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| Valuation Methodology |

Three Approaches to Value

There are three traditional approaches typically available to develop indications of real property value: the Cost, Sales Comparison, and Income Capitalization Approaches.

Cost Approach

The Cost Approach is based upon the principle that a prudent purchaser would pay no more for a property than the cost to purchase a similar site and construct similar improvements without undue delay, producing a property of equal desirability and utility. This approach is particularly applicable when the improvements being appraised are relatively new or proposed, or when the improvements are so specialized that there are too few comparable sales to develop a credible Sales Comparison Approach analysis.

Sales Comparison Approach

In the Sales Comparison Approach, the appraiser analyzes sales and listings of similar properties, adjusting for differences between the subject property and the comparable properties. This method can be useful for valuing general purpose properties or vacant land. For improved properties, it is particularly applicable when there is an active sales market for the property type being appraised – either by owner-users or investors.

Income Capitalization Approach

The Income Capitalization Approach is based on the principle that a prudent investor will pay no more for the property than for another investment of similar risk and cash flow characteristics. The Income Capitalization Approach is widely used and relied upon in appraising income-producing properties, especially those for which there is an active investment sales market.

Subject Valuation

In this appraisal, two traditional approaches to value are used to determine the subject's as is market value (as encumbered by the ground lease) of the leased fee interest; which reflect the Income Capitalization and Sales Comparison Approaches. Due to the age of the improvements and very long remaining duration of the ground lease, a Cost Approach was not deemed applicable in this appraisal.

As the scope of this appraisal is to estimate the market value of the subject leased fee interest, and given the lack of such ground leased fee sales from our research, it was initially necessary to appraise the fee simple interest in the subject land. Thus, in following Section 1 – Fee Simple Land Valuation, only the Sales Comparison Approach is used to estimate the underlying land value.

Next in Section 2 –Leased Fee Valuation, we will estimate the market value of the subject leased fee interest via a series of analyses, first involving an allocation for the lessee’s positive or negative leasehold interest and deducting or adding amount relative to the concluded fee simple land value in arriving at a subject leased fee value estimate. Alternatively, this will be cross-checked with a discounted cash flow analysis involving the projection of the contract rent payable on the underlying ground lease over the remaining term of the ground lease, and discounting this cash flow plus the reversionary interest in the subject land back to a present value equating another value estimate of the leased fee interest.

Finally, in Section 3 – Reconciliation and Final Conclusion, these two value estimates will be reconciled into a final as is market value of the subject lease fee interest.

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| Section 1 – Fee Simple Land Valuation |

Methodology

Land is most often valued using the Sales Comparison Approach. The opinion of market value is based on an analysis of sales, listings and pending sales of properties similar to the subject property, using the most relevant units of comparison. The comparative analysis focuses on the difference between the comparable sales and the subject property using all appropriate elements of comparison.

Unit of Comparison

Commercial zoned land in the subject market area is typically valued using either the price per square foot, or price per acre unit of comparison (after deducting any unusable portions). Due to its more common usage by buyers and sellers in the greater Salem metro market area, the price per square foot unit of comparison is used in this analysis.

Elements of Comparison

Elements of comparison are the characteristics or attributes of properties and transactions that cause the prices of real estate to vary. The main elements of comparison that are considered in sales comparison analysis are as follows: (1) real property rights conveyed, (2) financing terms, (3) conditions of sale, (4) expenditures made immediately after purchase, (5) market conditions, (6) location and (7) physical characteristics.

Sale Adjustments

When applicable, the comparables are adjusted for property rights conveyed, financing terms, conditions of sale, market conditions, location, and physical characteristics. After adjustments, analysis reflecting market behavior is used to determine which comparables are superior or inferior to the subject after considering the remaining characteristics that could not be accounted for in the adjustment process. This analysis establishes value parameters for the subject, allowing for a final conclusion of value.

Land Sale 1 was adjusted upward / downward …. Etc. etc.

No other specific adjustments were made to the comparables’ sale prices; although qualitative economic and property characteristics adjustments are addressed in the following analysis.

Land Valuation Analysis

Presented on a following page is a summary chart of the selected land transaction data. Our research found there to be few recent, larger acreage, industrial zoned land sales with commercial potential in the immediate Hillsboro area. Hence, in order to gather enough recent land transactions, the appraiser was forced to expand our search to include reasonably similar submarkets as proxy in estimating the subject’s current land value. This resulted in an array of commercial sales from throughout the Portland metro area, including the Tigard, Wilsonville, Sherwood and Wood Village areas. In aggregate, they were considered sufficiently comparable to render a reasonable estimate of land value.

The land sales occurred between July 2017 and December 2018, plus one deal pending for June 2019. These comparables indicate adjusted prices ranging widely from $11.17 to $19.77 per SF. The properties range in size from 5.74 to 15.85 net acres, which brackets the subject site at ${netacre} acres, and overall are considered sufficient and relevant for purposes of our analysis. Presented following is our fee simple land valuation analysis.

Insert Data Analysis merge of individual comparables here

Additional Quantitative Analysis

In addition to the preceding, an adjustment grid for the comparable sales is provided as additional analysis following the summary chart. The adjusted comparables indicate an adjusted price per square foot between $14.20 and $14.85 per SF with an average price of $14.53 per SF and median price of $14.50 per SF. Note that a market conditions adjustment of 2.0% per year was applied in this analysis through the date of inspection. The adjusted value range provides additional support for the following final value conclusion.

Subject Land Sale Activity

None.

Concluded Market Land Value

The subject site has a good broad highway frontage location with above average site access and exposure in close proximity amid a concentration of commercial retail and auto dealership uses in the southeast sector of the City of Hillsboro. Overall, primary emphasis is placed near the upper mid-range of Land Sales 2, 3, 4 and 5 ($11.69, $11.17, $13.11 and $15.00 per SF). Strong secondary consideration is also placed on the average and median adjusted prices ($14.50 and $14.75 per SF). Hence, a unit land value of **$14.50 per SF** is concluded in this assignment.

Therefore, it is the appraiser’s opinion that the **concluded market value** of the fee simple interest in the **subject land** (${netsf} SF land area) is rounded to:

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| --- | --- | --- | --- |
|  |  |  | |
| **Concluded Market Land Value** | **$14.50 / SF** | **$8,370,000** |





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| **Land Sales Location Map** |
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Insert Land Sale Aerial Plats or Comp Write-ups

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| Section 2 – Leased Fee Valuation |

Methodology

There are two opposite methods an appraiser can employ in approaching the valuation of the subject leased fee interest, as encumbered by the existing ground lease. In the first method, this involves allocations of value by direct deduction or addition of the tenant / lessee’s positive or negative leasehold interest to the concluded fee simple land value in arriving at a leased fee value estimate for the subject. In the second method, a discounted cash flow analysis involving the projection of the contract rent payable on the underlying ground lease over the remaining term of the ground lease (reasonably assumed over the 30 years potentially remaining on the lease as of January 10, 2019, which assumes the current 5-year term plus the remaining [5] 5-year options to extend), and discounting this cash flow plus the reversionary interest in the subject land back to a present value equating the current leased fee interest. Finally, these two value estimates will be reconciled into a final market value of the subject leased fee interest.

Based on the preceding, our leasehold analyses are provided as follows.

Method 1 – Allocation of Value

As noted, the subject site is currently 100% leased to one master ground Lessee. In estimating the leased fee value of the subject property (as of ${eff\_date\_value}), it is necessary to adjust its concluded fee simple value for the impact of the tenant's leasehold position caused by the payment of below or above-market, contract rent over their remaining lease terms.

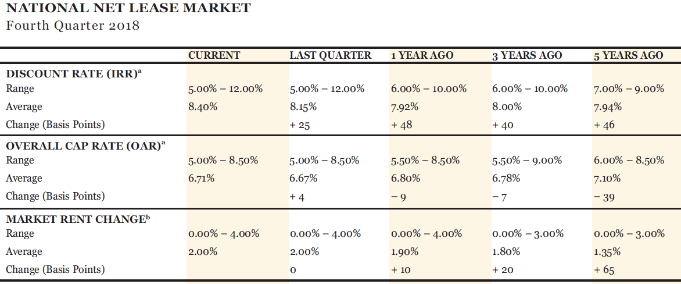
As previously discussed in the Sale History subsection, the subject ground lease is for an initial 20-year period to the lessee – Home Depot USA, Inc. (NYSE HD; Moody’s “A2” / S&P’s “A” credit ratings), with the lessee having (6) 5-year options to extend. The original 20-year term began February 1, 1999 and ended January 31, 2019 (shortly after the effective date of value of ${eff\_date\_value}). The terms are absolute triple net with tenant responsible for all expenses, including management and reserves for capital improvement replacement. Pertinent excerpts of the ground lease are contained in the Addenda of this report. A tenant rent roll relative to the master ground lease is provided below.



On February 1, 2014, the contract rent for the 5-year period which ended January 1, 2019 was fixed a monthly rate in advance at $48,054.20 per month ($576,650.40 per year), when ran through the end of the initial 20-year lease term. Section 4.1 & 4.2 of the original ground lease stipulated that every 5 years thereafter, the rent adjusts by the percentage increase in CPI – Urban Wage Earners and Clerical Workers (All Items, USA, 1982-1984 = 100), but in any event no greater than 12.5%. According to the ground lessor’s representative, the CPI increase over the prior 5 year period results in a contract rate for the 1st / current 5-year period beginning February 1, 2019 of $52,304.01 per month ($627,648.18 per year) or a +8.84% increase over the prior period (less than the maximum of 12.5%). The tenant also has (5) remaining 5-year lease options to extend, or the potential for up to 25 years in option extensions beyond the current first renewal term.

Overall, the current contract rent is considered slightly below market with a measurable positive leasehold interest. Our leasehold analysis of the subject is presented in the chart following this subsection, and explained in the following narrative.

With respect to market rent escalations, we have anticipated future inflation at a rate of +2.0% per year. This rate of appreciation is supported by investor expectations indicated by recent, long-term tenant leases in the Portland market. Finally, as indicated in the following chart from the PwC Real Estate Investor Survey – Q-4 2020 this survey indicates current investor expectations for rent inflation range from 0.0% to 4.0% with an average of 2.0% for the National Net Lease Market.



Over the remaining term of the tenant lease, the positive (or negative) leasehold position held by the tenant is merely the sum of the present values of the monthly differential between market and contract rents. Because the tenant's rent is payable on a monthly basis, it was necessary to project the rent differential on a monthly basis, much like an annuity. The periodic (monthly) rent differential between contract and market rent for the remaining months of the lease was brought back to a present value based on proper discount rate.

Our determination of a proper, market supported discount rate is based on surveyed national risk rate criteria from the PwC Real Estate Investor Survey provided preceding. As of Q-4 2020, this survey indicates current investor expectations of 5.0% to 12.0% with an average of 8.40% for the National Net Lease Market. Overall, we have assumed an upper-range 10.00% discount rate for purposes of this cash flow. While the Lessee has a very strong credit rating, the uncertainty related to the short 5-year renewal periods is a more than offsetting factor suggesting an upper end discount rate is applicable.

The calculations relating to our valuation of the subject leasehold interest are provided in the following chart. Note that market rents are forecast to increase at 2.0% per year. However, contract rents are forecast to go up below a maximum rate of 12.5% every 5 years, as the formula states the rate of increase will be either the change in CPI, or no more than 12.5%. For example, assuming a standard inflation rate of 2.0% over years, this would mean that CPI would be roughly a 10% increase. Hence, it is considered likely the contract bumps will continue to be below the maximum of 12.5% for each 5-year renewal, and remain at this level for each successive 5-year renewal period.

Multiplying the estimated fee simple land value of $8,370,000 by a reasonable return on land of 8.0%, this equates to market ground rent of $55,800 per month. This is somewhat less than the current contract ground rent of $52,304 per month as of February 1, 2019 (i.e. there is measurable positive tenant leasehold position), with this positive position to continue over the remaining 30 years of the lease ending January 31, 2049 (again, assuming the remaining [5] 5-year options are exercised).

The calculations relating to our valuation of the subject leasehold interest are provided in the following chart. Based on this analysis, the **market value of the lessee’s positive** **leasehold interest** in the subject property is concluded at **$780,000**, which under this methodology would likely be recognized as a deduction in value relative to the fee simple value by a potential investor to recognize the right to receive this below-market cash flow for the remainder of the ground lease.

Deducting the market value of the positive leasehold interest in the subject property from the concluded fee simple land value results in a **concluded market value** of the **leased fee** interestin the subject property via leased fee allocation analysis - Method 1 as indicated following:

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
|  |  |  | | | **Value Conclusion** |
| **Concluded Market Land Value – Fee Simple** | | |  |  | **$8,370,000** |
| Less: Value of Positive Leasehold Interest | | |  |  | **($780,000)** |
| **Method 1) Leased Fee Market Value** | | |  |  | **$7,590,000** |



Method 2 – Discounted Cash Flow Analysis

A second approach to valuing the subject’s leased fee interest is to measure the value of the existing ground lease in place through a discounted cash flow analysis. In conducting a Discounted Cash Flow Analysis, income and expenses are projected over a typical investor holding period, and expense projections are then subtracted from income projections, resulting in net operating income. Net operating income projections are then discounted for time to reflect their future receipt, and then added together, resulting in a present value of the income stream. The reversionary value (net sales proceeds at the end of the holding period) of the property is estimated and discounted, resulting in a present value of the reversion. The present value of the reversion is then added to the present value of the income stream, resulting in the overall improved property value via a discounted cash flow analysis.

The following yield capitalization analysis will use much of the same data, analyses, and projections already set forth in the previous approach. Similar assumptions and projections are made about the growth in income, discount rates, occupancy, and reversion. These projections and assumptions are made and presented following.

In the case of the subject property, the cash flow period is projected over 30 years or 360 months (February 1, 2019 through January 31, 2049), which reflects the remaining current 5-year term of the ground lease, plus a probable total of (5) 5-year extension options. The contract rent as of February 1, 2019 is $52,304 per month, and per the terms of the ground lease, we have estimated the contract rate will step up by a projected rate of +10.0% every 5 years. In remaining consistent with Method 1, we have assumed contract rent inflation of +2.0% per year. As the subject lease is based on an absolute triple net expense structure, no expenses are deducted. Also, no vacancy / credit loss deduction is considered appropriate based on the ground lease tenancy and tenant’s ownership interest in the improvements. Thus, it is unlikely the lessee would vacate the subject site before the end of their term, though certainly any risk in this regard is built into the selected high discount rate.

In this analysis, the reversion was calculated by appreciating the current estimated fee simple land value also by an annual rate of 2.0% per year. Sales commissions of 5.0% will be deducted as a reasonable cost to the owner at the end of the lease term. In this analysis, a discount rate of 10.00% will be used for both the cash flow and reversion, which is similar to the rate used in the previous analysis. The present value of the cash flow and reversion are added to indicate the total leased fee value.

The discounted cash flow calculations relating to our valuation of the subject leased fee interest are provided in following chart.

Based on this analysis, the **market value of the leased fee** interest in the subject property via discounted cash flow analysis – Method 2, is concluded at **$7,550,000**.



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| Section 3 – Reconciliation and Final Conclusion |

Concluded As Is Market Value – Leased Fee

A summary of the two methodologies used to estimate the current market value of the subject leased fee interest is provided in the following chart.

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| --- | --- | --- | --- |
| **Valuation Approach** |  |  | **Value Conclusion** |
| **Method 1 – Allocation of Value** | Fee Simple Land Value: Less: Positive LH Value: | $8,370,000 ($780,000) | **$7,590,000** |
| **Method 2 – Discounted Cash Flow** | Leased Fee Value: |  | **$7,550,000** |

The preceding two methodologies indicate a relatively narrow range of leased fee value for the subject property. Overall, the slightly lower value indicated by the discounted cash analysis (Method 2 – discounted cash flow analysis) is considered more credible and reliable as it basically mirrors the investment decisions making process of a typical leased fee buyer.

Based on the preceding, it is the appraiser’s opinion that the **concluded as is market value** of the leased fee interest in the **subject property**, as of ${eff\_date\_value}, is as follows:

|  |  |
| --- | --- |
|  |  |
| **Concluded As Is Market Value – Leased Fee** | **$7,550,000** |

Extraordinary Assumptions:

* This report is based on a retrospective date of ${eff\_date\_value}. The condition and status of the property on the retrospective date was confirmed with the client. The appraiser inspected the subject on ${inspect\_date}. Overall, the owner representative’s confirmation appears to be accurate. Any significant deviation from the assumption could have an impact on the final value conclusion.

Hypothetical Conditions:

* None.

Exposure Time and Marketing Periods

Based on statistical information about days on market, escrow length, and marketing times gathered through national investor surveys, sales verification, and interviews of market participants, marketing and exposure time estimates of up to 6 months, respectively, is considered reasonable and appropriate for the subject property.