



Downtown Toolkit
Head Lease Financial Template
Guide

Contents

Capital Investment.....	4
Capital Investment Budget.....	4
Predevelopment Costs	4
Inputs.....	5
Construction/Retrofit Costs	5
Inputs.....	5
Construction Insurance	6
Inputs.....	6
Contingency Budget10%.....	6
Input	6
Operating Revenue and Costs	7
Rental Income – Residential.....	7
Inputs.....	8
Rental Income – Commercial	8
Inputs.....	8
Auxiliary Revenue	9
Inputs.....	9
Operating Costs	10
Maintenance	10
Inputs.....	10
Utilities and Services	10
Inputs.....	11
Inputs.....	11
Inputs.....	11
Property Taxes	12
Inputs.....	12
Property Insurance	12
Inputs.....	13
Property Management	13
Inputs.....	13
Project Financing and Capital Reserves	15
Project Funding	15

Inputs.....	15
Financing Costs – operations	16
Inputs.....	16
Head Lease Payment.....	16
Inputs.....	17
Capital Reserves.....	18
Inputs.....	18
Loan/Bond Repayments	18
Inputs.....	18
Financial Viability – Cashflow	19

Capital Investment

Capital Investment Budget

Predevelopment Costs	\$ xx
Construction/Retrofit Costs	\$ xx
Construction Insurance	\$ xx
Contingency	\$ xx
Total Capital Investments	<u>\$ xx</u>

Predevelopment Costs

Every action and task done on a project before breaking ground (construction/retrofit) is considered predevelopment. As such, a wide range of activities and their associated costs are involved in predevelopment. It is an iterative process and details compound with each step of the site and building design. Often the most challenging aspect of any project is getting it to the point where it is construction/retrofit (“shovel”) ready. Once construction begins, there will inevitably be challenges, although the bulk of land entitlement, official plan/zoning amendments and any social/political opposition will have already been dealt with.

Predevelopment costs will vary widely based on the scope and location of the project. It’s critical to budget appropriately for the predevelopment costs in the early stages of the project.

Listed below are the most common costs associated with predevelopment. This list is not exhaustive as each project will have its own unique set of requirements to make the project construction ready.

1. Site selection and land acquisition (not applicable for properties already owned or leased).
2. Feasibility study – to determine the viability of the project, including the market for rental units, environmental impact, zoning/compliance and preliminary financial feasibility.
3. Design and Engineering – architectural, engineering, blueprints, etc.
4. Legal fees - real estate transactions, zoning compliance checks.
5. Permits and approvals - municipalities have their own unique set of requirements before a project is approved. These include studies/reports and municipal permit and development fees. Producing the required studies/reports often requires hiring consultants. Common permits, approvals, assessments, reports/studies include:
 - o Environmental assessments I and potentially II.
 - o Site plan approval.
 - o Erosion control and stormwater.
 - o Parking limits and driveway permits.
 - o Traffic impact studies.
 - o Utility connection permits.
 - o Grading/land disturbance permits.
 - o Flood/stream/wetland impact permits.

- Lighting permits.
- Building permits.

Note: Most municipalities have a preapproval process that allows developers an opportunity to present an initial development concept. Generally, this is circulated to the various departments within the municipality for comments and feedback. This process provides an initial assessment of what official plan and/or zoning amendments (if any) are required and highlights any studies/reports required before approval is granted and construction can begin.

Inputs

Estimated cost for each: Study, Report, Assessment, Permit, Development Fee, etc.

Predevelopment Costs Formula: Summation of Input Costs

Construction/Retrofit Costs

How to calculate construction/retrofit costs?

1. Measure the total area of the project.
2. Determine the type of construction/retrofit (residential, commercial).
3. Check the material costs – consider supply chain availability, inflation, tariffs.
4. Calculate labour costs – one of the most significant expenses.
5. Include finishing costs – appliances and fixtures, etc.
6. Government and approval costs (those not in predevelopment).
7. Use a cost per square foot formula – by using the findings in the above cost calculations.
8. Contingency (10% is a standard)

A general contractor/developer will provide a construction/retrofit quote by giving a cost per sq/ft. amount.

Inputs

- **Cost per sq/ft to construct/retrofit**
- **Total sq/ft of project**

Construction Cost Formula

Cost per sq/ft X sq/ft of project = Construction Cost

Construction Insurance

Obtaining construction insurance is highly recommended. Such insurance covers both hard and soft costs associated with a construction project, which should include general liability.

Those offering construction insurance often have online links to obtain a quote. Alternatively, insurance brokers will assist in obtaining a quote for construction insurance.

Inputs

- **Total amount of construction costs**
- **Number of years (or part thereof) of construction period**

Construction Insurance Formula

Each \$1 million of construction = \$1,000 X number of construction years

Contingency Budget10%

A standard contingency budget is 10% of the construction/retrofit costs. It's a cushion to address the risk associated with construction/retrofit projects – such as the complications in the scope of the project, inflation in material costs, labour disruptions/rate increases and other cost overruns and time delays.

Depending on the specific outcomes of the project, spending the contingency budget ranges from zero to more than 10%. If the contingency budget is not sufficient to cover the budgeted overruns, the total project budget is to be revised.

Input

- **Total Construction Budget**

Contingency Budget Formula

Total Construction Budget X 10% = Contingency Budget

Operating Revenue and Costs

Statement of Operations

Revenue

Rental income – residential	\$ xx
Rental income – commercial	\$ xx
Auxiliary revenue	\$ xx
Total Operating Revenue	\$ xx

Operating Costs

Maintenance	\$ xx
Utilities and services	\$ xx
Property taxes	\$ xx
Property management	\$ xx
Total Operating Costs	\$ xx

Net Income from Property Operations	\$ xx
--	--------------

Rental Income – Residential

Determining rental income from residential units has both quantitative and qualitative elements.

The steps to calculate rental income from residential units:

1. The number of rental units for the project.
2. The type of rental unit and the number of units (bachelor, 1 bd, 2 bd, 3 bd, etc.).
3. The number of market rental units and the rental rate per unit for each type of unit.
4. The number of attainable (workforce) rental units and the rental rate per unit for each type of unit.
5. The number of deeply affordable rental units and the rental rate per unit for each type of unit.

How to determine rental rates for residential units?

- Research the local rental market by unit type (bachelor, 1 bd, 2 bd, 3 bd, etc.).
- Analyze comparable rental listings.
- Factor in the demand for each unit type.
- Refer to data provided by CMHC, real estate associations and local NGOs for rental rates for the various unit types.
- Adjust rental rates accordingly to comply with funder and municipal criteria. This becomes applicable when financing and/or approvals have been granted to provide attainable or deeply affordable housing units.

Note: CMHC uses 30% of before tax income to determine affordability for individuals and families. Whereas municipalities often use 80% of the average market rents to determine attainability/affordability.

Inputs

- Number of each type of unit (bachelor, 1-bd, 2-bd, 3-bd, etc.)
- Monthly rental rates for each type of unit

Rental Income Residential Formula

# of bachelor units	X	market rate	= Residential Income (sub total)
# of 1-bd units	X	market rate	= Residential Income (sub total)
# of 2-bd units	X	market rate	= Residential Income (sub total)
# of 3-bd units	X	market rate	= Residential Income (sub total)
# of bachelor units	X	attainable rate	= Residential Income (sub total)
# of 1-bd units	X	attainable rate	= Residential Income (sub total)
# of 2-bd units	X	attainable rate	= Residential Income (sub total)
# of 3-bd units	X	attainable rate	= Residential Income (sub total)
# of bachelor units	X	affordable rate	= Residential Income (sub total)
# of 1-bd units	X	affordable rate	= Residential Income (sub total)
# of 2-bd units	X	affordable rate	= Residential Income (sub total)
# of 3-bd units	X	affordable rate	= Residential Income (sub total)
		X	12

= Total Annual Residential Income

Rental Income – Commercial

Commercial leases generally consist of three components:

- Base Rent price per sq/ft.
- Operating costs allocation of total cost based on per sq/ft. of leased space.
- % of gross income for retail space in a percentage lease.

Inputs

- Number of commercial units
- Per sq/ft of each commercial unit
- Base rent per sq/ft for each commercial unit
- Total operating costs for commercial space on the property
- If percentage lease:
 - Estimated gross sales
 - Percentage rate of gross sales

Rental Income - Commercial Formula (for each commercial unit)

Per sq/ft rent X sq/ft space leased = Base Rent

Operating costs	/	% commercial space leased	= Cost Recovery
Gross retail sales	X	% of gross sales rate	= Gross Sales Rent

Auxiliary Revenue

Auxiliary revenue encompasses all income derived from services beyond basic rental income. This source of revenue is not about ‘nickel and diming’ residents, rather it’s about offering perceived genuine enhancements to the residents’ living experience. Each project will have its unique opportunities for auxiliary revenue. The list below are some examples auxiliary revenue:

- Laundry services
- Parking fees
- Storage facilities, including bikes
- Vending machines
- Cable and internet
- Key deposit/replacement
- Credit and reference verification fees.

Inputs

- **Estimated revenue for each service offered**

Auxiliary Revenue Formula: **Summation of Revenue Inputs**

Operating Costs

Maintenance

There are three primary systems used in apartment maintenance – predictive, preventative and reactive maintenance. The system approach taken will impact on the costs of maintenance in the short medium and long term. Examples of maintenance items include:

- HVAC, plumbing, electrical maintenance
- Safety checks
- Building repairs
- Exterior and preventative maintenance

Inputs

- **Total amount of rent – residential**
- **Total amount of base rent -commercial**

Maintenance Cost Formula:

- **2% of total residential and commercial rent (new properties)**
- **4-5% of total residential and commercial rent (5-10-year-old properties)**

Utilities and Services

Standard utilities include electricity, water/sewage and gas (natural or propane). They can also include Internet and cable.

To determine the cost of utilities, consideration must be given as to whether each unit's utilities are metered separately, and therefore the tenant is responsible for paying these charges. If this is so, then only the non-metered utilities for the common areas are considered as operating costs. New construction and retrofit projects should consider having separate utility metering built in for each unit. The assumption for this template is that utilities are paid for by tenants.

In scenarios where this is not the case, residential rents are adjusted to account for the cost of utilities.

Electricity charges are calculated by kilowatt hours and are often priced at varying rates for off-peak, mid-peak or on-peak hours.

Water rates are calculated based on usage by cubic meters. The rate increases when usage thresholds are reached.

Sewage Service Rates are calculated based on water usage and a fixed charge.

Other building services include:

- Landscaping

- Snow removal
- Pest control
- Cleaning services
- Garbage collection
- Regular inspections (fire alarms/extinguishers, carbon monoxide testing)

Service costs are specific to each property depending upon the services required. Calculate the total dollar amount of service costs and divide by the number of units. This results in the service cost per unit.

Inputs

- **Cost per kilowatt hour for off-peak, mid-peak and on-peak**
- **Kilowatt hour usage for off-peak, mid-peak and on-peak**
- **Amount of flat rate delivery charge**

Utilities – Electricity Formula

kWh used (off-peak)	X	cost per kWh	= electricity charge
kWh used (mid-peak)	X	cost per kWh	= electricity charge
kWh used (on-peak)	X	cost per kWh	= electricity charge
Flat Rate Delivery Charge			= <u>electricity charge</u>
			Total Electricity Charges

Inputs

- **Cost per cubic meter for water usage 1**
- **Cost per cubic meter water usage 2**
- **Flat rate meter size service charge (monthly)**
- **Cost per cubic meter sewage usage 1**
- **Cost per sewage cubic meter usage 2**
- **Flat rate (monthly)**

Utilities – Water/Sewage Charges Formula

Cubic meter usage 1	X	cost per usage 1	= consumption charge
Cubic meter usage 2	X	cost per usage 2	= consumption charge
Meter Size Service Charge (flat rate based on size)			= service charge (x12)
Sewage Service	X	cost per usage 1	= consumption charge
Sewage Service	X	cost per usage 2	= consumption charge
Fixed Month Charge	X	flat rate	= <u>service charge (x12)</u>
			Total Water/Sewage Charges

Inputs

- **Estimated cost for each service required**
- **Total cost of all services required**

- **Number of rental units**

Services Cost Formula

$$\text{Service cost per unit} \times \text{Number of Units} = \text{Service Costs}$$

Property Taxes

The amount of property taxes are calculated using several variables:

- The current value assessment (CVA) – determined by a Municipal Property Assessment Corporation (MPAC).
- Municipal or Regional Tax Rates – approved by Council.
- Educational Tax Rate – set by the Government of Ontario.
- Additional levies – approved by Council (infrastructure, special projects, etc.).

Note: There is a lag time in CVA when new construction or retrofit has occurred on the property. Using a prior property tax statement will not accurately reflect the amount of property taxes charged after construction/retrofit.

Inputs

- **Previous CVA + construction costs = Estimated CVA**
- **Tax rate approved by Council**
- **Educational tax rate set by Ontario Government**
- **Additional tax rate approved by Council (if applicable)**

Property Tax Formula

Estimated CVA	X	Council tax rate	= property tax
Estimated CVA	X	education tax rate	= property tax
Estimated CVA	X	additional tax rate	= <u>property tax</u>
			Total property tax

Property Insurance

It's advisable that the terms of the lease/rental agreement, for both residential and commercial, requires tenants to have adequate insurance and to provide proof of such insurance.

In Ontario, on average, landlord insurance will cost approximately 15% -25% more than a standard homeowners policy. There are many factors that set property insurance costs for landlords. These include:

- Size and age of the rental property.
- The location of the rental property.

- Security features such as smoke detectors and burglar alarms.
- Long or short-term rental/lease agreements.
- Claims history.

Ontario landlords, on average pay between \$1,450 to \$1,550 per year, per unit for insurance on a rental property.

Inputs

- **Estimated annual insurance premium per unit of rental property**
- **Number of units on the rental property**

Property Insurance Formula

Annual premium per unit ~ \$1500 X number of units = property insurance

Property Management

Property management fees depend on several factors. These include the location of the property, the estimated billable hours for providing the services, and the level of landlord property management involvement. The property management fee is often set as a percentage of rental income – typically between 6% - 12%. When rental incomes are low, often the management fee is a flat rate for the property or calculated as a flat rate per unit.

In head lease arrangements, property management fees could be reduced or eliminated with property net operating profits/cashflow going to the lessor of the head lease in lieu of property management fees. Such terms and conditions are set out in the lease agreement.

Property management services ordinarily include:

- New tenant placement
- Eviction charges
- Vacant unit charges
- Maintenance management
- Miscellaneous – inspections, advertising

Inputs

- **Rental income amount**
- **Percentage charge rate for property management**
- **Flat rate charge for property management**

Property Management Formula

Rental income amount X % rate OR = property management fee

Flat rate charge = property management fee
OR
Net operating income/cashflow = ...property management fee

Project Financing and Capital Reserves

Project Funding

Government grants	\$ xx
Grants from non-government sources	\$ xx
Capital fundraising campaign	\$ xx
Landlord investment	\$ xx
Loans from government sources	\$ xx
Loans from commercial sources	\$ xx
Community bonds	<u>\$ xx</u>
Total Capital Investment	<u>\$ xx</u>

Financing Cost – operations

Government loan interest	\$ xx
Commercial loan interest	\$ xx
Community bonds interest	<u>\$ xx</u>
Total Financing Cost	<u>\$ xx</u>

Head Lease Payment	<u>\$ xx</u>
---------------------------	---------------------

Capital Reserves	<u>\$ xx</u>
-------------------------	---------------------

Loan/Bond Repayments

Principle repayment of government loans	(\$ xx)
Principle repayment of commercial loans	(\$ xx)
Maturing par value of community bonds	<u>(\$ xx)</u>
Cashflow Requirement	<u>(\$ xx)</u>

Project Funding

In the predevelopment phase of a development, the project must ‘pencil out.’ This means that the amount of project funding secured is sufficient to cover the capital investment (budget) of the project. Otherwise, the project is not viable due to insufficient capital to complete and the project will not move forward.

Inputs

- **Terms and conditions of government funding from all levels – amount of grants, loans, other contributions**
- **Terms and conditions of all non-government funding – amount of grants, loans, and other contributions**
- **Amount to be raised through capital fundraising campaigns**

- Amount of landlord contribution
- Amount to be raised in community bond campaigns

Project Funding Formula

Summation of Project Funding Inputs = Capital Investment = project budget

Financing Costs – operations

These are financing charges that are accounted for in the Statement of Operations of the property. They include loan interest payable to all levels of government, commercial lenders, community bond holders and other potential financial lenders to the project.

Inputs

- Terms and conditions of government loans (from all levels)
- Terms and conditions of all non-government loans
- Terms and conditions of community bonds

Financing Cost Formula

Government loan amount (1,2, 3+)	X ...interest rate	= Loan interest
Non-government loan amount (1, 2, 3+)	X... interest rate	= Loan interest
Community Bonds (series A, B, C +)	X... interest rate	= <u>Loan interest</u>
		Total Financing Costs

Head Lease Payment

A head lease is a contractual arrangement between two parties. The basic concept is that a property owner with empty or underutilized space (lessor) signs a long-term lease with the head tenant (lessee) as property manager of that property or rental space. The timeframe, head lease payment amount and other details are to be set out in the terms of the head lease agreement.

The lessee/property manager is responsible for all aspects of the project.

- Preparing capital budgets.
- Securing project funding.
- Preparing operating budgets.
- Property management for the rental space covered by the head lease.
- Financial management of the rental space covered by the head lease.
- Payments to the lessor (property owner) under the terms of the head lease.

Inputs

- **Terms of the head lease agreement**

Head Lease Payment Formula = \$ amount set out in head lease agreement

Capital Reserves

A capital reserve plan is a property management tool that every property owner should have in place. It ensures that there is sufficient money available to replace/repair roofs, windows, balconies, appliances, mechanical equipment, paved surfaces and other significant capital assets.

There are guides and software available to develop capital reserve policies and best practices. Property management providers and other professionals can assist in determining the appropriate amount to allocate to capital reserves.

Inputs

- **Capital assets identified for reserve allocation**
- **Useful life in years of capital assets identified**
- **Estimated cost to replace/repair at end of useful life of the asset**

Capital Reserve Formula

Estimated cost to replace/repair **capital asset**
Divided by: **# of years of useful life**
Equals: **Annual Capital Reserve Amount**

***** Repeat for each capital asset with a reserve *****

Annual Capital Reserve Amount **= Summation of all capital asset reserves**

Loan/Bond Repayments

Each loan, whether government or commercial, will have a unique set of terms and conditions. Community bonds will have a prospectus (investor package) that outlines all the terms and conditions of the bond investment.

For both loans and community bonds, the length of term, the interest rate and when interest and principal are to be repaid are the most important factors in determining the cashflow impacts – a critical factor to determine whether the project is financially viable or not.

Inputs

- **Terms and conditions of government loans, commercial loans and community bonds.**

Loan/Bonds Repayment Formula

Repayment terms/schedule for all loans/bonds **= Total cashflow requirement**

Financial Viability – Cashflow

Net Income from Property Operations	\$ xx
Less: Financing Costs	(\$ xx)
Net Income from Property Operations	<u>\$ xx</u>
Less: Capital Reserves	(\$ xx)
Less: Head Lease Payment	(\$ xx)
Less: Loan/Bond repayment amounts	<u>(\$ xx)</u>

Net Cashflow from Property Operations **\$ xx**

The above cashflow schedule should be prepared for the first five years of a project and often longer to align with the term-length of the loan and community bond agreements.

Assessing financial viability, of a project, is an iterative process. This financial template is a tool to help assess financial viability at an early predevelopment stage. Although, it's not a 'one-and-done' process. As new or revised information becomes available, template inputs are adjusted according.

This financial template will continue to be a useful tool for determining financial viability throughout the predevelopment stage of the project. Government agencies and commercial lenders, and those issuing community bonds have their own financial viability templates to be completed before providing funding toward the project.

Once completed, this financial template is a valuable assessment tool. It provides the preliminary information necessary to decide whether to proceed with a project's development and continue the process of engaging with external stakeholders, funders, governments and the public.

These are exciting times!