

The Conception and Implementation of a Real Estate Development Project

by

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The Conception and Implementation of a Real Estate Development Project

Real estate development is a vast and very complex sector of the business world. Due to the natural growth in population, the transition of raw land into developed land is and always will be a major part of the real estate industry. In order for neighborhoods or shopping centers to be built in an area, infrastructure has to be put into place. Infrastructure ranges from the streets, to curbs, to drainage, to park areas, to utilities. This is what land developers do, they input the infrastructure, thus transforming raw land into developed land.

Late last summer, I formed a company, ICS Investment Group, LLP. This company is in the business of developing residential land. Currently, we are developing three different tracts of land. I have been asked over and over again why I am doing this at such a young age. My answer is because over the last four years, I have been given the attitude that I can do anything that I put my mind to, no matter how expansive.

During my college career, I have changed my major four different times, from business to petroleum engineering to economics and back to business economics. This experience taught me that I could in fact climb any mountain that sits on the horizon. Additionally, several honors classes have taught me how important it is to think “outside of the box.” Specifically, I was a student in a class taught by Andy Wilkinson called *The Llano Estacado and the Sense of Place*. One would think that studying about the Panhandle of Texas would be mundane, however, I learned more about life in that one class than I did in most others combined. Andy not only insisted that we change the way we looked at the simplest of things, but he also set clear hurdles for the class to overcome

in order to get a certain grade. I grew as a person while taking this simple looking class about West Texas. This along with many other experiences in college has laid the groundwork for where I am today: the owner of a startup real estate development company.

The largest, most involved project is Milwaukee Ridge. It is going to span over 200 acres and will be located on the southwest corner of 34th Street and Milwaukee Avenue in Lubbock, Texas. This project will entail not only 660 single family homes on 60' by 110' lots, but it will also boast a 10 acre apartment tract, a 2 acre light commercial tract, and 15 acres of donated, developed city park land. In addition, there are fifty surrounding acres that will be developed by CMS Properties, the largest commercial real estate developer in the Lubbock area, into commercial property for strip centers and multi-family living. Milwaukee Ridge is the largest single subdivision that has been developed in Lubbock in the last five years.

Additionally, we are developing a tract of land located on the southeast corner of 82nd Street and Brownfield Highway, The Alcove Estates. This 60 acres of land will be developed into a subdivision of 112 single family homes. Along with the residential area, CMS Properties is developing 40 acres of surrounding commercial property.

Last but certainly not least, ICS is in the process of acquiring a large ranch 65 miles west Dallas/Fort Worth. Currently, the McMurrey Ranch, some 6600 acres, is untouched raw land that sits on the Brazos River. Developing ranch land is different than developing land inside a city. The developer shoulders far fewer responsibilities developing ranchland. For example, when subdividing a ranch, the responsibility rests with the buyer of the subdivided land to acquire utility services.

Developing a tract of real estate is an incredibly complex task. From the outside looking in, it seems as though it would be somewhat straightforward, with a list of things to get done, and once they are completed, there lies a developed tract of land that is now worth much more money than it was before. In fact, the President of First United Bank, the bank we use for financing, tells us over and over each week that “there is a lot more to developing land than paving a street and selling the lots.” From expansive civil engineering studies to coordination with utility companies, developing raw land is a large undertaking.

There are two general phases associated with land development. First is the conception of the idea, which includes the process of developing and implementing a strategic plan. Second is the configuration of the financing involved with the project.

Conception of the Idea

This is the most crucial part of the entire process. It not only takes an incredible idea to start with, but it also takes an idea that can be built upon and molded into an attainable goal. In my experience with this project, at first we only had the general idea that we wanted to get involved in real estate development. However, when we were presented with the Milwaukee Ridge project, we had to conceive an idea that was very unique.

This is where the most important ingredient in the conception phase occurs. Any successful developer, or group of developers, will have the inherent ability to look at a piece of property that has been looked over by a hundred other interested pairs of eyes and be able to envision something different. It is difficult to look at a tract of land that is

nothing but stalks of cotton and rolling weeds and see a residential subdivision with people walking their dogs and kids playing in the front yards. Similar to the 3-D posters that one must focus intently upon to see what lies beneath the design, one must spend hours upon hours envisioning what could possibly be done with the raw land.

Once an idea has been fabricated, many hours have to be spent “doing your homework.” This is the process of researching the individual aspects of the idea. Some examples of questions that should be researched thoroughly are:

- Is it financially feasible?
- Does the location have the correct potential?
- Does demand for the project exist?
- Is the project possible from a city or county zoning standpoint?
- Have the proper environmental studies been completed?

Researching the idea and properly answering all possible questions is by far and away the most crucial and important part of the conception phase. Often, red flags are raised that simply cannot be overlooked. And, “doing your homework,” tends to reveal those red flags in the early going which is the most opportune time for them to be exposed.

The next step is to take the idea and turn it into a concrete strategic plan. This will have to be done in order to properly convey it to everyone that will be involved in the project in the future, from investors to contractors to builders to homeowners. A

good strategic plan, one that will have a good chance at being successful, is one that has clear, concise goals.

The following are two examples of strategic plans that we have disbursed to potential investors in our projects. The first example is pertaining to the Milwaukee Ridge development, and the second is pertaining to the McMurrey Ranch project.

ICS Investment Group, LLP

Milwaukee Ridge

Strategic Plan/Investor Proposal

Milwaukee Ridge

Milwaukee Ridge is a forthcoming residential subdivision located at 34th and Milwaukee in Lubbock, Texas, that will contain around 665 homes ranging from \$90,000 to \$150,000. The subdivision will be developed in multiple stages, with the first stage beginning as soon as possible.

The development will encompass 215 acres which are currently under contract, with hard closing occurring December 9th. We are presently pre-selling lots to builders. Based on the high demand for lots in the price range that we are providing, we expect to have 200 lots pre-sold and contracted by the time that the project commences. The size and scope of the first phase of development will be contingent upon how many lots are pre-sold. Based on 325 lots, approximately 80 acres will need to be developed.

The project will be financed through bank debt and through the contributions of investors. Investors will be paid a dividend in the fashion of preferred stock, with a fixed return of 17%. Investor dividends will be paid after property taxes and debt service are covered, but before we, the developers, reap any returns. The minimum investment will be \$100,000.

We will make every effort to ensure the success of the project. The ultimate decision to begin development is contingent on several factors including pre-sale of lots, cost of land, cost of development, and the results of an environmental survey. If every sign does not point to success, the development will not be undertaken, and investors will be returned their contribution. Our goal is to tie down every possible loose end far before reaching the point of no return. A final commitment to the development will not be made

until the final day of closing, when the land is purchased. At that point, investors will be required to leave their initial principal invested until the completion of phase one.

After the completion of phase one, investors will be given the option of continuing on with the project. Additional phases will provide the opportunity of higher returns for both investor and developer, and those investors who are “in on the ground floor” will have the opportunity to be a part of the even more profitable future stages.

ICS Investment Group, LLP

McMurrey Ranch

Strategic Plan

McMurrey Ranch Development Proposal

The McMurrey Ranch is a 6650 acre ranch 65 miles west of the Dallas/Fort Worth metropolitan area. Texas State Highway 4 is located along the eastern boundary, and the Fortune Bend County Road runs from the eastern edge westward throughout the ranch. The land has large amounts of elevation change with a 2200 acre plateau, the Brady Creek Plateau, located on the north/northwestern boundary. In addition, a 250 acre mountain, the Shut-In Mountain, is located on the western boundary. There is approximately 2.5 miles of river frontage on the property, and, surprisingly, it runs bend-free. As is, there are 5 stock tanks that hold water year round located sporadically around the property, and several running creeks. We plan on purchasing the land for \$1650/acre.

One of the basic strategic principles we would implement on this land is the appreciation of land over time. For example, we think it would be highly advantageous to initially take the entire land off the market for 8-10 months. During this time, we would make all initial improvements necessary. These would include building roads to service the Brady Creek Plateau and the Brazos River Ranchettes and the clearing of roads in all the individual tracts of land that would be needed to show them to potential buyers. Other improvements would include the construction of the community area on the river, the construction of entry gates, and the platting of all individual tracts of land. In essence, we would spend this time “getting all of our ducks in a row,” so we could approach the actual marketing and selling of the land “full throttle”.

Another main strategic principle would be to break up each individual tract of land based on the selling price, not on the size. We believe that the demand for land

changes drastically as the selling price exceeds the \$850,000-\$900,000 level. Thus, we are going to aim for each tract to be broken up into a size that warrants a selling price no higher than \$750,000.

The following is a breakdown of our strategic plan for the McMurrey Ranch by geographical area.

Brady Creek Plateau

(2200acres @ \$3500/acre)

The Brady Creek Plateau is for the most part flat and untouched. There are three stock tanks on top of the plateau, and its cliffsides are quite steep. We plan on dividing up this part of the ranch into smaller estate ranchettes of 100 and 200 acres. This would leave us with twelve 100 acre tracts selling for \$350,000, and five 200 acre tracts selling for \$700,000.

We would plan to bring, or to enhance, an existing road off of Fortune Bend County Road onto the top of the plateau which would serve as a division for the entire area. This road would likely have to be paved along the sections climbing the steep elevation, but could be gravel or caliche in all other areas. Each estate lot would be rectangular in shape and would have frontage to the edge of the plateau. We would have to engage the services of the engineering firm in order to plat out each estate lot.

In addition, it would be a gated-entry estate area with a large rock entrance off the county road. The buyers would be required to construct a 5-wire fence around the property line. The homes would be 4000 square foot minimum which would result in \$500,000 homes. Obviously, our vision for this area is very nice, upscale homesites.

Because this area would not have lake-frontage we would construct a private area along the banks of the river for the landowners. This would consist of another gated rock entrance, covered patio, grilling areas, and nice grass maintained along the banks of the river. In order to finance this, we would establish a neighborhood association. This is a concept that we have learned a lot about in our residential development in Lubbock. In short, all the landowners would pay yearly dues, no more than \$500 per year per 100 acres. This money, \$11,000 per year, would then be put toward upkeep on the entrance gates to the plateau and the river and also the facilities built along the banks of the river.

We would market these lots predominantly in the Metroplex area. Based upon our research, we expect to sell these lots for a \$3500/acre minimum with areas having stock tanks on them bringing even more.

Brazos River Ranchettes

(1500acres @ \$3500/acre)

The Brazos River Ranchettes would consist of all the land with direct frontage on the river. This land is also mostly flat, and it has no cliffs or sudden elevation change on the banks of the Brazos. We plan on dividing this land into 215-acre ranchettes. This would result in seven tracts of land selling at a price of \$752,000.

In order to avoid very long and very narrow ranchettes, we think we would have to construct a new gravel road extending off State Highway 4. As with the Brady Plateau, we would construct a very nice rock entrance off of the highway. This would be a gated entry road which would assure privacy for the landowners along the river. These ranchettes would also be rectangular in shape and would all have a gate off of the newly

constructed road. As with the Brady Creek lots, we would have to have the services of a civil engineering firm to efficiently lay out these ranchettes.

These buyers would also be required to construct a 5-wire fence, and the homes would be restricted similar to the Brady Plateau homes. We would also implement the neighborhood association concept on the ranchettes. This money would go towards maintenance of the newly constructed roads and also the gates located along Highway 4 and possibly where the new road would intersect Fortune Bend County Road.

We would also market these predominantly in the Metroplex area. Similarly, we expect to be able to sell the ranchettes for \$3500/acre minimum.

Texas Highway 4 Estate Lots

(500 acres @ 2500/acre)

The Highway 4 Estate Lots will be located all along the eastern edge of the entire ranch. As can be seen when looking at the map, the eastern boundary is Highway 4, and we plan on sectioning it off into 25-acre tracts of land. This subdividing would result in 20 tracts selling at a price of \$62,500.

These tracts would take very little, if any, improvements. The only foreseeable expense is very little engineering fees in order to plat the lots along the Highway. These lots would face the state highway, and the homes would all be restricted to a prescribed setback from the highway. These homes would be equally restricted in all ways as the other areas of the ranch, but they would be 2500 square foot minimums. This would equivilate to houses in the \$250,000 range. Similarly, the landowners would be required to construct a 5-wire fence around the property line.

We would not only market these lots in the Metroplex area, but we would also in the Mineral Wells and Weatherford communities. We expect to be able to sell these lots for \$2500/acre minimum.

Shut-In Mountain Estates

(200 acres @ \$4500/acre)

The Shut-In Mountain is located on the southwestern part of the ranch close to the Brazos River. This is the highest part of the ranch and thus will offer the best views. From the top of Shut-In Mountain, one can see the top of Brady Creek Plateau and the rest of the ranch including the Brazos River and the various pastures. From the north side of the mountain, the view includes the Possum Kingdom Lake. We would divide this land into 25-acre tracts which would result in eight plots of land selling at \$112,500 each.

Some improvements to this land would have to be made, but they are predominantly minor. There would have to be a road extended off Fortune Bend County Road, and it would have to be paved up the side of the mountain. In addition, we would build a very nice entrance off of the county road.

Randy Andrews, one of the owners of the ranch, is going to build a vacation home on Shut-In Mountain. We would be purchasing the surrounding land to the east and to the west of his homesite. According to everyone involved, his intentions are to build a multi-million dollar home. Taking that into consideration, we are going to market this land to a very high-end market. These lots will not be cut into exact tracts of land as the other areas, but the acres will be on the market for a premium. There will be a minimum

amount of land one could purchase, probably 25 acres, and a maximum, probably 75 acres.

This land would be the most highly restricted land on the entire ranch. The landowners would have to construct a high-end fence around their ranch, they will have to have a nice rock gated entry to their property, and their homes will have to be a minimum of 5000 square feet. We understand, and expect, this land to take longer to sale. However, since the land involved is so limited, and the view second to none in the entire region, we believe this land will sell at such a premium.

The Shut-In Mountain Estates would be marketed primarily in the Metroplex area. This would be a very exclusive area of the ranch and would be shown only to very interested buyers. We plan on playing off the exclusiveness of the area. We expect to be able to sell this land for a minimum of \$4500/acre.

Improved Interior Land

(1000 acres @ \$2250/acre)

Of the remaining 2250 acres, we expect to be able to make some small yet significant improvements on 1000 of them, in order to increase its value. This land would be the land that is not located on the higher elevations with the views and is not located along the Brazos River. With simple improvements such as the construction of private fishing ponds, we think we can change this land from agriculture-based land to recreation-based land.

We have been advised that a five acre stock tank can be built for around \$5000. Additionally, the engineering firm we are using in our Milwaukee Ridge development,

Freese & Nichol, informed us today that they got their start in farm and ranchland engineering, and they have assured us that they could find each and every potential location for a stock tank, at a minimal cost. We believe that these minimal improvements would increase the value of the land up to the point to which we are aiming.

Another strategic principle we will employ on this land is the principle of time. As we sell off the other, more prime, parts of the ranch, every buyer will naturally see this land as well. We believe that as each large home is constructed on the ranch, this land will become more and more valuable.

After the proper improvements have been made, we expect to be able to sale this land for a minimum of \$2250/acre.

Unimproved Interior Land

(1250 acres @ \$1500/acre

Finally, we project that 1250 acres of the ranch located interiorally will not be able to be improved upon. This will be the land that is not susceptible to the construction of fishing ponds, will not have any elevation for views, and is not located along the Brazos River.

In order to maximize the potential of this land, we would wait until most all the other areas of the ranch have been divided up and sold before marketing it. This would allow us to employ more than one tactic in the appreciation of its value.

First, the passing of time leads to the natural appreciation in the value of land. Since we project the other, more prime land to sell in two to three years, it would give this land that much time to become more and more valuable. Secondly, as more and

more tracts of land are sold and large homes are constructed, the value of the surrounding land will in turn increase.

The goal for this land is to break-even with our purchase price. Since we do not anticipate selling any of it for at least two to three years, we would be able to lease these acres out for hunting and agricultural use. All in all, we expect to sell this land at a minimum of \$1500 per acre.

Overview

- **Total Acres Purchased: 6650**
- **Total Average Cost/acre: \$1650**
- **Total Land Cost: \$10,800,000**
- **Total Initial Improvement Cost: \$300,000**
- **Total Acres Sold: 6650**
- **Total Average \$/acre: \$2891.25**
- **Total Profit/acre: \$1241.25**

ICS would be the managing entity of the day-to-day operations of the project with added consulting and advising from Brent Isom, a local Texas Game Warden who manages a ranch in the surrounding area. We would use the Freese & Nichol civil engineering firm based out of the Metroplex. As we have worked with them on our residential development projects in Lubbock, we have been highly pleased with their pricing and timing.

All in all, we feel like this project is and will be a very good opportunity for everyone involved. Given its proximity to the Metroplex and its “red-hot” demand for ranchland, especially along the Brazos River, this land will be some of the most prime tracts available in the area.

Financing Configuration

Once an idea has been conceived and the strategic plan has been put into place, the next step is to decide upon the configuration of the entire project. At this point in the process, there are several different options from which to choose. The basic decision to make is whether it will be financed using debt, equity, or a mixture of the two. Most projects are financed using a mixture of debt and equity. However, borrowing money from a bank costs money.

In the Milwaukee Ridge project, we have raised money in two different ways. First, we secured equity in the form of cash injected by investors. In return for these investments, we have committed to paying them 17% annually on their money. Admittedly, this rate of return on the investor's money is slightly higher than usual. However, since we are a startup company, we have had to think "out-of-the-box" in order to convince individual investors to invest in our unproven company. Using the cash investments as equity, we were able finance the remaining portion of the project with bank-issued debt.

In contrast, we have approached our other projects in different ways. For example, The Alcove Estates are being financed entirely by one outside individual investor. This investor will retain an 80% ownership in the entire project. Our company will manage every single aspect of the project from start to completion. For our involvement, we will retain a 20% ownership along with being paid a management fee for the life of the project.

The McMurrey ranch project is setup in an even different way. Similar to The Alcove Estates, a group of outside investors is financing the project in return for an 90% ownership. ICS will manage the development of the ranch, and will in turn retain a 10% ownership position as well as a management fee. The difference comes in the arrangement in the sales of the individual tracts of land. ICS will also receive a small portion of the selling price for each piece of land.

For the Milwaukee Ridge project, we have had to do extensive financial studies and calculations because of the several different entities involved (See Table 1). Similarly, we have started the same process for The Alcove Estates (See Tables 2,3).

ICS Investment Group, LLP

Milwaukee Ridge

Financing and Tax Considerations

Milwaukee Ridge – Financing and Tax Considerations

The project will be financed through bank debt and through the contributions of investors. Investors will be paid a dividend in the fashion of preferred stock, with a fixed annual return of 17%. Investors will hold no equity in the company or the project, but will hold claim to the 17% return guaranteed to them through their investor agreement.

The total amount needed to begin and complete phase one, including land purchase and development costs is \$3,390,232. This will be the basis for the loan amount. Federal regulations prohibit banks from exceeding a 75% loan-to-value ratio on raw land development projects. This regulation limits our total debt to a maximum of \$2,514,274.

The remainder of the capital needs of the project will come from the investors and a builder/contractor who has agreed to take payment for some of the development cost in lots.

Taxation for a project such as this one is a very complex subject. Once the land is divided into more than five separate parcels, the tax laws that usually apply to the sale of real property no longer apply. At that point, the developer actually becomes a “dealer” of real estate, and any income is subject to normal income taxation. Each lot is assigned a pro-rata share of the total land, development, and other costs, and a taxable profit or loss for each lot sale is calculated (See Table 1). This project will be subject to an effective tax rate of approximately 26%.

Table 1

GROSS REVENUE	5,200,000.00
INTEREST EXPENSE	(293,825.00)
PROPERTY TAXES	(30,000.00)
DEVELOPMENT COST	(2,160,000.00)
PRO RATA LAND COST	(647,428.57)
TAXABLE REVENUE	2,068,746.43
TAXES (26% EFFECTIVE RATE)	(537,874.07)

ICS Investment Group, LLP

Milwaukee Ridge

Pro-Forma Cash Flows

Table 2

PRO-FORMA CASH FLOWS - PHASE ONE			
Date	Amount In (Out)	Source	Cash Total
Today			-
Closing			
	\$3,247,000.00	Bank Debt	
	\$1,000,000.00	Investor Contribution	
	(\$2,060,000.00)	Land Cost	
	(\$10,000.00)	Legal Fees	
			\$2,177,000.00
1st Day of Construction			
	\$520,000.00	Builder's Deposit into Escrow	
	(\$2,180,000.00)	Development Cost	
			\$517,000.00
Completion			
	\$520,000.00	From Escrow	
	\$4,680,000.00	Remaining Payment From Builders	
	(\$30,000.00)	Property Tax	
	(\$537,874.00)	Income Tax	
	(\$389,640.00)	Interest Expense	
	(\$119,000.00)	Dividend Payment to Investors	
	(\$3,247,000.00)	Debt Principal Repayment	
		Cash at End of Phase One	\$873,486.00

ICS Investment Group, LLP

The Alcove Estates

Profit/Cost Breakdowns

Table 3

Item	Profit/Cost Breakdown				Total
	Quantity	Unit	Unit Price		
Asphalt Paving	22000	SY	\$11.00		\$242,000.00
Curb and Gutter	17732	LF	\$10.00		\$177,320.00
Water Service 8"	8866	LF	\$16.00		\$141,856.00
Fire Hydrant Assy	16	EA	\$2,000.00		\$32,000.00
Water Valves	2	LS	\$20,000.00		\$40,000.00
Water Connections	112	EA	\$300.00		\$33,600.00
On-Site Sewer	8866	LF	\$23.00		\$203,918.00
Sanitary Manholes	20	EA	\$2,500.00		\$50,000.00
Sewer Connection	112	EA	\$250.00		\$28,000.00
Lot Grading	112	EA	\$250.00		\$28,000.00
Fence	1	EA	\$55,000.00		\$55,000.00
					\$1,031,694.00
Contingency			30% of Total Cost		\$309,508.20
Land Cost	60	Acres	\$8,500.00		\$510,000.00
Engineering					\$115,000.00
Total Cost					\$1,966,202.20
Lot Price w/fence		# of Lots			Total Price
\$29,450.00		112			\$3,298,400.00
					Total Gross Profit
					\$1,332,197.80
Intrest @ 8% over 4 yrs.	w/ an avg.	of \$600,000	per year		
\$192,000.00					\$192,000.00
Total Tax Expense at a	20 % Rate				
\$228,039.56					\$228,039.56
					Total Net Profit
					\$912,158.24

Conclusion

Thus far, my experience in real estate development has provided me great opportunities; the greatest being educational. One thing that my education at Texas Tech University and, more importantly, the Honors College has instilled in me is to expand my horizons and to always try to look at things from all different perspectives and angles.

Whether it is a new economics class or a 660 home real estate development project, the same principles of success apply. I feel blessed to have been involved with the Honors College during my undergraduate career, and I could not have asked for any more out of it.