

Understanding Commercial Real Estate Values

Courtesy of KBS Capital Markets Group

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Understanding Commercial Real Estate Values

Today's Topics

1. “Cap” Rates 101
2. Net Operating Income (NOI)
 - ✓ Property Selection
 - ✓ Active Asset Management

What impacts Commercial Real Estate values?

Unlike residential, commercial real estate is valued on its income stream.

CAP RATES

Net Operating Income

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Purchase Price

EXTERNAL FACTOR

NET OPERATING INCOME

Revenues

-

Operating Expenses

INTERNAL FACTOR

Cap Rates 101

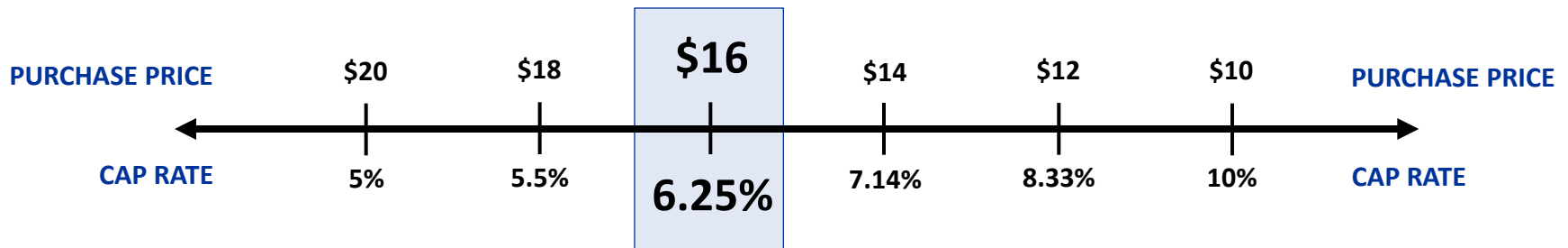
Capitalization (Cap) Rates: Expected return on an investment based on the perceived risk of a specific asset or market sector

Cap Rate = NOI / Purchase Price

$$\frac{\$1}{\$20} = 5\% \text{ Cap Rate}$$

$$\frac{\$1}{\$10} = 10\% \text{ Cap Rate}$$

As cap rates rise, purchase prices for property decrease

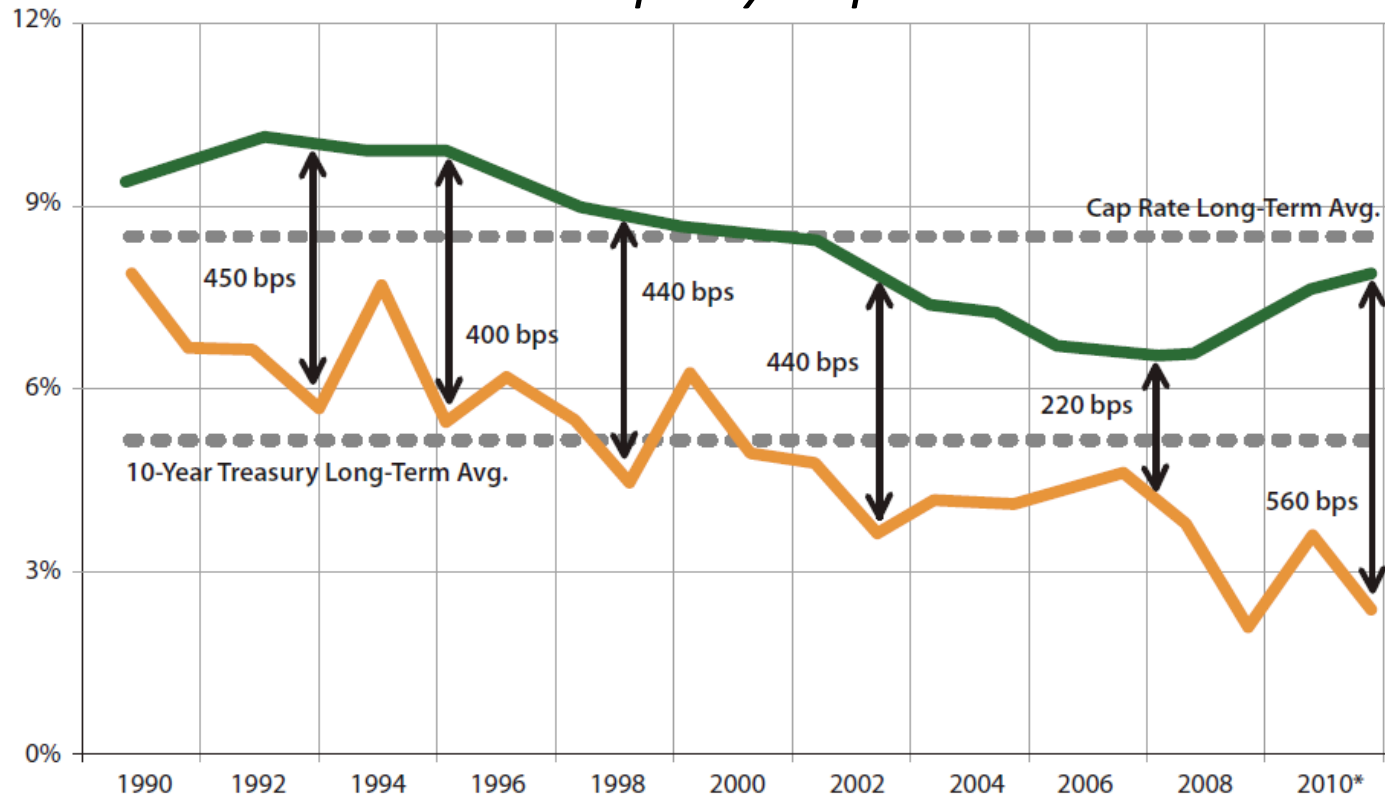


Approximate value = NOI / cap rate

EXTERNAL FACTOR

Cap Rates 101

Commercial Property Cap Rate Trends



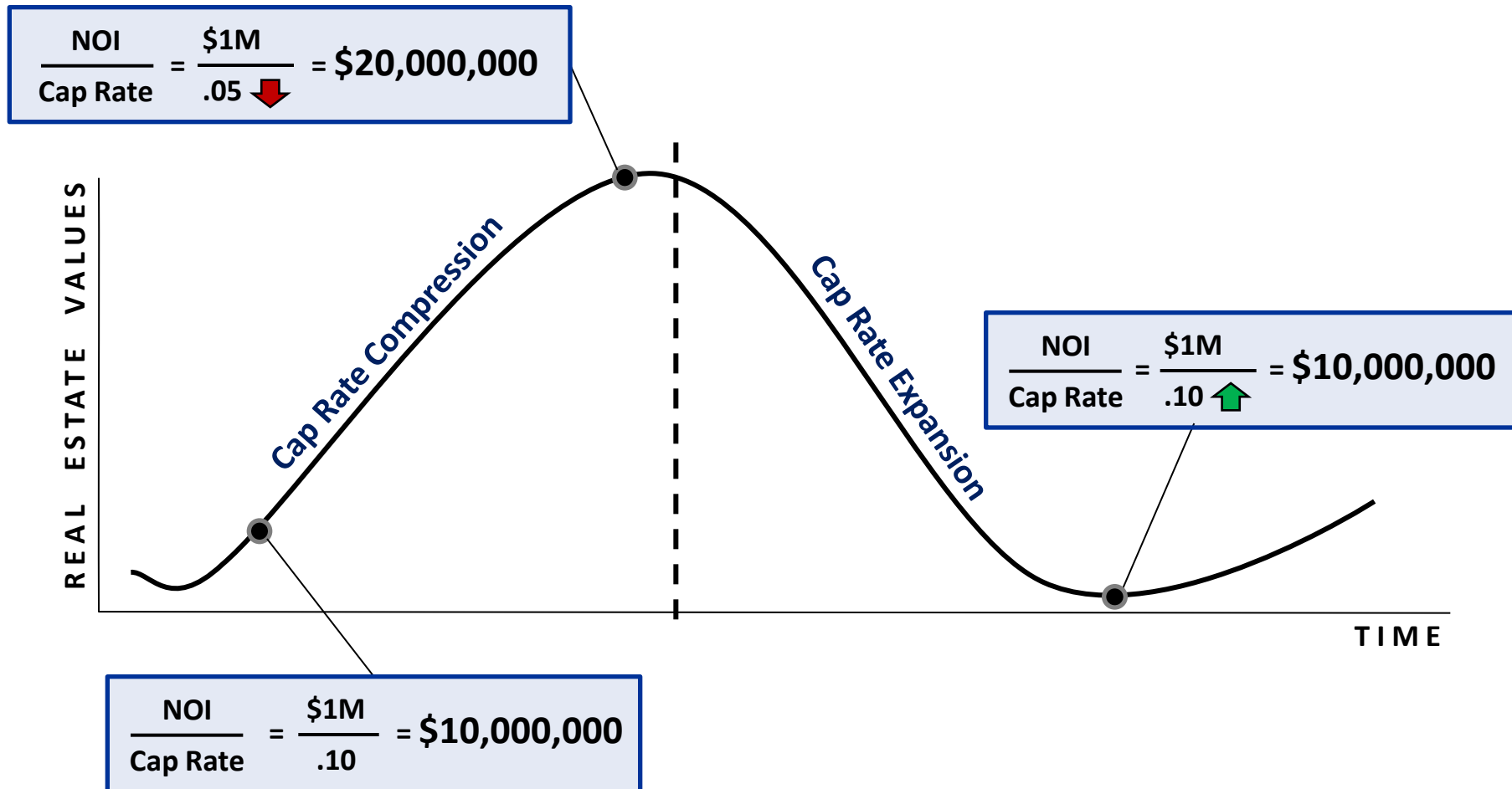
* As of 3Q
Includes sales of apartment, office, retail and industrial properties \$1M +

— Commercial Property Cap Rate

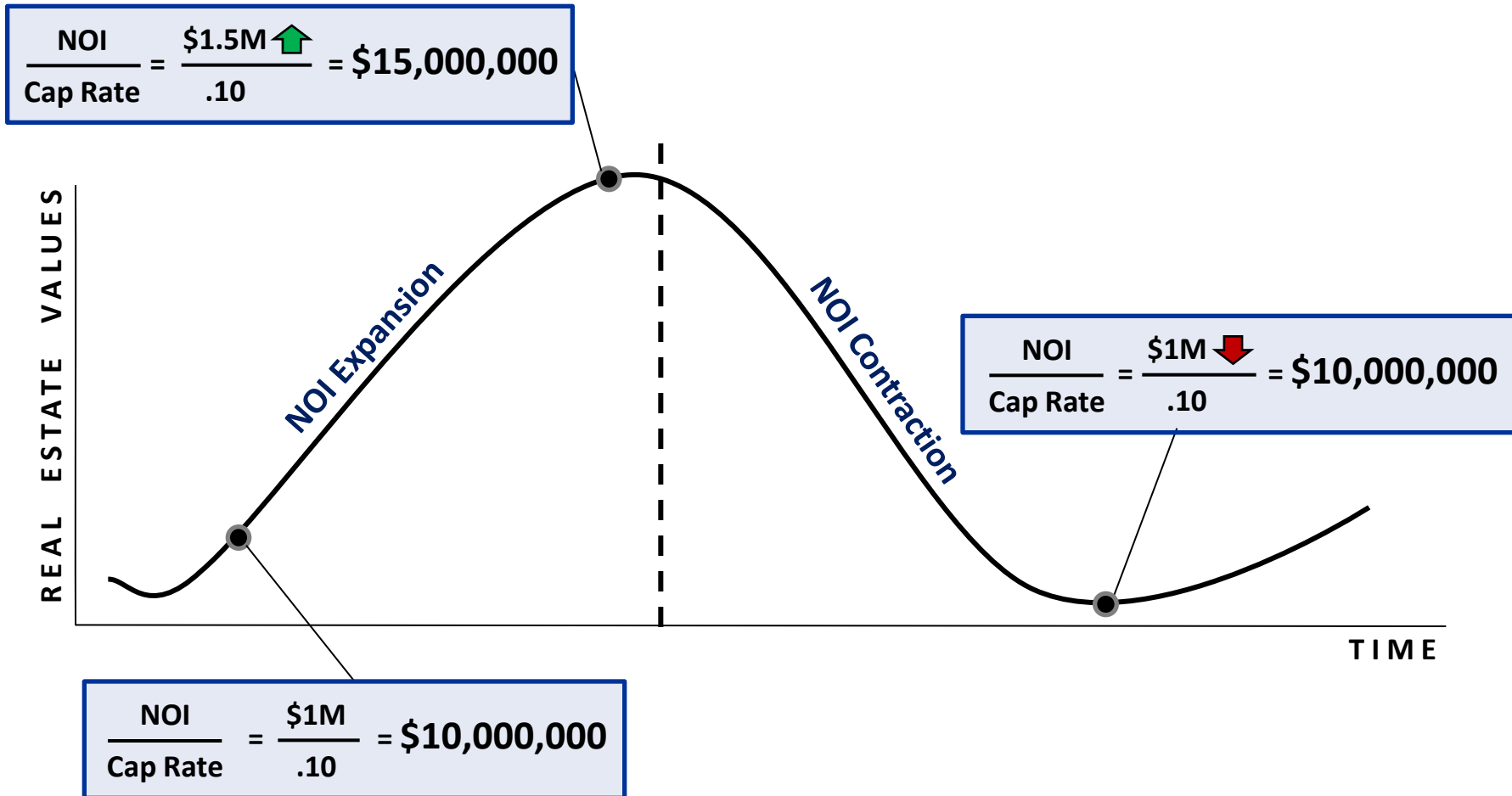
— 10-Year Treasury Rate

Source: Marcus & Millichap Research Services, CoStar Group, Inc., RCA

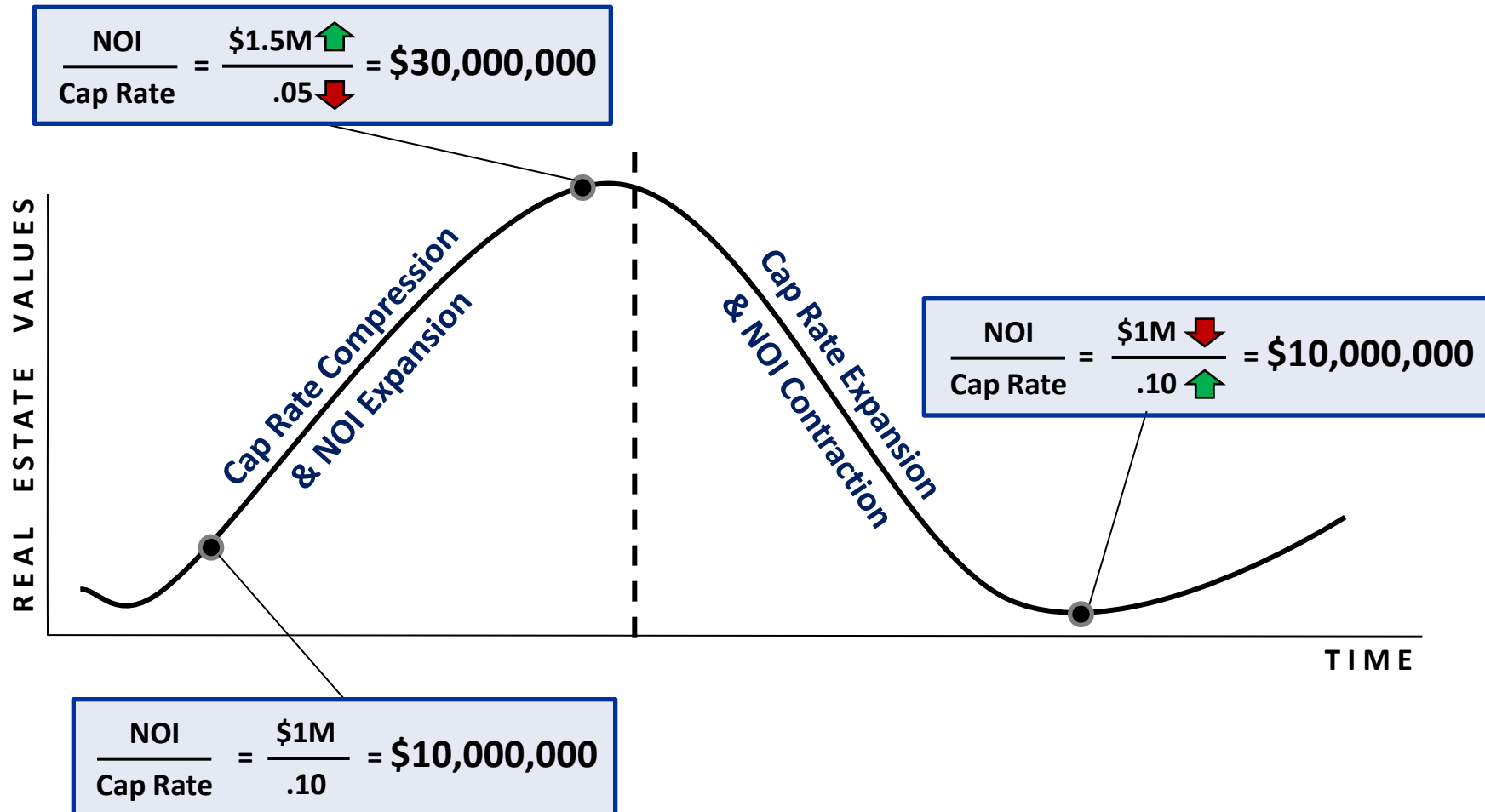
Scenario 1: Cap Rate Movement, NOI Static



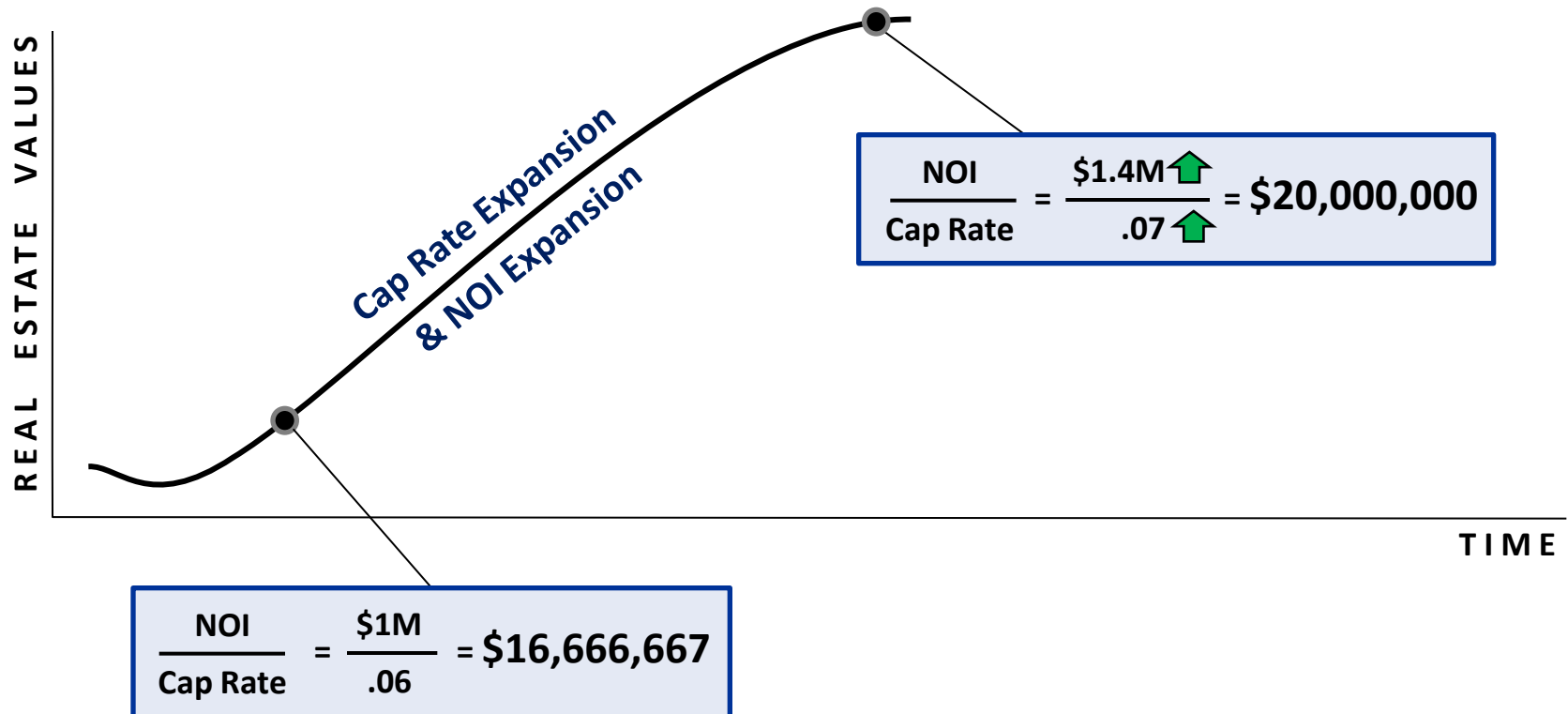
Scenario 2: NOI Movement, Cap Rates Static



Scenario 3: Cap Rate & NOI Movement



Scenario 4: Cap Rate & NOI Expansion



Net Operating Income (NOI)

What determines NOI?

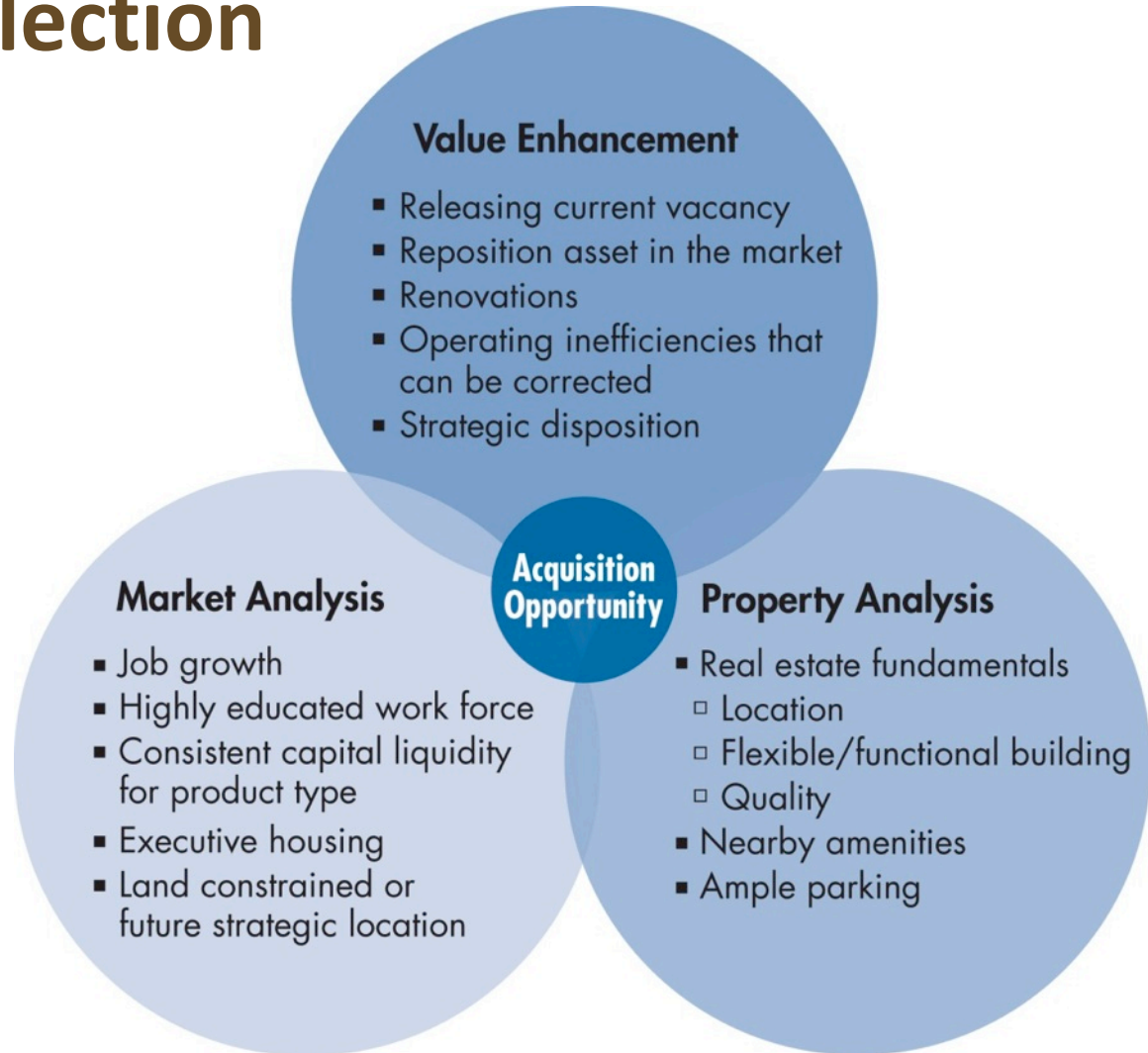
NOI can be managed through:

- 1. Property Selection**
- 2. Asset Management**



INTERNAL FACTORS

Property Selection



Lease Durations Vary by Property Type:

Multi-family, Retail, Office, Industrial



Long-Term Leases — May offer downside protection with lower tenant turnover and more predictable income, but limited ability to raise rent and increase NOI

Short to Medium-Term Leases

**Enable landlords to respond quickly to tenant demand,
economic growth and inflation**



MULTI-FAMILY RESIDENTIAL / APARTMENTS

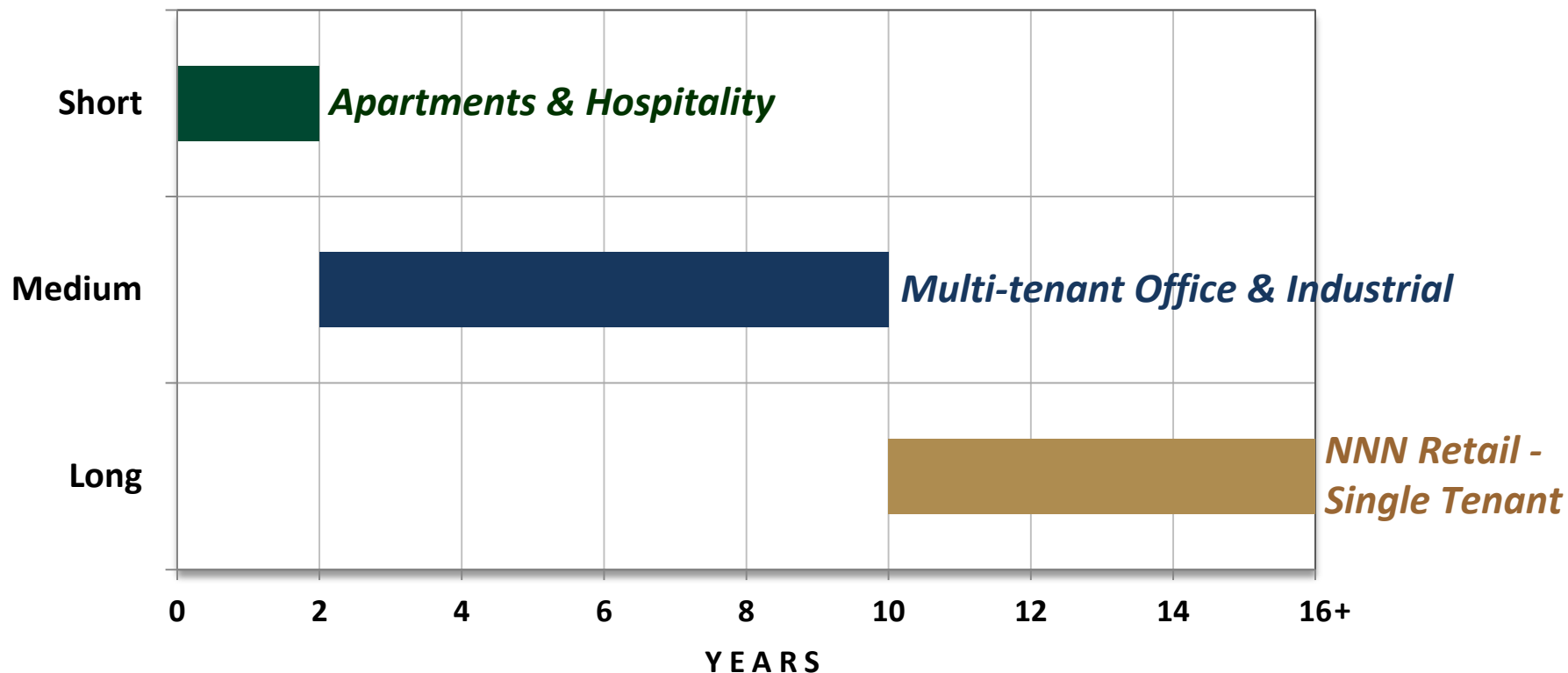
- High occupancy → Stable revenue
- Today: Unprecedented demand, and
- Historically low supply



MULTI-TENANT OFFICE

- Quality tenants → Steady income
- Class-A core assets → Value retention
- Opportunity for growth

Diversify Lease Durations



Diversifying lease durations can help reduce risk and potentially maximize NOI in a portfolio of properties*

**Diversification does not ensure a profit or protection against a loss in a declining market.*

For Broker Dealer Use Only

Active Asset Management

Picking a manager with expertise and experience to:



Increase Occupancy (%)



Increase price per square foot



Reduce operating costs

Active Asset Management: KBS Case Study

TOWN CENTER
OFFICE PARK



90.5%
LEASED*

*As of October 2012, includes
in process leases of 2.98%

\$28.54

KBS AVERAGE
PSF RENTAL RATE*
*5-months since sale

78.8%
LEASED*

*As of December 2011

\$23.72

PAST OWNER
PSF AVERAGE
RENTAL RATE*
*Year prior to sale

The **PROPERTY**

- Three buildings, 523,000 square feet
- Adjacent to premier entertainment retail center in Dallas metro
- Previous owner lost key tenants and failed to capitalize on the property's prime location

The **PLAN**

- Improved quality and tenant experience. Upgraded landscaping, music and custom scents
- Added shuttle service, improved signage and renovated lobbies



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In Summary

Understanding Commercial Real Estate Values

- **Cap Rates**
- **Managing NOI through...**
 - ✓ Property Selection
 - ✓ Active Asset Management

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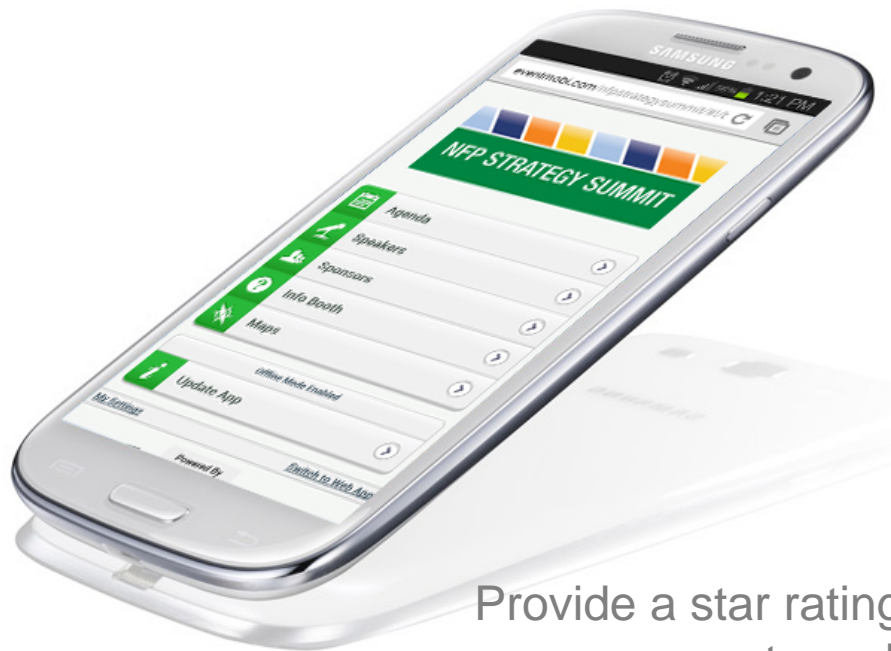
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