

RE 618 / Fin 618 – Real Estate Investment Analysis

Homework – NOI, Cap Rates and Multiplier Analysis

Dr. Stanley D. Longhofer

- 1) Vinnie is considering investing in a commercial office building in downtown Wichita. The building has 140,000 square feet of gross leasable area. Of this, 55,000 square feet rent for \$22.50 per square foot (psf), 65,000 square feet rent for \$18.00 psf, while the remaining 20,000 square feet rent for \$15.25 psf. All leases in this building are gross leases. Currently, the average vacancy rate for similar office space in east Wichita is 12%. The asking price for this property is \$10 million.

Based on the prior owner's past tax returns, Vinnie has forecasted the following expenses for the property:

Depreciation allowances	225,000
Utilities	195,000
Maintenance	215,000
Management expenses	10% of EGI
Mortgage interest	220,000
Property insurance	155,000
Property taxes	360,000

- Write out the pro forma operating statement for this property. What is its expected net operating income?
- At what cap rate is the seller offering this property?
- Similar office buildings have recently been selling at an 10.00 percent cap rate. Based solely on a comparison of cap rates, does this appear to be a good investment at the current asking price? Explain.
- Provide two specific reasons why the cap rate may be a misleading indicator of a property's true value as an investment. That is, what factors might cause you to change your answer in part (c) above?
- If Vinnie were to buy this property at an 10.00 percent cap rate, what price would he pay?
- Calculate the gross income multiplier for this property based on the asking price (using effective gross income).
- If the market gross income multiplier for similar office buildings is 5.0, estimate this building's market value.
- Calculate the operating expense ratio for this building. If the typical operating expense ratio for similar office buildings is 55 percent, what does the ratio you calculated tell you about this office building?
- Assume that 70 percent financing (\$7 million) is available at 7.25 percent interest over 20 years with annual debt service of \$663,916. Calculate the breakeven ratio for this building.

- j) Calculate the debt coverage ratio for this property.
- k) Calculate the cash-on-cash return for this property.