

# Purchase Price Allocations

## FAS 141

# Discussion & Examples

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# Purchase Price Allocations FAS 141



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E.J. Huntley specializes in real estate valuation and has participated in and led valuation and consulting engagements throughout the United States and internationally. He has more than 18 years of professional experience in working within the real estate industry. He holds a Master's Degree in land economics and real estate. Mr. Huntley also holds the M.A.I. designation through the Appraisal Institute.

Mr. Huntley has significant experience in purchase price allocation appraisals, transaction due diligence and underwriting complex real property valuations, portfolio analyses, and cost segregation and tax depreciation services, as well as providing expert testimony and litigation support.

# Today's Presenter

**Mike Straneva, Partner  
Americas Director  
Transaction Real Estate  
Ernst & Young LLP**



## Experience

Mike focuses on due diligence and strategic planning for real estate operating companies and REITs and has provided a wide variety of real estate advisory services in his 21 years of professional practice. Mike has been involved in assisting companies apply accounting pronouncements including FIN 46 and FAS 141/142.

Mike is a CPA, a state certified real estate appraiser and Certified Insolvency and Reorganization Advisor (CIRA). He spent 12 years in the firm's real estate audit practice group before specializing in real estate advisory services.

# Purchase Price Allocations FAS 141

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Methodology

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Office Property Example

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# Accounting for Leases in Real Estate Acquisitions

- Prior to FAS 141, when real estate companies acquired improved property, the cost of the acquisition was allocated between land and building, with building being depreciated over its remaining useful life
- No value was allocated to the in-place leases
- Continuous debate over whether the acquisition of real estate constitutes a business combination and thus requires the application of FAS 141

# Methodology

- In the context of a real estate transaction we typically allocate the purchase price to the following tangible and intangible asset classes:
  - Tangible Assets:
    - Land
    - Building as Vacant
    - Site Improvements
    - Tenant Improvements
  - Intangible Assets:
    - In Place Leases
    - Above Market Leases
    - Below Market Leases
    - Customer Relationships
    - Leasing Commission
    - Legal & Marketing Costs
    - Assumed Debt

# Methodology

- The relative fair value of the tangible assets is determined using the following valuation methodologies.

<b>Land</b>	<b>Sales Comparison Approach</b>
<b>Building as if vacant</b>	<b>Income Approach and/or Cost Approach</b>
<b>Site Improvements</b>	<b>Cost Approach</b>
<b>Tenant Improvements</b>	<b>Sales Comparison Approach and/or Cost Approach</b>

# Methodology

- The relative fair value of the intangible assets is determined using the following valuation methodologies.

<b>In-Place Leases</b>	<b>Income Approach</b>
<b>Above/Below Market Leases</b>	<b>Income Approach</b>
<b>Customer Relationship</b>	<b>Income Approach</b>
<b>Leasing Commissions</b>	<b>Cost Approach and/or Sales Comparison Approach</b>
<b>Legal &amp; Marketing Costs</b>	<b>Cost Approach and/or Sales Comparison Approach</b>
<b>Assumed Debt</b>	<b>Income Approach</b>

# Allocation Steps Summary

- Step 1** Estimate the fair value of the land using sales comparison approach and residential approach if applicable.
- Step 2** Estimate the “as if vacant” fair value of the building using the income approach and cost approach.
- Step 3** Estimate the fair value of the site improvements using cost approach.
- Step 4** Estimate the fair value of tenant improvements using a sales comparison and actual net book value, if available.

# Allocation Steps Summary

- Step 5** Estimate the fair value of the in-place leases using an income approach.
- Step 6** Estimate the fair value of leasing commissions using the sales comparison approach and net book value, if available.
- Step 7** Estimate the fair value of legal & marketing costs using sales comparison approach and net book value, if available.
- Step 8** Estimate the above/below market lease fair value using income approach.

# Allocation Steps Summary

- Step 9** Estimate customer relationship fair value using an income approach.
- Step 10** Assumed debt is marked to market using an income approach.
- Step 11** Allocate the actual purchase price based upon the resulting purchase price allocation component values.

# Office Property Example

The background of the slide features several interlocking puzzle pieces in various shades of blue, ranging from a light sky blue to a dark navy blue. The pieces are scattered across the frame, with some overlapping others, creating a textured, abstract pattern.

# Office Property

- Land Value – Sales Comparison Approach
  - Ideally, comparable land sales and/or listings are assembled, analyzed and adjusted to estimate land value.
  - Relevant and recent comparable sales are gathered from the market place, adjustments are made to the sale prices so that they are comparable to the subject.
  - A final value is concluded as indicated by the adjusted sale prices.

# Office Property

LAND VALUATION	Subject	Sale 1	Sale 2	Sale 3	Sale 4
Location	MidRise Offices 5000 Main Street Big Town, TX	NE/C Old North Road & Wooded Trail Big Town, TX	SW/C West Bridge Road & North Parkway Big Town, TX	W/Side Oak Lane at Trader Road Big Town, TX	Preston Road At Morgan Street Big Town, TX
Sale Information					
Price		\$800,000	\$4,000,000	\$3,384,900	\$1,707,500
Price Per Acre		\$344,828	\$283,708	\$265,004	\$250,110
Price Per SF		\$7.92	\$6.51	\$6.08	\$5.74
Land Area	(Acres)	8.47	2.32	14.099	12.77
	(Square Feet)	368,953	101,059	614,152	556,392
Property Rights Conveyed					
Adjusted Price per Acre/Adjustment		\$344,828	0%	\$283,708	0%
Financing Terms					
Adjusted Price per Acre/Adjustment		\$344,828	0%	\$283,708	0%
Conditions of Sale					
Adjusted Price per Acre/Adjustment		\$344,828	0%	\$283,708	0%
Market Conditions		May-03	Nov-05	Oct-04	Feb-04
Annual Adjustment Factor:	3.0%	9.32%	1.80%	5.01%	7.13%
Adjusted Price per Acre		\$376,967	\$288,815	\$278,291	\$267,933
<b>Locational &amp; Physical Characteristics</b>					
Overall Location	Good	Similar	0%	Superior	-10%
Access/Visibility	Average	Similar	0%	Similar	0%
Topography	Level/Sloping	Similar	0%	Similar	0%
Shape/Configuration	Irregular	Similar	0%	Similar	0%
Size (Acres)	8.47	Smaller	-35%	Comparable	0%
Zoning	LI and OCMS	Similar	0%	Similar	0%
Utilities	All Available	Similar	0%	Similar	0%
Overall Direction		Downward	-35%	Downward	-10%
Adjusted Sales Price Per Acre		\$245,029		\$259,933	
Range of Adjusted Sale per Acre	\$222,633	To	\$267,933		
Median Adjusted Sale Price	\$252,481				
Average Adjusted Sale Price	\$248,882				
Concluded Value Per Acre	\$247,500			Concluded Value	\$2,100,000

# Office Property

- Building As If Vacant
  - The building value “as if vacant” reflects the base building value exclusive of certain tangible and intangible assets.
  - The “as if vacant” scenario is hypothetical in nature and requires a number of assumptions.
- Allocation Methods
  - Income Approach - Discounted Cash Flow
  - Income Approach - Direct Capitalization
  - Cost Approach

# Office Property

- Building As If Vacant – Discounted Cash Flow
  - Prepare a cash flow model based on *market rent* assumptions
  - Make a market-based assumption about lease-up period
  - Apply market derived assumptions for
    - Vacancy and credit loss
    - Operating expenses
    - Tenant improvements and leasing commissions
    - Sales cost for reversion estimate
  - Apply market-based assumptions for
    - Discount rate
    - Exit capitalization rate

# Office Property

- Building As If Vacant – DCF (Continued)
  - Calculate the Net Present Value of the cash flows and reversion
  - Calculate the “as if vacant” building value by deducting
    - Land value
    - Site improvements value

# Office Property

Building Size (SF - GLA)	162,995
Initial Occupancy	0.0%
Stabilized Occupancy	95.0%
Lease-up Period (Months)	12

## Discounted Cash Flow Analysis (From Argus)

Yr-1	(\$3,955,258)
Yr-2	\$2,221,053
Yr-3	\$2,406,304
Yr-4	\$2,510,581
Yr-5	\$2,612,538
Yr-6	\$96,828
Yr-7	\$2,135,063
Yr-8	\$2,656,870
Yr-9	\$2,775,866
Yr-10	\$2,895,474
Yr-11	\$793,575
Valuation Discount Rate	8.25%
Cash Flows NPV	\$9,421,989

Terminal Value	
Yr-12 NOI	\$2,954,863
Valuation Cap Rate	7.50%
Gross Sale Proceeds	39,398,173
Less Selling Costs	2.00% <u>(787,963)</u>
Net Sale Proceeds	38,610,210
Present Value	\$16,143,407

Total Estimated Value	\$25,565,396
Less Land	(2,100,000)
Less Site Improvements	<u>(623,199)</u>
Building As If Vacant	\$22,842,197

# Office Property

- Building As If Vacant – Alternate Method
- Direct Capitalization
  - Appropriate for properties with a stable or near stable occupancy
  - Estimate the net operating income using market assumptions
  - Capitalize the net operating income using the acquisition capitalization rate
  - Deduct the following:
    - Land value
    - Depreciated site improvements value
    - Estimated rent loss during lease up
    - Tenant improvements and leasing commission costs

# Office Property

- Building As If Vacant – Alternate Method
- Cost Approach
  - Review costs incurred by developers in the construction of the similar assets and consult industry cost manuals to develop applicable unit costs and depreciation estimates.
  - Estimate the replacement cost new of the buildings including entrepreneurial profit for a developer.
  - Estimate the remaining useful life based upon the total life of the improvements and their effective age.
  - Deduct depreciation to estimate the contributory value of the buildings.

# Office Property

- Site Improvements – Cost Approach
  - Site improvements are generally valued based on the replacement cost method and then depreciated based on their estimated remaining useful life and effective age of the improvements.
  - Estimate site improvement values using a per square foot cost based upon the Marshall & Swift cost manual, increased to account for indirect costs and entrepreneurial profit.



# Office Property

- Tenant Improvements – Cost Approach
  - The net book values from the previous owner may be the easiest and most accurate current value estimate, if such information is available and deemed accurate, including the utilized useful lives.
  - Or estimate using replacement cost based on market rates less depreciation. The amortization period is the shorter of either the useful life of the tenant improvements or the remaining lease term.

# Office Property

Depreciated Tenant Improvements

Office

Tenant Improvement Allowance PSF

\$15.00

No.	Tenant	Suite No.	Square Feet (a)	Lease Start	Lease End	Total Days	Remaining Days	Remaining Months	Percent Remaining (b)	Interest Acquired (100.0%)			
										TI Cost PSF (c)	Total TI (d) = (a) x (c)	Remaining TI (e) = (b) x (d)	Interest Acquired (f) = (e) x (% Acq.)
1	Disaster Insurance	140	11,725	1-Sep-03	31-Jan-12	3,074	2,042	68.07	66%	\$15.00	\$175,875	\$116,830	\$116,830
2	Disaster Insurance	200-400	86,329	1-Feb-02	30-Jan-12	3,650	2,041	68.03	56%	15.00	1,294,935	724,099	724,099
3	Disaster Insurance	620	3,649	1-Nov-05	31-Jan-12	2,282	2,042	68.07	89%	15.00	54,735	48,978	48,978
4	Bank Lobby	120	2,157	1-Oct-03	31-Jan-09	1,949	947	31.57	49%	15.00	32,355	15,721	15,721
5	Capital Investments	600	7,247	1-Apr-03	30-Jun-08	1,917	732	24.40	38%	15.00	108,705	41,509	41,509
6	Commercial Mortgage	130	3,390	1-Apr-04	31-Mar-09	1,825	1,006	33.53	55%	15.00	50,850	28,030	28,030
7	Capital Investments	500	17,531	1-Oct-01	31-Mar-07	2,007	275	9.17	14%	15.00	262,965	36,032	36,032
8	Bank Offices	150	3,500	1-Feb-02	31-Mar-07	1,884	275	9.17	15%	15.00	52,500	7,663	7,663
9	Dot Com Company	550	9,265	1-Apr-03	31-Mar-08	1,826	641	21.37	35%	15.00	138,975	48,786	48,786
10	Dot Com Company	555	1,961	1-Aug-04	31-Mar-08	1,338	641	21.37	48%	15.00	29,415	14,092	14,092
11	Tax Accountant	625	1,834	1-Oct-03	28-Feb-09	1,977	975	32.50	49%	15.00	27,510	13,567	13,567
12	Oil & Gas	627	3,786	1-Mar-05	28-Feb-09	1,460	975	32.50	67%	15.00	56,790	37,925	37,925
13	Oil & Gas	650	10,621	1-Mar-03	28-Feb-09	2,191	975	32.50	45%	15.00	159,315	70,896	70,896
Totals			162,995			27,380	13,567	50.55 <sup>(1)</sup>			\$2,444,925	\$1,204,128	\$1,204,128
Average TI \$ / SF =											\$15.00		

Notes:

(1) Weighted Average

# Office Property

- In-Place Leases – Income Approach
  - We calculate the value of In-Place Leases to capture any premium paid because the purchaser benefits from an in-place income stream.
  - Analyze the following items:
    - Rent loss during the theoretical lease-up period
    - Operating expenses the landlord would have incurred during the lease-up period which are considered an avoided cost
    - The remaining unamortized leasing commissions. Some purchasers also estimate avoided costs such as legal fees that would need to be expended to reach the existing occupancy level.
    - Unamortized tenant improvement costs

# Office Property

- Rent Loss and Landlord Expenses
  - The simplest methodology is to calculate the actual cash flow used by the purchaser at acquisition that equals the transaction price and subtract the value derived from the as vacant cash flow.
  - Adjustments must be made to reflect the impact of unamortized leasing commissions, legal & marketing costs, tenant improvement costs and above/below market leases.
  - The adjusted difference reflects the fair value of leases in place.
  - The following slides illustrate the cash flow differentials prepared using Argus.

# Office Property

## Property Value As Occupied - Discounted Cash Flow

Property Type	Office
Building Size (SF - GLA)	162,995
Occupancy at Purchase Date	100.0%
Stabilized Occupancy	95.0%
Lease-up Period (Months)	0

### Discounted Cash Flow Analysis (From Argus)

Yr-1	\$2,357,838
Yr-2	\$2,496,196
Yr-3	\$2,231,224
Yr-4	\$2,681,236
Yr-5	\$2,765,549
Yr-6	\$874,846
Yr-7	\$2,218,890
Yr-8	\$2,313,554
Yr-9	\$2,446,322
Yr-10	\$2,868,319
Yr-11	\$1,045,670

Valuation Discount Rate	8.25%
Cash Flows NPV	\$15,859,175

## Property Value As Vacant - Discounted Cash Flow

Property Type	Office
Building Size (SF - GLA)	162,995
Initial Occupancy	0.0%
Stabilized Occupancy	95.0%
Lease-up Period (Months)	12

### Discounted Cash Flow Analysis (From Argus)

Yr-1	(\$3,955,258)
Yr-2	\$2,221,053
Yr-3	\$2,406,304
Yr-4	\$2,510,581
Yr-5	\$2,612,538
Yr-6	\$96,828
Yr-7	\$2,135,063
Yr-8	\$2,656,870
Yr-9	\$2,775,866
Yr-10	\$2,895,474
Yr-11	\$793,575

Valuation Discount Rate	8.25%
Cash Flows NPV	\$9,421,989

# Office Property

Cash Flows NPV	\$15,859,175
Terminal Value	
Yr-12 NOI	\$2,978,074
Valuation Cap Rate	7.50%
Gross Sale Proceeds	39,707,653
Less Selling Costs	(794,153)
Net Sale Proceeds	<u>38,913,500</u>
Present Value	\$16,270,217
<b>Total Estimated Value - Property as Occupied</b>	<b><u>\$32,129,392</u></b>

Cash Flows NPV	\$9,421,989
Terminal Value	
Yr-12 NOI	\$2,954,863
Valuation Cap Rate	7.50%
Gross Sale Proceeds	39,398,173
Less Selling Costs	(787,963)
Net Sale Proceeds	<u>38,610,210</u>
Present Value	\$16,143,407
<b>Total Estimated Value - Property as Vacant</b>	<b><u>\$25,565,396</u></b>

<b>Value Differential</b>	<b>\$6,563,996</b>
Less: Unamortized Leasing Commissions	982,560
Less: Legal/Marketing	31,282
Less: Unamortized TI	1,204,128
Less: Above Market Leases	1,152,388
Add: Below Market Leases	208,431
<b>Total In-Place Lease Value</b>	<b><u>\$3,402,069</u></b>

# Office Property

- The fair value of unamortized leasing commissions and legal & marketing costs is estimated based on actual net book value or using market based costs

Tenant Allocation							
No.	Tenants	Suite No.	Square Feet	Remaining Rent	Remaining Term (%)	Remaining Commissions	Legal/ Marketing
1	Disaster Insurance	100	11,725	\$1,229,845	66%	\$73,791	\$3,321
2	Disaster Insurance	200-400	86,329	12,184,043	56%	731,043	2,796
3	Disaster Insurance	620	3,649	457,912	89%	27,475	4,474
4	Bank Lobby	120	2,157	113,244	49%	6,795	2,429
5	Capital Investments	600	7,247	342,167	38%	20,530	1,909
6	Commercial Mortgage	130	3,390	204,333	55%	12,260	2,756
7	Capital Investments	500	17,531	328,706	14%	19,722	685
8	Bank Offices	150	3,500	66,103	15%	3,966	730
9	Dot Com Company	550	9,265	397,840	35%	23,870	1,755
10	Dot Com Company	555	1,961	84,206	48%	5,052	2,395
11	Tax Accountant	625	1,834	99,286	49%	5,957	2,466
12	Oil & Gas	627	3,786	212,357	67%	12,741	3,339
13	Oil & Gas	650	10,621	655,954	45%	39,357	2,225
<b>Total</b>			<b>162,995</b>	<b>\$16,375,996</b>		<b>\$982,560</b>	<b>\$31,282</b>

# Office Property

- Above / Below Market Leases – Income Approach
  - We must first determine whether the acquirer has a positive, negative, or neutral leased fee position.
  - Compare contract rent to the prevailing market rent for each tenant.
  - There are three possible leased fee scenarios:
    - When the contract rent is equal to market rent, there is no above or below market value
    - When the contract rent exceeds market rent, a positive fair value exists, and
    - When the contract rent is less than the market rent, a negative fair value exists.

# Office Property

## Existing Contract Rent

For Years Ending		Jun-07	Jun-08	Jun-09	Jun-10	Jun-11	Jun-12
1	Disaster Insurance	213,581	216,512	219,443	222,374	225,306	132,629
2	Disaster Insurance	2,092,903	2,131,247	2,170,455	2,210,526	2,251,460	1,327,452
3	Disaster Insurance	77,395	79,718	81,847	83,489	85,143	50,320
4	Bank Lobby	42,872	44,163	26,209	-	-	-
5	Capital Investments	170,268	171,899	-	-	-	-
6	Commercial Mortgage	72,470	74,631	57,232	-	-	-
7	Capital Investments	-	-	-	-	-	-
8	Bank Offices	-	-	-	-	-	-
9	Dot Com Company	225,997	171,843	-	-	-	-
10	Dot Com Company	47,834	36,372	-	-	-	-
11	Tax Accountant	36,362	37,456	25,468	-	-	-
12	Oil & Gas	77,777	80,112	54,468	-	-	-
13	Oil & Gas	238,194	250,656	167,104	-	-	-

## Market Rent

For Years Ending		Jun-07	Jun-08	Jun-09	Jun-10	Jun-11	Jun-12
1	Disaster Insurance	246,225	253,612	261,220	269,057	277,128	166,508
2	Disaster Insurance	1,812,909	1,867,296	1,923,315	1,981,015	2,040,445	1,225,967
3	Disaster Insurance	76,629	78,928	81,296	83,735	86,247	51,820
4	Bank Lobby	45,297	46,656	28,032	-	-	-
5	Capital Investments	152,187	156,753	-	-	-	-
6	Commercial Mortgage	71,190	73,326	56,644	-	-	-
7	Capital Investments	-	-	-	-	-	-
8	Bank Offices	-	-	-	-	-	-
9	Dot Com Company	194,565	150,301	-	-	-	-
10	Dot Com Company	41,181	31,812	-	-	-	-
11	Tax Accountant	38,514	39,669	27,240	-	-	-
12	Oil & Gas	79,506	81,891	56,232	-	-	-
13	Oil & Gas	223,041	229,732	157,749	-	-	-

# Office Property

- The rent differential for each year of the lease commencing from the acquisition date to the estimated end of the lease term is calculated and discounted to present value.

## Difference between Contract and Market Rent

For Years Ending	Jun-07	Jun-08	Jun-09	Jun-10	Jun-11	Jun-12
1 Disaster Insurance	(32,644)	(37,100)	(41,777)	(46,683)	(51,822)	(33,879)
2 Disaster Insurance	279,994	263,951	247,140	229,511	211,015	101,485
3 Disaster Insurance	766	790	551	(246)	(1,104)	(1,500)
4 Bank Lobby	(2,425)	(2,493)	(1,823)	-	-	-
5 Capital Investments	18,081	15,146	-	-	-	-
6 Commercial Mortgage	1,280	1,305	588	-	-	-
7 Capital Investments	-	-	-	-	-	-
8 Bank Offices	-	-	-	-	-	-
9 Dot Com Company	31,432	21,542	-	-	-	-
10 Dot Com Company	6,653	4,560	-	-	-	-
11 Tax Accountant	(2,152)	(2,213)	(1,772)	-	-	-
12 Oil & Gas	(1,729)	(1,779)	(1,764)	-	-	-
13 Oil & Gas	15,153	20,924	9,355	-	-	-

# Office Property

- When the contract rent exceeds market rent a positive fair value exists

Above Market Lease Value			Jun-07	Jun-08	Jun-09	Jun-10	Jun-11	Jun-12	
For Years Ending									
		Discounted	Interest Acquired						
1	Disaster Insurance	-	-	-	-	-	-	-	
2	Disaster Insurance	1,023,342	1,023,342	279,994	263,951	247,140	229,511	211,015	
3	Disaster Insurance	1,786	1,786	766	790	551	-	-	
4	Bank Lobby	-	-	-	-	-	-	-	
5	Capital Investments	29,240	29,240	18,081	15,146	-	-	-	
6	Commercial Mortgage	2,716	2,716	1,280	1,305	588	-	-	
7	Capital Investments	-	-	-	-	-	-	-	
8	Bank Offices	-	-	-	-	-	-	-	
9	Dot Com Company	46,819	46,819	31,432	21,542	-	-	-	
10	Dot Com Company	9,910	9,910	6,653	4,560	-	-	-	
11	Tax Accountant	-	-	-	-	-	-	-	
12	Oil & Gas	-	-	-	-	-	-	-	
13	Oil & Gas	38,575	38,575	15,153	20,924	9,355	-	-	
<b>Total</b>			<b>1,152,388</b>	<b>1,152,388</b>	<b>353,359</b>	<b>328,218</b>	<b>257,634</b>	<b>229,511</b>	<b>211,015</b>

# Office Property

- When the contract rent is less than the market rent a negative fair value exists.

## Below Market Lease Value

For Years Ending			Jun-07	Jun-08	Jun-09	Jun-10	Jun-11	Jun-12	
		Discounted	Interest Acquired						
1	Disaster Insurance	(190,620)	(190,620)	(32,644)	(37,100)	(41,777)	(46,683)	(51,822)	(33,879)
2	Disaster Insurance	-	-	-	-	-	-	-	-
3	Disaster Insurance	(1,950)	(1,950)	-	-	-	(246)	(1,104)	(1,500)
4	Bank Lobby	(5,906)	(5,906)	(2,425)	(2,493)	(1,823)	-	-	-
5	Capital Investments	-	-	-	-	-	-	-	-
6	Commercial Mortgage	-	-	-	-	-	-	-	-
7	Capital Investments	-	-	-	-	-	-	-	-
8	Bank Offices	-	-	-	-	-	-	-	-
9	Dot Com Company	-	-	-	-	-	-	-	-
10	Dot Com Company	-	-	-	-	-	-	-	-
11	Tax Accountant	(5,367)	(5,367)	(2,152)	(2,213)	(1,772)	-	-	-
12	Oil & Gas	(4,589)	(4,589)	(1,729)	(1,779)	(1,764)	-	-	-
13	Oil & Gas	-	-	-	-	-	-	-	-
<b>Total</b>		<b>(208,431)</b>	<b>(208,431)</b>	<b>(38,950)</b>	<b>(43,585)</b>	<b>(47,136)</b>	<b>(46,929)</b>	<b>(52,926)</b>	<b>(35,379)</b>

# Office Property

- Customer Relationship Value – Income Approach
  - An existing tenant or customer relationship can reflect a positive intangible value.
  - We can measure the present value of potential avoided revenue loss and turnover cost that are associated with the renewal probability for existing tenants.
  - Tenant or customer relationship value is typically recognized when renewal probabilities for existing tenants are well above general renewal rates reflected in the marketplace.

# Office Property

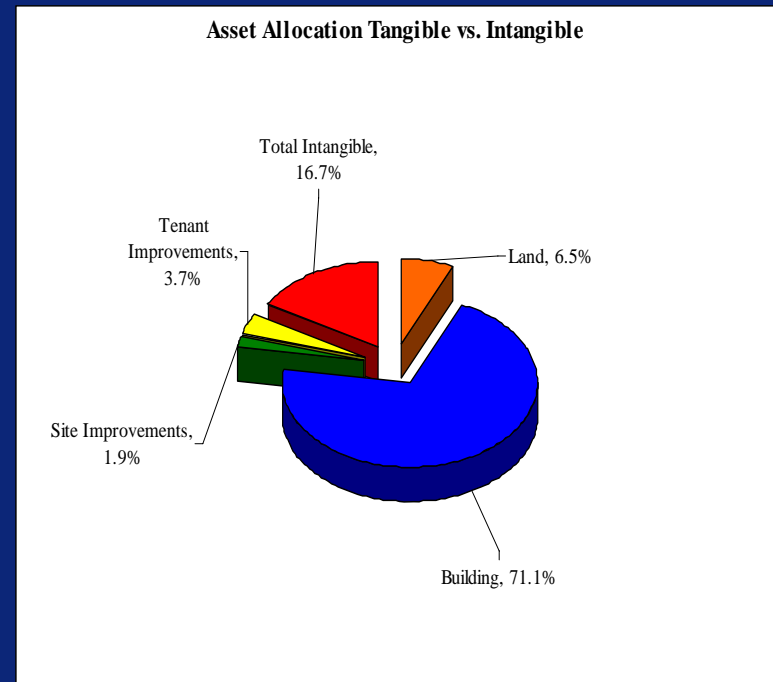
Property & Acquisition Data		Market Rent & Occupancy Assumptions			Market Leasing Assumptions	
<u>Property Data</u>		<u>Market Rent</u>			<u>Leasing Expenses</u>	
Property Name	MidRise Offices	Office	(PSF)	\$21.00	Leasing Commissions New	6.00%
Address	5000 Main Street	Retail	(PSF)	\$0.00	Leasing Commissions Renewal	3.00%
City, State	Big Town, TX				New T.I. Allowance	\$15.00
Property Type	Office	<u>Market Lease Structure</u>			Renewal T.I. Allowance	\$6.00
Building Size (SF GLA)	162,955	Office		Gross	Legal/Marketing Costs	\$5,000
Year Built/Renov	2000	Retail (Separate)		NNN		
Occupancy at Acquisition	100%				<u>Growth Rates</u>	
Land Size (Acres)	8.47	<u>Lease Term</u>			Growth Rate (Year 1)	3.00%
Ownership Interest Acquired	100.0%	Average Lease Term (Yrs)		5	Growth Rate (Year 2)	3.00%
Zoning	Office Use				Growth Rate (Year 3)	3.00%
		<u>Market Occupancy</u>			Growth Rate (Year 4)	3.00%
<u>Acquisition Data</u>		Stabilized Occupancy		95.00%	Growth Rate (Year 5)	3.00%
Acquisition Date	June 29, 2006	Preleased Occupancy		0.00%		
Acquisition Price	\$30,069,970					
Acquisition Cap Rate	7.00%					
Acquisition Terminal Rate	7.50%					
Acquisition Discount Rate	8.25%					

# Office Property

- Make sure the adjusted allocated fair value total equals the transaction price.

SFAS 141 Purchase Price Allocation Summary Table

	Allocated Fair Value	Adjustment Factor	Adjusted Allocated Fair Value	% of Total
<b><u>Tangible Assets</u></b>				
Land	\$2,100,000	-6.41%	\$1,965,395	6.5%
Building Value As If Vacant	22,842,197	-6.41%	21,378,063	71.1%
Site Improvements	623,199	-6.41%	583,254	1.9%
Tenant Improvements	1,204,128	-6.41%	1,126,946	3.7%
<b>Total Tangible</b>	<b>\$26,769,524</b>		<b>\$25,053,658</b>	<b>83.3%</b>
<b><u>Intangible Assets</u></b>				
In Place Leases	\$3,402,069	-6.41%	\$3,184,004	10.6%
Leasing Commissions	982,560	-6.41%	919,580	3.1%
Legal/Marketing	31,282	-6.41%	29,277	0.1%
Above Market Leases	1,152,388	-6.41%	1,078,523	3.6%
Below Market Leases	(208,431)	-6.41%	(195,071)	-0.6%
<b>Total Intangible</b>	<b>\$5,359,868</b>		<b>\$5,016,312</b>	<b>16.7%</b>
<b>Total Estimate</b>	<b>\$32,129,392</b>		<b>\$30,069,970</b>	<b>100.0%</b>



# What Can Go Wrong

- Rent
  - Not adjusting rent for tenant size and type of tenant. Putting anchored tenant at shop space rents
- Rent: Not accounting for gross vs. net leases rates
- Tenant Improvements:
  - Not coordinating tenant improvements with rents charged. TI of \$20 with \$20 rents on a five year lease.
- Land value at FAR not just per foot space
- Not differentiating the type of tenants offered on the discount rate
- Not including the cost of underground parking structures in the cost approach
- Using actual age not effective age In the cost approach. Example: a 20 year old building still can have a 30 year remaining useful life.
- Make sure to account for soft cost and entrepreneurial profit In your cost approach
- Account for legal, marketing and lease commission costs