Social Purpose Real Estate Toolkit

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Introduction

Real Estate is about reconfiguring a piece of land to meet the needs of people using it. There can be a lot of players involved and a long-term commitment required for making a real estate idea a reality.

This toolkit guides readers from not-for-profit organizations through the process of purchasing real estate – from planting an idea to finalizing the purchase of a property – in fifteen steps. These steps are organized into four key stages of the real estate journey. The process doesn't stop when the property is bought and it is important to know about managing and maintaining a property. However, these later stages are not a part of this toolkit.

The steps covered in the toolkit are most applicable to projects that involve the purchase and renovation of existing buildings, rather than projects involving the construction of new buildings.

This toolkit is intended for readers who have little experience with real estate, but who are considering undertaking a project of their own that is relatively small scale (being under $5 million). The content of this toolkit is geared towards not-for-profit organizations that are currently leasing space and interested in pursuing social purpose real estate – owning property for the primary benefit of the community. This toolkit looks closely at how to analyse the financial viability of the project.

The toolkit should be used as an introduction, helping to provide an idea of what to expect through the real estate journey and whether an organization is ready to embark on it. It is not a substitute for professional guidance (real estate advice, financial planning, legal advice, etc).

The process of purchasing real estate is dependent on the local zoning and regulatory context. Different municipalities, cities and regions will have different processes, regulations and bylaws. This toolkit is a guideline based on the Vancouver context; however, it will be generally applicable for people and organizations across Canada and the United States.

The real estate process takes time and patience to complete, undertaking the right actions at the right time. The entire process can take between two years and ten years to complete, depending on the scope of the project and the capacity that your organization has to undertake the increased responsibility of becoming an owner of real estate.

Lastly, there is a lot of jargon in real estate. At the end of this toolkit is a list of important terms to know, and which will help explain many of the terms used throughout the toolkit.

Let's get started….

First Stage: Assessing Organizational Readiness

This section of the toolkit will help your organization determine its capacity to take on a real estate project, as well as evaluate if owning a real estate asset will be beneficial or detrimental to your mission. While owning a real estate asset can seem exciting and the ‘right thing to do’ it is not for everyone – it is necessary to assess your financial and organizational capacity to do so.

Step 1 Idea Conception

Time to complete: six months to two years

A real estate idea is a flexible picture of how a property can become something that helps to accomplish the mission of your organization.

Having access to a significant amount of capital (money) is one of the most critical parts to making a real estate idea become a reality. As a not-for-profit organization that is probably already stretched for financial resources to provide programming and service work, this can be very challenging. You probably need to start saving money years, if not decades, in advance in order to accumulate enough liquid cash to purchase and adapt a property to suit your needs.

Your first step should be to set up a savings account with a financial institution and start looking for potential sources of money. Over time, these savings will grow into a financial asset that can be leveraged by your organization to undertake a project – it will become your down payment.

Owning real estate requires a long-term commitment of significant resources, and will certainly increase your responsibilities. It is important to carefully consider how real estate relates to your organization’s mission and if owning real estate will help or hinder your ability to meet your mission. Mission drift can be a very real possibility if the work of maintaining a real estate asset starts taking you off focus of your main mission.

Real estate is an “illiquid” asset. That means, simply, that the property may be worth a large amount of money, but this money is not easily accessible and therefore cannot easily be used for your organization’s various other needs (like program funding or staff salaries, for example).

It is important that your organization is financially stable and that it has a strategic vision about future programs before moving ahead with a real estate project.

You must evaluate the differences between leasing and owning. Leasing usually allows you more flexibility; for example, if you need to move to gain more space or to downsize if a program ends. Owning, however, can help to shield your organization from increasing rents and provide security of tenancy. The best option depends on the mission of your organization and the way it operates.

Questions to Answer:

- Where are the current pitfalls of your leasing or renting situation? How would a real estate investment help to alleviate these issues (or exacerbate them)?
- What would owning real estate mean to the organization? What effect would ownership (and the associated new responsibilities) of real estate have on the work done?
- How might the organization benefit from owning real estate? How would it constrain the organization?
- What are the resources available to the organization in order to undertake a real estate project? For example, do you have some equity for a down payment? Do you have the staff resources and capacity to undertake feasibility planning? Have you connections with real estate professionals?
- How can the organization leverage its current resources?
- What contributions are other people and organizations prepared to make? For example, cash for a down payment, in-kind assistance (design work, legal fees), mentorship of real estate process.

Start mapping out your dream in rough, using your the answers to the above, but at this point, do not get caught up on details. Talk about your dream with others and start looking for people who are interested, and have conversations with people who are doing related work.

Most importantly, do not fall in love with a building and try to build a dream around it; this is the most common mistake that other not-for-profits have made in the past. Dreaming is good, but dream about what might be possible, and not about how to fit your vision into a building that happens to be available right now.

Idea Conception Checklist:

- ✓ Start saving money for a down payment.
- ✓ Begin creating a contact list of folks who can help you out and what they can offer to the project.
- ✓ Developing a visual mind map is useful for showing how people will be connected.
- ✓ Put together a resource list – past research studies, planning documents

If you find out that a dream is not possible, then it's back to the drawing board to think of a new idea. While this can be frustrating, remember that this is the easiest time in the project to reconsider or start over – better now than a couple years down the line with much more money and time invested in a project with no possibility of becoming a reality.

Step 2 Financial Profile

Time to complete: one month to three months

Owning real estate is a major financial commitment. As an organization, you must be in a financially healthy position before any plans are made to purchase a property.

At the same time you are thinking about how real estate will affect your mission, you must be looking into the financial profile of your organization. This usually means working with an accountant to better understand your fiscal circumstances.

Questions to Answer:

- What are your organization's revenue sources? How secure are they?
- Is your organization a charity? Could it be eligible for charitable status? How could other funds be generated?
- What are your organizational expenses? What are fixed costs associated with programming? What are variable costs? Are there opportunities for efficiencies?
- What are total rental expenses for the organization? What are the details of your current lease (who pays for space improvements, operating costs, when does the lease expire)?
- Will you still be able to cover all current expenses if revenues change?
- What are your organization's assets? Liabilities?
- What is the liquidity of assets? Could they be sold and used to pay for something else?

By completing this research first, you will better understand what your organization can afford. This financial profile will help you to establish realistic expectations for what could be possible through a real estate project and whether or not real estate acquisition is an appropriate venture. It should be used to underpin all ideas and decision-making throughout the real estate process.

It is important to clearly understand what your organization can afford, before you start to even think about potential locations. In the preliminary stages of the real estate process, it is important to keep the vision grounded in the financial realities of the organization.

This means working backwards from your financial profile, and using it to inform what could be possible in a real estate project. What are the specific expectations for money coming in and money going out? In accounting terms, this is called a pro forma.

A pro forma analysis will help your organization take its financial profile and understand what type of real estate project you could hypothetically afford – without having any specific building in mind.

Putting together a spreadsheet is the best way to have all of the numbers in the same place and to be able to see how these numbers are interrelated. You will begin by making assumptions and must provide justification for each of these. For example, Listed below are the numbers that you must provide, as well as justify why you are using them.

Proforma Checklist:

- ✓ Current rent paid by organization (amount that could be used to make mortgage payments)
- ✓ Equity available (down payment)
- ✓ Requested Loan Amount
- ✓ Mortage Conditions – interest rate, amortization, term, loan to value ratio
- ✓ Debt to Credit Ratio (DCR)

From a risk perspective, the DCR is the most important number. It shows the relationship between income and debt. Credit unions and banks will usually lend money at a 1.2 DCR. The lower this number, the higher the risk that your organization will not have enough money to cover the mortgage payment should circumstances change (interest rates go up for example).

With this pro forma, you can analyze the project and find out other key figures.

Analysis Checklist:

- ✓ Net Operating Income (NOI)
- ✓ Maximum Loan the project can support
- ✓ Annual Debt Service
- ✓ Cash Flow
- ✓ Funding Gap

The NOI is the money that you effectively bring in every year from the project. It is all the revenue minus all the expenses – not including mortgage payments.

The Cash Flow is the money left over after you pay the Annual Debt Service (mortgage payments). It is your cushion. Cushion is important because circumstances may change and you have to be prepared to pay more than you initially expected.

The Funding Gap shows if the income generated by the property is sufficiently high, given the Annual Debt Payments. This number is connected with DCR. The project could have a positive Cash Flow, but still have a Funding Gap because the difference in income and mortgage payments is too low for the lenders comfort. If this is the case, you will need to increase the down payment or negotiate for a second unconventional mortgage – which will have a higher interest rate.

Since the real estate process takes a long time to complete and financial circumstances can change suddenly, it is important that you update your financial profile frequently and re-evaluate how it links back to your real estate vision.

Second Stage: Developing an Organizational Plan

This section will help you determine your organization's needs now and in the future, and how a new space will help meet those needs. The section also considers all the planning that is required in order to evaluate these needs, including for example architectural programming and fundraising. This stage is essentially about the 'what' and the 'how'.

Step 3 Fundraising Program

Time to complete: six months to six years

Your real estate vision will not happen without money up front to purchase the building and undergo needed renovations. Money can come from your organization, government and non-governmental funding groups, private investors, and lending institutions.

Usually, the largest amount will come from a lending institution in the form of a mortgage, which you will have to pay back over time. You will need equity, or a down payment, which is usually 25% of the total appraised value of the project.

As a not-for-profit, your organization likely does not have large sums of money available or at least easily accessible for a down payment. Therefore, you will need to fundraise the required amount.

As already stated, starting to save money and establishing a fundraising program should be one of the first steps you take in the real estate process. You will need to fundraise throughout the entire journey and will likely continue raising money even after the mortgage is secured and the offer to purchase is formally closed.

It is a good idea to set up a trust fund or savings account in which you can deposit financial contributions for the project. This should be done at the very beginning of the process, even before the initial real estate idea is worked out. As already stated, the largest barrier to any real estate project is having the required capital available to support the purchase and renovation of a property. The sooner you start saving, the larger the financial resource your organization will have available to finalize and close upon an offer to purchase.

Make sure that if your organization has charitable status that you consider ways to use that status to provide tax-creditable receipts to potential donors – there may be opportunities related to the purchase of the building (a tax receipt to the vendor) or some other forms of receipting. Someone with a financial background – perhaps from your lending institution – can help you think of creative structures that might make use of your charitable status.

It is important for any organization considering a real estate purchase to understand the implications of accumulating capital (down payment money) on its balance sheet, as there are current interpretations (Summer 2012) by the Revenue Canada Agency that cast concerns about how much savings charitable organizations can accumulate.

If you are setting aside funds in a saving account for the future purchase of a building, it will be in your best interest to seek a legal opinion from a charity lawyer about how much to save, and how to describe that savings (i.e. board-restricted building fund) so that you don't run the risk of losing your status because you have accumulated deemed excessive or non-accidental surpluses.

Step 4 Functional Programming

Time to complete: three months to one year

At this stage, you are narrowing down the information that will help to determine the purpose of the real estate project and where it might be physically located. You should involve staff members and clients from your organization in this process. These people will provide valuable feedback on how they currently use space and how they would like to use space in the future. You should produce a written document that can be shared with professionals and other people who may be involved in later stages of the project.

A functional program is different than an architectural program. The latter is focused on specific design details and is completed further down in the real estate process. A functional program attempts to match the needs of the organization with its general needs for space.

You must define your property criteria (e.g. target area, size of building, special features). A good functional program will help your organization avoid committing to a building that does not truly meet your needs.

Questions to Answer:

- Who are you (organization)?
- What do you do?
- Who are your users/customers?
- How do they currently use space?
- How would they like to use space?

There are professional consultants that can help guide you through this process. Sometimes, grants and loans provided by local foundations or government agencies can help cover the costs of hiring professional consultants.

Functional Program Checklist:

- ✓ Community issues
- ✓ Site selection criteria
- ✓ Building orientation
- ✓ Hours of operation
- ✓ Peak usage times
- ✓ Universal design principles: barrier free
- ✓ Special needs
- ✓ Cultural diversity
- ✓ Sustainability: green design
- ✓ Facility management

Changes can be hard for people within your organization even at the early stages of a project, as well as when the move actually occurs. It is important to be sensitive to these concerns and think about how to mitigate stresses that moving may cause for staff and clients.

Step 5 Market Analysis

Time to complete: one month to three months

The objective of this step is to formally prove that a real need for your potential real estate project. You must be able to prove that there is a high demand for this type of space and a short supply.

In order to accomplish this, you must clearly describe whom the people are that will occupy this space (define the target market) and the attributes or amenities that make this place unique (define the market area).

You must think from a macro and micro perceptive. What's happening in the country, region and city as a whole? How does this compare to the specific neighbourhood or block that your project is located in? It is important to be using information about the past to think about the future and where the trends are going. More specifically, what is an area going to look like in five, ten and fifteen years? Why are conditions likely to change, or why should they stay the same?

There are public data sources available, such as the Statistic Canada Census and CMHC Housing Reports, to find general information, however getting specific details at the neighbourhood level is difficult and will probably cost you money. There are market research consultants that specialize in this type of work and have access to advanced survey software, such as Environics Envision.

Market Demand Checklist:

- ✓ total population
- ✓ average age
- ✓ # of households
- ✓ household make up
- ✓ marital status
- ✓ household income
- ✓ # of people working
- ✓ key occupations
- ✓ key transportation modes
- ✓ # of people who rent, who own
- ✓ average amount spent on housing per household

You must research the supply of similar space and determine what the competition is. This can be done by looking at comparable properties in the area and finding information on recent sale prices, rental rates and vacancy. You should conduct a rental survey of similar units to determine what people are willing to pay. This means calling property owners or visiting different sites and asking what rent is charged, the sqft/unit, vacancy rates, and operating expenses.

Depending on the scope of work you have agreed upon, a lot of this information may already be assembled in the appraiser's report. This is something that you should negotiate for before you sign a contract with the appraiser. Appraisers have the experience and tools available to complete this work relatively quickly.

Third Stage: Physical Space

This section will look at the things you have to do once you start looking for a physical space or when you've already found one. It will look at all the necessary processes and approvals that you'll need once you find a building that fits your needs.

Step 6 Refining the Idea

Time to complete: one month to three months

Now is the time to start searching for a specific physical site where your real estate dream could materialize. This doesn't necessarily mean that a property is listed for sale. Most commercial real estate sales happen without the site being listed on the market. Therefore, you cannot depend on browsing local listings to find a potential property. It is up to you to take the initiative – work with a realtor to help you identify a site that works for your organization and then have that realtor approach the owner about his or her interest in selling the potential site.

A professional realtor will be very useful to bring at this stage. It will not cost money up front and the realtor can provide expertise that will help guide you through the entire process of buying a property. There will be details on the benefits of a realtor in subsequent sections.

Questions to Answer:

- Is the site for sale? Listed or unlisted?
- What are comparable sites? How much are they selling (sold) for?
- Approximately how much will it cost to buy? Does this match comparable properties?
- What are the surrounding amenities and how do they link up with project vision (transit, parks, restaurants, libraries)?
- Do you need to secure the site to make sure someone else won't buy it before you complete necessary research? (details in the next section)

You must continue to develop the network of people that will be involved in the project. Talk with prospective tenants, owners, lenders, partners and professionals to see if the dream is realistic. Don't get caught up on details – they will be flushed out later on – but remember that the earlier you find potential roadblocks, the easier it is to adjust the dream accordingly.

It is important to let ideas percolate throughout the entire real estate journey. Don't rush into anything. See how real estate ideas fit with staff and clients in your organization, as well as other stakeholders in the community. You must provide opportunities for dialogue and input. For example, hold sessions where people can discuss their ideas, concerns and aspirations for the real estate project. You should consider ways of involving different personality types – small group discussions and presentations to a larger audience. The collaboration and involvement of a variety of people is an important resource for your organization to utilize.

Refining the Idea Checklist:

- ✓ Keep building your contact list
- ✓ Keep building your savings and looking for financial resources
- ✓ Go to the mls.ca website to check out properties for sale
- ✓ Search for unlisted properties
- ✓ Create a list of prospective sites and comparables.

If you discover that there is not a suitable site, or another factor that won't allow the vision to happen, then you may need to go back to the drawing board and think of a new approach. This could mean reconsidering how real estate affects your organization and why owning real estate will help accomplish your mission. It could also mean that even though your idea is on track, the timing is not right. Real estate requires patience and you may need to wait for an appropriate site to present itself or for the market to change.

Step 7 Project Financial Viability

Time to complete: one month – three months

Lenders and investors need to assess if the specific project and building that you are considering purchasing will be self-supporting – when revenue is greater than expenses.

At this stage you will need to complete another more detailed pro forma that analyses specifics of the project and site in question. Assumptions will be made, which must be justified by supporting research.

Assumption Checklist:

- ✓ Sale price
- ✓ Building improvement
- ✓ Furniture & Fixtures
- ✓ Soft costs (design, laywer, apprasial)
- ✓ Appraised Value
- ✓ Requested Loan Amount
- ✓ Mortage Conditions – interest rate, amortization, term, loan to value ratio
- ✓ Revenue – rent rates, parking, laundry
- ✓ Vacancy & bad debt
- ✓ Property taxes
- ✓ Management, Insurance, Utilities, Operating, Repairs, and Contingency
- ✓ Debt to Credit Ratio (DCR)

With this pro forma, you can analyze the project and find out other key figures.

Analysis Checklist:

- ✓ Maximum Loan the project can support
- ✓ Net Operating Income (NOI)
- ✓ Annual Debt Service
- ✓ Cash Flow
- ✓ Breakeven Rent
- ✓ Safety Margin
- ✓ Capitization Rate
- ✓ Funding Gap

The Cash Flow is the money left over after you pay the Annual Debt Service (mortgage payments). It is your cushion. Cushion is important because circumstances may change and you have to be prepared to pay more than you initially expected.

The Safety Margin summarizes the viability of a project. It shows the percentage that NOI can decrease until NOI and Annual Debt Service are equal to each other. When they are equal, this means there is no cushion.

The break-even rent is a similar analysis to the safety margin. It shows what rent must to be charged in order for NOI to equal Annual Debt Service.

The Capitalization Rate shows how efficient the property is at generating income, based on how much the property is appraised at. You want this percentage to be as high as possible.

The Funding Gap shows if the income generated by the property is sufficiently high, given the Annual Debt Payments. This number is connected with DCR. The project could have a positive Cash Flow, but still have a Funding Gap because the difference in income and mortgage payments is too low for the lenders comfort. If this is the case, you will need to increase the down payment or negotiate for a second unconventional mortgage – which will have a higher interest rate.

You will also have to do several sensitivity studies. This involves changing numbers on the pro forma to see how it affects other numbers in the analysis, such as Cash Flow and Safety Margin. Listed below are key sensitivities that you will want to test.

Sensitivity Checklist:

- ✓ Interest Rate
- ✓ Rennovation Costs
- ✓ Vacancy Rate
- ✓ Rental Rate
- ✓ Downpayment

Step 8 Offer to Purchase

Time to complete: two weeks to two months

If the vision is sounding realistic and the potential site seems to be appropriate, the property now needs to be "secured." This simply means locking down the ownership and transfer of title to your organization. You don't want to spend more resources and conduct expensive professional research, only to find out that someone else has purchased the property.

You must make a conditional offer to purchase and provide the seller with a deposit. This means that you are technically agreeing to buy the property at a set price, subject to all of the research and conditions going as expected.

Offer to Purchase Conditions Checklist:

- ✓ Appraisal supports the purchase price
- ✓ No environmental contamination is found
- ✓ Mortgage approval
- ✓ Planning approval
- ✓ Required equity is gathered

An offer usually lasts for 90 to 120 days, meaning you will have to complete all research within this time period. Ideally, your deposit will be fully refundable, so that if any of the conditions are not met, you'll get your money back. However, you should be prepared to make a non-refundable deposit. Make sure you understand the distinction at the time you make the deposit.

The deposit should not exceed 10% of the purchase price. It must be high enough to let the seller know you are serious, but is still an affordable amount that your organization can realistically access, without compromising it's day-to-day operations.

The seller will typically require you to enter into a purchase agreement before you can have access to the building to perform the necessary research such as environmental assessment, design work, and appraisal.

Gathering capital (money) for the deposit to complete this step can be a roadblock.

Deposit Options:

1. If your relationship with the seller is very good, they may accept a $1 deposit, which can be increased once your research is complete
2. Liquid money in a savings account or term deposit you may have on hand.
3. Capital grant or donation from a third party. Unfortunately, many grants are for upgrading properties that have already been purchased and cannot be used as a deposit.

4. Line of Credit – a financial institution can provide access to a few thousand dollars through a working capital loan (known as a line of credit), however they will charge you interest for this.

If you decide to go through with this step and secure the property, you will need to get professional support from a realtor and/or lawyer to make sure that everything is done correctly.

The process of purchasing a property is complex, and many people find it easiest to have a real estate agent by their side. There will be lots of paperwork and it is helpful to have someone familiar and professional to help you navigate it. Other parts of the transaction will be happening quickly as well – hiring inspectors, negotiating who pays for needed repairs, and doing a certified appraisal. All of this is second nature to a good agent. Real estate agents have contacts with experienced professionals who can make the process much easier.

One of the best reasons to hire a real estate agent is that the seller is likely to use their own agent and you do not want that agent to take over the process. Furthermore, the seller's agent may ask to represent both of you, in a "dual agency" relationship that primarily benefits the seller.

As a buyer, you do not have to pay directly for the services of an agent. Realtors get paid from commission on the sale of the property, which is usually 3% of the sale price. However, this amount is ultimately passed on to the buyer as part of the sale price.

Alternatively, you can set up a purchase agreement using only a real estate lawyer. If both you and the seller are agreeable, separate lawyers that represent the buyer and seller can formalize a conditional offer. This process is more cost effective compared to using real estate agents, however there are more potential headaches.

For example, lawyers get paid up front and hourly, whether or not the sale actually goes through. The lawyer is not responsible for ensuring that the entire purchasing process goes smoothly, they only make sure that legal requirements are satisfied.

It is wise to learn as much as you can about the purchasing process, regardless of whether you use a real estate agent or lawyer. For example, researching the market value of comparable properties in the area will protect you against pressure to make an unreasonably high offer.

If the seller is not willing to accept your conditional offer, or if you cannot gather capital for a deposit then it’s back to the drawing board to think of a new idea, find a new site, or keeping saving money for the deposit.

Step 9 Environmental Assessment

Time to complete: one month – two months

A professional needs to complete what is known as a “Phase 1 Environmental Assessment” to determine whether there is contamination or other environmental concerns on the site. Depending on the scope of work this will cost approximately $3,000. This assessment will look into the historic uses of the site, as well other nearby sites to determine the likelihood of sub-surface contamination. It will also provide a general description of the geophysical features of the site – drainage, topography, and geology.

If serious contamination issues are discovered (such as the presence of an old underground storage tank), you will need to complete a more detailed Phase 2 Environmental Assessment, which is also more expensive.

You must check that your potential mortgage provider has listed the assessor you will be working with as a certified professional. Otherwise, you might find yourself going through this process twice.

Questions to Answer:

- Has there been a previous environmental assessment completed? Depending on the date, you may still have to complete an updated version, but having the prior one available will save a lot of time.

You will need to complete a HAZMAT report, where a professional collects samples from the building and has them tested in a laboratory. Depending on the severity, these hazards will have to be mitigated – more detail in the design section.

Hazard Checklist:

- ✓ Storage tanks
- ✓ Waste management and chemical handling
- ✓ Soil fill and land reclamation
- ✓ Polychlorinated Biphenyls (PCBs)
- ✓ Asbestos-containing materials
- ✓ Lead-based paint and lead in drinking water
- ✓ Ozone-depleting substances
- ✓ Urea Formaldehyde foam insulation
- ✓ Mould
- ✓ Air Emissions

Step 10 Project Design & Cost Estimating

Time to complete: two months – six months

At this stage of the process, you are narrowing in on project specifics. A professional architect or space designer must be hired to complete design work that precisely illustrates what the space will become. That professional will listen to what your needs are and incorporate them into drawings that can be used to estimate renovation costs, apply for planning permission, and for contractors to use in construction.

Architectural work is expensive and charged on an hourly basis, so you need to make sure that the necessary groundwork is finished. This means completing functional programming and ensuring general consensus is met with your staff and board of directors regarding the project vision. You do not want to flip flop on ideas for the space, because making these changes will be expensive. By the time that you start this stage, it is important to have already thought carefully about how well the design fits the project's objectives. You should also set a change work order process up. This means clearly describing a plan of action on how to move forward if a key individual or partner in the project is unable to continue working on it. Given that real estate projects take a long time to complete, this roadblock is very likely to occur.

The architect will need access to drawings of the existing structure and site plans, with precise measurements so that she or he can incorporate them into the new design. All architectural drawings submitted for official building permit applications are kept on record at City Hall. It is quite possible that the City has records of the building you are trying to buy. For a fee, you can get access and make copies of these, which will save time and money required to produce scaled drawings from scratch.

The architect will need access to the Environment Phase 1 and HAZMAT report that you will have completed in the previous Step. These will help to show what hazards will have to be mitigated or designed around. Design considerations may include complete removal of these hazards, which can be very expensive, or isolating hazards, preventing disturbance and building around them.

Things to think about:

- Have a clear vision for what designs elements are required to achieve the objectives of your organization
- Do a site tour with a contractor, architect, and environmental consultant
- Ask professionals for a discounted rate for not-for-profits
- Check out professionals past work and get references
- Get access to all past reports and drawings on buildings and give them to consultants

It is important to establish a development and renovation budget based on projected costs that your architect and construction estimator have provided. The budget should include what are known as “hard costs” – physical bricks and mortar and “soft costs” – design and consulting work. Your budget must account for both, helping you plan for all of the financial obligations of construction.

Real Estate Development Cost Checklist:

- ✓ Purchase price of property
- ✓ Site and infrastructure upgrades (sidewalks, sewer connection)
- ✓ Environmental remediation
- ✓ Design fees (architectural, engineering)
- ✓ Hard costs (structural upgrades to satisfy building code and cosmetic –labour and materials)
- ✓ Permitting costs
- ✓ Financing costs (permanent loan commitment fees, construction interest, construction loan fees)
- ✓ Marketing costs (promotion, advertising, leasing commissions, brokers fees)
- ✓ Preopening operating costs
- ✓ Legal fees
- ✓ Accounting costs
- ✓ Inspection costs
- ✓ Overhead
- ✓ Contingencies
- ✓ Development fees

Ideally, each of these estimates will be confirmed by market data. The largest item will be hard costs and these numbers should be confirmed by comparison with the cost of similar projects, costs estimation services, and the prospective general contractor.

Step 11 Property Appraisal

Time to complete: one month – two months

You will need to get a professional appraisal of the property in order to ensure that it is actually worth the amount that you have agreed to pay. This will cost approximately $3000, depending on the scope of the work.

You must check that your potential mortgage provider has included the appraiser on its list of approved and vetted professionals. If it has not, then the findings from the appraisal will not be deemed as reliable.

The appraisal is important, because as will be discussed in future sections, a lending institution will not lend money for a building that is worth less than the purchase price, or for renovations that do not increase a building's market value.

An appraiser will value the property using two or three of following techniques:

- Income Approach – all potential revenue and expense streams are projected and valued using a capitization rate (required rate of return) that is determined by the market.
- Comparison Approach – recent sales of properties near to the subject site are averaged based on how well the compared to your property.
- Cost Approach – estimates the cost of the material and labour needed to reconstruct the building and adds the tax assessed land value. This is not a commonly used method.

If you are making renovations to the building, you will need to do a second appraisal, where the architects drawings and construction cost estimates are used to revalue the property. Certain renovations could make the building more valuable for your organization specifically, but create little value for other potential occupants - for example, an amazing twirling sign. These improvements would add minimal market value to the building, compared to installing new windows or a watertight roof, which almost all potential occupants would benefit from.

Appraisal techniques are different for commercial and residential properties. It is usually more complicated to appraise a commercial property because revenue and expense streams can vary depending on tenant type, and market characteristics (income of population, traffic volume).

When a site has both commercial and residential occupants it is called mixed use. Mixed-use appraisals are difficult to do because the site's different uses influence each other and depending on how they are integrated, it can either add positively or negatively to the property value. The conclusions from these appraisals can be subjective and must be supported by qualitative and quantitative research.

Appraisers will usually include a market analysis as part of their report. You should negotiate for them to do specific research for your project – see market analysis section.

Step 12 Planning Approvals

Time to complete: three months – two years

Planners are important people. They decide what can and can't be done in a city. As it relates to your real estate vision, planners will help determine whether your project fits within the goals of the area's Official Community Plan (OCP) and thus allowed to proceed. If it is outside of the OCP, then amendments or a rezoning must be made; this takes time and money.

The role of planners is to meet the needs of everyone in the community. Therefore, in order for planners to support a project, you need to get the community to buy into the project. Formally, this means getting signed letters of support.

It is important to go deeper than just looking for people's signatures. A project that the community truly stands behind will engage local stakeholders throughout the process, starting from the very beginning when the real estate idea is being initially crafted (see Step 2 and Step 3).

There are many application fees charged by the city on any real estate project. You need to know what these fees are and how much you should expect to pay, for example, on development permits, building permits, water main connections, and licences.

A good starting point is to visit the Enquiry Centre at City Hall and ask them to review the specific property you are interested in. They will tell you what the zoning currently is and what local policies, programs and bylaws you will need to follow.

If your vision for the property does not align with City mandates, then you will need to apply for a development permit. This can cost several thousand dollars, but not-for-profit organizations are usually eligible for a discounted rate. In order to make this application, you will need to present a site plan, floor plan and a letter describing the operations to be located on the site. If possible, you should apply for a minor amendment to the OCP and not a rezoning. A rezoning takes a long time to go through the necessary bureaucratic process.

If you want to make any changes to the building structure you need to apply for a building permit. This process will also cost money, but depending on the scope of work, it will be faster than the development permit. You will need completed architectural drawings of the proposed changes.

It is important to have a good relationship with the City and make sure they clearly understand your vision. It is best to approach people at the City early in the process and start a conversation about the project, even if you do not have final drawings and building plans ready to present.

Step 13 Project Plan

Time to complete: one month – two months

This step is where everything comes together. Your project plan will pull information from all the work you have done and describe what exactly the project is and why it is the right match for your organization.

A strong project plan will help convince potential funders and lenders that the project is a good idea and that you have done all the necessary research.

General Questions to Answer:

- What is it that we are doing?
- Where is our capital coming from (investors)?
- Who are we doing it for (market)?
- Will it succed (do better than okay)?

The project plan should start by profiling the organization and what the real estate vision is. It is important to be as detailed as possible and to clearly articulate the opportunity that this project presents. You will need to support the vision both qualitatively and quantitatively. There should be a plan for raising the necessary capital (down payment) and a schedule for the development (expiry of the offer to purchase, renovation dates, payment of construction costs, occupancy dates).

You will need to include pictures of the building, maps of the area and other visuals to break up the text.

Project Plan Checklist:

- ✓ Executive Summary
- ✓ Organization Information
- ✓ Project Vision
- ✓ Organizations and People Involved
- ✓ Neighborhood Background & Amenties
- ✓ Description of Site & Structure
- ✓ Environmental Assessment
- ✓ Design & Rennovations
- ✓ Appraisal
- ✓ Zoning & Implications
- ✓ Market Analysis & Implications & Absorption
- ✓ Financial Assumptions & Analysis & Sensitivities
- ✓ Funding Options
- ✓ Financial Profile of the Organization &
- ✓ Development Schedule
- ✓ Overal Conclusions

Step 14 Secure a Mortgage

Time to complete: one month – three months

Undertaking a real estate project is a risky process. There are a lot of variables that can cause a project to fail, from its marketability and financing, to the experience of the organization and project team.

Generally, a project has a greater risk of failure the earlier in the real estate process it is. At these elementary stages, relatively few resources have been committed so failing at this stage has limited consequences. As the project progresses uncertainty and the risk of failure steadily declines. However, by this point, significant resources have been spent and if the project fails, consequences will be much more severe.

The primary concern for lending institutions is reducing their risk when you take out a mortgage (they want to know that they will get their money back). Your main objective is to convince the bank that this project has a zero or minimal risk of failing.

You will need to present your business plan to the bank, as well as all supporting information in order to be approved for a mortgage. Be prepared to present the following:

Organizational Information

- ✓ Year to date internally prepared interim financial statements
- ✓ Current year's Approved Budget
- ✓ Last 3 years of accountant-prepared financial statements
- ✓ Constitution and Bylaws
- ✓ Names, positions and length of time for all Board members and key personnel
- ✓ Proof of board approval for purchase of the property
- ✓ Brief history of organization, programs & services, mission, etc.
- ✓ List of other loans held by the organization (cars, line of credit, etc.)

Credit Requirements

- ✓ Brief outline of financing needs that would be required from Lender
- ✓ Confirmation of which, if any, programs will be moved into the building
- ✓ Cost / benefit analysis confirming cash flow is available for repayment of the loan (i.e. savings of rent at another location)

Asset Description:

- ✓ Copy of accepted offer to purchase
- ✓ Appraisal for the lands, prepared by a professional appraiser
- ✓ Environmental assessment for the site, prepared by a professional firm

It is important to have a good relationship with your lender and make sure that they are involved early in the process. Lenders can provide insights on potential barriers and how to mitigate them.

A letter of interest for a mortgage from your mortgage lender is different than their formal commitment to provide you with a mortgage. Early on in the process a lender can guarantee loan conditions (interest rate, term, amortization) for a defined period of time. However, this does not necessarily mean that they will provide you with a mortgage. Risk assessors at the credit union or bank will look closely at the project after required due diligence is complete (environmental assessment, appraisal, etc.) and then decide whether or not to formally commit to providing a mortgage.

If you are making significant renovations and need a loan to pay for these, you may want to consider a construction loan. This is a short-term loan that will increase your organization's interim cash flow. During major renovations, construction bills will be coming in, but the building will not be generating revenue. So the loan can help bridge this gap. Of course, the interest rate will be high (because it is riskier for the credit union or bank) but you could make payments only the interest portion of the loan.

Construction loans depend heavily on the creditworthiness of the borrower and are a good idea if you know that your building project, once complete will be generating sufficient revenue to pay your mortgage comfortably.

When renovations are complete and the building is fully leased, you will convert the construction loan into a permanent mortgage. This mortgage will have a lower interest rate, but payments will be larger – now including both principal and interest.

There are many pre development costs early in the real estate process. These are called start up costs, or soft costs. For example, hiring consultants and professionals to complete due diligence requires money up front. If your organization does not have this money, or cannot access grants supporting this work, it may be possible to take out a line of credit with a lending institution. This type of loan is risky because there are no physical assets supporting the loan that can be resold if your organization is unable to make payments. Therefore, the interest rate will be high.

If your project is not approved for a mortgage, it means that the project is too risky and changes have to be made. This means renegotiating the offer to purchase, finding capital to make a larger down payment, finding another site, or changing the project vision.

Fourth Stage: Ownership and Beyond

The real estate process doesn't stop once you have purchased your building; there are important things to know about managing and maintaining a property. This toolkit doesn't go into that detail but there are many resources that exist to help you with these later stages of property management. These resources are listed at the end of the toolkit.

Step 15 Closing

Time to complete: one month – two months

If the credit union or bank that you are working with formally accepts your mortgage application and you decide that this property is without any reasonable doubt the right fit for your organization's needs, it is time to official close on the offer to purchase. This is where legal ownership of the property is actually transferred and money (minus the deposit) is exchanged between the buyer and seller.

This step requires the assistance of a real estate attorney to coordinate the closing, ensuring the all of the legal requirements are satisfied. The attorney will make sure that all outstanding issues regarding the property are resolved before you take ownership.

Closing Checklist

- ✓ Search and clearance for liens on the property
- ✓ Copy of your Agreement of Purchase & Sale
- ✓ Title check
- ✓ Contact details to your real estate agent & mortgage broker/lender
- ✓ Closing funds (i.e. money) - certified cheque and mortgage monies represent the funds needed and must be made payable to the attorney for them to hold in trust

Once the offer to purchase has been officially closed, you will begin to incur holding costs (insurance, property taxes, security, board-up if vacant, etc.). It is very important to keep the real estate process moving in order to minimize holding costs and other expenses associated with delays. You should have a development schedule carefully planned before closing is complete. This will give you a good picture of when renovations will be made, when construction bills will be due, and ultimately when tenants will be able to occupy the building.

The actual development and renovation of a property after closing is an intricate and detailed process. You should get professional advice, for example from a construction manager, as well as educate yourself about this stage of the real estate process.

This is also the point where this toolkit finishes. There is a significant amount of resources online, as well as many books that you can continue to educate yourself with.

Glossary of Terms

Absorption rate: The amount of real estate that will be leased or sold in a given time period.

Agent (broker): A person who, for a commission, acts as the agent of another in the process of buying, selling, or managing a property.

Amortization: The periodic repayment of debt over a specified time.

Anchor tenant: The major tenant who pays the largest dollar amount of rent.

Build to suit: Construction according to a tenant or purchaser's specifications.

Buildout: Construction of specific interior finishes to a tenant's specifications.

Capital: Money or property invested in an asset for the creation of wealth.

Capitalization (cap) rate: The rate, expressed as a percentage, at which a future flow of income is converted into a present value figure.

Capture rate: Percent of total demand within a target market that a project attracts.

Comparable: Another property to which a subject property can be compared to reach an estimate of market value.

Compound interest: Interest that is earned and immediately added to the principal, thereafter earning interest on itself.

Concession: Discount given to a prospective tenant to help get them to sign a lease, typically in the form of free rent or cash for tenant improvements.

Construction loan: A loan usually made by a commercial lending institution to be used for the construction of improvements on real estate and usually running six months to two years.

Covenant: A restriction on real property that is binding, regardless of changes in ownership, because it is attached to the title.

Debt service: Periodic payments on a loan, with a portion of the payment for interest and the balance for repayment of principal.

Discounted cash flow: Present Value of monies to be received in the future; determined by multiplying projected cash flows by the discount factor.

Dual agency: An agency representing both the buyer and the seller in a real estate transaction.

Due diligence: A candid effort to investigate all reasonable considerations in a timely manner.

Equity: That portion of a real estate asset that is owned outright, that is any value greater than the loan or mortgage issued.

Floor space ratio (FSR): The ratio of floor area to land area, expressed as a percent or decimal, that is determined by dividing the total floor area of the building by the area of the lot.

General contractor: A party to a building contract who contracts directly with the owner and who is charged with total construction of an entire building.

Hard Costs: In construction, this includes payments for land, labour, materials, and the contractor's fee.

HAZMAT: A hazardous material report.

Holdback: A contingency provision in a loan commitment reducing the amount disbursed if certain conditions are not met.

HVAC: A building system supplying heating, ventilation, and air conditioning

Lease-up: Time period during which a real estate rental property is marketed, leasing agreements signed and tenants begin to move in.

Lien: The right to hold property as security until debut that it secures is paid. A mortgage is one type of lien.

Liquid asset: Cash or assets that are immediately convertible to cash, at a predictable price, if sold.

Pro forma: A financial statement that projects gross income, operating expenses, and net operating income for a future period based on a set of specific assumptions.

Purchase agreement: A sale agreement or contract between a buyer and a seller setting forth, in general, the term of the sale.

Market Area: Geographic region from which the majority of demand and the majority of completion are drawn.

Market research: A study of the needs of groups of people to develop a product appropriate for an identifiable niche.

Official plan: A program or policy by an official planning body and adopted by a governing entity to designate land use of a particular area.

Permanent mortgage: A long-term loan on real estate used to finance a completed development (as opposed to a construction loan).

Property manager: An individual or firm responsible for the operation of improved real estate. Management functions include leasing and supervising maintenance.

Sensitivity analysis: A cost/benefit examination of the various features and aspects of a real estate development project such as operating costs, amenities, management costs, and the impact of adjustments to them on the value of the project.

Soft costs: Outlays for interest, design fees, appraisals, and other third-party charges associated with real estate development.

Stabilization: In appraisal, the use of one year's typical property income and expenses plus annualized capital reserve expenditures to represent each year's income stream.

Title: Evidence of ownership of real property, indicating a person's right to possess, use, and dispose of property

Zoning: Classification and regulation of land by local governments according to use categories (zones); often includes density designations as well.

Further Reading:

Housing, A Multidisciplinary Dictionary. Kamal S. Sayegh. Academy Book. Ottawa, ON. 1987.

Real Estate Development Principals and Process. Fourth Edition. M. Miles, G. Berens, M Eppli, M. Weiss. Urban Land Institute. 2007.

Real Estate Investment Analysis and Advanced Income Appraisal. Sauder School of Business, Real Estate Division. University of British Columbia. 2008.

Real Estate Market Analysis, A Case Study Approach. A. Schmitz, D. Brett.Urban Land Institute. 2007.

Sustainable Urban Development Reader. T. Beatley. Routledge Urban Reader Series, Oxford, UK: 2004.