A HISTORY OF SHOPPING CENTERS

Shopping centers have existed in some form for more than 1,000 years as ancient market squares, bazaars and seaport commercial districts. The modern shopping center, which includes everything from small suburban strip centers to the million-square-foot super regional mall had its genesis in the 1920s.

1920s

The concept of developing a shopping district away from a downtown is generally attributed to J. C. Nichols of Kansas City, Mo. His Country Club Plaza, which opened in 1922, was constructed as the business district for a large-scale residential development. It featured unified architecture, paved and lighted parking lots, and was managed and operated as a single unit.

In the latter half of the 1920s, small strip centers were built on the outskirts of large cities. The centers were usually anchored by a supermarket and a drugstore, supplemented by other convenience-type shops. The typical design was a straight line of stores with space for parking in front, such as the

Grandview Avenue Shopping Center in Columbus, Ohio, which opened in 1928 and included 30 shops and parking for 400 cars.

Many consider Highland Park Shopping Village in Dallas, Texas, developed by Hugh Prather in 1931, to be the first planned shopping center. Its stores were built with a unified image and managed under the control of a single owner. Highland Park occupied a single site and was not bisected by public streets. And, its storefronts faced inward, away from the streets—a revolutionary design.

1930s-1940s

In the 1930s and 1940s, Sears Roebuck & Co. and Montgomery Ward set up large freestanding stores, with on-site parking, away from the centers of big cities.

1950s

The early 1950s marked the opening of the first two shopping centers anchored by full-line branches of downtown department stores. Northgate in Seattle,

Wash., (two strip centers face-to-face with a pedestrian walkway in between) opened in 1950, and Shoppers World in Framingham, Mass. (the first two- level center), debuted the following year. The concept was improved upon in 1954 when Northland Center in Detroit, Mich., used a "cluster layout" with a single department store at the center and a ring of stores around it. In 1956, Southdale Center in Edina, Minn., outside of Minneapolis, opened as the first fully enclosed mall with a two-level design. It had central air-conditioning and heating, a comfortable common area and, more importantly, it had two competing department stores as anchors. Southdale is considered by most industry professionals to be the first modern regional mall.

1960s

By 1964 there were 7,600 shopping centers in the United States. Most of the centers built in the 1950s and 1960s were strip centers serving new housing developments.

1970s

By 1972 the number of shopping centers had doubled to 13,174. During the 1970s, a number of new formats and shopping center types evolved.

In 1976 The Rouse Co. developed Faneuil Hall Marketplace in Boston, Mass., which was the first of the "festival marketplaces" built in the United States. The project, which revived a troubled downtown market, was centered on food and retail specialty items. Similar projects were built in Baltimore, New York City, and Miami, and have been emulated in a number of urban areas.

The bicentennial year also marked the debut of the country's first urban vertical mall, Water Tower Place, which opened on Michigan Avenue in Chicago. To many experts, Water Tower Place with its stores, hotel, offices, condominiums and parking garage, remains the preeminent mixed-use project in the United States.

1980s

The 1980s saw an unparalleled period of growth in the shopping center industry, with more than 16,000 centers built between 1980 and 1990. This was also the period when super-regional centers became increasingly popular with shoppers.

Between 1989 and 1993, new shopping center development dropped nearly 70 percent, from 1,510 construction starts in 1989 to 451 starts in 1993. The sharp decline in new center starts was attributed to the savings and loan crisis, which helped precipitate a severe credit crunch.

1990s

Factory outlet centers were one of the fastest-growing segments of the shopping center industry in the 1990s. In 1990, there were 183 outlet centers. Today, there are more than 225 outlet centers in the United States.

By 1992, the prevailing trend in the shopping center industry had become the remodeling and expansion of existing projects. In 1992, these renovations outstripped new construction, with 571 additions and alterations reported.

One of the retail formats that became increasingly popular in the 1990s was the power center. Power centers are often located near regional and superregional malls. San Francisco–based Terranomics is credited with pioneering the concept

at 280 Metro Center in Colma, Calif.

In 1995, with the construction of the Mall of America in Bloomington, Minn., entertainment quickly became an industry buzzword as technological advances allowed shopping center developments to foster the same magical experiences that were once only seen in national amusement parks such as Disney World. The Mall of America, currently one of the largest malls in the U.S., includes a seven-acre amusement park, nightclubs, and restaurants, and covers 4.2 million square feet (with about half that total devoted to retailing).

Since the start of the entertainment wave, retailers have focused on keeping their presentations exciting, and shopping center owners have striven to obtain tenant mixes that draw traffic from the widest audience possible. Under one roof or in an outdoor retail format, consumers enjoy children's playscapes, virtual reality games, live shows, movies in multiplex cinemas, a variety of food in either the food court or theme restaurants, carousel rides, visually stunning merchandising techniques, robotic animal displays, and interactive demonstrations.

Many shopping centers are also focused on added service- oriented tenants, which offer today's busy consumer an opportunity to complete weekly errands or to engage in a variety of other activities. Among the many services found in today's malls are churches, schools, postal branches, municipal offices, libraries, and museums.

2000-2012

Many hurdles were faced during this decade, which shook up the shopping center industry and ultimately created a "new normal." The economic downfall hit during the end of this decade and had a strong impact on the way future business would be conducted. By 2010 there was an all- time high of 112,384 shopping centers in the United States. Due to the downturn in the economy, sales took a hit and shopping center development saw little to no activity during the latter half of the decade. Signs of improvement have been surfacing and a new era of the shopping center industry is starting to occur. Instead of building new centers, owners are redeveloping the centers they already have, making them more appealing and driving consumers back into malls.

Green initiatives have made their way into the retail real estate industry. Developers and mall owners have taken steps to create sustainable centers by implementing "greener" methods into everyday practices. From the land that the centers are built on to the materials used when remodeling or building a new center, to putting energy-saving solar panels on roofs, green methods can be found in many of today's shopping centers. In this process of going "green," a favorable situation has occurred: malls are now more eco-friendly while operating more cost efficiently for the owners. Sustainability is a trend that will likely stick around for the coming years.

Although this decade had its moments of ups and downs, the shopping center industry proved its strength.

Did You Know?

• California has the most shopping centers—15,160. Wyoming has the least with 74.

• At year end 2013 there are 1,511 enclosed malls in the U.S.

• The average enclosed mall contains 875,187 sq. ft. of total floor space.

• There are 398 lifestyle centers operating in the U.S.

• In 2013, shopping center- inclined sales accounted for $2.5 trillion.

• Shopping center- inclined sales generated $137.2billion in state sales tax revenue in 2012.

• Shopping center-related employment totaled 12.5 million jobs in 2013.

• Supermarkets are the most common anchor in open-air centers.

• Apparel and accessories stores account for 57.8% of all non-anchor mall space.

• The last enclosed mall that was built was in 2011—City Creek Center in Salt Lake City, Utah.

• Wal-Mart was the highest grossing retailer in 2012, earning $468 billion in

sales.

This Section gives the student the opportunity to review and present a loan submission package on a Shopping Center

First, several concerns all lenders must address when reviewing a Shopping Center loan request are addressed. The shopping center in this example is a small center, often called a "Strip Center". This type of Shopping Center was chosen for a Case Study because of the large number of loan requests on this type of Income Property. Then a sample Executive Loan Summary is provided as a guideline for the student.

A Narrative Case Study is presented, providing all the information necessary to complete a loan request in the form of an Executive Loan Summary. The Executive Loan Summary requires the student to make a loan recommendation based on the analysis of the information provided. The student must also project a "Best Case" and "Worse Case" cash flow analysis, including interest rates for the next year.

When reviewing a loan request on any Shopping Center, there are several important lender concerns. Among them: vacancy, tenants, and terms of the leases, location and class of building and the determined values of the appraisal.

Just as in Office Building loan requests, there is concern among lenders about high vacancy rates in retail shopping centers. Because of lender and builder enthusiasm there is a great deal of overbuilding in most areas of Shopping Centers, especially smaller retail shopping centers.

Most building owners project a 5% Vacancy and Collection loss, which in many commercial real estate markets is often unrealistic. A lender must determine the actual Vacancy Rates for buildings of this type and use this figure to analyze the potential cash flow. Again it is important to point out the need for all credit professionals to know the current vacancy rates of all commercial real estate in the areas in; which they are lending.

In some areas of the country where there is overbuilding in all types of Income Property, vacancy rates as high as 15-20% are common among less established Strip Centers. When presenting loan requests on this type of Income Property, it is important to give
Best Case" and "Worse Case" projections. This gives a more accurate cash flow analysis to the lender, taking several different projections into consideration.

Tenants: The type and credit rating of the tenant is extremely important in analyzing the commercial loan request on any shopping center. Tenants may be National, Regional or local in nature. National and Regional tenants are considered the "Anchor Tenants, drawing customers who also use the other services available in the center. Leases with these Anchor Tenants are considered very stable and add to the strength of the loan request. Depending on cash flow,

Conventional lenders will loan up to 75% on Shopping Centers with major Anchor Tenants.

Most tenants in the smaller neighborhood Shopping Centers are usually local in nature, with an occasional owner/operator of a regional or national franchise. For many tenants this may be their first business and there is little credit background or history to take into consideration when evaluating their lease. The lender may find it difficult to evaluate the continued viability of these types of tenants and their likelihood of a continued presence in the shopping center.

The unknown stability plus the high turnover of tenants in smaller shopping centers, causes lenders considering this type of loan request to advance less than 80% loan to value.

Terms of the Lease: When reviewing all Income Property loan requests, the terms and conditions of the leases must be thoroughly reviewed. Oftentimes a summary of all tenants and lease terms are included in loan requests. However the credit professional is responsible for reviewing each lease in detail. Just as in Office Complexes, Shopping Center leases have similar provisions. Besides rental concessions and expensive tenant improvements, retail leases have other unique provisions.

The most common lease in shopping centers is the Triple Net Lease, often abbreviated NNN. The terms and conditions of this type of lease require the tenant to pay a proportionate share in all the expenses for the maintenance and upkeep of the building, excluding the management of the building. In some very desirable centers a tenant may also pay a proportionate share of the management expenses. This lease is called an Absolute Net Lease.

Another type of lease in shopping centers is the Percentage Lease. This is a lease where the owner of the building receives a basic rent, plus an agreed percentage of gross sales. These are especially prevalent in high dollar volume tenants. The owner may give a low base rent, but hope to make additional income by sharing in a percentage of the gross income.

Most smaller centers, with less established tenants usually have a form of the Triple Net lease, with the leases including provisions for an Expense Stop. In the present competitive environment among smaller shopping centers, there may also be provisions for the landlord to pay the costs of tenant improvements. These expenses are usually considered in the costs of the startup operation of the center. However with high turnover of tenants, large amounts of tenant improvements can greatly affect the continuing cash flow of the building.

In the previous Section of the Workbook there was a detailed discussion of the impact of rental concessions on the cash flow of the building. Rent concessions greatly affect the actual cash flow from the leases, and the overall cash flow of the center. This is a special concern for lenders considering a Shopping Center loan request in a competitive real estate market. Rent concessions may not be readily apparent to the lender and only a thorough review of the terms and conditions of the leases will disclose rent concessions.

Location and Class of Building: The success or failure of any retail shopping center is dependent on its location and convenience to the shopping public. Its traffic is greatly affected by the presence of an Anchor Tenant. Just as in Office Buildings, Shopping Centers are rated by size, overall square footage and type of Anchor Tenant. Shopping Centers are classified as

Regional where there are one or more nationally known Anchor Tenants, drawing customers from a very large radius.

A Neighborhood Shopping Center is exactly as the name indicates, drawing from the neighborhoods and immediate area around the Center. It may have a nationally known Anchor Tenant, or one or more local or regional Anchors. A W is a function of convenience, with no major Anchor tenants to draw shoppers. This type of center depends mostly on its location and nearness to neighborhood population. The Strip Shopping Center has the highest turnover of tenants in all the types of Shopping Centers.

The Appraisal concerns the lender has when reviewing an appraisal for a Shopping Center. Some of the specific lender concerns about an MAI Appraisal on a Shopping Center are:

Neighborhood Analysis: The appraisal should thoroughly document the population, demographics and economic trends of the area in which the shopping center is located. The economic trends in the neighborhoods surrounding the shopping center are an important consideration in determining not only the value of the center, but also its future success. The lender reviews this portion of the appraisal to see if the center is located in an area of growth and rising income. Not only must the age and architecture be compatible with the neighborhood, but the tenant mix and services offered at the center must fit the needs of the neighborhood.

Another important concern for the lender when reviewing neighborhood data is the number of competitive shopping centers in the immediate area. Several similar shopping centers in the area offering the same services means the lender must determine if there is adequate population to support the number of centers in the area.

Site and Improvements: Critical factors in the success of any shopping center are convenience, attractiveness and tenant mix. The lender must review the description of the site and improvement to see if the site is near major, well-traveled intersections. The center must have easy access and adequate parking for the shopping public. The building must be clean and well maintained in order to attract shoppers. A good tenant mix is important to attract a broad cross section of shoppers to the center.

Gross and Net Operating Income Figures: The lender must review the source of the numbers the appraiser uses when calculating the Gross and Net Operating Income. Are the calculations based on Actual Operating statements or is the center new, with no operating history? If Projected Income and Expenses are used rather than Actual figures, the lender must determine if these figures are realistic in relation to the present real estate market. In reviewing the figures used to calculate Gross Income, the lender must look closely to see if there is any consideration or discussion of rental concessions and how the concessions affect the cash flow of the property.

Vacancy Factors: An important consideration when reviewing the appraisal is what Vacancy Factor does the appraiser use when calculating income? The lender must review the figures the Appraiser uses to see if they are reflective of current market conditions.

Overall Capitalization Rate: The lender must look closely at both the Capitalization Rate and Gross Income Multiplier the appraiser uses to determine value. It is the lender's responsibility to

check with several different sources to see if these very important figures are realistic in today's commercial real estate market.

Lease Summary: The appraisal should contain a Lease Summary and an Addenda containing copies of all the leases. These should be reviewed for any rental concessions or "giveaways" which will affect the cash flow of the property.

SUMMARY: Included in the next part of this Section is a sample Executive Loan Summary for a Shopping Center loan request. This gives the student an idea of how a Loan Request of this type is presented. In this presentation all the aspects of the credit are presented in a concise summary, easily understood by the lender.

This sample loan summary is followed by a Narrative Case Study, presenting all the information necessary for a student to present an Executive Loan Summary. A blank loan summary is Included at the end of this Section which the student can complete, with the opportunity to recommend a loan amount, terms and payments, and list the positive and negative aspects of the credit, with a summary and final recommendations.

EXECUTIVE SUMMARY
PROJECT NAME AND ADDRESS:
Shoppers Mall
#1, No. 2nd. St.
Cove. OR 94070

BORROWER/GUARANTOR:
Lawrence U. Bartley
321 No. Garnet
Echo. OR 97400
(503)555-5555
Cash and Liquid Assets: $290,000
Net Worth (Unaudited) as of 12/2014: $9,000,000

TYPE OF PROPERTY:
Shoppers Mall is an 18,000 Sq. Ft. retail shopping center located at the corner of 2nd. St. and Main St. in Cove, Oregon. The property was built by the present owner in
2001. There are 7 retail stores, with 100 parking spaces. The property is located on 100,000 Sq. Ft of land.

LOAN AMOUNT: $1,500,000

LOAN TO VALUE: 77% LTV, based on an MAI Appraisal completed/ 2014 for $1,950,000.
RATE: 10.0% Fixed rate

TERM: 30 year amortization, with a 5 year due date.

No pre payment penalty.

PAYMENTS: $13,163 Monthly, $157,962 Annual payment amount.

Balloon payment of $1,448,614

POINTS AND FEES: $30,000 Lender Points (2%)
$10,000 Estimated closing costs and fees

PURPOSE OF THE LOAN: Pay off bank loan due in 1/88. Plus tenant improvements to the building and parking lot, and equity recovery.

Proceeds of the Loan

$910,000 Echo Bank and Trust
1445 E. Echo Lane
Echo, Oregon 94441
(503)555-5555 C. Homer, V. P.

$100,000 Building improvements, new cooling/heating system, repave parking lot, landscaping and new signage.

$450,000 To Mr. Bartley, for investment in new center

30,000 Lender Points (2%)

$ 10,000 Closing Costs

$1,500,000 Total Loan Amount

VALUATION: Available to the lender is the MAI Appraisal dated 11/2014 for $1,950,000. The appraiser from Tedder and Associates, is on our lender approved list. The appraiser's credentials show lengthy experience in retail shopping center appraisals. The valuations are well documented and reflect the current market conditions. The summary of values:

Cost Approach: $1,900,000

Land: $650,000 ($6.50 Sq. Ft.) 3 Comparables

Building: $1, 250,000 ($70.00 Sq. Ft.) Marshall & Swift, plus comparables.

Market Approach: $1,950,000
Six comparables are used to determine the value. Most weight is given two sales of similar buildings to the subject. Sale date is 6/2014 and 9/2014, similar square footage, type and age of subject property.

Income Analysis: $1,950,000

Appraiser calculates an NOI of $195,000 and uses an Overall

Capitalization Rate of 10%.

CASH FLOW ANALYSIS: The project reached full occupancy in

6/2012 and maintained 100% occupancy since then. All leases are Triple Net leases, with each tenant paying a proportionate share of all expenses, excluding management fees.

The financial information available to the lender includes 3 years of Actual Income and Expense Statements. A recap of two years statements show:

	2012 ACTUAL	2013 ACTUAL
GROSSINCOME:	$223,300	$218,500
Expenses		
Miscellaneous Costs:	$ 7,800	$ 7,800
Management(5%):	$ 11,250	$ 11,000
Replacement Reserves (2%):	$ 4,500	$ 4,500
TOTAL EXPENSES:	$ 23,550	$ 23,300
NET OPERATING INCOME:	$198,750	$195,200
MONTHLY NOI:	$ 16,562	$ 16,266
LOAN PAYMENT:	$ 13,163	$ 13,163
D. S. C. RATIO:	1.26/1.0	1.24/1.0

Expenses not passed through to tenants.

The 18,000 Sq. Ft. building is presently 100% occupied, and is anchored on two ends with a 5,000 Sq. Ft. Bub's Cafeteria (Regional Anchor). The other regional anchor tenant is Import Stereo-TN. City with 5,000 Sq. Ft. Both tenants have long term leases and draw heavy customer traffic for other retailers. For this reason the center always has a very high occupancy.

CASH FLOW ANALYSIS: BEST CASE/WORSE CASE PROJECTIONS

	BEST CASE	WORSE CASE
INCOME:		
Gross Potential Income:	$234,000	$234,000
Vacancy & Collection:	(11,700) (5%)	(35,100) (15%)
Effective Gross Income:	$222,300	$198,900
EXPENSES:		

Miscellaneous:	$ 7,800	$ 21,800
Management:	$11,250	$10,000
Replacement Reserves:	4,500 (2%)	4,000 (2%)
TOTAL EXPENSES:	$23,550(10.5%)	$ 35,800 (18%)
NET OPERATING INCOME:	$198,750	$163,100
MONTHLY N.O.I.	$ 16,562	$ 13,591
PAYMENT AMOUNT:	$ 13,163	$ 13,163
DSC RATIO:	1.26/l.0	1.03/1.0

Best Case" Projections is identical to the present Income and
Expense of the Center. The Center is presently operating at its maximum profitability.

The "Worse Case" Projection assumes a 15% Vacancy and an increase in the Expenses of the Center. Because of the increase in Vacancy and tenant turnover, expenses increase substantially. These expenses include additional Tenant Improvements (TI's), advertisement, and building upkeep. No cost of rental concessions is included in these projections. The loan interest rate and payment is fixed for the term of the loan.

A LEASE SUMMARY OF TENANTS

Tenant: Bub's Cafeteria
Premises: Suite #1, 5,000 Sq. Ft.
Term: 5 year lease, expires 12/18, 5 year renewal option
Rate: $13.00 Sq. Ft.
Comments: In an effort to achieve high occupancy, Mr. Bartley negotiated this lease without a percentage of the gross sales of Bub's Cafeteria. The management of Bub's have expressed their intentions to renew the option when the lease expires.

Tenant: Glo's Video Store
Premises: Suite #2. 1,500 Sq. Ft.
Term: 5 year lease expires. 1/17. 1 year renewal option
Rate: $13.00 Sq. Ft.
Tenant: Samantha's
Specialty Shop

Premises: Suite #3, 1,500 Sq. Ft.
Term: 3 year lease, expires 1/17 3 year renewal option
Rate: $13.00 Sq. Ft.

Tenant: Pure Health Foods
Premises: Suite #4, 2,000 Sq. Ft.
Term: 5 year lease, expires 2/18, 5 year renewal option
Rate: $13.00 Sq. Ft.

Tenant: Pat's Fresh Baked Pastries
Premises: Suite #5, 1,500 Sq. Ft.
Term: 3 year lease, expires 11/18, 1 year renewal option
Rate: $13.00 Sq. Ft.

Tenant: Anne's Animal Boutique
Premises: Suite #6. 1,500 Sq. Ft.
Term: 3 year lease expires 2/16, 5- 3 year renewal options
Rate: $13.00 Sq. Ft.

Tenant: Import Stereo City
Premises: Suite #7, 5,000 Sq. Ft.
Term: 5 year lease, expires 1/16. 5 year renewal option
Rate: $13.00 Sq. Ft.
Comments: According to Mr. Bartley the management is in the process of reviewing the renewal option on this lease.

POSITIVE ASPECTS:

1. The shopping center is 100% occupied in an excellent location with two major local anchor tenants

2. The building is well maintained and planned improvements will add to the value of the center.

3. Mr. Bartley is an experienced owner and manager with excellent credit and large net worth.

NEGATIVE ASPECTS:

1. If Import T.V./Stereo City fails to renegotiate their lease. It would seriously jeopardize the future cash flow of the building.

2. Mr. Bartley has indicated he is preparing to sell this center in the near future. If the loan is paid off early there is no provision for prepayment penalties.

SUMMARY/RECOMMENDATIONS:

Mr. Bartley specializes in the building, managing and selling of small strip shopping centers. His strategy is to get major anchor tenants by offering favorable lease terms at no percentage of gross income. The borrower prefers offering terms to keep his centers
100% occupied, making them desirable to buyers because of their cash flow and occupancy levels.

Using the "Worse Case" Projections for cash flow shows the Center can still service the debt. Because of the experience of the owner, the Centers high occupancy rate, adequate Debt Service Coverage and acceptable Loan to Value Ratio, this credit is recommended.

Before funding this request Import Stereo City must renew their lease with the Center for a minimum of 3 years. A review and acceptance of all the terms and conditions of the lease by the lender will be part of the requirements before funding.

The lease with Samantha's Specialty Shop expires this month and a requirement for funding is the signing of this lease for a minimum term of 2 full years. A review and acceptance of all the terms and conditions of the lease must be completed by the lender before funding.

COMMENTS ON THIS EXECUTIVE LOAN SUMMARY AND

LOAN REQUEST:

What additional information would you like to see about the two Anchor tenants?

Do you think there should be lender controls on the use of funds for the improvements to the Center?

Should there be any controls on the large amount of Equity Recovery to the borrower?

Do you feel there are any additional requirements necessary to approve or fund the loan?

Would you approve this loan request as submitted, or would you recommend changes in the loan amount or terms?

CASE STUDY

MOUNTAIN HEIGHTS CENTER

Mr. Mesa is referred to your lending institution by one of your present clients. The income property Mr. Mesa owns in partnership with a Mr. Chandler is a 21,000 Sq. Ft. retail shopping center called Mountain Heights Center. It is located at 111 South Mountain Heights Rd. Payson, Colorado, 68766. Mountain Heights Center was built in 2004, by Mr. Mesa and Mr. Chandler in a 50/50 partnership venture. The property has 10 retail shops, with Peter's Pizza Parlor, a regional franchise, as the largest tenant (5,000 Sq. Ft.). Mr. Mesa is seeking to borrow the maximum loan amount your company lends on this type of property.

The property is located in the rapidly growing area of Mountain Heights. The center occupies the corner of Mountain Heights and lst Street, with high visibility from both well-traveled streets. There are 3 main entrances to the center, 2 on Mountain Heights Rd. and 1 on lst Street. There is a 4th entrance from a side street leading to a neighborhood of apartments and residences.

A MAI Appraisal is brought in by Mr. Mesa showing a value of $2,000,000 dated 11/2014. The appraisal is by A & B Appraisal, a lender approved appraisal firm. A summary of value shows

the 21,000 Sq. Ft. center is located on 110,000 Sq. Ft. with 110 parking spaces. The property is zoned C-2 and is compatible with the neighborhood and future City Zoning Plans.

Using the Cost Approach to Value the appraiser determined the land value of $615,000 ($5.60 Sq. Ft.) and building at $1,386,000 ($66.00 Sq. Ft.) The appraiser used four comparable sales to determine land values. Building value is determined by use of comparable shopping centers in the region and Marshall and Swift Cost Valuation, less depreciation.

The Market Approach to value used 7 comparable sales to determine a value of $2,000,000. Two comparable sales within 2 miles of the subject are given the most weight, since both are recent sales and similar square footage.

The Income Approach to Value used an No1 of $208,000 and an
Overall Capitalization Rate of 9.5%. Indicating a Value of $2,100,000.

Mr. Mesa presents financial information on the Center for a full year. The following Financial Summary for one year indicates:

2014

ACTUAL

GROSS INCOME (92% Occupancy in '2014): $230,000
EXPENSES“:

Insurance: $ 200

Management(3.5%): $ 8,000

Reserves for Replacement (2%): $ 4,300

Bookkeeping: $ 500

Advertising: $ 6,000

Common Area: $ 1,200

Taxes: $ 1,800
TOTAL EXPENSES (9.5%): $ 22,000
NET OPERATING INCOME: $208, 000

Expenses not passed through to tenants. Since Mr. Mesa and Mr.
Chandler have a small real estate office in the center, they pay a portion of the taxes, insurance and common area maintenance.

The partners are projecting a 2015 Net Operating Income higher than '2014's. They claim the 8% Vacancy can be reduced to nearly zero next year. You look briefly at the projections

presented by Mr. Mesa. However you know the credit committee will question using a 5% or less vacancy factor in any projections.

The proceeds of the loan are designated to pay off First Liberty Savings, #11 Downtown Blvd, Payson, Colorado, 67676 (203)559- 9999. The balance is $902,000 for a 25 year loan at 11%, due on 6 2015. The payments are $9,400 monthly on an original loan of $950,000, taken out in 6/2010.

The remaining funds are for payments to two investors who each loaned $100,000 to the Partnership for 5 years at 12% in 2010. Each investor has agreed to accept $175,000 cash for their interest. (Total settlement of $350,000.) Mr. Mesa and Mr. Chandler wish to handle the payment to the investors through a lender's attorney and escrow so all the papers are filed correctly. The borrowers wish to receive any additional available funds for setting up a new partnership to build or buy a similar center.

Later in the week you meet Mr. Chandler and Mr. Mesa at the Mountain Heights Center. The purpose is to pick up personal financial statements on each of the principals and inspect the center.

At that time you receive copies of all the leases and have an opportunity to tour the center. The visit is in the morning when customer foot traffic is low giving you an opportunity to inspect some of the shops and meet the owners and managers.

On the return to the office you drive through the neighborhood and area. The Mountain Heights area is growing rapidly and the location of the shopping center is excellent. You take time to discuss the site with a knowledgeable broker in the area who mentions the large Regional Shopping Mall planned for opening within 18 months. The planned 200,000 Sq. Ft. Center has two large National Anchor Tenants, with many small shops planned. This new mall will have an impact on the Mountain High Center, but you are uncertain how much it will change the future earnings of the Center.

The Summary of leases provided by the borrowers gives the following information on the tenants:

Suite #1. Peters Pizza Parlor; 5,000 Sq. Ft.; 5 year leases;
Expires 6/17; 5 year renewal option; $12.00 Sq. Ft.

Suite #2, Jerry's Music Store; 2,500 Sq. Ft.; 5 year lease; expires
9/18; 5 year renewal option; $12.00 Sq. Ft.

Suite #3, Victors Video Store; 2,000 Sq. Ft.; 3 year lease; expires
12/17; 3 year renewal option; $12.00 Sq. Ft.

Suite #4, Gentle Health Food; 2,000 Sq. Ft.; 5 year lease; expires
7/18, 2 year renewal option; $12.00 Sq. Ft.

Suite #5, A Good Book; 2,500 Sq. Ft.; 3 year lease; expires 6/18;
3 year renewal option; $12.00 Sq. Ft.

Suite #6, Vacant; 1,500 Sq. Ft. Available; Store was a small specialty store. When lease expired store moved to another center. Presently asking $11.75 Sq. Ft.

Suite #7, Mountain High Center Management; 1,000 Sq. Ft.
Management office occupied by Mr. Mesa and Mr. Chandler; $10.75 Sq. Ft.

Suite #8, Hairs End. 1,500 Sq. Ft.; 3 year lease; expires 6/17; 3 year renewal option; $12.00 Sq. Ft.

Suite #9, Specialty Meat Market; 1,500 Sq. Ft.; 3 year lease expires 9/18; 3 year renewal option; $11.75 Sq. Ft.

Suite #9, Eileen's Eyeglasses; 1.500 Sq. Ft.; 3 year lease, expires 1/17; 1 year renewal option; $11.75 Sq. Ft.

All the leases are triple Net Leases (NNN) with each tenant paying a proportionate share of all expenses. The leases call for annual rental increases equal to the increase in the Consumer Price Index. There is no expense Cap on any of these leases, so the tenants share in the costs of maintaining the center.

Mr. Mesa and Mr. Chandler present unaudited financial statements with a combined net worth of $12,500,000. Mr. Mesa shows a net worth of $6,000,000 with $110,000 in cash and liquid assets. Mr. Chandler shows a net worth of $6,500,000 with $100,000 in cash and liquid assets. Mr. Chandler lives at 1224 C. Street, Show Low, Colorado, 67666, phone number (203)551-1662. Mr. Mesa lives at 14 Easy Street, Show Low, Colorado, 67665, phone number (203) 555-0119. Both own their own homes and have been in all phases of commercial real estate for a combined 35 years.

The General Partnership shows a Net Worth of $6,000,000, with Cash and Liquid assets of $60,000. The Partnership was formed in 2009 by Mr. Mesa and Mr. Chandler.

Before beginning your initial loan presentation to credit committee you call First Liberty Savings and talk to Mrs. Leena, a Vice President. She verifies the payoff figures and recommends both partners.

A credit report verifies the partners' lengthy credit history. There is no derogatory information.

The lender when reviewing this credit has to determine the effect of the new regional shopping mall has on Mountain Heights Center. The new regional center could have a negative effect on the center's cash flow. Several of the tenants may consider moving to the new regional mall when their leases expire in the next year or two. It is necessary for you to do a projected cash flow for 2015 and you must determine what is a realistic vacancy and collection percentage. Also since the leases are tied to the Consumer Price Index, there will be an increase of rental income. The partners project next year's rental increase to be 4% overall with no increase in expenses.

Your company presently uses the 1 year Treasury Bill as the Interest Rate Index. Assume the rate is presently 7.5% and the spread over this rate is 300 Basis Points (3%). However it is

important to remember the 1 year T-Bill is presently moving upwards. There is no floor or ceiling on this loan and it is important to consider the effect of any increase in interest rate on the cash flow of the property.

The lending institution's guidelines are for a minimum of 1.10/l.0 DSCR. However the Credit Committee is concerned about overbuilding and increasing Vacancy in several Shopping Centers. They prefer an l.20-1.25/1.0 DSCR, but make exceptions on credits with outstanding qualities. These same guidelines apply to the Loan to Value Ratios on loan requests. The credit committee uses a guideline of 75% Loan to Value, but gives some flexibility on established income properties.

They look closely at projected income and expense. There is some concern about rising interest rates and its effect on any Income Property's Net Operating Income and ability to make the payments on the loan.

ASSIGNMENT:

Enough information is provided in this Narrative Case Study to prepare a complete Executive Loan Summary. As you prepare the presentation you may wish to consider the following questions and concerns:

What loan amount, including payments and terms will you recommend given the previous lender guidelines? What are the positive and negative aspects of this loan request?

As you complete the Cash Flow Analysis, using the borrower's Actual 87 Income and Expenses, you must also complete a "Best Case" and "Worse Case" projection for income and expense in 1988.

In the "Best Case" projections use the borrower's projected increase in income (plus a 4% increase based on the CPI) and stable expenses.

On the "Worse Case" Projections, what Vacancy and Collection percentage do you feel will cover any drastic increase in vacancies including tenants not renewing leases.

In your Summary/Recommendations discuss what you feel the effects of the new Regional Shopping Center will have on this Center. Present your arguments for consideration or rejection of the credit.

Your lending committee is flexible in requiring personal guarantees.

Will you require personal guarantees from both Partners? How will this affect the credit request?

EXECUTIVE LOAN SUMMARY

PROJECT NAME AND ADDRESS:

BORROWER/GUARANTORS:

TYPE OF PROPERTY:

LOAN AMOUNT:

LOAN TO VALUE:

RATE:

TERM:

PAYMENTS:

POINTS AND FEES:

PURPOSE OF LOAN:

Proceeds:

VALUATION:

CASH FLOW ANALYSIS:
87

ACTUAL

CASH FLOW ANALYSIS: BEST CASE AND WORSE CASE
88 88

BEST CASE WORSE CASE

COMMENTS:

POSITIVE ASPECTS:

NEGATIVE ASPECTS:

SUMMARY/RECOMMENDATIONS: