Money Isn’t the Only Anchor That Is Holding Back the Industry’s Performance

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Regulations covering building material requirements and design requirements have not only enforced performance levels, but have also affected how buildings are constructed. In addition, developers think that certain items now required in buildings substantially increase costs, but sometimes provide only negligible benefits.

Developers are also annoyed with numerous government regulations that are subject to different interpretations and enforcement. Dow Chemical Company discovered this when they spent more than $10 million on the development of a plant in northern California; it was finally abandoned due, largely, to the company’s inability to satisfy conflicting government regulations. But before abandoning the plant, Dow dealt with 40 agencies to get 64 permits. In one case, three agencies were involved with the same regulation, each demanding a different requirement.

Is it any wonder that companies such as Dow are sometimes confused and frustrated when they find no coherent policy in force among interacting agencies? Is it any wonder that the industry is clamoring for less government involvement?

Unrestrained industrial development and inappropriate zoning have resulted in significant damage to the environment. And many of today’s building requirements have resulted from past use of substandard products, which created safety hazards.

In addition, government plays a vital role in forcing the industry to respond to the public interest. Government—not industry—has taken the lead in providing housing for low- and moderate-income families. Indeed, some developers have shied away from this because of poor profit margins.

“There’s always going to be government review of projects because government is responsible for what is built in the city,” states Kathleen Connell, director of housing for the City of Los Angeles. “Government, by the very nature of its position, is a gatekeeper. There are certain situations where only government will respond . . . such as going into Watts to build badly needed housing or providing shelter for the poor who can’t pay their way.”

What can be done about these problems? How can the conflict of satisfying social concerns be balanced with the industry’s need for freedom and a reasonable relationship between risk and reward?

Developers offer a number of suggestions:

Reorganize government agencies, laws, and policies according to a “one-stop shopping” concept. Thus, interacting government agencies
would consolidate and present a uniform set of requirements to the developers.

Stabilize the level of changes in building code and zoning requirements and exempt existing projects from new requirements not in force when initial development activities occurred.

Consider cost/benefit relationships when laws are enacted. When it is important that social goals prevail over entrepreneurial considerations, government subsidies may be more appropriate than requiring developers to absorb the added costs.

Establish specific time limits, giving developers a legal right to proceed if the government does not act.

Energy Costs

Energy costs and conservation have become major concerns for all industries, including real estate. Because of recent increases in everyday operating costs and shortages experienced during the oil embargo, developers must now consider energy efficiency as a major factor in development.

“We face a very keen problem today,” admits John Kilroy of Kilroy Industries. “In the past, people would say, I’m not concerned about that. It’s not that big a deal.’ But now they are concerned. As a result, we have ‘designed out’ energy consumption where we can. Of course, costs are significantly higher to construct a building in this fashion, but the long-range return is better and results in significantly lower occupancy costs.”

Along with maximizing energy efficiency, those interviewed also realize the importance of obtaining energy from uninterruptible sources. In fact, industries located in states with restrictive energy policies are relocating to areas where energy is more plentiful.

“We are discouraging energy development in California,” notes Rocky Tarantello. “The benefactors are those states that have an abundant supply of energy. The Rocky Mountain states should grow greatly because they generally have an aggressive policy toward energy development.”

Location is also a major factor in energy consumption. Employee commuting costs have to be accounted for and, as mentioned, there can be substantial energy cost differentials in alternative locations.

A clear energy policy is important to the industry’s well-being. If developers know where they stand, they can deal with energy problems.

However, the prevailing uncertainty fosters caution and restricts development.

Inflation

Inflation has been one of the biggest problems in the industry—and is likely to remain so. Increased labor, material, and energy costs have skyrocketed to the point where development planning has become almost impossible. Although the United States government has designated inflation as its major problem and has vowed to regain control over the economy, developers are pessimistic.

The problems in planning a multi-phase development that will not be completed for years—but which requires precise estimates—are extremely troublesome. With construction costs increasing at a rate of 1.5 percent per month, even small errors in estimation can turn the good deal of today into a poor deal in the future.

Inflation has also greatly increased
the cost of delays. When developers must wait to build, they face greater costs in materials and labor. The red tape that a developer encounters in obtaining the necessary permits extends the development time of a project and makes it more costly. Today, more than ever before, time is money.

When asked how to overcome problems of inflation, developers invariably focus on cutting the time involved in getting a project approved and started. As mentioned previously, a one-stop government-approval system would go a long way in speeding up the process, as would restricting government’s retroactive enforcement of environmental and other regulations.

Even if the development time is shortened, industry experts believe that inflation will still represent a major problem. Today, consequently, most developers are trying to build inflation into the quoted price.

“Today it is necessary to develop cost-sharing formulas, so if there are unexpected inflationary cost increases, the tenant will share in them,” says John Kilroy. “Without this type of protection, very few projects would be economically feasible.”

Conclusion

Some of the problems faced by the real estate and construction industries are not new. For example, capital availability and government regulation have been concerns of developers for years. Energy and inflation, however, are newer concerns and present additional risks and uncertainties to the industry.

Whether old or new, the problems caused by increased government reporting, complex tax planning, and the need for better operating and financial information must be dealt with effectively as the industry continues to evolve. One means of dealing with the industry’s increasingly complex environment is to ensure that its managerial capabilities are sophisticated enough. Incorporating new management technologies, such as the greater use of job cost control and EDP systems, will aid practitioners in coping with new industry demands as well as in planning more systematically for its future. The quality and level of management expertise may make the competitive difference as the future unfolds.

To date, the industry has coped with these problems with reasonable success. But, the real question is: what will the future bring? Will the industry be able to satisfy social goals, such as revitalization of urban areas and reasonably priced residences for prospective home owners and renters? What resources will be available to builders to aid in these processes, e.g., will there be adequate land, capital, and energy? And, will satisfying the nation’s demands reward the satisfiers?