

## RE 618 / Fin 618 – Real Estate Investment Analysis

### Corporate Real Estate Decisions Lecture Notes – Part II

#### 4) Valuing Leasehold Interests and Subleases

a) Consider the following situation: Three years ago you entered into a 10-year lease for 25,000 sf at \$8.50 psf gross. Now market rent for this space is \$10.00 psf.

- What is the value of your leasehold interest if your cost of capital is 10%?

<u>Years</u>	<u>Market</u>	<u>Contract</u>	<u>Diff</u>
0	-0-	-0-	-0-
1-7	-250,000	-212,500	-37,500

$$N=7, PMT = -37,500, FV=0, I=10$$

$$P/Y=1 \Rightarrow PV = \$182,566$$

- Suppose your landlord wants to buy you out of your lease so that he can tear down the building and redevelop the land. How much must you be paid to be willing to give up this lease?

At least \$182,566

plus, cost of moving, hassle, etc

b) Suppose instead that current market rents are \$8.00 psf.

- What is the value of your leasehold interest in this case?

<u>Year</u>	<u>Market</u>	<u>Contract</u>	<u>Diff</u>
0	-0-	-0-	-0-
1-7	-200,000	-212,500	\$12,500

$$PMT = 12,500 \Rightarrow PV = -60,855$$

- Suppose you would like to move to new space and terminate your lease. How much would the landlord insist on being paid to let you out of the lease?

At least 60,855  
+ TI, vacancy costs, etc.

- What is the most you would be willing to pay?

60,855 less costs of moving.



- What are non-financial factors that will affect your decision?
  - Employee morale.
  - Accurately measuring moving costs
  - Quality of subtenant
  - TI?
  - Differing lease terms.
  - Do I want to manage a sublease
- ~~Use alternatives in sublease analysis.~~

HW #12

$$\begin{array}{r}
 1) \quad 8,000 \times 15 = \$120,000 \quad \text{Contract} \\
 \quad \quad 13 = \underline{104,000} \quad \text{market} \\
 \quad \quad \quad 16,000 \quad \text{diff.}
 \end{array}$$

$$N=4, P/Y=1, PMT = -16,000, I = 11$$

$$FV=0 \Rightarrow PV = 49,639$$

$$\begin{array}{r}
 2) \quad \text{Contract: } 28,000 \times 5.50 = 154,000 \\
 \quad \quad \text{Alt. : } 4.00 = 112,000 \\
 \quad \quad \text{Sublease}_{1-4} \quad 5.00 = 140,000 \\
 \quad \quad \text{Sublease}_{5-10} \quad 5.25 = 147,000
 \end{array}$$

<u>Years</u>	<u>Sublease</u>	<u>Keep</u>	<u>Diff</u>
0	-110,000	-0-	-110,000
1-4	-126,000	-154,000	28,000
5-10	-119,000	-154,000	35,000

$$IRR = 24.67\%$$

$$NPV = 66,496$$