

RE-Development Academy Real Estate Webinars

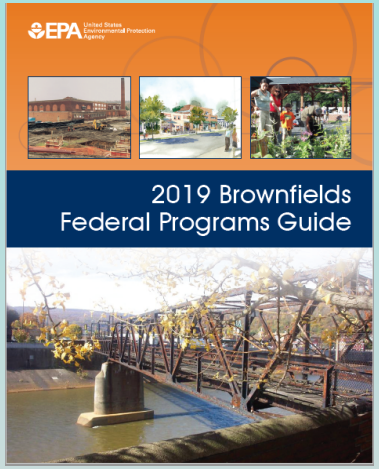
Part 3: Pulling Back the Curtain: How Developers Make Money

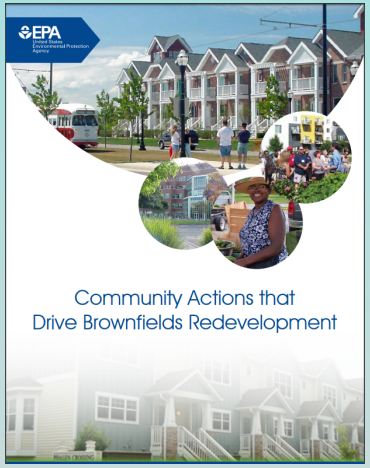
Hosted by EPA's Office of Brownfields & Land Revitalization

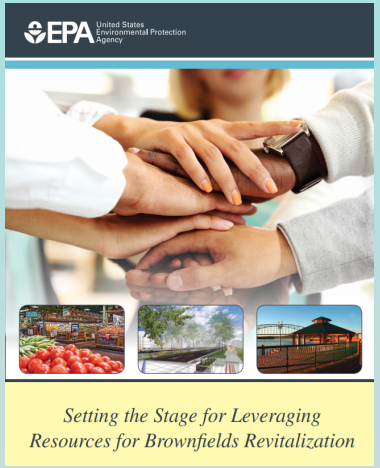
November 8, 2019

Land Revitalization at EPA

Guides, tools and technical assistance that helps communities put previously contaminated properties back into productive use







Welcome to EPA's RE-Development Academy Series

Webinars:

- Sep 13 — Part 1: Intersection of Real Estate and Brownfields
  https://clu-in.org/conf/tio/RE-DA1/
- Oct 18 — Part 2: Peering into the Crystal Ball: How the Market Decides Future Use https://clu-in.org/conf/tio/RE-DA2/
- Nov 8 — Part 3: Pulling Back the Curtain: How Developers Make Money

Training Workshop:

- Dec 10 — Part 4: RE-Development Academy - Let's Make a Deal!

Certificate will be available for completion of all four parts of the series.

Join us at the 2019 National Brownfields Training Conference

Webinar Instructors

Elaine Richardson has nearly 30 years of experience in senior positions in firms servicing the real estate and environmental industries. She has significant experience as a researcher and strategist, and has worked with nationally recognized developers on site selection, repositioning and community relations related to the redevelopment of underutilized properties.

Tony Bialecki has worked with a wide range of public and private entities to create economic development opportunities resulting in increased job growth and the creation of real estate and business investment. As a licensed Commercial Realtor Mr. Bialecki has worked on behalf of buyers, tenants and sellers of real property to locate, relocate and expand businesses, create investment opportunities

Agenda

I. Setting the Stage – Fundamentals of Real Estate Finance

II. Evaluating Redevelopment Potential –Midwestern Industrial Site Redevelopment

III. Financial Feasibility – Financing and the Pro Forma

IV. Developers' Perspective – Two Developers; Two Developments

Course Objectives

- Provide a basic understanding of how real estate developments are financed
- Demonstrate how environmental cleanup and liability affects decision-making and costs;
- Enhance leadership and decision-making skills by learning how regulatory decision interacts with the real estate finance process.
- Appreciate the opportunity that contaminated properties present for economic revitalization.

Real Estate Terms and Jargon

Risk – Reward	Pro Forma Analysis	Back of the Envelope
Skin in the Game	Cap Rate	IRR (Internal Rate of Return)
Time Value of Money	Sources and Uses Schedule	Hard Money Lender
Leverage	NPV (Net Present Value)	Mezzanine Debt

Importance of Redevelopment Finance

Understanding project financing helps communities:

- Set expectations
- Recognize quality developers and developments
- Identify synergies between projects and phases
- Craft stronger grant applications
- Create stronger agreements
- Offer appropriate incentives and leverage opportunities

Redevelopment Costs

- Property Costs
  - Taxes and tax policies can change
- Environmental Costs
  - Potential short and long-term costs
  - Liability risks
  - Delay
- Site Costs
  - Site preparation
  - Infrastructure
  - Building construction costs

Key Considerations:

- Developer has “skin in the game”
- Deals with lenders, designers, community, contractors, and regulators
- Availability and cost of funding is crucial
- Timing is critical

Four Market Tiers

- 1st tier real estate market
  - Areas with active market – all classes (ind., res., com.)
  - Requires little if any public involvement unless sites are heavily contaminated or other encumbrances. Gateway cities, around ports, major metro areas.
- 2nd tier real estate market
  - Areas with active real estate market mostly focused on residential and downtown.
  - Public/Private partnerships required for redevelopment. Many times, build to suit.
- 3rd tier real estate market
  - No significant development
  - Some public investments/almost always build-to-suit.
- 4th tier real estate market
  - Rural

pwc Emerging Trends in Real Estate 2018

Stages of Redevelopment Financing

1. **Pre-Development Financing**
   - Equity
   - Grants and tax credits
   - In-kind contributions
2. **Construction Financing**
   - Private loans (banks)
   - Public sector loans (EDC, HUD, CBDG)
   - Public infrastructure investments
   - Grants and incentives
3. **Permanent Financing**
   - Mortgage (insurance companies, pension fund)
   - Tax increment financing
   - Industrial revenue bonds
4. **Management Funding**
   - Operating income (e.g. rents)
   - Tax abatement
   - Workforce, economic development incentives

Sources of Financing

- Private Sector Investment
  - Developer and equity investors
  - Construction lenders: Banks
  - Permanent Lenders: Insurance Companies, Pension, Hedge, and Sovereign Funds
  - Public Markets: REITs and CMBS, crowd-funding
- Public Sector Investment
  - Land and infrastructure, capital investment
  - Economic development incentives
  - Tax increment financing/abatements
- Local Institutions
  - Non-profit institutions (e.g., universities, hospitals)
  - Foundations and organizations

Predicting Financial Feasibility

Midwestern Industrial Site Example

- City-owned property
  - All appropriate inquiry performed
  - Taken by tax foreclosure
  - City goal is jobs and taxes
- Analyses prior to City RFP Process
  - Opportunities and Constraints Analysis
  - Market Analysis
  - Feasibility Analysis

Opportunities & Constraints

Opportunities

- 265 acre City-owned property
- Inexpensive land prices
- Rail-served; adjacent rail yard
- Access off four-lane divided highway
- Major electric transmission access
- 1-hour drive to 3 commercial airports
- Close to Great Lake shipping port
- Community Reinvestment Area
- Job Creation Tax Credits available

Constraints

- 145 developable acres
- Large site; 3rd tier market
- Former building foundations remain onsite
- Substantial infrastructure investment required
  - Sanitary sewer
  - Public water
  - Interior roadways
  - Stormwater management
- Environmental contamination

Opportunities & Constraints

Environmental Constraints

- Phase I and II conducted prior to tax foreclosure
- Soil impacted with lead and arsenic
- Remediation to be integrated with redevelopment
  - Excavation and disposal required where encountered for infrastructure improvements
  - Additional areas capped underneath parking and roadways
- Institutional controls and deed restrictions

Market Summary

Warehouse Redevelopment Potential

Optimal Sizes

- Multi-tenant: 50,000—500,000 sf
- Single Tenant: 50,000 sf
- Ceiling Heights: 30’ with 50’ x 50’ column bays

Average Cost To Build

- Warehouse: $38-$42/sf
- Loading Dock: $5,000-$7,000/ dock

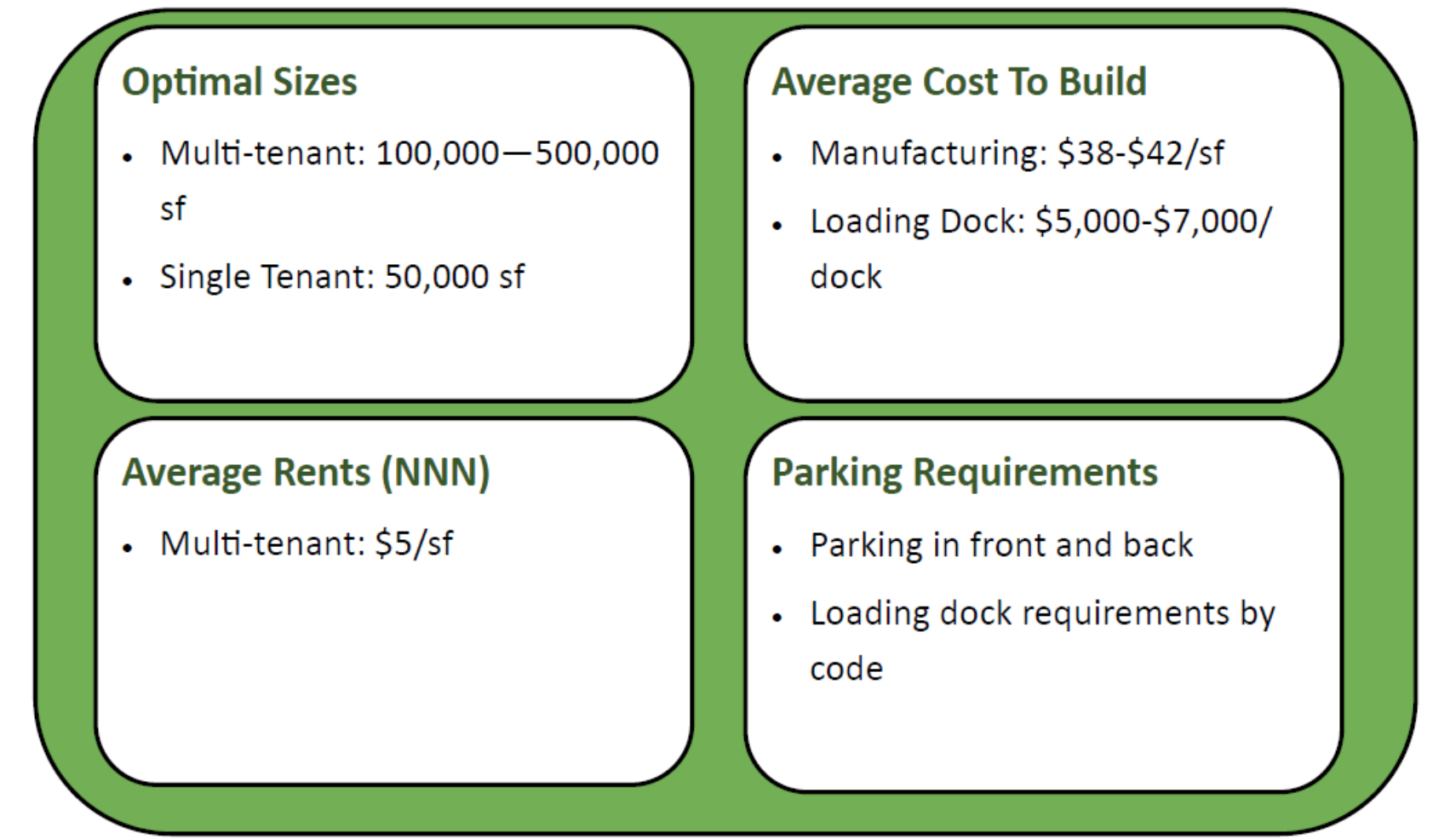
Average Rents (NNN)

- Multi-tenant: $3/sf
- Single Tenant: $3/sf

Parking Requirements

- Parking in front and back
- Loading dock requirements by code

Manufacturing Redevelopment Potential



Industrial Flex Redevelopment Potential

Optimal Sizes

- Multi-tenant: 100,000—500,000 sf
- Single Tenant: 40,000 sf
- Ceiling Heights: 30’ - 40’

Average Cost To Build

- Flex Industrial: $38-$42/sf
  - As high as $80/sf
- Loading Dock: $5,000-$7,000/ dock

Average Rents (NNN)

- Multi-tenant: $5/sf

Parking Requirements

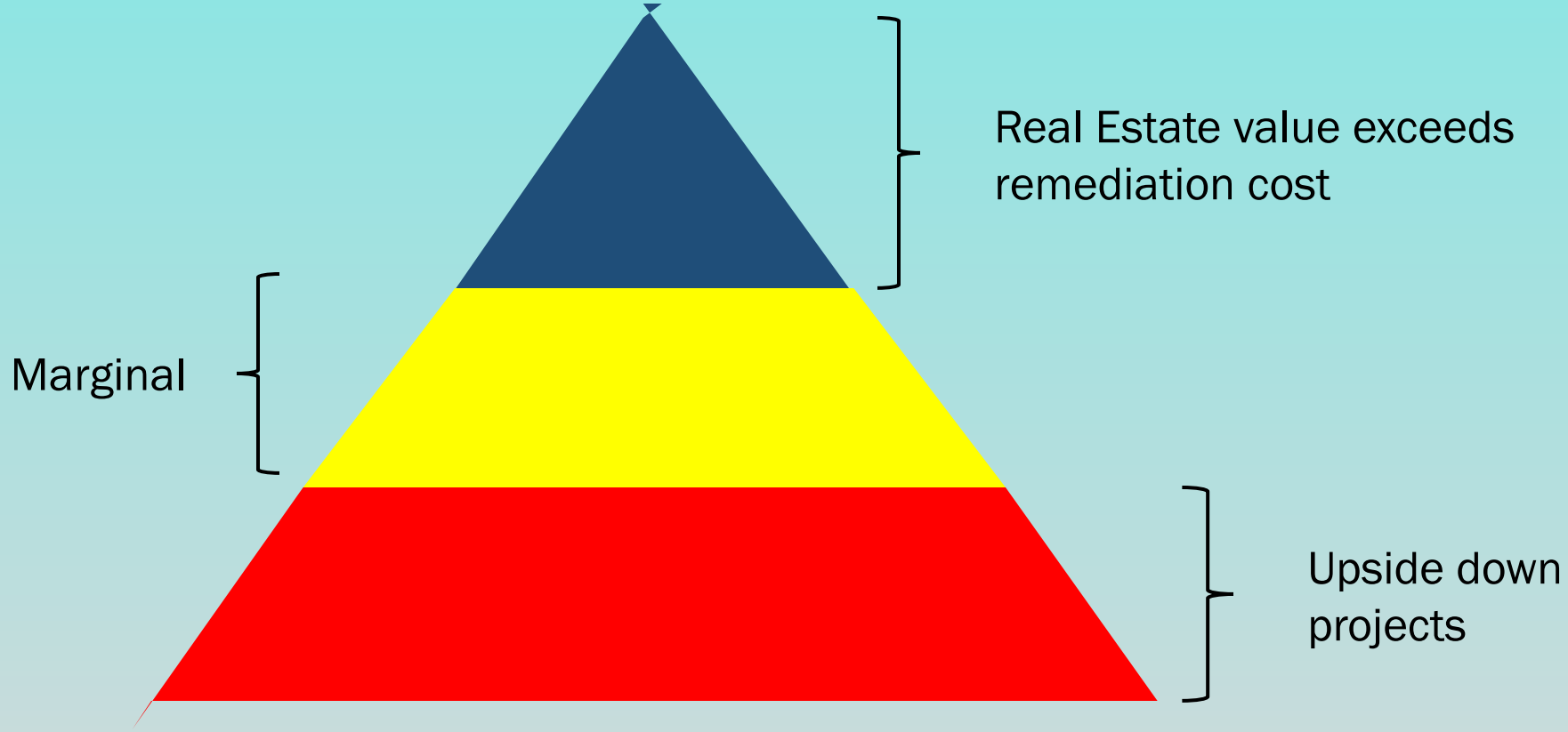
- Parking in front and back
- Loading dock requirements by code

Run the Numbers

Back of the Envelope	
Remediation Costs	$500,000
Infrastructure	$1,900,000
Hard Construction Costs	$20,575,000
Soft Costs	$2,250,000
Carrying Costs	$5,175,000
Total Costs	$30,400,000
Value When Complete Net Operating Income/Cap Rate	$30,475,000
Profit / Loss	$ 75,000

Why would a developer move forward?

Real Estate/Environmental Value Pyramid



What happens when the deal is upside down?

- Public financing (grants, loans, incentives, special districts)
- Public uses / investments (government uses, public utilities, infrastructure)
- Untraditional developers (brownfields developers, demolition/scrap developer)
- Alternative structures (long-term leases)
- Hold until market improves

Run the Numbers

Back of the Envelope	
Remediation Costs	($500,000)
Infrastructure	($1,900,000)
Hard Construction Costs	$20,575,000
Soft Costs	$2,250,000
Carrying Costs	$5,175,000
Total Costs	$28,000,000
Value When Complete Net Operating Income/Cap Rate	$30,475,000
Profit / Loss	**$2,475,000**

Is the potential profit worth moving forward with a comprehensive Feasibility Analysis?

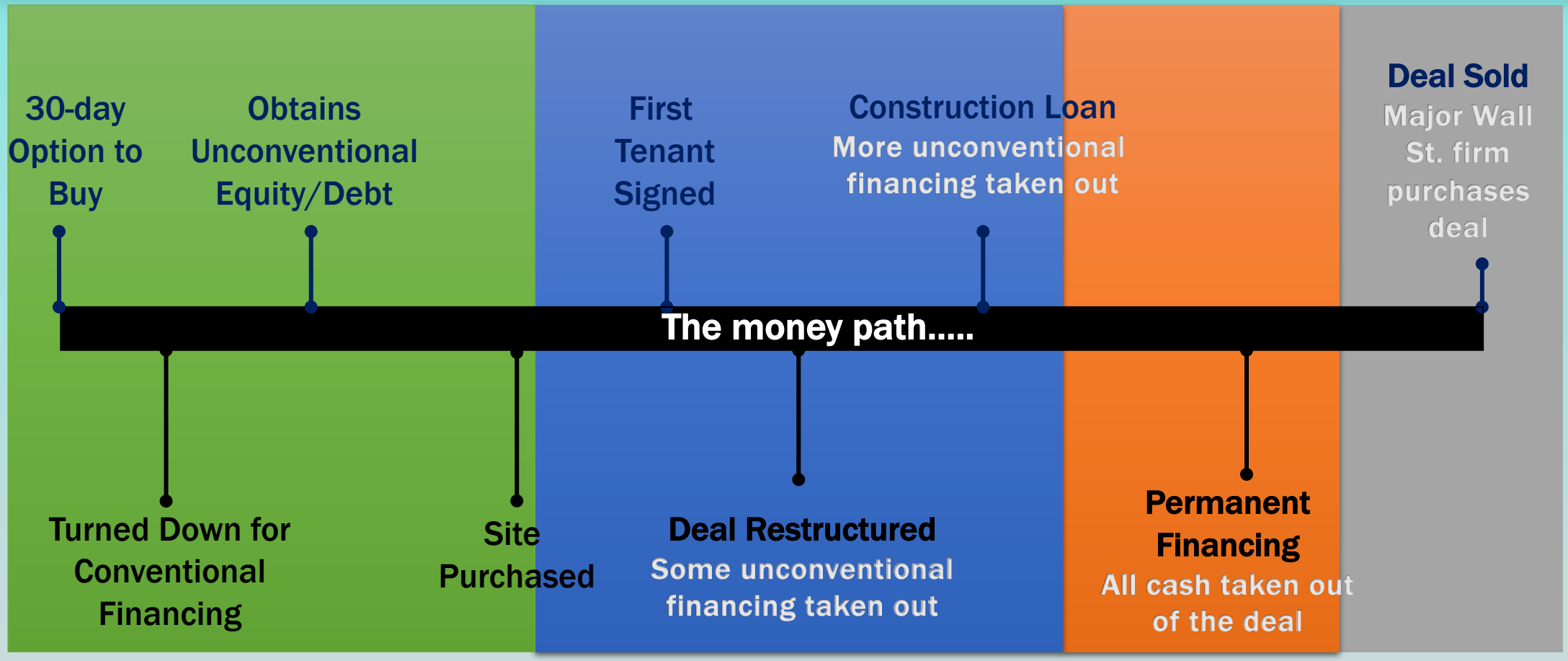
Evaluating Financial Feasibility

- What is a Proforma?
  - A statement, usually a spreadsheet, that provides a clear, numeric representation of future costs and income, and also calculates projected returns on investment.
- Often includes:
  - Operating or Cash Flow Statement
  - Income & Expense Analysis
  - APOD (Annual Property Operating Data)
  - Return on Equity
  - Loan information including repayment schedule

Sources of Financing

Sources		Uses	
City Priority of Jobs/Taxes	0	Site Acquisition	0
EPA Brownfields Cleanup Grant	$500,000	Remediation Costs	$500,000
State Tax Increment Financing Proceeds	$2,000,000	Infrastructure	$1,900,000
1st Construction Loan	$14,900,000	Hard Construction Costs	$20,575,000
2nd Mortgage Loan (private)	$6,125,000	Soft Costs	$2,250,000
Developer Equity	$6,875,000	Carrying Costs	$5,175,000
TOTAL FUNDING	$30,400,000	TOTAL EXPENSES	$30,400,000

Brownfields Financing Structure



Evaluating Financing: Value and Cap Rates

- The **capitalization rate (cap rate)** is the annual **rate** of return on real estate based on the income that the property is expected to generate.
- The **cap rate** is used to estimate the value of a project when completed based upon expected income

$$\text{Value (V)} = \frac{\text{Net Operating Income (NOI)}}{\text{Capitalization Rate (R)}}$$

$$\$1{,}000{,}000 = \frac{\$120{,}000}{12\ \%}$$

$$\$1{,}500{,}000 = \frac{\$120{,}000}{8\ \%}$$

$$\$\ 857{,}143 = \frac{\$120{,}000}{14\ \%}$$

Evaluating Financing: Role of Leverage

- **Leverage** is using borrowed capital to increase the return on investment
- The **leveraged return** is the **rate of return** on equity with the benefit of a loan at a cost lower than rate of return
- The actual realized rate of **return** will depend on the **amount and rate** of borrowed funds used for the project

Midwest Industrial Site Proforma

Building Area (Square Feet)	
Existing Industrial	44,650
Manufacturing	490,000
Materials Handling/Laydown	-
Industrial Flex	-
Light Industrial	-
Manufacturing Showroom	-
Total Building Area	534,650
Loading Docks	11

Capital Investment Summary	Phase 1 Assumptions		
Infrastructure Development	See Attached	$	1,868,400
Soil Remediation		$	500,000
Existing Building Renovation - $/SF	$ 20		893,000
Manufacturing Hard Cost - $/SF	$ 40		19,600,000
Industrial Flex Hard Cost - $/SF	$ 40		-
Light Industrial Hard Cost - $/SF	$ 40		-
Manufacturing Showroom Hard Cost - $/SF	$ 40		-
Loading Dock Hard Cost $/dock	$ 7,500		82,500
Soft Costs	@ 10%		2,244,390
Carrying Costs	7% @ 36mo.		5,184,541
Total Development Costs		$	30,372,831
(Less State Taxes/EPA Grant)		$	(2,368,400)
Total Development Costs		$	28,004,431

Income and Expenses	Assumptions	
Existing Industrial - $/SF	$ 4.15	$ 185,298
Manufacturing - $/SF	$ 5.15	2,523,500
Laydown/Materials Storage - $/SF		-
Industrial Flex - $/SF	$ 5.15	-
Light Industrial - $/SF	$ 5.15	-
Manufacturing Showroom - $/SF	$ 5.15	-
Gross Income		$ 2,708,798
(less) Vacancy	@ 10%	$ (270,880)
Net Operating Income		$ 2,437,918

FEASIBILITY ANALYSIS		Phase 1
Project Value @ Cap Rate	8.00%	$ 30,473,972
Outside Public Subsidy - $/sf	$4.43	$ 2,368,400
Total Development Costs		28,004,431
Project Value (less) Total Development Cost		2,469,541
Profit as % of Total Development Cost	11.3%	

Community Role in Redevelopment Finance

- Facilitate public/private partnerships
- Help secure public financing (grants, loans, special districts)
- Leverage multiple projects (e.g. infrastructure investments supporting redevelopment)
- Impact deal timing (slow deal down or speed it up)
- Influence synergy between remediation and redevelopment, strengthening the long term sustainability of the cleanup

QUESTIONS?

Key Conference Events

December 10th | Re-Development Academy - Let's Make a Deal!
12-4pm Training Workshop

- See inside the redevelopment process and become brownfield developers for a day
- Conduct due diligence, prepare reuse plans, line-up equity funding, make an offer to purchase, and compete with other development teams
- See inside the deal, how the real money is made!

December 11th | National Brownfields Leadership Breakfast
7- 8:45am Register at: https://www.cclr.org/node/1260

Meet the Developers:
Northpoint Development

Chad Meyer has 20 years of industrial engineering and construction experience. Chad is responsible for the general oversight & growth of development, brownfield redevelopment and Design-Build industrial construction for NorthPoint Development projects nationwide. Currently, NorthPoint has over 34,000,000 SF of industrial projects completed, and is on track to double industrial deliveries nationally in the next 24 months.

P: 913-752-7919
E: cmeyer@northpointkc.com
W: https://www.beyondthecontract.com/

NORTHPOINTDEVELOPMENT

Corporate Snapshot

71.5MM SF
INDUSTRIAL SPACE **DEVELOPED & MANAGED** SINCE 2012

$6+BILLION
TOTAL CAPITAL **RAISED** SINCE 2012

15.6MM SF
INDUSTRIAL SPACE CURRENTLY **UNDER CONSTRUCTION**

11.7MM SF
INDUSTRIAL SPACE **LEASED** IN 2018

±46,500JOBS
CREATED IN OUR DEVELOPMENTS

$800MILLION
INCENTIVES NEGOTIATED FOR OUR CLIENTS

Last updated beginning of Q3 2019

CORE VALUES

LIVE GENEROUSLY
We believe we have an obligation to give back to the community through charitable efforts and, as a token of our appreciation to those who have helped us succeed, we will pay it forward.

PUT PEOPLE FIRST
The relationships with our customers, employees, and investors are our most valuable assets. We will strive to always take care of each other and to operate our business so that we maintain our culture of appreciation, respect, transparency, and we shall avoid office politics.

MAINTAIN OUR FINANCIAL DISCIPLINE
We will approach every deal with an appropriate margin of safety and maintain our financial discipline while never stretching for a deal or becoming greedy.

TAKE OWNERSHIP OF EVERY SITUATION
Every individual shall take ownership, be accountable, and take responsibility while avoiding blame, excuses, and denial. We will always strive to admit, learn, and grow from failure and mistakes.

DO THE RIGHT THING EVERY TIME
As we conduct our business, we will operate with the highest integrity and we shall strive to live by the Golden Rule.

NORTHPOINTPARTNERS

dataPoint analytics
sitePoint
NORTHPOINT FORWARDING
COLDPOINT LOGISTICS
beyond SELF STORAGE
studioNorth ARCHITECTURE

ACTIVEMARKETS

ASSETCLASSES

INDUSTRIAL

MULTI-FAMILY

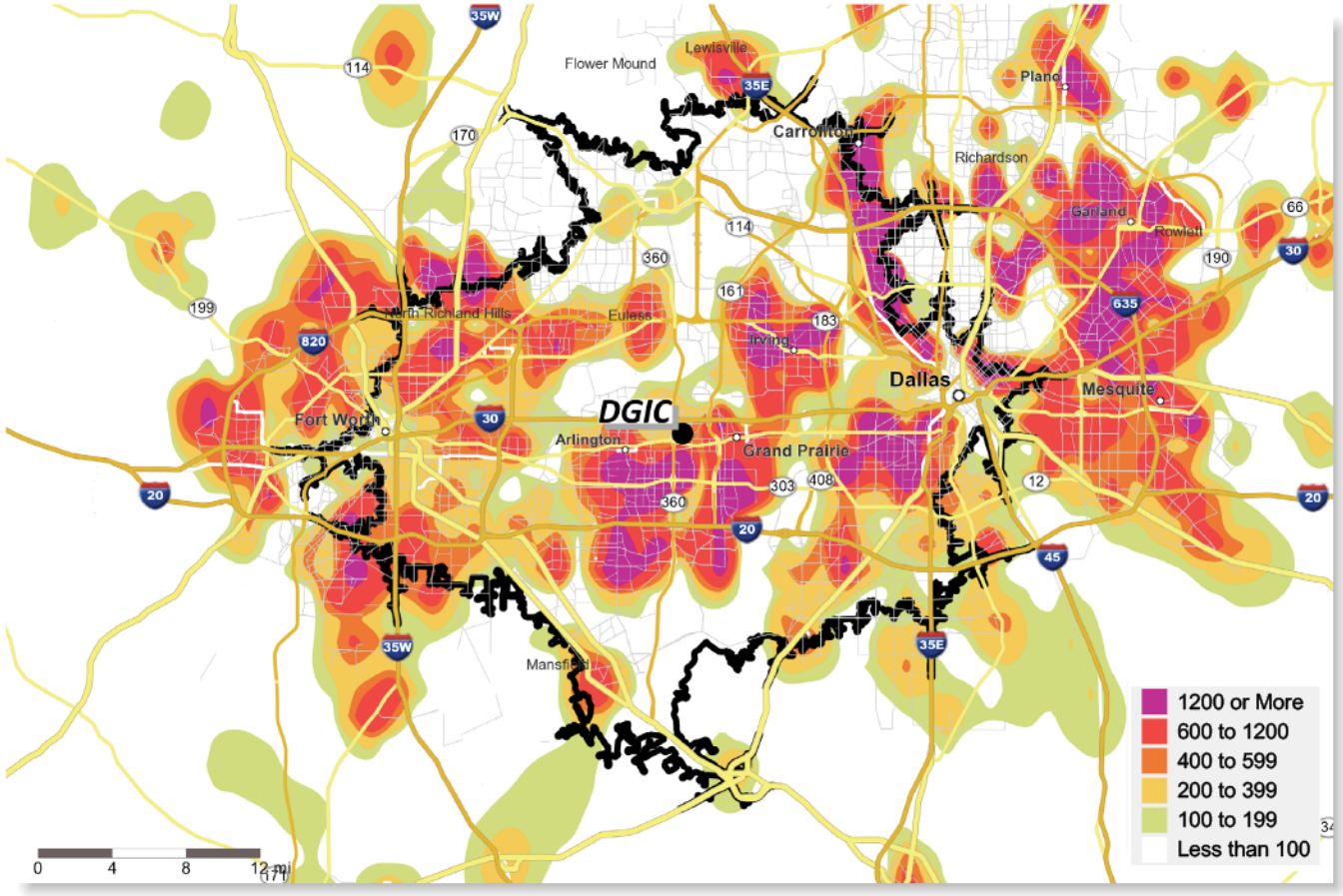
SELF STORAGE

JANUARY, 2016

UNDER CONSTRUCTION: COMPLETE MAY 2018

PROGRESS PHOTOS

Warehouse Worker Labor Pool Density (People per Square Mile)
with 25-Minute Drive Time Boundary from Property Depicted



Meet the Developers:
Catalyst Development Partners

Steve Parnes has over two decades of real estate development experience in the highly competitive northeast markets, including positions with several high profile development companies. Steve is a Principal and founding member of a national brownfield redevelopment firm with over 6,000,000 SF of industrial development projects currently in the development pipeline.

P: 917-602-2328
E: steve@catalyst-dp.com
W: http://catalyst-dp.com/

Mike McMullen has over 20 years' experience in all facets of brownfield redevelopment including senior positions in the environmental engineering, environmental insurance and brownfield development industries. Mike is a Principal and founding member of Catalyst Development Partners, a national brownfield redevelopment firm.

P: 415-265-3447
E: mike@catalyst-dp.com
W: http://catalyst-dp.com/

Elm Street Distribution Center

Perth Amboy, NJ

November 2019

Catalyst Development Partners
Land Renewal and Development

CATALYST DEVELOPMENT PARTNERS

- Catalyst Development Partners, LLC ("Catalyst") sustainably redevelops under-utilized, blighted and often environmentally impaired industrial and commercial properties primarily located in the Northeast and California.
- Catalyst acquires, remediates, repositions and entitles property whose historic use has left it contaminated.
- Catalyst is founded by principals with long experience in redevelopment, risk management and remediation on dozens of projects nationwide.
- Catalyst works closely with regulatory agencies, and sees the development of a remedial strategy as a team effort between the developer, the governing agencies, and the local community.

CATALYST TRACK RECORD

- Three major projects successfully completed over last 5 years.
- 2.5M SF of new modern industrial warehouse projects in New Jersey.
- Estimated 1,500 new jobs created.
- $3.3M in new property taxes annually for state of NJ, not including construction, the taxes paid and the secondary economic activity.
- Bringing a defunct or underperforming property back to life has huge effects for the economy for the town, city and state.

FORMER GERDAU RARITAN RIVER STEEL PLANT

- 92 acres located on the Raritan River
- 300,000 SF steel rod manufacturing plant that operated for 40 years and closed for over 7 years
- Prior use was a copper smelter plant that was demolished in the early 1970's

Catalyst Development Partners
Land Renewal and Development

STEEL RUN LOGISTICS CENTER

Catalyst Development Partners
Land Renewal and Development

SITE LOGISTICS

NJ TRANSIT TRAIN STATION
0.1 MILES

OUTERBRIDGE CROSSING
0.5 MILES

STATEN ISLAND
3.6 MILES

NEW JERSEY TURNPIKE, EXIT 11
4.1 MILES

NEWARK LIBERTY INT'L AIRPORT
15 MILES

PORTS NEWARK/ ELIZABETH
16 MILES

MANHATTAN
27 MILES

LINCOLN TUNNEL
31 MILES

HOLLAND TUNNEL
31 MILES

GEORGE WASHINGTON BRIDGE
38 MILES

Catalyst Development Partners
Land Renewal and Development

REDEVELOPMENT PROCESS

- Process for Redevelopment Agreement which involved City of Perth Amboy and NJDEP representative to Perth Green infrastructure and bio basins
- Public Amenities valued at $6.4M
  - Public access to the waterfront for first time in over 80 years and over 10% open space
  - Public amphitheater on the waterfront with seating for over 200 people
  - Donation and restoration of historic building to the City of Perth Amboy for use for Parks & recreation dept.
  - Purchase of additional land next to senior center and donation of funds to create outdoor exercise area and outdoor seating areas
  - Reconstruction of main roadway
  - Replacement of public water main line improving water pressure for entire community

COMPLEX ENVIRONMENTAL CHALLENGE

- Site had significant environmental issues from the different uses
- The property seller required Catalyst to close on the property prior to the Remedial Investigation being finalized or approved.
- Remediation Funding Sources established with $7.5M an additional escrow of $3.7M
- Demolition, asbestos abatement of 300,000 SF steel mill

SITE REMEDIATION

- Construction of 4,400 linear SF slurry wall to protect the Raritan River. Depth's of up to 75 feet. Construction timeline 3 months and 6 months of design work.
- Removal of PCBs, arsenic and other contaminants.
- Import of 500,000 tons of fill for capping the site.

SIGNIFICANT PROJECT AMENITIES

PROJECT RISKS

Real Estate Risk

- Overall economy
- Local market risk
- Entitlement
- Geotechnical
- Traffic
- Local Community Acceptance
- Utility Availability

Brownfield Risk

- Environmental Cost Overrun
- Natural Resource Damages
- Regulatory Delay

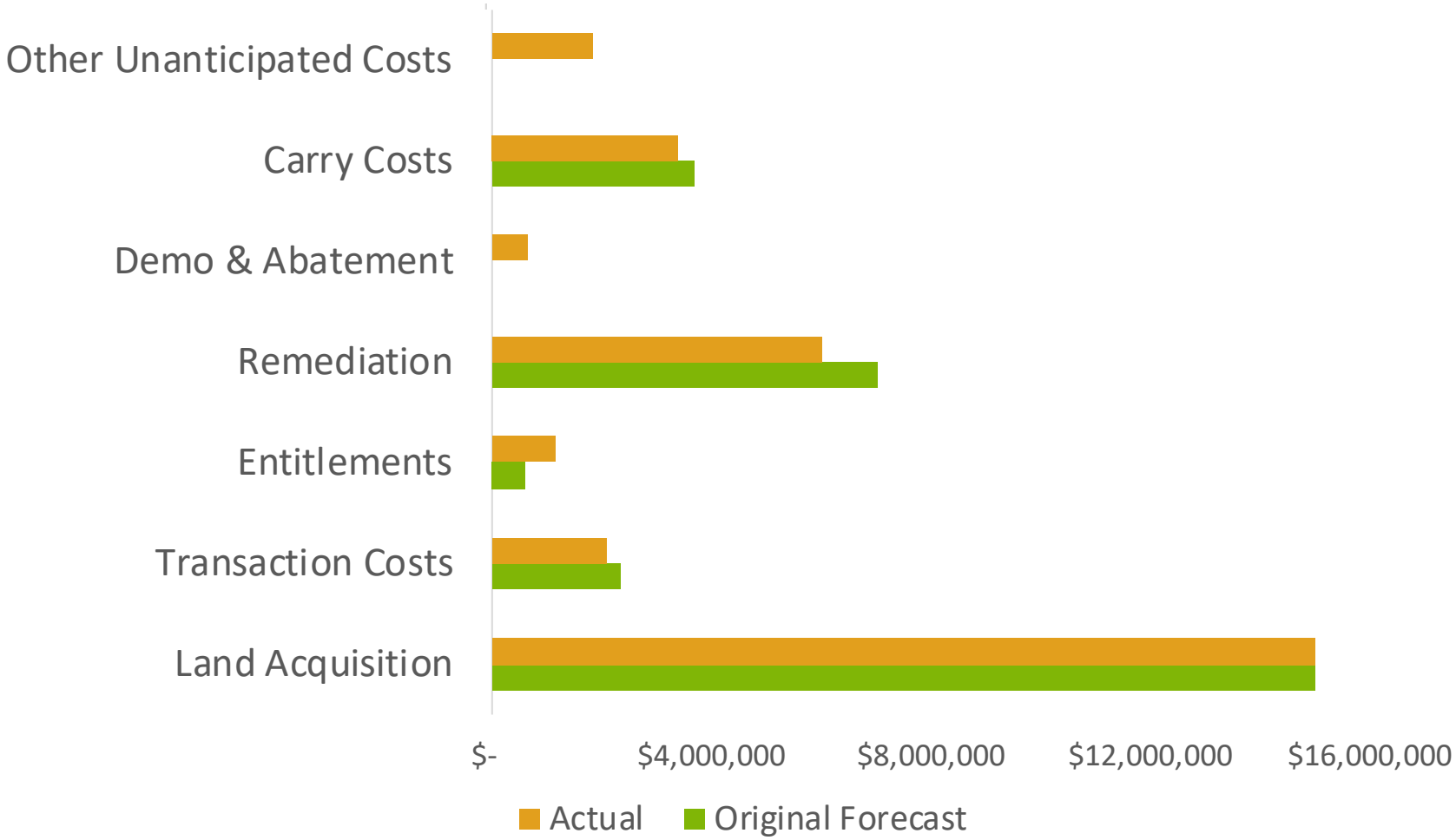
Why Do It?

- Irreplaceable Real Estate
  - Location
  - Size
  - Access
- Ability to Compartmentalize Risk
  - Did not accept NRD or offsite environmental
  - Sufficient site characterization to determine onsite cleanup costs (with reasonable uncertainty)
- Rising industrial real estate market

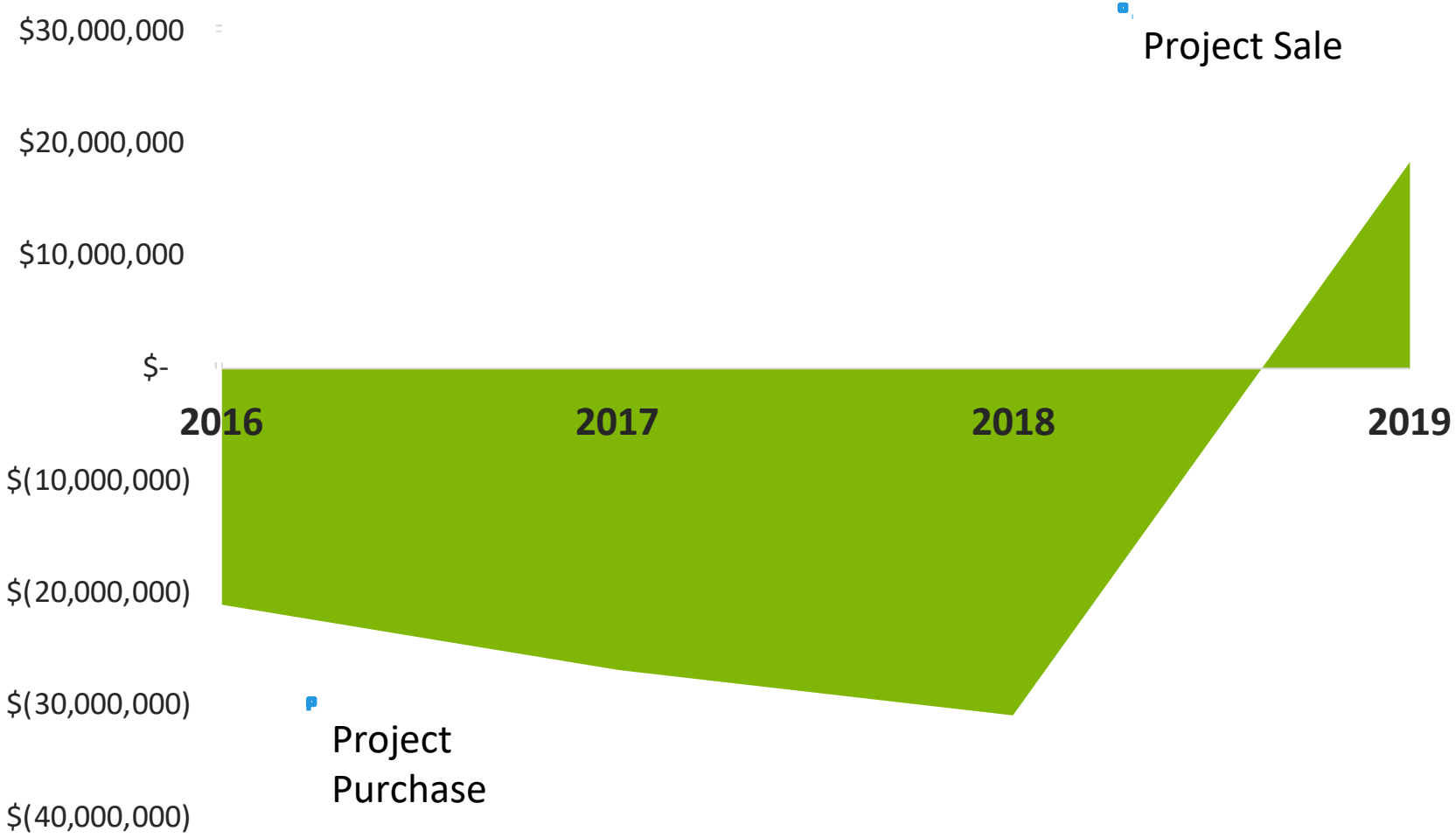
SURPRISE!

- Buried industrial waste throughout the site
- Unknown underground structures and utility lines
- Oil-filled electrical transmission line
- Praxair line
- Buried rail ties
- Interconnected utilities
- Public amenities

PROJECT BUDGET



Cumulative Project Cash Flows



Catalyst Development Partners
Land Renewal and Development

QUESTIONS?

Upcoming Workshop

National Brownfields Training Conference:

- December 10th | Re-Development Academy - Let's Make a Deal! 12-4pm Training Workshop