realistic financial model not muddied by wishful thinking, yet not so conservative that it paralyzes any action			
NOTES:			
Phase 4: Financing	Н	L	Ο
Financial relationships – Having or establishing strong relationships with equity partners and/or lenders who can provide funds			
Trust and competence – Well organized, demonstrating aptitude and an ability to get things done, to instill faith in your financial partners			
NOTES:			
Phase 5: Design & Construction	Н	L	0
Design sense – Making good decisions about materials, layouts, features, and trade-offs that influence your building's sale or rental value			
Construction and management skills – Hiring many skilled tradespeople and coordinating their work; keeping your project on time and on budget			
Engineering & technical drawings – Designing a structurally sound building			
Knowledge of building code and regulations – Ensuring construction is safe and performed appropriately			
NOTES:			
Phase 6: Lease Up & Property Management	Н	L	Ο
Marketing and people skills – Attracting good tenants and maintaining a good brand image for your development			
Negotiation skills – Negotiate financial and other lease terms to ensure a strong lease, but also a good ongoing tenant relationship			
Conflict resolution – Handling any tenancy issues professionally			
Building maintenance – Looking after major heating and cooling, plumbing, landscaping and building exterior elements.			
NOTES:			

III. Determining Your Business Model

Business Model Spectrums

Before you jump into the real estate world, you should consider what your strategy, or your business model, will be. The reality is that real estate investing is an extremely broad term and there are numerous different models for investing depending on the market and your abilities, interests, risk appetite, and goals. One way to determine your business model is to evaluate where you should be on each of six different real estate spectrums.

Acquisition (Buy, Redevelop, Build) – This spectrum differentiates an investor from a developer. An investor who only purchases fully leased buildings that do not require additional investment is interested in an existing, stable rent stream. On the opposite end is the developer who starts with a raw piece of land and does everything from design and construction to entitlements to lease up. At this end, the process is lengthy, and the risk is high, but the financial and personal rewards can be substantial. There are also many degrees along this spectrum, including acquiring and doing a minor refresh to a full-scale redevelopment of an existing property.

Term (Flip v. Hold) – Some real estate investors like to buy or build properties and hold onto them to have a stable, long-term income producing portfolio. Others, however, seek to buy and improve a property in some way (or hope the market simply rises), and then sell off that property for a good profit. Property flips can be lucrative if done well, but they also can be high risk since they usually have less flexibility if the investment does not go well in the timeframe planned.

Asset Type (Residential, Retail, Office, Industrial, Other) – Asset type is not so much a spectrum, but it does provide a variety of options requiring consideration. Many real estate investors, especially smaller ones, initially focus on residential because it is familiar to them. Retail may also be attractive to newer investors since it can be done on a small scale and often as part of a mixed-use development with residential. Office and industrial may be more intimidating to real estate investors who do not have familiarity with those asset classes, and investments tend to be larger in scale, but smaller, rewarding opportunities do exist.

Financing – Unless you have a substantial amount of money saved up, where you are on the financing spectrum may not be entirely up to you. Nonetheless, it is still a decision that must be considered. If you do have enough money to finance an acquisition or development on your own, you may choose to do so without outside equity or debt. This gives you full control, requires less coordination, and can enable you to move more quickly. However, if you do not have enough of your own money or want to limit your exposure, you may choose to pull in other investors or debt. Because it gives you leverage, taking on debt can provide an overall better return. However, debt also will increase your risk in other ways – if you can't cover debt service you can lose your entire investment (or more if you have a personal guarantee.)

Tenant – Another spectrum to consider is the tenant spectrum, specifically how far along with a tenant do you want to be before you proceed. Most developers find a property that they think will be attractive to tenants, get it under control (i.e., sign a purchase agreement) then work to get commitments from enough tenants to fill a minimum amount of the space to get them to feel secure. However, not all developments work this way. Some developers will build "on spec," meaning they are willing to fully buy and build a property without any firm commitments. If they expect the market to be strong and they want to move quickly, this can pay off. On the other hand, if their predictions are incorrect, they can be stuck with a beautiful, expensive, and empty building. The other end of this spectrum is to develop a strong relationship with a tenant from the beginning and only pursue a development opportunity with that tenant's requirements in mind. This route is the least risky, but likely will provide

the lowest return since your tenant partner will expect to pay you less because they are mitigating much of your risk.

Your combined position on each of these individual spectrums collectively makes up your business model. For example, perhaps you want to redevelop under-occupied



office buildings for a short-term hold using debt financing. Alternatively, maybe you want to fully develop new multi-family residential using no debt and hold them for the long term. Some developers consider themselves to be "opportunistic" and remain flexible, investing in anything they determine to be a good opportunity. While this does work for some people, early on it may be beneficial to keep a narrower scope in order to strengthen your knowledge, relationships, and expertise through a single, repeatable business model.

Geography – One last area that should be considered as part of your real estate business model is geography. While this is not exactly a spectrum, there are trade-offs to be made when determining where you want to focus. You may choose to invest in an established neighborhood where demand is good, but prices are also high. Alternatively, you may want to invest in a neighborhood that has more economic challenges. Here the risk is higher because demand may be low and not arrive as quickly as you anticipate. Yet the reward can be good financially if you get into an up-

and-coming neighborhood just ahead of the rush, and it can be personally fulfilling if your own investment helps to improve that neighborhood. In choosing your geographic focus, you also will likely want to focus on an area that you know. Because real estate is so local and so much of it is about location, it will ultimately be important to have deep knowledge of what is happening with and around your development. Also, since you will be on site frequently, it makes sense to invest in an area that doesn't require a lot of burdensome travel for you.

Applying This to You!

Put together your business model. Where do you see your focus in each of the six real estate business model "spectrums"?

Four Elements Needed for Success

Successful development depends on four elements: A site, tenant(s), money, and knowledge. Odds are that you do not have all four of those things from the beginning – if you do, you are one fortunate developer. Your goal, over the course of the development, will be to obtain and bring together each of these four elements. Your Day 1 goal is to start with at least one of the four and grow from there.

Site - Perhaps you own or could acquire a site that you know will be a great location for a particular use. If it truly is a great location, or at least great for a certain type of tenant, you have your first element. You will then need to go out and find that tenant, get money to acquire and develop the site, and get (or hire) the knowledge to get through the process.

Tenant – If you don't have a site in mind, only have a little money, and are not that knowledgeable in real estate, but you have a relationship with a tenant who is willing to work with you, you have your first element. Perhaps you have a friend who owns a business. She wants to lease some space but can't find what she is looking for in the market and doesn't want to deal with developing and owning real estate herself. This is an opportunity for you to find her a good site, secure financing, and bring together the knowledge to develop it to her business requirements...in return for a decent lease income, of course.



Money – If you have money to invest in a property but do not have the knowledge, a site, or a tenant in mind, you still are at a good point. Many development deals fall apart because the developer is unable to secure financing. If this is not an issue, you will be in a strong position to reach an agreement with the seller because you can move quickly and there is less risk for the seller that you will not be able to close. If you are in this situation, you can either patiently look for a good site and/or tenant on your own. Alternatively, you could look to be the equity partner (a highly sought-after role) with someone who has a site, a tenant, or the knowledge to move it all forward.

Knowledge – If you don't have a site, a tenant, or money, you can still lead a successful real estate development by relying on your knowledge. Some of the most successful developers don't initially have anything but their knowledge. However, because they know how to pull all the complexities together, how to manage through the process, how to analyze a deal, have at least a basic understanding of construction, and, importantly, how to build relationships to find opportunities, tenants, and financing, they are able to do deal after deal. Even if you start off not knowing anything about real estate, but you can "herd cats" and build strong relationships, you have a place to start. In fact, this element is perhaps the most beneficial because it will produce not just one opportunity but can lead to an ongoing pipeline of developments.

⁶⁶ The journey of 1,000 miles begins with a single step. ²⁷ - Lao Tzu

As stated, a successful development ultimately depends on all four of these elements. While you may only begin with one, you will need to acquire all four; the earlier you pull all four together the lower the risk and the better likelihood of success. The good news is these build on one another. If you have a good site or a strong tenant, it will be easier to secure financing. If you have a knowledgeable team, you will quickly be able to assess a site and demonstrate confidence to a tenant. If you have two or three of the elements, it gets easier to fill in the missing pieces.

Finally, access to all four of these elements does not mean you must possess them yourself. You may not need to own the site, have the tenant relationship, know everything about the development process, and have the money. The key to effective development is understanding your own abilities, and then either acquiring any missing ones yourself, or partnering with others who have them.

Applying This to You!

How would you rate yourself (1-10 scale) on the four critical elements a developer needs to succeed? Which one is your starting point? How can you improve your scores in areas where you fall below a 5?

Element	Score	Low (1)	Medium	High (10)
Site		Have not started looking at properties	Good local knowledge and identified some interesting opportunities	Own the perfect site
Tenant		No existing relationships with potential tenants	Some relationships with potential tenants and have expressed interest in partnering	A firm commitment from a high credit tenant (or tenants) for the entire development
Money		No money, no financing relationships	Some cash on hand and have relationships with equity partners and/or lenders	Cash on hand to fully finance the development
Knowledge		No experience, and new to real estate development	Completed 1-2 projects and have some good relationships with key real estate partners	Completed multiple projects and have relationships with potential experts in the industry

Establishing Your Role – Capital Partner v Operating Partner, etc.

While a developer must ultimately be able to access the four elements of site, tenant, money, and knowledge, each developer will differ slightly in which of these elements he or she is strongest or wants to focus. In particular, someone who has access to capital (i.e., money) and who wants to invest in real estate often may not have the ability, time, or interest to pull together all of the other elements of the development. Therefore, it is common in real estate for an operating partner (sponsor) who leads the project to connect with *capital partners (limited partners)* who have the money to make the deal happen. The level of involvement by the capital partner(s) can vary greatly from virtually no involvement (i.e., "silent equity") to an active partner who reviews and approves all major and many minor decisions. If a capital partner is silent, they will typically have a trusted relationship with the operating partner who has a proven record of accomplishment. The capital partner will invest the capital upfront and then earn an agreed upon return on that capital (after debt is paid but before the operating partner is paid.) The operating partner will serve as the day-to-day operator of the deal, bringing together knowledge, relationships, time, and attention to make the development happen. The operating partner may have his own money in the deal as well, but not always. The operating partner will earn her money by receiving a development fee, typically a small percentage (e.g., 3-5%) of the overall development cost, and often by receiving a return on the equity after the equity partners receive a certain minimum return.

Starting Small with Lower Risk – Owner Occupied and Stable Properties

If you are reluctant to jump headfirst into development, you can still take small steps to increase your knowledge and get experience and confidence. If you are new to real estate, perhaps developing a 20-story office tower is not realistic. Instead, find an opportunity that is manageable, but expands your capabilities in one or two areas. We must walk before we can run. Secure financing from a single source before attempting to pull together a complicated financing stack from several debt and equity partners. It is helpful to understand firsthand what attracts tenants to a space before attempting to design a 50-unit residential building. Often developers begin their journey in real estate as an extension of their own home, on a small scale, and/or with stable properties.

One of the best ways to dip your toe into real estate is as an owner occupier. By buying a duplex and living in one unit and renting the other, you can begin investing without having to spend much more than you would on your own home. Starting with a small, duplex or triplex also enables you to use traditional financing options with affordable terms. Finally, starting small like this will give you familiarity with what it takes to manage a tenant and maintain a rental property. New development can be exciting and financially rewarding, but starting with a stable property or one that requires little to no additional work can still provide a good income and plenty of learning opportunities. Owning a stable property will give you exposure to day-to-day management and operating costs, help you build tenant relationships, and provide access to knowledge of what is happening in the community. Further, even stable properties may have opportunities for improvement through smart capital investments, better management, and other creative ways to add value.



Even if you are not yet ready to purchase your first investment property, there are still things you can be doing to prepare for a smart investment in the future. A lot of good information is available online today, and you should use that to build your knowledge base. However, online and book knowledge will only get you so far. Nothing quite

compares to getting out and exploring on your own. Walk and drive around to understand how your city and neighborhood works. What is successful? What is not? What could improve your neighborhood? Most importantly, talk to people – building owners, tenants, residents, neighbors, investors, lenders, builders, brokers, attorneys, contractors, architects, city staff, mail carriers, bus drivers, etc. Each conversation will provide a clue or piece of the puzzle to help you intimately understand the complex workings of your community and lead the way to your first undertaking – and you will likely build many great relationships along the way.

Activity B: Model Participant Activity

My Small Development Business Concept

Instructions: Circle your primary approach and note any specific ways you intend to modify/enhance the approach.

1. What is my primary prope	rty acquisition and disposition st	rategy?
Buy Existing Buildings	Build New Buildings	Buy Under Valued and Renovate
Notes:		
2. What is my primary building	ng ownership and portfolio appr	oach?
Projects to sell immediately (Build/Fix and Flip)	Projects to stabilize, hold for a while, then sell	Projects to rent for long term cash flow
Notes:		

3. What will be the primary function of the buildings?

Residential	Commercial (Retail or Office)	Mixed-Use	Industrial or Other

Notes:

4. What level of tenant commitment will I require before purchasing and construction?

Commitment for 100% of space	Commitment from anchor	No commitment needed
(Build to suit)	tenant(s) or set % of space	(Spec Development)

Notes:

5. How will I start out financing projects?

- With my own capital via mortgages/loans with low down payments
- With my own capital acting as an investor (25% + down payment) with mortgages/loans
- With friends and family investors to provide equity for small/medium mortgages/loans
- With an equity partner to provide capital for a commercial grade loan

Notes / Other Methods:

6. In what area of the city and specific neighborhood/district will I concentrate my work?



Chapter 3: Site Selection & Opportunity Identification

Key Concepts

- Many factors affect the viability of a real estate investment which makes selecting the right investment both challenging and fascinating. These factors should be understood early in the site selection process to filter out poor investments and home in on better opportunities.
- When selecting a property, an investor should understand how each factor may impact the investment, namely, will each help drive revenue and keep costs manageable, or will they hinder income, increase cost, and add risk.
- While there are many factors to consider when selecting a site, several important ones to consider include basic site specifications (e.g., size, ownership, age), zoning, price, market potential, tenants, property conditions (e.g., environmental, soils), and availability.
- More detailed property information will still require investigation by external resources, but a great deal of information needed for preliminary site selection is readily available online. Hennepin County, the City of Minneapolis, and several listing services provide extensive information through various websites.

I. What to Consider When Selecting a Site

Part of what makes investing in real estate so fascinating is the wide array of factors that impact the viability of a successful project. Of course, just as they can make a project interesting, they also can create challenges that must be thoroughly considered. When evaluating a site, an investor must consider how factors of that site may help or hinder their ability to earn revenue (i.e., get and keep good tenants at a good rate) and manage costs (i.e., construction, ongoing management, and maintenance.) We detail some of the most important factors to consider below, though each site is different and may have unique circumstances that must be considered – which, again, is what makes real estate so interesting!

Basic Specifications

Perhaps obvious, but when considering a property for acquisition there are some basic specifications that should be noted to understand the nature of the property.

Size - To start, the property size is critical as it is going to impact both the amount of revenue that can be generated, the purchase price, construction costs, and operating costs. Land size is typically reported in acres or square feet (SF). It is also important to note if any portion of the property is unbuildable. For example, a 2-acre property with

wetlands on half of the property would only be considered to have one acre of buildable area. Easements, topography, and other restrictions may also make a



portion of a property unbuildable. You should also note the lot dimensions and shape; an irregular shaped lot may be more challenging to develop in an efficient manner.

For building size, it is important to note the gross, rentable, and usable square footage.

- **Gross** Total size of the building on all floors from outside walls.
- **Rentable** Space for which you can actually charge rent. This typically is gross square feet minus vertical penetrations such as stairwells and elevators. Rentable square feet does include common space that all tenants share and are charged back on a "pro rata" basis.
- **Usable** The space tenants exclusively use themselves (Rentable SF less common space).

Tenants will want the most efficient space possible – they don't want to pay for space they are not using. A certain amount of common space in office buildings and some other buildings is acceptable (e.g., 15%), especially if that space is used for amenities

that the tenants would value such as a fitness center, meeting space, or a cafeteria. However, too much space will make spaces harder to lease or require lower rates to make up



for the inefficiency. Similarly, rentable square feet should not be too much lower than gross square feet because you are then just paying for space that does not produce revenue. In residential buildings, common space is not considered part of a tenant's square footage; nonetheless, you still will want to be sure that the building is efficient.

Ownership – Not only is ownership important to know simply as a data point, but it can be extremely informative to understand appetite for sale and motive. Is the owner a company that has recently been divesting assets and therefore may be willing to sell? Is the owner also the occupant who might be nearing retirement and wanting to close his business and sell his building? Perhaps the property is owned by a bank or the city through foreclosure and they are eager to dispose of the property. Alternatively, if you discover that the land is owned by the railroad or a government institution that rarely has an interest in selling, you may save yourself a lot of trouble. Further, if the current owner has a reputation (good or bad), this information can help

you understand how difficult it may be to work through the purchase process or if there is a risk of deferred maintenance or poor management.

Age - If structures are built on the property, it is important to note the age of those buildings and the age of any additional construction or upgrades to the property. While an older building may offer unique character that cannot be replicated in new construction, it also may pose additional challenges (i.e., cost) during construction. Buildings built before about 1980 may have lead paint and/or asbestos that can add cost to maintain or mitigate, even if the building is being demolished. Buildings over a certain age or within a special district may be historically designated. Such a designation usually means that the amount and type of renovation that can be conducted to the building will be limited. However, in some cases historical designation can also mean that government incentives are available to assist in the redevelopment.

History/Previous Use – In addition to building age and ownership, it can be helpful to know more about the overall history of the building. If the property was once used as dry cleaner or for paint production, there may be environmental concerns. (This should come out in your environmental Phase I review, but it helps to find out what you can even before getting that far.) Knowing how long ago the current owner purchased the property and for how much can also inform what her motive and expectations may be for selling.

Parking – Because parking is such an important component of any development, can consume a large amount of land area, and is often tightly controlled by municipalities, it is important to note early on the amount of parking that is available. Ample parking, particularly in high density areas, can be a valuable amenity. Alternatively, lack of parking without adequate access by alternative modes of transportation can severely limit the success of a development.

Building Specs – There are numerous pieces of information about existing buildings that should be gathered in early stages of identifying a site. These include number of levels, number and location of elevators, ceiling heights (aka clear height), and mechanical systems.

Applying This to You!

If you own a property or are considering purchasing a property, note the basic specifications of this site. When assessing these aspects of the property, will they help or hinder your ability to earn a profit?

Zoning

One of the most important factors to investigate when looking for a good site, particularly for new development, is the zoning specific to that property. To start, each property will be zoned to allow particular uses, either expressly or conditionally, by the local municipality, and other uses will be prohibited. Zoning has traditionally been labeled as residential, commercial, office, industrial, or something similar. You may want to build a small commercial building to house a restaurant on a property, but if it is zoned for residential, that might not be allowed. While Minneapolis zoning still uses this traditional approach to land use as a foundation, with the Minneapolis 2040 plan, land use designations have been updated to reflect many of the nuanced needs in modern urban areas. Current Minneapolis land use designations include Urban Neighborhood,



Neighborhood Mixed Use, Corridor Mixed Use, and Production and Processing. Some cities, including Minneapolis, also have overlay districts that further expand or restrict uses for unique areas or purposes.

In addition to "Land Use", zoning code details a great deal more about how and where buildings can be constructed on a particular site. This is often referred to as "Built Form." Built Form regulations are put in place to control density, environmental impact, and community character. These regulations often include maximums and/or minimums for height limits, property setbacks, parking, and floor-to-area ratios (FAR, the ratio of building gross floor area to property size), and other factors. These are critical to understanding whether your desired building can legally be built. Often a developer will seek density (e.g., height, limited setbacks) to provide enough income to make a development financially feasible but may be limited by zoning code. For this reason, it is important to determine early in your site selection process if zoning will support your desired development.

If your desired use or design is not explicitly permitted for a property under current zoning code, this does not necessarily mean you can't proceed with your development. Variances for things like height limit and setbacks can be obtained, but they require following an in-depth process with the municipality to explain why a variance is necessary and to garner support from decision makers and influencers (e.g., city council, planning commission, planners, neighbors.) Further, variances are not a given; there is a risk that you go through the process and the request is still denied. Getting a property rezoned is also possible but requires a lengthy process and can be more challenging to get approval than obtaining a variance.

CITY OF MINNEAPOLIS ZONING DISTRICT DESIGNATIONS

Source: Minneapolis Code of Ordinances, Section 530 (July 2024)

Primary Zoning Districts	Built Form Districts	Overlay Districts
UN1 Urban Neighborhood	BFI1 Interior 1	HA Harmon Area
UN2 Urban Neighborhood	BFI2 Interior 2	UA University Area
UN3 Urban Neighborhood	BFI3 Interior 3	DH Downtown Housing
RM1 Residence Goods and Services	BFC3 Corridor 3	DP Downtown Parking
RM2 Residence Office and Services	BFC4 Corridor 4	DS Downtown Shelter
RM3 Residence and Institutional	BFC6 Corridor 6	SZ Split Zoning
CM1 Neighborhood Mixed-Use	BFT10 Transit 10	TP Transitional Parking
CM2 Corridor Mixed-Use	BFT15 Transit 15	AP Airport
CM3 Community Mixed-Use	BFT20 Transit 20	SH Shoreland
CM4 Destination Mixed-Use	BFT30 Transit 30	FP Floodplain
DT1 Downtown Center	BFC50 Core 50	MR Mississippi River Corridor
DT2 Downtown Destination	BFPA Parks	Critical Area
PR1 Production Mixed-Use	BFPR Production	
PR2 Production and Processing		
TR1 Transportation		

City of Minneapolis - Developers Technical Assistance Program (D-TAP) Real Estate Development Basics

CITY OF MINNEAPOLIS FUTURE LAND USE MAP

Source: Minneapolis 2040 Comprehensive Plan (updated June 2024), Figure T1.3, p. 61 https://minneapolis2040.com/media/2018/pdf_minneapolis2040_updated-june-2024.pdf (6/27/24)



CITY OF MINNEAPOLIS BUILT FORM MAP

Source: Minneapolis 2040 Comprehensive Plan (updated June 2024), Figure T1.4, p. 74 https://minneapolis2040.com/media/2018/pdf_minneapolis2040_updated-june-2024.pdf (6/27/24)



Price

When starting out, real estate developers will often spend a lot of energy on what sale price they can get for a development once it has been built or improved, but less so on their upfront purchase. However, there is a thought in real estate that a bad investment does not come from selling too low – it comes from buying too high. When investing in real estate, an investor must seriously consider what purchase price makes sense for that specific investment. Investors should consider purchase price from three perspectives: market, investment, and personal capability.

Looking at the market by doing a sales comparison, is important to understand if a purchase price is in line with other recent sales for similar properties in the market. The process involves finding recently sold properties that are like your target property and adjusting the price, up or down, based on any differences. Because no two properties are exactly the same, nor can all differences be fully accounted for, the comparison approach is not a perfect science.

A sales comparison provides important data points when evaluating a property but should be used cautiously. In fact, market price should be used more to understand potential sale price and lender expectations, and less on whether the investment makes sense. You may have an opportunity to purchase а property for less than what an



estimated market price may be, but if the investment still does not make sense for you financially, it is still a bad price. If you are hoping to buy a property for "below market" without any indication a seller is willing to sell at such a price, you may have unrealistic expectations. However, if a seller is asking a price that is well "above market," it might be reasonable to assume a good chance the price will eventually come down (unless, of course, the seller doesn't want to admit the reality of the market.) Finally, a lender will generally be unwilling to lend money to purchase a property for more than it is worth based on the market; even if you think you can make an investment work by paying "above market," you may have trouble getting a loan to buy the property.

The second approach to determining what price you should pay for a property, and typically the approach that is most important for an investment property, is the investment (or income) approach. This approach answers the question, "what is the maximum price I can pay for this property while still earning an appropriate return?"

To answer this question, you must look at all other costs (both upfront and ongoing) and your expected revenue. We explain this as part of financial analysis in more detail in Chapter 6: Introduction to Financial Feasibility. Backing into a price you are willing to pay based on realistic financial inputs, assumptions, and investment criteria ensures you have structure, consistency, and logic behind a complex, and sometimes emotional, decision. Obviously, if you can purchase a property for something below your maximum price, that is even better!

A third consideration, beyond the market and investment approach, when evaluating what you can pay for a property is your own ability. If a property is worth \$500,000, but you only have \$400,000, you will be limited in what you can offer. What you can pay includes both the equity (yours and your partners') and whatever debt you can obtain. (Note: Your equity partners and your lenders(s) will use both the market and investment approach themselves to determine what they are willing to put into the investment.) If a property is worth more than you can pay, it is likely that the seller will hold out for another buyer, though that is not always the case.

Market Potential

Simply because a site is zoned for a particular use does not mean that it will necessarily be successful supporting that use. For a development to be successful, it must be a good site for potential tenants – hence the old adage, "location, location, location!" Retail sites may be the most sensitive to the right location. Retail tenants will want a location that is easy for their customers to see and reach. A customer will choose to shop at a competing location if he feels that site is easier to access, even if that is a subconscious decision. First, retailers will want to be located close to a strong population base and their target demographic. Retailers will also look for sites with a lot of traffic – often at least 10,000 vehicles per day for smaller retailers and 50,000 or more vehicles per day for large national chains. Usually retailers focus on vehicle



traffic, but in rare cases such as on university campuses or the downtown skyway system, the focus can be pedestrian traffic. Retailers also want to ensure people, whether driving, walking, etc., can easily access the locations; this means being on the proper side of the road (right in/right out) during rush hour traffic, signaled turns into the lot, and convenient parking. Retailers will also want good

visibility, both for signage and the front door entrance. The storefront is one of the most important branding opportunities they have.

While other tenants may not be quite as sensitive to location as retailers, market potential for residential, office, industrial, and other uses is still critically important. Residential locations will generally do better near employment hubs, good schools, strong transportation (roads or mass transit), and amenities (natural and commercial); and will struggle more if adjacent to noxious uses (e.g., industrial areas, blight, railroad tracks) and areas with high crime. Strong office locations tend to be similar to residential – locations that will be attractive for people to work such as those with desirable amenities and good transportation. Industrial tenants will seek locations that minimize operating costs, such as near suppliers or customers, easy access to transportation, and will want to ensure stable operations.

While needs of tenants may change over time, the evolution of neighborhoods and regions are more likely to drive changes in a location's market potential. The expansion of the suburbs in the second half of the twentieth century and the more recent shift back to urban cores are good examples of trends that impact marketability. The addition of a light rail line or a freeway exit can also change market potential. On a smaller scale, simply the opening of a successful restaurant in a neighborhood can increase market potential for nearby properties.

Existing Tenants

If you are developing a property from the ground up, or buying a vacant property, you do not need to worry about existing tenants. However, if you are considering purchasing a property with existing tenants in place, you should fully understand the tenant situation. To start, you should understand the basic terms of the leases in place, including how much they are paying and how much more time is left on the lease. In particular, a buyer should understand if rents are above or below market (i.e., is income likely to decrease or increase?) and if leases are expiring soon. Ultimately, all leases should be fully reviewed to understand all terms, including options to renew or terminate, who is responsible for property management, and which party pays for operating expenses and repairs. Beyond the terms of the lease agreement, you will want to understand background on the tenants as well to understand how stable they are. Are they a financially sound business who has been operating for many years, or

Remember!

When buying a commercial property, it is important to have the seller provide an **Estoppel Certificate** from each existing tenant where the tenant verifies the terms and status of the lease. are they a fledgling tenant that might be struggling to stay in business? Even if financially stable, how likely is the business to continue to operate in that location? Might they be outgrowing their space or looking to move to a different

location at lease expiration? Finally, while having tenants in place can be a good thing since they provide immediate income, if you are looking to redevelop a property,

existing tenants with long-term leases in place can be a hurdle, requiring you to either wait out the leases (risking market timing) or buy tenants out of their leases.

Property Conditions

Some sites may be great locations to attract tenants and produce revenue but may require extensive construction to deal with poor site conditions. Sites with poor soils may need to have significant work done beneath the surface of both the building and parking lot to support structures and ensure the ground does not sink. Properties that are environmentally contaminated may also require corrective measures such as soil replacement, capping, and venting before development can occur. Existing buildings may also have issues that would require significant cost to correct such as failing structural and mechanical systems, asbestos, or mold. While these building and site conditions should be fully uncovered during due diligence, you can do your own investigating during preliminary site selection by looking for potential issues (or bringing a knowledgeable friend) during building tours, understanding the history of the site, and learning if adjacent properties had environmental or soil issues.

Availability

While property availability may seem to be the most straightforward – is there a "For Sale" sign out front, or not? – it isn't always that simple. Yes, properties listed for sale generally have a willing seller, but they also likely have more potential buyers (i.e., competition) which could lead to a higher price. Still, working directly with a seller or a broker to find listed properties can be a great way to find a lot of good opportunities quickly. Alternatively, some excellent purchases can still be found "off market," either not formally listed for sale or from an owner who wasn't necessarily focused on selling until a willing buyer (you!) approached them.

Applying This to You!

Think about a site that piques your interest. What makes it marketable? What might limit its marketability? Is there anything you can reasonably and cost effectively change to make the property more marketable?

II. Resources for Site Selection

Clearly there is a lot of information that must be pulled together when learning about and selecting a site. Some of this information may be obtained simply by observation and much of it should be provided by the seller. However, what if you are not able or willing to speak with a seller, or want further validation? A great deal of this preliminary site selection information can be gathered from various online sites,
including government and broker sites. In Minneapolis, the following are good resources.

1) Hennepin County Property Information Search

www.hennepin.us/residents/property/property-information-search

Hennepin County puts all public information about every property in the county on this website. Properties can be looked up by address, property ID (PID), or map. Information on this site includes size and dimensions, ownership, assessed market value (for tax purposes), property taxes and assessments, and sale information.

2) Minneapolis Property Information

http://apps.ci.minneapolis.mn.us/AddressPortalApp/

The City of Minneapolis Property Info site has much of the same information as the Hennepin County site, but also provides details on zoning, inspections, rental information, and business licenses. The Minneapolis site also lists the neighborhood and police precinct where the property is located. This website includes a link to the neighborhood profile of each property. (Hint: This is often the fastest way to find the zoning classification. Click on the "Lot info" tab on the Property summary page)

3) Minneapolis Communities and Neighborhoods

www.minneapolismn.gov/resident-services/neighborhoods/

This site is a good starting point for information on Minneapolis neighborhoods and neighborhood organizations including leadership, reports, and plans. Access to demographic information and maps are also available at this site.

www.mncompass.org/profiles/neighborhoods/minneapolis-saint-paul#!community-areas

Minnesota Compass is a good resource for information on Minneapolis neighborhoods. Profiles can be pulled up online at either the community or neighborhood level. Profile information includes current detailed demographics and some historical information.

4) Minneapolis Planning and Zoning

www2.minneapolismn.gov/business-services/planning-zoning/

Minneapolis's Planning and Zoning site has detailed zoning maps covering all city properties. This high-level view can be helpful to understand areas intended for residential, commercial, etc. and zoning of sites adjacent to your target property. This site also includes a link to the city's zoning code (Code of Ordinances, Title 20), which provides extensive detail on allowed uses, setbacks, height limits, and other important site development information. This site includes a link to the city's comprehensive plan, which details the city's long-term vision for property use and development.

Understanding this can be helpful to spot future opportunities and to align your own development goals with those of the city.

5) Minneapolis Zoning Map

https://www2.minneapolismn.gov/business-services/planning-zoning/zoning-maps/

One of the first places you will want to go when trying to learn about a site and its development potential is this zoning map. The numbered "plate" pdf files are helpful, but the best feature is the interactive ArcGIS map link further down on the page (Look for the "View zoning map" link.)

6) Minneapolis Interactive Maps

cityoflakes.maps.arcgis.com/home/index.html

This site includes various interactive mapping applications including ward/neighborhood look up and crime mapping.

7) Minneapolis Data Source

www.minneapolismn.gov/government/government-data/datasource/search/

Use this website to look up data on various topics from across the city including real estate related websites and others. Some useful dashboards include crime, vacant and condemned properties, and inclusionary zoning.

8) Best Neighborhoods

bestneighborhood.org/household-income-minneapolis-mn/

This site shows income levels, rental rates, and other useful information spatially at the block level. Sources are listed, but it is not clear how accurate and updated the information provided is.

9) Minnesota Pollution Control Agency – What's In My Neighborhood

https://www.pca.state.mn.us/data/whats-my-neighborhood

This MPCA website enables users to search properties by text or by map to access known environmental information including potentially contaminated sites and environmental permits and registrations.

10) MetCouncil Census Data

metrotransitmn.shinyapps.io/census-2020/

The Metropolitan Council provides an opportunity to visually analyze census data for the entire Twin Cities metro area using this site. Data includes the most recent 2020 census and provides historical information on area demographics going back 30 years. Information such as population, incomes, race, and ethnicity can be mapped at various geographic levels from block groups to counties.

11) Traffic Counts

minneapolis.ms2soft.com/tcds/tsearch.asp?loc=Minneapolis&mod

dot.state.mn.us/traffic/data/tma.html

Minneapolis has a great website that enables users to look up traffic counts (by street or interactive map.) The site provides both current as well as historical traffic counts.

The Minnesota Department of Transportation also has a useful site to look up traffic counts from across the state.

12) Broker Sites

www.mncar.org/public-commercial-listing

www.loopnet.com

www.costart.com

www.themlsonline.com/minnesota-real-estate

<u>zillow.com</u>

realtor.com

Several real estate broker sites exist that can be great sources of information including properties for sale, asking prices, asking rates for leases, and site details for listed properties. MNCar runs an extensive commercial site in Minnesota. MNCar provides public access to sale and lease listings with basic information, though detailed information requires a paid membership. Residential oriented sites such as The MLS Online will primarily list single family homes. However, these sites also list some duplexes, small apartment buildings, and even some small commercial properties.

13) Electronic Certificate of Real Estate Value (eCRV)

www.mndor.state.mn.us/ecrv_search/app/openCustomSearch

This MN Department of Commerce site can be used to find details about a real estate transaction. A public search is available to pull up the eCRV of a property, which provides information on the date, buyer, seller, sale price, financing, and deed type.

14) Department of Transportation Noise Map

maps.dot.gov/BTS/NationalTransportationNoiseMap/

This site provides excellent visual representation of noise pollution due to airports, roads, and railroads.

15) FEMA Flood Map

www.arcgis.com/apps/webappviewer/index.html?id=8b0adb51996444d4879338b5529aa9cd

Use this site to see if your property is in a flood zone as designated by FEMA.

III. Inventory Comparison

You will find that much of the information you uncover during your early stages of site selection you will use frequently throughout the acquisition and development of the property. Therefore, it is recommended that you keep all critical information together in a single location to avoid repetitive searches. In addition, to easily compare opportunities, it is helpful to organize this information in a manner than easily displays similarities and differences among properties. Therefore, you may want to use an Inventory Comparison as is shown here. Like when shopping for electronics or other products, online sites enable you to compare specifications across columns, the Inventory Comparison allows you to quickly and easily compare specs across properties. This template also helps to ensure you thoroughly investigate potential purchases and quickly identify missing information.

Building Name	Option 1	Option 2	Option 3	Option 4
BASIC BUILDING INFORMATION				
Address	123 Main St.	2300 Chicago	900 N 2nd St	1400 Lake St
City	Minneapolis	Minneapolis	Minneapolis	Minneapolis
Zip	55408	55423	55454	55450
Previous Sale Date	9/14/2006	5/17/2015	6/21/2005	6/23/2009
Previous Sale Price	\$624,850	\$985,000	\$453,000	\$789,000
Estimated Market Value	\$850,000	\$1,015,000	\$759,500	\$1,256,000
Number of Units	2	2	2	2
Parcel ID (PID)	0474824120007	0474824120004	0474824120006	0474824120005
Legal/Abstract or Torrens	Torrens	Torrens	Torrens	Torrens
Lot Size	9,000	6,000	5,500	5,000
Lot Dimensions	100x90	120x50	110x50	125x40
Gross Bldg SF	6,000	7,200	5,000	8,300
Net Bldg SF	5,000	6,200	4,500	7,500
Building Efficiency	83%	86%	90%	90%
Number of Levels	2	2	2	3
Basement (Y/N)	N	N	Y	Y
Elevator	N	N	N	Y
Dock	N	N	N	N
Year Built	1975	1958	1923	2001
Historic (Y/N)	N	N	Y	N
Clear Heights (Interior)	12	9	10	12
Vehicle Counts (X cars/day or VPD)	10,500	4,300	19,450	23,950
Parking	10	8	0	12
ZONING				
Current Use	Residential	Residential	Mixed Use	Mixed Use
Proposed Use	Residential	Mixed Use	Mixed Use	Mixed Use
Current Zoning	BFC3 / CM1	BFC6 / RM3	BFC3 / CM1	BFC6 / CM2
Proposed Zoning	No change	No change	No change	No change
Height Restriction	2.5 stories/35'	2.5 stories/35'	2.5 stories/35'	4 stories/45'
Proposed Height	28'	23'	25'	40'
SITE EVALUATION				
Access	Excellent	Good	N/A	Good
Visibility	Poor	Excellent	Good	Good
Signage	Monument	None	None	Monument
Neighborhood	Uncertain	Good/Stable	Strong	Emerging
Building charm/character	Good	None	Excellent	Very Good
Proximity to LRT/Transit	5 blocks	1 block	2 blocks	1 block

EXAMPLE PROPERTY INVENTORY COMPARISON

Activity C: Site Selection Research

Site Selection Questionnaire



Instructions: Answer the following questions using resources described in this chapter.

Answe	er Question	Suggested Source
1	What is the assessed market value and annual taxes for 1719 Franklin Ave W in Minneapolis?	Hennepin County
2	What is the Property ID (PID) for the Russian Museum (5500 Stevens Avenue S) in Minneapolis?	Hennepin County
3	Who is the taxpayer for the McDonald's at the NE corner of Lake St E and 31st Ave S in Minneapolis (Longfellow neighborhood)?	Hennepin County
4	What is the lot size for the Bakken Museum (3537 Zenith Ave S, Minneapolis) in square feet?	Hennepin County
5	Find the property immediately to the west of 1850 38th St E, Minneapolis. When was it last sold and what was the purchase price?	Hennepin County
6	In the Phillips neighborhood, what percentage of occupied housing is occupied by renters?	MN Compass
7	What is the median monthly rent paid in the Whittier neighborhood?	MN Compass
8	What was the Total Estimated Market Value for 3100 Excelsior #102 in 2020?	City of Mpls / Prop InfoValuation History
9	In what zoning district(s) is the Surly Brewery (520 Malcolm Ave SE, Minneapolis)?	City of Mpls / Prop InfoLot Info
10	How has the total number of households in Minneapolis changed betweent 2010 and 2020?	MetCouncil
11	What is the Median Household Income in the Seward Neighborhood?	MN Compass
12	Based on TheMLSOnline results, how many multifamily buildings are listed for sale in Minneapolis for \$500,000 or less?	TheMLSonline
13	What is the most recent traffic count on W Lake St between Nicollet Ave and Blaisdell Ave?	MnDot
14	Between 2012 and 2016, did traffic on Cedar Ave S, between E 24th and E 25th Street, increase or decrease?	Mpls traffic
15	Based on LoopNet results, how many industrial or office buildings smaller than 20,000 square feet are listed for sale in Minneapolis?	LoopNet
16	Based on a MNCar search, how many buildings are for sale in Minneapolis that sit on 0.25 to 0.50 acres?	MNCar

Note: Properties chosen at random for educational purposes only.

Chapter 4: Acquisition, Due Diligence, and Entitlements

Key Concepts

- Pre-acquisition due diligence is a critical step in uncovering a good development opportunity. It requires time, effort, and relationships to build up the necessary knowledge but can save time and help avoid costly mistakes in the long run.
- Though every real estate purchase will have its own unique circumstances, the overall acquisition process includes four distinct steps: Letter of Intent, Purchase Agreement, Due Diligence, and Closing.
- The due diligence period is your opportunity to learn as much as you can about the property, secure funds to pay for it, obtain approvals for planned changes, and confirm it is still a good financial investment.
- Any significant change in use or construction on the property will require municipal approval. The approval process includes submitting an application, site plans, and drawings to the city; participating in Planning Commission and City Council meetings; and ultimately receiving a vote for or against your plan.
- The zoning code includes several items which control how a structure can be built on a property. These controls are intended to manage density and ensure complementary design and effective use of the property with the surrounding area. Understanding any restrictions to building is important so that you can plan and design your development accordingly.

I. Pre-Acquisition

We often think of property acquisition as the first step in real estate development and ownership. However, it is much better to think of acquisition as one of the last steps. As a developer, ideally you will have answers to all of your major questions about the property before you close on the property, transfer funds, and lock into a loan agreement. From a developer's perspective, you want to know if your development plan for the site is physically possible, legally permissible, and financially feasible. In other words, make sure you aren't going to pay big bucks to only get stuck with a useless (or even less useful than intended) piece of land.

The acquisition process typically includes the activity from signing of the purchase agreement to closing. For small, simple transactions this period may be a few weeks to a couple of months (60 days is common). For more complex transactions, this period may be several months to several years. The duration depends on how much work is needed to inspect the property, obtain government approvals, secure equity and debt financing, line up tenants, etc.

While a buyer does not normally put up all funds to buy the property at purchase agreement execution, the acquisition process requires a significant investment on the part of the buyer. She will typically need cash for an earnest money deposit and will spend money on inspections, design, attorney fees, approvals, appraisal, etc. While some of this may be refundable (e.g., earnest money) a developer must have access to a substantial amount of cash to successfully get to closing. (There are times when acquiring a property before spending a lot of money on due diligence is necessary, but this is risky and still doesn't negate the need for capital.)

For this reason, it can be beneficial to do a significant about of "due diligence" prior to even making an offer and beginning the acquisition process. The more you know about the location, community, economic cycles, nearby development activity, demographics, crime, needs, financials, site conditions, political environment, seller, competition, sources of debt and equity, and so on before making an offer, the better positioned you will be to make an informed offer and to move quickly and avoid pitfalls (or pass on the opportunity.) Much of this pre-acquisition due diligence can be done at little or no cost but takes time. This knowledge is gained from experience, from relationships with people in the industry and community who have insights, from free online and government resources, and from observation. The most successful developers are those that are continuously farming this knowledge and these opportunities so that they are ready to move quickly when the right opportunity arises.

II. Acquisition process

Letter of Intent - Once you find a property you want to buy, there are several steps you must take before you own it. After preliminary conversations with the owner (directly or via your real estate agent) you often will draft a Letter of Intent (LOI) or term sheet, which outlines the terms of the purchase at a high level. The LOI would include items, in simple language, such as purchase price, due diligence period, and major contingencies to close. Importantly, the LOI should also include language stating that it is a non-binding agreement, meaning that it is only a "handshake" agreement, and technically can be broken at any time without financial and legal implications. The purpose of an LOI is to see if there is agreement on the major business terms before spending time and money (lawyers don't come cheap!) drafting a formal purchase agreement that includes all business and legal terms. Note that a Letter of Intent is not always necessary. With most small transactions, such as 1-4 unit residential and some small commercial properties, the buyer will skip the LOI and submit (typically via the buyer's real estate agent) a signed purchase agreement to make the offer.

Purchase Agreement – Upon agreement of terms in the LOI by both the buyer and the seller, both parties work on a longer, legally binding agreement known as the *purchase agreement*. For small commercial and residential transactions, the buyer

and seller may use a standard purchase agreement form produced by the National Association of REALTORS, the Minnesota State Bar Association, or a similar organization. However, since commercial and residential investment purchases are typically more complicated than buying a single-family home, buyers often pull in a real estate attorney to draft the purchase agreement, though a knowledgeable real estate agent or the buyer himself is able to do so. The purchase agreement will formalize the terms outlined in the LOI as well as add in other standard or more minor terms to describe the closing process and protect the buyer and seller. In short, a purchase agreement will detail 1) answers to the basic questions (who, what, where, when, how much, disclosures), 2) what each party must do before and at closing, and 3) contingencies, or why and how either party (mainly the buyer) can back out of the agreement. Once the purchase agreement is fully executed, the property is "under contract" and the buyer has "site control" to take certain actions that impact the property, but he does not yet own the property.

Due Diligence – After full execution of the purchase agreement the official due diligence period begins. While the seller does have some responsibility during this period to provide information she has about the property to the buyer, most of the work falls to the buyer. The purpose of the due diligence period is to confirm:

- 1) you fully understand what you are buying
- 2) the seller can legally sell it and you can legally buy it
- 3) you have the money to buy it
- 4) you can use it (including develop it) in the way you intend, and
- 5) it makes sense for you to buy it (financially and otherwise)

Ideally, you answer these questions before closing on the property or, even better, before any of your earnest money "goes hard" (i.e., is non-refundable.) However, a seller will not always be willing to agree to so many contingencies in the purchase agreement. For example, a seller may agree to give you 30 days to inspect the property, do an environmental study, and get financing, but may not be willing to wait for you to get an agreement from a future tenant. What due diligence is included as a contingency in the purchase agreement comes down to negotiations between the buyer and the seller. A detailed listing of the most common activities during due diligence is presented in the Due Diligence Checklist below.

Closing – After the due diligence period is over and all contingencies have been met or waived, the last major event is to close. Of course, there is a lot that happens at closing, including transfer of title, transfer of funds, completing financing, settling payments for taxes, paying commissions and fees, etc. To make all of this come together at closing, the title company, lender(s), attorneys, agents, buyer, and seller, are spending time in the days and weeks prior to closing, getting all paperwork in order and arranging for funds to be transferred. When everything is in order – which always seems to occur the day or hours before the closing is scheduled – the seller is paid, the buyer receives the deed, and the transaction documents are recorded with the county. The transaction is complete!

Applying This to You!

Before signing a purchase agreement for your property, review the due diligence section to make sure it gives you the right to answer these questions to your satisfaction or walk away from the deal without significant consequences. Do you fully understand what you are buying? Are you certain the seller can sell it and you can buy it? Do you have the money to buy it? Can you develop it the way you want? Does it make sense for you to buy it?

III. Due Diligence Checklist

No matter what property you seek to acquire – from a vacant parcel to a small singlefamily residential home to a downtown office building – there is a certain amount of due diligence needed to ensure you are making a smart decision. Due diligence is a term describing the activity performed to understand a property and the facts and details around that property and potential transaction. Commercial transactions (including larger multifamily residential) tend to be more complex than small residential ones and therefore often require more investigations. A commercial purchase is also unique from a residential purchase because there are fewer seller disclosure requirements protecting the buyer. Nonetheless, for all transactions there are important details to uncover before committing to the purchase and so it is important to be thorough with your due diligence. While the following is by no means a complete list, some of the most common due diligence activities are detailed below.

Financing	If you need a loan to purchase the property or do your construction, you will want to be sure that closing on the property is contingent on getting financing. (Note: Lenders will often require many of the other items on this checklist be completed, even if you do not think they are necessary.)
Title	You will need to confirm that the seller is actually the owner and is legally able to sell you the property. You will likely not want to purchase the property until it has a "clean" title (i.e., free of liens, etc.)
Survey (ALTA)	A survey will confirm the property boundaries and indicate if there are any easements, or similar restrictions on the property.

Environmental (Phase I & II)	An environmental services company should conduct a Phase I environmental assessment, which includes an on-site visit, and review of public records, property history, and adjacent properties to determine if it is at risk of environmental contamination. If a reasonable risk is present a Phase II should be conducted which would involve testing soil and groundwater samples.
Property Inspections	You will want to conduct a thorough inspection of the building and grounds to understand if anything needs repair and/or will cost money to fix in the near future. In particular, items such as the roof, parking lot, foundations, heating and cooling systems, and potential asbestos issues should be inspected.
Appraisal	A lender will require a property appraisal to determine the value of the property. The appraisal will be based on recent comparable sales and may also consider the income generated by tenants.
Zoning/Use Approvals	If you intend to do construction or change the current use of the property, you will want to understand if your plans will be acceptable and, ideally, get fully entitled before closing. Because a full approval process can take several months and adds risk, a seller may be reluctant to make closing contingent on getting all zoning and use approvals. If a seller does not agree, you must determine if that is a risk you want to take.
Licenses & Permits	Like zoning and use approvals, you will want to be sure any uses that require licenses or special permits can be maintained and/or obtained.
Taxes & Assessments	You will need to understand how much in property taxes the owner must pay and if any assessments are due, pending, or being considered. Taxes are typically split on a pro rata basis based on the calendar year. Assessments are subject to negotiation.
Property Management Review	You will want to review property management records to understand how well the property has been maintained. You will also want to refine your estimates for future operating expenses based on historical records, your investigations, and discussions with a property manager, if you intend to hire one.

Tenant/Lease Review & Estoppels	If you are buying a property with existing tenants, you will need to understand the intimate details of those tenants. Specifically, you should study all the terms of the lease and any amendments, review payment history, and investigate tenant credit and their business situation. You should adjust your income assumptions based on any risk you identify based on that information. You may also want to obtain estoppels, which serve as legal verification from the tenants that the information you have about them is true.
Financial Review	Even though you should conduct a financial feasibility analysis before signing a purchase agreement, you will want to continuously refine your assumptions based on new information you uncover during due diligence. If your financial metrics degrade to unacceptable levels after your knowledge of the property increases, you may need to renegotiate the deal or terminate the purchase agreement.

IV. Entitlements

Approval Process



If you plan to develop a property from the ground up, or even redevelop a property that fundamentally changes the use or exterior of the building, you will be required to get approval from the city and potentially other governmental agencies, for the intended changes. Obtaining the approvals necessary to develop your property is called getting the property *entitled*. While each municipality may have slight variations in how developers obtain the necessary approvals to build and use a property, the process is fairly similar and guided by state law. Generally, to receive approval, the developer must submit an application which will include proposed site plans and basic building drawings. A city planner will work with the applicant to make sure everything is complete, provide guidance, obtain feedback and required changes from various city departments, and ultimately issue a report and recommendation for the approval committee(s). The project will be presented to a zoning board of adjustment, planning commission, and/or city council for review and approval. These public hearings typically allow the applicant to discuss the project and provide an

opportunity for the public to express their support for or concerns with the proposal. The review committee will then vote to approve the application as presented, approve with conditions, or deny the application. (In some cases, a review committee makes a recommendation, but final approval falls to another committee such as city council.) Once final approval is granted and any appeals periods have lapsed, the applicant will get a final review from city planning staff and required city departments and can then apply for permits.

If the application is denied, the developer can typically rework the plan and go back through the development review process again. Unfortunately, this situation could set you back several months, costing you time and money, and putting your ability to acquire the site and develop it at risk. Therefore, it is critical to actively manage the approvals effort to ensure you are bringing forward a viable project. Given the importance of the entitlement process, the complexity of zoning code, and the numerous stakeholders involved, it is important to submit a well-informed and professional application and have a knowledgeable and articulate presentation during public hearings. Having good partners to lead this work; namely an architect, and possibly a civil engineer and attorney; who are familiar with the approval process and can help make sure everything is in order can improve your chances of getting approval in a timely manner.

Minneapolis Development Review

In Minneapolis, the approvals process is called the Minneapolis Development Review (MDR). As with other cities, development review in Minneapolis begins at the staff

level, specifically with a city planner. The planner will help the developer navigate through the application and approval process. Depending on what is planned for the property, the development review process



will require either an administrative review or a public hearing land use application.

Land Use Application: Administrative Review – For "small" developments that fit within the permitted zoning requirements, review and approval can occur at the administrative (staff) level. In Minneapolis, this includes 1-3 unit residential properties, construction of accessory dwelling units (ADUs), and small expansions of existing residential properties. As depicted in the process map below, the applicant begins with a pre-application meeting (optional) with the city planner to prepare for application submittal. The full application, including completed forms, required drawings, and fees can then be submitted through Minneapolis's online Electronic Plan Review (ePlan) system. Once the application is determined to be complete, it will be reviewed by city staff to ensure it adheres to the zoning code and any other

pertinent city requirements. If no issues arise, the application will be approved by city staff and the developer can apply for a construction permit. The administrative review process does not require public notice and public hearings, and the public is not able to provide input on the proposed development. However, it is important to note that the applicant and public can appeal staff decisions. Any appeals would be reviewed by one of the three public hearing boards, depending on the nature of the appeal.





Land Use Application: Public Hearing – While many land use applications can be approved at the staff level, commercial and larger residential developments and any development that deviates from what is allowed by right in the zoning code (variances, conditional uses, rezoning, etc.) must follow a more involved process which requires public hearings and approval by at least one of three different committees – board of adjustment, planning commission, or city council.

Many of the early steps in the public hearing process are the same as in the administrative review process. However, the Pre-Application meeting with a city planner is required and participation in neighborhood meetings and the Planning Committee of the Whole (an informal meeting with planning commissioners to present preliminary concepts and solicit feedback) are optional, but strongly recommended. It is also expected (and often required) for applications to go through a Preliminary Development Review (PDR) where staff from city departments make sure there are no concerns with the proposed project from a fire, public works, parks, etc. perspective. If an application cannot be approved at the administrative level the planner will still help guide the applicant through the review process including writing a staff report with a recommendation that will be presented in the public hearing. The staff recommendation will generally be based on whether the development plan is in line with current zoning, the city's long-term plan, uses and design that complement the area, and area impacts to traffic, environment, etc. While the reviewing body can choose to agree or disagree with the staff recommendation, the recommendation carries a lot of weight, and so it is beneficial to submit a plan that has staff support.

MINNEAPOLIS LAND USE APPLICATION PROCESS – PUBLIC HEARINGS



The major difference between the public hearings process and the administrative process is the public hearing requirement. Rather than application approval occurring at the staff level, the application must be reviewed by the Zoning Board of Adjustment, Planning Commission, and/or City Council. As part of this review process, notification of the proposed development must be given to the public and the public has an opportunity to comment on the proposal and observe the approval meetings. The board(s) that must review the application depends on what aspect(s) of the project require(s) approval. For example, in Minneapolis, a request for a variance is reviewed and approved by the Board of Adjustment but a Conditional Use Permit is reviewed by the Planning Commission. The table below shows which zoning requests are handled by each of the three public hearing boards.

Board of Adjustment Planning Commission City Council Approval Approval Approval Variance Site Plan Review Rezoning Non-conforming use Conditional Use Permit • Comp Plan amendment Appeal of Staff Approval Vacation of Right of Way (CUP) • Non-conforming use Interim Use (expansion or change) Appeal of Board of Appeal of Staff Approval Adjustment or Planning Commission Recommendation Rezoning Comp Plan amendment Vacation of Right of Way

MINNEAPOLIS PUBLIC HEARING REVIEW AND APPROVAL AUTHORITY

It is important to note that many large cities, such as Minneapolis and St. Paul, grant full approval authority to the Board of Adjustment and Planning Commission to reduce the number of reviews that go before City Council. However, smaller cities, including most suburbs, have applications first reviewed by a planning commission to simply make a recommendation, but then go to city council for final approval. Even when city council has full authority to approve or deny an application, they heavily consider the staff recommendation and the planning commission vote.

MINNEAPOLIS LAND USE APPLICATION PROCESS GUIDE

www2.minneapolismn.gov/media/content-assets/www2-documents/business/Land-Use-Application-Process-Guide.pdf

Land Use Application: Heritage Preservation – One additional approval is required for situations where a change in a property will impact the historical nature of the property or area. The Heritage Preservation Commission was established in part to protect the historical, cultural, architectural, archaeological or engineering heritage of the city. This commission will review applications for various actions including demolition of historic resources, historic variances, and designations of landmarks and historic districts. As with the Board of Adjustments and Planning Commission, the applications that go before the Heritage Preservation Commission typically must allow for public comment. The commission has some authority to approve applications, but in many cases the commission's role is only to provide a recommendation to City Council who then makes the final decision on the application.

Administrative Staff – Planning & Zoning	City staff within the department of Community Planning and Economic Development (CPED). Responsibilities include guiding applicants through planning and zoning approvals process, managing applications, and approval of small residential projects that meet all zoning requirements
Administrative Staff – Other Departments	City staff within various city departments such as public works, Fire, Community Safety, etc. Responsibilities include reviewing applicant plans (mainly during Preliminary Development Review and Final Plan Approval) for potential code violations or inconsistencies with approved plans.
Heritage Preservation Commission	10 members – all appointed or representatives, most with specific expertise in architecture, real estate, etc. Responsible for reviewing applications that may impact the (historical, etc.) heritage of the city. May either approve/deny application (when authorized) or make a recommendation to City Council.

	REVIEW KEY		RESPONSIBIL
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Zoning Board of Adjustments	9 members – all appointed. Responsibilities include reviewing applications for variances and non-conforming uses. May either approve/deny application (when authorized) or make a recommendation to City Council.
Planning Commission	10 members – all appointed or representatives. Responsibilities include reviewing applications for site plan review, conditional uses, rezoning, and other similar action. May either approve/deny application (when authorized) or make a recommendation to City Council.
City Council	13 members – all elected. Primary zoning related responsibilities include review and final approval of applications for rezoning, interim use, vacation of right of way, comprehensive plan amendments, and appeals from other boards/commissions.

Applying This to You!

Put together a schedule that outlines each of the key milestones in the entitlement process for your development. Reach out to the city's planning and zoning staff contact to discuss and refine your schedule.

Zoning & Buildable Potential

Beyond restricting the type of uses allowed on a property, the zoning code specifies several other factors that will impact how a site can be built. The purpose of these restrictions is to ensure functionality in site design, both individually and collectively, and to support complementary design within an area. For example, you may not be

- Did you know?

In 1899, congress passed the Height of Buildings Act which limits building heights in Washington D.C. to 110 feet, in order to maintain the visible prominence of several government monuments. too happy if someone built a 20-story apartment building fifteen feet away from your single-family rambler. Understanding the various site constraints and designing a building that is allowed within those

constraints but is still financially feasible is one of the puzzles that developers must solve – this is one-way developers add value. Several of the most notable restrictions that impact site design and should be understood early in the site selection and due diligence are listed on the next page.

Notable Zoning Restrictions

Lot Size	To manage/limit density, zoning may require a minimum and/or maximum lot size (acreage, lot width) for a given use. For example, code may state that a lot must be at least 0.20 acres to allow for a twin home.
Height Limits	Zoning often will limit the height of a building to preserve the character of a street or neighborhood and/or to control density on a site so as to prevent excessive burdens on infrastructure like roads and sewers.
FAR	Floor-to-Area ratio, or FAR, is calculated by dividing a building's total (gross) floor area by the size of the land upon which the building is built. Like height limit, the FAR is used to control density on a property. For example, a 2-story building with 5,000 SF on each floor (10,000 SF total) built on a 20,000 SF property would have an FAR of 0.5 (10k SF / 20k SF).
Setbacks (aka Yard Requirements)	Properties often will have minimum or maximum setbacks. While this can help control density, it is primarily used to maintain a certain character, ensure adequate site lines, and prevent buildings from being too close together. You might not be too happy if your living room window was right on your lot line and then your neighbor built a garage six inches away in his lot. Setbacks often exist, but may differ, for front, back, and side yards. While cities have had minimum setbacks in place to prevent crowding, more recently, cities are focusing on maximum setbacks to encourage and activate the streetscape.
Lot coverage	Lot coverage is similar to FAR, but only looks at the building footprint, rather than the total floor area of the building. The largest building footprint you could build on a 20,000 SF lot with a maximum lot coverage of 0.70 would be 20,000 SF x $0.70 = 14,000$ SF. Like setbacks, lot coverage is primarily used by municipalities to limit crowding of buildings and ensure some open space.
Impervious Surface Coverage	Impervious surface coverage is a maximum percentage of the lot area that can be covered with surfaces that do not allow drainage, such as building and parking lots. The intent of this is to promote landscaping and prevent excess rainwater from burdening sewer systems.
Parking	Parking requirements are typically based on use. For example, a retail building will require more parking than an industrial building. Cities may have a minimum parking ratio to ensure the property can support the projected vehicle counts without excessive overflow onto the streets or nearby properties. Cities may also have a maximum parking ratio to prevent a "sea of parking," encourage alternative forms of transportation, and to promote a certain character for a neighborhood.

Activity D: Zoning Research

Directions

Using the City of Minneapolis Zoning Code (see appendix) look up the zoning requirements for the property listed below. The planned use that you should assume is noted in the table. (Ignore any opportunities for zoning performance premiums.)

Drenerty	3801 17th Ave S, Minneapolis		
Property	SE corner of East 38th St and 17th Ave S		
Planned Use	Multi-Family Apartment building (4+ dwelling units)		
	Site Detail	Source	
Zoning Classification	BFC4 / RM1	City of Minneapolis Property Info (Lot Info)	
Lot size	0.26 acres; 11,310 SF	Hennepin County Property Information Search	
Lot dimensions	92.30 ft x 122.40 ft	Hennepin County Property Information Search	
	Zoning Requirement (min & max)	Source Minneapolis Zoning Code (Section & Table)	
FAR (max, min)			
Height Limits (max, min)			
Lot Area (max, min)			
Lot Width (min)			
Yard (Setback) - Front (min)			
Yard (Setback) - Corner (min)			
Yard (Setback) - Rear/Side (min)			
Maximum Lot Coverage (max)			
Impervious Surface Coverage (max)			
Vehicle Parking (max)			
Bicycle Parking (min)			



Chapter 5: Design & Construction

Key Concepts

- Design and construction can be one of the most exciting parts of real estate development but, given its complexity and cost, it is wise to fully consider what you can do on your own versus what you should hire out. Avoiding professional fees upfront may backfire if that leads to poor design, work redo, schedule delays, and missed savings opportunities.
- While your designers and contractors should understand, design, and build to code, it can be helpful for you as the developer to be familiar with where and how building codes are defined including the Minnesota Building Code and the Minnesota Residential Code.
- Good design can help make a development successful by meeting building requirements in creative ways that lower costs. Designs that are repeatable, flexible, and cost-effective can be attractive and will usually save developers on design and construction.
- Construction begins at property inspection. Knowing risks and getting a preliminary estimate of costs early in the process is critical to assessing financial feasibility and determining if the investment is even worth pursuing.
- A knowledgeable and trusted general contractor can be one of a developer's most critical partners, but that begins with a solid contract. A developer should have a good understanding of how contractors are paid, different contract structures, and the key elements of a contract to establish a clear, solid relationship from the start.
- Construction is more than just knowing how to build a building. A successful developer and contractor will need to understand how to manage cash flows (loan draws, working capital), navigate permitting and inspections, and manage labor and wage requirements.

I. Initial considerations

Do it yourself v. Hiring expertise

When it comes to design and construction, your decision about whether you hire out all or a portion of the work will depend on your knowledge, time, and project complexity. Many individuals who are knowledgeable with home construction expand into owning rental properties as a natural investment. Understanding how buildings work and having the skill to build and make improvements can save a developer money and make it easier to identify opportunities. While that skill set can apply to residential properties with multiple units and even commercial properties, as a building gets more complex (e.g., elevators, HVAC units, asbestos, roof membranes) even a knowledgeable developer may want to engage design and construction partners. While the cost of this can be concerning initially, good partners will typically be worth more than their fees by managing costs, preventing mistakes, and keeping a project on schedule. Losing a few months in the development process due to having to resubmit a proposal or redoing electric work because it is not to code will negatively impact on your financial outcome. In short, you will need to determine if the cost of bringing on outside experts justifies the time they save you and the risk (financial, schedule, legal, etc.) they help you avoid.

Numerous technical design and construction books have been written to help practitioners understand codes and learn about the basics, complexities, and best practices of design and construction. Accomplished architects, engineers, contractors, and tradespeople spend many years in school and on the job to learn their trades and hone their skills. While this chapter is intended to provide some guidance on the design and construction aspects of development, it is far from comprehensive. The intent is to help you as a developer understand some of the general concepts to consider so that you can have a more effective conversation with your design and construction partners. This section also provides you with some guidance on contracts and pricing so that you can establish a fair and productive working partnership with your vendors.

Key partners

The partners needed on a design and construction team can vary depending on the size and complexity of the development. The construction team will typically include subcontractors who specialize in foundations, framing, mechanical systems, plumbing, electrical, drywall, roofing, etc. Some more complex developments may have elevator contractors, lighting and sound specialists, landscape architects, and structural engineers – and maybe even a feng shui consultant! Fortunately, most small developments do not require so many specialists. Nonetheless, there are a few key partners that are critical to design and construction that any small developer should consider bringing onto the development team early, especially if the developer does not have expertise in those areas.

Architect or Designer – An architect does more than simply layout floor plans and design an interesting building exterior. An architect must be knowledgeable in local building and zoning codes to ensure your building is designed property. A good architect will know the local entitlement process and help you navigate through approvals. An architect should creatively translate the developer's vision to reality, while managing within a given budget. Finally, the architect should be a leader in the

process, pulling together other engineers and consultants to create an effective and attractive design.

That said, architects don't come cheap and may be overkill. If you are looking to build a simple structure on a straightforward lot, you may only need to find a good designer. Like an architect, a designer is knowledgeable in building design, computer aided design, and common building codes, but may not be licensed and insured as an architect. If your project is straightforward, it may be sufficient and most cost effective to hire a designer rather than an architect. A designer can still create or modify simple plans that can be used for city approvals, bidding, and construction.



Photo Credit: www.freepik.com

General Contractor – Unless you are well versed in building construction, having a knowledgeable contractor is essential to managing costs and mitigating risk. Your "GC" should walk through any building you are considering purchasing, ideally even before a purchase agreement is signed. Your contractor should provide you with a rough, but informed estimate of construction costs to help you run your financial analysis, and regularly refine that estimate throughout the development process as new information is discovered. In addition, your general contractor should be able to coordinate the work of many subcontractors, ensuring quality work and keeping them on schedule and budget.

Structural Engineer – A structural engineer is a professional who has extensive knowledge in how the design and materials of a foundation, supports, walls, and roof work together to ensure a building stands and can withstand the forces of wind, snow loads, earth movements, and floor loads. While an architect (or designer) can usually handle the structural design of a typical small residential or commercial building, larger, more complex structures may require the expertise of a structural engineer. Additionally, it may be necessary to pull in a structural engineer on rehab projects with older foundations and support systems to understand what, if any, additional work is required to shore up the building structure.

Surveyor or Civil Engineer – As with the structure, often the architect or designer has sufficient knowledge to do site design for a small, straightforward development. However, you will still need a surveyor to create or update a site survey to confirm boundaries, topography, locations of structures and utilities, and encroachments. The

surveyor may also be able to assist in the design of the planned development, identifying curb cuts, driveways, etc.

For large, more complicated sites with soils, drainage, water retention, topography, or utilities challenges or site constraints it may be necessary to engage a civil engineer. In these cases, it can be important to pull a civil engineer into the project in the early stages. Given so much of the design and construction variables have to do with the property – property survey, soil conditions, drainage, vehicle access and circulation, building positioning, parking, etc. – a strong civil engineer will identify site risks early in due diligence and the cost and feasibility of overcoming them.

Energy Rater – One additional partner that is not commonly considered is the energy rater. However, with increasing importance placed on building energy efficiency and the number of energy related requirements and/or available incentives for developers, having an energy rater on your team can be beneficial. An energy rater is trained and certified to inspect and evaluate a building's energy features and make recommendations for improvements.

Applying This to You!

What is your level of knowledge and skill, availability, and access to tools in architecture, construction, and civil engineering? How complex is your development or redevelopment? Are there any aspects of your project that may require specialized expertise? If the project complexity exceeds your capabilities, now is the time to start getting to know potential partners.

II. Design

Design Process

Understanding the main phases of the design process is helpful when engaging with your design team and determining timing and pricing. For large and complex projects there are five main phases of design. Smaller or more straightforward projects may condense the process (e.g., skip design development.)

Programming – Programming isn't technically a "design" phase given no designs are produced at this point. Instead, this is the opportunity for the architect and developer to align on the details of the desired outcome. The output of this phase is an outline and/or spreadsheet documenting the project goals and desired technical and conceptual aspects of the design. This "program" could include use(s), size, floors, number of units, amenities, parking needs, design style and characteristics (i.e., "feel").

Schematic Design (SD) – In this phase, drawings preliminary known as Schematic Designs are created that show general building massing, rough locations and sizes of main areas, and exterior renderings. These drawings are intended to align architect and developer, without going into too much detail (and therefore time and cost.) This phase typically includes a lot of rough sketches, back and forth discussions, and design iterations. This can often be one of the most fun parts



Schematic Design Example (Sanctury Lofts, Minneapolis)

of development! Schematic drawings will provide a good idea of rentable area for financial analysis and are also used for approvals during the entitlement process.

Design Development (DDs) – This phase is intended to be more detailed than schematic design, and begins to include aspects such as mechanical, electrical, and plumbing, but stops short of producing the level of detail needed for construction. Types of materials to be used will also be identified during this phase. Design development further aligns the developer and designers and can be beneficial in identifying efficiencies and cost savings opportunities. The output of this phase are Design Development drawings.

Construction Drawings (CDs) – During this phase, Construction Drawings (or Construction Documents) are produced which provide sufficient detail about all aspects of the building design to enable construction. This phase focuses documenting the details needed to enable the design created in prior phases to be approved and built. CDs include both drawings and specifications, written instructions indicating

systems, materials, equipment and other standards to follow. **Construction Documents** are used for getting a project permitted (approval from the city to start construction) and for bidding (determining project cost by soliciting bids from contractors and subcontractors).



Construction Drawings Example (Sanctuary Lofts, Minneapolis)

Building Code

In the 19th and early 20th centuries cities across the country faced devastating fires that cost many lives and millions of dollars in damage. (Perhaps the most famous is the great Chicago fire of 1871. Minneapolis, however, also faced its own tragedy – in the great Minneapolis fire of 1893 more than 23 city blocks in Northeast were burned.) While building codes date back thousands of years, the scale of these great fires enabled by highly flammable buildings in close proximity drove cities to be more deliberate about enacting building codes to protect property and their citizenry.

Building codes, and where to look for those codes, will vary based on the building type, building system or component, state, and municipality. Given that code books can be hundreds of pages long and involve complex building systems, it can be overwhelming to try to understand and follow all codes. Therefore, it is important to ensure you have knowledgeable partners (designers, engineers, contractors, and subcontractors) that understand the code and will follow it. While it can take years of study and practice to truly understand building codes (and ongoing awareness to stay on top of code changes), as a developer it can at least be helpful to understand how codes are documented and organized and who the code authorities are.

To start, there is an organization called the International Code Council (ICC) that establishes and publishes building codes that are used across the United States and in many countries throughout the world. The ICC publishes two sets of codes:

International Residential Code (IRC) - The IRC is used for all single-family, two-family (duplexes) and buildings consisting of three or more townhouse units. All buildings within the scope of the IRC are three stories (above ground) or less. The IRC includes code that addresses construction of all components of a house or townhouse including structure, insulation, mechanical systems, fireplaces, plumbing, and electric.

- Remember!

Both the IRC and the IBC are updated every 3 years (2018, 2021, 2024, ...). The MRC and the MBC are updated every 6 years (2014, 2020, ...).

Because the IRC focuses just on smaller residential buildings, the code may appear more straightforward than the more comprehensive International Building Code.

International Building Code (IBC) – The IBC covers construction of all buildings (e.g., commercial, industrial, and multi-family residential) except those smaller residential buildings which are covered by the International Residential Code. IBC, which consists of over 700 pages, focuses on all aspects of building construction including egress, stability, sanitation, light and ventilation, energy conservation, and property and life safety.

While it is good to understand the existence of the IRC and IBC as the foundation for building codes across the country, it is important to know that each state has its own building codes. Each state adopts and modifies the international code as they deem necessary, and which creates code variances from state to state. Therefore, when building in Minnesota, it is important that Minnesota state building code is followed. Like the ICC, the Minnesota Department of Labor and Industry publishes two sets of codes:

Minnesota Residential Code (MRC) – Like the IRC, the Minnesota Residential Code covers code requirements for the construction of small residential. However, while the IRC covers single-family, 2-family, and townhomes, the MRC only covers 1- and 2-family houses. Therefore, a developer that is building 3+



units in Minnesota must adhere to the Minnesota Building Code rather than the MRC.

Minnesota Building Code (MBC) – The Minnesota Building Code is based on the IBC and applies to commercial buildings and residential construction not covered in the MRC (including 3+ unit townhomes). Because the MBC covers a broader range of building types and larger and more complex buildings, it can be a more involved process and more costly to understand and build to MBC rather than MRC.

Both Minnesota Residential Code and Minnesota Building Code serve as the construction standard for all municipalities and counties in Minnesota but are only enforceable if adopted by local ordinance. It is also important to note that while these codes set a *minimum* requirement for how a building must be constructed, often municipalities require even more stringent code requirements than what are defined. Developers may also choose to exceed code requirements for various purposes (e.g., sustainability, quality, operational cost savings).

While international and Minnesota building codes cover a significant portion of building construction, they are not exhaustive. Some building codes are established by other organizations and documented in other publications. Examples are the Minnesota State Fire Code (MSFC) and the Minnesota Accessibility Code, both of which can be found on the ICC website listed below. The Minnesota Board of Electricity determines the state's electrical code, which is based on the National Electrical Code (NEC) published by the National Fire Protection Association (NFPA).



Copies of both International and Minnesota building codes can be purchased online through the **International Code Council** website:

codes.iccsafe.org/

Accessible Design and Universal Design

In recent decades, architects and property managers have become more aware of the importance of having buildings that are accessible and usable by all populations, not just the average user.

Fair Housing Act - In 1988, the Fair Housing Act was created which mandates that multifamily buildings (>4 units) built from 1991 on must have either all units accessible (if the building has an elevator) or all ground floor units accessible (if the building does not have an elevator.) Accessible, as defined by the Fair Housing Act, includes building and common areas access, wide doors and bathrooms, and accessible controls such as light switches and outlets.

Americans with Disabilities Act (ADA) - In 1990, the Americans with Disabilities Act was signed into law which, in part, established minimum requirements for accessibility for public buildings, which primarily is focused on commercial buildings. The ADA does not cover residential units but does have accessibility requirements for public spaces in multifamily residential buildings. The ADA also requires landlords to make "reasonable accommodations" for tenants with disabilities, such as adding grab bars and ramp access to units.

Accessible v. Universal - The Fair Housing Act and ADA together set requirements to ensure residential and commercial properties are accessible and provide the guidelines for what is known as Accessible Design. Accessible Design is a design process in which the needs of people with disabilities are specifically considered. A broader design concept known as Universal Design has also been promoted over the past few decades. Universal Design's objective is to ensure environments are designed for use by all people without the need for adaptation or specialization. In other words, usability for all regardless of age, disability, culture, etc. is integrated in the design from the beginning. Examples may include designing all units with wide doors and larger bathrooms, zero-entry buildings and units (no steps), and nongender individual public restrooms.

A knowledgeable architect can help you navigate the nuances of the various accessibility codes, but it can be helpful to understand potential impacts on your property, usability for tenants, and financials. Many universal design concepts can be incorporated into your design at no additional cost but make your property more attractive and marketable to tenants. However, some accessible design and universal design features do cost money. Understanding when these features are required, not

required but will increase usability and value, or can be avoided will help you make choices that will result in a more successful project. Buildings with multiple floors can be challenging because the cost of an elevator is a significant investment; the small building size may not generate enough income to absorb the price of the elevator. For housing, this issue can often be resolved by building an accessible unit or units on the ground floor. For example, the building in the floor plan shown has four units on an upper level, but because it also has a fifth unit at ground level, an elevator is not necessary.

It is also important to understand that IRC, ADA, and Fair Housing laws are primarily focused on commercial buildings and residential buildings with four or more units. While there are still code requirements for 1-3 family buildings, accessibility







requirements are typically less stringent. However, even if code does not mandate a certain level of accessibility, developers may need to incorporate accessible or universal design to meet funding requirements. For example, for those applying for funding from Minnesota Housing, projects earn additional points for incorporating universal design features into their projects. Minnesota Housing also requires all senior housing developments that receive their funding to incorporate universal design in their project.

Applying This to You!

Look at your design. Are there any ways to incorporate universal design without losing attractiveness or increasing cost?

Principles of good design

Given the hundreds of pages of building codes that dictate how buildings can and cannot be built, one may understandably wonder if there is any opportunity for diversity, creativity, and decision-making in building design. Fortunately, the answer is "Yes, absolutely!" Despite all the requirements, designers and builders have immense flexibility in layout, size, lighting, materials, features, and styles. Designed well, a building can be both functional and beautiful, cost effective and timeless. Designed poorly, a building may have functional shortcomings, expensive to build and operate, deter prospective tenants, and fall into obsolescence.

Often, a building can be built to be both attractive and functional – they are not necessarily mutually exclusive. However, this is not always the case. An office building with a curved exterior wall may look beautiful from the street, but it leaves inefficient floor plates for offices and workstations – not to mention it is expensive to build. This is as true for small developments as it is for multi-million dollar buildings. Fortunately, there are some proven building typologies that are the bread and butter of the small developer that deliver functionality and efficiency. These typologies include duplex, fourplex and eight-plex rectangular apartments, townhomes, and simple mixed-use retail and residential buildings. These designs continue to be used because they have simple building layouts and use local materials. Not only are these building designs typically more affordable to design and build, they also avoid many of the headaches that buildings with structured parking, elevators, etc. have. There are a few common attributes that make these typologies endure:

Repeatable – Even though no two sites are exactly the same, building designs with common shapes and basic elements can often be repeated with little alteration. This reduces the time and cost of design and construction.

Stackable – Residential and commercial buildings that stack the same floor plan on multiple floors benefit by having plumbing, mechanical, and electric systems run through the same space, improving usability and reducing the cost of design and construction. (No one wants the toilet drain from the apartment above running through their living room!)

Flexible – Designs that are flexible, accommodating a range of tenant needs not only can be used in multiple development situations, but are more marketable since they can support a broad range of tenants.

Cost-Effective – Design is not just about shape; it includes material selection as well. Choosing materials during design that are proven to be attractive and durable yet are reasonably priced will keep overall construction costs in check.

Sustainable Design

With the awareness of global climate change and the significant impact building construction and operations have on the environment, sustainability is increasingly a priority for governments, tenants, property owners, and property managers. These stakeholders have long desired to sustainable incorporate or environmentally friendly designs into residential and commercial developments to optimize site potential, lower water and energy usage, reduce waste, improve air quality, support reuse and recycling, and use low-impact materials that promote (Developer: Kaleidoscope, Architect: A W A K E N Architecture)



Firefly Apartments, 2716 Grand Ave

quality and durability. In the past, one of the biggest limitations to sustainable design was upfront cost, especially for small scale development. Fortunately, significant progress has been made over the past few decades to lower the cost and improve the financial return of many of these sustainable design elements. Today, solar panels, heat pumps, green roofs, superior insulation, and renewable, reusable, and recyclable materials are some of the ways that developers can affordably develop more sustainable projects.

To encourage and support environmentally friendly construction, many governmental agencies have prioritized sustainability as part of their selection criteria and funding requirements. Through grants, loans, and rebates, agencies across the state including MN Department of Employment and Economic Development (DEED), Minnesota Pollution Control Agency (MPCA), MetCouncil, and numerous counties and cities provide financial assistance to developers who commit to sustainable design features in their projects.

Life Cycle Cost

Because the cost of construction is such a major factor in whether a development project is feasible, it is understandable that a developer will want to spend a significant amount of time focused on lowering the cost of construction. Still, as with most things in development, there are trade-offs. Cutting too much upfront or in the wrong areas can have negative implications that can lead to more costly operations or repairs, or lower revenue, in the future. For example, installing lower quality bathroom fixtures may seem like a smart move, but over time could end up costing you more given the need for constant repairs and the high-water bills from leaking faucets.

Considering the cost, not just of initial construction, but the full cost throughout the life of the building is called **Life Cycle Cost**. The Life Cycle Cost accounts for the total cost to build, own, operate, repair, replace, and dispose of a building or property. To effectively make smart choices with design and construction, it is important to consider the full life cycle cost rather than just the upfront cost of construction. Will the higher R-value (insulated) windows reduce your energy costs? If so, will that benefit you, your tenant, both? Will inexpensive bath fans be sufficient or lead to expensive mold problems? Are higher end appliances necessary to attract tenants and keep your units occupied and rents up? Will your choice of roof design lead to higher (already expensive) insurance premiums? In some cases, it may make sense to reduce costs upfront, but in other cases, it could be worth the initial investment to save costs in the future. Having knowledgeable design and construction partners can help you make smart design decisions accounting for life cycle cost.

It is also important to understand this life cycle cost trade off when buying or selling a property. If the original developer built the property with the intention of selling it shortly after completion, did that developer take short cuts or make choices with life cycle costs in mind? Similarly, if your plan is to develop and sell, you want to consider how the choices you make in design and construction impact the building quality and sustainability, your financial return, and your reputation as a developer.

III. Construction

Construction is often one of the most exciting parts of the development process, but it also can produce anxiety. After months, or even years, of hard work to find and purchase a property, evaluate the opportunity, design the building, and obtain approvals, you finally begin to see the physical reward for all of that effort. Nonetheless, construction can be stressful because of the amount of money now being spent and the potential for unforeseen conditions to arise that can delay the project and increase the cost. To mitigate that risk, it is important to be proficient in certain elements of the construction world, including contracts, scope of work, and budgeting, to enable strong and trusting relationships with contractors.

Evaluating a building

When purchasing a built property (even if you plan to tear down the building) you will need to do a thorough inspection to understand if it meets your needs, if there are any concerns that may need to be corrected, and roughly what your plans for the site will cost. You may be able to conduct your own initial evaluation when first assessing the property, but you should be sure to have a detailed inspection conducted by a qualified individual prior to closing. Regardless of whether you hire your inspection out, or you feel qualified to do the inspection yourself, there are a few key elements that should especially be inspected.

- Roof What type of roof is it (sloped, flat, etc.)? What is the condition of the roof? How steep is it and how many slope changes are there? Is there sufficient drainage?
- Insulation Where is it located? How effective is it (R-rating)? Does it contain asbestos?
- Foundations and structure Can it be inspected? Are there any visible cracks or other issues?
- Mechanical System How is the building heated, by water (radiators), air (furnace), or electric (baseboard)? What are the age and efficiency of the heating units?
- Electrical Systems What is the age of the panel? Does the panel include breakers or fuses? How old is the wiring? Are outlets grounded and have GFCI where necessary?
- Plumbing Are the pipes copper, plastic, steel or iron? Is the water pressure and flow adequate? How old is the main line drain?
- Doors and Windows How old are they? How do they operate? Are they sufficiently airtight? Do they all have screens?

Contracts

If you are hiring a project manager or general contractor to manage your construction, it is helpful to understand some of the basics of construction contracts to aid in your discussions and negotiations. To start, often developers will reach out to multiple contractors (typically three or more) to get bids based on a specific scope of work. If the scope is clear enough, including detailed drawings, contractors should be able to provide a fairly accurate estimate of cost. Ideally you will have pre-qualified all contractors (i.e., you've confirmed they have the skills and experience and will do a good job) and can then make your decision based on the lowest bid price – though you still may select your GC based on factors other than just cost. If you have a relationship with a specific contractor or otherwise do not want to "go out to bid" you may simply seek a negotiated contract.

When negotiating a contract, there are a few important items that the owner should be sure are included in the agreement, namely:

- Scope What work is the contractor's responsibility? The more detailed scope, the better, ideally based on construction documents and specifications. If scope is based on drawings, the date of the drawings should be referenced.
- Schedule Project phases, start and finish dates of each phase, dates of other critical milestones, final project end date.

- Budget How much will the contractor get paid?
- Terms of Payment How will they be paid, how often will they send invoices, and how long does the owner have to pay the invoice?
- Insurance and Bonding The contract should confirm they are covered, list
- what is covered, and the dollar amount of coverage.
- Liens How are liens managed, both for the contractor and subcontractors?

Cities, lenders, and other stakeholders often require specific types and levels of insurance coverage for developers and their contractors and require that they are listed as an "additional

insured" on the policy. Understand these requirements so you know what to include in your construction contract.

• Disputes – How disputes will be handled

Scope of Work

Sometimes, when pulling together a contract, it can be tempting to disregard the importance of having a good description of the work that will be performed. Having a well-crafted scope of work will greatly reduce the odds of future conflict between contractor and owner and can save time and money. Referencing drawings in a scope of work goes a long way to clarifying exactly what work needs to be performed. Yet, even with drawings, there are still additional considerations that should be covered in the scope of work to ensure alignment between developer and contractor.

- Work performed Detailed explanation of the work that will be performed, including a clear description of the finished state.
- Major fixed equipment Specify who is furnishing major equipment, contractor or owner, and who is installing the equipment.
- Fixtures and finishes Include specifications or names of hardware, fixtures, finishes to be installed or used as examples of level of quality and cost. The contract should also be clear about when and how approvals for fixtures and finishes will be obtained.
- Permits It should be clear if the owner is responsible for obtaining permits for work or if that will be handled by the contractor.

Contracts – Fee Structure

Pricing within contracts (i.e., how contractors are paid) can take many forms. Pricing must cover both the work and materials as well as the overhead and profit for the contractor. Which type of pricing structure is used will depend on many factors, including how well the project scope is defined, risk tolerance by each party, negotiating position, and project complexity.

Lump Sum – The owner agrees to pay the contractor a fixed fee for the work. In this structure, the contractor is taking on all risk of unexpected costs; as a result, the contractor will want a higher markup to help cover unforeseen costs and their added risk. Most small development projects use this structure.

Time & Materials – In a time and materials contract the contractor is reimbursed for the cost of materials and labor at a set rate. The contractor does not charge an explicit fee on top of the time and materials. Instead, the agreed upon rates for the time and materials is marked up to enable the contractor to cover



overhead and earn a profit. This approach may be desired by contractors when the scope of work has significant uncertainty. Conversely, a time & materials contract is less favorable to owners as all unforeseen costs get passed along directly to them. Further, the contractor has little incentive to seek out ways to reduce construction costs since they are paid the same, or more if the fee is a percentage, if costs rise.

Cost Plus – A cost plus contract is like a time & materials contract in that the owner agrees to pay for all costs of construction (i.e., labor and materials) at a set rate. Unlike a time and materials contract though, in a cost plus contract the contractor's fee for profit and overhead is added on top of the total cost and not as a markup of individual line item rates. The fee paid is typically either a percentage of the cost or a fixed fee.

Unit Price – A unit price contract may be used when the quantities of certain tasks or items are not fully known. The contract specifies a price per task or per unit, but then charges the owner based on the final number of "units." Since the number of units is variable, this approach shifts some of the risk away from the contractor and on to the owner.

Guaranteed Maximum – In a guaranteed maximum contract, the contractor and owner agree on a project cost plus a set fee for the contractor, but the contractor also agrees to set a maximum total cost of the project. This structure keeps some of the risk to the owner but limits his total exposure. It also gives the contractor some incentive to carefully manage costs.

Incentives/Fees at risk – While less common with smaller projects, contracts sometimes incorporate incentives paid to the contractor if cost savings are achieved, the project is finished ahead of schedule, or other beneficial outcomes are achieved. These incentives may be in the form of flat bonuses or cost savings sharing. Similarly,

owners may even negotiate a contract that penalizes contractors (i.e., puts their fees at risk) if certain goals are not met.



Finally, it should be noted that even with lump sum contracts or guaranteed maximums, contracts can still exceed the maximum if the owner requests a change to the original scope of the project; this is known as a change order. Change orders can get pricey and add up, causing havoc on a project budget. Therefore, it is important to try to get as much of the

scope defined and locked in before the contract is signed and be judicious about approving any change orders.

Capital Considerations during Construction

Understanding how to finance a development project through debt and equity is covered in detail in a later section. However, there are some important financing and budgeting considerations during construction that are critical to understand – loan draws and working capital.

Loan Draws – When a developer secures a construction loan, the lender does not distribute 100% of the funds upon closing of the loan. Instead, the lender will disburse funds incrementally throughout the project as work is completed. This approach benefits the lender by ensuring that funds are not provided without a corresponding increase in value of the collateral. In other words, the lender wants to be sure that they aren't loaning out more than the property is worth. This approach also benefits the borrower (developer) since it means that the amount of principal distributed is limited during construction which lowers the total cost of interest during construction. Each month during construction the developer will receive a payment **application** (payapp) from the general contractor which documents the work completed for that period, including subcontractor work, and the costs incurred. The payapp is typically confirmed by the architect. The developer will include the payapp along with any other costs incurred directly by the developer (with invoices and receipts) in a draw request. Upon review and approval of the draw request by the lender (or designated third party) the lender will release the additional funds requested.

Working Capital – While construction loan draws provide benefits to both lender and borrower, it also creates a problem for the developer and contractor since it creates delays between when labor, materials, and fees are "purchased" and when the developer or contractor are paid. For example, if a contractor orders \$10,000 worth of lumber and then must pay subcontractors another \$10,000 in labor costs to frame a building, the contractor is spending \$20,000 before receiving funds from the loan draw. This is why it is critical for contractors and developers to have working capital on hand. Working Capital is the difference between your assets (what you own) and your liabilities (what you owe). This difference is effectively the capital that enables you to keep a construction project going. Working capital can come in the form of cash, but also can be provided through a line of credit. While developers and contractors often can negotiate contract terms that allow payments to be made after the loan draw, this isn't always the case (e.g., government fees and materials). Delays in receipt of funds from the lender or other sources such as gap financing can put a project at risk if the developer and/or GC do not have enough working capital to keep things moving. How much working capital is needed will depend on the size of the project and contract terms but can be sizeable and is an often-overlooked consideration for inexperienced developers and contractors.

Construction Approvals

Permitting

Earlier we discussed the design and entitlement processes, which are critical steps in pre-development. Once the design is fully locked in, all planning and zoning approvals have been received, bidding is complete, and the construction team has been selected and has executed contracts in place, one more major step must be taken before construction can begin – permitting. The number and type of permits required will depend on the project scope, but typical permits include building (general structure), electric, plumbing, mechanical, and demolition. Permits applications can be made through the city (except for electric permits which are managed by the state) and either the property owner or the contractor can apply for the permit. As with planning approvals, the applicant will be required to submit an application, permit fees, and often drawings showing the work to be completed. The permit application will be reviewed by all appropriate city departments and, if acceptable, a permit will be issued. In Minneapolis, applications can be made in one of three ways:

- In-person at the Minneapolis Development Review center in the Public Service Building (505 Fourth Ave S, Room 220)
- Mail a completed application to the Minneapolis Development Review center (same address as in person)
- Online using Minneapolis's Online Permitting System (select 1- and 2-family residential permits only)

In Minneapolis, once submitted, the permitting process usually takes about 2-4 weeks for review and approval if everything is in order and resubmittal is not required. Therefore, it is important to plan accordingly!

Inspections

Construction inspections are required by state law and city ordinance for any work that requires a permit. These inspections are necessary to ensure the project follows the approved plan, complies with state laws and city ordinances, and meets safety requirements. It is the owner's responsibility (though typically managed by the contractor) to schedule all inspections. Information about what/when inspections are required will be provided with the approved permit. While some building components only require a single inspection, many components must be inspected at several stages. For example, foundations require inspections at three points: 1) completion of footings, 2) installation of rebar, and 3) completion of foundation walls. It is also important to remember that many inspections must occur before subsequent work commences, particularly if that subsequent work impairs visibility. For example, insulation must be inspected prior to hanging sheetrock. If an inspector cannot see the work that was done, he cannot inspect it and will likely require the area be torn open. At each inspection the inspector will review the work and approve it (by signing off on the permit) if the work is complete and there are no code violations.

Certificate of Occupancy

Perhaps the most anticipated milestone in construction is receipt of the Certificate of Occupancy or "CO". The Certificate of Occupancy is critical since it marks the end of the inspection period and the point the building can open to the public or "occupied." The CO will be granted after all required permit inspections have been completed and the building passes a final inspection. In development, this is often a critical milestone because so many schedules are linked to this



Certificate of Occupancy for U.S. Bank Stadium, issued Juen 3, 2016

date. Lease agreements commonly tie the lease and rent commencement dates to the CO date. If receipt of the certificate of occupancy slips, will not only impact move in dates and developer income, but it can create downstream problems for residential tenants and businesses who must delay equipment deliveries, face moving deadlines from prior locations, must postpone openings, and risk losing business revenue. Ideally, the full Certificate of Occupancy is received on schedule, but if a project is
delayed the owner or contractor may be able to request a temporary CO for the building or a portion of the building for a limited time. If granted, this may alleviate the some of the downstream implications of impacted tenants until the final CO can be obtained.

While the CO is an important milestone, it is not the end of construction. A building may be considered complete from a code and safety perspective, but final touch ups may be needed. Examples are cosmetic updates such as finish painting, minor repairs, furniture, etc. To ensure all of these one-off fixes are completed the GC and owner will compile a "punch list" to make sure everything is finished prior to the contractor turning the building over to the owner and closing out the project.

Prevailing Wage and Living Wage

Prevailing wage laws are in place to ensure that construction workers on publicly funded projects are paid a wage that is equal to or greater than the local prevailing wage (as determined by either the federal or state government). The federal government (via the Davis-Bacon Act), state of Minnesota, and many local governments including MetCouncil, Hennepin County, and City of Minneapolis have prevailing wage requirements for publicly funded projects. Though projects pursued by emerging developers are not typically public works projects (e.g., roads, bridges, libraries, city offices) developers that are looking to secure public funding from government grants, loans, tax credits, or other incentives need to be aware of prevailing wage laws.

Minneapolis also has a Living Wage ordinance that requires city contracts to pay a living wage and requires that projects that receive city subsidies demonstrate support of the city's living wage goals. A living wage is a wage that is high enough to maintain a normal standard of living in a given location. This is typically defined as a certain percentage (i.e., 130%) of the federal poverty level.

While prevailing wage and living wage requirements promote fair and equitable pay in the construction industry, they can have a material impact on construction budgets and contracting. Requirements will vary depending on the source and amount of funding and project type, but it is increasingly common for these funding sources to come with prevailing wage and/or living wage requirements. For example, in 2024 Minnesota became the first state in the nation to require prevailing wages for Low-Income Housing Tax Credit-funded affordable housing projects.

For more information on Prevailing Wage and Living Wage requirements in Minneapolis, contact the City of Minneapolis Civil Rights department.

Applying This to You!

Make a list of the aspects of your property and existing structure(s) that face the greatest risk of negatively impacting your construction budget or timeline. Determine a plan for mitigating those risks. Do the same for your planned new construction.

What is the scope of work you need from a general contractor? Before speaking with potential contractors, draft your own scope of work. This will help you determine what questions to ask during interviews and aid in your review of any proposals you receive.

Activity E: Buildable Area Analysis

Directions



Using the results of your research from Activity D and the steps below, determine a basic design for your development (number and size of units, floors, parking count, and total gross area.)

- 1. Using the image below, sketch out the yard requirements (front, side, and rear setbacks) and determine the remaining buildable area. (Assume your building will not exceed 42 ft in height for yard calculations.)
- 2. Calculate the maximum building size (GSF) you can build based on the site size and maximum FAR.
- 3. What is your average unit size (Rentable SF)? (There is no right answer, but this should be based on your target customer, the market, etc.) Multiply the unit size (RSF) x 1.10 to estimate an average Gross SF (GSF) per unit to account for circulation, common area, exterior walls, etc.
- 4. Based on what you know about max building height, max floor area, and average unit GSF how might your building be designed (i.e., how many floors, units per floor, and total units)? Assume all floors are the same size and assume 10-11 feet per floor for height.
- 5. Calculate your building footprint by dividing your total building area (GSF) by the number of floors. Adjust your design if your footprint does not fit within the max buildable area from Step #1.
- 6. Calculate the maximum lot coverage requirement. Adjust your design if your footprint exceeds this.
- 7. Based on zoning and the market, determine how much parking is needed and the total SF of parking. Assume all parking is surface parking and requires 350 SF per stall, including circulation/drive aisles.
- 8. Calculate the impervious surface coverage and compare that against the zoning requirement.
- 9. Adjust your design as necessary to optimize the site and meet all zoning requirements.





Chapter 6: Introduction to Financial Feasibility

Key Concepts

- Real estate is a business, and like any business, financial success means generating a profit, a return on investment, that can be justified based on the risks taken and alternative investments.
- Real estate revenue is created by "selling" space, usually on a temporary basis via a lease. This expected revenue is known as Effective Gross Income.
- A profit is realized from real estate revenue after paying the costs to create and maintain that space. In real estate, revenue remaining after subtracting out operating and capital costs is referred to as Net Operating Income, NOI.
- Real estate financial analysis further breaks down cash flow by removing debt payments to report Cash Flow after Financing.
- Positive cash flow is important but is only the first step to ensuring a good investment. The return, or cash flow relative to the investment, must be large enough to justify the risks being taken. Real estate financial analysis looks at various return metrics but Return on Investment (ROI) and Return on Cash (i.e., Cash on Cash Return) are two of the most common.
- Cap Rate, the ratio of NOI to property value, is perhaps the most commonly used real estate ratio, and is used to compare property values and demonstrate risk.
- At times, development projects that provide an economic or social benefit do not generate enough income or value to justify the cost of development. For these projects to proceed the developer will typically need to secure sources of gap financing to make a project work.

I. Real Estate is a Business

There are many good reasons to invest in and develop real estate. People enjoy creating a place that can be a benefit to people and the community – a place to live, a place to work, a place to shop or eat, etc. Real estate developers can alter the landscape of a street, building a beautiful new structure or fixing up a storefront that has been neglected for too long. Yet, whether it is the primary incentive or simply a benefit to doing something you love, the financial outcome of a real estate investment must make sense. Real estate, after all, is a business – and a business must make a profit to be sustainable.

In its simplest form, business profit is the difference between revenue and costs:

Profit = Revenue – Costs

For a business to generate revenue and be viable, it must have something of value to sell. In real estate, that "something" is space; the space is either sold on a permanent basis or temporary basis, via a lease. In addition, a business must have buyers, or customers. In real estate those buyers of your space for a set amount of time are tenants, and the rent they pay is your income, or revenue. (This concept of your tenant as your customer is important to remember. Even though a real estate transaction, with its numerous terms and negotiations, is more complicated and sometimes contentious than buying milk at the grocery store, it still requires a customer; that customer should be valued and respected by the business owner.)

In addition to revenue, the other half of the profit equation that must be considered is cost. Every product or service that is sold has costs – materials, labor, etc. For real estate, the obvious cost is the expense required to acquire the property and build and maintain the building. Indeed, real estate has a whole gamut of costs, including land acquisition, design and construction, repairs and maintenance, taxes, utilities, insurance, borrowing costs, and asset and property management.

Going back to our simple equation, in real estate we must make sure the income being paid to us by our tenants sufficiently exceeds our total cost to provide and maintain the space to those tenants. That difference is our profit. Though just because an investment generates a profit, it still may not be a good investment. The bigger question is how much profit it generates *relative to how much money we put into it*. In real estate, we look at profit in two ways:

Annual profit compared to amount invested (i.e., our annual return)

Total profit compared to amount invested (i.e., our total return)

To calculate our annual return, we need to calculate the expected income minus the expected expenses for that year and divide that by the amount invested. To keep it simple, we will focus on a single year in this section. However, more sophisticated analysis looks at annual returns over several years in what is known as a *pro forma*. Pro formas are covered in detail in Chapter 8.

Total return is important as it looks at not just the profit generated each year, but also the profit generated from selling the property at the end of the investment period. While total return is helpful to understand even for long holding periods, it is especially critical for short term holds.

II. Single Year Financial Analysis

Gross Income, Net Effective, NOI, Cash Flow

A single year real estate financial analysis is simply a means of documenting revenue and expenses to determine profit and calculate investment metrics. This analysis can be simple and straightforward, or it can be quite involved. To do this analysis, we start by adding up all our revenue and then systematically deducting our costs one step at a time to calculate our profit (e.g., cash flow) at various stages (e.g., cash flow before financing, cash flow after financing).

Here is an outline of a basic single year financial analysis

- A. Potential Gross Income
- B. + Reimbursed Expenses (Commercial only, not residential)
- C. Vacancy
- D. Effective Gross Income
- E. Operating Expenses (RE Tax, Insurance, Maintenance, Utilities, Reserves)
- F. Capital and Leasing Costs
- G. Net Operating Income (NOI)
- H. Debt Service
- I. Cash Flow after Financing

Effective Gross Income

We begin by building up our revenue to capture all the potential income we could receive. With a single tenant, this is fairly straightforward. However, if our property has multiple tenants, in varying sized spaces, paying different rates, this could become much more involved. We also want to add in other income that could come from things like parking, laundry, vending, and fees. All of this together is the Potential Gross Income (A).

If this is a commercial building, we then add income that would be received through Reimbursed Expenses (B) (aka Recoverable Expenses). Residential (and many small commercial) leases are usually gross leases, meaning the tenant pays a fixed rate and does not pay the landlord separately for operating costs (though the tenant may pay certain utilities that they are billed for directly by the provider.) Therefore, Reimbursed Expenses can typically be ignored for residential properties and commercial properties with gross leases. Commercial leases (that aren't gross leases), however, are more complicated because they net out certain expenses from the base rent. For these expenses, the landlord pays the cost upfront and then the tenant reimburses the landlord for that amount. (Typically, these costs are reimbursed by tenants on a pro rata basis based on the size of each tenant's space relative to the size of the entire property.) What a tenant reimburses a landlord for should be detailed in the lease. For example, things like the property management fee percentage and what qualifies as a reimbursable repair could be negotiated differently by each tenant. If

there are many leases, each with different terms, sorting out reimbursements can get be fairly involved.

After adding reimbursed expenses, if relevant, we need to adjust for any ongoing Vacancy (C) we may have. Because there is always some



risk in keeping spaces filled and rent paid, even with a signed lease, and because there can be short term vacancy as tenants turnover, it is common for an analysis to include a vacancy factor. This vacancy factor is often 5% but should be adjusted based on the level of turnover and risk present. (Note: Fluctuations in vacancy overtime may require a multi-year pro forma as described in Chapter 8.) Once all the vacancy is deducted from the Potential Gross Income, we are left with the Effective Gross Income (D).

Net Operating Income (NOI)

To calculate Net Operating Income (G) we must deduct the Operating Expenses (E) and the Capital and Leasing Costs (F) from the Effective Gross Income. Below is a list of common operating expenses:

- Property taxes
- Property insurance
- Water and sewer
- Utilities
- Garbage collection
- Landscaping
- Snow removal

- Property management
- Maintenance and repairs
- Administrative and accounting
- Janitorial service
- Pest control
- Advertising

However, operating expenses are not the only expenses incurred when owning and managing a property. There are other expenses that we must subtract from EGI to get a better handle on the actual financial situation. These other expenses are Capital and Leasing Costs that are necessary for long-term upkeep and upfront costs to bring in a tenant. The three most common costs in this section are:

- Tenant Improvements Costs to build out space for a specific tenant (or given to a tenant if the tenant is doing the build out himself). For residential properties, this could include the cost of refreshing or updating individual units.
- Leasing Commissions Fees paid to real estate brokers for finding a tenant and negotiating the lease. This is typical only for commercial properties.

 Capital Costs/Reserves –Variable (often significant) property expenses such as a new parking lot, roof, or elevator upgrade. Sometimes a financial analysis will include a fixed amount every year to budget for these large, irregular expenses.



After operating expenses and capital expenses and leasing costs are deducted, we are left with the Net Operating Income (NOI). NOI is one of the most fundamental metrics in real estate investment because it is used in property valuation as we will soon discuss.

It is important to note that while real estate cash flow statements typically follow this same order, some analysts will exclude capital and leasing costs from NOI and include it "below the line." When this is

done, they calculate another line known as Cash Flow Before Financing (aka Unlevered Cash Flow). The rationale for excluding these expenses from NOI is because they are irregular and the costs in any given year may not accurately represent the costs, and therefore net cash flow, of the property. However, excluding them can also be deceiving given that such costs are necessary. Arguably, including capital and leasing costs in some way as part of the NOI calculation reflects a more realistic picture

of actual income generated by the property. Because of these differences in methodologies, when evaluating a property, it is important to understand what is included or excluded from NOI – sometimes NOI can be deceptively high (making the property seem more valuable).

Treatment of Capital and Leasing Costs

Be certain to fully understand which costs are included and which are excluded from a property's NOI calculation. Failure to do so can provide a misleadingly high NOI value causing you to overpay for a property.

Cash Flow after Financing

But wait, there's more! If there is debt on the property, we also need to consider the Debt Service (H). Debt service is the ongoing cost of "servicing" the debt (your annual loan payment including principal and interest). When we subtract debt service from all our loans from NOI we are left with Cash Flow after Financing (I), CFAF, or Levered Cash Flow. We separate this debt service out from other line items in the financial analysis because loan payments will vary by loan terms. They are unique to each individual buyer (borrower) and do not affect the actual value of the property.

Yet another step could be taken that is not shown here. This step is a further adjustment to cash flow for income taxes. However, that is even more unique to each individual, and can depend on the investor's tax situation, which may be broader than this single property.

Applying This to You!

Make a list of all the operating expenses you expect to incur for your property. Then, start to estimate how much each of those individual expenses will cost. Keep track of your assumptions so that you can refine them as you learn more. Is each cost a flat fee, a certain cost per square foot, a certain cost per unit, etc.? Reach out to service providers and other owners to see if your assumptions seem accurate or need refinement. (Hint: See template on next page.)

Key Return Metrics: Return on Investment and Return on Cash

As stated previously, simply knowing a real estate investment is cash flow positive does not tell us if it is a good investment. If look at two opportunities, and one provides a \$5,000 cash flow (profit) and the other provides a \$10,000 cash flow, we may assume the second is the better investment. However, if our cost to acquire the second opportunity is four times greater than the cost to acquire the first for only double the profit, we are better off with option A. Therefore, when analyzing a real estate opportunity, it is important to also determine critical return metrics: Return on Investment and Return on Cash.

Return on Investment (ROI)

While there are many ways to calculate Return on Investment (ROI) depending on the structure of the investment, the basic concept is to divide what you are getting out of the investment by what you are putting in. For example, when flipping a property, if you buy a building for \$200,000 and put \$120,000 into it (\$320,000 total investment) and then sell it for \$400,000, your ROI is 25%

$$ROI = \frac{Investment Return}{Total Investment} = \frac{\$400,000 - \$320,000}{\$320,000} = 0.25$$

Operating Expense Template

PROPERTY OPERATING EXPENSES Property Name:

					(B) TAP
		Fixed or Variable	Variable Cost		BUSINESS TECHNICAL ASSISTANCE PROGRAM
	\$ per Year	(per SF, per Unit)	(if applicable)	Comments	supporting useries utwels@fifefit in the City of Minneapolis
Payroll					
Manager/Laretaker					
Leasing					
Other					
Other					
Management					
Maintenance & Repair					
Maintenance					
Plumbing					
Irrigation					
Electric					
Roof					
Supplies					***************************************
Window cleaning					
Exterminating					
Grounds					
Snow					
Landscaping/Irrigation					
Parking Lot/Garage Repair					
Utilities					
Electricity					
Gas					
Water/Sewer					
Phone					
Trash					
Advertising/Marketing/Leasing					
Administration					
License/Permits					
Gen Admin					
Professional Fees					
Legal					
Accounting					
Other					
Security					
Real Estate Taxes					
Insurance					
Miscellaneous					
Total Operating Expenses					

NOTE: Template may not be comprehensive of all required property expenses.

Minneapolis

In the previous example, we calculated the total return on investment regardless of the time period. That is helpful particularly if our investment period is short. However, if we are developing a property and holding on to it, it can be more informative to calculate an Annual Return on Investment. To calculate the Annual ROI for an income producing property we use the Net Operating Income, which is the return (profit) a property generates in a given year.

If we use the same example as before, but instead of selling the rehabbed building for \$400,000, we hold onto it and receive \$30,000 per year of cash flow (NOI) before we pay our annual financing cost, it has an Annual ROI of 9.4%.

Annual ROI =
$$\frac{\text{Net Operating Income}}{\text{Total Investment}} = \frac{\$30,000}{\$320,000} = 0.094$$

Return on Cash (ROC)

Our return on investment calculations (both annual and overall) look at the return relative to the total investment (regardless of whether some of that investment is debt.) However, a potentially more important return metric is the return relative to the upfront equity (cash) that the investor(s) put into the deal. For simplicity, we refer to this as Return on Cash here, though the real estate industry has many different names for these calculations.

Return on Cash (ROC) is similar in concept to ROI, but it takes into consideration if an investor takes out a loan to make the investment. If an investor has a loan, the investor's return will be less (since they have debt to pay off), but the amount of cash (upfront equity) they put into the investment will also be less. In the buy and flip example, we used to calculate ROI, let's assume we bought the property with our own \$200,000, but borrowed \$120,000 to fix it up. When we sell the rehabbed property for \$400,000, we have to pay off our \$120,000 loan plus \$8,000 in interest. Therefore, our net income from the sale is \$272,000 (\$400,000 - \$120,000 - \$8,000), but our initial equity investment (cash) is only \$200,000. This produces a Return on Cash of 36%. As with ROI, this overall Return on Cash is helpful for a short hold period, but less informative over a long investment period.

$$\text{Return on Cash} = \frac{\text{Equity (Cash) Return}}{\text{Equity (Cash) Investment}} = \frac{\$272,000 - \$200,000}{\$200,000} = 0.36$$

As with ROI, if we are holding rather than flipping a property, we will want to understand our Annual Return on Cash. (The industry usually refers to this at the Cashon-Cash Return). If our NOI is still \$30,000 and our annual debt service is \$8,000 then our Cash Flow after Financing is \$22,000. On a \$200,000 initial equity investment, our annual Return on Cash is 11%.

Annual ROC =
$$\frac{\text{Cash Flow after Financing}}{\text{Equity Investment}} = \frac{\$22,000}{\$200,000} = 0.11$$

Return on Investment and Return on Cash can be even more involved when analyzing an investment that has both ongoing rental income over a long period of time as well as a final sale of the property. We will cover these situations, along with a couple other important investment metrics when we look at multi-year pro formas in a later section.

Activity F: Develop & Sell Financial Feasibility

Develop & Sell: Twin Home Analysis



Directions

You are looking to develop a twin home property on a small lot in Minneapolis. You have engaged a designer who drew up plans to build a 2-unit building. Each unit would be 1,770 SF for a total building size of 3,540 SF. You can purchase the vacant property for \$115,000 (including all acquisition fees.) You estimate that you can sell each unit upon completion for \$495,000. Your cost of sale (broker, attorney fees, etc.) will be 6% of the total sale price.

You speak with a general contractor who estimates hard costs will be \$190 per SF and your design costs will be \$47,000. You will also incur \$13,000 in other soft costs for site investigations, carrying costs, and other fees.

You speak with a local bank and can get a \$625,000 interest-only loan with a 7.2% interest rate. Because it is interest-only, you won't pay down any principal. You will pay only interest on the loan each month and then you will pay off the full loan amount when you sell the property. (Since it is interest only your loan constant will be the same as your interest rate, 7.2%.)

You anticipate that the project will take 15 months, so you will need to include 15 months of debt service (interest payments) in your soft cost (Debt Service during Development). (Hint: Calculate your annual debt service (loan constant x loan amount), then monthly debt service, then total debt service for the full 15 months period.)

Using the template provided, calculate the ROI, Return on Cash, and Equity Multiplier for this project.

PROPERTY DETAILS
Unit 1 SF
Unit 2 SF
Total SF
USES
Acquisition Cost
Hard Costs
Soft Costs - Design
Soft Costs - Debt Service during Development
Soft Costs - Other (Investigations, Fees, Carrying)
TOTAL USES: Total Development Cost (TDC)
DEBT SERVICE
Loan Amount
Loan Constant
Debt Service (annual)
Debt Service (monthly)
Development Period (months)
Debt Service During Construction
SOURCES
Debt
Equity Investment
IOTAL SOURCES (Total Investment)
DEVELOPER PROFIT FROM SALE
Sale Price per Unit
Number of Units
Total Sale Price
less Cost of Sale
Investment Returned from Sale
less Loan Payoff
Equity Returned from Sale
Investment Return (Profit after Sale)
Equity Return (Profit after Loan Payoff)
DEVELOPER PROFITABILITY
Return on Investment (ROI)
Return on Cash (Equity)
neturi on cash (Equity)

Activity G: Single Year Financial Feasibility

Develop & Hold: Multi-Family Analysis



Directions

Create a single year financial analysis for a 20-unit residential property based on the assumptions listed. Calculate NOI, Cash Flow after Financing, Return on Investment, and Return on Cash.

CASH FLOW
Number of Units
Rent (\$, Monthly per unit)
Rent (\$, Monthly per RSF)
Rent (\$, Annual)
Expense Reimbursement
Potential Gross Income (PGI)
Vacancy Factor
Effective Gross Income (EGI)
Operating Expense
Leasing & Capital Costs
Net Operating Income (NOI)
Debt Service
Cash Flow after Financing (CFAF)
INVESTMENT COST
Acquisition Cost (\$)
Hard Costs (\$)
Soft Costs (\$)
Total Cost (\$)
Cost per Unit (\$)
DEBTINPUTS
Debt (\$)
Equity (\$)
Interest
Amortization (vrs)
Loan Constant
Debt Service (\$)
DSCR
RETURN CALCULATIONS

Assumptions

- 1. Units will average 750 rentable square feet (RSF). The building gross square footage will be 16,500 SF, which is 110% of total RSF to account for building circulation.
- 2. After doing your research, you determine that monthly rents for similar sized apartment buildings in this area are approximately \$1,950 per unit per month.
- 3.You determine your total monthly operating expense is likely to be about \$0.85/RSF.
- 4. You have determined that typical leasing and capital costs for this type of property average around \$250/unit per year.
- 5.Your broker has provided you with recent comparable sales and has estimated that you could purchase the property for \$280,000.
- 6. Your general contractor tells you that to build a 3-4 level apartment building without extensive amenities on that site will likely cost about \$195 per gross square foot. She estimates that your soft costs will add another 20%.
- 7. Through discussions with your lender, you believe you could secure a loan of up to 70% of your cost at a 5.0% interest rate and an amortization period of 30 years. (Note: A loan with a 5.0% interest rate and a 30-year amortization period has a Loan Constant of 6.44%. You can multiply the Loan Constant by the total loan amount to determine the annual Debt Service)

Return on Investment (ROI)

Cash on Cash Return (CoC)

III. Cap Rate

The Capitalization Rate ("Cap Rate") in real estate is perhaps the most referenced metric in real estate finance. It is used to give investors, brokers, and lenders a quick way to compare investments, estimate value, and determine risk. While it is often defined by its calculation, it is important to understand why this formula is important and what it means.

Cap Rate: Defined in Math

The Cap Rate equation is simply:

$$Cap Rate = \frac{NOI}{Property Value}$$

It is equally as important to look at this formula in the following way:

Property Value =
$$\frac{\text{NOI}}{\text{Cap Rate}}$$

We will explain the meaning and importance of those equations in a moment, but first let's look at an example.

Cap Rate: Defined in English



and the second		
NOI = \$100,000	NOI = \$100,000	NOI = \$100,000
Low Risk	Medium Risk	High Risk
Cap Rate = 6%	Cap Rate = 8%	Cap Rate = 10%
Value = \$1.67 million	Value = \$1.25 million	Value = \$1.00 million

Let's assume we are looking at three properties, each one generates an NOI of \$100,000. Since the value of an investment property depends on how much profit it generates, we might initially think that each property should be worth the same amount. But what if Property A has a very stable, long-term lease with a high credit tenant; Property B has a good tenant but only has 18 months left on the lease; and Property C has a fledgling business in a neighborhood with a lot of vacancies? Surely, in that case we be much more willing to pay more for Property A than we would for Property C. This is where the Cap Rate comes in.

3 Properties...Same NOI...Same Price?

While Capitalization Rate is used to determine the value of a property, it is technically a way to quantify the level of risk that a real estate investment has. The higher the risk, the higher the cap rate.

Whether it is real estate or any investment, the value of that investment depends on the amount of income it produces *and* the stability of that income. (It also is impacted by the investment liquidity, or how quickly the investor can get his investment back, but we won't focus on that here since real estate generally is not considered to be very liquid.) If the net operating income is highly unstable (tenant may leave or

 $\begin{array}{c} & & \\$

Higher Risk → Higher Cap Rate → Lower Price Lower Risk → Lower Cap Rate → Higher Price default, getting replacement tenants will be difficult, expenses may spike, etc.) an investor will require a higher return to take on that investment, which will lower what they are willing to pay for that income stream.

Going back to our equations, if the property is low risk, we may be willing to pay \$1.67 million for an NOI of \$100,000, giving us a cap rate of 6%. However, if the property is high risk, we may only be willing to pay \$1 million for an NOI of \$100,000, giving us a cap rate of 10%. Said another way, if we were to buy the riskier property we would require a 10% return ("cap rate") on an NOI of \$100,000, so the most we would be willing to pay for it is \$100,000 \div 10% = \$1 million.

How to Determine the Cap Rate

Even when all of this makes sense, confusion of how Cap Rate is determined still exists. There are two ways to answer this. The first is to focus on the concept of "what return would you require to take on that risk?" In real estate, there are many factors that can affect risk including:

- Location strength
- Building layout and amenities
- Asset class
- Market conditions (geography, economy, vacancy)
- Tenant credit and stability
- Building age/condition
- Existing building vacancy
- Management quality (will there be a lot of unexpected repairs coming?)
- Competition

When you consider how stable an NOI will be based on these and other factors, you can begin to calculate how much return you would require, and the cap rate can come from that.

The second part of the answer is to understand that cap rate is regularly estimated based on cap comparable rates of properties. lf similar apartment complexes, in a comparable part of town, of similar age and condition, etc. recently sold "at a 6.5 cap" (calculated by dividing the



NOI by the purchase price) investors and brokers will use this as a starting point for an apartment complex they are evaluating.

It is also important to point out that when calculating the cap rate (and therefore value) at any given time, the NOI used is the forecasted NOI for the next 12 months. For example, if you are buying a property on December 31, the NOI you use is based on income and expenses from Jan 1-Dec 31 of the upcoming year.

Finally, if you are thinking, "Cap Rate and Return on Investment (ROI) seem to be very similar. What's the difference?", that's a good question! Effectively, they are the same thing. The cap rate is the anticipated ROI of a property in the first year after it is purchased (assuming the Value = Investment).

IV. Financial "Gap"

When demand for space is high, rents increase. Increased rents push up net operating income which drives up property value (since Value = NOI/R). When property values are high enough to cover the cost of development and provide a reasonable (risk-adjusted) return, developers start building. Alternatively, if the cost to develop is less than the property will be worth at completion there is no incentive for developers to build so construction slows. These continuous shifts in supply and demand and building booms and busts are all part of the self-correcting nature of the real estate market. But what if there are some desired outcomes that the free market does not produce? What if certain outcomes are simply not financially feasible in the real estate industry?

If costs are too high or property values are too low (due to NOI, high risk, etc.) projects are not financially feasible and development doesn't happen. Sometimes developers need additional help to close this gap between cost and value. For example, an affordable housing development with below market rents will have below market NOI and therefore, below market value. As a result, the cost of construction is usually

more than the completed value of an affordable housing project. This is why affordable housing projects are not typically built without some incentive to help close that gap.

Another example is with sustainable (green) construction. While much progress has been made to bring down the cost of environmentally friendly buildings, some aspects still come at a premium. If a project would cost an extra \$100,000 to install solar panels without a commensurate increase in property values (due to the energy savings) it would not make financial sense for a developer to include solar. If a community saw value in having more solar energy, they may offer incentives to developers to help close that gap so that they install solar panels on their project.

Let's look at a numerical example:

Project 1: Market Rents

Cost	Land Cost = \$40,000 Construction = \$760,000	\$900,000
	Profit (12.5%) = \$100,000	
Value	NOI = \$54,000 /year	\$900,000
	Cap Rate = 6%	(\$54k/6% = \$800k)
Gap		\$0

Project 2: Affordable Rents (lower NOI)

Cost	Land Cost = \$40,000 Construction = \$760,000 Profit (12.5%) = \$100,000	\$900,000
Value	NOI = \$51,000 /year Cap Rate = 6%	\$850,000 (\$51k/6% = \$800k)
Gap		\$50,000

We have two identical 4-unit apartment buildings being developed, but one will lease apartments at market rate while the other one will lease apartments at a slightly lower "affordable" rate. The lower rents in Project 2 result in a lower Net Operating Income (\$51,000 v. \$54,000). This lower NOI, given the same 6% cap rate, means the property is only worth \$850,000 rather than Project 1 which is worth \$900,000. A developer is willing to proceed with Project 1 since she can build it for \$800,000, sell it for \$900,000, and earn her required 12.5% return (\$100,000).

However, Project 2 would cost the same \$800,000 to develop but could only be sold for \$850,000. The developer's profit would be \$50,000 which is only 6.25%, so she wouldn't pursue this project without additional assistance (i.e., gap financing).

But wait! Why does the developer have to earn a 12.5% profit and make \$100,000? Isn't \$50,000 plenty? Is this developer just being greedy? Maybe. Maybe not. Remember, the developer is taking a lot of risk to develop this project, which is why she is looking for a commensurate return. She may be happy with a 6.25% return on a lower risk investment (e.g., bonds), but given the amount of risk that developers assume with development projects, it may not be financially prudent to proceed without a sufficient return. Even if the developer can accept the lower return despite the risk, she may still be unable to proceed with the project because her funding sources will have limits on how much they are willing to put into the project. Lenders limit the amount they are willing to loan based on the project NOI and value. Likewise, equity investors are going to compare this project to other investment opportunities and choose those with the best "risk-adjusted" return. Together, these could limit the total amount of debt and equity (i.e., capital) a developer can raise, which causes the gap between capital available and project cost. We will discuss this in more detail in the next section.

Chapter 7: Financing

Key Concepts

- Just like any business, investors and lenders are looking for projects that make good financial sense based on their investment criteria. They will evaluate both you and your project to see if it fits their needs.
- Financing for a real estate investment can come from either equity or debt. Except for funds from family and friends, small scale investments most commonly rely on bank loans.
- There are both advantages and disadvantages of using equity and debt financing.
 What you use will depend on various factors including the investment, your personal finances, and the level of control you want to maintain.
- When applying for a loan, it is important to understand the key lending terms as well as what a lender considered when determining whether to approve a commercial loan. These considerations cover both the quality of the investment and strength of the borrower.
- Commercial loan approval follows a typical process which includes five stages: Credit appetite, Loan terms, Underwriting & Approval, Due Diligence, and Closing
- Given the financial "gaps" that sometimes exist between development cost and economic value, governments and non-profit organizations have various economic development financing tools including grants and favorable loans that can help make a project financially feasible.

I. Financing Overview

It is not often that a developer, especially one just starting out, has plenty of her own money that she does not need to reach out to others. And even if a developer could fund a project entirely on her own, she may decide to use other sources of funding for financial leverage and diversification so that she does not have to tie up too much of her own cash in a single investment. What is important to understand is that financial partners, regardless of whether they are providing equity or debt, are not doing you a favor – they are not giving you a gift. Just like this development is a business to you, their investment is a business for them. Financiers and lenders are looking for business partners and investments that can provide them with a good risk-adjusted return. They will evaluate your development in much the same way you should be doing – attempting to fully understand the opportunity and risk, and making sure they maximize their ability to make, not lose, money.



In addition, because they want to smart financial decisions, make potential financial partners will be evaluating you to see if you will be a trusted and capable partner. They will look at your knowledge, credit, experience, and performance history, to determine if you know what you are doing and can complete the development. Despite this personal evaluation, do not get discouraged if you are turned down by one or more partners. To be sure, you should take any feedback they provide to heart and make necessary adjustments. However, also understand that lenders and investors, just like developers, are

each unique in what they are seeking in an investment. They may be seeking a different type of project to balance their investment portfolio. Alternatively, they may have set specific risk or return requirements that do not align with your project. Simply because one investor (or a few) is not interested in your project, does not mean you will not get funding – make any necessary adjustments and keep asking.

Further, if you are just starting out and do not have any performance history, this does not mean you will not be able to secure financing, though you may be limited by the amount of financing you can obtain or the level of project risk. If you do not have experience and a track record, you may need to start with smaller projects, partner with others who do have a few successful projects under their belt, and/or invest in more stable assets with less risk.

Importantly, even if you have a fantastic opportunity, you will not secure funding if you are unable to articulate the value to your potential partner. It is critical to be fully prepared, well-organized, thoroughly knowledgeable about the investment, and deliver a high-quality written and verbal presentation. Not only will this help answer their questions, but it will give your potential investors confidence in you and your ability.

II. Financing Options

Debt v. Equity

If you need additional financing to make a development work, your first step is to determine if you need debt, equity, or both. Simply put, an equity partner is a partial owner in the development and therefore has higher risk and potentially higher return,

while a debt partner is an external partner who is only involved until he recoups his money and any interest or fees he is charging you for the loan.

Debt partners are lenders, such as a bank. They make loans over a certain period of time for an agreed upon return. Assuming all goes as planned, they will recoup their principal and interest per the agreement, but nothing more. Once the loan is paid off, the lender is no longer involved. The lender is not an owner and therefore does not have the financial upside, nor the liability, of being an owner. This does not mean, however, that a lender does not have any control. Often debt partners will include

controls in their agreements that give them approval rights over lease agreements, limit the developer from taking on additional debt, and manage distributions (i.e., limit how much of the yearly profit can be distributed to equity partners.) Loan agreements often include covenants that require the investment to produce a minimum cash flow to maintain a given debt coverage ratio; if the property cash flow falls short, the borrower may be in default and the lender can take over.



On the other hand, equity partners are owners, and experience all the upside and risk that being an owner involves. Equity partners will typically own a percentage of the development based on the amount of the investment they make. If your project cost is \$500,000, you put in \$50,000 and a partner puts in \$450,000, you would own 10%

Remember!

Loan funds are usually only available incrementally after construction begins. You will need other sources of capital to cover your predevelopment costs and working capital during construction. and your partner would own 90%. Because your equity partner is an owner, he will have a fair amount of control over your project, especially if his ownership stake is 50% or greater. Some equity partners will be "silent partners," leaving most of the day-today operations and decisions to you, but others will be highly involved.

Sometimes, developers do not want to bring on equity partners because they must forgo some control and profit. However, because lenders will usually only provide loans up to a certain percentage of the total investment (typically 60-80%) having an equity partner may be necessary. Further, in addition to capital, equity partners may also provide a good reputation, strong relationships, experience, and other benefits to the investment.

Equity is subordinate to debt, meaning that lenders get paid before owners. If all goes according to plan, this won't matter; but if the development starts to unravel, who gets paid first will be extremely important. This means that equity partners are taking on more risk (if money runs out, they don't get paid) and therefore they will expect a greater potential return. Because an equity partner is an owner, his return will be tied to the profit the development creates. Debt partners, however, will be limited to getting back the principal and agreed upon interest only.

Debt Options

Some of the most common sources for debt financing are listed below. For emerging developers with smaller projects, local banks and credit unions, large banks with programs geared towards emerging developers, and government and non-profit lenders will be the most viable options for debt.

Banks	Includes both large and community; Banks will loan funds from another party or their own funds (portfolio lender)
Credit Unions	Like banks, but privately owned by members
Mortgage Brokers	Individuals or companies that have relationships with various lenders and act as the intermediary between lenders and borrowers. (Note: The borrower, not the lender, pays the mortgage broker's fee.)
Private Lenders	Individuals who make loans formally or informally in real estate, including family and friends
Real Estate Funds	Professionally managed funds raised for the purpose of real estate lending over a set period of time

Equity Options

Some of the most common sources for equity financing are listed below. For emerging and even established developers, private investors who have a relationship with the developer (e.g., friends and family) are the most likely sources of equity for projects.

Private Investors	Individuals who invest formally or informally in real estate, including family and friends
Real Estate Funds	Formal funds raised by a professional fund manager and invested over select time period

Pension Funds	State and corporate managed retirements funds; usually focused on larger investments
Insurance Companies	Usually focused on larger investments
Real Estate Investment Trusts (REITs)	Publicly traded companies that invest in, acquire, develop, and manage real estate; Usually focused on larger investments

Applying This to You!

How do you plan to secure additional finances for your development?

If you plan to use debt, do you have enough of your own cash to make up the difference in cost between what the lender will provide and the total cost of the development?

If you plan to use equity, do you know who your equity partners might be? Are you comfortable giving up some control and ownership to others?

III. Debt Financing / Mortgages

Most small-scale developers, especially those who are just starting out, generally focus on debt financing over equity for various reasons noted below. (Though it is common for small scale developers to pull in family, friends, and other private individuals to be equity participants.) For this reason, it is important for small scale developers to understand the basics of debt financing.

Advantages

Easier to obtain – Similar to acquiring a mortgage for your house, there are numerous established sources of funding of residential and small-scale commercial lending; Equity providers tend to focus on larger investments. Further, equity investors typically do not have a public "storefront" presence like lenders do; finding equity investors can depend on building a network of relationships.

Range of options – Debt financing can come from many sources. The federal and local governments have extensive programs to support residential and some commercial development. Smaller residential investments (≤4 units) can be purchased with the same mortgages a buyer would obtain to purchase a house. Further, mortgage brokers are available to connect lenders seeking to make small, community based real estate loans.

Control – Because a lender does not have an ownership position, the developer retains control and full ownership. This gives the owner power to make decisions

(though sometimes big decisions still require lender approval), complete control when the loan is paid off, and all the profit.

Disadvantages

Collateral – Lenders will require collateral, or something of value to be pledged as security for repayment of the loan. This is typically the property itself, but could be another property including the developer's own home.

Guarantee – Similar to collateral, this is a typical lender requirement to protect their ability to get their money back. Unlike collateral that is tied to an asset, a guarantee is tied to a person or business. The guarantor can be the borrower herself or another entity. If the borrower fails to make loan payments, the lender can sue the guarantor to recoup any losses.

Limited amount – To keep risk managed, lenders will often limit the loan amount to create a "cushion." The loan amount is typically limited to a certain percentage (e.g., 60-80%) of the value (loan-to-value) or cost (loan-to-cost) of the property and to ensure the debt service does not exceed a certain percentage of the expected cash flow (debt coverage ratio.)

Payback requirement – Equity investors accept ownership risk and understand that when a development fails, they lose their investment (though they ain't happy!) However, with debt, borrowers are required to pay the lender back regardless of how well or poorly the development is performing.

Commercial Lending Terms

As noted in the process overview, determining the terms of the loan occurs fairly early in the loan process. After all, you will want to know before spending too much time if the terms are competitive with your other options and will make sense for you financially. If you are familiar with mortgage financing for your home, you will recognize many of the lending terms, though loans to support an investment do differ in some cases.

Interest rates – The amount a borrower must pay for borrowing funds, indicated as a percent of the amount owed over a period of time. Commercial loan interest rates are determined based on three factors: risk, cost of funds, and the loan amount.

- Risk Lenders will look at both the property/development and the borrower to assess the risk. Commercial loans are generally considered riskier than personal home mortgages, so the rates are usually slightly higher
- Cost of Funds Lenders borrow the money that they loan to you, so they set rates based on their cost to borrow (e.g., U.S. Treasury rates 1 year-CMT, SOFR) and then add their profit ("spread") to determine the rate they will charge you

 Loan Amount – Smaller commercial loans often have a higher interest rate than larger loans. This is due to economies of scale – the lender does not make as much money from a smaller loan so he will charge more to make it worth the effort.

Term – Term indicates the duration of the loan. While residential mortgages are often 15, 20, or 30 years, a commercial loan will typically have a shorter term. Loans of 3-7 years are common in commercial lending. Loans that cover new construction may be even shorter and are intended to be refinanced once the property is built and occupied.

Amortization Period – Amortization is the time-period over which the debt is calculated to be paid off. With residential mortgages the term and amortization period are usually the same (e.g., 30 years) – when the term is over, the entire debt has been paid back. In commercial lending, it is common to have a term, (e.g., 7 years) that is shorter than the amortization period (e.g., 20 years.) This structure enables smaller payments during the term but results in a lump sum payoff ("balloon payment") at the end of the term. Borrowers will often refinance the loan at the end of the term to avoid having to make that balloon payment in cash.

Debt Service – Debt Service is the total amount of interest and principal a borrower must pay in a given period. For commercial loans, debt service is usually an annual amount. For small residential loans, the debt service is usually the monthly payment and is more commonly called the monthly mortgage payment.

Loan Constant – Loan Constant (or mortgage constant) is a way to measure the loan cost (%) that accounts for both the interest rate and the amortization period. Mathematically, *Loan Constant = Annual Debt Service ÷ Total Loan Amount*. Higher interest rates and shorter amortization periods increase the loan constant. Loan constants are only applicable to fixed rate loans.

- Tip: Calculating Loan Payments

Use these Excel functions to calculate payments for loans with constant payments and a constant interest rate

PMT = Total payment periodic payment IPMT = Interest payment for a specified period PPMT = Principal payment for a specified period Loan to Value (LTV) – The Loan-to-Value ratio is a way for lenders to ensure they do not lend out more money than they can recover if the borrower defaults. In the case of default, the lender will take ownership of the collateral (usually the property) and sell it to recoup the loan. They want to be sure that what they sell it

for, less any costs they incur in the foreclosure and sale, will cover what is owed in debt. For stable properties, the LTV is fairly straightforward as the value is, well, stable. For new developments and redevelopments, there may be little value initially because nothing has been built and no tenants are in place. In this case the loan-to-value (LTV) will be based on a third-party appraisal of the expected value after project

completion or a loan-to-cost (LTC) will be used based on current value (e.g., land value) plus the cost of construction.

Debt coverage ratio (DCR) – The debt coverage ratio is a term that is not used in personal mortgages because it is tied to the cash flow an investment property produces. The debt coverage ratio equals the Net Operating Income (NOI) divided by the Debt Service (e.g., principal and interest payment.) Lenders use the debt coverage ratio to make sure the borrower's cash flow from the investment will be enough to cover the debt payments plus a bit more. Typical debt coverage ratios are around 1.20-1.25; if your annual debt service is \$1,000, your investment should be generating at least \$1,250 in NOI each year (to meet a DCR of 1.25.) This gives the lender a bit of a cushion, so that if your cash flow slips a bit, you can still make your debt payments.

Applying This to You!

What is the expected purchase price of a property you are considering buying? (Assume \$400,000 if you don't have a property in mind.) If your lender requires a 75% LTV, how much equity will you need? How much NOI will the property need to generate to cover your debt service? (Estimate the loan interest rate and amortization.)

Lender considerations

Before agreeing to lend you money, a lender will want confidence that you and your development are likely to succeed so that they are paid back in full and make a profit. To assess the level of risk, the lender evaluates several items, commonly grouped into the "Five Cs of Credit."

- Capacity (Cash Flow) One of the most critical items a lender will assess is your plan for development. The core of this will be the financial analysis – you will need to demonstrate that your plan will provide a sufficient return to cover your debt service. Of course, they will be looking for well thought out and realistic expectations for income, costs, etc. and the sources of those assumptions. In some cases, a lender will want evidence to support these assumptions such as an independent market analysis. Your business plan should also demonstrate that you will be able to make non-financial aspects of your development work including acquiring the property, getting it entitled, and getting it leased up.
- 2. Capital A lender typically does not want to cover the entire cost of the investment to ensure some coverage in case the borrower defaults. Also, lenders want you (directly or as a representative of the equity) to have a cash stake in the development to provide incentive to make sure the project succeeds. As a result, a lender will want to understand all the sources of equity going into the deal. A lender will also want to understand your ability to access other capital not being used on the project. If issues arise, will you be able to

tap into other sources of funds to keep the project on track and ensure the lender gets paid?

- 3. **Collateral** As noted earlier, a lender will want something of value as security to ensure repayment of the loan. They will want to make sure the collateral is sufficient to cover the cost of the loan in case they need to sell it to recoup their investment. If a bank is providing a loan for more than the property is currently worth (which would be needed if you are doing construction), they will want to understand the expected stabilized value and assurances that the construction will be completed (e.g., name of contractor, completion guarantees, bonds, or letters of credit.)
- 4. Character In addition to evaluating the development, your lender will also want to ensure you are trustworthy and capable. They will look at your resume and want to understand what sort of real estate experience you and your partners have development, operations, brokerage, financing, etc. While personal character can be subjective and difficult to fully uncover, lenders find it important. People do not like doing business with those they feel are not upstanding citizens, dependable, and honest. Lenders will also look at your personal assets and debts, known as your Personal Financial Statement (PFS), your tax returns, and your credit history. Your personal financial situation is a

good indication of how well you will manage the investment. This is even more critical if you are providing a personal guarantee;

- Virtual Constraints - Tip: Remember your online presence! Just as prospective employers do, lenders will often look online to learn more about your character. Make sure any online searches and social media posts communicate the right message about you.

lenders will want to ensure that you have the financial means to cover the debt, even if the project falls short.

5. **Conditions** – While the first four Cs are directly tied to you and your investment, this last category is one that is largely out of your control. Lenders will look at current economic conditions at the time of your loan application, both at a macro level and specifically for your situation (e.g., geography, asset type, etc.) If the economy overall is facing pressure, or there is, for example, concern of a residential development bubble, a lender may be hesitant to approve a related loan.

Applying This to You!

Conduct your own self-assessment to prepare for a lender assessment. For each of the considerations above, how would you grade yourself? Be honest! What factors might prevent you from getting a high score? How can you overcome those limitations?

IV. Commercial Lending Process

Where to Start

If you have never pursued a loan for an investment property, it can seem intimidating at first. However, as with all journeys, it begins with a single step. To begin, start reaching out to several banks with whom you are familiar. Even if they do not offer the type of loan that you need, they should be able to give you some recommendations for lenders who do. You can also look at other similar developments to find out who is providing their financing – sometimes they even advertise it on the property under construction. Talk to other developers and brokers to see if they have any recommendations.

Tip: Seek out CDFIs

Community Development Financial Institutions (CDFIs) provide loans to communities underserved by traditional commercial lenders. CDFI designated lenders can be a good source of funding if your property is located within their target market. For smaller developments, especially, it is wise to start with local banks for financing. They will be more familiar and focused on lending in your area. Local banks have a desire to make loans available to support the community and likely have personal

knowledge of properties, local market trends, contractors, tenants, etc. However, banks do have lending caps which may limit smaller, local banks from financing bigger projects. As your investments grow, you may need to develop relationships with regional or even national banks. In addition, lending specialists at smaller banks may be generalists that focus on many types of commercial loans, not just real estate. If your development has some unique attributes, you may decide it is beneficial to seek out a lender that has experience handling loans related to your situation.

Remember, it is not just the bank who chooses you. You must also choose your bank. This is a business partnership, and it must work well for both parties. In selecting a lender, you of course will want competitive terms (e.g., low rate, low fees, appropriate term) but you will also want a bank you can trust. They will need to be your partner throughout the early stages of the development and if they are unable to fulfill their end of the partnership, you may be left scrambling for a new partner late in the process or forced to abandon the opportunity. Because commercial lending requires a strong ongoing relationship, it is recommended that you reach out to the lender in person. This gives you an opportunity to demonstrate your competence and professionalism, build trust, and get to know your partner on a personal level. When you meet with your potential lender, have your Personal Financial Statement and resume on hand and be prepared to ask intelligent questions about their process and requirements. In addition, because you are also interviewing them, be sure to ask questions about how they operate and manage their business. Ask them about their loan policies, who approves your size loan, how to get a proposal, and their success rate in closing loans like yours. Although you will want to give them sufficient information to determine that you and your investment are worthwhile, be sure the information you are providing is simple and concise. Overwhelming a potential lender with details and information will not answer their questions, it will complicate things for them and suggest to them that you are not fully organized. Provide them with clear simple descriptions, but have additional information available to get into details if requested.

Steps to Securing Financing

Just like most phases of real estate development, the bank lending process follows a fairly consistent process across the industry.



- Credit appetite/loan policies Upon contacting a bank and being assigned a loan officer, you and the bank will begin to understand if a lending relationship makes sense. You will complete and submit a loan application which includes information about both you and the development opportunity. During these early conversations you will get to understand the bank, their loan policies and general lending requirements, and you will want to assess the bank to see if it and its terms would be a fit for you.
- 2. Determine loan terms A bank will typically have a clear set of criteria for which it establishes real estate investment loans. Like any investor, they will want a diverse portfolio of asset classes, geographies, investment types, and risk/return levels. During this stage of the process, the lender will consider where your project fits into those criteria, and then look at the current economic and lending market to calculate what terms they would likely want to issue you a loan. Whereas the terms in home mortgages are generally set, negotiating the terms of a commercial loan is common. Once the lender provides you with a term sheet or written proposal, it is your opportunity to request more favorable terms, if desired. Remember, this is a business for

them too, so they have an incentive to get you as a customer. They want to lend money for good investments; they aren't simply doing you a favor.

- 3. **Underwriting and approval** In many ways, a bank's underwriting process is the equivalent of your financial analysis. They will pull together their own financial analysis, along with the other information they collected from you, to determine the risk of investing in your project. From that underwriting they will determine if your project meets their investment criteria. If so, they will finalize the loan terms and approve your loan.
- 4. Due diligence Bank due diligence is, in many ways, the same as the due diligence you should do even if you didn't need debt financing. A bank, just like any equity investor, will want to understand the opportunity as clearly as it can and take all reasonable measures to mitigate risk. As such, a bank's due diligence will include steps like title review, survey, appraisal, and environmental studies. Be sure you are aligned with your lender during due diligence; she will order most work to be completed (at your expense) and will have certain requirements for how it is managed, such as preferred venders.
- 5. Loan Closing Much like closing on a home loan, once due diligence is complete and the loan is approved, the bank will still require some time to pull all its paperwork together. Typically, you will then close on the loan at the same time you close on the property, just before you start construction.

Post-closing

Closing on a loan is a big milestone but does not end the relationship with your lender. Of course, critically, the borrower must make her loan payments on the schedule that she agreed. Commercial loans, however, require a bit more active management than home mortgages. To start, a commercial loan will typically have certain reporting requirements (which also can be negotiated.) For example, a loan agreement may stipulate that the borrower must submit annual or quarterly financial statements. A lender requires this information to ensure that the property is being managed sufficiently and that the financial status remains stable.

A commercial loan may also have various loan covenants that restrict what the borrower is able to do with the property or even with his business. For example, a lender may restrict a borrower from significantly altering the structure without approval or finalizing a lease without lender approval. A lender will also want to be sure the business does not become over leveraged (take on too much debt) so it may limit additional debt on the property or business.

Finally, it is important for a borrower to manage the relationship with the lender. Just as you did during the application process, you will want to continue to demonstrate professionalism and high competency when you submit reporting requirements, seek approvals, and otherwise interact with your lender. In addition to making her job easier, it will build a strong relationship for the future. You may want to obtain another loan for a second or third project and the lender's history in working with you will be a critical factor. Additionally, demonstrating strong management and being transparent with your reporting will help you work through any issues that may arise; your lender will be more likely to work with you to help resolve it and/or modify the loan, rather than to call the loan, tighten terms, or push the property into foreclosure.

When it comes to securing financing for your development it is important to remember that a lender should be your "business partner." Both words are important. Lending is their business. They want to make loans. If they don't, they don't make money. But they need to be your partner too. A strong relationship with your lender builds trust and helps support your business needs during both good and bad times.

Applying This to You!

Start to identify who your lender partners might be. Conduct an internet search, ask other developers and brokers for recommendations, and look for posted "Financed by ..." signs at construction sites. Record the results of your research in one location including names, contact information, and comments.

V. Gap Financing and Economic Development Financing

Gap Financing

In the last section, we discussed why some projects due to low income, high costs, and/or high risk (cap rate) do not "pencil out." If the cost of a project (including the required profit) is more than its completed value it will have a financing gap and not be feasible without additional financial assistance. Even if a developer does not plan to sell the property once it is stabilized (i.e., built and leased up), the developer may still face a financing gap due to limits on the amount of debt and equity she can obtain.

Let's look at our 4-unit apartment building, with an \$800,000 total cost to acquire and construct. If the value upon completion is \$850,000 (\$51,000 NOI \div 6% cap rate) and a lender is willing to provide a loan using a maximum Loan-to-Value of 65% the maximum loan amount will be \$550,000. This leaves \$250,000 in required equity (\$800,000 cost - \$550,000 loan). However, let's assume that the project Cash Flow After Financing is \$12,500/year* and investors require a minimum 8% cash on cash return. This means that the maximum amount equity that investors would be willing to put into the deal is roughly \$156,000 (\$12,500/8%). Unfortunately, that means total debt plus equity is \$550,000 + \$156,000 = \$706,000. Since the total development cost is \$800,000, this project has a gap of \$94,000. Neither lenders nor investors are willing

to put in more money to help close the gap since it lowers their returns and/or increases their risk. The project cannot proceed without "gap financing." Gap Financing are funds, typically provided by a government or non-profit organization, to help close financing gaps in projects. We explore why and how these organizations provide gap financing in the next section.

* Assumptions: Debt Service = loan constant of 7% x \$550,000 loan = \$38,500. NOI \$51,000 – Debt Service \$38,500 = CFAF \$12,500.

Economic Development Financing

Much of the time, the natural market forces within the real estate economy do a sufficient job of ensuring adequate supply meets the existing demand. When populations increase, housing gets built. When businesses grow, office and industrial space is developed. However, as previously discussed, there are times when real estate requires a "nudge" because the market does not support the investment required. Examples where economic development financing may be needed include affordable housing, , projects to support jobs and tax growth, communities with depressed values due to historical injustices, health and other public services, historic preservation, sustainable building, and environmental cleanup. This nudge is often provided through economic development financing.

Economic development financing is a method of using public and private funds to support local and regional economic development projects. It can include investments in physical development, redevelopment, and businesses and industries. The goal is to create positive social, economic, and environmental outcomes, such as improved infrastructure, better waste management, and clean energy. While economic development financing covers a wide range of financing support, for purposes of this course we are focused on gap financing of real estate development projects.

Economic development financing can come in various forms. Federal, state, and local governments use a wide range of tools to help developers close the gap or reduce risk to encourage development. Some examples include:

- **Grants** Grants are direct contributions of cash into a project. This is the most straightforward type of economic development financing but is often the most difficult to obtain, at least in large amounts.
- Favorable loan terms Given that most real estate development depends on debt financing, but the interest, fees, and other loan terms can be costly, finding loans with favorable terms can be highly beneficial. Economic development financing tools include no/low interest loans, favorable amortization periods, larger loan amounts, and mezzanine (secondary) loans. These various loan terms can close financing gaps and increase cash flows. Many organizations also provide loans that adhere to the principles of Sharia Law. There are also "forgivable" loans, that do not need to be repaid if certain

conditions are met after a period of time (effectively making them act like a grant.)

- Bonds Bonds backed by a city, county, or state will typically have more favorable debt terms than a developer would secure through a traditional loan given the strong credit and revenue raising ability of the governing agency. Developers benefit from these more favorable terms by partnering with the issuing body to obtain debt financing for a project.
- Credit enhancement/guarantees Developers sometimes can secure a credit enhancement with a strong credit tenant such as a city, county, or wellestablished non-profit organization by having the partner entity back or guarantee the loan (to make payments or repay the loan if the borrower risks default. This lowers the risk to the lender allowing the developer (borrower) to secure a loan with an lower interest rate and/or better loan terms.
- Property tax incentives Cities and other taxing entities have various tools to reduce the property tax burden for properties. Tax abatement and Tax Increment Financing (TIF) enables a developer to forgo all or a portion of the property tax payments (or have the payments refunded) for a period (usually many years). Other programs, such as Minnesota's "4d" program assigns property owners a lower tax rate for certain property types (e.g., low-income rental housing.)
- Fee reduction/waivers Fees such as park dedication fees, permitting fees, and sewer and water access charges can be pricey and add up. Some cities will reduce or waive certain fees to help support a project.
- **Rebates** Some organizations, especially utilities, have rebate programs for developers that build in energy efficiencies or other features into their project.
- Tax credits Tax credits are one of the most competitive and more complex forms of economic development financing, but also can be the most powerful and substantial. Tax credits are credits that are given to a project (developer/investors) that can be used over a period of years to lower the income tax burden of an organization. Developers typically partner with an large for-profit investor who will benefit from the tax credits. Two of the most common are Low-Income Housing Tax Credits (LIHTC) and New Market Tax Credits (NMTC).
- Vouchers Vouchers (e.g., Section 8) are "coupons" typically provided by the federal government to residential property owners to cover the rental difference between market rates and "affordable" rate charged to low-income tenants

Most of the tools detailed here provide financial support for projects during and after construction given most expenses come from acquisition, construction, financing, and operations. Still, some of the greatest need, particularly for emerging developers, is in the pre-development phase to support due diligence, design, and feasibility analysis. Fortunately, several entities including the City of Minneapolis, Hennepin County, MetCouncil, and Local Initiatives Support Corporation (LISC) offer pre-development grants, loans, and technical assistance for pre-development.

While economic development financing can close some or all of the gap needed for many projects, securing the funding is typically competitive, complicated, and time consuming. Developers need to be able to clearly identify and rationalize the gap amount for their specific project through detailed financial analysis. Developers also will need to be able to justify the economic development benefits that the project will provide to the community. However, despite the challenging nature of securing gap financing, numerous free (and some fee based) resources and technical assistance are available for emerging developers to help navigate the world of gap financing.

VI. Lending for small scale development

Financing tools for small development

For small scale development, there are various options for financing that, depending on asset class, down payment, owner occupancy, and if construction is new or a renovation, should be considered. Options for residential and some commercial development that are backed by the Federal Housing Administration (FHA), Department of Veterans Affairs (VA), Fannie Mae, Freddie Mac, and the Small Business Administration (SBA) are available to help developers more easily secure financing.

For the lowest cost end of the spectrum, for example a "fix and flip" home or for constructing an Accessory Dwelling Unit, ADU (a second, smaller residential structure on an existing residential lot) financing would likely come from personal home equity, friend and family investments, and/or hard money. Hard money are loans provided for short periods of time (e.g., 6 months.) Hard money loans can benefit developers by providing needed funds up front without interim interest payments. However, hard money interest rates are typically much higher than other forms of debt financing.



Investors buying and/or remodeling 1-4 unit residential structures have additional some loan sources available to them, primarily through the FHA. The FHA 203(b) loan can be used to finance the purchase of a primary residence of 1-4 units with a minimal down payment. Also for 1-4 unit residential properties, the FHA 203(k) loan provides funds for both acquisition and remodeling. VA loans are similar to FHA 203(b) loans but have additional benefits for veterans

including reduced fees and zero down payment. For both FHA and VA loans, the home must be your primary residence; however, if there are 2, 3, or 4 units, you can live in one and rent the others out. In addition, Fannie Mae and Freddie Mac have various lending options for purchasing 1-4 unit and larger multifamily properties, depending on an investors specific situation.

For owner-occupied commercial properties, a real estate investor may want to obtain an SBA 504 loan. The 504 loan will provide debt funds of 30-40% of the cost to buy or build a building (paired with another 50% from the bank), up to a cap of usually \$5 million. The borrower must use at least 51% (80% if new construction) of the building for its own operations, but it can lease out the remaining space.

To help finance mid-sized properties, investors and developers will typically seek out traditional financing through a bank that offers multifamily and commercial lending. Freddie Mac, however, does offer a Small Balance loan for residential properties with 5 or more units that are non-recourse and offer competitive terms.

Lending before value exists

A new developer may question how she can borrow money to construct or significantly renovate a building when lenders are so focused on limiting loans to a percentage of the value of the property. Prior to construction, the property value may be fairly low. To overcome this, lenders do provide various types of construction loans that can be paired with first mortgages to allow for purchase and construction. As noted previously, the value used to calculate maximum loan amount is based on either the current value plus the projected construction cost, or on the estimated appraised value upon completion of construction. Funds for construction loans are refinanced by the borrower upon completion and property stabilization in order to secure better terms. Some loans are structured as "single-closing" transactions where
the construction loan automatically converts to permanent financing once construction is complete.

Starting development with a "house"

While there are various lending options available for small scale commercial, the number of options and favorability of terms for residential property lending is even more extensive. It is for this reason that many small developers begin investing in residential properties. At the same time, it is important to understand that for a property to qualify as a residential property and be eligible for many of the favorable loans, including FHA financing and even conventional home mortgages, it does not have to be 100% residential. A mixed-use property that has up to 49% of its space as commercial can still be considered a "house" for lending purposes. This means that a three-story mixed use building with apartments on floors 2 and 3 and commercial office or retail space on the ground floor can be considered a "house."

Applying This to You!

What lending programs might work best for your situation? Are there any creative ways to adjust your development plan that might enable you to qualify for more or better lending options?

Chapter 8: Detailed Financial Feasibility

Key Concepts

- While a simple, single year financial analysis is a good way to quickly assess a real estate investment, a multi-year pro forma should be used for more complex investments to account for year-to-year changes in income and expenses.
- A pro forma enables an investor to analyze financial details that change over time, including rental rates, turnover vacancy, operating expenses, turnover expenses, capital improvements, construction, initial lease up, and debt service.
- While the Return on Investment and Return on Cash are still important metrics, when looking at the investment over several years, the Internal Rate of Return (IRR) is a more complex but effective ways to evaluate the quality of the investment.
- The structure of commercial and residential pro formas are fundamentally the same, though there are some slight variances between the two, such as how income is calculated, inclusion of operating expenses, and costs at tenant turnover.

I. Pro Forma Structure

Overview

In Chapter 6 we introduced the basic concepts of real estate financial analysis, covering effective gross income, operating costs, net operating income, and cap rate among other things. We learned how in real estate, as in any business, our income must exceed our expenses to produce positive cash flow, and that cash flow should give us a high enough return on our investment to justify any level of risk we are taking. In our discussion, we focused on a stable property with a one-year timeframe. However, the reality is that real estate is quite dynamic, with both revenue and costs having the potential to fluctuate from year to year. To track financial assumptions over time and understand their impact, real estate professionals will run a multi-year financial analysis (often over a 10-year period), commonly called a pro forma. In addition to giving you a better understanding of your potential investment, pro formas are a standard method of communicating financial analysis in the real estate community, especially to potential capital partners and lenders. Whether you are applying for a loan, seeking economic development (gap) financing, or looking to pull in investors, you will likely need to present a pro forma showing at least 3 years of financial projections.

Additional considerations for multi-year analysis

While the pro forma has the same inputs that are listed vertically in a simple, single year financial analysis (rental income, operating expenses, NOI, etc.), its actual inputs

run horizontally across several years. This enables the analyst to account for expected year to year changes and more accurately incorporate investment uncertainties. Several of the most notable variances from year to year are noted below.

Rental Rates – Leases typically have regular rental rate increases over the term of the lease. While some are simple (e.g., 3% annual increase), others may be more involved. With multiple tenants, each with different lease agreements, spelling out exactly what is expected will provide a more accurate income picture.

Tenant turnover – As leases expire, tenants may move. Vacancy for a couple of months (sometimes many months!) is common during that period. Accounting for a realistic turnover period as leases expire is important so that you do not overestimate income. Also, for commercial properties, don't forget that operating expenses must be paid, but are not reimbursed during any time that space is vacant.

Operating expenses – Operating expenses may not increase significantly year over year, but they do typically increase with inflation. Often analysts will assume at least 2.5-3.0% annual increases though they may project greater increases in high inflationary environments and/or for line items that tend to outpace inflation (e.g., property insurance). These inflationary, as



well as potentially more significant changes, should be incorporated into your pro forma. If you do plan to invest in the property to build or improve it, remember that the assessed value, and therefore the property taxes, will jump in the year or so after completion. Finally, while operating expenses do tend to rise, they don't always. If you identify ways to operate a property more efficiently, you may want to forecast a reduction in certain operating expenses in future years, once your changes have been implemented.

Tenant Improvements and Leasing commissions – When a tenant vacates a space, not only is there a period of reduced income, but there are also costs associated with bringing in another tenant. Tenant improvements are generally necessary which could involve just a fresh coat of paint or as much as a full gut and remodel of the unit. If you or your tenant are using a broker to lease up a commercial space, you will have to pay leasing commissions when a new lease is signed. Also keep in mind that you may incur tenant improvement costs and leasing commissions for a commercial property when an existing tenant extends its lease (though usually these costs are less than those from a new tenant.)

Capital Improvements – Roofs need replacing, parking lots need resurfacing, and elevators need upgrading. Improvements like these don't occur every year, but when they do, the costs are massive, sometimes enough to produce a cash flow negative year. Ideally, you will be setting aside money every year in a reserve for when these costs hit, but you will want to be sure the reserve is sufficient, especially if you will incur major costs early on into your investment. Just be sure in your pro forma not to double count reserve costs and capital costs for the same repair!

Construction – While it is important to track potential changes in income and operating expenses, the pro forma is perhaps most valuable for laying out acquisition and construction expenses early on during a new development or even a redevelopment. These early years in a pro forma are critical to understanding if cash flow will be sufficient to make a project work, and how much urgency there is or flexibility you have before income needs to be stabilized.

Lease up period – A new building or one that is vacant will face a period without tenants, so income and operating reimbursements will be zero, and slowly ramp up as the building is filled. This has the same impact to income as noted in tenant turnover but is more critical due to the upfront magnitude and timing.

Debt service – Unless you have a variable rate on your loan, your debt service should be one of the most stable costs you have. However, if it is paid off during the period covered in your pro forma, modeling this change is important as it is likely to be a large expense. Further, if you are taking on a short term (construction) loan upfront with the intent to refinance once a property is



stabilized, a pro forma enables you to track the value of the loan upfront, the payoff a couple of years in, the value of the new loan, and the related debt service amounts for both.

Ending a Pro Forma

A pro forma is a nice way to account for financial changes over a longer time-period, say 10 years, but what happens then? Changes will still occur in years 11, 12, etc. Do we just keep going? It is true that changes will occur in those out years, but analysts typically feel comfortable ending a pro forma after that point for three reasons: property stabilization, time-value of money, and use of the reversionary value.

Property stabilization – Much of the value of a pro forma is in the early years when major investments are being made, operations are modified, and tenancy is stabilizing. Of course, leases still terminate, inflation still occurs, and capital investments are still required in later years. However, when looking out as far as 10 years, analysts can usually make some general assumptions about these somewhat predictable changes.

Time-value of money – A common principle in finance is that money is worth more today than it is tomorrow. (Wouldn't you rather be paid today than tomorrow? Or 10 years from now?) Therefore, the income and expenses we realize in year 1 are going to impact how we value the investment much more than those in year 11. This is not to say the profit earned in year 11 is meaningless, but rather if that profit is slightly higher or slightly lower than expected, because it is "discounted," the overall impact is likely relatively small.

Reversionary value – Just because we feel comfortable only running our pro forma out for a certain number of years, does not mean that the property ceases to exist after that period. We sure hope we will continue to earn income in years 11, 12, etc. To account for this, we use a *reversionary value*. The reversionary value is the estimated value of the property at the end of the pro forma. It is determined by

Outgoing Cap Rate Demonstrating Value Add

Goal: Outgoing Cap Rate < Initial Cap Rate

You want to sell a property for more than you put into it – this is called adding value. One way to do this is to lower risk. If NOI is constant and your outgoing cap rate is lower than your initial cap rate, you successfully increased value. dividing the NOI from the year following the end of the pro forma (i.e., use Year 11 NOI with a 10-year proforma) by the "outgoing cap rate." The outgoing cap rate is estimated based on the expected amount of risk in the investment at that point. For example, if a property is expected to generate NOI=\$50,000 in the Year 11 and the outgoing cap rate is 8%,

the reversionary value will be 50,000 / 8% = 625,000. (See Chapter 6 for more explanation of the cap rate.)

The reversionary value assumes you hold on to the property indefinitely. However, if you plan to sell the property after a certain period, you should include that assumption in your pro forma. Assumptions for selling a property are similar to those in the reversionary value - the value will still be NOI/Cap Rate. Except when selling a property, you will need to account for the cost of the sale (e.g., closing costs, broker commissions) and you will want to show the payoff of the principal of any outstanding loans.

Key metrics

In a pro forma, there are a few metrics that should be calculated to measure the quality of a real estate investment. Some of these are similar to those metrics in a simple analysis, though others, such as IRR, can be included now that you are



risk) that you plan to add tomorrow!

looking at financials over a period of time.

Annual Return on Investment and Return on Cash – Just like in a single year analysis, the annual Return on Investment and Return on Cash are important metrics in analyzing a real estate investment. However, because the cash flow (return) likely varies from year to year, the ROI and ROC will vary from year to year, sometimes fluctuating quite wildly. These annual returns are informative but not always the most helpful in determining if an investment is good. The average ROC and ROI over the pro forma period provides a more consolidated metric for assessment, but it can distort wild swings and does not place any greater value on returns earned in year 1 over those in year 10. As a result, annual ROI and ROC are good metrics for stable investments. When looking at new developments, analysts will often focus on the annual return in the first year that the property is "stabilized." Stabilized means the development is fully leased and significant changes to income and expenses from year to year aren't expected. Alternatively, many investors will focus on other metrics that better account for annual fluctuations, such as Internal Rate of Return (IRR).

IRR – Internal Rate of Return (IRR) is one of the more confusing metrics in finance but is quite powerful. Without getting into a complicated explanation, IRR is a metric that indicates the return on an investment over a period of time. Rather than a simple ratio or average, it takes into consideration how much money is invested and earned and, importantly, because of the time value of money, when those investments and earnings occur. Manually determining the IRR is difficult, but it can be easily calculated in Excel using the IRR function. You typically want an IRR that is higher than the return you would get from other investments, real estate and otherwise.

Cash Flow – One of the biggest risks in new development is running out of cash.

Development requires a significant amount of money up front, but it can take a while, months or sometimes years, before that development begins to generate income. An investment with a fantastic ROI that runs out of cash in the second year is not a good investment; if you are unable to pay your bills and lose the property, you will not be around to realize that fantastic return in future years. A pro forma is an ideal way to calculate year to year (or even month to month) what your cash flow will be. If at any time you show negative cash flow, or even low cash flow, you will have to find a way to lower your costs, access additional cash to cover the deficit, or skip the investment. A pro forma is also a good way to assess your risk by running sensitivities. What if it takes 18 months rather than a year to find a tenant? What if construction costs run 10% higher. Will any of these



cause you to run short on cash? If so, do you have a way to cover those costs in the short term?

Applying This to You!

What assumptions do you now need to include for your specific development when you extend your financial analysis out 5, 7, or 10 years?

Pro Forma Development Considerations

Acquisitions &	 What is the expected purchase price of your property?
Construction	• How much do you expect to spend in closing costs (e.g., financing, attorney fees, inspections, title)?
	 What improvements do you plan to make to the property?
	 How much do you or your contractor estimate hard costs for construction will be? Soft costs?
	 How much construction cost contingency are you including?
Income	 What space do you have to lease? How big is each unit?
	• For commercial spaces, are you including a pro rata share of common space in each unit?
	 How much rent do you think each unit will generate?
	When do you anticipate that each space will start generating rent?
	 Do you anticipate getting income from any other sources (e.g., parking, vending, billboard on building)?
	 How much will income change year over year?
	 What will you use as your vacancy factor?
Operating Expenses	 How much do you pay in property taxes? If you are investing in the space, how much will taxes increase when complete?
	 How much will property insurance cost?
	 What are your costs to maintain and repair the building?
	 What are your costs for landscaping, snow removal, and cleaning? Utilities? Security?
	 What are your administrative expenses (e.g., property management, accounting) both internally and externally?
	 Do you have any other operating expenses?
	 How much will operating expenses increase every year?
	 How much do you plan to put in replacement reserves each year?
	 Will any of these operating expenses be reimbursed by tenants? If so, how much (don't forget to plan for vacancy)?
Capital and Leases	• How much do you expect to have to pay brokers to help you lease out your space (tenant and landlord side)?
Expenses	• Will you have to make any tenant improvements or provide a tenant improvement allowance? If so, how much?
	 How much will you need to spend on broker commissions and tenant improvements as tenants turnover?
	• Do you anticipate any other capital expenses over the course of the pro forma (e.g., new roof)?

Financing	• What is your total building value (or building cost) based on the acquisition price and construction?
	 What is the maximum you expect you can borrow based on a Loan- to-Value (LTV) ratio or Loan-to-Cost (LTC) ratio?
	 What is your Net Operating Income (NOI = Income – Operating Expenses)? What is the maximum debt service you can pay based on your NOI and debt service coverage ratio (DSCR)?
	 What is your interest rate, loan term, and amortization term?
	 How much do you intend to borrow? Based on that amount and your loan terms, what will your annual debt service be? Will your LTV ratio and/or DSCR limit how much you borrow?
Exit Value	 What is the NOI in the year after the last year of your pro forma?
(or Reversion)	• What cap rate will you assume at exit? You can't predict the market, but you can estimate level of risk, and ideally you will have lowered the risk.
	 Estimate the sale price during the last year (NOI/Cap Rate).
	 What would your cost of sale be (e.g., broker commissions, closing costs)?
	 How much principal would you still owe on your debt at the time of sale?
	 Calculate your net proceeds from the sale.
Analysis	 What is the total cost of this investment (debt and equity)?
	 How much equity do you need to put into this investment?
	 What is your annual NOI and Cash Flow after Financing?
	 Calculate the annual and average ROI and ROC, and the IRR.
	• Do the return metrics meet your thresholds? If not, how can it be improved? What is the maximum you can pay for the property? Is there a way to lower construction costs without sacrificing income?
	 If the returns fall short, are there sources of gap financing that could help make your project more feasible?
	 How does this investment compare to others you are considering?
	 How does this investment compare to your other non-real estate investment opportunities (considering return, risk, and liquidity)?
	 Are you being too cautious with your assumptions? Are you not being cautious enough?

II. Differences in the Residential and Commercial Pro Formas

Structurally, residential and commercial pro formas are similar. They both follow the same format of Effective Gross Income, NOI, and Cash Flow, and both look across several years. There are, however, a few ways in which residential and commercial pro formas differ, including:

- Income detail Commercial pro formas will often detail revenue by each tenant since they vary by size, rates, term, etc. Residential income is typically grouped by type of unit (2 bedroom, 1 bedroom, studio, etc.) and are often calculated in a separate table to show number of units, SF, rate per SF, monthly rent, etc. Also, do not forget to include supplementary income for both asset classes, such as from parking, storage, vending, and laundry.
- Operating Expenses Because residential leases are typically gross leases, tenants do not pay operating expenses separately. As a result, a residential pro forma will have zero expense reimbursements. Commercial leases are often net leases, and therefore commercial pro formas will include base rent as part of Potential Gross Income and operating expense/CAM reimbursements after the expenses line item.
- Leasing commissions Residential leases do not usually require the payment of broker commissions, but commercial leases usually will.
- **Tenant Improvement costs** Residential units may turnover regularly. For example, if the average length a tenant stays in an apartment is 3 years, one-third of units will turnover every year. You should include turnover costs (e.g., cleaning, repairs, painting, etc.) every year for a certain percentage of units, depending on your expected turnover rate. Commercial lease tenant improvement costs tied to turnover will be much more irregular due to longer lease periods, but costs will be much higher at turnover, often due to a complete renovation of the space.

Mixed use pro formas add an additional layer of complexity given that they bring together both residential and commercial asset classes with different assumptions and requirements (e.g., part of the space has operating expenses reimbursements, part of the space does not.) While you can capture these differences in a single pro forma, it may be easier to create two separate pro formas (one residential and one commercial) and then bring all the critical line items (e.g., EGI, NOI) together into a third consolidated pro forma.

III. Sample 10 Year Pro Forma – Residential

PRO FORMA

DTAP	Address	1234 Main Street Apytown, MN 00000												
DEVELOPERS TECHNICAL	Address	1254 Main Street, Anytown, Mix 00000												
ASSISTANCE PROGRAM			,	lease l In	Stahilized	For Resale								
USD unless otherwise indic	rated			YR 1	YR 2	YR 3	YR 4	YR 5	YR 6	YR 7	YR 8	YR 9	YR 10	YR 11
obb unless other mise indie	atea													
DEVELOPER SOURCES & US	SES	1 Bed/1 Bath	3.0%	94.080	96.902	99.809	102.804	105.888	109.065	112.336	115.707	119.178	122.753	126.436
Acquisition Cost	396.000	2 Bed/1 Bath	3.0%	101.760	104.813	107.957	111.196	114.532	117.968	121.507	125.152	128,907	132.774	136,757
Hard Costs	1.946.880	2 Bed/2 Bath	3.0%	110.160	113.465	116.869	120.375	123,986	127,706	131.537	135,483	139,547	143.734	148.046
Soft Costs	486,460		0.0%	.,	-,	.,			,	. ,	,		-, -	.,
Total Uses	2.829.340		0.0%											
	,,	Rental Revenue		306.000	315.180	324.635	334.374	344.406	354.738	365.380	376.341	387.632	399.261	411.238
Debt	1.980.538												, -	,
Equity	748.802	Expense Reimbursement (commercial)												
Gap Financing	100.000	Other Income		1.200	1.230	1.261	1.292	1.325	1.358	1.392	1.426	1,462	1.499	1.536
Total Sources	2,829,340			2,200	1,200	1,201	1,252	1,020	2,000	1,002	2) 120	2, 102	2) 100	1,550
	2,025,010	Potential Gross Income		307.200	316.410	325.896	335.667	345.730	356.096	366.772	377.768	389.094	400.759	412.775
DEVELOPER DEBT FINANCI	NG		L	,	, -	,	,	,	,	,		,	,	, -
Interest Rate	6.00%	Vacancy	5.00%	153,600	15,821	16,295	16,783	17,287	17,805	18,339	18,888	19,455	20,038	20,639
Amortization (yrs)	30													
Loan Constant	7.19%	Effective Gross Income		153,600	300,590	309,601	318,883	328,444	338,291	348,433	358,879	369,639	380,721	392,136
Payment (annual)	142,492													
Payment (monthly)	11,874	Property Taxes	0.0%	39,024	39,024	39,024	39,024	39,024	39,024	39,024	39,024	39,024	39,024	39,024
		Property Insurance	0.0%	15,484	15,484	15,484	15,484	15,484	15,484	15,484	15,484	15,484	15,484	15,484
DEVELOPER PROFIT FROM	SALE	Utilities	0.0%	8,310	8,310	8,310	8,310	8,310	8,310	8,310	8,310	8,310	8,310	8,310
Year of Resale	10	Maintenance & Repairs	0.0%	7,038	7,038	7,038	7,038	7,038	7,038	7,038	7,038	7,038	7,038	7,038
NOI at Resale	296,100	Landscaping/Snow	0.0%	4,927	4,927	4,927	4,927	4,927	4,927	4,927	4,927	4,927	4,927	4,927
Exit Cap Rate	8.00%	Trash	0.0%	5,400	5,400	5,400	5,400	5,400	5,400	5,400	5,400	5,400	5,400	5,400
Value at Resale	3,701,250	Property Management	0.0%	9,853	9,853	9,853	9,853	9,853	9,853	9,853	9,853	9,853	9,853	9,853
Cost of Sale (%)	4.00%	Reserves	0.0%	6,000	6,000	6,000	6,000	6,000	6,000	6,000	6,000	6,000	6,000	6,000
less Cost of Sale	(148,050)	Other	0.0%											
Profit from Sale	3,553,200	Operating Expenses		96,036	96,036	96,036	96,036	96,036	96,036	96,036	96,036	96,036	96,036	96,036
less Loan Payoff	(1,657,428)													
Equity Returned from Sale	1,895,773	Leasing & Capital Costs				4,000			2,000	8,000		10,000		
		Net Operating Income		57,564	204,554	209,566	222,848	232,408	240,255	244,397	262,844	263,603	284,685	296,100
		Debt Service	[1/12 /102	1/12 /102	1/12 /102	1/12 /02	1/12 /102	1/12 /102	1/12 /102	1/12 /102	1/12 /102	1/12 /102	1
		Debt Service Coverage Ratio	-	0.40	1 //	1 /7	1 56	1 62	1 60	1 77	1 0/	1.95	2 00	
		Debt Service Coverage Ratio		0.40	1.44	1.47	1.50	1.05	1.09	1.72	1.04	1.65	2.00	
		Cash Flow After Financing		(84,928)	62,062	67,074	80,356	89,916	97,763	101,905	120,352	121,111	142,194]
		Return on Investment		2.0%	7.2%	7.4%	7.9%	8.2%	8.5%	8.6%	9.3%	9.3%	10.1%	
		Return on Cash		-11.3%	8.3%	9.0%	10.7%	12.0%	13.1%	13.6%	16.1%	16.2%	19.0%	
			¥5.0	¥5.4	¥5.2	¥5.3		¥5.5	VD C	¥8.7	¥5.0		VD 40	
			<u>YR 0</u>	<u>YR 1</u>	<u>YR 2</u>	<u>YR 3</u>	<u>YR 4</u>	<u>YR 5</u>	<u>YR 6</u>	<u>YR 7</u>	<u>YR 8</u>	<u>YR 9</u>	<u>YR 10</u>	
		Cash Flow after Financing		(84 928)	62 062	67 074	80 356	89 916	97 763	101 905	120 352	121 111	142 194	1
		Equity In/Out	748.802)	(2.,2-0)		,-, -		,.10		,000	,-02	,	1.895.773	

(748,802)

15.3%

(84,928)

62,062

67,074

80,356

89,916

Discount Rate

97,763

10.00%

101,905 120,352 121,111 2,037,966

Net Present Value (NPV) 387,101

Cash Flow from Operations & Sale

Levered Internal Rate of Return (IRR)

IV. Sample 10 Year Pro Forma – Commercial

PRO FORMA

DTAP DEVELOPERS TECHNICAL Example Commercial 1234 Main Street, Anytown, MN 00000

ASSISTANCE PROGRAM				leaselln	Stabilized	Stabilized	Stabilized	Stahilizod	Stahilized	Stabilized	Stabilized	Stabilized	Stabilized	For Resale
USD unless otherwise indica	ited			YR 1	YR 2	YR 3	YR 4	YR 5	YR 6	YR 7	YR 8	YR 9	YR 10	YR 11
DEVELOPER SOURCES & US	<u>ES</u>	Tenant 1 - 3,200 SF	3.0%	40,000	41,200	42,436	43,709	45,020	46,371	47,762	49,195	50,671	52,191	53,757
Acquisition Cost	550,000	Tenant 2 - 2,100 SF	3.0%	24,000	24,720	25,462	26,225	27,012	27,823	28,657	29,517	30,402	31,315	32,254
Hard Costs	375,000	Tenant 3 - 1,700 SF	3.0%	21,000	21,630	22,279	22,947	23,636	24,345	25,075	25,827	26,602	27,400	28,222
Soft Costs	50,000	7,000 SF total	0.0%											
Total Uses	975,000		0.0%											
		Rental Revenue		85,000	87,550	90,177	92,882	95,668	98,538	101,494	104,539	107,675	110,906	114,233
Debt	731,250													
Equity	243,750	Expense Reimbursement (commercial		35,578	36,645	37,744	38,876	40,043	41,244	42,481	43,756	45,069	46,421	47,813
Gap Financing	-	Other Income		-	-	-	-	-	-	-	-	-	-	-
Total Sources	975,000	Peterstiel Crees Income		120 570	124 105	127 021	121 750	105 711	120 702	142.070	140.205	452 744	157 226	102.040
DEVELOPER DERT FINANCIN	IG	Potential Gross Income		120,578	124,195	127,921	131,/58	135,/11	139,782	143,976	148,295	152,744	157,326	162,046
Interest Rate	6.50%	Vacancy	5.00%	6.029	6.210	6.396	6.588	6.786	6.989	7,199	7,415	7.637	7.866	8.102
Amortization (yrs)	30	,		0,020	-,	-,	0,000	-,	-,	.,	.,	.,	.,	-,
Loan Constant	7.58%	Effective Gross Income		114,549	117,985	121,525	125,170	128,925	132,793	136,777	140,880	145,107	149,460	153,944
Payment (annual)	55,464													
Payment (monthly)	4,622	Property Taxes	3.0%	13,000	13,390	13,792	14,205	14,632	15,071	15,523	15,988	16,468	16,962	17,471
		Property Insurance	3.0%	4,000	4,120	4,244	4,371	4,502	4,637	4,776	4,919	5,067	5,219	5,376
DEVELOPER PROFIT FROM S	ALE	Utilities	3.0%	6,000	6,180	6,365	6,556	6,753	6,956	7,164	7,379	7,601	7,829	8,063
Year of Resale	10	Maintenance & Repairs	3.0%	4,450	4,584	4,721	4,863	5,009	5,159	5,314	5,473	5,637	5,806	5,980
NOI at Resale	103,614	Landscaping/Snow	3.0%	3,000	3,090	3,183	3,278	3,377	3,478	3,582	3,690	3,800	3,914	4,032
Exit Cap Rate	7.50%	Trash	3.0%	3,000	3,090	3,183	3,278	3,377	3,478	3,582	3,690	3,800	3,914	4,032
Value at Resale	1,381,521	Property Management	3.0%	2,500	2,575	2,652	2,732	2,814	2,898	2,985	3,075	3,167	3,262	3,360
Cost of Sale (%)	4.00%	Reserves	3.0%	1,500	1,545	1,591	1,639	1,688	1,739	1,791	1,845	1,900	1,957	2,016
less Cost of Sale	(55,261)	Other	0.0%											
Profit from Sale	1,326,261	Operating Expenses		37,450	38,574	39,731	40,923	42,150	43,415	44,717	46,059	47,441	48,864	50,330
less Loan Payoff	(619,925)													
Equity Returned from Sale	706,335	Leasing & Capital Costs		-	5,000	-	-	12,000	6,000	-	8,000	-	5,000	-
		Net Operating Income		77,099	74,412	81,794	84,248	74,775	83,378	92,060	86,822	97,666	95,596	103,614
		Debt Service		55 /6/	55 /6/	55 /6/	55 /6/	55 /6/	55 /6/	55 /6/	55 /6/	55 /6/	55 /6/	1
		Debt Service Coverage Ratio		1 39	1 34	1 47	1 52	1 35	1 50	1 66	1 57	1 76	1 72	
		Debt Service Coverage natio		1.55	1.54	1.47	1.52	1.55	1.50	1.00	1.57	1.70	1.72	
		Cash Flow After Financing		21,635	18,948	26,330	28,784	19,311	27,914	36,596	31,358	42,202	40,132	1
														-
		Return on Investment		7.9%	7.6%	8.4%	8.6%	7.7%	8.6%	9.4%	8.9%	10.0%	9.8%	
		Return on Cash		8.9%	7.8%	10.8%	11.8%	7.9%	11.5%	15.0%	12.9%	17.3%	16.5%	
			<u>YR 0</u>	<u>YR 1</u>	<u>YR 2</u>	<u>YR 3</u>	<u>YR 4</u>	<u>YR 5</u>	<u>YR 6</u>	<u>YR 7</u>	<u>YR 8</u>	<u>YR 9</u>	<u>YR 10</u>	
														1
		Cash Flow after Financing		21,635	18,948	26,330	28,784	19,311	27,914	36,596	31,358	42,202	40,132	
		Equity In/Out	(243,750)										706,335	-
		Cash Flow from Operations & Sale	(243,750)	21,635	18,948	26,330	28,784	19,311	27,914	36,596	31,358	42,202	746,467]
		Levered Internal Rate of Return (IRR)	18.6%				ם	iscount Rate	10.00%		Net Present	Value (NPV)	197,868	

Activity H: Developing a Pro Forma



Directions Create a 10-year pro forma for the development designed and analyzed in Activities E and F. Build your own model in Excel or use the template on the following page.

Consider the following when building out your pro forma:

- How many different residential unit types and sizes will you have in your development? Will rent vary by unit? (Tenant spaces and unit types are often more detailed when analyzing at the pro forma level.)
- How will rental income change over time?
- Will there be a lease up period where only a portion of rental income will be realized?
- How will operating expenses change over time?
- What costs are included in your operating expenses? Will individual expenses change at different rates over time, rather than just increasing with inflation?
- How will any lease up period affect operating expenses and operating expense reimbursements?
- When will investment costs be paid (e.g., purchase price is typically up front, but construction may span several months or years)?
- Will you have any expenses (e.g., tax, insurance) that will need to be paid before you start collecting rent? If these costs are not included in your construction costs, they should be called out in operating expenses.
- Are there tenant improvements that need to be assumed on an annual basis or inconsistently over the next 10 years?
- Will your development require any capital expenses at various points over the next 10 years (e.g., new roof)?
- Will you need to pay leasing costs (i.e., brokerage commissions) up front or now and again to lease out commercial space?
- When will loan disbursements occur?
- Will you refinance after construction is complete?
- What exit cap rate will you assume you can achieve at the end of your pro forma? (Remember this correlates to the stability of the income your development generates.)
- What will your outstanding loan balance be at the end of your pro forma? How much will it cost you to sell the property? Remember to deduct these costs from the value of your property at the end of year 10.
- Are there any points where cash flow puts your investment at risk (e.g., where you may not be able to pay financial obligations)?

YR1 YR1
Stabilized Stabil
Stabilized Stabilized Stabilized VR.4 VR.5 VR.6 VR.6 VR.6 VR.6 VR.6 VR.6 VR.6 VR.6
Stabilized Stabilized Stabilized Stabilized Stability VR.4 VR.5 VR.7 VR.7 VR.1 VR.4 VR.5 VR.7 VR.7 VR.1 VR.4 VR.6 VR.7 VR.7 VR.7 VR.6 VR.7 VR.7 VR.6 VR.7 VR.7 VR.7 VR.7 VR.6 VR.7 VR.7 VR.7 VR.7 VR.6 VR.7 VR.7 VR.7 VR.7 VR.7 VR.7 VR.7 VR.7

Small Developers Training

Chapter 9: Lease Up and Property Management

Key Concepts

- Finding tenants to lease up your space can require a lot of effort but is obviously critical to a successful project. Marketing to tenants should include digital and physical advertising, but also proactive word-of-mouth efforts through new and established relationships.
- Leases can be simple or complex, but should at least cover the key business terms, rights and obligations of both tenants and landlords, and remedies for default.
- For commercial properties, providing tenant improvements (actual work or via an allowance) may be beneficial to both landlords and tenants as it helps tenants get operational space at low upfront cost and work, and it provides landlords with additional investment return over the term of the lease.
- Property management can be demanding or simple, depending on how a lease is written. Residential leases typically require more active day-to-day management, but the issues are often smaller, whereas commercial leases may have less frequent, but more complex demands.
- Successful property management over the long-term requires building strong relationships with tenants and good planning with smart investments to keep the property marketable.

I. Lease up

Rental Licenses

Most of what we have talked about so far has had to do with spending money – finding and acquiring a property, securing financing, and design and construction. Those expenses can only be considered an investment if they lead to income, which is where lease up activity comes in. For residential properties, before securing a tenant you want to be sure that you have obtained the rental license for the property so that you can legally rent the unit(s). The purpose of rental licensing programs is to protect the safety, health, and welfare of the public. They can help ensure that rental properties are well-maintained and meet standards. Regulations vary from city to city, but most will require some sort of rental license for residential properties. Rental licenses must be obtained when a property is developed or changes ownership and the license typically needs to be renewed annually.

In Minneapolis, a rental license is required for any dwelling unit where the owner is not occupying the unit even if no rent is paid, if the occupant is a relative, or if the unit is vacant but being advertised as for rent. To obtain a rental license in Minneapolis the property owner can submit the license application and fee in person at Minneapolis Service Center or by mail to same location. Applications can also be submitted online (link can be found through the City of Minneapolis website.) Applications usually require 3-4 weeks for processing. Fees are based on number of units and historical property condition (which dictate how frequently the city must do a property inspection.)

Information on City of Minneapolis rental licenses including applications and fees are available in the Rental Licenses section of the city's website:

www2.minneapolismn.gov/business-services/licenses-permits-inspections/rental-licenses/

Finding a tenant

For commercial developments, it is never too early to start the lease up process. As we mentioned in Chapter 2, often the best place to start a development project is with a good tenant. If you do not have a tenant committed to your development in advance, you will want to actively start marketing your property once you have it under control (i.e., have a signed purchase agreement.) Lenders for commercial developments (and residential condos) will often require tenant commitments for a minimum percentage of the space before providing a loan. Because residential tenants won't often commit to a lease far in advance and without understanding how the building and units will look, residential property marketing and lease up generally begins after construction begins.

When marketing your property, ideally you will do so using three means of communication – digital, physical, and word of mouth.

Digital - Your digital marketing will include listing your property on commercial listing sites such as LoopNet, CoStar, and MNCar's REDI/Catalyst and residential sites such as Apartments.com and Zillow. It may also include free sites like Craig's List, posting on your own website, and communicating via social media.

Physical – Physical marketing primarily includes signage and brochures, including a "for lease" sign onsite. If you are developing or redeveloping your property, having renderings of what the property will look like after completion is critical to helping prospective tenants visualize the end product.

Word of mouth – Digital and physical marketing, by and large, are passive forms of marketing. You put your product out there and wait for a response. The most successful marketing efforts typically come from combining passive forms with word of mouth, or relationship based marketing. This is particularly true for commercial leasing. This can be extremely active and time consuming, but the payoff can be huge. Word of mouth marketing includes knocking on doors and making phone calls to

business owners and their representatives who might be good candidates for your space. This approach also enables you to get feedback from others in the market about what tenants are seeking, strengths and limitations with your property, and general market information.

As with other steps in the development process, you may choose to find a tenant on your own, or you may seek assistance from a real estate leasing agent. Sometimes, especially with smaller developments, the cost of paying a real estate agent may feel like a significant financial burden. However, if having a strong broker enables you to fill your space sooner and negotiate better terms, it can be worth the cost. A good leasing agent will have a strong network of tenant representatives and prospective tenants and should actively promote your property. She should know what is happening in the market on both the landlord and tenant side and may also have access to various digital listing services that you may not. For residential leasing, the lease-up is handled by the property owner or the property manager, if the owner is outsourcing property management. You can also hire a company specifically to only do the marketing and initial property lease-up.

Applying This to You!

Make a list of your target tenants. Which tenants do you think would be most interested in your space? What do you think are the best ways to reach them and get them to consider your property?

Basic lease terms

Tip

Once you have found a tenant and agreed upon the basic business terms of a lease (as documented in a term sheet or letter of intent) the agreement should be made official by drafting and executing a lease agreement. Leases can be as simple as a page or two or can be extremely detailed and complicated. Residential leases tend to be

A good source to purchase residential leases and other rental documents is the Minnesota Multi Housing Check out their website at: <u>mmha.com</u> simpler (tenants do not want to hire a lawyer to help them sign a lease) and often are a standard template that does not involve much or any negotiation on terms. Various residential lease templates can be downloaded online. Commercial

leases, on the other hand, are typically more involved because the lease duration is often longer, the terms can be more complex, and the deal points are negotiated.

Regardless of whether a lease is residential or commercial, the following elements are typically included in a lease:

Basic Terms – This includes the business terms agreed upon between the landlord and tenant, including:

Parties – Who the lease agreement is between, defining Landlord and Tenant, and providing contact information for all parties.

Space – Location of the property and the premises, in addition to any related space rights like common space and parking.

Dates – When the lease starts and ends, when the tenant can access the space, when the tenant must pay rent (Note: these are not always the same).

Costs – Rental rates, including base plus any additional costs to be paid by the tenant for operating expenses, property taxes, insurance, property management, utilities, etc. This section should clearly spell out exactly what the rent will be throughout the entire lease.

Use – How the property can and cannot be used.

Obligations of the Landlord – The lease should clearly articulate what the landlord is doing for and providing to the tenant. These obligations include ensuring the tenant has access to and can use the premises as intended, and keeping the property clean, in good repair, and well maintained.

Rights of the Landlord – This includes rights such as how and when a landlord can access the premises.

Obligations of the Tenant – The lease should also clearly articulate what the tenant must do during the lease, which includes paying rent on time, agreed upon upkeep and maintenance, maintaining liability insurance, how to leave the premises upon lease expiration, not disturbing other tenants, and agreements to work with the landlord in special circumstances (e.g., when a landlord is refinancing the property.) Tenant obligations would also include following any property rules such as not having pets, not parking commercial vehicles in the parking lot, etc.

Rights of the Tenant – In addition to the right to the premises as outlined in the basic terms, other tenant rights may include any renewal options, rights to sublease, and rights to modify the space (usually after getting landlord approval.)

Default and Remedies – Leases will often have a section to describe what each party can do to remedy if the other party does not uphold its obligations under the lease. This could include notice, late fees, using security deposit funds, termination of lease, filing a lawsuit, etc.

Miscellaneous provisions – These provisions include indemnifications (protecting each other from harm or loss), what happens if the property is taken under eminent domain or is destroyed, etc.

Tenant improvements (Commercial Leases)

One of the important terms that will likely be negotiated with a commercial tenant is how the premises will be built out to serve the tenant's needs. Like so many things in a commercial lease, how tenant improvements are handled can vary widely. Some landlords will do nothing, while other landlords will build out the entire space to the exact specifications of the tenant. In addition, there are actually two ways to define



what we mean when we say, "who provides the tenant improvements." The first is who is paying for them and the second is who is doing or contracting to do the work. A tenant and landlord may agree to split costs (e.g., landlord builds the walls; tenant paints and installs carpet) but then agree to use a single contractor for simplicity, efficiency, and cost savings. Some tenants may want to manage the build out of the space themselves but negotiate to have the landlord pay for a portion of the space. In this case, the landlord agrees to provide a Tenant Improvement Allowance (TIA) for a certain dollar amount that the tenant can use in the space.

How tenant improvements are structured can vary wildly, but there is some logic behind most situations. Smaller tenants who are not frequently involved in building out leased locations will often look to the landlord to lead the work. These tenants may not have the knowledge, construction partners, nor buying power of a landlord. Tenants who have multiple locations, such as regional or national retailers, may want to control their build out as they want to be sure it is built to their specifications and by their trusted partners. This is especially the case for retailers who consider their space to be a reflection of their brand.

Tenants may be reluctant to pay for the build out of their space since it requires a significant amount of money up front and is not something they can use once they vacate the space. Landlords, however, by paying for a tenant's improvements upfront and then charging the tenant more in rent can create a second source of income for themselves – effectively the landlord is financing the build out and (ideally) getting a good return on that "loan." Because many tenants need or want the landlord to finance the build out upfront, a landlord that is "cash poor" and unable to do so, will limit his pool of prospective tenants. This is especially important to consider if the landlord is hoping to bring in a tenant that has a high build out cost, such as a restaurant. Of course, with any "loan" there is the risk that the lender will default – a landlord could build out the space for a 5-year lease term and if the tenant breaks the lease after one year, the landlord will face a loss.

Residential leases do not typically deal with tenant improvements as it is generally expected that the tenant is moving into a space that is built-out as livable space and the tenant is accepting it in as-is condition.

II. Property Management

Tenants are customers

Sometimes, especially during lease negotiations, it can be easy to forget that as a landlord the tenant is your customer. Remember, real estate is a business and the product you are selling is space. For any business to succeed over the long term, it needs to have satisfied customers that want to keep coming back. Even though a tenant signs a lease, this does not mean that they are locked in and you can negate your responsibilities as a landlord. Eventually, that lease will end, and they will again have to decide whether to buy your product or go to a competitor. Further, during the lease they will communicate to others about their experience with you as a landlord. Today, with the proliferation of online reviews through Google, Yelp, etc. it is even easier for tenants to spread the word (good or bad) about their experience as a tenant. Having a strong brand and a good reputation is important. Providing good customer service does not mean you can't be a strong negotiator in lease discussions, nor does it mean you should short-change yourself. It does mean respecting your tenants and fully providing the product and service that you agreed to in the lease – and, in some cases, going a bit further.

Property Management - Do it yourself or Hire it out

Once a property is financed, acquired, built, and fully leased out, it is considered "stabilized." The owner can just sit back and let the lease payments roll in. Or not. Unless a lease is a triple-net or an absolute net lease where the tenant is responsible for everything (which usually only happens with commercial leases), the landlord will

still have ongoing property management responsibilities. These responsibilities will vary based on the terms of the lease, but very often will include things such as landscaping, snow removal, cleaning, maintaining

Management Fee

Commercial leases commonly allow for a property management fee as part of operating expenses to be reimbursed by the tenant. Even if you are self-managing, it is reasonable to charge a fair market cost to your tenant for that management.

and repairing common space, maintaining and repairing occupied space, collecting rent and tracking down missing payments, obtaining and reporting financial information, accounting, dealing with tenant issues, negotiating lease extensions and modifications, and filling vacated spaces. For smaller properties with only a single or few tenants, you may find that the property management, and even the work itself (e.g., cleaning, landscaping, repairs, etc.), can be performed by you directly. However, if you do not have the time and/or the capability to manage the property yourself you may want to consider hiring this out. This is particularly important with larger properties and as you add more properties to your portfolio. You may eventually find that it is worth it to pay someone to manage the day-to-day activities so that you can spend time on other activities that provide greater value-add, such as your next investment!

Finally, keep in mind that operations shouldn't be an afterthought. When you are doing site selection, be sure to put on your property management hat (or solicit input from your property manager) and consider the implications of that property during operations. Does the property have a lot of landscaping that will need maintaining? Do you have public sidewalks or drives that will need to be cleared promptly after every snowfall? Are there a lot of common spaces that will need cleaning?

Residential v. Commercial

While property management of residential and commercial properties both require similar responsibilities – landscaping, repairs, accounting, etc. – the nature of the work does vary considerably. Residential leases generally are shorter term which means tenants tend to turnover more frequently than in commercial spaces. Mid to large size apartment buildings may constantly have an apartment available for lease. Residential landlords are generally expected to maintain the building, grounds, and common areas, as well as do repairs inside the apartments such as changing lightbulbs and fixing leaking toilets. These small, but more frequent needs can be time-consuming. Still some landlords do manage through this, however, by having an agreement with a tenant to mow the lawn or shovel the walk-in return for a small rent reduction.

Commercial leases are often 3, 5, 7 years or longer and therefore tenant turnover is not as great as with residential. However, when a commercial space does become vacant, the work involved to find а replacement tenant, negotiate а lease, and potentially build out new space can require numerous



hours over several months. Also, commercial leases vary more than residential leases in structure. Some commercial leases stipulate that the tenant will take full responsibility for cleaning, maintenance, repairs, etc. In those cases, the day-to-day management of a commercial lease can be minimal. Alternatively, when landlords take on much of the operational responsibility, which is more often the case in multitenant properties, the workload can be substantial. Commercial property managers may have fewer calls for clogged toilets, but when they do get called, the scope and complexity of the project is frequently more significant than with residential requests.

Applying This to You!

Make a list of the property management responsibilities required to maintain your property. For each of these, write down if you have the capability and desire to perform this work. Keep in mind your flexibility and accessibility to respond to emergencies. Also, consider if performing this work is the best use of your time.

Ongoing investments

Even when properties are stable, operations are being managed, and rent is being paid, an owner should not become complacent. With time, all properties need special attention. Major repairs and upgrades such as roofs, elevators, and parking lots require a lot of planning, coordination, and cash. At the least, a property owner should estimate when major future work will be needed and plan for covering that cost.

Some investments in your property may not be necessary to maintain the infrastructure and functionality but may be important to maintain a level of quality and image, and therefore income. Properties that become dated (e.g., that aqua and mauve wallpaper in the lobby) will not command rents that they once did. Some of these fixes are easy and affordable, such as replacing wallpaper. Others, such as floor layouts and the amount of natural light, can be expensive or unrealistic. Nonetheless, it is important to stay attuned to market trends, competition, and changing tenant needs, and respond appropriately to keep your property desirable and marketable.

Conclusion

Investing in real estate can be an exceedingly rewarding experience. The people you meet, challenges you solve, community impact you have, and the income you earn makes being a real estate developer highly attractive. Not all investors must be full-time, professional real estate developers. Many opportunities exist in every community to develop or redevelop small commercial and residential properties – and the outcome can be just as fulfilling as with big developments. Success comes, not by being an expert across all aspects of the development cycle, but by having a vision and passion, being eager to learn, taking informed risks, and building relationships with strong partners to bring a complex, but exciting project together. Good luck!

APPENDIX A: Glossary – Pro Forma Terms

TERM	DEFINITION
Amortization	The gradual paying off of a debt by periodic installments.
Amortization Term	The period of time required to pay off an entire loan amount with periodic installments at a specific rate.
Annual Return on Cash (Cash-on-Cash Return)	Yearly return on an investment of cash (equity) after accounting for debt service payments, calculated by dividing Cash Flow After Financing for the year by the total equity invested in the property.
Annual Return on Investment (ROI)	Yearly return on an investment ignoring whether the investment made included any debt, calculated by dividing Project Cash Flow for the year by the total investment cost.
Asset Management Fee	The cost to an external party to manage the property including maintenance, repairs, leasing, capital upkeep, etc.
Building Code	Rules and regulations for how a building must designed and built in order to promote health, safety, and accessibility.
Cash Flow After Financing	Money available from income after all expenses are paid except income taxes. Project Cash Flow plus borrowed cash but less debt service payments.
Contingency	An amount of money budgeted for unexpected or higher than expected construction costs.
Debt Coverage Ratio (DCR)	A ratio calculated by dividing NOI by Debt Service. This ratio is used by lenders to ensure a property owner should have more than enough income to cover their regular debt payments. Most lenders require a DCR of 1.20 to 1.25, meaning their NOI must be at least 20-25% more than their debt payments. (also known as Debt Service Ratio or Debt Service Coverage Ratio.)
Debt Service	Regular payments, typically both principal and interest, paid on a loan.
Debt Serviceable Loan Amount	The maximum amount an investor can borrow based on a given Debt Coverage Ratio and the Income Available for Debt Service (= Income Available for Debt Service x DCR.)
Effective Gross Income	Total income calculated as Potential Gross Income less Vacancy Expense.
Exit Cap Rate (Sale Cap Rate)	Cap Rate (Capitalization Rate) is the rate of return used to derive the capital value of an income stream, calculated as NOI divided by Value. A higher cap rate is typically associated with a property with higher risk and/or lower demand, which translates into a lower property value.
Evponce Crowth Pate	Exit Cap Rate is the rate of return expected for a property upon sale or in the last year of a pro forma. NOI at exit is divided by the Exit Cap Rate to calculate the value of a property in that year (upon sale.) The goal of investment is to have a lower Exit Cap Rate than an Initial Cap Rate or Return on Cost. (A property should be more stabilized at exit than at startup and therefore should have a lower cap rate and thus be worth more.)
Expense Growth Rate	i në estimated value that expense will increase each year.

Gap Financing (aka	Funds such as grants or low interest loans provided by a governmental
Economic Development	agency, non-profit, or other interested party that helps close the
Financing)	financial gap between the cost of development and the value of a
	project. Gap financing is often necessary to enable projects that have an
	economic or social benefit but that are not cost effective to proceed.
Gross Square Feet (GSF)	Measurement of the size of the building from outside the exterior walls.
Hard Costs	Direct costs of construction including labor and materials
Income Growth Rate	The estimated value that income will increase each year.
Internal Rate of Return	One indication of the value of an investment. The true annual rate of
(IRR)	earnings on an investment. The percentage rate earned on each dollar
	invested for each period it is invested. IRR is also the discount rate that
	makes the Net Present Value (NPV) equal to zero.
Leasable Square Feet	Total space in the building that can be leased. Typically used in
	residential buildings where stairs, elevators, and common areas are
	excluded.
Loan to Cost (LTC)	The ratio of the amount of debt (borrowed money) to the cost of the
	property. This ratio is used by lenders to determine the amount of risk it
	has in lending money; often lenders limit loans to a given maximum LTC.
Loan to Value (LTV)	The ratio of the amount of debt (borrowed money) to the value of the
	property. This ratio is used by lenders to determine the amount of risk it
	has in lending money; often lenders limit loans to a given maximum LTV.
Mortgage Constant	The percentage ratio between the annual debt service and the loan
(aka Loan Constant)	amount. The Mortgage Constant can be used to calculate the annual
	debt service by multiplying the Mortgage Constant by the initial Loan
	Principal.
Mortgage Insurance	The fee paid by a borrower to obtain mortgage insurance on a loan.
Premium (MIP)	Mortgage insurance helps protect the lender from borrower default, and
	is often required by lenders and/or government mortgage insurers (e.g.,
	FHA.) MIP can be paid either as a lump sum payment at closing or in
	periodic payments.
Net Operating Income (NOI)	Income from a property after operating expenses have been deducted,
	but before deducting income taxes and financing expenses, calculated
	as Effective Gross income – Operating Expenses + income for
Operating Expenses	The costs of energing a property. These may include real estate tay
Operating Expenses	ne costs of operating a property. These may include real estate tax,
	directly by tonants, and administrative and property management foos
	Commercial operating expenses are twoisally directly reimbursed by
	tenants on a pro-rate basis (net lease), while residential tenants do not
	usually directly nay for operating expenses (though the cost should be
	rolled into their rent as gross rent)
Outstanding Loan Balance	The total amount of principal still owed by a borrower at a given point in
	time
Parking Ratio	Number of parking stalls per unit
Potential Gross Income	Total annual income that could be earned from a property if it is 100%
	occupied including income from rent and other income including
	parking fees, laundry, etc.

Project Cash Flow	Money available from income (Rental Income, Reimbursed Expenses, Other Income) after all expenses (Operating Expenses, Vacancy, Reserves, Leasing, and Capital) are paid except financing and income taxes.
Rentable Square Feet (RSF)	Total space in the building that can be leased by commercial tenants which includes the space directly usable to tenants along with common area space which is leased to tenants on a proportional basis.
Replacement Reserves	Money set aside on a regular basis for larger, irregular expenses that are not included in annual upkeep costs. These include repairs such as roof replacement, parking lot paving, etc. Lenders will often require a minimum Replacement Reserve.
RU Factor (aka Load Factor)	Rentable to Usable Factor, a ratio which indicates the percentage of space that a tenant rents that is not exclusively available to them, calculated as the (Rentable SF - Usable SF)/Usable SF. The difference is due to common area space such as lobbies, corridors, and bathrooms, of which each tenant pays a proportionate share.
SAC/WAC	Sewer Availability Charge and Water Availability Charge. Fees charged by the Met Council and Minneapolis/St. Paul metropolitan area cities for new connections to water and sewer systems.
Sales Cost at Disposition	The cost to sell the property, including broker commissions and other disposition fees.
Soft Costs	Indirect costs of construction, including design, financing, legal, and other related pre and post construction expenses.
Sources	A breakdown of all sources of funding for the project including all sources of equity and all loans. Sources should balance out with Uses.
Stabilized	A property that is fully leased to its maximum projected level.
Tenant Improvement Allowance (TIA)	An amount of money the landlord offers to the tenant to build out the tenant's space.
Tenant Improvements (TI)	Improvements to a leased space for a tenant's use. TI can include walls, ceiling, lights, restrooms, carpet, and may even include Furniture, Fixtures, and Equipment (FFE.)
Uses	A breakdown of how all cash that goes into a project will be used including property acquisition, construction (hard and soft costs), financing costs, fees, and carrying costs. Uses should balance out with Sources.
Vacancy Expense	An offset to Potential Gross Income based on the assumption of a certain level of vacancy in a building. Vacancy expense is calculated by multiplying a Vacancy Factor (often 5-15%) by Potential Gross Income based on current market conditions.
Vacancy Factor	An assumed percentage of the rentable space that will be vacant over the course of the year. Vacancy of this nature will typically result from market conditions and/or tenant turnover. The Vacancy Factor is used to calculate an estimated Vacancy Expense, an amount of rental income that will be lost due to expected vacancy. Vacancy factor is often 5-15%.

APPENDIX B: Minneapolis Zoning Code - Select Sections

Included Sections

540.110	Maximum floor area ratio
540.130	Minimum floor area ratio
540.410	Maximum height for principal structures
540.420	Minimum height for principal structures
540.720	Specific minimum and maximum lot dimension requirements
540.850	Front yard requirements in urban neighborhood and residential mixed-use districts
540.860	Corner side yard requirements in urban neighborhood and residential mixed-use districts
540.870	Interior side and rear yard requirements in urban neighborhood and residential mixed-use districts
540.910	Maximum lot coverage
540.920	Maximum impervious surface coverage
555.220	Vehicle parking requirements
555.230	Bicycle parking requirements

Source: <u>https://library.municode.com/mn/minneapolis/codes/code_of_ordinances</u> (Supplement 69, Update 2. Online content updated July 29, 2024. Data pulled August 28, 2024)

540.110. Maximum floor area ratio.

(a) *In general.* The maximum floor area ratio requirements of principal structures, except cluster developments, shall be as set forth within Table 540-2, Maximum Floor Area Ratio.

(b) *Cluster developments.* The maximum floor area ratio requirements of cluster developments shall be as set forth within Table 540-3, Maximum Floor Area Ratio for Cluster Developments.

Built Form Overlay	Primary Zoning District	Maximum Floor Area Ratio				
District	Category	(Multiplier)				
Interior 1	UN, RM	All uses except Institutional and Civic Uses: 0.5				
		Institutional and Civic Uses: 0.8				
	All other districts	Residential buildings with 1-3 units: 0.5				
		All other buildings: 1.4				
Interior 2	UN, RM	Residential buildings with 1-3 units 0.5				
		All other buildings: 0.8				
	All other districts	Residential buildings with 1-3 units: 0.5				
		All other buildings: 1.4				
Interior 3	UN, RM	Single-family dwellings and state credentialed care				
		facilities serving 6 or fewer persons: 0.5				
		Two-family dwellings: 0.6				
		Three-family dwellings: 0.7				
		All other uses: 1.4				
	All other districts	Single-family dwellings and state credentialed care				
		facilities serving 6 or fewer persons: 0.5				
		Two-family dwellings: 0.6				
		Three-family dwellings: 0.7				
		Other uses: 1.6				
Corridor 3	UN, RM	1.5				
	All other districts	1.9				
Corridor 4	UN, RM	2.0				
	All other districts	2.4				
Corridor 6	UN, RM	3.0				
	All other districts	3.4				
Transit 10	UN, RM	5.0				
	All other districts	5.4				
Transit 15	UN, RM	6.0				
	All other districts	6.4				
Transit 20	UN, RM	7.0				
	All other districts	7.4				
Transit 30	UN, RM	10.0				
	All other districts	10.4				
Core 50	All primary districts	16.0				
Production	All primary districts	3.0				
Parks	UN	Residential buildings with 1-3 units 0.5				
		All other uses: 0.8				
	All other districts	2.0				

I ADIE 340-2 IVIAXIIIIUIII FIUUI ALEA NALIU	Table	540-2	Maximum	Floor	Area	Ratio
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Built Form Overlay District	Maximum Floor Area Ratio (Multiplier)
Interior 1	0.5
Interior 2	
All other districts	0.7

Table 540-3 Maximum Floor Area Ratio for Cluster Developments

540.130. Minimum floor area ratio.

(a) *In general*. The minimum floor area ratio requirements of principal structures located in the built form overlay districts shall be as set forth within Table 540-4, Minimum Floor Area Ratio. Floor area devoted to parking or loading shall not be counted toward compliance with the minimum floor area ratio. Minimum floor area ratio regulations shall not apply to the expansion of buildings existing on the effective date of this ordinance.

(b) *Exception.* Minimum floor area ratio requirements shall not apply on lots existing on the effective date of this ordinance with less than five thousand (5,000) square feet of area.

Built Form Overlay District	Minimum Floor Area Ratio (Multiplier)
Interior 1	None
Interior 2	None
Interior 3	None
Corridor 3	None
Corridor 4	None
Corridor 6	1
Transit 10	1
Transit 15	1.5
Transit 20	2
Transit 30	3
Core 50	4
Production	None
Parks	None

Table 540-4 Minimum Floor Area Ratio

540.410. Maximum height for principal structures.

(a) *In general.* The maximum height requirements of principal buildings located in the built form overlay districts shall be as set forth within Table 540-6, Maximum Height by District, and Table 540-7, Other Maximum Height Requirements by Use.

- (b) *Exemptions*. Except in the SH Shoreland Overlay District and when not allowed in the MR Mississippi River Corridor Critical Area Overlay District, the following may be exempt from the maximum height requirements of principal structures as set forth within each built form overlay district:
 - (1) Communication antennas, wind energy conversion systems, and solar energy systems otherwise allowed by administrative review in Chapter 550, Development Standards.

- (2) Parapets not exceeding three (3) feet, except where located on single-, two-, or three-family dwellings or cluster developments.
- (3) Railings up to four (4) feet in height as measured from the roof, and not more than sixty (60) percent opaque.
- (4) Rooftop features used exclusively for mechanical equipment, elevators, or stairways, provided all of the following conditions are met:
 - a. Such building features are not located on single-, two-, or three-family dwellings.
 - b. The combined coverage of such building features shall not occupy more than thirty (30) percent of the roof area of the floor below.
 - c. Such building features may extend up to sixteen (16) feet above the roof of the floor below.
 - d. Where located within fifteen (15) feet of the wall of the floor below, such building features shall not exceed twenty (20) feet in width as measured parallel to the adjacent wall.
- (5) Rooftop features used exclusively for mechanical equipment, elevators, or stairways on single, two-, or three-family dwellings, provided all of the following conditions are met:
 - a. Such building features may extend up to ten (10) feet above the roof of the floor below.
 - b. The combined coverage of such building features shall not occupy more than one hundred fifty (150) square feet of the roof area.
- (c) *Existing buildings.* Principal buildings existing on the effective date of this ordinance, that exceed the maximum height requirements shall be considered legally conforming, except that additions to such buildings or other redevelopment shall be subject to the standards of this chapter.

Built Form Overlay District	Maximum Height, except as otherwise required
	in Table 540-7
Interior 1	2.5 stories, 35 feet
Interior 2	2.5 stories, 35 feet
Interior 3	3 stories, 42 feet
Corridor 3	3 stories, 42 feet
Corridor 4	4 stories, 56 feet
Corridor 6	6 stories, 84 feet
Transit 10	10 stories, 140 feet
Transit 15	15 stories, 210 feet
Transit 20	20 stories, 280 feet
Transit 30	30 stories, 420 feet
Core 50	No limit
Parks	2.5 stories, 35 feet
Production	10 stories, 140 feet

Use	Built Form	Maximum Height
	Overlay District	
Single- and two-family	All districts	2.5 stories, 28 feet
dwellings		The highest point of a gable, hip, or gambrel roof
		shall not exceed 33 feet.*
Three-family dwellings	Interior 1 and Interior 2	2.5 stories, 28 feet
and cluster developments		The highest point of a gable, hip, or gambrel roof
		shall not exceed 33 feet.*
Three-family dwellings	Interior 3, all Corridor	3 stories, 42 feet
and cluster developments	districts, all Transit	For 3 rd story additions, the following compatibility
	districts, Core 50, and	design standards shall apply:
	Production	
		a. The roof pitch of a partial 3 rd story addition shall
		match an existing roof pitch if more than one roof
		pitch is present on the structure.
		b. The primary roof pitch shall be at least 6/12 for full
		3 rd story additions, unless designed as a flat roof.
		c. Dormers shall meet the following conditions.
		Dormers that meet these conditions shall be exempt
		from conditions a and b.
		1. The dormers are located no closer than three (3)
		feet from any end-of-house corner of the floor below
		and any gable end wall.
		2. The dormers will not extend beyond the wall
		below and will not interrupt the eave edge of the hip
		or gable roof.
		3. The roof of the dormer shall not extend above the
		primary roofline.
Institutional and civic uses	Interior 1 and Interior 2	3 stories, 42 feet

Table 540-7 Other Maximum	I Height Requirements by Use
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*Notwithstanding the height limitations of this chapter, the maximum height of single-, two-, and three-family dwellings may be increased to thirty-five (35) feet when the established height of a minimum of fifty (50) percent of the single-, two-, and three-family dwellings within one hundred (100) feet of the subject site exceed the maximum height. The highest point of a gable, hip, or gambrel roof shall not exceed forty (40) feet.

540.420. Minimum height for principal structures.

(a) *In general.* The minimum height requirements of principal structures located in the built form overlay districts shall be as set forth within Table 540-8, Minimum Height. The minimum height requirement shall apply to at least fifty (50) percent of the building footprint in the BFC6 Corridor 6 and BFT10 Transit 10 Built Form Overlay Districts. In all other districts, the minimum height requirement is satisfied if any portion of a building on the zoning lot complies with the minimum.

- (b) *Existing buildings.* Buildings existing on the effective date of this ordinance, that do not comply with the minimum height requirements shall be considered legally conforming, except that additions to such buildings or other redevelopment shall be subject to the minimum height standards of this chapter when the resulting floor area of the building is equal to or greater than double the existing gross floor area.
- (c) *Exceptions.* Minimum height requirements shall not apply on lots existing on the effective date of the ordinance, with less than five thousand (5,000) square feet of area.

Table 540-8 Minimum Height

Built Form Overlay District	Minimum Height
Corridor 6	2 stories, 20 feet
Transit 10	2 stories, 20 feet
Transit 15	4 stories
Transit 20	6 stories
Transit 30	10 stories
Core 50	10 stories

540.710. Minimum lot area.

Lot area provided for an existing structure or use shall not be reduced below, or further reduced if already less than, the minimum requirements of the zoning code for equivalent new construction. No minimum lot area allocated to any structure or use shall be used to satisfy minimum lot area requirements for any other structure or use.

540.720. Specific minimum and maximum lot dimension requirements.

(a) In general. Minimum and maximum lot dimension requirements shall be as set forth in Table 540-15, Lot Dimension Requirements. The requirements of Table 540-16, Minimum Lot Dimension
Requirements by Built Form Overlay District and Table 540-17, Maximum Lot Area Requirements by
Built Form Overlay District only apply when indicated in Table 540-15, Lot Dimension Requirements.
Nothing in this section shall be construed to authorize uses not otherwise allowed in a primary zoning
district as set forth in Table 545-1, Uses Allowed. All primary zoning districts are included in the table for
each use category to clarify lot dimension requirements for any legal nonconforming uses.

- (b) *Abbreviations*. For purposes of Table 540-15, Lot Dimension Requirements, "sq. ft." shall mean square feet, "ft." shall mean feet, and "CUP" shall mean conditional use permit.
- (c) *Planned unit developments.* The minimum lot area for planned unit developments shall be one-half (½) acre, except as otherwise authorized by this zoning ordinance. Maximum lot area for planned unit developments shall be determined by conditional use permit.
- (d) *Mixed-use developments.* Notwithstanding Table 540-15, Lot Dimension Requirements, residential uses as part of a mixed-use development with both residential and nonresidential uses shall not be subject to minimum lot area requirements except for any minimum lot area required for the nonresidential use.

Uses	Primary Zoning District	Minimum Lot Dimensions		Maximum Lot Area
		Area	Width	
COMMERCIAL				
Bulk Goods and	Production districts	20,000 sq. ft.	None	See Table 540-17
Heavy Equipment	All other districts	1 acre	None	See Table 540-17
Sales				
Commercial	All districts	None	None	See Table 540-17
Agriculture (except				
as noted below)				
Market gardens	All districts	5,000 sq. ft.	None	See Table 540-17

Table 540-15 Lot Dimension Requirements

Commercial	All districts	None	None	See Table 540-17
Recreation and				
Assembly (except				
as noted below)				
Amphitheater	All districts	½ acre	None	See Table 540-17
Indoor recreation	Residential mixed-	10,000 sq. ft.	None	See Table 540-17
area	use districts			
Outdoor recreation	Residential mixed-	20,000 sq. ft.	None	See Table 540-17
area	use districts			
Food and	Residential mixed-	5,000 sq. ft.	None	See Table 540-17
Beverages	use districts			
	All other districts	None	None	See Table 540-17
General Retail Sales	Residential mixed-	5,000 sq. ft.	None	See Table 540-17
and Services	use districts			
	All other districts	None	None	See Table 540-17
High-Impact	All districts	None	None	See Table 540-17
Commercial				
Lodging (except as	All districts	None	None	See Table 540-17
noted below)				
Bed and breakfast	Urban	5,000 sq. ft.	40 ft.	See Table 540-17
home	neighborhood and			
	residential mixed-			
	use districts			
Hospitality	Urban	10,000 sq. ft.	80 ft.	See Table 540-17
residence	neighborhood and			
	residential mixed-			
	use districts			
Medical Facilities	Residential mixed-	4,000 sq. ft.	None	See Table 540-17
(except as noted	use districts			
below)	All other districts	None	None	See Table 540-17
Hospitals	Residential mixed-	20,000 sq. ft.	None	See Table 540-17
	use districts			
Office	Residential mixed-	4,000 sq. ft.	None	See Table 540-17
	use districts			
	All other districts	None	None	See Table 540-17
Sexually Oriented	All districts	None	None	See Table 540-17
Uses				
INSTITUTIONAL AND	CIVIC	-	1	1
Community	UN1 and UN2	20,000 sq. ft.	None	None
services (except as	Districts			
noted below)	UN3 District or	10,000 sq. ft.	None	None
	residential mixed-			
	use districts	Neve	News	Nava
	All other districts	None	None	None
Cemetery	All districts	80 acres	None	None
Child care center	Urban	4,000 sq. ft.	None	None
	neignbornood and			
	residential mixed-			
		Neze	Nere	Neze
	All other districts	None	None	None

Community center	UN1 and UN2	10,000 sq. ft.	None	None
	UN3 District or	5.000 sq. ft.	None	None
	residential mixed-	-,		
	use districts			
	All other districts	None	None	None
Community garden	All districts	None	None	None
Educational	UN1 and UN2	20,000 sq. ft.	None	None
Facilities (except as	Districts			
noted below)	UN3 District or	10,000 sq. ft.	None	None
	residential mixed-			
	All other districts	None	None	None
College or	All districts	2 acres	None	None
university				
Parks and Public	Urban	20,000 sq. ft.	None	None
Open Spaces	neighborhood and			
	residential mixed-			
	use districts	News	News	News
Bocrostional	All other districts	None	None	None
Facilities	neighborhood and	20,000 sq. m.	None	None
i demetes	residential mixed-			
	use districts			
	All other districts	None	None	None
Social and Cultural	Urban	20,000 sq. ft.	None	None
Assembly (except	neighborhood and			
as noted below)	residential mixed-			
	Use districts	Nono	Nono	Nono
Convent monastery	Lirban	10 000 sq. ft	None	None
or religious retreat	neighborhood and	10,000 34. 11.	None	None
center	residential mixed-			
	use districts			
Religious place of	Urban	10,000 sq. ft.	None	None
assembly	neighborhood and			
	residential mixed-			
PRODUCTION	use districts			
Lower-Impact	Production districts	None	None	None
Production and	All other districts	None	None	See Table 540-17
Processing (except				
as noted below)				
Artist studio	Residential mixed- use districts	10,000 sq. ft.	None	See Table 540-17
Moderate-Impact	Production districts	None	None	None
Production and	All other districts	None	None	See Table 540-17
Processing	Droduction districts	1 2010	Nono	Nono
Production and	All other districts	None	None	
Processing		None	None	See 10018 340-17

Post-Consumer	Production districts	None	None	None
Waste Processing	All other districts	None	None	See Table 540-17
Warehousing and	Production districts	None	None	None
Storage	All other districts	None	None	See Table 540-17
PUBLIC SERVICES	All districts	As determined by	As determined by	As determined by
AND UTILITIES		CUP	CUP	CUP
RESIDENTIAL				
Cluster	Urban	5,000 sq. ft. ¹	40 ft.	As determined by
Developments	neighborhood districts			CUP
	All other districts	5,000 sq. ft.	40 ft.	As determined by CUP
Congregate Living (except as noted below)	All districts	5,000 sq. ft.	None	See Table 540-17
Community correctional facility	All districts	10,000 sq. ft.	None	See Table 540-17
Dormitory	All districts	10,000 sq. ft.	None	See Table 540-17
Emergency shelter	UN1 District	Not less than 750 sq. ft./bed	None	See Table 540-17
	UN2 and RM1 Districts	Not less than 325 sq. ft./bed	None	See Table 540-17
	All other districts	As determined by CUP	None	See Table 540-17
Fraternity or sorority	All districts	5,000 sq. ft.	40 ft.	See Table 540-17
Intentional community	All districts	5,000 sq. ft.	40 ft.	See Table 540-17
Residential hospice	Urban neighborhood and residential mixed- use districts	10,000 sq. ft.	None	See Table 540-17
Single room occupancy	All districts	See Table 540-16	See Table 540-16	See Table 540-17
State credentialed care facility serving six (6) or fewer persons	Urban neighborhood and residential mixed- use districts	5,000 sq. ft.	40 ft.	8,999 sq. ft.
State credentialed care facility serving seven (7) to sixteen (16) persons	All districts	See Table 540-16	See Table 540-16	See Table 540-17
State credentialed care facility serving seventeen (17) or greater persons	All districts	5,000 sq. ft.	40 ft.	See Table 540-17, except board and care home, nursing home, and assisted living uses shall be exempt from maximum lot area requirements

Supportive housing	Urban neighborhood districts and RM1 District	10,000 sq. ft.	40 ft.	See Table 540-17
	All other districts	5,000 sq. ft.	40 ft.	See Table 540-17
Dwellings (as noted b	elow)	1	1	
Single-, two- or three-family dwelling	Urban neighborhood and residential mixed- use districts	5,000 sq. ft.	40 ft.	8,999 sq. ft.
	All other districts	5,000 sq. ft.	None	See Table 540-17
Multiple-family dwelling, four (4) units or more	All districts	See Table 540-16, except where a greater requirement applies in the SH Shoreland Overlay District	See Table 540-16, except where a greater requirement applies in the SH Shoreland Overlay District	See Table 540-17
Common lot development	Urban neighborhood districts	5,000 sq. ft. ¹	40 ft.	See Table 540-17, except the maximum shall be 8,999 sq. ft. when no more than three (3) dwelling units are proposed ¹
	All other districts	5,000 sq. ft.	40 ft.	See Table 540-17, except the maximum shall be 8,999 sq. ft. when no more than three (3) dwelling units are proposed
TRANSPORTATION, V	EHICLE SERVICES, AND	PARKING		
Automobile Services	All districts	14,000 sq. ft.	None	See Table 540-17
Industrial Transportation Services	All districts	12,000 sq. ft.	None	See Table 540-17
Principal Parking (except as noted below)	All districts	5,000 sq. ft.	40 ft.	See Table 540-17
Off-site parking lots serving multiple- family residential uses and congregate living uses	All districts	5,000 sq. ft.	50 ft.	See Table 540-17
Off-site parking lots serving institutional and civic uses	All districts	5,000 sq. ft.	50 ft.	See Table 540-17

Vehicle Fleet-	All districts	12,000 sq. ft.	None	See Table 540-17
Oriented Services				
Vehicle Storage	All districts	12,000 sq. ft.	None	See Table 540-17

¹Or in Interior 1 and Interior 2 built form overlay districts, a minimum lot area per principal structure of the average of the single-, two-, and three-family zoning lots located in whole or in part within three hundred fifty (350) feet, where the average lot area is nine thousand (9,000) square feet or more. Where a greater minimum lot area requirement applies, the maximum lot area requirement per principal structure shall be one hundred thirty (130) percent of said average minimum lot area.

Table 540-16 Minimum Lot Dimension Requirements by Built Form Overlay District

Built Form Overlay District	Minimum Lot Area (Square Feet)	Minimum Lot Width (Feet)
Interior 1	9,000	50
Interior 2	7,500	50
Interior 3	5,000	40
Corridor 3	5,000	40
Corridor 4	5,000	40
Corridor 6	5,000	40
All other built form overlay districts	5,000	40

Table 540-17 Maximum Lot Area Requirements by Built Form Overlay District

Built Form Overlay District	Maximum Lot Area
	(Square Feet)
Interior 1	14,000
Interior 2	14,000
Interior 3	18,000
Corridor 3	28,000
Corridor 4	28,000
Corridor 6	43,560 (one acre)
All other built form overlay districts	None

540.850. Front yard requirements in urban neighborhood and residential mixed-use districts.

(a) *In general*. The minimum front yard requirements for uses located in the urban neighborhood and residential mixed-use districts shall be as set forth in Table 540-18, Minimum Front Yard Requirements in Urban Neighborhood and Residential Mixed-Use Districts, except as otherwise required in this section.

(b) Front yard increased, interior built form overlay districts. The required front yard shall be increased in the interior built form overlay districts where the established front yard of the closest principal building originally designed for residential purposes located on the same block face on either side of the property exceeds the front yard required by the zoning district. In such case, the required front yard shall be not less than such established front yard, provided that where there are principal buildings originally designed for residential purposes on both sides of the property, the required front yard shall be not less than that established by a line joining those parts of both buildings nearest to the front lot line, not including any obstructions allowed by Table 540-22, Permitted Obstructions in Required Yards. In determining an increase in the required front yard, one (1) of the nearest principal residential structures maybe removed from consideration where such structure exceeds the established front yard of any other such building on the same block face by twenty-five
(25) feet or more and there are no fewer than four (4) principal residential structures on the block face, including the proposed structure. In such instance, the next-nearest principal building originally designed for residential purposes shall be incorporated in determining the increased front yard.

- (c) Front yard decreased, in general. The required front yard may be decreased where the established front yard of the majority of the principal structures on the same block face are less than the front yard required by the urban neighborhood or residential mixed-use zoning district, provided the decreased front yard shall not be less than the established front yard of the principal structures on either side of the property. The front yard is established by a line joining those parts of both buildings nearest to the front lot line, not including any obstructions allowed by Table 540-22, Permitted Obstructions in Required Yards or attached garages.
- (d) Front yard decreased in residential mixed-use districts. In addition to section (c) above, the minimum front yard requirement may be eliminated where adjacent to a goods and services corridor in the residential mixed-use districts when the mixed-use commercial and residential floor area ratio premium standards are met provided an unobstructed site triangle of not less than twenty (20) feet from a street or alley intersection is maintained.

Table 540-18 Minimum Front Yard Requirements in Urban Neighborhood and Residential Mixed-Use Districts

Built Form Overlay District	Minimum Front Yard
	(Feet)
Interior 1, Interior 2, Interior 3, Parks	20
Corridor 3, Corridor 4	15
Corridor 6, Transit 10, Transit 15, Transit 20, Transit 30	15, except where fronting on a goods and services corridor in which case the front yard requirement shall be 10

540.860. Corner side yard requirements in urban neighborhood and residential mixed-use districts.

(a) *In general.* The minimum corner side yard requirements for uses located in the urban neighborhood and residential mixed-use districts shall be as set forth in Table 540-19, Minimum Corner Side Yard Requirements in Urban Neighborhood and Residential Mixed-Use Districts, except as otherwise required in this section.

- (b) Corner side yard decreased in residential mixed-use districts. When the mixed-use commercial and residential floor area ratio premium standards are met in the residential mixed-use districts, the corner side yard requirement may be eliminated where adjacent to a goods and services corridor provided an unobstructed site triangle of not less than twenty (20) feet from a street or alley intersection is maintained.
- (c) *Corner side yard decreased, goods and services corridors.* In the BFC6 Corridor 6, BFT10 Transit 10, BFT15 Transit 15, BFT20 Transit 20, and BFT30 Transit 30 Built Form Overlay Districts, the corner side requirement may be reduced to ten (10) feet where fronting on a goods and services corridor.

Table 540-19 Minimum Corner Side Yard Requirements in Urban Neighborhood and Residential Mixed-Use Districts

Building Height*	Minimum Corner Side Yard
(Feet)	(Feet)
Less than 42	8
42-52.99	10
53—63.99	12
64—74.99	14
75 or greater	15

*Not including authorized height exemptions in Article V, Height of Principal Buildings.

540.870. Interior side and rear yard requirements in urban neighborhood and residential mixed-use districts.

(a) *In general.* The minimum interior side and rear yard requirements for uses located in the urban neighborhood and residential mixed-use districts shall be as set forth in Table 540-20, Minimum Interior Side and Rear Yard Requirements In the Urban Neighborhood and Residential Mixed-Use Districts, except as otherwise required in this section.

- (b) Interior side yard increased. Increased interior side yard requirements shall be provided in the urban neighborhood and residential mixed-use districts in the following circumstances:
 - (1) When the length of a building along an interior side property line exceeds seventy-five (75) percent of the depth of the lot, the required interior side yard shall be increased by an additional two (2) feet.
 - (2) Where a side lot line in the BFC6 Corridor 6 Built Form Overlay District or any transit built form overlay district abuts a side lot line in an BFI1 Interior 1 or BFI2 Interior 2 Built Form Overlay District, the required interior side yard shall be increased by an additional five (5) feet for any building sixty-four (64) feet or taller in height.
 - (3) The minimum width of interior side yards for residential uses with a principal entrance facing the interior lot line, shall be not less than fifteen (15) feet, unless a greater width is required by the regulations governing interior side yards in the district in which the structure is located. The increased interior side yard requirement shall not apply to the following:
 - a. Converting a single-family dwelling to a two- or three-family dwelling, or converting a twofamily dwelling to a three-family dwelling, where a side-facing entrance existing on the effective date of this ordinance becomes a principal entrance.
 - b. Subdividing a property in a manner that that would result in less than a fifteen (15) foot side yard adjacent to a side-facing entrance existing on the effective date of this ordinance.
- (c) Institutional and civic uses. In the BFI1 Interior 1 and BFI2 Interior 2 Built Form Overlay Districts, the minimum interior side yard requirement for institutional and civic uses exceeding twenty-eight (28) feet in height shall be seven (7) feet.

Building Height*	Minimum Interior Side and Rear Yard
(Feet)	(Feet)
Less than 42	5
42-52.99	7
53—63.99	9
64—74.99	11
75—85.99	13
86—96.99	15
97—107.99	17
108—119.99	19
120 or greater	20

Table 540-20 Minimum Interior Side and Rear Yard RequirementsIn the Urban Neighborhood and Residential Mixed-Use Districts

*Not including authorized height exemptions in Article V, Height of Principal Buildings.

540.910. Maximum lot coverage.

Maximum lot coverage requirements shall be as set forth in Table 540-23, Maximum Lot Coverage by District.

Built Form Overlay District	Urban Neighborhood and Residential Mixed-Use Districts Maximum Lot Coverage	Commercial Mixed-Use, Downtown, Production, and Transportation Districts Maximum
	(Percent)	Lot Coverage (Percent)
Parks	45	45
Interior 1 Interior 2	45	100
Interior 3 Corridor 3	60	100
Corridor 4 Corridor 6	70	100
Transit 10 Transit 15 Transit 20 Transit 30	80	100
Core 50	100	100
Production	100	100

Table 540-23 Maximum Lot Coverage	hv	District
Table 340-23 Maximum Lot Coverage	ъy	District

540.920. Maximum impervious surface coverage.

(a) *In general.* Maximum impervious surface coverage requirements shall be as set forth in Table 540-24, Maximum Impervious Surface Coverage by District.

- (b) *Exception.* Impervious surfaces shall not cover more than sixty-five (65) percent of any zoning lot with less than six thousand (6,000) square feet of lot area and no access to a public alley or a second street frontage, provided one (1) the following conditions are met:
 - (1) The zoning lot is in the BFPA Parks Built Form Built Form Overlay District.
 - (2) The zoning lot is in the BFI1 Interior 1 or BFI2 Interior 2 Built Form Overlay District and an urban neighborhood and residential mixed-use district.

Built Form	Urban Neighborhood and	Commercial Mixed-Use,
Overlay District	Residential Mixed-Use Districts	Downtown, Production and
	Maximum Impervious Surface	Transportation Districts Maximum
	Coverage	Impervious Surface Coverage
	(Percent)	(Percent)
Parks	60	60
Interior 1	60	100
Interior 2		

Table 540-24 Maximum Impervious Surface Coverage by District

Interior 3	75	100
Corridor 3		
Corridor 4	85	100
Corridor 6		
Transit 10	90	100
Transit 15		
Transit 20		
Transit 30		
Core 50	100	100
Production	100	100

555.220. Vehicle parking requirements.

(a) *In general*. Accessory, off-street parking shall be limited for principal uses as specified in Table 555-1, Specific Maximum Off-Street Parking Requirements, except as otherwise specified in this zoning ordinance.

(b) *Tandem spaces.* Tandem parking spaces provided for residential uses shall be subject to applicable maximum parking requirements.

Use	Maximum Parking Allowed, Generally	Maximum Parking Allowed in Transit 10, Transit 15, and Transit 20 Built Form Overlay Districts	Maximum Parking Allowed in Transit 30 and Core 50 Built Form Overlay Districts
Maximum parking allowed,	in general. Uses subject to a	maximum parking requireme	ent may provide parking up
be restricted to fewer than	ten (10) total accessory park	ing spaces on a zoning lot	
Bulk Goods and Heavy Equipment Sales (except as noted below)	1 space per 200 sq. ft. of GFA + 1 space per 1,000 sq. ft. of outdoor sales, display, or storage area	1 space per 1,000 sq. ft. of GFA	1 space per 1,500 sq. ft. of GFA
Building material sales	1 space per 200 sq. ft. of GFA + 1 space per 500 sq. ft. outdoor sales or display area	1 space per 500 sq. ft. of GFA	1 space per 500 sq. ft. of GFA
Commercial Agriculture (except as noted below)	1 space per 200 sq. ft. of GFA + 1 space per 500 sq. ft. outdoor sales or display area	1 space per 500 sq. ft. of GFA	1 space per 500 sq. ft. of GFA
Market garden	1 space per 2,500 sq. ft. of growing or storage area or as determined by Chapter 545, Use Regulations	1 space per 500 sq. ft. of GFA	1 space per 500 sq. ft. of GFA
Urban farm	1 space per 200 sq. ft. of GFA of office, sales, or display area + 1 space per	1 space per 1,000 sq. ft. of GFA	1 space per 1,500 sq. ft. of GFA

Table 555-1 Specific Maximum Off-Street Parking Requirements

	2,500 sq. ft. of growing or		
Commercial Recreation	1 space per 300 sq ft of	1 space per 600 sq. ft. of	1 space per 1 000 sg. ft
and Assembly (except as	GFA	GFA	of GEA
noted below)	GIA	GIA	
Amphitheater	As approved by CUP	As approved by CUP	As approved by CUP
Convention center, public	As determined by the	1 space per 600 sq. ft. of	1 space per 1.000 sq. ft.
	zoning administrator	GFA	of GFA
Entertainment venue	1 space per 75 sq. ft. of GFA	1 space per 200 sq. ft. of GFA	1 space per 300 sq. ft. of GFA
Nightclub	1 space per 75 sq. ft. of GFA	1 space per 200 sq. ft. of GFA	1 space per 300 sq. ft. of GFA
Food and Beverages	1 space per 75 sq. ft. of	1 space per 200 sq. ft. of	1 space per 300 sq. ft. of
(except as noted below)	GFA	GFA	GFA
Catering	1 space per 200 sq. ft. of GFA	1 space per 200 sq. ft. of GFA	1 space per 300 sq. ft. of GFA
Liquor store, off-sale	1 space per 200 sq. ft. of GFA	1 space per 200 sq. ft. of GFA	1 space per 300 sq. ft. of GFA
General Retail Sales and	1 space per 300 sq. ft. of	1 space per 500 sq. ft. of	1 space per 500 sq. ft. of
Services (except as noted	GFA	GFA	GFA
below)			
Dry cleaning	1 space per 200 sq. ft. of GFA	1 space per 1,000 sq. ft. of GFA	1 space per 1,500 sq. ft. of GFA
Funeral home	20 spaces per chapel	1 space per 500 sq. ft. of GFA	1 space per 500 sq. ft. of GFA
Grocery store	1 space per 300 sq. ft. of GFA	1 space per 300 sq. ft. of GFA	1 space per 300 sq. ft. of GFA
Post office	1 space per 200 sq. ft. + 1 space per official postal vehicle based on the maximum number of such vehicles at the site at one time	1 space per 500 sq. ft. of GFA	1 space per 1,000 sq. ft. of GFA
High-Impact Commercial	1 space per 300 sq. ft. of GFA	1 space per 500 sq. ft. of GFA	1 space per 500 sq. ft. of GFA
Lodging (except as noted below)	1 space per guest room + Parking equal to 30% of the capacity of persons for affiliated uses such as dining or meeting rooms	1 space per guest room + Parking equal to 30% of the capacity of persons for affiliated uses such as dining or meeting rooms	1 space per guest room + Parking equal to 30% of the capacity of persons for affiliated uses such as dining or meeting rooms
Bed and breakfast home	1 space per guest room + 1 space for the primary dwelling unit	1 space per guest room + 1 space for the primary dwelling unit	1 space per guest room + 1 space for the primary dwelling unit
Hospitality residence	1 space per bed	1 space per bed	1 space per bed
Medical Facilities (except	1 space per 300 sg. ft. of	1 space per 600 sg. ft. of	1 space per 1,000 sg. ft.
as noted below)	GFA	GFA	of GFA
Hospital	As approved by CUP based on a parking study of the institution, but not more than 1 space per 2 beds	1 space per 600 sq. ft. of GFA	1 space per 1,000 sq. ft. of GFA

Office (except as noted	1 space per 300 sq. ft. of	1 space per 600 sq. ft. of	1 space per 1,000 sq. ft.		
below)	GFA	GFA	of GFA		
Contractor's office	1 space per 300 sq. ft. of GFA	1 space per 500 sq. ft. of GFA	1 space per 500 sq. ft. of GFA		
Sexually Oriented Uses	1 space per 300 sq. ft. of GFA	1 space per 500 sq. ft. of GFA	1 space per 500 sq. ft. of GFA		
INSTITUTIONAL AND CIVIC	USES				
Community Services	1 space per 300 sq. ft. of	1 space per 600 sq. ft. of	1 space per 1,000 sq. ft.		
(except as noted below)	GFA	GFA	of GFA		
Cemetery	As approved by CUP	As approved by CUP	As approved by CUP		
Child care center	1 space per 200 sq. ft. of GFA + up to 4 drop off spaces	1 space per 500 sq. ft. of GFA	1 space per 500 sq. ft. of GFA		
Community center	As determined by the zoning administrator based on the principal uses in the community center	1 space per 600 sq. ft. of GFA	1 space per 1,000 sq. ft. of GFA		
Educational Facilities	1 space per 300 sq. ft. of	1 space per 600 sq. ft. of	1 space per 1,000 sq. ft.		
(except as noted below)	GFA	GFA	of GFA		
College or university	1 space per 1,000 sq. ft. of GFA	1 space per 1,000 sq. ft. of GFA	1 space per 1,000 sq. ft. of GFA		
School, grades K-12	1 space per 1,000 sq. ft. of GFA	1 space per 1,000 sq. ft. of GFA	1 space per 1,000 sq. ft. of GFA		
School, vocational or business	1 space per 1,000 sq. ft. of GFA	1 space per 1,000 sq. ft. of GFA	1 space per 1,000 sq. ft. of GFA		
Parks and Public Open	As approved by CUP	As approved by CUP	As approved by CUP		
Spaces	where the use requires a	where the use requires a	where the use requires a		
	CUP otherwise, as	CUP otherwise, as	CUP otherwise, as		
	determined by the zoning	determined by the zoning	determined by the zoning		
	administrator.	administrator.	administrator.		
Recreational Facilities	1 space per 300 sq. ft. of	1 space per 600 sq. ft. of	1 space per 1,000 sq. ft.		
(except as noted below)	GFA As approved by CUD	GFA As approved by CUD	OT GFA		
Athletic field	As approved by COP where the use requires a CUP otherwise, as determined by the zoning administrator.	As approved by COP where the use requires a CUP otherwise, as determined by the zoning administrator.	As approved by COP where the use requires a CUP otherwise, as determined by the zoning administrator.		
Social and Cultural Assembly (except as noted below)	1 space per 300 sq. ft. of GFA	1 space per 600 sq. ft. of GFA	1 space per 1,000 sq. ft. of GFA		
Convent, monastery, or	1 space per bed	1 space per bed	1 space per bed		
religious retreat center					
PRODUCTION AND PROCES	PRODUCTION AND PROCESSING USES				
Lower-Impact Production	1 space per 200 sq. ft. of	1 space per 1,000 sq. ft.	1 space per 1,500 sq. ft.		
and Processing (except	GFA up to 20,000 sq. ft. +	of GFA	of GFA		
as noted below)	1 space per 1,000 sq. ft.				
	of GFA in excess of				
D	20,000 sq. tt.	4 202 5 5	4 200 5 5		
Brewery or distillery	1 space per /5 sq. tt. of	1 per 200 sq. tt. of	1 per 300 sq. tt. of		
	taproom, tasting room, or	taproom, tasting room, or	taproom, tasting room, or		

Limited production and processing	restaurant area, 1 per 200 sq. ft. of production, processing, shipping, and warehousing area up to 20,000 sq. ft., 1 per 1,000 sq. ft. of production, processing, shipping, and warehousing area in excess of 20,000 sq. ft. 1 space per 200 sq. ft. of GFA up to 4,000 sq. ft. + 1 space per 500 sq. ft. of GFA from 4,000 sq. ft. to 20,000 sq. ft. + 1 space	dining area, 1 per 1,000 sq. ft. of production, processing, shipping, or warehousing area 1 space per 1,000 sq. ft. of GFA	dining area, 1 per 1,500 sq. ft. of production, processing, shipping, or warehousing area 1 space per 1,500 sq. ft. of GFA
	per 1,000 sq. ft. of GFA in		
Moderate-Impact Production and Processing (except as noted below)	excess of 20,000 sq. ft. 1 space per 200 sq. ft. of GFA up to 20,000 sq. ft. + 1 space per 1,000 sq. ft. of GFA in excess of 20,000 sq. ft. + 1 space per 2,500 sq. ft. of outdoor sales, display, or storage area	1 space per 1,000 sq. ft. of GFA	1 space per 1,500 sq. ft. of GFA
High-Impact Production and Processing (except as noted below)	1 space per 200 sq. ft. of GFA up to 20,000 sq. ft. + 1 space per 1,000 sq. ft. of GFA in excess of 20,000 sq. ft. + 1 space per 2,500 sq. ft. of outdoor sales, display, or storage area	1 space per 1,000 sq. ft. of GFA	1 space per 1,500 sq. ft. of GFA
Crushing and processing for recycling or disposal of concrete, asphalt, and	As approved by CUP	1 space per 1,000 sq. ft. of GFA	1 space per 1,500 sq. ft. of GFA
Grain elevator or mill	As approved by CLIP	1 space per 1 000 sq. ft	1 space per 1 500 cg. ft
		of GFA	of GFA
Post-Consumer Waste Proc	cessing (as noted below)	·	·
Recycling facility	As approved by CUP, but not more than 1 space per 200 sq. ft. of GFA up to 20,000 sq. ft. + 1 space per 1,000 sq. ft. of GFA in excess of 20,000 sq. ft.	1 space per 1,000 sq. ft. of GFA	1 space per 1,500 sq. ft. of GFA
Waste transfer facility	As approved by CUP	As approved by CUP	As approved by CUP
Warehousing and Storage (except as noted below)	1 space per 200 sq. ft. of GFA of office, sales, or display area + 1 space per 1,500 sq. ft. of GFA of warehousing up to 30,000 sq. ft. + 1 space	1 space per 1,500 sq. ft. of GFA of warehousing up to 30,000 sq. ft. + 1 space per 2,500 sq. ft. GFA of warehousing over 30,000 sq. ft.	1 space per 1,500 sq. ft. of GFA of warehousing up to 30,000 sq. ft. + 1 space per 5,000 sq. ft. GFA of warehousing over 30,000 sq. ft.

	per 2,500 sq. ft. GFA of		
	warehousing over 30,000		
	sq. ft. or for any outdoor		
	storage, sales, or display		
Snow storage site	As approved by CUP	As approved by CUP	As approved by CUP
PUBLIC SERVICES AND UTIL	LITIES USES		
Basic Utilities	As approved by CUP	1 space per 500 sq. ft. of GFA	1 space per 1,000 sq. ft. of GFA
Principal Electric	As approved by CUP, but	1 space per 500 sq. ft. of	1 space per 1,000 sq. ft.
Generation	not more than 1 space	GFA	of GFA
	per 200 sq. ft. of GFA up		
	to 20,000 sq. ft. + 1 space		
	per 1,000 sq. ft. of GFA in		
	excess of 20,000 sq. ft.		
Public Safety and	As approved by CUP	1 space per 500 sq. ft. of	1 space per 1,000 sq. ft.
Welfare (except as noted		GFA	of GFA
Delow)	1	1	1
Animal shelter	GFA	GFA	of GFA
Pre-trial detention	1 space per 200 sq. ft. of	1 space per 500 sq. ft. of	1 space per 1,000 sq. ft.
facility, existing on the	GFA	GFA	of GFA
effective date of this			
ordinance			
Cluster Development	As approved by CUP	As approved by CUP	As approved by CUP
Congregate Living (except as noted below)	1 space per bed	1 space per bed	1 space per bed
Intentional community	2 spaces per dwelling or	1.5 spaces per dwelling or	1.5 spaces per dwelling or
	rooming unit	rooming unit	rooming unit
Overnight shelter	As approved by CUP	As approved by CUP	As approved by CUP
	where the use requires a	where the use requires a	where the use requires a
	CUP otherwise, as	CUP otherwise, as	CUP otherwise, as
	determined by the zoning	determined by the zoning	determined by the zoning
Circle and a second second	administrator.	administrator.	administrator.
Single room occupancy	1 space per 2 rooming	1 space per 2 rooming	1 space per 2 rooming
Dwellings (as noted below		units	units
Single- two- or three-	No maximum excent as	No maximum except as	No maximum excent as
family dwelling	regulated by Article VIII	regulated by Article VIII	regulated by Article VIII
idinity dwelling	Special Parking Provisions	Special Parking Provisions	Special Parking Provisions
	for Specific Zoning	for Specific Zoning	for Specific Zoning
	Districts	Districts	Districts
One (1) to three (3)	2 spaces per dwelling unit	1.5 spaces per dwelling	1.5 spaces per dwelling
dwelling units, as part of	or rooming unit	unit or rooming unit	unit or rooming unit
a mixed-use building	-	-	-
Multiple-family dwelling,	2 spaces per dwelling unit	1.5 spaces per dwelling	1.5 spaces per dwelling
four (4) units or more	or rooming unit	unit or rooming unit	unit or rooming unit
Common lot	2 spaces per dwelling unit	1.5 spaces per dwelling	1.5 spaces per dwelling
development	or rooming unit	unit or rooming unit	unit or rooming unit
TRANSPORTATION, VEHICI	E SERVICES, AND PARKING L	JSES	

Automobile Services (except as noted below)	1 space per 300 sq. ft. of GFA + 2 spaces per	1 space per 300 sq. ft. of GFA + 2 spaces per	1 space per 300 sq. ft. of GFA + 2 spaces per
	service bay or 2 spaces	service bay or 2 spaces	service bay or 2 spaces
	per 20 ft. of washing line	per 20 ft. of washing line	per 20 ft. of washing line
Industrial Transportation	1 space per 200 sq. ft. of	1 space per 500 sq. ft. of	1 space per 1,000 sq. ft.
Services (except as noted	GFA	GFA	of GFA
below)			-
Railroad switching yards	As approved by CUP	1 space per 500 sq. ft. of	1 space per 1,000 sq. ft.
and freight terminals		GFA	of GFA
Vehicle Fleet-Oriented	1 space per 200 sq. ft. of	1 space per 500 sq. ft. of	1 space per 1,000 sq. ft.
Services (except as noted	GFA	GFA	of GFA
below)		-	-
Courier and package delivery services with on-	1 space per 200 sq. ft. of GFA of office. sales. or	1 space per 1,000 sq. ft. of GFA of warehousing up	1 space per 1,000 sq. ft. of GFA of warehousing up
site vehicle fleets	display area + 1 space per	to 30,000 sq. ft. + 1 space	to 30,000 sq. ft. + 1 space
	1,000 sq. ft. of GFA of	per 2,500 sq. ft. GFA of	per 5,000 sq. ft. GFA of
	warehousing up to	warehousing over 30,000	warehousing over 30,000
	30,000 sq. ft. + 1 space	sq. ft.	sq. ft.
	per 2,500 sq. ft. GFA of		
	warehousing over 30,000		
	sq. ft. or for any outdoor		
	storage, sales, or display		
Rental of trucks, trailers,	1 space per 200 sq. ft. of	1 space per 500 sq. ft. of	1 space per 1,000 sq. ft.
boats, and recreational	GFA + 1 space per 1,000	GFA	of GFA
vehicles	sq. ft. of outdoor sales,		
	display or storage area		4 000 6
Taxicab services	1 space per 200 sq. ft. of GFA excluding service	1 space per 500 sq. ft. of GFA	1 space per 1,000 sq. ft. of GFA
	bays + 1 space per service		
	bays		
Vehicle Storage (except	1 space per 200 sq. ft. of	1 space per 500 sq. ft. of	1 space per 1,000 sq. ft.
as noted below)	GFA	GFA	of GFA
Public impound lot	As approved by CUP	As approved by CUP	As approved by CUP
Towing services	1 space per 200 sq. ft. of	1 space per 500 sq. ft. of	1 space per 1,000 sq. ft.
	GFA + 1 space per 2,000	GFA	of GFA
	sq. ft. of motor vehicle		
1	storage area	1	

555.230. Bicycle parking requirements.

(a) *In general*. Bicycle parking shall be provided for principal uses as specified in Table 555-2, Bicycle Parking Requirements, except as otherwise specified in this zoning ordinance. The numbers specified in the "Notes" column shall have the following meanings:

- (1) The number one (1) shall mean that not less than fifty (50) percent of the required bicycle parking shall meet the standards for short-term bicycle parking.
- (2) The number two (2) shall mean that not less than fifty (50) percent of the required bicycle parking shall meet the standards for long-term bicycle parking, and not less than five (5) percent of the required bicycle parking shall meet the standards for short-term parking.
- (3) The number three (3) shall mean that not less than ninety (90) percent of the required bicycle parking shall meet the standards for long-term bicycle parking.

- (b) *Bicycle parking standards.* Each required bicycle parking space must meet the following standards:
 - (1) Bicycle parking spaces must be accessible without moving another bicycle and its placement shall not result in a bicycle obstructing a required walkway.
 - (2) Bicycle racks shall be installed to the manufacturer's recommended specifications, including the recommended distance from obstructions. Accommodation of varied bicycle sizes and styles, including electric bicycles and cargo bicycles, is encouraged through provision of racks installed with greater clearance from obstructions, walkways, and other bicycle parking spaces.
 - (3) Bicycle parking spaces shall include a bicycle rack that permits the locking of the bicycle frame and one (1) wheel to the rack, and that supports the bicycle in a stable position without damage to wheels, frame or components.
 - (4) No more than seventy-five (75) percent of required bicycle parking spaces may be provided in wall mounted racks that require the user to lift a bicycle into place.
 - (5) Required short-term bicycle parking spaces shall be located in a convenient and visible area within fifty (50) feet of a principal entrance. With the permission of the city engineer, required bicycle parking may be located in the public right-of-way. Public bicycle parking spaces may contribute to compliance with required bicycle parking when located adjacent to the property in question.
 - (6) Required long-term bicycle parking spaces shall be located in enclosed and secured or supervised areas providing protection from theft, vandalism and weather and shall be accessible to intended users. Required long-term bicycle parking for residential uses shall not be located within dwelling units or within deck or patio areas accessory to dwelling units. Not less than fifty (50) percent of required long-term spaces shall be accessible without requiring the use of stairs or an elevator. Residential bicycle rooms shall include access to electricity. With permission of the zoning administrator, long-term bicycle parking spaces for nonresidential uses may be located off-site within three hundred (300) feet of the site.

Use	Minimum Bicycle Parking	Notes	
	Requirement	(see 555.230)	
Minimum bicycle parking requirement	nt, in general. Nonresidential uses havi	ng one thousand (1,000) sq. ft. or	
less shall be exempt from minimum l	picycle parking requirements. Multiple-	tenant or multiple-use buildings	
may exempt no more than four (4) u	ses of one thousand (1,000) sq. ft. or le	ess from the minimum off-street	
bicycle parking requirement.			
COMMERCIAL USES	All commercial uses having one thousand (1,000) sq. ft. or more shall		
	provide three (3) short-term spaces of	or the amount listed below,	
	whichever is greater.		
Farmer's market	1 space per 2,000 sq. ft. of sales	1	
	area, except where approved as a		
	temporary use		
General retail sales and services	1 space per 5,000 sq. ft. of GFA	1	
(except as otherwise noted in this			
table)			
Grocery store	1 space per 2,000 sq. ft. of GFA	1	
Hospital	As approved by CUP	2	
Medication-assisted treatment site	1 space per 10 beds	2	
Office	1 space per 4,000 sq. ft. of GFA	2	

Table 555-2 Bicycle Parking Requirements

Performing, visual or martial arts school	1 space per 1,000 sq. ft. of GFA	1
Post office	3 spaces	1
Sports and health facility	1 space per 10,000 sq. ft. of GFA	1
Urban farm	3 spaces 1	
INSTITUTIONAL AND CIVIC USES	All Institutional and Civic uses having	one thousand (1,000) sq. ft. or more
	shall provide three (3) short-term spa	aces or the amount listed below,
	whichever is greater	
Colleges and universities	3 spaces per classroom	1
Community center	6 spaces, or 1 space per 2,000 sq.	1
	ft. of GFA, whichever is greater	
Community service facility	1 space per 5,000 sq. ft. of GFA	1
Convention center	1 space per 50,000 sq. ft. of GFA	1
Library	1 space per 5,000 sq. ft. of GFA	1
Museum	1 space per 10,000 sq. ft. of GFA	2
Regional sports arena	1 space per 5,000 sq. ft. of GFA	1
School, grades K—12	3 spaces per classroom	1
School, vocational or business	3 spaces per classroom	1
Theater, indoor, provided live	3 spaces, 1 space per 2,000 sq. ft.	2
performances only	of GFA, whichever is greater	
PRODUCTION USES	No requirement unless otherwise no	ted below.
Limited production and processing	3 spaces	2
Lower-impact production and	2 spaces or 1 space per 20,000 sq.	2
processing	ft. of GFA, whichever is greater,	
	excluding GFA devoted to bulk	
	storage of materials	
Moderate-impact production and	2 spaces or 1 space per 30,000 sq.	2
processing	ft. of GFA, whichever is greater,	
	excluding GFA devoted to bulk	
Warehousing and storage	2 spaces or 1 space per 40,000 sq	2
warenousing and storage	ft of GEA whichever is greater	2
	excluding GFA devoted to bulk	
	storage of materials	
PUBLIC SERVICES AND UTILITIES	No requirement unless otherwise no	ted below.
USES		
Passenger transit station	As approved by CUP	1
RESIDENTIAL USES		
Single-, two-, and three-family	None	N/A
dwellings		
Multiple-family dwelling, 4 units or	1 space per dwelling unit	3
more		
Congregate living	1 space per 4 beds provided the	3
	requirement shall not exceed 8	
	spaces	
Common lot and cluster	1 space per dwelling unit	3
developments, 4 units or more		
TRANSPORTATION, VEHICLE	No requirement.	
SERVICES, AND PARKING USES		

APPENDIX C: Answers to Select Activities

Activity C: Site Selection Research

	Answer	Question	Suggested Source
1	\$3,675,000 and \$57,198.24 (2024 payable)	What is the assessed market value and annual taxes for 1719 Franklin Ave W in Minneapolis?	Hennepin County
2	22-028-24-12-0002	What is the Property ID (PID) for the Russian Museum (5500 Stevens Avenue S) in Minneapolis?	Hennepin County
3	YHD Foods Inc	Who is the taxpayer for the McDonald's at the NE corner of Lake St E and 31st Ave S in Minneapolis (Longfellow neighborhood)?	Hennepin County
4	112,335 SF	What is the lot size for the Bakken Museum (3537 Zenith Ave S, Minneapolis) in square feet?	Hennepin County
5	Sold 6/2022 for \$205,000	Find the property immediately to the west of 1850 38th St E, Minneapolis. When was it last sold and what was the purchase price?	Hennepin County
6	66.4%	In the Phillips neighborhood, what percentage of occupied housing is occupied by renters?	MN Compass
7	\$ 1,256	What is the median monthly rent paid in the Whittier neighborhood?	MN Compass
8	\$ 1,661,500	What was the Total Estimated Market Value for 3100 Excelsior #102 in 2020?	City of Mpls / Prop InfoValuation History
9	BFT15 and PR2 with SH and UA overlays	In what zoning district(s) is the Surly Brewery (520 Malcolm Ave SE, Minneapolis)?	City of Mpls / Prop InfoLot Info
10	Increased from 163,540 to 187,670	How has the total number of households in Minneapolis changed betweent 2010 and 2020?	MetCouncil
11	\$71,004 (2022 Dollars)	What is the Median Household Income in the Seward Neighborhood?	MN Compass
12	Will depend on time search is done	Based on TheMLSOnline results, how many multifamily buildings are listed for sale in Minneapolis for \$500,000 or less?	TheMLSonline
13	MN: 19,100 AADT (2019); Mpls: 17,636 (2015)	What is the most recent traffic count on W Lake St between Nicollet Ave and Blaisdell Ave?	MnDot
14	Decrease. 17,387 AADT in 2012 to 15,422 in 2016	Between 2012 and 2016, did traffic on Cedar Ave S, between E 24th and E 25th Street, increase or decrease?	Mpls traffic
15	Will depend on time search is done	Based on LoopNet results, how many industrial or office buildings smaller than 20,000 square feet are listed for sale in Minneapolis?	LoopNet
16	Will depend on time search is done	Based on a MNCar search, how many buildings are for sale in Minneapolis that sit on 0.25 to 0.50 acres?	MNCar

Activity D: Zoning Research

Property	3801 17th Ave S , Minneapolis		
Filiperty	SE corner of East 38th St and 17th Ave S		
Planned Use	Multi-Family Apartment building	g (4+ dwelling units)	
	Site Detail	Source	
Zoning Classification	BFC4 / RM1	City of Mpls Property Info (Lot Info)	
Lot size	0.26 acres; 11,310 SF	Hennepin County Property Information Search	
Lot dimensions	92.30 ft x 122.40 ft	Hennepin County Property Information Search	
	Zoning Requirement	Source	
	(min & max)	Minneapolis Zoning Code (Section & Table)	
EAR (max_min)	max = 2.0, so 22,620 SF	Section 540.110, Table 540-2	
	min=none	Section 540.130, Table 540-4	
Height Limits (may min)	max=Lesser of 4 stories or 56ft	Section 540.410, Table 540-6	
	min=none	Section 540.420, Table 540-8	
Lot Area (max_min)	max = 28,000 SF	Section 540.720, Table 540-15 and Table 540-17	
	min = 5,000 SF	Section 540.720, Table 540-15 and Table 540-16	
Lot Width (min)	min = 40 ft	Section 540.720, Table 540-15 and Table 540-16	
Yard (Setback) - Front (min)	15 ft	Section 540.850, Table 540-18	
Yard (Setback) - Corner (min)	8ft if <42ft (height) 10ft if < 53ft 12ft if < 64ft etc.	Section 540.860, Table 540-19	
Yard (Setback) - Rear/Side (min)	5ft if <42ft (height) 7ft if < 53ft 9ft if < 64ft etc.	Section 540.870, Table 540-20	
Maximum Lot Coverage (max)	70%; so max coverage = 7,917 SF	Section 540.910, Table 540-23	
Impervious Surface Coverage (max)	85%; so max coverage = 9,614 SF	Section 540.920, Table 540-24	
Vehicle Parking (max)	Max = 2 per Dwelling Unit Min = None	Section 555.220, Table 555-1	
Bicycle Parking (min)	Min = 1 per Dwelling Unit	Section 555.230, Table 555-2	

Activity E: Buildable Area Analysis

Answers will vary depending on individual design and assumptions. The following is a potential solution.

ZONING REQUIREMENTS AND DESIGN		
Address	3801 17TH AVE S	
Primary Zoning District	RM1	Residence Goods and Services
		(mainly small to moderate-scale residential)
Built Form District	BFC4	Corridor 4
Overlay District	None	
Lot Width (Ft)	92.3	
Lot Depth (Ft)	122.4	
Lot Size (SF)	11,310	
Min Lot Area (SF)	5,000	
Max Lot Area (SF)	28,000	
Min Lot Width (Ft)	40	
1 Sotback Front (ft)	15	
1 Setback Front (It) Setback Boar/Side (ft)		If huilding height under 42': more if higher
Corpor Sido (ft)		If building height under 42', more if higher
Puildable Width (Et)	0 70 2	Lot Width Sido Corpor Sotbacks
Buildable Width (Ft)	102.4	Lot Width - Side, Comer Setbacks
Buildable Area (SE)	9 1 2 0	Lot Deptil - Floht & Real SetDacks
Buildable Area (SF)	8,120	
2 FAR (max)	2.0	
FAR Max Bldg Size (GSF)	22,620	
3 Average unit size (RSE)	750	
Average unit size (GSE) (110% of RSE)	825	
Average unit size (651) (110/001 (51)	025	
4 Max Height	Min of 4 flrs or 56ft	
Floors	4	Assume floor height=10.5'; Building total = 42'
Units per floor	5	
Units	20	
Building Size (RSF)	15,000	750 RSF per unit x 20 units
Building Size (GSF)	16,500	825 GSF per unit x 20 units
E Pldg Ecotorint (CSE)	/ 175	
	4,125	
6 Lot Coverage %	70%)
Max Lot Coverage (SF)	7,917	Max Lot Coverage % x Lot Area
7 Parking Ratio (Stalls per Unit)	0.75	
Parking stalls	15	
Parking Size (SF)	5,250	Est. 350 SF/stall, including circulation
8 Impervious %	85%	
Max Impervious (SF)	9,614	Max Impervious % x Lot Area
Planned Impervious (SF)	9,375	Building Footprint + Parking

Activity F: Develop & Sell Financial Feasibility

PROPERTY DETAILS		
Unit 1 SF	1,770	
Unit 2 SF	1,770	
Total SF	3,540	
USES	\$	
Acquisition Cost	115,000	given
Hard Costs	672,600	\$190 x Total SF
Soft Costs - Design	47,000	given
Soft Costs - Debt Service during Development	56,250	calculated below
Soft Costs - Other (Investigations, Fees, Carrying)	13,000	given
TOTAL USES: Total Development Cost (TDC)	903,850	sum of all uses
DEBT SERVICE		
Loan Amount	625,000	given (~70% LTC)
Loan Constant	7.20%	given (7.2% I/O)
Debt Service (annual)	45,000	LC x Loan Amount
Debt Service (monthly)	3,750	DS (annual) / 12
Development Period (months)	15.0	given
Debt Service During Construction	56,250	15 months x DS (monthly)
SOURCES		
Debt	625,000	Loan Amount
Equity Investment	278,850	TDC - Debt
TOTAL SOURCES (Total Investment)	903,850	Debt + Equity
DEVELOPER PROFIT FROM SALE		
Sale Price per Unit	495,000	given
Number of Units	2	given
Total Sale Price	990,000	Price per Unit x 2
less Cost of Sale	(59,400)	6% of Sale Price
Investment Returned from Sale	930,600	Total Sale Price - Cost of Sale
less Loan Payoff	625,000	Loan Amount (not paid down since I/O)
Equity Returned from Sale	305,600	Profit from Sale - Loan Payoff
Investment Return (Profit after Sale)	26,750	Investment Rtd from Sale - Total Investmen
Equity Return (Profit after Loan Payoff)	26,750	Equity Rtd from Sale - Equity Investment
DEVELOPER PROFITABILITY		
Return on Investment (ROI)	3.0%	Investment Return / Total Investment
Return on Cash (Equity)	9.6%	Equity Return / Equity Investment
Equity Multiplier	1.10	Equity Returned from Sale / Equity Investme

Activity G: Single Year Financial Feasibility

Number of Units		Per design
Rent (\$ Monthly per unit)	1 950	Financial Input
Rent (\$, Monthly per RSE)	2.60	Monthly rent per unit / Unit RSF
Rent (S. Annual)	468.000	Monthly rent per unit x 12 x # of units
Expense Reimbursement	-	None in residential (Gross leases)
Potential Gross Income (PGI)	468,000	Annual Rent + Expense Reimbursement
Vacancy Factor	(23,400)	Assume 5% (5% x PGI)
Effective Gross Income (EGI)	444,600	PGI less Vacancy Factor
Operating Expense	(153,000)	\$0.85/RSF x 12 months x 15,000 RSF
Leasing & Capital Costs	(5,000)	\$250/unit x 20 units
Net Operating Income (NOI)	286,600	EGI - Operating Expense - Leasing & Capital Costs
Debt Service	(186,676)	See below
Cash Flow after Financing (CFAF)	99,924	NOI - Debt Service
INVESTMENT COST		
Acquisition Cost (\$)	280,000	
Hard Costs (\$)	3,217,500	\$195/GSF x 16,500 GSF
Soft Costs (\$)	643,500	20% x Hard Costs
Total Cost (\$)	4,141,000	
Cost per Unit (\$)	207,050	Total Cost / 20 units
DEBT INPUTS		
Loan to Cost	70%	Financial input
Debt (\$)	2,898,700	Loan to Cost x Total Cost
Equity (\$)	1,242,300	Total Cost - Debt
Interest	5.00%	Financial input
Amortization (yrs)	30	Financial input
Loan Constant	6.44%	Financial input
Debt Service (\$)	186,676	Loan Constant x Debt amount
DSCR	1.54	NOI / Debt Service
RETURN CALCULATIONS		
Return on Investment (ROI)	6.9%	NOI / Total Cost

8.0% CFAF / Equity

Cash on Cash Return (CoC)

Activity H: Developing a Pro Forma

Answers will vary depending on individual assumptions. The following is a potential solution.

PRO FORMA														
DTAP A	operty ddress	Activity G 3801 17th Ave S, Minneapolis												
DEVELOPERS TECHNICAL ASSISTANCE PROGRAM				Lease Up	Stabilized	Stabilized	Stabilized	tabilized	Stabilized 5	stabilized	Stabilized S	Stabilized	stabilized F	or Resale
USD unless otherwise indicate	ba			YR 1	YR 2	YR 3	YR 4	YR 5	YR6	YR 7	YR 8	YR9	YR 10	YR 11
DEVELOPER SOURCES & USES		1 Bed (8@6905F eq. Yr 1 Rent=\$1830/mn)	3.0%	175.680	180.950	186.379	191.970	197.729	203.661	209.771	216.064	222.546	229.223	236.099
Acquisition Cost	280,000	2 Bed (12@7905F ea, Yr 1 Rent=\$2030/mn)	3.0%	292,320	301,090	310,122	319,426	329,009	338,879	349,045	359,517	370,302	381,411	392,854
Hard Costs Soft Costs	3,217,500 643.500		0.0%											
Total Uses	4,141,000		0.0%											
		Rental Revenue		468,000	482,040	496,501	511,396	526,738	542,540	558,816	575,581	592,848	610,634	628,953
Debt Fquitv	2,898,700 1.242.300	Expense Reimbursement (commercial)		,		,							,	,
Gap Financing		Other Income			1	,	,	1	1		1	,	,	•
Total Sources	4, 141, 000	Potential Gross Income	Γ	468,000	482,040	496,501	511,396	526,738	542,540	558,816	575,581	592,848	610,634	628,953
DEVELOPER DEBT FINANCING	,		1	•										
Interest Rate Amortization (vrs)	5.00%	Vacancy	5.00%	23,400	24,102	24,825	25,570	26,337	27,127	27,941	28,779	29,642	30,532	31,448
Loan Constant	6.44%	Effective Gross Income		444,600	457,938	471,676	485,826	500,401	515,413	530,876	546,802	563, 206	580,102	597,505
Payment (annual)	186,676	ļ].											
Payment (monthly)	15,556	Property Taxes	3.0%	48,000	49,440	50,923	52,451	54,024	55,645	57,315	59,034	60,805	62,629	64,508
		Property Insurance	3.0%	15,000	15,450	15,914	16,391	16,883	17, 389	17,911	18,448	19,002	19,572	20,159
DEVELOPER PROFIT FROM SA	1	Utilities	3.0%	30,000	30,900	31,827	32,782	33, 765	34,778	35,822	36,896	38,003	39,143	40,317
Year of Resale	10	Maintenance & Repairs	3.0%	16,000	16,480	16,974	17,484	18,008	18,548	19,105	19,678	20, 268	20,876	21,503
NOI at Resale	388,886	Landscaping/Snow	3.0%	10,000	10,300	10,609	10,927	11,255	11,593	11,941	12,299	12,668	13,048	13,439
Exit Cap Rate	8.00%	Trash	3.0%	6,000	6,180	6,365	6,556	6,753	6,956 25 Fo.4	7,164	7,379	7,601	7,829	8,063 70 F.C.
	6/001		0.070	22,000	7,400	23, 340	24,040	74'/0T	23, 304	20,203	1CU,12	200,12	CU/ '07	000'67
Cost of Sale (%)	4.00%	Reserves	3.0%	6,000	6,180	6, 365	6,556	6,753	6,956	7,164	7,379	7,601	7,829	8,063
less cost of sale Profit from Sale	(194,443) 4 666 637	Uther Onerating Expenses	0.0%	153 000	157 590	162 318	167 187	177 203	177 369	182 690	188 171	193 816	199 630	205 619
less Loan Pavoff	4,000,034 (2.358.560)	Operating typenses	J	DOD'CCT	חברי ורד	010'201	101(101	CN7'7/T	COC'//T	0.00 1201	T/T'00T	OTOCCT	nen/cet	CT0'007
Equity Returned from Sale	2,308,072	Leasing & Capital Costs		5,000	•	•	10,000	4,000	•	•	15,000	12,000	•	3,000
		Net Operating Income	Γ	286,600	300,348	309, 358	308,639	324,198	338,044	348, 186	343,631	357,390	380,472	388,886
		De ht Service		186.676	186.676	186.676	186.676	186.676	186.676	186.676	186.676	186.676	186.676	
		Debt Service Coverage Ratio		1.54	1.61	1.66	1.65	1.74	1.81	1.87	1.84	1.91	2.04	
		Cash Flow After Financing	Γ	99,924	113,672	122,682	121,963	137,522	151,368	161,509	156,955	170,714	193,796	
		Dottine on Incontenant)00 J	/0C F	7 50	1 50/	100	/06 0	/0/ 0	/00 0	0 20/	/06 0	
		Return on Cash		8.0%	9.2%	%6.6	%?'/	11.1%	0.2% 12.2%	0.4% 13.0%	0.3% 12.6%	8.0% 13.7%	3.2% 15.6%	
			YR 0	<u>YR 1</u>	<u>YR 2</u>	YR3	YR 4	YR 5	YR6	<u>YR 7</u>	YR 8	YR9	<u>YR 10</u>	
		Cash Flow after Financing		99,924	113,672	122,682	121,963	137,522	151, 368	161,509	156,955	170,714	193,796	
		Equity In/Out (1 Cash Flow from Operations & Sale (1	1,242,300) 1.242.300)	99.924	113.672	122.682	121.963	137.522	151.368	161.509	156.955	170.714	2,308,072 2.501.868	
			44.00/						,000,01					
		Levered Internal Kate of Keturn (IKK)	14.9%				DI SC	count Kate	10.UU%	2	et Present va	ilue (NPV)	481,870	

