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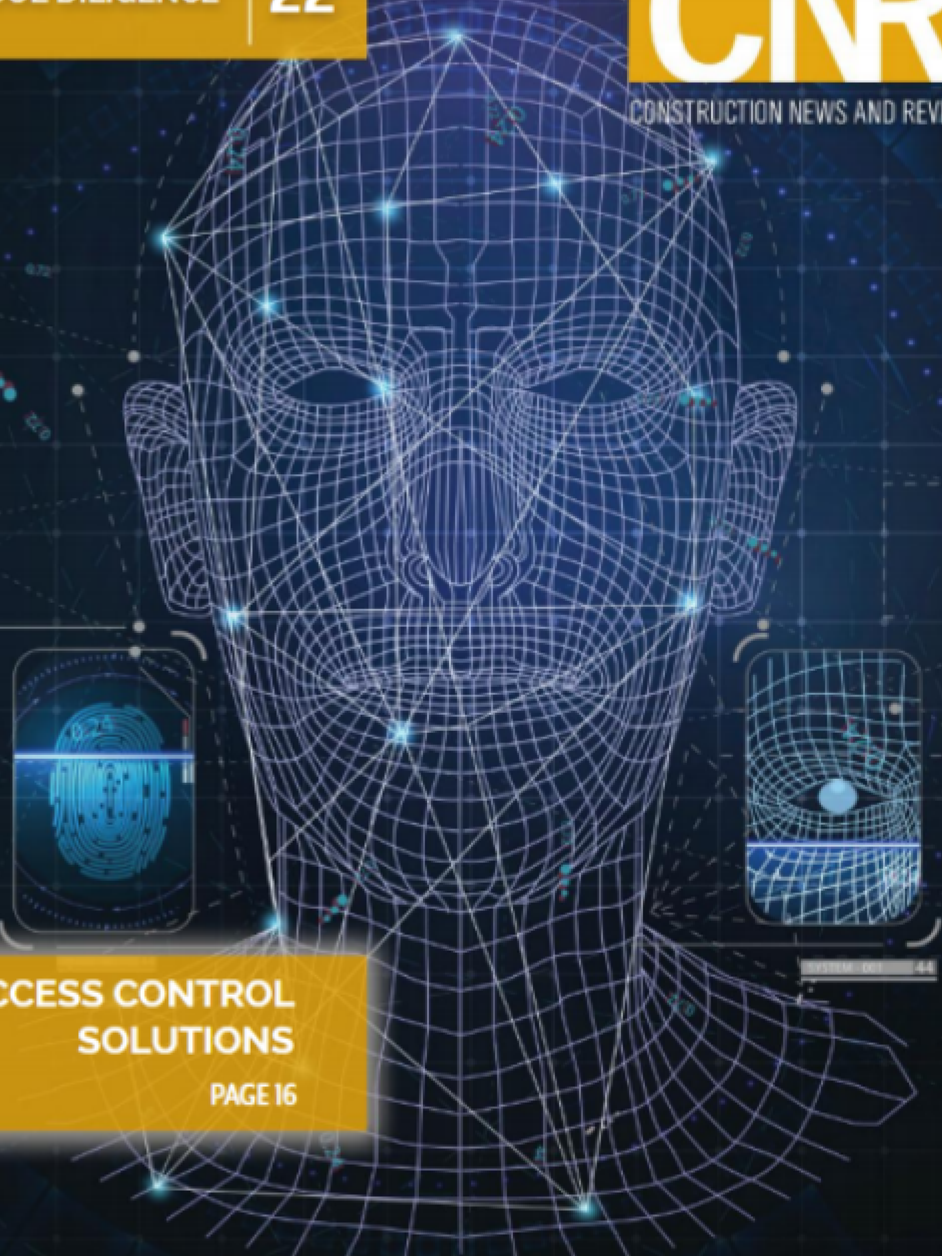
CONSTRUCTION NEWS AND REVIEW



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THE VOICE FOR THE ST. LOUIS CONSTRUCTION INDUSTRY SEPTEMBER-OCTOBER 2020

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VOLUME 51 | NUMBER 5

PROJECTS • COLUMNS • DEPARTMENTS

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ISSN 1045-3792

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CNR St. Louis Construction News and Review (ISSN: 1045-3792) (USPS 988-340) is published bimonthly for $32.00 per year by Visio, LLC. Back issues are available for $5 per copy. Periodicals-class postage paid at High Ridge, MO and at additional mailing offices.

POSTMASTER: 1038 Walnut Terrace • Byrnes Mill, MO 63049

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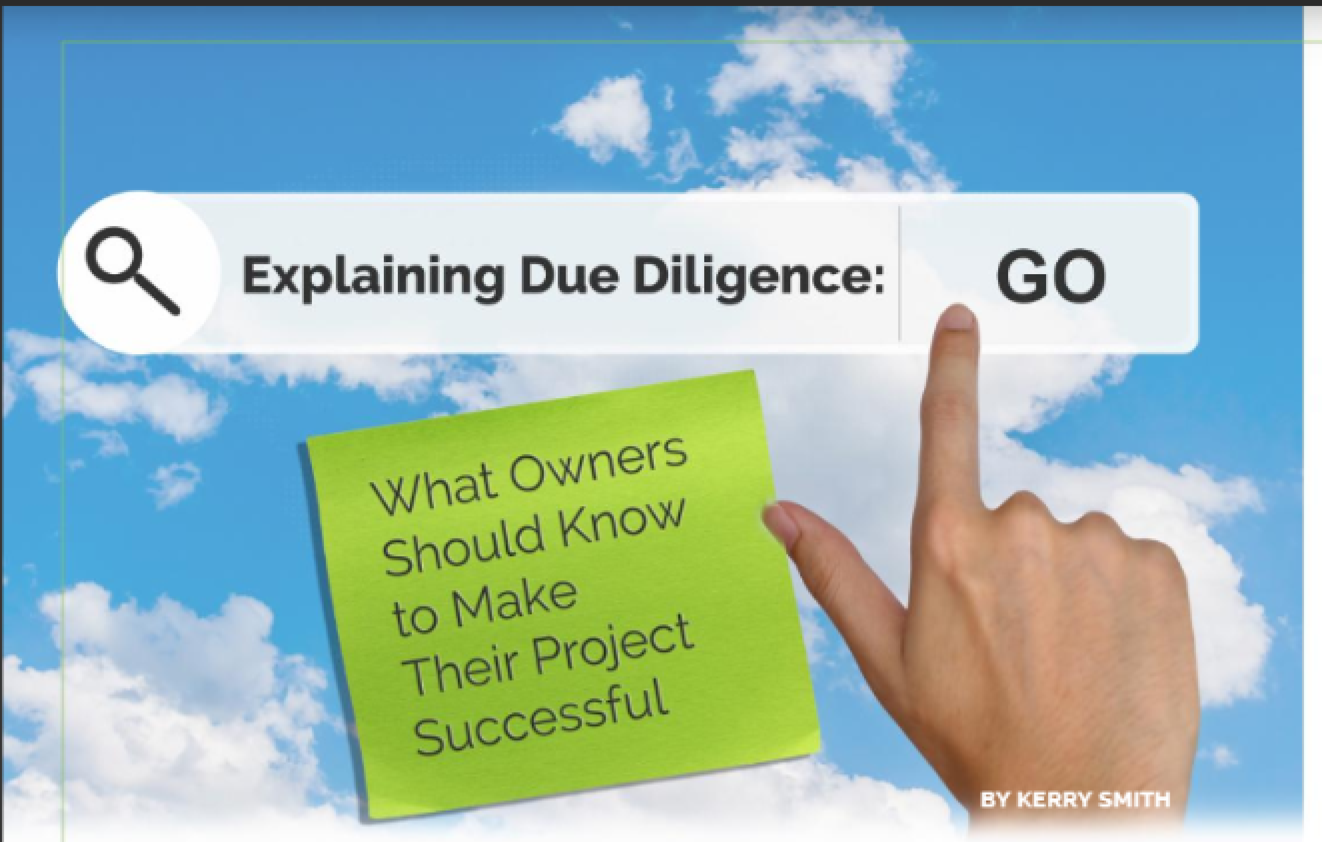

Explaining Due Diligence: GO

What Owners Should Know to Make Their Project Successful

BY KERRY SMITH

When project owners practice due diligence to its fullest extent, it equips them with the knowledge and expertise they need to either move forward on a fully vetted site with confidence or raise the red flag.

Interpreted most broadly, construction project due diligence includes risk management tied to cost, schedule and performance.

How does a project owner navigate and evaluate these risks?

As comprehensively and realistically – and as early on in the proposed project's life cycle – as possible, according to Tony Thompson, chairman and CEO of Kwame Building Group.

"Where and when does the owner begin?" said Thompson. "That's a great question. Too many times, owners are aware of the facets of due diligence, but they approach them out of sequence."

Thompson's firm is the owner's rep for St. Louis Major League Soccer Stadium project that broke ground in early 2020 and is anticipated to be completed in 2023.

"The first thing owners should be doing, if they don't have this resource internally, is to identify an owner's rep," Thompson said. "Owners should hire someone who understands the entire design and construction process from beginning to end and is fluent in due diligence. They should bring this project partner (the owner's rep) on before the budget is finalized and before they hire an architect, construction manager/general contractor and other project partners so the owner's rep can assist the owner in vetting potential project partners. Too many owners establish a budget based upon a previous build they did, essentially pulling the number out of the air. If owners look at the potential (cost) growth between their original project estimate and the actual cost, it's often a 25 percent increase. Bringing an owner's rep on at the start brings the owner a set of eyes that understand what the entire project entails and helps keep project costs in line every step of the way."

Without the due diligence expertise provided by an owner's rep, the project's cost often begins to soar as early as during the design phase, and even earlier if the project's budget did not include adequate funds for site-related due diligence such as permitting and environmental testing/remediation. "If not managed properly, a project could typically go over budget before you ever put a shovel in the ground," said Thompson.

Richard Striler is president of The Striler Group, an owner's representative on current projects including the Harbor Freight Distribution Center and Continental Motors Manufacturing Facility.

Financing – the owner's realization of what their cash requirement will be and what their payment obligations will be – is an ideal place to begin, according to Striler. "As the owner, will I need to put $2 million equity into an $8 million job? Financing construction includes financing the hard costs – the actual costs associated with building – along with financing the soft costs, such as design fees, permits, furniture and others. An all-too-common pitfall is when owners regard the cost of construction and land as being the cost of the entire project. That's not the case. There's far more."

The Striler Group assists owners in assembling what Striler refers to as a master budget. This budget includes any and all capital expenditures associated with any facet of the construction project, along with necessary contingencies. "The master budget is a document that the owner can bring to lending institutions that's essentially a snapshot of the entire project," said Striler. "When bankers examine the information they receive from owners, although they may not fully understand the whole (construction) process, the master budget provides them with a level of confidence that the owner has his/her arms around the complete project."

Steven Albart, regional president for Enterprise Bank & Trust, says cash and capital are key considerations for any operating business that's looking at a new piece of real estate or a construction project. Enterprise finances a great number of construction projects across the St. Louis metro region and beyond.

"What's the highest and best use of their capital for their business?" said Albart. "Does investing capital in real estate provide the greatest return to their business? These are important questions for owners to ask if they determine that investing in real estate is right for them. Before they head in that direction, owners need to determine what the outlook is for their business in the short and long term. Right now, owners should be asking, 'Does the debt (associated with developing and building new construction) make sense for me and my business?'"

Albart offers the example of a recent client that was contemplating building a new office building but is now

"When bankers examine the information they receive from owners, although they may not fully understand the whole (construction) process, the master budget provides them with a level of confidence that the owner has his/her arms around the complete project."

reevaluating space needs and capital requirements in light of the workplace-related impacts of COVID-19. "In a good banking partnership, the owner and the lending institution are thinking through all the things the company will need to use its capital for, looking at the total project and thinking through it in as much detail as possible," Albart said. "Identifying the potential 'blind spots' is essential. Rightsizing their real estate and construction budget is critical. It should even include considerations such as the cost of the move itself."

Scouting incentive opportunities is a logical next step in the project owner's journey of due diligence. Incentives may be defined as any financial benefit to the project, according to Striler, such as real estate tax abatement, sales tax abatement on construction materials or machinery, tax incentives afforded by municipalities, counties or the state, workforce training incentives and more. "If you've got a substantial building project, incentives may provide a level of offset that could vary by county or even by community," Striler said. "You will want to know all of this ahead of finalizing a site selection."

Off-site impediments comprise another critical subcategory of due diligence for construction project owners to explore. "We've seen too many times where an owner identifies a site for his project and when he begins investigating it further, government requirements (city or county) dictate that he must add a turn lane, a sidewalk, easements or other costly infrastructure, or even contribute to a city fund for infrastructure," Striler said. "We're assisting a client on a project in North Carolina where the developer got hit with an inordinate number of off-site requirements before we were involved. The developer is stuck with it because the developer owns the ground, and it has had a serious negative impact on the developer's pro forma. Another project we represented in Kansas City, MO, the street department required the owner to put in a stoplight at an intersection that was a mile away from the project site. When you get in there and begin talking with different departments in city or county government (authorities having jurisdiction), that's when you may learn about significant project costs you hadn't anticipated and that will impact the master budget."

Zoning is another due diligence consideration. Before purchasing a site, checking to see how it is currently zoned and researching the process of petitioning to have the zoning changed to suit the project is a must for owners, according to Striler.

Bill Ahal, president of Ahal Preconstruction Services LLC, agrees that making sure the proposed site suits the nature of the project is key. Ahal's company assists owners in site-specific due diligence on land and on existing buildings. Ahal Preconstruction Services is the owner's representative for the new Plumbers and Pipefitters Welfare Educational Fund Training Center in Earth City and for the Missouri State Capitol renovations project.

"If the owner is considering purchasing an existing building, we help them make sure that it's up to code and we do the due diligence on what it will take to get an occupancy permit," said Ahal. "Parking – and overall developable space – is another big issue with regard to owner's due diligence. With a new site, it may look like you have plenty of room for parking, but the zoning requirements and environmental regulations may prevent you from utilizing as much as you had envisioned. For example, you may think you've got five acres available for development, but due to water quality, necessary detention basins and more, you may really only have three acres that you can develop. And make sure, early on, that you locate all your utility easements, test your soil conditions and any other beneath-the-surface factors that could impact your project," Ahal added.

Ahal echoes Striler's point about doing due diligence with respect to the specific municipality within which the proposed construction project will occur. "There are 88 different municipalities across St. Louis County," Ahal said. "We had a client from out of town who was seeking to build nearly 20 retail franchise locations in the St. Louis metro area. Where they came from, they were able to go to one governmental body and get permits to build in their region. They assumed in St. Louis they could go to the county courthouse in Clayton and get one permit to cover all the sites they planned to build here. When I informed them that they'd need to work with 13 different municipalities on permitting to build identical layouts – and that each municipality's permit required different specifics – they eventually decided to build their projects somewhere else."