

PARTIALLY CONSTRUCTED RESIDENTIAL DEVELOPMENTS

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The housing market collapse has caused many developers to halt the investment needed to complete some residential subdivisions. Landowners and developers have always faced challenges from competition, regulations, financing, engineering, and construction. Now, home foreclosures and increased competition have forced the sales price down significantly, thereby reducing profit margin. Financing has become very difficult for both developer and home purchaser. This article reviews the possible project stages, offers some strategies to mitigate some of the ill effects, and suggests a decision-making methodology for future action.

Background

The normal progression for a residential subdivision begins with an idea and a business plan. The developer must then progress through various engineering, construction, and sales activities according to the business plan:

- Due diligence
- Property purchase
- Engineering design
- Permitting
- Commencement of construction
- Completion of construction and agency approvals
- Marketing and sales
- Additional phases for multi-phase projects

When the housing bubble burst, many developments were caught within the various stages of development mentioned previously. For developments undergoing the due diligence process, the land purchase was often halted, even if at the sacrifice of earnest money. Losing that investment was often the developer's best option, especially in light of the falling real estate market. Current land prices are now typically less than the original cost minus the earnest money. More importantly, though, additional financial commitments were avoided.

For projects that were in the engineering and permitting phase, the developer evaluated the point to stop work. Halting the engineering would minimize the expense that would not be soon recouped. Thus, a partial design is relatively worthless. Comparing the additional expense to complete the design against the value of having a product was required. Proceeding with permitting was also evaluated with expense minimization as one tactic and locking in the project according to current rules was another. Such decisions varied according to developer preference but rarely resulted in significant financial hardship.

Developers in the sales and multi-phase projects situations are experiencing reduced incomes. Where operating expenses exceed revenue, projects are often sold at a reduced price to more financially stable developers either via negotiation or bankruptcy proceedings. Some developers are able to endure the slow and less profitable sales.

The most damaging circumstance that developers are experiencing is where the property is purchased and construction is in some level of completion but where certificates of occupancy are not yet attainable. This circumstance is the primary topic of this article.

Considerations When Construction is Not Completed

Whether due to a contractor failing to complete construction, an owner or developer failing to completely fund construction, or merely in an effort to minimize expense incurred toward an investment with an unknown return on investment time line, a variety of issues arise when a residential development is partially completed:

- Asphalt. Asphalt pavement deteriorates over time without routine traffic. Additionally, traffic on poorly installed asphalt can often provide the compaction not originally provided by the contractor. Years later, it will be difficult to determine if the asphalt was defective at installation or has deteriorated.
- Platting. Platting significantly increases taxes paid by the developer. Residential lots are taxed at a much higher rate than pasture land. Not platting also results in utility easements not being created, which in turn prevents acceptance by a utility provider. Further, lots cannot be sold.
- Security. Security of the property is a concern. When there are no residents, the facilities are prime targets for vandalism or dumping.

- Pump Stations. Wastewater pump stations can develop odors due to stagnant sewage caused by low flows. When multi-phase projects have a central wastewater collection and pumping system, lower than design populations can cause the pump station to run too infrequently.
- Water Mains. Water mains lose chlorine residual and become stagnant. This situation occurs when either the main lines within the subdivision are not connected to the water provider or there is a dead end line with no users.
- Gravity Sewers. Infiltration in gravity sewers becomes evident. Normally, even minimal flows obscure the telltale stain lines of minor leaks into the gravity sewer system. If there is no flow and the stain lines show that leaking occurred, then the wastewater utility may require leak repair from the developer long after the normal warranty period. The contractor usually repairs the leaks at no charge during the warranty period. However, once that period expires (normally a year), then the owner or developer may have to fund the repair.
- Power. Power companies are reluctant to install equipment if little power will be sold. Power companies want to see a return on investment. Hence, if there is to be little power usage, then they may be averse to invest in facilities.
- Erosion. Erosion can change the mass grading of a site. Normally the crown of the road is about two feet below the finished floor elevation. Without stabilization such as sod and maintenance that accompanies residents, storms can cause erosion of the earth, onto the road and into the storm sewers.
- Maintenance. Maintenance expense is borne by the developer longer because the homeowners' association either may not be established yet or does not have enough members to sustain it. Although it is typical for the owner/developer to handle maintenance costs during the active sales period, slow sales will extend this period significantly.
- Utility Stubs. Utility stubs can be damaged if obscured by uncontrolled weeds and vegetation. Until the final grading takes place during home construction, utility stubs are often left above ground to make them visible. When weeds grow, they obscure the locations and the stubs are often damaged. Repair expenses and loss of good will are experienced.
- Permits. Permits and approvals for the development may expire prior to the work being complete. Cash flow may dictate that the approvals are allowed to expire. However, there is no guarantee that the same design could be re-permitted due to the possibility of standards changing. When construction has already occurred, a change in design would require reconstruction.
- Bonds. Performance or maintenance bonds require extensions. Where required, bonds usually have to be renewed annually. The expense to renew is not great, but when profit is already hard to attain, such costs can impact performance significantly.
- Retainage Payments. Contractor requests payment of retainage but the work is not accepted for dedication. As stated previously, utility easements are often created through platting. Without the easements, the utility will not be able to maintain the facilities. Hence, the utility will not accept dedication of the utility. This situation puts the owner/developer in a situation wherein the contractor has been paid fully without all the expectations being satisfied.
- Warranties. Warranties expire before the required time. Most warranties start when delivery is made, yet the utility or municipality requires a full warranty upon acceptance.
- Concurrency. Concurrency can become an issue. With utility capacity being finite, the utility will often not hold capacity indefinitely for a particular development. Other concurrency issues such as road and school capacity also change with time. Hence, projects that are able to show concurrency at one point may not be able to do so at some time in the future. When a significant investment has already taken place, losing concurrency can result in significant monetary loss.

Maintenance Strategy

To counteract the issues listed above, actions to both avert ancillary costs and to protect the investment already made can be implemented. Consider the following suggestions:

- Install a fence around the perimeter, even across the roads, to keep out vandals.
- Seed any bare earth to minimize erosion, especially near the roadway where washouts can impact the new asphalt or wash into the stormwater collection system.
- Keep asphalt fresh by maintaining it in a clean state and ensure compaction is complete during or after construction,
- Write metes and bounds legal descriptions and record utility easements for the installed water or other utility systems. Dedicate them to the utility, if possible.

- Remove the hardware from wastewater pumping stations and store for later use. Offer the pumps for sale or restock; otherwise, the warranty will run out prior to use.
- Barricade utility services to prevent damage and/or keep weeds mowed to maintain visibility.
- Provide fencing, security at entrances, and/or security patrols to control vandalism.
- Wait to plat until homes are sold.
- Flush water mains periodically to prevent deterioration from bacterial growth.
- Construct model homes to provide wastewater flow. Otherwise the utility may object to otherwise undetected infiltration instances.
- Encourage traffic on idle asphalt where possible.
- Attempt to negotiate lower construction bonds.
- Renegotiate with contractors to reflect lower material pricing that currently exists.
- Take advantage of the recent, more flexible permitting mindsets by municipal and state agencies.
- Take advantage of impact fee reductions implemented by many municipalities and counties.

Planning Strategy

One way to determine the timing to complete construction of a development is to use a cash flow approach to engineering economy, also known as time value of money, economic analysis or economic decision analysis. Single event and recurring expenses are added to a time line and then inflation is applied to determine the total profit or loss over the length of the project. “What if” scenarios can be proposed and evaluated. Examples of alternative scenarios might be various sales predictions, impact of more advantageous permitting, or the hidden cost of construction deterioration. The economic analysis may not yield news that is encouraging but it will point the way to the optimum completion of the project.

As indicated previously, an investor will typically perform a business analysis during the due diligence phase of the project. Financing costs, taxes, salaries, and other such expenses are identified and weighed against the anticipated income. Of course, expenses and income do not happen during the same time periods. Hence, the time value of money approach is used to assess all expenses and profits. If sales do not occur at the assumed rate, then the development may not provide a profit even though costs and incomes are as planned. Some items such as salaries, loan interest, and taxes will increase with a longer duration. Indeed, projected income from sales has seen a downward pressure, further exacerbating the bleak profit picture.

One expense that might be new since the beginning of the recession is deterioration of a system prior to completion. Many developments for which infrastructure are partially in place were stopped due to the thinking that further investment would not be recouped. This can work in the short term because effects of halting construction are minimal. However, as the duration of the cessation increases, the magnitude of the deterioration cost also rises. Consideration of this cost in particular can change the decision to proceed with development completion.

Conclusion

There are many potential work stoppage situations between inception and completion of a residential development. The situation that can result in the greatest financial hardship is where construction has begun but has not been completed due to the financing and maintenance costs while the project is idle. An engineering analysis is the best method to optimize the timing of completing a project based on a sequence of known and estimated costs and projected profits.

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