Module 3:
The Financial Feasibility Analysis

For the accountants out there, the financial feasibility analysis (the Feasibility) is simply a profit and loss statement. The difference is that it's not a financial statement of what has already occurred but a snapshot of what you believe will be the outcome of your venture, based on today's costs and selling price.

The Feasibility is the most critical element of your due diligence. If you get this wrong, you will probably end up either overpaying for the land or walking away from a perfectly viable project. Be careful to avoid 'paralysis by analysis': you do not want to be so conservative that you find reasons to throw out every potential project. On the other hand, if you are too enthusiastic you may be tempted to massage the figures to produce the result you want rather than reveal the reality. In this way you may end up with a project that is not viable and will cost you valuable time and money.

All the decisions you make should be based on the Feasibility. It will allow you to determine the residual value of the land you want to acquire, and therefore how much you would be willing to pay, which is not necessarily the actual residual value. Remember that if you have done your homework well and selected the right site, the residual should always be more than the property's market value. It is this that allows you to acquire property that is not on the market. More on this in the 'Site negotiations' section.

A number of off-the-shelf feasibility models allow you to fill in the fields and automatically calculate the outcome. Some of these models are very good, and you may well want to purchase one in the future. However, it is critical that you learn how to do a feasibility analysis organically and understand all the sensitivities involved before you start using an off-the-shelf modelling program. It is too easy to put figures into a spreadsheet that someone else has built and manipulate it to produce figures that may look good, but are totally misleading. Remember: garbage in, garbage out.

I recommend that you build your own feasibility spreadsheet using Excel, which will require you to input your own formulae. This is how you learn to appreciate the sensitivities and the relationships between the figures you input.

It is a skill you will require to be able to create not only financial feasibilities but funding models to determine the source and application of funds.

A summary of a financial feasibility analysis may look as simple as the one shown here. It is often found in this format in the Executive Summary of an investor proposal or business case for funding.

PROPERTY DEVELOPMENT
WORKSHOPS

Summary of simple financial feasibility analysis

The financial feasibility analysis

FEASIBILITY ANALYSIS SUMMARY		
Revenue	Gross sales realisation, inc GST*	$ 26,405,519
	less: selling costs (net of GST)	-$ 532,828
	less: GST paid on ALL revenue	-$ 1,764,138
	Revenue net of GST and selling costs	$ 24,108,553

Development Costs net of GST	Land value	$ 7,000,000
	Development costs	$ 10,337,599
	Total Development Costs (TDC)	$ 17,337,599

Performance Indicators	**Net development profit**	$ 6,770,954
	Profit Margin (% of Development costs inc Selling Costs)	37.89%

*Goods & Services Tax

Essentially, as you can see, the formula used is simply:

Revenue – Cost of Goods Sold (COGS) = Profit

PROPERTY DEVELOPMENT
WORKSHOPS

The example in the Financial Feasibility Study expands on the total development costs components in the summary.

Financial Feasibility Summary

FEASIBILITY ANALYSIS SUMMARY		
Revenue	Gross sales realisation, inc GST*	$ 26,405,519
	less: selling costs (net of GST)	-$ 532,828
	less: GST paid on ALL revenue	-$ 1,764,138
	Revenue net of GST and selling costs $ 24,108,553	$ 24,108,553

Total Development Costs	Land Value	$ 7,000,000
	Stamp Duty	$ 430,490
	Other acquisition costs	$ 0
	Total building costs	$ 7,511,931
	Total consultants' costs	$ 1,036,646
	Total building permit fees	$ 255,398
	Total on costs	$ 117,528
	Total finance costs, excl interest	$ 117,439
	Development costs, excl interest	**$ 16,469,433**
	Plus: Capitalised interest costs	$ 868,166
	TOTAL DEVELOPMENT COSTS	**$ 17,337,599**

Performance Indicators	Net development profit	$ 6,770,954
	Profit Margin (% of Development costs inc Selling Costs)	37.89%

FEASIBILITY ANALYSIS TOOL

A good feasibility analysis tool should provide the following:

- Feasibility analysis snapshot summary, as shown above. (This assumes that all sales and development costs, including land, are at today's prices. Therefore no escalation has been allowed)
- Cash flows for the duration of the project
- Sensitivity analysis
- Funding models, incorporating combinations of bank, external investors, landowners, developer
- Costs of funds for any combination sources of finance (refer to section on 'Funding')
- Source and application of funds table
- Offer schedule for acquisition of land, showing the effect on profits for a combination of different offers to multiple landowners
- Direct sales comparison table
- Summary reports.

