NAVIGATING THE DEVELOPMENT PROCESS

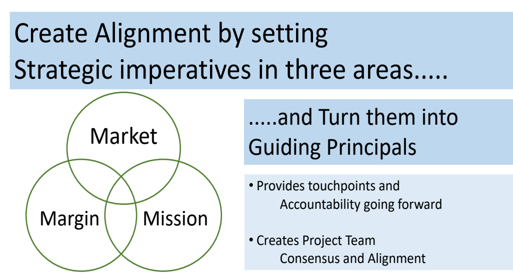
Introduction

The process of growth is arduous. And envisioning, planning, financing, and building a new project or expanding an existing campus is no different. And without the right people, the proper systems, and team discipline, it becomes more difficult. Like navigating a road with land mines, navigating the development process is tricky. But there are ways to identify and avoid those "development land mines".

The purpose of this paper is to identify and provide tools to ***help organizations successfully navigate the development process.*** The process is not linear and there will be detours. However, creating a roadmap will increase the likelihood of success. And that roadmap should include pursuing *team alignment, creating a functional task force, developing dashboards with metrics and guardrails, insisting on fiscal discipline, and creating an executable plan of finance*.

Creating Project Team Alignment

The development process often gets off on the wrong foot because there is a lack of alignment. As discussed in another PCA white paper, Leadership Lessons Learned from Gettysburg, the lack of organizational alignment is the primary cause of organizational failure. So, how do we create executive team, board, and project team alignment from the very beginning? Leaders do so ***by clearly communicating intent and making sure everyone understands the rationale for a project, thereby creating a "well-aligned team."*** Most leaders are surprised to discover widespread disagreement when they thought that everyone understood and agreed with the rationale for a decision. However, unless leaders get clear signals that everyone understands and agrees on goals, group misalignment will result.



To create alignment, project rationale should include three components. First, does the project further the organization's current mission or expand its mission in a way that is compatible with its current mission? Second, does the project meet a market need and is the project "market defendable"? And third, is the project financially viable?

Pursuing the answers to these questions in an intellectually honest fashion will create alignment. It is possible that honest answers may lead to changing or canceling a project early in the process. Sometimes, during the development process, outside forces can cause a project to no longer meet the original metrics agreed to. And no amount of price adjusting, right-sizing or value engineering can change that. This is where dashboards and maintaining alignment is critical. Sometimes, the right decision is to cancel a project. This is indeed a very difficult thing to do. But it has been done - not enough, but more often than you think. Organizations not honest or brave enough to do so end up with a bad project or even worse.

So, to make sure an organization is pursuing the right kind of project, several additional questions can be asked. How does the project fit the business model and how does it impact current operations? Is this something that we have expertise in? Does the market want the product that is being offered and is there enough demand to fill it? Are there less costly alternatives to meeting the perceived demand? Does the project create incremental value financially?

Creating a Task Force and Dashboards

Once a project has been identified, it is important to create a task force that is responsible for monitoring implementation. The task force should approximate 5 to 7 people and include board members and other constituents who have the required expertise, the time, and proclivity for the endeavor. In addition, the task force should have tools to ensure accountability and continued alignment. Three such tools include qualitative dashboards, quantitative dashboards, and timeline mileposts. It is not unusual during the development process to veer away from the original purpose or mission of a project, to modify the project scope or modify the product by changing important components like unit count and price points. These changes are not themselves a problem. In fact, they may be necessary. However, they become a problem when not fully vetted against original metrics and scope, which can lead to organizational misalignment and loss of fiscal discipline. It is the task force's responsibility to ensure that this does not happen.

Task Force - Best Practices

- Define Criteria and Objectives against which decisions should be made
- Review initial actions to ensure clarity and alignment
- Isolate Key Assumptions and Variables that are critical to success
- Perform Sensitivity Analysis to determine potential outcomes
- Define Guardrails and Mileposts that need to be met to maintain alignment
- Monitor Using Qualitative and Quantitative Dashboards
- Provide Feedback to development team and keep Board Informed

Once a task force has been created, it is important to have a "Team Charrette", where the development team and task force meet to clarify goals, develop dashboards and mileposts, define preliminary unit configuration, phasing, and cost assumptions. This early planning process is always best approached as an interactive process with all disciplines represented including design, construction, marketing, finance, and mission. To facilitate the process, it is necessary to have a Project Manager identified.

> "Information Silos" are detrimental to the development process.

The role of Project Manager can be filled by a staff member or contracted to an outside party. If internal, make sure that the Project Manager has the **skill set** and is given the **authority** to do the job. If external, check references (especially other professionals) to ensure that the Project Manager uses a collaborative process that shares information with all members of the team. Some external Developers and Project Managers prefer "information silos" so that they can control the development process. This is detrimental and can lead to a breakdown in fiscal discipline and alignment.

By clarifying objectives, creating criteria against which progress can be measured and identifying and isolating key drivers to success, meaningful dashboards and realistic mileposts can be developed to ensure the development process stays on track. Specific tasks or action items can also be identified. This disciplined process helps to preserve organizational and team alignment and fiscal discipline. A quantitative dashboard might include "Debt Service Coverage" and "Days Cash on Hand" ratios with "Green", "Yellow" and "Red" target ranges. Green would signal "move forward". Yellow would signal "move forward with caution". And red would signal to "stop development and reevaluate". These target ranges create guardrails and fiscal discipline, allowing tactical decisions to be made by the development team without the board or task force approving every decision.

This also creates a more efficient process and greater autonomy. By clearly communicating organizational intent and eliminating micromanagement by creating "guardrails" for decision-making, the development team feels empowered. If decisions support intent and fall within the guardrails agreed to by everyone, the development team can be more creative in advancing the project forward.

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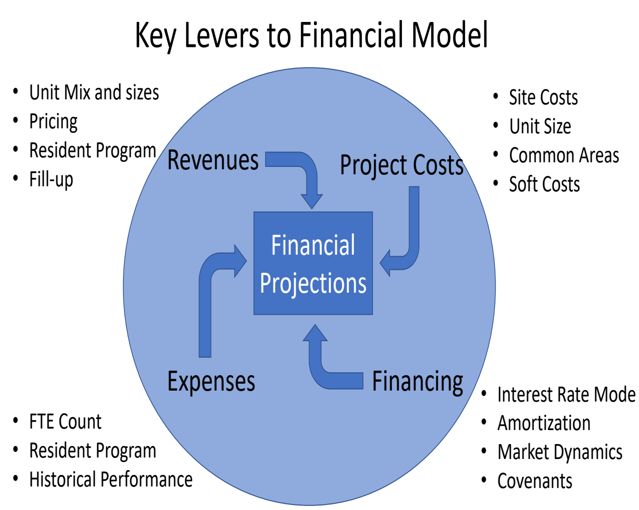
A point on "upward management" - sometimes development team members believe that by not assuming responsibility for clarifying objectives, they are "off the hook" because the owner did not clearly communicate expectations. Too many times as a project becomes unfeasible, I hear members of the development team tell the client, "I gave you what you asked for." Each development team member owes it to the team to understand core objectives to hold each other and themselves accountable. Hence the necessity of eliminating "information silos". Each discipline on the team (design, construction, finance, operations, marketing, etc.) should have specific goals that support the overarching goals for the project. This "upward management" and "peer management" helps maintain accountability and alignment.

In summary, a functional task force is critical. As the liaison between the Board and development team, the task force needs to clearly understand board objectives. And by using agreed upon dashboards and metrics, it creates a feedback loop with the development team that ensures objectives are being met. This also gives the task force the confidence to make critical decisions. The task force should also communicate progress relative to dashboards and mileposts to the board on a regular basis.

Maintaining Fiscal Discipline

No development project can be monitored without a financial model to determine financial viability. Without good financial projections, maintaining fiscal discipline and making good decisions is impossible.

In the early stages, the model can be quite straightforward and simple. However, as one moves forward in the development process, the financial model should increase in sophistication so sensitivity analysis can be performed, allowing the development team and task force to isolate the key drivers to financial success. The importance of creating a "real time" operating financial model cannot be overemphasized. It will be a key tool in providing the information needed for the quantitative dashboard, which will be used by the task force to monitor the status of the project and to maintain fiscal discipline.



Four key components feed into the operating financial model. They include Revenues, Expenses, Project Costs, and Financing Costs. Revenue and Expense assumptions will come from the operator, Project Cost assumptions will come from the architect and contractor, and Financing assumptions will come from the Municipal Advisor or Investment Banker. Each of these components are also referred to as "levers" that can be pulled in different directions. However, each of these levers must operate within reality. ***So, it is important to identify the key drivers within each component or lever*** to determine operating margin sensitivity. And a key driver in the "Expense" lever will be staffing. In the past, this important driver has been given little thought or consideration. Organizations cannot afford to do this going forward due to changes in the workforce.

Because the financial model is being used to determine financial viability, transparency is paramount. Whomever is responsible for creating and maintaining the financial model should be able to explain the key drivers in the model to the task force and demonstrate through sensitivity analysis why certain assumptions are key drivers. In addition, assumptions should be reasonable, especially drivers. This focus on transparency keeps the model from being a "Black Box". In fact, when I performed feasibility studies for hospitals in the 1990's, I would sit down with the CFO and go through the model step-by-step with the intent of leaving the model with the client. So, the creator of the model must be willing to share components of the model with other members of the team. This guarantees transparency and acts as a possible quality control measure in case there are formula anomalies in the model.

Creating an Executable Plan of Finance

Once Revenue assumptions, Expense assumptions and Project Cost assumptions have been identified, it is necessary to create an executable plan of finance. A financial model will help determine which financing options may be most attractive and most executable. Therefore, when pursuing financing for any project, the capital formation strategy should focus on more than cost. The more financial resources the sponsor has at its disposal, the more options it may have. More information on developing a proper plan of finance can be found in the white paper Capital Formation for Senior Living.

Certainty of execution within the constraints of the current market is paramount. Before going too far down the development path, make sure that your project can be financed under a plan of finance that has a high certainty of execution. This plan of finance would be the "Back-up Plan" or "Plan B". While establishing Plan B, also pursue a "Plan A" that has a lower cost of capital but may have more execution risk. So, Plan A should be pursued to improve the plan of finance, but it should not be counted on as the primary plan of finance. This approach allows the borrower to pursue a best-case structure but also creates a back-up financing structure in case the preferred structure is unavailable. This Plan A or preferred structure might include bank debt, USDA debt or tax credits.

- Have good partners
- Planning lays the foundation for success
- Gather good data
- Listen to the feedback
- Be willing to adjust along the way
- Stay true to your overarching goals

In summary, navigating the development process is a tricky business, filled with land mines. As one of my clients recently articulated in a webinar on development best practices, if you hire good partners, do good planning, get good data, listen to the market, are willing to adjust, and stay true to your mission and overarching goals, you are more likely to stay away from those hidden, yet dangerous development land mines.