

JAMES A. GRAASKAMP COLLECTION OF TEACHING MATERIALS

V. INDUSTRY SEMINARS AND SPEECHES - SHORT TERM

A. Appraisal Organizations

11. 1981

- c. "Contemporary Issues in the Use of the
Income Approach", sponsored by AIREA
Illinois Chapter 6, May 19, 1981

CONTEMPORARY ISSUES IN THE USE OF THE

INCOME APPROACH

AMERICAN INSTITUTE OF REAL ESTATE APPRAISERS

ILLINOIS CHAPTER NO. 6

The Covenant Club

May 19, 1981

Presented By

Prof. James A. Graaskamp, CRE, SREA
School of Business, University of Wisconsin

I. Introduction

It is generally recognized that the real estate market is dependent on substantial amounts of credit to support effective demand so that real estate prices and perhaps values vary with the terms and supply of credit generally available in the marketplace. Indeed the old timers have seen the definition of fair market value gradually move away from the firm premise of cash to the seller to a somewhat more subjective condition of terms generally available in the market.

- A. The pressure of double digit inflation is eroding many of the appraisers' favorite simplifications of the market model:
1. The long term fixed interest mortgage, amortized from property productivity is gone.
 2. The simple division of income between the mortgage and the equity component is smothered in participating mortgages, limited partnerships, convertible mortgages and seller financing.
 3. As the government had removed general subsidies to real estate finance such as regulation Q, it has made greater use of specific interest subsidies to selected special groups.
 4. Real estate markets must be defined not only in terms of use, age, income, but also access to capital.
 5. Moreover, most properties exist in a 3-tier market, utility to house an activity, commodity and money speculation, and as part of a going concern.
 6. The 3-tier market can be further subdivided by the nature of permits or other entitlements that are site specific and define risk of a vested or non-vested opportunity.
- B. Volatile money market conditions and the widespread use of creative financing leave the appraiser in considerable difficulty in defining typical market terms, cash equivalent prices or the relationship of

fair market value to transaction price. Does the client want fair market price, most probable price, going concern value, contributory value, investment value, or liquidating value in event of delinquency and foreclosure.

C. The impact of these elements is significantly different for problems involving:

1. Income investment properties
2. Economic development properties
3. Multi-family residential properties
4. Single family residential properties

D. The impact of financing in each situation requires that we go back to basics. The appraiser or his client must define:

1. What is the function of the appraisal?
2. Which rights are to be appraised? (Those that run with the establishment on the site, with the ownership position, or with fee simple title).
3. Which definition of value is appropriate?
4. How is productivity allocated to the agents of production?

E. Reference to Exhibit 1

F. Reference to definition of fee simple title in Exhibit 2

G. Reference to definition of fair market value in Exhibit 3 and compare to most probable price in Exhibit 4

II. The Games People Play With Income Investment Property makes it very difficult to apply any one of the three approaches to value.

A. Sales prices are engineered by accountants to some degree to shift asset values among various classifications for land, structure, personalty, intangibles, capital gains and losses and ordinary gains and losses, making market comparison anything but objective (not to mention adjustments for non-market financing discussed in Section III).

B. Similarly, the income approach has great difficulty in applying the truism that income value is the present value of income plus the present value of reversion.

1. There is the problem of defining net operating income in terms of what is attributable to the real estate (aside from financing effect on cash throwoff).
2. There is the problem of defining the net reversion to equity in an uncertain future (aside from financing effect on mortgage balance).

Exhibit I

Critical Issues Which Define Appraisal Process

Function of the Appraisal	Property Rights	Relevant Definition of Value	Allocation of Productivity	Buyer Motivation Presumed
Tax assessment	Fee simple private rights unencumbered	Fair market value	Income attributable to land and structures only	Purchase of economic productivity
Mortgage loan (non-participating)	Encumbered fee simple private rights plus additional rights pledged	Regulations - fair market value Underwriting - solvency price or liquidating value	Fixed income pledged from all sources less costs of creative management	Share of economic productivity contributed by capital
Mortgage loan (participatory)	Encumbered title plus non-vested interest in selected future revenues	Present value of all future cash flows	Variable income pledged plus share of reversionary interest	Share of economic productivity contributed by capital plus share in selected management returns plus positioning against devaluation due to changing conditions
Sale of an investment	Encumbered title plus vested entitlements plus going concern profit center opportunities	Most probable price above minimum acceptable alternative opportunity	Returns from land, structures, personality, and selected entitlements	Increase in spendable cash Increase in liquidity value of estate Positioning to maximize probability of survival of benefits despite changing conditions
Purchase of Investments	Encumbered title plus positioning for access to entitlements	Most probable price within perceived peril point limit	Land, structure, personality, and intangible assets less profit centers for management	Increase in spendable cash Increase in liquidity value of estate Positioning to maximize probability of survival of benefits despite changing conditions
Going concern purchase of a business	Encumbered title plus positioning for access to entitlements plus reduction in risk for business start-up plus monopolistic market controls	Most probable price within perceived costs of alternative	Land, structure, personality, and intangible assets and good will plus profit centers for management	Increase in spendable cash Increase in liquidity value of estate Positioning to maximize probability of survival of benefits despite changing conditions

EXHIBIT 3

FAIR MARKET VALUE - The highest price in terms of money which a property will bring in a competitive and open market under all conditions requisite to a fair sale, the buyer and seller, each acting prudently, knowledgeably and assuming the price is not affected by undue stimulus.

Implicit in this definition is the consummation of a sale as of a specified date and the passing of title from seller to buyer under conditions whereby:

1. buyer and seller are typically motivated.
2. both parties are well informed or well advised, and each acting in what he considers his own best interest.
3. a reasonable time is allowed for exposure in the open market.
4. payment is made in cash or its equivalent.
5. financing, if any, is on terms generally available in the community at the specified date and typical for the property type in its locale.
6. the price represents a normal consideration for the property sold unaffected by special financing amounts and/or terms, services, fees, costs, or credits incurred in the transaction.

Source: P. 137, Real Estate Appraisal Terminology, Editor Byrl Boyce.

EXHIBIT 4

The most probable price is that selling price which is most likely to emerge from a transaction involving the subject property if it were to be exposed for sale in the current market for a reasonable time at terms of sale which are currently predominant for properties of the subject type.

Source: P. 8, The Appraisal of 25 N. Pinckney, Editor James A. Graaskamp.

FEE SIMPLE—An absolute fee; a fee without limitations to any particular class of heirs or restrictions, but subject to the limitations of eminent domain, escheat, police power, and taxation. An inheritable estate.

From: Byrl N. Boyce, Real Estate Appraisal Terminology, Revised Edition, Ballinger Publishing Company, Cambridge, 1981, p. 102.

Fee simple.

Absolute. A fee simple absolute is an estate limited absolutely to a man and his heirs and assigns forever without limitation or condition. An absolute or fee-simple estate is one in which the owner is entitled to the entire property, with unconditional power of disposition during his life, and descending to his heirs and legal representatives upon his death intestate. Such estate is unlimited as to duration, disposition, and descendibility. *Slayden v. Hardin*, 257 Ky. 685, 79 S.W.2d 11, 12.

The estate which a man has where lands are given to him and to his heirs absolutely without any end or limit put to his estate. 2 Bl.Comm. 106. The word "fee," used alone, is a sufficient designation of this species of estate, and hence "simple" is not a neces-

sary part of the title, but it is added as a means of clearly distinguishing this estate from a fee-tail or from any variety of conditional estates. Fee-simple signifies a pure fee; an absolute estate of inheritance clear of any condition or restriction to particular heirs, being descendible to the heirs general, whether male or female, lineal or collateral. It is the largest estate and most extensive interest that can be enjoyed in land.

Conditional. Type of transfer in which grantor conveys fee simply on condition that something be done or not done. A defeasible fee which leaves grantor with right of entry for condition broken, which right may be exercised by some action on part of grantor when condition is breached.

At common law an estate in fee simple conditional was a fee limited or restrained to some particular heirs, exclusive of others. But the statute "De donis" converted all such estates into estates tail. 2 Bl. Comm. 110.

Defeasible. Type of fee grant which may be defeated on the happening of an event. An estate which may last forever, but which may end upon the happening of a specified event, is a "fee simple defeasible". *Newbern v. Barnes*, 3 N.C.App. 521, 165 S.E.2d 526, 530.

Determinable. A "fee simple determinable" is created by conveyance which contains words effective to create a fee simple and, in addition, a provision for automatic expiration of estate on occurrence of stated event. *Selectmen of Town of Nahant v. U. S.*, D.C.Mass., 293 F.Supp. 1076, 1978.

Fee simple title. See Fee simple.

From: Henry Campbell Black, Black's Law Dictionary, Fifth Edition, West Publishing Co., St. Paul, 1979, p. 554.

3. There is the problem of selecting a conversion process which reduces income cash flows and reversionary cash flows to a single present value.
- C. Neither revenue, nor expenses nor debt service are constant over time anymore so that NOI/OAR is no longer a useful valuation model. Instead rents, vacancies, expenses, and financing must be staged using a spread sheet for both income and the reversion. Lenders may share in appreciation and owner and lender may share the risk of variable interest and the first principal payment.
- D. The definition of economic rent attributable to the real estate
1. Is income attributable to entitlements that go with fee simple title to the land and are point specific or to transportable permits?
 - a. For example - does liquor license go with the building? Is permit to build or maintain a dam assignable? Does right to management fee and brokerage fee go with general partnership or property?
 2. Is the real estate income from retailing of space or from wholesaling space?
 - a. Parking ramp lease versus parking space by the hour, observation deck versus ticket, condominium conversion fee versus apartment project investment.
 3. Is the income for extraordinary services or intangible assets rather than customary?
 - a. Maid service versus janitorial, shopping center premium for proximity or for joint merchandising and risk management.
 4. Ancillary to rather than integral with the project.
 - a. Can services be acquired off premises such as janitorial or utilities?
 5. IRS classification as 1250 property (real) or 1231 property (personalty) or Section 38 (tangible) or Section (intangible).
 6. Is income attributable to governmental agencies in exchange for contractual entitlements of control or use to the public interest for the term of the contract?
- E. Problem of defining or forecasting a reversion
1. Pricing real estate for utilitarian purpose, to buy access to service sales, or speculate in long term demand/supply commodity relationships of long term commodity/money ratios.
 2. Can the appraiser prove presence of necessary conditions for appreciation and amount of depreciation?
 - a. Rising net income
 - b. Falling interest rates
 - c. Falling investor expectations

3. When is appreciation speculative, non-vested and excluded from fair market value?
4. Can the appraiser simulate alternative speculative gains for most probable price?
5. When a premium is paid anticipating syndication of condominium conversion, should there be an adjustment for purchase of a business opportunity? Does fair market value include management fees for conversion?

III. Case Study of an appraisal of a 50-year old high rise office building in the CBD with vacancy problems, utility problems and management problems.

- A. Revenues reflected loss of a major tenant (State of Wisconsin), lack of demand for retail space on the first floor, a soft market for B-class space, and a reluctance of management and tenants to use pass-throughs for operating costs.
- B. It was necessary to do a spread sheet indicating a gradual reduction of vacancy loss, a gradual updating of existing leases with pass-through clauses, and investment in critical energy conservation.
- C. Resale price is tied to projected net income and gross with a debt cover ratio and a cash-on-cash yield. Loan-to-value ratio is irrelevant. (See The Appraisal Journal, January 1981, DCR/R_e Cap Rate Tables for Today's Financing, p. 15.)
- D. Our firm makes heavy use of the backdoor approach on MRCAP for valuation.

LUNCH BREAK

V. Aside from the problem of defining and allocating income and reversion to the real estate interest, income property appraisal is at C. with the problem of cash equivalency adjustments for both comparable sales and the subject property. Many of the issues on how to appraise properties with economic development loans, state-subsidized housing loans, or seller financed property relate to when and how cash equivalency rules should be applied.

A. Fair market value seems to call for cash to the seller (Exhibit 3) but then provides an exception where market practice may be different. The Institute textbook says,

"Unusual financing or other factors that might result in a price deviation from market value are also excluded. However, if the availability of other than conventional financing (such as FHA or VA loan terms) is sufficiently extensive to constitute a market within which the property being appraised is expected to sell, the typical purchaser may be expected to take advantage of this available financing, and the market value of the property reflects the probable sale price in this market. In market valuation assignments the appraiser first identifies the market in which the property being appraised will be exposed and sold. The market value of the property is then identified within parameters that reflect conditions in this market." Source: The Appraisal of Real Estate, Seventh Edition.

B. In addition to market characteristics, we need to know the purpose of the appraisal before determining where their fair market value based on fee simple title or most probable price or going concern value is appropriate.

1. For example, the assessor is required by law to look at fee simple title; he does not recognize contract rents when they are below market rent nor can he look at premium rents and going concern values over and above market or economic rents. Cash equivalency is a must.

2. However, in a Section 8 loan from a state housing authority, it is typical to take an assignment of the general partnership position which can be exercised by the Housing Authority in the event of default on the mortgage terms or the related property management agreement. Control of the property can pass through subsequent assignment without disturbing the tax position or the special non-market interest rate of the deal. Moreover, the rights transferred include existing reserve funds. Therefore, fair market value is not relevant relative to the security of the loan. The investor purchases a fee simple title encumbered by transfers of owner prerogatives to the government in exchange for tax privileges and minimum income guarantees for 20-40 years. That is the question of most probable price or going concern value.

WEIGHTED MATRIX FOR COMPARABLE PROPERTIES

FEATURE/ WEIGHT	Rating/Weighted Rating						Subject 110 E. Main
	#1 30 W. Hiffman	#2 50 E. Hiffman	#3 16 N. Carroll	#4 123 W. Washington	#5 102 N. Hamilton	#6 212 E. Washington	
Parking 25%	5/1.25	3/.75	0/0	0/0	3/.75	3/.75	3/.75
Location 20%	5/1.00	5/1.00	5/1.00	3/.60	1/.20	3/.60	3/.60
First Floor Retail Lease In Place 15%	5/.75	5/.75	0/0	3/.45	3/.45	0/0	1/.15
Need for Renovation 15%	5/.75	1/.15	3/.45	5/.75	1/.15	1/.15	3/.45
Visual Quality of Office Entrance 10%	5/.50	3/.30	3/.30	5/.50	3/.30	3/.30	1/.10
Vacancies in Existing Office Space 15%	5/.75	0/0	5/.75	5/.75	0/0	0/0	1/.15
Total Weighted Score	5.00	2.95	2.50	3.05	1.85	1.80	2.20
Selling Price	\$2,555,500	\$850,000	\$615,270	\$2,896,000	\$330,000	\$472,000	X
Total Net Rentable Area (NRA)	65,000 sq. ft.	38,500 sq. ft.	35,725 sq. ft.	138,000 sq. ft.	28,000 sq. ft.	38,000 sq. ft.	74,000 sq. ft.
Price Per Square Foot (NRA)	\$39.30	\$22.10	\$17.20	\$21.00	\$11.80	\$12.40	
Price Per Square Foot of NRA	7.86	7.49	6.88	6.89	6.38	6.89	
Total Weighted Score							

EXHIBIT 22

EXHIBIT 23

CALCULATION OF MOST PROBABLE PRICE USING MEAN PRICE PER POINT EQUATION METHOD

Comparable Property	Selling Price/ per NRA	Point Score	Price per NRA per Total Weighted Score (x)
1	\$39.30	5.00	7.86
2	22.10	3.45	7.49
3	17.20	2.50	6.88
4	21.00	3.05	6.89
5	11.80	1.85	6.38
6	12.40	1.80	<u>6.89</u>
TOTAL			42.39

$$\text{Mean Value } (\bar{x}) = 42.39 \div 6 = 7.07$$

$$\text{Standard Deviation} = \frac{\sqrt{\frac{\sum (x - \bar{x})^2}{n-1}}}{\sqrt{n}} = .214$$

where:

x	\bar{x}	$(x - \bar{x})$	$\sum (x - \bar{x})^2$	n	n-1
7.86	7.07	.79	.62	6	5
7.49	7.07	.42	.18		
6.88	7.07	.19	.04		
6.89	7.07	.18	.03		
6.38	7.07	.69	.48		
6.89	7.07	.18	.03		
			<u>1.38</u>		

Value Range: 7.07 \pm .21

High Estimate: 7.28 = (X/74,000¹ sq. ft.) \div 2.2², \therefore X = 1,185,184 or \$1,200,000

Central Tendency: 7.07 = (X/74,000 sq. ft.) \div 2.2, \therefore X = 1,150,996 or \$1,150,000

Low Estimate: 6.86 = (X/74,000 sq. ft.) \div 2.2, \therefore X = 1,116,808 or \$1,120,000

¹74,000 sq. ft. = NRA of subject property

²2.2 = Weighted point score for subject property

Schedule of Rental Revenues¹ for the Period of April 30, 1980 Through April 29, 1985

Occupancy as of April 30, 1980	Space Sq. Ft.	Annual Rent per Sq. Ft. ²	Lease Terms as of 4/30/80 ³	Annualized Gross Rental Revenues						
				4/30/80- 4/29/81	4/30/81- 4/29/82	4/30/82- 4/29/83	4/30/83- 4/29/84	4/30/84- 4/29/85		
Lower Level & Roof										
B Level Vault-Vacant	700	3.00	--	\$ 2,100	\$ 2,100	\$ 2,270	\$ 2,270	\$ 2,450		
B Level-Showroom & Office	4000	3.00	--	12,000	12,000	12,960	12,960	14,000		
A Level-Storage	400	4.00	6/30/80	1,600	2,400	2,600	2,800	3,000		
Honeywell Phone Box	--	--	--	600	600	600	650	650		
Total-Lower Level	5100			\$16,300	\$17,100	\$18,430	\$18,680	\$20,100		
First Floor										
Chez Vous-112	454	4.80	10/1/76 - 9/30/81	\$ 2,180	\$ 2,290	\$ 2,360	\$ 2,360	\$ 2,360		
Chez Vous-114	1000	4.80	10/1/76 - 9/30/81	4,810	5,030	5,200	5,200	5,200		
North Entry	2000	9.00	--	18,000	19,500	21,000	22,500	24,000		
South Entry-Leaf & Ladle ⁴	3500	9.00	1/1/80 - 12/30/84	31,500	33,130	33,950	36,670	39,600		
Total-First Floor	6954			\$56,490	\$59,950	\$62,510	\$66,730	\$71,160		
Second Floor										
201 Vacant	150	6.50	--	\$ 970	\$ 970	\$ 1,050	\$ 1,050	\$ 1,140		
202 State ⁵	600	6.70	7/1/79 - 6/30/80	4,020	4,320	4,320	4,670	4,670		
203-4 Vacant ⁵	543	6.20	9/1/78 - 8/31/79	3,370	3,640	3,640	3,640	3,930		
205-6 State	506	7.00	3/1/78 - 5/31/80	3,540	3,820	3,820	4,120	4,120		
207-8 Homecrafts	386	7.20	1/1/79 - 12/31/81	2,780	2,850	3,000	3,000	3,080		
209-10 State ⁵	451	6.25	11/1/79 - 5/31/80	2,820	3,040	3,040	3,280	3,280		
211 Dr. Regez	219	7.00	--	1,600	1,730	1,730	1,870	1,870		
212-14 Dr. Wierwill	700	6.50	4/1/78 - 3/31/81	4,570	4,900	4,900	4,900	5,210		
215 Vacant	415	6.75	7/1/78 - 6/30/79	2,800	3,020	3,020	3,270	3,270		
216 UPI	500	7.50	5/1/80 - 4/30/81	3,750	4,050	4,050	4,370	4,370		
218-19 Rape Crisis Center	816	7.00	1/1/80 - 12/31/81	5,840	6,120	6,260	6,530	6,690		
220-21 State ⁵	1400	6.25	12/1/79 - 5/31/80	8,750	9,450	9,450	10,200	10,200		
Total-Second Floor	6686			\$44,810	\$47,910	\$48,280	\$50,900	\$51,830		

EXHIBIT 24

Schedule of Rental Revenues¹ for the Period of April 30, 1980 Through April 29, 1985

Occupancy as of April 30, 1980	Space Sq. Ft.	Annual Rent per Sq. Ft. ²	Lease Terms as of 4/30/80 ³	Annualized Gross Rental Revenues				
				4/30/80- 4/29/81	4/30/81- 4/29/82	4/30/82- 4/29/83	4/30/83- 4/29/84	4/30/84- 4/29/85
Third Floor								
01 Vacant	150	5.75	--	\$ 860	\$ 860	\$ 930	\$ 930	\$ 1,000
02-3 State ⁵	1179	5.75	--	6,780	7,320	7,320	7,900	7,900
04 State ⁵	230	6.70	--	1,540	1,660	1,660	1,800	1,800
05-8 State ⁵	942	6.70	--	6,300	6,800	6,800	7,360	7,360
09 The Journal Co.	232	7.20	9/1/79 - 8/31/80	1,810	1,880	1,970	2,030	2,120
10-11 State ⁵	456	6.70	--	3,050	3,300	3,300	3,560	3,560
12 Vacant	234	5.75	--	1,340	1,450	1,450	1,570	1,570
13-14 Dr. R. Meng	482	7.20	6/1/79 - 5/31/80	3,490	3,730	3,750	4,000	4,030
15 Vacant	731	6.70	10/1/79 - 9/30/80	5,000	5,080	5,310	5,480	5,630
16-19 Wisc. Builders Assoc.	1091	7.00	1/1/80 - 12/31/80	7,810	8,180	8,360	8,730	8,940
20-24 Vacant	1363	7.00	--	9,540	10,300	10,300	11,130	11,130
Total-Third Floor	7090			\$47,520	\$50,560	\$51,150	\$54,490	\$55,040
Fourth Floor								
01 Vacant	150	6.40	--	\$ 960	\$ 960	\$ 1,040	\$ 1,040	\$ 1,120
02 Furst, Carlson Inc.	648	6.40	5/1/79 - 4/30/80	4,350	4,370	4,700	4,730	5,090
03-11 State	2147	6.75	1/1/80 - 12/31/81	14,500	14,880	15,670	16,100	16,960
12 Vacant	202	6.40	--	1,290	1,290	1,400	1,400	1,500
13-14 Wisconsin Alliance of Cities	679	6.80	--	4,980	5,020	5,420	5,420	5,850
15 State ⁵	259	7.00	3/1/79 - 2/28/81	1,830	1,940	1,970	2,100	2,130
16-19 State ⁵	1370	6.00	vacated 6/30/80	8,220	8,880	8,880	9,590	9,590
20-20a State ⁵	560	6.70	vacated 6/30/80	3,750	3,750	4,050	4,050	4,370
21-22 State	300	6.70	vacated 6/30/80	2,010	2,010	2,170	2,170	2,340
23-24 Ed Konkol	340	6.60	9/1/79 - 8/31/80	2,240	2,240	2,420	2,420	2,620
Total-Fourth Floor	6655			\$44,130	\$45,340	\$47,720	\$49,020	\$51,570

EXHIBIT 24 -- Continued

Schedule of Rental Revenues¹ for the Period of April 30, 1980 Through April 29, 1985

Occupancy as of April 30, 1980	Space Sq. Ft.	Annual Rent per Sq. Ft. ²	Lease Terms as of 4/30/80 ³	4/30/80- 4/29/81	4/30/81- 4/29/82	4/30/82- 4/29/83	4/30/83- 4/29/84	4/30/84- 4/29/85
Eighth Floor								
01 Wisconsin Radio News	150	7.00	to 6/30/80	\$ 1,050	\$ 1,050	\$ 1,130	\$ 1,130	\$ 1,220
02-5 State	1536	7.55	to 10/31/83	11,600	11,600	11,600	12,060	12,520
06-7 Dr. Mannis	470	7.50	9/1/79 - 8/31/80	3,840	4,000	4,000	4,210	4,320
08-22 State	4580	6.00	7/1/79 - 6/30/80	27,480	36,620	37,100	37,100	39,580
23-24 Dr. Boyle	339	7.60	9/1/79 - 8/31/80	2,780	2,880	3,040	3,120	3,120
Total-Eighth Floor	7075			\$46,750	\$56,150	\$56,870	\$57,620	\$60,760
Ninth Floor								
01 Hillman & Robertson	150	8.00	1/1/80 - 12/31/80	\$ 1,230	\$ 1,300	\$ 1,340	\$ 1,400	\$ 1,400
02 Wisc. Ins. Alliance	864	7.00	6/1/79 - 5/31/80	6,400	6,480	6,910	7,000	7,000
03-6 Mulcahy & Wherry	980	8.00	1/1/79 - 12/31/81	8,070	8,530	8,750	9,210	9,210
07 Robert Uehling	225	8.00	4/1/80 - 3/31/81	1,810	1,960	1,980	2,110	2,110
09-10 Larry Hall	700	6.00	6/1/79 - 5/31/80	4,520	4,550	4,870	4,900	4,900
11 Dr. Schwartz	248	7.75	1/1/79 - 12/31/80	1,920	1,970	2,060	2,140	2,230
12-19 Davine Insurance	2580	7.00	4/1/80 - 3/31/83	18,060	18,060	18,180	19,350	19,350
21 State	575	7.00	vacated 7/1/80	4,020	4,350	4,350	4,700	4,700
22-23 Judicial Commission	355	6.50	5/1/79 - 4/30/81	2,300	2,500	2,500	2,700	2,700
24-25 Dr. Rundell	339	7.20	6/1/79 - 5/31/80	2,650	2,680	2,860	2,880	2,880
Total-Ninth Floor	7016			\$50,980	\$52,380	\$53,800	\$56,390	\$56,480
Tenth Floor								
001 Victor Lind	150	6.80	11/1/79 - 10/31/80	\$ 1,050	\$ 1,200	\$ 1,250	\$ 1,300	\$ 1,350
002 Wisc. Assoc. of Indep. Colleges	864	6.50	1/1/80 - 12/31/80	5,760	6,050	6,190	6,480	6,650
003-4 Wisc. Cannery & Freezers	756	8.00	5/1/79 - 4/30/80	6,050	6,050	6,530	6,530	7,050
005-8 Boelter Co.	911	6.80	12/1/79 - 11/30/80	6,370	6,650	6,880	7,200	7,400
009-10 Vacant	455	6.50	--	2,950	3,190	3,190	3,450	3,450
011-13 Dr. Doll	727	6.65	6/1/79 - 5/31/80	5,230	5,270	5,640	5,670	6,100
014 Vacant	229	6.25	--	1,430	1,430	1,540	1,540	1,670
015-18 State	1616	7.50	11/1/79 - 10/31/83	12,120	12,120	12,120	12,600	13,090
019-21 Vacant	680	6.70	vacated 2/29/80	5,380	5,440	5,870	5,910	6,350
022 Herb Walsh	171	8.00	12/1/79 - 11/30/80	1,420	1,490	1,490	1,540	1,600
023-24 Dane Co. Advocate for Battered Women	331	7.20	8/1/79 - 7/31/80	2,610	2,680	2,840	2,900	3,070
Total-Tenth Floor	6890			\$50,370	\$51,570	\$53,540	\$55,120	\$57,780
Annual Totals for	74,054 sq. ft.			\$493,960	\$522,120	\$537,260	\$565,460	\$586,210

EXHIBIT 24 -- Continued

Schedule of Rental Revenues¹ for the Period of April 30, 1980 Through April 29, 1985

Occupancy as of April 30, 1980	Space Sq. Ft.	Annual Rent per Sq. Ft. ²	Lease Terms as of 4/30/80 ³	4/30/80- 4/29/81	4/30/81- 4/29/82	4/30/82- 4/29/83	4/30/83- 4/29/84	4/30/84- 4/29/85
Annualized Gross Rental Revenues								
Fifth Floor								
501 E. C. Barton	150	7.60	--	\$ 1,240	\$ 1,270	\$ 1,270	\$ 1,380	\$ 1,380
502 Vacant	842	7.50	--	6,310	6,820	6,820	7,360	7,360
503-5 Vacant	810	7.50	--	6,070	6,070	6,440	6,800	6,800
506-19 State	3922	6.25	11/1/79 - 10/31/83	24,500	24,500	24,500	30,590	31,770
520 State-Bd. of Aging	555	6.70	7/1/79 - 6/30/81	3,950	4,000	4,270	4,330	4,940
521-22 Dr. Coryell	339	7.20	7/1/79 - 6/30/80	2,440	2,690	2,740	2,920	2,950
523-24 Green Bay Press Gazette	337	7.60	9/1/79 - 8/31/82	2,560	2,690	2,760	2,760	2,760
Total-Fifth Floor	6955			\$47,070	\$48,040	\$48,800	\$56,140	\$57,960
Sixth Floor								
601 Vacant	150	6.70	--	\$ 1,000	\$ 1,000	\$ 1,080	\$ 1,080	\$ 1,170
602-4 State ⁵	1473	6.00	vacated 6/30/80	8,840	9,540	9,540	10,300	10,300
605 Vacant	204	6.40	--	1,300	1,300	1,410	1,410	1,520
			to 6/30/80					
606-10 State	1000	6.70	then mo. - mo.	7,370	7,500	7,500	8,100	8,100
611 The Evjue Foundation	286	7.00	vacated 11/30/80	2,000	2,000	2,160	2,160	2,330
612-14 State	647	7.50	11/1/79 - 10/31/83	4,850	4,850	4,850	5,080	5,240
615 Tenney Bldg.	344	7.00	--	2,400	2,400	2,600	2,600	2,800
616 John Barsness	850	6.00	3/1/79 - 2/28/81	5,170	5,520	5,590	5,950	6,020
617 Bill Ward	250	6.70	vacated 5/31/80	1,940	2,120	2,120	2,300	2,300
618-19 State	494	8.00	vacated 5/31/79	3,950	3,950	4,270	4,270	4,610
620-24 Vacant	1262	6.70	--	8,450	9,130	9,130	9,860	9,860
Total-Sixth Floor	6960			\$47,270	\$49,310	\$50,250	\$53,110	\$54,250
Seventh Floor								
701 Lawton & Cates	150	5.75	6/1/79 - 5/31/83	\$ 930	\$ 970	\$ 1,100	\$ 1,050	\$ 1,090
702-19 Lawton & Cates	5417	5.75	6/1/79 - 5/31/83	33,600	35,100	36,450	37,850	39,160
720-24 Vacant	1106	7.00	--	7,740	7,740	8,360	8,360	9,030
Total-Seventh Floor	6673			\$42,270	\$43,810	\$45,910	\$47,260	\$49,280

EXHIBIT 24 -- Continued

Notes to Schedule of Rental Revenues for the
Period of April 30, 1980 Through April 29, 1985

- ¹ The annualized gross rental revenue for the period from April 30, 1980 through April 29, 1981 is consistent with the actual lease terms, if at market rents, as of April 30, 1980. Increases in rents are assumed to take place according to lease terms and conditions; an increase of 8 percent is used at lease renewal dates. This factor was taken from a survey of office rent increases in Class B buildings on and near the Capitol Square in Madison and is the current rate used by the Tenney Building manager.
- ² The annual rental market rate is given as of April 30, 1980. Only one tenant in Rooms 909-10 is considered to be below market rent at \$4.73/square foot; therefore the rent for this space is calculated at a market rate of \$6.00/square foot. Market rents are also imputed to spaces used by the building owner.
- ³ Of the 87 rental space units in the Tenney Building as of April 30, 1980, there are 62 leases in place, but 54 of those terminate between 1980 and 1982. Only eight have leases that extend beyond April 30, 1982.
- ⁴ The Leaf and Ladle Restaurant began its lease of 3500 sq. ft. of the first floor retail space on January 1, 1980. The restaurant had closed its door by October 1, 1980, and the remodeled space is once again on the market. The rental rate of \$9.00 with an annual escalator of 8% per year commencing in the second year is considered comparable for the area. A most probable investor might consider an escalator based upon a percentage of gross sales to encourage rental of this space if restaurant use is most likely; the projected revenues probably would not increase as rapidly as forecast.
- ⁵ The state has given notice that it will vacate these spaces by June 30, 1980.

**Schedule of Vacancies by Floor and by Lease Terms for
the Period of April 30, 1980 Through April 29, 1985**

	Space Sq. Ft. ²	% Vacant	Annual Rental Rate Per. Sq. Ft.	# of Months Vacant	Projection Period				
					4/30/80- 4/29/81	4/30/81- 4/29/82	4/30/82- 4/29/83	4/30/83- 4/29/84	4/30/84- 4/29/85
Basement Level & Roof									
Vault	700	100	3.00	12	\$ 2,100				
	700	100	3.00	12		\$ 2,100			
	700	100	3.25	12			\$ 2,270		
	700	50	3.25	6				\$ 1,140	
	700	50	3.50	6					\$ 1,140
Second Level									
Warehouse and Office	4,000	100	3.00	12	12,000				
	4,000	100	3.00	6		6,000			
	4,000	50	3.25	6			3,250		
	4,000	50	3.25	6				3,250	
	4,000	50	3.50	3					1,750
Level - Storage	400	100	7.00	6				1,400	
	400	100	7.50	9					2,250
Total - Lower Level					\$14,100	\$ 8,100	\$ 5,520	\$ 5,790	\$ 5,140
First Floor									
2 East Main	454	100	5.20	8		\$ 1,570			
	454	100	5.20	12			\$ 2,360		
	454	100	5.20	4				\$ 780	
4 East Main	1,000	100	5.20	8		3,480			
	1,000	50	5.20	12			2,600		
	1,000	50	5.20	4				860	
Inf & Ladie	3,500	100	9.00	7	18,370				
	3,500	100	9.50	3		8,310			
	3,500	100	10.50	3				9,190	
	3,500	100	11.30	3					\$ 9,890
North Entry	2,000	100	9.00	9	13,500				
Total - First Floor					\$13,870	\$13,360	\$ 4,960	\$10,830	\$ 9,890

EXHIBIT 25

Schedule of Vacancies by Floor and by Lease Terms for
the Period of April 30, 1980 Through April 29, 1985

EXHIBIT 25 -- Continued

	Space Sq. Ft. ²	% Vacant	Annual Rental Rate Per Sq. Ft.	# of Months Vacant	Projection Period				
					4/30/80- 4/29/81	4/30/81- 4/29/82	4/30/82- 4/29/83	4/30/83- 4/29/84	4/30/84- 4/29/85
<u>Ninth Floor</u>									
909-10	700	100	6.50	6		\$ 2,280			
	700	100	7.00	6			\$ 2,440		
922-23	355	100	7.00	12			2,500		
	355	100	7.60	6				\$ 1,350	
Total - Ninth Floor					0	\$ 2,280	\$ 4,940	\$ 1,350	0
<u>Tenth Floor</u>									
1009-10	455	100	6.50	12	\$ 2,950				
	455	100	7.00	12		\$ 3,190			
	455	100	7.00	9			\$ 2,390		
1014	229	100	6.25	12	1,430				
	229	100	6.25	12		1,430			
	229	100	6.70	6				770	
1019-20	680	100	6.70	1	380				
Total - Tenth Floor					\$ 4,760	\$ 4,620	\$ 2,390	\$ 770	0
TENNEY BUILDING TOTALS ⁴					<u>\$120,790</u>	<u>\$85,330</u>	<u>\$66,480</u>	<u>\$59,910</u>	<u>\$39,220</u>

Notes to Schedule of Vacancies by Floor and by Lease Terms
For the Period of April 30, 1980 Through April 29, 1985

- ¹The lower level space has a continued record of vacancy; it is assumed that until the space is made more marketable by remodeling, rents will not keep pace with the market. Uses other than a showroom for the 4000 sq. ft. will need to be explored; subdividing the larger space for office space and/or storage space are possibilities.
- ²It is assumed that the smaller office spaces from 200-500 square feet will experience less overall vacancy than the larger spaces. There appears to be a trend toward several small independent businessmen sharing a common secretarial staff; some of the larger vacant suites could be remodeled for this type of use.
- ³The second and third floors have the greatest amount of vacancy due to the exodus of State tenants. By the end of June, 1980, the State's move alone will cause 44% of the second floor vacancies; the third floor will experience a vacancy rate of 39.5% due to loss of State tenants; the State related vacancy rates on the fourth and sixth floors will be 29% and 21% respectively. A most probable buyer will have to anticipate a large capital investment in 1980 to remodel and refurbish the Building to make it competitive in the Class B office market that already has a large supply of space available on and near the Square.
- ⁴Vacancies are assumed to gradually decrease between 1981 and 1983; a most probable buyer will institute a vigorous marketing program which will involve research of space needs in the area and remodeling which will be targeted to those needs.

**Schedule of Vacancies by Floor and by Lease Terms for
the Period of April 30, 1980 Through April 29, 1985**

	Space Sq. Ft. ²	% Vacant	Annual Rental Rate Per Sq. Ft.	# of Months Vacant	Projection Period				
					4/30/80- 4/29/81	4/30/81- 4/29/82	4/30/82- 4/29/83	4/30/83- 4/29/84	4/30/84- 4/29/85
<u>Sixth Floor</u>									
601	150	100	6.70	12	\$ 1,000				
	150	100	6.70	12		\$ 1,000			
	150	100	7.20	9			\$ 810		
602-4	1,473	100	6.00	6	4,420				
	1,473	50	6.50	12		4,770			
	1,473	50	6.50	12			4,770		
	1,473	50	7.00	9				\$ 3,870	
	1,473	50	7.00	6					\$ 2,580
605	204	100	6.40	12	1,300				
	204	100	6.40	12		1,300			
	204	100	6.90	12			1,410		
	204	100	6.90	9				1,060	
617	250	100	7.75	4	640				
620-24	1,262	100	6.70	12	8,450				
	1,262	100	7.20	6		4,540			
	1,262	100	7.20	6			4,540		
	1,262	50	7.80	9				3,690	
Total - Sixth Floor					\$15,810	\$11,610	\$11,530	\$ 8,620	\$ 2,580
<u>Seventh Floor</u>									
No Vacancies Projected									
<u>Eighth Floor</u>									
801	150	100	7.00	10	\$ 880				
	150	100	7.00	12		\$ 1,050			
	150	100	7.50	6			\$ 560		
Total - Eighth Floor					\$ 880	\$ 1,050	\$ 560	0	0

EXHIBIT 25 -- Continued

**Schedule of Vacancies by Floor and by Lease Terms for
the Period of April 30, 1980 Through April 29, 1985**

	Space Sq. Ft. ²	% Vacant	Annual Rental Rate Per Sq. Ft.	# of Months Vacant	Projection Period				
					4/30/80- 4/29/81	4/30/81- 4/29/82	4/30/82- 4/29/83	4/30/83- 4/29/84	4/30/84- 4/29/85
Fourth Floor									
401	150	100	6.40	12	\$ 960				
	150	100	6.40	12		\$ 960			
	150	100	6.90	12			\$ 1,040		
	150	100	6.90	12				\$ 1,040	
	150	100	7.45	12					\$ 1,120
412	202	100	6.40	12	1,290				
	202	100	6.40	12		1,290			
	202	100	6.90	12			1,400		
	202	100	6.90	12				1,400	
	202	100	7.40	12					1,500
416-19	1,370	100	6.00	6	4,110				
	1,370	50	6.50	12		4,450			
	1,370	50	6.50	12			4,450		
	1,370	50	7.00	12				4,800	
	1,370	50	7.00	6					2,400
420-20a	560	100	6.70	6	1,880				
	560	50	6.70	12		1,870			
	560	50	7.20	9			1,520		
Total - Fourth Floor					\$ 8,240	\$ 8,570	\$ 8,410	\$ 7,240	\$ 5,020
Fifth Floor									
502	842	100	7.50	12	\$ 6,310				
	842	50	8.00	12		\$ 3,410			
	842	50	8.00	12			\$ 3,410		
	842	50	8.75	6				\$ 3,410	
520	555	100	7.70	6			2,130		
	555	50	7.80	12				2,160	
	555	50	8.90	9					\$ 1,850
Total - Fifth Floor					\$ 6,310	\$ 3,410	\$ 5,540	\$ 5,570	\$ 1,850

EXHIBIT 25 -- Continued

Schedule of Vacancies by Floor and by Lease Terms for
the Period of April 30, 1980 Through April 29, 1985

	Space Sq. Ft. ²	% Vacant	Annual Rental Rate Per Sq. Ft.	# of Months Vacant	Projection Period				
					4/30/80- 4/29/81	4/30/81- 4/29/82	4/30/82- 4/29/83	4/30/83- 4/29/84	4/30/84- 4/29/85
3rd Floor³	150	100	5.75	12	\$ 860				
	150	100	5.75	12		\$ 860			
	150	100	6.20	12			\$ 930		
	150	100	6.20	12				\$ 930	
	150	100	6.70	12					\$ 1,000
B2-3	1,179	100	5.75	6	3,390				
	1,179	50	6.20	12		3,650			
	1,179	50	6.20	12			3,650		
	1,179	50	6.70	6				3,950	
B4	230	100	6.70	6	770				
	230	100	7.20	12		1,660			
	230	100	7.80	6					900
B5-8	942	100	6.70	6	3,150				
	942	50	7.20	12		3,390			
	942	50	7.20	12			3,390		
	942	50	7.80	3					1,830
10-11	456	100	6.70	6	1,530				
	456	50	7.20	12		1,640			
	456	50	7.20	12			1,640		
B12	234	100	5.75	12	1,340				
	234	100	6.20	12		1,450			
	234	100	6.20	12			1,450		
	234	100	6.70	12				1,570	
	234	100	6.70	12					1,570
315	731	100	6.70	4	1,610				
320-24	1,363	100	7.00	12	9,540				
	1,363	100	7.60	6		5,150			
Total - Third Floor					\$22,190	\$17,800	\$11,060	\$ 6,450	\$ 5,300

EXHIBIT 25 -- Continued

Schedule of Vacancies by Floor and by Lease Terms for
the Period of April 30, 1980 Through April 29, 1985

	Space Sq. Ft. ²	% Vacant	Annual Rental Rate Per Sq. Ft.	# of Months Vacant	Projection Period				
					4/30/80- 4/29/81	4/30/81- 4/29/82	4/30/82- 4/29/83	4/30/83- 4/29/84	4/30/84- 4/29/85
Second Floor ³									
201	150	100	6.50	12	\$ 900				
	150	100	6.50	12		\$ 900			
	150	100	7.00	12			\$ 1,050		
	150	100	7.00	12				\$ 1,050	
	150	100	7.60	12					\$ 1,140
202	600	100	6.70	6	2,010				
	600	50	7.20	12		2,160			
	600	50	7.20	12			2,160		
	600	50	7.80	6				1,170	
	600	50	7.80	3					580
203-4	543	100	6.20	12	3,370				
	543	50	6.70	12		1,820			
	543	50	6.70	12			1,820		
	543	50	6.70	9				1,360	
205-6	506	100	7.00	6	1,770				
	506	50	7.50	12		1,900			
	506	50	7.50	12			1,900		
	506	50	8.15	9				1,550	
	506	50	8.15	6					1,030
209-10	451	100	6.25	6	1,410				
	451	50	6.75	12		1,520			
	451	50	6.75	12			1,520		
	451	50	7.30	9				1,230	
215	415	100	6.75	12	2,800				
	415	100	7.30	6		1,510			
	415	100	7.30	3			760		
218-19	816	100	8.00	8				4,370	
	816	100	8.20	12					6,690
220-21	1,400	100	6.25	6	4,370				
	1,400	50	6.75	12		4,720			
	1,400	50	6.75	6			2,360		
	1,400	50	7.30	6				2,560	
Total - Second Floor					\$16,630	\$14,530	\$11,570	\$13,290	\$ 9,440

EXHIBIT 25 -- Continued

EXHIBIT 25 -- Continued

Schedule of Projected Revenues and Expenses From
April 30, 1980 Through April 29, 1985

	<u>4/30/80- 4/29/81</u>	<u>4/30/81- 4/29/82</u>	<u>4/30/82- 4/29/83</u>	<u>4/30/83- 4/29/84</u>	<u>4/30/84- 4/29/85</u>
Revenues:					
Gross Income	\$493,960	\$522,120	\$537,260	\$565,460	\$586,210
Less: Vacancies	(120,790) (24.5%)	(85,330) (16.3%)	(66,480) (12.4%)	(59,910) (10.6%)	(39,220) (6.7%)
Effective Gross	<u>373,170</u>	<u>436,790</u>	<u>470,780</u>	<u>505,550</u>	<u>546,990</u>
Parking Rentals	<u>12,960</u>	<u>12,960</u>	<u>12,960</u>	<u>14,000</u>	<u>14,000</u>
Total Revenues	\$386,130	\$449,750	\$483,740	\$519,550	\$560,990
Expenses: ¹					
Accounting & Legal	4,200	4,640	5,120	5,650	6,240
Building Security ²	21,840	24,100	26,620	29,390	32,440
Insurance	7,000	7,730	8,530	9,420	10,400
Maintenance ³	28,850	31,850	35,160	38,820	42,860
Wage & Salaries	60,000	66,240	73,130	80,730	89,130
Payroll Taxes	11,500	12,700	14,020	15,470	17,080
Repairs	14,880	16,430	18,130	20,020	22,100
Telephone ⁴	1,600	1,770	1,950	2,150	2,380
Utilities ⁴	90,600	101,470	107,560	114,380	122,020
Office Expenses ⁵	7,040	7,520	8,250	8,840	9,690
Management ⁶	22,390	26,320	27,540	30,280	32,570
Concourse Special Assessment	<u>2,360</u>	<u>2,410</u>	<u>2,630</u>	<u>2,550</u>	<u>2,480</u>
Total Operating Expenses Before R.E. Taxes ⁷	<u>(\$272,260)</u>	<u>(\$303,180)</u>	<u>(\$328,640)</u>	<u>(\$357,700)</u>	<u>(\$389,390)</u>
Net Operating Income Before R.E. Taxes	\$113,870	\$146,570	\$155,100	\$161,850	\$171,600
Real Estate Taxes ⁸	<u>(26,680)</u>	<u>(28,000)</u>	<u>(29,400)</u>	<u>(30,880)</u>	<u>(32,420)</u>
Net Operating Income	\$ 87,190	\$118,570	\$125,700	\$130,970	\$139,180

Notes to Schedule of Projected Revenues and Expenses
From April 30, 1980 Through April 29, 1985

Expenses

In general, expenses are projected to increase according to the average annual change of 10.4% in the All Item Consumer Price Index over the past five years. (See amended Exhibit 27).

Building Security

Security personnel is hired from 10 P.M. to 6 A.M. on weekdays with 24 hour coverage on the weekends. The building is open to the public from 6 A.M. to 6 P.M. each weekday. The continuing problems created by the presence of bars and adult entertainment places across the street make this security protection mandatory.

Maintenance

This account includes an elevator maintenance contract at \$9,060 a year.

Utilities

At present the Tenney Building consumes approximately 55,000 to 70,000 gallons of No. 2 fuel oil per year depending upon the weather. The cost of fuel has increased as follows:

January 12, 1979	.43/gallon
October 1, 1979	.77/gallon
February 1, 1980	.95/gallon

In thirteen months the cost has risen 121%. Though the Tenney Building is converting to natural gas on its primary boiler, the cost of natural gas is also volatile. Over the past five years natural gas has had an average annual increase of 17.6% for the commercial time-of-use consumer, according to Milton Spiros, Madison Gas & Electric Co.

The installation of combination storm windows throughout the building should help to conserve fuel costs. To stabilize utility costs it is assumed management will place energy cost escalators in renewed leases; therefore in the pro forma income statement utility costs are escalated at 12 percent annually with 50 percent of the increase passed through to the tenant after year 2.

⁵Office expenses include rental of space in the Tenney Building for management operations.

⁶Management costs are computed as 6% of effective gross office revenue with 4% allowed for management and 2% for leasing commissions for space turnover.

EXHIBIT 27 -- Continued

Notes to Schedule of Projected Revenues and Expenses
From April 30, 1980 Through April 29, 1985

⁷ Total operating expenses are calculated before including real estate taxes for ease in using the MRCAP discounted cash flow program.

⁸ Real estate taxes are calculated as 5.4% of gross revenues in the first year and increased at 5% per annum thereafter. These calculations are based on the following fact and assumptions:

1. The assessed value as of 1/1/80 is \$1,200,000.
2. The mill rate is assumed to increase slightly (approximately 1%) after several years of decrease.
3. Taxes will continue to increase due to inflated city budgets and decreasing state aids.

end of the second year when the leases have been renegotiated.

4. Conversion of Net Income to Present Value

The MRCAP program from the National EDUCARE library of programs, previously described, is used to convert net income to a present value after taxes as of April 30, 1980, for the Tenney Building at the end of a five-year holding period.

C. Assumptions Used in MRCAP

The MRCAP discounted cash flow program can solve for a justified project value by specifying the ratio of net income to debt service acceptable to an institutional mortgage lender. Given the interest rate and term available as of April 30, 1980, the program will solve for the justified amount of mortgage and for justified cash equity, assuming typical before-tax cash-on-cash investor requirements for office buildings, with potential for inflation sensitive rents. Exhibit 28 is a simplified flow chart depicting the steps in solving for the justified project budget.

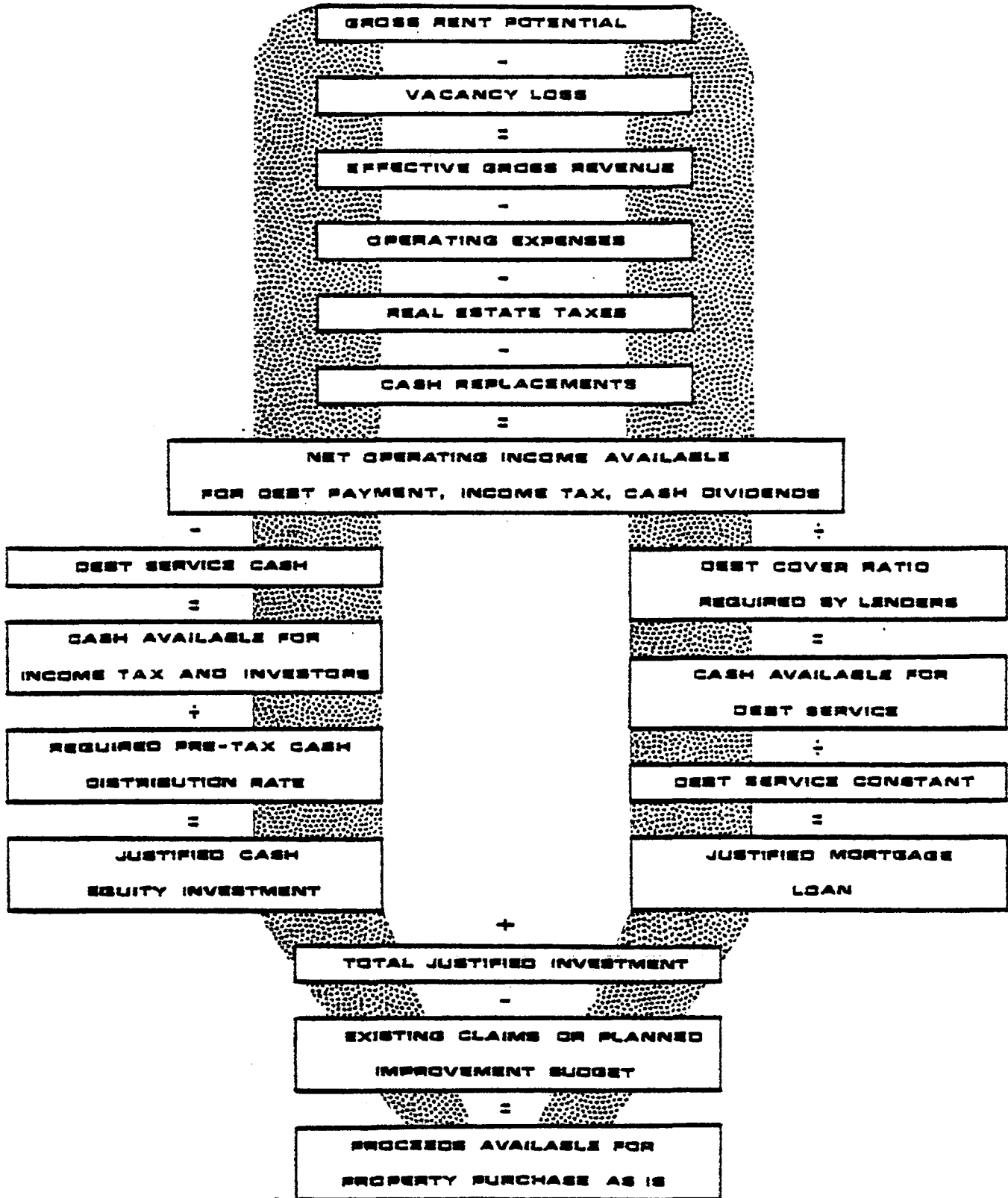
On April 30, 1980, prudent lenders will require a minimum debt cover ratio of 1.3 and equity investors expect no less than 6 percent cash-on-cash.

1. Inputs into MRCAP Program

- a. Debt cover ratio = 1.3
- b. Before tax cash-on-cash requirements = 6%
- c. Project holding period = 5 years

EXHIBIT 28

REVENUE JUSTIFIED CAPITAL BUDGET
DEBT COVER RATIO APPROACH



- d. Real estate taxes = historical pattern suggests real estate taxes at 5.4 percent of first year's gross with an annual inflation factor of 5% (see assumptions discussed below)
- e. Discount rate = 13% (present value factor used to discount cash flow)
- f. Reinvestment rate = 6% after tax rate applied to after tax cash flow
- g. Resale price = 10 times net operating income in year of sale
- h. Resale cost rate = 4%
- i. Working capital reserves from equity to cover one month's expenses = \$30,000
- j. Investor marginal income tax rate = 50%
- k. Land = \$340,000, as of most recent appraisal for IRS
- l. Buildings = 60% of total improvement value
- m. Mechanicals and site improvements = 40% of total improvement value
- n. Elevators = remaining book value of \$73,000
- o. Improvements for Energy Conservation = a total of \$54,000 which includes \$43,000 for storm windows and \$11,000 for natural gas conversion unit.
- p. Tenant Improvements = \$50,000 for carpeting and partitions as needed to upgrade vacant office space
- q. Investment Credit Dummy = to allow for tax benefit of investment credit in first year for capital improvement for energy conservation
- r. Mortgage = principal amount determined by debt cover ratio; interest rate a minimum of 12% with a 20-year term, paid monthly, on the first mortgage and 13% interest and an 8-year term for the second mortgage

2. Real Estate Tax Assumptions

Real estate taxes are a function of assessed value (or fair market value when assessed value is 100 percent of market value) and the net mill rate; therefore, real estate taxes are estimated as a function of gross rental income. During the past two years, real estate taxes have been between 5 percent and 6 percent of the Building's potential gross rental income. As a result of tests of several values between 5 percent and 6 percent, it is determined that 5.4 percent of gross rental revenues best represents the historical pattern of the Building's real estate taxes. MRCAP is programmed to use 5.4 percent of the first year's gross rental income to compute the first year's real estate taxes and then provides for a growth factor of 5 percent to increase the taxes each year thereafter.

D. Analysis of Test Results

Four runs of the MRCAP program were done using different assumptions about the amount of real estate taxes that would be paid on the subject property. Taxes and net mill rates for the past three years on the subject property have been:

<u>Year</u>	<u>1977</u>	<u>1978</u>	<u>1979</u>
<u>Real Estate Taxes</u>	\$33,118.75	\$29,951.95	\$25,340.93
<u>Net Mill Rate</u>	.026495	.024153	.022036

Real estate taxes estimated at various percentages of the first year's projected gross and inflated 5 percent a year gave these results in the MRCAP runs:

<u>Percentage of First Year's Gross Rental Revenue</u>	<u>Real Estate Taxes</u>				
	<u>1980</u>	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>
5.0	\$24,698	\$25,933	\$27,230	\$28,591	\$30,021
5.4	\$26,674	\$28,008	\$29,408	\$30,878	\$32,422
5.8	\$28,650	\$30,082	\$31,586	\$33,166	\$34,824
6.0	\$29,638	\$31,119	\$32,675	\$34,309	\$36,025

The real estate taxes estimated at 5.4 percent of the first year's gross rent best approximates the shift from a decreasing to an increasing net mill rate that can now be expected due to an anticipated decrease in state aids to cities. Rising costs of local government can be expected to be borne by the local taxpayer.

The input and output for the MRCAP program using real estate taxes estimated at 5.4 percent of gross rental revenue are found in Exhibit 29.

If taxes are a conservative 5.4 percent of gross rental revenue, MRCAP substantiates the fair market value of \$1,150,000 estimated by the market comparison approach to value.

EXHIBIT 29

MRCAP INPUT AND OUTPUT--
JUSTIFIED CAPITAL BUDGET WITH
REAL ESTATE TAXES AT 5.4% OF
FIRST YEAR'S GROSS RENT

MRCAP 09:49CST 12/20/80

ENTER INPUT FILE NAME?TENNEY

THE PROGRAM MRCAP IS THE PROPERTY OF
MICHAEL L. ROBBINS
C/O REAL ESTATE DYNAMICS INC.
4701 WINNEQUAH RD.
MONONA, WISC.

USER NO. 66

(608)-221-1120

NO REPRESENTATION IS MADE THAT THE ASSUMPTIONS OR
COMPUTATIONAL FORMAT USED IN THIS PROJECTION WILL
BE ACCEPTABLE TO TAXING AUTHORITIES.

*\$10.00 LIB CHG APPLIED

R E P O R T S E C T I O N N U M B E R 1 PAGE 1
=====

* GROSS RENT	\$ 554378.	* RATE OF GROWTH OF GROSS RENT	0.0432
* EXPENSES	\$ 330234.	* RATE OF GROWTH OF EXPENSES	0.0936
* R E TAXES	\$ 29478.	* RATE OF GROWTH OF R E TAXES	0.0500
INCOME TAX RATE	0.5000	PROJECT VALUE GROWTH OF	2.0000
* VACANCY RATE	0.1375	WORKING CAPITAL LOAN RATE	0.1400
EQUITY DISCOUNT	0.1300	EXTRAORDINARY EXPENSES	\$ 0.
RESALE COST	0.0400	REINVESTMENT RATE	0.0600
WKG CAPITAL RS	\$ 30000.	CAPITAL RESER INTEREST RATE	0.
INITIAL COST	\$ 1091502.	INITIAL EQUITY REQUIRED	\$ 486009.

ALL ** VALUES ARE AVERAGE AMOUNTS FOR HOLDING PERIOD. OF 5 YRS.

INITIAL COST DERIVED THROUGH BACKDOOR TYPE 3 USING 2 MORTGAGES

EXHIBIT 29 -- Continued

P R O F O R M A

INVESTMENT ANALYSIS OF
BUILDING
FOR

REPORT SECTION NUMBER 2
=====

PAGE 1

C O M P O N E N T S U M M A R Y

TITLE	PCT. DEPR	BEGIN USE	USEFUL LIFE	DEPR METHOD	COST	SCH
LAND	0.	1	25.	0	\$ 340000.	0
BUILDING	0.80	1	29.	2	\$ 338221.	0
HVAC	0.90	1	9.	2	\$ 225481.	0
ELEVATORS	0.90	1	4.	2	\$ 73000.	0
ENERGY CONSERVATION	0.90	1	5.	2	\$ 54000.	0
TENANT IMPROVEMENTS	0.90	1	10.	4	\$ 50000.	0
INVESTMENT CREDIT DU	1.00	1	1.	2	\$ 10800.	0

M O R T G A G E S U M M A R Y

TITLE	INTR RATE	BEGIN YR.	END YR.	TERM	ORIG BALC	PCT VALUE
FIRST MORTGAGE	0.1200	1	20	20	\$ 531493.	0.487
SECOND MORTGAGE	0.1300	1	8	8	\$ 104000.	0.095

EXHIBIT 29 -- Continued

PRO FORMA
INVESTMENT ANALYSIS OF
BUILDING
FOR

REPORT SECTION NUMBER 3

PAGE 1

CASH FLOW ANALYSIS

	1980	1981	1982	1983	1984
1 GROSS INCOME	506920.	535080.	550220.	579460.	600210.
2 LESS VACANCY	120790.	85330.	66480.	59910.	59220.
3 LESS REAL ESTATE TAXES	26674.	28008.	29408.	30878.	32422.
4 LESS EXPENSES	272260.	303180.	328640.	357700.	389390.
5 NET INCOME	87196.	118562.	125692.	130972.	139178.
6 LESS DEPRECIATION	76323.	64398.	63442.	62629.	45513.
7 LESS INTEREST	76472.	74515.	72298.	69785.	66938.
8 TAXABLE INCOME	-65599.	-20351.	-10048.	-1443.	26726.
9 PLUS DEPRECIATION	76323.	64398.	63442.	62629.	45513.
10 LESS PRINCIPAL PAYMENTS	14730.	16687.	18904.	21417.	24263.
11 CASH THROW-OFF	-4006.	27361.	34490.	39770.	47976.
12 LESS TAXES	0.	0.	0.	0.	13363.
13 LESS RESERVES	0.	0.	0.	0.	0.
14 CASH FROM OPERATIONS	0.	27361.	34490.	39770.	34613.
15 WORKING CAPITAL LOAN	0.	0.	0.	0.	0.
16 DISTRIBUTABLE CASH AFR TAX	0.	27361.	34490.	39770.	34613.
17 TAX SAVING ON OTHER INCOME	32799.	10175.	5024.	721.	0.
18 SPENDABLE CASH AFTER TAX	32799.	37536.	39514.	40491.	34613.

EXHIBIT 29 -- Continued

MARKET VALUE & REVERSION

=====

CASH FLOW ANALYSIS

=====

	1980	1981	1982	1983	1984
19 END OF YEAR MARKET VALUE	871962.	1185625.	1256921.	1309717.	1391778.
20 LESS RESALE COST	34678.	47425.	50277.	52389.	55671.
21 LESS LOAN BALANCES	620764.	604077.	585173.	563756.	539493.
22 PLUS CUM. CASH RESERVES	25994.	25994.	25994.	25994.	25994.
23 BEFORE TAX NET WORTH	242314.	560117.	647466.	719566.	822608.
24 CAPITAL GAIN (IF SOLD)	-181096.	182544.	313511.	426719.	551596.
25 CAPITAL GAINS TAX	-36219.	36509.	62702.	85344.	110319.
26 MINIMUM PREF. TAX	0.	0.	0.	0.	0.
27 INCOME TAX ON EXCESS DEP.	1500.	2438.	2897.	2950.	2657.
28 TOTAL TAX ON SALE	-16610.	38946.	65599.	88294.	112977.
29 AFTER TAX NET WORTH	258924.	521171.	581867.	631273.	709632.

BEFORE TAX RATIO ANALYSIS

=====

CASH FLOW ANALYSIS

=====

	1980	1981	1982	1983	1984
30 RETURN ON NET WORTH B/4 TAX	-0.5014	1.4245	0.2175	0.1728	0.2099
31 CHANGE IN NET WORTH B/4 TAX	-243696.	317803.	87349.	72100.	103042.
32 ORIG EQUITY CASH RTNB/4 TAX	-0.0082	0.0563	0.0710	0.0818	0.0987
33 ORIG EQUITY PAYBACK B/4 TAX	0.0000	0.0563	0.1273	0.2091	0.2803
34 B/4 TAX PRESENT VALUE	846386.	1092030.	1126006.	1142995.	1174189.

AFTER TAX RATIO ANALYSIS

=====

CASH FLOW ANALYSIS

=====

	1980	1981	1982	1983	1984
35 RETURN ON NET WORTH AFR TAX	-0.3998	1.1578	0.1923	0.1545	0.1790
36 CHANGE IN NET WORTH AFR TAX	-227086.	262248.	60696.	49406.	78359.
37 ORIG EQUITY CASH RTNAFR TAX	0.0675	0.0772	0.0813	0.0833	0.0712
38 ORIG EQUITY PAYBACK AFR TAX	0.0675	0.1447	0.2260	0.3093	0.3806
39 AFTER TAX PRESENT VALUE	893655.	1102069.	1124564.	1133307.	<u>1150032.</u>

CASH FLOW ANALYSIS

=====

	1980	1981	1982	1983	1984
40 NET INCOME-MARKET VALUE RTO	0.1000	0.1000	0.1000	0.1000	0.1000
41 LENDER BONUS INTEREST RATE	0.0000	0.0000	0.0000	0.0000	0.0000
42 DEFAULT RATIO	0.7696	0.7894	0.8165	0.8280	0.8547

EXHIBIT 29 -- Continued

INPUT FILE

09:48CST 12/20/80

```

110 1, BUILDING, DAVIS
120 10,1980.0,1,1,0.5,74000
130 20,3,2,1,3,.06,2,2
140 40,493960,522120,537260,565460,586210
150 50,12960,12960,12960,14000,14000
160 60,120790,85330,66480,59910,39220
170 70,.054,.05,*
180 80,272260,303180,328640,357700,389390
190 100,.13,.50,.06
200 101,0,10,2
210 102,.14,1,.04,0
220 103,0,30000,0,0
230 200,1,1,LAND
240 201,1,340000,0,0
250 202,1,1,25,0
260 200,2,BUILDING
270 201,2,.60,.80,2
280 202,2,1,29,0
290 200,3,HVAC
300 201,3,.40,.90,2
310 202,3,1,9,0
320 200,4,ELEVATORS
330 201,4,73000,.90,2
340 202,4,1,4,0
350 200,5,ENERGY CONSERVATION
360 201,5,54000,.90,2
370 202,5,1,5,0
380 200,6,TENANT IMPROVEMENTS
390 201,6,50000,.90,4
400 202,6,1,10,0
410 200,7,INVESTMENT CREDIT DUMMY
420 201,7,10800,1,0,2
430 202,7,1,1,0
440 300,1,FIRST MORTGAGE
450 301,1,1,0,.12,0,20
460 302,1,12,1,20,0
470 303,1,0,0,0,0
480 300,2,SECOND MORTGAGE
490 301,2,104000,.13,0,8
500 302,2,12,1,8,0
510 303,2,0,0,0,0
520 400,9
530 403,99,1,2,3,4,5
540 999,99

```

3. Going concern value may be more relevant to an economic development loan. The public purpose of the loan subsidy is to create employment, improved physical environment, and the seeds of an economic base appropriate to redevelopment. In appraising the property for loan purposes the cash equivalency of fee simple title is not relevant if eventual delinquency on the loan gives the lender several options other than foreclosure. For example:
 - a. assignment of business ownership as collateral permits transfer and sale of the going concern to better management.
 - b. It could permit a change of use within constraints of the economic development program as a workout.
 - c. It could look to additional forms of subsidy, such as applied to Section 8 rehab money as a deep subsidy applied to rescue of a delinquent moderate 236 subsidy program.
 - d. Public purposes may create a monopoly for the facility to be appraised which provides a market price superior to fee simple title where it is not directly encumbered by long-term public priorities and commitments.
- C. If the appraisal is for loan security, then the issue is whether similar nonmarket credit terms would be available to the next buyer. VA loans are assignable; economic development loans may be transferable with a change in management; subsidized rental housing loans may be undisturbed by default because of the assignability of control via transfer of partnership interests.
 1. The appraiser does not discount a purchase price of a home purchased with a shared appreciation mortgage. That is contingent interest for the lender.
 2. If a builder of condominiums buys down the loan of his customer, what are those points really worth? It depends on how long the buyer owns the property and is really an oblique form of a shared appreciation mortgage, is it not? Contingent interest for the borrower as well as the lender.
 3. Appraisers have generally overlooked cash equivalency arguments relative to the seller paying the points to buy down the loan for the buyer in VA loans. Similarly, it should be disregarded on financing through prior builders' commitments. Do you discount project unit values because he bought a FNMA commitment or hedged in the GNMA certificates market? After all, these costs are also included in the price and may be included in the resale price.
- D. What is a point really worth? Refer to Exhibit 30.

EXHIBIT 30

WHAT IS A POINT REALLY WORTH?

Daniel J. O'Connell

Many real estate professionals compile lists of personal rules of thumb. Ideally these rules of thumb serve to reduce effort and raise productivity in daily decision making—with minimal sacrifice in accuracy and quality.

One rule-of-thumb that seems to have made a lasting impression is that the payment of one loan point¹ should equate to an $\frac{1}{8}$ percent reduction in the loan interest rate. For example, a borrower choosing between a $12\frac{3}{4}$ percent loan with 2 points from ABC Mortgage Company and a 13 percent loan without points from the XYZ Mortgage Company would be indifferent as to the choice.² According to the rule-of-thumb, the two-point charge supposedly equates to the $\frac{1}{8}$ percent ($\frac{1}{8}$ percent per point) difference in interest rates. However, that may not be a valid rule, as can be seen when comparing the points and no-points alternatives.

A purchaser buys a house to be financed with a \$100,000, 30-year loan. Financing is available from ABC Mortgage at $12\frac{3}{4}$ percent plus 2 points (\$2,000), and is also available from XYZ Mortgage at 13 percent with no points. This is illustrated in Table 1.

Assume the borrower plans to hold the property for a period of only two years at which point the balance of the

loan will be paid. The difference in payments between the two loans is \$468.00 for the two-year period, favoring the lower interest rate loan:

2-year payments @ 13%	\$26,548.80
2-year payments @ $12\frac{3}{4}$ %	<u>- 26,080.80</u>
Payment savings with $12\frac{3}{4}$ % loan	\$ 468.00

The difference in remaining balances upon the loan pay-off must also be taken into account. Because the $12\frac{3}{4}$ percent loan will amortize faster, it will have a remaining balance that is \$34.71 lower than the 13 percent loan at the end of the two years. Adding this balance to the \$468.00 in reduced payments results in a savings of \$502.71 over the two-year life of the loan:

Payment savings with $12\frac{3}{4}$ % loan	\$468.00
Additional loan reduction	<u>+ 34.71</u>
Total savings with $12\frac{3}{4}$ % loan	\$502.71

The borrower, if choosing the $12\frac{3}{4}$ percent loan, saves \$502.71 in payments and additional amortization over the 13 percent loan, but has paid \$2,000 to do so. Obviously, the two-point fee does not always equate to the corresponding $\frac{1}{8}$

Table 1

	ABC Mortgage Co.	XYZ Mortgage Co.
Loan	\$100,000	\$100,000
Interest rate	$12\frac{3}{4}$ %	13%
Monthly payments	\$1,086.70	\$1,106.20
Annual payments	\$13,040.40	\$13,274.40
Points	2	0
\$ Point charge	\$2,000	0

¹As used here, a point is defined as an additional, up-front charge made by a lender and paid by a borrower, that enables a loan to be made at a lower interest rate. A point is computed as 1% of the loan amount. More than one point may be charged, with

each point creating a corresponding decrease in the interest rate.

²Assuming the borrower has the available funds to pay the points.

Table 3

Discounted, after-tax payment savings with 12¾% loan

	1	2	3	4	5
Year	Payment Difference	Tax Savings On 13% Loan	Annual After-Tax Payment Savings	Column 3 Discounted @ 8%	Cumulative Payment Savings
1	\$234.00	\$92.74	\$141.26	\$130.80	\$ 130.80
2	234.00	93.26	140.74	120.66	251.46
3	234.00	93.82	140.18	111.28	362.74
4	234.00	94.41	139.59	102.60	465.34
5	234.00	95.02	138.98	94.59	559.93
6	234.00	95.56	138.44	87.24	647.17
7	234.00	96.31	137.69	80.34	727.51
8	234.00	96.95	137.05	74.04	801.55
9	234.00	97.62	136.38	68.22	869.77
10	234.00	98.25	135.75	62.88	932.65
15	234.00	100.49	133.51	57.26	1,180.99
20	234.00	97.34	136.66	54.27	1,350.33
25	234.00	77.38	156.62	22.87	1,475.26
30	234.00	12.91	221.09	21.97	1,584.75

Column 1 is the annual difference in payments between the two loans with the advantage to the 12¾% loan.

Column 2 is the annual savings in taxes attributable to the 13% loan due to additional interest payments.

Column 3 is the combined effects of the first two columns: Column 1 minus Column 2 = Column 3.

Column 4 is Column 3 discounted to the present at 8% per annum.

Column 5 is the cumulative total of Column 4.

Table 4

Discounted, after-tax pay-off and combined savings with 12¾% loan

	1	2	3	4
Year	Pay-Off Difference	Column 1 Discounted @ 8%	Cumulative Payment Savings (Table 3, Col. 5)	Combined Savings
1	\$ 16.65	\$ 15.42	\$ 130.80	\$ 146.22
2	34.71	29.76	251.46	281.22
3	54.29	43.10	362.74	405.84
4	75.44	55.45	465.34	520.79
5	98.26	66.87	559.93	626.80
6	122.80	77.38	647.17	724.55
7	149.09	86.99	727.51	814.50
8	177.13	95.70	801.55	897.25
9	208.96	103.59	869.77	973.30
10	238.51	110.48	932.65	1,043.13
11	271.70	116.53	990.61	1,107.14
12	306.38	121.67	1,044.06	1,165.73
13	342.37	125.89	1,093.37	1,219.26
14	379.38	129.16	1,138.90	1,268.06
15	416.98	131.45	1,180.99	1,312.44
20	589.40	126.45	1,350.33	1,476.78
25	601.55	87.84	1,475.26	1,563.10
30	0	0	1,584.75	1,584.75

Figure A

Present value of borrower's after-tax savings with up-front point deduction (TABLE 4)

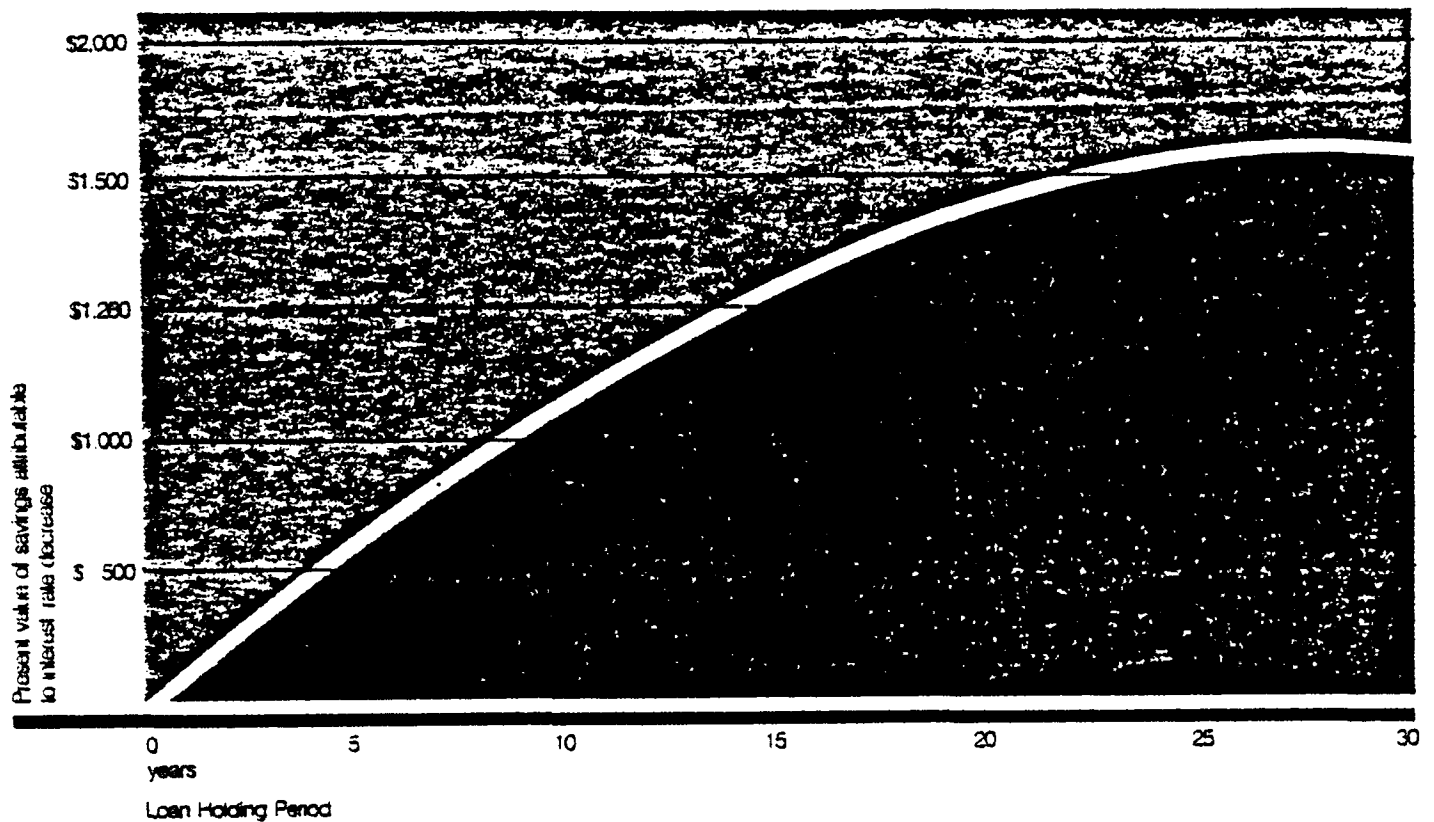


Figure B

Present value of borrower's after-tax savings with point charge added to basis

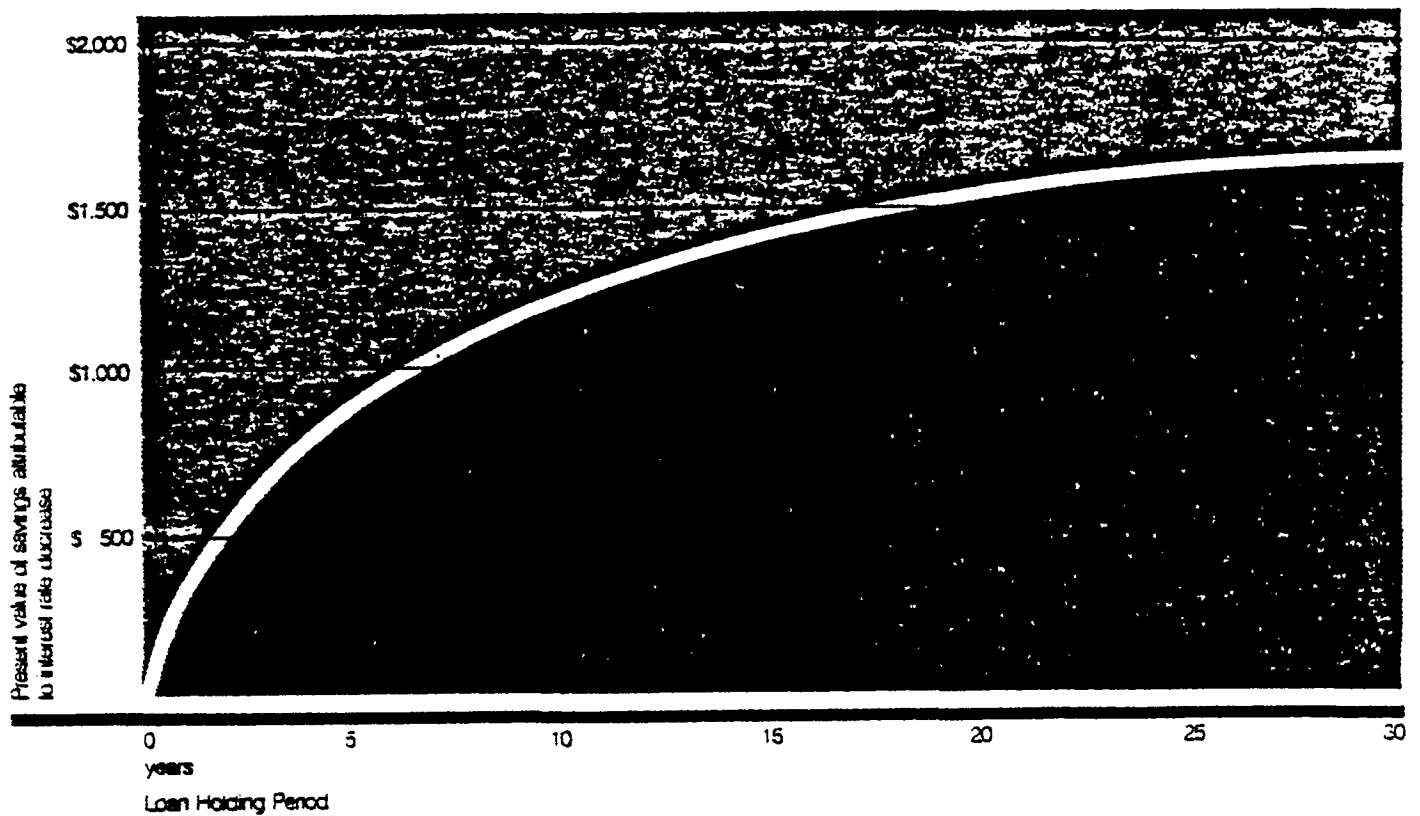


EXHIBIT 31

Example Problem: Cash Equivalent Price - Existing Mortgage plus
Purchase Money Mortgage

Given the following information, determine the cash equivalent
price of the transaction:

Sale Price	\$1,000,000
Existing Mortgage (assumed)	Balance \$682,052 Mo. Pmt. \$6,039.20 Contract rate 8.5% Expired Term 6 years Remaining Term 19 years
Purchase Money Mortgage	\$200,000 @ 10% Amortization over 20 years, balloon in 10 years
Current Financing	14.5%, 20 year amortization with 10 year balloon

- What is the equity investment?
- What is the balance outstanding on the existing (assumed)
mortgage in 10 years?
- What is the payment on the PMM?
What is the balance outstanding EOY 10?
- What is the cash equivalent price of the transaction?

Suggested Solution - II
Existing Mortgage plus PMM

A.	\$117,948
B.	\$454,781
C.	\$ 1,930 \$146,049
D.	Equity \$117,948
Assumed Existing Mortgage	
PW \$6,039.20, 120 mos.	
@ 14.5%	\$381,535
PW \$454,781, EOY 10	
@ 14.5%	
Purchase Money Mortgage	
PW \$1,930, 120 mos.	\$121,931
@ 14.5%	
PW \$146,049, EOY 10	
@ 14.5%	<u>\$ 34,558</u>
Total (Cash Equivalent Price)	\$763,581

EXHIBIT 32

IX. PROBLEM (CASH EQUIVALENCY)*

*Courtesy of A. Robert Parente, SREA, MAI.

An income producing property (special purpose) was resold by the Midland National Bank on a "workout." The terms of the sale were as follows:

Sale Price: \$1,178,808, no cash by purchaser, i.e., 100% debt financing

Terms of Financing: First year - interest only at a rate of 4-1/2% and payable monthly

Second year - interest only at a rate of 6% and payable monthly

For the next 23 years - principal and interest at 8-1/2%, payable monthly

The property (a 12,000 sq. ft., 3-year old restaurant building) was purchased on November 10, 1977 for \$1,178,808. Typical terms of financing at that time (11/77) were 9-3/4% interest for 25 years on a 75% loan-to-value ratio. It is estimated that equity required a 12-15% return.

Questions:

- A. What are the monthly interest costs in years 1 and 2?
- B. What is the constant on the amortized portion of the mortgage?
- C. What is the monthly payment on the mortgage?
- D. What is the unadjusted sales price per square foot for use in the DSC approach?
- E. What is the cash equivalent price assuming 100% financing were typical in the market?
- F. What is the cash equivalent price assuming an equity yield requirement of 12% 15%?
- G. What is the adjusted sales price per square foot under each of the conditions set forth above?

EXHIBIT 32 (continued)

Suggested Solution - IX Problem (Cash Equivalency)

A. Year 1: \$4,420.53
Year 2: \$5,894.04

B. $f = .09913$

C. \$9,737.97

D. $\$1,178,808 \div 12,000 = \$98.23/\text{sq. ft.}$

E. PW i Costs Year 1 @ 9-3/4% = \$ 50,347.92
PW i Costs Year 2 @ 9-3/4% = 60,918.28
PW Amortization payments
Years 3-25 @ 9-3/4% = 881,198.63

Cash Equivalent Price
(100% Financing) = \$992,464.83*

*\$186,343.17 less than face value of note

$\$992,464.83 \div 12,000 = \$82.71/\text{sq. ft.}$

F. Discount Rates given $Y = 12\%$, $Y = 15\%$, $m = 75\%$ $i = 9.75\%$

$Y = 12\%$

$Y = 15\%$

Mortgage $.75 \times .0975 = .073125$
Equity $.25 \times .12 = \underline{.03}$

$.75 \times .0975 = .073125$
 $.25 \times .15 = \underline{.0375}$

Discount Rate (r) = .103125 Discount rate (r) = .110625

PWCF @ 10.3125%

PWCF @ 11.0625%

Year 1 \$ 50,198.33
Year 2 60,399.42
Years 3-25 835,796.73

\$ 49,999.88
59,715.07
780,188.86

\$946,394.48**

\$889,903.81***

\$232,413.52 below face *\$288,904.19 below face

G. $\$946,394.48 \div 12,000 = \$78.87/\text{sq. ft.}$

$\$889,903.81 \div 12,000 = \$74.16/\text{sq. ft.}$

EXHIBIT 33

CASH EQUIVALENCY EXAMPLE

NAKOMA HEIGHTS
168 APARTMENT UNITS
SOLD NOVEMBER 1, 1979
NOMINAL SALES PRICE \$3,450,000

- A. One appraisal reviewed recently contained the following summary analysis.
It is used as it probably parallels the Madison Assessor's Office perception
of the transaction:

<u>Date</u>	<u>Price</u>	<u>Gross</u>	<u>Net</u>	<u>GIM</u>	<u>Income Expense</u>	<u>S.P. Unit</u>	<u>OAR</u>
7/79	\$3,450,000	\$449,249	\$196,548	7.68	56.3	\$20,536	5.7

- B. Cash Equivalency - Monthly payment differential

If 25% down with 75% L/V at 10.55 for 25 years	Down	862,000
	Mortgage	\$2,588,000
		<u>\$3,450,000</u>

Monthly payment \$24,528; Annual payment \$294,335

1979 - 4/80	Conv. Mortgage	\$294,335	
	L.C. (9.25)	<u>272,875</u>	
		\$ 21,460/12	= \$1,788 (A)

4/80 - 4/81

\$2,950,000			Conv. Mortgage	\$294,335
<u>250,000</u>	L.C.	=		<u>249,750</u>
\$2,700,000	X .0925			\$ 44,585/12 = \$3,715 (B)

4/81

\$2,700,000			\$294,335
<u>250,000</u>			<u>226,625</u>
\$2,450,000	X .0125		\$ 67,710/12 = \$5,643 (C)

NET PRESENT VALUE UNDER
L.C. FINANCING AND BALLOON PAYOUT
ACCORDING TO CONTRACT ON 12/31/85

	<u>1979</u>	<u>1980</u>	<u>1981</u>	<u>1982 - 84</u> 4 years
Down Payment	\$500,000	\$250,000	\$250,000	
	<u>3,576 (2A)</u>	<u>5,364 (3A)</u>	<u>11,145 (3B)</u>	\$ 67,710 (12C)
	\$503,576	33,435 (9B)	50,787 (9C)	
		<u>\$288,799</u>	<u>\$311,932</u>	
				Balance <u>2,450,000</u>
				<u>\$2,517,710</u>

NET PRESENT VALUE CONVENTIONAL LOAN

	<u>1979</u>	
Down Payment	\$862,000	
	--	Balance <u>2,404,022</u>

Cash year 1	\$503,576	\$288,799	\$311,932	
		<u>.884666</u>	<u>.796455</u>	
Cash year 2	255,491	\$255,491		
Cash year 3	248,440		248,440	
Cash year 4	48,551			\$67,710
Cash year 5	43,710			67,710
Cash year 6	39,351			67,710
Cash year 7	<u>\$1,317,332</u>			
	\$2,456,451			\$2,517.710
		Total Cash Equivalency (Versus \$3,450,000 nominal selling price)		

INCOME PREPORTED (Contract)	GROSS INCOME	\$499,249
	NET INCOME	<u>196,548</u>

MARKET RENT LEVELS

At least gross	\$450,000
Less 40% expense	<u>180,000</u>
NOI	\$270,000

$$\text{OAR} = \frac{270,000}{2,456,451} = .109915$$

$$\text{SP/Unit} = \frac{2,456,451}{168} = 14,622$$

1. Most probable price always requires a statement as to the financial terms which are a condition of effective demand at that price. Fair market value definition is sufficiently ambiguous to require a statement of financial terms as a qualification on conclusion.
 2. In practice you ignore points paid by the seller in a VA loan. To predict the most probable price, why not ignore points paid by the seller for a conventional loan? For loan security the lender is interested in the most probable price at which it will sell or whether the spread between probable price and fair market value will be covered by private mortgage insurance. In the latter case the appraiser could provide both numbers if asked.
 3. Only the assessor is locked into cash equivalent fair market value!
- E. The mechanics of cash equivalency values come into play where income properties are sold subject to non-market financing or for purposes other than income investment, such as syndication or condominium conversion. Professors Byrl Boyce and William Kinnard have prepared an excellent half-day presentation on cash equivalencies. The cases in Exhibits 31 and 32 are from their seminar and are suggestive of the mechanics of cash equivalency due to non-market financing.
- V. The fair market value appraisal for tax assessment of subsidized, rental housing is a very frustrating experience for both the assessor and the ownership position. None of the components of value are what they seem to be.
- A. It should be noted that 221 d3 and d4 and 236 projects involve subsidy of the interest rate only, while Section 8 recognize the damage done by inflation to cost to construct and operating expenses, so that it subsidizes the total project.
1. Section 8 was intended to subsidize conventionally financed apartments within a larger project, thus avoiding a ghetto of subsidized projects and permitting the depth of subsidy to vary; government would pay the difference between fair market rents and 25% of eligible tenants income.
 2. The legislation included instructions that the subsidy would cover full taxes and utilities, presuming taxes would be similar to non-subsidized development pegged at prevailing market rents. It was an operating subsidy program with no specific relationship to financing.
 3. The 1974 legislation did say that if the Section 8 contract was used as collateral to obtain financing, HUD had the right to approve financing and refinancing.
 4. Three factors precluded the original concept - rising interest rates in the conventional market, the evolution of HUD prerogatives for auditing, management, and tenant selection or eviction, and finally the operating procedures of state housing finance agencies and GNMA tandem plans which provide virtually all of the financing.



Exhibit 34

 WHFA FORM NO. #100
 Revised 1/19/77
 Page 1 of 4

Wisconsin Housing Finance Authority

I. GENERAL INFORMATION			
1. Development Name: <u>Woodview Park</u>	<u>Real</u>		4. (x) Feasibility () Firm
2. Development Sponsor: <u>Munz Investment Estate, Inc.</u>			5. Type of Mortgagor: (x) L.D. () N.P.
3. Development Location: <u>Tyrell Ave. & Geneva St.</u> (Street) <u>Delavan, Walworth</u> (City) (County)			
6. (x) New Construction () Rehabilitation	7. Permanent Mtg. Interest Rate <u>7.5%</u>	8. Construction (x) WHFA Financing: () Conventional	
9. Type of Development. No. of Units. No. of Stories			
(x) Low Rise (1-3 stories)	<u>84</u> Apt. Units	<u>6</u> T.H. Units	<u>E - 3 Story</u>
	<u> </u> Duplex Units	<u> </u> S.F. Units	<u>F - 2 Story</u>
() Mid Rise (4-6 stories)	<u> </u> No. of Units		
() High Rise (7 stories and over)	<u> </u> No. of Units		
10. Accessory Buildings: (No. and type) <u>None</u>			
11. Total Number of Buildings: <u>Three</u>			
12. Total Number of Units: <u>90</u> (Family <u>22</u> ; Elderly <u>68</u> ; Handicap <u> </u>)			
13. Total Number of Units: <u>90</u> Revenue; <u> </u> Non-Revenue			
14. Density: <u>20</u> Units Per Acre			
15. Building Information: Structural System <u>Wood frame w/interior & exterior masonry</u> Exterior Finish <u>Masonry</u> /bearing walls Floor System <u>Wood</u>			
16. Gross Floor Area (Including Basement and Common Areas) <u>85,600</u> Sq. Ft.			
17. Net Rentable Floor Area: <u>53,396</u> Sq. Ft.			
18. Number of Parking Spaces: <u>34</u> Elderly <u>44</u> Family		19. Parking Ratio: <u>1/.87</u>	

II. AMENITIES

III. SERVICES

☒ Range (~~Gas~~ Electric)
☒ Refrigerator
☒ Air Conditioning (Sleeve Only)
☒ Air Conditioning (Sleeve Unit)
☒ Central Air Conditioning
☒ Kitchen Exhaust Fan
☒ Central Laundry Facilities
☒ Unit Laundry Facilities
☒ Disposal
☒ Dishwasher
☒ Carpet
☒ Drapes
☒ Shades
☒ Rods
☒ Common Area Furnishings
☒ Tot Lot
☒ Other (Specify) _____

	Included in Rent	
	Yes	No
<u>Heat</u>		
Gas/Hot Water.....	(x)	()
Gas/Forced Air.....	(x) 3Bdr.	()
Electric.....	()	()
<u>Hot Water</u>		
Gas.....	(x)	()
Electric.....	()	()
Unit Electric.....	(x)	()
(Lights, Cooking, etc.)		
<u>Water</u>	(x)	()
<u>Other Fuel</u> (Specify).....		
.....	()	()
.....	()	()
.....	()	()

IV. RENT SCHEDULE

No. of Units	Type	Bdrms	Size by Sq. Ft.		FMR	Contract Rent	Utility Allowance
			Net	Gross			
67	E -L.R.	1	500	546	\$271	\$258.10	\$14G, \$4E
1	E -L.R.	2	800	860	\$348	\$278.84	\$20G, \$8E
16	W- L.R.	2	820	875	\$293	\$278.84	\$20G, \$8E
6	T.H.	3	996	1080	\$381	\$372.21	\$35G, \$12E

Gross Annual Contract Rent - - - - - \$ 291,194

Gross Annual Contract Rent & Utility Allowance - - - - - \$ 314,762

V. EQUITY CALCULATION

- Total Replacement Cost - - - \$ 2,212,267
- Mortgage Amount- - - - - \$ 1,991,040
- BSPRA - - - - - \$ 192,737
- BSPRA & Mtg. Amount - - - \$ 2,183,777
- Equity Cash (Line 1 - - - - \$ 28,490
minus Line 4)

VI. INCOME COMPUTATION

- Gross Annual Income
(Contract Rent) - - - - - \$ 314,762
- Vacancy (5 %) - - - - - \$ 15,738
- Effective Gross Income - - - \$ 299,024
- Debt Service (7 1/2 %) - - - \$ 137,229
- WIFA Service Fee (4 %) - - - \$ 9,955
- Total Operating
Expenses & Taxes - - - - - \$ 118,568
- Return on Equity- - - - - \$ 13,274

VII. SETTLEMENT REQUIREMENTS - INITIAL CLOSING

- | | |
|--|--|
| <ol style="list-style-type: none"> Cash
Equity Cash - - - - - \$ _____ Construction Adjustments- - \$ _____ Off-Site- - - - - \$ _____ Completion Assurance- - - - \$ _____ Total Cash Requirement - - - \$ _____ | <ol style="list-style-type: none"> Letter of Credit
Construction Adjustments- - \$ _____ Off-Site- - - - - \$ _____ Completion Assurance- - - - \$ _____ Total Letter of Credit
Requirement - - - - - \$ _____ Total Cash & Letter of
Credit Requirement - - - - \$ _____ Bonds
Completion Assurance- - - - \$ _____ Off-Site- - - - - \$ _____ |
|--|--|

VIII. RECONCILIATION

- ACC Authorization - - - - - \$ _____
- Tenant Payments - - - - - \$ _____
- Expected HUD Contributions- - - - \$ _____
- Total Revenue - - - - - \$ _____
- Total Expenses- - - - - \$ _____

IX. REPLACEMENT COST AND MORTGAGE

A. CONSTRUCTION CONTRACT		Per Unit	Total	
1.	STRUCTURES:			
1a.	Apartments	\$ 15,162	\$ 1,273,600	
1b.	Townhouses	\$ 23,000	\$ 138,000	
1c.	Duplexes	\$	\$	
1d.	Single Family	\$	\$	
1e.	Other Buildings	\$	\$	
1f.	TOTAL STRUCTURES	\$ 15,684	\$ 1,411,600	\$ 1,411,600
2.	LAND IMPROVEMENTS:			
2a.	Usual (landscaping paving, etc)	\$ 1,433	\$ 129,000	
2b.	Unusual	\$	\$	
2c.	TOTAL LAND IMPROVEMENTS	\$ 1,433	\$ 129,000	\$ 129,000
3.	GENERAL REQUIREMENTS ()			\$ 15,550
4.	GENERAL OVERHEAD ()			\$ 28,935
5.	BOND PREMIUM/LETTER OF CREDIT FEE			\$ 16,123
6.	OTHER Tyrell Ave. Improvements-Eng. Est. \$70 ² 75000+122 D.U.'s=\$614 per D.U. X 90 =			\$ 55,260
7.	TOTAL CONSTRUCTION CONTRACT			\$ 1,676,468
7a.	Per Unit Construction Contract	\$ 18,627		
8.	ARCHITECTURAL FEES			
8a.	Design ()		\$ 46,000	
8b.	Supervision ()		\$ 14,000	
8c.	TOTAL ARCHITECTURAL FEES			\$ 60,000
8d.	Per Unit Architectural Fees	\$ 666.67		
9.	TOTAL CONSTRUCTION CONTRACT & ARCHITECTURAL FEES			\$ 1,736,468
10.	CONSTRUCTION INTEREST (10 mo. @ 8% for 3 Bdrms.		\$ 65,139	
11.	CONSTRUCTION TAXES		\$ 13,875	
12.	CONSTRUCTION INSURANCE		\$ 3,020	
13.	TITLE & RECORDING		\$ 2,366	
14.	WHFA PROCESSING FEE (2.5%)		\$ 49,776	
15.	LOAN LOSS RESERVE (2.5%)		\$ 49,776	
16.	LEGAL (\$ 4950) & COST CERTIFICATION (\$ 2,000)		\$ 6,950	
17.	TOTAL CARRYING CHARGES & FINANCING FEES			\$ 190,902
17a.	Per Unit Carrying Chgs. & Fin. Fees \$	2,121		
18.	TOTAL (Lines 9 + 17)			\$1,927,370
19.	BSFRA			\$ 192,737
20.	LAND			\$ 92,160
21.	TOTAL REPLACEMENT COST (Lines 18 + 19 + 20)			\$2,212,267
21a.	Per Unit Replacement Cost	\$ 24,581		
22.	MORTGAGE (90%)			\$ 1,991,040
22a.	Per Unit Mortgage	\$ 22,123		

X. OPERATING EXPENSES

	Est. assessed Mkt. value Per Unit	Sub-Total
1. REAL ESTATE TAXES:		
	2 \$17,000 x 68 x 67% = \$774,520	
	2 Br \$19,000 x 16 x 67% = \$203,680	
1a. Est. Assessed Val. 67 1/3 Br \$26,000 x 6 x 67% = \$104,520		
	\$ 33.37 per \$1000 X \$1,082,720	\$ 36,672
1b. Per Unit R.E. Taxes	\$ 408	
2. SERVICE ACCOUNTS:		
2a. Fuel (Htg. & Dom. Hot Water)	\$ 198.40	\$ 17,856
2b. Electric	\$ 63.47	\$ 5,712
2c. Water - Sewer	\$ 45.07	\$ 4,056
2d. Garbage & Trash Removal	\$ 27.00	\$ 2,430
2e. Other - Advertising	\$ 3.00	\$ 270
2f. TOTAL SERVICE ACCOUNTS		\$ 30,324
2g. Per Unit Service Accounts	\$ 336.94	
3. INSURANCE		\$ 4,062
4. AUDIT		\$ 1,080
5. LEGAL		\$ 540
6. MANAGEMENT:		
6a. Fees		
6b. Central	\$ 6,756	
6c. On-Site	\$ 9,192	
6d. Administrative	\$	
6e. TOTAL MANAGEMENT		\$ 15,948
6f. Per Unit Management	\$ 177.20	
7. MAINTENANCE:		
7a. Caretaker Salary	\$ 6,480	
7b. Other Salaries	\$	
7c. Contract Services	\$ 4,998	
7d. Supplies	\$ 2,700	
7e. Other - Repair Services	\$ 7,170	
7f. TOTAL MAINTENANCE		\$ 21,348
7g. Per Unit Maintenance	\$ 237.20	
8. REPLACEMENT RESERVE		\$ 8,594
9. TOTAL OPERATING EXPENSES (Lines 1a + 2f + 3 + 4 + 5 + 6e + 7f + 8)		\$ 118,563
10. DEBT SERVICE		\$ 167,183
10a. Per Unit Debt Service	\$ 1,857.59	
11. RETURN ON EQUITY		\$ 13,274
12. TOTAL OPERATING EXPENSES, DEBT SERVICE & RETURN ON EQUITY (Lines 9 + 10 + 11)		\$ 299,025



WISCONSIN HOUSING FINANCE AUTHORITY

WIFA Form No. 1
Page 1 of 1

5/12/77		CONTRACTOR'S and/or MORTGAGOR'S COST BREAKDOWN (SCHEDULES OF VALUES)		Project No. 214	
Mung Woodview Park Assoc.		Woodview Park		Delavan Wis	
This form represents the Contractor's and/or Mortgagee's firm costs and services as a basis for disbursing dollar amounts when advances are requested.					

DV	TRADE ITEM	COST	TRADE DESCRIPTION
2	Excavating & Backfill	43438	
3	Concrete	75657	
4	Masonry	147825	
5	Metals	10638	
6	Rough Carpentry	143688	
6	Rough Carpentry Labor	94282	
6	Finish Carpentry	23157	
6	Finish Carpentry Labor	40094	
7	Waterproofing	54007	
7	Insulation	24400	
7	Roofing	20032	
7	Sheet Metal	16175	
8	Doors	47500	
8	Windows	13063	
8	Glass	12282	
9	Lath & Plaster		
9	Drywall	93050	
9	Tile Work	7250	
9	Acoustical	4600	
9	Wood Flooring		
9	Resilient Flooring	4025	
9	Painting & Decorating	17625	
10	Specialities	5938	
11	Special Equipment	6563	
11	Cabinets	38157	
11	Appliances	42900	
12	Blinds & Shades, Artwork	9325	
12	Carpets	45600	
13	Special Construction		
14	Elevators	24911	
15	Plumbing & Hot Water	122000	
15	Heat & Ventilation	125073	
15	Air Conditioning	1000	
16	Electrical	149777	
	Accessory Structures	4000	
	TOTAL STRUCTURE(S)	1432623	
2	Earth Work	11250	
2	Site Utilities	16406	
2	Roads & Walks	30720	
2	Site Improvements	4000	
2	Lawns & Planting	34964	
2	Unusual Site Condition	55260	
	TOTAL LAND IMPRVTS.	152600	
	TOT. STRUCT. & LAND IMPRVTS.	1581223	
1	GENERAL REQUIREMENTS	35500	
	SUBTOTAL (Lines 41 and 42)	1616723	
	BUILDER'S OVERHEAD	28935	
	BUILDER'S PROFIT		
	SUBTOTAL (Lines 43 thru 45)	1645658	
	OTHER FEES		
	BOND PREMIUM	16123	
	TOTAL FOR ALL IMPROVEMENTS	1668781	
	BUILDER'S Profit paid by means other than cash		
	TOTAL FOR ALL IMPROVEMENTS LESS LINE 52		
	TOTAL \$		

NONRESIDENTIAL AND SPECIAL
EXTERIOR LAND IMPROVEMENT

(costs included in trade item breakdown)

DESCRIPTION

EST. COST

OFFSITE COSTS

(costs not included in trade item breakdown)

DESCRIPTION

EST. COST

TOTAL \$

DEMOLITION

(costs not included in trade item breakdown)

DESCRIPTION

EST. COST

TOTAL \$

TOTAL \$

Mortgagor Mung Woodview Park Assoc. By Mung Woodview Park Assoc. Date 5/12/77
Contractor Paul Petals Inc. By Paul Petals Inc. Date 5/12/77

IFA

Date

3/6/79

- B. Fair market rent (FMR) has nothing to do with rents from the marketplace for the specific units in question. Instead, they are established by HUD at a level which is expected to justify construction costs in a particular locale; if the FMR's don't work, deviations as high as 10% upward are premitted, but they are indexed to HUD estimates of cost to construct rather than community norms.
- C. Using the FMR's for the unit mix of a proposed project, the developer works through the 2013 form (See WHFA, Exhibit 34) backwards to arrive at a capital budget available for hard construction costs; he typically buys his land at a value not to exceed 90% of the HUD acceptable unit cost of land. The 2013 budget is then a tentative maximum but actual project costs are audited and any savings are used to adjust the maximum mortgage commitment. The 2013 does not recognize points paid for the permanent loan or overruns on cost, but the audit doesn't recognize rents collected prior to the audit certification date. With adroit phasing these costs may be offset with revenues during a period when most operating costs are funded as indirect costs of construction.
- D. The cost approach to value is distorted by HUD's specifications, lengthy procedures, hidden profit centers in fixed allowances for design, supervision, bonding, overhead, etc. Space allocations within the project may reflect social purposes such as meeting rooms, medical centers, craft shops, and infirmary. Moreover most projects are multiple site, multiple buildings, mixed units where perhaps the FMR on elderly will subsidize inadequate FMR's on family units.
- E. Comparative operating budgets for 100-unit one bedroom project is provided in Exhibit 35.
- F. The market comparison approach is inoperative because of constraints on resale inherent in the mortgage and management contracts, the tax trap of accelerated depreciation, the loss of depreciation benefits to the second owner, the emphasis on profit centers for construction rather than management, the rent controls following construction, and the fact that conversion to a conventional market rent structure in the early years would mean rents below the government level with interest rates higher than government level, thus forcing a resale price at a capital loss to the sellers.
- G. In short, it will be almost impossible to find or simulate a sale at fee simple title. Rather a transfer would come with all the liens and contractual obligations because the owners are not the controlling powers; HUD and the finance authorities are. Owners may change but the contractual pyramid will remain in place.
- 1. The Legislature recognized higher costs and higher risks could not be funded up front by direct subsidy so what has emerged is a series of mandatory management and operational reform and a series of initial and delayed profit centers, augmented by favorable tax rules, and automatically guaranteed.

2. Three groups of restrictions are the 1974 Act, complimentary administrative rules, and financing restrictions.
 3. Section 8 developments are built to conform to the regulatory mold rather than market or merchandising feasibility. Size 10-15% less, finishes are utilitarian, secondary locations, etc. for inferior products.
 4. The inferior product may cost more because of mandatory union wages, mandatory bonding and escrows, and non-competitive bidding to the degree that FMR's permit capital cost inflation. These costs can only be amortized by maintaining Section 8 agreements or conversion to tenant ownership. HUD is not encouraging the latter and there is no financing available that would place the tenants as owners at the same level of occupancy costs.
- H. As a practical matter revenue could be subsidy payments plus actual payments from the tenants. But the subsidy payment includes a payment for the right to set rents, tenant eligibility standards and cash dividends to the investor - in short, a defeasible partial transfer of the fee to the public. Is that parallel to a lease or an easement in gross to the public?
1. As a practical matter the assessor can use the annual audited financial statement of the Section 8 project.
 2. Gross rent equals 1/5 the ACC contract amount plus actual receipts from tenants.
 3. Operating expenses should be used for the actual operations because they are different for subsidized projects (See Exhibit 36).

COMPARATIVE OPERATING BUDGETS FOR 100 ONE-BEDROOM UNITS

			Conventional			
Section 8			High Range		Low Range	
Rent	342,000	285/U	276,000	230/mo	240,000	200/mo
Management	15,800	158/yr	16,200	162/yr	12,000	120/yr
Maintenance	20,300	203/yr	18,000	180/yr	10,000	100/yr
Services/ Heat	27,000	270/yr	24,000	240/yr	22,000	220/yr
Insurance	6,850	68/yr	6,000	60/yr	4,000	40/yr
Audit/Legal	900	9/yr			-0-	
Replacement Reserve	9,200	92/yr			-0-	
Equity Return	14,000	140/yr	-0-	-0-		
Taxes*	51,600		42,960		37,200	
Mortgage	2,150,000		1,532,567		1,405,125	
Debt Service	184,834		168,840		154,800	
Total Replacement Cost	2,391,000		1,803,020		1,653,088	
*Based Upon Unadjusted Total Costs						

V1. Until now, cash equivalent prices have made adjustment for differences in fixed mortgage constants and predictable mortgage balances due at some future point in time. However, today we are faced with variable rate mortgages and a subsector of those called mortgage participation loans.

A. Variable rate mortgages should offer the appraiser little problem; indeed, it should help in that tricky allocation problem in terms of the source of value. Adjusting a sale price subject to an existing favorable mortgage is simply attributing value to the intangible element of finance rather than the productive asset of real estate.

1. To the degree that the variable rate mortgage removes the commodity speculation in money from the benefits of ownership, the more likely the price represents the value of the real estate rather than real estate plus an option on cheap money.
2. The form of the variable rate mortgage may cause cash throwoff to vary or net reversion on sale to vary. Hence, the necessity of doing a spread sheet if the appraiser has reason to believe rates will be adjusted upward or downward within the foreseeable future. In the absence of a rate notification or in the presence of a maximum rate limit, the appraiser does not have to speculate (capital budgeting theory would hold that the cap rates should be loaded for the third moment of the maximum interest variance to reflect the risk of alternative financial outcomes, but I doubt if appraisers are ready for that).
3. Lenders may modify debt cover ratios or mortgage investment guides like default points or loan-per-unit.

B. Various forms of equity participation represent contingent interest payments to the lender. The appraiser has no alternative but to do a spread sheet forecast year by year for five or ten years of the proforma income and resale possibilities of the property. Participation takes on a variety of forms:

1. Participation in gross rent, generally above a floor of normalized gross. (May reduce value for mortgage loan-to-ratio value purposes).
2. Participation in effective gross rent (set at a minimum level so that excessive vacancy penalizes the borrower; may exclude certain rental units or percentage rents or rents for services not funded by mortgage, i.e., a defined base effective rent).
3. Percentage of net operating income (certain expenses allowed in full while other discretionary expenses and vacancy allowance may be defined in amount or percentage of effective gross). Sometimes found on land leases and reduces net income available for debt service if land lease is unsubordinated.

Exhibit 36

Assessment Valuation of Section 8
Using Income Approach

Gross Receipts = \$142,000 Collected from tenants
190,000 Collected from ACC contract for
five years totalling \$950,000

Net Revenue \$332,000

Vacancy deduction - none ACC pays up to 60 days of vacancy and
tenants pay only when occupying unit

Management fee \$ 15,800

Maintenance 20,300

Services/heat* 27,000

Insurance 6,850

Audit-legal 900

Replacement reserve 9,200

Net operating exp \$80,050

Net operating income

B/4 real estate taxes $\$251,950 / .1374264 = \$1,833,344$

Capitalization rate = .126384 (25 year 12% mortgage)

$(.126384 \times .85) + (.15 \times .05) + (.75 \times .03 \text{ mill rate})$

.1074264 .0075 .02225 =

Cap rate .1374264

*Be sure gross receipts include utility allowance; in some cases
the tenant contribution is less than the utility bill.

4. Percentage of cash throwoff, after debt service and with defined priorities and allowable debt limits. Other restrictions may include mandatory reserves to be set aside before participation.
 5. One of the above plus participation in refinancing surplus, net resale proceeds, or other capital transactions subject to a floor permitting recapture of equity capital and a ceiling for good fortune.
- C. Some forms of equity participation are more subtle, such as the convertible mortgage which takes several forms:
1. A community shopping center costing \$6 million to build and with a million in runaway construction interests can be sold for \$7.3 million for \$800-850,000 net operating income in the first five years. Lender provides \$7.3 million for 11% interest only ten-year mortgage; in addition, he receives 50% of cash throwoff and whatever percentage of ownership is needed in the tenth year to provide overall 18% return.
 2. An office building in San Francisco received 100% financing for construction and eight year balloon. In addition, the developer-borrower becomes a general partner with two limited partners, the land owner and the lender, each receiving some percentage of tax shelter, cash dividends, refinancing surplus or resale value and perhaps retaining first right of refusal as well.
 3. In each case, the mortgage loan represents fee simple title while the interests above that represent entitlements to tax shelter, nonvested future interests, management and contracting fees and marketing skills.