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FUNDAMENTAL PRINCIPLES OF LAND DEVELOPMENT PART 6

SECRETS OF SUCCESSFUL SITE SELECTION

by DAVID S. THALER, PE, LS, F., ASCE, F., NSPE, D.S. THALER & ASSOC., LLC AND JEFF BARBA, MBA, EMERALD BUILDERS

It has often been said that the three keys to real estate success are location, location, location. Some would argue that the three keys are schools, schools and schools. Of course, location and schools are vitally important elements for the success of a real estate project, but the art and science of acquisition and site selection are much more complicated than that. In fact, successful selection of a site is really the effort to answer a simple question: Will the expected financial return on the project be sufficient given expected level of risk?

The identification of suitable parcels for development purposes should be an objective process based upon economic, market and sales data. While there are subjective elements to the site selection process, like looking in those areas that you would consider home, inevitably, if you were only to rely on your gut, many opportunities would be overlooked.

The process of site selection includes the following elements:

1. Prospecting – where to buy and what's for sale.
Identifying suitable submarket and locating prospective sites that might be available.

2. Preliminary Analysis – assessing the site.
Performing preliminary engineering and market analyses to determine what density a site might yield and what would be necessary to bring it to market, as well as undertaking a preliminary financial analysis to determine the expected financial return.

3. Negotiations/Offer – structure of the deal.
Negotiation to determine the structure of the transaction, price and terms to maximize/meet internal return thresholds. Usually done by way of a Letter of Intent (LOI).

4. Executing a contract – agree on terms.
During this process, the high-level details of the LOI are expanded and agreed upon. In the development world, most contracts are contingent on a property being free of any unusual development challenges and contingent upon some level of jurisdictional approval.

5. Due Diligence Study – does the deal work?
Prior to deposit funds going hard and becoming non-refundable, a due diligence study is usually undertaken (and strongly advised) to ensure that the project is viable and that the deposit is protected.

WHERE TO BUY

There are four main objective criteria when selecting sites. These are:

- Schools,
- Income levels
- Employment
- Sales Data

Schools
The importance of schools cannot be over emphasized. Schools are critical to the home buying decision and, in general, it's a safe bet to look in areas with high performing schools. One must keep in mind, however, the targeted buyer profile when evaluating schools. For example, when building townhouses, elementary and middle schools are typically more important to the buying decision; whereas, middle school and high schools are typically more important when building single family detached homes. This is because townhouse buyers typically have younger kids and single family detached buyers have older kids. The objective quality of schools can be determined from several online resources including: GreatSchools.org and SchoolDigger.com. But don't forget the subjective aspect of schools – reputation. The school's reputation is also critically important.

Income
Generally, the metric considered is household median income. Numerous web based sites rate household median income by area in Maryland and the U.S. Census publishes median income by area on regular basis via its website at Census.gov. Needless to say, the higher the median household income in the area, the more resources potential buyers have to purchase homes.

Employment
Simply put, buyers need a source of income to purchase a home, and so it is important to know the level of employment in an area and to ensure that there are employment centers within commuting distance. The U.S. Department of Labor routinely publishes data on its website at BLS.gov including statistics on inflation, employment, unemployment, projections, pay/benefits and more. In addition, for Maryland specific insight, one should review data published on Maryland's Department of Labor at dllr.state.md.us and Maryland Department of Commerce at commerce.maryland.gov.

> "As a buyer's exposure to risk increases, the less the buyer is willing to pay for the lot. And vice versa, as buyer's exposure to risk decreases, the more the buyer is willing to pay for the lot.

Sales Data
Success leaves clues, and proven sales in a submarket mitigate market risk. Are other builders in the general area doing well? If they are, your probability of success typically increases. The pricing trend for new and resale home sales is another important factor to consider. Are they appreciating, flat, or decreasing? Of course, it is best to be in an appreciating market. On the other hand, be aware of a decreasing market as that tends to indicate that there is an oversupply or another problem that you may have to overcome.

Subscription services are a great source for this information and include Metro Study, Xonda and the MLS. For free services, search for current listings and sold records at Redfin.com (or other similar websites) and review market data available on Long and Foster's Market Minute website at marketminute.longandfoster.com and the Maryland Association of Realtors' at mdrealtor.org.

Consideration of the above factors will give you a sense of what submarkets to look at in the site selection process. Don't be discouraged, however, if you are looking in area with some negative factors, because with proper subdivision design, onsite amenities, quality of submarket retail, quality of schools and access to transportation, objections can be overcome. One can be successful almost anywhere in Maryland if it is possible to commute to jobs and the product is priced right.

FINDING THE OPPORTUNITY – WHAT'S FOR SALE

Perhaps unsurprisingly, the most effective technique to finding good opportunities is networking, for life is, as they say, a network. You will find that the most productive source of leads is from developing your professional network. Engineers, landowners and developers are a tremendous source of leads and these tend to be closer to the source of the sale, the landowner. The closer to the source you are, the more likely you are to be able to buy at a good price. MBIA provides a vast array of networking opportunities and project leads, and one should take advantage of them. There are many other sources including brokers, real estate listings and subscription services, but as these are public and widely disseminated, the price is likely to be higher. There is no getting closer to the source than contacting the land owner directly. By using SDAT, County GIS websites or other land mapping tools, one can uncover information to contact the owner directly.

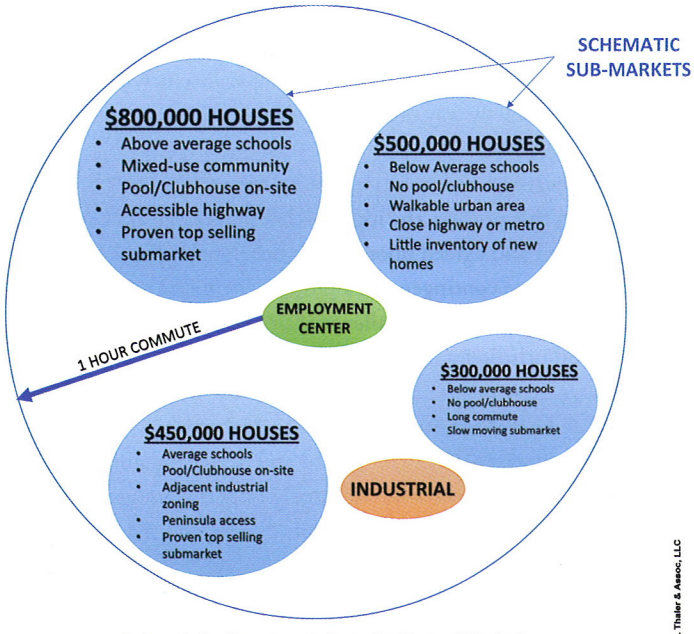
ASSESSING THE SITE

Other elements to be considered include:

Engineering Assessment

For all properties that require engineering or entitlement, an engineering feasibility study should be undertaken to evaluate engineering and development risks. Just because a property is zoned for a certain number of units, does not, by any means, mean that the maximum permitted density can be actually achieved. The elements of an engineering feasibility study include: open space requirements, wetlands, availability of public utilities, forest buffers, forest conservation requirements, toxic and hazardous waste assessment, zoning requirements, to name but a few.

At this stage in the process, a preliminary title report should be undertaken both to verify the actual title ownership, but also to determine if there are any covenants or restrictions on the title affecting the property. These are not uncommon. Also, one should obtain a boundary survey, for often the actual size



Schemtatic Representation of a Target Market

of a property does not match the area of the deed or in the tax records and this affects density.

Walk the Site

It is also highly recommended that you actually walk the site. It is surprising how many buyers don't (Google street view doesn't count). Walking the site will likely uncover much relevant information that was not revealed from a search of the public records. The site must also be assessed for red flags, such as, high tension power lines, landfills, power plants, smoke stacks, crime, etc. Beware of these red flags, as they will likely lead to lower home prices.

Architectural Requirements

Consider also, any architectural requirements mandated by a subdivision or a jurisdiction, as architectural requirements can greatly increase your costs or limit the house plans you are able to sell. Many localities (such as Honeygo in Baltimore County) have specific architectural requirements that may not fit into a builder's generic product line, and may add significant costs that are not recoupable from the home buyer.

County Fees

Not to be overlooked are County impact fees or other exactions which can be very substantial. In Montgomery County for instance, fees can be as high as $40,000 to $60,000 per unit.

Lot Comps

By now you know the deal works based on your pro forma (backing into price based on costs/perceived value), but is it a good price? There are several sources for this information (similar to those mentioned in the Sales Data section). In Maryland, one of the best sources for this data is Maryland's MDLANDREC.net website. Use this website to access to all verified land record instruments in Maryland. Finished lot comps are easily searched using this website according to builder or developer name and address.

STRUCTURE OF THE DEAL – AGREE ON TERMS

There are many possible land development deal structures: Will you be buying raw land, engineered and entitled land, or finished lots? Will you be closing at Record Plat, preliminary approval, base paving, or with permits in-hand? Will you be buying in bulk or in phases? How much deposit is required, when is it released, and how is it secured? All factors impacting price, deposit, land type, takedown structure and closing requirements will impact the bottom line. Being flexible in terms can often overcome objections from the Seller.

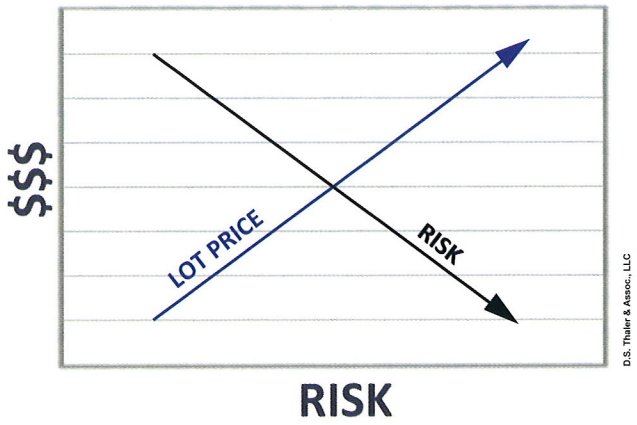
Keep in mind, most buyers are looking to purchase land with the least amount of risk. The more the buyer is able to eliminate risk, the more the buyer is willing to pay for the lot (finished lots obviously eliminate engineering and development risk.) On the other hand, most developers/land owners are looking to sell land as early in the process as possible, but that typically means the buyer will be exposed to entitlement or development risk, and thus, the less likely the buyer is willing to pay for the lot. In either scenario, the buyer is still exposed to market risk, but that's their job.

In summary: as a buyer's exposure to risk increases, the less the buyer is willing to pay for the lot. And vice versa, as buyer's exposure to risk decreases, the more the buyer is willing to pay for the lot.

INTANGIBLE ITEMS

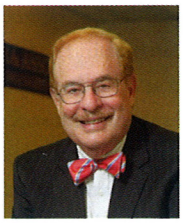
There are also intangible elements to be considered. Is there community or political opposition? In the case of being the first developer in a particular submarket can the risks of an unproven market be overcome? Does the acquisition fit the builder's brand, or maybe even more importantly, is the type of acquisition in line with the builder's current market strategy?

Finally, there is the gut-check; how does the submarket/community feel; what's its vibe? Is it friendly; do people say hello to each other? What's its profile; millennial or baby boomer?



Schematic Relationship Between Price and Risk

Would *you* want to live there? At any price? If the answer is no, identify the reasons why and be certain that you are able to successfully overcome those reasons or don't go forward.



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