Valuation Viewpoint

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MARKET RENT AND THE RENEWAL LEASE

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Changing market conditions may have a significant impact on the lease renewal process as landlord and tenant attempt to capitalize on the lease agreement terms. Each party to the lease studies the market, including current rents, with an eye to negotiating the most favorable renewal terms.

The typical commercial lease is drafted in anticipation of a renewal term. The original lease generally includes specific language, such as "renewal rate based on current market conditions," which defines the renewal terms. It is important to recognize that the relationship between market conditions and a renewal lease is very different from the relationship between market conditions and a new lease. In an economy laced with high vacancy and low rents, landlords recognize that the tenant will seriously consider the cost of moving to a new space versus the cost of remaining in an existing space.

In order to attract new tenants in the current market, landlords are willing to make significant concessions, such as free rent, full broker-paid commissions, and elaborate tenant improvements. Knowing these concessions are available, established tenants often shop for new space in an effort to capitalize on the full menu of concessions. To

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MARKET TRENDS AND INDICATORS

Office Buildings	→	0%
Retail Centers	↑	2%
Industrial Buildings	↑	1%
Apartments	↑	5%
New Housing Starts–Midwest	↓	30%
Productivity	↓	.8%
Composite PE	↓	5.8%
US Unemployment	↓	8.3%
Consumer Confidence Index	↑	70.8

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MARKET TRENDS AND INDICATORS

ECONOMIC INDICATOR

	2005	2006	2007	2008	2009	2010	2011
New Housing Starts—Midwest Yearly Totals	357,400	279,500	211,700	137,700	97,600	99,400	69,600

P/E RATIOS IN SELECT INDUSTRIES

Industry (Year end)	2006	2007	2008	2009	2010	2011	Feb 2012
Basic Materials	13.7	14.1	15.2	21.6	27.4	19.7	14.5
Conglomerates	20.1	18.4	15.8	10.7	15.0	16.9	15.2
Consumer Goods	25.8	24.4	16.3	15.9	24.9	21.1	13.5
Financials	14.3	13.7	11.7	9.6	36.2	17.9	12.6
Healthcare	38.8	40.0	26.0	57.7	26.1	18.9	20.7
Industrial Goods	25.1	19.5	19.5	20.3	23.5	17.9	13.3
Services	25.6	28.7	24.2	20.1	26.6	27.1	20.6
Technology	26.3	38.4	23.8	16.4	45.2	20.2	16.4
Utilities	24.0	20.0	15.3	12.0	28.5	16.2	15.5
Composite	**24.4**	**24.0**	**18.7**	**20.5**	**28.2**	**19.5**	**15.8**

ECONOMIC INDICATORS

Indicator (5 yr. avg.)	2000	2005	2006	2007	2008	2009	2010	2011
Inflation	3.4%	3.4%	3.2%	2.9%	3.8%	-.3%	1.6%	3.1%
Productivity	2.9%	1.8%	1.5%	1.6%	2.8%	5.1%	1.5%	.8%
GDP	3.9%	3.1%	2.7%	2.1%	.4%	-2.6%	3.0%	1.7%
Consumer Confidence	128.6	107.2	105.6	87.9	56.6	52.9	62.0	70.8

UNEMPLOYMENT

	1990	1995	2000	2005	2007	2008	2009	2010	2011	Feb 2012
US	**5.4%**	**5.6%**	**4.0%**	**5.3%**	**4.6%**	**5.0%**	**7.7%**	**9.4%**	**8.5%**	**8.3%**
Northeast	5.0%	6.0%	4.0%	4.9%	4.4%	4.7%	7.8%	8.4%	8.0%	7.9%
Midwest	5.7%	4.5%	3.5%	5.7%	5.0%	5.3%	9.1%	8.7%	7.9%	7.7%
South	5.4%	5.4%	4.0%	5.2%	4.3%	4.6%	8.4%	9.3%	8.4%	8.2%
West	5.1%	6.6%	4.6%	5.5%	4.5%	5.2%	9.5%	11.0%	8.5%	8.3%
Minnesota	**4.6%**	**3.6%**	**2.9%**	**4.5%**	**4.5%**	**4.8%**	**7.2%**	**7.0%**	**5.7%**	**5.7%**

RATES OF RETURN AND RISK HIERARCHY

Investment	Current
30 Year Treasury	3.1%
Aaa Bond	3.8%
Bbb Bond	4.5%
Commercial Mortgage	4.5–6.5%
Institutional Real Estate	5.25–8.75%
Non-Institutional Real Estate	7.75–11.5%

Investment	Current
S & P Equity (Ibbotson)	9.8%
Equipment Finance Rates	10.0–12.0%
Speculative Real Estate	12.0–16.0%
NYSE/OTC Equity (Ibbotson)	13.9%
Land Development	15.0–30.0%
NYSE Sm Cap. Equity (Ibbotson)	21.8%

Sources: Appraisal Institute, Business Week, Value Line, U.S. Chamber of Commerce, Standard & Poors, Investment Dealers Digest, U.S. Government Census, Yahoo Finance, Bureau of Labor Statistics, Ibbotson Associates, and PwC Real Estate Investor Survey.

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retain existing tenants, landlords may or may not offer some concessions during the renewal negotiations. For the most part, existing tenants understand they cannot expect the perks that come with a new lease, but they do expect the landlord to sweeten the deal.

> *"In an economy laced with high vacancy and low rents, landlords recognize that the tenant will seriously consider the cost of moving to a new space versus the cost of remaining in an existing space."*

In an environment where tenant improvements, free rents, and broker-paid commissions for new leases are the norm, it is difficult to estimate an appropriate "market" renewal rate for an existing tenant. It is not unusual for landlords and tenants to engage an appraiser to estimate fair market rates. Consider the following example:

The subject tenant occupies a 50,000 square foot office space at a rate of $11.75 per square foot, and the lease term is coming to an end. The lease includes a three-year option, but the tenant must give the landlord a notice of intent six months before the base term ends. The landlord proposes a renewal rate of $12.50 per square foot for a three-year term beginning on March 1, 2011. The rental rate will remain flat ($12.50) for the first two years of the term and increase to $13.00 for the third year. As a concession, the landlord offers one month of base rent free.

Comparable new leases are $11.00 per square foot with two month's free rent for each year. Broker commissions are $5.00 per square foot and new tenants receive $20 per square foot for tenant improvements.

How does the tenant decide if the proposed renewal terms are fair and reasonable? All things being equal, a new lease sounds like a much better deal than the renewal lease. While the landlord has offered some concessions, it's easy to understand why the tenant is strongly tempted to jump ship. From the tenant's perspective, even though relocation is expensive, time-consuming, and risky, the renewal rates are steep and new leases are a dime a dozen with good terms. From the landlord's perspective, empty space produces no income, good tenants are hard to find, and the building already features tenant-specific improvements. When landlords and/or tenants seem to be at cross-purposes, it makes good business sense to seek the advice of an experienced appraiser.

> *"For the most part, existing tenants understand they cannot expect the perks that come with a new lease, but they do expect the landlord to sweeten the deal."*

In our example, the tenant does not recognize that new leases and renewal leases are quite dissimilar. The latter is based on the terms laid out in a pre-existing contract, while the former is a new contract waiting to happen. The appraiser will first clearly identify

LEASE RENEWAL COMPARABLES									
	BUILDING SIZE	RENEWAL DATE	RENEWAL RATE (NET) PSF	TENANT IMPROVEMENTS	MONTHS OF FREE RENT	INCREASES	BROKER COMMISSION	TERM	AVERAGE EFFECTIVE NET RENT PSF
Subject	50,000	3/2011	$12.50 (proposed)	None	1	Flat for first 2 years, then $0.50 in the 3rd year	None	3 years	$12.32
Comp 1	70,000	12/2010	$12.50	None	2	$0.25 annually	$1.00 PSF	3 years	$11.72
Comp 2	40,000	1/2011	$12.60	$50,000	None	$0.25 in the 3rd & 4th year	$3.00 PSF	4 years	$11.73
Comp 3	25,000	6/2011	$13.00	$75,000	4	Flat for 1st 3 years, then $0.25 annually	None	5 years	$11.68

These comparable leases do *not* include parking, options for expansion space, or favorable holdover provisions that are included in the subject leases. These provisions will make the market rate increase because they are significant landlord concessions.

the problem to be solved: are the terms and rates of the renewal lease at fair market value? Since the case at hand is a lease renewal, the appraiser will consider lease renewal comparables, not newly-signed lease comparables. Furthermore, because the market continually changes, the appraiser will focus on renewal data effective as of the same market period. Since the subject renewal date is March 1, 2011, comparable data should be proximate to that date as well.

The lease renewal table summarizes salient data for the subject and comparable renewal leases, including the net effective rent for each. Calculating the effective net rent boils down the actual rental renewal rate that the landlord receives after direct dollar deductions of the leasing concessions (not including landlord financing of the concessions in this example). The net comparable effective rental range is $11.68 to $11.73 while the subject rate stands above at $12.32.

“When the market is out of balance, the rental conditions can shift dramatically, producing extreme differences.”

In conclusion, landlords and tenants must be careful to rely on the market information that mirrors the circumstance at hand. When the market is out of balance, rental conditions can shift dramatically, producing extreme differences. In an effort to agree on market rent in the renewal scenario, landlords and tenants should discuss market conditions thoroughly to avoid misunderstandings. Do you think the tenant and landlord should be fighting in this case? Would they benefit from the advice of attorneys and/or appraisers to resolve the matter? VV

STANDARDS OF VALUE: WHY SO MANY?

BY JOSHUA R. JOHNSON

A standard is a norm, an established pattern or method against which similar items can be compared. In valuation, the appraiser determines the "worth" of the subject asset as it relates to a particular standard of value. There are many types of value: fair market value, investment value, liquidation value, intrinsic value, etc. Clients often ask how one asset can have several different values? Which standard(s) of value applies and when? Most owners comprehend the concept of fair market value: the amount of money the seller is likely to realize from the sale of an asset in the current market. According to the *International Glossary of Business Valuation Terms*, the definition of fair market value is just exactly that:

> *the price, expressed in terms of cash equivalence, at which property would change hands between a hypothetical willing and able buyer and a hypothetical willing and able seller, acting at arm's length in an open and unrestricted market where neither is under compulsion to buy or sell and when both have reasonable knowledge of the relevant facts.*

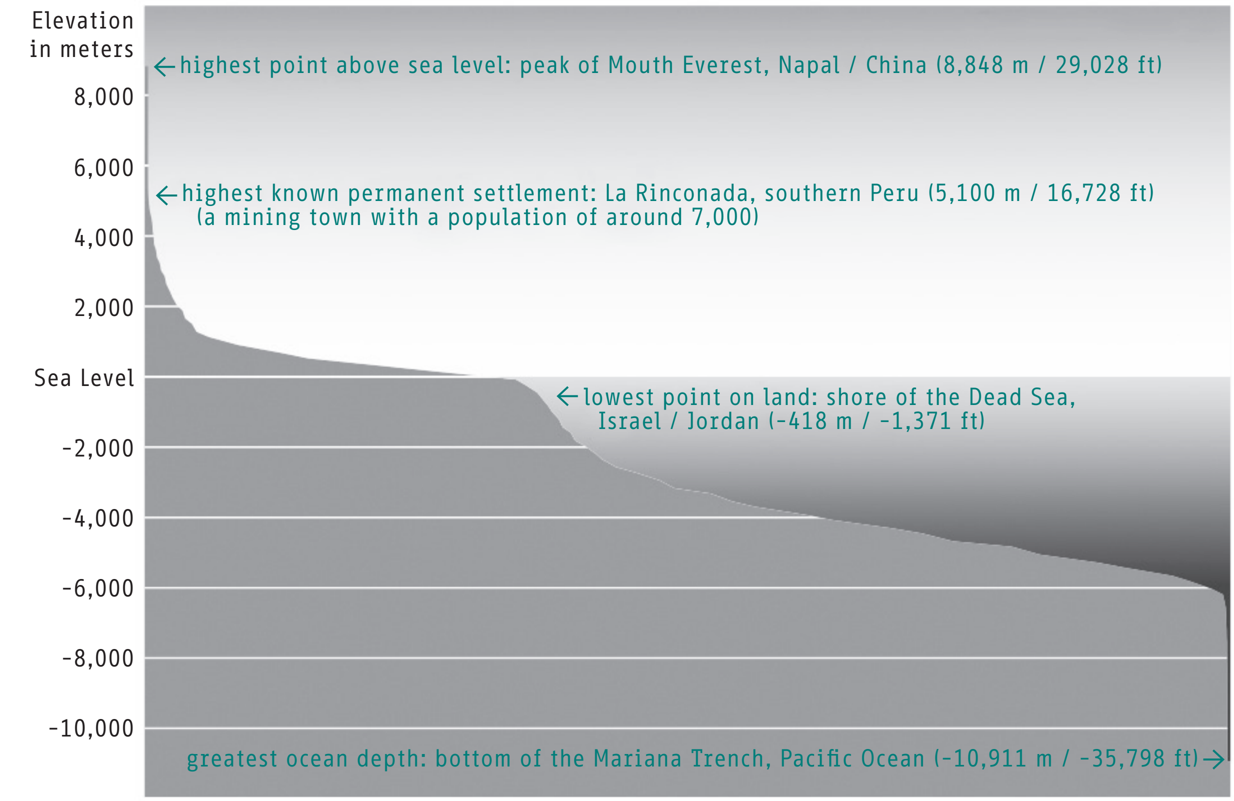
> "In valuation, the appraiser determines the "worth" of the subject asset as it relates to a particular standard of value."

The standard of fair market value is the most commonly referenced and used standard in the appraisal profession. However, there are times when fair market value does not sufficiently express the value of an asset. Consider, for example, the difficulty of valuing rare artwork. When only the original exists and no replication is possible, there are no comparables from which to establish price, nor is the market open or unrestricted. What's an appraiser to do? The following discussion may help the reader understand other standards of value and when they are applicable.

To illustrate the relationship of value to a given standard of value, we offer the following analogy. Most of us are familiar with the concept of sea level. In simple terms, every spot on earth, from the highest peak to the lowest trench, can be defined by its relationship to sea level. For purposes of comparison, the standard of fair market value is most similar to sea level; other standards of value can be above or below it. Fair market value is considered "sea level" because the buyer and seller are on the same footing with regard to negotiating price. That is, neither buyer nor seller has the upper hand, and neither has the need to buy or sell unless the price is reasonable. Illustration I is a generic depiction of the earth's elevations relative to sea level. Illustration II uses the same framework to show how the standards of value relate to each other.

If sea level represents fair market value, liquidation value may fall below sea level, while investment

ELEVATION HISTOGRAM OF THE EARTH'S CRUST



Each tick-mark represents 10% of the surface of the earth (about 51,006,560 km²)

Photo Courtesy of: http://en.wikipedia.org/wiki/Elevation

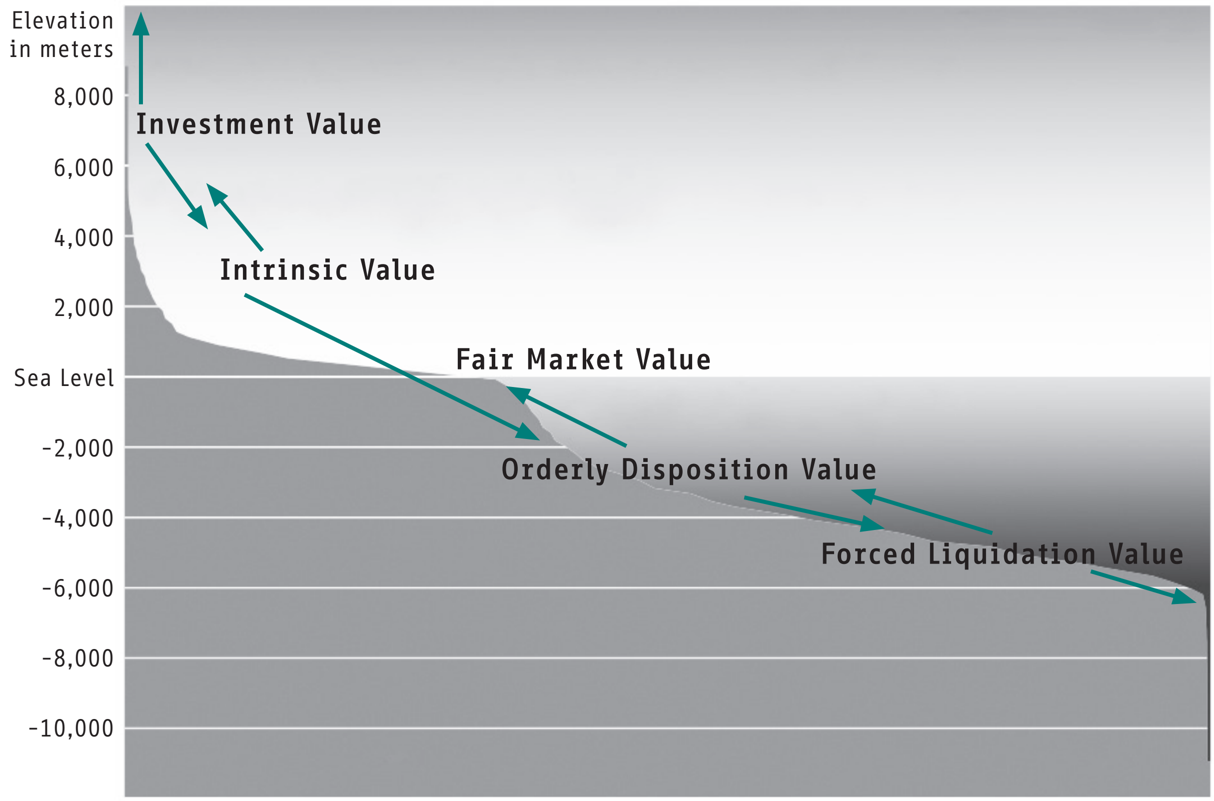
value may be significantly above sea level, and intrinsic value can be above or below sea level. Let's investigate each of these, in turn, using a typical business as the subject to be valued.

Liquidation is typically the result of extenuating circumstances surrounding the business, such as bankruptcy or foreclosure. The potential seller is typically under compulsion to sell and a potential buyer is motivated to buy. Liquidation does not imply negative value. Rather, it means liquidating the business will provide the owner more benefit than maintaining it as an ongoing operation. In this situation, the standard of fair market value cannot be used. The buyer and seller are not on equal footing (not at sea level) when it comes to negotiating the sale price; in this instance, the buyer is favored. Thus, the appraiser will determine liquidation value.

> *"There are times when fair market value does not sufficiently express the value of an asset."*

There are two types of liquidation: orderly disposition and forced liquidation. An orderly disposition involves the sale of assets with the express purpose of maximizing creditor or owner monetary benefits with minimal regard for timeliness. Forced liquidation, on the other hand, is for the express purpose

ELEVATION HISTOGRAM OF THE VARIOUS STANDARDS OF VALUE



Note: Graph is for illustration purposes only and is not representative of all cases

Photo Courtesy of: http://en.wikipedia.org/wiki/Elevation

of selling or disposing of assets. There is minimal regard for monetary benefits, but maximum interest in timeliness (e.g. the classic going out of business fire sale). The value for orderly disposition is not the same as the value for forced liquidation; they will be different from each other, perhaps, significantly so.

Moving back towards sea level in our analogy, we have intrinsic value which may be above or below fair market value. Intrinsic value is the worth of a particular asset to a particular investor or analyst based on available information which is not being reflected in the marketplace.

> “For purposes of comparison, the standard of fair market value is most similar to sea level; other standards of value can be above or below it.”

Intrinsic value is defined in *Valuing a Business, 4th Ed.* as:

> *The amount that an investor considers, on the basis of an evaluation of available facts, to be the 'true' or 'real' worth of an item, usually an equity security. The value that will become the market value when other investors reach the same conclusions.*

As such, the range of values derived using this standard may be above or below fair market value. Investors often produce widely diverging analyses when it comes to the value of a given asset, depending on the facts available and their personal interpretations of those facts. Typically, however, intrinsic value is above fair market value. The required return on investment metrics for a particular investor or analyst may not even be close to making the investment itself particularly worthwhile. This standard of value does not take into consideration the individual's motivation with regard to the particular asset.

> *"Fair market value serves as a baseline where the overall universe of buyers and sellers is assumed to be rational and objective, and all financial analysis is detached."*

The last standard we will discuss is investment value, also known as strategic value. Relying, once again, on our sea level analogy, investment value is most similar to the highest mountain peaks. Strategic value is above intrinsic value and fair market value. Investment value is defined by *The Dictionary of Real Estate Appraisal, 3rd Ed.* as:

> *The specific value of an investment to a particular investor or class of investors based on individual investment requirements; distinguished from market value, which is impersonal and detached.*

With regard to investment value, the sky is truly the limit. Historically, this has been the case where an established business desires a particular asset (typically newer/start-up businesses). Because the buyer is willing to pay more than market value, the seller stands to realize a premium. The buyer may want to incorporate the seller's assets into its own operations or the buyer may anticipate additional benefits, such as cost savings, from the purchase. Regardless of the reasons, these types of unique synergies are not available to the overall market. Thus, we have an example of unequal footing in favor of seller. Establishing investment value is difficult, as the factors driving value are largely dependent on the end-user, the potential buyer. However, since a potential buyer is oftentimes unknown, the accuracy of an investment valuation cannot be guaranteed and may "have no more basis than so many feet of blue sky", as Joseph McKenna wrote in his 1917 Supreme Court Opinion. It should be noted that while the investment value of a particular asset may fall below its fair market value, the seller is unlikely to consummate a deal under such unfavorable conditions.

Clearly, there is some overlap between the standards and each valuation is unique. Fair market value serves as a baseline where the overall universe of buyers and sellers is assumed to be rational and objective, and all financial analysis is detached. The appraiser or analyst must determine, and articulate to the client, the appropriate standard of value in a given situation. Our discussion summarized a few of the more common standards of value. Several others, including the standard of fair value (as promulgated by FAS 157), also play important roles in determining value. However, each of them is complex enough to warrant its own article. VV

MARKET TRANSACTION: REAL ESTATE

Property:	5995 Opus Parkway, Minnetonka, Minnesota
Buyer:	FFI MN 5995, LLC (Founders Properties)
Seller:	Wells REIT II 5995 Opus Parkway LLC (Wells REIT)
Source:	Public record, appraisal of property
Sale Date:	January 11, 2012
Sale Price:	$22,750,000
Unit Price:	$120.90 per square foot of gross building area
Net Rentable Area:	164,931 square feet
Gross Building Area:	188,170 square feet
Zoning:	PUD – Planned Unit Development district
Utilities:	Served with all utilities
Topography and Soil:	Generally level, soil assumed stable
Visibility and Access:	Good
Age:	24 years, built in 1988
Land Size:	385,817 square feet (8.86 acres)
Remarks:	This Class A suburban five-story office building was 95 percent leased to two tenants at the time of this transaction. The property serves as the headquarters of the anchor tenant, G & K services, and the other tenant's headquarters, United Healthcare, is located adjacent to this property. Rents in place at the time of the sale were considered slightly below market, reducing the risk of the property for the buyer. The property is well-located, was in good condition at the time of sale, and we expect it to enjoy strong occupancy in the future.

Insider Guides, Inc.
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New Hope, Pennsylvania

With all of the news and hype surrounding the initial public offering (IPO) of Facebook, Inc., along with its recent acquisition of photo sharing application company Instagram, Inc., another social networking company has been generating news of its own. Insider Guides, Inc., the owner and operator of social networking site www.myYearbook.com was acquired, in a cash and stock transaction, by Quepasa Corporation on November 10, 2011. Quepasa Corp., of West Palm Beach, Florida, owns and operates social networking website www.quepasa.com, which focuses on providing content and services for persons of Hispanic and Latino heritage.

myYearbook.com was founded in August 2005 by brother and sister David and Catherine Cook, with financing from older brother Geoff Cook. The website is aimed primarily at users aged 13 to 24. The idea is that users will interact with and meet new people (whom they otherwise would not have met in their day-to-day lives), for the purpose of friendship or romantic relationships. The company derives the majority of its revenues from advertising, with the remainder coming from virtual currency sales and subscription fees. The virtual currency, called Lunch Money, can be purchased with U.S. legal tender or won by playing games on the website. Subsequently, Lunch Money is used to purchase web-based gifts for other users or to upgrade a user's profile layout. It may also be donated to participating charities.

Quepasa plans to combine its operations with myYearbook's, and rebrand the two entities as a single entity called MeetMe. Instead of focusing solely on Latin America and high school as did the two original companies, the new brand aims to capture a broader international audience. The target date for this conversion is July 2012.

Quepasa announced its plans to acquire myYearbook in July 2011. At that time, myYearbook

SELECTED FINANCIAL HIGHLIGHTS FOR INSIDER GUIDES, INC. D/B/A MYYEARBOOK.COM

					COMMON SIZE			
Year	FYE Dec-09	FYE Dec-10	TTM Jun-11	TTM Sep-11	FYE Dec-09	FYE Dec-10	TTM Jun-11	TTM Sep-11
Total Revenue	$15,427,514	$23,664,405	$30,275,728	$28,919,211	100.0%	100.0%	100.0%	100.0%
Operating Income (Loss)	-$1,079,564	$1,765,465	$2,049,533	$1,633,502	-7.0%	7.5%	6.8%	5.6%
Net Income (Loss)	-$1,557,939	$3,071,298	$3,291,785	$2,814,063	-10.1%	13.0%	10.9%	9.7%
EBIT	-$1,079,564	$3,557,511	$3,819,989	$3,375,092	-7.0%	15.0%	12.6%	11.7%
EBITDA	$1,420,981	$6,510,818	$6,927,270	$6,447,350	9.2%	27.5%	22.9%	22.3%

generated revenues of $23.7 million for the year ended 2010, and was on track to produce revenues of $30.3 million for the June 2011 trailing twelve month period (TTM). The company's profitability in 2010 was $3.1 million, with profits of $3.3 million for the June 2011 TTM period. The chart below outlines the company's financial highlights over the last three years, along with the June 2011 TTM period (when the deal was announced) and the September 2011 TTM period (when the deal was closed).

As can be seen, the company's EBITDA (earnings before interest, taxes, depreciation, and amortization) profitability was quite high for a relatively young internet company. This played a significant role in the investors of myYearbook receiving a healthy level of cash as compensation relative to acquiring company stock (nearly 25%). The terms of the transaction are outlined below, along with an allocation of purchase price.

TERMS OF TRANSACTION
INSIDER GUIDES, INC. D/B/A
MYYEARBOOK.COM

Transaction Closed on November 10, 2011	
Cash	$20,720,000
17.0 million shares of Quepasa Corp. Common Stock @$4.08/share	$69,360,000
	$90,080,000
Purchase Price Allocation	
Cash & Equivalents	$8,530,190
Accounts Receivable	$6,740,930
Property & Equipment	$3,890,671
Identified Intangible Assets	$9,750,659
Other Assets	$1,049,980
Total Assets Acquired	$29,962,430
Less: Accounts Payable	-$2,424,040
Less: Notes Payable	-$5,397,653
Net Implied Equity	$22,140,737
Goodwill	$67,939,263
Total Purchase Price	$90,080,000

Considering the price paid for myYearbook, along with its revenues and earnings, the following multiples were derived.

IMPLIED TRANSACTION MULTIPLES
INSIDER GUIDES, INC. D/B/A
MYYEARBOOK.COM

Total Transaction Value: $90,080,000

Year	FYE Dec-09	FYE Dec-10	TTM Jun-11	TTM Sep-11
Price to Revenue	5.8	3.8	3.0	3.1
Price to EBIT	-83.4	25.3	23.6	26.7
Price to EBITDA	63.4	13.8	13.0	14.0

The multiples appear reasonable since myYearbook is a growing and profitable company. However, the stock price for Quepasa Corporation declined considerably after the July 20, 2011 announcement of the acquisition, indicating that investors in Quepasa were not as optimistic about the acquisition as was management. Although Quepasa's share price was $9.93 per share on July 20, 2011, a downward trend started immediately thereafter, with prices falling to a low of $2.87 per share on October 3, 2011 as the transaction closing date approached. Since the November 10, 2011 closing, when share price was $4.08, the company's share price has remained stagnant, fluctuating between $2.98 and $4.98. On April 10, 2012, Quepasa closed at $3.37 per share. VV

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SCOPE OF SERVICES

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- Going public or private
- Highest and best use studies
- Industrial properties
- Insurance indemnification
- Intangible asset valuation
- Internal management decisions
- Investment counseling
- Land development cost studies
- Lease and rental analyses
- Lost profit analyses
- Marriage dissolution
- Mortgage financing
- Multi-family residential properties
- Municipal redevelopment studies
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- Railroad right-of-ways
- Special assessment appeals
- Special purpose real estate
- Tax abatement proceedings
- Tax increment financing
- Utility and communication easements

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