

DEVELOPMENT AS AN IMPLEMENTATION METHODOLOGY OF REAL ESTATE PROJECTS

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Real estate development issues, its interpretation, relevance and content are increasingly the subject of attention of Russian experts - economists and lawyers. The works devoted to the description of this phenomenon and its core content¹ are gradually replaced by works with more in-depth analysis: highlighting distinguishing features of “real estate development” approach to investment and construction projects, determining the effectiveness of developer’s activity, and the core of its specific aspects².

However, the idea of real estate development as a special way for implementing investment and construction projects is still underdeveloped: there are no papers determining the meaning and scope of the developer’s approach to the implementation of investment and construction projects; developer’s functions are not clearly distinguished from the functions of other project participants such as “investor”, “project manager”, “customer “, etc. This is how the author defines the meaning of “development”: “development is a form of integrated management process of investment and construction industry, in which the company-developer performs the functions of several market subjects in terms of classical approach to the organization of processes. Developer companies at the same time can be a customer- investor, for example, a designer and a contractor (or a subcontractor) - a list of functions is determined by the specific features of the project, as well as by the company’s capabilities. In practice, the use of real estate development scheme involves a number of specific management measures to optimize the project implementator’s internal costs and obtain synergies through his multi- functional nature “. This approach is not indisputable and needs more precise definition. Thus, the author defines development as a form of organizing investment and construction projects, which, in our opinion, is permissible, but does not accurately reflect the meaning of development, since the form is still something external to the content. Second, as is evident from the above quotation, the developer is a subject that brings together a number of other participants, such as investors, customers, etc., and this is his hallmark. Finally, the meaning of the developer is reduced by the author to costs optimization and incomprehensible wording - “obtaining synergies through his multifunctionality.”

¹ See: Maksimov S. N. Development. Real estate development: organization, management, financing. SPb.: Peter, 2002; Kushchenko V. V. Development: modern concept of property development , Moscow: Norma, 2004.

² See: Mazur I.I., Shapiro V. D., Olderogge N. G. Development. Moscow: Economics, 2004. Fedotova M. A., Tazihina T. V., Bakulina A.A. Development in real estate. M. KNORUS, 2010.

In our view, this definition does not accurately reflect developer's role in the real estate development projects, because it implies that by his activities the developer replaces the functions of other participants. In reality, however, he does not. A company or entrepreneur organizing the process of real estate development can, undoubtedly, act as an investor, but it only means that they appear in two economic status - as an investor and as a developer. The same can be said of other possible combinations: developer- contractor, developer- project manager, etc.

To reduce the developer's task to costs optimization is also inaccurate. The meaning of development as a process of real estate development in the economic sense is to create an object with a greater value than the cost of the developed object and the development costs, that is to create added value. The added value is achieved through maximizing the value of the created object and minimizing the costs for its creation. It is due to this new value, an investor and developer get their income. The question is to reveal the developer's role and function, due to which increment of value but not just cost reduction occurs.

Another point of view, which is formulated in the monograph by M. A. Fedotova, T. V. Tazihina and A. A. Bakulina is more appropriate. They define development as "a method of organizing the investment process that involves the arrangement of financing and implementing the real estate development project on time and within the appropriate limits for the purpose of commercial gain³." However, in this definition not all essential aspects of the developer's activity are reflected, for example, such an important function as the choice of the most efficient design, the point from which real estate development, in fact, begins, is not mentioned. Similar point of view is taken by Yu. A. Bakrunov defining real estate development as a way to organize the investment and construction activity, however, attributing it only to income-generating real estate. The authors of the most in-depth textbook on the subject published in today's Russia, also see development efficiency in reducing costs, noting that thanks to the real estate development "system," the following results can be obtained: "Reduction in the duration of construction -7-25%, laboriousness of building -5-15%, construction costs reduction - 10-20%."⁴

Definition of the real estate development as a particular mode of implementation of the projects of real estate development seems to the author of this article to be mostly justified, at the same time revealing another aspect of this multi-faceted phenomenon⁵ and adding to the definition given in our earlier papers by pointing out that development - is a certain way, technology aimed to increase development projects effectiveness that can not be only reduced to lowering costs.

Short aphoristic definition of development as a means of real estate development implementation has been given by us in one of the works in this way: an ideal option is to choose the best design, implement it in the best way, and thereby ensure the maximum possible increase in property values. We will decipher and elaborate this thesis. We have

³ Fedotova M. A., Tazihina T.V., Bakulina A.A. Development in real estate. M. KNORUS, 2010. p. 17.

⁴ Mazur I. I., Shapiro, V. D., Olderogge N. G. idem. P. 36.

⁵ See: Maksimov S. N. Development and its role in economic development // Bulletin of ENGECON. Series "Economy", Issue 3 (46), 2011.

already noted that development as an implementation methodology for real estate project development can not be reduced to the fact that it provides cost savings for the project. The meaning of real estate development is the increase in property value but developer's qualification and his revenues are determined by his ability to maximize this growth. This predetermines the goal for the project developer : to maximize gains (this allows to ensure the project attractiveness to the investor) and maximize their own share in this growth.

The matter is to identify the sources of this growth and use them effectively.

We list the main ways to achieve these goals.

A basis to maximize the value of the projected object (note that, no matter how long of an ongoing controversy about the nature of value, the value of the created real estate object is actually the price, at which it can be realized in the market or capitalized rent generated by it) is its best matching the demand in the market, matching development to best land use principle. We should bear in mind that the core of this principle is that such a use of land is the best, which maximizes its value. The value of land, as is known, is determined by the rent generated by it. The given value of the land price, following the best use principle provides value added maximization and developer's income. The best use principle would ensure the optimal combination of the land and the project: finding the best design for a given piece of land or a plot to suit the existing project. Ultimately, the goal is to ensure the identity between the parameters of the project (construction type - residential, commercial, project scale, project category, architectural and planning solutions, etc.) - land - market needs. In this case, between the land plot and a new building created on it, there should be an agreement, both qualitative and quantitative: a newly created combination of factors of production (land and factors unrelated to land) should match land characteristics as an immobile basis for any property. This agreement being reached, the result of combining factors of production is more than the sum of these factors thus providing gains maximized at best use of land.

How to obtain the best option at the initiation of the project? What is the algorithm of its choice? In formulating the principle of its best and most efficient use, the following definition is most often used : the best use is "such a land use option that is legally permissible, physically possible, economically feasible, and leads to the maximum value of the land."⁶ However, this definition has little to say about how to identify the option and what criteria should be taken into account in this case. Referring to a well-known work "Analysis and evaluation of real estate returning interest" by J.Friedman and N.Ordney, who do not limit themselves to general definition and make an emphasis on the fact that in addition to these parameters the best use option must be "sufficiently substantiated" and explain its validity through such parameters as location potential, market demand, legal validity, site resource quality, technological and financial feasibility⁷. As we see, the selection is based on "location potential" and "market demand", because they are the factors that determine the users demand for a particular

⁶ Portal Appraiser.ru. Herald of appraiser <http://www.appraiser.ru/default.aspx?SectionId=507> # N Date of access 04/20/2012 .

⁷ Friedman, J., Ordway N. Income property appraisal *and* analysis /Analysis and evaluation of income properties. M: "Delo Ltd", 1995. P.270,271-272.

development of land and, therefore, the factors that determine the profitability of the construction project. We stress the point here that location is of primary importance, since it is, rather than the current demand, strategically guiding the future profitability of the facility and its competitive advantages. We mean the economic position, which is defined as the location of the land, the nature of its current and future environment, access to potential purchasers. It is the analysis of the economic location of the land and its potential are the starting point for selecting the type of development, since they together with the market demand determine the yield generated by the property. Among other factors affecting the profitability of the development product, is the land resource potential (the “potential of the spot“, as some Russian developers have expressed) that determines the possible volumes of finished products (housing units, areas of commercial premises), which can be created with the legal restrictions on the land. An essential factor is a “competitive differential“, which is a distinct advantage of the land to others at any variation of development. As such, there may be the location of commercial facility at the intersection of major highways in the city, expanded parking, etc.

The task of the developer is to determine most accurately and fully the best land use, and on this basis - the project parameters: its scope, type of development, and its class. It is here we can appropriately apply the synergy concept, which is achieved through the optimal investment volumes (investment scale) and their form (variation of development) combining unrelated to land factors with land factors, and is expressed in maximizing the value of the land determined by the capitalization of rent brought by it or maximizing the present value of the created construction project.

Another activity of the developer, ensuring value maximization created by the construction project is to achieve the quality that corresponds to the object class or views of its potential users. Thus, quality serves as a comprehensive description, which includes the quality of architectural and design solutions, materials, technology, works, which together ensure object compliance with the user’s requirements. The focus on achieving the required quality is to be reflected in the design assignment, selection and terms of contractors engagement and ensured throughout the project life, as well as through the project control and financing.

Alternative choice of building an object, which meets the best use criteria, and ensuring the required quality of the created object maximize the value of real estate development, i.e. property resulting from the project. However, maximization of value alone does not mean achieving developer’s objectives - to maximize income, which is a part of the newly created value - the difference between the cost (actually, price) of the created facility and the costs to create it.

Consequently, the second group of tasks solved in the course of developing the project is minimizing project costs, including the costs associated with the use of debt capital (cost of capital).

To find the ways to reduce costs, it is useful to view the project as a process unfolding over time using scarce materials, labor, financial and information resources. Therefore, the task is, first, to reduce the time of the project implementation, and, secondly, the resources used, which must be assessed also in terms of the possible loss of benefits of their alternative use.

Solving these problems can be achieved by the developer through a series of activities, including the key ones:

1. Efficient organization of the project approval process with government agencies that requires professional project presentation to matching bodies, upholding the parameters of the project, which allows to reduce the time of the project implementation and, at the same time, increase its commercial appeal, for example, by increasing its tallness, building areas, reducing the administrative burden on the project.

It should be noted that building permits are among the most complex problems in the real estate development projects. Currently, the building permit must pass 51 procedures, and total deadlines to obtain a permit in Russia are on average 423 days⁸.

2. Effective organization of work with contractors, involving subcontractors with prices and time minimization of projects implementation with contract bidding, effective customer control with the assistance of engineering firms, the use of financial tools to encourage contractors enable to reduce construction time, improve quality of work, reduce costs and thereby increase the project added value.

An important tool to increase the effectiveness of construction project management is the use of professional project managers with the knowledge of building technologies and able to take on the role of technical project managers (directors), including the use of contractors, control over their work, acceptance of work, etc.

3. The effective organization of financing the project means the formation of low-cost, reliable, dynamically growing portfolio of financing involving the combination of various sources of financing and changes in the relationship between them as the project develops. The funding portfolio should provide in the first place the liquidity of the project, i.e. developer's ability in all phases of the project to meet his obligations (for example, to contractors), and second, to maximize return on equity, i.e. such a use of external financing, on such a scale and in such terms that maximize the effectiveness of equity capital due to the positive financial leverage.

The sources of funds for real estate development projects are developer's equity capital, direct investors' means, borrowed current assets (including banking credits, means of financial institutes such as unit investment trusts), obtained funds (including obtained funds by the agreements of equity participation), increase of the share capital (including through IPO).

Each of these sources has its advantages and disadvantages, its scope and application and the most appropriate application period to the extent of the project. So, real estate developer's own means, which as a rule, make up a smaller share of the total funding for the project, can be expediently used in the early stages of its life cycle: design and project. The main source of funding for the project during the construction phase are borrowed funds and funds of direct investors with the increased share of the latter upon completion of the project. The developer should be able to combine these sources as the project develops, avoiding over-reliance on project funding from a single source and minimizing the fees to raise funds.

⁸ Progress report on the roadmap projects of national entrepreneurial initiative to improve the investment climate in the Russian Federation, the results of the first quarter 2012. Agency of strategic initiatives. Electronic resource: [http://www.asi.ru/initiatives/Doklad% 20NPI% 201% 20kvartal.pdf](http://www.asi.ru/initiatives/Doklad%20NPI%201%20kvartal.pdf)

4. Effective sales (renting) of the created object with specialized brokerage firms, an increase of sales capacity through the use of different ways of organizing sales: online, using social networks, field sales and other forms of promoting created goods.

Importantly for the effective organization of the project in general, and to minimize the use of paid financial resources, is the selection of early pre-sales of the object (in one legal form or another), and the use of a flexible pricing policy providing discounts, installment plans to raise funds of the future users.

Concluding the review, allowing to determine real estate development as a special way of development projects implementation, we present the summary of the previous analysis as a following figure (see Figure 1). It suggests, the developer aims to maximize his own revenue (including him as an investor.) The source of this income is the value added created during the project as the difference between the value of the object created under development and the project costs. Consequently, developer activities should be aimed at maximizing the value of the object and costs minimization. Main directions and solutions to these problems have been presented above⁹.

Summarizing the analysis of the main aspects of the “real estate development” concept made in the present, previous and mentioned above articles, we state them again. The “real estate development” concept reflects three interrelated aspects of the phenomenon addressing three key issues related to the development of the real estate as one of the key processes in the property market: first, development is a process of qualitative transformation of the material properties (WHAT), and secondly, it is a professional activity in the property market, the object of which is to initiate the process and organization of development (WHO), and third, it is a certain way of implementing development projects providing maximization of the created added value (HOW). Graphically, their relationship is represented in Fig. 2.

Among other components, real estate development is an indispensable element of any property market and its qualities influence, to a large extent, the prospects of the Russian market.

Literature

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⁹ Such an important issue as the acquisition of land or rights to its construction whose costs are a considerable part of the development is outside of this article. It requires special treatment and the author intends to dedicate to it a special article

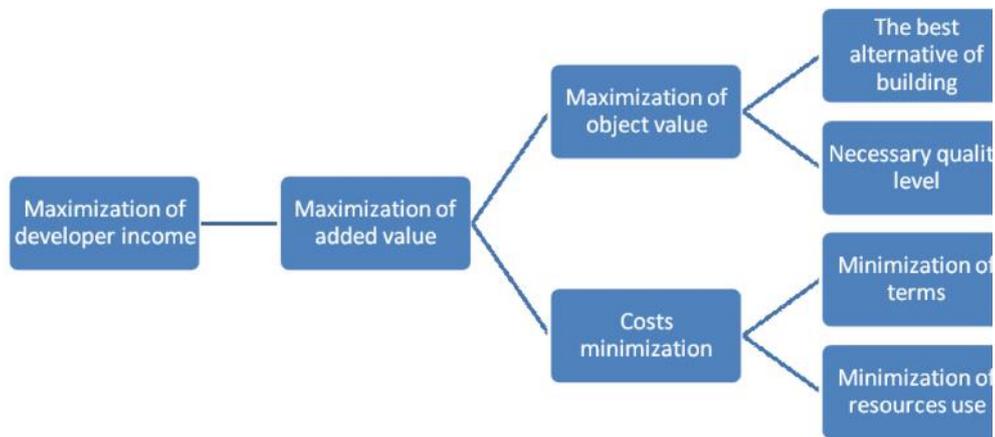


Fig. 1. Developer's goals and objectives when implementing development projects

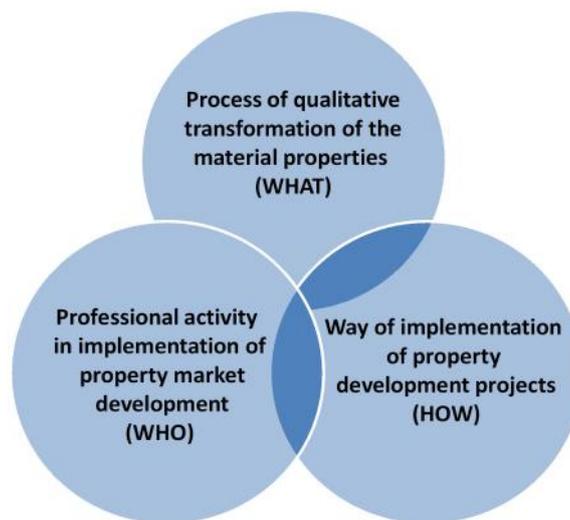


Fig. 2. Three aspects of the concept "development"

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Abstract

Abstract The article considers some features of development as a real estate projects implementation methodology and techniques improving the projects development performance.

Key words: *development, value-added, best use, costs, project financing.*

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