

DODGING PROFORMA PITFALLS

Newsletter of Iowa Realty Commercial



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A photograph showing a person in a dark suit and white shirt sitting at a desk. Their right hand holds a black pen over a document, while their left hand holds a small white model house with green window frames and a red roof. A laptop is partially visible on the right side of the desk.

MAXIMIZING REAL ESTATE PROFITS STRATEGICALLY

Dear Esteemed Clients,

Proformas... Love them or hate them, they are part of the real estate investing landscape. I have opened dozens of potential deals with the promise of double digit returns only to find unrealistic improvement plans, vacant units producing zero income and mandatory expense items not included at all. Sometimes I'd prefer to just skip the headache altogether but then I remind myself that within all the noise, some clients have found amazing opportunities. Value-add investors in particular need to hone their skills on underwriting, estimating and verifying the accuracy and veracity of proforma claims. Let's explore common proforma pitfalls.



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REAL ESTATE REALITY CHECK

1. Unrealistic rental increases and “easy” income that hasn’t been realized

When you see something similar to “units are rented for \$1,000/mo but market rent is \$1,400/mo” in an offering memorandum or proforma, a warning light should start going off in your head. If you were an owner or property manager of let’s say a 48 unit property, would you let an “easy” \$19,200/mo just slip away? Doubtful. Take extra effort to verify. What is the quality of the units? What is the tenant turnover? What are neighboring properties renting for? Are there different amenities in neighboring properties? Call multiple brokers, property managers and even call on apartments for rent to confirm the market rent.

2. Low expenses or Omitted expenses

Expenses and expense ratios can have a large impact on Net Operating Income. Omitting expenses or low estimates on expenses can skew NOI and change the entire financial outlook of a property. For small multifamily, the most common item I see omitted is a property management expense. Be aware of this for smaller self-managed properties. Even if you plan on self-managing as well, it’s best to add in the expense for underwriting. The most newly prevalent underestimated expense is INSURANCE. Insurance premiums and building replacement costs have both significantly increased in the past two years. There’s a good chance the property you are looking at is underinsured and a new policy is going to cost you more. Other items to verify are lawn care, snow removal, trash, repairs and maintenance.

3. New development or renovation plans

Adding units, creating income producers (garages, storage units, laundry) and changing buildings to a highest and best use can be a great value-add proposition. Two of the top media stories affecting real estate investing are ADU’s (additional dwelling units) and multifamily conversions.

If you are considering a project that has one of these aspects don't forget to think about the following.

- You MUST be on the same page with your local ordinances and planning/zoning departments. Most have specific rules for where and when you can do the above projects.
- Make sure you are working closely with your contractors, builders and/or civil engineering firms. Some projects, like an office to multifamily conversion or adding more units might look great on paper but the actual costs can add up quickly.
- YOU are going to have to do the work to realize these value-add projects or increase in NOI, not the seller. Don't overpay for the potential of a project if you don't have to.

Proformas can be a useful tool to show the future performance and potential of a property. That being said, I don't often see Proformas produced by a listing broker that I would truly call "conservative". Stay disciplined in your underwriting and evaluation of properties and you should be able to avoid this Proforma Pitfalls.

Thank you for joining us on this insightful journey through the nuances of real estate investment. We hope these insights empower you to navigate the complexities of proforma analysis with confidence. Should you have any further questions or insights to share, feel free to reach out.

Best wishes,

Joanne M. Stevens and Dan Dempsey

CONFIDENTIAL Market
Evaluation of your property

Contact us for a FREE

WHAT IS YOUR PARK WORTH?

I am always happy to do a FREE, NO OBLIGATION, Real Estate Review for your park(s). You ought to know today's market value of your real estate investments.

If this is something you would like, simply give me a call at 319-378-6786, email me at joannestevens@iowarealty.com, or visit <http://joannemstevens.com/>

Joanne Stevens is a specialist in listing and selling mobile home parks and manufactured housing communities throughout the U.S. With her 20 plus years of experience in developing, zoning, owning, retailing, managing, turning around and brokering parks, she can maximize your sale price.