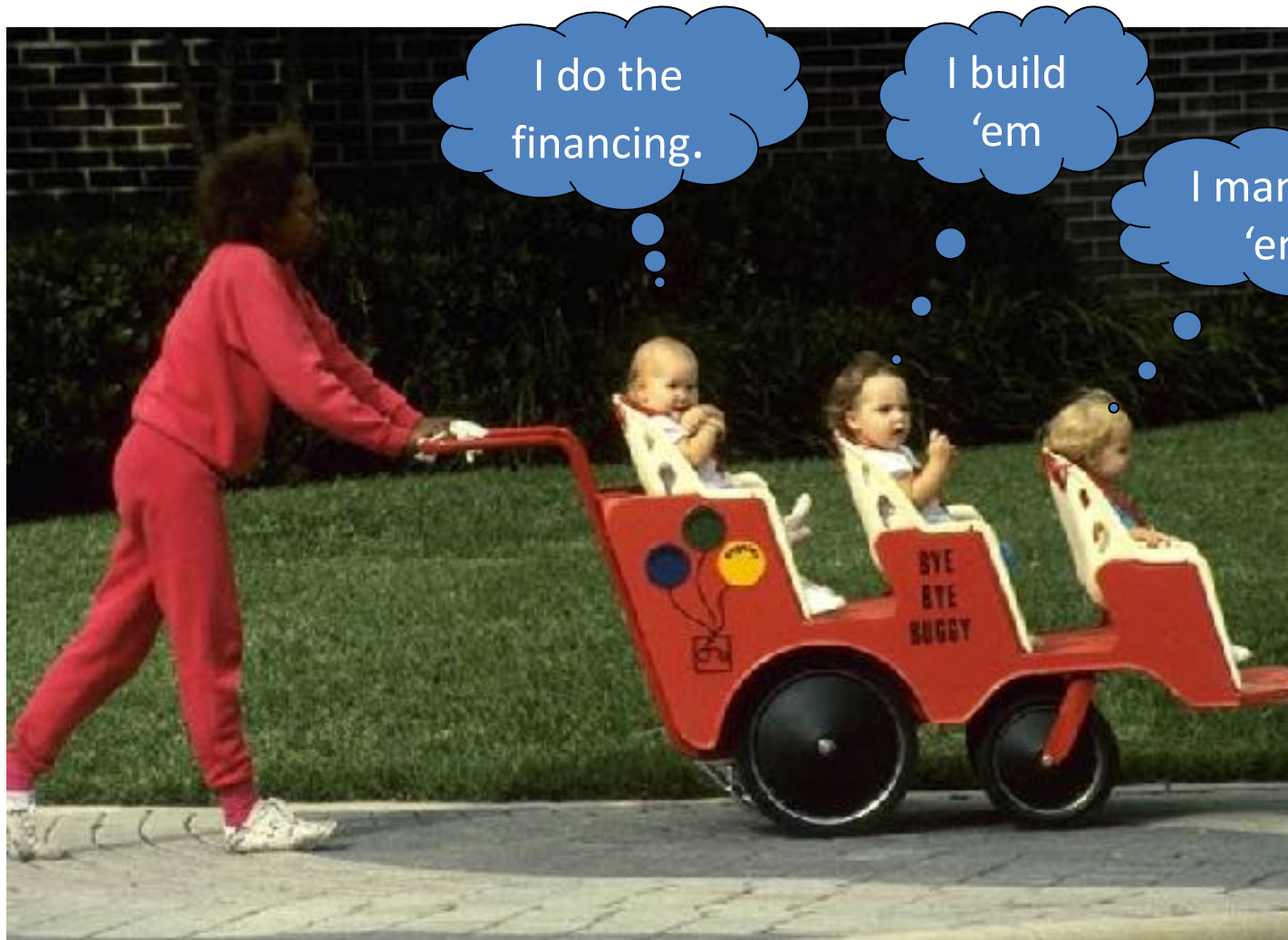


Financial Feasibility



Three Different Businesses



Real Estate Financial Analysis



Two Financial Statements

- Sources and Uses
- Project Pro Forma

Sources and Uses: Project Capital Deck

Uses

- Due Diligence
- Construction Costs
- Soft Costs
- Adequate Contingency

Sources

- Owners Equity
- Loans
- Grants

Developing Sources and Uses

Uses

- Don't skimp on the A's.
- Construction Costs
- Soft Costs are Real
- Contingency is King

Sources

- This is where Main Street can help
- Capital comes from many places these days

Realistic Budget With 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



Pro-Forma: Project Income & Expenses

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?

Developing the Pro Forma Income

Gross Income

Less Vacancy Rate

Effective Gross Income

Less Operating Expenses

Net Operating Income

**Net Operating Income (NOI)
is the key number!**

Project Income & Expense

Expenses

- Taxes
 - Likely impact of upstairs investment?
- Utilities
 - Separate meters or not?
- Insurance
 - De facto redlining?
- Maintenance
 - Common areas and site

Developing the Pro Forma

Expenses

- Management
 - By owner or by third party?
- Other
 - Special assessment district
 - Annual rental unit inspection fee

Simple Pro Forma

Income

Gross Rent

Rent Collected at 100% Occupancy

Tenant Contributions

Tenant Contributions towards operating expenses

Gross Income

Total Income at 100% Occupancy

(Vacancy Rate)

Adjustment for Vacancy and Collections Loss

Effective Gross Income

Anticipated Cash Actually Collected

Expenses

Taxes

Research and negotiate with assessor

Insurance

Discuss your project with your provider

Maintenance

Snow removal, window washing, common area

Utilities

Are utility expenses paid as part of rent?

Management

Are you going to manage the project or pay someone?

Reserves

Appliances need to be replaced, Units need repainting

Total Expenses

 **Net Operating Income**

Cash generated by the project

Debt Service

Interest, principal payments to lender

Cash Flow

Return to owner

How Much Debt Can the Project Service?

Net Operating Income

- 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 \times a constant.

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.
- There is no upside for traditional lenders

Simple Project Pro Forma

Gross Rent	\$800 X 2 X 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

How Much Debt Can a Project Support?

Debt Service

The annual amount needed to pay off or service the loan.

Debt Coverage Ratio

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

Debt Coverage Ratio

Using debt coverage ratio formula:

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

$$\text{For Tom's project: DCR} = \frac{\$11,480}{\$11,037} = 1.04$$

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 \$108,685

The Project Gap

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

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





Four 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

There are other financial benefits to owning real estate than cash flow:

- Tax Benefits
- Appreciation

An upstairs project provides unique benefits:

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

The Virtue of Patient Capital



Appraisal Gap Issue

Loan commitment validated by an appraisal



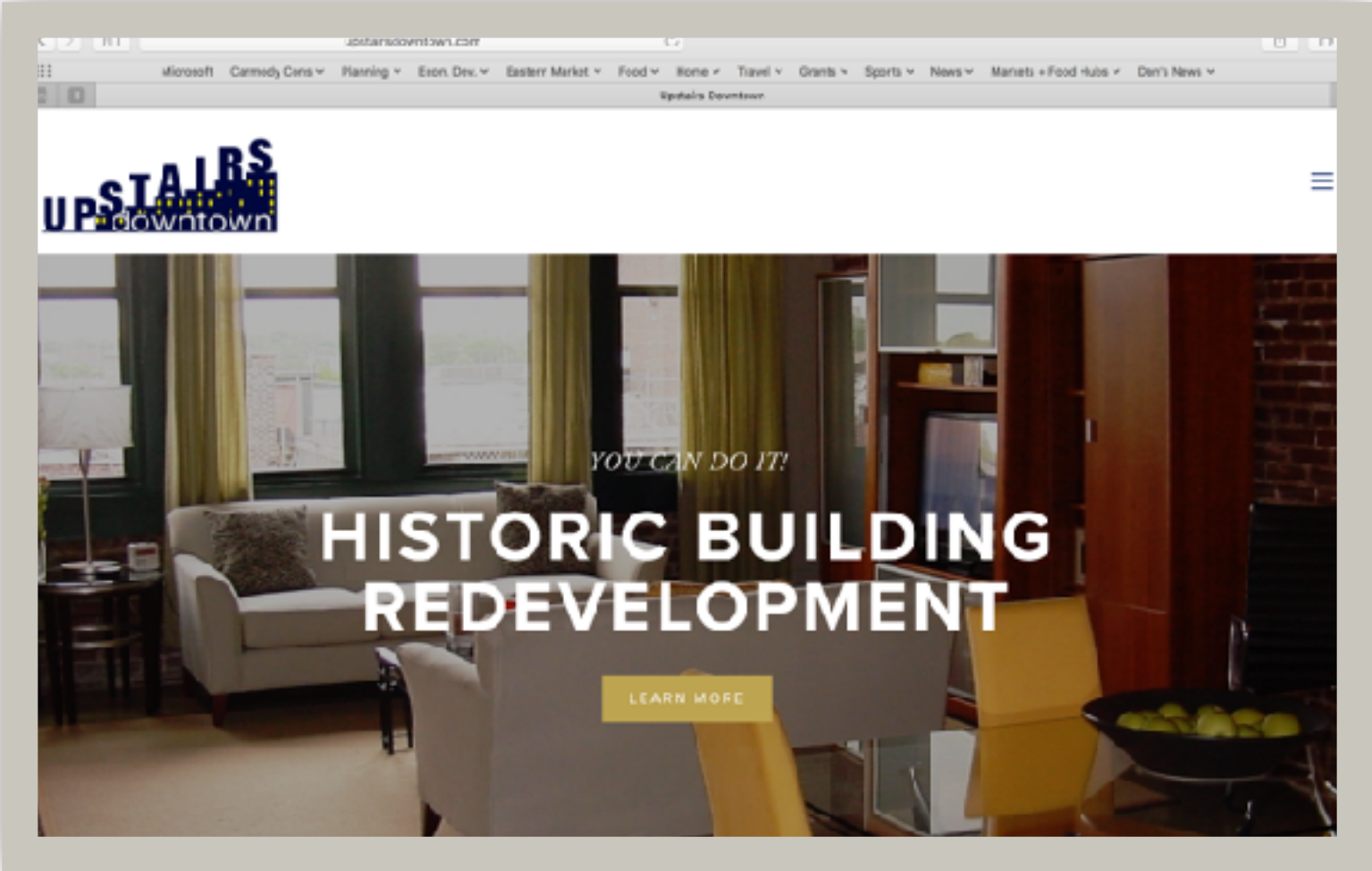
Monthly Rent per unit	Estimate of Expenses	Monthly Net Operating Expenses (NOI)	Loan @ 6% 20 Year Amortization With a 5 Year Balloon
350	40%	210	31,820
400	40%	240	36,366
450	40%	270	40,911
500	40%	300	45,457
550	40%	330	50,003
600	35%	390	59,895
650	35%	422	63,944
700	35%	455	68,944
750	35%	488	73,944
800	35%	520	78,793
850	35%	552	83,642
900	35%	585	88,642
950	35%	617	93,641
1000	30%	700	106,167
1050	30%	735	111,371
1100	30%	770	116,674
1150	30%	805	121,977
1200	30%	840	127,281

Rule of Thumb

How Much Debt Can You Service At Different Rents?



More Intel at www.upstairsdowntown.com



Lodging Industry Upstairs



Calumet, MI

Upper floor office space



Live Work projects work at many price points

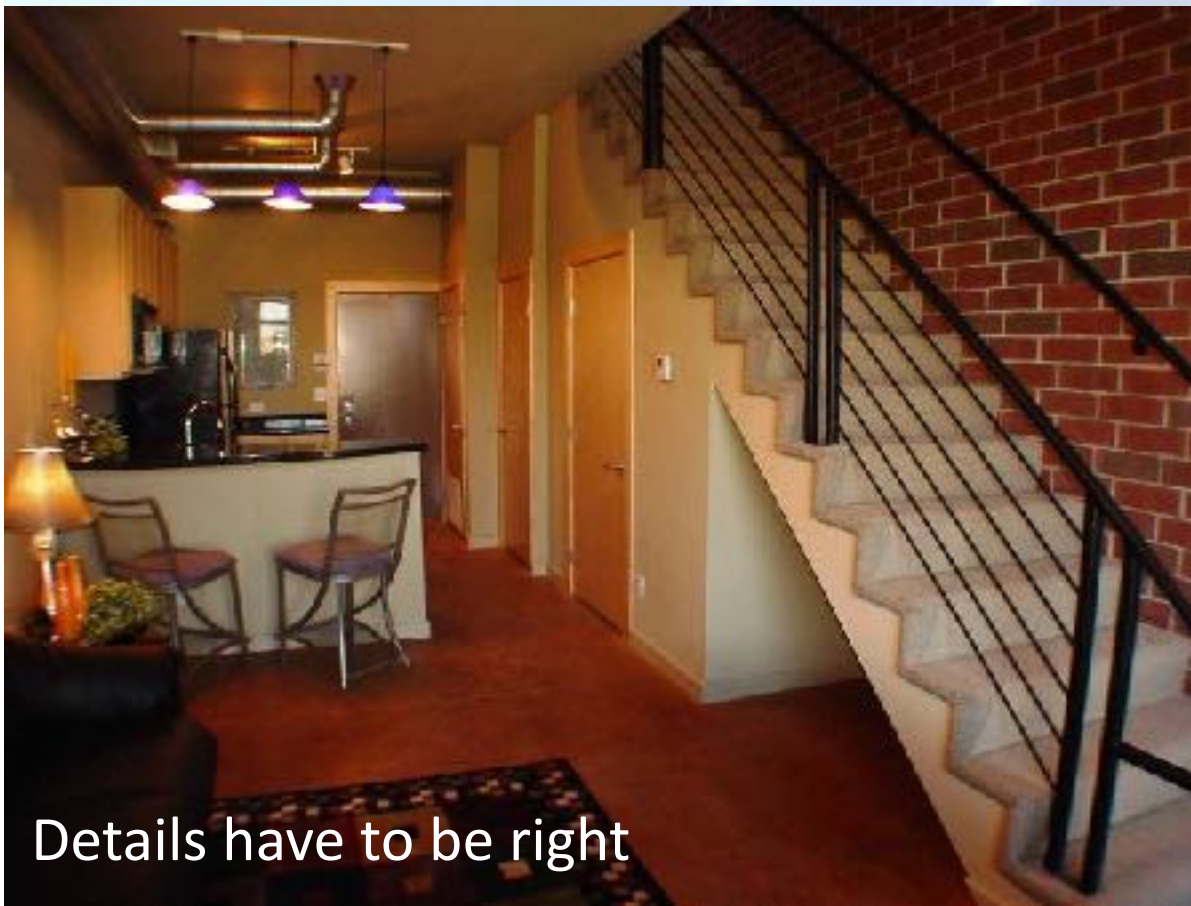
\$300,000 – 500,000 per unit



\$300 – 500 rent per month



New Vs. Old



Details have to be right

Connecting urban fabric has become as important as preserving our heritage.

Many incentives to fill upper floor project gaps

State

- Historic Tax Credits
- Tax Abatement
- HOME
- Section 42 Tax Credits
- Targeted Investment Tax Credits
- Preservation Design Services

Federal

- Historic Tax Credits
- New Markets Tax Credits
- CDBG Section 108 loans
- EDA

Local

- Tax Increment Financing
- Tax Abatement
- Façade Programs
- Revolving Loan Funds
- Façade Easements

Private

- CRA activity
- FHLB
- Property Donations
- Intermediaries



Upside Economics:

More income opportunities UP than down!

