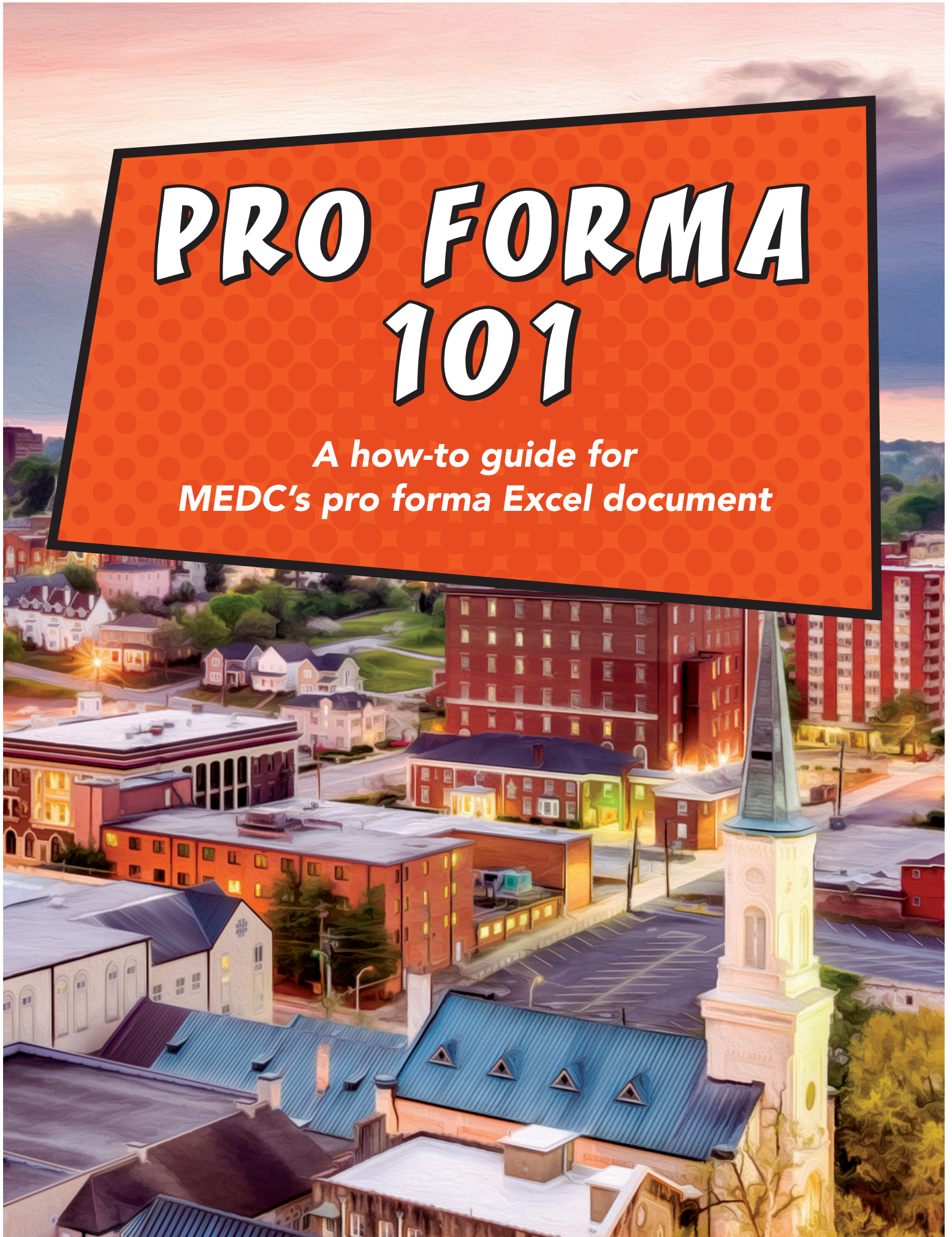



PRO FORMA 101

*A how-to guide for
MEDC's pro forma Excel document*





A pro forma is a financial model that is used to evaluate the financial feasibility of a real estate development project over time.

If you have a building that you are considering redeveloping, completing a pro forma analysis of the project can help you evaluate important elements of the project. For example, a pro forma analysis can help you decide how many residential units or how much commercial space can or should be included in your project based on how much income is needed to cover costs associated with operating your project.

The MEDC pro forma addresses the major components of a typical commercial and/or mixed-use project. The goals of the pro forma include:

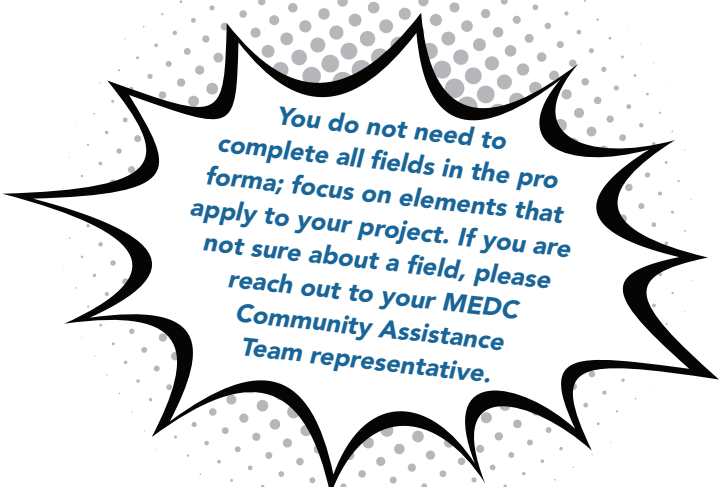
- Organize the projects total development budget to identify all development costs.
- Organize the developments projected operating revenue and operating expenses to determine if the development generates positive cash flow.
- Organize the projects potential sources of funding, including debt, grants and developer equity.

When completing the MEDC pro forma, enter information into the light blue boxes as directed by the instructions within the pro forma Excel document; let the pro forma do the calculations, do not change the built-in formulas.

This guide focuses on the three tabs within the pro forma that will require the most information from you to complete: "Revenue Input," "Pro Forma," and "Sources & Uses." The remaining tabs will primarily be populated based on information you enter in the three worksheets explained in this guide.

The information you enter in a pro forma will often be based on assumptions—information that is not known but is based on what you expect will happen in the future based on the information available to you at

the time. As you proceed with your development, you will continually refine your assumptions based on new information, updated architectural drawings, revised cost estimates and many other factors. The following guide has been developed to assist interested building owners, developers and other stakeholders in completing the MEDC pro forma, which is part of the application process for many MEDC community development tools, resources and incentives. If you have questions about the pro forma or any content in this guide, please reach out to the MEDC for additional information and assistance.



You do not need to complete all fields in the pro forma; focus on elements that apply to your project. If you are not sure about a field, please reach out to your MEDC Community Assistance Team representative.

REVENUE INPUT

worksheet

Note: You only need to complete the **light blue boxes** that apply to your project; anything in white will be automatically calculated.

INSTRUCTIONS

This worksheet is where you **enter revenues that you expect will be generated by your property** once construction is complete. Revenue from each use/tenant in your building should be entered in the appropriate table, including residential, commercial, hospitality and parking/other. The information entered here will automatically transfer to specific places in the "Pro forma" and "Cash flow" worksheets.

HOW DO I KNOW WHICH ASSUMPTIONS/INPUTS TO USE?

Revenue information can come from a variety of sources, including market studies, information about similar developments (often called "comps," short for comparable), other people who have completed similar projects, current listings for similar spaces, online research, news articles about recent developments in your area, local brokers/Realtors, and community partners (Main Street, chamber, DDA, etc.).

INCOME INCREASES & VACANCY RATE

Adjacent to each income table is a table to enter assumptions for income increases and vacancy rate. "**Income increases**" are the amount that you expect your revenues to increase each year; often this increase is tied to annual rental rate increases included in tenant lease agreements.

Vacancy rate assumptions should be based on how long you expect it will take you fully lease your property, how frequently tenants will leave and how long it will take you to re-lease space when tenants do leave their space.

Early on, these will be guesses based on what you see in your local market; if you secure tenants and leases for your spaces in advance of construction, you can base these numbers on those lease agreements.

INCOME RESIDENTIAL TENANTS

In this table you will enter information about any residential rental units that you plan to include in your project. Enter one line for each unit type; unit type is determined by the number of bedrooms, bathrooms and unit sizing.

Fields you need to complete

Unit Type Drop-down menu; choose the appropriate number of bedrooms.

Units Enter the number of units with that bedroom count.

Baths Drop-down menu; choose the number of bathrooms.

Square Feet Enter the average square feet per unit for that unit type. For example, if you have two units that will have 1-bedroom and 1-bathroom, but one unit will be 500 sq. ft. and the other will be 600 sq. ft., you would enter 550 sq. ft. in the workbook since that is the average size of the two units.

Monthly Rent Enter the average monthly rent per unit for that unit type. In the example above, if you charged \$700 per month for one unit and \$800 per month for the other, you would enter \$750 as the average monthly rent for 1-bed, 1-bath units.

Common Area Square Feet Enter space that is not within a rental unit and will not generate income but is within the area assigned for residential use. See "Common Area Calculations" for additional information.

Income Source Drop-down menu to identify any other sources of income associated with your residential units; included here are items like storage fees or application fees. Be sure to enter income on a monthly basis, even if you typically receive the income annually. For example, if you expect to receive a \$150 application fee each year for two units in your building (for a total of \$300/year in application fees), you would enter \$25 in monthly income ($\$300 \text{ a year} / 12 \text{ months a year} = \25 per month).

INCOME COMMERCIAL/RETAIL/OFFICE TENANTS

In this table you will enter information about any commercial, retail or office tenants you plan to include in your project. Enter one line for each tenant you expect in your property; this is typically based on how many individual spaces you plan to include in the project.

Fields you need to complete

Description Enter the type of tenant you expect to recruit to this space (i.e., retail tenant, etc.).

Lease Type Drop-down menu; enter the type of lease you expect each tenant to have. See "Commercial Lease Descriptions" if you're not sure which option to select.

Square Feet Enter the square footage leased to each tenant.

REVENUE INPUT

worksheet

INSTRUCTIONS CONTINUED

INCOME COMMERCIAL/RETAIL/OFFICE TENANTS *cont.*

Rent/Square Foot Enter the annual rent per square foot that each tenant will pay for their space. For example, if a tenant is leasing a 1,000-square-foot space and pays \$1,800 each month, the annual rent per square foot that should be entered here is \$21.60 ($\$1,800/1,000 \text{ SF} = \1.80 per month ; $\$1.80 \times 12 \text{ months} = \$21.60 \text{ annual rent per square foot}$).

CAM/Square Foot If applicable, enter the annual common area maintenance (CAM) revenue per square foot that you expect to receive from tenants. See “Commercial Lease Descriptions” for additional information.

Common Area Square Feet Enter space that is not leased to a single tenant but is within the area assigned for commercial use. See “Common Area Calculations” for additional information.

Income Source Enter any other uses that you expect to generate income from the commercial space(s) within your building; examples could include renting storage space in a basement, application fees, etc. Be sure to enter the income you expect to receive from these other sources as a monthly amount.

INCOME HOSPITALITY

Enter information about any hospitality uses you plan to include in your project; you will likely need to have a separate list of individual room sizes/prices in order to complete this table.

Fields you need to complete

Rooms Enter the number of hotel rooms you expect to include in your project.

Avg. Daily Rate/Room Enter the average room rate you expect to receive for each room; be sure to account for seasonal and daily rate changes in your average daily rate.

Square Feet Enter the average room size for hotel rooms in your project.

Other Rev/Room Enter revenue per room from other sources including food/beverage, phone/data, etc.

Other Income—Banquet, Conference, Restaurant, Misc. Enter the square footage allocated to each use; enter the expected monthly income generated by each use. Be sure to account for seasonal changes when calculating averages.

PARKING

Enter information about parking included in your project, whether structured or surface.

Fields you need to complete

of Spaces Enter the number of spaces for each type of parking provided (public or other dedicated).

Square Feet Enter total square footage dedicated to each type of parking.

Monthly Income Enter the expected monthly income from renting/leasing of parking spaces.

OTHER INCOME

Enter information about any other sources of revenue you expect to generate.

Note: You only need to complete the **light blue boxes** that apply to your project; anything in white will be automatically calculated.

COMMERCIAL LEASE DESCRIPTIONS

The descriptions below are based on typical lease structures; regardless of lease type, responsibility for all expenses should be clearly defined in any lease agreement.

Gross Lease: Tenant pays a set lease amount; building owner pays costs associated with owning and operating the building (taxes, insurance, maintenance).

Modified Gross: Tenant pays a set rent and some portion of other costs associated with operating associated with the space.

NNN (Triple Net): Tenant pays a set lease amount and is also responsible for taxes, insurance, maintenance and other costs associated with their space.

CAM (Common Area Maintenance): A fee for expenses associated with operating a building that may be charged in addition to the rental rate; may be structured as a flat fee or a variable charge depending on specifics in the lease agreement. Be sure to clearly spell out how the fee will be assessed and the type of expenses that will (and will not be) covered by the fee in the lease agreement.

For a project that includes a **hospitality component**, you will likely need a third-party analysis to generate accurate room rate estimates and occupancy assumptions.

COMMON AREA CALCULATIONS

Within your building, you likely have spaces that are not assigned to a specific tenant and do not generate revenue (for example, shared stairways, hallways, elevators, entries, etc.). Though these spaces do not generate revenue, you still need to include the square footage in appropriate table on the revenue worksheet.

The total square footage of rentable and common area space will filter to the “Sources & Uses” tab to determine your construction and development costs per square foot; these calculations are one way that your project will be reviewed for feasibility and benchmarked against other similar projects in the market.

PRO FORMA

worksheet

Note: You only need to complete the **light blue boxes** that apply to your project; anything in white will be automatically calculated.

INSTRUCTIONS

Within this tab, **the project's income will be compared to debt the project can support.** The information displayed will reflect your project's overall operating expenses, proposed loan amounts, and in general helps to inform the user of the project's debt service capacity. Certain assumptions will carry over from the previous "Revenue Input" tab; however, project specific data related to utility, management, taxes, etc., will further build out the operating performance of the deal.

DEVELOPMENT INCOME

Within this tab, you'll notice that information from the income assumptions on the previous "Revenue Input" tab carried over onto the top of the page, filling in the "Development Income" area. This information summarizes an annual gross income for what the proposed project will generate based upon the previously input assumptions. Note that the revenue information is on a per month basis and the operating pro forma is an annual "as stabilized" snapshot of the project.

DEVELOPMENT OPERATING EXPENSES

As you move through this section, the costs associated with each of these line items should reflect an annual expense for each of the items. If, for example, the project is a residential multi-family product there will likely be a bulk management fee for the operation of said project. This category is comprised of several generic expenses related to the project's operation and maintenance over time.

Fields you need to complete

Administrative Expenses Items contained within this section highlight expenses related to the performance of the property itself related to management of the commercial space, or residential units, marketing of the property, any legal expenses annually incurred, etc.

Utilities Again, on an annual basis this should highlight natural gas, or propane, electricity and/or water /sewer usage.

Maintenance/Repairs It is understood that while working with the MEDC we expect a holistic renovation, however, in time as the property ages this category assumes an annual maintenance schedule for things like pest control, snowplowing, elevator updates if necessary, landscaping, etc.

Taxes & Tax Abatements Significant investment in a property should increase its taxable value. Coordinate with the local assessor's office to determine what that new assessed value is projected to be post completion of the proposed project, in the event that a related tax incentive could be provided. If the project will utilize an abatement of any kind, this portion of the spreadsheet should reflect that annual value, or discount received per the abatement.

Insurance This portion should reflect both property and/or liability insurance projected for the project.

Reserve Requirements/Other Each of these sections should reflect a "nest-egg" or any other unique costs associated with the project.

Each applicable line item contains an annual value. The project will demonstrate its ability to support debt for improvements, acquisition of land, tenant build out, etc. As highlighted in the "Pro Forma" tab, this will be demonstrated within the cash flow available for debt service, or your net operating income (NOI).

EVALUATING YOUR OPERATING EXPENSES

As a general rule, it is not uncommon for a renovated property to carry operating expenses between 25–40% of the overall project's anticipated revenue assumptions. If the operating expenses are much below or above this threshold, it may be a point of discussion to address various ways to either hold more equity in reserve, or potentially reduce the impacts of the project through efficiencies to make the deal perform.

LOAN TERMS

Within this section, enter both the name of the lender(s) are related to the project as well as what the loan amount and terms are for the debt. Once entered, the spreadsheet will quickly illustrate how "healthy" a deal is as well as provide a ball-park level of support lenders may have for a project based upon its debt service coverage ratio (DSCR).

For example, if the subject project anticipates utilizing a grant from the MEDC, then the lower portion of the "Loan Terms" box should have a zero (0) entered into the "override" box of this section. However, if the project is looking for loan support from the MEDC, then you would enter the requested amount in the fillable blue cell for this purpose.

Another general rule, if the project's DSCR is less than 1.2:1.0 (\$1.20 in revenue for every \$1.00 in debt) this may be cause for reflection of either the overall costs related to the project, or potentially reworking the deal. Factors related to the project such as unit size, rents/sale value of space, unit mix, property cost, etc., are general indicators that not only the MEDC focus is on, but also traditional lenders when considering support of a project. A DSCR less than 1.2:1.0 will like be viewed as too risky for traditional lenders. Conversely, a DSCR above 1.35:1.0 or 1.4:1.0 could mean additional debt could be supported.

SOURCES & USES

worksheet

Note: You only need to complete the **light blue boxes** that apply to your project; anything in white will be automatically calculated.

INSTRUCTIONS

This worksheet is utilized to input the **total sources and uses of funds for the project** from acquisition to construction completion. In addition, the maximum amount of eligible incentive for the project is calculated, based on the total cost of all eligible activities. This is one calculation used in determining the financial gap and the project structure.

HOW DO I KNOW WHICH ASSUMPTIONS/INPUTS TO USE?

Include all expected sources and uses of funds based on your third-party costs estimates, discussions with lenders and investors, and commitments of local support.

PROJECT STRUCTURE

(One piece of the development analysis process which is indicated on this sheet, used in the underwriting process)

$$\begin{array}{r} \text{Total Project Cost} \\ - \text{Bank Loan} \\ - \text{Equity} \\ \hline \text{Project Gap} \end{array}$$

- If the gap is positive, find other sources to fill the financial gap
- If the gap is negative, the project cost is less than the amount of funding proposed to cover those costs (there is no gap!)

TOTAL DEVELOPMENT COSTS

Enter all uses of funds contributing to the physical development, including acquisition (even if it already occurred), hard costs for construction, and soft costs.

Fields you need to complete

Acquisition Enter any expected or previous land or building purchase at project site. These costs are not considered as part of your total project costs for the purposes of financial evaluation by MEDC, but are helpful in gaining a better understanding of the holistic project.

Hard Costs The first section covers work performed on the site, including any brownfield tax increment financing eligible activities. Complete all applicable cells. Note: eligible brownfield activities may vary by location.

The second section of **Hard Costs** includes any construction and/or rehabilitation costs of the structure(s) on site. Complete all applicable cells, as a reflection of your third-party construction cost estimate, including any confirmed tenant build out.

Other Eligible Costs Enter any expected costs related to furniture and fixtures, machinery and equipment, architectural and engineering, as well as environmental and survey work. These are considered part of your eligible total project budget. For projects seeking grant or loan incentives: Within the "% Eligible" cell, enter 20%, unless the project qualifies as historic building rehabilitation (see MCRP guidelines for eligibility) then 25% can be calculated.

After completing these sections, your "Total Eligible Basis" and "MEDC Max Investment" will be calculated to the right. This is merely a guide to provide you with a general idea of your eligible investment and eligible ask for funding.

Ineligible Soft Costs and Other Ineligible Soft Costs Under "Related Party Fees," enter expected fees associated with the development or development process. Related party fees are considered to be any fee paid to individuals that are benefiting from the success of the project. These costs are not considered as part of your total project costs for the purposes of financial evaluation by MEDC, but are helpful in gaining a better understanding of the holistic project.

TOTAL DEVELOPMENT SOURCES

Enter all sources of funds contributing to the project, including existing equity on buildings and/or land involved in the project. Loan information entered in the previous pro forma tab will automatically populate in this section.

Fields you need to complete

Senior Debt Enter all sources of senior debt. "Loan Information" and the "MSF/MCRP Conventional Loan" cells will automatically populate based on your entry of information in the pro forma worksheet.

Subordinate Debt/Grants Under "MEDC Grant," enter expected grant or loan needed. Enter all subordinate debt or grants from non-MCRP sources.

Deferred Fees/Cash Equity Enter information on any deferred fees, cash equity from owner (as required in all projects. See MCRP guidelines for more information), any equity in land or buildings from owner, and other forms of equity injected into the project, such as brownfield TIF reimbursement expected. Note: MEDC expects proof of final financing prior to MSF consideration.

SOURCES & USES

worksheet

INSTRUCTIONS CONTINUED

Note: You only need to complete the **light blue boxes** that apply to your project; anything in white will be automatically calculated.

CONSTRUCTION FINANCING

Enter expected or confirmed construction loan provider and terms into applicable cells. Note: MEDC expects proof of financing prior to MSF consideration, such as terms sheet from a financial institution, evidence of equity, etc.

SOURCES AND USES/OTHER CALCULATIONS

Enter square footage of common/other space not yet accounted for. Other than this cell, both tables will automatically populate based on information entered throughout the file.

ADDITIONAL WORKSHEETS

DEPENDING ON THE PROJECT, YOU MAY HAVE ADDITIONAL ITEMS THAT NEED TO BE COMPLETED ON OTHER WORKSHEETS.

This guide focused on the three worksheets within the MEDC pro forma that require the most information from you to complete: "Revenue Input," "Pro forma," and "Sources & Uses." Your MEDC Community Assistance Team representative can provide additional guidance on any questions related to these items. Once your project information has been entered in the pro forma, you will be able to see whether additional modifications to the project need to be made to make the development financially feasible. You will also be able to see the type of potential return that the project may generate by using the "Dev Ret" (or Developer Return) worksheet. Note that the capitalization rate used by MEDC is fixed and should not be modified. Using a fixed rate allows MEDC to evaluate developer returns across a variety of projects and markets.

NEXT STEPS

As you move forward with your project, expect to **continually return to your pro forma to update your inputs and assumptions** as you fine tune your project or receive new information. Be sure to connect with your MEDC Community Assistance Team representative with any questions as you complete the pro forma and move forward with your project.



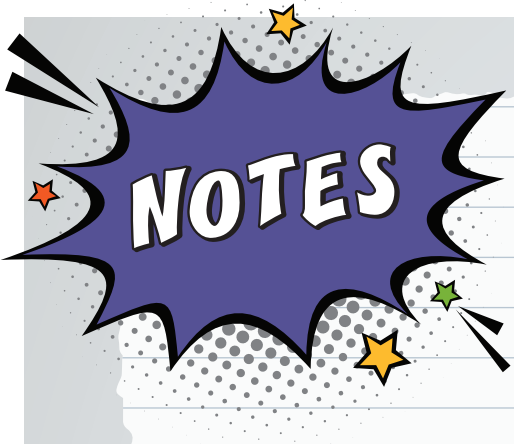
WHAT IS A CAPITALIZATION RATE?

Capitalization rate, or cap rate, is the rate of return on a real estate investment based on the income that the property is expected to generate.

The cap rate for a project is calculated with the below formula:

$$\frac{\text{Net Operating Income}}{\text{Current Market Value}} = \text{Cap Rate}$$

The higher the cap rate, the greater potential return to investors. For example, a project that generates \$100,000 in net operating income (operating income less operating expenses) and has a market value of \$1 million would have a capitalization rate of 10%. The capitalization rate is not the only measure of the strength of a project, but is one way to compare project performance when looking at multiple investment options.



A large, vertically oriented rectangular area with a white background and horizontal blue lines, resembling a sheet of lined paper. The top and bottom edges of this area are irregular and jagged, mimicking torn paper. The rest of the page has a light grey background.