

JAMES A. GRAASKAMP COLLECTION OF TEACHING MATERIALS

V. INDUSTRY SEMINARS AND SPEECHES - SHORT TERM

H. Presentations Sponsored by Other Universities

9. "Real Estate Investment Seminar", sponsored
by Ostendorf-Morris, November 6-7, 1981

REAL ESTATE INVESTMENT SEMINAR

OSTENDORF-MORRIS
Cleveland, Ohio

November 6-7, 1981

Presented by: Prof. James A. Graaskamp, Ph.D. CRE, SREA
University of Wisconsin

Friday, November 6

10:00 A.M. Session #1 - Changing Investor Motivations and Strategies

11:00 A.M. Session #2 - Real Estate Dynamics and Changing Perception
of Ownership

LUNCH

1:00 P.M. Session #3 - Basic Financial Analysis for Investment Property

2:00 P.M. Session #4 - Investment Analysis and Risk Management

3:00 P.M. Session #5 - Real Estate Lease Analysis - Risk Management
Viewpoint

4:00 P.M. Session #6 - Basic Tax Ploys and the 1981 Tax Law

Saturday, November 7

****** 9:00 A.M. Session #7 - Advanced Income Forecasting Considerations *Outline plus
some exhibits*

10:00 A.M. Session #8 - Civil Rights and Social Factors For Corporate
Real Estate

****** 11:00 A.M. Session #9 - Real Estate Investment Broker As Investment
Counselor - *Outline only*

II. Real Estate Revenue Versus Service Revenue

A. 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 real estate space and services?
 - 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?

B. 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

CASE STUDY - EXHIBITS 4-29 - SEMINAR

LIST OF EXHIBITS

	Page
1 Location of Subject Site Relative to the Capitol Square.	2
2 Subject Site in Original Madison Plat.	8
3 Site Plan of Subject Property.	10
4 Proposed Capitol Concourse Plan.	15
5 Proposed Parking for Concourse Plan.	16
6 Traffic Patterns and Public Parking Upon Completion of Capitol Concourse.	18
7 View from the East Main Office Entrance of the Subject Property	22
8 Photographs of Subject Property.	25
9 Location of First Floor Retail Vacancies on the Capitol Square	32
10 First Floor Retail Vacancies on the Square Existing or Known to be Available as of January 1, 1980.	33
11 Madison Downtown Office Space as of January 1, 1980.	35
12 Expression of State's Interest in Post Office Building-- Wisconsin State Journal Article.	37
13 Location of Comparable Sales on or Near Capitol Square	40
14 Comparable #1 - 30 West Mifflin.	41
15 Comparable #2 - 50 East Mifflin.	43
16 Comparable #3 - 16 North Carroll	45
17 Comparable #4 - 123 West Washington.	46
18 Comparable #5 - 102 and 110 North Hamilton	48
19 Comparable #6 - 212 East Washington.	50
20 Comparable #7 - 2 West Mifflin	51
21 Scale for Scoring Comparables on Important Investor Considerations	54
22 Weighted Matrix for Comparable Properties.	55
23 Calculation of Most Probable Price Using Mean Price Per Point Equation Method.	57

LIST OF EXHIBITS -- Continued

	Page
24 Schedule of Rental Revenues for the Period of April 30, 1980 Through April 29, 1985	62
25 Schedule of Vacancies by Floor and By Lease Terms for the Period of April 30, 1980 Through April 29, 1985.	68
26 Average Rate of Increase in Consumer Price Index - All Items May 1975 Through April 1980	75
27 Schedule of Projected Revenues and Expenses from April 30, 1980 Through April 29, 1985	77
28 Revenue Justified Capital Budget - Debt Cover Ratio Approach	82
29 MRCAP Input and Output--Justified Capital Budget with Real Estate Taxes at 5.4% of First Year's Gross Rent	86
30 Sources of Comparable Land Sales from 1973-1980 in Madison, Wisconsin	94
31 Location of Comparable Class B Office Sites in Odana Area	96
32 Analysis of Comparable Land Sales	97
33 BFCF Test of Justified Land Cost.	105

WEIGHTED MATRIX FOR COMPARABLE PROPERTIES

FEATURE/ WEIGHT	Rating/Weighted Rating						Subject 110 E. Main
	#1 30 W. Mifflin	#2 50 E. Mifflin	#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 Total Weighted Score	7.86	7.49	6.88	6.89	6.38	6.89	

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>		

$$\text{Value Range: } 7.07 \pm .21$$

$$\text{High Estimate: } 7.28 = (X/74,000^1 \text{ sq. ft.}) \div 2.2^2, \therefore X = 1,185,184 \text{ or } \$1,200,000$$

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

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

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

²2.2 = Weighted point score for subject property

Session #7 - Introduction

- I. 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 price, most probable price, going concern value, contributory value, investment value, or liquidating value in event of delinquency and foreclosure.
 - C. 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?
 - D. Reference to Exhibit I

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								
EXHIBIT 24								
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									
301 Vacant	150	5.75	--	\$ 860	\$ 860	\$ 930	\$ 930	\$ 1,000	
302-3 State ⁵	1179	5.75	--	6,780	7,320	7,320	7,900	7,900	
304 State ⁵	230	6.70	--	1,540	1,660	1,660	1,800	1,800	
305-8 State ⁵	942	6.70	--	6,300	6,800	6,800	7,360	7,360	
309 The Journal Co.	232	7.20	9/1/79 - 8/31/80	1,810	1,880	1,970	2,030	2,120	
310-11 State ⁵	456	6.70	--	3,050	3,300	3,300	3,560	3,560	
312 Vacant	234	5.75	--	1,340	1,450	1,450	1,570	1,570	
313-14 Dr. R. Meng	482	7.20	6/1/79 - 5/31/80	3,490	3,730	3,750	4,000	4,030	
315 Vacant	731	6.70	10/1/79 - 9/30/80	5,000	5,080	5,310	5,480	5,630	
316-19 Wisc. Builders Assoc.	1091	7.00	1/1/80 - 12/31/80	7,810	8,180	8,360	8,730	8,940	
320-24 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									
401 Vacant	150	6.40	--	\$ 960	\$ 960	\$ 1,040	\$ 1,040	\$ 1,120	
402 Furst, Carlson Inc.	648	6.40	5/1/79 - 4/30/80	4,350	4,370	4,700	4,730	5,090	
403-11 State	2147	6.75	1/1/80 - 12/31/81	14,500	14,880	15,670	16,100	16,960	
412 Vacant	202	6.40	--	1,290	1,290	1,400	1,400	1,500	
413-14 Wisconsin Alliance of Cities	679	6.80	--	4,980	5,020	5,420	5,420	5,850	
415 State ⁵	259	7.00	3/1/79 - 2/28/81	1,830	1,940	1,970	2,100	2,130	
416-19 State ⁵	1370	6.00	vacated 6/30/80	8,220	8,880	8,880	9,590	9,590	
420-20a State ⁵	560	6.70	vacated 6/30/80	3,750	3,750	4,050	4,050	4,370	
421-22 State	300	6.70	vacated 6/30/80	2,010	2,010	2,170	2,170	2,340	
423-24 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
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

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
Eighth Floor								
801 Wisconsin Radio News	150	7.00	to 6/30/80	\$ 1,050	\$ 1,050	\$ 1,130	\$ 1,130	\$ 1,220
802-5 State	1536	7.55	to 10/31/83	11,600	11,600	11,600	12,060	12,520
806-7 Dr. Mannis	470	7.50	9/1/79 - 8/31/80	3,840	4,000	4,000	4,210	4,320
808-22 State	4580	6.00	7/1/79 - 6/30/80	27,480	36,620	37,100	37,100	39,580
823-24 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								
901 Millman & Robertson	150	8.00	1/1/80 - 12/31/80	\$ 1,230	\$ 1,300	\$ 1,340	\$ 1,400	\$ 1,400
902 Wisc. Ins. Alliance	864	7.00	6/1/79 - 5/31/80	6,400	6,480	6,910	7,000	7,000
903-6 Mulcahy & Wherry	980	8.00	1/1/79 - 12/31/81	8,070	8,530	8,750	9,210	9,210
907 Robert Uehling	225	8.00	4/1/80 - 3/31/81	1,810	1,960	1,980	2,110	2,110
909-10 Larry Hall	700	6.00	6/1/79 - 5/31/80	4,520	4,550	4,870	4,900	4,900
911 Dr. Schmitz	248	7.75	1/1/79 - 12/31/80	1,920	1,970	2,060	2,140	2,230
912-19 Devine Insurance	2580	7.00	4/1/80 - 3/31/83	18,060	18,060	18,180	19,350	19,350
921 State	575	7.00	vacated 7/1/80	4,020	4,350	4,350	4,700	4,700
922-23 Judicial Commission	355	6.50	5/1/79 - 4/30/81	2,300	2,500	2,500	2,700	2,700
924-25 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								
1001 Victor Lind	150	6.80	11/1/79 - 10/31/80	\$ 1,050	\$ 1,200	\$ 1,250	\$ 1,300	\$ 1,350
1002 Wisc. Assoc. of Indep. Colleges	864	6.50	1/1/80 - 12/31/80	5,760	6,050	6,190	6,480	6,650
1003-4 Wisc. Cannery & Freezers	756	8.00	5/1/79 - 4/30/80	6,050	6,050	6,530	6,530	7,050
1005-8 Boelter Co.	911	6.80	12/1/79 - 11/30/80	6,370	6,650	6,880	7,200	7,400
1009-10 Vacant	455	6.50	--	2,950	3,190	3,190	3,450	3,450
1011-13 Dr. Doll	727	6.65	6/1/79 - 5/31/80	5,230	5,270	5,640	5,670	6,100
1014 Vacant	229	6.25	--	1,430	1,430	1,540	1,540	1,670
1015-18 State	1616	7.50	11/1/79 - 10/31/83	12,120	12,120	12,120	12,600	13,090
1019-21 Vacant	680	6.70	vacated 2/29/80	5,380	5,440	5,870	5,910	6,350
1022 Herb Walsh	171	8.00	12/1/79 - 11/30/80	1,420	1,490	1,490	1,540	1,600
1023-24 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

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

¹The 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.

²The 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.

³Of 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.

⁴The 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.

⁵The 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
<u>Lower Level & Roof</u> ¹									
B Level - 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
<u>B Level</u>									
Showroom 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
<u>A Level - Storage</u>									
	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
<u>First Floor</u>									
112 East Main	454	100	5.20	8		\$ 1,570			
	454	100	5.20	12			\$ 2,360		
	454	100	5.20	4				\$ 780	
<u>114 East Main</u>									
	1,000	100	5.20	8		3,480			
	1,000	50	5.20	12			2,600		
	1,000	50	5.20	4				860	
<u>Leaf & Ladle</u>									
	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
<u>North Entry</u>									
	2,000	100	9.00	9	13,500				
Total - First Floor					\$31,870	\$13,360	\$ 4,960	\$10,830	\$ 9,890

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

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
Third Floor ³									
301	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
302-3	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	
304	230	100	6.70	6	770				
	230	100	7.20	12		1,660			
	230	100	7.80	6					900
305-8	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
310-11	456	100	6.70	6	1,530				
	456	50	7.20	12		1,640			
	456	50	7.20	12			1,640		
312	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
<u>Fourth Floor</u>									
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
<u>Fifth Floor</u>									
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
<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
<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					\$120,790	\$85,330	\$66,480	\$59,910	\$39,220

EXHIBIT 25 -- Continued

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

- ¹ The 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.
- ² It 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.
- ³ The 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.
- ⁴ Vacancies 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 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>
<u>Revenues:</u>					
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
<u>Expenses:</u> ¹					
77 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

¹Expenses

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).

²Building 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.

³Maintenance

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

⁴Utilities

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.

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

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

⁸Real 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

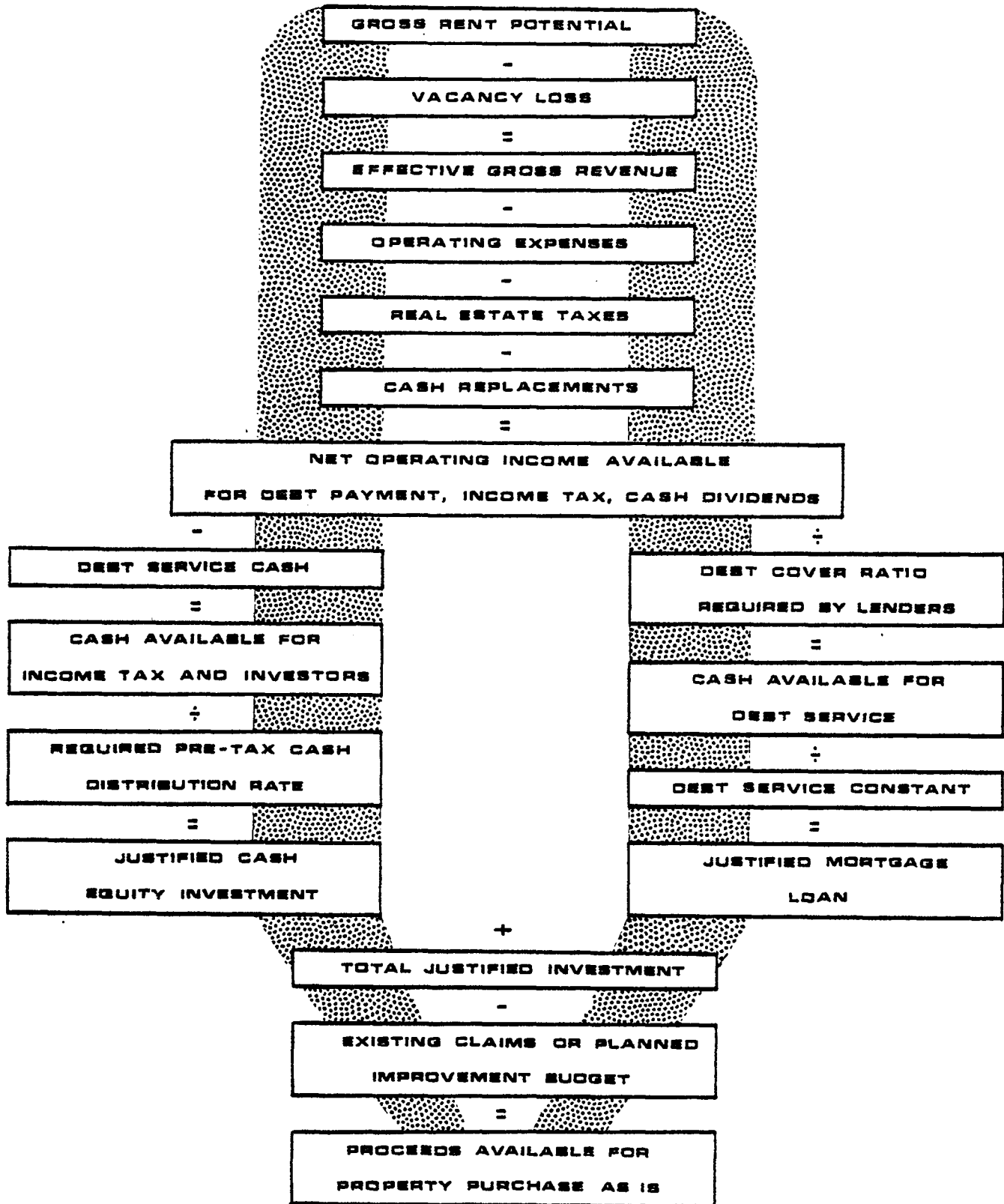
The MRCAP discounted cash flow program can solve for a justified project value by specifying the ratio of net income to debt service acceptable to an institutional mortgage lender. Given the interest rate and term available as of April 30, 1980, the program will solve for the justified amount of mortgage 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

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

PRO FORMA
INVESTMENT ANALYSIS OF
BUILDING
FOR

REPORT SECTION NUMBER 2
=====

PAGE 1

COMPONENT SUMMARY

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 BU	1.00	1	1.	2	\$ 10800.	0

MORTGAGE SUMMARY

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

P R O F O R M A
INVESTMENT ANALYSIS OF
BUILDING
FOR

R E P O R T S E C T I O N N U M B E R 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.	39220.
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	34878.	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>1150082.</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	0.8220	0.8547

EXHIBIT 29 -- Continued

INPUT FILE

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170 70,.054,.05,*
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320 200,4,ELEVATORS
330 201,4,73000,.90,2
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350 200,5,ENERGY CONSERVATION
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470 303,1,0,0,0,0
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520 400,9
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540 999,99

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IV. 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.

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.

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 $\frac{1}{4}$ 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- $\frac{3}{4}$ %	- 26,080.80
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	+ 34.71
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 $\frac{1}{4}$

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	206.96	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)

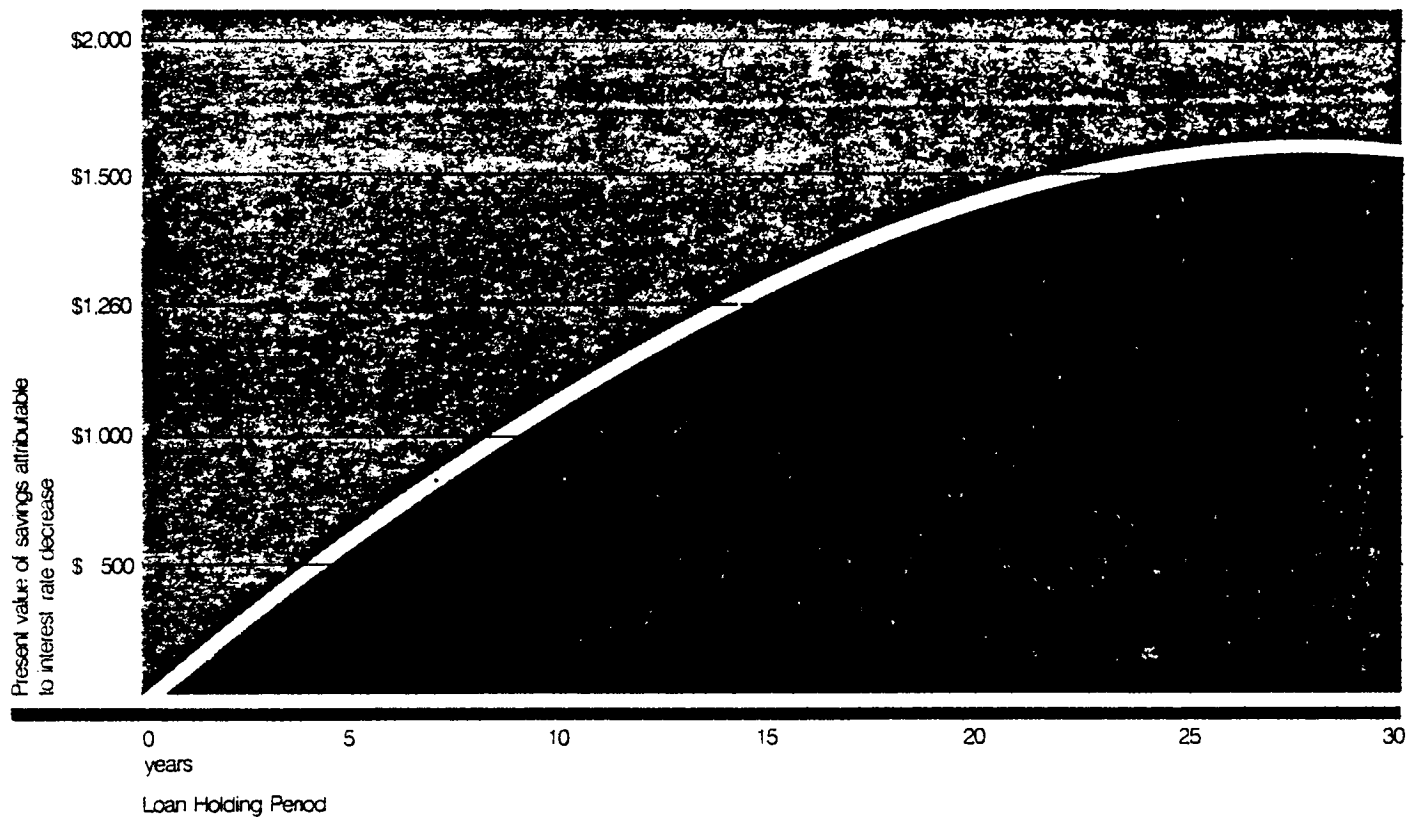


Figure B

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

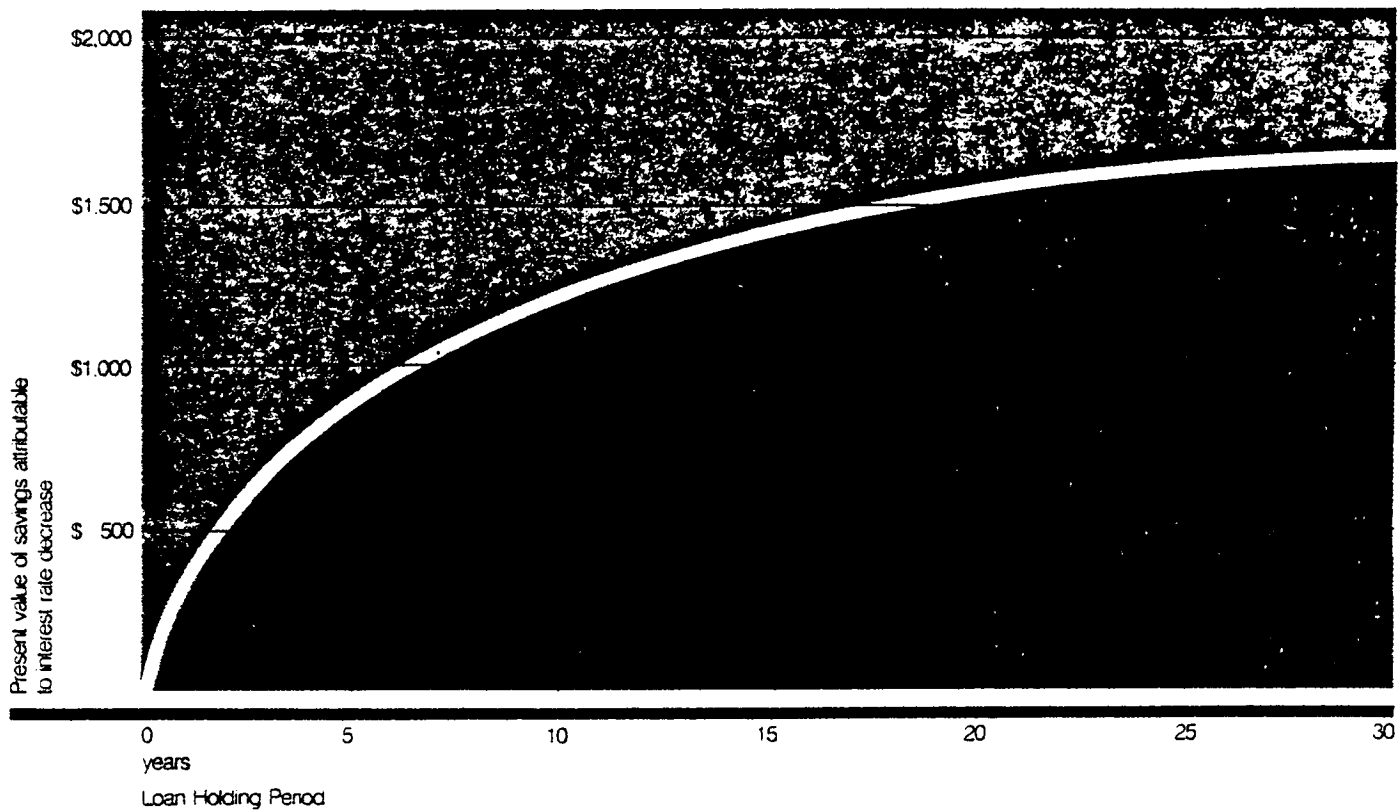


EXHIBIT 31

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. @ 14.5% \$121,931
	PW \$146,049, EOY 10 @ 14.5% <u>\$ 34,558</u>
	Total (Cash Equivalent Price) \$763,581

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?

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	<u>\$2,588,000</u>
	\$3,450,000

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>				<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> <u>4 years</u>
Down Payment	\$500,000 <u>3,576 (2A)</u> \$503,576	\$250,000 5,364 (3A) <u>33,435 (9B)</u> \$288,799	\$250,000 11,145 (3B) <u>50,787 (9C)</u> \$311,932	\$ 67,710 (12C)
				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>			\$2,517.710
	\$2,456,451	Total Cash Equivalency (Versus \$3,450,000 nominal selling price)		

INCOME PREPOTED (Contract)	GROSS INCOME NET INCOME	\$499,249 <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.

Session #9 - The Real Estate Investment Broker as Investment Counselor

- A. Almost everybody approaches a real estate appraiser or a broker with a false premise as to just what they do and how they operate. There is a tendency to presume the product desired as a fair market appraisal if you are talking about somebody who calls himself an appraiser; there is also the presumption that one will buy or sell if you contact a broker so that by the time the contact is made the client already perceived the problem as having reached the point that he needs an appraisal or needs a transaction.
- B. The role of the consultant is to assist the client in moving from the problem as originally perceived, subject to the unconscious buyers position, to a broader based position of the problem as understood. What is the real question is more important than the search for answers. There are a variety of creative tricks to initiate that process:
 - 1. Rollback the problem to a lower level of significance on some hierarchy of the decision process. If the client wants to buy, find out if the problem would work with a short term lease; if the client wants to lease, find out if he could avoid any additional real estate by changing his procedures for purchasing, warehousing, etc.
 - 2. Reduce a new problem to a familiar format by analogy or gain perspective on a familiar problem with a far-fetched analogy.
 - 3. Put the problem in a chronological order of development - the dates and time of who said what to who.
- C. Guide discussion with the client along the following line:
 - 1. See if he can teach you his format for success in whatever he does.
 - 2. How does he compensate employees?
 - 3. How does he meet competitive risk?
 - 4. How does he meet systematic risk?
 - 5. What are his personal goals?
 - 6. What is his favorite investment?
 - 7. Why does he want to invest in real estate?
- D. Another way to understand a client's real estate problem is to understand the linkages of each item in his balance sheet and P&L statement to the institutional framework in which it operates - its situs factor.
 - 1. Networks and capacity of the terminal points
 - 2. Contiguous uses and ownership pattern
 - 3. Nearby generators of demand and supply
 - 4. Relationships remote in distance or in time
- E. The consulting functions are related to basic decision making and problem solving.
 - 1. Reduce anxiety for the client
 - 2. Dilute responsibility for the client
 - 3. Help redefine the question more appropriately
 - 4. Help select a statement of objectives
 - 5. Help select criteria with which to evaluate alternative courses of action
 - 6. Allow the client to make the choice between/among alternatives

- F. Selection criteria should be customized to focus on the problem:
1. Cost per sq. ft. of first floor area or gross building area
 2. Income per acre or income per dollar investment
 3. Gross profit as percentage of sales or dollars per sq. ft.
- G. Rejection criteria or payoff matrix should be carefully defined to represent strategic and personal goals as well as technical maximization.