



Case Study

OFFICE BUILDING



Income Producing Property Investment

Address: DeBartolo Office Building - 4401 W Kennedy Blvd, Tampa, FL- 33609



1. Introduction:

Our analysis outlines the evaluation of purchasing an income producing property for investment. This assessment includes a macroeconomic purchase valuation using levered pre-tax returns on the subject property.

Applying geographic movement trends, our market investigation led us to Tampa, Florida. Analyzing in a lense beginning with the CoronaVirus pandemic, the Tampa CRE market has transformed into one of the most coveted real estate markets in the United States. A greater and greater number of people, and companies are quickly moving to the region looking to lease office space, warehouses, and industrial sites. As per EVP Cecora at JLL, *“Unprecedented demand drives industrial rental rates through the roof”*(2). The area is one of the fastest growing regions in the country; supported by industries such as finance, healthcare, technology, and tourism. Harboring the largest port in Florida, the Tampa market appears to be flourishing with a steady prediction for growth in the years to come.

2. Property Description:

We identified a mid-tier B class office building, the DeBartolo Building, located at 4401 W. Kennedy Blvd, in Tampa, Florida; near the heart of the Westshore Business District. Built in 1986 and renovated in 2006, the three story multi-tenant office building is 28,255 square feet. The physical lot is 1.8 acres, with a purchase price of \$8,200,000. The building was constructed with open floor plans and currently has 87% occupancy.

Current tenants occupy are broad range of industries;

The Health and Wellness

Burke Collins Therapy, Inc.
Renew IV Wellness
Stemcellix

Law Firms

Mendes, Reins & Wilander
McCumber & Partners

Construction

DeBartolo Development

Community Outreach

David A Straz Foundation

Nestled in the CBD, the Debartolo building is only an 11 minute drive from Tampa

PROPERTY FACTS

Sale Type	Investment or Owner User	Property Type	Office
Building Size	28,255 SF	Building Class	B
Year Built/Renovated	1986/2006	Price	\$8,200,000
Price Per SF	\$290	Cap Rate	6.43%
NOI	\$527,129	Percent Leased	87%
Tenancy	Multiple	Building Height	3 Stories
Typical Floor Size	11,110 SF	Building FAR	0.36
Land Acres	1.80 AC	Opportunity Zone	No
Zoning	CG - "Commercial General" City of Tampa		

Bay Port, and an 8 minute drive from Tampa International Airport.

Assumptions:

Assumptions without Justification:

- Price - \$8,200,000
- Building size - 28,255 square feet
- Price per Square Foot - \$290
- Going in CAP - 6.43%
- Occupancy - 87%
- The largest tenant leases 11,100 square feet, or 39.32% of total leasable square footage.
- Vacancy - 13%
- Selling expenses - 4%
- Purchasing closing costs - 2.5% of purchase price.
- Financing with a 30-year fully amortized fixed rate loan.
- DCR no less than 1.25
- Hold period - 8 years

Assumptions with Justification:

- Mortgage rate - 6.5%
- The mortgage rate was quoted on October 7, 2022, per down payment. The 33.5% down payment of \$2,747,000 was derived via the Debt to Credit Ratio limitation of 1.25 and found to be the most efficient use of cash opportunity cost as it relates to timing of cash flow and IRR.
- Required Rate of Return - 8.89%
- *Required Return = Risk Free + Risk Premium + "Property Risk"*
- The required rate of return is 8.89%, as follows:
 - 3.89% - Treasury bond risk free rate.
 - 4.50% - Risk premium for B+ (industry long-term average).

- 0.50% - Subject Property Risk - location and age adjustment per review of local comparables (CAP over market)..
- The levered required rate of return is 9.89% adjusted upwards 100 *bps* to account for the increased risk of levered capital.
- NOI - \$527,129
- NOI reported by the seller (or the implied NOI reported, given the asking price and the reported CAP) is correct and no due diligence is required.
- Occupancy is currently at 87%, with 3% annual increase in place for all four tenants.
- NOI was obtained from the income statement provided by the seller. No change in NOI over the projected period was made as the subject property was assumed to continue to cash flow at the current occupancy, rental rates, and contributing NOI factors.
- Terminal Cap Rate - 6.54%
- Terminal CAP rate factored cashflow for the current year of sale increased by the expected growth rate the subsequent year.
- NOI Growth Rate - 3.00%
- The 10 year Treasury Yield was 3.89%. All lease agreements have a 3.00% annual fixed increase, therefore an estimated 3.00% NOI Growth rate was utilized.
- Currently at 87% occupancy with one unit not occupied. Occupancy is in line with national office occupancy.
- Terminal NOI Growth Rate - 2.36%
- The 10 and 20-year projected inflation for NOI growth was 2.35% and 2.36%, respectively.
- All tenant leases expire before projected sale. Terminal NOI growth was estimated to reflect the long-term inflation rate as the lease prices are not expected to be brought to market upon renewals due to the age of the building. On-site inspection and local market diligence would be necessary to further consider a mark-up to market rates.
- Expected Long Term Inflation - 2.35%
- As of 09/01/22, the St. Louis Federal Reserve Bank's expected 10 and 20 year inflation was 2.35% and 2.36%, respectively.
- 2.35% was utilized as the growth rate for our hold period and adjusted up 1 basis points for the terminal NOI growth rate.

3. Before-tax expected return:

When accounting for and factoring all input data, the expected return on investment was;

- Levered IRR: 12.16%
 - NPV: \$425 010
- The 12.16% return can be broken down further into price appreciation effect and cash-flow effect.
- Cash Flow Effect - 71.3%
 - Price Appreciation Effect - 28.7%

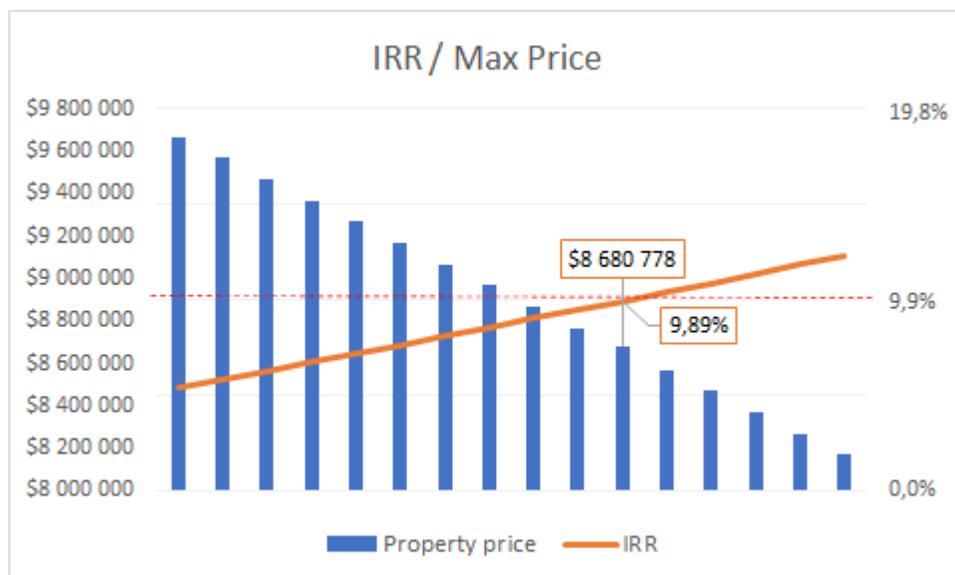
Return	12,16%
Annuual cashflow	71,3%
Price appreciation	28,7%

End of year	NOI	Acquisition/Disposition	CF	PV of CF	DS	Levered CF	PV of Levered CF
0		(\$8 405 000)	(\$8 405 000)	(\$8 405 000)		\$ (2 747 000)	(\$2 747 000)
1	\$527 129		\$527 129	\$484 093	(\$417 577)	\$109 552	\$99 693
2	\$542 943		\$542 943	\$457 908	(\$417 577)	\$125 366	\$103 816
3	\$559 231		\$559 231	\$433 139	(\$417 577)	\$141 654	\$106 747
4	\$576 008		\$576 008	\$409 710	(\$417 577)	\$158 431	\$108 645
5	\$593 288		\$593 288	\$387 548	(\$417 577)	\$175 712	\$109 650
6	\$611 087		\$611 087	\$366 585	(\$417 577)	\$193 510	\$109 889
7	\$629 420		\$629 420	\$346 756	(\$417 577)	\$211 843	\$109 473
8	\$648 302	\$9 740 948	\$10 389 251	\$5 256 301	(\$5 234 407)	\$5 154 844	\$2 424 098
						Total PV:	\$3 172 010
						NPV:	\$425 010
						IRR:	12,16%

4. Max price:

Given the analysis undertaken, the maximum price seen as justifiable for this property would be \$8,680,778. This is approximately 5.8% higher than the initial purchase price.

This stands because when IRR equals the levered required rate of return at 9.89%, traditionally would serve to indicate the minimum return which investor aims to receive. With this property price, NPV = 0 which would mean the return projections on subject investment are neutral with no gains or losses. During this exercise, our DCR requirement could not be fulfilled at 1.25; however the bank was still willing to work with us on the property with the given max price analysis.



5. Sensitivity Analysis

a. Optimistic Scenario

The optimistic investment scenario given a terminal cap rate of 6.5% is feasible with an NOI growth rate of more than 2% per year. In this case, IRR is greater than the levered required rate of return.

As long as the current annual increase of 3% is secured in contract with the majority of tenants, the investor can feel secure that NOI growth will maintain or surpass the 2% threshold.

If terminal cap rates are 6.5% and real NOI is less than expected; our investment still pays back as IRR is 10.59% and RRR is 9.89% which would still yield profit to investors.

b. Pessimistic Scenario

In the analysis where NOI growth declines to 1.5% or amounts to a number less than \$497,000 annually; the investment would not be considered a beneficial endeavor as IRR would return less than RRR.

This pessimistic scenario could be prompted by a few varying factors;

- NOI represents current occupancy at 87% leased. The national average occupancy for Offices is 87%. NOI is at risk of occupancy dropping below 87% as all leases expire before the planned disposition year.
- The terminal CAP rate is at risk of an increase in risk premium as a result of newly constructed offices with updated floor plans.
- Unforeseen capital expenses (~Emergency roof replacement).
- Increasing level of operating expenses following a projected increase in inflation.

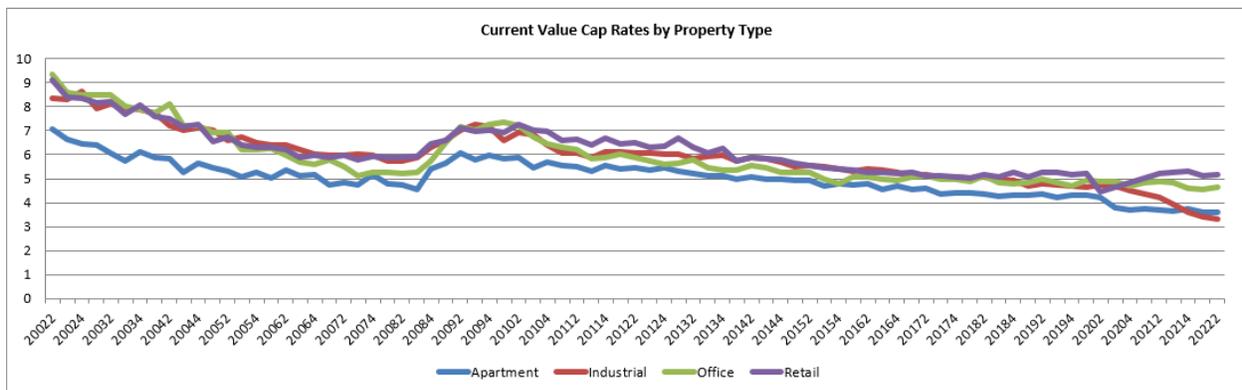
IRR		NOI										
12,16%		\$ 477 000	\$ 487 000	\$ 497 000	\$ 507 000	\$ 517 000	\$ 527 000	\$ 537 000	\$ 547 000	\$ 557 000	\$ 567 000	\$ 577 000
CAP rate (terminal)	4,50%	16,72%	17,41%	18,10%	18,76%	19,42%	20,05%	20,68%	21,29%	21,89%	22,48%	23,06%
	5,00%	14,44%	15,17%	15,88%	16,58%	17,26%	17,92%	18,57%	19,21%	19,83%	20,44%	21,04%
	5,50%	12,30%	13,07%	13,81%	14,54%	15,25%	15,94%	16,61%	17,27%	17,92%	18,55%	19,17%
	6,00%	10,26%	11,07%	11,85%	12,61%	13,35%	14,07%	14,77%	15,46%	16,13%	16,79%	17,43%
	6,50%	8,28%	9,14%	9,96%	10,76%	11,54%	12,29%	13,02%	13,74%	14,44%	15,12%	15,78%
	7,00%	6,36%	7,26%	8,13%	8,97%	9,79%	10,58%	11,35%	12,09%	12,82%	13,53%	14,22%
	7,50%	4,45%	5,41%	6,34%	7,23%	8,09%	8,92%	9,72%	10,50%	11,26%	12,00%	12,72%
	8,00%	2,54%	3,57%	4,55%	5,50%	6,41%	7,29%	8,13%	8,95%	9,75%	10,52%	11,27%
	8,50%	0,60%	1,71%	2,77%	3,78%	4,75%	5,68%	6,57%	7,43%	8,27%	9,08%	9,86%

IRR		NOI growth										
12,16%		0,50%	1,00%	1,50%	2,00%	2,50%	3,00%	3,50%	4,00%	4,50%	5,00%	5,50%
CAP rate (terminal)	4,50%	15,57%	16,51%	17,42%	18,32%	19,20%	20,06%	20,91%	21,74%	22,56%	23,37%	24,16%
	5,00%	13,22%	14,21%	15,17%	16,11%	17,03%	17,93%	18,81%	19,67%	20,52%	21,35%	22,17%
	5,50%	10,99%	12,04%	13,06%	14,05%	15,01%	15,95%	16,86%	17,76%	18,63%	19,49%	20,33%
	6,00%	8,85%	9,97%	11,05%	12,09%	13,10%	14,08%	15,03%	15,97%	16,87%	17,76%	18,63%
	6,50%	6,76%	7,95%	9,10%	10,21%	11,27%	12,30%	13,30%	14,27%	15,22%	16,14%	17,04%
	7,00%	4,69%	5,97%	7,20%	8,38%	9,50%	10,59%	11,64%	12,65%	13,64%	14,59%	15,53%
	7,50%	2,60%	4,00%	5,33%	6,58%	7,78%	8,93%	10,03%	11,09%	12,12%	13,12%	14,09%
	8,00%	0,48%	2,02%	3,45%	4,80%	6,08%	7,30%	8,46%	9,58%	10,66%	11,70%	12,70%
	8,50%	-1,72%	-0,02%	1,55%	3,02%	4,39%	5,69%	6,92%	8,10%	9,23%	10,32%	11,37%

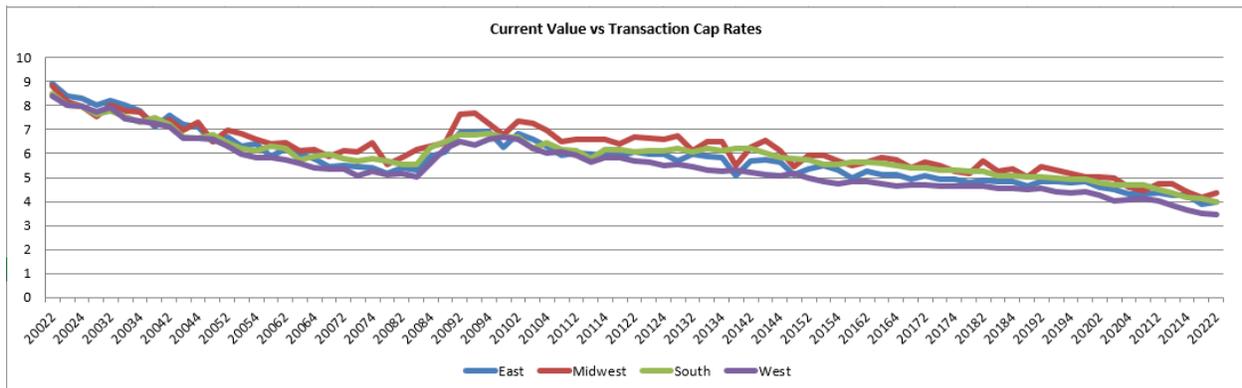
c. Market Analysis

Economic Overview:

National Office CAP rates hovered around 5% from 2015Q2 through 2021Q2, dipped to about 4.75% through 2022Q1, then rose slightly to about 4.8% 2022Q2. An increase in Office CAP rates as a result of the slowed economy during the pandemic are not evident in this data set. In fact, Office CAP rates decreased subsequent to the pandemic, evidence that a mix of demand and projected income growth outweighed tenant defaults and risk premiums.



Additional media attention has illuminated interest rate hikes, the effect on stocks, and other markets; however, office CAP rate trends across the nation held relatively steady at 5% throughout the 2020 pandemic. The data indicates that Office CAP rates are less reactive to economic changes than the other asset types.



National CAP rate trends by region clearly reflect macro economic conditions with a spike up 2008Q4, then trending down as the economy grew stronger.

East and Midwest CAP Rates ticked up roughly 40 basis points between 2022 Q1 and Q2, while the West began to stabilize and the South inched down about 10 basis points.

On a national level, real estate transactions have slowed as the FED increased interest rates during 2022, and the growth in GDP was a negative (0.6)% and (1.6)% in 1Q2022 and 2Q2022, respectively. GDP for 3Q2022 was not released as of our research but the Atlanta FED's GDPNow estimate was 2.9% for 3Q2022, as of October 7, 2022. Net Exports and Residential Investments were the two largest contributors to GDP basis points

from Q1, to Q2, to estimated Q3 2022. Net Exports contributed (3.13)%, to 1.16%, to 2.23%, and Residential Investments contributed (0.15)%, to (0.93)%, to (1.27)%, to total GDP over the respective Q1, Q2, and estimated Q3 2022. Net Exports show a significant improvement, which is a positive sign for the economy. Residential Investments decreased, which is not an unexpected reaction when interest rates significantly increase over a short period of time putting pressure on profit margins in the residential sector.

From our review of data, we have not found signs alluding to a recession spiral. We believe that the GDP's gauge on economic health will improve over the short term. On a national level, we believe that Office CAP rates will range from stabilization to a continued decrease over the next 8 years.

We performed a market analysis to gauge the confidence of how strongly the market indicates whether the proposed investment would realize projected returns.

Conclusion:

Concluding this analysis, the numbers indicate that this is a sound investment for the current state of market. NPV is positive at \$425,010; levered IRR of 12.16%, is 2.27% greater than the levered required RRR. The investment would result in minimum required returns.

Locally, the Tampa market appears healthy, with projections for steady growth; nationally, the USD is strong. From a leasehold perspective, the building is centrally located, has a higher occupancy rate than average, and its tenants represent a broad range of industry. Categorically, office spaces have a historically stable CAP rate reinforcing the projection of this project being a sound stream of revenue.

Currently, NOI is comprised of approximately 87% occupancy per Profit and Loss Statement supplied by seller. As defined in the brief market analysis, it is holding at the national average of 87%. All leases were noted to have a 3% annual increase and were projected to renew with no increase-to-market rent.

Additionally, there is room for a further increase in the subject NOI with a decrease in vacancy, or an increase in the rent roll. The current rental rate is 18% less than comparable marketed properties and not factored into cash flows.

Limitations:

In the analysis of this scenario, limitations were encountered; noteworthy hindrances are mentioned but not exclusively listed below:

- If the nature of this assessment was to perform Due Diligence; then our sensitivity analysis would factor rental rates, occupancy, & capital expenses to assess. However, due to the scope of assessment; NOI was taken from the seller at face value.
- An estimate of CapEx was not included in the P&L Statement.
- P&L Statement doesn't factor inflation towards expense growth.
- Limitation in terms of the pre negotiated, fixed increase of rental growth rate for the current tenants vs. conforming to market rents.
- In reality, NOI can grow only via 100% occupancy or a decrease in net expenditure.
- While P&L Statement projects an increase in rental income for 2023, the expenses stay constant thus negating the impact inflation has on the projected growth of expenses in their financial model.
- The model includes an inconsistency in the formula of Terminal CAP rate. The disposition sale price is calculated utilizing a CAP rate based on the "Terminal NOI Growth," which is correct. The Terminal CAP rate is calculated utilizing the "Expected LT Inflation" rather than the growth rate of the NOI in the year subsequent to sale (Terminal NOI Growth).



BLUESTAR CONSULTING

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