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Development in a world with uncertainty: Requires luck - by Daniel Calano

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Everyone knows that the most important principle in successful real estate development and investment is “location, location, location.” In fact, since everybody does know, it is fairly easy to determine the best location, at least in the Boston metropolitan area, by simply looking to see where the action is. If you are lucky enough to uncover, and be able to afford, a “best location,” it’s probably Boston downtown or in the Seaport, Kendall Sq., Cambridge, Watertown, Somerville, etc. In other words, these areas are abuzz with frenzied searchers.

Let’s move past the old location axiom and explore a new one. Above, you may note the words “lucky enough.” I believe luck can be one of the most significant factors in the development process. Hold on before you say I am crazy and that thoughtful due diligence plays the most significant role. I completely agree. But due diligence is a fairly certain process. You can mostly control it. Luck is at the essence of uncertainty.

For example, you may start out making a careful demand/supply analysis to determine the viability of building at all. You’re using your expertise and instincts, before specific due diligence begins. As I said before, you already know the locations you’re interested in. If you don’t know this, you probably shouldn’t be in the business at all. Finding a good site in your selected area also requires your skills of sleuthing, comparing alternatives, and negotiating prices. You are using your skills, creating a fairly controlled process.

Now, events start to move out of due diligence and into implementation. For those of us who have been in it, the permit process requires skill, but that does not guarantee success. Something will get approved, but not necessarily what you had hoped for. Unpredictable neighbors, state and local agencies, planners all working independently make for an untidy process. When you finally get through permitting, then labor pricing, unforeseen site problems, construction delays, weather are all, once again, somewhat out of your control, somewhat uncertain. You need a few lucky breaks.

Fast forward to today. Now that we are through the election and some of the growing pains for the new administration, regardless of your politics, you’ll have to admit these are uncertain times. In fact, there are many recent articles out that suggest 2017 may be the most uncertain year we have faced in decades. As one example, Wharton Business School recently summarized the opinions of interviewees, saying: “The U.S. Economy in 2017: Why Uncertainty is the Biggest Risk.” Uncertainty issues include: U.S. government, unifying the country, European elections, interest rate changes, terrorism, social unrest, cyber warfare, to name a few. To exacerbate things, news of uncertainty travels fast and far over millions of twitter feeds. Things can change on a dime. All these recent factors need to be added to the “normal” list of real estate uncertainty, and any combination of a few could become a “black swan” event.

The good news is that our industry has adapted to endure issues related to timing of unlucky events. Real estate is bigger, more merged, institutionalized, better financed, and risks are spread over more players, lowering individual impacts. So, if we have some bad luck, there is less pressure to resolve it at the moment. If you have the time and the luxury of patient financing, you can mitigate some of the impact of bad luck. We can ride it out more easily these days. We can withstand the down cycle. Unlike the severe downturn of the early 1990s, and subsequent foreclosures, all of today's real estate players are more sympathetic to the uncertainties of our business. Thankfully, our business has morphed from some of the wild-catter mentality to a ..., well, to a business.

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