

RE 310 – Principles of Real Estate
Real Estate Investment Homework

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- 1) You are considering the purchase of a 24,000 square foot shopping center. Of the total space in this center, 18,000 square feet rents for \$25 per square foot, while the remaining 6,000 square feet rents for \$20 per square foot. Market vacancy rates for similar retail properties have been approximately 7 percent over the past several years, and you expect to incur management expenses and other operating expenses totaling 15 percent of effective gross income.

You are considering purchasing this building for \$3.75 million. Underwriter's Life has indicated that it will provide 70% loan-to-value (LTV) ratio financing at 7.25% interest with a 25-year term. Annual debt service on this loan will be \$227,684.

- a) Construct the pro forma operating statement for this shopping center. What is the net operating income and cap rate for this property?
- b) If retail centers like this are current selling at a 10% cap rate, is this property a good buy? Explain.
- c) Under these assumptions, how much would you be able to pay for this property and still earn a 10% return?
- d) Why might the cap rate you calculated in part (a) be a misleading indicator of the property's true worth?
- e) Calculate the cash-on-cash return for this property. Does this exhibit positive or negative leverage? Explain.
- f) Calculate the break-even ratio.
- g) Calculate the debt coverage ratio.