

Manchester Law Office Valuation

Edward Sapp

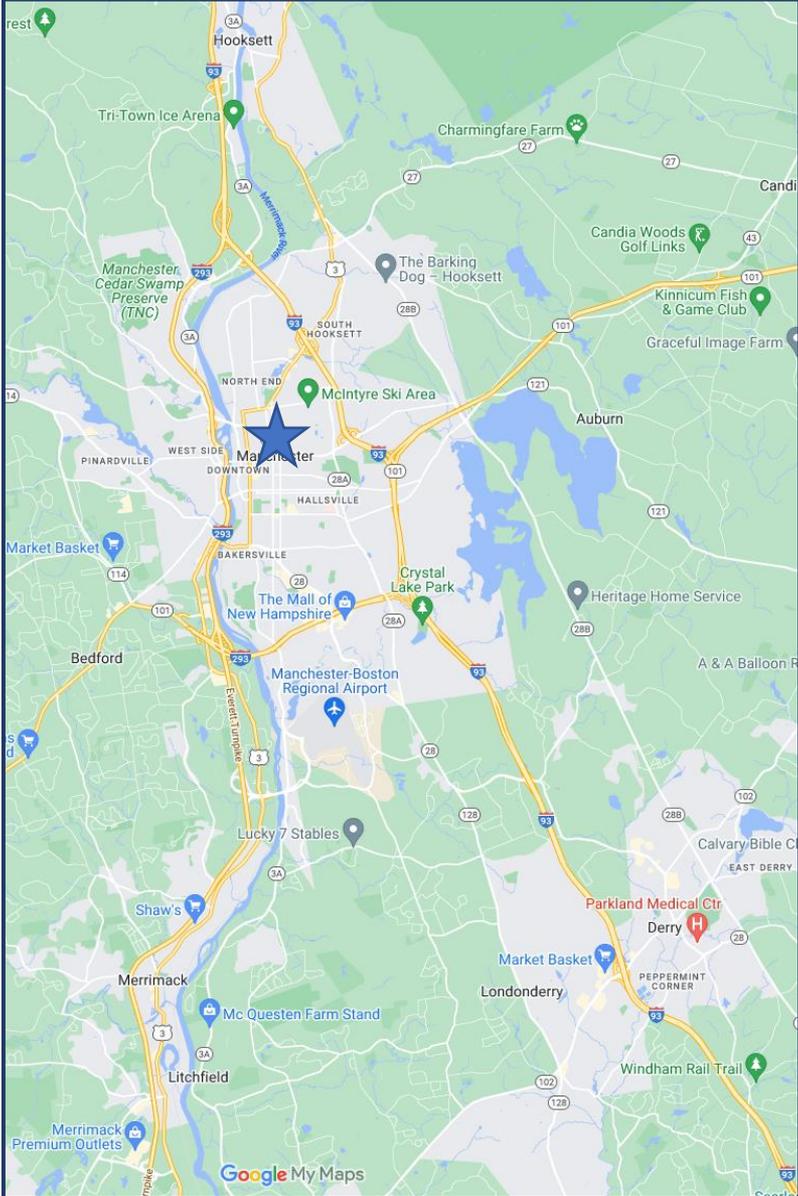
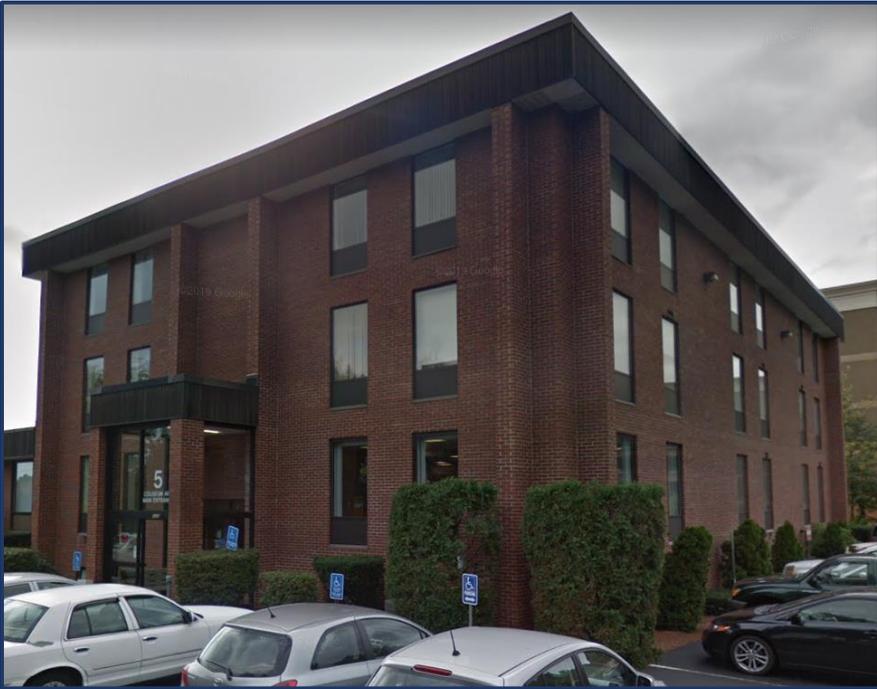
April 27th, 2023

Executive Summary

- 5 Consortium Ave (“the Property”) is a 62.9k SF Law Office Building in Manchester, NH
- The building currently has three owners (the “Seller”), two of which are retired from the group, and one is soon to retire
- The five practicing lawyers (the “Practicing Group”) and two of the Sellers (together, the “Buyer” or “Buyers”) contemplate completely buying out one of the three Sellers and partially liquidating down the other two so there would eventually be seven equal owners (14.3% each)
- The Practicing Group, Manchester Law Group, currently rents the space and represents the largest footprint at 46.9k SF, or 74.5% of the 62.9k SF building. The other tenants also represent legal uses, barring SRN Realty which occupies 752 SF or 1.2% of the building
- Manchester Law Group engaged Edward Sapp on April 25th, 2023 to determine the following:

| Question | Response |
|---|---|
| Whether the \$17.0M asking price is reasonable | <ul style="list-style-type: none">• \$17.0M ask (5.0% going-in cap rate) is tight vs. 8.5% market cap rate, reflecting an inflated valuation. Further, would return 2.2% over 10-year hold period, significantly below market rate of return• \$13.2M offer would achieve client’s 5.75% hurdle rate of return• \$9.5M invested today into a relatively safe 5.75% investment account would cover rent for next 10 years |
| Determine potential ways to value the building in the future for when new lawyers enter/leave the Buyer group and come in and out of the LLC which owns the real estate | Short answer would be to refresh the Excel file provided in this analysis on a rolling basis. The stickiest part is always going to be to agree on a cap rate. In situations where parties need to agree, typically you each bring an appraisal and meet in the middle on cap rate and projections. |
| How to execute the purchase in a tax-efficient manner | Will ultimately need to contract a qualified tax advisor or accountant, tax can be a very localized beast. That said, I have outlined some high-level tax strategies on P9: 1031 Exchange, Installment Sales, Opportunity Zones. |

Asset Map and Images



Transaction Summary

| Owner | Ownership % | | | Total Basis (Purchase Price + Fees) | | |
|-------------------|---------------|----------|---------------|-------------------------------------|---------------|---------------------|
| | Pre-Trx | Trx | Post-Trx | Pre-Trx | Trx | Post-Trx |
| Seller A (Kim) | 26.7% | (26.7%) | — | \$4,601,333 | (\$4,601,333) | — |
| Seller B (Walker) | 36.7% | (22.4%) | 14.3% | 6,326,833 | (3,861,833) | 2,465,000 |
| Seller C (Davis) | 36.7% | (22.4%) | 14.3% | 6,326,833 | (3,861,833) | 2,465,000 |
| Buyer D | — | 14.3% | 14.3% | — | 2,465,000 | 2,465,000 |
| Buyer E | — | 14.3% | 14.3% | — | 2,465,000 | 2,465,000 |
| Buyer F | — | 14.3% | 14.3% | — | 2,465,000 | 2,465,000 |
| Buyer G | — | 14.3% | 14.3% | — | 2,465,000 | 2,465,000 |
| Buyer H | — | 14.3% | 14.3% | — | 2,465,000 | 2,465,000 |
| Total | 100.0% | — | 100.0% | \$17,255,000 | — | \$17,255,000 |

| Valuation | Entry | Exit |
|---|--------------|--------------|
| Value Summary | Entry | Exit |
| Value | \$17,000,000 | \$11,808,269 |
| NTM NOI | 855,261 | 1,003,703 |
| Cap Rate | 5.03% | 8.50% |
| Transaction Costs | Entry | Exit |
| Transaction Cost % | 1.50% | 1.50% |
| Transaction Cost \$ | \$255,000 | \$177,124 |
| Timing | | |
| Hold Period (yrs) | 10 | |
| Exit Cap Rate Comps & Exit Cap Rate for Analysis | | |
| CBRE Boston Suburban Office Class A Value Add Cap Rate | 6.75% | |
| NAR Boston-Cambridge Office Market Cap Rate (Class A) | 7.00% | |
| SPGlobal Median Office REIT Cap Rate | 9.50% | |
| Live Exit Cap Rate (Class B Suburban) | 8.50% | |

| Sources & Uses | \$ | % |
|------------------------|---------------------|---------------|
| Sources | | |
| Buyer D-H Cash | \$12,325,000 | 71.4% |
| Seller B Rolled Equity | 2,465,000 | 14.3% |
| Seller C Rolled Equity | 2,465,000 | 14.3% |
| Total Sources | \$17,255,000 | 100.0% |
| Uses | | |
| Purchase Building | \$17,000,000 | 98.5% |
| Entry Costs | 255,000 | 1.5% |
| Total Uses | \$17,255,000 | 100.0% |
| Returns | | |
| UIRR | | 2.18% |
| UMoC | | 1.19x |

Note: Model assumes building purchased at end of 2023, free-and-clear.

Valuation Sensitivity

Sensitivity Table - UIRR / MoC

| | | Exit Value / Exit Cap | | | | | | | | |
|----------------------------|--------------------------|-----------------------|-----------------------|-----------------------|-----------------------|-----------------------|-----------------------|-----------------------|-----------------------|-----------------------|
| | | \$10,565,294 9.50% | \$11,152,255 9.00% | \$11,808,269 8.50% | \$12,546,286 8.00% | \$13,382,705 7.50% | \$14,338,613 7.00% | \$15,441,583 6.50% | \$16,728,382 6.00% | \$18,249,144 5.50% |
| Entry Cap / Purchase Price | 5.0% \$17,000,000 | 1.4% / 1.1x | 1.8% / 1.2x | 2.2% / 1.2x | 2.6% / 1.2x | 3.1% / 1.3x | 3.6% / 1.3x | 4.1% / 1.4x | 4.8% / 1.5x | 5.4% / 1.6x |
| | 5.3% 16,000,000 | 2.2% / 1.2x | 2.6% / 1.2x | 3.0% / 1.3x | 3.4% / 1.3x | 3.9% / 1.4x | 4.4% / 1.4x | 4.9% / 1.5x | 5.5% / 1.6x | 6.2% / 1.7x |
| | 5.7% 15,000,000 | 3.1% / 1.3x | 3.4% / 1.3x | 3.8% / 1.3x | 4.3% / 1.4x | 4.7% / 1.4x | 5.2% / 1.5x | 5.8% / 1.6x | 6.4% / 1.7x | 7.1% / 1.8x |
| | 6.1% 14,000,000 | 4.0% / 1.4x | 4.4% / 1.4x | 4.8% / 1.4x | 5.2% / 1.5x | 5.6% / 1.6x | 6.2% / 1.6x | 6.7% / 1.7x | 7.3% / 1.8x | 8.0% / 1.9x |
| | 6.6% 13,000,000 | 5.0% / 1.5x | 5.4% / 1.5x | 5.8% / 1.6x | 6.2% / 1.6x | 6.7% / 1.7x | 7.2% / 1.7x | 7.7% / 1.8x | 8.4% / 1.9x | 9.0% / 2.0x |
| | 7.1% 12,000,000 | 6.1% / 1.6x | 6.5% / 1.6x | 6.9% / 1.7x | 7.3% / 1.7x | 7.8% / 1.8x | 8.3% / 1.9x | 8.9% / 2.0x | 9.5% / 2.1x | 10.2% / 2.2x |
| | 7.8% 11,000,000 | 7.4% / 1.7x | 7.8% / 1.8x | 8.2% / 1.8x | 8.6% / 1.9x | 9.1% / 2.0x | 9.6% / 2.1x | 10.1% / 2.2x | 10.7% / 2.3x | 11.4% / 2.4x |
| | 8.6% 10,000,000 | 8.8% / 1.9x | 9.2% / 2.0x | 9.6% / 2.0x | 10.0% / 2.1x | 10.5% / 2.2x | 11.0% / 2.3x | 11.5% / 2.4x | 12.2% / 2.5x | 12.8% / 2.6x |
| | 9.5% 9,000,000 | 10.5% / 2.1x | 10.8% / 2.2x | 11.2% / 2.2x | 11.6% / 2.3x | 12.1% / 2.4x | 12.6% / 2.5x | 13.2% / 2.6x | 13.8% / 2.8x | 14.5% / 2.9x |
| | 10.7% 8,000,000 | 12.4% / 2.4x | 12.7% / 2.4x | 13.1% / 2.5x | 13.5% / 2.6x | 14.0% / 2.7x | 14.5% / 2.8x | 15.0% / 3.0x | 15.7% / 3.1x | 16.3% / 3.3x |

Rent vs. Buy Analysis

The least capital-intensive solution would be to continue renting. You could invest \$9.5M into a low-risk investment fund yielding 5.75%, from which you could pay your rent annually.

- Alternatively, you could purchase the property for \$13.2M (inclusive of purchase costs) and expect a similar return on investment (5.75% annually over 10 years).
- The \$13.2M assumes any deferred maintenance capital identified by 3rd party reports (PCA, Seismic, Environmental, etc.) is funded out of the \$13.2M gross purchase price. I highly recommend this stipulation given what appears to be limited historical capital improvement spend on the property.
- The \$17.0M asking price (\$17.3M including additional purchase cost estimates) would yield a significantly below-market return (2.18%), far beneath the rate you should expect from a high-yield savings account or government bonds.

| Cash Flows | Historical | | Projections | | | | | | | | | | |
|---|--------------|------|-----------------------|--------------------|--------------------|--------------------|--------------------|--------------------|--------------------|--------------------|--------------------|--------------------|---------------------|
| | 2021 | 2022 | 2023 | 2024 | 2025 | 2026 | 2027 | 2028 | 2029 | 2030 | 2031 | 2032 | 2033 |
| Projected Rent | Own % | | | | | | | | | | | | |
| Manchester - 1st Floor Litigation | 100.0% | | \$460,346 | \$469,571 | \$478,963 | \$488,551 | \$498,322 | \$508,288 | \$518,454 | \$528,823 | \$539,399 | \$550,187 | |
| Manchester - 1st Floor Contracts | 100.0% | | 40,366 | 41,175 | 41,999 | 42,839 | 43,696 | 44,570 | 45,461 | 46,371 | 47,298 | 48,244 | |
| Manchester - 1st Floor Corporate Law | 100.0% | | 94,474 | 96,367 | 98,295 | 100,262 | 102,267 | 104,313 | 106,399 | 108,527 | 110,698 | 112,912 | |
| Manchester - Intellectual Property (2nd Floor) | 100.0% | | 115,564 | 117,879 | 120,237 | 122,644 | 125,097 | 127,599 | 130,151 | 132,754 | 135,409 | 138,117 | |
| Manchester - Employment Law (2nd Floor) | 100.0% | | 81,066 | 82,691 | 84,345 | 86,033 | 87,754 | 89,509 | 91,299 | 93,125 | 94,987 | 96,887 | |
| Manchester - Litigation Support (LL) | 100.0% | | 55,235 | 56,341 | 57,468 | 58,619 | 59,791 | 60,987 | 62,207 | 63,451 | 64,720 | 66,014 | |
| Manchester - Research (LL) | 100.0% | | 28,887 | 29,466 | 30,056 | 30,657 | 31,270 | 31,896 | 32,534 | 33,184 | 33,848 | 34,525 | |
| Manchester - Family Law (LL) | 100.0% | | 38,359 | 39,127 | 39,910 | 40,709 | 41,523 | 42,353 | 43,200 | 44,064 | 44,946 | 45,845 | |
| Manchester - Administrative (LL) | 100.0% | | 171,731 | 175,172 | 178,676 | 182,253 | 185,898 | 189,616 | 193,408 | 197,276 | 201,222 | 205,246 | |
| Surgery Partners - Auditorium | 40.0% | | 68,032 | 69,396 | 70,784 | 72,201 | 73,645 | 75,117 | 76,620 | 78,152 | 79,715 | 81,310 | |
| Surgery Partners - Storage Lower Level | 40.0% | | 5,270 | 5,376 | 5,483 | 5,593 | 5,705 | 5,819 | 5,935 | 6,054 | 6,175 | 6,299 | |
| Surgery Partners - Suite 207 2nd floor (Reception Area) | 40.0% | | 11,637 | 11,869 | 12,107 | 12,349 | 12,596 | 12,848 | 13,105 | 13,367 | 13,634 | 13,907 | |
| Value of Renting - 10 Year Cash Flow | | | (\$9,463,585) | \$1,170,967 | \$1,194,432 | \$1,218,320 | \$1,242,709 | \$1,267,563 | \$1,292,914 | \$1,318,772 | \$1,345,148 | \$1,372,051 | \$1,399,492 |
| <i>Rent Growth %</i> | | | | | 2.0% | 2.0% | 2.0% | 2.0% | 2.0% | 2.0% | 2.0% | 2.0% | 2.0% |
| Discount Rate / Return | | | | | 5.75% | | | | | | | | |
| NPV over 10 years | | | | | \$9,463,585 | | | | | | | | |
| Demonstration - Pay for Rent out of Investment Account | | | | | | | | | | | | | |
| Begin Balance | | | \$9,463,585 | \$9,463,585 | \$8,836,775 | \$8,150,458 | \$7,400,789 | \$6,583,626 | \$5,694,621 | \$4,729,148 | \$3,682,302 | \$2,548,886 | \$1,323,396 |
| Returns | | | - | 544,156 | 508,115 | 468,651 | 425,545 | 378,558 | 327,441 | 271,926 | 211,732 | 146,561 | 76,095 |
| Pay Rent | | | - | (1,170,967) | (1,194,432) | (1,218,320) | (1,242,709) | (1,267,563) | (1,292,914) | (1,318,772) | (1,345,148) | (1,372,051) | (1,399,492) |
| Ending Balance | | | \$9,463,585 | \$8,836,775 | \$8,150,458 | \$7,400,789 | \$6,583,626 | \$5,694,621 | \$4,729,148 | \$3,682,302 | \$2,548,886 | \$1,323,396 | - |
| Offer Price at "Fair Value" - 10 Year Cash Flows | | | (\$13,217,918) | \$812,498 | \$850,756 | \$861,979 | \$873,285 | \$884,620 | \$896,005 | \$907,435 | \$918,907 | \$930,414 | \$12,573,099 |
| Discount Rate / Return | | | | | 5.75% | | | | | | | | |
| NPV over 10 years | | | | | \$13,217,918 | | | | | | | | |
| Ask Price at \$8.5M - 10 Year Cash Flows | | | (\$17,255,000) | \$812,498 | \$850,756 | \$861,979 | \$873,285 | \$884,620 | \$896,005 | \$907,435 | \$918,907 | \$930,414 | \$12,573,099 |
| Discount Rate / Return | | | | | 2.18% | | | | | | | | |
| NPV over 10 years | | | | | \$17,255,000 | | | | | | | | |

1. For comparability, the rent scenario assumes you rent for the next 10 years. The purchase scenarios both assume you purchase, hold, then sell after 10 years.

Appendix

High-Level Tax Strategies

Tax strategies are highly localized. I would suggest you explore strategies with a qualified tax advisor or accountant. That said, here are the most popular options that you will likely explore:

- 1. 1031 Exchange:** Also known as a like-kind exchange, a 1031 exchange allows you to defer capital gains taxes by reinvesting the proceeds from the sale of one property into the purchase of a similar, or “like-kind,” property within a specific time frame. Can also invest in funds if you don’t want the headache of managing a property. There are strict rules and deadlines to follow, so it’s crucial to work with a qualified intermediary and a tax advisor familiar with 1031 exchanges.
- 2. Installment Sales / Seller Financing:** If Seller is willing to finance the Buyer’s purchase, they can use an installment sale to spread out their capital gains tax liability over several years. The client would receive payments over time, with each payment being partially taxed as capital gains.
- 3. Opportunity Zones:** Believe this property is not located in an OZ, but these allow Seller to reinvest proceeds into a Qualified Opportunity Fund within 180 days of sale to defer capital gains.

Further Diligence Questions

1. How many renewal options does each tenant have? What are the terms of the renewal options?
2. Are there any major deferred capital items? Noting capex was zero in 2022 per the Cash Flow Statement.
3. Are there any major outstanding payables that the buyer would assume? TAs, LCs, Accounts Payable, etc.?
4. Are there any vacant units not shown on the January 1 rent roll, or is the building completely occupied?
5. What was the nature of the \$71,547 capital expense in 2021?
6. Is seller able to provide a Cash Flow statement for 2020? Trying to get a sense for steady-state capex
7. Are you able to provide budgeted expenses for 2023-2024?
8. Generally, what drove the 30.5% increase in expenses in 2022?
9. Cleaning Purchased Time: \$48.6k -> \$85.2k. Also, what is the nature of this expense?
10. What is the nature of admin purchased time? It seems to fluctuate from negative to positive
11. What was the 2021 legal expense associated with?
12. Why did property tax drop significantly in 2021?
13. What is the difference between "Taxes" and "Property Taxes"? Why has it been increasing so significantly in recent years?
14. Have you identified any backfill tenants to replace Sightline Law Group, PLLC? If so, are you able to share how far along the discussions are and any preliminary figures around Rent PSF, TIs, LCs, etc. to fill the space?
15. Has SRN Realty indicated any intent to vacate their space? Do you intend to increase their rent during your hold period?
16. How does the Seller currently manage the property? Are any third-party leasing brokers, property managers, etc. involved?
17. Does the annual increase of 2% or CPI for each tenant have a cap?
18. Which 2021 expense account in the income statement includes the \$2,221.86 of "Other Liabilities" that I see backed out in the 2021 Cash Flow Statement? Same question in 2022.

Suggested Next Steps

1. Run through this presentation as a group, explain key financial concepts driving the analysis
2. Review and potentially refine the assumptions driving the valuation model
3. Follow-up on diligence questions
4. Comparable sales analysis
5. Rental comps analysis