Real Estate Finance

- Comparison with business finance
- Real estate development process and financing
- Real estate financial statements
- Finance instruments & underwriting
- Funding gaps
- Project Examples
- City Plaza

Real Estate vs. Business Finance

- Similarities to business fixed asset financing
  - Scale of investment is large
  - Financing of physical, fixed assets
  - Need for long-term financing
- Differences with business finance
  - More use of debt: 3:1 or 4:1 debt to equity ratio
  - Separate construction & permanent financing
  - Competition & markets are local or regional
  - More predictable income & expenses
- Land development vs. building development
- Development for lease vs. development for sale

Three Phases of Development

- Predevelopment
  - Planning & design, **site control,** permitting, pre-leasing/sales, securing financing
  - Large costs with high risk and no revenue =>requires equity, grants, deferred loans
- Construction & development
  - Site acquisition, final design & contractor selection, construction
  - Limited risk => construction or mini-perm loan and equity, bridge loans
- Occupancy and management
  - Asset management=> permanent debt take-out
  - Retire debt, realize equity returns

RE Financial Statements: Development Budget

- Sources and uses of funds statement
- Analogous to a balance sheet
  - Acquisition, hard costs, and soft costs
  - Contingencies and reserves
  - Per square foot basis useful for comparisons
- Sources of funds
  - Debt sources, equity investments, syndication/sale of tax credits, grants

RE Financial Statements: Operating Pro Forma

- Revenue, expenses and net cash flow
- CAM, escalators, and percentage rent
  - Lease terms define revenue –key to analyze leases
- Vacancy rates
- Operating expenses
  - IREM, ULI comparable project data to analyze
  - Replacement and operating reserves
- Cash flow, debt service and net cash flow
- Supportable debt: PV of [cash flow/DSCR]
- Supportable equity: PV of net cash flow & expected gain on sale

Sizing Real Estate Debt: Downtown Building Example

- Start with **lowest** annual pro forma net cash flow (54,299)
- Calculate cash flow available for debt service (CFADS):
  - Divide by lender's required debt service coverage ratio (54,299/1.25 = 43,439)
- Calculate Present Value of CFADS per loan terms:
  - PV(.08/12, 240, 43,439/12) = 432,777

Real Estate Finance Tools

Debt

- Predevelopment loan
- Acquisition loan
- Construction loan
- Real estate mortgage
- Mini-perm loan
- Bridge loan

Equity

- Developer and investor cash equity
- Tax credit equity (historic, new market, LIHTC)

Grants

Underwriting Real Estate Loans

- Development Team Capacity
  - Experience & ability of development team members
  - Management company deserves special attention
- Project cash flow risk
  - Initial lease-up risk: will property be occupied at target rent?
  - Tenant credit risk: will tenants pay their rent?
  - Re-leasing/market risk: will space be released at target rent?
  - Operating expense risk: are operating costs adequate?
- Collateral value and appraisals
  - Appraisals set the market value, LTV and maximum loan
  - Quality of construction
  - Quality of maintenance and replacement funding

Real Estate Funding Gaps

- Supply of pre-development and equity financing
- Weak markets:
  - Market rents do not support development costs
  - New development is needed to change market dynamics
  - Lithgow Block example:
    - Income supported 57.5% of development costs
    - Grant/subsidy for 42.5%

Jamaica Plain Brewery Reuse

- Closed brewery complex acquired by neighborhood non-profit (JPNDC) in 1983
- Renovated in phases over 25 years
- Final phase: difficult and costly
  - Interior demolition and entire reconstruction of 68,000 square feet
  - Reuse as fitness center, retail restaurant and office space
- Home to 50 small businesses

JP Brewery: Project Financing

Total Dev Costs	$12,105,000
Senior Debt (Life Ins. Fund)	$4,700,000
Historic Tax Credits (MHIC)	$4,000,000
New Market Tax Credits (MHIC)	$2,160,000
City of Boston Loan	$150,000
Developer loan & deferred fees	$1,095,000

The Auburn Mixed-Use Development

Part of multi-project and investment strategy to attract new residents to Midtown Detroit neighborhood

- Demolition and new construction project
- 58 market rate apartments
- 9,100 SF retail space
- Completed in 2012
- Hard to finance after Great Recession

The Auburn: Financing Sources

CDFI Loan	$3.7 million
New Market Tax Credits	$7.6 million
State Grant	$1.0 million

- 2^{nd} local CDFI guaranteed retail rental income
- Market rate project needed 70% subsidy
- Due to low rents and low property values in Detroit

ReFresh Development Budget

Sources	Amount	Uses	Amount
Senior Debt-GS	$3,000,000	Acquisition	$2,400,000
Junior Debt-LIIF	$1,558,000	Construction	$12,421,638
Fresh Food Financing Initiative	$1,000,000	Soft Costs	$2,749754
New Orleans Redevelopment Authority	$900,000	Developer Fee	$610,436
NMTC Equity	$5,491,200	Total	**$18,181,818**
Whole Foods Build out	$5,300,000	**Uses**	**PSG**
Foundation for LA Grant	$500,000	Acquisition	$37
Newman's Own Grant	$250,000	Construction	$191
Developers Equity	$181,818	Soft Costs	$42
Total	**$18,181,818**	Developer Fee	$9
		Total	$279

ReFresh Proforma Year One

Tenant	Year 1	Year 5
BCC Rent	$6,250	$6,250
Whole Foods Rent	$130,000	$130,000
Liberty's Kitchen Rent	$73,883	$73,883
Tulane Rent	$46,890	$46,890
First Line Rent	$56,250	$56,250
Other Tenant Rent	$127,735	$127,735
Tenant Reimbursements-Operating Cost	$186,624	$206.042
Vacancy Allowance (10%)	$62,138	$64,170
Total Income After Vacancy	**$559,244**	**$577,630**
Management and Operating Expenses	$201,071	$226,307
NOI	**$358,173**	**$351,223**
Debt Service	$339,529	$339,529
Net Cash Flow	**$18,644**	**$11,694**
Percentage Rent on $15 million sales	***$125,000***	***$125,000***

City Plaza: Supportable Debt and Financing Gap

Minimum Annual Cash Flow	$144,550
Divide by Debt Service Coverage Ratio	1.25
= Cash Flow Available for Debt Service (144,550/1.25)	$115,640
Supportable Mortgage Loan =PV(.08/12,240,115640/12)	$1,152,105
Estimated Value at .11 cap rate (144,550/.11)	$1,314,091
Maximum Senior Loan at .80 LTV (.80 * 1,314,091)	$1,051,273
Senior Loan Amount Rounded	1,051,000
TDC (1,490,000) less grants (150,000)	1,340,000
Remaining Funding Gap (1,340,000- 1,051,000)	289,000

City Plaza: Subordinate Loan Analysis

Minimum Annual Cash Flow	$144,550
Divide by Debt Combined Coverage Ratio	1.10
= Cash Flow Available for Debt Service	$131,409
Less Senior Debt Service 12* pmt(.08/12, 240, 1,051,000)	$105,492
=Cash Flow to Repay Subordinate Loan	$25,917
Supportable Sub Loan per CF -pv(.09/12,240, 25,917/12)	$240,045
LTV at .95 (.95*$1,314,091), rounded	$1,248,000
Max Sub Loan per LTV (1,248,000-1,051,000)	$197,000
Remaining Gap (1,340,000-1,248,000)	$92,000