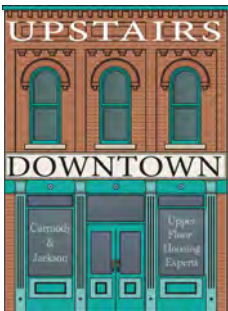
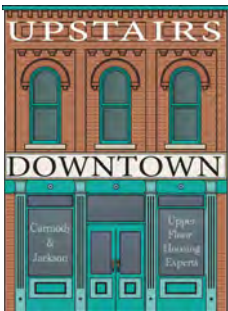


Financial Feasibility

Of upper floor development

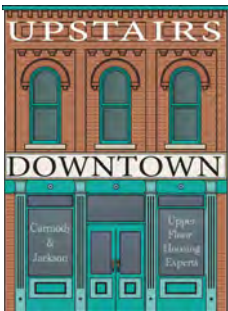
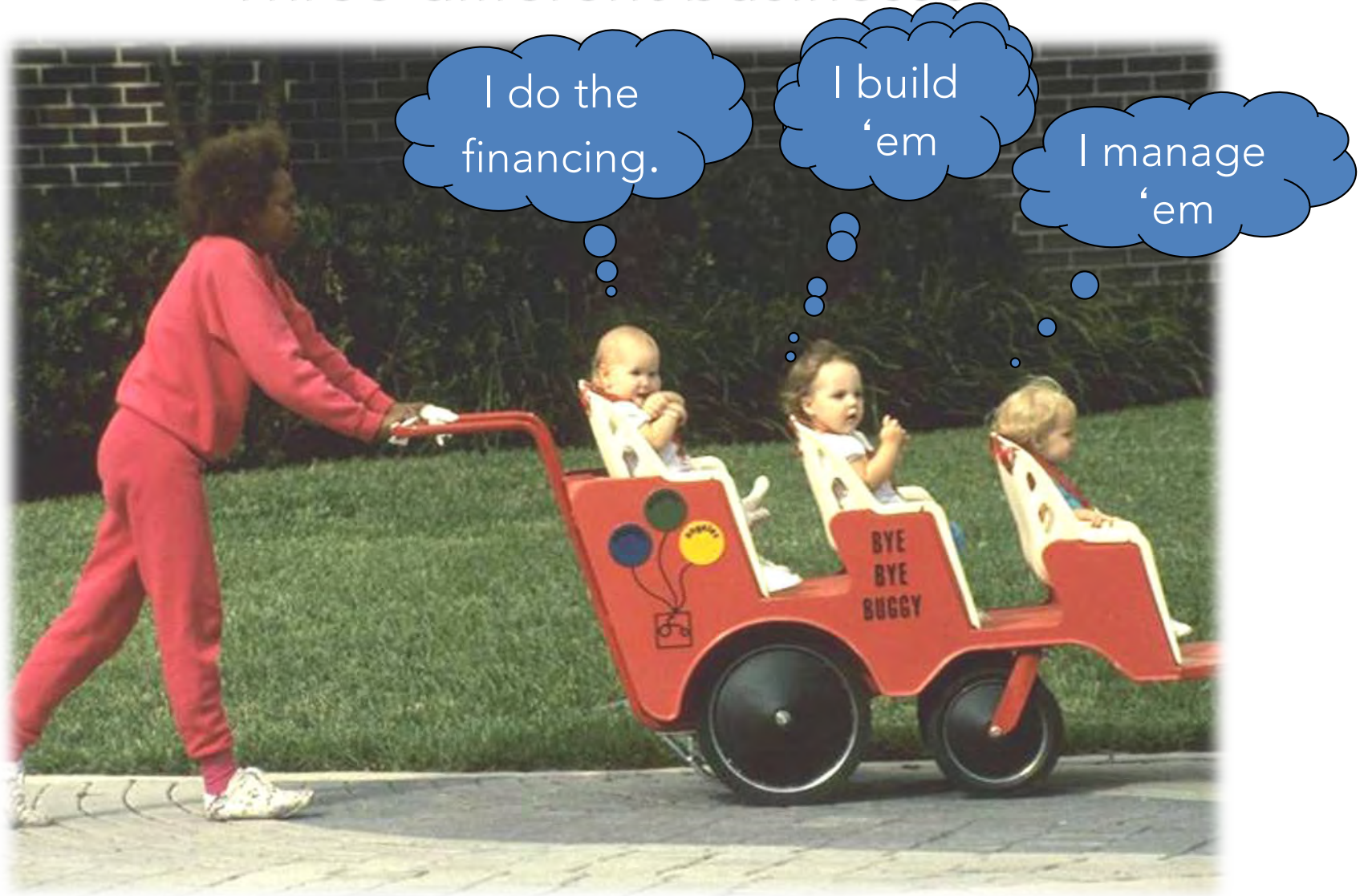


Financial Feasibility Of upper floor development



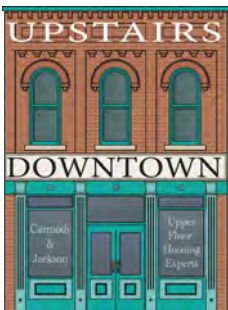
Real Estate Development

Three different businesses



Real Estate Financial Analysis

Two key financial statements



Developing Sources and Uses

Due diligence to understand capital requirements

Uses

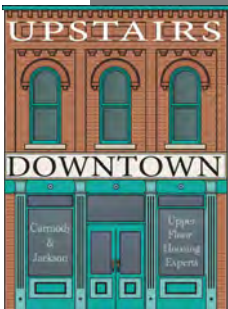
Soft Costs

- ✓ Accounting
- ✓ Legal
- ✓ A & E
- ✓ Loan application
- ✓ Building permits

Sources

Equity

- ✓ Owner Capital
- ✓ Relatives & Friends
- ✓ Partners
- ✓ Frequent Flier Miles



Developing Sources and Uses

Due diligence to understand capital requirements

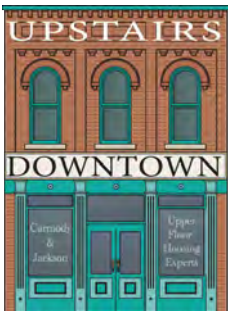
Uses

Soft Costs

- ✓ Accounting
- ✓ Legal
- ✓ A & E
- ✓ Loan application
- ✓ Building permits

Hard Costs

- ✓ Construction Costs
- ✓ Contingency



Developing Sources and Uses

Due diligence to understand capital requirements

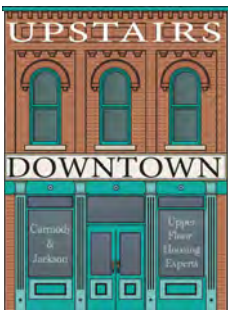
Sources

Equity

- ✓ Owner Capital
- ✓ Relatives & Friends
- ✓ Partners
- ✓ Frequent Flier Miles

Debt

- ✓ Conventional Debt
- ✓ Banks
- ✓ Credit Unions
- ✓ Insurance Policies

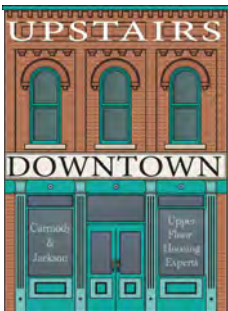


Develop a realistic budget

Always include a generous contingency

Which of you wishing to construct a tower does not first sit down and calculate the cost to see if there is enough for its completion? Otherwise, after laying the foundation and finding himself unable to finish the work the onlookers should laugh at him and say, ‘This one began to build but did not have the resources to finish’ .

Luke 14: 27-30



Project Pro Forma

Annual Income and Expenses of a project

Income

Rent Roll

How much rent for each unit

Tenant Contributions

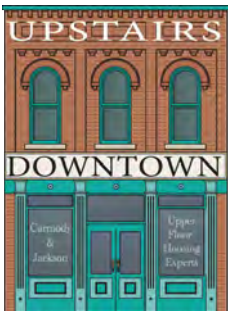
Utilities

Laundry

Parking

Vacancy Factor (5 -10%)

How long will vacant unit take to rent?



Project Pro Forma

Annual Income and Expenses of a project

Expenses

Taxes

Likely impact of upstairs investment?

Utilities

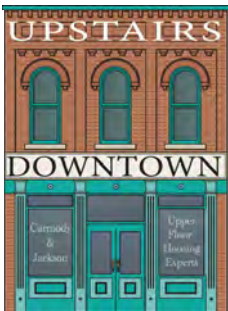
Separate meters or not?

Insurance

De facto redlining?

Maintenance

Common areas and site



Project Pro Forma

Annual Income and Expenses of a project

Expenses

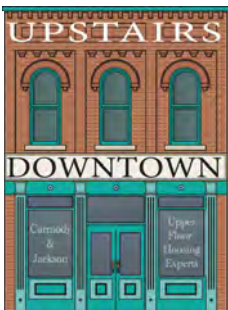
Management

By owner or by third party?

Other

Special assessment district levees

Annual rental unit inspection fee



Project Pro Forma

Annual Income and Expenses of the Project

Income

Gross Income

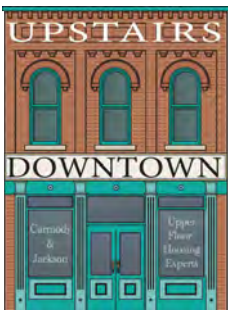
Less Vacancy Rate

Effective Gross Income

Less Operating Expenses

Net Operating Income

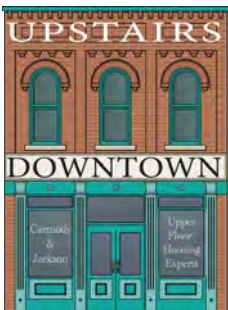
Net Operating
Income is the
key number of
a project!



Net Operating Income

Helps Determine Debt Service

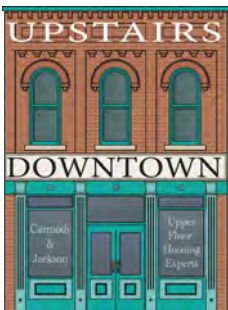
- ✓ NOI is the number that drives project financing.
- ✓ Banks lend mostly to cash flow
- ✓ Debt service is the annual cost to pay off the loan determined by loan interest and amortization X a constant.



Rule of Thumb

How much rent can you service at different rents

Monthly Rent per unit	Allocation to Expenses	Monthly Net Operating Expenses (NOI)	Loan @ 7% 20 Yr Amort 5 Yr Balloon (c = .0931)
350	40%	210	27,068
400	40%	240	30,934
450	40%	270	34,801
500	40%	300	38,668
550	40%	330	42,235
600	35%	390	50,268
650	35%	422	54,458
700	35%	455	58,646
750	35%	488	62,836
800	35%	520	67,025
850	35%	552	71,214
900	35%	585	75,403
950	35%	617	79,592
1000	30%	700	90,225
1050	30%	735	94,737
1100	30%	770	99,248
1150	30%	805	103,759
1200	30%	840	108,270



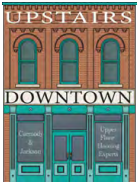
Simple Operating Pro Forma

Income

Gross Rent	Rent Collected at 100% Occupancy
<u>Tenant Contributions</u>	<u>Tenant Contributions towards operating expenses</u>
Gross Income	Total Income at 100% Occupancy
<u>(Vacancy Rate)</u>	<u>Adjustment for Vacancy and Collections Loss</u>
Effective Gross Income	Anticipated Cash Actually Collected

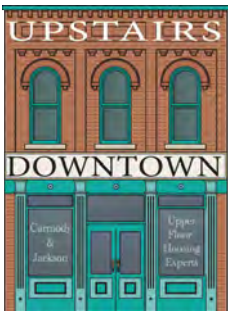
Expenses

Taxes	Research and negotiate with assessor
Insurance	Discuss project with your provider, shop around!
Maintenance	Snow removal, window washing, common area
Utilities	Are utility expenses paid as part of rent?
Management	Manage the project yourself or pay someone?
<u>Reserves</u>	<u>Appliances replaced, units painted, etc.</u>
Total Expenses	
<u>Net Operating Income</u>	Cash generated by the project
Debt Service	Interest, principal payments to lender
Cash Flow	Return to owner



What Bankers Want

- ✓ Acceptable level of risk
- ✓ Reduce risk of default and/or foreclosure
- ✓ Lenders want to limit their risk rather than maximize their profits.
- ✓ Lenders are in a high volume – low margin business. The spread between interest paid to entice deposits and interest earned from loans ranges is how they make money.
- ✓ There is no upside for traditional lenders



Case Study Sources & Uses

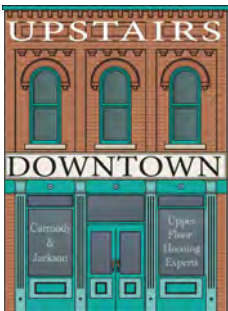
Two residential units above the business

Uses

Acquisition	0
Arch / Engineer	10,000
Permits	500
Hard Construction	119,500
Appliances	5,000
Contingency	15,000
<hr/>	
Total	150,000

Sources of funds

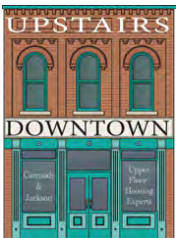
Owner Equity	20,000
Bank Financing	130,000
<hr/>	
Total Sources	150,000



Case Study Pro Forma

Two residential units above the business

Gross Rent	$800 \times 2 \times 12 =$	19,200
Less Vacancy Rate	10%	(1,920)
Less Expenses		
Utilities	1,200	
Taxes	2,400	
Insurance	1,200	
Maintenance	1,000	
	<hr/>	
Total Expenses		(5,800)
Net Operating Income		11,480

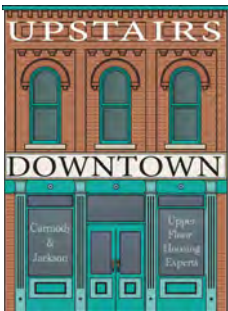


Debt Service

Annual amount needed to pay off or service loan

Debt Coverage Ratio

$$\text{DCR} = \frac{\text{Net Operating Income (NOI)}}{\text{Debt Service}}$$

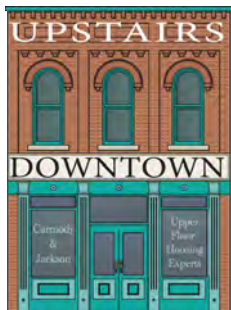


Debt Coverage Ratio

Using the debt coverage ratio formula

$$\text{DCR} = \frac{\text{Net Operating Income (NOI)}}{\text{Debt Service (D/S)}}$$

$$\text{Case study project: DCR} = \frac{11,480}{11,037} = 1.04$$



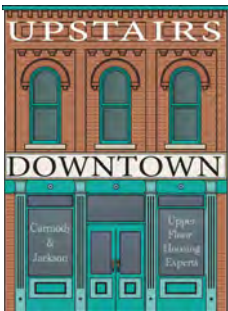
How Much Will the Bank Lend?

This lender requires a DCR of 1.2

The largest loan this bank would make given NOI of \$11,480 is

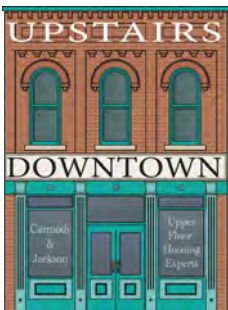
$$D/S = \frac{NOI}{DCR} = \frac{11,480}{1.20} = \$9,567$$

$$\text{Loan \$} = \frac{D/S}{c} = \frac{9,567}{.08481} = \$108,685$$



Appraisal Gap Issue

Just when financing seemed in place



A bank financing commitment must be validated by an independent appraisal.

Project Funding Gap

Capital costs exceed available funds

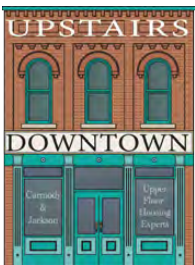
Difference between how much you can raise between owner equity and conventional financing and the cost of the project.

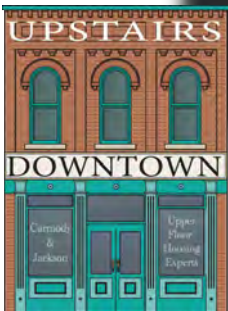
Use of funds

Acquisition	0
Arch / Engineer	10,000
Permits	500
Hard Construction	119,500
Appliances	5,000
<u>Contingency</u>	<u>15,000</u>
Total	150,000

Sources of funds

Owner Equity	20,000
<u>Bank Financing</u>	<u>108,000</u>
Total Sources	128,000
Gap	22,000

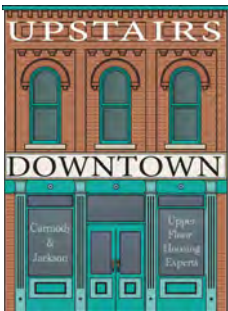




Project Funding Gap

Many ways to fill the gap

- ✓ Additional owner equity
- ✓ Historic or old building tax credit
- ✓ Subordinated loan or grant –
importance of local, simple solutions
- ✓ Reduce the scope of the project



More than Cash Flow

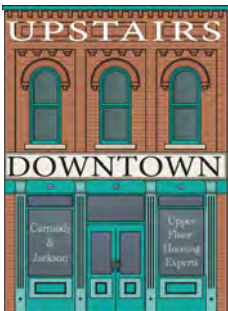
Other benefits from owning real estate

All real estate projects:

- ✓ Tax Benefits
- ✓ Appreciation

Unique upstairs project benefits:

- ✓ Improving the value of first floor retail
- ✓ Lowers first floor utility costs



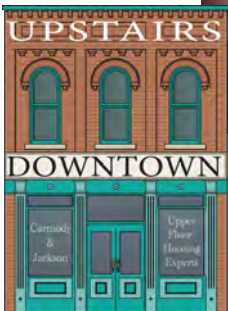
Many incentives

Available to fill upper floor project gaps



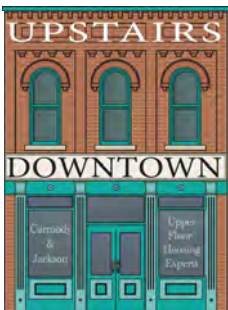
S

F



New or Renovation

Details are similar



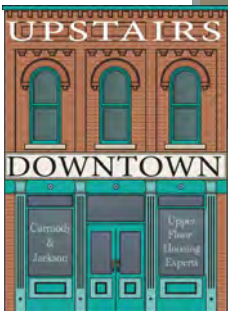
Connecting urban fabric is now as important as preserving building stock.

Live/Work Projects

Work at many price points

\$300,000 – 500,000 per unit

\$300 – 500 rent per month



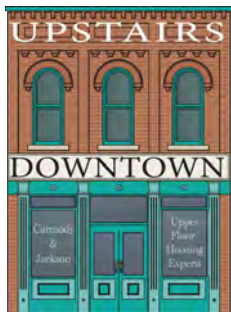
Loft office space

Desirable space wherever people spend time



Co-Working Space

Demand Skyrocketing Post Pandemic

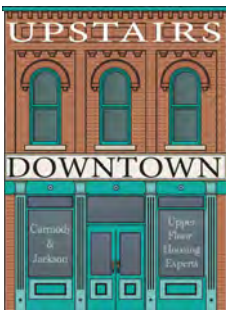


Lodging Industry Upstairs

Nearly a plague in the Airbnb era

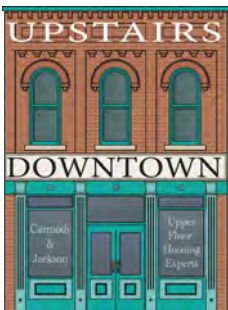


Calumet, MI



Upstairs Economics

More income opportunities up than down!



Next Up: Case Studies & Incentives