Private Practice (B)

It wouldn't be the last time. Duna Wright glared at the caller ID number that seemed to have burned itself into the display of his cell phone. N.P. Venter had just left another voice message.

Reconsideration

To Duna's surprise, Venter's tone on the message sounded uncharacteristically disappointed, even a little embarrassed. She informed Duna that Ottathe Money Managers' pension client had phoned to say it was no longer interested in pursuing additional real estate acquisitions; instead, it now considered itself a net seller of real estate based on the portfolio rebalancing recommendations recently approved by the plan's investment committee. A recent decline in the value of the plan's stock holdings had significantly reduced the aggregate value of the plan's assets. Real estate, which had been performing well and increasing in value, was now over-allocated.

Venter was cautioned that Ottathe Money Managers could expect to lose some assets under management as well as the attendant annual asset management fees. And word traveled quickly: the investment sales brokers were already circling.

Rebound

But that's not why N.P. Venter was calling. She actually needed *more* analysis done on the three properties that were still on the short list to acquire. A long-time client of the firm, the Barman Baskin Berger Partnership (BBBP) – which had also been humbled by the volatility and decline of the broader equity markets − had just come to realize that real estate might be a prudent addition to their ailing equity investment portfolio. According to Aaron Quinn, the trustee of this large family investment partnership, BBBP was interested in investing between \$5 and \$20 million, although such parameters were more guidelines than constraints.

N.P. Venter had dealt with Aaron Quinn for decades. She knew that the dozen-or-so beneficiaries of the partnership were financially comfortable, yet tax sensitive. She also knew that Quinn wouldn't commit to any investment position in anything until he

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completely understood the tax treatment of the investment, the magnitude and timing of the expected after-tax cash flows, and the resulting expected investment return. That's why N.P. Venter needed Duna to re-run the numbers again. This weekend.

Reaction and Review

Infringed upon, but intrigued. Since Duna only had tentative plans with friends for the weekend, he didn't particularly mind staying in Cambridge and crunching some more numbers. More importantly, he'd just finished a riveting lecture on federal income taxation and was actually itching to apply some of the concepts he'd learned.

His instructor had presented the major federal income tax concepts and accounting methods applicable to commercial real estate investments. Duna's review of his lecture notes highlighted the following:

- For purposes of preliminary analyses, each property's depreciable basis could be estimated as the assessed value (for property tax purposes) of its improvements, excluding the assessed value of the land. Assessed values of the improvements on each property had been identified as follows:

Pace Place	\$28,275,000
Ciller Centre	\$ 5,850,000
Rowe House	\$11,825,000

- Closing costs (due diligence and legal fees) as well as future capital expenditures relating to both tenant and building improvements would be added to the cost basis of each property and then depreciated for tax accounting purposes over the property's applicable depreciable life (39 years for Pace Place and Ciller Centre; 27.5 years for Rowe House);

- Future capital expenditures relating to leasing commissions would be added to the cost basis of the property and then amortized for tax accounting purposes over the term of the lease[1]; and

- Taxable income from real estate investments would be subject to the following marginal federal income tax rates:

Ordinary income (loss)	35%
Gain-on-sale attributable to previously-claimed depreciation deductions	25%
Remaining taxable gain-on-sale	15%

Duna understood that the beneficiaries of BBBP paid income taxes at such marginal rates.

[1] Duna assumed that (i) any future leases signed at Pace Place and Ciller Centre would be for terms of five years and (ii) renewal probabilities at each building would be 50% and 75%, respectively.

Based on the foregoing parameters and the projection of property before-tax cash flow he had previously prepared (see Exhibit 1), Duna began to prepare a projection of property taxable income (loss) from operations for Pace Place (see Exhibit 2). Duna knew that the penultimate line on Exhibit 2 was nothing more than an accounting fiction, the result of following many arbitrary although (arguably) consistent tax accounting principles and rules prescribed by the Internal Revenue Service. His instructor had pejoratively described them in class as sanctioned lies that benefited taxpayers. Duna was still thinking a bit about what that really meant. But one thing was quite clear: the accounting fiction known as taxable income was important to know how to calculate because that's the measure of income that taxpayers pay tax on. Duna needed to get that calculation right, along with the likely amount of annual federal income tax owed.

And that went for taxable gain on sale, too. Duna knew that the inherent deferral of income taxes associated with annual "non-cash" deductions such as depreciation and cost amortization came to a bitter end when an asset was sold. Not only did the investment value of tax deferral end upon sale, but the IRS then "got even." It had recently been explained in class that the concept of a property's *adjusted tax basis* is the mechanism by which the IRS keeps track of all of the non-cash deductions previously provided to taxpayers, and that the IRS uses that tracking mechanism to get even by requiring taxpayers to recognize taxable income upon sale equal to the amount of non-cash deductions previously claimed.

Applying the logic presented in class, Duna prepared Exhibit 3 to estimate both the resulting taxable gain on sale and the corresponding federal income tax liability. To double-check his calculations, Duna also laid out the capital account analysis procedure his real estate finance instructor had showed him after class. The instructor said that if the difference between the property's projected net sale price and adjusted tax basis was equal to the difference between the owners' projected tax capital account balance before the sale and the amount of the projected before-tax cash distribution in connection with the sale, then the calculation of taxable gain on sale was correct. The fundamental accounting result that needed to be achieved was that, after accounting for both the projected cash distribution and taxable gain on sale, the owners' tax capital account equaled zero. Apparently the instructor was some sort of closet accountant or something.[2]

Redial

As he was about to pull together his after-tax analysis of Pace Place, his cell phone rang. N.P. Venter had one more request. The developer of Rowe House had just informed her that he had received a financing commitment from the state housing finance agency for a 30-year interest-only loan for any amount between 50% and 80% of the value of the property. The interest rate on the loan was 5.5%, a full 100 basis points below an

[2] The instructor tried to further impress Duna by explaining that he could similarly double-check his calculation of adjusted tax basis by adding together the balances of the owners' tax capital account and the outstanding loan(s). After thanking him for his insights, Duna wondered why some people couldn't just get a life.

equivalent market-rate loan. Loan fees equal to one point would be charged by the agency. The loan officers at the housing finance agency were quick to point out that because the property met the minimum threshold of 20% affordable units, the owners of the project would automatically qualify to claim about $95,000 of the so-called 4% Low Income Housing Tax Credits (LIHTC) each year for a period of 10 years. Kim Lee, the developer of the property, was now instructing each of her 3 short-listed bidders that she expected their final bids to incorporate the value of both the below-market financing and the LIHTCs.

"That's not a problem, is it?" queried Venter.

Duna acknowledged that it would be relatively straightforward to incorporate such financing assumptions into his analyses, and further suggested that he could make equivalent market-rate financing assumptions in connection with his analyses of Pace Place and Ciller Centre. Venter thought that might be a good idea and further instructed Duna to assume the following:

- market-based interest rates of 6.5%, compounded monthly;
- 30-year amortization terms with monthly payments;
- 10-year terms-to-maturity;
- loan fees of one point;
- loan-to-value ratios of both 50% and 80%; and
- loan closing costs of about $75,000 (although the loan from the state housing finance agency would likely be double that figure).

Redux

Duna knew that his first task would be to prepare a loan payment and amortization schedule for each property (see Exhibit 4). In terms of applying loan-to-value or leverage ratios, Duna figured it might make sense to initially value each property based on an arbitrary (albeit consistent) unlevered before-tax discount rate of 8.5%. Duna knew that that assumption would be questioned by both Venter and Quinn, but was prepared to argue that it was within a reasonable market range for such properties.

Next, Duna would need to incorporate the resulting annual debt service payment obligations into his previous schedules of property before-tax cash flow, taxable income (loss) from operations, and taxable gain on sale (see Exhibits 5, 6 & 7). Duna knew that he would also need to incorporate allowable tax deductions for cost amortization of capitalized loan points[3] and loan closing costs.

[3] Loan points paid in connection with arranging financing on the properties would be added to the cost basis of each property and then amortized for tax accounting purposes over the term-to-maturity of the respective loans.

Duna also knew he would have to pull all of these component analyses together into consolidated schedules of projected net investment flows on before- and after-tax and levered and unlevered bases (see Exhibit 8).

Finally, with regard to Rowe House, Duna recalled that if an investor were to acquire Rowe House and then sell it prior to the end of fifteen years (the so-called "tax credit compliance period"), one-third of the Low Income Housing Tax Credits previously claimed by such investor would be "recaptured" by the IRS in the form of an additional tax liability assessed upon sale. However, if the property were held for more than 10 years, the amount of the tax penalty would be reduced by one fifth for each year of continued ownership beyond 10 years (i.e., by the end of 15 years, the tax penalty would be zero). Duna was also aware that an investor could post a bond with the IRS in lieu of paying such recapture taxes − and avoid recapture tax all together upon a disposition of the property within the 15-year tax credit compliance period − provided the property continued to be rented in compliance with the existing affordability restrictions. For purposes of his analyses, Duna decided to assume that the cost of any such "recapture bond" would be *de minimis*.

Reflection

Duna had a lot to think about. On one level, Venter's latest request for analysis involved nothing more than additional cash flow mechanics (schedules, revisions, etc.). Duna was fine with that; that's what they paid him to do.

But on a more intellectual and strategic level, Duna knew he had some hard thinking to do about taxes, leverage, risk, and return. For example, while he understood that commercial banks[4] were the typical investors in affordable housing developments nationwide, he was surprised to read in a recent affordable housing investment fund prospectus that acceptable levered after-tax investment returns were apparently below 10% − and for highly levered investment positions. He wondered aloud if that level of after-tax investment return should be applicable to, or appropriate for, BBBP.

In his quick estimation, he thought that the operating risks of each of the three prospective acquisitions seemed essentially equivalent. Yet he knew he needed to decide how, if at all, debt and taxes should affect required investment returns and resulting bid prices (asset values). And he needed to decide that quickly. After all, the sellers were demanding best-and-final offers, and Venter was growing increasingly hungry for additional acquisition fees, asset management fees, and client commendations.

It wouldn't be the last time.

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[4] Due to (i) their compliance requirements under the Community Reinvestment Act (which affordable housing investments help satisfy), (ii) the relatively favorable financial accounting treatment (booked as earnings under GAAP) afforded Low Income Housing Tax Credits, and (iii) 20 years of empirical evidence that 99+% of the LIHTC's projected to be received by LIHTC fund investors actually have been.

Exhibit 1

Projection of Property Before-Tax Cash Flow

Pace Place

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10	Year 11
Gross Rental Revenues	$4,323,000	$4,467,000	$4,512,000	$4,876,000	$4,912,000	$4,995,000	$5,147,000	$5,209,000	$5,536,000	$5,662,000	$5,988,000
Less Vacancy	(88,000)	(90,000)	(94,000)	(602,000)	(123,000)	(136,000)	(147,000)	(160,000)	(685,000)	(303,000)	(189,000)
Plus Expense Reimbursements	287,000	311,000	336,000	175,000	201,000	228,000	256,000	285,000	156,000	186,000	217,000
Effective Gross Income	4,522,000	4,688,000	4,754,000	4,449,000	4,990,000	5,087,000	5,256,000	5,334,000	5,007,000	5,545,000	6,016,000
Less Operating Expenses	(1,300,000)	(1,339,000)	(1,379,000)	(1,391,000)	(1,463,000)	(1,507,000)	(1,552,000)	(1,599,000)	(1,615,000)	(1,696,000)	(1,747,000)
Less Property Taxes	(800,000)	(824,000)	(849,000)	(874,000)	(900,000)	(927,000)	(955,000)	(984,000)	(1,014,000)	(1,044,000)	(1,075,000)
Net Operating Income	**2,422,000**	**2,525,000**	**2,526,000**	**2,184,000**	**2,627,000**	**2,653,000**	**2,749,000**	**2,751,000**	**2,378,000**	**2,805,000**	**3,194,000**
Less Tenant Improvements	0	0	0	(456,000)	0	0	0	0	(613,000)	0	
Less Leasing Commissions	0	0	0	(98,000)	0	0	0	0	(141,000)	0	
Less Capital Reserve Funding	(100,000)	(100,000)	(100,000)	(100,000)	(100,000)	(100,000)	(100,000)	(100,000)	(100,000)	(100,000)	
Property Before-Tax Cash Flow	**$2,322,000**	**$2,425,000**	**$2,426,000**	**$1,530,000**	**$2,527,000**	**$2,553,000**	**$2,649,000**	**$2,651,000**	**$1,524,000**	**$2,705,000**	

Exhibit 2

Projection of Property Taxable Income (Loss) From Operations

Pace Place

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10	Year 11
Gross Rental Revenues	$4,323,000	$4,467,000	$4,512,000	$4,876,000	$4,912,000	$4,995,000	$5,147,000	$5,209,000	$5,536,000	$5,662,000	$5,988,000
Less Vacancy	(88,000)	(90,000)	(94,000)	(602,000)	(123,000)	(136,000)	(147,000)	(160,000)	(685,000)	(303,000)	(189,000)
Plus Expense Reimbursements	287,000	311,000	336,000	175,000	201,000	228,000	256,000	285,000	156,000	186,000	217,000
Effective Gross Income	4,522,000	4,688,000	4,754,000	4,449,000	4,990,000	5,087,000	5,256,000	5,334,000	5,007,000	5,545,000	6,016,000
Less Operating Expenses	(1,300,000)	(1,339,000)	(1,379,000)	(1,391,000)	(1,463,000)	(1,507,000)	(1,552,000)	(1,599,000)	(1,615,000)	(1,696,000)	(1,747,000)
Less Property Taxes	(800,000)	(824,000)	(849,000)	(874,000)	(900,000)	(927,000)	(955,000)	(984,000)	(1,014,000)	(1,044,000)	(1,075,000)
Net Operating Income	**2,422,000**	**2,525,000**	**2,526,000**	**2,184,000**	**2,627,000**	**2,653,000**	**2,749,000**	**2,751,000**	**2,378,000**	**2,805,000**	**3,194,000**
Less Depreciation											
Building	(725,000)	(725,000)	(725,000)	(725,000)	(725,000)	(725,000)	(725,000)	(725,000)	(725,000)	(725,000)	
Tenant Improvements	0	0	0	0	(12,000)	(12,000)	(12,000)	(12,000)	(204,000)	(22,000)	
Capital Reserve Expenditures	0	(3,000)	(6,000)	(9,000)	(12,000)	(15,000)	(18,000)	(21,000)	(24,000)	(27,000)	
Less Cost Amortization											
Due Diligence / Legal Fees	(3,000)	(3,000)	(3,000)	(3,000)	(3,000)	(3,000)	(3,000)	(3,000)	(3,000)	(3,000)	
Leasing Commissions	0	0	0	0	(20,000)	(20,000)	(20,000)	(20,000)	(20,000)	(28,000)	
Taxable Income (Loss)	**$1,694,000**	**$1,794,000**	**$1,792,000**	**$1,447,000**	**$1,855,000**	**$1,878,000**	**$1,971,000**	**$1,970,000**	**$1,402,000**	**$2,000,000**	
Tax Savings (Liability) @ 35.0%	($593,000)	($628,000)	($627,000)	($506,000)	($649,000)	($657,000)	($690,000)	($690,000)	($491,000)	($700,000)	

Exhibit 3

Projection of Taxable Gain on Sale

Pace Place

Projected Sale Price *		**$46,971,000**
Less Cost of Sale @ 2%		(939,000)
Net Sale Price		**$46,032,000**
Acquisition Cost **	$35,545,000	
Due Diligence / Legal Fees	100,000	
Tenant Improvements	1,069,000	
Leasing Commissions	239,000	
Other Capital Expenditures	1,000,000	
Accumulated Depreciation	(7,689,000)	
Accumulated Cost Amortization	(128,000)	
Less Adjusted Basis (Net Book Value)		**30,136,000**
Taxable Gain on Sale		**$15,896,000**

Gain Attributable to Straight-Line Depreciation		$7,689,000
Tax @ 25%	$1,922,000	
All Other Taxable Gain		$8,207,000
Tax @ 15%	$1,231,000	

* Projected Year 11 NOI capitalized at 6.8%
** Based on before-tax unlevered IRR of 8.5%

Tax Basis Capital Account Analysis

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
		[+]	[-]	[+ or -]	[1+2+3+4]	[-]	[-5 - 6]	[5+6+7]
Year	Beginning Capital Account Balance	Cash Contributions	Cash Distributions From Operations	Taxable Income (Loss) From Operations	Capital Account Balance Before Sale	Cash Distribution Upon Sale	Resulting Taxable Gain on Sale	Ending Capital Account Balance
0	$0	$35,645,000	$0	$0	$35,645,000	$0	$0	$35,645,000
1	35,645,000	0	(2,322,000)	1,694,000	35,017,000	0	0	35,017,000
2	35,017,000	0	(2,425,000)	1,794,000	34,386,000	0	0	34,386,000
3	34,386,000	0	(2,426,000)	1,792,000	33,752,000	0	0	33,752,000
4	33,752,000	0	(1,530,000)	1,447,000	33,669,000	0	0	33,669,000
5	33,669,000	0	(2,527,000)	1,855,000	32,997,000	0	0	32,997,000
6	32,997,000	0	(2,553,000)	1,878,000	32,322,000	0	0	32,322,000
7	32,322,000	0	(2,649,000)	1,971,000	31,644,000	0	0	31,644,000
8	31,644,000	0	(2,651,000)	1,970,000	30,963,000	0	0	30,963,000
9	30,963,000	0	(1,524,000)	1,402,000	30,841,000	0	0	30,841,000
10	30,841,000	0	(2,705,000)	2,000,000	30,136,000	(46,032,000)	**15,896,000**	**0**

Exhibit 4

Loan Amortization Schedule

Pace Place

Loan Amount	$17,772,500
Interest Rate	6.50%
Compounding Periods / Year	12
Payments / Year	12
Amortization Term (Years)	30
Term-to-Maturity	10
Periodic Payment	$112,334.29
Annual Payment	$1,348,011
Points	1.00
Closing Costs	
Lender	$50,000
Borrower	$75,000

Year	Beginning Balance	Payment	Interest	Principal Amortization	Ending Balance
0					$17,772,500
1	$17,772,500	$1,348,011	$1,149,364	$198,648	17,573,852
2	17,573,852	1,348,011	1,136,060	211,952	17,361,901
3	17,361,901	1,348,011	1,121,865	226,146	17,135,754
4	17,135,754	1,348,011	1,106,720	241,292	16,894,463
5	16,894,463	1,348,011	1,090,560	257,452	16,637,011
6	16,637,011	1,348,011	1,073,318	274,694	16,362,317
7	16,362,317	1,348,011	1,054,921	293,090	16,069,227
8	16,069,227	1,348,011	1,035,292	312,719	15,756,508
9	15,756,508	1,348,011	1,014,349	333,662	15,422,846
10	15,422,846	1,348,011	992,003	356,008	15,066,837
11	0	0	0	0	0
12	0	0	0	0	0
13	0	0	0	0	0
14	0	0	0	0	0
15	0	0	0	0	0
16	0	0	0	0	0
17	0	0	0	0	0
18	0	0	0	0	0
19	0	0	0	0	0
20	0	0	0	0	0
21	0	0	0	0	0
22	0	0	0	0	0
23	0	0	0	0	0
24	0	0	0	0	0
25	0	0	0	0	0
26	0	0	0	0	0
27	0	0	0	0	0
28	0	0	0	0	0
29	0	0	0	0	0
30	0	0	0	0	0

Exhibit 5

Projection of Equity Before-Tax Cash Flow

Pace Place

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10	Year 11
Gross Rental Revenues	$4,323,000	$4,467,000	$4,512,000	$4,876,000	$4,912,000	$4,995,000	$5,147,000	$5,209,000	$5,536,000	$5,662,000	$5,988,000
Less Vacancy	(88,000)	(90,000)	(94,000)	(602,000)	(123,000)	(136,000)	(147,000)	(160,000)	(685,000)	(303,000)	(189,000)
Plus Expense Reimbursements	287,000	311,000	336,000	175,000	201,000	228,000	256,000	285,000	156,000	186,000	217,000
Effective Gross Income	4,522,000	4,688,000	4,754,000	4,449,000	4,990,000	5,087,000	5,256,000	5,334,000	5,007,000	5,545,000	6,016,000
Less Operating Expenses	(1,300,000)	(1,339,000)	(1,379,000)	(1,391,000)	(1,463,000)	(1,507,000)	(1,552,000)	(1,599,000)	(1,615,000)	(1,696,000)	(1,747,000)
Less Property Taxes	(800,000)	(824,000)	(849,000)	(874,000)	(900,000)	(927,000)	(955,000)	(984,000)	(1,014,000)	(1,044,000)	(1,075,000)
Net Operating Income	**2,422,000**	**2,525,000**	**2,526,000**	**2,184,000**	**2,627,000**	**2,653,000**	**2,749,000**	**2,751,000**	**2,378,000**	**2,805,000**	**3,194,000**
Less Tenant Improvements	0	0	0	(456,000)	0	0	0	0	(613,000)	0	
Less Leasing Commissions	0	0	0	(98,000)	0	0	0	0	(141,000)	0	
Less Capital Reserve Funding	(100,000)	(100,000)	(100,000)	(100,000)	(100,000)	(100,000)	(100,000)	(100,000)	(100,000)	(100,000)	
Property Before-Tax Cash Flow	**2,322,000**	**2,425,000**	**2,426,000**	**1,530,000**	**2,527,000**	**2,553,000**	**2,649,000**	**2,651,000**	**1,524,000**	**2,705,000**	
Less Debt Service	*(1,348,000)*	*(1,348,000)*	*(1,348,000)*	*(1,348,000)*	*(1,348,000)*	*(1,348,000)*	*(1,348,000)*	*(1,348,000)*	*(1,348,000)*	*(1,348,000)*	
Equity Before-Tax Cash Flow	**$974,000**	**$1,077,000**	**$1,078,000**	**$182,000**	**$1,179,000**	**$1,205,000**	**$1,301,000**	**$1,303,000**	**$176,000**	**$1,357,000**	

Exhibit 6

Projection of Taxable Income (Loss) From Operations

Pace Place

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10	Year 11
Gross Rental Revenues	$4,323,000	$4,467,000	$4,512,000	$4,876,000	$4,912,000	$4,995,000	$5,147,000	$5,209,000	$5,536,000	$5,662,000	$5,988,000
Less Vacancy	(88,000)	(90,000)	(94,000)	(602,000)	(123,000)	(136,000)	(147,000)	(160,000)	(685,000)	(303,000)	(189,000)
Plus Expense Reimbursements	287,000	311,000	336,000	175,000	201,000	228,000	256,000	285,000	156,000	186,000	217,000
Effective Gross Income	4,522,000	4,688,000	4,754,000	4,449,000	4,990,000	5,087,000	5,256,000	5,334,000	5,007,000	5,545,000	6,016,000
Less Operating Expenses	(1,300,000)	(1,339,000)	(1,379,000)	(1,391,000)	(1,463,000)	(1,507,000)	(1,552,000)	(1,599,000)	(1,615,000)	(1,696,000)	(1,747,000)
Less Property Taxes	(800,000)	(824,000)	(849,000)	(874,000)	(900,000)	(927,000)	(955,000)	(984,000)	(1,014,000)	(1,044,000)	(1,075,000)
Net Operating Income	**2,422,000**	**2,525,000**	**2,526,000**	**2,184,000**	**2,627,000**	**2,653,000**	**2,749,000**	**2,751,000**	**2,378,000**	**2,805,000**	**3,194,000**
Less Interest Expense	*(1,149,000)*	*(1,136,000)*	*(1,122,000)*	*(1,107,000)*	*(1,091,000)*	*(1,073,000)*	*(1,055,000)*	*(1,035,000)*	*(1,014,000)*	*(992,000)*	
Less Depreciation											
Building	(725,000)	(725,000)	(725,000)	(725,000)	(725,000)	(725,000)	(725,000)	(725,000)	(725,000)	(725,000)	
Tenant Improvements	0	0	0	0	(12,000)	(12,000)	(12,000)	(12,000)	(204,000)	(22,000)	
Capital Reserve Expenditures	0	(3,000)	(6,000)	(9,000)	(12,000)	(15,000)	(18,000)	(21,000)	(24,000)	(27,000)	
Less Cost Amortization											
Due Diligence + Legal Fees	(3,000)	(3,000)	(3,000)	(3,000)	(3,000)	(3,000)	(3,000)	(3,000)	(3,000)	(3,000)	
Leasing Commissions	0	0	0	0	(20,000)	(20,000)	(20,000)	(20,000)	(20,000)	(28,000)	
Loan Points	*(18,000)*	*(18,000)*	*(18,000)*	*(18,000)*	*(18,000)*	*(18,000)*	*(18,000)*	*(18,000)*	*(18,000)*	*(18,000)*	
Loan Closing Costs	*(8,000)*	*(8,000)*	*(8,000)*	*(8,000)*	*(8,000)*	*(8,000)*	*(8,000)*	*(8,000)*	*(8,000)*	*(8,000)*	
Taxable Income (Loss)	**$519,000**	**$632,000**	**$644,000**	**$314,000**	**$738,000**	**$779,000**	**$890,000**	**$909,000**	**$362,000**	**$982,000**	
Tax Savings (Liability) @ 35%	($182,000)	($221,000)	($225,000)	($110,000)	($258,000)	($273,000)	($312,000)	($318,000)	($127,000)	($344,000)	

Exhibit 7

Projection of Taxable Gain on Sale

Pace Place

Projected Sale Price *			$46,971,000
Less Cost of Sale @ 2%			(939,000)
Net Sale Price			**$46,032,000**
Acquisition Cost **	$35,545,000		
Due Diligence / Legal Fees	100,000		
Tenant Improvements	1,069,000		
Leasing Commissions	239,000		
Other Capital Expenditures	1,000,000		
Loan Points	*178,000*		
Loan Closing Costs	*75,000*		
Accumulated Depreciation	(7,689,000)		
Accumulated Cost Amortization	*(388,000)*		
Less Adjusted Basis (Net Book Value)			**30,129,000**
Taxable Gain on Sale			**$15,903,000**
Gain Attributable to Straight-Line Depreciation			$7,689,000
Tax @ 25%		$1,922,000	
All Other Taxable Gain			$8,214,000
Tax @ 15%		$1,232,000	

* Projected Year 11 NOI capitalized at 6.8%
** Based on before-tax unlevered IRR of 8.5%

Tax Basis Capital Account Analysis

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	*(9)*	*(10)*
		[+]	[-]	[+ or -]	[1+2+3+4]	[-]	[-5 - 6]	[5+6+7]		*[5+9]*
Year	Beginning Capital Account Balance	Cash Contributions	Cash Distributions From Operations	Taxable Income (Loss) From Operations	Capital Account Balance Before Sale	Cash Distribution Upon Sale	Resulting Taxable Gain on Sale	Ending Capital Account Balance	*Outstanding Loan Balance*	*Adjusted Tax Basis*
0	$0	*$18,126,000*	$0	$0	$18,126,000	$0	$0	$18,126,000	*$17,773,000*	*$35,899,000*
1	18,126,000	0	*(974,000)*	*519,000*	17,671,000	0	0	17,671,000	*17,574,000*	*35,245,000*
2	17,671,000	0	*(1,077,000)*	*632,000*	17,226,000	0	0	17,226,000	*17,362,000*	*34,588,000*
3	17,226,000	0	*(1,078,000)*	*644,000*	16,792,000	0	0	16,792,000	*17,136,000*	*33,928,000*
4	16,792,000	0	*(182,000)*	*314,000*	16,924,000	0	0	16,924,000	*16,894,000*	*33,818,000*
5	16,924,000	0	*(1,179,000)*	*738,000*	16,483,000	0	0	16,483,000	*16,637,000*	*33,120,000*
6	16,483,000	0	*(1,205,000)*	*779,000*	16,057,000	0	0	16,057,000	*16,362,000*	*32,419,000*
7	16,057,000	0	*(1,301,000)*	*890,000*	15,646,000	0	0	15,646,000	*16,069,000*	*31,715,000*
8	15,646,000	0	*(1,303,000)*	*909,000*	15,252,000	0	0	15,252,000	*15,757,000*	*31,009,000*
9	15,252,000	0	*(176,000)*	*362,000*	15,438,000	0	0	15,438,000	*15,423,000*	*30,861,000*
10	15,438,000	0	*(1,357,000)*	*982,000*	15,063,000	*(30,965,000)*	**15,902,000**	**0**	*15,067,000*	***30,130,000***

Note: Totals may not add due to rounding.

Exhibit 8

Pace Place: Summary of Projected Net Investment Flows and Return Metrics

Unlevered Before-Tax OCC		**8.5%**
	$35,545,000	
Resulting Property Before-Tax Bid Price	6.5%	
Resulting Acquisition Cap Rate	5.4%	
Resulting Cash-on-Cash Return		
Leverage Ratio		**2 : 1**

Year	Due Diligence / Legal Fees	Bid Price	Gross Loan Proceeds	Loan Points / Closing Costs	PBTCF: Operations	Debt Service	Tax Savings (Liability): Operations	PBTCF: Sale	Loan Repayment	Tax Savings (Liability): Sale	Net Investment Flows	Projected IRR	Effective Tax Rate
	Unlevered Before-Tax Cash Flows												
0	($100,000)	($35,545,000)									($35,645,000)	8.5%	
1					2,322,000						2,322,000		
2					2,425,000						2,425,000		
3					2,426,000						2,426,000		
4					1,530,000						1,530,000		
5					2,527,000						2,527,000		
6					2,553,000						2,553,000		
7					2,649,000						2,649,000		
8					2,651,000						2,651,000		
9					1,524,000						1,524,000		
10					2,705,000			46,032,000			48,737,000		
	Unlevered After-Tax Cash Flows												
0	($100,000)	($35,545,000)									($35,645,000)	6.3%	26%
1					2,322,000		(593,000)				1,729,000		
2					2,425,000		(628,000)				1,797,000		
3					2,426,000		(627,000)				1,799,000		
4					1,530,000		(506,000)				1,024,000		
5					2,527,000		(649,000)				1,878,000		
6					2,553,000		(657,000)				1,896,000		
7					2,649,000		(690,000)				1,959,000		
8					2,651,000		(690,000)				1,961,000		
9					1,524,000		(491,000)				1,033,000		
10					2,705,000		(700,000)	46,032,000		(3,153,000)	44,884,000		
	Levered Before-Tax Cash Flows												
0	($100,000)	($35,545,000)	$17,772,500	($253,000)							($18,126,000)	9.9%	
1					2,322,000	(1,348,000)					974,000		
2					2,425,000	(1,348,000)					1,077,000		
3					2,426,000	(1,348,000)					1,078,000		
4					1,530,000	(1,348,000)					182,000		
5					2,527,000	(1,348,000)					1,179,000		
6					2,553,000	(1,348,000)					1,205,000		
7					2,649,000	(1,348,000)					1,301,000		
8					2,651,000	(1,348,000)					1,303,000		
9					1,524,000	(1,348,000)					176,000		
10					2,705,000	(1,348,000)		46,032,000	(15,067,000)		32,322,000		
	Levered After-Tax Cash Flows												
0	($100,000)	($35,545,000)	$17,772,500	($253,000)							($18,126,000)	7.8%	20%
1					2,322,000	(1,348,000)	(182,000)				792,000		
2					2,425,000	(1,348,000)	(221,000)				856,000		
3					2,426,000	(1,348,000)	(225,000)				853,000		
4					1,530,000	(1,348,000)	(110,000)				72,000		
5					2,527,000	(1,348,000)	(258,000)				921,000		
6					2,553,000	(1,348,000)	(273,000)				932,000		
7					2,649,000	(1,348,000)	(312,000)				989,000		
8					2,651,000	(1,348,000)	(318,000)				985,000		
9					1,524,000	(1,348,000)	(127,000)				49,000		
10					2,705,000	(1,348,000)	(344,000)	46,032,000	(15,067,000)	(3,154,000)	28,824,000		