CEDAM
COMMUNITY ECONOMIC DEVELOPMENT ASSOCIATION OF MICHIGAN

Real Estate Development Glossary of Terms

A

Ad Valorem Tax: A tax based on the value of a property.

Allowable Lot Coverage: The maximum percentage of a lot that can be covered by improvements; how the development potential of vacant land is measured.

Amortization: The repayment of loan principal through equal payments over a designated period of time, consisting of both principal and interest; an accounting method that allows for the gradual allocation of the cost of a loan over its term.

Annual Debt Service (ADS): The total amount of principal and interest payments made on a loan over 12 months, representing the cash flow needed to cover the financial obligations of a property's mortgage.

Appraisal: A professional analysis used to estimate the value of the property. This includes examples of sales of similar properties.

Appraiser: A professional who conducts an analysis of the property, including examples of sales of similar properties, to develop an estimate of the value of the property. The analysis is all an appraisal.

Assessed Value: The dollar amount a local government uses to calculate property taxes; a percentage of a property's market value. This is determined by a property assessor who examines various factors to determine how a property will be taxed.

B

Base Year: The year in which a property's taxes are assessed.

Baseline Environmental Assessment (BEA): A document that describes the environmental conditions of a property at the time of its acquisition, particularly focusing on contamination levels. A key tool for protecting new property owners from

liability for pre-existing environmental issues they didn't cause.

Brownfield: In Michigan, a brownfield is a property that is contaminated, perceived to be contaminated, historic, blighted, or obsolete. Michigan law allows for the use of tools and incentives to help redevelop brownfields.

Buyer's Market: A housing market where the supply exceeds the demand. This means that though many properties are available, there's a shortage of buyers interested in purchasing them. These market conditions give buyers the upper hand over sellers, compelling the market to respond accordingly.

C

Cap Rate: Also known as capitalization rate; the ratio of a property's net operating income to its purchase price (net operating income divided by purchase price), used to evaluate the potential return on investment of a property.

Cash Flow: In investment property, the actual cash the investor will receive after deduction of operating expenses and debt service (loan payment) from gross income.

CDFI: A specialized lender that provides financial products and services to underserved communities, focusing on supporting small businesses, affordable housing, and other community development initiatives.

Clear Title: Property free from debt or other claims, such as taxes.

Closing Costs: Completion of a loan transaction in which all appropriate papers are signed and money from the loan is disbursed.

Common Area: Shared spaces within a property or community that are available for the use of all residents or tenants, not just one specific individual or unit.

Community Land Trust: A nonprofit organization that owns land on behalf of a community, ensuring long-term affordability and community benefits by retaining ownership of the land while leasing the land to residents who purchase the houses built on it.

Condominium: A condominium is a type of ownership in which each unit owner owns a unit in a building and shares ownership of the common areas with the other unit owners.

Contingency: A specified sum of money included in a loan to cover any potential or expected construction cost overruns, usually calculated as a percentage of the bid or estimate for contracted work.

Cooperative (Co-Op): A type of property ownership in which each member owns a share in the cooperative and has the right to occupy one unit in the property.

D

Density Bonus: A zoning incentive that allows developers to build at a higher density than normally allowed in exchange for providing affordable housing.

Depreciation: An accounting method that allows for the gradual allocation of the cost of a property over its useful life.

Debt Service: The periodic payment of interest and principal on a loan.

Debt Coverage Ratio: The ratio of a property's net operating income to its debt service.

Debt-to-Equity Ratio: A ratio to get an idea of how much a company is relying on borrowed money to finance its operations, calculated by taking the total amount of a company's liabilities and dividing it by shareholders' equity.

Debt Service Coverage Ratio: A ratio that measures a company's ability to make its debt payments, calculated by dividing a company's net operating income by its debt service.

Developer Fee: A payment made to a developer for their services in overseeing and managing a development project, including preconstruction, construction, and post-construction phases. The fee typically covers the developer's overhead, labor, and other project-related expenses.

Due Diligence: The process of investigating a property to assess its suitability for investment.

E

Earnest Money: Also known as a good faith deposit; a sum of money a buyer deposits with a seller to demonstrate their serious commitment to purchasing a property. This deposit is usually applied to the down payment or closing costs if the sale goes through.

Easement/Right of Way: A right to use someone else's land for a specific purpose.

Environmental Assessment: A study of the potential impact of a project on the environment.

Equity: The portion of a property's ownership that the investor holds; can be used to finance the purchase of a property or to provide a return on investment.

Equity Stake: An ownership interest in a company or property; can be used to finance the purchase of a property or to provide a return on investment.

Exit Strategy: A plan for how an investor will sell their investment; may also be referred to as an "exit" or a "disposition strategy."

F

Fixed Expenses: Costs that remain relatively consistent over time, meaning they are regularly occurring and generally don't change in dollar amount.

Floor Area Ratio (FAR): The ratio of the total floor area of a building to the size of the lot on which it is built.

Fully Amortized Mortgage Loan: A loan where the borrower makes regular payments that cover both principal and interest, ensuring the entire loan balance is paid off by the end of the loan term.

G

Gap Financing: Financial support to bridge the gap between the amount of money available from other sources and the total purchase price or total cost to develop a property.

General Contractor: A licensed professional who manages and oversees the day-to-day activities of a construction project from start to finish, ensuring it's completed on time, within budget, and to the required standards. They serve as the main point of contact between the property owner and all other contractors and tradespeople involved in the project.

Greenfield: A parcel of land that has not been developed and is suitable for development.

Gross Operating Income (GOI): Sometimes referred to as gross operating profit; a property's total revenue before deducting recurring operating expenses, but after adjusting for potential vacancies and credit losses.

H

Hard Costs: The construction costs associated with a development project.

Height Limit: A zoning regulation that limits the height of buildings in an area.

I

Internal Rate of Return (IRR): The percentage rate earned on each dollar that remains in an investment each year. The IRR of an investment is the discount rate at which the sum of the present value of future cash flows equals the initial capital investment.

Internal Rate of Return Method: A comparison method that calculates the internal rate of return of the differential cash flow between any two investment alternatives, then compares that rate with the user's opportunity cost. See internal rate of return.

J

Joint Venture: An agreement between two or more companies to develop and operate a project jointly.

L

Land Bank: A public entity with unique powers to acquire, hold, and dispose of vacant, abandoned, deteriorated, and tax-foreclosed properties to return them to productive use, often focusing on community goals and addressing blight.

Lease: A contract that creates the relationship of landlord and tenant; a binding agreement that grants a right to exclusive possession or use of property, usually in return for a periodic payment called rent (Encyclopedia of Real Estate Terms, 2nd Edition, Damien Abbott).

Lessee: The tenant.

Lessor: The landlord.

Letter of Intent: A non-binding agreement between two parties that outlines the terms of a proposed transaction.

Leverage: The use of debt to finance the purchase of an asset. Leverage can increase the return on investment of an asset, but it also increases the risk.

Loan Point: Also known as discount point; a fee paid to a lender to lower the interest rate on a loan, typically equivalent to 1% of the loan amount.

Loan-to-Value (LTV): The relationship of a mortgage to the appraised value of a security. This ratio is expressed to a potential purchaser of property in terms of the percentage a lending institution is willing to finance.

M

Managing Principal: The individual responsible for the overall management of a development company.

Market Analysis: Also known as comparative market analysis (CMA); a systematic evaluation of market conditions to assess property values, identify trends, and determine investment opportunities by comparing the property to similar ones recently sold in the area.

Mill Rate: The amount of tax per dollar of assessed value calculated by dividing the total amount of taxes by the assessed value of all property in the jurisdiction.

Mortgage: A formal document executed by an owner of property, pledging that property as security for payment of a debt or performance of some other obligation; a security instrument.

Mortgage Points: A form of prepaid interest, essentially a one-time fee paid upfront to the lender in exchange for a lower interest rate on the loan.

Multifamily Property: Usually a structure or property with five or more housing units; sometimes used to refer to any property with more than one unit, particularly if shared ownership is involved.

Multiple Listing Service (MLS): A database system used by real estate agents and brokers to share information about properties for sale, facilitating cooperation and wider exposure for listings, and ultimately connecting buyers with sellers.

N

Net Income: Income after deductions.

Net Operating Income (NOI): In rental properties, the gross income from rents and other sources minus the vacancy allowance and operating expenses. The NOI is the amount available for making loan payments (debt service) and paying investors (cash flow).

O

Operating Expenses: The regular required outlays associated with the ownership of income-producing real estate. Traditionally, operating expenses are divided into fixed expenses, variable expenses, and a reserve for replacement.

Option Agreement: A contract where a seller (optioner) gives a buyer (optionee) the right, but not the obligation, to purchase a property within a specific timeframe and at a set price, allowing the buyer to explore their options and potentially secure the property at a later date without immediate commitment.

Ordinary Income: Income subject to tax at full or ordinary rates rather than at favorable capital gains rates.

Origination Fee: The fee charged by a lender to prepare loan documents, make credit checks, inspect, and, sometimes, appraise a property. It is usually computed as a percentage of the face value of the loan.

Originator: An individual or institution that lends money directly to the borrower.

Owner Financing: A purchase in which the seller provides all or a part of the financing.

Owner's Equity: The difference between the fair market value of a property and the current indebtedness.

P

Paper Lots: Unbuilt parcels of land created through the subdivision process.

Partnership: An agreement between two or more people to own and operate a business jointly.

Phase I Environmental Assessment: An investigation of the history of a property to determine if any past uses of the property, or nearby properties may have contaminated the site.

Phase II Environmental Assessment: An investigation of a property to determine the extent of contamination of any hazardous substances found in a Phase I assessment.

Potential Rental Income: Also known as gross potential income (GPI) or gross potential rent (GPR); the maximum amount of rental income a property could generate if it were fully rented at market rates for the entire year, assuming 100% occupancy and full payment.

Present Value: The current value of an amount of money to be received at a future date.

Pro Forma: An estimated financial statement real estate developers use to forecast the future performance of a project, taking into account factors such as expected revenues, operating expenses, and debt service.

Property Tax: A tax levied on the ownership of that real estate.

R

Rate of Return (ROR): Also known as return on investment (ROI); measures the profit or gain on an investment compared to its original cost, expressed as a percentage, helping investors assess profitability and investment efficiency.

Real Estate Cycles: A predictable pattern of fluctuations in the real estate market, characterized by periods of expansion, peak,

contraction, and trough. These cycles, which typically last 10-18 years, impact property values, demand, and investment opportunities. Understanding these cycles helps investors make informed decisions about buying, selling, and managing properties.

Real Estate Fluctuations: Refers to cyclical patterns of rise and fall in the prices and activity within the real estate market. These fluctuations are driven by supply and demand, economic conditions, and investor sentiment, resulting in market cycles with phases like expansion, peak, contraction, and trough.

Real Estate Investment Trust (REIT): A company that owns, operates, or finances income-producing real estate; a type of investment that allows individuals to participate in the gains and losses of real estate properties without having to directly own or operate them. REITs are structured like corporations or trusts and are often traded on stock exchanges, allowing investors to buy and sell shares.

Real-Estate Owned (REO): Property a lender acquires as the result of foreclosure.

Realtor: A real-estate broker or associate with an active membership in a local real-estate board affiliated with the National Association of Realtors (NAR). The word "realtor" is a registered trademark of the NAR.

Regulatory Requirements: The rules, laws, and standards that govern property ownership, transactions, and usage, including zoning, building codes, environmental regulations, and fair housing laws.

Replacement Reserves: Funds set aside to cover the costs of replacing or repairing long-term capital assets like roofs and HVAC systems. They act as a financial safety net for property owners, helping them avoid unexpected expenses and ensuring the property remains in good condition.

Right of Way: A type of easement that gives the holder the right to pass through someone else's land.

S

Sales Proceeds: The total amount of money received from the sale of a property, which can be broken down into gross proceeds (the total sale price) and net proceeds (the amount remaining after deducting all costs associated with the sale).

Setback: A zoning regulation that requires buildings to be set back a certain distance from the property line.

Soft Costs: The non-construction costs associated with a development project, such as architectural and engineering fees, financing, and overhead costs.

Special Assessment: A tax levied on a property to pay for improvements to the surrounding areas, such as streets or sidewalks.

Subdivision: A division of a piece of land into smaller parcels.

Subsidy: Generally, any funds provided from a source (unit of local, state, or federal government) that either reduces the amount of financing a borrower needs to obtain from a conventional lender, or provides support payments, low-interest loans, or grants that allow low-income people to afford housing otherwise unaffordable or unavailable.

Sunk costs: Money, time, or resources already spent on a property or project that cannot be recovered regardless of whether the project is completed or abandoned.

T

Tax Shelter: The process of using real estate investment properties, investment accounts, or transactions to lower your income tax rate through deductions and credits. Examples include: Claiming tax breaks like property depreciation expense, borrowing against equity, etc.

Title Insurance: Protects against financial losses arising from defects or issues with the property's title, like liens or fraudulent claims, that could jeopardize ownership.

Transferable Development Rights (TDRs): The rights to develop a property that can be bought and sold separately from the land.

V

Vacancy: A property or unit within a property that is unoccupied and available for rent or sale.

Vacancy Allowance: The percentage of rental units in a property that are unoccupied, representing potential income lost due to vacancies.

Vacancy Rate: The ratio between the number of vacant units and the total number of units in a multi-tenant building or development.

Y

Yield: The annual income generated by a property expressed as a percentage of the property's cost or market value, essentially measuring the rate of return from the investment.

Z

Zoning: A set of municipal laws or regulations that govern how property can and cannot be used in specific geographic locations. Zoning has been used both as a tool to build cities and as an exclusionary practice to keep neighborhoods, towns, and cities racially and economically divided.