

MEMORANDUM

**TO: Nancy Colbert Puff
Deputy City Manager, City of Portsmouth**

FROM: Barry Abramson

SUBJECT: Evaluation of Proposals for McIntyre Property

DATE: January 11, 2018

This memorandum summarizes our evaluation of the proposals submitted in response to the City's Stage II RFP for the McIntyre Property in downtown Portsmouth. Our evaluation focused on the real estate and financial elements of the proposals, based on the original proposals submitted November 6, 2017 and proposers' responses to the City's follow-up questions and requests for clarification submitted by proposers on December 15, and 20, 2017. Proposer qualifications were evaluated by City staff and all of the proposers appear to possess sufficient experience and capability to carry out their proposed projects, assuming the projects prove financially feasible.

Proposals were submitted by three development teams:

- Leggat McCall Properties
- A Joint Venture of Ocean Properties Hotels & Two International Group
- A Joint Venture of Redgate & The Kane Company

The key aspects of the proposals are discussed below, followed by exhibits summarizing:

- Development Program
- Development Cost, Market Assumptions & Est. Real Estate Taxes
- Proposed Financial Terms
- Rent Adjustments and Comments by proposers in response to program and design alternatives posed by the City

Program. The major programmatic characteristics of the proposals are summarized as follows:

Leggat McCall Properties – This is the largest program at almost 238,000 gross square feet¹. The McIntyre Building would be redeveloped for a 98-key boutique hotel with restaurants

¹ – References to gross square footage for this and other proposals exclude parking and basement

and 2,000 square feet of retail. New development would comprise 120 units of rental apartments and the bulk of the project's 23,128 square feet of retail space (approximately half proposed for a food market) plus artist stalls. 184 parking spaces would be supplied below grade.

Ocean Properties Hotels/Two International Group – This project is smaller (172,000 gross square feet) but also features a mix of hotel (120-keys in McIntyre and an addition), rental apartments (34 units) and commercial space (29,460 square feet of retail and office), with 239 parking spaces (nearly all below-grade).

Redgate/Kane – This proposal is the smallest at 149,505 gross square feet and takes a significantly different programmatic approach by proposing redevelopment of the McIntyre Building's upper floors for office (43,075 square feet) with ground floor retail (25,820 square feet). New development would include 19,510 square feet of retail (bringing the total retail program to 45,330 square feet) and 50 condos (which could be switched to 63 rental apartments if indicated by challenges with marketability due to the land lease, GSA prohibitions, or City preference). Only 67 parking spaces (mostly below-grade) are proposed which would serve the residential component.

The programmatic differences between the proposals set the stage for significant differences in design, market/feasibility risk, and financial outcome to the City.

Development Cost. Tracking with the greater magnitude of its program, Leggat McCall's proposed project has substantially higher development cost than the other proposals (approximately \$84 million versus \$66 and \$68 million for the other two proposals). Estimated total development costs for the proposals reflect many differences in program and other factors, making detailed analysis and comparison problematic at this stage. These development cost estimates must be regarded as preliminary and subject to potentially significant refinement based on refinements to program, design, value engineering, and other factors. However, we note that the TDCs are comparable on a dollar per net (rentable) square foot basis.

Market Viability. As indicated by recent market experience in downtown Portsmouth, residential and hotel appear to be market-feasible uses and the market pricing assumed by the proposers appear to be generally consistent with market experience, implying relatively limited market risk for these uses.

Retail is also a strong use in downtown, though the magnitudes of addition to supply to be absorbed and the rents assumed in the proposals vary considerably, with Redgate/Kane's proposal taking the most aggressive (and potentially problematic) stance. Its 45,000 square feet of retail space would represent a very sizable addition to a downtown inventory, estimated to be somewhere in the low hundred thousands of square feet, raising some concern for both the project's ability to absorb the space and the impact on the existing downtown retail supply. Redgate/Kane's estimated retail rents of \$45 per square foot on

triple net basis for such a large infusion of space appear to be pushing the market, with this concern only somewhat mitigated by the above-standard tenant improvement allowance that is assumed to be provided.

The major market question in the proposals is Redgate/Kane's proposed redevelopment of the McCintyre Building's upper floors for office. The downtown office market, comprised primarily of Class B and C space with only a relatively modest amount of Class A space, is healthy with minimal vacancy and a lack of available contiguous space of significant size (e.g. more than 3,500 square feet) for lease, pushing tenants out of downtown. However, two proposers (Leggat McCall and Two International), with extensive experience in office development and leasing, feel strongly that the limitations of the building, particularly very limited windows, and the inability to provide on-site parking for office tenants would strongly inhibit leasing and feasibility.

Redgate/Kane maintains that there is a strong pent-up market of tenants eager to lease blocks of space in a newly redeveloped building in this amenity-rich downtown location and that the availability of public parking nearby at the High Hanover Garage would satisfy tenants' parking expectations, allowing the project to command rents at or even above the top of the downtown market for Class A space with on-site (or owner-provided permit) parking. This market challenge would be compounded to the extent that the developer or its financing sources require space be pre-leased prior to construction (Redgate Kane proposes a 50% threshold), requiring likely multiple (fairly large, for downtown, and credit-worthy) tenants to commit well in advance of space being available for occupancy

Interviews conducted with realtors knowledgeable about the downtown office market yielded varying opinions ranging from support for Redgate/Kane's market assumptions to skepticism unless the project can provide a significant amount of tenant parking requirements on-site or, at least, in the form of landlord-provided parking permits at the Hanover High Garage (a cost not assumed in the proposer's underwriting), and even then, concern about the ability to achieve the target rental rate.

The above issues do not rule out successful preleasing and implementation of the Redgate/Kane proposal, but they do indicate its somewhat speculative nature and the sense that it poses the most risk among the proposals as to its successful implementation. A designation, significant predevelopment work, and serious preleasing effort would be required to determine the outcome.

Real Estate Taxes. Estimated assessed values and real estate taxes were developed in consultation with the City Assessor. These estimates should be considered illustrative for comparative purposes and may vary from ultimate assessments which would be based on the specific characteristics of the selected project.

Real estate taxes appear to present the greatest opportunity for the City to realize financial benefit from the project. The proposed development programs yield estimated real estate

taxes in a fairly narrow range. Estimated stabilized year annual taxes (in \$2018) range from \$850,000 for Ocean/Two International to \$980,000 for Leggat McCall, with Redgate/Kane falling in between at \$900,000. Hotel and residential condos are estimated to be the highest (assessed) value uses. If the residential component in the Redgate/Kane proposal is switched to rental, the estimated stabilized year tax for this project would be significantly reduced to \$570,000.

Proposed Terms. The major financial terms are proposed rent and allowance or allocation for environmental costs. Leggat McCall proposes the highest base rent – \$450,000 as well as a participation in upside. Redgate/Kane offers an annual base rent of \$360,000 (\$300,000 if its residential component is switched to rental) or a one-time pre-paid rent of \$4,500,000. Both of these two proposers’ base rents are proposed to escalate 10% every 5 years. Ocean/Two International proposes rent in the form of percent of gross revenues with a percentage escalating over time which their estimates indicate would grow to approximately \$350,000 by year 7. This percentage rent would be considered less reliable than the fixed base rent in the other proposals.

The proposers’ very different allowances for abatement and environmental remediation could significantly impact their ability to hold to the proposed rents (or, should such costs be less than the allowance, potentially provide an opportunity for increase in rent that can be paid to the City). Redgate/Kane provides for the strongest allowance at \$2,700,000, with Leggat McCall at \$1,050,000 and Ocean/Two International at only \$500,000.

It should be noted that other budgeted cost components could provide cushion to absorb overages in remediation or, if underestimated, cause for proposers to need to reduce rents. In this regard, Leggat McCall’s sitework and demo budget of \$6,130,000 versus much lower estimates specified by the other proposers could be meaningful.

Rent Adjustment for Potential Program and Design Alternatives. The City asked proposers to supplement their original proposals with rent adjustments for various program and design alternatives. Proposers’ responses are presented in the fourth exhibit. In some cases, the proposers did not provide adjustments where the alternative was not applicable or the proposer did not consider it to be viable. For the rent adjustments that have been presented, it should be noted that multiple adjustments would be additive and, in some instances, could push the rent payment to the City that the project could support below zero, indicating infeasibility or a need for tax reduction or other support.

Real estate tax adjustments for a limited amount of community space or affordable housing requirements would be estimated to result in relatively marginal reductions in tax revenues, and reductions in programmed square feet would yield tax decreases that could be estimated on a pro rata basis based on the per use tax assumptions presented in the exhibit.

Summary. The proposed projects and terms represent a starting point for negotiation and community process. Any of the proposals could be collaboratively molded to yield a project

which provides strong design and a high level of activation including community-oriented uses, especially on the ground floor. Negotiation may also provide an opportunity to improve financial outcome to the City and/or support additional community-desired program or design changes.

Ultimately, the selection may hinge in large part on whether the City feels strongly about giving office use (reinforcing downtown as an employment center) a chance to succeed, or, it feels risk, financial, and other concerns, or the positive programmatic aspects of hotel use (such as activation and visitor-generated economic activity) warrant opting for a proposal that reuses McIntyre for that use.

Should the City opt for the office-oriented proposal, we recommend that terms of the designation be negotiated to strongly incentivize the proposer to maximize the preleasing effort, with any potential subsequent proposed change to an alternate use subject to the City's discretion.

McIntyre Property RFP
Comparative Proposal Summary - Program

Proposal Developer	Linden Square Leggat McCall Properties hotelAVE - hotel partner			Ocean Properties Hotels & Two International Group JV			SoBow Square LLC Redgate & The Kane Company JV		
Program	Rehab	New	Total	Rehab+Addtn	New	Total	Rehab	New	Total
Residential									
Gross SF		152,312	152,312		47,954	47,954		61,100	61,100
Net SF (units)		108,236	108,236		37,691	37,691		51,950	51,950
# Units		122	122		34	34		50	50
Unit Type, Mix		rental apts: primarily 1- & 2-bed			rental apts: mostly one-bed & studios		condos:	42 1- & 2-bed & 8 THs	
NSF/Unit		887	887		1,109	1,109		1,039	1,039
							lf rental:	63 units @ 825 SF/unit	
Hotel									
# rooms	98		98	120		120			-
Gross SF	62,270		62,270	95,005		95,005			-
Net SF	47,154		47,154	64,958		64,958			-
		includes 15,500 SF of restaurants			includes 2,944 SF bar				
Office Gross, Net SF							43,075		43,075
Retail/Rest Gross, Net SF	2,032	21,096	23,128	14,701	14,759	29,460	25,820	19,510	45,330
		plus artist stalls							
Total Gr SF (excl parkg, basement)	64,302	173,408	237,710	109,706	62,713	172,419	68,895	80,610	149,505
Total Net SF	49,186	129,332	178,518	79,659	52,450	132,109	68,895	71,460	140,355
Parking # Spaces		184	184		239	239		75	75
		2 levels structured			236 in 2 levels structured & 3 surface			67 partially structured & 8 surface	
		122 resi (1/unit), 62 retail, valet hotel			for project and public			All for residtl @ 1.5/unit	

McIntyre Property RFP
Comparative Proposal Summary - Development Cost, Market Assumptions & Est. Real Estate Taxes

Proposal Developer	Linden Square Leggat McCall Properties hotelAVE - hotel partner	Ocean Properties Hotels & Two International Group JV	SoBow Square LLC Redgate & The Kane Company JV
Total Development Cost	\$83,683,467	\$65,930,618	\$67,600,000
\$/GSF	\$352	\$382	\$452
\$/NSF	\$469	\$499	\$482
Budget Allocation for:			
Abatement	\$400,000		
Contaminated soil removal	\$650,000	\$500,000	\$2,700,000
Total	\$1,050,000		
Other sitework,	Sitework & demolition: \$6,130,000	Sitework: \$1,200,000	Demolition: \$1,600,000
Market Assumptions			
Residential			
Rental Avg Monthly \$/SF	\$2,917 \$3.29	\$3,326 \$3.00	\$2,829 \$3.60
Condo Avg Price \$/SF			\$782,000 prior to discount for land lease \$753 (to be further evaluated)
Hotel ADR	\$234	\$225	
Stabl Occ Rt	80%	79%	
Office Rent, TI /SF		\$36 Mod Gross (\$30 NNN*), \$45 TI	\$27 NNN, \$60 TI*
Retail Rent, TI /SF	\$20 NNN, \$30 TI	\$40 Mod Gross (\$34 NNN*), \$45 TI * NNN based on proposer's est exp carry	\$45 NNN, \$90 TI* * high TI supports some rent premium
Real Estate Taxes \$/unit			<u>If Resi Condos</u> <u>If Resi Rental</u>
(Est Stabilized Yr \$2011 or NSF)			
Resi Rental mkt rate \$3,000	\$370,000	\$100,000	\$0 \$190,000
Resi Condos mkt rate \$10,400			\$520,000 \$0
Office \$3.50	\$0	\$0	\$150,000 \$150,000
Retail \$5.00	\$120,000	\$150,000	\$230,000 \$230,000
Hotel \$5,000	<u>\$490,000</u>	<u>\$600,000</u>	<u>\$0</u> <u>\$0</u>
Total	\$980,000	\$850,000	\$900,000 \$570,000

**McIntyre Property RFP
Comparative Proposal Summary - Proposed Financial Terms**

Proposal Developer	Linden Square Leggat McCall Properties hotelAVE - hotel partner	Ocean Properties Hotels & Two International Group JV	SoBow Square LLC Redgate & The Kane Company JV									
<p>Responsibility for Costs</p> <p>Base Rent</p> <p>annual:</p> <p>Participation Rent (subordinated)</p>	<p>LMP will bear all responsibility for site redevelopment, including ... environmental remediation expenditures...</p> <p>LMP will conduct thorough environmental and site due diligence prior to finalizing project budget, which may affect base ground lease payments</p> <p style="text-align: right;">\$450,000 escalating 10% every 5 yrs</p> <p>25% of remaining proceeds once respective parcel has achieved cumulative unleveraged return on cost of 12% (cash flow) or cumulative unleveraged IRR of 12% (sale)</p>	<p>Developer will bear all costs of development and operation of the project, subject to limitations set forth below</p> <p>Developer and City will evaluate adjustments to rental stream if development costs are materially different than anticipated to extent it affects Developer's reasonable return</p> <p>City will bear cost over \$500,000 in form of discount to ground rent or deferred RE taxes</p> <p style="text-align: center;">None</p> <p>Rent abated 1st 3 yrs following CO Yr 4 - 1% of Gross Revenues Yr 5 & 6 - 2% of Gross Revenues Thereafter - 3% of Gross Revenues</p> <p>Participation Rent Based on Developer Est Gross Revenues:</p> <table style="margin-left: auto; margin-right: auto;"> <tr> <td>Yr 4</td> <td>1%</td> <td>\$110,000</td> </tr> <tr> <td>Yr 5</td> <td>2%</td> <td>\$220,000</td> </tr> <tr> <td>Yr 7</td> <td>3%</td> <td>\$350,000</td> </tr> </table>	Yr 4	1%	\$110,000	Yr 5	2%	\$220,000	Yr 7	3%	\$350,000	<p>Est.demo and abatement costs represent best estimate based on what is known today</p> <p>Contingencies for environmental, geotechnical, property condition, any required upgrades to infrastructure</p> <p>Orig Proposal - Prepaid \$4.5M ground lease payment or alternatively an annual ground rent based on profitability level of project</p> <p style="text-align: center;">If Resi is condos: \$360,000 If Resi is rental: \$300,000 escalating 10% every 5 years</p> <p>Additional annual payment based on profits above a "reasonable rate of return"</p>
Yr 4	1%	\$110,000										
Yr 5	2%	\$220,000										
Yr 7	3%	\$350,000										

**McIntyre Property RFP
Comparative Proposal Summary - Rent Adjustments & Comments re. Program, Design Alternatives**

Proposal Developer	Linden Square Leggat McCall Properties hotelAVE - hotel partner	Ocean Properties Hotels & Two International Group JV	SoBow Square LLC Redgate & The Kane Company JV
1.a. 10,000SF Comty Use	Some combination of History Museum/ gathering space and/or District Hall concept -\$200,000	No pro forma analysis or proposals for ground rent adjustments Lost retail rent of \$350,000 - \$400,000/yr (= approx amount of est stabilized % rent)	Recommend similar gather space to District Hall If on 2nd flr: -\$235,000 If on 1st flr: -\$360,000
1.b. McIntyre as Office	Feel there are too many impediments to make office a viable use	Would evaluate if City subsidizes cost of providing more parking and guaranty spaces in High-Hanover	N/A
1.c. McIntyre as Office w no other dev on site	Same response as for 1.b.	Would need subsidy, including no developer risk for remediation	-\$285,000
1.d. 10,000 office if McIntyre not dev as office	Office on upper floors of residential or hotel building highly inefficient, given need for separate lobbies, elevators, egress stairs. 11,000 sf proposed for a market could be converted to office but difficult to create successful office in this location District Hall concept would be a better office-oriented option	Believe feaible in 14,759 SF of office/retail	N/A
1.e. 10% of residential afford @ 80%	12 affordable units: -\$270,000	4 affordable of 34 total units Believe feasible without significant trade-offs	Condo - 5 affordable units: -\$235,000 Rental - 6 affordable units: -\$175,000
2. Scale, Open Space, Steeple View	If reduce building on NE -\$80,000 corner from 5 to 4 stories (decrease 22,000 GSF, 22 units) To maintain view of steeple from Market Street, building on NE corner would need to be 1 - 2 two stories; If critical, LMP will respond to financial ramifications	Increase massing, density in other parts of site and/or less open space	Only 3 stories and 65 ft of frontage proposed on Bow St. Could explore stepping back to accommodate church view by relocating displaced units to replace PO space (may not be feasible)
3. If can't demo 1-story PO	Alternatives including 1-story on Daniel St with enclosed 9,000 SF community space replacing open plaza (\$2mm cost)	Lose up to 64 parking spaces, garage entry	Would lose Linden St, some retail. Could explore increasing density of residential building
If no Hotel in McIntyre	Don't believe office is financially viable use	Might consider rental apartments with office/retail ground flr; requires addtl parking on-site or guaranteed at High-Hanover	N/A
If Hotel Only in McIntyre, not addition	N/A	Apartments likely next best use; possibly micro-units; preferably long term stay	N/A

ASSUMPTIONS AND LIMITING CONDITIONS

- Information provided by others for use in this analysis is believed to be reliable, but in no sense is guaranteed. All information concerning physical, market or cost data is from sources deemed reliable. No warranty or representation is made regarding the accuracy thereof, and is subject to errors, omissions, changes in price, rental, or other conditions.
- The Consultant assumes no responsibility for legal matters nor for any hidden or unapparent conditions of the property, subsoils, structure or other matters which would materially affect the marketability, developability or value property.
- The analysis assumes a continuation of current economic and real estate market conditions, without any substantial improvement or degradation of such economic or market conditions except as otherwise noted in the report.
- Any forecasts of the effective demand for space are based upon the best available data concerning the market, but are projected under conditions of uncertainty.
- Since any projected mathematical models are based on estimates and assumptions, which are inherently subject to uncertainty and variation depending upon evolving events, The Consultant does not represent them as results that will actually be achieved.
- The report and analyses contained therein should not be regarded as constituting an appraisal or estimate of market value. Any values discussed in this analysis are provided for illustrative purposes.
- The analysis was undertaken to assist the client in evaluating and strategizing the potential transaction discussed in the report. It is not based on any other use, nor should it be applied for any other purpose.
- Possession of this report or any copy or portion thereof does not carry with it the right of publication nor may the same be used for any other purpose by anyone without the previous written consent of The Consultant and, in any event, only in its entirety.
- The Consultant shall not be responsible for any unauthorized excerpting or reference to this report.
- The Consultant shall not be required to give testimony or to attend any governmental hearing regarding the subject matter of this report without agreement as to additional compensation and without sufficient notice to allow adequate preparation.