

What can
an industrial
developer
pay for a

Land Site

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Assessing the feasibility of a land site for an industrial development is more complicated than looking at similar recent land sales in a particular market. The price of the land per acre needs to be within acceptable ranges for market conditions, but it is not the final determining factor. The critical concept is the cost of the land related to the total buildable square footage on the site.

Preliminary Site Review

Let's assume that the site is properly zoned for industrial uses and there are no obvious obstructions to development (i.e. wetlands, topography, etc.). A site engineer will lay out preliminary building foot prints to ascertain the maximum square footage obtainable. If the developer is successful in putting

the property under contract, during the due diligence period he will order a survey, examine the environmental history, and conduct soil borings. Contour maps will then be created by an engineer to confirm the original buildable square footage calculations.

Initially the developer will calculate what can be used for the building and related parking. This is the net useable land, defined as the gross acreage less any wetlands or other impediments where buildings cannot be constructed. The critical calculation is the price of the land under the total building area. Will the finished project be competitive with other properties in the market? This financial calculus will determine the feasibility of developing at this specific location, and it will inform the maximum price the developer can pay for the land component.

Reviewing Competitive Properties to Establish Market Criteria

Table A shows competitive sites to the subject property and their resulting land costs under the building area.

Financial Analysis

Let's create an example that illustrates this financial process from a developer's standpoint based on the following assumptions:

- 1,000,000 square feet of the building are
- 100 acre net useable
- Asking price is \$200,000 per acre / \$4.59 psf for land / \$20,000,000

Property	Acres	Total Bldg. SF on Site	Sales Price	Price Per Acre	\$ Under Building
Developer purchase #1	53	795,753	\$8,000,000	\$150,943	\$10.05
Developer purchase #2	33	600,315	\$5,440,000	\$164,848	\$9.06
Developer Purchase #3	113	1,100,000	\$9,300,000	\$82,301	\$8.45
Developer Purchase #4	42	518,130	\$5,309,929	\$126,427	\$10.25

Table A

- Minimum year one rate of return for developer – 8 percent

The cost per square foot for the land under the building area, based on the seller's asking price, is \$20 (\$20,000,000 / 1,000,000 Sq. Ft.). We can see that this asking price does not work for the developer because it far exceeds the land basis for competitive properties in the market.

Why does the cost of the land have to be comparable to other industrial projects in the market competition? Because the land cost under the building translates back to the competitive rental rate that the developer can charge under current market conditions.

The competition advertises the current asking rates:

Property	Asking Base Rental Rate PSF
Property #1	\$4.95
Property #2	\$4.75
Property #3	\$4.85
Property #4	\$4.95

Can the developer ask a rental rate in the market that is competitive and still achieve his initial rate of return? Table B calculates the developer's rate of return is using the seller's asking price for the land and a market asking rental rate of \$4.80 per square foot.

In this example, the developer's rate of return is 11 percent less than he needs

to achieve a viable project if he pays the sellers asking price (8.00 percent - 7.16 percent).

The developer does not have the luxury of raising the market rental rate to reach his return goals because his property would become unleaseable compared to the competition. While it may be possible to tweak the other expenses slightly, in a large part they are set costs with minimum variables.

The best option for a developer is to purchase the land at a price that will make the development the most attractive to tenants. So what price can he or she pay for this land site?

Table C is the analysis of the optimum price one can pay for the land.

The developer can pay \$13,000,000 / \$130,000 per acre / \$2.98 psf of land area to achieve the desired 8 percent rate of return and still have the development competitive in price to other developments in the market.

Most land sellers are not aware of the constraints and the risks of industrial development. However, to better conclude a sales transaction that is beneficial to both parties the seller must recognize the reality of these concepts. If a developer takes on the risks and capital commitments of bringing new industrial products to market, he or she must purchase the land at a price that leads to competitive rental rates. ♥

Building Size:	1,000,000
Land acres	100
Price per acre asking	\$200,000
Total land cost:	\$20,000,000.00
Cost per bldg. S.F.:	\$20.00
Budget Item	Cost PSF
Land cost under bldg.	\$20.00
Impact Fees / Permitting	\$3.00
Site & Shell	\$32.00
T.I.	\$7.00
A&E	\$2.00
Brokerage	\$2.00
Dev Fee	\$1.00
Total Costs	\$67.00
Lease Rate:	\$4.80
Rate of Return	7.16%

Table B

Building Size:	1,000,000
Land acres	100
Price per acre asking	\$130,000
Total land cost:	\$13,000,000.00
Cost per bldg. S.F.:	\$13.00
Budget Item	Cost PSF
Land cost under bldg.	\$13.00
Impact Fees / Permitting	\$3.00
Site & Shell work	\$32.00
T.I.	\$7.00
A&E	\$2.00
Brokerage	\$2.00
Dev Fee	\$1.00
Total Costs	\$60.00
Lease Rate:	\$4.80
Rate of Return	8.00%

Table C