THE OHIO STATE UNIVERSITY
FISHER COLLEGE OF BUSINESS

# The Offices up North

*Case written by Spencer Couts*
*(2.1.17 Version)*

**Objective:** Understand how multiple tenants, vacancy, and operating expenses influence property valuations.

**Investor Profile:** The date is December 31, 2016 and Urban Smith has contacted you to help him value a potential investment property called "The Offices up North." He and his capital partner, Gene Meyer, are looking for an investment opportunity in a potentially undervalued, up and coming area. The Polaris area is growing quickly and has the potential to be such an area. Your objective is to value the property based on its expected cash flows and to determine an appropriate price to offer for the property. The potential investment assumes a January 1, 2017 investment date.

**Property-level Information:**

- Address: 480 Olde Worthington Rd.
- City: Westerville, OH 43082
- Building SF: +/- 97,000 SF Medical Office Building
- Year Built: 2000
- Land Acres: 8.96 AC
- Bldg FAR: 0.25
- GIS Map: http://www.delco-gis.org/auditor/
- County Property Report: http://delaware-auditor-ohio.manatron.com/Property.aspx?mpropertynumber=318-443-01-008-001&p=31844301008001

**Financing Terms:**

- Loan Term: 25 year, fixed-rate, amortizing, non-recourse mortgage
- Interest rate: 4.15%
- Loan-to-value: 75%
- Loan fee: 1.5%
- Payments: monthly

**Required Returns:** 7.5% (unlevered) / 15.0% (levered)

**Purchase & Sale:**

- Purchase date: January 1, 2017
- Holding period: 10 years
- Exit cap rate: Current market cap rates

**Operating Expense Assumptions:**

- Property Taxes: $2.88 per square foot of rentable space
  (**Please note:** the 65% property tax abatement discussed in the CoStar report has expired and will not affect the property tax liability going forward. Detailed property tax information is provided on the Delaware County Property Report. Also note that the attached Tax Incentive document discusses an operating tax incentive to inHealth and not a property tax incentive.)

- Other Operating Exp.: 4.0% of effective gross income
- Management Fee: 3.5% of effective gross income

**Rent Roll:** See Exhibit 1

**Sales Comps:** See Exhibit 2

**Lease Comps:** See Exhibit 3

**Attachments:**

- Delaware County Property Report (*assume* dated 12/31/16)
- Market Analysis Report (dated Q3 2015)
- City of Westerville Proposed Tax Incentive Agreement (dated 12/30/14)
- CoStar Property Report (dated 6/23/16)
- Cushman & Wakefield Sales Brochure (date unknown)
- Cushman & Wakefield Leasing Report (date unknown)

Your task is to analyze the investment opportunity and make recommendations to Urban based on your analysis. Follow these steps:

1. Prepare a memorandum to Urban summarizing your analysis and recommendations. Please make it short, concise and include the following the following.

2. Value the property based on a static version of the Pro forma valuation model.

3. Value the property based on a dynamic Pro forma valuation model.

4. Build a base Pro forma valuation model.
    a. <u>Obtain Unlevered Property Cash flows:</u> Build a model that forecasts the expected incremental cash flows from purchasing the property.

    b. <u>Obtain Levered Property Cash flows:</u> Add to the model the incremental loan proceeds and payments associated with obtaining financing on the property. Calculate the residual cash flows to and from the equity investor.

    c. <u>Calculate the Expected Unlevered and Levered Property Values and IRRs:</u> Value the projected cash flows from the property before and after levering with debt. Calculate IRR values based on the levered and unlevered cash flow streams based on a purchase price calculated in the static valuation model.

5. Discuss the following points in your analysis.
    a. <u>Tenant Mix:</u> How risky is the current tenant mix going forward. Please reference the Tax Incentive Agreement document dated 12/30/14 from Jason Bechtold at The City of Westerville. Please discuss how the information on this document may influence your view of the riskiness of the tenant mix going forward.

    b. <u>Lease Expiration:</u> Please discuss the lease expiration dates and how this may affect the riskiness of the tenant mix going forward.

    c. <u>Rent Growth:</u> Please discuss what assumptions you make regarding the rent growth and why you made those assumptions.

    d. <u>Property Taxes:</u> Please discuss your analysis of the property tax point estimates you used along with your analysis of the riskiness of those estimates.

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**Helpful Excel Tips**

1. Debt Service Payment
    - =PMT($C$59/12,$C$60*12,$H$41)*12
    - This formula calculates the yearly total of monthly debt service payments based on the following.
        - C59 = annual interest rate
        - C60 = number of payment periods (amortization period x # of years)
        - H41 = loan amount originally borrowed

2. Principle Portion of the Debt Payment
    - =CUMPRINC($C$59/12,$C$60*12,$H$41,H3*12+1,I3*12,0)
    - This formula calculates the yearly total of the principle portion of the monthly debt service payments based on the following.
        - C59 = annual interest rate
        - C60 = number of payment periods (amortization period x # of years)
        - H41 = loan amount originally borrowed
        - H3*12 +1 = first month of this year's debt service payment
        - I3*12 = last month of this year's debt service payment