Become the Successful Developer Every Houstonian Wants To Be with These Key Words

A GLOSSARY OF TERMS

Some cities were founded by religious leaders or by socialists. Houston's founders were real estate speculators through and through. With this guide, you can follow in their footsteps. The basics never change but the language of developers has, well, developed a bit since 1836. Here's a brief guide to navigating your new lexicon.

Words Monte Large, José Solís, and Raj Mankad

CAPITAL STACK

The list of where the money comes from and who's going to come after you and your children if the project doesn't work out. Usually in a graph.

CAP RATE

Capitalization Rate. Calculated by dividing net income by the sale price of the asset. This number is used to estimate the investor's potential return. Let's say you buy a building for $1 million and it nets $100,000 annually; the cap rate is 10 percent.

CREDIT-WORTHY TENANT

Yes, they might be credit-worthy but they won't make the best 100 restaurants list. Most Houston investors/landlords like credit-worthy tenants the best. The more credit-worthy your tenants are, the lower your interest rates will be. That's why there are so many mattress stores and so few cute little cafes.

DSCR

Debt Service Coverage Ratio. This number shows whether you earn enough quarters every year to cover your debt obligations. The ratio of the operating income to the mortgage has to be greater than 1.

FAR

Floor to Area ratio. Not a big deal in Houston since we don't have zoning or laws limiting FAR. In huge cities like New York, there is essentially a limit on how tall one can build and how much "light and air" must be present towards the top of the buildings. Almost every developer in New York tries to maximize their FAR. In Houston, you can usually build however high you want ... unless you're Ashby Highrise.

HISTORIC PRESERVATION TAX INCENTIVES

It's sometimes possible to maximize your profits by not bulldozing old buildings.

LOW INCOME HOUSING TAX CREDIT (LIHTC, PRONOUNCED LI-TECH)

Cool credits that almost no one in Houston ever thinks about or uses. The nonprofits that build much of the low-income housing don't pay taxes, but you can always sell your credits to others.

LTV

Loan to Value. The ratio of the bank loan to the full value of the property. If the bank loan is a high proportion of the project's value, say 95 percent, the risk will be high for the bank and the interest rate will be into nosebleed territory for the borrower.

NOI

Net Operating Income. This one is pretty intuitive. NOI is how much you bring in minus your expenses, not including debt. You want this to be positive.

PRIVATE EQUITY

It always helps to have a few "friends of the family" or to know someone who represents people with deep-pockets looking to invest millions in exchange for a good return. You can minimize your LTV and maximize your DSCR if you have a good chunk of private equity in your capital stack if you know what I mean, and you should by now.

PRO FORMA

Usually in Excel. Lots of numbers on a page projecting all the money you will make or lose on a real estate deal. All the jargon and ratios come together in this document. No matter how forward-thinking the design, investors are unlikely to support your project if these numbers do not work out.

REITs

Real Estate Investment Trusts. Like a mutual fund but for real estate. Usually pretty conservative. They like credit worthy tenants. They typically have multiple properties, like Uptown Park. If your employer contributes to a big pension plan or 401K you might own part of a REIT without knowing it.

SOVEREIGN FUND

Did your main bank loan fall through because of dropping oil prices? Try finding a deep-pocketed, state-owned fund from Singapore, Norway, Japan, China, Saudi Arabia, or Abu Dhabi. Houston seems shaky to our own banks but foreign investors might see your project as a sure bet compared to what's going on in their own countries.

STABILIZATION

When you first finish the building, the time between when it opens and when it is effectively fully leased. Usually about two to three years. Good luck!