Commercial Real Estate Financial Analysis: <u>Cash Flow Model</u>

California Association of REALTORS® Region 20 California Commercial Alliance (CCA)

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In commercial real estate financial analysis, it's customary to prepare a "setup" The "setup" is usually provided within the marketing package for a listed property

The setup typically includes cash flow and other financial analysis calculations and investment indices

Let's take a look at a standard multifamily residential income property setup...it's the easiest for us to develop and understand a cash flow model

					11 Units 1234 King	Kingsley Isley Ct Los Angeles	у А , СА	rms 90029
Summary		Current			Financing			
Price: Down Payment Number of Units:	35%	\$1,650,000 \$577,500 11			Proposed Financing First Loan Amount: Terms: 30-vr Fixed	\$1,072,500		
Cost per Unit:		\$150,000			Interest rate:	5.00%		
Current CAP:		5.57%			Central Hollywood		-	The second
Approx. Age:		1957			Pitched roof			
Approx. Lot Size:		7,884			On site laundry	and the second second	and in	10-7
Approx. Gross SF:		7,841			(2) units Section 8	and the second		
Cost per Gross SF:		\$210.43			20 TA	9		1
Annualized Operatin	g Data	1	Cu	rent Rents	3			
Scheduled Gross Inc	come:		\$	152,008				
Less Vacancy Rate R	eserve:		\$	(4,560)	3.0% *			
Gross Operating Inco	me:		\$	147,448				
Less Expenses:			\$	(55,563)	37% *			
Net Operating Incom	ie:		\$	91,885				
Less Loan Payments:			\$	(69,089)				
Pre-Tax Cash Flow:			\$	22,796	3.9% **			
Plus Principal Reducti	ion:		\$	15,464				
Total Return Before	Taxes:		\$	38,260	6.6% **			
No.	Approx	Avg. Monthly	- 2	Monthly		Taxes (est. 1.125%)	\$	18,56
10	Sy.Ft.	61 110	¢	11 100		Insurance	φ ¢	2,00
1	0	\$1,110	¢	1 478		Repairs & Maintenance	9 6	5,00
1	0	\$0	¢ ¢	1,470		I Itilities	¢	8,00
		00	Ψ	17		Oundes		0,00
1	0	\$0	\$	-		On-site Manager	S	-
1	0	\$0 \$0	\$	-		On-site Manager Reserves	\$	4 60
1	0 0	\$0 \$0 \$0	\$ \$ \$			On-site Manager Reserves Management	\$ \$ \$	4,60
1 1 1 1	0 0 0	\$0 \$0 \$0 \$0	\$ \$ \$ \$			On-site Manager Reserves Management	\$ \$ \$	4,60 13,00
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1 1 1 1 1 1 Total Scheduled Rer	0 0 0 0 0 0	\$0 \$0 \$0 \$0 \$0 \$0 \$0 \$0	* * * * * * *	- - - - - 12,578		On-site Manager Reserves Management	\$ \$ \$	4,60 13,00
1 1 1 1 1 1 Total Scheduled Ren Laundry:	0 0 0 0 0 1 1	\$0 \$0 \$0 \$0 \$0 \$0 \$0	* * * * * * * *	- - - - 12,578 89		On-site Manager Reserves Management	\$ \$ \$	4,60 13,00
1 1 1 1 1 1 Total Scheduled Ren Laundry: Less Rent Concession	0 0 0 0 0 0 1 1	\$0 \$0 \$0 \$0 \$0 \$0 \$0	\$ \$ \$ \$ \$ \$ \$ \$ \$ \$ \$ \$	- - - 12,578 89		On-site Manager Reserves Management	\$ \$ \$	4,60 13,00
1 1 1 1 1 Total Scheduled Ren Laundry: Less Rent Concession Other Income:	0 0 0 0 0 0 1t:	\$0 \$0 \$0 \$0 \$0 \$0 \$0	* * * * * * * * * *	- - - 12,578 89 -		On-site Manager Reserves Management	\$ \$ \$	4,60 13,00
1 1 1 1 1 Total Scheduled Ren Laundry: Less Rent Concession Other Income: Monthly Scheduled (0 0 0 0 0 1t: 3ross In	\$0 \$0 \$0 \$0 \$0 \$0 \$0 \$0	\$ \$ \$ \$ \$ \$ \$ \$ \$ \$ \$ \$ \$ \$ \$ \$ \$ \$ \$	- - - 12,578 89 - 12,667		On-site Manager Reserves Management	\$ \$ \$	- 4,60 13,00 55,56
1 1 1 1 1 Total Scheduled Ren Laundry: Less Rent Concession Other Income: Monthly Scheduled G	0 0 0 0 1t: Aross Inc	\$0 \$0 \$0 \$0 \$0 \$0 \$0 \$0 \$0	\$ \$ \$ \$ \$ \$ \$ \$ \$ \$ \$ \$ \$ \$ \$ \$ \$ \$ \$	- - 12,578 89 - 12,667 152,008		On-site Manager Reserves Management *Total Expenses: Per Net Sq. Ft.: Expenses Per Unit:	\$ \$ \$ \$ \$	4,60 13,00 55,56 7.0 5,05

Work with a setup model you like...your commercial mortgage brokers can help you with this We'll start with income...and then move to expenses...then calculate cash flow Actual or current numbers vs. "pro forma" or "market" numbers

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1 1 1 1 1 1 Total Scheduled Rer	0 0 0 0 0 0	\$0 \$0 \$0 \$0 \$0 \$0 \$0 \$0	* * * * * * *	- - - - - 12,578		On-site Manager Reserves Management	\$ \$ \$	4,60 13,00
1 1 1 1 1 1 Total Scheduled Ren Laundry:	0 0 0 0 0 1 1	\$0 \$0 \$0 \$0 \$0 \$0 \$0	* * * * * * * *	- - - - 12,578 89		On-site Manager Reserves Management	\$ \$ \$	4,60 13,00
1 1 1 1 1 1 Total Scheduled Ren Laundry: Less Rent Concession	0 0 0 0 0 0 1 1	\$0 \$0 \$0 \$0 \$0 \$0 \$0	\$ \$ \$ \$ \$ \$ \$ \$ \$ \$ \$ \$	- - - 12,578 89		On-site Manager Reserves Management	\$ \$ \$	4,60 13,00
1 1 1 1 1 Total Scheduled Ren Laundry: Less Rent Concession Other Income:	0 0 0 0 0 0 1t:	\$0 \$0 \$0 \$0 \$0 \$0 \$0	* * * * * * * * * *	- - - 12,578 89 -		On-site Manager Reserves Management	\$ \$ \$	4,60 13,00
1 1 1 1 1 Total Scheduled Ren Laundry: Less Rent Concession Other Income: Monthly Scheduled (0 0 0 0 0 1t: 3ross In	\$0 \$0 \$0 \$0 \$0 \$0 \$0 \$0	\$ \$ \$ \$ \$ \$ \$ \$ \$ \$ \$ \$ \$ \$ \$ \$ \$ \$ \$	- - - 12,578 89 - 12,667		On-site Manager Reserves Management	\$ \$ \$	- 4,60 13,00 55,56
1 1 1 1 1 Total Scheduled Ren Laundry: Less Rent Concession Other Income: Monthly Scheduled G	0 0 0 0 1t: Aross Inc	\$0 \$0 \$0 \$0 \$0 \$0 \$0 \$0 \$0	\$ \$ \$ \$ \$ \$ \$ \$ \$ \$ \$ \$ \$ \$ \$ \$ \$ \$ \$	- - 12,578 89 - 12,667 152,008		On-site Manager Reserves Management *Total Expenses: Per Net Sq. Ft.: Expenses Per Unit:	\$ \$ \$ \$ \$	4,60 13,00 55,56 7.0 5,05

Scheduled Gross Income (SGI) = Total Monthly Income "Annualized"

Annualized Operati	ng Data		Cur	rrent Rents	3		
Scheduled Gross In	come:		\$	152 008			
Less Vacancy Bate F	Reserve:		\$	(4,560)	3.0% *		
Gross Operating Inco	ome:		\$	147,448			
Less Expenses:			\$	(55,563)	37% *		
Net Operating Incor	me:		\$	91.885			
Less Loan Payments	5:		\$	(69.089)			
Pre-Tax Cash Flow:			\$	22,796	3.9% **		
Plus Principal Reduc	tion:		\$	15,464			
Total Return Before	Taxes:		\$	38,260	6.6% **		
* As a percent of Sch	neduled Gr	ross Income.					
** As a percent of Dov	vn Paymer	nt.					
Scheduled Income		Curre	ent l	Rents		Annualized Expenses	
No.	Approx	Avg. Monthly	1	Monthly		Taxes (est. 1.125%)	\$ 18,563
of Units	Sq.Ft.	Rent/ Unit		Income		Other	\$ 2,600
10	0	\$1,110	\$	11,100		Insurance	\$ 3,000
1	0	\$1,478	\$	1,478		Repairs & Maintenance	\$ 5,000
1	0	\$0	\$	-		Utilities	\$ 8,800
1	0	\$0	\$	-		On-site Manager	\$ -
1	0	\$0	\$	-		Reserves	\$ 4,600
1	0	\$0	\$	-		Management	\$ 13,000
1	0	\$0	\$	-			
1	0	\$0	\$	-			
1	0	\$0	\$	-			
1	0	\$0	\$	-			
Total Scheduled Re	ent:		\$	12,578			
Laundry:			\$	89			
Less Rent Concession	on		\$	-			
Other Income:			\$	-			
Monthly Scheduled	Gross Inc	come:	\$	12,667		*Total Expenses:	\$ 55,563
Annual Scheduled	Gross Inc	ome:	\$	152,008		Per Net Sq. Ft.:	\$ 7.09
						Expenses Per Unit:	\$ 5,051

Vacancy Rate Reserve = Vacancy Rate % X SGI

Annualized Operating Data	Cur	rent Rents	
Scheduled Gross Income:	\$	152,008	
Less Vacancy Rate Reserve:	\$	(4,560)	<mark>3.0%</mark> *
Gross Operating Income:	\$	147,448	
Less Expenses:	\$	(55,563)	37% *
Net Operating Income:	\$	91,885	
Less Loan Payments:	\$	(69,089)	
Pre-Tax Cash Flow:	\$	22,796	3.9% **
Plus Principal Reduction:	\$	15,464	
Total Return Before Taxes:	\$	38,260	6.6% * *
* As a percent of Scheduled Gross Income.			
** As a percent of Down Payment.			

Gross Operating Income (GOI) = SGI - Vacancy Rate Reserve

Annualized Operating Data	Cur	rent Rents		
Scheduled Gross Income:	\$	152,008		
Less Vacancy Rate Reserve:	\$	(4,560)	3.0% *	
Gross Operating Income:	\$	147,448		
Less Expenses:	\$	(55,563)	37% *	
Net Operating Income:	\$	91,885		
Less Loan Payments:	\$	(69,089)		
Pre-Tax Cash Flow:	\$	22,796	3.9% **	
Plus Principal Reduction:	\$	15,464		
Total Return Before Taxes:	\$	38,260	6.6% **	
* As a percent of Scheduled Gross Incor	ne.			
** As a percent of Down Payment.				
Scheduled Income	Current I	Rents		Annualized Expenses

Total Expenses = Property Taxes + Ordinary Expenses + Capital Expense Reserves

Annualized Operatin	ig Data		Cur	rent Rents				
Scheduled Gross Ind Less Vacancy Rate R Gross Operating Inco	come: eserve: me:		\$ \$ \$	152,008 (4,560) 147,448	3.0% *			
Net Operating Incom Less Loan Payments: Pre-Tax Cash Flow: Plus Principal Reduct	ion:		» \$ \$ \$ \$	(55,563) 91,885 (69,089) 22,796 15,464 38,260	3/% ** 3.9% **			
* As a percent of Sche ** As a percent of Dow Scheduled Income	eduled Gi n Paymer	ross Income. nt. Curre	ent F	Rents	0.070	Annualized Expenses		
No. of Units	Approx Sq.Ft.	Avg. Monthly Rent/ Unit	r I	Monthly Income		Taxes (est. 1.125%) <mark>Other</mark>	\$ <mark>\$</mark>	18,563 <mark>2,600</mark>
10	0	\$1,110	\$	11,100		Insurance	\$	3,000
1	0	\$1,478	\$	1,478		Repairs & Maintenance	\$	5,000
1	0	\$0	\$	-		Utilities	\$	8,800
1	0	\$0	\$	-		On-site Manager	\$	-
1	0	\$0	\$	=		Reserves	\$	4,600
1	0	\$0	\$	-		Management	\$	13,000
1	0	\$0	\$	-				
1	0	\$0	\$	-				
1	0	\$0	\$	-				
1	0	\$0	\$	-				
Total Scheduled Rer	nt:		\$	12,578				
Laundry:			\$	89				
Less Rent Concession	n		\$	-				
Other Income:			\$	-				
Monthly Scheduled	Gross In	come:	\$	12,667		*Total Expenses:	\$	55,563
Annual Scheduled G	iross Inc	ome:	\$	152,008		Per Net Sq. Ft.:	\$	7.09
						Expenses Per Unit:	\$	5,051

We know what Ordinary Expenses are, but what are Capital Expenses?

Scheduled Income		Curre	ent I	Rents
No.	Approx	Avg. Monthly	I	Monthly
of Units	Sq.Ft.	Rent/ Unit		ncome
10	0	\$1,110	\$	11,100
1	0	\$1,478	\$	1,478
1	0	\$0	\$	-
1	0	\$0	\$	
1	0	\$0	\$	-
1	0	\$0	\$	-
1	0	\$0	\$	
1	0	\$0	\$	-
1	0	\$0	\$	-
1	0	\$0	\$	-
Total Scheduled Rei	nt:		\$	12,578
Laundry:			\$	89
Less Rent Concessio	n		\$	-
Other Income:			\$	-
Monthly Scheduled	Gross Ind	come:	\$	12,667
Annual Scheduled G	aross Inc	ome:	\$	152,008

U.S. companies report financials according to GAAP (Generally Accepted Accounting Principles), which are established by FASB (Financial Standards Accounting Board)

Under GAAP, Ordinary Expenses are "expensed" during the year the cost was incurred

Capital Expenditures add to the life of an asset and must be depreciated over a cost recovery period of years (useful life), so we reserve for these anticipated costs

Common examples of capital expenses:

Roof
Hot water boiler
Elevator

The reserve is a financial analysis recognition of an anticipated capital cost...the owner doesn't actually put money into an account that gets transferred upon sale

Here's an example... There's ten years of life left in the roof, and a new roof is \$60,000, what should be reserved each year for this anticipated cost?

\$60,000/10 years remaining = \$6,000 per year to be reserved

Net Operating Income (NOI) = GOI - Expenses

Annualized Operating Data	Cur	rent Rents		
Scheduled Gross Income:	\$	152,008		
Less Vacancy Rate Reserve:	\$	(4,560)	3.0% *	
Gross Operating Income:	\$	147,448		
Less Expenses:	\$	(55,563)	37% *	
Net Operating Income:	\$	91,885		
Less Loan Payments:	\$	(69,089)		
Pre-Tax Cash Flow:	\$	22,796	3.9% **	
Plus Principal Reduction:	\$	15,464		
Total Return Before Taxes:	\$	38,260	6.6% **	
* As a percent of Scheduled Gross Inco	ome.			
** As a percent of Down Payment.				
Scheduled Income	Current I	Rents		Annualized Expenses

Pre-Tax <u>Cash Flow</u> = NOI – Loan Payments

Summary	Current		Financing	
SummaryPrice:Down Payment35%Number of Units:Cost per Unit:Current GRM:Current CAP:Approx. Age:Approx. Lot Size:Approx. Gross SF:	\$1,650,000 \$577,500 11 \$150,000 10.85 5.57% 1957 7,884 7,841		Proposed Financing First Loan Amount: Terms: 30-yr Fixed Interest rate: Investment Highlights: Central Hollywood Pitched roof On site laundry (2) units Section 8	\$1,072,500 5.00%
Cost per Gross SF:	\$210.43			A a ch
Annualized Operating Data		Current Ren	ts	
Scheduled Gross Income: Less Vacancy Rate Reserve: Gross Operating Income: Less Expenses: Net Operating Income: Less Loan Payments: Pre-Tax Cash Flow: Plus Principal Reduction: Total Return Before Taxes: * As a percent of Scheduled G ** As a percent of Down Payme	ross Income.	 \$ 152,008 \$ (4,560 \$ 147,448 \$ (55,563 \$ 91,885 \$ (69,089 \$ 22,796 \$ 15,464 \$ 38,260 	3.0% * 3) 37% * 5) 3.9% ** 6.6% **	
Scheduled Income	Curr	ent Rents		Annualized Expenses

This is called "positive" cash flow, and it's very important

Total Return Before Taxes = Pre-Tax Cash Flow + Principal Reduction

Annualized Operating Data	Cur	rent Rents		
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** As a percent of Down Payment.				
Scheduled Income	Current I	Rents		Annualized Expenses

Total Rate of Return (ROR) = Total Return / Down payment

(This is also called the "Cash-on-Cash" Return)

The Cash-on-Cash Return is the ROR based upon the total return and the investor's actual cash outlay (down payment)

Summary	Current		Financing	
Price:	\$1,650,000		Proposed Financing	
Down Payment 35%	\$577,500		First Loan Amount:	\$1,072,500
Number of Units:	11		Terms: 30-yr Fixed	l de la construcción de la constru
Cost per Unit:	\$150,000		Interest rate:	5.00%
Current GRM:	10.85		Investment Highlights:	
Current CAP:	5.57%		Central Hollywood	
Approx. Age:	1957		Pitched roof	
Approx. Lot Size:	7,884		On site laundry	
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* As a percent of Scheduled G	ross Income.			
As a percent of Down Payme	nt.			-
Scheduled Income	Curr	ent Rents		Annualized Expenses

Debt Service Coverage Ratio DSCR = NOI/Loan payments

(The Debt Service is the total of the loan payments, principle + interest)

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* As a percent of Scheduled Gross Inco	me.		
As a percent of Down Payment.			
Scheduled Income	Current I	Rents	

In this example,

DSCR = \$91,885/\$69,089

DSCR = 1.33

Capitalization Rate (CAP Rate) = NOI/Price

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As a percent of Down Payme	nı.				
Scheduled Income	Curr	ent Re	ents		Annualized Expenses

The CAP Rate is analogous to a ROR (Rate of Return), which is commonly used to rate the performance of many types of investments

For example, if you invest \$100,000 into a CD (Certificate of Deposit) and your annual return (interest) is \$10,000...what is your ROR?

If your client invests \$1,000,000 into an apartment building and the net operating income is \$70,000...what is the CAP Rate?

A building is listed for \$10M and the net operating income is \$500,000

What is the CAP Rate?

Get to know the average "CAP Rates" within the market areas you serve

Gross Rent Multiplier (GRM) = Price/SGI

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* As a percent of Scheduled G	ross Income.				
As a percent of Down Payme	nt.				
Scheduled Income	Curr	ent R	lents		Annualized Expenses

Therefore, using algebra... Price = GRM X SGI

Which means...the Price is expressed by the GRM in "multiples" or "orders of magnitude" of the annual income

GRM is a function of:

PriceIncome

CAP Rate is a function of:

Price
Income
Expenses

Investor Success



Questions?



