

TRANSLATING THE FINANCIAL MODEL INTO FINANCIAL STATEMENTS

Example #1:

Where the CRE Asset is an Investment Property

CONTEXT

Flintstone Partners show you the essential snapshots from the financial model of their latest CRE deal – acquisition of a residential apartment building meant for leasing.

They are the GPs* to this project.

Flintstone has already formed an SPE^ called – Serene Homes Series LLC that will carry on the business of owning and managing this investment property.

CRE Type	Multifamily Apartment Building
Deal Type	Core plus Acquisition
Investment Holding Time	5 years
Business Model	Buy-Operate-Sell

They need help in drawing up a projected 3-part financial statements out of the inputs from their financial model

*GP: General Partner/ Sponsor/ Promoter/ Deal Originator/ Investment Manager

^LP: Limited Partner/ The various investors that subscribe to the deal and contribute a major chunk of the equity capital, say – 70-100%



SNAPSHOTS FROM THE FINANCIAL MODEL

I SOURCES AND USES OF FUNDS

All Amounts in Million USD

		[#] <u>Year 0</u>	<u>Year 1</u>	<u>Year 2</u>	<u>Year 3</u>	<u>Year 4</u>	<u>Year 5</u>
<u>Uses</u>							
Acquisition Costs	97.74%	60.60	-	-	-	-	-
Closing Costs	0.48%	0.30	-	-	-	-	-
Total Project Cost (without Financing)	98.23%	60.90	-	-	-	-	-
Lender Reserves	1.16%	0.72	-	-	-	-	-
Financing Costs	0.61%	0.38	-	-	-	-	-
Total Uses/ Project Cost (with Financin	100.00%	62.00	-	-	-	-	-
<u>Sources</u>							
Equity	38.71%	24.00	-	-	-	-	-
Debt	61.29%	38.00	-	-	-	-	-
Total Sources	100.00%	62.00	-	-	-	-	-

#Year 0 ~ Month 0 ~ Date of Financial Closure:

the date by which a legally binding commitment is received from the Equity Investors as well as the Debt Lenders to provide funds for the Project. This is the date by which the Equity investors put down a major chunk, atleast 90% of their contribution into the Project.

SNAPSHOTS FROM THE FINANCIAL MODEL

II LIFETIME CASHFLOWS

All Amounts in Million USD

		<u>Year 0</u>	<u>Year 1</u>	<u>Year 2</u>	<u>Year 3</u>	<u>Year 4</u>	<u>Year 5</u>
A <u>Investment Cashflows</u>							
Project Cost (with Financing)		-62.00	-	-	-	-	-
(+) Debt raised		38.00	-	-	-	-	-
Equity Investment		-24.00	-	-	-	-	-
B <u>Operating Cashflows</u>							
Rental Income (net of concessions)		-	5.22	5.65	6.23	6.35	6.48
Other Income		-	0.23	0.28	0.32	0.32	0.33
Total Potential Income		-	5.45	5.93	6.55	6.67	6.81
General Vacancy & Credit losses		-	-0.41	-0.38	-0.39	-0.40	-0.41
Effective Gross Revenue	EGR	-	5.04	5.55	6.16	6.27	6.40
Operating Expenses		-	-1.76	-1.87	-1.96	-1.99	-2.03
Net Operating Income	NOI	-	3.28	3.68	4.20	4.28	4.37
GP Fees		-0.15	-0.23	-0.23	-0.23	-0.23	-0.61
Capital Reserves		-	-0.05	-0.06	-0.06	-0.07	-0.07
Cashflow from Operations	CFO	-0.15	3.00	3.39	3.91	3.98	3.69
Debt Service		-	-2.40	-2.40	-2.40	-2.40	-2.40
Interest		-	-1.81	-1.78	-1.75	-1.72	-1.68
Principal repaid		-	-0.60	-0.63	-0.66	-0.69	-0.72
Cashflow After Financing	CFAF	-0.15	0.60	0.99	1.51	1.58	1.29

SNAPSHOTS FROM THE FINANCIAL MODEL

II LIFETIME CASHFLOWS

All Amounts in Million USD

C Exit Cashflows (Sale of CRE Asset)	Year 0	Year 1	Year 2	Year 3	Year 4	Year 5
Gross Sale Proceeds	-	-	-	-	-	68.00
Selling Costs	-	-	-	-	-	-0.68
Net Sale Proceeds	-	-	-	-	-	67.32
Lenders Reserves refunded	-	-	-	-	-	0.72
Loan Proceeds	-	-	-	-	-	-34.72
Net Proceeds for Equity	-	-	-	-	-	33.32
Net Equity Cashflows	-24.15	0.60	0.99	1.51	1.58	34.61

III PARTNERSHIP CASHFLOWS

	Capital Contribution Ratio	Year 0	Year 1	Year 2	Year 3	Year 4	Year 5
Contribution from LPs	95%	-22.94	-	-	-	-	-
Contribution from GP	5%	-1.21	-	-	-	-	-
		-24.15	-	-	-	-	-
Distribution to LPs		-	0.57	0.94	1.43	1.50	32.53
Distribution to GP		-	0.03	0.05	0.08	0.08	2.08
		-	0.60	0.99	1.51	1.58	34.61
Net Equity Cashflows		-24.15	0.60	0.99	1.51	1.58	34.61
Net Distribution ratio (including Promotes to the GP)							
LP			95%	95%	95%	95%	94%
GP			5%	5%	5%	5%	6%
			100%	100%	100%	100%	100%

SNAPSHOTS FROM THE FINANCIAL MODEL

IV ADDITIONAL INPUTS

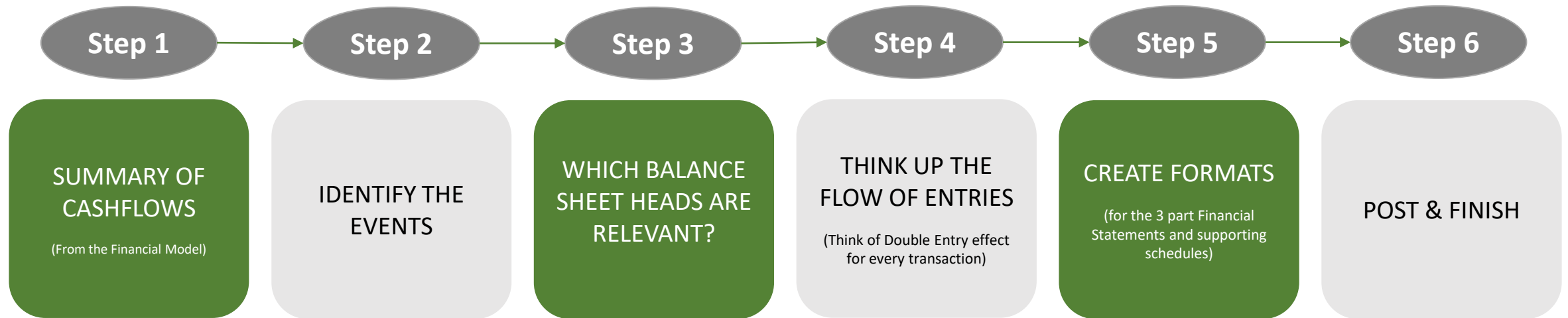
	<u>Year 0</u>	<u>Year 1</u>	<u>Year 2</u>	<u>Year 3</u>	<u>Year 4</u>	<u>Year 5</u>
A Fair Market Value* of the Property		60.50	62.00	64.00	66.00	68.00

Basis - Likely market cap rates

B Debt Schedule

	Interest Rate: 4.75%	<u>Year 0</u>	<u>Year 1</u>	<u>Year 2</u>	<u>Year 3</u>	<u>Year 4</u>	<u>Year 5</u>
Beginning Balance	Term: 360 Months	-	38.00	37.40	36.78	36.12	35.44
Capital Draw		38.00	-	-	-	-	-
<u>Repayment through</u>		-	0.60	0.63	0.66	0.69	35.44
Debt service		-	0.60	0.63	0.66	0.69	0.72
Final payoff		-	-	-	-	-	34.72
Ending Balance		38.00	37.40	36.78	36.12	35.44	-
<u>Debt Service</u>			2.40	2.40	2.40	2.40	2.40
Interest		-	1.81	1.78	1.75	1.72	1.68
Principal repayments		-	0.60	0.63	0.66	0.69	0.72

6 STEPS TO THE PROJECTED FINANCIAL STATEMENTS



Let's look at the first 5 steps closely. We can handle the 6th one in the excel.

Step 1

Cashflow Model Summary

A. INVESTMENT CASHFLOWS:

Property Acquisition Cost
Closing Cost
Lender Reserves
Financing Cost

TOTAL PROJECT COSTS

FUNDED BY -

Equity
From GP
From LP
Debt

B. OPERATING CASHFLOWS:

Rental & Other Incomes
(-) Vacancies and Credit losses
(-) Operating Expenses
(-) Capital Reserves

CASHFLOW FROM OPERATIONS

(-) Debt Service
Interest
Principal repaid

CASHFLOW AFTER FINANCING

Distributions to LP
Distributions to GP

C. EXIT CASHFLOWS:

Sale Proceeds of CRE Asset
(-) Selling Costs
(+) Lender Reserves received back
(-) Outstanding loan paid back

NET PROCEEDS FOR EQUITY

Distribution to LP
Distribution to GP

Step 2

Major Events

Purchase of CRE Asset
- Investment Property

Escrow deposit paid to Lenders
against Debt

Equity Invested

Debt Raised

Incomes

Expenses

Debt repaid

Sale of CRE Asset
- Investment Property

Escrow deposit received back

Equity Distribution

Step 3

Relevant Accounting Heads

BALANCE SHEET

Liability Heads

Debt

Equity

Asset Heads

Investment Property

Restricted Cash: Lender
Reserves

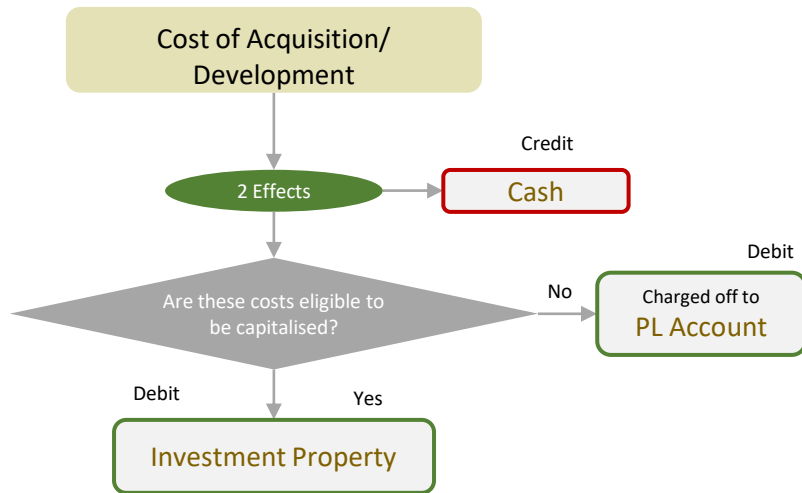
Cash

Step 4

Flow of Entries

CRE Asset as Investment Property: Acquisition | Annual Restatement | Sale

ACQUISITION/ DEVELOPMENT OF THE INVESTMENT PROPERTY



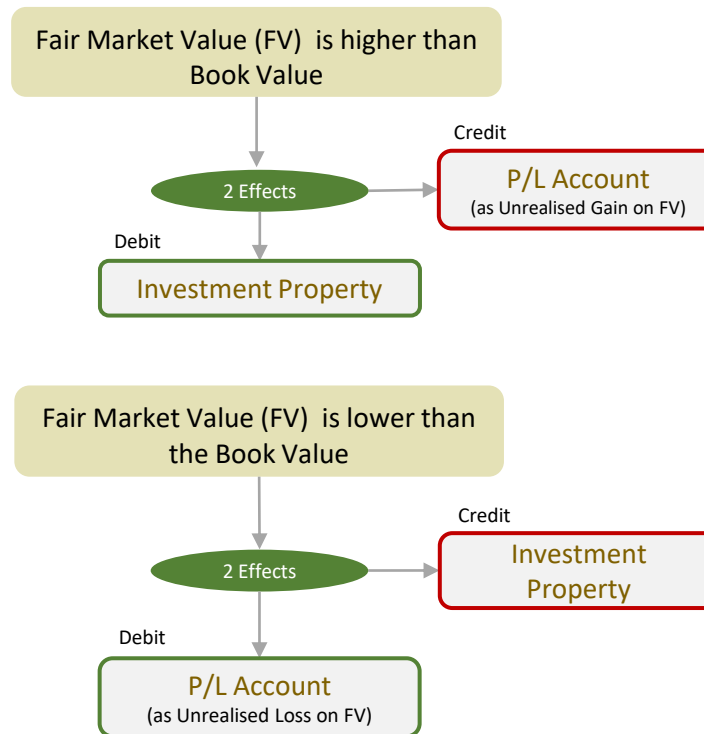
Project Costs eligible for capitalisation:

Where property is developed: Land Cost, All Construction related Hard and Soft Costs, Financing Fees, Interest accrued during construction.

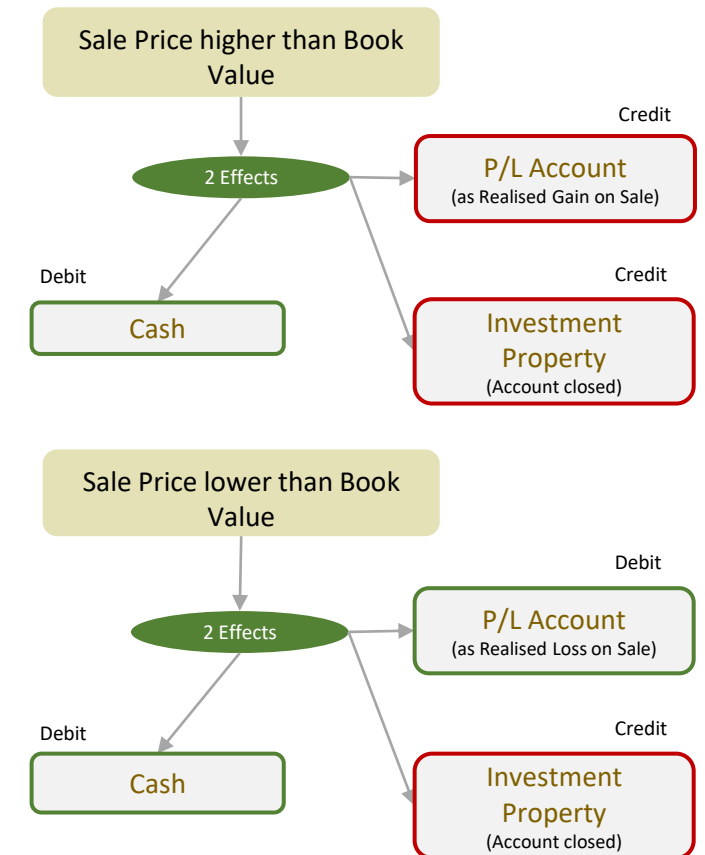
Where property is purchased: Purchase cost, Closing costs, financing fees.

Ineligible Project related Costs such as Marketing costs, general and admin expenses are **written off to PL account**.

RESTATEMENT IN THE BALANCE SHEET AT EVERY PERIOD-END



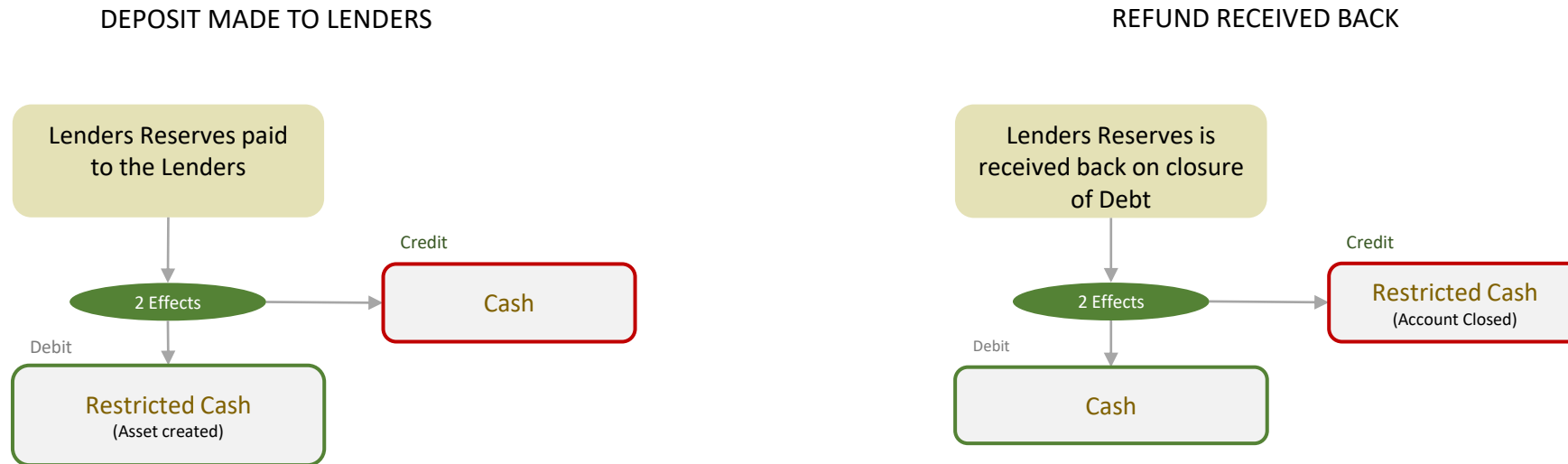
SALE AT THE END OF THE HOLDING PERIOD



Step 4

Flow of Entries

Lender Reserves*: Deposit to the Lenders | Refund at the closure of Debt



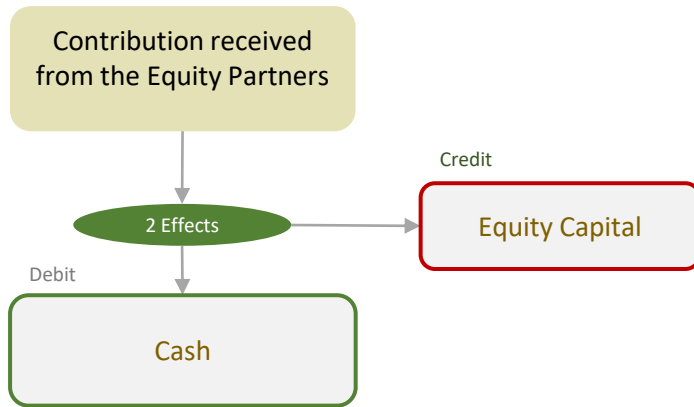
***Lender Reserves:** Cash balance held in escrow by the lenders as a security against a potential default on part of the borrower to service the debt on time.

Step 4

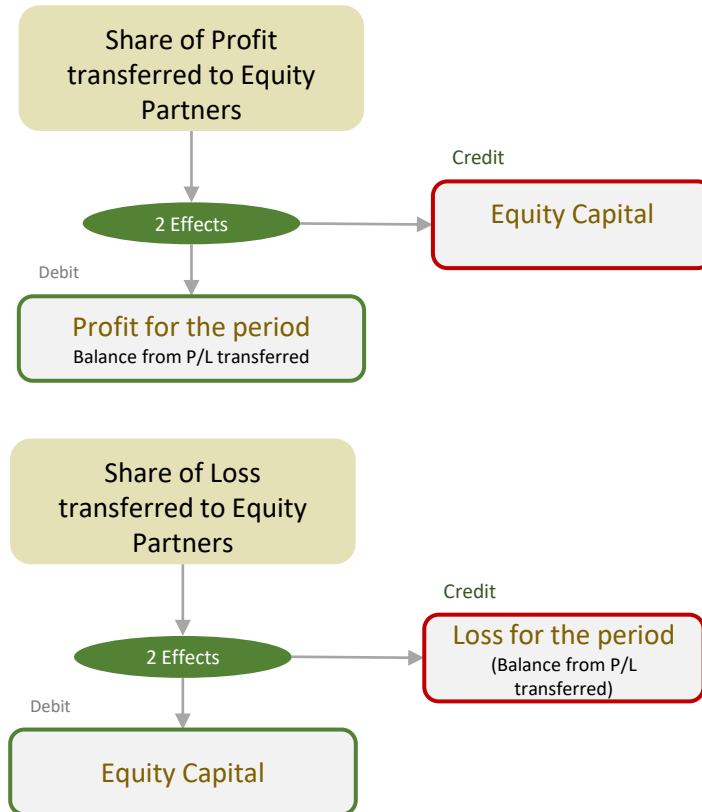
Flow of Entries

Equity Transactions: Contribution | Share of Profit/(Loss) | Distribution

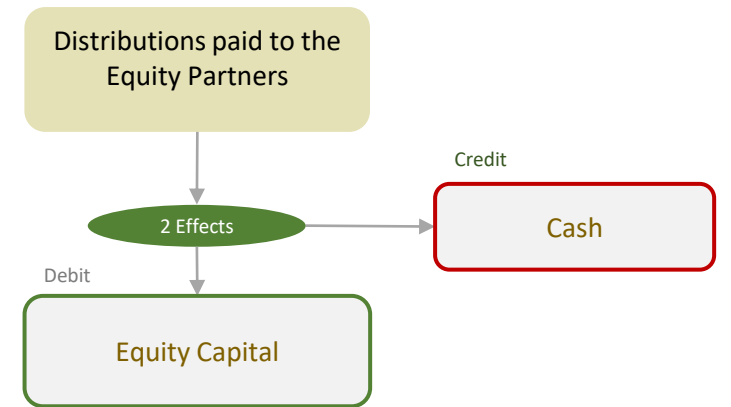
CAPITAL RECEIVED



SHARE OF PROFITS/ LOSSES



DISTRIBUTIONS PAID

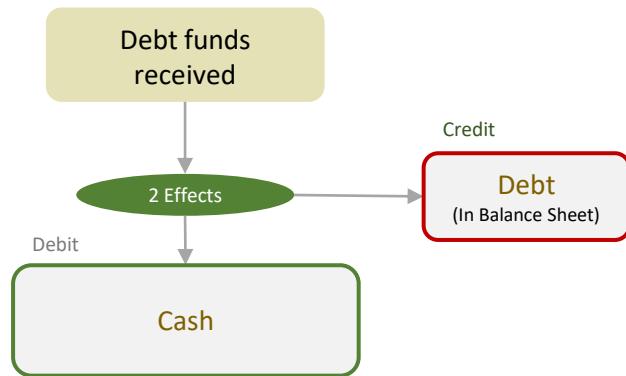


Step 4

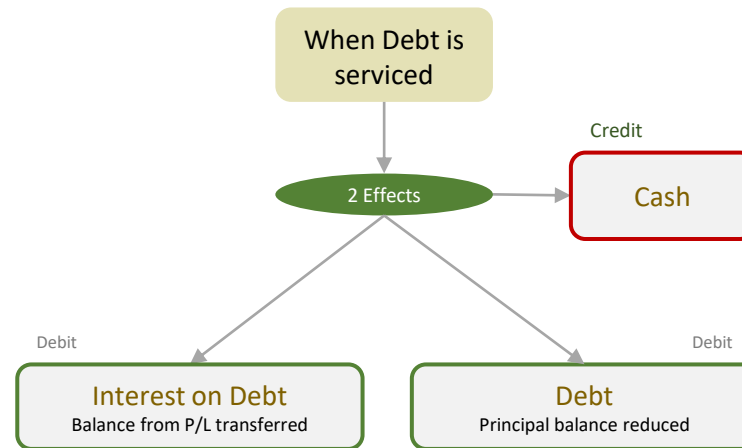
Flow of Entries

Debt Transactions: Debt raised | Debt Service | Outstanding balance repayment

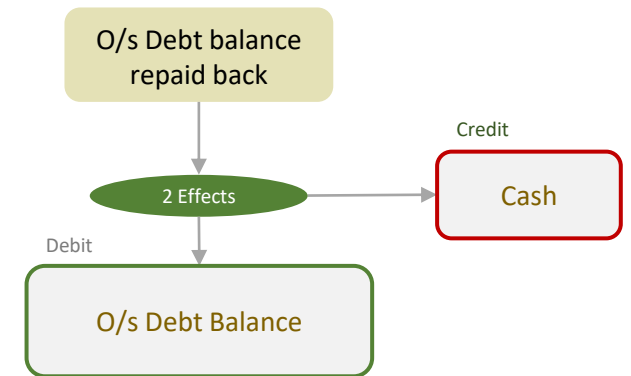
CAPITAL RECEIVED



DEBT SERVICE



DISTRIBUTIONS PAID

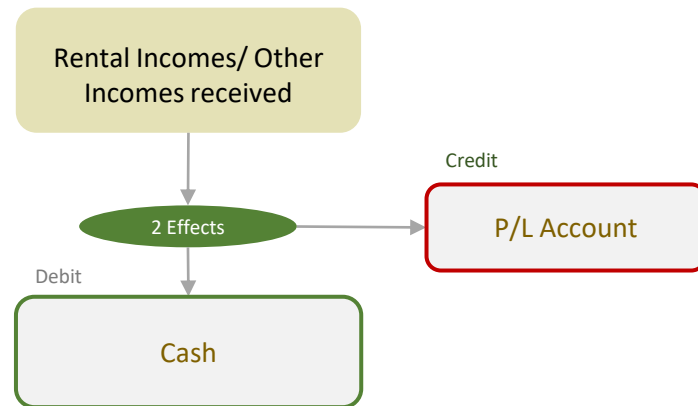


Step 4

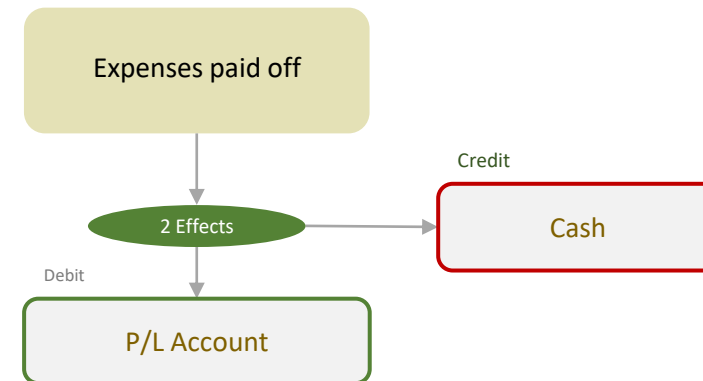
Flow of Entries

Operations: Incomes and Expenses

RECORDING INCOMES IN THE P/L ACCOUNT



RECORDING EXPENSES IN THE P/L ACCOUNT



There's No Debtors or Creditors here !!

Since we are directly drawing up the balance sheet from the cash based financial model, we are **ignoring the accrual principle**.

In the real world, Income is recorded in books when it becomes due, by creating a corresponding asset - "Accounts Receivable" in the balance sheet. Cash is received against this "Accounts Receivable" balance.

Step 5

CREATE FORMATS

Balance Sheet

Assets

Investment Property
 Restricted Cash:
 Lender Reserves
 Cash Balance

Assets Total

Liabilities & Equity

Debt
Equity
 LP Equity
 GP Equity

Liabilities & Equity Total

Equity Schedule

LP Equity

LP Capital: Beginning balance
 Share of Net Profit/(Loss)
 Contributions
 Distributions

LP Capital: Ending balance

GP Equity

GP Capital: Beginning balance
 Share of Net Profit/(Loss)
 Contributions
 Distributions

GP Capital: Ending balance

Profit/ Loss Account

Income

Rental Income
 Other Income

Total Income

Expenses

Bad debts (Credit & Vacancy losses)
 Operating Expenses
 GP Fees
 Repairs & Maint. (Capital Reserves)
 Selling Costs

Total Expenses

EBITDA

[-] Interest Expenses
 [+/-] Gain/(Loss) on FV (unrealised)
 [+/-] Gain/(Loss) on sale (realised)

Profit Before Tax

[-] Income tax expenses

Profit After Tax

Attributable to Equity Partners -

LPs
 GPs

Total

Cashflow Statement

A. Cashflow from Operating Activities

Net Profit/(Loss) before tax (from P/L)
 (+) Loss on Fair value (Unrealised)
 (-) Gain on Fair value (Unrealised)
 (+) Loss on Sale (realised)
 (-) Gain on Sale (realised)
 (-) taxes paid

Cashflow from Operating Activities

B. Cashflow from Investing Activities

Acquisition
 Disposition
 Lender reserves held
 Lender reserves released

Cashflow from Investing Activities

C. Cashflow from Financing Activities

Debt raised
Debt repaid
 Debt service
 Final payoff
 LP Equity Contribution
 GP Equity Contribution
 LP Equity Distribution
 GP Equity Distribution

Cashflow from Financing Activities

Net Cashflows during the year

Cash: Beginning balance

Cash: Ending balance

2 Ways to calculate CASHFLOW FROM OPERATING ACTIVITIES: Direct Method and Indirect Method

As per Direct Method –

Cash Incomes minus Cash Expenses = Cashflow from Operating Activities.

As per Indirect Method –

Take Net Profit Before Tax :

Add back: Non cash expenses such as Depreciation/ Unrealised losses, etc..

Less: Increase in Current Assets and Decrease in Current Liabilities (These are Cash Outflows)

Add: Decrease in Current Assets and Increase in Current Liabilities (These are Cash Inflows)

Less: Tax expense actually paid.

Indirect Method is a preferred method because it ensures that we don't miss out on anything.

In the real world, there is always cash as well as credit components of Incomes and Expenses.

Indirect Method makes sure that we capture the exact & Complete Cashflows from Operations.

Step 5

CREATE FORMATS

Investment Property

Investment Property

Beginning Balance

[+] Purchase

[+/-] Gain/(loss) on FV (unrealised)

[+/-] Gain/(loss) on sale (realised)

[-] Sale

Ending Balance

Lender Reserves

Lender Reserves

Beginning Balance

[+] Cash held by Lenders

[-] Cash released back by Lenders

Ending Balance

Debt

Debt Schedule

Beginning Balance

Capital Draws

Repayment

Debt Service

Final Payoff

Ending Balance

To Your Success -
Padmaa Iyer

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