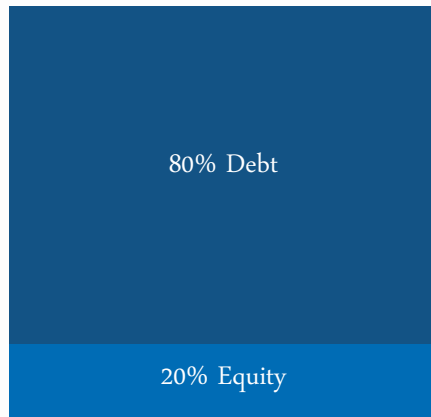

LESSON 4 - THE KEY INFORMATION FOR MAKING GOOD
INVESTMENT DECISIONS

CAPITAL STRUCTURE

You must understand where you are or where you want to be in the capital stack. The capital structure drives the debt and equity structure and determines your degree of financial risk. The capital stack is the total cost to buy and improve the property.



SOURCE AND USES

SOURCES AND USES OF FUNDS

	AMOUNT	PSF (\$)
SOURCES OF CASH		
Equity:	\$3,000,000	\$30
Loan:	\$10,900,000	\$109
Total:	\$13,900,000	\$139
USES OF CASH		
Acquisition costs:	\$13,000,000	\$130
Rehab costs:	\$500,000	\$5
Interest reserve:	\$400,000	\$4
Total:	\$13,900,000	\$139

CURRENT AND HISTORICAL OPERATING STATEMENTS

A good real estate investor must understand the prior and current project-level profit and loss statements (operating statements). Operating statements are the key to any property analysis. Before you can develop a plan for where your project is going, it is important to fully understand where you have been and where you stand now. Therefore, underwriting and decisions should be made with historical operating statements as a basis. The upside for the project is how much the investor can improve upon the historical results. The figure below shows an easy way to outline this information.

HISTORICAL NOI
(Most Current Year)

\$1,000,000

PRO FORMA NOI
(After Improvements)

\$1,500,000

CHANGE

\$500,000 (50%)

RENT ROLL

TENANT RISKS: What are the risks of tenants defaulting or not renewing their leases?

LEASE EXPIRATIONS: When do leases expire? This information reveals your re-leasing risk.

EXTENSION OPTIONS: Look closely at the extension options of larger tenants. If they are locked in at good rates, they are likely to stay. A good investor will know whether tenants have extension options.

CO-TENANT PROVISIONS: Co-tenancy provisions are common in retail. These provisions prohibit the property owner from leasing to other similar tenants or allow smaller tenants to leave if an anchor tenant leaves.

PROJECT PRO FORMA

The project pro forma is the investor's plan for the property. It is the culmination of all the historical analyses and their projected results.

After investors finalize the capital improvements budget and study the rent roll and historical operating statements, they should prepare a future or forward-looking operating statement.

This statement shows the potential for the property and concludes with the investor formulating a future stabilized NOI. The stabilized NOI is the wealth driver in every real estate transaction. If it can be achieved, the investor should do very well.

The purpose of the project Pro Forma is to derive the property's exit value.

EXIT STRATEGIES

Exit value is a crucial number that the value added investor is trying to achieve. This value is based on the stabilized net operating income (NOI), which is derived from all the analyses that go into the project pro forma.

KEY FORMULA: Commercial Real Estate Value

$\text{NOI} / \text{Cap Rate} = \text{Value}$

Note: \$The NOI used should be stabilized but can be historical, current, or pro forma.