



# PRO FORMA 101

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**REAL ESTATE MATH**

# PRO FORMA 101



A pro forma is a **financial projection** of a  
**real estate project**

# PRO FORMA 101



Construction Pro Forma

Operating Pro Forma



# CONSTRUCTION

# CONSTRUCTION PRO FORMA



- Sources- Where money is coming from
- Uses- Where money is being spent

# CONSTRUCTION PRO FORMA

- Sources:
  - Senior Debt
  - Subordinated Debt
  - Equity- Cash
  - Grants
  - Equity- Tax Credits
  - Deferred Fees

# CONSTRUCTION PRO FORMA

USES	Amount	% of Project
<u>Senior Debt</u> Lake Trust Credit Union	\$1,000,000	47.6%
<u>Subordinated Debt</u> County Revolving Loan Fund	\$80,000	3.8%
<u>Equity- Cash</u> Owner	\$400,000	19%
<u>Equity- Tax Credits</u> Bank of America	\$520,000	25%
<u>Deferred Developer Fee</u> Owner	\$100,000	4.6%
<b>Total</b>	<b>\$2,100,000</b>	<b>100%</b>

# CONSTRUCTION PRO FORMA

- KEY ISSUES:

Lenders may not want to be only debt source -or- want more cushion

- May fund 80% of a strip mall but only 50% of a downtown building

Locally-based lenders are typically easier to work with

Lack of comparable projects (“comps”)



# CONSTRUCTION PRO FORMA

- Uses:
  - Acquisition
  - Hard Costs
  - Soft Costs

# CONSTRUCTION PRO FORMA

- Hard Costs:  
Construction (Detailed List)  
Site Work

# CONSTRUCTION PRO FORMA

- Soft Costs:
  - Planning, Design
  - Permit Fees
  - Overhead
  - Developer Fee

123 Main St							
<b>Current Configuration</b>		4,150 Two Story Mixed-Use					
<b>Potential Redevelopment</b>		Mixed-Use					
<b>Redevelopment Costs</b>							
1	Acquisition			Listing Price	*		
	Rehab	\$	820,000		*		
	New Construction	\$	-				
	Developer Fee						
	<b>Total Acquisition and Rehab</b>	<b>\$</b>	<b>820,000</b>				
<b>Redevelopment Incentives</b>							
2	State HTC	\$	(205,000)	25%			
	Federal HTC	\$	(164,000)	20%			
	Local Incentive			Add'l Incentive			
	<b>Total Incentives</b>	<b>\$</b>	<b>(369,000)</b>				
	<b>Net Investment</b>	<b>\$</b>	<b>451,000</b>				
	Equity	\$	164,000	20% Owner Equity			
	<b>Loan Amount</b>	<b>\$</b>	<b>287,000</b>				
<b>Income</b>							
			<b>Annual Gross Rent</b>	<b>Units</b>	<b>Sq Ft</b>	<b>Total Sq Ft Monthly Rent per Unit</b>	
3	Retail Units	\$	15,000	1	1,000	1,000 \$ 1,250	
	Office Space	\$	36,000	3	1,000	3,000 \$ 1,000	
	<b>Total Annual Income</b>	<b>\$</b>	<b>51,000</b>				
	<b>Annual Debt Service</b>	<b>\$</b>	<b>(24,674)</b>	6%	*		
	<b>Gross Cash Flow</b>	<b>\$</b>	<b>26,326</b>				
	<b>Annual Operating Expenses</b>	<b>\$</b>	<b>15,000</b>	Taxes, Insurance and Maintenance to be calculated			
	<b>Net Cash Flow</b>	<b>\$</b>	<b>11,326</b>				
<b>Return on Investment</b>			4%				
Notes:							
* = Key cost variable and dependent on negotiation							
.							





A	B	C	D	E	F	G	H	I	J	K	L	M
<b>Subtotal Hard Costs</b>									<b>\$2,653,186</b>		<b>86.01%</b>	
<b>Other Eligible Costs</b>												
	Machinery & Equipment											0.00%
	Furniture & Fixtures											0.00%
	Architectural & Engineering								\$150,000			5.19%
	Environmental Studies/Soiling Testing								\$2,700			0.09%
	Survey								\$1,000			0.03%
	Other:											0.00%
<b>Subtotal Eligible Soft Costs</b>									<b>\$163,700</b>		<b>5.31%</b>	
<b>Ineligible Soft Costs</b>												
	Other Professional Fees								\$164,650			
	Loan Fees								\$38,030			1.23%
	Construction Interest								\$0			0.00%
	Construction Taxes											0.00%
	Construction Insurance											0.00%
	MEDC Fees											0.00%
	Title Work											0.00%
	Rent-Up Reserve								\$0			0.00%
	Replacement Reserve											0.00%
	Operating Reserve											0.00%
	Other:											0.00%
	Other:											0.00%
	Other:											0.00%
<b>Other Ineligible Soft Costs - Related Party Fees</b>												
	Developer Fee											0.00%
	Project Management Fees											0.00%
	Construction Management Fees (Related Party)											0.00%
	Consulting Fees											0.00%
	Other Related Party Fees								\$30,000			0.97%
	Other:											0.00%
<b>Subtotal Ineligible Soft Costs</b>									<b>\$232,680</b>		<b>7.54%</b>	
<b>TOTAL DEVELOPMENT COSTS</b>									<b>\$3,064,566</b>		<b>100.00%</b>	



# OPERATING



# OPERATING PRO FORMA

- Income (Instead of Sources)
- Costs (Instead of Uses)



# Sources of Income

Residential Unit Leases  
Commercial Leases  
Other



# Operating Costs

Utilities  
Property Management  
Taxes  
Reserve Requirements

# OPERATING PRO FORMA

Revenue - Expenses =

**Net Operating Income**

# OPERATING PRO FORMA

Net Operating Income - Debt Service =

**Net Cash Flow**

# PRO FORMAS

## What Makes a Bad Project?

- Can't Cover Lender's Debt Coverage Ratio
- Poor Rate of Return
  - Negative
  - Less than 6%

# PRO FORMAS

$\frac{\text{Revenue}}{\text{Expenses}}$

=

Debt  
Coverage  
Ratio

# PRO FORMAS

Can't Cover Lender's Debt Coverage Ratio

- Typically 1.15 - 1.20

What Impacts This?

- Operating Costs/Expenses
- Rent Rates



# PRO FORMAS



Poor Internal Rate of Return/Return on Investment

# PRO FORMAS

## Internal Rate of Return

$n$  = number of cash flows

$CF_j$  = cash flow at period  $j$ .

$IRR$  = Internal Rate of Return

$$0 = \sum_{j=1}^k CF_j \cdot \left[ \frac{1 - (1 + IRR)^{-n_j}}{IRR} \right] \cdot \left[ (1 + IRR)^{-\sum_{q=1}^j n_q} \right] + CF_0$$

# PRO FORMAS

$$\frac{\text{Cash Flow}}{\text{Mortgage}} = \text{Return On Investment}$$

# PRO FORMAS

Poor Internal Rate of Return/Return on Investment

What Impacts This?

- Operating Costs/Expenses
- Rent Rates
- Mortgage



# How Developers Make Money

Developer Fee

- 5-10%

Cash Flow

At Sale of Property

## Session 3

# Pro forma 101

### Glossary of Terms

**Pro Forma**- a document that shows the financial projections of a project, including revenues and expenses

**Construction Pro Forma**- A pro forma that focuses on solely on the construction side of project- how much it will cost to build and where the money to pay for it will come from

**Operating Pro Forma**- A pro forma that focuses on the monthly or yearly operations of a property once it is built, including rents, other incomes, and expenses like taxes, staffing, and finance charges

**Sources**- Found on a Construction Pro Forma, this refers to where the money to pay for the project is coming from and at what amounts

**Uses**- Found on a Construction Pro Forma, this refers to the what the money will be spent on, such as Hard and Soft Costs

**Senior Debt**- A loan that has the right to be paid first before any other loans

**Subordinated Debt**- Loans that has second (or less) right to be paid after the senior debit is paid. These loans typically have a higher interest rate because there is more risk

**Equity (Cash)**- This is money for the project that is typically provided by the developer or other investor

**Equity (Tax Credits)**- This is money for the project that is the result of either direct cash subsidy to a project or cash to the project as the result of the syndication of tax credits

**Syndicated/Syndication**- The "selling" of tax credits, large financial institutions or entities with large amount of taxes often "buy" tax credit from developers at a discount to lessen their tax burden

**Deferred Fees**- These are costs generated by the project that will be recouped either at sale or project refinancing

**Hard Costs**- Costs associated with the physical construction of the project, such as concrete, sheet rock, windows, etc.

**Soft Costs**- Costs associated with the planning of a project, such as architectural fees, | permits, environmental review, etc.

**Net Operating Income**- Revenue less expenses

**Net Cash Flow**- Net Operating income less debt expenses (mortgage)

**Developer Fee**- A fee a developer makes for creating and building the project, this is not the profit from the sale of a project, but a direct project fee. Typically 5-15%.

**Debt Coverage Ratio**- Income divided by costs. Determines if there is enough income to pay mortgage.

**Return On Investment**- Cash Flow divided by mortgage amount. Key term that determines if a project is feasible or not.



# QUESTIONS

+ Thank you!