

DEVELOPERS USE CREATIVE STRATEGIES TO KEEP THE LIGHTS ON

JULIE SEROTE

Portland State University

With the disappearance of financing and equity from the real estate market, developers are no longer following business models from recent years past. They have had to retune their strategies. The developers who continue to survive utilize their entrepreneurial and creative skills to form new business models in order to keep the lights on. As a result, innovation and conservatism have emerged. Some have expanded into property management or fee-based development. Others have transferred their development skills overseas. Some who were laid off have started their own businesses utilizing their development expertise. New development work in the U.S. now exists around a few scarce industries where financing continues to exist. Developers are still working. But the job description of a developer has certainly expanded.

What exactly are real estate developers doing now that new development has virtually stopped? With pen and paper in hand, I hit the pavement to get answers to this question. The findings were much of what you would expect, mirroring the most recent recessions in the 1980s and 1990s, with many expanding into areas such as property and asset management and others having little time to pursue new ventures due to the extensive time spent managing creditors. Some developers who have the financial wherewithal are simply waiting it out until some sign of market cash flow appears. Others have become financially

overwhelmed and cease to exist. Many continue to work, day by day, persevering through adversity to create ways in which they can stay in business. Amidst the challenge of finding or creating work, I found stories of success where unemployment or lack of financing lead developers to new, innovative business plans and unexpected blessings in disguise. These are their stories.

EXPAND THE BUSINESS MODEL

In past years, Kirk Olsen, Partner for DP Partners' northwest region, spent much of his day raising capital and overseeing development of speculative and build to suit developments. Now, he is spending much of his time looking for land and, to survive in a depressed market, he has broadened the services his company provides.

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Based in Reno, Nevada, DP Partners recently signed a contract with an institutional investor to manage their portfolio of Portland properties. Olsen noted that expanding their business model to include third party property management was a natural transition given their experience managing their own portfolio of properties nationwide.

DP Partners has diversified its business model by acquiring existing buildings at prices below their replacement cost, adding value, and taking on the lease-up risk. Here they are utilizing their expertise in positioning and leasing new properties and transferring those same skills to existing properties.

While the company has traditionally developed properties for their own portfolio, DP Partners has begun developing property on a fee basis. Completed in May, 2010, Morgan Distributing recently moved to its new 105,000 square foot build-to-suit headquarters located at LogistiCourt at Portal Way in Portland, Oregon. This high-end, \$12 million project allowed Morgan Distributing to consolidate their headquarter facility in Oregon City with their distribution facility in The Dalles. Finding a company in an industry that is more recession-proof, such as beer distribution, was a fortunate find for Olsen and enabled him to develop one of only three industrial sites to complete construction in 2010.

FIND A MARKET THAT IS FINANCEABLE

Isaac Scott, Principal with Anthem Memory Care and Alumni of PSU's Graduate Certificate program, indicated his company has been fortunate to have active debt markets for their products. After experiencing the demand for secondary homes dry up, the principals of Pacific Santa Fe, a Portland-based development company with over 25 years development experience, formed a new development company in 2008. The company, Anthem Memory Care, develops senior housing specific to individuals with Alzheimer's disease. Funded through the HUD 232 program, Anthem currently has two, 54–60 bed communities underway, with construction expected to break ground by year-end.

Scott feels fortunate to be in a market where they can take advantage of some of the opportunities that come with a depressed construction market. From a construction point of view, it is an opportune time to build, as construction costs have decreased, primarily due to labor but also due to the reduced costs for certain materials. Land prices are low and the

entitlement process can be easier than in years past due to the absence of requests for new building permits.

When asked if Anthem's move into the memory care facility business was a reaction to the down economy, Scott responded affirmatively, but also indicated that it was a response to the realization of a huge unmet need in senior housing. Anthem determined that there was enormous demographic support for Alzheimer care facilities, and they spent approximately 6–8 months of their first year building a market research model to help them determine exactly which markets most needed a memory care facility. To date they have performed research on more than 150 submarkets, enabling them to discern where market demand is the strongest. Anthem's goal is to have four to six additional projects underway nationwide in 2011.

CREATE FINANCING AND INNOVATION

At the crux of the suspension of new development has been a lack of financing. With the capital markets essentially dry, developers have been forced to put proposed projects on the back burner, and many have significantly downsized their staffing as a result. How has Gerding Edlen Development, one of Portland's most prominent developers, responded to this recession? Dennis Wilde, principal with Gerding Edlen Development, noted three strategies they have underway.

First, Gerding Edlen has created a fund to raise capital for deep green renovations by updating or replacing dated, energy-consuming building systems with more efficient systems. Having extensive experience in green building and environmentally responsible systems, Gerding Edlen has shifted their business model to utilize their green building expertise from new construction to an existing stock of office and multi-family properties located in high growth, urban markets within the United States. With financing virtually non-existent, the company created the Green Cities Fund. It pools investor funds, primarily union pension fund money, for the purpose of acquiring existing buildings with good bones and a good location to perform a deep green renovation, with subsequent re-leasing and portfolio management. To date the Green Cities Fund has reached \$140 million to \$150 million of its targeted \$600 million in funding, according to Wilde.

Gerding Edlen Sustainable Solutions (GESS) is another arm of Gerding Edlen that is using its understanding of the need for energy, water and waste conservation by creating a new venture involving energy management. The company is joining forces with EqRM International to facilitate the sale of power to utility companies. GESS facilitates the management of an energy resource within a building or campus for property owners. The property owner experiences reduced utility bills. The energy saved is treated by the utility company the same as new energy generated, and it can sell the energy on the open market. The utility companies finance the renovation and retrofits that produce the energy savings at costs substantially lower than constructing new generation sources, thus providing lower cost energy than available from traditional generation sources. GESS earns a fee for their development management services.

Specifically, GESS first performs a detailed audit of the energy consumption of a building or campus and outlines specific action items that the building owner can take to improve the efficiency of their facilities. GESS then determines the necessary financing and returns that will be needed. Building owners do not pay for the energy efficiencies, but rather GESS finds

off balance sheet financing (i.e. investment partners) for their projects. GESS is working with EqRM to create some innovative financing structures that will allow building owners to reach for deeper savings than the typical 15–20 percent that they can normally achieve. “The GESS goal is to obtain a 50–70 percent reduction in energy and 50 percent reduction in water consumption,” Wilde notes.

Gerding Edlen created its own property management and leasing arm. Now they can better manage the environmental innovations that were originally developed to be part of the building

The “efficiency energy” that is produced results in lower gas, oil, or electricity costs for the building owner. This energy savings is sold to the utility company via a power purchase agreement. The building owners come out ahead because they are paid a percentage of the value of the energy generated (saved) for the use of the building “site.” GESS manages the project for the owner to assure that the targeted savings are achieved. Essentially, a profit incentive is utilized to create energy innovation and conservation.

Historically, Gerding Edlen’s development team has developed a fairly unique skillset working with innovative, green technologies such as conservation, solar and wind power in new development. This skillset, combined with their 15 years of public/private development experience, enables GESS to reposition their development services in a novel new business.

Finally, Gerding Edlen created its own property management and leasing arm to manage and lease their own portfolio. This not only has saved the company from paying outside fees, but also has resulted in their being able to better manage the environmental innovations that were originally developed to be part of the building.

For example, in the past a tenant or condo owner might remove the low flow fixtures in their units in an attempt to increase water flow. Property managers in the past had not been diligent in educating the tenant or owner not to do this. As property manager, Gerding Edlen now has a better handle on ensuring that owners are not negating the green technologies that were intended for the building.

LAUNCH YOUR OWN COMPANY

When Nancy Hubbard was laid off along with the bulk of Avamere’s development staff in March 2009, she decided to dust off her consultant hat and look for independent contract work where she could utilize her 20+ years of development experience. She had a solid background of development experience, ranging from land acquisitions and entitlement work, to working as the Development Director for the Vancouver Housing Authority. Prior to being laid off, she was developing senior independent living and assisted living facilities for Avamere Health Services.

After six months of marketing efforts, Hubbard responded to a RFP for Riverdale School District and was awarded the contract to be their owner representative for the construction of the new grade school. In this role she used her construction and development expertise to represent the owner (Riverdale School District) in facilitating the communication between the school district, staff, and public for the development of the new grade school. She eventually became the project manager for the Riverdale development project, which is slated for completion in August 2010. She also landed a contract with the West Linn/Wilsonville

School District to help them purchase owner supply items (i.e. furniture) for both new schools and five remodeling projects for existing schools in the district.

Hubbard not only found herself a job in a tough economic environment, but also found one that is fulfilling. She said that her new development niche (school development) is similar to the work she did in affordable housing and senior housing. "It's a good feeling at the end of the day to go home and know that the work I did is making a difference in people's lives." She also is enjoying the benefits of owning her own company and the flexibility of working independently. "The funny thing is that if someone offered me a development job now (as their employee) I would turn them down because I'm happy with what I'm doing."

TRANSFER DEVELOPMENT SKILLS OVERSEAS

John Bartell left Opus Northwest in May, 2009, to utilize his development skills to the creation of Camana Bay, a new urbanist town on Grand Cayman. Already underway, phase one of Camana Bay is the development of the town center consisting of approximately 550,000 square feet of built space, of which 100,000 square feet is retail, 63 apartment units, and the remainder being office space. Phase two, beginning later this year or early 2011, is the housing phase consisting of approximately 200 single family homes. John also manages and leases a six-building class B office park for the same owner as Camana Bay.

Bartell, who is filling the role of Director of Property Management, spends the majority of his time managing the properties, but also does some work with the development and leasing teams for Camana Bay. "I'm doing the same thing companies did 20 years ago in the recession. Companies like Trammell Crow and Koll reinvented themselves as property management companies, buying property management companies to obtain fee income, acquiring new clients, and managing a portfolio until the development market returns."

Bartell says he has been able to easily transfer his 26 years of development experience overseas. It is a matter of understanding the market, according to Bartell, so he has gotten to know his tenants and understands their needs, allowing him to effectively negotiate their leases as they expire. He is taking his operating practices and discipline that were so ingrained in his years of development work in the U.S. and transferring them to projects overseas.

Originally Bartell's contract for the Camana Bay project was two years. Needless to say, with a five minute walk to work from his ocean-front apartment, he now plans to be there longer.

PSU Real Estate Certificate student Mazen Abualhaija has over 10 years of development experience and has also taken his skills overseas. Abualhaija currently works for a large development company based in Dubai. While the company shrank from approximately 400 to 100 employees, the company is focused on completing projects that were already underway prior to the construction slowdown.

The scale of developments in Dubai is massive compared to those in the United States. Abualhaija is currently working on two residential towers: a 91-story tower and a 107-story tower. Once complete, the latter project will be the tallest residential tower in the world at approximately 414 meters tall, or 1,358 feet (108 feet taller than the Empire State Building), and contains 1.7 million square feet. Currently on the 83rd floor, this project is slated for completion at the end of 2011 and is close to 100 percent sold.



Figure 5.1 The tallest residential tower in the world, under construction in Dubai; plan for the “Tallest Block in the World” in Dubai

Abualhaija notes that if someone has a financial background, due diligence and valuation skills, then there are opportunities to transfer those skills overseas. Political changes and increased investor confidence in countries such as Saudi Arabia have resulted in increased development and the hiring of labor pools from countries such as Australia and the United

Kingdom. A recent report from Jones Lang LaSalle, a financial and professional services firm specializing in real estate services and investment management, notes:

Saudi Arabia is by far the largest real estate market in the Gulf and is poised to be one of the fastest growing markets in the region over the next three years, with up to 30 million square meters of commercial (office, retail and hospitality space) forecast across the major cities within the Kingdom by 2012. Unlike most of the other GCC markets, the Saudi real estate market is driven primarily by internal demand generated by the rapidly growing local population.

Saudi Arabia is just one example of a handful of countries that are now welcoming foreign developers' expertise as a result of recent changes in governmental policies and restrictions.

CONCLUSION

Developers are known for their entrepreneurial spirit, creative problem solving skills, and tenacious attitude to persevere through insurmountable challenges. These same skills are being used by developers today to survive this economic crisis. Change is inevitable, and the job description of developers will continue to evolve until the market settles on a "new normal." Developers will need to continue to be innovative in finding ways in which to make money in a world where new construction barely exists. Transferring development skills and knowledge such as project management, working with public officials, green building and energy efficiency, and creative problem solving into less traditional areas of development will enable developers to continue to do business. In the short term, developers may have to relocate either nationally or internationally to find development work. While developers have downsized staffing, new jobs will slowly emerge as they expand their business models into new ventures. Yes, the Great Recession has caused some developers to close up shop, but silver linings centered around innovation and ingenuity will undoubtedly appear, creating completely new businesses, and jobs, for the future and success for those developers who persevere through the storm. ■

Julie Serote is the assistant director at the Center for Real Estate, Portland State University. Her responsibilities include industry outreach, career counseling, administering industry networking and mentor programs, coordination of the Center's annual real estate conference, and fundraising for the Center. Ms. Serote brings more than nine years of real estate experience, including asset management, underwriting, loan servicing and workouts, and affordable housing lending to PSU's Center for Real Estate. She has has an MBA from Portland State University and a bachelor's in Business Administration from Pepperdine University.

