RealData *Real Estate Investment Analysis*

Case Study: The Urban Center Building, Mixed-Use

You are considering the purchase of the Urban Center Building, a small mixed-use property in the central business district. It has 5,000 rentable square feet of commercial space on street level, divided into two stores, and 19 apartments totaling 14,000 rentable square feet on the upper three floors. It has a 20-year old flat roof. Parking is on-street.

According to the assessor's records, 60% of the value of this property is in the building, 40% in the land. The prevailing capitalization rate for commercial properties like this one and in this location is 9%. The asking price for the property is $2.8 million.

Current rents for the apartments are as follows; you presume that you can raise rents 2% each year.

Unit Type	SF	# units	Rent/mo.
Large Studio	450	4	950
1 BR	650	7	1,200
2 BR	875	6	1,550
3 BR	1200	2	1,950

The commercial spaces are occupied by two retail tenants: a bank, Titanic Savings & Loan, and a retail store, Books and More Books.

The bank occupies 2,200 square feet and pays $20 per square foot. Their lease calls for 3% increases on March of 2021, 2024 and 2027. They also pay a pro-rata share (11.58% of the building's total rentable square feet) of annual property taxes in excess of $40,000.

The bookstore occupies 2,800 square feet and pays $22 per square foot, plus the same property tax pass-through based on a 14.73% pro-rata share. You doubt that they will renew their lease when it expires in July of 2021. You will ask for $26 for a five-year lease at that time, but will also plan to give the new tenant a $20 per square foot tenant improvement allowance. You expect to pay a leasing commission, which you estimate at $6,240.

After reviewing the property's most recent tax return, you believe the 2018 operating expenses will be as shown below. Based upon your experience with other properties, you have also made estimates of the rate of increase for each expense:

Expense	2018 Estimate	Increase
Accounting	4,000	3%
Advertising	1,000	3%
Insurance (fire and liability)	12,000	4%
Janitorial Service	15,000	3%
Lawn/Snow	2,000	3%
Legal	7,000	3%
Miscellaneous	500	3%
Property Management	5% of GOI	floats w/GOI
Repairs and Maintenance	17,500	4%
Supplies	1,800	3%
Taxes - Real Estate	42,000	4%
Trash Removal	6,000	3%
Utilities - Electricity	5,200	3%
Utilities - Sewer and Water	6,800	3%

A local bank has told you that it would finance 70% of the purchase price with a 20-year loan starting at 7.5%. The bank requires a Debt Coverage Ratio of at least 1.25. Your best guess is that this variable-rate loan will increase by 0.5% per year until it reaches 9.5% and levels off. You will have to pay two points to secure the loan. The bank will require you to deposit $25,000 into a reserve account at the closing.

You expect your closing costs to be about $15,000 when you purchase the building. When you ultimately sell it, you expect to pay 7% of the selling price for the services of a broker and attorney.

You do not want to hold the property for more than ten years, but would consider selling it sooner if that appeared advantageous.

Build a pro forma projection of income, expenses, cash flows, resale and key real estate investment metrics. Consider what your investment objectives might be in purchasing this property. Does it appear that the property would meet those objectives right out of the box? Would you consider making an offer on different terms? Are there significant considerations that have not been addressed in the discussion above? If so, how will you deal with them?
