# Rod Khleif
## MULTIFAMILY MASTERY

# Multifamily Case Study:

*Understanding the Basics*

# Executive Summary



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# To illustrate the basics of deal analysis, we've created a case study, based on the actual deal summarized below

## Opportunity Summary

- Property acquired by current owner in 2002

- Intent was to convert rents from market rate to affordable

- Owner obtained tax credits and deal financing in Dec. 2003

- Affordable program required 72% of units to be leased to residents earning less than 60% of the local median income

- Remaining units could be leased at a market rate

- Tax credits expired in 2018 and owner has decided to sell

- Property has a "three-year tail" where existing affordable residents can remain in their units

- Given location and proximity to job centers, excellent opportunity for new owner to convert back to market rate

- Historical tenant turnover is ~40%

## Property Overview

| | |
|---|---|
| **Purchase Price:  #** | $32,000,000 |
| **Location:** | Maple Shade, NJ 08052 |
| **Units:** | 408 |
| **Layout:** | Hi-Rise, 4 buildings |
| **Year Completed:** | 1969 |
| **Site:** | 27.67 Acres |
| **Amenities:** | None |
| **Occupancy** | 86% (August 2019) |
| **Avg. Monthly Rent:** | $1,207 |
| **Parking:** | 511 Spaces |
| **Utilities:** | Sub-metered |

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# In this case study, we're going to highlight the three stages of initial analysis that should be performed prior to writing an LOI

## 1. Location & Demographics

- Market vs. Submarket
- Property type vs. surrounding population
- Market stability & growth trends
- Proximity to transportation, jobs, and amenities
- Sub-market median home price vs. per unit sales price
- Sub-market education, income, and unemployment
- Employment composition
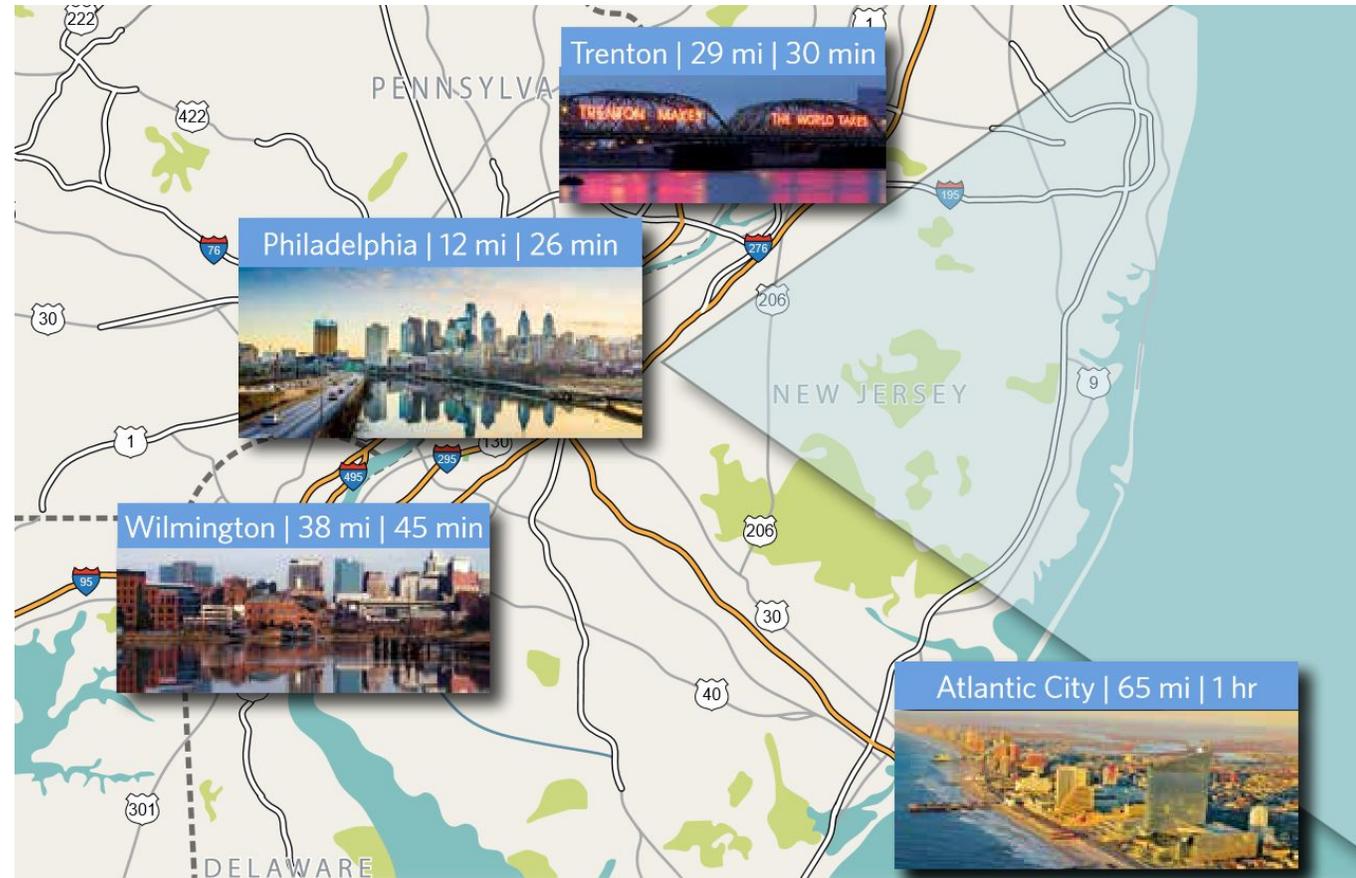
## 2. Market & Competition

- Identification of competitor properties
- Creation of a matrix to compare rents, amenities, and finishes
- Advertising and marketing efforts
- Analysis of property pictures
- Estimating renovation costs and ability to raise rents as a result

## 3. Financial Analysis

- Property rent vs. market rent
- Assessing the case for rent increases
- Steady state rental increases
- Vacancy and other income
- Current vs. market proforma and expense targets
- Estimating reserves
- Creating a renovation budget
- Sources and uses of financing

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# 1. Location & Demographics



Trenton | 29 mi | 30 min

Philadelphia | 12 mi | 26 min

Wilmington | 38 mi | 45 min

Atlantic City | 65 mi | 1 hr

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# The first step is to determine if the local market is a place you'd like to invest. There are components to this analysis:

**1** → **2** → **3**

### 1. Get to know the Sub-Market

- Does the building type support the surrounding population?
- Does surrounding retail indicate a growing market?
- Is the property close to transportation options like bus, rail, highway, or major thoroughfares
- Is the property close to non-retail sources of employment?

### 2. Study The Demographics

- Is the median home price vs. property per unit price favorable for purchase?
- Does the sub-market contain a high percentage of college graduates?
- Is sub-market median income at least 3X the average annual property rent?
- Is the percentage of sub-market residents below the poverty level <20%?
- Is the sub-market unemployment percentage between 5% and 10%
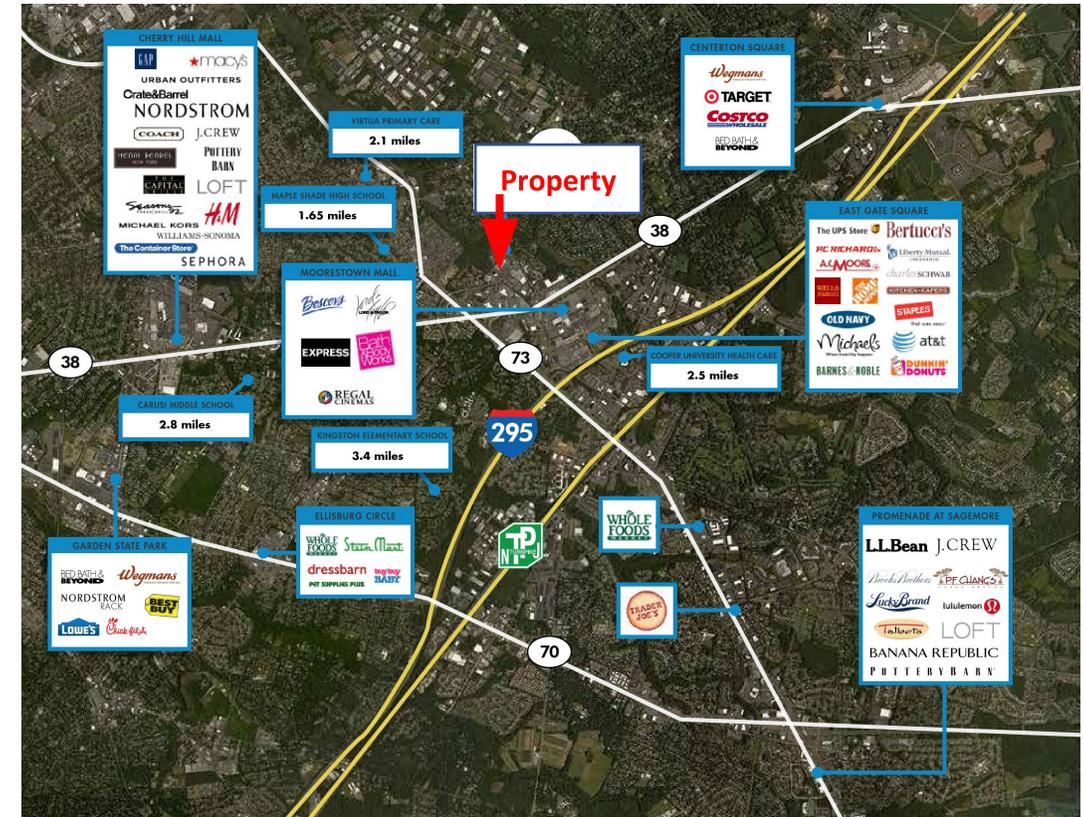
### 3. Study the Trends

- Property rent vs. market rent
- Assessing the case for rent increases
- Steady state rental increases
- Vacancy and other income
- Current vs. market proforma and expense targets
- Estimating reserves
- Creating a renovation budget
- Sources and uses of financing

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# Get to know the submarket by entering the address into Google Maps and taking a virtual "tour"

## Actions

1. Go to Google.com/Maps

2. In the upper left-hand corner, enter the property address

3. Switch to "satellite" view and locate the target property

4. Zoom out and take note of:

   - **Surrounding roads -** including entry, exit, and proximity to highway

   - **Surrounding businesses** – including who they are and what they do

   - **Shopping and dining options** – Does the tenant mix fit the surrounding area?

## Case Study Property[1]

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1 – Illustrative purposes only.  Google Maps will not provide this view

# Assess the property's location and sub-market by answering four questions
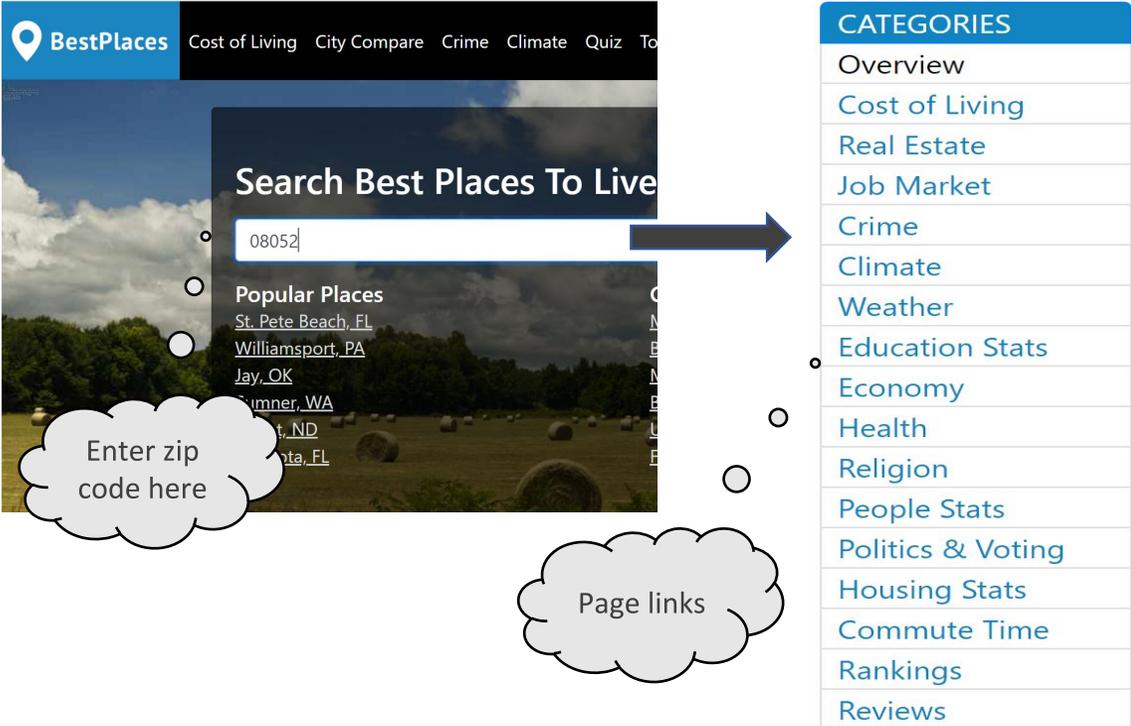
| | Questions | Case Study | Result |
|---|---|---|---|
| | Does the target property building type support the surrounding population? | Property has four buildings, two seven-story and two eight-story. Hi-rise configuration is consistent with sub-market population density and growth trends. | 🟢 |
| | Does the surrounding major retail indicate a stable and/or growing sub-market? | Yes. Retailers like Lowes, Whole Foods, Costco, and Starbucks are good barometers of a growing market. All are located nearby. | 🟢 |
| | Is the target property close to major roads, highway on-ramps, or public transportation? | Yes. Property is located adjacent to a bus stop and within close proximity to the interstate and rail options that provide access to the major metro areas of Philadelphia, Baltimore, and Trenton, NJ. | 🟢 |
| | Is the target property close to non-retail sources of employment? | Yes. Surrounding the property is a high concentration of finance, insurance, healthcare, and manufacturing jobs | 🟢 |

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# Next, utilize the internet to research sub-market income and employment demographics

1. Go to bestplaces.net and/or city-data.com

2. Enter property zip code

3. Click through the links to study sub-market income and employment demographics

4. Take special note of:

   • Median single-family home price vs. per unit price of the property

   • Percentage of college graduates in the sub-market

   • Relationship between sub-market median income and avg. rent

   • Sub-market unemployment rate

BestPlaces   Cost of Living   City Compare   Crime   Climate   Quiz   To

**Search Best Places To Live**

08052

**Popular Places**
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Williamsport, PA
Jay, OK
umner, WA
t, ND
ta, FL

Enter zip code here

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2

1 – Illustrative only

# Assess the property's income and employment demographics against five questions

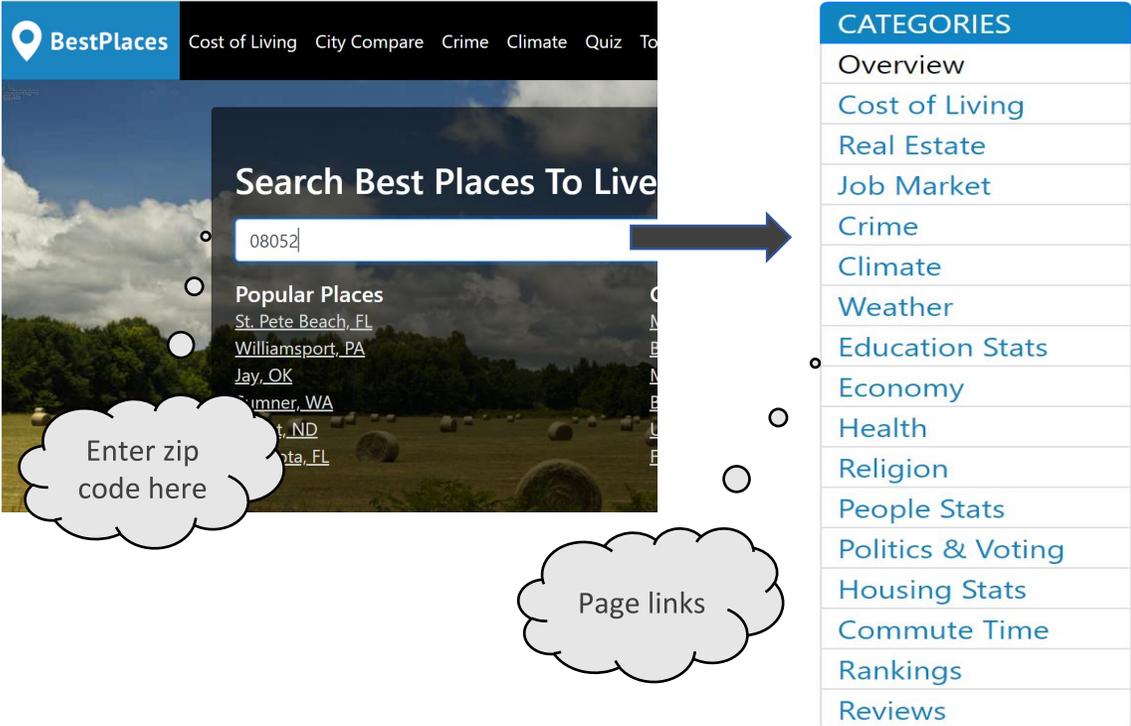| | Question(s) | Target | Case Study | Result |
|---|---|---|---|---|
| | Is the sub-market median home price vs. target property price per unit comparison favorable | Per Unit Price < Median Home Price | Median home price is $181,500 vs. per unit sales price of $80,000. | 🟢 |
| | Does the sub-market contain a high percentage of college graduates | > 25% college graduates | 26.4% of 08052 residents have a 4-year college degree vs. 36.2% for Philly metro and 38.1% for New Jersey. | 🟠 |
| | What is the relationship between sub-market median income and average annual rent? | Median income 3X average annual sub-market rent | Avg. household income is $57,460. Avg. annual 2-bedroom rent s $14,400. Ratio is 3.99X. | 🟢 |
| | What is the percentage of sub-market residents below the poverty level? | < 20% residents below the poverty level | 8.9% of residents in the 08052 zip code have incomes below the poverty level | 🟢 |
| | What is the current sub-market unemployment percentage? | Target range is 5% - 7% | Unemployment rate in the 08052 zip code is 3.30% vs. 3.70% nationally. | 🟢 |

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# Next, study sub-market growth and income trends using the same websites

## Actions

1. Go to bestplaces.net and/or City-Data.com

2. Enter property zip code

3. Click through the available links to study sub-market growth and income trends and their relationship with the state and country.

4. Take special note of:

   - **Population**:  Is it growing or shrinking?

   - **Unemployment**:  Is the trend up or down?

   - **Median Home Price**:  Is it up or down?

   - **Jobs**:  Is local employment in recession proof industries?

   - **Renters**:  Is the percentage of renters higher than the percentage of owners?

## Case Study Result[1]



Enter zip code here

Page links

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# Assess the property against five income and employment trend questions

| | Questions | Target | Case Study | Result |
|---|---|---|---|---|
| | Is the sub-market population growing or shrinking? | Growing | Population is flat over previous three decades. In 1990, it was 19,254. As of the 2010 census, it was 19,172. | 🔴 |
| | Do employment trends indicate strength? | Job growth at or above state and national trends | Job growth is .26% annually vs. 1.59% nationally. | 🟡 |
| | Is median single-family home price and median income growing? | Growth in median single-family home price and income. | Median income flat vs. national average. Median home price of $181,500 is below state and national averages. | 🟢 |
| | Do sub-market unemployment trends outperform the MSA and state? | Unemployment below state and national averages | Unemployment rate is 3.30% vs. 3.7% nationally. | 🟢 |
| | Are a high percentage of sub-market jobs in recession proof categories? | High concentration of jobs in finance, education, medicine, etc. | High concentration of jobs in the finance, insurance, manufacturing, and health care categories | 🟢 |
| | Is the percentage of renters higher than the percentage of owners? | More renters than owners | 52% of population are renters | 🟢 |

# **Summary:** Location and demographics are good, but must be aware of the downside risks

## Property Benefits

- Hi-rise **construction** is supported by sub-market population density
- Property is surrounded by a significant number of retail bellwethers like **Whole Foods** and **Costco**
- Good **location** close to major metro areas like Philadelphia, PA and Trenton, NJ
- Numerous **transportation** options including bus, train, rail, and interstate highways
- Diverse economy with a high concentration of jobs in **recession-resistant industries** such as finance and healthcare
- Sub-market **unemployment** below the **national average**
- **Median home price** compares favorably to the per unit asking price of the target

## Property Weaknesses

- 26% of zip code residents have a 4-year college degree, which is only slightly above target of 25%.
- Population growth is relatively flat over the last 3 decades of census history
- Historical job growth trends lag national averages with no catalysts on the horizon

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# 2. Market & Competition

# If the property passes the location & demographics screen, the next step is to analyze the competition in four steps

**1**

**2**

**3**

**4**

### Identify the Competition

Identify nearby properties with comparable construction, finishes, and amenities

### Compare photos

Compare available photos of competitor properties to see how they stack up against the target

### Make a comparison matrix

Create a matrix to compare all aspects of competitor properties to the subject

### Estimate renovation costs

If needed, create an estimate of per unit renovation costs to bring the property up to competitor standards

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# The first step in comparing the target property to the market is to identify the competition

## Actions

1. Go to Apartments.com and enter the address of the subject

2. Use the mapping tool to locate similar apartment buildings in the area

3. Narrow the choices to 3 - 4 properties whose construction, finish, and amenity packages are most similar to the target

OR

1. Request the broker's Offering Memo on the property, which will usually list the competitors

## Case Study Result



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# The target property has three hi-rise competitors[1]



### 1.  Cherry Hill Towers

**Built**:  1962

**# Units**:  434

**Occupancy**:  87%

### 2.  The Grand at Cherry Hill

**Built**:  1969

**# Unit**:  546

**Occupancy**:  93%

### 3.  Towers of Windsor Park

**Built**:  1966

**# Units**:  525

**Occupancy**:  95%

# With competitors identified, review the published pictures for each and compare them on similar dimensions

## Actions

1. Go to Apartments.com and enter the addresses (or name) of each competitor

2. Click through the published pictures for each with a particular focus on:

   • Kitchens

   • Bathrooms

   • Property exterior / amenities / remaining interiors

3. Compare pictures of the target to competitors to see where they're the same or different

## Case Study Result



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# For example, here's how the kitchens compare...[1]

## Target



**Cabinets**:  Wood

**Appliance Package**:  Regular

**Backsplash**:  None

**Cabinet Hardware**:  None

**Countertops**:  Laminate

## Cherry Hill Towers



**Cabinets**:  Wood

**Appliance Package**:  Stainless

**Backsplash**:  Tile

**Cabinet Hardware**:  Stainless / Nickel

**Countertops**:  Stone

## Towers of Windsor Park



**Cabinets**:  Wood

**Appliance Package**:  Stainless

**Backsplash**:  Tile

**Cabinet Hardware**:  Stainless / Nickel

**Countertops**:  Stone

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1 – Kitchen photos not available for The Grand Cherry Hill

# After viewing the photos, create a matrix to compare all aspects of the target property to the competition

## Actions

1. Using all available photos, websites, and marketing materials, compare all aspects of the target property to the competition, including:

   - Unit mix

   - Interiors

   - Exteriors

   - Finishes

   - Amenities

2. Create a matrix or "heat map" to determine where the target meets/exceeds the market and where it falls short

## Case Study Result[1]



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# Here's an example of the comparison matrix for the kitchen finishes[1]

| Kitchen | Potential Options | Target Property | Competitor 1 | Competitor 2 | Competitor 3 |
|---------|-------------------|-----------------|--------------|--------------|--------------|
| Appliances | "Regular" or Stainless | Regular | Stainless | N/A | Stainless |
| Backsplash | None, Tile, Marble | None | Tile | N/A | Tile |
| Cabinet Hardware | Present or Not Present | Not Present | Present | N/A | Present |
| Cabinets | Laminate or Wood | Wood | Wood | N/A | Wood |
| Ceiling | Popcorn; Knockdown; Skip Trowel, Swirl, Flat | Popcorn | Knockdown | N/A | Knockdown |
| Countertops | Tile, Laminate, Concrete, Marble, Quartz | Laminate | Marble | N/A | Marble |
| Flooring | Tile, Carpet, Laminate, Wood Plank | Tile | Tile | N/A | Laminate |
| Microwave | Present or Not Present | Not Present | Present | N/A | Present |
| Sink | Drop in, Undermount, Dual Mount, Farmhouse | Drop In | Undermount | N/A | Undermount |
| Stove | Gas or Electric | Gas | Electric | N/A | Gas |

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# For the items that are inferior to the competition, create a per unit renovation budget

## Actions

1. Create an "inventory" of all unit finishes that need to upgraded to meet market conditions

2. Using the inventory, create a per unit renovation budget estimate to get a feel for the required investment to bring the property to market conditions

## Sample Kitchen Renovation Budget

| Repair | Cost Est. |
|---|---|
| Stainless Steel Appliances | ~$1,500 / Unit |
| Plank Flooring | $1.85 - $2.50 PSF |
| Faucets | $200 - $250 / Unit |
| Interior Painting | $1.00 PSF |

# **Summary:** Target property finishes lag the market and likely require significant renovation to justify market rents

## Condition Notes

- Target property constructed in 1969

- Has undergone renovations, but no significant upgrades

- Property has three hi-rise competitors that are most similar to the target

- All three competitors were also constructed in the 1960s, but have undergone renovations to unit interiors

## Renovations Needed

- Based on review of available photos, significant renovations are needed upgrade the property to market standards, including:

  - Upgraded appliance package

  - Upgraded kitchen backsplash

  - Addition of cabinet hardware

  - Conversion of ceilings from popcorn to knockdown

  - Upgrade countertops from laminate to stone

  - Upgrade sink from drop-in to undermount

- Based on these renovations and others, it's estimated that the total cost of the renovation will be $10,000 per unit

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# 3. Financial Analysis

# If the property passes the market & competition screen, the last step is to perform financial analysis in four steps

```
1  →  2  →  3  →  4
```

**Check Proforma Revenue**

Using current rent roll and market averages, perform a sanity check on proforma revenue

**Analyze Vacancy & Other Income**

Using the rent roll and market averages perform sanity check on vacancy and other income

**Check Proforma Expenses**

Using the trailing 12 months operating statement, perform sanity check on proforma expenses

**Perform Final Checks**

Using operating statement and estimated financing terms and renovation budget, perform the final proforma checks

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# The first step in the financial analysis is to estimate property revenue.  There are three sources to pull from:

## Actions

1. Compile the three sources used to estimate proforma revenue:

    1. Trailing 12 months operating statement

    2. Current Rent Roll

    3. Market Averages per the Broker Estimates

2. Calculate current property revenue

3. Calculate potential market revenue (using Broker estimates)

4. Compare current and potential rent to competitors

## Case Study Result[1]

**T-12 Op. Stmt.**

| 5000-0000 | REVENUE | |
| --- | --- | --- |
| 5120-0000 | RENTAL REVENUE | |
| 5125-0000 | Rental Income | 3,775,991.85 |
| 5125-0020 | Subsidy Income | 283,714.15 |
| 5126-0000 | Less:  Vacancy Loss | -424,627.64 |
| 5127-0000 | Less:  Concessions | -146.00 |
| 5128-0000 | Less:  Emp Apt Rent | -6,024.00 |
| 5130-0000 | Less: Bad Debt | -56,868.44 |
| 5130-0005 | Less: Bad Debt Exp - Provision | -73.91 |
| 5131-0000 | Add:  Bad Debt Recovery | 24,633.63 |
| 5133-0000 | Less: Abatements | -12,165.00 |
| 5149-9999 | TOTAL RENTAL REVENUE | 3,584,434.64 |

**Current Rent Roll**

| | | As Of = 08/31/2019 | | |
| --- | --- | --- | --- | --- |
| | | Month Year = 08/2019 | | |
| Unit | Set Aside | Unit Type | Unit Sq Ft | Rent |
| Current/Notice/Vacant Residents | | | | |
| A101 | | 3a | 1,222.00 | 1,424.00 |
| A102 | Set Aside | 1a | 745.00 | 761.00 |
| A103 | Set Aside | 2a | 960.00 | 1,066.00 |
| A104 | | 2a | 960.00 | 1,123.00 |
| A105 | | 1a | 745.00 | 872.00 |

**Broker Estimates**

| Type | # of Units | SF | Market Rent |
| --- | --- | --- | --- |
| Studio | 23 | 284 | $850 |
| Efficiency | 14 | 565 | $900 |
| 1BR JR | 13 | 708 | $1,050 |
| 1BR | 204 | 745 | $1,100 |
| 1BR JR Deluxe | 9 | 745 | $1,100 |
| 2BR/1BA* | 75 | 960 | $1,400 |
| 2BR/2BA | 43 | 996 | $1,500 |
| 2BR/2BA Deluxe | 16 | 996 | $1,500 |
| 3BR/2BA* | 11 | 1,222 | $1,800 |
| **Total/Avg.** | **408** | **800** | **$1,209** |

# The trailing 12-months Operating Statement shows effective rental income of $4M and current rent roll shows $4.1M

## T-12 Operating Statement

| Unit Type | # Units | Avg. Rent / Unit | Total Rent |
|---|---|---|---|
| Studio | 23 | $503.20 | $138,883 |
| 1 Bed / 1 Bath | 240 | $753.12 | $2,168,995 |
| 2 Bed / 1 Bath | 75 | $916.98 | $825,282 |
| 2 Bed / 2 Bath | 59 | $997.41 | $706,166 |
| 3 Bed / 2 Bath | 11 | $1,301.29 | $171,770 |
| **TOTAL** | **408** | | **$4,011,096** |

Total rent per T-12

## Rent Roll Summary

| Unit Type | # Units | Avg. Rent / Unit | Total Rent |
|---|---|---|---|
| Studio | 23 | $493 | $136,092 |
| Efficiency | 14 | $652 | $109,476 |
| 1 Bed Jr. | 13 | $764 | $119,232 |
| 1 Bed | 204 | $789 | $1,930,776 |
| 1 Bed Jr. Dlx. | 9 | $747 | $80,676 |
| 2 Bed / 1 Bath | 73 | $964 | $844,440 |
| 2 Bed / 2 Bath | 43 | $1,031 | $531,816 |
| 2 Bed / 2 Bath Dlx. | 16 | $1,145 | $219,888 |
| 3 Bed / 3 Bath | 10 | $1,303 | $156,336 |
| **TOTAL** | **405[1]** | **$7,887** | **$4,128,732** |

Total per Rent Roll

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1 – Three units set aside for models/management use

# Compare rent roll rents to market averages to determine if there is room for rental increases

## Rent Roll Summary

| Unit Type | # Units | Avg. Rent / Unit | Total Rent |
|---|---|---|---|
| Studio | 23 | $493 | $136,092 |
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| 3 Bed / 3 Bath | 10 | $1,303 | $156,336 |
| **TOTAL** | **405**[1] | **$7,887** | **$4,128,732** |

## Market Averages

| Unit Type | # Units | Rent Roll Rent | Market Rent | Total Rent |
|---|---|---|---|---|
| Studio | 23 | $493 | $850 | $19,550 |
| Efficiency | 14 | $652 | $900 | $12,600 |
| 1 Bed Jr. | 13 | $764 | $1,050 | $13,650 |
| 1 Bed | 204 | $789 | $1,100 | $224,400 |
| 1 Bed Jr. Dlx. | 9 | $747 | $1,100 | $9,900 |
| 2 Bed / 1 Bath | 75 | $964 | $1,400 | $105,00 |
| 2 Bed / 2 Bath | 43 | $1,031 | $1,500 | $64,500 |
| 2 Bed / 2 Bath Dlx. | 16 | $1,145 | $1,500 | $24,000 |
| 3 Bed / 3 Bath | 11 | $1,303 | $1,800 | $19,800 |
| **TOTAL** | **408** | | | **$493,500** |
| | | | **TOTAL X 12** | **$5,920,800** |

Significant increases possible

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# Before concluding that market averages are correct, compare them to the identified competitors

| | Target | Cherry Hill Towers | Grand at Cherry Hill | Towers of Windsor Park |
|---|---|---|---|---|
| Year Built | 1969 | 1962 | 1969 | 1966 |
| Units | 408 | 434 | 564 | 525 |
| Occupancy | 86.2% | 87% | 93% | 95% |
| Studio Avg. SF | 424 | -- | 529 | 604 |
| Studio Avg. Rent | $572.36 | -- | $1,111 | $1,040 |
| Studio Avg. Rent PSF | $1.35 | -- | $2.10 | $1.72 |
| 1 Bed Avg. SF | 733 | 748 | 966 | 1,030 |
| 1 Bed Avg. Rent | $766.67 | $1,338 | $1,455 | 1,165 |
| 1 Bed Avg. Rent PSF | $1.05 | $1.79 | $1.51 | $1.13 |
| 2 Bed Avg. SF | 984 | 1,047 | 1,254 | 1,196 |
| 2 Bed Avg. Rent | $1,046.62 | $1,634 | $1,881 | $1,513 |
| 2 Bed Avg. Rent PSF | $1.06 | $1.56 | $1.50 | $1.27 |
| 3 Bed Avg. SF | 1,222 | -- | 1,603 | 1,527 |
| 3 Bed Avg. Rent | $1,303 | -- | $2,840 | $2,195 |
| 3 Bed Avg. Rent PSF | $1.07 | -- | $1.77 | $1.44 |

## Discussion

- Target property is the smallest, has the lowest occupancy, and the smallest average unit size

- Rent comparison confirms that target property rents are well below the current market

- However, property condition is also inferior to the market with competitors having undergone significant renovations

- To achieve full market rent, target will also need to undergo significant renovations

- So, the key income question is trying to figure out, if I invest "XX" amount renovating each unit, how much can I raise the rent?

- Or, put another way, how much do I need to invest per unit to achieve parity with the market?

- Per unit investment should be repaid within ~36-48 months through rental increases

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# The next step in creating a proforma is to estimate vacancy and "other income"

## Actions

1. Compile the three sources used to estimate vacancy and other income:

   1. Trailing 12 months operating statement

   2. Current Rent Roll

   3. Market Averages

2. Calculate current property vacancy

3. Calculate other income per the T-12 Operating statement

4. Compare vacancy and "other income" estimates to the market

## Key Definitions

**Vacancy:** The percentage of a property's total units that are unoccupied. Ex. A 100-unit property with 5 unoccupied units is 5% vacant.

**"Other" Income:** Property income that doesn't come from rent. Examples include late fees, pet rent, parking rent, or application fees.

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# Vacancy can be calculated from the rent roll and Other Income can be pulled from the trailing 12-months operating statement

## Vacancy Calculation

**Total # of Units:** 408

**# Vacant Units**: 52 (Per Rent Roll)

**Vacancy %**: 52/408 = **12.74%**

**NOTES**:
- Vacancy is a point in time calculation and will likely vary over the course of a year
- Property vacancy may be affected by several factors, including renovations
- The amount of rent lost due to vacant units is known as "Economic Vacancy."

## Other Income

| Source | Amount |
|---|---|
| Legal Fee Income | $20,202.64 |
| Damage Charges | $6,574.51 |
| Late Charge | $37,257.64 |
| Laundry Revenue | $54,130.74 |
| NSF Charges | $625.00 |
| Application Fee Income | $10,035.00 |
| Cable Commissions | $5,747.66 |
| Other Income | $4,110.00 |
| Forfeited Sec. Deposit | $5,115.43 |
| | |
| **TOTAL Other Income** | **$143,798.62** |

# To estimate proforma vacancy, compare vacancy per the rent roll to competitors

## Vacancy Comparison[1]

| | |
|---|---:|
| Target Property (Actual) | 12.74% |
| Cherry Hill Towers | 13.00% |
| Grand Cherry Hill | 7.00% |
| Towers of Windsor Park | 5.00% |
| **Average** | **9.43%** |
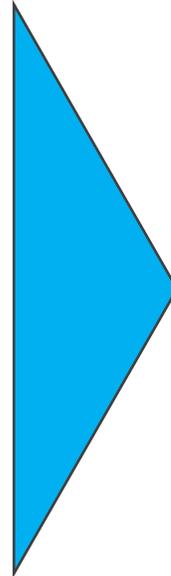
## Vacancy Estimate

- Target property vacancy is at the high end of the competition, which is logical because it also has inferior finishes

- If purchasing, renovating, and increasing rents, vacancy will likely go up before it moves back down towards a stabilized number

- Grand Cherry Hill and Towers of Windsor Park are likely indicators of where stabilized vacancy will end up

- But, its also important to be realistic and to err on the side of being conservative

- Given the facts, it'd likely make sense to model **15% vacancy** in years 1 & 2 of ownership, during renovations and rent raises

- Then, reduce vacancy to **~7%** in year 3, before reducing to **5%** on a stabilized basis

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# To estimate Other Income, use the T-12 and property business plan to inform proforma estimates

## T-12 Other Income

| Source | Amount |
|---|---|
| Legal Fee Income | $20,202 |
| Damage Charges | $6,574 |
| Late Charge | $37,257 |
| Laundry Revenue | $54,130 |
| NSF Charges | $625 |
| Application Fee Income | $10,035 |
| Cable Commissions | $5,747 |
| Other Income | $4,110 |
| Forfeited Sec. Deposit | $5,115 |
| **TOTAL Other Income** | **$143,798.62** |

## Other Income Considerations

- If property is purchased, will fees go up or down?

- Are there any items that appear likely to be different in future years?

- Is it possible to bill utilities back to residents?

- How do line items compare to the market and historically?

## Proforma Other Income

| Source | Amount |
|---|---|
| Legal Fee Income | $20,000 |
| Damage Charges | $6,000 |
| Late Charge | $38,000 |
| Laundry Revenue | $57,120 |
| NSF Charges | $4,120 |
| Application Fee Income | $15,000 |
| Cable Commissions | $10,000 |
| Other | $10,000 |
| Forfeited Sec. Deposit | $5,000 |
| Utility Reimbursements | $212,160 |
| **TOTAL Other Income** | **$377,400** |

Utilities Billed Back

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1 2 3 4

# Next, use the T-12 Operating Statement to estimate proforma expenses

## Actions

1. Compile the three sources used to estimate proforma expenses:

    1. Trailing 12 months operating statement

    2. Market Averages

    3. Expense "Guidelines"

2. Calculate T-12 expenses, compile into a series of preset expense categories

3. Compare T-12 expenses against proforma expense "guidelines."

4. Using T-12 and guidelines, create "normalized" expenses for the proforma

## Key Definitions

**Proforma Expenses:** Expense line items used to create the future property proforma. Line items will likely be the same as the T-12, but amounts will be different.

**Normalized Expenses**: Estimates of expenses, based on a set of standards.

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# Compare T-12 expenses to a set of "guidelines" that will assist in developing normalized proforma expenses

## T-12 Other Income

| Source | Amount | Per Unit |
|---|---|---|
| Advertising | $22,336 | $55 |
| Admin | $107,112 | $263 |
| Contract Services | $24,201 | $59 |
| Landscaping | $30,610 | $75 |
| Trash Removal | $18,721 | $46 |
| R&M | $250,000 | $613 |
| CapEx | $0 | $0 |
| Legal & Acct. | $38,900 | $95 |
| Make Ready | $0 | $0 |
| Utilities | $1,030,903 | $2,527 |
| Payroll | $753,912 | $1,848 |
| Property Insurance | $171,068 | $419 |
| Real Estate Taxes | $316,043 | $775 |
| Management Fees | $176,674 | $433 |
| **Total** | **$2,940,480** | **$7,207** |

## Expense Guidelines

| Source | Per Unit |
|---|---|
| Advertising | $100 |
| Admin | $250 |
| Contract Services | $75 |
| Landscaping | $80 |
| Trash Removal | $50 |
| R&M | $500 - $800 |
| CapEx | -- |
| Legal & Accounting | $100 |
| Make Ready | -- |
| Utilities | As Billed |
| Payroll | $1,100 - $1,300 |
| Property Insurance | $300 |
| Real Estate Taxes | Equal to Tax Bill |
| Management Fees | 5% - 8% of Rent |
| **Total** | -- |

## Proforma Year 1

| Source | Amount | Per Unit |
|---|---|---|
| Advertising | $40,800 | $100 |
| Admin | $102,000 | $250 |
| Contract Services | $30.600 | $75 |
| Landscaping | $32,640 | $80 |
| Trash Removal | $20,400 | $50 |
| R&M | $265,200 | $650 |
| CapEx | -- | -- |
| Legal & Accounting | $40,800 | $100 |
| Make Ready | -- | -- |
| Utilities | $1,020,000 | $2,500 |
| Payroll | $510,000 | $1,250 |
| Property Insurance | $102,000 | $250 |
| Real Estate Taxes | $624,571 | $1,531 |
| Management Fees | $135,190 | $331 |
| **Total** | **$2,924,201** | **$7,167** |

Utilities Billed Back

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1 2 3 4

# Finally, pull income and expenses together to create a full proforma

## Actions

1. Compile the sources needed to complete the proforma:
    1. Income
    2. Other Income & Vacancy
    3. Expenses
2. Pull together each item into a complete proforma for your desired holding period
3. Make income/expense increase assumptions
4. Perform final checks, calculate key return metrics, and compare them to your requirements

## Key Metrics

**Cash on Cash Return:** The ratio of annual before-tax cash flow to the total amount of cash invested, expressed as a percentage.

**Debt Service Coverage Ratio:** The ratio of annual before-tax cash flow to annual debt service.

# Pull together income and expenses to create a full proforma

| | T-12 | 1 | 2 | 3 | 4 | 5 |
|---|---|---|---|---|---|---|
| Gross Potential Rent | $4,011,096 | $5,035,292 | $6,059,492 | $6,180,682 | $6,364,328 | $6,555,528 |
| Vacancy & Loss to Lease | ($569,880) | ($805,647) | ($969,519) | ($370,841) | ($381,860) | ($393,315) |
| Bad Debt & Concessions | ($12,856) | ($100,706) | ($90,892) | ($123,614) | ($127,287) | ($131,105) |
| Other Income | $364,513 | $377,400 | $379,828 | $391,222 | $402,959) | $415,048 |
| **Total Revenue** | **$3,792,870** | **$4,506,339** | **$5,378,908** | **$6,077,450** | **$6,258,141** | **$6,445,885** |
| | | | | | | |
| Operating Expenses | $2,940,481 | $2,924,201 | $3,034,049 | $3,125,070 | $3,214,398 | $3,306,606 |
| | | | | | | |
| **Net Operating Income** | **$852,389** | **$1,582,138** | **$2,344,860** | **$2,952,380** | **$3,042,643** | **$3,137,280** |
| Expense Ratio | 78.00% | 65.00% | 56.00% | 51.00% | 51.00% | 51.00% |
| | | | | | | |
| Annual Debt Service | $1,816,384 | $1,410,178 | $1,410,178 | $1,410,178 | $2,591,369 | $2,591,369 |
| | | | | | | |
| Value @ 6% Cap Rate | $14,206,483 | $26,386,996 | $39,081,000 | $49,206,333 | $50,710,716 | $52,288,000 |
| | | | | | | |
| Cash on Cash Return | | 1.9% | 10.1% | 16.6% | 47.8% | 57.8% |
| **Debt Service Coverage** | **.47** | **1.12** | **1.66** | **2.09** | **1.17** | **1.21** |

## Discussion

- Rent assumes 2% annual rent bumps once stabilized
- Vacancy increases in years 1 & 2 due to renovations, but then reduces slowly to 5% on a stabilized basis
- Operating expenses assume 3% annual increases once stabilized
- NOI rises quickly as renovations are completed and rents convert to market rate
- Expense ratio in the T-12 is very high indicating opportunity for savings.  Reduces slowly to 51% on an annualized basis
- Debt service assumes 80% LTV, 5%, and 30-year amortization.  Refinance in year 3.
- Cash on Cash return assumes purchase price of $28M, with $9.4M in equity to close
- Cap rate of 6% is based on recent sales and estimate of future exit.
- CapEx reserves not shown

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# Lastly, check proforma and metrics against a series of metric targets

| Metric | Calculation | Target | Case Study Actual |
|---|---|---|---|
| LTV | = Loan Amount / Value of Property | 70% - 75% | 80.00% |
| DSCR | = Net Operating Income / Debt Service | >1.25X (Stabilized) | ~1.20 (Stabilized) |
| Cash on Cash Return | = (Net. Op. Income – Debt Service)/Equity | > 10% (Stabilized) | ~20% (Stabilized) |
| Expense Ratio | = Total Expenses / Total Rent | ~50% (Stabilized) | 51% (Stabilized) |
| CapEx Reserves | -- | ~$250 per unit, per year | $250 per unit, per year |
| Closing Costs | -- | 5% - 7% of loan amount | 5.00% of the loan amount |
| Working Capital | = Est. Monthly Expense * 6 | ~6 Months of expenses | 6 Months of working capital |

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# **Summary:** There are three steps to performing an initial deal review. If the property passes, proceed to the LOI phase

**1** → **2** → **3**

## 1. Get to know the Sub-Market

- Does the building type support the surrounding population?
- Does surrounding retail indicate a growing market?
- Is the property close to transportation options like bus, rail, highway, or major thoroughfares
- Is the property close to non-retail sources of employment?

## 2. Study The Demographics

- Is the median home price vs. property per unit price favorable?
- Does the sub-market contain a high percentage of college graduates?
- Is sub-market median income at least 3X the average annual rent?
- Is the percentage of sub-market residents below the poverty level <20%?
- Is the sub-market unemployment percentage between 5% and 10%?

## 3. Study the Trends

- Property rent vs. market rent
- Assessing the case for rent increases
- Steady state rental increases
- Vacancy and other income
- Current vs. market proforma and expense targets
- Estimating reserves
- Creating a renovation budget
- Sources and uses of financing

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