



### Balsa Construction

You have been presented with an office building for sale for \$135 PSF. The building is 240,000 SF. There is one tenant in place who leases 50% of the building at a full-service rental rate of \$25.00 PSF for 10 years, with 5% rent bumps every 2 years. Operating expenses for the building are \$13.00 PSF.

Your research has proven than market lease terms for this building are \$27.00 PSF full service for a 5-year lease. Tenant Improvements and leasing commissions on deals are \$15.00 and 6%. Buildings of this quality should trade on a 10% cap rate based on the forward twelve months NOI.

Assume that you will lease the balance of the space to two equal sized tenants at market rates. The first new lease will occur 8 months after you purchase the building, and the second new lease will happen 15 months after purchase.

The initial capex is \$200,000 with additional deferred capex of \$50,000/year for 3 years. The building has a parking ratio of 3.0 spaces/ 1,000 SF and the market-parking rate is \$100/month (net).

If you sell the building at the end of year 5 what is your unlevered IRR? Please use XIRR formula to calculate.

Now assume that you closed with a loan of 65% of your purchase price. Here are the terms of the loan, it is a 5-year loan with a 7% interest rate and has a one-point origination fee and a one point exit fee on the remaining outstanding loan balance. The loan amortizes on a 25-year schedule. What is your leveraged IRR? Please use the XIRR formula to calculate.

Based on your analysis and your general knowledge of real estate, what are other issues to consider when evaluating whether you should buy this building?

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Purchase Assumptions	
Purchase Price PSF	135 Price per square foot
Building Size (SF)	240000 Total building area
Building Information	
Tenant 1 (Leased SF %)	0.5 Tenant occupies 50% of building
Tenant 1 Rent PSF	25 Full-service rental rate
Leasing Assumptions	
Tenant 1 Lease Term (Years)	10 Lease term for Tenant 1
Rent Bumps (%)	5 Rent increases every bump period
Rent Bump Frequency (Years)	2 Frequency of rent bump
CAPEX	
Initial CapEx	200000 Initial capital expenditure upon purchase
Deferred CapEx (Annual)	50000 Deferred capex per year for first 3 years
OPEX	
Operating Expenses PSF	13 Annual operating expenses per SF

Debt Assumptions	
Loan-to-Value (LTV)	0.65 Loan covers 65% of purchase price
Loan Interest Rate	0.07 Interest rate on 5-year loan
Loan Term (Years)	5 Loan term used in IRR calc
Amortization (Years)	25 Amortization schedule for payments
Origination Fee (%)	0.01 Loan origination fee at closing
Exit Fee (%)	0.01 Loan exit fee on payoff
Holding Period (Years)	5 Assumed holding period
Market Information	
Market Rent PSF	27 Market full-service rent for 5-year lease
Market Cap Rate	0.1 Forward 12-month NOI cap rate
Parking	
	3 3.0 spaces per 1,000 SF
	Parking Ratio (spaces/1,000 SF)
\$	100 /month rate
	720 Total spaces



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	Year 0	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6
Purchase Price	\$ (32,400,000)						
Cash Flow Before Debt Service	\$ (155,000)	\$ 2,278,000	\$ 4,084,000	\$ 4,134,000	\$ 4,291,500	\$ 3,751,500	\$ 1,621,875
Sale Price	\$ 37,515,000						
<b>Unlevered IRR</b>	9%						
	Year 0	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6
Purchase Price	\$ (32,400,000)						
Cash Flow After Debt Service	\$ (2,090,020)	\$ 491,828	\$ 2,297,828	\$ 2,347,828	\$ 2,505,328	\$ 1,965,328	\$ (90,520)
Sale Price	\$ 37,515,000						
<b>Levered IRR</b>	4%						