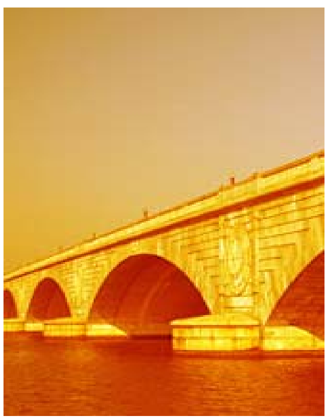

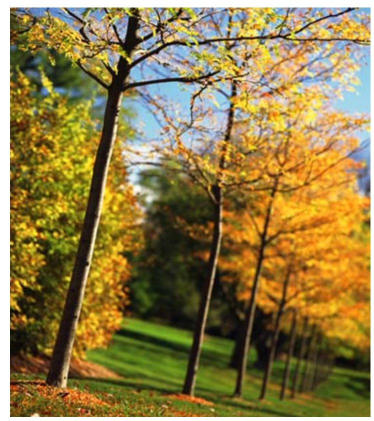

900 New Hampshire Mixed-Use Project

City of Lawrence, Kansas

3-Story Height Feasibility Analysis

Final June 12, 2012

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Mission Statement

Springsted provides high quality, independent financial and management advisory services to public and non-profit organizations, and works with them in the long-term process of building their communities on a fiscally sound and well-managed basis.

1. Executive Summary

The City of Lawrence retained Springsted to review the financial feasibility of a three-story project located at 900 New Hampshire Street, to determine if the project is feasible at height lower than the Developer's requested 4-story mixed use project. The project analyzed includes the construction of a three-story mixed-use commercial and apartment building, with corresponding site improvements, and an underground parking structure.

Springsted reviewed material prepared by the Developer and prepared TIF and TDD revenue projections. These revenue projections were utilized to determine financial feasibility of a three-story project with assistance. Springsted reviewed 10-year cash flow projections provided by the Developer, and tested the revenue and cost assumptions prepared by the Developer and determined the following:

- The projected Internal Rate of Return (IRR) to the Developer if a three-story structure is completed falls well below the current range expected within the marketplace and we conclude that the three-story alternative would not be financially feasible if a market return is expected.

- The development would have to realize either; significant savings in project costs, significant increases in project revenues, or a combination of the two to be feasible with estimated TIF/TDD assistance.

- The base return with assistance is illustrated below, along with the rate at which project assumptions would have to change for the three-story project to be considered feasible, with assistance.

Internal Rate of Return (IRR) – Feasibility Analysis

Analysis	**Change Necessary to be Feasible**	**Return with TIF/TDD**
Base Developer Return	N/A	3.83%
Decreased Costs	30% Decrease	8.61%
Increased Revenue	40% Increase	8.67%
Combined Cost Savings & Increased Revenues	16% Decreased Costs 16% Increased Revenue	8.29%

The PWC/Korpacz Real Estate Investor Survey, First Quarter 2012, reports discount rates (IRR) for the national apartment segment ranged from 5.25% to 14.0% with an average of 8.28%.

2. Purpose

The City of Lawrence has retained Springsted to review the application for a mixed-use project to be located at 900 New Hampshire Street. The project proposes the construction of a four-story structure, consisting of commercial retail space, a restaurant, apartments, and an extended-stay hotel; along with underground parking. The underground parking structure is deemed to be necessary based on the design and limited size of the site. The Developer is requesting the City Commission approve a four-story height allowance for the project, along with financial assistance in the form of Tax Increment Financing (TIF) and a Transportation Development District (TDD).

The City has requested this analysis determine the viability of the project at a reduced three-story height, both with and without the requested financial assistance. The Developer has requested permission to construct a mixed-use four-story project, which proposes to include an 81-unit extended stay hotel. According to the Developer a reduction of the project to a three-story height will result in a change to the proposed development mix, as the building would be incapable of housing a hotel of the size necessary to attract a major flag hotel brand.

The analysis that follows will examine the financial feasibility of a proposed 3-story project consisting of approximately 32 units, in addition to 14,640 square feet of retail space on the first floor. The smaller three-story project is still projected to include the 114-unit underground parking structure. The City has requested the analysis determine the viability of the project at the three-story height based on the Developer’s proposed project costs and operating revenues, with and without the requested financial assistance.

3. The Project

The 900 New Hampshire project includes the construction of a three-story structure with underground parking. The Developer indicates this iteration of the project will include approximately 32 rental units (total of 28,753 leasable square feet), and approximately 14,640 square feet of first-floor retail. In addition to the construction of the multi-use structure, site improvements will be completed. The site improvement costs include; street lights, landscaping, paving, site utilities and utility feeds associated with the development. In addition a 114-space underground parking garage will be constructed. The project costs include the following:

Item	**Cost**
Land Acquisition	$695,000
Site Improvement Costs	$845,287
Parking Garage	$2,507,472
Apartment/Retail Structure	$6,981,953
Developer Fee 4%	$413,388
Contingency (6.5%)	$671,756
Total Project Costs	**$12,114,856**

The above costs were estimated by the Developer. Additional detail is provided below:

- The land acquisition costs are related to the purchase of the site, and are based on the Developer’s contracted cost.
- Parking garage estimated at approximately $21,995 per stall for a total of 114 parking stalls and includes engineering and professional services, and a 2% contingency;
- Site improvement costs are related to the development of the site and include costs for permits, landscaping, paving, site utilities, and utility fees amongst other costs;
- The apartment/retail structure costs are related to the construction of the three-story structure. The Developer provided a cost estimate for the three-story project based on actual costs incurred in a similar neighboring project. The building cost estimate equates to a per square foot cost of $133. This cost estimate includes professional fees associated with the development of the site;
- The Developer Fee is based on 4% of the building, site work, and underground parking structure; and
- Contingency of 6.5% of the building, site work, and underground parking structure costs.

The permanent financing for the project includes, permanent private debt, partially supported by public subsidy revenues and Developer equity as follows:

Sources:	
Permanent Financing [1)]	$9,086,142
Permanent Developer Equity	$3,028,714
Total Sources	**$12,114,857**

1) *The permanent financing assumes 25 year debt with a 5.5% interest rate (estimated by the Developer). The revenue from the TIF and TDD would be provided on a pay-as-you-go basis -- revenue received would be used to offset the private debt of the Developer.*

4. Assistance Request

The Developer did not formally prepare a request for TIF and TDD assistance for the three-story project; however, for the purpose of this analysis we evaluated the potential feasibility of the project both with and without the financial assistance. We prepared TIF and TDD revenue projections based on the development assumptions provided by the Developer. Additionally, we used the TIF timing projections prepared by the Developer in their 4-story proposal. For the proposed 4-story project the Developer requested TIF and TID assistance in a principal amount of $3,352,759, plus interest at a rate of 5.5% to cover the cost of the site improvement costs and the parking garage. The Transportation Development District (TDD) would be authorized by the City to levy a 1.0% sales tax on the subject property.

For the purpose of our TIF projections we assumed a market value of $4,395,750 for the apartment portion of the project, and $1,939,656 for the commercial portion based on 7.0% and 7.5% cap rates respectively. We estimated annual sales for the commercial portion at $3,570,300, based on the Developer's $400 per square foot sale assumption for the primary retail space, and a $100 per square foot sale assumption for the other commercial space.

The annual TIF revenue is projected to be $96,052 from ad valorem property taxes, $45,521 from sales tax rebate, and $35,703 from the TDD for total annual assistance of $177,277. This amount is less than the projected annual assistance amount of $353,846 for the four-story scenario. Over a 20-year period, the assistance revenue has a projected net present value of $3,123,772 which is less than the $3,352,759 amount the Developer is seeking reimbursement for.

The TIF projections utilized in this analysis were based on information regarding timing and values prepared by the Developer, and do not take into account certain considerations for project timing and the lag in receipt of ad valorem property taxes following project construction. Additional City required TIF expenses may be included in the final amount of the TIF assistance, which may affect the rate at which the Developer is repaid or potentially the interest rate applied. Changes of this nature would have the affect of lowering the rate of return realized by the Developer in the with-assistance scenario and do not have an impact on the finding of this report.

5. Financial Feasibility/Developer Return – Proposed Three-Story Project

Utilizing the development pro forma prepared by the Developer we evaluated the proposed three-story project for feasibility. The Developer provided a 10-year operating pro forma for the mixed-use apartment and commercial property, which included all operating revenue and expense assumptions for the development, along with the appropriate inflation assumptions. The Developer's pro forma did not include TIF or TDD projections, so we prepared these based on the assumptions outlined in the previous section.

To demonstrate the potential return available to the Developer, an internal rate of return (IRR) calculation was performed, on both the with and without assistance scenarios. In order to complete an IRR analysis, a hypothetical sale of the asset is assumed in the tenth year of the pro forma by estimating the fair market value of the property. The fair market value of the asset is estimated based on the net income in the tenth year and an estimated capitalization rate, the Developer utilized a 7.0% capitalization rate for the apartment portion of the project, and a 7.5% capitalization rate for the commercial portion. These are reasonable assumptions based on current trends.

An adjustment was made to the Developer's submitted pro forma to estimate the potential IRR on an unleveraged basis. This conversion was done, in order to compare the potential return to the Developer based on the *Price Waterhouse Cooper (PWC)/Korpacz Real Estate Investor Survey, First Quarter 2012*, which provides a market comparison on which project feasibility can be judged.

Internal Rate of Return (IRR)

With TIF/TDD Payments	Without TIF/TDD Payments
3.83%	0.20%

The PWC/Korpacz Real Estate Investor Survey, First Quarter 2012, reports discount rates (IRR) for the national apartment segment ranged from 5.25% to 14.0% with an average of 8.28%.

The projected return with assistance of 3.83% falls below the desired return range as illustrated by the *PWC/Korpacz* study, which can be interpreted as an illustration that the potential three-story project, given the current projections, is unfeasible based on a comparison to market returns.

In order to understand the rate at which project assumptions would have to change for the project to be feasible at the three-story height, we performed a sensitivity analysis. Using the average return of 8.28% from the *PWC/Korpacz* study as a feasibility benchmark, we calculated the rate at which either; project costs would have to decrease, project revenues would have to increase, or a combination of the two for the project to have a feasible rate of return at the three-story height.

Internal Rate of Return (IRR) – Sensitivity Analysis

Rate of Change	Return with TIF/TDD
30% Cost Savings	8.61%
40% Increased Revenue	8.67%
Combined 16% Savings & Increased Revenues	8.29%

For the project to exceed the average national apartment market IRR of 8.28%, per the *PWC/Korpacz* study, the project would need to realize significant project cost savings or increased project revenues. Given our review of the Developer's proposed assumptions, we believe changes of the magnitude necessary for the project to be feasible at three-stories with assistance are unlikely to be realized.

6. Conclusions

This project involves the development of a vacant site. The Developer will bear all the risk until project completion and permanent financing is in place, and continued operating risk thereafter. This level of risk demands a positive return with a range between 5.25% and 14% based on the *PWC/Korpacz* study.

As detailed above, the projected IRR to the Developer if a three-story structure is completed, falls well below the current range expected within the marketplace. Therefore, Springsted concludes that the three-story alternative would not be financially feasible if a market return is expected.

7. Qualifying Statements

The above conclusions are reliant on preliminary information regarding many assumptions. These assumptions include the total cost to construct the project, the timing of Developer equity, the projected income and expenses during operation of the building, and the projected offsetting tax revenue.

We did test the project cost and revenue assumptions, and noted the level at which project assumptions would have to change for the project to be considered feasible. However, actual project costs and revenues differing from the initial assumptions would result in changes to the rate of return realized by the Developer.

The above conclusions are based on projected property tax and sales tax increment revenue generated by the three story project, as well as projected TDD sales tax revenue from the commercial operations. The Developer is requesting assistance equal to the cost of the site improvements and parking structure, which total $3,352,759. The Developer is requesting 100% of the TIF property tax revenue, 50% of the TIF sales tax revenue , and 100% of the TDD revenue as reimbursement, plus interest. For the purpose of our analysis we assumed a reimbursement interest rate of 5.5% based on the Developer’s borrowing interest rate. A higher reimbursement interest rate would result in a corresponding increase in the Developer’s return.