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Dude, Where's My Premium? The S Corporation Premium After the Tax Cuts and Jobs Act

by Cody J. Lindman

On December 22, 2017, President Trump signed the Tax Cuts and Jobs Act (TCJA) into law, the largest reform of the U.S. tax code since President Reagan's Tax Reform Act of 1986. For the purposes of this article, the most important change to the U.S. tax code is the reduction in corporate and individual income tax rates. With respect to taxation, the U.S. tax code does not treat the income earned by C Corporations and S Corporations (Pass-Through Entities) equally. Instead, income earned by C Corporations is taxed once at the corporate level and then again when the income is distributed to shareholders. Contrary to C Corporations, S Corporation income flows through to a shareholder's individual tax return, where it is then taxed at the shareholder's individual income tax rate.

Due to the previously explained differences in taxation for C and S Corporations, a theoretical value premium or discount exists. This premium or discount is known as the "S Corporation Premium" in the business valuation community.

Background

The theory behind the application of an S Corporation Premium is that a shareholder in an S Corporation can make discretionary distributions (distributions beyond those necessary to pay shareholder level taxes) tax free at the corporate level. In contrast, discretionary distributions in C Corporations are made

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Market Trends and Indicators

Office Buildings–Downtown	→	0.0%
Office Buildings–Suburban	→	0.0%
Retail Centers	→	2.0%
Industrial Buildings	→	2.0%
Apartments	→	2.0%
New Housing Starts–Midwest*	↓	1.0%
Productivity**	↑	1.2%
US Unemployment***	↓	4.1%
Consumer Confidence Index****	↑	124.5%

Statistics reflect year-over-year change from 4Q 2016 through 4Q 2017
*YoY Thru October 2017 ***YoY 3Q 2017
**November 2017 ****January 2018

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Market Trends and Indicators

Economic Indicator

	2010	2011	2012	2013	2014	2015	2016	2017
New Housing Starts—Midwest Yearly Totals	97,900	100,900	127,900	149,600	165,200	152,600	182,300	120,000

P/E Ratios in Select Industries

Industry (by year)	2010	2011	2012	2013	2014	2015	2016	2017
Basic Materials	15.0	16.0	10.7	10.4	11.87	*	*	*
Construction	5.3	5.8	6.5	7.1	6.0	5.2	3.7	4.8
Manufacturing	8.5	10.4	10.2	9.4	9.8	16.4	7.1	5.97
Wholesale Trade	6.6	8.3	7.4	9.6	8.5	7.1	6.1	7.57
Retail Trade	5.1	4.9	5.1	6.2	6.3	5.0	4.0	7.99
Transportation & Warehousing	6.7	5.9	5.6	5.6	5.8	5.2	3.4	4.51
Information	10.2	11.5	11.3	6.8	15.2	6.1	7.1	21.11
Finance & Insurance	9.3	7.2	6.4	7.1	8.1	5.2	16.5	7.88
Professional Services	7.8	10.2	7.3	7.9	9.9	5.9	5.2	18.1
Healthcare	5.8	9.3	5.2	6.9	6.6	7.1	6.9	5.78

Source: Pratt's Stats *Insufficient data

Economic Indicators

Indicator	2005	2010	2011	2012	2013	2014	2015	2016	2017
Inflation	3.4%	1.6%	3.2%	2.1%	1.5%	1.6%	0.1%	1.3%	2.1%
Labor Productivity	2.1%	3.3%	0.1%	0.9%	0.3%	1.0%	1.3%	-0.1%	1.2%
GDP	3.1%	3.0%	1.7%	2.2%	1.9%	2.4%	2.4%	1.6%	2.3%
Consumer Confidence	107.2	62.0	70.8	72.2	78.1	92.6	115.3	113.7	125.4

Data shows year-over-year growth of annual figures, with the exception of Consumer Confidence, which is the January 2018 figure.

Unemployment

	2000	2005	2010	2011	2012	2013	2014	2015	2016	DEC 2017
US	**4.0%**	**5.1%**	**9.6%**	**8.9%**	**8.1%**	**7.4%**	**6.2%**	**5.3%**	**4.9%**	**4.1%**
Northeast	3.8%	4.8%	8.7%	8.2%	8.1%	7.5%	6.2%	5.3%	4.8%	4.5%
Midwest	3.6%	5.4%	9.5%	8.4%	7.4%	7.2%	5.8%	4.8%	4.7%	4.0%
South	3.9%	5.0%	9.3%	8.8%	7.7%	7.0%	6.0%	5.3%	4.9%	4.0%
West	4.6%	5.2%	11.0%	10.3%	9.2%	8.0%	6.7%	4.7%	5.1%	4.2%
Minnesota	**3.2%**	**4.1%**	**7.4%**	**6.5%**	**5.6%**	**5.0%**	**4.2%**	**3.7%**	**3.9%**	**3.1%**

Source: Bureau of Labor Statistics

Rates of Return and Risk Hierarchy

Investment	
30 Year Treasury	3.14%
Aaa Bond	3.82%
Bbb Bond	3.92%
Commercial Mortgage	4.5-5.5%
Institutional Real Estate	5.75–7.0%
Non-Institutional Real Estate	8.0–10.0%

Investment	
S & P Equity (Duff & Phelps)	10.02%
Equipment Finance Rates	10.0–12.0%
Speculative Real Estate	11.0–16.0%
NYSE/OTC Equity (Duff & Phelps)	13.69%
Land Development	12.0–25.0%
NYSE Sm Cap. Equity (Duff & Phelps)	16.71%

Sources: Appraisal Institute, Business Week, Value Line, U.S. Chamber of Commerce, Standard & Poors, Investment Dealers Digest, U.S. Government Census, Bureau of Labor Statistics, Duff & Phelps, PwC Real Estate Investor Survey, The Conference Board, Pratt's Stats®.

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after corporate taxes are paid and are then subject to income tax a second time at the shareholder level.

However, income retained by the C Corporation is not subject to income tax a second time at the individual level – only those net proceeds which are distributed to the shareholders. This is an important distinction because of the rhetoric related to C Corporation values versus S Corporation values. It is often thought that C Corporations are “taxed twice” and S Corporations are “taxed once.” This view is too simplistic however and results in an inaccurate assessment of the taxation differences between C and S Corporations.

However, income retained by the C Corporation is not subject to income tax a second time at the individual level—only those net proceeds which are distributed to the shareholders.

In most businesses, the variable level of taxes discussed above creates a theoretical range of S Corporation value premiums (or discounts). Only when 100% of taxable income is distributed by the C Corporation is there true ‘double taxation’ because then there are no retained earnings. We note however that if an S Corporation is distributing income below the shareholder tax rate, a negative S Corporation Premium (a discount) may be appropriate. At Shenehon Company, we consider each S Corporation on a case by case basis when applying an S Corporation Premium.

The S Corporation Premium Under the Prior Tax Law

To determine the S Corporation Premium under the prior tax law, the applicable tax rates for C and S Corporations must be calculated. In the charts below, we calculated the marginal tax rates for C and S Corporations, noting that these tax rates are calculated using a specific set of assumptions and that the tax rates used may not be applicable for every business.

C Corporation Marginal Tax Rate Prior Tax Law
Source: Federal Reserve Board and Federal Reserve Bank Presidents

Federal Marginal Corporate Income Tax	35.00%
Average State Margina Tax Rate	7.50%
Federal Tax Deduction	-2.63%
Net State Corporation Income Tax Rate	4.88%
Combined Corporate Income Tax Rate	39.88%
Rounded	**40.00%**

S Corporation Marginal Tax Rate Prior Tax Law
Source: Federal Reserve Board and Federal Reserve Bank Presidents

Federal Marginal Individual Income Tax Rate	39.60%
Average State Marginal Tax Rate	5.33%
Federal Tax Deduction	-2.11%
Net State Corporation Income Tax Rate	3.22%
Combined Individual Income Tax Rate	42.82%
Rounded	**43.00%**

The chart on the next page illustrates the calculation of the S Corporation Premium under the prior tax law using the assumptions of a 40.0% C Corporation tax rate, a 20.0% C Corporation dividend tax rate, and a 43.0% S Corporation (Pass-Through Entity) tax rate.

Therefore, the aforementioned assumptions result in an S Corporation having a theoretical value premium ranging from a high of 18.8% for an S Corporation distributing 100.00% of its taxable income to a low of -5.0% (a 5.0% discount) for an S Corporation distributing 40.00% or less of its taxable income.

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S Corporation Premium Under the Prior Tax Law

Source: Shenehon Company

C Corporation Shareholder Benefit											
Pre-Tax Income	$100.00	$100.00	$100.00	$100.00	$100.00	$100.00	$100.00	$100.00	$100.00	$100.00	$100.00
Tax Rate	40.0%	40.0%	40.0%	40.0%	40.0%	40.0%	40.0%	40.0%	40.0%	40.0%	40.0%
Tax	–$40.00	–$40.00	–$40.00	–$40.00	–$40.00	–$40.00	–$40.00	–$40.00	–$40.00	–$40.00	–$40.00
Net Income	$60.00	$60.00	$60.00	$60.00	$60.00	$60.00	$60.00	$60.00	$60.00	$60.00	$60.00
C Corporation Dividend % of Net Income	**100.00%**	**90.00%**	**80.00%**	**70.00%**	**60.00%**	**50.00%**	**40.00%**	**30.00%**	**20.00%**	**10.00%**	**0.00%**
Dividend	$60.00	$54.00	$48.00	$42.00	$36.00	$30.00	$24.00	$18.00	$12.00	$6.00	$0.00
Tax Rate	20.0%	20.0%	20.0%	20.0%	20.0%	20.0%	20.0%	20.0%	20.0%	20.0%	20.0%
Tax	–$12.00	–$10.80	–$9.60	–$8.40	–$7.20	–$6.00	–$4.80	–$3.60	–$2.40	–$1.20	$0.00
Retained by Shareholder	$48.00	$43.20	$38.40	$33.60	$28.80	$24.00	$19.20	$14.40	$9.60	$4.80	$0.00
Retained by Corporation	$0.00	$6.00	$12.00	$18.00	$24.00	$30.00	$36.00	$42.00	$48.00	$54.00	$60.00
Total C Corporation Shareholder Benefit	$48.00	$49.20	$50.40	$51.60	$52.80	$54.00	$55.20	$56.40	$57.60	$58.80	$60.00
S Corporation Shareholder Benefit											
Pre-Tax Income	$100.00	$100.00	$100.00	$100.00	$100.00	$100.00	$100.00	$100.00	$100.00	$100.00	$100.00
S Corporation Dividend % of Pre-Tax Income	**100.00%**	**94.00%**	**88.00%**	**82.00%**	**76.00%**	**70.00%**	**64.00%**	**58.00%**	**52.00%**	**46.00%**	**40.00%**
Dividend	$100.00	$94.00	$88.00	$82.00	$76.00	$70.00	$64.00	$58.00	$52.00	$46.00	$40.00
Shareholder Tax Rate	43.0%	43.0%	43.0%	43.0%	43.0%	43.0%	43.0%	43.0%	43.0%	43.0%	43.0%
Shareholder Tax	–$43.00	–$43.00	–$43.00	–$43.00	–$43.00	–$43.00	–$43.00	–$43.00	–$43.00	–$43.00	–$43.00
Retained by Shareholder	$57.00	$51.00	$45.00	$39.00	$33.00	$27.00	$21.00	$15.00	$9.00	$3.00	–$3.00
Retained by Corporation	$0.00	$6.00	$12.00	$18.00	$24.00	$30.00	$36.00	$42.00	$48.00	$54.00	$60.00
Total S Corporation Shareholder Benefit	$57.00	$57.00	$57.00	$57.00	$57.00	$57.00	$57.00	$57.00	$57.00	$57.00	$57.00
S Corporation Premium (Discount)	**18.8%**	**15.9%**	**13.1%**	**10.5%**	**8.0%**	**5.6%**	**3.3%**	**1.1%**	**–1.0%**	**–3.1%**	**–5.0%**

The S Corporation Premium After the Tax Cuts and Jobs Act

The signing of the TCJA brought forth a myriad of changes to the U.S. tax code. For our purposes however, one of the main changes precipitated by the TCJA was the reduction in the top marginal tax rate for C Corporations from 35.0% to 21.0%. Additionally, the top marginal tax rate for individuals was reduced from 39.6% to 37.0%, individuals are now limited to $10,000 in state and local tax deductions, and S Corporations are able to deduct 20% of "Qualified Business Income." "Qualified Business Income" is vaguely defined as "...the net amount of qualified items of income, gain, deduction, and loss with respect to any qualified trade or business of the taxpayer." For the purposes of this article, we will consider all of the income in the following charts to be "Qualified Business Income."

To determine the S Corporation Premium after the TCJA, the applicable tax rates for C and S Corporations must be re-calculated. We calculated a combined marginal tax rate for C Corporations of 27.0% and a combined marginal tax rate for S Corporations of 35.0% after the TCJA, as illustrated in the charts below.

C Corporation Marginal Tax Rate
Tax Cuts and Jobs Act

Federal Marginal Corporate Income Tax Rate	21.00%
Average State Marginal Tax Rate	7.50%
Federal Tax Deduction	-1.58%
Net State Corporate Tax Rate	5.93%
Combined Corporate Income Tax Rate	26.93%
Rounded	**27.00%**

S Corporation Marginal Tax Rate
Tax Cuts and Jobs Act

Federal Marginal Individual Income Tax Rate	37.00%
20% Deduction for Qualified Business Income	-7.40%
Effective Federal Marginal Individual Income Tax Rate	29.60%
Average State Marginal Tax Rate	5.33%
Federal Tax Deduction	-0.37%
Net State Corporate Tax Rate	4.93%
Combined Individual Income Tax Rate	34.93%
Rounded	**35.00%**

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The chart below illustrates the calculation of the S Corporation Premium after the signing of the TCJA using a 27.0% C Corporation tax rate, a 20.0% C Corporation dividend tax rate, and a 35.0% S Corporation (Pass-Through Entity) tax rate.

Therefore, the aforementioned assumptions result in an S Corporation having a theoretical value premium ranging from a high of 11.3% for an S Corporation distributing 100.00% of its taxable income to a low of -11.0% (an 11.0% discount) for an S Corporation distributing 27.00% or less of its taxable income.

Final Thoughts

Despite falling short of President Trump's initial goal of simplifying the U.S. tax code, the TCJA was successful in narrowing the taxation gap between C Corporations and S Corporations (Pass-Through Entities), as evidenced by the previous charts illustrating the decline of the S Corporation Premium. For example, under the prior tax law, an S Corporation distributing 100% of its taxable income would have a theoretical S Corporation Premium of approximately 18.8%. However, after the signing of the TCJA, the theoretical S Corporation Premium for the same entity is reduced to approximately 11.3%. We note however that the previous charts were created using a specific set of assumptions about C and S Corporation tax rates and that the tax rates used may not be applicable to every business. Regardless, the key takeaway from this article is that the S Corporation Premium decreased after the TCJA. VV

S Corporation Premium After the Signing of the Tax Cuts and Jobs Act

Source: Shenehon Company

C Corporation Shareholder Benefit												
Pre-Tax Income	$100.00	$100.00	$100.00	$100.00	$100.00	$100.00	$100.00	$100.00	$100.00	$100.00	$100.00	$100.00
Tax Rate	27.0%	27.0%	27.0%	27.0%	27.0%	27.0%	27.0%	27.0%	27.0%	27.0%	27.0%	27.0%
Tax	–$27.00	–$27.00	–$27.00	–$27.00	–$27.00	–$27.00	–$27.00	–$27.00	–$27.00	–$27.00	–$27.00	–$27.00
Net Income	$73.00	$73.00	$73.00	$73.00	$73.00	$73.00	$73.00	$73.00	$73.00	$73.00	$73.00	$73.00
C Corporation Dividend % of Net Income	**100.00%**	**90.00%**	**80.00%**	**70.00%**	**60.00%**	**54.80%**	**50.00%**	**40.00%**	**30.00%**	**20.00%**	**10.00%**	**0.00%**
Dividend	$73.00	$65.70	$58.40	$51.10	$43.80	$40.00	$36.50	$29.20	$21.90	$14.60	$7.30	$0.00
Tax Rate	20.0%	20.0%	20.0%	20.0%	20.0%	20.0%	20.0%	20.0%	20.0%	20.0%	20.0%	20.0%
Tax	–$14.60	–$13.14	–$11.68	–$10.22	–$8.76	–$8.00	–$7.30	–$5.84	–$4.38	–$2.92	–$1.46	$0.00
Retained by Shareholder	$58.40	$52.56	$46.72	$40.88	$35.04	$32.00	$29.20	$23.36	$17.52	$11.68	$5.84	$0.00
Retained by Corporation	$0.00	$7.30	$14.60	$21.90	$29.20	$33.00	$36.50	$43.80	$51.10	$58.40	$65.70	$73.00
Total C Corporation Shareholder Benefit	$$58.40	$59.86	$61.32	$62.78	$64.24	$65.00	$65.70	$67.16	$68.62	$70.08	$71.54	$73.00
S Corporation Shareholder Benefit												
Pre-Tax Income	$100.00	$100.00	$100.00	$100.00	$100.00	$100.00	$100.00	$100.00	$100.00	$100.00	$100.00	$100.00
S Corporation Dividend % of Pre-Tax Income	**100.00%**	**92.70%**	**85.40%**	**78.10%**	**70.80%**	**67.00%**	**63.50%**	**56.20%**	**48.90%**	**41.60%**	**34.30%**	**27.00%**
Dividend	$100.00	$92.70	$85.40	$78.10	$70.80	$67.00	$63.50	$56.20	$48.90	$41.60	$34.30	$27.00
Shareholder Tax Rate	35.0%	35.0%	35.0%	35.0%	35.0%	35.0%	35.0%	35.0%	35.0%	35.0%	35.0%	35.0%
Shareholder Tax	–$35.00	–$35.00	–$35.00	–$35.00	–$35.00	–$35.00	–$35.00	–$35.00	–$35.00	–$35.00	–$35.00	–$35.00
Retained by Shareholder	$65.00	$57.70	$50.40	$43.10	$35.80	$32.00	$28.50	$21.20	$13.90	$6.60	–$0.70	–$8.00
Retained by Corporation	$0.00	$7.30	$14.60	$21.90	$29.20	$33.00	$36.50	$43.80	$51.10	$58.40	$65.70	$73.00
Total S Corporation Shareholder Benefit	$65.00	$65.00	$65.00	$65.00	$65.00	$65.00	$65.00	$65.00	$65.00	$65.00	$65.00	$65.00
S Corporation Premium (Discount)	**11.3%**	**8.6%**	**6.0%**	**3.5%**	**1.2%**	**0.0%**	**–1.1%**	**–3.2%**	**–5.3%**	**–7.2%**	**–9.1%**	**–11.0%**

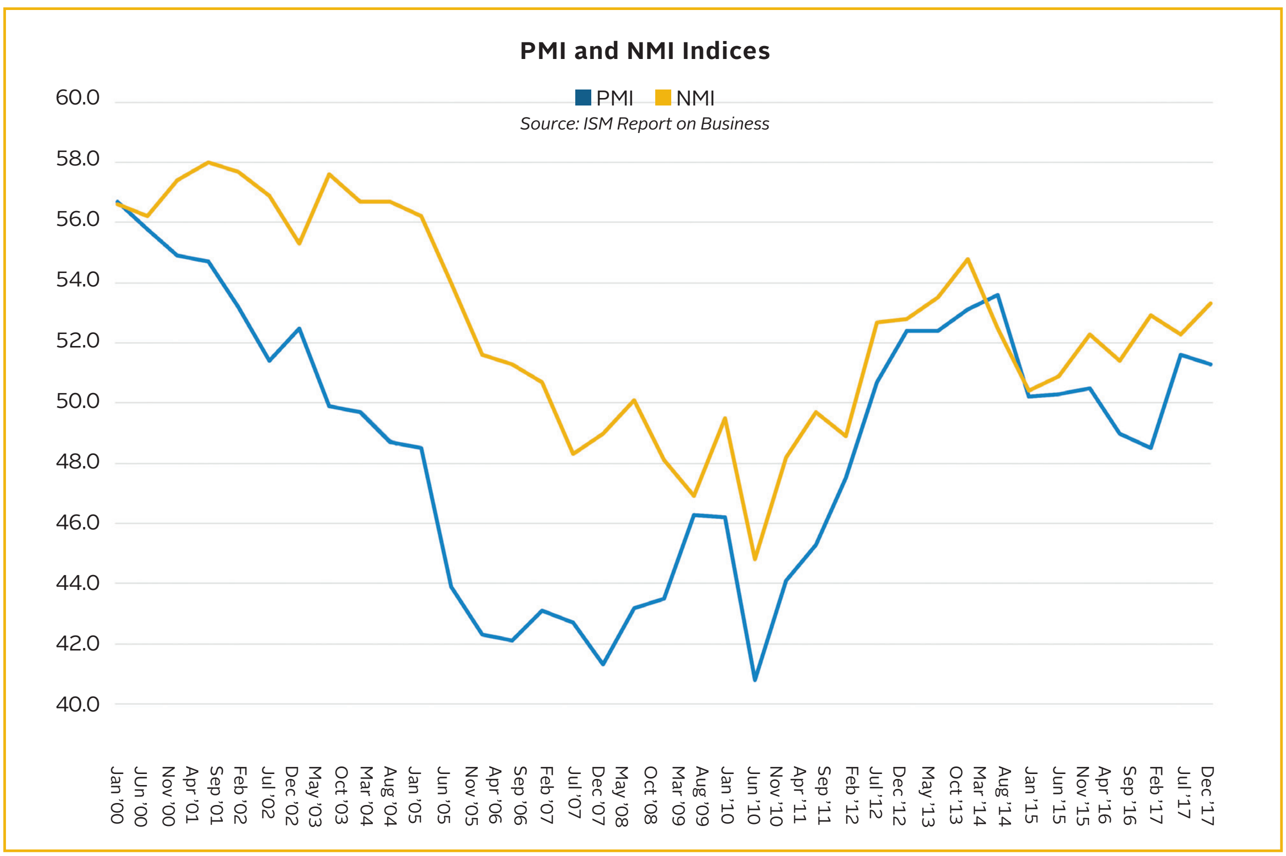
Marketview 1Q 2018

According to the January 17, 2018 edition of the Federal Reserve's Beige Book, the economy of the United States continued to expand through the last month of 2017 and the start of 2018 at a modest to moderate pace. Manufacturing and transportation services generally expanded throughout the nation, with most districts reporting modest to moderate gains since the December edition of the Beige Book. Mixed results were observed in the agricultural sector, with some districts reporting poor conditions. Non-auto retail sales rose throughout the nation since December, with auto sales showing mixed results. Limited housing stock has slowed growth in the real estate market, with the housing shortage raising home prices and lowering days that properties remain on the market.

Overall, most districts indicated a modest to moderate pace of economic growth, and the overall economic outlook for the United States economy for 2018 is positive.

Nationally, employment rose slowly throughout 2017, though the slow pace in job growth has been mostly due to tight labor markets in numerous industries. The trend of high-skill jobs struggling to fill openings continued in some districts, with the problem of finding qualified labor extending into lower-skilled positions in some locations as well. This tightness in the labor market drove wage increases, a trend expected to continue through 2018.

The Federal Reserve Bank of Minneapolis covers the Ninth District of the Federal Reserve, which includes the states of Minnesota, North Dakota, South Dakota, Montana, and western Wisconsin. Economic projections for the Ninth District in early 2018 are generally strong, with wage growth expected to



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Marketview 1Q 2018 *continued from page 6*

continue in the range of three percent throughout the year, building off the momentum of a tightening employment market.

> ***"Overall, the economic health of the State of Minnesota in coming years is projected to remain strong, though considerable uncertainty remains, mostly due to national economic factors."***

Consumer spending in the district has been strong since the last Beige Book release, buoyed by a strong holiday and winter tourism season. With the overall economy preforming well, both commercial and residential construction were relatively strong in the Minneapolis-St. Paul metropolitan area, though not as strong in outlying areas of the district. Economic conditions have generally been better in Minneapolis-St. Paul than the surrounding district. It should be noted, the economic impact on the local economy of Super Bowl LII will not be known until the release of the next Beige Book.

In the most recent economic outlook provided by the Minnesota Office of Management and Budget (released November 2017), total wage and salary growth of 4.7% per year is projected to occur over the next two years, as a strong demand for employees combined with a tight labor market continues to coax wages upward. Wage growth is anticipated to outpace inflation over that period. The population of the state is anticipated to rise by 0.7% over the course of 2018, while housing permits issued rise by 1.4%. Overall, the economic health of the State of Minnesota in coming years is projected to remain strong, though considerable uncertainty remains, mostly due to national economic factors.

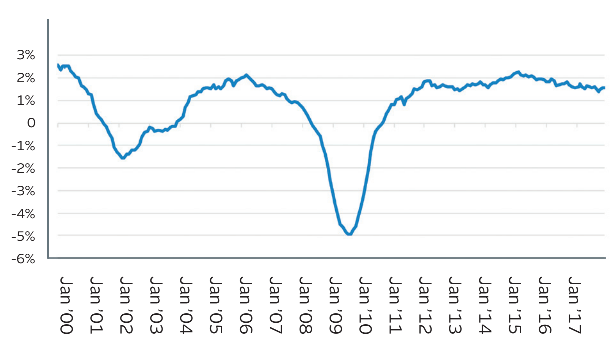
Throughout the first half of 2017, the national manufacturing sector fluctuated, due in part to poor performance from some industries within the sector. According to the ISM Report on Business, the PMI (Purchasing Managers' Index) was recorded at 59.1% in January 2018, down slightly from 59.3% recorded in December 2017, and up significantly from the 56.0% recorded in January 2017.

Economic activity in the non-manufacturing sectors (NMI) was 59.9% in January 2018, up from the 56.0% recorded in December 2017 and the 56.5% recorded in January 2017. The graph on page 6 presents the PMI and NMI index readings since the start of 2000.

Data from the Bureau of Labor Statistics show that non-farm employment at the national level increased by roughly 1.56% in the year that ended in December 2017, on the net addition of roughly 2.29 million jobs. Job growth by percentage was the largest in the Mining and Logging sector, which added 54,000 jobs, a year-over-year gain of 8.4%. The Construction sector added far more jobs overall (271,000 jobs), but showed a smaller percentage gain, at 4.0%. The Transportation and Warehousing sector also showed a gain of 2.7% (141,700 jobs). Year-over-year losses were observed in the Information (-44,000 jobs, 1.6%), Utilities (-2,300 jobs, 0.4%), and Retail Trade (-3,800 jobs, less than 0.1%) sectors. The following graph presents overall national non-farm employment growth in the United States from 2000 through 2017.

United States
Non-Farm Employment Growth

Source: Bureau of Labor Statistics



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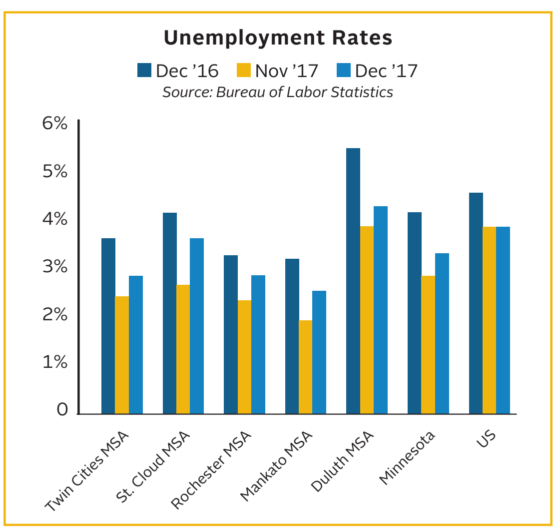
Marketview 1Q 2018 *continued from page 7*

Employment gains noted across nearly all major sectors continue to put downward pressure on national, statewide, and local unemployment rates. Nationally, the non-seasonally adjusted unemployment rate decreased to 3.9% in December 2017, down 60 basis points from the 4.5% rate recorded 12 months prior. The non-seasonally adjusted unemployment rate in the State of Minnesota stood at 3.3% in December 2017, down 80 basis points from the 4.1% rate recorded in December 2016.

Within the state, unemployment rates in December 2017 fell in every major metropolitan area when compared to their rates in December 2016. In the Minneapolis-St. Paul MSA, the year-over-year unemployment rate fell 70 basis points, from 3.6% to 2.9%. Smaller metropolitan areas posted similar improvements in unemployment rates, with the rate falling by 60 basis points in the St. Cloud MSA (to an December 2017 rate of 3.6%), by 60 basis points in the Mankato MSA (2.5%), and by 50 basis points in the Rochester MSA (2.8%). The Duluth MSA, which has generally had the highest unemployment rate of the Minnesota metropolitan areas over the past several decades, saw the unemployment rate fall by 120 basis points, to 4.3%.

The following graph presents non-seasonally adjusted unemployment rates at the national, state, and local levels.



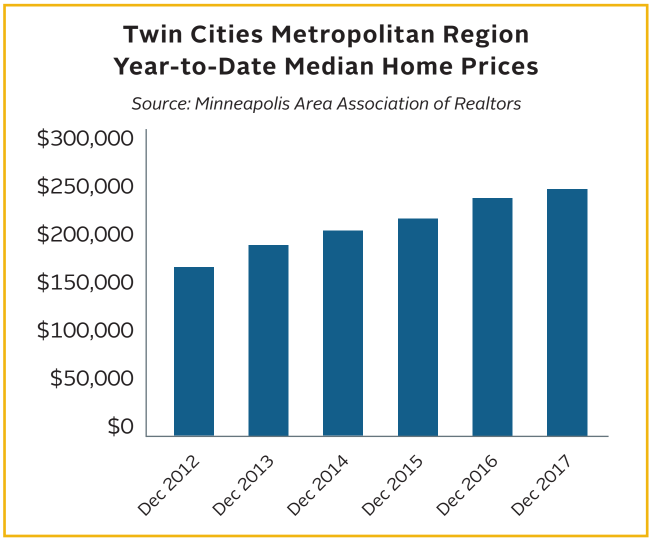
Retail sales and real estate markets remain healthy nationally, aiding economic growth. According to the U.S. Census Bureau, retail sales at the national level grew by 4.2% in 2017 (projected) when compared to year-end figures from 2016. Consumer confidence was measured at 125.4 in January 2018, up from 123.1 in December 2017. The University of Michigan Consumer Sentiment Index stood at 95.7 in January 2018, down from 95.9 in the prior month, and down from 98.5 in January 2017.

Meanwhile, transaction volume in the real estate markets continues to drive further growth and underlying market fundamentals are generally encouraging. According to the National Association of Realtors, existing home sales in the nation rose by 1.1% in 2017 when compared to 2016, with the 6.48 million existing home sales in the year the highest recorded since 2006. When comparing December 2017 to the previous year, however, sales fell by 3.6%, though median home sales prices rose by 5.8%, from $233,300 in December 2016 to $246,800 in December 2017. Over the same period, all four regions of the United States saw median existing home prices increase. In the commercial sector, fundamentals across all four major property types at the national level remain healthy to improving.

Conditions in the residential and commercial real estate markets within the Twin Cities market mirror national trends. According to data released by the Minneapolis Area Association of Realtors, in the Twin Cities for-sale residential market, the projected number of year-to-date closed home sales remained roughly flat in December 2017. Year-to-date median existing home sale prices in the region increased by 6.9% from December 2016 to December 2017, rising from $232,000 to $247,900. Further indicating healthy demand, the average days on market decreased by 14.1% and the percentage of original list price received increased by 0.9% during this same period to 98.4%, as available inventory remains lim-

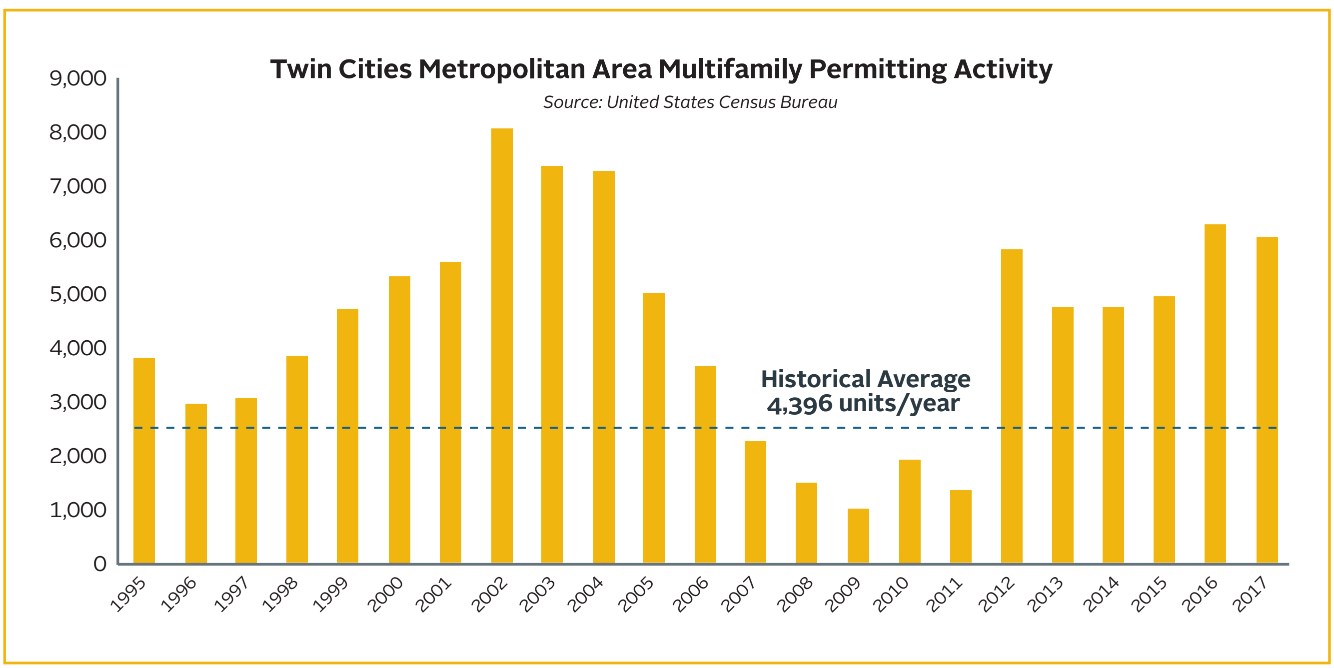
continued on page 9

ited. The following graph presents historical median home sale prices in the Twin Cities market.



The local apartment market is strong, with underlying fundamentals in the Twin Cities apartment market among the strongest in the nation. While new construction activity in the Twin Cities market remains above historical norms, demand continues to exceed the pace of new additions to the existing apartment inventory, keeping vacancy rates well-below the market equilibrium of 5.0% and putting upward pressure on rental rates. According to Marcus and Millichap, the vacancy at the end of 2017 was 2.9%, with 5,100 apartment units expected to be added to the local market in 2018. At the same time, 34,000 new jobs are expected to be created. Effective rents rose 5.1% over the course of the year, to $1,298. At the same time, demographic trends are in place to suggest demand for apartment units will remain healthy over the long term.

"The local apartment market is strong, with underlying fundamentals in the Twin Cities apartment market among the strongest in the nation."



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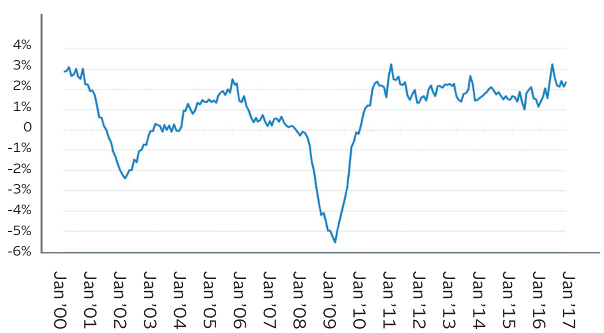
Marketview 1Q 2018 *continued from page 9*

The region's broad-based economy and employment growth continue to facilitate healthy demand within both the local for-sale residential and apartment markets. Non-farm employment in the Twin Cities metropolitan area increased by 2.37% over the year ended in August 2017 on the net addition of about 46,700 jobs. Growth in the Twin Cities market was strongest within the Mining, Logging, and Construction sector, which saw a 10.2% year-over-year increase (on the strength of 7,200 new jobs). The Leisure and Hospitality sector saw a 4.1% year-over-year growth (7,000 new jobs), while the Education and Health Services grew by 3.8% (14,400 jobs added). Two employment sectors in the Minneapolis-St. Paul MSA recorded losses from December 2016 through December 2017, the Information sector, which contracted by 1.3% (500 jobs lost), and the Financial Activities sector, which contracted by 1.2% (1,700 jobs lost). The following graph presents overall non-farm employment growth in the Twin Cities metropolitan area.

Twin Cities Metropolitan Area
Non-Farm Employment Growth

Source: Bureau of Labor Statistics

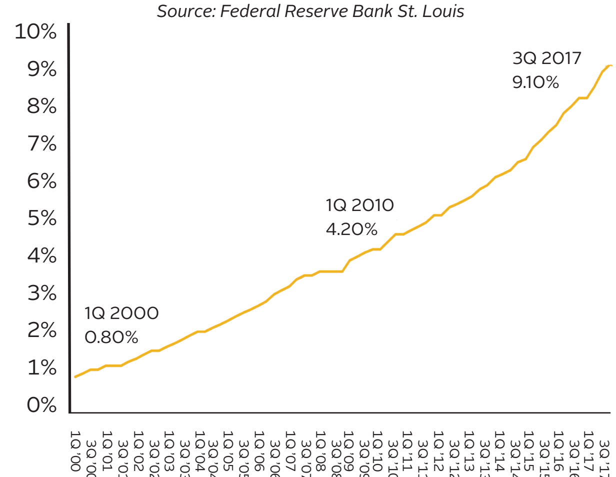


The rise of e-commerce, is driving much of the demand for warehouse and distribution space. Now accounting for 9.1% of total retail sales (more than double the market share posted in 2010), e-commerce is anticipated to continue rising at a steady pace, and will continue to foster strong demand for warehouse and distribution space in the local, regional, and national industrial markets into the long term, while possibly hurting brick-and-mortar retail locations. The following graph presents historical e-commerce retail sales as a percent of total retail sales. VV

> *"Non-farm employment in the Twin Cities metropolitan area increased by 2.37% over the year ended in August 2017 on the net addition of about 46,700 jobs."*

E-Commerce Retail Sales
as a Percent of Total Retail Sales

Source: Federal Reserve Bank St. Louis



Data referenced in this report was current as of February 2018, and includes preliminary figures, which are subject to revision.

Market Transaction: Business Valuation

General Mills Buys Blue Buffalo

Synopsis:	General Mills (#165 in 2017 Fortune 500, headquartered in Golden Valley) acquired Blue Buffalo (based in Wilton, Connecticut), a manufacturer of dog and cat food.
Approved:	January 4, 2017
Date of Sale:	February 23, 2018
Zoning:	B4-2 Downtown Business District
Sellers:	Macy's, Inc.
Purchaser:	601W Companies Minnesota, LLC
Source:	Star Tribune, Minneapolis/St. Paul Business Journal, Blue Buffalo company website
Sale price:	$8 Billion ($40 per share, 17% premium over the closing price on February 22, 2018)
Remarks:	On February 23, 2018, General Mills announced the acquisition of Connecticut-based Blue Buffalo, a manufacturer of natural dog and cat food.

On February 23, General Mills completed the second-largest acquisition in the company's history, purchasing Blue Buffalo Pet Products, a maker of cat and dog food known for their use of natural ingredients. Most famously, the brand produces "BLUE Life Protection Formula" the top-selling natural pet food in the nation. In 2017, Blue Buffalo saw sales growth of 11%, and the full year adjusted profit rose by 25%.

For General Mills, the sale represents a continued effort to break into the natural foods market, though the first such effort in the portion of the natural foods market for pets. In 2014, General Mills paid $820 million to acquire Annie's Homegrown, a successful manufacturer of natural and organic food products. In purchasing Annie's, it was estimated that General Mills paid a price to earnings multiple of about 28 times earnings before taxes and other costs, compared to an industry average of 16.5 times. In comparison, the purchase for Blue Buffalo is estimated to represent a multiple of 25 times Blue Buffalo's earnings before taxes and other costs of about $319 million.

Correction:
In the "2017 in Review" edition of Valuation Viewpoint (Volume 22, Number 4), in "Market Transactions: Top of 2017" (page 9), the sale of Central Park Commons was highlighted. The shopping center was erroneously reported to contain 1.6 million square feet of retail space, when it contains 403,219 square feet. We at Shenehon apologize for the error.

SHENEHON
BUSINESS & REAL ESTATE VALUATIONS

88 South Tenth Street, Suite 400
Minneapolis, Minnesota 55403
612.333.6533
Fax: 612.344.1635
www.shenehon.com

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Contributors:
Ellis Beck, Joshua Johnson, Cody Lindman, and Bob Strachota