

INCOME APPROACH

The Income Approach considers the return on Investment and is similar to the method that investors typically use to make their investment decisions. It is most directly applicable to income producing property because the expectation of income is the primary motivating factor for the purchase of real estate. Other important considerations are leverage, tax advantages through depreciation, and pride of ownership. In addition, the investor also benefits from equity build-up due to mortgage loan amortization and potential increases in value.

The Income Approach consists of first estimating the probable annual gross income, based upon actual leases or market rentals. From this amount is deducted an allowance for vacancy and rent loss, based upon the property's historical operating experience and/or future projections. Next, all expenses attributable to the real estate are deducted. Also deducted, when appropriate, is a Reserve for Replacement of short-lived components that would normally be replaced during the investment holding period. The resulting net income is then converted into value by capitalization.

Gross Income Estimate

To verify that the subject's projected rentals are at market and to arrive at a projected gross income, we made an examination of the rentals of other similar buildings in the market area. We evaluated the area's rental environment, market orientation, and comparable rental facilities. Our investigation was limited to properties that were similar in style and/or age and had tenant appeal similar to that of the subject property.

It is our determination, after reviewing the general market and studying competitive facilities, that the current rentals are at market. Based upon current rentals, potential gross income for the first year of our analysis, before an allowance for vacancy and rent loss, amounts to \$1,564,820.

Vacancy and Rent Loss

Even when a building is fully occupied as of the date of the appraisal, it is prudent to anticipate some rent loss over the projection period in order to estimate "stabilized" occupancy. Based upon our analysis of the current rental market and the historical rent loss of the subject, a "stabilized" frictional vacancy rate for the subject property is projected at 12.00% of gross income, or \$187,778. The vacancy rate for the first year of our analysis is projected at 7.50%,

Leased Fee Income Approach Example

or \$117,362.

Effective Gross Income

Deducting the first year vacancy and rent loss of \$117,362 leaves an Effective Gross Income for the first year of our analysis of \$1,447,459. Annual income for each year of our projected holding period is shown below.

Multi-Year Income Schedule

REFERENCE NO: SAMPLE ANALYSIS
 PROPERTY: Office Building
 ANALYSIS DATE: 08-01-09

| | <u>Year 1</u> 08-2009 | <u>Year 2</u> 08-2010 | <u>Year 3</u> 08-2011 | <u>Year 4</u> 08-2012 | <u>Year 5</u> 08-2013 | <u>Year 6</u> 08-2014 | <u>Year 7</u> 08-2015 |
|----------------------------|--------------------------|--------------------------|--------------------------|--------------------------|--------------------------|--------------------------|--------------------------|
| <u>Gross Income</u> | | | | | | | |
| Suite #1 | 7,000 | 7,000 | 7,000 | 7,000 | 7,000 | 7,000 | 7,000 |
| Suite #2 | 5,600 | 5,600 | 5,600 | 5,600 | 5,600 | 5,600 | 5,600 |
| Suite #3 | 7,000 | 7,000 | 7,000 | 7,000 | 7,000 | 7,000 | 7,000 |
| Suite #4 | 8,400 | 8,400 | 8,400 | 8,400 | 8,400 | 8,400 | 8,400 |
| Suite #5 | 9,800 | 9,800 | 9,800 | 9,800 | 9,800 | 9,800 | 9,800 |
| Suite #6 | 11,200 | 11,200 | 11,200 | 11,200 | 11,200 | 11,200 | 11,200 |
| Suite #7 | 12,600 | 12,600 | 12,600 | 12,600 | 12,600 | 12,600 | 12,600 |
| Suite #8 | 14,000 | 14,000 | 14,000 | 14,000 | 14,000 | 14,000 | 14,000 |
| Suite #9 | 15,400 | 15,400 | 15,400 | 15,400 | 15,400 | 15,400 | 15,400 |
| Suite #10 | 16,800 | 16,800 | 16,800 | 16,800 | 16,800 | 16,800 | 16,800 |
| Suite #11 | 18,200 | 18,200 | 18,200 | 18,200 | 18,200 | 18,200 | 18,200 |
| Suite #12 | 19,600 | 19,600 | 19,600 | 19,600 | 19,600 | 19,600 | 19,600 |
| Suite #13 | 21,000 | 21,000 | 21,000 | 21,000 | 21,000 | 21,000 | 21,000 |
| Suite #14 | 22,400 | 22,400 | 22,400 | 22,400 | 22,400 | 22,400 | 22,400 |
| Suite #15 | 23,800 | 23,800 | 23,800 | 23,800 | 23,800 | 23,800 | 23,800 |
| First Floor Retail | 270,000 | 270,000 | 270,000 | 270,000 | 270,000 | 270,000 | 270,000 |
| Texas Company - Office | 75,000 | 75,000 | 75,000 | 75,000 | 75,000 | 75,000 | 75,000 |
| CBC Computer | 75,000 | 75,000 | 75,000 | 75,000 | 75,000 | 75,000 | 75,000 |
| Masterplan Office | 84,000 | 84,000 | 84,000 | 84,000 | 84,000 | 84,000 | 84,000 |
| Sentinel | 126,000 | 126,000 | 126,000 | 126,000 | 126,000 | 126,000 | 126,000 |
| Science Foundation Ltd | 70,000 | 70,000 | 70,000 | 70,000 | 70,000 | 70,000 | 70,000 |
| Mutual Investment | 140,000 | 140,000 | 140,000 | 140,000 | 140,000 | 140,000 | 140,000 |
| Capital Formation Part. | 210,000 | 210,000 | 210,000 | 210,000 | 210,000 | 210,000 | 210,000 |
| Modern Design | 210,000 | 210,000 | 210,000 | 210,000 | 210,000 | 210,000 | 210,000 |
| Masterplan - storage | 20,000 | 20,000 | 20,000 | 20,000 | 20,000 | 20,000 | 20,000 |
| Storage Income | 21,562 | 21,562 | 21,562 | 21,562 | 21,562 | 21,562 | 21,562 |
| Miscellaneous Income | 19,825 | 19,825 | 19,825 | 19,825 | 19,825 | 19,825 | 19,825 |
| Parking lot fees | 30,633 | 30,633 | 30,633 | 30,633 | 30,633 | 30,633 | 30,633 |
| Total Income | 1,564,820 | 1,564,820 | 1,564,820 | 1,564,820 | 1,564,820 | 1,564,820 | 1,564,820 |
| CAM Charges | 33,520 | 34,190 | 34,874 | 35,571 | 36,283 | 37,008 | 37,749 |
| Vac / Credit Loss | <u>-136,146</u> | <u>-136,202</u> | <u>-136,260</u> | <u>-136,319</u> | <u>-136,379</u> | <u>-136,440</u> | <u>-136,502</u> |
| Effective Gross | 1,462,194 | 1,462,808 | 1,463,434 | 1,464,073 | 1,464,724 | 1,465,388 | 1,466,066 |

Estimate of Expenses

To arrive at a projected annual Net Income, it is necessary to deduct those expenses

Leased Fee Income Approach Example

| | | | | | | | |
|--|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|
| Texas Company - Office | 75,000 | 75,000 | 75,000 | 75,000 | 75,000 | 75,000 | 75,000 |
| CBC Computer | 75,000 | 75,000 | 75,000 | 75,000 | 75,000 | 75,000 | 75,000 |
| Masterplan Office | 84,000 | 84,000 | 84,000 | 84,000 | 84,000 | 84,000 | 84,000 |
| Sentinel | 126,000 | 126,000 | 126,000 | 126,000 | 126,000 | 126,000 | 126,000 |
| Science Foundation Ltd | 70,000 | 70,000 | 70,000 | 70,000 | 70,000 | 70,000 | 70,000 |
| Mutual Investment | 140,000 | 140,000 | 140,000 | 140,000 | 140,000 | 140,000 | 140,000 |
| Capital Formation Part. | 210,000 | 210,000 | 210,000 | 210,000 | 210,000 | 210,000 | 210,000 |
| Modern Design | 210,000 | 210,000 | 210,000 | 210,000 | 210,000 | 210,000 | 210,000 |
| Masterplan - storage | 20,000 | 20,000 | 20,000 | 20,000 | 20,000 | 20,000 | 20,000 |
| Storage Income | 21,562 | 21,562 | 21,562 | 21,562 | 21,562 | 21,562 | 21,562 |
| Miscellaneous Income | 19,825 | 19,825 | 19,825 | 19,825 | 19,825 | 19,825 | 19,825 |
| Parking lot fees | <u>30,633</u> | <u>30,633</u> | <u>30,633</u> | <u>30,633</u> | <u>30,633</u> | <u>30,633</u> | <u>30,633</u> |
| Total Income | 1,564,820 | 1,564,820 | 1,564,820 | 1,564,820 | 1,564,820 | 1,564,820 | 1,564,820 |
| CAM Charges | 33,520 | 34,190 | 34,874 | 35,571 | 36,283 | 37,008 | 37,749 |
| Vac / Credit Loss | <u>-136,146</u> | <u>-136,202</u> | <u>-136,260</u> | <u>-136,319</u> | <u>-136,379</u> | <u>-136,440</u> | <u>-136,502</u> |
| Effective Gross | 1,462,194 | 1,462,808 | 1,463,434 | 1,464,073 | 1,464,724 | 1,465,388 | 1,466,066 |
| <u>Fixed</u> | | | | | | | |
| Real Estate Taxes | | | | | | | |
| School Taxes | 200,000 | 204,000 | 208,080 | 212,242 | 216,486 | 220,816 | 225,232 |
| Local Taxes | 80,000 | 81,600 | 83,232 | 84,897 | 86,595 | 88,326 | 90,093 |
| County Taxes | 20,000 | 20,400 | 20,808 | 21,224 | 21,649 | 22,082 | 22,523 |
| Insurance | 31,207 | 31,831 | 32,468 | 33,117 | 33,779 | 34,455 | 35,144 |
| <u>Operating</u> | | | | | | | |
| Utilities | 80,913 | 82,531 | 84,182 | 85,865 | 87,583 | 89,334 | 91,121 |
| Cleaning | 53,950 | 55,029 | 56,130 | 57,252 | 58,397 | 59,565 | 60,757 |
| Maintenance/Repair | 62,414 | 63,662 | 64,935 | 66,234 | 67,558 | 68,910 | 70,288 |
| Management | 87,732 | 87,768 | 87,806 | 87,844 | 87,883 | 87,923 | 87,964 |
| <u>Other</u> | | | | | | | |
| Roads/Grounds/sec | 24,965 | 25,465 | 25,974 | 26,493 | 27,023 | 27,564 | 28,115 |
| <u>Leasing Costs</u> | | | | | | | |
| Tenant Improvements | 10,000 | 0 | 0 | 0 | 0 | 0 | 0 |
| <u>Reserve</u> | | | | | | | |
| Reserve for replacement | <u>58,488</u> | <u>58,512</u> | <u>58,537</u> | <u>58,563</u> | <u>58,589</u> | <u>58,616</u> | <u>58,643</u> |
| Total Expenses | 709,668 | 710,798 | 722,151 | 733,732 | 745,543 | 757,591 | 769,880 |
| NET INCOME | 752,526 | 752,009 | 741,282 | 730,341 | 719,181 | 707,797 | 696,186 |
| <u>Vacancy Percentage-Input</u> | | | | | | | |
| Vacancy Percentage-Input | 8.52% | 8.52% | 8.52% | 8.52% | 8.52% | 8.52% | 8.52% |
| Imputed Vacancy-calc. | 8.70% | 8.70% | 8.71% | 8.71% | 8.72% | 8.72% | 8.72% |
| Expense Ratio | 44.40% | 44.45% | 45.14% | 45.85% | 46.56% | 47.30% | 48.04% |
| Growth Rate - E.G.I. | N/A | 0.04% | 0.04% | 0.04% | 0.04% | 0.05% | 0.05% |
| Growth Rate in Expenses | N/A | 0.16% | 1.60% | 1.60% | 1.61% | 1.62% | 1.62% |
| Growth Rate in Net Income | N/A | -1.38% | -1.43% | -1.48% | -1.53% | -1.58% | -1.64% |

Leased Fee Income Approach Example

Reversion at the End of the Holding Period

The estimate of the Reversion is an integral part of any valuation method that relies upon the projection future cash flows. The Reversion is the net cash received by the investor upon sale of the property at the end of our projected holding period of 7 years. Net cash proceeds are calculated by estimating the sale price of the property at the end of the holding period and then deducting any remaining mortgage balance and selling expenses incurred by the seller. The future sale price at the end of the 7th. year of \$7,227,153 was estimated by applying a capitalization rate of 9.47% to the projected terminal year net income of \$684,343. The Terminal Year capitalization rate was developed using the Advanced Mortgage Equity Technique. The terminal year Income Statement and the capitalization rate calculations are presented below.

Terminal Year Income Statement

REFERENCE NO: SAMPLE ANALYSIS
 PROPERTY: Office Building
 ANALYSIS DATE: 08-01-09

| | Amount | % of Gross |
|-------------------------|---------------|--------------|
| Total Income | \$1,603,324 | 100.00% |
| Vacancy / Credit Loss | -136,566 | -8.52% |
| Effective Gross Income | \$1,466,758 | 91.48% |
| Real Estate Taxes | 344,606 | 21.49% |
| Insurance | 35,847 | 2.24% |
| Utilities | 92,943 | 5.80% |
| Cleaning | 61,972 | 3.87% |
| Maintenance/Repair | 71,693 | 4.47% |
| Management | 88,005 | 5.49% |
| Roads/Grounds/sec | 28,677 | 1.79% |
| Reserve for replacement | <u>58,670</u> | <u>3.66%</u> |
| Total Expenses | \$782,414 | 48.80% |
| NET INCOME | \$684,343 | 42.68% |

CAPITALIZATION

Year 8 Net Income Divided by Terminal Cap Rate = Terminal Value

| | | |
|-----------|----------|-------------|
| \$684,343 | 0.094690 | \$7,227,160 |
|-----------|----------|-------------|

Analysis Type: Lease

Leased Fee Income Approach Example

AMET Calculation - Terminal Year

REFERENCE NO: SAMPLE ANALYSIS
PROPERTY: Office Building
ANALYSIS DATE: 08-01-09

Input Variables

| | |
|------------------------------------|----------|
| Projected Holding Period | 7 Years |
| Loan Ratio 1 | 70.00% |
| Interest Rate | 7.00% |
| Loan Term | 20 Years |
| Investor Equity Portion | 30.00% |
| Required Investor Yield (IRR) | 11.000% |
| Growth Rate in Value per Year | 0.000% |
| Growth Rate in Net Income per Year | 0.000% |
| Soft Costs in Addition to Equity | 2.000% |
| Selling Expenses: Terminal Year | 7.000% |

CALCULATION

| | |
|---|-------------------|
| Loan 1 x Constant (.70000 x 0.093036) | 0.0651251 |
| Equity x Required Yield (.30000 x 0.110000) | <u>0.0330000</u> |
| | 0.0981251 |
| LESS Credit for Equity Build-up | |
| | |
| RATIO x %PAID OFF x SINKING FUND | |
| Loan 1 70.00 0.2073 0.102215 | <u>-0.0148340</u> |
| BASIC RATE | 0.0832911 |
| ADD Amortization of Soft Costs (2.00 x 0.21222) | <u>0.0042443</u> |
| | 0.0875354 |
| ADD Depreciation Factor | <u>0.0071551</u> |
| | |
| TERMINAL YEAR CAP RATE | 9.4690% |

Analysis Type: Lease

Leased Fee Income Approach Example

Capitalization of Net Income

Capitalization is the process of converting into present value (or obtaining the present worth of) a series of anticipated future periodic installments of net income. It is the procedure of expressing such anticipated future benefits of ownership in dollars and processing them into a present worth at a rate that is attracting purchase capital to competitive investments.

The types of capitalization are Yield Capitalization and Direct Capitalization.¹

Yield Capitalization

This method of capitalization uses the discounting procedure to convert future benefits to present value on the premise of a required level of profit or rate of return on invested capital.

Direct Capitalization

This method is used to convert an estimate of a single year's income expectancy into an indication of value in one direct step.

The Direct Capitalization method, using a rate abstracted from the market was not used because there was insufficient income and expense data available for the known comparable sales. Detailed income and expense histories are vital to abstracting a capitalization rate that is reliable.

We have chosen a yield capitalization method in our analysis of income. Two generally accepted methods of yield capitalization are the Mortgage Equity Technique and the Discounted Cash Flow Method. In all methods of yield capitalization, the future benefits that will be derived from a property are discounted to their present worth to estimate a "present value". The benefits typically considered consist of periodic net income, the growth in periodic net income, the equity build-up through mortgage loan amortization, and the reversion of the sales proceeds in excess of the mortgage loan balance and other costs at the end of the term. The rate at which these cash flows and reversion are discounted to a present value is designated by various analogous terms. Among them are the Equity Yield Rate, the Internal Rate of Return (IRR) and the Discount Rate. IRR is considered by many financial analysts to be the most comprehensive measure of financial benefits that will be received by the investor during the period of ownership.

The Mortgage Equity Technique was not used in our analysis to develop the income value because the expected net income generated by the subject property will vary from year to

Leased Fee Income Approach Example

year over the projected holding period of our analysis. Since the capitalization rate derived using the Mortgage Equity technique is applied to the first year's net income, it would not be proper to apply this rate to a net income that fluctuates each year due to the existing lease contracts, projected rentals, fluctuating expenses, or vacancy that varies from year to year. In these instances, the proper technique is the Discounted Cash Flow Method. However, we did use the Mortgage Equity Technique to develop the Terminal Year capitalization rate because income and expenses are projected to be stabilized in the terminal year and beyond.

Discounted Cash Flow Method

Because the subject's cash flows will change during the projected holding period of our analysis, we have chosen the Discounted Cash Flow Method to be the most appropriate method of capitalizing the income of the subject into value. This method accounts for the variance in net income from year to year.

Of particular significance in our analysis are the mortgage interest rates, the estimated holding period, the loan to value ratio, the required cash on cash IRR. The following assumptions were used in our calculations:

| | |
|-----------------------------------|----------|
| Projected Holding Period | 7 years |
| Loan Ratio | 70.00% |
| Loan Term | 20 years |
| Investor Equity Portion | 30.00% |
| Required Investor Yield | 11.00% |
| Soft Costs in addition to Equity | 2.00% |
| Selling Expenses in Terminal Year | 7.00% |

Leased Fee Income Approach Example

Final Value by the Income Approach

The subject's projected annual income and expenses over the holding period of our analysis and the assumptions above were used to calculate the present value of the annual cash flows by the Discounted Cash Flow Method. An indicated value of \$7,481,256 was calculated. This value has been rounded to \$7,500,000.

Final Value by the Income Approach

Seven Million Five Hundred Thousand Dollars

\$7,500,000

Leased Fee Income Approach Example

Projected Cash Flow Analysis

REFERENCE NO: SAMPLE ANALYSIS
 ANALYSIS DATE: 08-01-09

| | |
|-------------------|------------------|
| Indicated Value | \$7,481,259 |
| Less Loans 70.00% | <u>5,236,882</u> |
| Equity | 2,244,378 |
| Soft Costs: 2.00% | <u>149,625</u> |
| Total Investment | \$2,394,003 |

| | <u>Year 1</u> | <u>Year 2</u> | <u>Year 3</u> | <u>Year 4</u> | <u>Year 5</u> | <u>Year 6</u> | <u>Year 7</u> |
|--------------------------|---------------|----------------|----------------|----------------|----------------|----------------|----------------|
| | 08-2009 | 08-2010 | 08-2011 | 08-2012 | 08-2013 | 08-2014 | 08-2015 |
| <u>Cash Flows</u> | | | | | | | |
| Net Income | 752,526 | 752,009 | 741,282 | 730,341 | 719,181 | 707,797 | 696,186 |
| Interest Expense | -362,634 | 353,628 | 343,970 | 333,615 | 322,511 | 310,604 | -297,836 |
| Loan Amortization | -124,584 | - | - | - | - | - | - |
| Cash Flow | 265,308 | <u>264,792</u> | <u>254,065</u> | <u>243,123</u> | <u>231,963</u> | <u>220,580</u> | <u>208,969</u> |
| Cash on Cash Yield | 11.08% | 11.06% | 10.61% | 10.16% | 9.69% | 9.21% | 8.73% |
| Debt Coverage Ratio | 1.54 | 1.54 | 1.52 | 1.50 | 1.48 | 1.45 | 1.43 |

Reversion - Proceeds of Sale at the end of 7 Years

| | |
|-------------------|------------------|
| Future Sale | \$7,227,160 |
| Sale Costs: 7.00% | -505,901 |
| Less Loans | <u>4,151,154</u> |
| Reversion | \$2,570,105 |

Internal Rate of Return: 7 Year Holding Period

| | | | | | | | |
|-------------------------|------------|---------|---------|---------|---------|---------|-----------|
| Initial Investment | -2,394,003 | | | | | | |
| Cash Flow | 265,308 | 264,792 | 254,065 | 243,123 | 231,963 | 220,580 | 208,969 |
| Reversion | | | | | | | 2,570,105 |
| INTERNAL RATE OF RETURN | 11.000% | | | | | | |

Present Value of Cash Flows using a Discount Rate of 11.000%

| | | | | | | | |
|-----------------|-----------------|----------------|----------------|----------------|----------------|----------------|------------------|
| Cash Flow | 265,308 | 264,792 | 254,065 | 243,123 | 231,963 | 220,580 | 208,969 |
| Reversion | | | | | | | <u>2,570,105</u> |
| | | | | | | | 2,779,074 |
| Present Value | | | | | | | |
| Discount Factor | <u>0.900901</u> | <u>0.81162</u> | <u>0.73119</u> | <u>0.65873</u> | <u>0.59345</u> | <u>0.53464</u> | <u>0.481658</u> |
| Present Value | 239,016 | 214,911 | 185,770 | 160,153 | 137,659 | 117,931 | 1,338,564 |

P V of CASH FLOWS \$2,394,003 approximates Initial Investment of \$2,394,003,
 based upon a value of \$7,481,259

Leased Fee Income Approach Example

Discounted Cash Flow Methodology

Because we have assumed that the typical investor in the subject property would finance the property at the best prevailing mortgage terms, we discounted the cash flows rather than the net incomes during the projection period. This method recognizes that the typical investor would be most concerned with the "yield" on equity, based upon the annual cash flows; that is, actual cash available after all expenses and debt service. The present value of these total cash flows is equal to the total investment, including closing costs.

Using the subject property as an example, the present value of the discounted cash flows of the equity portion of the investment is \$2,394,002, which is equal to the sum of the cash equity of \$2,244,377 and closing costs of \$149,625. Therefore, if we divide the present value of the investment (\$2,394,002) by the percentage of the equity 32.00% (Cash Equity = 30.00% and Soft Costs = 2.00%), the result is the present value of the property, \$7,481,256 ($\$2,394,002/32.00\%$).

Leased Fee Income Approach Example

Net Present Value Analysis

As a proof of the calculations performed in the Discounted Cash Flow Method, we performed a Net Present Value analysis of the cash flows, using the same Required IRR of 11.00% and Holding Period of 7 years. The net present value of the cash flows, i.e. the Present Value of the cash flows less Initial Cash Investment, is near zero. This verifies that the calculations used in the Discounted Cash Flow Method are correct.

Proof of Yield on Equity

REFERENCE NO: SAMPLE ANALYSIS
 PROPERTY: Office Building
 ANALYSIS DATE: 08-01-09

| | | | |
|------------------------|--------------|-----------------------------------|----------------------|
| | | Required Rate of Return | 11.000% |
| | | Holding Period | 7 Years |
| Original Equity | Ratio | Value | |
| Equity | 0.30000 | \$7,481,259 | \$2,244,378 |
| Soft Costs | 0.02000 | \$7,481,259 | <u>149,625</u> |
| | | Initial Cash Investment | \$2,394,003 |
| Terminal Equity | | Resale Value | \$7,227,160 |
| | | Loan Balance | -4,151,154 |
| | | Sale Expenses | <u>-505,901</u> |
| | | Net Reversion | \$2,570,105 |
| PROOF | | | |
| Year | Cash Flow | Present Value Factor @ 11.000% | Present Value |
| 1 | 265,307.72 | 0.9009009 | 239,015.96 |
| 2 | 264,791.53 | 0.8116224 | 214,910.73 |
| 3 | 254,064.59 | 0.7311914 | 185,769.84 |
| 4 | 243,123.28 | 0.6587310 | 160,152.84 |
| 5 | 231,962.78 | 0.5934513 | 137,658.62 |
| 6 | 220,579.59 | 0.5346408 | 117,930.85 |
| 7 | 208,968.84 | 0.4816584 | 100,651.60 |
| Net Reversion | 2,570,104.75 | 0.4816584 | <u>1,237,913.00</u> |
| | | Present Value of Cash Flows | 2,394,002.94 |
| | | Initial Cash Investment | <u>-2,394,002.75</u> |
| | | Net Present Value | 0.19 |

Leased Fee Income Approach Example

Yield Analysis

To examine the effect upon value of different Internal Rates of Return, we selected a range of yield rates above and below the Internal Rate of Return of 11.00% that was used to calculate the final estimate of value by the Income Approach of \$7,481,256. Applying the same mathematical analysis, but using this selected range of Internal Rates of Return, the results are presented below.

Yield Range Analysis

REFERENCE NO: SAMPLE ANALYSIS
 PROPERTY: Office Building
 ANALYSIS DATE: 08-01-09

Input Variables

| | |
|----------------------------------|-------------------|
| Projected Holding Period | 7 Years |
| Loan Ratio 1 | 70.00% |
| Interest Rate | 7.00% |
| Loan Term | 20 Years |
| Investor Equity Portion | 30.00% |
| Yield Range Analyzed (IRR) | 8.000% to 14.000% |
| Soft Costs in Addition to Equity | 2.000% |
| Selling Expenses: Terminal Year | 7.000% |

| Selected IRR | Indicated Value | Required Equity | D.C.R. |
|---------------------|------------------------|------------------------|---------------|
| 8.00% | 8,344,076 | 2,670,105 | 1.38 |
| 8.50% | 8,185,894 | 2,619,486 | 1.41 |
| 9.00% | 8,033,921 | 2,570,855 | 1.44 |
| 9.50% | 7,887,792 | 2,524,093 | 1.46 |
| 10.00% | 7,747,170 | 2,479,095 | 1.49 |
| 10.50% | 7,611,755 | 2,435,762 | 1.52 |
| 11.00% | 7,481,260 | 2,394,003 | 1.54 |
| 11.50% | 7,355,407 | 2,353,730 | 1.57 |
| 12.00% | 7,233,961 | 2,314,867 | 1.60 |
| 12.50% | 7,116,685 | 2,277,339 | 1.62 |
| 13.00% | 7,003,365 | 2,241,077 | 1.65 |
| 13.50% | 6,893,808 | 2,206,019 | 1.68 |
| 14.00% | 6,787,815 | 2,172,101 | 1.70 |

Leased Fee Income Approach Example

Debt Coverage Ratio

The Debt Coverage Ratio is often considered by lenders when underwriting a loan secured by an income producing property. The formula for the DCR is:

$$\text{Net Income} / \text{Annual Debt Service} = \text{Debt Coverage Ratio}$$

Based upon a first year net income of \$752,526 and an annualized loan payment that is based upon a Loan to Value Ratio of 70.00% of value, the indicated DCR for the first year of our analysis is 1.54.