



Income Valuation



A Study of Market Rents



Objectives

- Define market rent
- Discuss various lease types
- Define leasable area
- Discuss rent concessions
- List data sources
- Review an apartment appeal



Fee simple vs leased fee

- **Fee simple estate** – ownership of property unencumbered by any other interest or estate, aside from taxation, eminent domain, police power & escheat. (ownership of the full bundle of rights)
- **Leased fee estate** – ownership of property whereby the owner transfers a portion of the bundle of rights to the tenant for a specified period of time.



Why Does “Market” Matter

- **Fee simple estate**
 - To arrive at a fee simple value, we must assume that all space in the building can be leased at current market rates and terms.
 - Market rent
 - Market V&C
 - Market expenses
 - Market capitalization rate



Market Rent Defined

- **Market rent** – the amount of rent a space would bring in the open market as of the appraisal date.
- Also referred to as “economic rent”



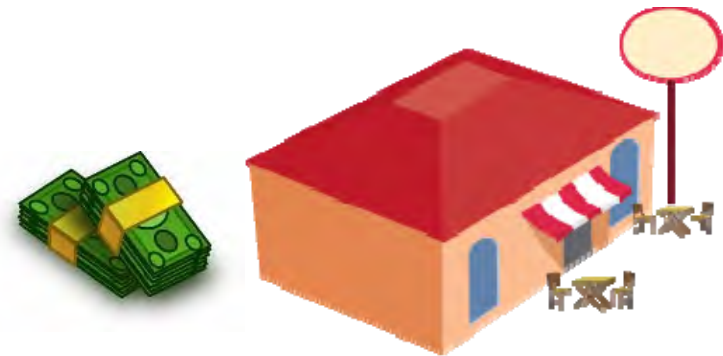
Definitions

- **Contract rent** – the actual amount of rent that is specified by the lease
- **Leasehold rent** – happens when contract rent is less than market rent
- **Excess rent** – the dollar amount of contract rent that exceeds market rent



Market Rent

- Driven by:
 - Location
 - Size
 - Quality of construction
 - Supply & Demand
 - Terms of the Lease
 - Duration
 - Gross vs. Net





Lease Types

- Gross Lease
- Net Lease
 - Single net lease (N lease)
 - Double net lease (NN lease)
 - Triple net lease (NNN lease)
 - Absolute triple net lease
- Modified Gross Lease



Gross Lease

- May be called a “full service lease”
- Income to the lessor is considered gross
- Landlord pays all or most expenses associated with the real estate (rent is all-inclusive)
- Expenses to landlord include: property taxes, insurance, property maintenance, utilities, janitorial, common area maintenance (CAM), etc.
- Landlord has the greatest risk



Net Leases

- Landlord charges a lower base rent than with a gross lease
- Defined expenses are passed on to tenant
- There are three “nets”:
 - Property Taxes
 - Insurance
 - Maintenance



Net Leases

- Single net (N lease)
 - Not very common
 - Tenant pays base rent plus: **property tax** , utilities & janitorial
- Double net (NN lease)
 - More common than single net lease
 - Tenant pays base rent plus: property tax, **building insurance**, utilities and janitorial



Net Leases

- Triple net (NNN lease)
 - Extremely common lease type
 - Tenant pays base rent plus property tax, building insurance, **building maintenance & repairs**, utilities, janitorial & **common area maintenance (CAM)**.
 - Tenant shoulders the greatest risk



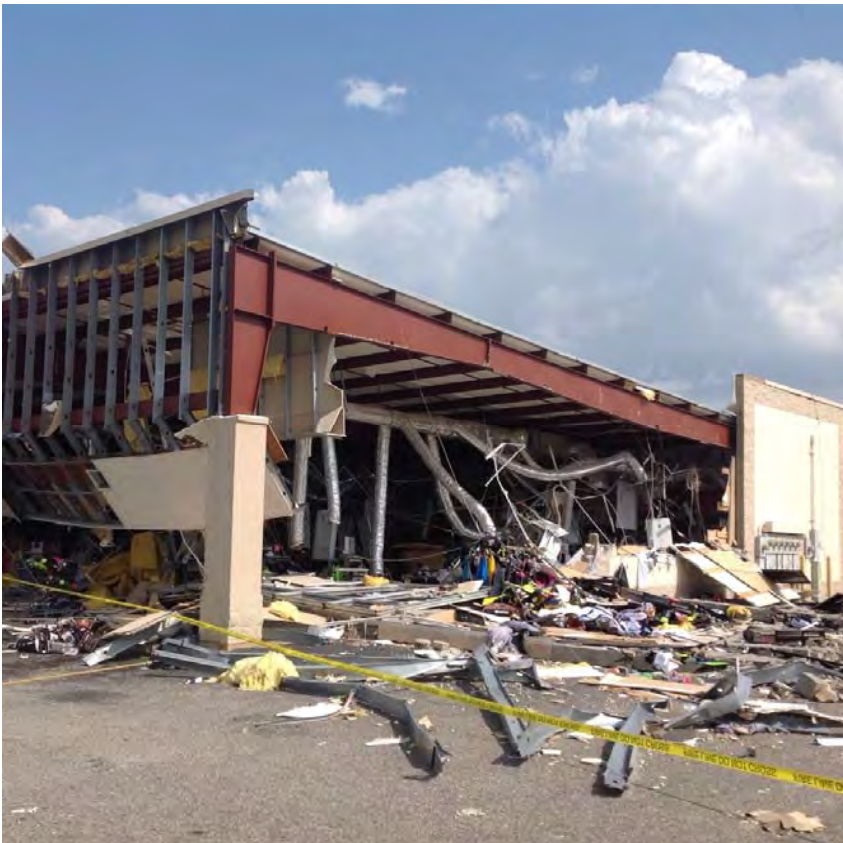
Net Leases

- Absolute triple net
 - Aka: Bondable triple net lease
 - Not as common as NNN lease
 - Tenant:
 - Bears all risk
 - Pays all expenses under NNN lease
 - Responsible for rebuilding after a catastrophe
 - Must pay rent even if building is not habitable



Determining Market Rents

Absolute Triple Net Risk



August 6th



October 1st



Modified Gross Lease

- May be referred to as a Hybrid lease
- Individual expense components are negotiated
- Typically:
 - Landlord pays all major expense items (property tax, building insurance & building maintenance)
 - Tenant pays directly related expenses (utilities, janitorial, unit or interior maintenance & repairs)



Typical Lease Types

Typical Lease Type by Property Type

Property Type	Gross	Net	Modified Gross
Industrial			X
Multifamily	X		
Office	X		
Retail		X	
Special Use	X	X	



GLA vs NLA

- Gross leasable area (GLA) vs. Net leasable area (NLA)
- Gross leasable: All interior square footage excluding stairs, shafts or other areas which span more than one floor
- Net leasable: Only the area that is occupied by a tenant. All common area is excluded.



Rent Concessions

- Rent concessions are a loss in income for the lessor for a short period of time as agreed upon by the two parties
 - Used to lure tenants
 - Adjustment should only be made if this is typical in the market
 - Effectively lowers the rental rate for the duration of the lease



Rent Concession Example

- “Retailer A” will receive 6 months free rent on their new five year lease. The contract rent is \$10/Sq. Ft.

$$6 \text{ months} / 60 \text{ months} = 10\%$$

$$\$10.00 \times 10\% = \$1.00$$

$$\$10.00 - \$1.00 = \$9.00$$

Effective rent is \$9.00



Sources of Rental Rates

- Questionnaires
- Informal hearings
- Board of Equalization hearings
- Realtors / Brokers
- Appraisers
- MLS: local, LoopNet, Costar, etc.
- SEC filings



Determining Market Rents

Apartment Case Study





Apartment Case Study

- Local apartment complex owner files protest with the BOE.
- Taxpayer submits fee appraisal at BOE hearing.
- BOE reviews all information and rules in favor of the county.
- Unhappy with the BOE results, the taxpayer files in circuit court.
- County appraisal staff partners with state analysts to defend value in litigation.



Apartment Case Study

- The subject:
 - Two story, garden style apartment complex
 - Average quality (class D0)
 - Built in 1974
 - 76 units
 - Located in Central Alabama
 - Population of roughly 8,150
 - Median household income of approximately \$26,700



Apartment Case Study

- Cost approach
 - Inventory was verified
 - Depreciation was estimated equitably
- Local sales comparison
 - No recent sales of apartments in the county
 - No trending
 - No local sales comparison
- Income valuation
 - Limited local income data



Apartment Case Study

- Rental rate search
 - Similar in: age, quality, number of units, location, etc.
 - Within the county
 - Collected all comparable rental rates
 - Nearby counties
 - Contacted similar surrounding counties for assistance
 - Commercial MLS Services
 - LoopNet
 - Costar



Apartment Case Study

- Costar rent query
 - Provided valuable information such as: rental rates, vacancy rates, market derived capitalization rates, etc.
 - Data was dumped into Excel and trimmed by numerous criteria, such as:
 - Location
 - Age
 - Quality
 - Number of Units



Apartment Case Study

- Costar rent query
 - Comparable properties were identified
 - Data was compiled & reconciled with the local market data



Determining Market Rents

Apartment Case Study

- Costar query raw data sample

City	Building Address	Building Name	Building Status	Construction Material	County Name	Market Segment	Number Of 1 Bedrooms	Number Of 2 Bedrooms	Number Of 3 Bedrooms	Number Of Other Bedrooms	Number Of Stories	Number Of Studios	Number Of Units	One Bedroom Mix	One Bedroom Rent High
Troy	920 E Academy St	The Grove at Troy	Existing		Pike	Student	0	62	130	0	3	0	192		
Enterprise	100 Access Rd	Shady Grove Apartments	Existing	Masonry	Coffee	All	0	0	0	0	2	30	30		
Enterprise	1105 Alberta St		Existing		Coffee	All					2		8		
Union Springs	130 Bluff Cir	Conecuh Bluffs	Existing		Bullock	All	12	28	0	0	1	0	40	12(1 / 1.0)	12(1 / 1.0) - \$456
Enterprise	505 Briarwood Dr	Briarwood Court Townhomes	Existing		Coffee	All	0	104	0	0	2	0	104		
Ozark	84-102 Brookview Dr	Rolling Meadows Apartments	Existing		Dale	All	12	56	0	0	2	0	68	12(1 / 1.0)	12(1 / 1.0) - \$395
Andalusia	809 Carson St	Captains Quarter Apartments	Existing	Wood Frame	Covington	All	8	24	0	0	2	0	32	8(1 / 1.0)	8(1 / 1.0) - \$425
Greenville	809 Cedar St	Meadowview Apartments	Existing	Masonry	Butler	All	0	16	8	0	2	0	24		
Union Springs	821 Conecuh Avenue East	Liveoak Village	Existing		Bullock	Senior	24	0	0	0	1	0	24	24(1 / 1.0)	
Brundidge	211 CR 3320		Existing	Wood Frame	Pike	All	0	12	4	0	2	0	16		
Greenville	1132 Dogwood Trl		Existing		Butler	Senior	10	0	0	0		0	10	10(1 / 1.0)	
Troy	102 Easy St	Easy Street Duplex Communit	Existing		Pike	All	0	0	30	0	2	0	30		
Troy	110 Ellen Dr	Trojan Arms Apartments	Existing		Pike	All					2		48		
Troy	503 E Elm St		Existing		Pike	All	0	8	0	0	2	0	8		
Eufaula	406 N Eufaula Ave	Heritage Apartments	Existing		Barbour	All	0	28	12	0	2	0	40		
Troy	100 Gibbs St	Pointe at Troy	Existing		Pike	Student	0	12	0	96	3	0	108		
Enterprise	103 Gibson St		Existing	Masonry	Coffee	All	0	5	0	0	1	0	5		
Andalusia	601 Henderson St		Existing	Wood Frame	Covington	Senior					1		16		
Enterprise	200 Heron Cove Dr	Heron Cove	Existing		Coffee	All	40	96	62	2	2	0	200	40(1 / 1.0)	40(1 / 1.0) - \$515
Ozark	421 Highland Ave	Heaton Apartments	Existing	Masonry	Dale	All					2		8		
Ozark	455 Highland Ave	Heaton Apartments	Existing		Dale	All	0	6	2	0	2	0	8		
Fort Deposit	Highway 185	Fort Deposit Villas	Existing		Lowndes	All	0	0	0	0	1	23	23		
Evergreen	101 Hillside Dr	Pine Tree Villas	Existing		Conecuh						1				
Daleville	715 E Hwy 84	Asbury Oaks	Existing	Masonry	Dale	All	0	4	0	0	1	0	4		
Troy	416 Jane Rd	Willow Terrace Apartments	Existing		Pike	All	24	80	24	0	2	0	128	24(1 / 1.0)	24(1 / 1.0) - \$600
Tuskegee	4106 Joshua Ln	Pinecrest Apartments	Existing		Macon	Senior	30	6	0	0	2	0	36	30(1 / 1.0)	30(1 / 1.0) - \$587
Tuskegee	300-400 Katherine Dr	Macon Gardens Apartments	Existing		Macon	All	20	40	0	0	2	0	60	20(1 / 1.0)	20(1 / 1.0) - \$375
Tuskegee	205 Lakeview Rd	Lakeshore Apartments	Existing		Macon	All	29	5	0	0	2	0	34	29(1 / 1.0)	29(1 / 1.0) - \$593
Enterprise	817 E Lee St		Existing		Coffee	All					2		12		
Troy	123 W Madison St		Proposed		Pike	Student	3	12	9	0		0	24	3(1 / 1.0)	3(1 / 1.0) - \$475
Evergreen	238 Magnolia Ave	Magnolia Apartments	Existing		Conecuh	All					1		48		



Apartment Case Study

- Local market data reconciled with Costar data

1Br / 1Ba Subject County Comparable Rent Analysis					
Apartment Complex	City	County	State	Unit Type	Rent
Localville Village	Local	Subject	AL	1/1	\$360
United Hopes Inc	Local	Subject	AL	1/1	\$403
Hillcross Haven	Local	Subject	AL	1/1	\$490
Ivy Village	Local	Subject	AL	1/1	\$490
Woodglen Apartments	Local	Subject	AL	1/1	\$505
Localville Housing II LTD	Local	Subject	AL	1/1	\$513
Average					\$460
Median					\$490

1Br / 1Ba Costar Comparable Rent Analysis					
Apartment Complex	City	County	State	Unit Type	Rent
Lakeridge Apartments	Eufaula	Barbour	AL	1/1	\$385
Rolling Meadows Apartments	Ozark	Dale	AL	1/1	\$395
Captains Quarter Apartments	Andalusia	Covington	AL	1/1	\$425
Cypress Village Apartments	Tuskegee	Macon	AL	1/1	\$430
Lakeshore Apartments	Tuskegee	Macon	AL	1/1	\$593
Average					\$446
Median					\$425

1Br / 1Ba Indicated Rent: \$450



Apartment Case Study

- Local market data reconciled with Costar data

2Br / 1Ba Subject County Comparable Rent Analysis					
Apartment Complex	City	County	State	Unit Type	Rent
The Heatherton Apartments	Local	Subject	AL	2/1	\$355
Localville Village	Local	Subject	AL	2/1	\$420
United Hopes Inc	Local	Subject	AL	2/1	\$428
Hillcross Haven	Local	Subject	AL	2/1	\$500
Ivy Village	Local	Subject	AL	2/1	\$520
Woodglen Apartments	Local	Subject	AL	2/1	\$530
Localville Housing II LTD	Local	Subject	AL	2/1	\$533
				Average	\$469
				Median	\$500

2Br / 1Ba Costar Comparable Rent Analysis					
Apartment Complex	City	County	State	Unit Type	Rent
Lakeridge Apartments	Eufaula	Barbour	AL	2/1	\$439
Cypress Village Apartments	Tuskegee	Macon	AL	2/1	\$460
Rolling Meadows Apartments	Ozark	Dale	AL	2/1	\$475
Captains Quarter Apartments	Andalusia	Covington	AL	2/1	\$500
Lakeshore Apartments	Tuskegee	Macon	AL	2/1	\$608
Capricorn Apartments	Tuskegee	Macon	AL	2/1	\$616
				Average	\$516
				Median	\$488

2Br / 1Ba Indicated Rent: \$500



Apartment Case Study

- Local market data reconciled with Costar data

3Br / 2Ba Subject County Comparable Rent Analysis					
Apartment Complex	City	County	State	Unit Type	Rent
The Heatherton Apartments	Local	Subject	AL	3/2	\$403

3Br /1Ba Costar Comparable Rent Analysis					
Apartment Complex	City	County	State	Unit Type	Rent
Capricorn Apartments	Tuskegee	Macon	AL	3/1	\$646
Lakeridge Apartments	Eufaula	Barbour	AL	3/1	\$469

Average \$558
Median \$558

3Br / 1.5 Ba Indicated Rent: \$550



Apartment Case Study

- Indicated market rental rates

Market Rent Analysis

Unit Type	Indicated Market Rent
1 BR / 1BA	\$450
2 BR / 1BA	\$500
3 BR / 1.5 BA	\$550



Apartment Case Study

- Vacancy rate analysis

Costar Local Market Vacancy Comparables								
Building Name	City	County Name	State	Secondary Type	Style	Market Segment	Number Of Units	Vacancy %
Briarwood Court Townhomes *	Enterprise	Coffee	AL	Apartments	Garden	All	104	4.81%
Capricorn Apartments	Tuskegee	Macon	AL	Apartments	Garden	All	51	7.84%
Captains Quarter Apartments	Andalusia	Covington	AL	Apartments	Garden	All	32	9.38%
Cypress Village Apartments	Tuskegee	Macon	AL	Apartments	Low-Rise	All	28	10.71%
Lakeridge Apartments	Eufaula	Barbour	AL	Apartments	Garden	All	30	3.33%
Lakeshore Apartments	Tuskegee	Macon	AL	Apartments	Garden	All	34	0.00%
Rolling Meadows Apartments	Ozark	Dale	AL	Apartments	Garden	All	68	0.00%
Median								4.81%

Comparable Sale Vacancy Rates								
Building Name	City	County Name	State	Secondary Type	Style	Market Segment	Number Of Units	Vacancy %
Courtyard Apartments	Selma	Dallas	AL	Apartments	Garden	All	44	4.55%
Daugette Towers*	Gadsden	Etowah	AL	Apartments		All	100	11.00%
Eastway Heights	Troy	Pike	AL	Apartments	Garden	All	24	5.00%
Indian Hills	Anniston	Calhoun	AL	Apartments	Garden	All	140	1.43%
Montevallo Place	Alabaster	Shelby	AL	Apartments	Garden	All	200	5.00%
Parkway Apartments	Opelika	Lee	AL	Apartments	Garden	All	56	0.00%
Plainsman Apartments	Auburn	Lee	AL	Apartments	Garden	All	98	4.00%
Median								4.55%

Concluded Market Vacancy Rate: 5%



Determining Market Rents

Apartment Case Study

- Capitalization rate analysis

Published Cap Rates								
PWC's Investor Survey*:	3rd Quarter 2011	7.96%						
	3rd Quarter 2012	8.00%						
RERC Real Estate Report (Third Tier):	Fall 2011	9.00%						
	Fall 2012	8.90%						
Realty Rates Investor Survey:	2nd Quarter 2011	8.31%						
		<u>8.31%</u>	8.31% Median					
* PWC average institutional OAR plus average basis point spread noninstitutional to institutional								
Cap Rates Derived from Comparable Sales								
Property Name	City	County Name	State	Secondary Type	Year Built	Sale Date	Number Of Units	Actual Cap Rate
Courtyard Apartments	Selma	Dallas	AL	Apartments	1971	3/16/12	44	9.00%
Daugette Towers	Gadsden	Etowah	AL	Apartments	1929	10/14/11	100	9.05%
Indian Hills	Anniston	Calhoun	AL	Apartments	1974	1/16/13	140	11.00%
Montevallo Place	Alabaster	Shelby	AL	Apartments	1978	12/29/12	200	8.79%
								Median: 9.03%

8.90% Median of all Sources

9.00% Concluded Cap Rate
0.85% Effective Tax Rate

9.85% Loaded Overall Rate



Importance of Loading the CAP Rate

- Loading the rate allows for variance in value

Loaded Cap Rate

Assume Current County Value of:	\$2,500,000
PGI	\$463,200
V&C	5%
EGI	\$440,040
Expense %	50%
Total Expenses	\$220,020
NOI	\$220,020
CAP	9.00%
ETR @ 42.5 mils	0.85%
Loaded Cap Rate	9.85%
Indicated Value	\$2,233,706

Property Taxes Expensed

Assume Current County Value of:	\$2,500,000
PGI	\$463,200
V&C	5%
EGI	\$440,040
Expense %	50%
Expenses before Property Tax	\$220,020
Property Tax Bill @ 42.5mils	\$21,250
Total Expenses	\$241,270
NOI	\$198,770
Unloaded CAP	9.00%
Indicated Value	\$2,208,556

Difference in Appraised Value: \$25,150



Determining Market Rents

Apartment Case Study

- Income approach indicated value

SUBJECT APARTMENTS											
201 ANY DRIVE				PARCEL #: 10-08-01-11-0-004-035.000							
TOTAL UNITS:		76		TOTAL SIZE:		70,400		YEAR BUILT: 1974			
# OF UNITS	# OF BDRMS PER UNIT	SIZE PER UNIT	RENT/UNIT PER MONTH	TOTAL RENT / UNIT TYPE	RENT PER SQ. FT.	# OF BDRMS	INCOME & EXPENSE				
8	1	650	\$450	\$3,600	\$0.69	8	PGI: (Monthly)	\$38,600			
							PGI: (Annual)	\$463,200			
48	2	900	\$500	\$24,000	\$0.56	96	V & C %:	5%			
							V & C LOSS (\$):	\$23,160			
20	3	1,100	\$550	\$11,000	\$0.50	60	EGI	\$440,040			
							EXPENSE %:	50%			
CAP RATE: 9.00 MILL RATE: 42.5 ETR: 0.85							EXPENSE:	\$220,020			
<div style="border: 1px solid black; padding: 5px; width: fit-content;"> Effective Tax Rate = Millage Rate x Assessment Rate </div>							NET INCOME:	\$220,020			
							OAR %:	9.85			
CONCLUSION											
Rounded Value:							\$2,233,700				
Value / Unit:							\$29,400				
VALUE / SQ. FT.:							\$31.73				
VALUE / BDRM:							\$13,620				



Apartment Case Study

- Income approach value was: \$2,230,700 or \$29,400 per unit (rounded)
- Cost approach value was: \$2,283,000 or \$30,000 per unit (rounded)
- County value was supported



When Data is Scarce

- Reliable data is essential
- Exhaust all know sources
- Use weaker data in a more peripheral role
- Stand on the best data you have
 - Sales
 - Income
 - Cost