|  |
| --- |
| Reconciliation |

Summary of Value Indications

The reconciliation of value indications is the final step in the appraisal process and involves the reviewing and weighing of the individual valuation techniques in relationship to their substantiation by market data, and the reliability and applicability of each valuation technique to the subject project. The reconciliation criteria are appropriateness, accuracy, and quantity of evidence.

Only the Sales Comparison and Income Capitalization Approaches to value were utilized in this assignment, each involving separate and distinct techniques. The Cost Approach was omitted due to its inapplicability in this assignment. Based on the two selected methods of appraisal, the estimated **stabilized market values** of the fee simple interest in the **subject property** are as follows:

|  |  |  |  |
| --- | --- | --- | --- |
| **Valuation Approach** |  |  | **Value Conclusion** |
| **COST APPROACH** |  |  | **Not Applicable** |
| **SALES COMPARISON APPROACH** |  |  | **$\_\_\_\_\_\_\_\_\_\_\_** |
| **INCOME APPROACH** |  |  | **$\_\_\_\_\_\_\_\_\_\_\_** |

**Option 1 – Concluded As Is (No Leasehold Interest)**

Concluded As Is Market Value

Due to the strong appeal to an investor due to its leased status primary emphasis is placed on the Income Approach. Little weight is placed on the Sales Comparison Approach as the building is fully leased and thus, not available for an owner-occupant. Note that the large spread in values is representative of the delta in pricing between what an owner / partial owner-user would be willing to pay for the subject property versus what an investor would be willing to pay as currently fully leased. This spread is typical of the market and illustrates the challenge for investors in competing for industrial properties that are not encumbered by long-term leases In effect, properties like the subject are worth more as vacant than as leased. However, since the subject is a leased investment, primary emphasis must be placed on the Income Approach for reconciliation purposes.

Based on our market rent analysis, the contract rent for the subject tenant is considered reasonably close to market with no measurable leasehold interest noted. Therefore, the market value of the subject leased fee and fee simple interests is considered equal to one-another.

Based on the preceding, the **final concluded as is market value** of the fee simple interest in the subject property, as of ${eff\_date\_value}, is as follows:

|  |  |
| --- | --- |
|  |  |
| **Concluded As Is Market Value** | **$\_\_\_\_\_\_\_\_\_\_\_\_** |

**Option 2 – Concluded As Is (Measurable Leasehold Interest)**

Concluded Stabilized Market Value

Primary emphasis is placed on the Income Approach due to the subject’s leased status (2 years / 9 months remaining), which is further supported given that the rent comparables, vacancy statistics, and cap rate data were also considered relatively reliable. Note that if the subject property were vacant, it would have good owner-user appeal, and given the reasonable credibility of a number of the noted local improved sales to owner-owner-users would suggest that if the subject tenant were to vacate at the end of its lease, the reversionary sale potential of the subject would be closer to the value indicated via the Sales Comparison Approach. Discussions with local brokers indicate most owner users would only be willing to wait up to 12 months to buy / occupy a property like the subject. Thus, since the tenant still has 2 years / 9 months remaining, only weak secondary emphasis is given to this method for reconciliation purposes.

As previously, discussed, the tenant’s contract rent and continued escalations are considered at below market with a measurable positive leasehold interest noted. Therefore, the market value of fee simple interest is greater than the leased fee interest.

Based on the research, analyses and conclusions contained within this report, it is the appraiser’s opinion that the **concluded stabilized market value** of the fee simple interest in the **subject property** is as follows:

|  |  |
| --- | --- |
|  |  |
| **Concluded Stabilized Market Value- Fee Simple** | **$\_\_\_\_\_\_\_\_\_\_\_\_** |

As Is Leased Fee Valuation

As previously noted, the as is market value of the leased fee interest in the subject property represents the value of the subject property encumbered by the current arm’s length, tenant lease which was determined to be at a below market rent resulting in a measurable positive leasehold interest. The as is market value of the subject property is estimated by deducting an allocation for the positive leasehold interest from the concluded stabilized fee simple market value.

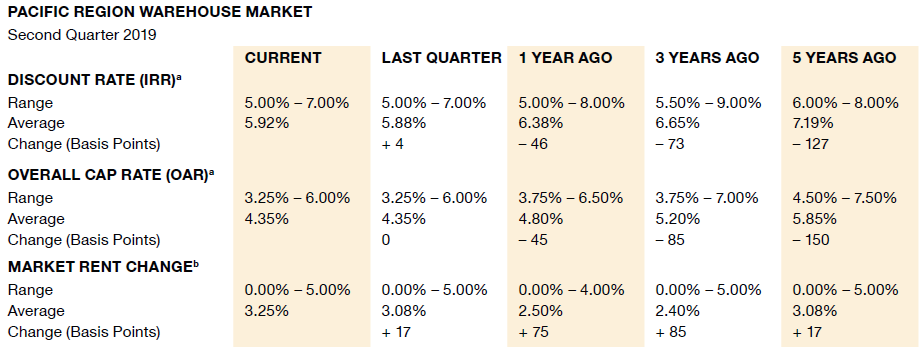
Leasehold Valuation

As noted, the subject property is encumbered by a 5-year lease extension to Carl Zeiss Vision, Inc. which began April 1, 2016 (2 Years / 9 months remaining, as of July 1, 2019 – no options to extend). A tenant rent roll is provided below, while copies of the lease & 2nd amendment to lease are contained in the Addenda of this report. This is a triple net lease with a current contract rent payable monthly as follows: Year 1 - $11,826.46 per month ($0.597 per SF; blended), which then escalates annually by a fixed rate of +3.0% per year. The current contract rent is $12,923.09 ($0.653 per SF, blended), with then escalates to $13,310.78 per month ($0.672 per SF, blended) for final Year 5. The average rent over the next 12-month period equates to $0.658 per SF, blended. Note that applying an office surcharge of $0.800 per SF to the office portion infers a current contract shell rate of $0.378 per SF, which is well below the concluded market shell rent of $0.520 per SF.

Based on the preceding, the subject tenant will continue to have contract rent at below market, and overall it was considered prudent that any investor would recognize the potential for continued fixed / below market contract rent over the term of the lease.

In estimating the current leased fee value of the subject property, it is necessary to adjust its concluded fee simple value for the impact of the tenant's positive leasehold position caused by the payment of below market contract rent over the remaining renewal lease term. The tenant’s lease terms were summarized previously in the Tenant Rent Roll, with the projections of market rent for the tenant space was provided as part of the Income Approach. Based on the preceding, our analysis is presented as follows.

With respect to rent escalations, we have anticipated long-term inflation at a rate of +3.0% per year. This rate of appreciation matches investor expectations indicated by recent, long-term industrial tenant leases in the Medford metro area (which generally indicate 3.0% / year escalations – see Rent Comps). Note that the PwC Real Estate Investor Survey – Q‑2 2019 indicates that investor expectations for the Pacific Region Warehouse Lease Market (the closet category to match the subject’s use) forecasts average market rent changes at 0% to 5.0% (average = 3.25%) which reasonably brackets our concluded assumed market rent escalation factor.



Over the remaining term of the tenant lease, the positive 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 tenants’ rents are 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 each lease was brought back to a present value based on a reasonable discount rate. Note that the PwC Real Estate Investor Survey – Q-2 2019 indicates that investor expectations for the Pacific Region Warehouse Market forecasts average discount rates at 5.00% to 7.00% (average = 5.92%).

Due to the subject's good locational and physical characteristics, as well as the lower risk of default related to the below market rent over the remainder of the tenant lease term*,* a **discount rate** toward the lower portion of the range, or **6.00%** is indicated. 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 positive** **leasehold interest** in the subject property is concluded at **$120,000** (rounded), which would likely be recognized by a potential knowledgeable investor.



Final Concluded As Is Market Value – Leased Fee

By deducting the market value of the tenant’s positive leasehold interest from the stabilized fee simple value, it is the appraiser’s opinion that the **final concluded as is market value** of the leased fee interest in the **subject property**, as of ${eff\_date\_value}, is as follows:

|  |  |
| --- | --- |
|  |  |
| Stabilized Market Value – Fee Simple | $\_\_\_\_\_\_\_\_\_\_\_ |
| **Less: Positive Leasehold Interest** | **($\_\_\_\_\_\_\_)** |
| **Concluded As Is Market Value – Leased Fee** | **$\_\_\_\_\_\_\_\_\_\_** |

The preceding equates to leased fee unit value of $140.91 per SF GLA which is still reasonably bracketed by the improved sales analyzed as part of the Sales Comparison Approach. Further, deducting 5% each for vacancy and expenses from the annual contract rent (next 12-month period) of $156,240 results in leased fee NOI of $141,007. Divided by our as is market value, this infers a leased fee cap rate of 5.05% - well below the comparables, but reasonable given the upside potential in market rents upon renewal or possible re-tenanting.

**Option 3 – Concluded Prospective (Absorption Analysis)**

Concluded Prospective Market Value - Stabilized

Assuming the subject’s future 100% leased / stabilized status as a two-tenant industrial property, primary emphasis would be placed on the Income Capitalization Approach due to its strong investor appeal. However, good credible support is also provided by the Cost and Sales Comparison Approaches which were given strong secondary consideration in arriving at the concluded prospective stabilized market value.

Note that this prospective stabilized valuation was conducted under the assumption that the subject will be leased at market rents under typical market terms. Therefore, the prospective stabilized value conclusions is reported as leased fee, consistent with the client’s requested scope of work. However, the prospective stabilized leased fee and fee simple values are considered equal to one-another.

Based on the research, analyses and conclusions contained within this report, it is the appraiser’s opinion that the **concluded prospective stabilized market value** of the leased fee interest in the subject project (95% stabilized occupancy), as of ${eff\_date\_value}, should be:

|  |  |
| --- | --- |
|  |  |
| **Concluded Prospective Market Value - Stabilized** | **$\_\_\_\_\_\_\_\_\_\_\_\_** |

Prospective Market Valuation at Completion

Absorption / Lease-up Analysis

As previously discussed, the subject property is forecast to be 100% leased two tenants on stabilization, each assumed with an equal size space with an equal amount of office build-out. Given that marketing has already begin for the project, with groundbreaking in May 2020, and project completion by February 2021, this leaves approximately 12 months in order to sign one or possibly even two tenant leases. Our review of tenant interest relating to companies currently seeking distribution space like the subject (see Listings / Offers / Contracts subsection near the beginning of this report) would suggest current active interest and a strong possibility of pre-leasing at least 50% of the subject project on completion.

Note that our Market Analysis section reported the average lease-up time for space in the immediate CBD / West Vancouver submarket at 5.7 months, while the average leasing time in the larger Clark County market was reported at 6.3 months. Further, the market statistics indicate an approximate 75% probability of leasing a space within 6 months, and a +90% chance within 12 months of being actively marketed. With a pre-construction / development period of 12 months, an additional absorption period of 6 months after the date of completion is reasonably anticipated. This would infer a prospective stabilization date of August 1, 2021. Based on the preceding, we have assumed 50% of the subject will be leased on completion, with the remaining 50% leased within 6 months thereafter.

With 50% pre-leased on completion (96,212 SF GLA), in order for the entire 192,424 SF project to theoretically achieve stabilized occupancy (192,424 SF x 95% = 182,803 SF stabilized occupancy over a 10-year investment holding term), there needs to be 86,591 SF to be leased. However, the reality is that the developer will need to lease the entire project with likely two individual tenant leases, with this analysis taking into account the entirety of both tenant spaces to be absorbed.

Note that no incremental lease-up is assumed in this analysis, with the average square footage for the two tenant spaces (96,212 SF GLA) assumed to achieve full occupancy at the end of the 6‑month absorption period. Our projection assumes the first space will leased / occupied on completion, with the final space leased in Month 6.

Rent loss over the 6-month lease-up period is based on the average monthly blended market rent for the entire project of $0.619 per SF NNN, and includes a 5.0% deduction for stabilized vacancy. Leasing commission of 4.0% of the total rent over an assumed typical 7.5-year lease (assuming likely range of 5 to 10 years for the subject spaces) are deducted, as are the developer’s pro forma Tenant Improvement cost estimate at $120.00 per SF office area. Foregone monthly expense recoveries are roughly estimated at $0.169 per SF, which is considered to cover property taxes, insurance, nominal utilities, common area expenses (landscaping, etc.) and management fees over the lease-up period, and was also adjusted for stabilized vacancy of 5.0%. Total expenses over the absorption period are estimated at $1,629,100.

The final consideration for lease-up costs is in the form of developer’s profit, which is typically applicable for income-producing properties. However, in the case of the subject project, it is being developed as institutional grade investment property, with a reasonable entrepreneurial required to compensate for the risk and effort of lease-up. Such projects are typically in the range of 10% to 20% , depending on the level of perceived risk. Therefore, a 15% developer’s profit is assumed in this analysis due to its average risk characteristics.

Overall, a total deduction of **$1,875,000** (rounded to the nearest $5,000) from the prospective stabilized market value of the subject for **Absorption / Lease-Up Costs** is applicable to conclude at the prospective value at completion.The lease-up calculations are provided following this subsection.

Concluded Prospective Market Value - At Completion

Deducting the lease-up cost from the concluded prospective stabilized market value results in the **concluded prospective market value at completion** of the leased fee interest in the **subject project** (50% pre-leased), as of ${eff\_date\_value}, as follows:

|  |  |
| --- | --- |
|  |  |
| Concluded Prospective Market Value - Stabilized | $\_\_\_\_\_\_\_\_\_ |
| Less: Absorption / Lease-Up / Remaining TI Costs | ($\_\_\_\_\_\_\_\_\_) |
| **Concluded Prospective Market Value - At Completion** | **$\_\_\_\_\_\_\_\_\_** |



Extraordinary Assumptions:

* The prospective market value concluded to in this report is predicated upon the proposed improvements being built as detailed in this report with non-defective building materials and is based on preliminary plans supplemented by conversations with the developer. It is therefore fundamental that the proposed improvements be built as described in this report. Finally, the prospective completion date is based on conversations with the developer and is not a guarantee by the appraiser that the project will be competed at that time. If actual construction / timing of the improvements is different than described in this report, the assignment results may be invalid.
* Note that this prospective stabilized valuation was conducted under the assumption that the subject will be leased at market rents under typical market terms. Therefore, the prospective stabilized value and prospective value at completion conclusions are reported as leased fee, consistent with the client’s requested scope of work. However, the prospective stabilized leased fee and fee simple values are considered equal to one-another. If this assumption is later found to be incorrect, this may impact the assignment results.

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 12 months, respectively, are considered reasonable and appropriate for the subject property.

SWOT ANALYSIS

Strengths:

* Newer, good quality construction in good condition (less repair and maintenance expenses).
* Good, nearby highway access and retail proximity location within an established, newer industrial park.
* High demand, smaller warehouse bays ideal for a variety of small light manufacturing or wholesale warehouses uses.
* Smaller project site, is attractive to a wide pool of potential purchasers – including both investors and small, likely partial owner-users.
* Current leases are longer term agreements with national tenants, with investor purchasers being attracted to the stability of the project cash flow.

Weaknesses:

* None.

Opportunities:

* Good long-term potential for a sale to an owner that may pay a premium for the property upon roll-over of the tenant leases.

Threats:

* Current COVID-19 crisis has shaken the market and may have unforeseen consequences (please refer to the Market Overview discussion).
* Mortgages of all kinds continue may be more difficult to obtain due to the pandemic, and by extension, investor required rates of return have to rise in correspondence with this added financing risk, as well as the greater economic risk.