



Building it Right: Development Terminology

Much like the non-profit sector has a distinct language, real estate is a technical field with complex jargon and acronyms. It is really important to make clear the intended definitions of words and phrases at the outset of conversations to ensure you and all parties you are working with have a clear understanding of what is meant and can communicate effectively. Below are the definitions of some of the more commonly used terms and phrases. Three separate lists are provided: one for real estate terms, one for financial terms, and one for social-purpose real estate terms

Real Estate

Deed

The legal document conveying title to a property.

Density

A specific measurement of the population of an urbanized area, excluding non-urban land-uses. Non-urban uses include regional open space, agriculture and water-bodies.

Developer

The organization that is the driving force and central decision maker of a project. Usually, the first contributor of equity that takes the greatest risk. A developer's primary goal is to maximize the economic value of the land.

Easement

A right of way giving persons other than the owner access to or over a property.

Effective Age

An appraiser's estimate of the physical condition of a building. The actual age of a building may be shorter or longer than its effective age.

Encumbrance

Anything that affects or limits the fee simple title to a property, such as mortgages, leases, easements, or restrictions.

Fair Market Value

The highest price that a buyer, willing but not compelled to buy, would pay. Also, the lowest a seller, willing but not compelled to sell, would accept.

Feasibility

The analysis of how capable a project or idea is of being accomplished. There are many types of feasibility to be analyzed including: political and economical but the most common type of feasibility is financial.

Fee Simple

The greatest possible interest a person can have in real estate. In other words, outright ownership with no debt owing or holds against the asset.

Foreclosure

The legal process by which a borrower in default under a mortgage is deprived of his or her interest in the mortgaged property. This usually involves the forced sale of the property with the proceeds being applied to the mortgage debt.

FSR – Floor Space Ratio

Also referred to as Floor area ratio (FAR), floor space index (FSI), site ratio and plot ratio.

It is a way of measuring density. As a formula it equals the total covered area on all floors of all buildings on a certain site divided by the area of the site.

Lease

A written agreement between the property owner and a tenant that stipulates the payment and conditions under which the tenant may possess the real estate for a specified period of time.

Leasehold

A form of land tenure or property tenure where one party buys the right to occupy land or building for a given length of time.

Legal Description

A property description, recognized by law, that is sufficient to locate and identify the property without oral testimony.

Lien

A legal claim against a property that must be paid off when the property is sold. (A mortgage is considered a lien.)

Occupancy

The building is in use or operation for its intended purpose.

Percentage of occupancy refers to the proportion of units leased or sold as compared to total number of units or square footage.

Purchase Agreement

A written contract signed by the buyer and seller stating the terms and conditions under which a property will be sold.

Real Estate Development

Though it is often thought of as simply building or renovating buildings, this refers to the full process of turning an idea on paper into real property.

Subdivision

A housing development that is created by dividing a tract of land into individual lots for sale or lease. (Subdividing is the process of legally separating a portion of land so it can be registered as its own lot)

Financial

Amortization

The loan payment consists of a portion which will be applied to pay the accruing interest on a loan, with the remainder being applied to the principal. Over time, the interest portion decreases as the loan balance decreases, and the amount applied to principal increases so that the loan is paid off (amortized) in the specified time.

Appraised Value

An opinion of a property's fair market value, based on an appraiser's knowledge, experience, and analysis of the property. Since an appraisal is based primarily on comparable sales, and the most recent sale is the one on the property in question, the appraisal usually comes out at the purchase price.

Assessed Value

The valuation placed on property by a public tax assessor for purposes of taxation.

Balloon Mortgage

A mortgage loan that requires the remaining principal balance be paid at a specific point in time. For example, a loan may be amortized as if it would be paid over a thirty year period, but requires that at the end of the tenth year the entire remaining balance must be paid.

Capitalization Rate (Cap Rate)

The ratio between the net operating income produced by an asset and its capital cost or current market value. The rate is calculated by dividing annual net operating income by the cost or current value. Industry averages are regularly produced for each specific asset class in major cities and key geographic areas. This rates are used to help determine a fair value to pay for an asset or to determine what level of operating income is required to support a property at a certain listed price.

For example, if the cap rate in Victoria is 4.5% and the building is expected to produce \$100,000 in positive net operating income during one year, then a fair valuation would be calculated as follows:

$$\$100,000 / 4.5\% = \$2,222,222$$

Cap rates provide a tool for investors to use for roughly valuing a property based on its Net Operating Income. A comparatively lower cap rate for a property would indicate less risk associated with the investment (strong or increasing demand for the product).

Construction Financing

A short-term, interim loan for financing the cost of construction. Construction financing loans are usually paid off in full from the mortgage or take-out financing that is arranged once substantial completion has been achieved.

Debt

An amount of money owed to another. Usually in the form of a loan or mortgage.

Debt Service Coverage Ratio (DSCR)

The amount of cash flow available to meet annual interest and principal payments on debt. It is calculated by dividing net operating income by total annual debt service.

Down Payment

The part of the purchase price of a property that the buyer pays in cash and does not finance with a mortgage.

Equity

The owner's financial interest in a property. It is the difference between the fair market value of the property and the amount still owed on its mortgage and other debt.

Escrow

An item of value, money, or documents deposited with a third party to be delivered upon the fulfillment of a condition. For example, a purchaser's deposit is put into escrow until delivered to the seller then the transaction is closed.

Interest

Fees or cost of borrowing money.

Loan

A sum of borrowed money (principal) that is generally repaid with interest.

Loan to Value Ratio (LTV)

The amount of the mortgage compared to the value of the property.

The calculation is $1 - (\text{down payment or total amount of equity} / \text{property value})$

Maturity

The date on which the principal balance of a loan, bond, or other financial instrument becomes due and payable.

Mortgage

A legal document that pledges a property to the lender as security for payment of a debt.

Net Operating Income (NOI)

The total operating income after operating expenses are deducted but before income taxes and interest are deducted. If the value is negative it is referred to as a net operating loss (NOL).

Principal

The amount borrowed or remaining unpaid. The part of the payment that reduces the remaining balance of a mortgage.

Revolving Debt

A credit arrangement, such as a credit card or line of credit, that allows a customer to borrow against a preapproved amount of credit. The borrower must pay back the amount that is actually borrowed plus any interest due.

Right of First Refusal

A provision in an agreement that requires the owner of a property to give another party the first opportunity to purchase or lease the property before they offer it for sale or lease to others.

Second Mortgage

A mortgage that has a lien position subordinate to the first mortgage.

Take-out Financing

A commitment to provide permanent financing (usually a mortgage) following construction of a planned project. The takeout commitment is generally predicated upon specific conditions, such as a certain percentage of unit sales or leases secured. It is called “take out” financing because it replaces or, “takes out” the construction loan that was in place to finance the construction activities.

Term

The length of time, usually represented in years (sometimes months), in which the parameters of a financial obligation have legal effect.

Transfer Tax

Tax payable when title passes from one owner to another.

Vacancy Rate

The average rate of vacant units as compared to total units available for a specific geographic area. The higher the rate, the more vacancies are in that area.

Construction

Cost-plus Contract

A contract where a contractor is paid for all of its allowed expenses to a set limit *plus* additional payment to allow for a profit (Also known as a cost-reimbursement contract.)

Construction Deficiency

Poor quality or substandard workmanship or materials.

Fixed Price Contract

A contract where the amount of payment does not depend on the amount of resources or time expended. The risk of cost overrun is shifted to the contractor.

Latent Defect

A fault in the property or construction that could not have been discovered by a reasonably thorough inspection before the sale or before the owner accepts the building from the building contractor.

Substantial Completion

The construction project, or designated phase, is sufficiently complete in accordance with a contract for the owner to occupy and/or utilize it for its intended use without undue interference.

Testing & Commissioning

A process that includes the integrated application of a set of engineering techniques and procedures to check, inspect and test every operational component of the project, from individual functions, such as instruments and equipment, up to complex amalgamations such as modules and systems.

Social Purpose Real Estate

Social Purpose Real Estate

refers to property and facilities owned and operated by mission-based organizations and investors for the purpose of community benefit, and to achieve blended value returns.

Shared Space

More than one organization or group operating out of the same physical space.

Co-location

More than one organization or group operating out of the same physical space and achieving efficiencies through shared resources, joint programming or another form that is in addition to being physically located together.

Social Value

Is about maximizing the impact of real property and/or land. It looks at what is created, and sometimes what is forsaken, through the development process. Social value considers much more than just the financial transaction. It can include but is not limited to: Health and wellbeing, security, inclusion and empowerment.