McIntyre Redevelopment Project

A Public/Private Partnership

July 2019

Presentation Overview

- Colliers Assignment
- Origin of Public/Private Partnership
- Project Summary
- Economic Feasibility
- Documentation Summary
- Structure of Public/Private Partnership

Colliers Assignment

Colliers Assignment

Primary Responsibilities & Process

- Evaluate Developer financial assumptions for economic feasibility
- Create financial model to evaluate project feasibility and profitability
- Assist in negotiating and structuring business terms for Public/Private Partnership to assure equitable balance for City and Developer
- Negotiate and assist with:
  - Development Agreement
  - Ground Lease
  - National Park Service Application

Origin of Public/Private Partnership

Origin of Public/Private Partnership

City has opportunity to be gifted the McIntyre Building from General Services Administration (GSA) through the National Park Service (NPS) Monument Program.

- NPS Monument Program primary requirements / challenges:
  - McIntyre Building listed on historic register and must be preserved
  - City required to retain title - grants leasehold interest to developer
  - NPS Application must be approved
    - Preservation Plan
    - Use Plan
    - Financial Plan

- Leasehold Interest
  - An agreement between title holder (City) and lessee (Developer) that defines the rights of use and occupancy for a stated term

Origin of Public/Private Partnership

City issued Request for Proposals in 2017 seeking development partner

- 3 Respondents
  - Leggat McCall Properties
    - 238,000 SF
    - Hotel anchored
  - Ocean Properties & Two International Group
    - 172,000 SF
    - Hotel anchored
  - Redgate/Kane
    - 154,000 SF
    - Office and residential anchored
- Smaller, Redgate/Kane project selected

Origin of Public/Private Partnership

City Benefits from Partnering

- No capital investment
  - Mitigated financial risk
  - Leasehold interest not subordinate to financing

- Greater input to site uses and development plan
  - No hotel
  - Increased open space & community utilization
  - Indoor community space provided at no cost

- Revenue generation opportunities, in addition to real estate taxes
  - Ground Rent
  - Project revenue sharing
  - Participation in project capital events (refinancing and leasehold interest sales proceeds)

Origin of Public/Private Partnership

City Benefits from Partnering (Continued)

- Refinancing Proceeds
  - Refinancing events happen periodically during ownership typically at loan maturity- Residential versus Commercial
  - City participates in net proceeds
    - Net proceeds = new loan amount, less transaction costs, less outstanding loan balance

- Leasehold Interest Sales Proceeds
  - Developer can and will likely sell leasehold interest during term
  - City has input into sale
  - City participates in net proceeds
    - Net proceeds = sales price, less transaction costs, less outstanding loan balance

Project Summary

Project Summary

Project Scope

City will receive 2.14 acres of land with the vacant McIntyre Building	**61,500 Gross SF** + garage & basement
Proposed renovation & redevelopment	**158,400 Gross SF**
McIntyre Building renovation/expansion	69,800 Gross SF
New buildings construction	88,600 Gross SF
Proposed open space (approx. 43% of site): hardscape, landscape	
Comprising 40,000 SF (9/10 of an acre)	
Zoning requirement: 10%	

Project Summary

Project Uses

McIntyre Building Uses	
Ground floor commercial	22,700 Rentable SF
Ground floor indoor community space	3,300 Rentable SF
Upper floor office	40,400 Rentable SF
TOTAL	**66,400 Rentable SF**
New Buildings Uses	
Ground floor commercial	12,250 Rentable SF
76 residential units	55,100 Rentable SF
TOTAL	**67,350 Rentable SF**
92 covered parking spaces	

Project Summary

Timeline

30 Months to Construct & Stabilize

Construction Period	Months 1-18
McIntyre Building Renovation Completed	Month 12
New Buildings Construction Completed	Month 18
McIntyre Building Lease Up Completed	Month 24
Project Lease Up Completed	Month 30

Economic Feasibility

Economic Feasibility

What is Economic Feasibility?

The ability of a project to meet defined investment objectives.

Objectives

1. Conclude that project pro-forma revenue streams are achievable.
2. Confirm a reasonable vacancy allocation for underwriting in the Portsmouth market.
3. Research the projected operating expenses and capital reserves to verify adequacy to operate and preserve the improvements.
4. Validate that standard underwriting requirements for securing debt capital are structured.
5. Substantiate that ownership period profit is adequate to attract equity capital.

Economic Feasibility

1. **Year 3 pro-forma revenue of $6.53 million is achievable.**

Office						
40,400	RSF	$32.50	PSF average net base rent		$	1,315,000
Commercial						
35,000	RSF	$38.90	PSF average net base rent		$	1,360,000
Operating Expense Reimbursements						
75,400	RSF				$	885,000
Apartments						
76	units	$2,975	/ month / unit average		$	2,715,000
Other Income						
Covered Parking, Pet Fees, Other Fees					$	260,000
Gross Potential Income					**$**	**6,535,000**

Economic Feasibility

2. **The Portsmouth market can support a 5% vacancy allocation for underwriting.**

- Vacancy
- Adjusted Gross Income (AGI)
  - Anticipated annual revenue to be collected & available to pay operating expenses

Gross Potential Income	6,535,000
Less Vacancy	327,000
Adjusted Gross Income	**6,208,000**

Economic Feasibility

3. **The projected annual operating expenses and capital expense reserve allocation are adequate to operate and preserve the improvements.**

- Annual operating expense budget of $1.565 million reviewed
  - Confirmed against numerous other operating budgets
- Capital expense reserve
  - $500,000 reserve account, funded over 10 years
- Net income
  - Income available to pay annual debt service and return on equity capital

Adjusted Gross Income	6,208,000
Less Operating Expenses	1,565,000
Capital Expense Reserves	50,000
Net Income	**4,593,000**

Economic Feasibility

Project Costs Funded with Project Capital

PROJECT COSTS

$61.1 Million

Community Improvements
$7.05 million (11.5%)

Building Construction
$43.25 million (71%)

Soft Costs
$10.8 million (17.5%)

PROJECT CAPITAL

$61.1 Million

Equity Capital
$21.4 million (35%)
Developer & Investment Groups

Debt Capital
$39.7 million (65%)
Financial Institution

Economic Feasibility

4. **Standard underwriting requirements for securing debt capital are achieved.**

- Debt Capital Underwriting Requirements
  - Leverage
    - Debt Capital / Project Costs $39,700,000 / $61,100,000 = 65%
  - Debt Service Coverage Ratio (DSCR)
    - Net Income / Annual Debt Service $4,593,000 / $2,855,000 = 1.60

Net Income	4,593,000
Less Annual Debt Service	2,855,000
($39,700,000 - 6% interest, 30 year amortization)	
Cash Flow After Debt Service	**1,738,000**

Economic Feasibility

5. **The project provides adequate ownership period profit to attract equity capital.**

- Real estate investment profit components
  1. Annual cash flow → return on equity capital
  2. Proceeds from a sale → return of equity capital

- Internal Rate of Return (IRR) Calculation Use
  - Industry wide applied method for comparing alternative investment opportunities and how each alternative might perform over a given ownership period.

- IRR calculation formula takes into account a discount for receiving cash flows and profit in the future versus today. Future cash flows are not as valuable as today's.

Economic Feasibility

Comparing Investment Opportunities

- Risk equals reward- the greater risk of the investment performance mandates the requirement for a greater potential reward.
- Equity capital investors and debt capital lenders weigh the risk in the requirement for reward.
- Leasehold interest generally perceived as more risky than ownership interest.

Comparing Investment Opportunities

- Stabilized investments: less risky
  - demonstrated financial performance
  - proven credit worthy tenants
  - successful locations
  - primary versus secondary markets

- Development investments: more risky
  - no financial performance history
  - all projections
  - cost overruns
  - economic cycles can change during project stabilization

Economic Feasibility

Comparing Investment Opportunities

- Investor appetites range from 12% (less risky) to 18% (more risky) with a likely additional premium for leasehold versus fee interests

Less Risky Asset Types	More Risky Asset Types
Apartments	Office
Industrial / Warehouse	Retail
Self Storage	Hotel
Mobile Home Parks	

Economic Feasibility

IRR Example

- Purchase a rental condominium unit with a $50,000 down payment (equity capital).
- Receive annual cash flows after all operating expenses and debt service payments of $2,000 the 1st year, increasing $250 per year for a 5 year ownership period (return on equity capital).
- Sell the condominium unit year 5 and receive $60,000 in sales proceeds (return of equity capital + 20% appreciation)

Equity Capital	($50,000)		
	Year 1	$2,000	
	Year 2	$2,250	
	Year 3	$2,500	
	Year 4	$2,750	
Sale Proceeds	Year 5	$3,000	+ $60,000
IRR	8.3%		

Economic Feasibility

IRR McIntyre Redevelopment

Equity Capital	($21,400,000)	
	Year 1	$ -
	Year 2	$ -
	Year 3	$1,500,000
	Year 4	$1,775,000
	Year 5	$1,900,000
	Year 6	$2,000,000
	Year 7	$2,125,000
	Year 8	$2,200,000
	Year 9	$2,325,000
	Year 10	$2,475,000
	Year 11	$2,525,000
	Year 12	$2,675,000
Leasehold Sale Proceeds	Year 13	$2,800,000 + $40,450,000
IRR	11%	

Economic Feasibility

Conclusion

McIntyre Redevelopment Project is Economically Feasible

1. Projected revenue can be achieved.
2. Vacancy assumption is realistic.
3. Operating expense projections and capital expense allocations are reasonable.
4. Project underwriting can support the proposed debt capital and the debt capital terms are achievable.
5. Equity capital can be attracted to the project based upon the assumptions and projections for financial performance.

Documentation Summary

Documentation Summary

- **Development Agreement** – ready for execution by partners
  - Binds the parties to move forward
  - Outlines general terms and structure of partnership
- **Ground Lease** – being finalized
  - Specifics of Tenant/Landlord relationship and financial obligations
  - Will be binding simultaneously with transfer of property to City
- **National Park Services Application**
  - Includes draft of ground lease
  - 3 Components:
    - Preservation Plan – accepted
    - Use Plan – accepted
    - Financial Plan – being reviewed

Documentation Summary

Proposed NPS Financial Plan

- Financial responsibilities detailed in financial plan represent the Ground Lease terms
- Reasonable Profit Provision
  - 100% excess income, above “reasonable profit”, paid to City and restricted for historic preservation uses
  - Counterintuitive to private investment
  - Financial plan draft under NPS review
    - Years 1 – 13: 21% annual operational cash flow return on owner’s equity
    - Years 14+: 15% annual operational cash flow return on owner’s equity – deficit accrual applied
    - Equity capital and accrual reset upon a sale or refinance event

Structure of Public/Private Partnership

Structure of Public/Private Partnership

Goal

Create an equitable Public/Private Partnership realizing key community objectives and establishing public space benefits. Combined with opportunities for the Public Partner to share in the profitability, while supporting the Private Partner's efforts to effectively raise capital, construct, and manage a successful redevelopment project.

Structure of Public/Private Partnership

Financial Benefit Summary

1. Real Estate Taxes
   - Projected at approximately $500,000 annually
2. Ground Lease Rent
   - Term: 75 years
   - Rent: $100,000 annually (paid monthly) commencing 18 months after building permit, increasing 2.5% annually
3. 3,311 SF of Indoor Community Space
   - No base rent, approximately $123,000 annually
   - No operating expenses, approximately $39,000 annually
4. Revenue Sharing
   - 1% of collected revenue, beginning Year 11
   - Pro-forma collected revenues Year 11: $7.5 million - $75,000
   - Revenues projected to increase 2.5% annually

Structure of Public/Private Partnership

Financial Benefit Summary (Continued)

5. Shared Proceeds from Refinancing Events
   - 7.5% of net proceeds of 1st event
   - 10% of net proceeds of all events thereafter
6. Shared Proceeds from all Leasehold Sales
   - 20% of net proceeds after an 18% IRR to the developer partner
7. Capital Expense Account
   - Segregated escrow account, payments commencing Month 30
   - Annual contribution (paid monthly) over 10 years to total $500,000 and be maintained at $500,000
   - Begins at $25,000 annually for 5 years, increases to $75,000 annually (years 6-10)
8. Financial Accountability
   - Annual financial reports will be provided

Questions