

Finance 673
Real Property Valuation

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Income and Expense Analysis

Lease Data

- Rent
 - ▶ Contract rent
 - ▶ Base rent
 - ▶ Percentage rent
 - ▶ Escalation rent
- Rent concessions
- Lessor/lessee division of expenses
 - ▶ Who pays for taxes, insurance, utilities, heat, janitorial service, repairs, common area maintenance (CAM)
 - ▶ Degree of netness
- Renewal options

Lease Data (continued)

- Expense cap and expense stop
 - ▶ Cap - Operating expenses borne by tenant up to a specified level after which landlord picks up difference
 - ▶ Stop - Landlord meets defined expenses to a specified level, after which tenant pays
 - Stop might be specified for individual items
 - First year expenses may establish stop

Lease Data (continued)

- Escalation clause
 - ▶ Based on CPI changes
- Expense recoveries
 - ▶ Pass-throughs
 - ▶ Billables
 - ▶ Reimbursables
 - ▶ Treated as expense and income
- Tenant Improvements
 - ▶ Usually addressed in DCF
 - ▶ Based on what market expects

Reconstructed Operating Statement

- Income and expense history of subject
- Income and expense histories of competitive properties
- Recently signed leases, proposed leases, asking rents
- Actual vacancy levels for subject and competitive properties
- Management expenses for subject and competitive properties
- Published operating expense data
- Forecast changes in taxes, energy costs, etc.

Reconstructed Operating Statement (continued)

- Potential gross income (PGI)
 - ▶ Rent for all space (100% occupancy)
 - ▶ Rent from escalation
- Vacancy and collection allowance
 - ▶ Physical vacancy as an income loss
 - ▶ Collection loss from concessions and non-payment
- Effective gross income (EGI)
 - ▶ Difference between PGI and vacancy and collection loss
 - ▶ Physical and economic vacancy
 - ▶ Includes reimbursement and other income

Reconstructed Operating Statement *(continued)*

- Operating expenses
 - ▶ Fixed - tend not to vary with occupancy, and not subject to budgetary control
 - Real estate taxes
 - Tax rates for various jurisdictions
 - Assessed value trends and methods used by assessing office
 - Insurance
 - Annualized premiums
 - Localized

Reconstructed Operating Statement *(continued)*

- ▶ Variable - Tend to vary with occupancy, more subject to budgetary control
 - Management
 - market standard or norm
 - should be considered even if self managed (consistent with market)
 - varies with revenues
 - Utilities
 - market trends in usage and rates
 - actual experience of subject

Reconstructed Operating Statement *(continued)*

- Heating, ventilating, air conditioning (HVAC)
 - Market trends, standards
 - Actual experience of subject
- Personnel and payroll
 - includes fringe benefits and costs
- Maintenance and repair
 - maintain the structure and its major components
 - ex. roof repair
 - NNN lease: maintenance costs borne by tenants, repairs by landlord (check lease)
 - local area contracting services
 - price per unit, percent of gross

Reconstructed Operating Statement *(continued)*

- ▶ Allowance for replacements - typical (annual) amount to provide for needed replacement of short-lived items
 - Short lived: useful life less than total useful life of structure (long lived) other LL - elevators ex of SL in Table 21.4 (p. 519)
 - Usually included in direct capitalization
 - When yield capitalization is used, expenditures may be entered either when they are expected to occur or annually (annualized amount)
 - Does not include tenant improvements
 - Be consistent in use of capitalization rates derived from comparable sales

Sources of Data

- Published industry studies, standards
 - ▶ Building Owners and Managers Association (BOMA): office buildings
 - ▶ Institute of Real Estate Management (IREM): apartments, offices
- Local studies, surveys (including comparable sales)
- Local/regional property managers
- Local/regional lenders
- Other appraisers
- Appraiser's own files
- Record of subject property
- Principals
- Utility companies
