TANGIBLE
Consulting Services

DATE: May 15, 2017

TO: John Slack, Perkins+Will

FROM: Thomas Leighton, Tangible Consulting Services

RE: Bridgeview Plaza Redevelopment – Pro Forma analysis

The Bridgeview Plaza property has been identified as a potential opportunity for redevelopment of a type and scale that could impact market perceptions of north La Crosse, and invite subsequent investment in the area. A high quality redevelopment concept has been developed and illustrated for the site, representing one plausible change scenario. Tangible Consulting Services has evaluated that redevelopment concept from a financial perspective, and our findings are the subject of this memorandum. Note that the development concept is quite general, so the financial analysis is high level as well.

The development concept represents an ambitious redevelopment of the property. It creates a storefront retail corridor of special character. It offers new public park/plaza space. The place-making characteristics of the project would result in maximizing the residential and commercial rents that could be achieved in this particular part of the City—with the caveat that development in this location is pioneering, and thus will not bring the level of returns that would be achieved in parts of the city that are already seen as highly desirable locations.

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Findings

The analysis finds that the development concept is challenging but potentially achievable. It would require significant public sector financial support. Utilizing a range of assumptions, our model estimated the total development cost to be around $100 million, when all aspects of the project are accounted for. A developer, with typical financing, could support roughly 77% of these costs. This yields a financial gap of around 23% of project costs.

A good share of these costs could potentially be derived from capitalizing the future property taxes that the development would generate, using a tax increment financing mechanism. Tax increment financing is an advantageous first choice for addressing a development financial gap such as this, since it doesn't add to the tax burden on La Crosse citizens, or compete with the funding of other city needs. But the analysis suggests that tax increment financing will not be sufficient to meet the financial need. Additional public financial resources would need to be identified and employed to advance the project.

Project performance is highly sensitive to the rents that can be achieved by the development. Those rents can't be projected with a high degree of accuracy, because the prospective project is quite unique in its location, and in the context that would be built around it. There are no other developments in La

Crosse that are close comparisons. If future rents for the apartment component of the project turns out to be $1.65 per square foot, instead of $1.75, the public contribution to the project would increase to 26% of project costs. By the same token, if future rents are $1.85 per square foot, the public financial support that is required is 20% of project costs.

Analysis

This analysis evaluated:

a) The cost of the project
b) The return of the project (in the form of the operating income that would be generated), and
c) The amount of development costs that would be supported by a lender and the developer

The projected rents that the project generates, after deducting operating costs, were used to estimate both the lender contribution and the developer contribution to the project. The estimated financial gap is simply the part of the total estimated project cost that exceed the lender and developer contributions.

In reality, a project like this proceeds in multiple phases. To make it manageable, this analysis considered the development as a whole, so that total costs were incurred at a single point in time, and rents from all seven buildings were available after the project was completed.

Development costs. Development costs fall into three cost categories—a) property acquisition and site preparation, b) street construction and park development, and c) building development.

Acquisition and Site Preparation	$5,400,000
Development Cost—Streets and Parks	$1,800,000
Development Cost—Seven Buildings	$93,400,000
Total Development Cost	**$100,600,000**

For the buildings, cost estimates were derived for construction (hard) costs, soft costs, and developer fees of each component (retail, office, or residential) of each of the seven proposed buildings.

Operating Income. Rental income was also estimated for each component of each of the seven buildings, based on the estimated rent per square foot for residential, office and retail areas in the buildings. The seven buildings combined were estimated to produce around $9.3 million per year in rents, given typical vacancy rates.

Residential Gross Rent	$7,140,000
Retail Gross Rent	$660,000
Office Gross Rent	$1,450,000
Total Annual Gross Rent	**$9,300,000**

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The net operating income was derived by estimating operating expenses for each of the three development types. After deducting for operating expenses, the annual net operating income (NOI) for all seven buildings is estimated to be around $5.7 million.

Residential Net Operating Income	$4,020,000
Retail Net Operating Income	$650,000
Office Net Operating Income	$990,000
Total Net Operating Income	**$5,700,000**

Project Finance. The net operating income provides a basis for estimating the size of a loan that project would receive from a lender. This analysis used assumptions for the lender's debt service coverage ratio and loan terms that are somewhat conservative, based on current lending norms. But in the timeframe of this project they could still prove to be overly optimistic, which would result in a greater financial gap.

$5,700,000 NOI ÷ 1.25 (debt service coverage ratio) = $4,530,000 debt service
$4,530,000 debt service, given conservative prevailing loan terms for permanent development financing, equates to:

Development Loan	**$69,600,000**

The equity that a developer would bring to the project is based on a wide range of considerations, including financial return. A developer has choices about where to invest his or her resources, and a financial cushion will be built into the project because new development is inherently risky. A key financial metric for developers is the projected cash flow of the development after the debt service has been paid (cash flow after financing). The developer's investment in a project (equity) will be partly based on the project's projected cash flow after financing.

$5,700,000 NOI - $4,530,000 debt service = $1,130,000 cash flow after financing
Given an estimated 15% ratio between developer equity and its annual return, as measured by its cash flow after financing:

Developer Equity	**$7,550,000**

The estimated financial gap that the development faces is simply the remaining project cost, after the development equity and loan amount are accounted for. The financial gap represents around 23% of total project costs.

Total Development Cost	$100,600,000
Developer Equity	- $7,550,000
Loan Amount	- $69,600,000
Financial Gap	**$23,400,000**

Assumptions. The findings of this analysis are dependent on the accuracy of a wide range of assumptions, which are detailed in the last page of this memorandum. There will be errors in the assumptions, since a) the time available to gather information on each variable was not unlimited, and b) it is impossible to make perfect assumptions about costs, market conditions, developer or lender

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behavior, or what the future will hold. Having said that, this analysis worked to avoid a pattern of errors—which would have the effect of producing an overly optimistic or pessimistic assessment of the financial viability of the development concept.

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Variable Name	Assumed value	Basis for Value
% of Bridgeview property purchased	65%	P+W Concept
GFA of Bridgeview building purchased	60%	P+W Concept
Appraised value / Assessed value	115%	Tangible estimate
Timing Premium for property acquisition	10%	Tangible estimate
Premium for tenant lease negotiations (shopping center)	5%	Tangible estimate
Demolition cost (Strip Mall, psf)	$5	Multiple online rules of thumb
Demolition cost (Gas Station, Building, psf)	$10	Multiple online rules of thumb
Demolition cost (Gas Station, tank excavation)	$10,000	Recently posted website suggests $1K to $3K per tank, if there are no leaks. http://www.kompareit.com/homeandgarden/hvac-removing-underground-fuel-tank.html
Road Construction (40' width)	$700/lf	ISG
Road Construction (26' width)	$410/lf	ISG
Park Construction	$100,000	P+W
New retail rents (annually, NNN, psf)	$15	Existing rents are $8 to $10. Three Rivers Plaza rents are $16. Average La Crosse rents per Costar is $12.50.
New residential rents (monthly, psf)	$1.75	Residences of Belle Square is renting at $1.75 to $2.20 psf
Office rents (annually, NNN, psf)	$15	Existing average rent in La Crosse is $13.50 per Costar. Stanheim Building is part of Three Rivers Plaza. 30,000 s.f. Rents $16 psf NNN.
Construction Costs, residential, Buildings with Basements (psf)	$150	Actual costs from comparison developments
Soft Costs, Residential, Buildings with Basements (psf)	$25	Actual costs from comparison developments
Developer Fee, Residential, Buildings with Basements (psf)	$10	Actual costs from comparison developments
Construction Costs, Office (psf)	$173	RS Means, https://www.rsmeans.com/model-pages.aspx. 1 story, nonunion, with 8% inflation increment since 2013.
Soft Costs, Office (psf)	$24	RS Means, https://www.rsmeans.com/model-pages.aspx. 1 story, nonunion, with 8% inflation increment since 2013. TI not included. Doubled to include additional soft costs beyond architect.
Developer Fee, Office (psf)	$8	RS Means, https://www.rsmeans.com/model-pages.aspx. 1 story, nonunion, with 8% inflation increment since 2013.
Construction Costs, Retail (psf)	$117	RS Means, https://www.rsmeans.com/model-pages.aspx. Using cost for retail store. TI not included. Nonunion, with a 15% increase for quality appearance, and 8% inflation increase since 2013.
Soft Costs, Retail (psf)	$20	RS Means, https://www.rsmeans.com/model-pages.aspx. Using cost for retail store. TI not included. Nonunion, with a 15% increase for quality appearance, and 8% inflation increase since 2013. Doubled to include other soft costs.
Developer Fee, Retail (psf)	$8	RS Means, https://www.rsmeans.com/model-pages.aspx. Using cost for retail store. TI not included. Nonunion, with a 15% increase for quality appearance, and 8% inflation increase since 2013.
Vacancy Rate, Retail	8%	Tangible estimate

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Vacancy Rate, Office	5%	Tangible estimate
Vacancy Rate, Residential	4%	Tangible estimate
Residential Operating Expense (as % of Gross Potential Rent)	42%	2016 NAAHQ Operating Cost Survey. https://www.naahq.org/news-publications/units/august-2016/article/2016-naa-survey-operating-income-expenses-rental. 43.9% average for midrise to highrise buildings. Decreased slightly because it's a newer building.
Retail Operating Expense (as % of Gross Potential Rent)	2%	Tangible estimate
Office Operating Expense (as % of Gross Potential Rent)	30%	2015 IREM Report. https://www.irem.org/about-irem/media-resources/irem-releases-2015-incomeexpense-analysis-reports. 30% comes from Average Net Operating Costs of $6.31 for $19.50 avg rent. Decreased slightly because it's a newer building
Cap Rate Retail	7.3%	Costar - La Crosse 5 year average
Cap Rate Office	7.9%	Costar - La Crosse 5 year average
Cap Rate Residential	7.0%	Loopnet shows range from 5.9% to 9%, with newer downtown buildings selling for the lowest cap rates
Developer Required ROI Cap Rate	7.5%	Tangible estimate
Property Tax Rate (Retail)	2.3%	As observed for shopping center and gas station parcels
Property Tax Rate (Office)	2.3%	Assuming same as retail
Property Tax Rate (Multifamily)	2.5%	As observed in La Crosse assessment records
Loan Terms - Length	30	Tangible estimate
Loan Terms - Interest Rate	5.0%	Tangible estimate
Debt Service Coverage Ratio	1.25	Tangible estimate
Required Return on Equity	15%	Tangible estimate

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