

REAL ESTATE FEASIBILITY ANALYSIS AND THE EMERGING PUBLIC-PRIVATE PARTNERSHIP IN LAND USE DECISIONS

by Charles H. Wurtzebach

During the past several years great interest in real estate feasibility analysis has developed.¹ It has been stressed as a prerequisite for both new development and investment in existing projects. The focus of the analysis primarily has been to justify economically a particular investment decision from the individual investor's point of view. This perspective generally emphasizes investor rate of return based on the availability of project financing, market demand and rent and operating expense levels. Determining user needs has concentrated on project operating income and investor return requirements which often have overshadowed the impact that the public sector has on the feasibility of real estate investment.

In many instances the role of the public sector in land use decisions has been ignored completely.² This has happened despite rapid expansion of local, state and Federal levels of the public sector's role in affecting land use decisions. As a result, although an investor may have obtained a feasibility analysis indicating enough user demand for an acceptable investor return, the project may be dropped due to lack of public support. In many cases this is because the real estate analyst has not included the public's perspective affecting the land use decision as an integral part of the feasibility analysis.

The result of this oversight by an analyst often leads to ill will between the develop/investor and the public, not to mention the deterioration of the client's faith in the analyst. This disagreeable outcome might be avoided if the public sector is viewed

as a partner rather than an adversary in the development process.

A framework which incorporates the public sector perspective in real estate feasibility analysis is needed. To develop this framework, the land use decision environment must be viewed as a partnership between the public sector, investors/producers and users. The acceptance of this partnership relationship requires that each partner examines and considers how the other partner's needs are met in land use decisions affecting a particular site.

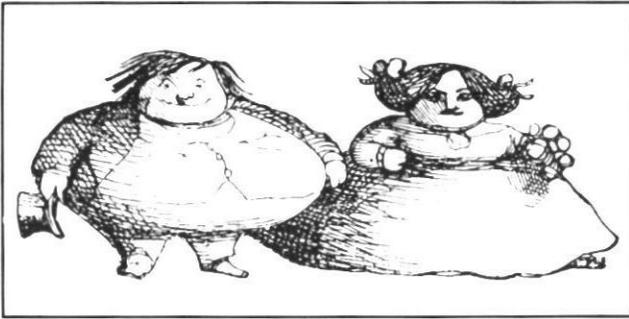
The Land Use Decision Environment

A realistic view must be taken of the key participants involved in the process in order to analyze the land use decision environment. In a broad sense, these participants include the public sector, developers/investors or producers, and consumers or users.³ Any land use decisions which affect any site or parcel of land will require interaction among these three parties. This interaction suggests the need for cooperation with the ultimate understanding that the three participants are not adversaries but partners. While the specific goals of the individual participants may differ, the participants must recognize each other's needs and work within a partnership atmosphere. Each must survive the short run and prosper through the long run to achieve equilibrium.

The short run constraints for each participant revolve around their cash management cycle. Developers must be able to meet their short run cash needs and remain financially solvent in order to successfully complete the development process. This requires them to accurately estimate, control and finance development expenditures and complete the project on time.

The public sector participants are faced with a similar cash management problem to finance or fund public

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development expenditures. For example, public services to a site usually must be provided following annexation and the initial costs may exceed the revenue generated by property taxes from the annexation. As a result, master planning may attempt to coordinate growth with the public sector's ability to provide public services as well as pay for them.

Real estate users or consumers also must operate within a cash management cycle. Owner-occupants and/or tenants must be able to pay the real estate market price. In commercial real estate, users effectively must meet monthly rental payments and still earn a market profit on their goods and services. Residential real estate users must be able to pay market prices and still meet consumption and saving demands.

In the short run then, land use decisions affecting any site should recognize each participant's cash management needs. Both on a collective and individual basis the participants should work each other's cash management needs into their respective decision-making process. It is not suggested that one or two participants must cater to the specific needs or demands of the third participant, but rather each participant should be aware of the others' roles and responsibilities within a partnership atmosphere.

Long run constraints on the development participants revolve around the economic and cultural stability of the community where development occurs. This stability or societal equilibrium requires continued communication among the participants. Developers have a long run responsibility to the community to create or produce real estate services which will provide an acceptable environment. An example of this type of commitment is community political involvement and leadership.

The public sector needs to consider expected demographic and economic changes in planning for future growth. By determining where growth might occur, development and planning can be encouraged.

Real estate users or consumers also contribute to societal equilibrium through their input in the development of local land use policy. Users also can support policy decisions made in the public sector which affect community attractiveness such as public transportation systems and political activism.

Site And Participant Relationships

Each participant in the land use decision process interacts with and relies on the other participants in an effort to successfully develop a particular site. The responsibilities, decisions, and services contributed and/or received by each participant actually are the culmination of extensive participant cooperation. The Figure presents a simplified version of participant and site relationship.

Public Sector/Site

The fundamental relationship between the public sector and the site is presented as 1 in the Figure. This relationship is dominated by the services and policy decisions affecting the site. In return, the site represents the basis for levying real estate taxes which are used to finance the many services provided by the public sector including police and fire protection, utilities, schools, libraries, roadway maintenance, etc. Policy decisions include master planning, zoning, building codes, environmental controls, and capital improvement programs. The availability of public services coupled with the implementation of policy decisions may serve to encourage, discourage or preclude development.

Public Sector/User

The relationship between the public sector and the user (2 in the Figure) concentrates on policy decisions and services to the user, and tax payments and political input to the public sector. Services provided directly to the user include health facilities, schools, transportation, recreational facilities, etc. Policy decisions affecting the user might include utility charges, neighborhood zoning decisions and tax rate decisions. The user pays real estate, personal property, sales, and income taxes, which are used to finance public sector operations. Users also should provide a great deal of input to the public sector, which is directed through the elective process and direct government participation achieved through service on appointed boards and commissions.

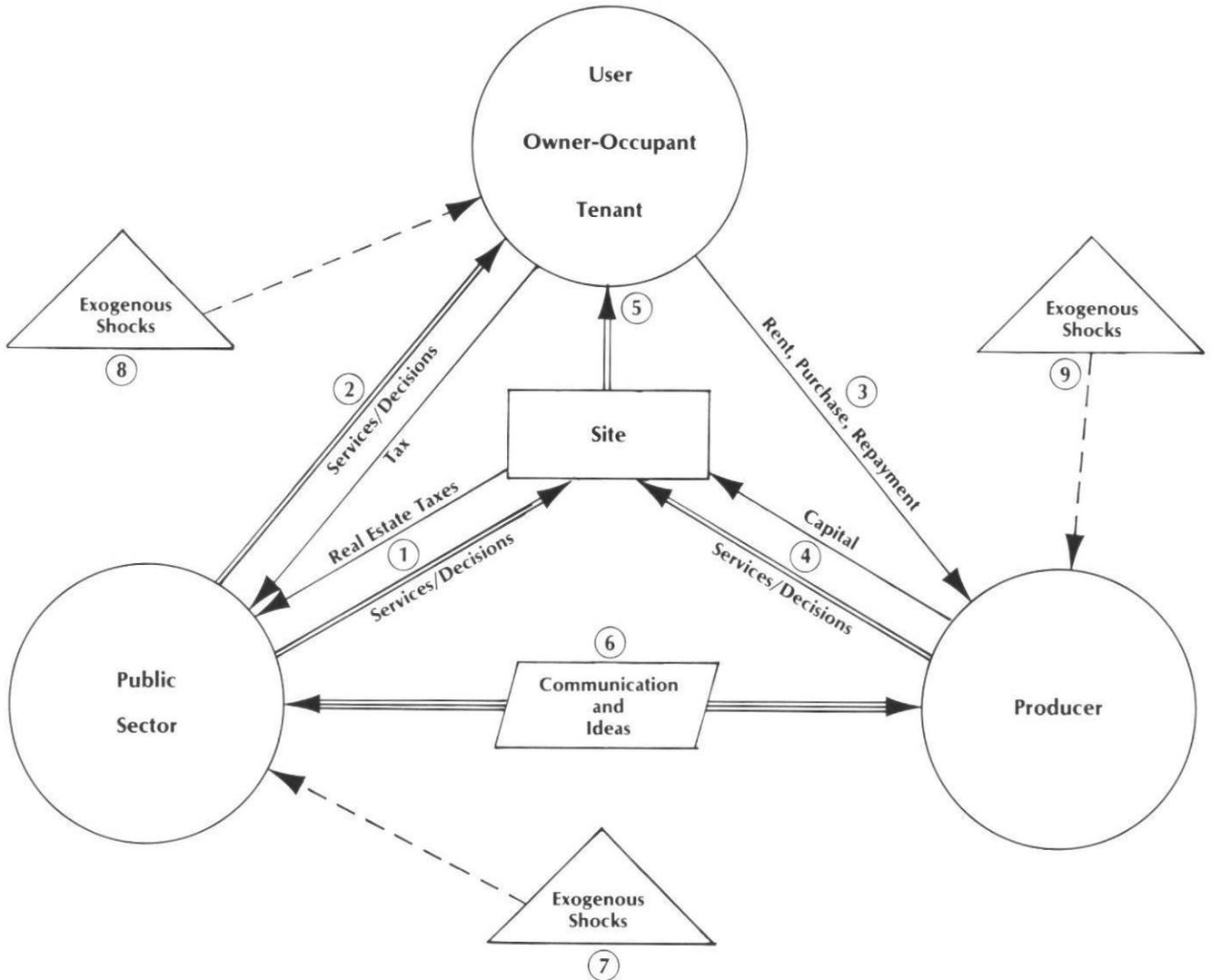
User/Producer

User and producer relationships (3 in the Figure) are developed through the market system. Rental levels and purchase prices are the result of the interaction of market supply and demand for real estate services. Relative increases in profits may stimulate new development, while relative declines would discourage it.

Producer/Site

The relationship between the producer and the site (4 in the Figure) is dominated by services and policy decisions of the producer which affect the site and its capital. These services and decisions include development concept, design and actual development. Capital applied to the site includes financing, labor and management skill.

FIGURE



User/Site

Number 5 shows the primary relationship between the user and the site as the net benefits to the user. These benefits represent the utility derived from the site by the user and are either pecuniary or nonpecuniary. Pecuniary benefits could include increased sales due to location or design, while nonpecuniary benefits might include prestige associated with the site.

Public Sector/Producer

Number 6 represents the relationship between the public sector and the producer, perhaps the least understood and recognized of the relationships. With the recent increase of public sector influence in the development process, difficulties have emerged which tend to put the two participants in an adversary position. The primary relationship between the public sector and the producer includes communica-

tion and an exchange of ideas, which generally are informal at best and nonexistent at worst.

Producers may perceive the public sector as representing a series of obstacles to development, whereas the public sector may perceive producers as insensitive to macro-socioeconomic issues. Neither perception represents the attitude of the participants who are making efforts to be fair and responsive to each other's needs.

A major problem area in the relationship between the public sector and producers lies in the nature of their day-to-day interaction where often communication only occurs when a problem arises. For example, a request for a zoning change may require interaction that is usually carried out through a fairly well-defined series of steps. An application requesting the change is made and is followed by review and recommendation by the public sector. During the process both parties are aware that

something is at stake. Often, if the applicant is asking for something that the public sector does not wish to grant, the parties will be pitted in an adversary position. To remedy this situation it is necessary to develop a communication network or medium devoid of specific confrontation, such as workshops sponsored by the public sector or by producers. Explanations of city growth management policy and producer involvement would provide understanding between the two parties.

Exogenous Shocks To The Public-Private Partnership

In addition to the relationships among the public sector, producers and users, there exist potential exogenous shocks (triangles in the Figure) which affect how the participants affect the site. The participants usually cannot control these shocks which are external, but can respond or react to them.

Public Sector

Exogenous shocks affecting the public sector's impact upon land use decisions can be the result of several factors. Changes in elected officials via appointments to boards and commissions or through a change in support for certain policy decisions may cause a shift in policy orientation towards land use decisions. As elected officials come and go over the years, local government's attitude toward land use policy may change. These changes usually are not controlled by public sector administrators. Therefore, while the employees remain, the policies they must implement may vary.

Changes in key personnel may also cause changes in public sector land use decisions. For example, a new planning department head may recommend new policy guidelines for growth management. Other lower level personnel changes may affect land use planning to a lesser extent.

Citizen support could also affect public sector land use which may result in an attitude change. For example, a desire for less government may result in a demand by citizens for tax cuts. Existing public sector land use policy may require substantial expenditures of public funds generated by either taxes or bond proceeds. Unwillingness to approve tax increases or bond referendums could result in reduced public sector activity in land use policy areas.

These exogenous shocks basically are outside the control of the public sector. As a result, public sector land use decisions must respond to these shocks on a continuous basis. Policy changes cause difficulties not only for the public sector but also for producers and users who discover that the "rules of the game" have changed as reflected in land use policies and guidelines.

Users

The majority of exogenous shocks to owner-occu-

pants and tenants affect user's ability or willingness to pay for real estate services. Macro-economic changes to general economic activity, employment and inflation significantly can affect user decisions. Corporate users will plan plant and office expansions based on expectations of future economic growth. If their expectations are jolted by major changes in economic policy decisions, the response may change drastically the outcome of decisions concerning a particular site. Just as adverse economic news may cause a reduction in demand, optimistic news may increase it.

Other sources of exogenous shocks that directly affect users and normally cannot be controlled include job transfers, promotions, loss of job, death, illness or divorce. These shocks can significantly alter personal land use decisions.

Producers

Exogenous shocks to all producers or an individual producer could develop in the general marketplace. These shocks would include the same macro-economic changes which affect users such as increases in unemployment and inflation. Inflation increases cost which must be passed on to the ultimate consumer; unemployment can reduce demand for real estate services.

Exogenous shocks affecting individual producers, or micro shocks, would include increased competition, major local employer relocations and producer-employee labor problems. Policy decisions from the public sector such as growth policy, zoning decisions, and local ordinances on development may impact a producer's ability to develop a site in a certain manner. Financial changes such as project failure may limit a producer's ability to attract adequate backing for future projects.

Implications For The Participants

The framework here implies the need to develop new relationships among the participants. The public sector, producers and users must realize that they are partners in the development and growth of a city. The public sector and producers especially share responsibility in developing this partnership.

Users contribute to the partnership through the market system, public forums and governmental involvement. Through the market system and their willingness to buy or rent the developed properties, users accept or reject the site development. In the public forum, users voice their ideas and comments concerning local growth patterns and specific site developments. Generally not organized structurally as well as the public sector or producers, users usually cannot provide the physical framework for partnership development. Thus, user responsibility in this area lies primarily in supporting the concept and participating with the public sector and producers through the development of neighborhood associations and other organizations of concerned citizens.

Public sector and producer responsibility in the development of the partnership lies in the area of communication and idea exchange. The process of this exchange is evident through permit and zoning variance requests and the public meetings where these decisions are ultimately made. Often, the public hearing results in misunderstanding and confusion due to ill preparation on the producer's part. The concept of a public-private partnership requires development of a forum to enhance producer ability to understand public sector development requirements. This could be facilitated through workshops, seminars and informal presentations.

Through explanation of policies, growth strategies and ordinances, etc., by the public sector, and through the acceptance of feedback from producers, land use policy could develop which would be better accepted, understood and implemented. A framework is necessary where public sector land use decision makers can interact professionally with producers in a nonconfrontative atmosphere, resulting in producers better understanding and appreciating the public sector perspective and vice versa.

The development of this framework of cooperation may require the creation of a new professional role in the land use decision environment. This role might be filled by land use government relations specialists who act as consultants to both the public sector and producers and concentrate on providing the link to advance communication and idea exchange. This role actually would be quasi-legal and enable the public sector to convey development ordinances and laws to producers, while advising both sides of the varied impact of land use decisions on the participants. The input of a land use government relations specialist would be an extension of the role of a market and economic feasibility analyst.

Feasibility Analysis And The Public-Private Partnership

Increases in public sector involvement in land use decisions should recognize the impact of a developing public-private partnership in real estate feasibility analysis. Understanding the framework in which land use decisions are made has become a prerequisite to the complete real estate feasibility analysis. This framework includes not only the administrative steps for development approval but also an appreciation of the short run constraints affecting participants. Analysis of the short run constraints often deals with immediate land use decisions. For

example, in cases where residential development might hinge on utility extension, the short run costs materially may affect the public sector's ability to support the land use decision. A complete feasibility analysis must also consider the long run impact of land use decisions such as development of transportation lines which may be made well in advance of individual land use decisions.

Since the complete real estate analysis includes a market and economic analysis, the critical relationships among the public sector, producers and users would be analyzed directly in the market study. A full analysis of the public-private partnership is essential to a complete market study and the land use government relations specialist should provide such input. The market study should include the short run and the long run constraints affecting the development partners. The analysis should be broken down into the perspectives of each participant. As such the analyst must understand fully the respective viewpoints of the public sector, producer and user.

The results of the complete market analysis will be used as inputs for the economic analysis which will reflect the critical relationships among the land use decision participants. The market study provides a more accurate picture of the actual land use decision environment and allows the economic study to more accurately reflect the expected outcome. By tying the relationship among the public sector, producer and user into the economic analysis via the market analysis, the resulting land use decision should represent a successful development that finds the participants in equilibrium.

NOTES

1. John B. Bailey, Peter F. Spies and Marilyn Kramer Weitzman, "Market Study and Financial Analysis = Feasibility Report," *The Appraisal Journal* (October 1977), 550-577; Richard U. Ratcliff, "Appraisal Is Market Analysis," *The Appraisal Journal* (October 1975), 485-490; James A. Graaskamp, "A Rational Approach to Feasibility Analysis," *The Appraisal Journal* (October 1972), 513-521; James A. Graaskamp, *A Guide to Feasibility Analysis*, Society of Real Estate Appraisers, 2nd Edition, (Chicago, Illinois, 1973).

2. It should be noted that this has not been true of Graaskamp's work that is cited above.

3. Much of the material in the following sections was adapted and expanded from the "Two-Day Workshop: Real Estate Feasibility for the Appraiser," sponsored by the American Institute of Real Estate Appraisers, as prepared by James A. Graaskamp and *Modern Real Estate* by Alvin L. Arnold, Charles H. Wurtzbech and Mike E. Miles, (Warren, Gorham and Lamont, 1980).