



LTCIF Case Study

2nd Street, Los Angeles, CA 90012

SUBJECT PHOTO



Source: Self & Tucker Architects

2nd Street, Los Angeles, CA 90012 (The "Subject")

The Subject is located along East 2nd Street, Los Angeles, Los Angeles County, California 90012. The Subject is two-story retail/office building constructed in 1979 and located in the Little Tokyo submarket of Downtown Los Angeles. It consists of 9,199 square feet; however, to take a conservative approach, only the retail bottom floor of the building is utilized in the LTCIM Case Study. The bottom floor retail unit consists of 6,288 square feet of net rentable area. For purposes of this case study, the Subject was listed for sale in June 2015 for \$4,500,000 and was sold in July 2016 for \$3,750,000.

Purpose

The purpose of the case study is to present possible outcomes had Little Tokyo Community Impact Fund ("the Fund" or "we") purchased the Subject in 2016. The Fund was established to provide an investment vehicle with the ability to purchase real estate in Little Tokyo. Family-owned businesses would then be able to continue to operate within the community with the help of the Fund's pool of investors, allowing the community to maintain its cultural integrity despite the challenges and pressures from the outside.

Case Study Overview

Investment Scenario #1

- All cash purchase of the Subject by the Fund
- Generate a 2.50% return for investors
- Lease the Subject below market rent at \$2.50 per square foot per month NNN; current market rent is estimated \$3.75 to \$4.00 per square foot per month NNN

Investment Scenario #2

- All cash purchase of the Subject by the Fund
- Refinance 40.0% of the Subject's equity in Year 2
- Generate a 2.50% return for investors
- Lease the Subject below market rent at \$2.75 per square foot per month NNN; current market rent is estimated \$3.75 to \$4.00 per square foot per month NNN



Investment Strategy

The implemented strategy for the investments will be a 10-year holding period with the sale of the Subject in the 10th year. This method has been selected for two main reasons: a 10-year holding period can more accurately determine how capital gains and losses will be taxed (typically long-term investments are taxed at a lower rate when compared to short-term investments) and can present the growth appreciation of the Little Tokyo/Downtown Los Angeles market throughout the forecast period. In addition, the critical assumptions, utilized in the Discounted Cash Flow (DCF) and Internal Rate of Return (IRR) calculations, were sourced via the Pricewaterhouse Coopers Investor Survey, Situs RERC, Integra Realty Resources 2016 multifamily market reports. The critical assumptions are detailed on the following page.

The DCF is a valuation method used to estimate the value of an investment based on the future cash flows. This analysis captures the present value (as of the sale date) of the expected future cash flows using a discount rate. Typically, if a value calculated through the DCF is higher than the current cost of the investment, the investment opportunity is favorable.

The IRR measures the profitability of a potential investment. This is a discount rate that sets the net present value of all cash flows equal to zero. Typically, if an IRR is positive, the investment opportunity is favorable.

Critical Assumptions

As the date of sale was in July 2016, the critical assumptions were sourced from 2016 market surveys rather than 2018/2019 market surveys.

Discount Rate

The Discount Rate is the interest rate used to determine the present value of future cash flows in the DCF analysis. For example, \$100 invested today in a savings vehicle offering a 10.00% annual interest rate will grow to \$110 in one year. In the reverse, a future value of \$110, discounted at a rate of 10.00%, is worth \$100 today or the present value. Below is a list of market data for retail discount rates:

DISCOUNT RATE						
Date	Source	Market	Minimum	Maximum	Average	
3Q 2016	Pricewaterhouse Coopers	National - Strip Shopping Center	5.50%	10.75%	7.46%	
3Q 2016	Situs RERC	Los Angeles - Neighborhood/Community	--	--	7.40%	
2016	Integra Realty Resources	Los Angeles - Community Retail Center	--	--	7.00%	
2016	Integra Realty Resources	Los Angeles - Neighborhood Retail	--	--	6.75%	
Concluded Rate					6.75%	

Going-In Capitalization Rate (Provided for informational use only – See Terminal Capitalization Rate)

The Going-In Capitalization Rate is the profitability or rate of return expected to be generated on an investment property. It is a measured relationship between the Net Operating Income (Potential Gross Income less Operating Expenses, but before Debt Service) and the Value of the Subject. Also known as 'cap rate', this metric represents the yield of a property over a one year span. Below is a list of market data for retail cap rates:

GOING-IN CAPITALIZATION RATE						
Date	Source	Market	Minimum	Maximum	Average	
3Q 2016	Pricewaterhouse Coopers	National - Strip Shopping Center	4.50%	9.50%	6.24%	
3Q 2016	Situs RERC	Los Angeles - Neighborhood/Community	--	--	6.10%	
2016	Integra Realty Resources	Los Angeles - Community Retail Center	--	--	5.75%	
2016	Integra Realty Resources	Los Angeles - Neighborhood Retail	--	--	5.75%	
Concluded Rate					5.75%	

Terminal Capitalization Rate

Similar to the Going-In Capitalization Rate, the Terminal Capitalization Rate is a metric that is linked to the Net Operating Income of a property. Unlike the Going-In Capitalization Rate, a reversionary rate or terminal rate is an exit rate or estimated resale value of the property at the end of the holding period. For example, for a 10-year hold period, similar to the analysis in this case study, the Year 11 Net Operating Income is divided by the Terminal Capitalization Rate to estimate the terminal value.

Given the relationship between the Going-In Capitalization Rate and the Terminal Capitalization Rate, the Terminal Capitalization Rate is typically several basis points higher than the Going-In Capitalization Rate. This spread is influenced by factors such as circumstances affecting the marketability of the property or perceived risk. Below is a list of market data for retail terminal capitalization rates:

TERMINAL CAPITALIZATION RATE						
Date	Source	Market	Minimum	Maximum	Average	
3Q 2016	Pricewaterhouse Coopers	National - Strip Shopping Center	4.75%	9.75%	6.44%	
3Q 2016	Situs RERC	Los Angeles - Neighborhood/Community	--	--	6.60%	
2016	Integra Realty Resources	Los Angeles - Community Retail Center	--	--	6.25%	
2016	Integra Realty Resources	Los Angeles - Neighborhood Retail	--	--	6.25%	
Concluded Rate					6.25%	

Income and Expense Growth

Typically, market income and expense growth rates between 2.00% to 3.00% are currently used by institutional market participants for underwriting real estate deals and evaluating future potential income and expenses. As such, we have utilized 3.00% for the market income and expense growth.

Investment Scenario #1

Investment Scenario #1 of the case study assumes an all cash purchase of the Subject for \$3,750,000, market leasing to the tenant at a monthly rental rate of \$2.50 per square foot NNN with an annual return of approximately 2.50% to the Fund's investors. The current market rent is approximately between \$3.75 and \$4.00 per square foot per month, NNN. For the purpose of the analysis, the Year 11 Potential Gross Income is readjusted to market rent to capture the fair market reversionary value.

Below are the assumption used in Investment Scenario #1:

ASSUMPTIONS			
Income Assumptions			
Vacancy			4.00%
Credit Loss			1.00%
	2016 Base Year Rate		
Expense Assumptions	Annual	Monthly	PSF
Real Estate Taxes	\$45,000	\$3,750	\$6.62
Property Insurance	\$3,400	\$283	\$0.50
Utilities	\$5,100	\$425	\$0.75
Landscaping	\$1,700	\$142	\$0.25
Repairs & Maintenance	\$6,800	\$567	\$1.00
Reserves and Replacements	\$1,700	\$142	\$0.25
Management Fee			3.00%
Growth Rates			
Income Appreciation			3.00%
Expense Appreciation			3.00%
Going in Capitalization Rate			5.75%
Terminal Capitalization Rate			6.25%
Discount Rate			6.75%
Building SF			6,800
Market Rent			
Monthly			\$2.50
Annually			\$30.00
Reimbursement Structure			NNN
Lease Term			10 Years
Investor Returns (Annual)			
Minimum			0.00%
Maximum			5.00%
Resale Assumptions			
Sale Year			10
Cost of Sale			3.00%

Investment Methodology

With the reversion of the Subject in Year 10, Investment Scenario #1, could produce a final IRR of 7.87%. In addition, with an annual return of 2.50% to the Fund's investors, Investment Scenario #1 would produce a profit throughout the forecasted period.

Below are the 10-year Cash Flows, IRR Calculations, and Investor Returns analyses, which assume an all cash purchase.

Investment Scenario #2

Investment Scenario #2 of the case study assumes an all cash purchase of the Subject for \$3,750,000, market leasing to the tenant at a monthly rental rate of \$2.75 per square foot NNN with an annual return of approximately 2.50% to the Fund's investors. In Year 2 of the analysis, the Fund refinances approximately 40.0% of the Subject's equity or approximately \$1,500,000 at an interest rate of 4.00% over a 15-year term. As a reminder, the current market rent is estimated to be between \$3.75 and \$4.00 per square foot per month, NNN. For the purpose of the analysis, the Year 11 Potential Gross Income is readjusted to market rent to capture the fair market reversionary value.

Below are the assumption used in Investment Scenario #2:

ASSUMPTIONS			
Income Assumptions			
Vacancy			4.00%
Credit Loss			1.00%
2016 Base Year Rate			
Expense Assumptions	Annual	Monthly	PSF
Real Estate Taxes	\$45,000	\$3,750	\$6.62
Property Insurance	\$3,400	\$283	\$0.50
Utilities	\$5,100	\$425	\$0.75
Landscaping	\$1,700	\$142	\$0.25
Repairs & Maintenance	\$6,800	\$567	\$1.00
Reserves and Replacements	\$1,700	\$142	\$0.25
Management Fee			3.00%
Growth Rates			
Income Appreciation			3.00%
Expense Appreciation			3.00%
Going in Capitalization Rate			5.75%
Terminal Capitalization Rate			6.25%
Discount Rate			6.75%
Building SF			6,800
Market Rent			
Monthly			\$2.75
Annually			\$33.00
Reimbursement Structure			NNN
Lease Term			10 Years
Investor Returns (Annual)			
Minimum			0.00%
Maximum			5.00%
Resale Assumptions			
Sale Year			10
Cost of Sale			3.00%

Investment Methodology

With the reversion of the Subject in Year 10, Investment Scenario #2, could produce a final IRR of 12.21%. In addition, with an annual return of 2.50% to the Fund's investors, Investment Scenario would produce a profit throughout the forecasted period.

Below are the 10-year Cash Flows, IRR Calculations, and Investor Returns analyses, which assume an all cash purchase.

DCF CALCULATION											
	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10	Year 11
Income											
Potential Gross Income	\$224,400	\$231,132	\$238,066	\$245,208	\$252,564	\$260,141	\$267,945	\$275,984	\$284,263	\$292,791	\$411,238
Expense Reimbursements											
Real Estate Taxes	\$45,000	\$46,350	\$47,741	\$49,173	\$50,648	\$52,167	\$53,732	\$55,344	\$57,005	\$58,715	\$60,476
Utilities	\$3,000	\$3,090	\$3,183	\$3,278	\$3,377	\$3,478	\$3,582	\$3,690	\$3,800	\$3,914	\$4,032
Vacancy	-\$8,976	-\$9,245	-\$9,523	-\$9,808	-\$10,103	-\$10,406	-\$10,718	-\$11,039	-\$11,371	-\$11,712	-\$16,450
Collection Loss	-\$2,244	-\$2,311	-\$2,381	-\$2,452	-\$2,526	-\$2,601	-\$2,679	-\$2,760	-\$2,843	-\$2,928	-\$4,112
Effective Gross Income	\$261,180	\$269,015	\$277,086	\$285,398	\$293,960	\$302,779	\$311,863	\$321,218	\$330,855	\$340,781	\$455,184
Expenses											
Real Estate Taxes	\$45,000	\$46,350	\$47,741	\$49,173	\$50,648	\$52,167	\$53,732	\$55,344	\$57,005	\$58,715	\$60,476
Property Insurance	\$3,400	\$3,502	\$3,607	\$3,715	\$3,827	\$3,942	\$4,060	\$4,182	\$4,307	\$4,436	\$4,569
Utilities	\$3,000	\$3,090	\$3,183	\$3,278	\$3,377	\$3,478	\$3,582	\$3,690	\$3,800	\$3,914	\$4,032
Landscaping	\$1,700	\$1,751	\$1,804	\$1,858	\$1,913	\$1,971	\$2,030	\$2,091	\$2,154	\$2,218	\$2,285
Repairs & Maintenance	\$6,800	\$7,004	\$7,214	\$7,431	\$7,653	\$7,883	\$8,120	\$8,363	\$8,614	\$8,872	\$9,139
Reserves and Replacements	\$1,000	\$1,030	\$1,061	\$1,093	\$1,126	\$1,159	\$1,194	\$1,230	\$1,267	\$1,305	\$1,344
Management Fee	\$7,835	\$8,070	\$8,313	\$8,562	\$8,819	\$9,083	\$9,356	\$9,637	\$9,926	\$10,223	\$13,656
Total Expenses	\$68,735	\$70,797	\$72,921	\$75,109	\$77,362	\$79,683	\$82,074	\$84,536	\$87,072	\$89,684	\$95,500
Net Operating Income	\$192,445	\$198,218	\$204,164	\$210,289	\$216,598	\$223,096	\$229,789	\$236,683	\$243,783	\$251,097	\$359,684
Operating Expense Ratio	26.3%	26.3%	26.3%	26.3%	26.3%	26.3%	26.3%	26.3%	26.3%	26.3%	21.0%
								Reversion			
								Year NOI 11	=		\$359,684
								Terminal Cap Rate	=		6.25%
								Reversion Value	=		\$5,754,951
								Less selling costs (3.0%)	=		\$172,649
								Net reversion	=		\$5,582,302

IRR CALCULATION											
	Year 0	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10
Net Operating Income	-\$3,750,000	\$192,445	\$198,218	\$204,164	\$210,289	\$216,598	\$223,096	\$229,789	\$236,683	\$243,783	\$251,097
Renovations		-\$200,000	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0
Debt Service		\$0	-\$134,912	-\$134,912	-\$134,912	-\$134,912	-\$134,912	-\$134,912	-\$134,912	-\$134,912	-\$134,912
Refinance		\$0	\$2,250,000	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0
Cash Flows (After DS)	-\$3,750,000	-\$7,555	\$2,313,306	\$69,253	\$75,378	\$81,686	\$88,184	\$94,877	\$101,771	\$108,871	\$116,185
Net Reversion											\$5,582,302
Principle Retirement Upon Sale		\$1,425,088	\$1,347,180	\$1,266,156	\$1,181,890	\$1,094,254	\$1,003,113	\$908,326	\$809,747	\$707,225	\$600,603
Total Leverage CF	-\$3,750,000	-\$7,555	\$2,313,306	\$69,253	\$75,378	\$81,686	\$88,184	\$94,877	\$101,771	\$108,871	\$5,097,885
IRR											12.21%

INVESTOR RETURN											
	Year 0	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10
Cash Flow (Afer DS)	-\$3,750,000	-\$7,555	\$2,313,306	\$69,253	\$75,378	\$81,686	\$88,184	\$94,877	\$101,771	\$108,871	\$116,185
Investor Return	-\$3,750,000	\$93,750	\$93,750	\$93,750	\$93,750	\$93,750	\$93,750	\$93,750	\$93,750	\$93,750	\$93,750
Cash-on-Cash Return		2.50%	2.50%	2.50%	2.50%	2.50%	2.50%	2.50%	2.50%	2.50%	2.50%
Net Profits		-\$101,305	\$2,219,556	-\$24,497	-\$18,372	-\$12,064	-\$5,566	\$1,127	\$8,021	\$15,121	\$22,435
Running Total			\$2,118,251	\$2,093,754	\$2,075,381	\$2,063,318	\$2,057,752	\$2,058,880	\$2,066,900	\$2,082,022	\$2,104,457
Cash Flows (Year 1 to 10)		\$8,023,657									
Initial Investment		-\$3,750,000									
Total Return on Equity		\$4,273,657									
Year-10 Cash-on-Cash Return											113.96%

As mentioned in the Assumptions tables above, the lease is structured as a 10-year triple net (NNN) lease. The NNN lease, which is a common lease structure in the Downtown Los Angeles retail market, requires the tenant to pay some or all property expenses that would normally be paid to the owner or landlord. In the DCF Calculations, the Fund pays the property taxes and utilities for the Subject. The tenant then reimburses the Fund for their pro-rata share of the property taxes and utilities. Income and Expenses are grown at an annual rate of 2.50%. With the refinance payments beginning in Year 2, the Subject produces an IRR of 12.21% with a cash-on-cash return of 113.96% over the 10-year period. In addition, while paying an annual 2.50% return to the investors, Investment Scenario #2 returns a net profit starting Year 7 when utilizing the cash pull from the refinance.