Highgrade Place Retail Strip Center

**Submitted By:**

Russ Dilworth

Teresa Mikesell

Rebecca Paulson

Anthony Trotter

Highgrade Place Retail Strip Center Case Study Name/Grading Sheet Finance 5770/6770/6780

**Student Name(s):**

Russ Dilworth

Teresa Mikesell

Rebecca Paulson

Anthony Trotter

Points Possible \_\_\_\_\_\_\_50\_\_\_\_\_\_\_\_

Points Missed \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

Score Received \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

Table

Description automatically generated

**Calculations**

**Cost Approach and Valuation Methodology**

**Using the known construction costs of three recently constructed strip retail buildings that are similar in size and quality, an approximate current construction cost is determined at $97.25, plus site improvement costs of $3.50. Multiplying these costs by the square footage of the Highgrade Place project, the replacement construction cost is $1,831,693.33. The developer profit of 10 percent of $183,169.33 was determined by asking area developers what their average return is. The facility is well maintained so no discounts have been taken for deferred maintenance. The building is 10 years old and its original economic life was 40 years when built so, the total cost $2,014,862.67 is reduced by 10/40 or 25 percent equaling $503,715.67, reducing the building value to $1,511,147.00.**

**Adding land value of $15.00 per square foot for 68,000 total square feet results in $1,020,000.00 and a Total Value by Cost Approach of $2,531,147.00. The current building owner may not want to sell at this price since this price does not reflect current market conditions in the area and is the lesser amount of the valuation methods considered.**

Table

Description automatically generated

**Calculations**

**Table

Description automatically generated**

Table

Description automatically generated

**Calculations**

Table

Description automatically generated

**Calculations**

**Sales Comparison Approach**

**To derive a project value using the Sales Comparison approach, we adjusted the comparable rental rates to arrive at an average.  The first adjustment was applied to sale #3.  This project has funded using seller's financing.  All the other projects were funded with cash.  We used an equivalent cash calculation to determine the necessary adjustment of -7.79%.**

**Sales 1 & 4 have sales dates that are 24 months old, whereas sales 2 & 3 are current.  We generated a percentage adjustment by comparing Sale 1 to Sale 2.  We chose these two properties for comparison since the sale date is the only variable differentiating these two properties.  This resulted in a positive adjustment of 15% to sales 1 & 4.**

**An adjustment is necessary based on the various street orientations.  The subject property is an interior lot.  Sale 4 is also an interior lot.  The other three properties are corner lots.  To make the adjustment, we compared Sales 2 & 4 as this variable is the differentiating factor between the two.  We arrived at an interior lot adjustment of -19.4% for sales 1, 2, & 3.**

**The final adjustment came from analyzing economic characteristics.  The subject property as well as sales 1, 2, & 4 have an effective economic age of 10 years.  Sale3 has an age of 5 years.  To bring these into consistent terms, we compared sales 2 & 3 due to the consistency of their variables.  This adjustment resulted in a -4.81% reduction to the rate.**

**All these adjustments result in an average rental rate of $160.80/sqft.  This is the basis we used to generate a Sales Comparison Value of $2,733,600.**

Table

Description automatically generated

**Calculations**

**The Direct Income Capitalization Approach**

**A value or $2,322,600 was derived utilizing the Income Approach to value. Current rents were estimated through analyzing rent comparables and calculating average rents for large and small tenants to determine Potential Gross Income of $240,750. Vacancy was calculated to be 6.38%, or a loss of $15,366.99 annually, using an average derived from sales comparisons, resulting in Effective Gross Income (EGI) of $225,383.01. Total Operating Expenses were calculated using a common area maintenance rate of $2/PSF, management fee of 5% of EGI, and reserves were estimated to be 2% of EGI, resulting in a Net Operating Income (NOI) of $174,606.20.**

**Additionally, a Band of Investment method was utilized to derive a capitalization rate from the weighted average of the mortgage and equity demands on net income generated from the property. This method involved estimating typical financing terms and an estimated rate of return on equity capital sufficient to attract investors. The mortgage interest rate available in the market is 6.75%, with a 75% loan-to-value amortized over 25-yers with a five-year balloon payment. Debt coverage ratio was quoted to be 1.25; however, a larger down payment would be required to meet the bank’s requirements on this property resulting in a DCR of 1.22 and an adjusted down payment of $882,669.87.**

**The mortgage constant was calculated to by 8.29% when solving for PMT with PV set = 1, i set = 6.75/12, n set = 300 (25 years \* 12 months).**

**Plugging the Re of 5.70% and the Rm of 8.29% into the Band of Investment calculations resulted in a Ro of 7.6%**

**Additionally, a capitalization rate of 7.52% was derived by taking the average cap rate for recent sales comparisons which ranged from 7% to 7.97%.**

**NOI of $174,606.20 was divided by the average cap rate of 7.52% to derive an estimated value of 2,322,600.**

Table

Description automatically generated

**Calculations**

Table

Description automatically generated

**Calculations**

Table

Description automatically generated

**Calculations**

Table

Description automatically generated

A screenshot of a computer

Description automatically generated with medium confidence

**Calculations**

A picture containing table

Description automatically generated

**Calculations**

**Recommendation**

**We compared three different approaches to determine value: The Cost Approach described above; the Sales Comparison Approach; and the Income Approach. We found significant variation in indicated value across these approaches.**

**This disparity in indicated value caused us to look very closely at the subject property, and we had to make some key changes to our assumptions before we could recommend a value to our client.**

**First, comparable properties in the market have an Operating Expense per Rentable Square Foot of $5. The subject property initially had an OE/Sq. Ft. of $2.93. So, when we adjusted the Operating Expenses of the subject property up to $5/Sq. Ft., the value indicated by the Income Approach dropped from 2.6mm to 2.3mm. Similarly, when priced at 2.6mm, the subject property had a GIM of 11.17 as compared to a market average GIM of 9.52.**

**Therefore, it appears that the subject property doesn’t produce as much gross income per square foot as comparable properties in the market. This means that our client cannot pay a price per square foot that is inline with the market average when other similar properties generate more income and more NOI.**

**Our recommended purchase price for this property is $2,322,600 or less. This gives us a GIM of 9.65 with an OE/Rentable Sq. Ft. of $5. However, this gives us a price per square foot for the subject property of $136.62 which is significantly less than the market average price per square foot of $181.15 but we feel is appropriate given the limitations in the property’s ability to generate sufficient income to hurdle the $5/sq ft in operating expenses which are average for the market.**