North Project Mixed-Use Development

City of Lawrence, Kansas

Need For Assistance Analysis

Final June 12, 2012

Table of Contents

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 need for assistance for a seven-story project located at 100 East 9th Street, to determine if the proposed project would not reasonably be anticipated to be developed without the adoption of the requested financial assistance. The project analyzed includes the construction of a seven-story mixed-use, commercial and apartment building, with corresponding site improvements, and an underground parking structure.

Springsted reviewed project costs, operating revenue and expense information, and the requested assistance revenues to determine the need for assistance for the seven-story project. 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) without assistance to the Developer falls below the current range expected within the marketplace. Based on the projected level of return without assistance we conclude the project is unlikely to be undertaken without the requested public assistance.

- The development would have to realize either; significant savings in project costs, significant increases in project revenues, or a combination of the two for the project be undertaken without the requested assistance.

- The base return without assistance is illustrated below, along with the rate at which project assumptions would have to change for the project to be considered feasible, without assistance.

Internal Rate of Return (IRR) – Return Analysis

Analysis	Change Necessary to be Feasible	Return with Subsidy
Base Developer Return	N/A	4.37%
Decreased Costs	15% Decrease	6.43%
Increased Revenue	15% Increase	6.63%
Combined Cost Savings & Increased Revenues	8% Decreased Costs 8% Increased Revenue	6.69%

2. Purpose

The City of Lawrence has retained Springsted to review the application for a mixed-use project to be located at 100 East 9th Street, referred to as the "North Project". The project proposes the construction of a seven-story structure, consisting of commercial space and apartments; 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 financial assistance in the form of Tax Increment Financing (TIF).

The City has requested this analysis determine the need for the requested TIF and TDD assistance of the project, based on the project cost and operating pro forma information provided by the Developer. The analysis that follows will examine the determination that the proposed project would not reasonably be anticipated to be developed without the adoption of the requested financial assistance.

We have approached this determination based on the proposed projects plans regarding development costs, outcomes, financing sources, and timing, to develop a measure of the Developer's expected return when compared to the amount of risk. If a project is owned and operated as an investment, a measure of return is calculated considering the time value of money, and involves an assumed sale of the property at a price appropriate in the market place. The final determination is based on whether or not the potential return is reasonable without the requested assistance, within the current marketplace and at the present time. The assistance request includes TIF (Ad valorem property taxes & sales tax rebate), and the issuance of an Industrial Revenue Bond (IRB).

3. The Project

The North Project includes the construction of a seven-story structure with underground parking. The Developer indicates the project will include approximately 114 rental apartment units (total of 106,500 leasable square feet), approximately 11,500 square feet of commercial/retail space, and an approximately 11,000 square foot clubhouse space. In addition to the construction of the multi-use structure, site improvements will be completed. The site improvement costs are estimates at this point in time, but are expected to be related to the development of the site. In addition a 120-space underground parking garage will be constructed. The project costs include the following:

Item	Cost
Land Acquisition	$1,625,000
Site Improvement Costs	$800,000
Parking Garage	$2,639,400
Apartment/Commercial Structure	$19,345,253
Bank Tenant Improvements (Developer)	$1,200,000
Bank Tenant Improvements (Tenant)	$1,200,000
Retail/Office Tenant Improvements (Developer)	$731,500
Demolition	$100,000
Total Project Costs	**$27,641,153**

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 120 parking stalls and includes engineering and professional services, and a 2% contingency;
- Site improvement costs are related to the development of the site and are based on the cost estimate for the nearby 900 New Hampshire project;
- The apartment/commercial structure costs are related to the construction of the seven-story structure. The Developer provided a cost estimate for the 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 all soft costs, contingency, and financing fees associated with the development;
- The project has total tenant improvement cost estimates of $3,131,500, of which $1,200,000 will be paid for by the proposed bank tenant.
- The demolition line-item is an estimate provided by the Developer.

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)]	$20,730,865
Permanent Developer Equity	$6,910,288
Total Sources	**$27,641,153**

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

The Developer anticipates the with assistance project will also include the issuance of an Industrial Revenue Bond (IRB) which will result in a project cost savings of approximately $946,790 through sales tax savings on purchases associated with the construction of the project. Therefore the with assistance scenarios have a slightly lower total project cost of $26,694,363, with the savings evenly split between the equity and financed amounts.

4. Assistance Request

The Developer has requested TIF assistance of $3,439,400 plus interest. The principal amount of the requested assistance is tied to the site development and underground parking structure cost. In addition to the principal amount the Developer is seeking reimbursement for interest expenses. For the purpose of reviewing the proposed TIF revenue, we adjusted the reimbursement interest rate to 5.5% based on the Developer's borrowing interest rate.

The Developer prepared TIF revenue projections based on market value assumptions of $15,042,639 for the apartments, and $2,000,000 for the commercial space. The apartment market values is based on 7.0% cap rate, while the commercial market value is based on a comparison to similar commercial space within the City.

The Developer is not estimating any annual sales to be produced by the commercial tenants. The Developer's annual TIF revenue is projected to be $202,00 from ad valorem property taxes. The Developer projects the annual TIF revenue is incapable of repaying the principal amount of $3,439,400 at the end of a 20-year period, at an interest rate of 5.5%.

The TIF projections utilized in this analysis were prepared by the Developer, and do not take into account considerations for project timing and the lag in receipt of ad valorem property taxes, following project construction. 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. Return Analysis

Utilizing the operating pro forma prepared by the Developer we evaluated the need for assistance for the proposed North Project by comparing the potential return, both with and without assistance. 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 included TIF, so we prepared an alternate pro forma without TIF to illustrate the potential return to the project without the requested assistance.

To demonstrate the potential return available to the Developer, an internal rate of return (IRR) calculation was performed. 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, which is a 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 Payments	Without TIF Payments
6.21%	4.37%

The PWC/Korpacz Real Estate Investor Survey, First Quarter 2012, reports discount rates (IRR) for the national apartment segment ranged from 5.25% to 14.00% with an average of 8.28%.

The without assistance return falls below the desired return rage as illustrated by the *PWC/Korpacz* study. Based on the marginal return without assistance, it can be interpreted that the project would be unlikely to be undertaken, given the current market conditions.

In order to understand the rate at which project assumptions would have to change for the project to be feasible without assistance, we performed a sensitivity analysis. Using the with assistance return of 6.21% as our 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 rate of return equal to the with assistance return of 6.21%.

Internal Rate of Return (IRR) – Sensitivity Analysis

Rate of Change	Return without TIF
15% Cost Savings	6.43%
15% Increased Revenue	6.63%
Combined 8% Savings & Increased Revenues	6.69%

For the project to meet or exceed the benchmark return of 6.21% without assistance, the development 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 without 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 comparable national market range of 5.25% to 14.00% as indicated in the *PWC/Korpacz* study.

As detailed above, the projected IRR to the Developer without assistance, falls below the current range expected within the marketplace. Therefore, Springsted concludes that the proposed project, without assistance would not likely be undertaken at this time without the requested assistance.

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 revenue generated by the seven story project. The Developer is requesting assistance equal to the cost of the site improvements and parking structure, which total $3,439,400. The Developer is requesting 100% of the TIF 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.