OAK INVESTMENT MANAGEMENT GROUP

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Real Estate development is one of the most risky but also most rewarded investment categories in real estate. It takes a special skill set to master the multi-layered dynamics in development: An appreciation of what the market is likely to look like at the point of delivery and a hard headed discipline to control process as well as costs with getting to that end point.

Development is used as a catch all term for what is in fact a multiple work streamed process. There is much work that is needed before completed real estate can be presented and either bought or rented by an end client. These processes need to be phased correctly otherwise even the best of projects can falter.

These processes can be fit into a few broad categories. It starts with the investment process that is required to acquire a site. This decision to purchase a site needs to have a margin of error sufficient to carry the investment through, possibly, multiple economic cycles – so a thorough stress testing of investment and return assumptions is required. The second process that needs to be managed is getting a re-zoning permit or overarching plan approved by the necessary authorities. Either greenfield or brownfield land usually requires some sort of zoning plan which either needs to be prepared / submitted / paid for by the investor but without which no further development can take place. The third process of development is to get a building permit for specific building plans drawn up by an architect (which accords to the investor's best guess of what the market will look like by the time the building process is complete). The fourth process of development, is managing the build process. This is the single most obvious process but it rests on the preparatory work of the previous three phases. So unless the site is purchased with a sufficient margin of error, unless the urban plan suits the overall scheme and unless the building permit accords with the requirements of the market then no amount of cost controlling during the build process will make up for those shortcomings. The final process is marketing of the finished product to the retail market.

From a commercial point of view there is a great deal of margin in each of these processes. If all are managed well by the same entity there is considerable economics to capture from the full development. The *quid quo pro* is that there are phasing risks all the time that what can come together to destroy thoroughly any hoped for return to an investment. Delays can have an exponentially destructive effect on expected financial returns.

In this recessionary environment, where debt and equity is expensive, there are two major problems with development in real estate. The first is the lag time between commitment to build, applications processing (sometimes which cannot be sped up at all) and the beginning of positive cash flow hitting the project. This can be called the operational risk. The second big factor is the lack of development financing as few individuals or institutions have the wherewithal or the breadth of liquidity to finance a project as a whole. This can be called the funding risk. Either of these issues can be addressed by a) breaking down the breadth of ambition by focusing on operational strengths as an investor, as an urban planner, as a builder, and / or b) speeding up the investing, the planning or the building process. In this way, only when expected (and observed) returns hit higher levels will liquidity return to the real estate development market.

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