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| Income Capitalization Approach |

Methodology

The market valuation of the subject property is summarized in this section via the **Direct Capitalization Method** of the Income Approach. In applying the Direct Capitalization Method, two components are necessary in arriving at an estimate of net operating income: potential revenues and projected operating expenses; with the difference resulting in net operating income. Value is then derived by dividing stabilized year's income by a market derived capitalization rate. Therefore, it is important to analyze both income and expenses for the subject property in terms of reasonability and their relative relationship to similar properties in the marketplace.

Potential Gross Rental Income

A review of current subject market trends indicates that typical tenant spaces in the subject market area for manufactured home spaces are written on a **modified gross** rental basis. Modified gross tenant rents in the marketplace typically include a base rent, with the tenant directly responsible for their own electricity, cable, and internet. Tenants also reimburse the landlord for water, sewer, and trash. The landlord is typically responsible for common area utilities, maintenance and repairs, property insurance, allocations for management fees, and reserves for the replacement of capital items. Hence, it is under the preceding modified gross basis we have anticipated that all future rent for the subject would be payable on this basis.

Comparable Rent Analysis

The following analysis focuses on the market stabilized value of the subject property. In order to estimate the current market rent achievable for the subject property, we conducted a survey of reasonably comparable manufactured housing communities with the immediate and expanded market areas. The results of this survey are summarized on the following pages along with location maps and photographs relating to each comparable manufactured housing community.

Rental Adjustments

Depending on market conditions, free rent and other incentives are used to attract tenants. When applicable, the comparable rents are adjusted to reflect current market terms with an effective rent to the property owner.



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| **Rent Comparable Location Map** |
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|  |

Merge & Insert Rent Comp Photos or Write-ups

Comparable Rent Analysis

Our rental survey includes comparable manufactured home or mobile housing communities in the subject’s general area in order to estimate achievable, stabilized market rent for the subject property. From our rental survey we selected leases of manufactured home park space most similar to the subject property. Overall, the comparables provide a reasonable basis for concluding an achievable, stabilized market rent for the subject property. All of the comparables are considered to provide a good basis for estimating the market rent at the subject property.

Double-Wide Spaces

Merge & Insert Rent Comp Data Analysis Output

Single-Wide Spaces

Merge & Insert Rent Comp Data Analysis Output

RV Spaces

Merge & Insert Rent Comp Data Analysis Output

Subject Leasing Activity

The following table summarizes the rent roll for the subject, as of the date of valuation. All space rents are equivalent (single or double-wide). The RV spaces are essentially are similar in terms of rental agreements and space characteristics. As such, rental rates are also similar. The provided rent roll was as of December 1, 2019; the property manager said no tenants or rental rates have changed through the date of the property inspection (${inspect\_date}).



The landlord pays for water and sewer and the tenants are responsible for garbage expenses. Tenants also pay for their own electricity, cable tv and portable propane gas when applicable. All of these expenses are included in the rent and there is no reimbursement income. The storage area is located on the western end of the development and is available to all occupants. Currently only four (4) owners use the space which produces approximately $1,295 per year in income and have averaged approximately $1,200 in the past three years according to expense documents provided by the owner.

The subject property is professionally managed by Tom Jarmer of Ridge Management (503.772.1790). In speaking with the management company, they stated the last time rent was increased was effective June 2018 and the increase was $15 per unit. He stated the current leases are mostly on a month to month basis because the tenants have all been very long term. He stated yearly leases are typical in the marketplace with new tenants but convert to month to month after the initial year. Therefore, the property is not encumbered by a persistent leasehold interest and the fee simple interest is considered equivalent to the leased fee interest.

Most subject spaces are average in size and dimension in comparison to competing projects in the market area (most parks include spaces large enough for double-wide home and/or some back-yard space). Some include carports and several have patio and sheds, although most are older and in fair condition. As stated earlier, approximately four (4) spaces with additional hook-up for RV parking. These are not nightly rentals, but typically extend for six months or more. To rent a space, a tenant has to open an account with the city and pay a $300 deposit for the activation of the electrical unit, then pay the $475 per month space fee.

Potential Gross Rent

The space rent range of the local manufactured home park comparables is $370 to $585 per month. The subject property spaces average $455 and $510 per month (average = $470 per month). The rents appear low in the marketplace given trash collection is not included and that they were raised only nominally in July 2018. Note that the most recent rent increase at the park of $15 per month (approximate increase of 3.30%) reportedly met with little resistance, and slightly more aggressive rate increase ($30 per month, or +6.4%) is considered reasonable for this year. Indeed, the subject’s pending buyer was also the investor purchaser of Improved Sale 2 where space rents were increased from far below market rate of $300 per month to reportedly $500 per month in the timeframe of 1 year without losing any tenants.

Considering comparable properties surveyed, along with the overall market area at very high occupancies (comparables are between 96% and 100%), we do not anticipate there to be any added risk to the subject property by raising rental rates to be within range of the closest competitors within Hood River County (albeit slightly below, due to space sizes/inferior quality/condition). Therefore, a more applicable **market rent of $500 per space** will be utilized in this analysis **for all ${spaces} spaces**.

Potential Gross Rental Income

Gross potential rental income at market rent is forecast at **$\_\_\_\_\_\_\_\_\_** ($\_\_\_\_\_\_\_\_ per space). This amount is indicated in the following stabilized income and expense statement for the subject property.

Other Storage Income

Other income at the subject property includes income from miscellaneous charges and RV Storage Fees. Between 2018 and 2020, miscellaneous charges amounted to $19, $12, and $13 per space per year, which is in-line with market indicators, which suggest a range from $0 to $350 per space per year. Considering the historic figures at the property, miscellaneous charges for the subject property are estimated at **$15 per space per year** for a total of **$915 per year.**

The subject has the unique positioning of having an RV storage yard with surplus capacity and has been collecting RV storage rent from residents within the subject and from the immediately surrounding mobile home park (Giadanj Estates, which is under the same ownership). We anticipate this arrangement would continue in the future, as it benefits both park owners and residents. RV Storage income between 2016 and 2018 was $11,062, $12,127, and $11,250. Considering the preceding, RV Storage income for the subject property is estimated at **$11,250 per year.**

Note that the landlord has an arrangement for revenue sharing with Comcast which produces additional income. However, this income is considered to be business-related and may not be available to a more typical market operator of the subject. It is therefore not considered in our analysis.

Utilities / Cable Reimbursements

The tenants pay electricity directly, while reimbursing the landlord for water (including reading and billing fee), sewer, and cable services. Between 2018 and 20 the reimbursements equated to $105, $109, and $109 per unit per month. Considering utilities typically increase each year, this analysis concludes at reimbursement income slightly above that of 2020, at **$110 per unit per month** for a total of **$915 per year.**

Potential Gross Income

Combining gross potential rental income with other income and reimbursements equates to potential gross income of **$\_\_\_\_\_\_\_\_\_** ($\_\_\_\_\_\_\_\_ per space).

Vacancy and Credit Loss

This expense category accounts for the time period between tenants, as well as possible prolonged vacancies under slow market conditions. The assignment will reflect the probable vacancy during the economic life of the property.

At the time of inspection, the subject property had no vacancies. A review of other comparable sale properties indicates most investors evaluate the income potential of similar projects using a zero to 5% vacancy and collection loss factor, while comparables surveyed indicate vacancies of less than 2% and have effectively been operating at stabilized levels long-term.

Copy these paragraphs directly from Market Analysis

According to the most recent **Multi-family Northwest Report** (Fall 2020), current average multi-family vacancy in the subject’s immediate Milwaukie area is at 3.0%. The current average rental rate is $1.43 per SF, which has stayed steady from $1.43 per SF from Spring 2018.

The subject primarily competes with manufactured home parks in the Clackamas / Milwaukie Submarket. As of April 2020, **CoStar** reports an overall vacancy rate of 4.1% (56 out of 1,363 units among 32 developments). which is down from the 5-year average of 4.5%. Occupancy rates have been relatively stable for the past five years. Rental rates have increased steadily over the past five years, with current rent estimated at $538 per months, in comparison to the 5-year average of $511.

Therefore, based on the above, a stabilized vacancy and credit loss of **5.0%** is estimated for the subject property. According to manufactured housing community investors, as well as brokers, this amount is reasonable.

Effective Gross Income

Based on the preceding, effective gross rental income for the subject property is estimated at **$\_\_\_\_\_\_\_\_\_** ($\_\_\_\_\_\_\_\_ per space).

Projected Operating Expenses

The next step in the Income Capitalization Approach is to estimate the subject's stabilized operating expenses. The market rent conclusion has been based upon a modified basis, similar to multi-family apartment properties. The landlord is responsible for expenses including real estate taxes, insurance, property management, administrative expenses, repairs and maintenance and some utilities (water / sewer / garbage expenses and common areas).

To estimate expenses applicable to the subject property, the subject’s most recent income statement was analyzed. Additional expense information was obtained from our files, which includes expenses from other manufactured housing communities in the region.

Real Estate Taxes: Real estate taxes for this analysis are based on the subject’s most recent tax obligation and a projection (3% by law increase) of next year’s rate because the fiscal tax year is more than half over of **$\_\_\_\_\_\_\_\_**.

Insurance: No historical insurance expenses of the subject were available. Therefore, recent comparables in the marketplace were referenced which suggest insurance expenses reported between $75 and $200 per space per year. Based on this figure, as well as information contained in our files, an annual expense of **$100 per space** is reasonable based on the subject’s age, limited amount of improvements and overall size.

Utilities: This category includes the water, sewer, trash, and minimal common area electricity. The property manager was only able to provide billings for the past three years, which amounted to $25,984, $29,545, $30,898 for the year for the 30 spaces suggesting a monthly rate of $866, $985 and $1,030 per unit per month. Similar properties range from $800 to $1,200 per unit per year. Given the subject historical billings fall well within the market range, it is given majority weight. Therefore, this stabilized analysis utilized an annual utility expenses of **$1,000 per space**.

Management & Administration: According Commonwealth Real Estate Services, a regional property management company, typically, professional management fees range between 5.0% and 10.0% of effective gross income, depending on the size and quality of the property. The property manager is presently collecting approximately 15.0% of potential gross income in fees according to the expense statement, which appears on the high side for the market, but considering the diminished / under-performing size of the project and outlying location, not surprising. As such, a more reasonable management fee of **9.0% of EGI** is applied for this analysis.

Repairs and Maintenance: This category includes ongoing routine repairs and maintenance of items such as interior streets and landscaping. It is typical in the market for the maintenance and repair expense to average 3.0% to 8.0% of the effective gross income of seasoned parks. This allocation is considered adequate to maintain the subject improvements in good condition, which is important in order to maintain and attract new tenants. In many instances, maintenance and some repairs are performed by on-site park management without separate allocation of time from the management account ledger. Therefore, this expense category is often under-reported. Based on the current age and condition of the park, repairs and maintenance is estimated at **6.0% of EGI**.

Reserves for Capital Replacements: This expense is typically not an annual cash outflow, but rather a set-aside for major expenses anticipated in the future for replacement of short-lived items. Park infrastructure is constantly in need of upkeep/investment. The annual expense for reserves for replacement is estimated by determining the replacement cost for the individual items and assuming a realistic economic life. The annual replacement expense is a contribution to the reserve account based on a four-percent sinking fund factor. While expenses for reserves will not be incurred for a number of years, and not every year, it is important that these short-lived components be kept in good condition in order to attract a good tenant base. Reserves for replacement will typically range from below 2.0% to over 3.0% or 4.0% percent of the effective gross income. The expense for reserves is estimated at **3.0%** **of EGI**.

Total Operating Expenses

Based on the preceding, total stabilized operating expenses for the subject property equate to **$\_\_\_\_\_\_\_\_\_** ($\_\_\_\_\_\_ per space; \_\_\_.\_\_% of EGI)*.* The estimated stabilized operating expenses are considered reasonably supported in this analysis.

Net Operating Income

Deducting projected annual operating expenses from effective annual effective gross income, results in projected net operating income for the subject property of **$\_\_\_\_\_\_\_\_\_** ($\_\_\_\_\_\_\_\_ per space), as is summarized on a following page. It is at this time that net operating income can be capitalized into a value estimate.

Overall Capitalization Rate

Direct Comparison Analysis

The final step of the Income Capitalization Approach is to capitalize the estimated net operating income by an appropriate rate. The capitalization rate is estimated using the market sales method. The overall capitalization rate of each sale is market derived by dividing its net operating income by its cash equivalent sale price. This technique illustrates what purchasers are willing to pay for the net operating income available from competitive investment properties. This method best approximates the decision-making processes of the typical investor.

The primary factors influencing capitalization rates are: 1) The quality and certainty of the net operating income stream; 2) risk factors; 3) physical and locational characteristics of the property; 4) the competitive market position of the property and 5) the potential for future appreciation. The following chart summarizes the data used to estimate the market capitalization rate applicable to the subject property.

Merge cap rate comparables from CARDS and insert into here (example below)

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **Comp. No.** | **Property Name Address Location** | **Sale Date** | **Year Built (Renovated)** | **Rentable Units** | **Cash Equivalent Sales Price** | **Cap Rate** |
| 1 | Summer Oaks Park 3220 Crescent Avenue Eugene, OR | 04/16 | 1997 | 102 | $10,400,000 | 4.80 % |
| 2 | Aspen Meadows MHC 13400 SE Holgate Boulevard Portland, OR | 07/17 | 1994 | 118 | $12,765,000 | 4.60 % |
| 4 | Country Manor MHP 15619 NE Caples Road Brush Prairie, WA | 10/18 | 1968 | 159 | $15,000,000 | 4.93 % |
| 5 | Clairmont MHP 13531 Clairmont Way Oregon City, OR | 03/19 | 1969 | 188 | $21,000,000 | 4.76 % |
| A | Nine Oaks MHP 4239 SE 122nd Avenue Portland, OR | 08/17 | 1993 | 14 | $1,050,000 | 5.50 % |
| B | Viking MHP 3441 SE 111th Avenue Portland, OR | 10/18 | 1964 | 31 | $2,225,000 | 5.25 % |
| C | Fir Haven MHP 17007 SE Stark Street Portland, OR | 04/19 (Listing) | 1928 | 54 | $4,100,000 | 6.24 % |

The surveyed capitalization rate sales data indicate a range of capitalization rates from 5.98% to 6.85% (average = 6.25%). The comparables show a relatively small range and are considered to be fair indicators of a market capitalization rate and all of them have been weighed on our conclusion. Based on the subject’s age / condition and unit mix, a capitalization rate toward the middle of the range is considered reasonable.

Cap Rate Conclusion

Based on the preceding, we have concluded a **direct capitalization rate** of **\_\_\_\_\_\_%** as reasonable for use in analyzing the subject property on a stabilized basis.

Concluded Market Value Via The Income Capitalization Approach

To value the subject by Direct Capitalization, the Net Operating Income was divided by the selected overall rate yielding a **stabilized market value** of the fee simple interest in the **subject property**, via the **Income Capitalization Approach** (rounded to the nearest $5,000):

|  |  |
| --- | --- |
|  |  |
| **Concluded Market Value Via the**  **Income Capitalization Approach:** | **$\_\_\_\_\_\_\_\_\_\_\_\_** |

Our analysis of the subject property via the Income Capitalization Approach is presented on the following page.

