

MIDTERM 1  
SEPTEMBER 27, 2017  
CHAPTER 1-5

SECTION A SELECT THE CORRECT ANSWER, 10 QUESTIONS, EACH QUESTION IS WORTH ½ GRADE.  
THE MAXIMUM POSSIBLE GRADE IS 5/5,

SECTION B SOLVE, SHOW YOUR CALCULATIONS, 5 QUESTIONS, UNDERLINE YOUR ANSWER.  
THE MAXIMUM POSSIBLE GRADE IS 5/5,

SECTION C READ THE TEXT, ANSWER THE QUESTIONS. 5 QUESTIONS.  
THE MAXIMUM POSSIBLE GRADE IS 10/10.

THE TOTAL MAXIMUM POSSIBLE GRADE FOR THIS MIDTERM IS 20/20.  
THE WEIGHT OF THIS MIDTERM IS 15% OF YOUR TOTAL COURSE GRADE. GOODLUCK!

NAME: \_\_\_\_\_

STUDENT ID: \_\_\_\_\_

Section A (10 QUESTIONS)

1) Which type of real estate is not considered commercial property?

- a) Office
- ✓ b) Single Family Housing
- c) Industrial
- d) Retail

2) It is time to develop properties when

- a) Interest rates and construction costs are escalating
- ✓ b) When the market value of space exceeds replacement cost
- c) When cash flow from property investments are falling
- d) When occupancy levels and rent levels are declining

3) You intend to purchase a shopping center as an investment. Which professional can help you to assess the value of your property?

- a) Surveyor
- b) Lawyer
- ✓ c) Appraiser
- d) Architect

4) Two years ago you leased a 2,000 square foot office space to a tenant for a five-year lease. Operating Expenses are stopped at \$8 per square foot. This year, actual expenses for the building were \$13 per foot. How much will the tenant be charged for Operating Expenses?

- a) \$16,000
- b) \$26,000
- c) \$ 5,000
- ✓ d) \$ 10,000

Tenant's Contribution to Operating Expenses:  
 $(\$13 - \$8) \times 2,000 \text{ sq.ft} = 5 \times 2,000 = 10,000$

5) You were successful in renting your 1000 square foot warehouse to a single tenant and agreed to pay the leasing agent 5% commission. Rent is calculated at \$15/sq.ft. The Lease is for ten years. How much commission will you pay?

- a) \$75
- b) \$750
- ✓ c) \$7,500
- d) \$0

Rent =  $\$15/\text{sq.ft} \times 1000 \text{ sq.ft} = \$15,000/\text{year}$   
Lease Term = 10 years  
Commission =  $5\% \times 10 \times 15,000 = \$ 7,500$

6) You leased a retail space and promised to pay a participation factor of 5%. Your break point is \$200,000. Your sales in year 1 was \$100,000 and your base rent is \$15 per square foot. Your space is 1000 square feet? What is your monthly rent in the year 1?

- a) \$2,083
- b) \$15,000
- ✓ c) \$1,250
- d) \$5,000

If Break Point > Sales then Participation = 0  
Rent =  $\$15/\text{sq.ft.} \times 1,000\text{sq.ft.} = \$15,000$  Annually  
Monthly Rent =  $\$15,000/12 = \$1,250$

7) A discounted cash flow analysis based on NOI is used to determine which value?

- a) Land allocation
- ✓ b) Asset value
- c) Equity value
- d) Leverage

8) A terminal or reversion value is:

- a) The tendency of property to decline in value over time.
- b) The tendency of return on investment in any industry to revert to the average of all industries.
- ✓ c) The resale price of a property at the end of a financial projection.
- d) Purchase price plus growth less depreciation.

9) A property has NOI of \$10 million, depreciation of \$ 1 million and similar properties trade at an 8% cap rates. What is the value of the property?

- a) \$80.0 million
- b) \$112.5 million
- ✓ c) \$125.0 million
- d) \$137.5 million

Depreciation is a an accounting concept and does not relate to valuation using the cap rate method.

Cap Rate = 8%

NOI = \$10 M

Value =  $\$10\text{M}/8\% = \$125\text{M}$

10) Which attributes of a property would influence the choice of valuation methods used and the accuracy of the valuation?

- I. Future growth in rent
  - II. Current property occupancy and cost of lease up
  - III. Expected changes in major leases
  - IV. The ownership structure of the holding company
- ✓ a) I, II, III
  - b) II, IV
  - c) I, III
  - d) All of the above

Section B (5 QUESTIONS)

- 1) Harry's Hat Shop operates a 4,000 square foot store in New Market Mall. There are 10 stores in New Market Mall totaling 40,000 square feet. What is the pro rata allocation of expenses to Harry's Hat Shop? (1/2 Mark)

$$\text{Pro Rata Allocation} = \text{Area of Shop} / \text{Total Area of Mall} = 4,000 / 40,000 = 0.1 = 10\%$$

- 2) Newco Real Estate owns a 250,000-square foot strip shopping center in Montreal. The center is valued at \$50,000,000. Security expenses are \$10,000 every two years; maintenance costs average \$500,000 depending on snow fall. Insurance is \$70,000 and administration is \$30,000. Next year the center will need a new roof at an expected cost of \$2,000,000. What are the annual operating expenses for the center per square foot? (1/2 Mark)

$$\begin{aligned} \text{Annual Expenses} &= \text{Security} + \text{Maintenance} + \text{Insurance} + \text{Administration} \\ &= 10,000/2 + 500,000 + 70,000 + 30,000 = 5,000 + 600,000 = \$605,000 \\ \text{Area} &= 250,000 \text{ sq.ft.} \\ \text{Annual Operating Expenses per Square Foot} &= \$605,000 / 250,000 = \$2.42/\text{sq.ft.} \end{aligned}$$

- 3) In the event that DCH does not renew its 10,000 square foot lease we will need to release the space. DCH has been in the space for 15 years and the new tenant will expect a completely different interior. This will cost \$25 per square foot. It will also cost 5% of the total rent for the new tenant's first term as a leasing commission. What will it cost to release the lease the space to a new tenant for a seven year term at a \$25 per square foot rent level? (1 Mark)

Cost to release the space: Tenant Allowance + Commission

$$\begin{aligned} \text{Tenant Allowance} &= \$25/\text{sq.ft} \times 10,000 \text{ sq.ft.} = \$250,000 \\ \text{Commission} &= \$25/\text{sq.ft.} \times 10,000 \text{ sq.ft} \times 7 \text{ yrs} \times 5\% = \$87,500 \end{aligned}$$

$$\text{Total Cost} = \$250,000 + \$87,500 = \$337,500$$

- 4) The Crescent Arms is a 15 story luxury apartment building in New Orleans's warehouse district. In 2009 the property had adjusted NOI of \$2.5 million. The property was marketed to a broad range of investors and sold for 29.5 million. At what cap rate did the property sell? (1 Mark)

$$\text{Cap Rate} = \text{NOI} / \text{Value} = \$2.5\text{M} / \$29.5\text{M} = 0.08474 = 8.47\%$$

- 5) Marvin Garden is a 200-unit B grade apartment complex in Scottsdale Arizona is currently 97% occupied and has Rent Revenue of \$2,328,000 per year. Net Operating Income for the period is \$1,750,000. Next year the property's rents will not increase, expenses will remain constant. For valuation purposes, a Vacancy Loss of 5% of Gross Potential Rent will be allocated. Estimate the Gross Potential Rent, Vacancy Loss and NOI for next year. What is the value of the property at a 5% cap rate? (2 Mark)

$$\text{NOI} = \text{Revenues} - \text{Expenses}$$

$$\text{Expenses} = \text{Revenues} - \text{NOI} = \$2,328,000 - \$1,750,000 = \$578,000$$

$$\text{Rent Revenue at 97\%} = \$2,328,000$$

$$\text{Rent Revenue at 100\%} = ?$$

$$\text{Gross Potential Rent} = \$2,328,000 / 0.97 = \$2,400,000$$

$$\text{Vacancy Loss} = 5\% \text{ of Gross Potential Rent} = 0.05 \times 2,400,000 = \$120,000$$

$$\text{NOI} = 2,328,000 - 578,000 - 120,000 = \$1,630,000$$

$$\text{Value} = 1,630,000 / 0.05 = \$32,600,000$$

Section C (5 QUESTIONS)

## EXCERPT: Campus crest buys delta centre-Ville hotel; U.S. company to convert property into student housing

OSHRAT CARMIEL. *The Gazette*; Montreal, Que. [Montreal, Que]10 July 2013: A.27.

Campus Crest Communities Inc [...] made its first international acquisition by buying a Montreal property for conversion into a residential tower for students.[...], Campus Crest acquired the Delta Centre-Ville hotel in downtown Montreal for about \$60 million [...] "The numbers are very compelling," Rollins said in a phone interview. "There are 80,000 students within walking distance to the property." The 33-storey property has 711 hotel rooms [...]

Redeveloped as student housing, the property may have as many as 1,300 beds as well as a library, study rooms and a conference center for university-sponsored events. [...]

Credit: OSHRAT CARMIEL; Bloomberg News Word count: 95 Copyright Infomart, a division of Postmedia Network Inc. Jul 10, 2013

- 1) Why did Campus Crest select Montreal for its first international acquisition? List 4 possible factors. (1 Marks)

Four distinct factors that are related to Montreal/Canada Specifically: For Example:  
Student City, Exchange Rate Advantage, Good Prospect for Economic Growth, High Cap Rate, Low Cost of Capital, Regulation Promotes Foreign Investments, Low Supply of Student Housing

- 2) Delta Hotel's ADR is \$150, occupancy historically averaged 60%. Their expenses typically average 45% of ADR regardless of occupancy levels. What is their NOI? (1 Marks)

Average Daily Rate of Rooms at Delta is \$150  
Number of Rooms = 711  
Occupancy = 60%  
Rent Revenue = \$150 x 711 x 365 x 60% = \$23,356,350  
Expenses = (\$150 x 711 x 365) x 0.45 = \$17,517,262.5  
NOI = Revenues - Expenses = \$23,356,350 - \$17,517,262.5 = \$5,839,087.5

- 3) Cap Rates for high rise downtown hotels in Montreal averaged 10% in 2013. What was the possible valuation of the property. (1 Marks)

Value = NOI/Cap Rate = \$5,839,087.5/0.1 = \$58,390,875

- 4) Campus Crest anticipates renting each bed for \$700/month and have close to 80% Occupancy in the first year. Its anticipates expenses to average 15% of monthly revenues. What is their anticipated NOI? Their Valuation? (Note: Assume that the leases are 10 months long and cap rates are 10%) (3 Marks)

Beds = 1,300  
Rent = \$700/month  
Lease = 10 Months  
Occupancy = 80%  
Cap Rate = 10%

Rent Revenue =  $1,300 \times 700 \times 10 \times 0.8 = \$7,280,000$   
Expenses =  $15\% \times \$7,280,000 = \$1,092,000$

NOI =  $\$7,280,000 - \$1,092,000 = \$6,188,000$

Value =  $\$6,188,000 / 0.1 = 61,880,000$

- 5) If the valuation of this building as a Hotel is close to its valuation as Student Housing, what might have motivated either party enter the deal? What might have been the current owner's outlook for the next few years? What might have been Campus Crest outlook for the next few years? (4 Marks)

Current Owner may have valued his property at a much lower value than what was offered to him.

Campus Crest may have seen the opportunity to convert this property as cheaper than the cost of construction.

Current Owner's Outlook is Negative - Less Tourism, Higher Competition (newer nicer hotels), Higher Expenses due to the aging of the building (60% Occupancy will decline, ADR will go down, Expenses might go up)

Campus Crest's Outlook is Positive = 80% Occupancy will go up, Rent Rate will be Higher.