Nº 215 FEBRUARY 2005

MainStreetNews

THE MONTHLY JOURNAL of THE NATIONAL TRUST MAIN STREET CENTER

CONTROL YOUR REAL ESTATE, CONTROL YOUR DESTINY

{ BY JAY C. JUERGENSEN }

If Main Street communities want to control their destinies, they need to control their real estate. Healthy communities are about creating great places. For Main Street, great places are a collection of real estate deals and developments completed over the course of 100 years, give or take a decade. To create and enhance your sense of place on Main Street and to control your destiny, real estate is the name of the game.

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9. **Cool Cities Make for...**
one cool state! Read about Michigan's Cool Cities Initiative. To try and stem the flight of young adults to other states, Michigan's governor launched a program in 2003 to spur revitalization and economic development throughout the state. See what Michigan's Cool Cities have been up to.

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20. **2005 National Main Streets Conference ...**
... is just around the corner! Find out how you can register online!

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Successful Main Streets create an environment for investment. However, private investment may not return at the pace you seek, embody the quality you prefer, or be able to take on tough or larger projects. It may be difficult to lure the traditional "development industry" to a small or difficult market, leaving you either to accept the speed of private-sector development or become the developer as a last resort. Being a Main Street developer isn't for the faint of heart and is not without risks, but with the right training and an investment of time and resources you can generate a quality development and learn to manage the associated risks.

When you think of Manhattan, images of the Empire State Building, Rockefeller Center, and Grand Central Station immediately come to mind. Thoughts of Chicago immediately bring visions of the Sears Tower, the Miracle Mile, the John Hancock Building, and Lakeshore Drive. These landmark buildings and developments contribute to the sense of place in these communities. The physical elements that frame your experience are real estate projects that are heavily influenced by a confluence of public decisions and private investments.

UNDERSTANDING PLACE

Real estate assets fundamentally define place in a downtown or neighborhood commercial district. A large percentage of America's Main Streets are about three blocks long by three blocks wide, with two- and three- story, mixed-use buildings that have retail on the first floor and housing, or other commercial or assembly uses, on the upper floors.

This physical form, so common in varying degrees among Main Street communities throughout the country didn't occur accidentally. In fact, most regional malls are built to the same physical scale as Main Street. After all, regional malls are little more than Main Streets wrapped in marble and glass.

In recent years, these malls have begun to struggle in much the same way that downtowns struggled decades ago. Yet malls are evolving in a retail Darwinian struggle: their rooftops are being removed and they are adopting more of a Main Street-like outward physical appearance. More importantly, these retailing centers are adapting to changing market conditions, and they are doing it more rapidly than Main Street ever could for one very important reason: ***one entity controls the real estate.***

Place is, however, more than just a collection of interesting buildings and civic spaces. Healthy communities have another important element and a distinct advantage over most malls — the social element. The social element is not easy to define or describe, but you know it when you see it. It can be the bridging of two social groups, such as the way the "Manchester Chicken Broil" in Manchester, Michigan, links the local high school football team with the Rotary Club for an annual community event (and don't bother to ask for the secret coleslaw recipe, you won't get it, but the slaw is worth the trip).

The Sense of Community Project at Michigan State University's Center for Urban Affairs defines the social element this way, "The term 'healthy communities' implies the presence of a vibrant social infrastructure consisting of numerous formal and informal organizations which are held together by the social fabric of the community. Social networks link organizations and individuals with each other and enable the community to function in a healthy way." Regardless of whether it is broiled chickens or downtown festivals, the social element is no less important than the physical element of community.

In healthy communities, residents actively relate and support one another and the community around them in broad public spaces. These social and intrinsic bonds can either be encouraged or discouraged by the land-use decisions made by public officials and private developers. "It expresses itself physically as connectedness," James Kunstler writes in *The Geography of Nowhere,* "as buildings actively relating to one another, and to whatever public space exists, be it the street or the courthouse square, or the village green."

The social fabric to which Kunstler is referring includes random encounters with old friends on the way to the theater or volunteering to work a booth at the local festival. We know our public decisions, as well as our investments, encourage or discourage the continued weaving of our social fabric. How we build our roads, support affordable housing, and promote economic development are all critical public decisions that impact our sense of community.

Curtis Johnson, of the Citistates Group, once said, "We built a lot of subdivisions in the second half of the 20th century, but not many real communities." Boeing Corporation moved its headquarters to Chicago because of its livability and sense of community. It might have chosen any number of cheaper alternatives, but according to Bank One Chief Economist Diane Swonk, "Chicago has become

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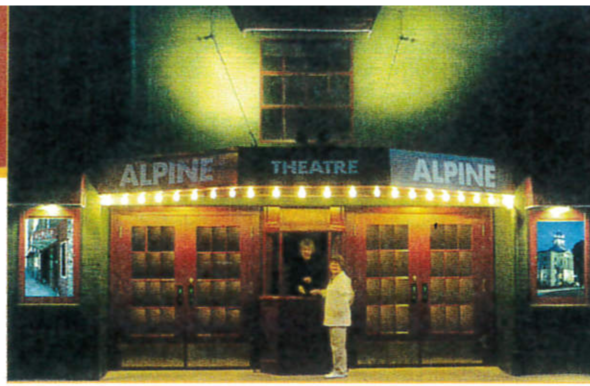

Built in 1936, the Alpine Theatre was a major eyesore in downtown Mount Ripley, W.Va., until the Main Street program purchased the building. With the exterior rehab finished and interior renovations slated for completion in spring 2005, the theatre will serve as a community arts center.

one of the most livable communities in the country."

Livability and quality of life are as much an economic decision today as lower taxes and freeway access. It has been suggested by the American Institute of Architects that homebuyers will pay a premium to live in "walkable" communities and National Trust President Richard Moe's book, *Changing Places,* suggests that consumers are seeking less staged and more authentic living and retail experiences, rather than impersonal reproductions.

THE MALL CHALLENGE

The best physical expression of community is Main Street. It is where work, art, leisure, and entertainment collide in one place. Main Streets are the diverse historic districts that are unique to each community. Over the last 50 years, our shopping anchors left downtown and we wrapped the scale of our commercial districts in regional malls surrounded by a sea of parking. More recently, developers have begun to offer consumers a cheap substitute for a sense of place through a re-invented Main Street form.

"Greyfields" is the new term for dying malls. A study by the Congress for New Urbanism found that 18 percent of malls are distressed and 40 percent are vulnerable based on per square foot sales. For regional malls, we are speaking generally of the 2.5 to 3 million square feet at the local interchange. Sears, once a staple at regional malls, recently announced its desire to merge with Kmart Holding Corporation, in large part to acquire their store locations and move Sears out of its exclusive mall presence, thereby allowing the chain to compete directly with Wal-Mart, Target, Home Depot, and Lowe's.

Many developers are offering consumers a substitute for place through re-invented Main Streets that range from cheap reproductions (bottom left) to upscale "lifestyle" centers such as this development outside Charlotte, N.C. (above left).

Wal-Mart and other big-box retailers, traditionally located in the suburbs, are radically downsizing and rethinking their footprints to give them the flexibility to fit into new, existing, or adaptively re-used buildings in downtown or urban locations. Successful developments include Wal-Marts in Bennington, Vermont, and the Los Angeles Crenshaw neighborhood; Home Depot in Tulsa; Toys-R-Us in Santa Monica; Target in Pasadena, Minneapolis, and Portland; and TJ Maxx, Rite Aid, and Media Play in Denver.

Yet as malls struggle and superstores attempt to remake themselves, another new trend is sweeping the shopping center industry. "Lifestyle" centers offering a smaller collection of typically upscale retailers housed in distinctive, quality architecture are now filling the landscape. However, while some Gap, Victoria's Secret, and Restoration Hardware stores have fled the marble and glass, climate-controlled malls for an open air environment, these developments still sit in a sea of parking in the usual suburban, single-use context.

Finally, another recent trend that makes the argument for Main Street development is what we call "Faux Place." Whether it's the decapitated regional mall, the lifestyle center, or new developments attempting to mimic downtown, these developments now have districts and street names. In Columbus, Ohio, Easton Town Center, a large lifestyle center about the size of a regional mall, houses its tenants in historic building look-a-likes and has as its centerpiece a new building that looks a rehabbed train station.

MAIN STREET'S REAL ESTATE ADVANTAGE

According to the *American Community Survey,* sponsored by Smart Growth America and The National Realtors Association, 86 percent of Americans think it is sound policy for states to fund improvements in existing communities over new developments in the countryside; and 72 percent place a high priority on homes in walkable communities. Homes in walkable neighborhoods sell for a premium over their suburban counterparts.

Recent trends support these findings. Empty nest baby boomers with retirement looming are downsizing, choosing two smaller homes in different locations as opposed to one large home. Healthy small towns are becoming popular retirement destinations. Older Americans who are finding it more difficult to drive place a high importance on the ability to walk to grocery and drug stores, medical facilities, churches, and local parks.

Shopping habits have also changed drastically over the past few decades. We now spend four hours per person per month shopping, down from 12 hours per month nearly two decades ago. For many women, going to the mall used to be a daylong experience. Today as more women enter the work force, shopping at the mall is no longer a viable recreational outlet. Convenience is now at the core of shopping decisions, and lifestyle centers are better than malls at providing that convenience. Even more convenient of course, is Internet shopping where you can buy anything from any online business 24 hours a day, seven days a week.

Retailers must grow or die and this often translates into opening new locations. Main Street districts, with their central location and convenient curbside design, along with much-overlooked urban markets, are becoming increasingly attractive to many stores that formerly located only in suburbs.

Commerce creates the architecture that defines the physical elements of community. Unlike European culture, our public square has become the mall and Starbucks is our attempt to achieve the casual community discourse that occurs in a corner café. Still, while our culture is driven by consumption, there is more we can do to enhance the physical elements of community.

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CONTROL YOUR REAL ESTATE, CONTROL YOUR DESTINY

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MAIN STREET AS THE DEVELOPER

We know that Main Street is a commercial district *management* program. The four elements of the Main Street approach – Organization, Design, Economic Restructuring, and Promotion – provide Main Street professionals with a framework for managing their "mall."

Malls, for all of their vices, do the same things that Main Street managers do every day, except the manager/owner controls all the real estate, because they are also the real estate developers.

Understanding that Main Street management and mall management are essentially the same and that controlling real estate gives the community control over its assets makes the case that Main Street organizations should consider taking on real estate development challenges in their community. To compete, Main Street programs must think like, talk like, act like, and maybe ***become*** a developer.

The great real estate cliché is – *location, location, and location*. While that is true, it does not tell the whole story. In reality, there are three circumstances that drive most community-initiated real estate development:

- Organizations get involved with real estate by default, whether they're building widgets or delivering human services. Real estate is necessary to support the organization even if it is not part of the core mission.
- Organizations get involved with real estate as a result of a crisis – lack of space, equipment failure, or the threatened demolition of a historic building.
- When confronted with the challenges of real estate development, most organizations realize that there are other challenges they must address – funding, expertise, the agility to respond to opportunities when they arise, or the desire and ability to more effectively control their destiny.

Throughout the country, "white elephants" (large, idle buildings) often present significant challenges and may act as a barrier to investment. For Main Street, the white elephant challenge is to leverage available public and private resources to make the deal work. Simply put, if you want to slay the white elephant, you often must become the developer.

When the private sector can't or won't act, but the community wants to see a building preserved, it is up to the Main Street organization to set the standard for the community. You may have to take charge if you want investment to happen.

Real estate development doesn't occur in "greenfields" *because* there is a market for new construction; it occurs *as a result* of the availability of financing. Land consumption increases not because of a growing demand for new offices, homes, or stores, but because a developer has a line of credit with a bank or other financial resources to build. Companies such as Wal-Mart and the regional mall developer aren't finding new consumers. They are taking them away from other retailers and from you.

UNDERSTANDING THE BASICS OF REAL ESTATE FINANCE

Education on real estate development is best provided in the context of a specific building or case study. The National Trust Main Street Center's *Community Initiated Development* (CID) manual by Donovan D. Rypkema, onsite CID training by the NMSC, and courses we have provided at National Trust and Main Street conferences include worksheets as examples of documents commonly used by the industry to examine financial feasibility. Absent that luxury, you might select a building in your commercial district that you would like to see developed and sketch out some of the financials as they are described here.

There are two guiding documents that drive the financial feasibility of any project, the *Sources and Uses of Funds Statement* and the *Pro Forma Operating Statement*. The genesis of these documents will be based upon research, which you, as the Main Street manager, should already have in-hand.

The Sources and Uses of Funds Statement identifies the costs of the project (Uses of Funds) and how the project will be funded (Sources of Funds). There are three critical cost components: acquisition, hard costs, and soft costs. The total of all three is commonly refer to as the *Total Development Costs* or *TDCs*.

Acquisition refers to the land and the building along with various fees, including title work, recording, and related transactional costs. If the property is distressed or reverted to a government agency – city, county, state, or the U.S. Department of Housing and Urban Development (HUD) –you might be able to work out a purchase agreement for as little as $1.

If the property is in private hands, it may require some negotiation, so pick up the phone and call the owner. As a nonprofit developer, you may be able to persuade the owner to donate a portion or all of the value of the property for tax purposes, but you will never know unless you call.

Total Development Cost Budget Worksheet

Property			Date
			Prepared by:
Acquisition			
	Land		
	Building		
	Title Insurance		
	Closing & Recording Costs		
Hard Costs			
	Intervention		
	Subcontractor's Costs		
	General Contractor's Costs		
	General Contractor's Overhead		
		Permits	
		Insurance	
		Payment Bond	
		Performance Bond	
	General Contractor Profit		
Soft Costs			
	Professional Fees		
		Architectural & Engineering Fees	
		Surveyor	
		Environmental Consultant	
		Attorney	
		Accountant	
		Appraiser	
		Marketing Research	
	Developer Fees		
		Developer Consultant	
		Owner's Representative/Project Manager	
	Financing Fees		
		Title Insurance	
		Loan Origination & Bank Fees	
		Closing & Recording Fees	
		Real Estate Taxes	
	Other Fees		
		Broker	
		Lease-Up	
		Marketing	
	Reserves		
		Replacement Reserve	
		Operating Reserve	
Total Development Costs (TDCs)			

Acquisition Costs
+ Hard Costs
+Soft Costs
= Total Development Costs

2004 Cornelius O'Brien/Indiana Main Street Conference
Be a Main Street Developer
Thursday, October 28, 2004

Prepared by: Juergensen & Associates
www.j-assoc.com

Total Development Cost Budget Worksheet

Construction costs are referred to as hard costs. If you can touch it (plaster, plumbing fixtures, or wood floors), it is a hard cost. These costs also include the contractor's overhead (costs of doing business such as insurance, permits, etc.) and profit, along with the materials that go into the building, and a construction contingency to cover anything unexpected or unforeseen. At inception, a 25 percent contingency might be prudent. As the project evolves and moves from concept to construction, the contingency is reduced as a better understanding of the risk is determined.

Professional fees and all the transactional costs are referred to as *soft costs*. These include the professionals you will need to hire – accountant, attorney, environmental consultants, development consultants – and market research, broker's fees, loan origination fees, interest expenses, etc. As a rule of thumb, soft costs are 25 to 33 percent of *hard costs.*

With a qualified architect and contractor, you can estimate the costs to renovate the building (hard cost). Because soft costs have a relationship to hard costs, this along with an understanding of the acquisition costs, will allow you to quickly generate the Total Development Costs for the project. *(See Total Development Cost Budget Worksheet, pg.4)*

Once you have determined the cost of the project, you need to determine how it will be financed. Like your home, often the single largest source for purchasing a property is debt. Equity (your down payment when you buy a house) is the other source of funds and might come from a variety of tax credits, other investors, or public and private grants. Similar to your home, in determining the debt and equity mix, the amount of debt (mortgage) the owner can support is based upon income.

The document used to calculate a building's ability to support debt is the *Pro Forma Operating Statement.* The two critical variables or elements that drive the pro forma are *revenues* and *expenses*. Revenues are obviously the dollars that come in and expenses are the dollars that go out. These elements will determine how the building will operate and are essential for calculating the level of debt financing available.

Revenues are the building's income, with the largest portion traditionally coming from rent. Other income might include secondary items, such as coin-operated laundry machines, billboards and signs, and/or parking. Rents are typically calculated by taking *gross rents,* the maximum rent if the building were completely occupied for the entire year, minus a vacancy factor (5 to 10 percent depending on the market), to achieve the *effective gross rents.*

There are three different types of expenses: *fixed expenses, variable expenses, and reserves.* Fixed expenses are the costs you can check beforehand, such as taxes and insurance, and should remain stable on an annual basis. Variable expenses can change from month to month; they include utilities, repairs, maintenance, and supplies.

The *operating reserve* is a cash set-aside in case the project runs into trouble, experiences an unexpected vacancy or expense, or fails to generate the anticipated income. In commercial real estate development, these items typically run between 40 to 60 percent of effective gross rents. For any development project, you need to tuck a few dollars away for replacement of the roof or the carpeting or the mechanical unit. This fund is called the *capital or replacement reserve* and is calculated after your debt service.

With revenues and expenses in place, you can calculate the *Net Operating Income* (NOI). NOI is your cash on hand after expenses and will be used to gauge the amount of debt the project can support. You calculate NOI on an annual basis by taking the effective gross rents and subtracting expenses. When you know how much you can pay, you can determine how much you can borrow.

There is one more important calculation that banks will review, the *Debt Coverage Ratio* (DCR). The bank wants to know that you have enough money available to make the payment, plus a little extra just in case. The DCR, as an industry standard, is between 1.1 and 1.25. Take your NOI and divide by the DCR and you are left with the *annual debt service.* Say, for example, your NOI is $10,000. Divide that by 1.25 and you are left with an $8,000 debt service to pay the mortgage. Terms of the loan as established by your local banker can help you understand the size of the loan. *(See Pro Forma Operating Statement below.)*

The debt service is important because it helps you determine the difference between what you can finance and what you need to make the project work, commonly referred to as the gap. The gap is the development hole that you have to plug using

continued on page 6

Proforma Operating Statement

Property | Date | Prepared by

INCOME/REVENUE

Revenue

Gross Rents - Housing — Qty | Monthly Rent | Extension
- One Bedroom
- Two Bedroom
- Three Bedroom
- One Bedroom AFF
- Two Bedroom AFF
- Three Bedroom AFF

Gross Rents - Commercial — SF | Annual Rent | Extension
- Retail
- Bathrooms

Gross Rents - Annual

– Expenses

Effective Gross Income (EGI - Net Rents)

OPERATING EXPENSES
- Fixed Expenses
- Variable Expenses
- Operating Reserves

Total Operating Expenses

Net Operating Income

DCR

Available for Debt Service

= NOI

Total Debt Service
- Debt Service (1st)
- Debt Service (2nd)
- Debt Service (3rd)

Cash Flow before Capital Reserve

Capital Reserves

Prepared by: Juergensen Associates

Pro Forma Operating Statement

continued from page 5

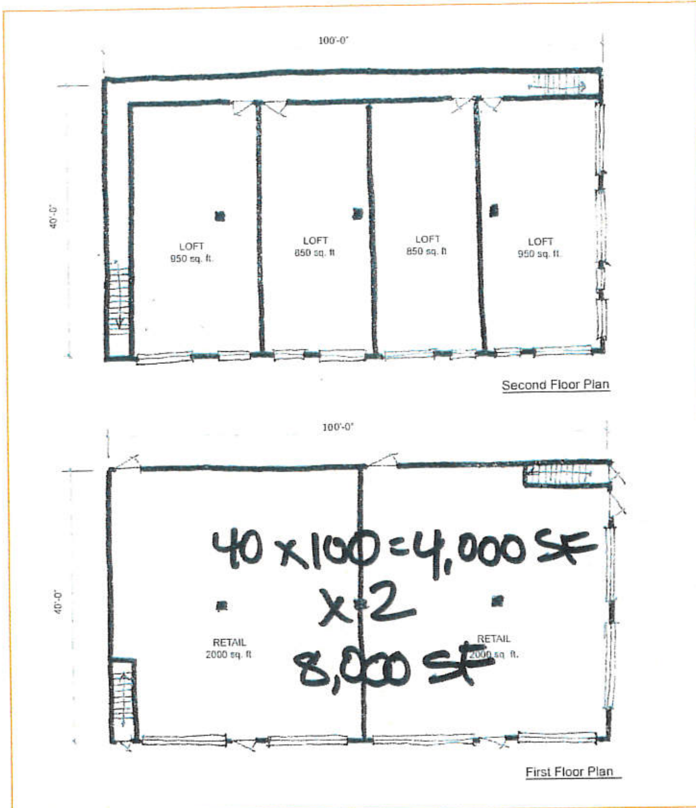

Image A

Dilapidated and depressed in the 1980s, downtown Clarksville, Mo., has experienced a remarkable resurgence, thanks to the efforts of Historic Clarksville, inc., which has spearheaded efforts to redevelop the commercial district's historic buildings.

Acquisition	**$2,000**
Hard Costs **8,000 SF @ $75/SF**	**$600,000**
Soft Costs **30% of Hard Costs**	**$180,000**
TDCs	**$800,000**

Image B

GROSS RENTS	
Housing **4 Units @ $600/mo x 12 mo.**	**$28,800**
Retail **4,000 SF @ $10/SF**	**$40,000**
	$68,800
VACANCY (5%)	**-$3,440**
EFFECTIVE GROSS RENTS (EGR)	**$65,360**
OPERATING EXPENSES (50% of EGR)	**-$32,680**
NOI	**$32,680**
DCR	**1.25**
DEBT SERVICE	**$26,144**

Image C

any and all available resources. It is at this point that you start to look at things such as Historic Tax Credits (See May 2003 and October 2004 issues of *Main Street News*), Community Development Block Grant Funds, HOME Funds (see the April 2004 *Main Street News*), or other philanthropic resources.

A qualified architect and contractor will help you determine the construction cost. Condition, current use, proposed use, and level of renovation/preservation are the key elements in estimating the cost. Using the example illustrated in images A above, and B above right, a 40' x 1000' footprint would be 4,000 square feet (SF) per floor x 2 floors = 8,000 SF. If we assume $75/square foot in renovation costs (including contingency) and a $10,000 acquisition cost, we could quickly determine that the Total Development Costs are $800,000.

If you have been tracking rents in your community, you will be well equipped to assess a building's potential income. If we assume the four housing units in the preceding example would rent for $600 per month, the annual rent would total $28,800.

Let's also assume the retail spaces rent for $10/square foot x 4,000 square foot = $40,000. With a 5 percent vacancy, the effective gross rent is $65,360 and with an assumption of 50 percent expenses, the NOI is $32,680. With a 1.25 DCR, the annual debt the building can support is $26,144. Now, see, wasn't that easy? *(See Image C above.)*

Using the debt, you can work with a local banking professional to calculate the size of the loan. The difference between the loan and your TDCs is the equity you must secure to make the deal work.

THE DEVELOPMENT TEAM

At this point, if you are completely overwhelmed or completely gung-ho about the prospect of tackling a development project, you need to consider professional help. No, not Doctor Phil. What you need is a cast of professionals who can help you move forward; this group should include an architect; an accountant; an attorney; a development consultant/owner's representative; an environmental consultant; and the funders, which may include one or more of the following: private investors, a bank, philanthropic interests, and government.

As the owner/developer/sponsor of the development, before you hire the development team, take an inventory of your Main Street board and committees. If you have not already done so, consider recruiting some real estate development professionals to serve on your board.

The owner's representative or development consultant should have the development experience to walk you through the entire development process, hire and manage the development team and contractors, and assemble the financing. If you have the capacity, you can do it yourself, though most Main Street organizations do not initially have the development experience to take on this role.

You will need a qualified architect and support from legal counsel with specific real estate and, preferably, tax credit experience. If professionals with specific experience are not available, you may have to look beyond your community for the requisite expertise. This may mean hiring someone from outside your region or state.

Because many old buildings have environmental challenges, environmental consultants are valuable members of your team. Depending upon the circumstances, the architect can work through some issues, but it pays to be careful as deals can be dramatically affected by unforeseen environmental problems.

The funders are crucial to the development process. The accountant and attorney will help you work through legal and financial obligations. Typically, banks and investors provide the bulk of the financing while philanthropic interests and government can help fill the gap.

Private investors want to see a return on their investment, which usually happens in two ways – either through regular cash payments resulting from profits from operation or through appreciation of the building's value over time.

While value is critical in obtaining financing, communities ultimately determine real value. A historic building may not have value to the bank, but it has tremendous intrinsic value, outside of traditional economic models. The primary reason investments may not be occurring in your community at the pace you would like is because the cost to rehab a building is more than its worth (its value) when it is completed. Investors and financial institutions cannot put a price on our shared history, so you must be prepared to make the case both to the bank and to philanthropic interests.

In community-initiated development, the forces of value are determined far differently than simple income and expense calculations. In distressed markets, properties are deeply undervalued. Community organizations are the final bulwark against complete disinvestment and blight. Remember, nearly every great revitalization story began with a community-initiated development project. These projects help stabilize the market until it becomes profitable for private investors to complete additional projects on their own, without public support.

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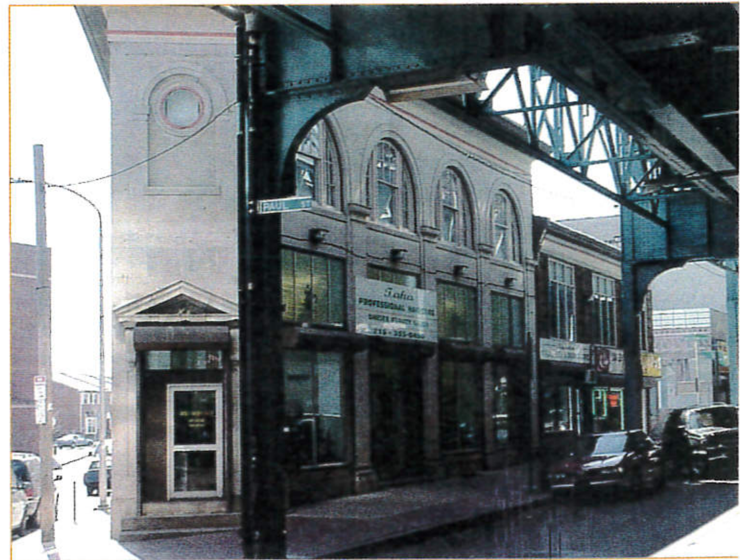
TAKING THE NEXT STEP

Find out how you can put the white elephants in your community back to productive use. Learn the process that real estate developers use when redeveloping a building. The National Trust Main Street Center's *Community Initiated Development* manual by Donovan Rypkema provides step-by-step instructions on how community-based organizations can use volunteers and vision to assemble a team and organize building redevelopment projects.

Community Initiated Development: A Manual for Nonprofit Real Estate Development in Traditional Commercial Districts is available from the National Trust Main Street Center for $55 (Network member price/$72 for nonmembers). To order online, go to **http://bookstore.mainstreet.org/** or call 202-588-6219.



Pictured here before and after rehab, the MAB Building in Philadelphia is the signature project of the Frankford CDC. It is home to three minority-owned businesses that the CDC helped start.

THE PRE-DEVELOPMENT CONUNDRUM

In the world of community and economic development, getting to the hammer and nail stage of any (re)development project requires a lot of time and effort, commonly referred to as pre-development. At this stage in the process, the project is still in question, which leads to considerable risk. Who, other than exurbia developers with deep pockets, can spend unlimited resources to deliver a project to closing? Only a brave few.

Pre-development is the tricky stage of the development process where you work to move past the idea stage and actually determine if you have the resources to make a deal successful. It is the equivalent to checking and packing a parachute before skydiving. If you find holes in the chute, you probably won't get on the plane. The same logic exists for development projects, if you find holes in the deal, if the rents won't support the debt, or if there are unmanageable environmental problems, it is unlikely that the deal will be successful. Either way, the upfront costs associated with packing the parachute are lost.

These costs are a form of risk capital, which means there is a probability that your upfront investment may never see a return. Pre-development costs include the architect's fees for design and determining construction costs, legal fees, and your time and effort. Pre-development isn't cheap or easy. For big development companies, 10 or 15 projects might be in the works at any given time, so if one or two projects don't work out, the cost can be absorbed into the development machine. For a small community that has a limited budget and is looking to develop one or two eyesores, a project that goes sideways can be overwhelming.

Because communities are risk-averse and therefore reluctant to take on a development project, local eyesores often remain vacant until a developer with the financial resources comes forward. Depending on the market, this may take a long time, during which the surrounding properties and the community suffer.

So what are the solutions? For starters, communities need to redirect some of their economic development funding into pre-development. Additionally, state economic development agencies need to partner with local communities to share the risk. If economic development is fundamentally about making great places, and great places are a collection of buildings, then communities need to come to terms with the risks of real estate development and find some resources to do pre-development.

Funding pre-development is not impossible. With a thorough understanding of the market and the development process, communities can easily pull off even a small real estate deal. In addition, by using local economic development agencies or community development nonprofits, communities can limit their exposure and minimize the financial risk. Realistically, in the context of a million dollar real estate deal, a few thousand dollars for pre-development is not a lot of money. This risk capital is often the difference between slaying the white elephant in your community or living with a constant eyesore.

Local community development directors must become familiar with the development process and the associated risks. Even though risks exist, if you understand the real estate development game you can anticipate some of the challenges and work to mitigate them. This requires local officials to understand local rents, annual retail sales, and other market data.

Understanding the predevelopment costs, process, and outcome, while also knowing your assets will help to mitigate any unforeseen challenges and risks.

THE DEVELOPER'S FEE – YOUR GOLDEN PARACHUTE

In any development project, a 10 to 15 percent fee should be set aside in the TDCs for the developer. Don't forget, your time is important too. Developers include this fee to pay for their own professional time and expenses. When you get a grant from a public agency, typically 10 percent is set aside for administrative cost. The development process is no different. If you have the expertise, you can take the 10 percent or use a portion of it to hire a development consultant/owner's representative. The owner's representative usually will cost about one-third of a maximized developers fee (or about 5 percent of TDCs), with the balance going to the organization.

GET STARTED

Now that you know the terminology and how to assemble a development team in place, you can take a look at a real development project. The first step is the concept. You may want to preserve the local hotel, or purchase and rehab the neighborhood eyesore, or simply tackle a building in need of development. Identify the building you wish to develop and put together a quick feasibility study, based on what was previously explained. Get the square footage; calculate the TDCs; determine the effective gross rents, NOI, total debt service, and the amount of the loan. Calculate the gap.

While reading this article is not enough to get you ready to take on a development project, look around your community and consider how you can assume a more active role in expediting investment by becoming a developer.

Assess the skills of your board and volunteers, ask your colleagues in other communities and states, seek out peers in the community development industry, query public agency representatives for their support, and don't forget local bankers who may be connected to other professional and financial resources.

While Main Street is confronted with numerous challenges in trying to manage all the components of a successful program, ultimately, you may find it necessary and rewarding to expand your Main Street organization's role in controlling your communities' destiny by controlling its real estate.

Jay C. Juergensen is a national expert in community and economic development, specializing in real estate development. His firm, Juergensen & Associates (www.j-assoc.com) is based in Detroit and works around the country, helping communities plan and implement revitalization projects. He has been active in Main Street-related activities for over a decade, including the creation of Detroit's and the re-establishment of Michigan's Main Street programs; and he is the developer, owner, and manager of more than 20 units of rental housing in his community. He wrote "Living Downtown: Promoting Affordable Housing Development on Main Street" in Main Street News, April 2004, and has been featured at the National Main Streets Conference and the National Trust's Preservation Conference. Michael Scholl leads the firm's policy efforts and significantly contributed to this article.

FOR MORE INFORMATION

To access a glossary of real estate development terms, go to http://msnews.mainstreet.org.