

NC General Convening on Opportunity Zones

# What is an “investment ready” real estate project, and how do you get there?

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UNC  
SCHOOL OF GOVERNMENT

12/13/18

## Agenda

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- DFI @ UNC School of Government
- What is an “investment-ready” project and why is it important in the context of Opportunity Zones?
- Getting to an “investment-ready” project
- Case Study: Durham County

## UNC School of Government

- Largest university-based local government training, advisory, and research organization in the U.S.
- Serves 12,000+ public officials each year through courses, webinars, and specialized conferences, publications, calls, and emails.
- Values: Nonpartisan, policy-neutral, responsive.
- “In the bloodstream” of state and local government.



## Development Finance Initiative

The Development Finance Initiative (DFI) is a program of UNC Chapel Hill's School of Government and collaborates with communities in NC to attract private investment for transformative projects by providing specialized finance and real estate development expertise.



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### Expertise:

- Real estate development
- Architecture
- Public and private finance
- Public-Private Partnerships (P3)
- Public development law
- Community engagement
- Land use & market analysis

## Typical DFI Projects Involve Public-Private Partnerships

### REACTIVE

- Private Owner needs government partner



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### PROACTIVE

- Government Owner needs private development partner



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## DFI Projects

End of 2017

**118 Projects since 2011**

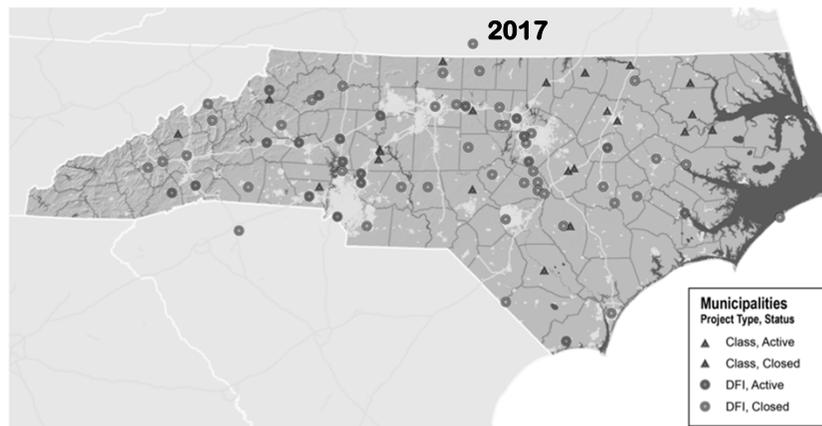
Over 30 class projects at no charge

### Size of Community

>50,000	23
<50,000	26
<20,000	51
<2,500	18

### Economic Development Tier

Tier 1	33
Tier 2	45
Tier 3	40

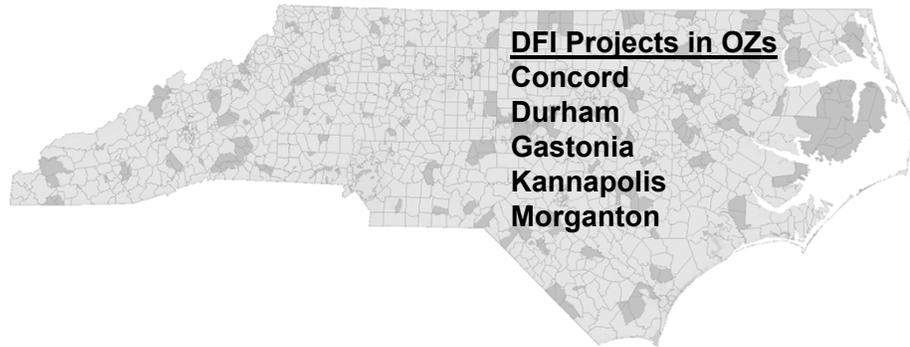


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# NC Opportunity Zones

Counties with the most OZs	
Mecklenburg	17
Wake	13
Guilford	12
Forsyth	11
Cumberland	9
Gaston	9
Robeson	7
Durham	7
Rowan	5
Pitt	5
Edgecombe	5
Buncombe	5

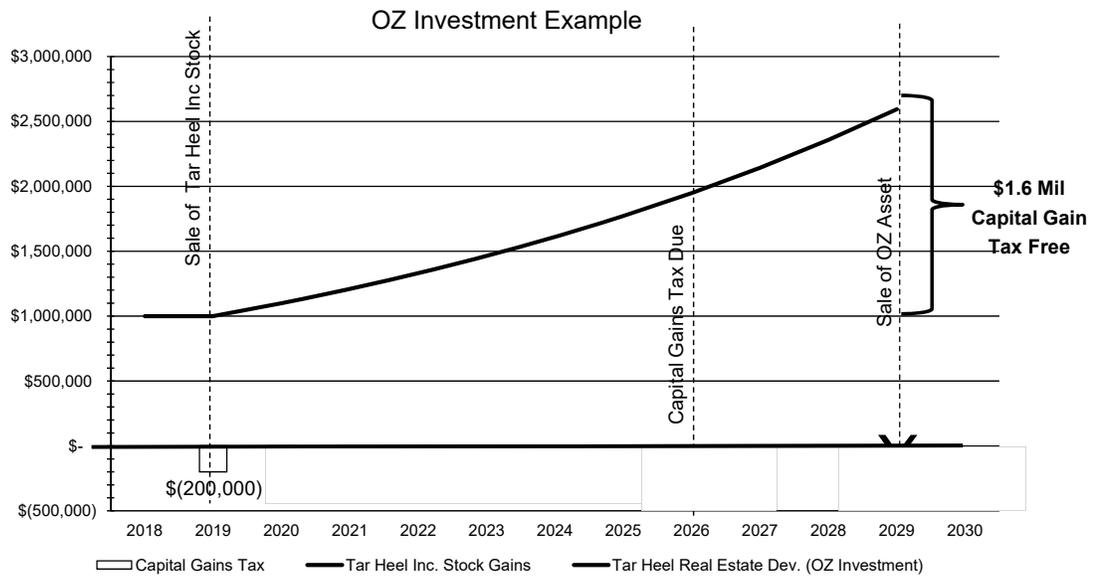


- NC Opportunity Zones: 252
- US Opportunity Zones: 8,700 (12% of US census tracts)



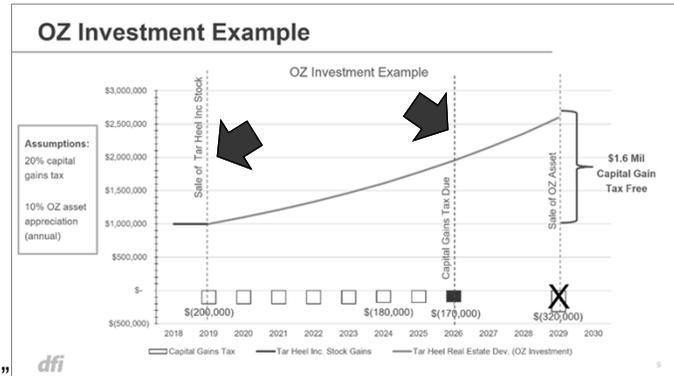
# 10 Year Hold: Advantage for Real Estate

**Assumptions:**  
 20% capital gains tax  
 10% OZ asset appreciation (annual)



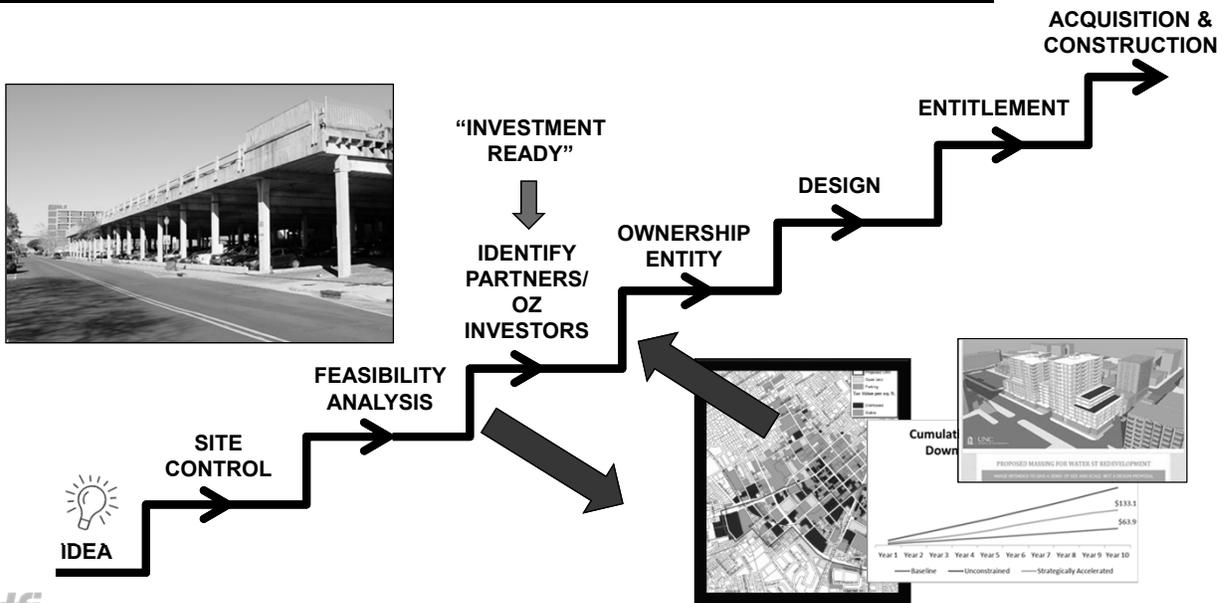
## Why “Investment Ready” Is Important

- **OZ designation is not a strategy**
  - Capital flows to “ready” projects
  - Best practice for P3 (OZ or not)
- **OZ timing**
  - Max benefits if invest by 2019
  - Short period to invest cap gains in OZ
    - Investor has 180 days to invest in “Opportunity Fund”
    - **No outside “fund” is required;** developer or investor can simply “self-certify” as “Opportunity Fund”
    - “Opportunity Fund” must hold OZ property for semi-annual 90% test



# What is an “investment-ready” project?

# Private Real Estate Development Process



Sources: Miles et al., Peca, Peiser & Hamilton

## What is an investment-ready project?

- Site control (of well-located and development-ready site)
- Financially feasible
  - Strong market for desired product type
  - Returns that exceed financial “hurdle rates”
- Good private partner: Experienced developer
- Good public partner: Low barriers to entitlement

# An investor opens up a prospectus...

### NORTHERN EDUCATION DISTRICT

Multi-university district walking distance to downtown



**ZONE TYPOLOGY TYPE\***  
Tier 2 Job Center & Mixed Job/Residential

**OPPORTUNITY ZONE JOBS**  
2015: 3,423  
2010: 3,399  
**+1% change**

**TOP 3 INDUSTRIES**  
1. Health Care and Social Assistance (24%)  
2. Educational Services (16%)  
3. Professional, Scientific & Technical Services (12%)

**OPPORTUNITY ZONE RESIDENTS**  
2016: 4,941  
2010: 4,848  
**+2% change**

**VACANT RESIDENTIAL PROPERTIES**  
Q42017: 253 (7%)  
**VACANT BUSINESS**  
Q42017: 61 (11%)

LOUISVILLE • INVESTMENT PROSPECTUS      \*See appendix for typology methodology



**The Assets**

- Expanding university district, distinct from the University
- Spalding University—focusing largely on in-demand healthcare and business fields.
- \$24 million Jefferson Technical & Community College Advanced Manufacturing and Information Technology
- Simmons College—Louisville’s rapidly growing HBCU.
- Invest in business start-ups aligned with research and entrepreneurship of each university.



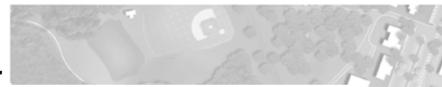
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Below average ←      → Above average





# ...and another prospectus...



## TOTAL PROJECT RETURNS

Project Year	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7
<b>Residential</b>							
Equity Contributed	\$ (4,140,551)	\$ (909,400)	\$ -	\$ -	\$ -	\$ -	\$ -
Before Tax Cash Flow from Sale - Townhomes	\$ -	\$ -	\$ 4,346,367	\$ -	\$ -	\$ -	\$ -
Before Tax Cash Flow from Sale - Single-Family	\$ -	\$ -	\$ 1,007,200	\$ 2,900,700	\$ -	\$ -	\$ -
<b>Total Cash Flows</b>	\$ (4,140,551)	\$ (909,400)	\$ 5,353,567	\$ 2,900,700	\$ -	\$ -	\$ -
<b>Commercial</b>							
Equity Contributed	\$ (2,602,546)	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Before Tax Cash Flow from Operations	\$ -	\$ 103,459	\$ 202,961	\$ 135,403	\$ 147,671	\$ 171,007	\$ 195,043
Before Tax Cash Flow from Sale	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 2,843,901
<b>Total Cash Flows</b>	\$ (2,602,546)	\$ 103,459	\$ 202,961	\$ 135,403	\$ 147,671	\$ 171,007	\$ 3,038,943
<b>Master Development Cash Flows</b>	\$ (6,743,097)	\$ (805,940)	\$ 5,556,528	\$ 3,036,103	\$ 147,671	\$ 171,007	\$ 3,038,943

IRR	16%
Equity Multiple	1.6x

Development Budget			
	Percent	Per GSF	Total
Acquisition	4%	\$ 12	\$ 555,750
Hard Costs & Contingency	79%	\$ 235	\$ 10,642,461
Soft Costs	17%	\$ 51	\$ 2,296,616
<b>Total Development Costs</b>		<b>\$ 298</b>	<b>\$ 13,494,826</b>
Permanent Capital Sources			
	Percent	Per GSF	Total
Historic Tax Credit Equity	24%	\$ 72	\$ 3,256,572
Primary Loan	52%	\$ 156	\$ 7,079,958
Seller Note	4%	\$ 12	\$ 555,750
Equity	19%	\$ 57	\$ 2,602,546
<b>Total Sources</b>		<b>\$ 298</b>	<b>\$ 13,494,826</b>

	Commercial Operating Cash Flow			
	Year 1	Year 2	Year 3	Year 4
Gross Revenues (NNN)	\$ 815,400	\$ 839,862	\$ 865,058	\$ 891,010
Vacancy (%)	18	19	19	20
Vacancy (\$)	\$ (335,250)	\$ (83,986)	\$ (86,506)	\$ (89,101)
<b>Gross Effective Income</b>	<b>\$ 480,150</b>	<b>\$ 755,876</b>	<b>\$ 778,552</b>	<b>\$ 801,909</b>
Operating Expenses	\$ 14,405	\$ 22,676	\$ 23,357	\$ 24,057
<b>NOI</b>	<b>\$ 465,746</b>	<b>\$ 733,200</b>	<b>\$ 755,196</b>	<b>\$ 777,851</b>
NOI Valuation	\$ 5,821,819	\$ 9,164,994	\$ 9,439,944	\$ 9,723,142
<b>Total Ownership Expenses</b>	<b>\$ (465,746)</b>	<b>\$ (530,239)</b>	<b>\$ (619,793)</b>	<b>\$ (630,180)</b>
<b>Before Tax Cash Flow with Reserve</b>	<b>\$ 103,459</b>	<b>\$ 202,961</b>	<b>\$ 135,403</b>	<b>\$ 147,671</b>



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# Getting to an “investment-ready” project (advice for governments)

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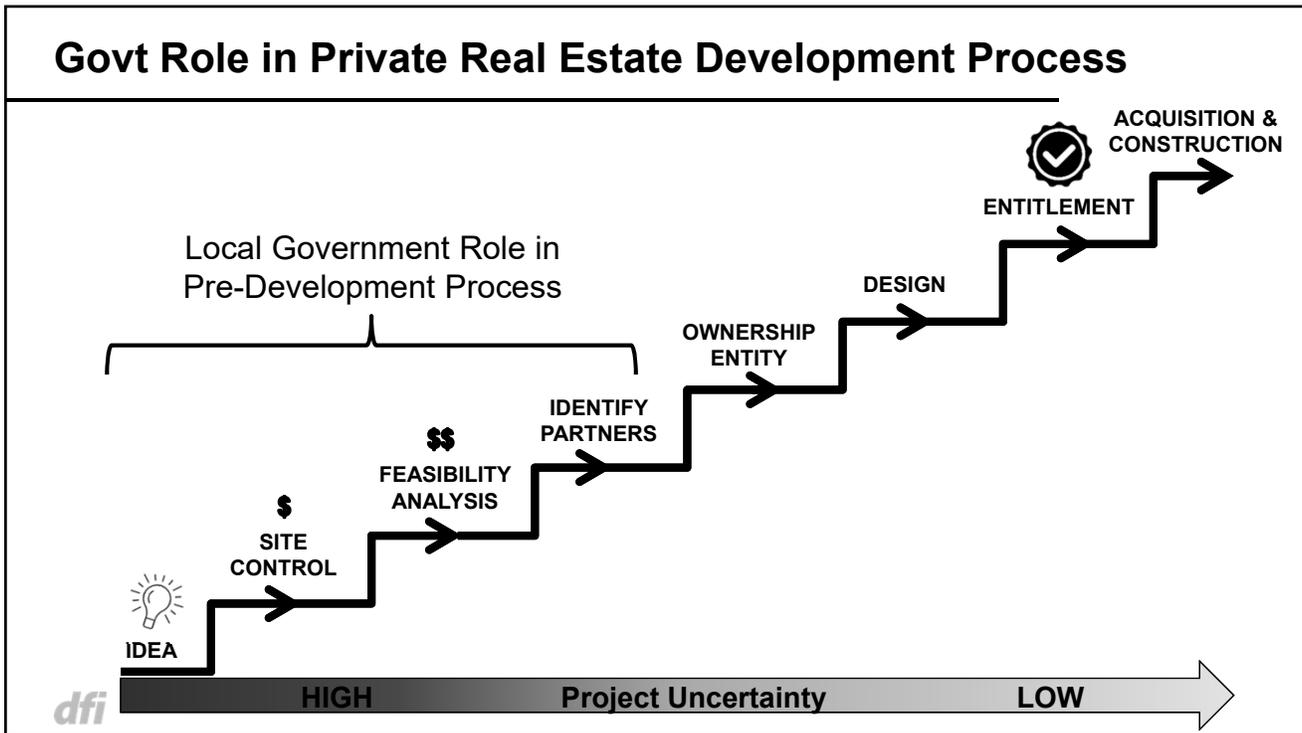
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## How Can Local Governments Be Proactive?

- Prepare the area for private investment:
  - Invest in public infrastructure
  - Invest in streetscape improvements
  - Reduce blight, code enforcement, clean up
    - Sends a market signal that promotes development
- Identify appropriate district designations
  - URA (Urban Redevelopment Area), MSD (Municipal Service District), Historic, Special Assessment District
- **Create an investment-ready project**

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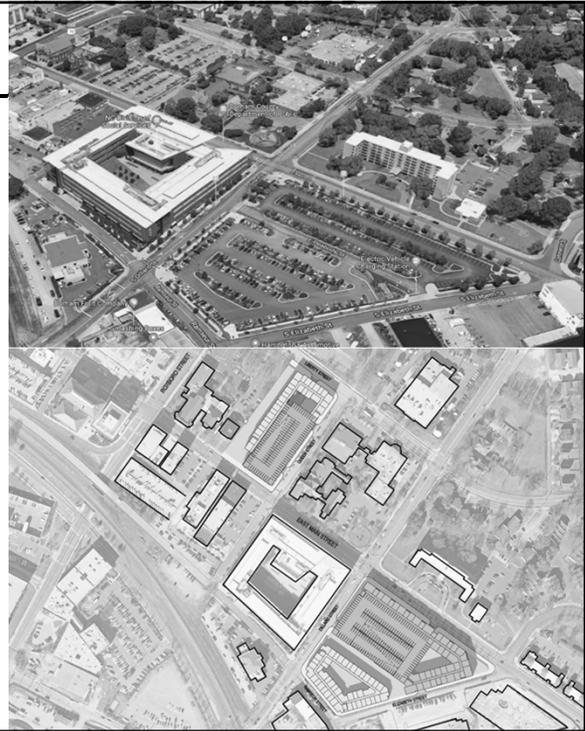


## Case Study Getting to an investment-ready project in Durham County

## Idea

- Two County-owned surface parking lots in downtown Durham. One lot located in opportunity zone.
- Initial plans to build just parking decks on the sites received considerable push back from well-organized advocacy groups who saw a missed opportunity for affordable housing
- DFI engaged to conduct pre-development process.
  - **Goal: Attract private development partner to execute the County's vision.**

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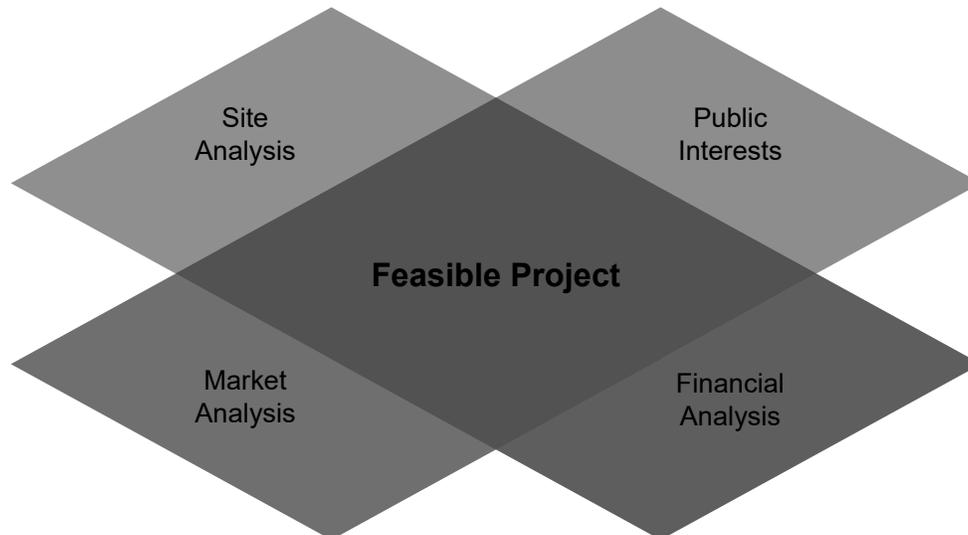


## Site Control



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## DFI Feasibility Analysis



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## Public Engagement on Public Interests



### Engagement included:

- Ongoing listening sessions with local stakeholder groups
- Four public input sessions
- Regularly updated project page on County website
- Online feedback form
- County employee survey

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# Market Analysis

## Pipeline Office Supply

Development Project	Office Space (SF)	Less Prelease	Total Pipeline
One City Center	130,000	(123,000)	7,000
Durham I.D.	270,000	(162,000)	108,000
555 Magnum	190,000	-	190,000
Golden Belt Campus	-	-	-

## Downtown Multi-Family

Family Rental Units	1,990
Occupancy Rate	7.1%
Median Rent (5-Year Average)	\$2.15
Median Rent	\$1.77
Median Rent	\$1.72
Median Rent	\$1.63

## Retail Trade Area

Despite the addition of office space remains feet based on basic properties are



9,800 Households

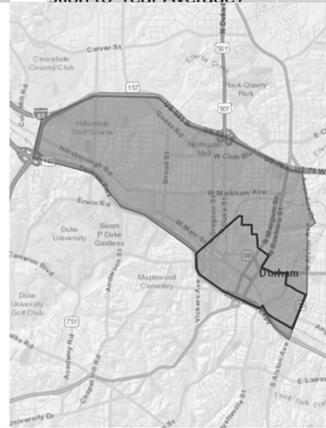
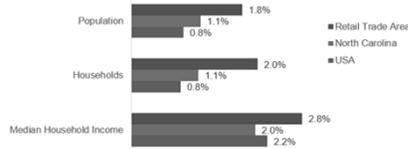


\$38,000 Median Income



32 Years Median Age

### Projected Annual Growth (2017 - 2022)



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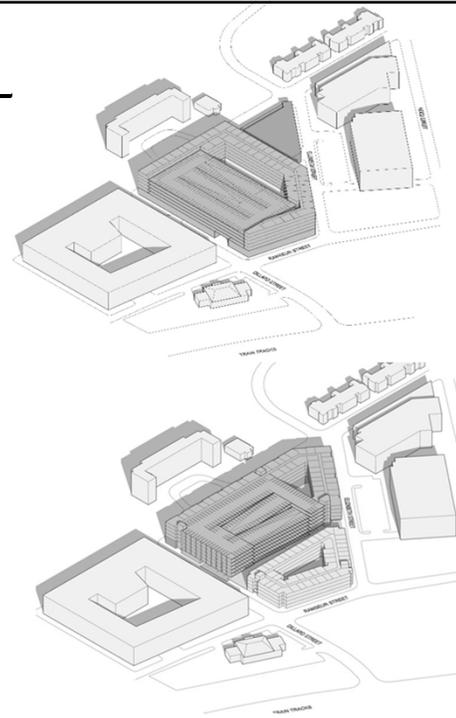
dfi Source: Esri, US Census Bureau

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# Site Analysis

## Design Requirements

- Downtown Durham UDO Code
- Downtown Durham Historic District
- NC Housing Finance Agency Qualified Allocation Plan
- Construction Type
- Stormwater Requirements
- Regulations for specific uses (i.e. daycare, pre-K, grocery store)

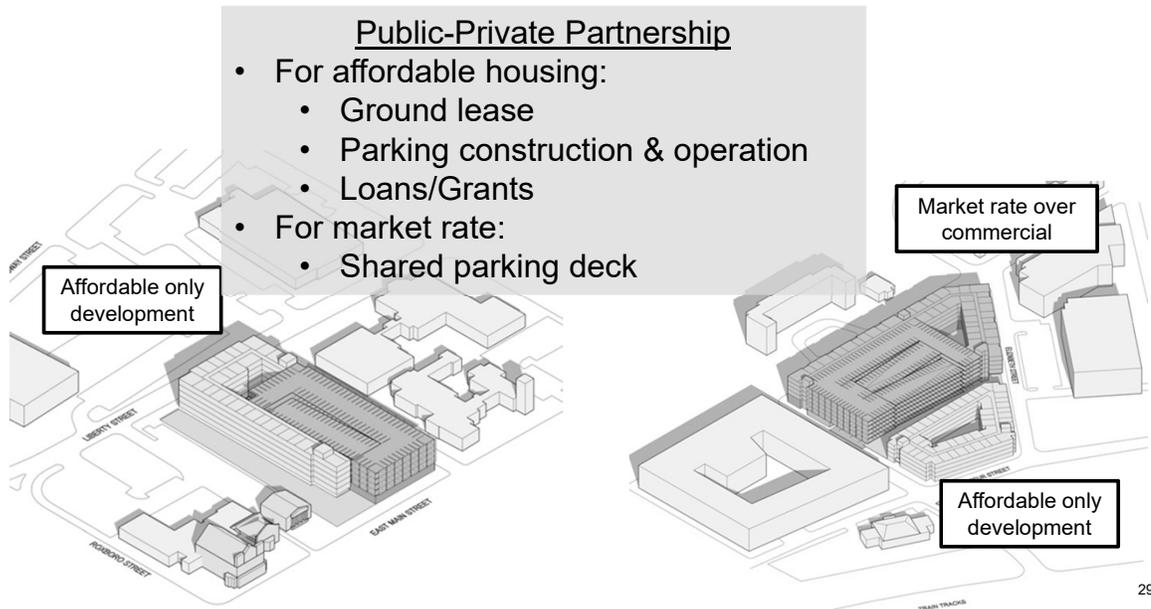


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## Development Plan Approved



## Public-Private Partnerships (P3s)

P3s are helpful when:

- Government has site control over a project but requires private investment to achieve public goals.
- Private owner has project that provides public benefits.  
Public participation needed to secure the public benefits.

## Next Steps

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- Identify a private development partner or partners.
- With an investment-ready project and public-private partnership in place, the developer is well-positioned to begin attracting investors (OZ or otherwise).

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## Conclusion

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- Opportunity Zone designation, by itself, is not a strategy
- Governments can proactively complete steps in the private real estate development process to make important projects “investment ready” (inside or outside of OZs)
- Best practices for real estate development are best practices for Opportunity Zones.

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