**MEADOW BROOK 300 OFFICE BUILDING**
**BIRMINGHAM, ALABAMA**

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TABLE OF CONTENTS

LIST OF EXHIBITS

EXHIBITS PAGE

Highway 280 Corridor, a high growth, high quality office market that begins approximately four miles southeast of downtown. The property was completed in October 1988 and is 100% leased to the engineering firm of Rust International.

## B. LOCATION

The property is in the Meadow Brook Corporate Park, a 180-acre office park located ten miles southeast of downtown Birmingham (see Exhibit 3). Primary access to the park is provided at three locations: two are from Route 280, one with a stop light and the second without. The third access is provided by Alabama Route 119 which borders the park on the southeast perimeter. Highway 280, a divided four lane highway is one of three traffic arteries that run north/south in southern Birmingham and has become a major office corridor in the past 8 years. U.S. Highway 31 is another north/south thoroughfare which has become a major retail corridor. Highway 280 provides direct access to downtown Birmingham and also provides excellent access to Birmingham's most exclusive residential neighborhoods (Mountain Brook and Homewood) five miles north of the property. Approximately three and one-half miles northwest of the property, Highway 280 intersects Interstate 459, a recently completed six-lane freeway that provides beltway access for southern Birmingham and connects Highway 280 with Highway 31, Interstate 65, and Interstate 20.

Inside the Meadow Brook Corporate Park, access to Meadow Brook 300 is provided by Corporate Parkway, a four-lane road that is divided by a landscaped median (see Exhibit 4). There is a traffic light at the intersection of Corporate Parkway and Highway 280.

## C. ADJACENT LAND USES

Meadow Brook Corporate Park is part of a master planned mixed use development by Daniel Corporation which contains 1,100 acres including single family, multifamily and office uses. Including the subject property, the park presently has six office buildings containing 522,000 square feet (see Exhibit 5). One of the office buildings in the park is the Alabama Resource Center, a computerized information center for the economic development activities of the State of Alabama. The Key Royal Corporate Headquarters is located at the northwest entrance to the park. A Kinder Care daycare center is also in the park. Presently under construction in the park is a regional post office, a Jefferson Federal Savings and Loan branch office and a Colonial Bank branch office. Buildings 100 and 500 are 100% leased to Rust. Building 1200 is a multi-tenant building in which Rust International, Daniel Corporation and [redacted] are major tenants. USF&G is the participating first mortgage holder on Buildings 100, 500 and 1200 in the Park. There are approximately 8 commercial sites remaining for future development in the park, and when fully developed, the park will have approximately 1.6 million square feet of office space.

Adjacent land uses outside the park include the Inverness Office Park to the northwest, a high-end office park developed as a joint venture between Metropolitan Life and Taylor & Mathis. The area to the south of Meadow Brook is predominantly newer executive homes that sell in the $140,000 to $500,000 range. Across Highway 280 to the north of the park is a master-planned community (controlled by Daniel) known as The Meadows. The interior of this parcel has been developed with multifamily projects, and Daniel plans to have a community retail center developed on the currently vacant portion of the parcel that fronts on Highway 280. This community center will provide a variety of amenities including shopping and restaurants that will be within walking distance from the subject property.

## D. THE SITE

The building is situated on approximately 5.9 acres in the Meadow Brook Corporate Park (see Exhibit 6). The site is irregularly shaped, fronting along the north side of Meadow Brook Corporate Parkway. Meadow Brook 100 and 500, Rust's corporate headquarters, are situated north of the site on adjacent parcels. The site slopes down to the south towards the parkway and is buffered from the parkway by a natural wooded area. Due to the slope of the site, the building shows five stories above grade from the parkway and four stories above grade from the north. The parking area has landscaped median areas with concrete curbings and walkways. Paving is three inch asphalt over a six inch limestone base, except in drive areas where the base is eight inches.

## E. THE IMPROVEMENTS

Meadow Brook 300 Office Building is a five-story structure containing 105,258 gross square feet, 98,592 BOMA net rentable square feet, and 96,312 rentable square feet using Rust's unique measuring convention (see Exhibits 7A - C). The ground floor contains 6,130 square feet of storage space which is currently being leased as office space to Rust International, the single tenant user. The building exterior is a combination of colored precast panels and dark thermal glass window walls, with a long curved facade facing a lake. The exterior materials are made of reinforced precast concrete spandrel wall panels with buttglazed thermal window walls. The building structure consists of a reinforced concrete skip joist structural system on spread footings. The roof construction is of a reinforced concrete structural deck with a single-ply rubber roof over ridged insulation. There are 386 surface parking spaces (4.21 per 1,000 usable square feet).

Rust office areas incorporate an open area design to allow for maximum use of space for engineers and model work. Interior common areas include a two-story glass walled atrium lobby, marble and carpet flooring and a recessed ceiling with alcove lighting and a mahogany wood inset. The building's HVAC system is a central mechanical plant with medium and low pressure duct work and resistant heat at perimeter zones. There are two high speed Dover elevators with nine foot opening heights. Other building features include an energy management system, a computerized card access system, and a computerized lighting controller. Exhibit 8 is a detailed construction summary of the building. Exhibits 9A-E are floor plans and elevations of the building.

## II. THE MARKET

### A. INTRODUCTION

The Birmingham Metropolitan Statistical Area (MSA) encompasses five counties with a total population of 931,200. This represents a 5.3% increase over the last 8 years (see Exhibit 10). Once dependent on the steel industry, Birmingham has successfully diversified its economic base with only 14% of the total work force in the manufacturing sector (see Exhibit 11). Although manufacturing firms such as USX Corporation and U.S. Pipe still have a major presence in the area with a total of 6,000 employees, other major employers include the University of Alabama at Birmingham (a leading medical research center) with over 11,000 employees, BellSouth with 9,100 employees and Hayes International Corporation with 2,800 employees. An estimated 10,000 engineers are employed in the area by firms such as Rust International, Harbert International, BE&K, BellSouth Services and Southern Company Services. Unemployment for the MSA currently stands at 5.8%, down from 13.9% in 1982 (see Exhibit 12).

### B. THE BIRMINGHAM OFFICE MARKET

The Greater Birmingham Office Market contains a total of 10,872,000 square feet of Class A and B office space (as of June 1988). Of this total, 1,811,000 square feet is available for lease indicating an overall occupancy rate of 83.3%. The Class A inventory is 6,306,600 square feet with a occupancy rate of 88.25%. Additional buildings scheduled for completion in early 1989 will lower the occupancy rate for Class A space to approximately 80% (assuming no additional absorption). Birmingham has experienced rapid office development over the past few years with the total inventory of Class A space doubling since 1982.

There are two active and growing office markets in Birmingham: the Central Business District and the Highway 280 Corridor. In general, leases in Birmingham range from three to five year terms except for larger institutional tenants that elect longer terms. Rent typically remains flat for the term of the lease except for leases longer than five years which usually have a fixed increase at the midpoint of the term. Rent concessions are averaging one month per lease year.

The Central Business District ("CBD") has a total Class A inventory of 2,230,000 square feet with a current vacancy rate of 12%. This vacancy rate will increase to 26% in 1989 (assuming no additional absorption) with the addition of the 570,000 square foot AmSouth/Harbert Plaza building (210,000 square feet available as of December 1988). With BellSouth Services relocating to the Colonnade Office Park, an additional 250,000 square feet of Class A space will be available downtown. Major tenants in the CBD are banks and financial institutions, professional firms and businesses affiliated with the university. Rental rates for Class A buildings range from $13.50 - $19.00 per square foot with concessions of one month per lease year.

The Highway 280 Corridor office market is located in the "Over The Mountain" area of Birmingham referring to Red Mountain, a significant physical boundary that separates downtown from the growing south side. The first entry in this market along Highway 280 was the Mountain Brook Office Park which was a series of 17 small, 10,000 - 30,000 square feet, buildings constructed from 1962 to 1965. The Mountain Brook/Homewood area was the focus for most new office development through the 1970's with a total inventory of about 1.9 million square feet developed by 1980.

Office development moved further south along Highway 280 beginning in the mid-1970's when the Metropolitan Life Insurance Company financed "Inverness", a 1,400-acre planned unit development (350 acres of office and 1,050 acres of residential) located one mile north of the subject property. At the time it was built, Inverness was a pioneering location on the outskirts of town. However, it did provide an anchor for the Highway 280 Corridor, and several in-fill developments followed in the late 1970's and early 1980's. Currently, Metropolitan Life owns the remaining land in Inverness, and Taylor & Mathis are providing the development services.

The construction and completion of the I-459 Beltway in 1984 provided access throughout the "Over Th ountain" area and stimulated new development activity. Five major office parks have been started along Highway 280 since its completion. A major retail office and hotel complex (The Galleria) was completed along U.S. Highway 31 which also benefits from the completion of the I-495 Beltway.

The Highway 280 Corridor is now an established office location offering an assortment of high quality space with 3,535,000 square feet of Class A office space and a 92.6% occupancy rate as of December 8, 1988 (see Exhibit 13). Additional buildings scheduled for completion in early 1989 will lower the occupancy rate for Class A space to approximately 86.6% (assuming no additional absorption). The Highway 280 Corridor has dominated the Birmingham market in recent years in terms of new development. While occupancy in the area has lagged slightly behind development activity, absorption remains strong and has increased markedly since the opening of I-459 in Spring 1984 (see Exhibit 14).

## C. COMPETITIVE PROPERTY SURVEY

The competition for the subject property are the other Class A office parks in the Highway 280 corridor. The subject property has three competitive advantages over most of the other office parks. First, because of its location in Shelby County, employees in Meadow Brook Corporate Park are not subject to any occupational taxes. Employees in office parks in Jefferson County such as International Park, Grandview, and the Colonnade are subject to a .5% occupational tax while employees in the cities of Birmingham and Mountain Brook are subject to an additional 1% tax. Colonnade and Grandview were recently annexed into the city of Birmingham and will be subject to this additional 1% tax after 1990. Second, South Central Bell has a telephone switching station located adjacent to Meadow Brook which provides substantial cost savings for office tenants because the rate for non-long distance services (such as call waiting or conference calling) are based on the tenants' distance from the nearest switching station. Rust International reports a savings on telephone bills of approximately $17,000 per month. Finally, there is a U.S. Regional Postal Facility, a Kinder Care daycare center, and two financial institutions in the Park. These conveniences are not found in any competing office park. Exhibit 15 is a survey of the competitive properties in the area, and Exhibit 16 is a map of the competitive properties.

Meadow Brook 1200 is located in the Meadow Brook Corporate Park adjacent to the subject property. This building was completed in 1988 and is currently 100% occupied. Rates are quoted at $15.50 per square foot full service with $4.55 per square foot expense stops and free parking. This building serves as the corporate headquarters of Daniel Corporation and the Birmingham office of [redacted]

The Inverness Center is the closest competitive office park located approximately one mile northwest of the subject on Highway 280. It is a low density, highly wooded and landscaped park with lake views for most of the buildings. Four 6-story speculative buildings between 94,000 and 135,000 square feet were built between 1980 and 1983, and three buildings were added on a build-to-suit basis in 1984-1985. The park has land available for an additional 1.2 million square feet of space, although nothing is currently under construction or planned. Rates are quoted at $14.50 per rentable square foot with $4.50 per square foot expense stops, free surface parking, and concessions averaging one free month per lease year. Inverness is located in Shelby County, and therefore their tenants' employees are not subject to any occupational taxes.

The International Park, a joint venture of BE&K Engineering and Polar (a Finnish Company), has three recently completed projects and a fourth project planned for 1989/90. BE&K Engineering is the major tenant in International Park Building I. The buildings are high quality with lake views and wooded sites. Space is being offered at $15.50 per rentable square foot with $4.50 per rentable square foot expense stops, free surface parking, and rent concessions of 10%.

The Colonnade is a development of CSL Associates, a joint venture between Carter and Associates in Atlanta and Sunlink Corporation, a subsidiary of BellSouth Services. Two buildings totaling 675,000 square feet have been completed and are 100% leased to BellSouth. Two more buildings of 150,000 square feet each are currently under construction, with BellSouth taking 100% of one of the buildings. The other building is not preleased. Space is being offered at $16.00 per rentable square foot with $4.50 per rentable square foot expense stops and one month free rent per lease year.

Grandview is an upscale 100 acre office park being developed by North Carolina National Bank (NCNB) and managed by Daniel. It is across Highway 280 from Colonnade and Perimeter Park. There is currently one building of 116,000 square feet under construction with no leases signed to date. Space is being offered at $16.50 per rentable square foot with $5.00 per rentable square foot expense stops, and one month free rent per lease year. When finished, the park will have approximately 800,000 square feet of office space.

## III. SELLER/DEVELOPER/PROPERTY MANAGER/GENERAL CONTRACTOR

### A. SELLER/DEVELOPER/PROPERTY MANAGER

The seller, developer, and property manager for the property is Daniel Corporation, a diversified real estate investment and development firm headquartered in Birmingham, Alabama. The development division of Daniel has been involved with numerous projects providing conceptual planning, design, general contractor management and lease-up services. Projects include construction of office buildings, multifamily apartment complexes, shopping centers and industrial/warehouse facilities. Daniel has developed 1,400,000 square feet of office and commercial space. Exhibit 17 is the track record of the development activities of Daniel.

The property management division of Daniel is an Accredited Management Organization as designated by the Institute of Real Estate Management. Property management staff include six Certified Property Managers. Daniel currently manages approximately 3,670,000 square feet of office and commercial space. Exhibit 18 is the track record of the property management activities of Daniel.

### B. GENERAL CONTRACTOR

Brasfield & Gorrie, Inc. was the general contractor for the project. They are a major regional construction company headquartered in Birmingham, Alabama, with branch offices in Atlanta, Georgia and Orlando, Florida. Founded in 1922, the company is experienced in all types of buildings including: light and heavy industrial, commercial, medium to high-rise residential, institutional, health care facilities, warehouses, and water treatment plant construction. Exhibit 19 is a list of Brasfield & Gorrie's recent projects.

## IV. THE RISK AND RETURN

### A. INTRODUCTION

The purchase price for Meadow Brook 300 is $10,634,000, with estimated closing costs of $125,000, for a total investment of $10,759,000. At this time, no financing has been secured. Therefore, for purposes of this analysis, a nonamortizing loan of $5,920,000 has been assumed (approximately 55% leverage). The seller as well as Daniel Corporation will guarantee a 9.6% annual cash return (after payment of all tenant refit and leasing commissions) on the purchase price for five years, beginning November 1, 1988. Of the total purchase price, $325,000 will be escrowed in an interest bearing account for tenant refit expenditures, releasing commissions, and rent concessions. Remaining funds in the escrow at the end of the guarantee period will revert to [redacted].

### B. LEASES

#### 1. Meadow Brook 300 Leases

Meadow Brook 300 is 100% leased to Rust International Corporation on terms summarized in Exhibit 20. The ground floor is leased for four years, the first two floors are leased for three years, the third floor is leased for five years, and the fourth floor is leased for one year. Renewal options for all floors are at market rate. Rust is leasing a total of 96,312 square feet measured using their own measuring convention.

The lease rate for Meadow Brook 300 is quoted on a rentable square foot basis using Rust's measuring convention. Rent for all floors is $12.70 per square foot throughout the lease terms. Expenses are stopped at $2.10 per square foot with Rust paying utilities for the whole building except for common areas. If Rust decides not to renew any one of its leases and the building becomes a multi-tenant building, then the rental rate will increase to $15.50 per square foot full service and the expense stop will also increase to $4.90 per square foot. Any space vacated by Rust can be released on a BOMA rentable square foot basis. This would add an additional 2,280 rentable square feet if Rust were to vacate the entire building.

#### 2. Rust International

The Rust Engineering Company was formed in Birmingham in 1905 by three brothers to sell a patented steam boiler system and to erect steam generation facilities. Over the years Rust expanded its operations to include the engineering, construction and management of major industrial plants and facilities with particular expertise in pulp and paper mills, environmental control facilities and refuse-to-energy plants. Rust has been a leader in the paper and pulp field for over 50 years and has participated in the development of over 175 pulp and paper mills, which accounted for 26% of the nation's production in 1986.

Ownership of the company was maintained by the Rust family until 1967 when Rust became a division of Litton Industries. In 1972, Wheelabrator-Frye, Inc. acquired the firm and in 1981, Wheelabrator consolidated Rust with Kellogg, Inc. (another Wheelabrator division) to form Kellogg Rust, Inc. In 1982, the operating divisions that had been associated with Rust Engineering were consolidated as Rust International Corporation though still owned by Kellogg Rust, Inc. and Wheelabrator. In 1983, the merger of The Signal Companies and Wheelabrator-Frye, Inc. brought Rust under the Signal corporate umbrella. In late 1985, Signal spun off several divisions including Rust to form the Henley Group. In June 1986, Henley formed Wheelabrator Technologies, Inc. (WTI), a group of companies including Rust. In late 1987, WTI went public, with a stock offering of 19.5% of its then outstanding common stock. This summer, Henley traded 23% of its holdings in WTI stock for the refuse-to-energy assets of Waste Management, Inc. As a result, WTI is now owned 22% by Waste Management, 60% by Henley and 18% by the public. An organization chart illustrating the current ownership structure is included as Exhibit 21.

While the ownership of Rust International has changed several times, the lease obligations are solely the responsibility of Rust International which has shown consistent profitability. Financial highlights of the company are provided in Exhibit 22.

Rust has experienced rapid growth. In the past three years, sales have grown from $246 million to $665 million. Rust has projected they will need an additional 350 employees in 1989 to handle their current contract obligations. Rust currently occupies 100% of Buildings 100, 500 and 300. It has 40,000 square feet of space in Building 1200 and 40,000 square feet in Inverness for a total of 426,000 square feet in the Birmingham area. Rust space projections for the near future show that additional space will be needed as shown in Exhibit 23.

## C. VALUATION

### 1. Pro-Forma Income and Expenses

First year pro-forma income and expenses for Meadow Brook 300 are presented in Exhibit 24. These projections are based on the lease summary and the assumptions summarized in Exhibit 25. The net operating income for 1989 is projected to be $1,020,907, which would not require any payment pursuant to the 9.6% NOI Guarantee. The return on total costs (purchase price plus closing costs) is 9.5%, and the return on equity, assuming 55% leverage, is 8.9%.

2. **Market Appraisal**

The letter of intent contains a requirement that [redacted] receives an estimate of market value from an approved MAI designated appraiser in an amount not less than $10,634,000. The appraisal completed for construction in January 1988 by Gene Dilmore, MAI indicated a market value of $10,740,000.

## D. RETURN

The returns for this investment are calculated over a 10 year holding period, using five different scenarios. The scenarios are defined as follows:

Best Case - Scenario 1: Rust will continue to occupy 100% of the building on a semi-net basis for the entire holding period, renewing their leases at market rental rates with no concessions.

Scenario 2: Same as scenario 1, except that Rust receives rent concessions of one month per lease year as leases renew.

Scenario 3: Rust vacates 25% of its space as its leases expire and renews the remainder of its space on a full service basis for the entire holding period at market rental rates with one month free rent per lease year. The vacated space is leased to other tenants on the same terms.

Scenario 4: Same as scenario 3, except that Rust vacates 50% of its space as its leases expire.

Worst Case- Scenario 5: Rust vacates 100% of its space as its leases expire.

It is assumed for purposes of this analysis that permanent financing in the amount of $5,920,000 at an interest rate of 10% (interest only) will be obtained by the partnership. The projections for all scenarios are based on the terms of the leases actually in place. Inflation is projected at 5% annually and appropriate cost numbers have been included for releasing and refitting the space as the leases rollover under the various scenarios.

1. **Annual Returns**

The annual returns to [redacted] for each of the five scenarios are presented in Exhibits 26A - E. The estimated return on equity to USF&G in the first year is 8.9% in all five scenarios. This cash return is entirely from operations, as no payments from the seller's 9.6% NOI guarantee are projected. Returns on total capital and on equity in years 1, 6 and 10 are as follows:

| Return on Total Capital | Year 1 | Year 6 | Year 10 |
|---|---|---|---|
| Scenario 1 | 9.5% | 10.1% | 12.3% |
| Scenario 2 | 9.5% | 9.0% | 10.9% |
| Scenario 3 | 9.5% | 7.6% | 10.2% |
| Scenario 4 | 9.5% | 6.8% | 9.6% |
| Scenario 5 | 9.5% | 5.5% | 8.9% |

| Return on Equity | Year 1 | Year 6 | Year 10 |
|---|---|---|---|
| Scenario 1 | 8.9% | 10.3% | 15.1% |
| Scenario 2 | 8.9% | 7.7% | 12.0% |
| Scenario 3 | 8.9% | 4.6% | 10.4% |
| Scenario 4 | 8.9% | 2.9% | 9.1% |
| Scenario 5 | 8.9% | -0.1% | 7.5% |

The low returns in Scenarios 3 through 5 in year 6 are a result of the high release expenditures because of Rust's projected lease non-renewals in that year.

## 2. Cash Proceeds at Sale

The projected sales price is computed by capitalizing projected net operating income for year 11 at 9%. The cash proceeds from sale are determined by subtracting estimated refit expenditures for year 11, estimated releasing commissions for year 11 and estimated selling expenses (at 3% of total sales price) from the projected sales price. The estimated cash proceeds from the sale in year 10 varies under each scenario due to differences in projected year 11 operating results. Estimated cash proceeds at sale for the five scenarios are as follows:

| | |
|---|---|
| Scenario 1 | $11,128,712 |
| Scenario 2 | $ 9,409,330 |
| Scenario 3 | $ 8,326,637 |
| Scenario 4 | $ 7,907,969 |
| Scenario 5 | $ 7,374,728 |

## 3. Yield Analysis

The nominal yields on total capital and equity and the inflation adjusted yields on equity for the base case under each scenario (5% inflation; 9% capitalization rate at sale) are estimated as follows:

| | Nominal Yield on Total Capital | Nominal Yield on Equity | Inflation Adjusted Yield on Equity |
|---|---|---|---|
| Scenario 1 | 13.6% | 16.9% | 11.9% |
| Scenario 2 | 12.3% | 14.6% | 9.6% |
| Scenario 3 | 11.3% | 12.6% | 7.6% |
| Scenario 4 | 10.8% | 11.7% | 6.7% |
| Scenario 5 | 10.2% | 10.4% | 5.4% |

The yield on this investment is very sensitive to Rust's occupancy status. Because of Rust's expanding businesses along with its commitment to Meadow Brook Corporate Park, Scenarios 2 and 3 are considered to be the "most likely" case. Consequently, the most likely yield on total capital (unleveraged) ranges from 12.37 to 11.3%, and the most likely yield on equity (55% leverage) ranges from 14.6% to 12.6%. Exhibit 27 graphically depicts the effects of Rust's occupancy levels on the expected yields.

The yield on this investment is also very sensitive to inflation. For example under scenario 3, if the inflation rate is 7%, the nominal and inflation adjusted equity yields increase to 15.4% and 8.4% respectively; but if the inflation rate is 3%, the nominal and inflation adjusted yields decrease to 9.4% and 6.4% respectively. Exhibits 28A-E graphically present the nominal equity yield's sensitivity to changes in inflation and changes in the capitalization rate at sale.

## E. RISK

In the proposed purchase, [redacted] is exposed to all of the risks associated with outright ownership of a real estate investment. The structure of the investment along with the due diligence and underwriting have minimized the major risks by providing seller guarantees, refit escrows, engineering and environmental reports, and property management budgets.

### 1. Market Risk

The immediate market risk of this investment has been greatly reduced because the building has been 100% leased to Rust International. As the different scenarios indicate, there would be an increased market risk should Rust decide to vacate some or all of its space in the building. However, Rust's headquarters are in the Meadow Brook Corporate Park next door to the subject property, and Daniel is currently negotiating a 15 year lease with Rust for its main headquarters to keep Rust in the park. If Rust's space needs decrease by 25%, they would still need the space in building 300 presented in scenario 3. Rust is projecting its office space needs to increase over the next several years, and the Meadow Brook Corporate Park is uniquely positioned to accommodate Rust's needs.

If Rust were to vacate some or all of its space in the building, Meadow Brook 300 would compete well in the market since it was designed and built as a multi-tenant building. Also, its location within the Meadow Brook Corporate Park and the park's position in the Highway 280 Corridor will enhance its competitiveness in this healthy market. The five year, 9.6% NOI guarantee will further alleviate the market risk in the near term.

### 2. Operational Risk

Operational risks involve the ability of Daniel to effectively manage the property on a day to day basis and to release the property in a timely and profitable manner if space becomes available. Daniel has been active in property management for over 20 years and currently has 3.67 million square feet of office and commercial space under management. Daniel has its headquarters in Meadow Brook Corporate Park; the proximity to the subject property should be a positive influence. The leasing performance of Daniel, as well as Daniel's large tenant base in the Birmingham market, indicates that Daniel should perform well if releasing is necessary. Daniel has agreed to a non-compete provision that states they will not lease any space to Rust with the exception of Buildings 100 and 500 as long as there is space available in Building 300 and they remain the property managers. Overall, the operational risk for this investment is minimal.

### 3. Financial Risk

There are two financial risks in this investment: interest rate risk and default risk. Interest rate risk exists because permanent financing has yet to be arranged for this investment. The projected return to the partnership is sensitive to the interest rate of the permanent financing. In the Scenario 3, a most likely case, the interest rate is assumed to be 10% and the yield is estimated to be 12.6%. However, if the interest rate is 10.5%, the nominal yield would decrease to 12.1%. On the other hand, if the interest rate is 9.5%, the nominal yield increases to 13.1%. Exhibit 29 graphically presents the nominal yield's sensitivity to the permanent financing rate.

The default risk in this investment is minimized due to the relatively low leverage (55% of total costs). The debt coverage ratio before payment of the seller NOI guarantee is 1.72, so the risk of default is small.

## V. CONCLUSION

Meadow Brook 300 is a high quality, class A office building located in the growing "Over the Mountain" area of Birmingham, Alabama. The project was developed and leased by Daniel Corporation, one of the leading developers in the Birmingham area. The property's accessibility is excellent, and its esthetic setting is unmatched in the entire suburban Birmingham market, giving the property a strong market position in which to capitalize on the forseeable growth of the Birmingham area.

The suburban Birmingham class A office market is experiencing rapid growth while maintaining healthy absorption with vacancies averaging 5% to 18%. The current occupancy rate in Class A space is 92.6%. Additional space under construction will decrease the occupancy to approximately 86% in 1989, assuming no additional absorption. However, with the current strong absorption expected to continue, the market should remain in balance.

The risk minimizing features of this investment include (1) a five year net operating income guarantee, (2) an escrow of $325,000 to be used for refit expenditures, leasing commissions, and concessions, and (3) restrictions that Daniel cannot lease any other space to Rust International as long as there is space available in Building 300 for as long as they are the managers with the exception of Buildings 100 and 500. The expected return on this investment provides an adequate return for the risks involved. Therefore, Potomac Realty Advisors recommends that the [redacted] Investment Committee approve the purchase of the Meadow Brook 300 Office Building under the terms and conditions outlined in Exhibit 1 - Letter of Intent.

If you have any questions, please feel free to call me or Jim Davis.

Sincerely,

Daniel B. Kohlhepp
President

# EXHIBITS

EXHIBIT 27
YIELD CURVE

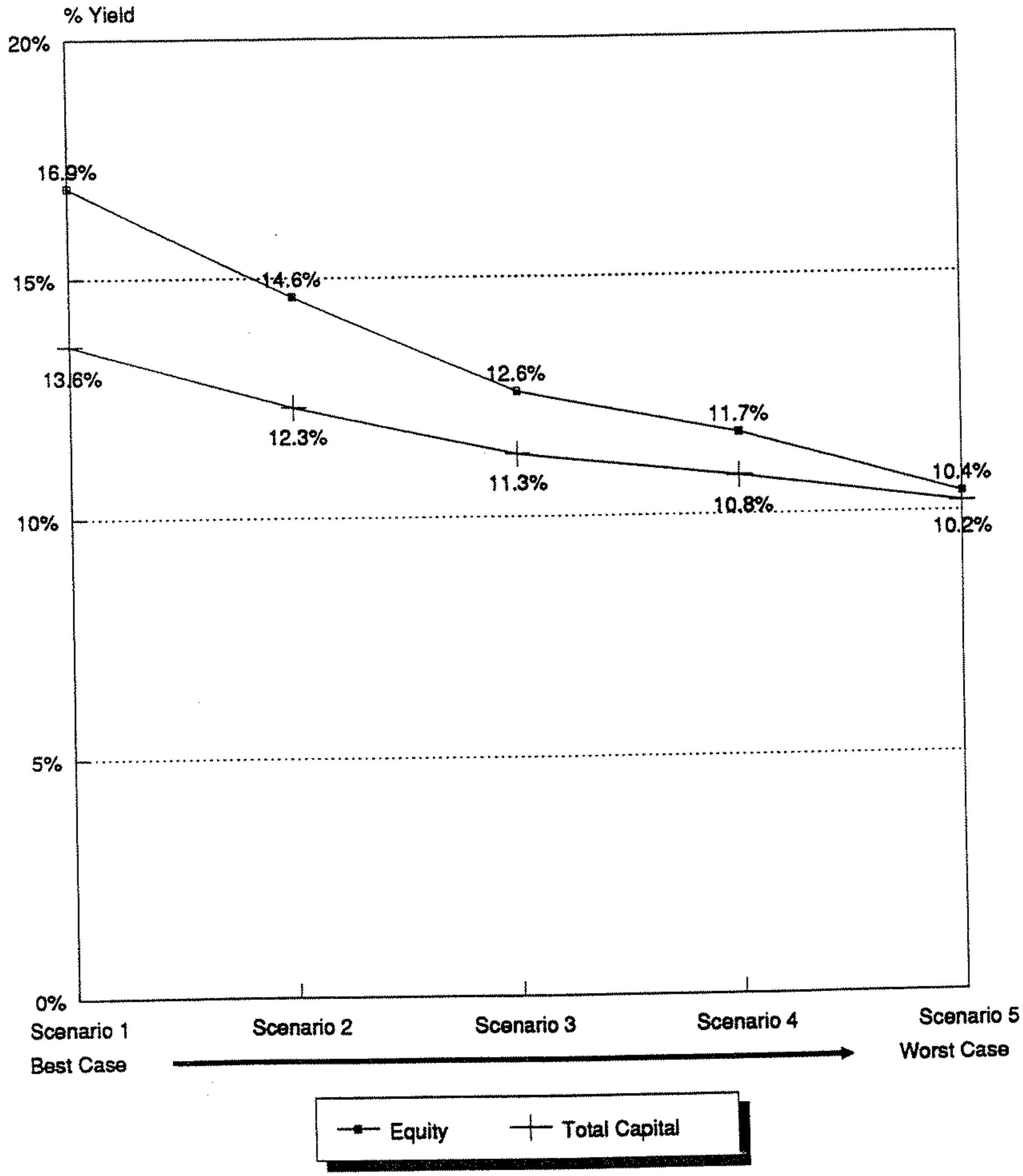

EXHIBIT 28B
SENSITIVITY ANALYSIS
RUST STAYS WITH CONCESSIONS ON RENEWALS

Scenario 2

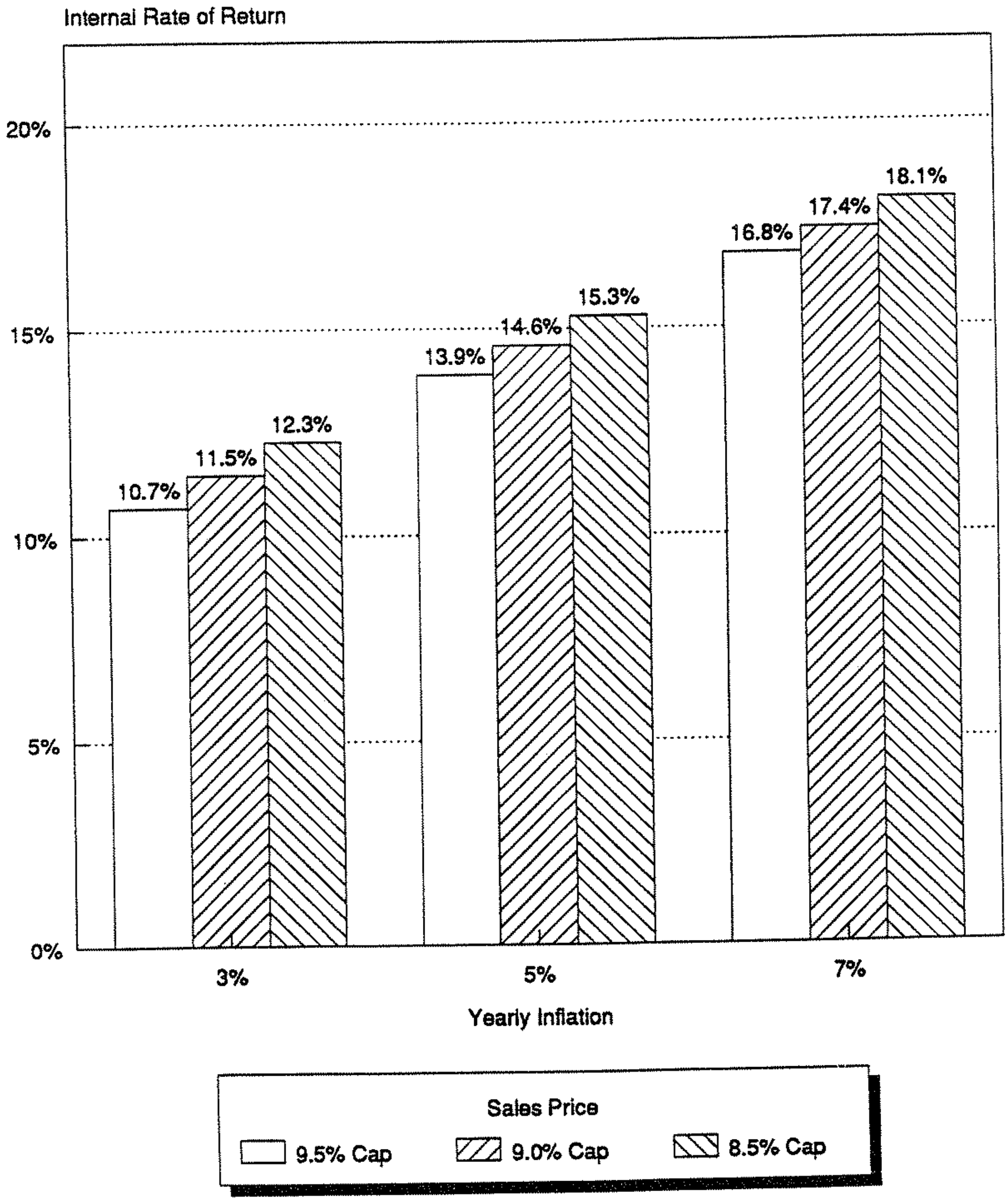

EXHIBIT 28D
SENSITIVITY ANALYSIS - RUST VACATES 50%
OF THE BUILDING BEGINNING IN YEAR 2

Scenario 4

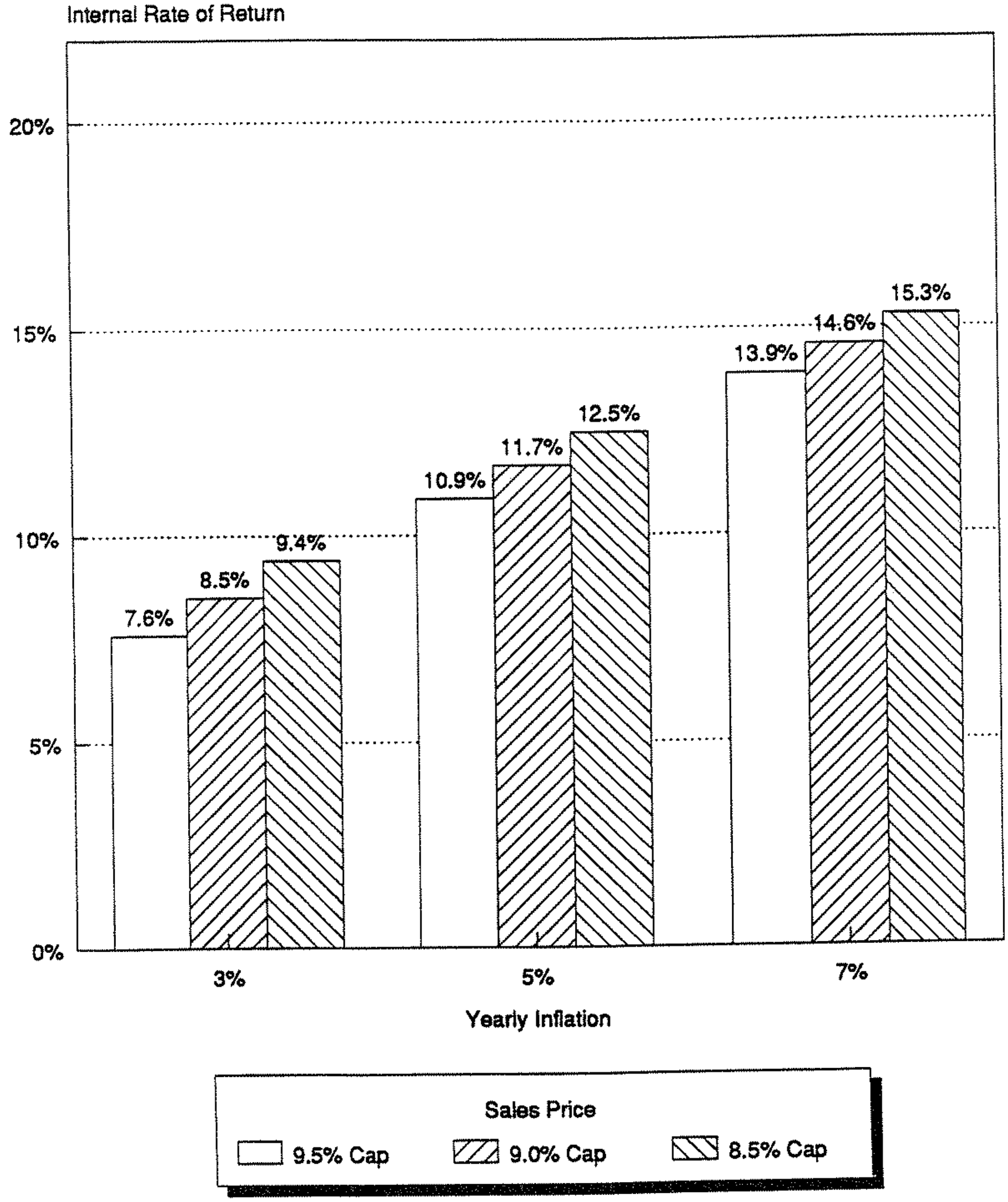

EXHIBIT 29
INTEREST RATE SENSITIVITY ANALYSIS
(5% Inflation; 9% Terminal Cap Rate)

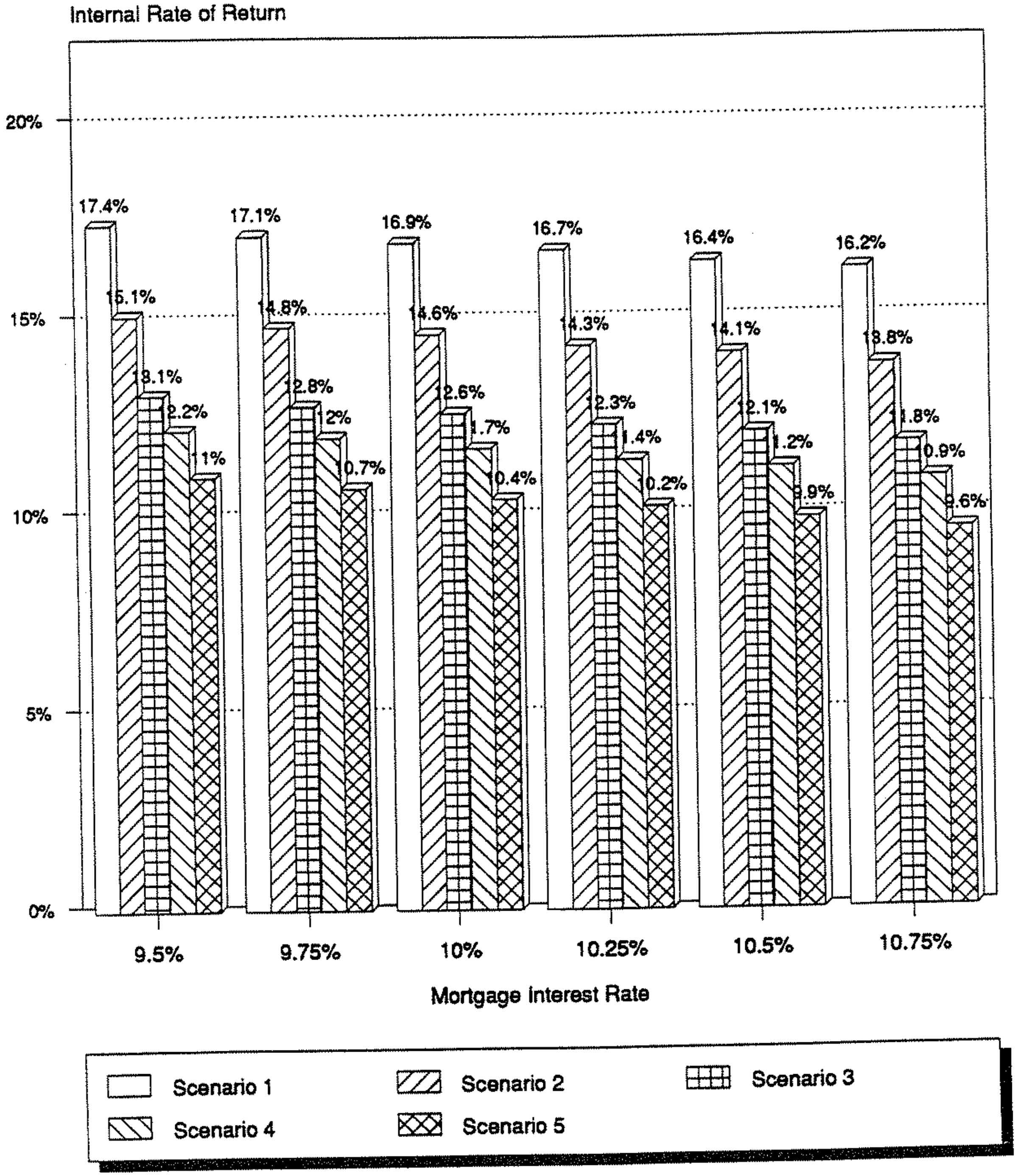

EXHIBIT 28E
SENSITIVITY ANALYSIS
RUST LEAVES BUILDING BEGINNING IN YEAR 2

Scenario 5

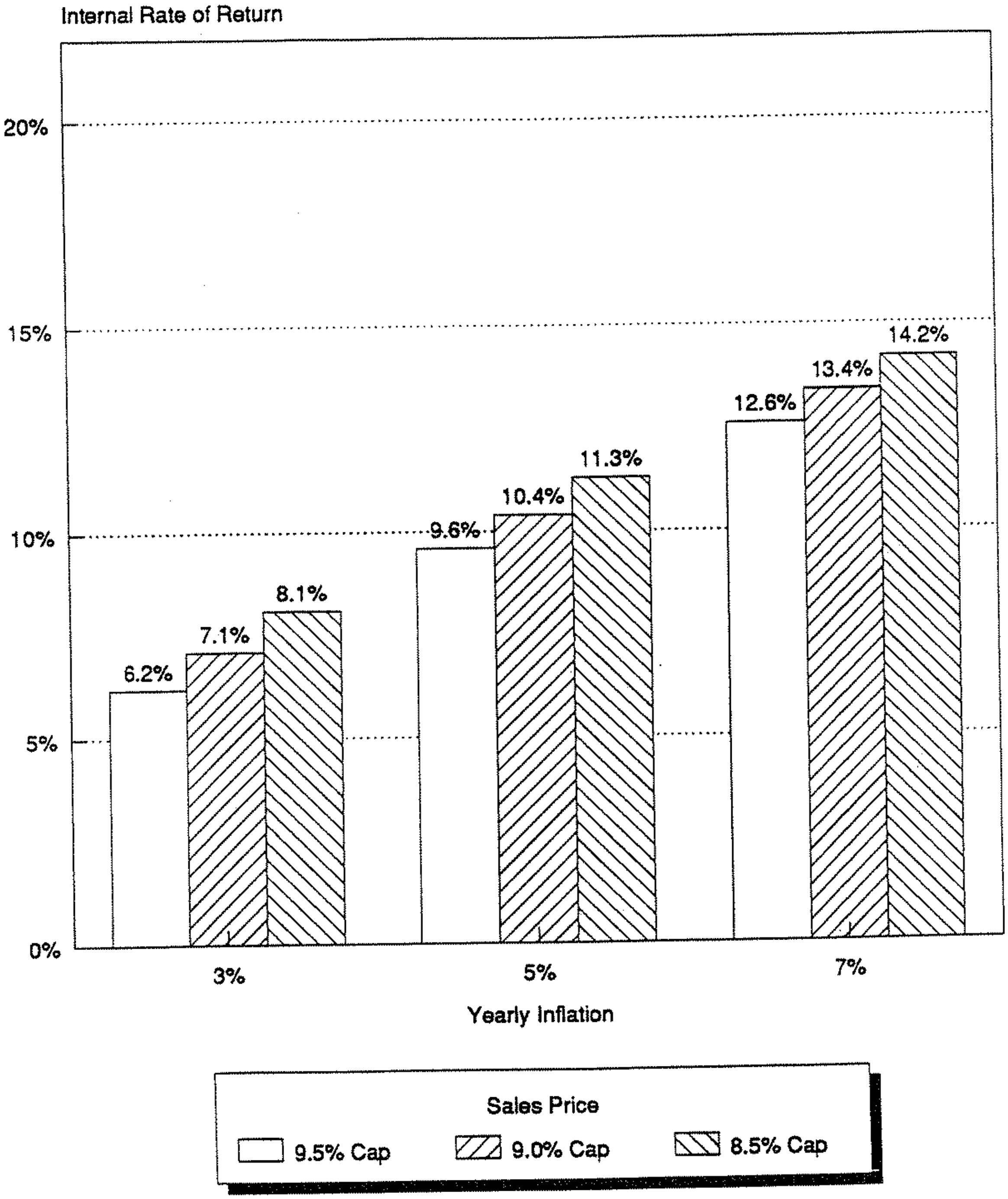

EXHIBIT 28C
SENSITIVITY ANALYSIS - RUST VACATES 25%
OF THE BUILDING BEGINNING IN YEAR 2

Scenario 3

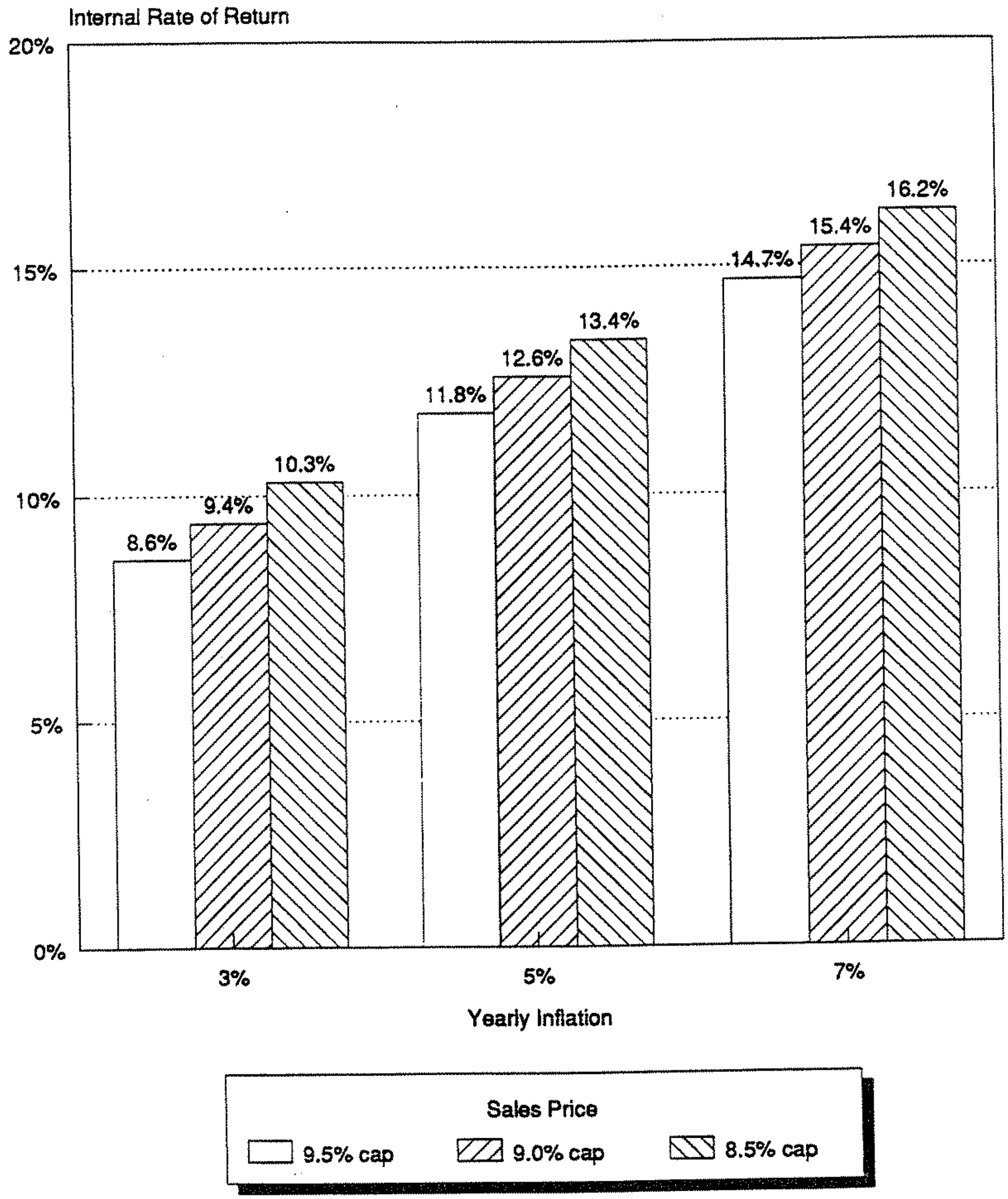

EXHIBIT 28A
SENSITIVITY ANALYSIS
RUST STAYS WITH NO RENT CONCESSIONS

Scenario 1