Entrepreneurial Planning

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EDITOR'S NOTE: For the past eight years, Agora Partners has specialized in identifying and creating value-add opportunities in urban environments, employing creative real estate tools and techniques to leverage neighborhood improvement strategies, unlock value and improve local quality of life. This article shares their perspective and approach, which focuses on applying the often disparate skill sets of urban planning and real estate concurrently to distill neighborhood and stakeholder needs in parallel with development feasibility.

REAL ESTATE INVESTMENT (IN BRIEF)

Real estate investing and development is, at its core, nothing more than guessing. By using past events, an investor makes predictions about the future. The search for development sites or adaptive reuse prospects is based on predicting future demand for the finished product. Determining how much the project will cost to build and what the project will ultimately be worth is based on historical precedent.

Similarly, determining the project program and the form of the project is often based on past performance, in terms of market acceptance, of similar concepts. Want to know how much a newly-built condominium will sell for when it is completed two years from now? The common tool for finding the answer is to consult "comps," or comparable sales. Since a 1,000 square-foot, two-bedroom, two-bath condo sold for $250,000 yesterday, that means that the same size and layout will sell for $260,000 two years from now. Of course, that assumes that absolutely nothing will happen in the world that might affect the price of that condo. Right? Wrong?

Your guess might be better than mine, or better informed than mine, but it is still just a guess.

PUBLIC SECTOR PLANNING (ALSO IN BRIEF)

Now take urban planning. Comprehensive plans for an entire city, neighborhood plans, or specific plans for designated parcels are similarly based on guesses. However, the historical metrics and predicted outcomes driving these plans are of a different type. While developers typically begin a project by researching comparable projects, planners are looking at demographic information—population growth, household size, incomes, to name but a few of the many factors—to determine where development should, or could, occur and what types of uses should be permitted.

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Certainly, predicting growth with such data is also part of some developers' toolboxes, but developers will typically use such information for time horizons of less than five years, whereas planners largely consider timelines greater than five years, and most often for ten years and beyond.

Planners then layer inputs from urban design guidelines, economic development initiatives, historic preservation overlays, transportation plans (which in and of themselves could include bus routes, pedestrian paths, roadways, etc.), and so on and so forth. These inputs ultimately inform developers' plans and, in cases where developers are seeking discretionary approvals, may act as trade currency between planners and developers.

Throughout this process, planners are engaging the community in various outreach efforts to temper a plan's assumptions with real-world perspectives from stakeholders. Whether through public forums, workshops, roundtables, charrettes, etc., the opinions solicited and knowledge shared—whether or not a constructive consensus is reached—comprise part of an extensive document that testifies to a large quantity of research intended to pave the way for a certain type of development to occur.

PARALLEL PATHS DO NOT INTERSECT

While urban planning and real estate development are inextricably linked—the former sets the rules and the latter acts upon them—the inputs used in the decision-making process for the respective sides are somewhat divergent. Because developers are charged with producing supply, their research is focused on comparable products. Because planners are charged with serving the public interest—the demand—their research is focused on people.

The paths become even more divergent when the planners' or the developers' assumptions about these respective sides are wrong. Certainly, when past events are being used to predict future outcomes, someone is bound to be wrong.

Skilled real estate developers are largely able to navigate inevitable changes and adjust accordingly. To wit, if demographics shift to favor families over single households in a particular neighborhood, the developer can shift the unit mix away from studios in favor of two- or three-bedroom units during the design and/or approvals stage.

Practically speaking, the project size and aesthetics do not necessarily have to change; rather, interior walls can be redesigned to resize units, for example. If financing terms change so that buying becomes less favorable, those condos can become rentals. While changes such as these can rarely be made instantaneously, they nevertheless can occur in a relatively compressed timeline.

What happens when a community plan needs to adjust to changing realities on the ground?

The public process afforded to a democracy is such that community plan revisions, updates, and subsequent zoning amendments and reverberant impacts most often initiate new rounds of soliciting, collecting and analyzing community input. This process, in an effort to be thorough and comprehensive, can take years in some cases.

From there, urban planning experts—typically outside consultants working with a city planning agency – make recommendations that are then presented to the decision makers, e.g. city council members. The decision makers vote for or against the plan, and then send the plan back to the planners to document those decisions accordingly. Needless to say, this is not a quick process.

THE NEED FOR CHANGE

Unfortunately, today finds increasingly urgent situations in cities, which necessitate a fundamental realignment of the planning and development process. Developers act opportunistically, meaning they act quickly upon changes in the market, and can adjust, at least in part, in response to these urgent situations. Planning departments, for reasons mentioned above, cannot react so quickly and, thus, miss opportunistic prospects.

In the real estate world, booms seem to get higher and higher, busts go deeper, and cycles continuously seem to get shorter. While this observation is well documented in various media, there already seems to be a lack of understanding (or an absence of genuine willingness to understand) combined with a lack of appreciation for where the real estate markets have been and where they are going.

The real estate market seems once again to be functioning based on the fundamentals of financial markets, as opposed to real estate fundamentals (of which financial markets are certainly a part, but only one part of many). Funds have mountains of money that they are under pressure to deploy, funds keep getting bigger, and real estate investing is following the trend as cap rates and returns push ever lower. Low interest rates, combined with this flood of capital, are exacerbating and further driving cap rates lower.

Pricing in most markets appears to show recovery, or maybe even approaching a peak. The five stages of real estate market cycles are recession, recovery, expansion, equilibrium and hyper-supply. Actual demographic data—e.g. job creation and household income—point to recovery. However, real estate development activity, lease rates and vacancies show, for the most part, expansion. But then again, financial markets are pointing dangerously close to hyper-supply, with the low interest rates, cap rates, and return thresholds identified above.

In broader terms, the world does not feel as though it is in full recovery. Economically, the disparities between rich and poor are at their largest, and are apparent at the local, regional, and national levels. Environmentally, climate change is more aggressively altering the physical landscape and ecology of cities and regions, resulting in dramatic seasonal cycles and increasing threats of natural disasters.

These factors, when considered alongside globalization, public health, technology, and myriad transportation considerations, rapidly shift attention toward or away from entire city neighborhoods—and in some cases, entire cities—leaving the future of a significant number of communities in jeopardy.

It can be argued that the speed with which real estate, economic, and environmental cycles are occurring follows a similar trajectory to Moore's Law, which states that the number of transistors on a computer microchip will double approximately every two years, thereby increasing processing speeds.

This observation was first made by Gordon Moore, co-founder of Intel, almost fifty years ago, and still holds true. And yet, technology, more than most industries, and certainly more than planning and development, operates not on precedent, but on innovation. The industry is almost entirely forward-looking. So companies like Intel, while documenting the foundational observation of Moore, use his observation to compel progress.

While some may argue that consumer goods, such as microprocessors, are not comparable to real estate, it is important to remember that real estate is the largest consumer good, within which all other consumer goods are created and housed and consumer activities take place.

ENTREPRENEURIAL PLANNING

At the time he co-founded Intel, Moore was most likely considered a businessman. Had he founded Intel today, he would more likely be known as an *entrepreneur*. Entrepreneurs, like real estate developers, are, by their very nature, risk takers.

Public planners are not risk takers within the purview of their posts, nor should they be. But, given the speed and breadth with which change is occurring, there is a defined need for *entrepreneurial planning* if cities and neighborhoods are to sustain themselves in the face of ever-increasing competition and challenging conditions.

The process by which an entrepreneur approaches a project is worth considering briefly. For starters, successful entrepreneurs do not first consider "projects" at all, but "ideas." This idea can originate out of a problem statement such as "My phone doesn't work well". Or it can start from a positive statement such as "I'd like to create a new way to communicate."

Regardless of the origin, there is often little time spent considering how this idea will translate into physical form during this initial phase. It is a need-based approach first, and a design and delivery approach once that need has been identified.

For planners, this step means substituting, "Our community needs a comprehensive plan" or, "Our community needs affordable housing," with "Our residents need new opportunities to improve their quality of life."

Idea in hand, the entrepreneur pursues seed funding to develop the idea further. Funding can come from a variety of sources and, again relative to planning and development requires comparatively minimal background research and strategy. The emphasis is on bold ideas with the potential for big impacts.

Planners can similarly pursue funding to develop their big ideas further, and should consider public-private partnerships at the "ideas" stage to allow the process to more quickly advance into tangible projects. The common method for such approaches is to apply for grants, but a new approach could include bringing developers and landowners to the table to expressly identify community needs and seek physical solutions that both meet those needs and are economically feasible.

Both sides—planners and developers—need to remember that the former works in the interests of the community, and the latter works in the interest of deriving profits in the face of considerable risks. If communities can obtain the uses they want and need through the work of a developer, who is supplying space and shelter for those uses, and the developer can supply that product profitably, then both sides are successful.

While options exist for creative partnership structuring, the point here is to recognize the synergies between need and know-how. The two sides should be, and are, complementary, not at odds.

Working together, this step provides an opportunity for planners, investors, and developers to collaborate much earlier than the traditional planning and development process. More often than not, projects that have been successful down the road stemmed from public-private partnerships that assessed neighborhood and stakeholder needs in tandem with development feasibility to limit and moderate the eventual hurdles that arise.

In essence, the guesswork inherent in planning and development is reduced due to the introduction of inputs from stakeholders along the way. This is not dissimilar from a developer bringing a contractor on to the team early to address constructability and value-engineering issues during the design phase.

Let's return to the entrepreneurs' model. Funding received, the entrepreneur goes into rapid prototyping with the goal of translating the idea into a product. There is the process of honing its functionality and front-end presentation:

(i) the ease with which its purpose can be understood,

(ii) the speed at which it can be used, and

(iii) the anticipated appeal of use.

Alongside that front-end is the fabrication and back-end operations:

(i) the cost to make,

(ii) materials required,

(iii) labor needed,

(iv) management, and

(v) maintenance, etc.

A number of these prototypes will fail for a variety of reasons. Through successive improvements, product testing with focus groups of potential users, expert reviews, and media previews, the product is then delivered to the market. In the design world, charrettes are a superficial attempt at this, but rarely (if ever) do they include the market analysts, lenders, and investors that help determine the underlying economic feasibility of such ventures.

But that is not the end for the entrepreneur. There is a customer feedback loop so that the next version of the product not only improves upon what does not work, but provides an opportunity for the product to continue to remain relevant. This is where developers can make alterations (to a point) to their final product in response to market dynamics, but where planners are often hamstrung by the drawn out public processes necessary to make many changes.

In practice, efforts should be oriented around the neighborhood scale to guide incongruent land uses and conflicting stakeholders toward progressively improving neighborhood fabric.

Whether converting a mid-block surface parking lot into a vibrant section of mixed-use street retail and residential presence, transforming sub-standard housing into a new affordable housing development, or exploring opportunities to convert single-family residences into a mix of retail and office space, to name a few examples, the focus should be on delivering timely solutions to expressed community needs.

The ability to assess development opportunities across product types and scales, particularly in service of and in collaboration with community economic development strategies, is a game-changer. Even further, when a community's quality of life becomes the orienting device for these economic development strategies, true real estate value extends beyond brick-and-mortar into the experience of the place.

ENTREPRENEURIAL INVESTING AND DEVELOPMENT

Let's say a city provides seed funding to a local neighborhood that strongly believes it has a certain need or opportunity (or perhaps there is a certain citywide need that is applicable for each neighborhood). Then, that neighborhood enlists a developer to help realize its goals. This, of course, relies on the community controlling the site(s) in question, structuring partnerships with landowners, and/or approaching the city together to pitch their joint ideas.

In this last scenario, city planners, the neighborhood, and developer together select a publicly owned site to work with. The planner represents stakeholder interests and the neighborhood's long term vision. The developer provides expertise related to financing, project management and identifying the market niches to be served.

This approach need not focus on large-scale efforts. In fact, small-scale efforts may be more palatable to diverse stakeholder groups. And, although developers typically find time better spent on larger projects with larger profit potential, the potential elimination of entitlements uncertainty may prove enough to attract top flight developers.

Whatever the example, it is important to convey that this process can, and perhaps should, start small-scale. With entrepreneurs, a product can be something that fits in your hand, or a service intended for individual users. There is also usually a small core team deeply dedicated to trying to develop the product. But over time, the expectation is that the product will have widespread, reverberant impacts.

This is a counterargument to developing a community plan, or at least to thinking differently about how that community plan is formulated and disseminated to stakeholders. Neighborhood change on a timeline that will be noticeable and make a substantial difference to the community is much more surgical and catalytic.

Real estate developers best exercise their skills and know-how by first considering location and then, after analysis and stakeholder input, executing on highest and best use in terms of not only financial returns, but community needs, as well. Again, it is not planners or stakeholders or communities against developers. It is communities expressing their needs and desires, then attracting a developer to work in partnership in realizing the local vision and, finally, city planners recognizing an aligned community vision.

Emphasis here is, again, on the fact that this is a highly localized process for small-scale developers. The difference between locating the project address on one street compared to the adjacent street can have significant impacts on the project value, for example. Local stakeholders possess this intimate knowledge and, therefore, should be welcomed as development team members.

What's great about this approach? With a willing partnership of community, developer and city, it can start NOW.