Market Analysis for Commercial Investment Real Estate

9

Case Study 1: Office Properties

In This Module

CCIM

Case Study 1: Office Properties

Case Study Goal

The goal of the office case study is to apply the CCIM Strategic Analysis Model to analyze an existing office market to locate the most suitable submarket area and then to select the property that best meets the specific needs of a client seeking a new office facility.

Case Study Objectives

- Analyze the current phase of the Dallas office market cycle, the Economic Base Multiplier (EBM) for the Dallas metropolitan area, and the results of the Shift-Share Analysis.

- Use STDB thematic mapping to conduct a smart map search and locate the census tract which contains the highest concentration of the targeted employee demographic criteria.

- Determine which office submarket the selected census tract is located.

- Determine the current total office inventory, total vacant inventory, space under construction, and the stabilized vacancy rate for the selected office submarket.

- Conduct an analysis of the current market vacancy and absorption rates and perform an office gap analysis to determine estimated changes to the future market conditions over the next 12-months.

- Conduct a competitive analysis to determine which available property best matches the targeted building selection criteria.

- Calculate the estimated average annual effective rent over the recommended lease term for the selected property.

Case Study 1: Office Properties

Client Background

Your client, Horizon Finance, is a growing financial services company located in Dallas, Texas. Their current lease is expiring soon and they have outgrown their current facilities. They have hired your real estate services firm to assist them with their future facility needs. They need to relocate into a suitable office space and will to commit to a new 5-year lease term, but they are willing to consider a longer lease term if the market conditions warrant.

Client Situation

Horizon has outgrown their existing office space and their current lease is expiring within the next 12-months. Horizon wants to be established in a new office prior to their lease expiration and your objective is to locate a submarket area and property that best matches their targeted criteria.

Demographic Criteria

The ideal office submarket area will have the highest concentration of demographics that match Horizon's ideal new hires that consist of:

- 25 to 34-year olds

- Who earn between $50 to $75K per year

- With a bachelor's degree or higher education level

- That work in the finance & insurance industries

Building Criteria

Within the selected office submarket area, the ideal office property will be a higher-quality, efficient multi-tenant office property that consists of the following characteristics:

- 30,000 RSF of contiguous office space

- Minimum parking ratio of 4.0 per 1000 RSF

- Class "A" quality

- Built since 2000

- Favorable highway access & visibility

- Five-minute walking distance to multiple restaurant options

- Efficient building design and lower overall occupancy costs are an important consideration

Lease Criteria

Upon selecting the best office building option, Horizon has given you the following parameters to negotiate a new office lease:

- Minimum 5-year lease term with options to extend, however, Horizon will consider up to a 10-year lease term with early termination options if forecasted market conditions indicate this is the best strategy

- Starting base rental rate, annual rental rate escalations, and any free rent concessions based upon current market competitive conditions

- Free parking

- Base year operating expense stop based upon current market expenses

- Assume that operating expenses will escalate at 2.5% annually, and such increases above the expense stop will pass through to Horizon

- All tenant improvement costs and moving expenses are to be paid by the prospective new Landlord

Scope of Analysis

The primary strategy for determining the most suitable office space for Horizon Finance is to first locate the specific census tract that contains the highest number of their targeted employee demographics. Then, select the available office property that best matches their facility needs.

You will present your recommendation to the client based upon the cumulative results of the CCIM Strategic Analysis process.

Location and Site Analysis

Task 9-1: Market Cycle, Economic Base Analysis, and Shift-Share Analysis

Objective

Analyze the current phase of the Dallas office market cycle, the Economic Base Multiplier (EBM) for the Dallas metropolitan area, and the results of the Shift-Share Analysis.

Rationale

The collective information will be used to determine current market cycle positioning; basic employment sectors; future employment growth forecasts; and employment sector competitive advantages.

Resources

Refer to the prior analysis conducted for the Dallas market area in Case Study

Steps

1. Determine the current phase of the Dallas office market cycle and how this would impact leasing strategy.

2. Calculate the EBM for the Dallas area. This information will be used later in Task 9-5 to conduct the office gap analysis.

3. Determine if the finance and insurance employment sectors have consistently had a positive regional shift over the past:

    ◘ 5 years
    ◘ 10 years
    ◘ 20 years

Note Your Findings

1. In what office market cycle is Dallas currently in?

    As of 3ʳᵈ quarter 2019 the DFW office market was in the Phase 2 –

    Expansion phase of the market cycle (source: Cycle Monitor Report)

2. What is the current EBM for the Collin County, TX?
    (This information will be used in Task 9-5)
    As of year-end 2018 the EBM is 6.48 (source: ESRI Shift-Share app)

3. Have the finance and insurance employment sectors consistently had a positive regional shift over the past:
    ◘ 5 years
        Yes (10.508 positive regional shift from 2013-2018) for NAICS sector 52
    ◘ 10 years
        Yes (12,646 positive regional shift from 2008-2018) for NAICS sector 52
    ◘ 20 years
        Yes (28,852 positive regional shift from 1998-2018) for NOICS sector 52

4. What do the shift-share results indicate about the competitive advantage for creating finance and insurance jobs in the Dallas area over time?
    As of year-end 2018, Dallas has exhibited a consistently strong competitive advantage in creating finance and insurance jobs.

5. How does the 10-year employment growth rate in DFW compare to the overall U.S.?
    As of the 4ᵗʰ quarter of 2019, the average 10-year employment growth rate in the Dallas metro area has grown at twice the rate of the overall US (2.8% for Dallas versus 1.4% for the US)

End of task

Task 9-2: Smart Map Search

Objective

Use STDB thematic mapping to conduct a smart map search and locate the census tract which contains the highest concentration of the targeted employee demographic criteria.

Rationale

The STDB smart map search tool provides for a sophisticated method of searching for multiple demographic variables to find the most desirable location(s).

Resources

STDB website https://www.stdb.com/

Steps

1. Link to the STDB website https://www.stdb.com/.

2. After log-in, open Business Analyst to load map and then zoom into the Dallas/Fort Worth metropolitan area (Census Tract zoom level).

3. Next click "Create Maps" / "Smart Map Search" / "Get Started" / "Create a Custom Variable" / "Advanced Options".

4. You are now ready to assemble the client's demographic criteria by dragging the variables to the selection area as follows:

    ◪ "Income" / "Income by Age" / "Household Income $50,000-$74,999 and Householder Age 25-34"
    ◪ "Education / Bachelor's Degree"
    ◪ "Jobs" / "Industry" / "Finance/Insurance"

5. After selecting "Add" and then "Next", move the left slider filter tool until only one census tract appears on the map.

Note Your Findings

1. Which census tract has the highest concentration of combined demographics that match Horizon's ideal new hires?

   As of December 2019, the highest concentration of combined demographics is Census Tract 480850314.05
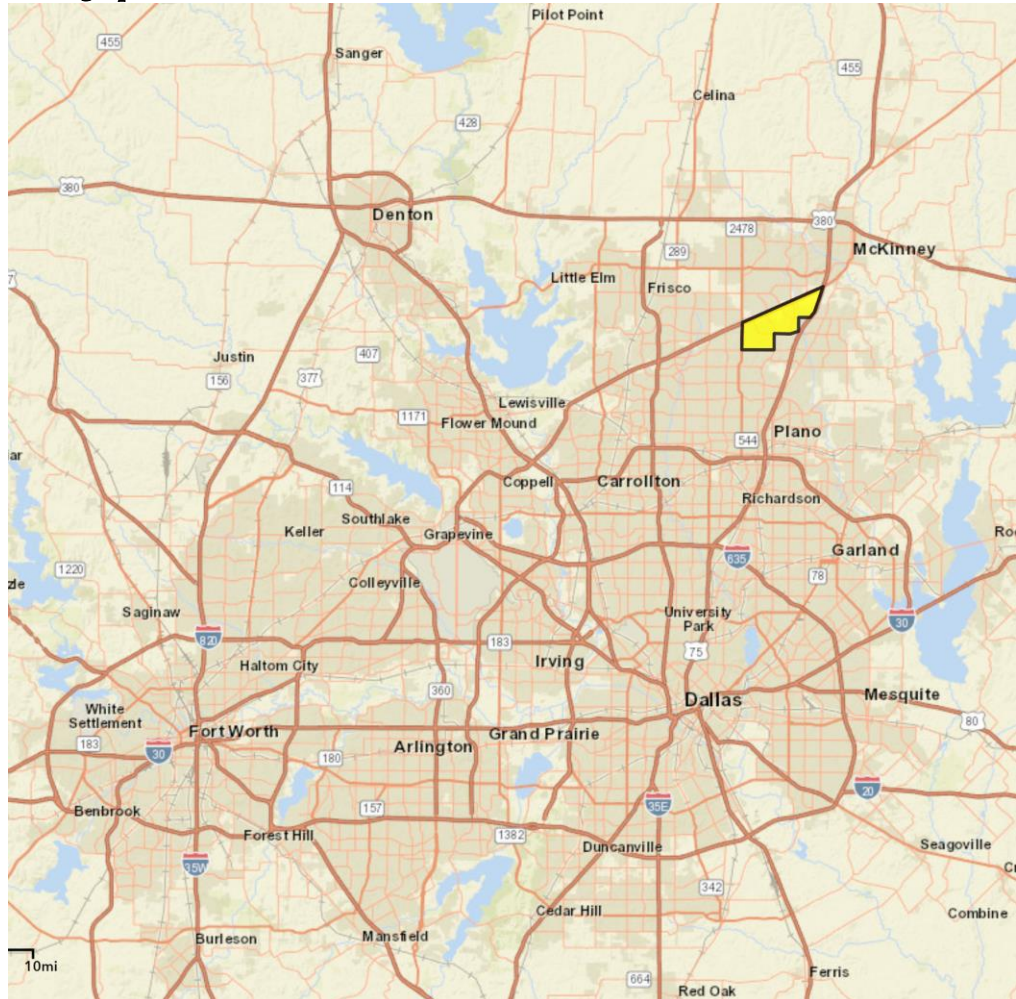
End of task

Task 9-3: Office Submarket Location

Objective

Determine which office submarket the selected census tract from Task 9-2 is located.

Rationale

After conducting the smart map search we need to determine which office submarket the targeted census tract is located in and to obtain office demand data

Resources

- STDB website https://www.stdb.com/

Steps

1. Using the Smart Map Search conducted in Task 9-2, determine the submarket area by clicking "Add Data" / "Web Maps and Layers" / "ArcGIS" / search for "REIS Dallas Office Submarkets" / select "Add".
2. Using the Clear Map tool on the right-hand side of the screen, select "Smart map search results", and click "Clear".
3. Click inside the selected submarket map and select "Reports" and then use the dropdown menu to select:
   ◘ "Business Summary" (in Excel) / "Run Report" / "Open Report"
   ◘ "Executive Summary" (in Excel) / "Run Report" / "Open Report"
4. Once downloaded, save the worksheets on your computer for later use in Task 9-5.

Note your findings

1. Which office submarket contains the census tract with the highest concentration of combined demographics from Task 9-2?

   As of December 2019, the targeted Census Tract is located within the Plano/Allen submarket as defined by REIS.

_____
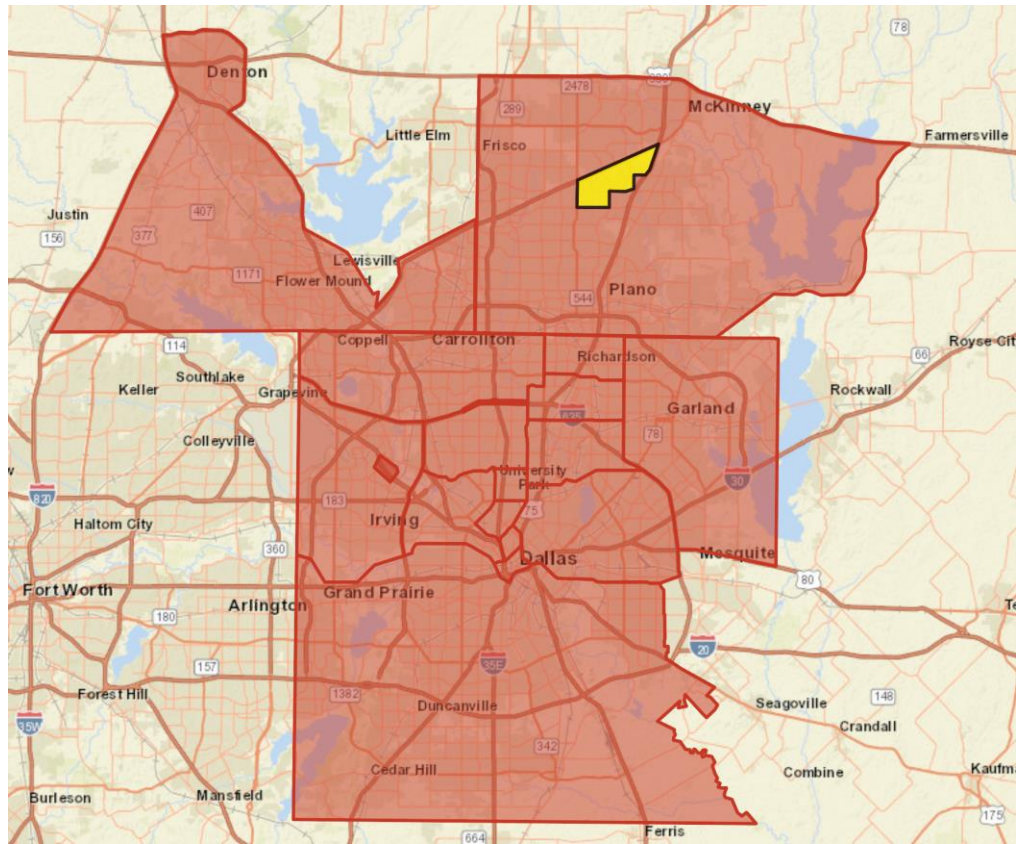
2. On the Business Summary worksheet by NAICS code (Page 2, Line 93), how many total employees work in the targeted submarket in the Finance & Insurance sector?

   As of December 2019, there are 20,793 employees working in the Finance & Insurance sector

End of task

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Task 9-4: REIS Submarket Analysis

Objective

Determine the current total office inventory, total vacant inventory, space under construction, and the stabilized vacancy rate using REIS data.

Rationale

The office submarket supply data will be used later in Task 9-5 to conduct the office gap analysis.

Resources

REIS Submarket Trend Futures report

Steps

1. Determine the current total "Inventory SF/Units" and current total "Vacant Stock" from the Submarket Trend Futures Report – Submarket Trend Data table.

2. Determine the 2-year forecasted "Completions" from the Submarket Trend Futures Report – Submarket Forecast Data table.

3. Determine the stabilized vacancy rate range by observing changes in the direction of "Asking Rent" and the corresponding "Vacancy Rate" from the Submarket Trend Futures Report – Submarket Trend Data table.

Note your findings

1. What is the current total office inventory?

   As of the 3rd quarter 2019, the current office inventory is 31,031,000 SF (Section 7 of the REIS Submarket Trend Futures report).

2. What is the total vacant inventory?

   As of the 3rd quarter of 2019, the total vacant stock is 7,137,000 SF (Section 7 of the REIS Submarket Trend Futures report).

4. What is the space under construction?

   As of the 3rd quarter of 2019, the total space under construction for 2020 delivery is 864,000 SF (Section 8 of the REIS Submarket Trend Futures report).

5. What is the stabilized vacancy?

   As of the 3rd quarter of 2019, there were no prior decreases noted in the asking rent changes but the smallest quarterly gain was 0.2% during the

2019Q2 period, where the vacancy rate was 22.8%. (Section 8 of the REIS Submarket Trend Futures Report).

End of task

Task 9-5: CCIM Office Gap Analysis

Objective

Conduct an analysis of the current market vacancy and absorption rates and perform an office gap analysis to determine estimated changes to the future market conditions over the next 12-months.

Rationale

The office gap analysis is used to analyze current market conditions and to forecast changes in demand and supply that impact absorption rates, vacancy rates and rental rate trends.

Resources

- CCIM Office Gap Analysis worksheet
- Worksheets from Task 9-3

Steps

1. Using the Office Gap Analysis worksheet input tab, fill in the data for the targeted office submarket as follows:

    ◘   Line 9: Current Total Supply (RSF) from task 9-4, step 1.
    ◘   Line 10: Current Overall Vacant Supply (RSF) from task 9-4, step 1.
    ◘   Line 11: New Supply in Construction Pipeline (RSF) from task 9-4, step 2.
    ◘   Line 12: Stabilized Vacancy Rate % from task 9-4, step 3.
    ◘   Line 16: Economic Base Multiplier from task 9-1, step 2.

2. In the Business Summary tab, copy and paste the entire Business Summary worksheet from Task 9-3.

3. In the Executive Summary tab, copy and paste the entire Executive Summary worksheet from Task 9-3.

Note Your Findings

1. What is the current occupancy rate (Gap Analysis Tab – Line 11)

   As of December 2019, the current occupancy rate is 77%

2. What is the forecast occupancy rate? (Gap Analysis Tab – Line 19)

   As of December 2019, the 12-month forecast occupancy rate is 76.8%

3. What is the forecast annual absorption rate (Gap Analysis Tab – Line 23)

   As of December 2019, the forecast annual absorption rate is 600,975 RSF

4. What is the forecast stabilization date? (Gap Analysis Tab – Line - 25)

   As of December 2019, the forecast stabilization date is March, 2021

5. Based upon your analysis of this submarket, what is the anticipated rental rate growth over the foreseeable future and how does this impact the recommended lease terms for Horizon?

   As of December 2018, the anticipated rental rate increases are expected to be moderate as new supply is expected to outpace new demand in the short run. If this trend continues, it could be best for Horizon to seek a shorter lease term in anticipation of moderate future rental rate growth over the foreseeable future

   End of task

Task 9-6: Property Match

Objective

Conduct a competitive analysis to determine which available property best matches the targeted building selection criteria.

Rationale

Select the most suitable property based upon the client's building selection criteria.

Resources

- CCIM Competitive Analysis worksheet
- REIS Rent Comps report
- Other online property search data

Steps

1. Weight the location criteria variables in the CCIM Competitive Analysis worksheet ("Location Analysis" tab, column C).

2. Weight the building criteria variables in the CCIM Competitive Analysis worksheet ("Building Analysis" tab, column C).

3. Using data from the REIS Submarket Rent Comps report and other online search data, score each of the comparable properties listed in the REIS Rent Comps report.

4. Select the property with the highest combined analysis rating in the CCIM Competitive analysis worksheet ("Summary Analysis" tab).

Note your findings

1. What property has the highest analysis rating?
   Student answers will vary

2. What additional resources did you use to make the recommended office property for Horizon?

   Student answers will vary

End of task

Financial Analysis

Task 9-7: Occupancy Cost Analysis Objective

Objective

Calculate the estimated average annual effective rent over the recommended lease term for the selected property.

Rationale

Horizon needs to budget their expected occupancy costs for the new office location.

Resources

- CCIM Lease Financial Analysis worksheet
- REIS Rent Comps report

Steps

1. Using the Lease Financial Analysis worksheet (Lease Input tab), fill in the data for the targeted lease criteria as follows:

   ◘ Line 1: Lease Term = 5-years, however, Horizon will consider up to a 10-year lease term with early termination options if forecasted market conditions indicate this is the best strategy.

   ◘ Line 2: Rentable Square Feet = 30,000.

   ◘ Line 3: Base Rent per SF (current asking rent listed at the top of the recommended REIS Rent Comps property summary).

   ◘ Line 5: Base Rent Concession (Number of Months) = REIS Rent Comps report Effective Rent Paid by Tenant, Free Rent (Months/Lease).

   ◘ Line 7: Real Estate Taxes/SF = REIS Rent Comps report.

   ◘ Line 8: Real Estate Tax Stop/SF = same amount as Line 7.

(continued next page)

◘ Line 9: Operating Expenses/SF = REIS Rent Comps report.

◘ Line 10: Operating Expense Stop/SF = same amount as Line 9.

◘ Line 20: Base Rent Escalation = REIS Rent Comps report. Year Asking Rent Growth Rate Percentage for Comp Group.

◘ Line 22: Real Estate Tax Escalation = 2.5 percent.

◘ Line 24: Operating Expenses Escalation = 2.5 percent.

2. Calculate the "Before Tax Average Annual Effective Rent" (Line 26 of the Lease Financial Analysis worksheet (Occupancy Cost tab).

Note your findings

1. What lease term was used in the analysis (Lease Financial Analysis worksheet Lease Input tab Line 1)?

As of December 2019, used a 5-year lease term

2. What is the Average Annual Effective Rent amount (Lease Financial Analysis worksheet Lease Input tab Line 26)?

As of December 2019, used an annual effective rental rate of $29.50/SF (Source: Section 4 of REIS Rent Comps report)

End of task

Task 9-8: Client Recommendation

Objective

Aggregate your analyses findings into a brief presentation for your client demonstrating your recommendations.

1. What office submarket best meets your client's demographic criteria? How did you make this determination?

   As of December 2019, the Plano/Allen office submarket contained the census tract with the highest concentration of targeted Horizon demographic employee base.

2. Which property best matches your client's building criteria? What information did you use to make this recommendation?

   Student answers will vary.

3. What is your client's estimated average annual effective rent for the selected property?

   As of December 2019, the average annual effective rent equals $936,678 (Source: Line 26 of the Lease Financial Analysis – Occupancy Cost Tab)

4. What additional lease terms and negotiating strategy would you recommend to your client before entering into a lease for the selected property?

   Student answers will vary.

End of task