Real Estate **Forecasting**

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What is Commercial Real Estate?

Retail Properties
Strip malls

Multi-family housing
Garden style

Office Buildings
CBD

Hotels
Full service
Ltd service

Industrial
Warehouses
Heavy mfg.

- **Medical**
- **Student housing**
- **Self-storage**
- **Mobile parks**
- **Senior living**

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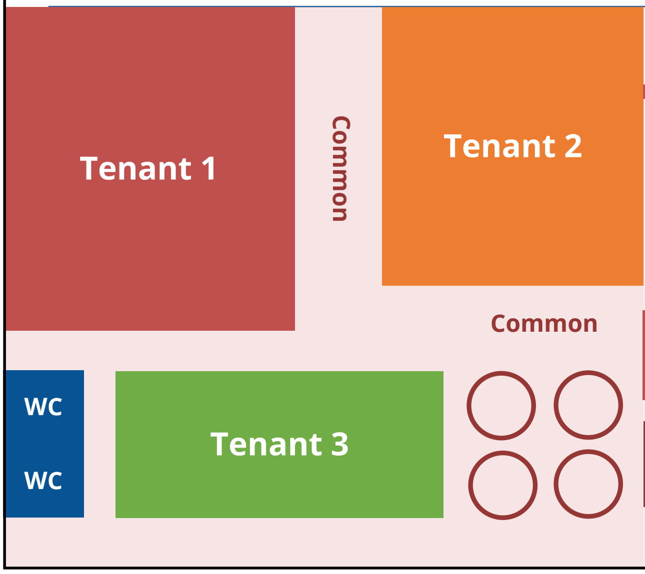
Space is a Big Driver of Value



Square Feet (meters) = L x W

Gross Building Area = Total interior floor area

Gross Leasable Area = Total usable floor area

Net Leasable Area = Floor area that can be leased to tenants

Common Area:
Restrooms, lobbies, eating area, electrical/elevator, parking

Rental Revenue =
Market Price per Sq Foot (Meter) x Net Leasable Area

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Forecasting is More Complex for Larger Properties

McDonald Williams, LLC

$39 sq/ft 6/1/2018 – 5/21/2027

FLOOR PLATES
Gross sq ft of each floor

STACKING PLAN
Shows details of each tenant on each floor

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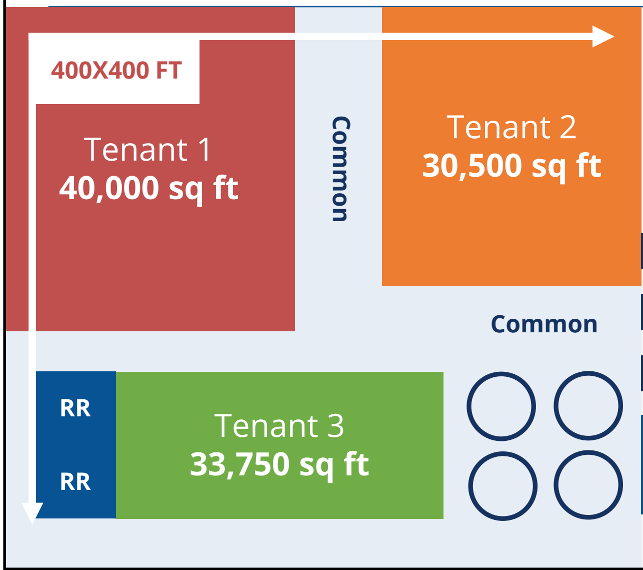
Pro Rata Measurements



Gross Leasable Area = 160,000 sq ft

Net Leasable Area = 104,250 sq ft

Common Area = 55,750

Tenant 1 pro rata = 38.3%

Tenant 2 pro rata = 29.3%

Tenant 3 pro rata = 32.4%

Important for calculating a tenant's share of operating expenses!

Types of Commercial Real Estate Leases

Triple Net (NNN)

Tenants **reimburse property owner** for all operating expenses (maintenance, security, utilities, insurance taxes). This is done on a **pro rata basis**.

Full Service Gross (FSG)

Landlord is **responsible for all expenses.**
"Base Year Stop" refers to the tenant paying a **pro rata share** of the **increase in opex after year 1.**

Modified Gross (MG)

Specific expenses are **reimbursed by tenants** such as metered utilities, janitor, and water. May use **base year stop** for taxes, insurance, and parking.

RE Modeling is Cash Flow Modeling

+	Rental Revenue
+	Other Income
-	Operating Expenses
=	Net Operating Income (NOI)
-	Capex
=	Unlevered Cash Flow
-	Debt Service
=	Levered Cash Flow

No real need **to forecast balance sheet** since we are dealing with **one asset**. **Sources** and **Uses table** is helpful.

Net Operating Income (NOI): Used by investors for valuation and lender for sizing loan

Unlevered Cash Flow: Used to determine ability to service debt

Levered Cash Flow: Used to determine returns to investors

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Forecasting Revenue

RETAIL/OFFICE/INDUSTRIAL
Market rent per sq ft X Net Leasable Area

MULTI-FAMILY
Market rent per sq ft X Units

GROSS POTENTIAL RENT (GPR)

LESS

Vacancy, model units, free rent, concessions

Forecast by number of units or % of GPR

LESS

Contractual rent loss to non-payment

Forecast by number of units or % of GPR

=

NET RENTAL REVENUE

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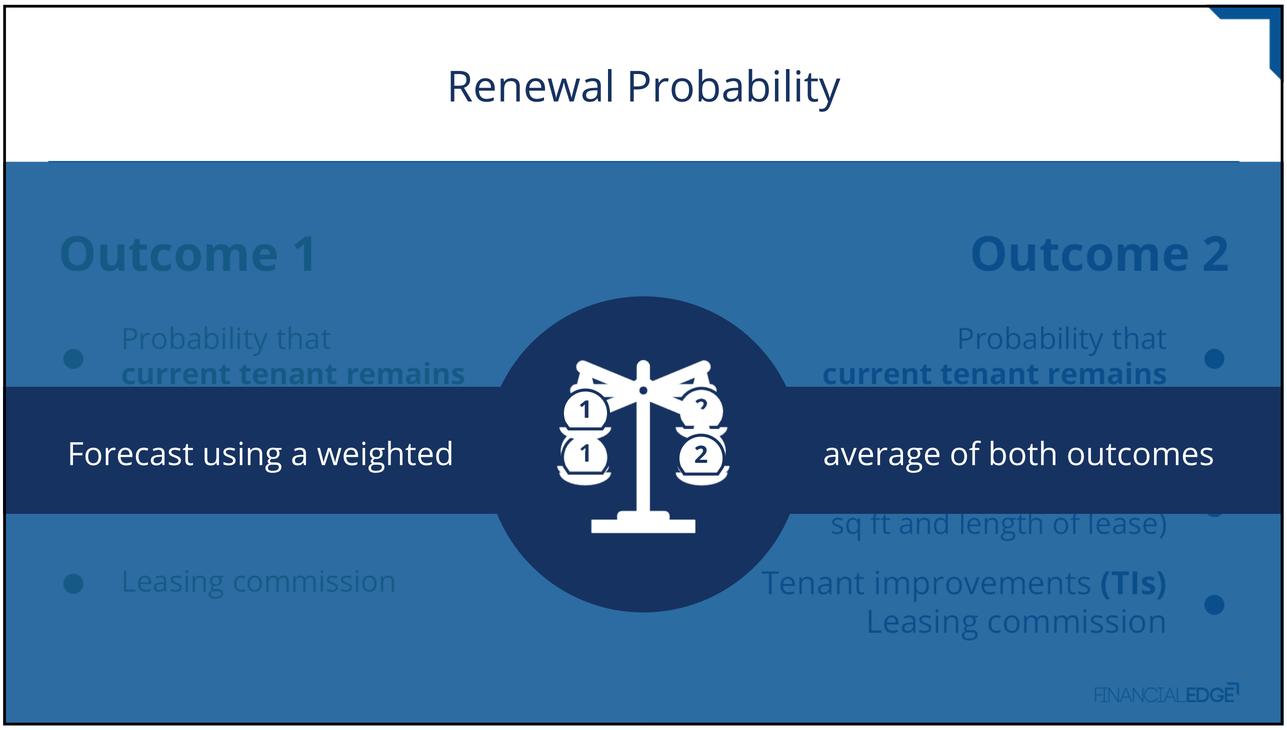
Renewal Probability
Outcome 1
Probability that
current tenant remains
Forecast using a weighted
Leasing commission
Outcome 2
Probability that
current tenant remains
average of both outcomes
sq ft and length of lease)
Tenant improvements (TIs)
Leasing commission
1
1
2
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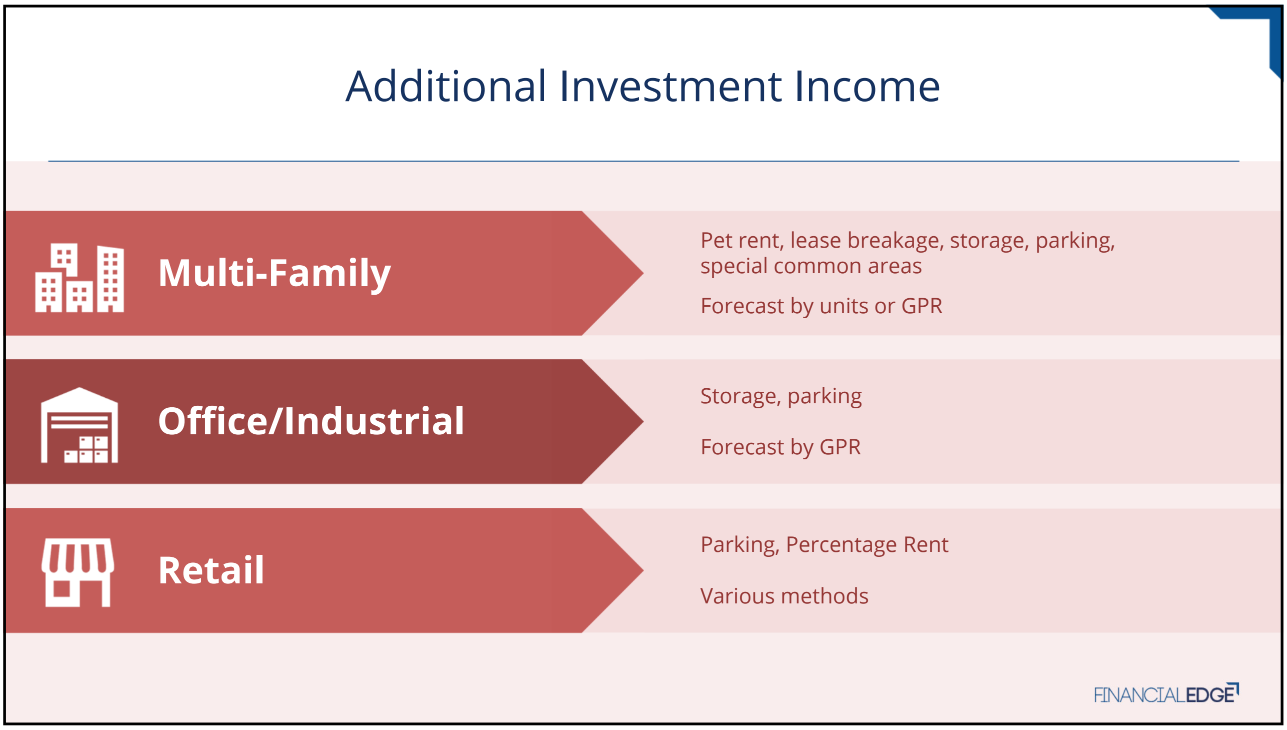
Additional Investment Income
Multi-Family
Pet rent, lease breakage, storage, parking, special common areas
Forecast by units or GPR
Office/Industrial
Storage, parking
Forecast by GPR
Retail
Parking, Percentage Rent
Various methods
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Percentage Rent for Retailers

Retailers
(in high traffic shopping centers)

Pay rent + **% of Revenues**

Landlord

Natural breakpoint: Annual base rent/Breakpoint %

(Tenant sales – breakpoint)*Breakpoint % = Percentage Rent

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Operating Expense Categories

Controllable	Non-controllable	Utilities	Property Mgmt.
Repairs **Maintenance** **Marketing** **Admin** **Janitorial** **Security**	**Property Taxes** (local jurisdictions establish amount and timing), **Insurance** (affected by geography, natural disaster, etc,)	**Separately metered in newer buildings, pro rata share in larger or older buildings.** **Multi-family buildings also use RUBS system (ratio utility billing system)**	**Day to day management of the building; typically outsourced but can come from within operating company**

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Expense Forecast Dependent on Lease Type

NNN Lease

($000)	Year 1
NET RENTAL REVENUE	**1,670.4**
Ancillary income	112.7
Expense Reimbursement	96.0
EFFECTIVE GROSS REVENUE (OR INCOME)	**1,879.1**
Repairs, maintenance	(28.8)
Property management fee	(19.2)
Utilities	(48.0)
TOTAL OTHER INCOME (EXPENSE)	**(96.0)**
Net operating income	1,783.1

Expense reimbursement should approximate **total opex**

FSG or MG

($000)	Year 1
NET RENTAL REVENUE	**1,721.4**
Ancillary income	112.7
Expense Reimbursement	41.8
EFFECTIVE GROSS REVENUE (OR INCOME)	**1,875.9**
Repairs, maintenance	(28.8)
Property management fee	(19.2)
Utilities	(48.0)
TOTAL OTHER INCOME (EXPENSE)	**(96.0)**
Net operating income	1,779.9

Expense reimbursement **less than total opex.** Revenues slightly higher as **expenses included in rent**

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Capital Expenditures

1. **Tenant Improvements (TIs)** — To attract new tenants, landlords offer upgrades or improvements to allow the tenant to customize according to needs. This can be anything from delivering a white shell space to providing funds for a buildout. Typically paid on a per sq ft basis
2. **Lease Commissions** — Operational Incentive to brokers to fill vacancies with tenants. These are typically paid-up front based on % of contractual net rent revenue. Renewals pay a smaller commission. owner
3. **Construction** — Construction expenses to renovate, improve or expand a building. These go beyond maintenance and are considered long term in nature. They also can add value to a building
4. **Reserves** — Project Manager / Funds set aside for future or planned construction projects Group

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What About Taxes?

+ Rental Revenue

+ Other Income

- Operating Expenses*

= Net Operating Income (NOI)

- Capex

= Unlevered Cash Flow

- Debt Service

= Levered Cash Flow

*Property Taxes

Pass-through earnings

Various investor groups and Individuals are responsible for taxes on cash returns or dividends

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