Development Research Partners

Date:	June 14, 2017
From:	Jesse Silverstein, Senior Economist, Development Research Partners
To:	Kevin Tilson, Director, Castle Rock Downtown Alliance
RE:	Development Proforma Review for 5th Street Apartments

Development Research Partners, Inc. (DRP) has been engaged by the Castle Rock Downtown Alliance to review the development budgets and forecast operating proforma for the referenced project.

This memorandum summarizes DRP's review and findings.

PROJECT BASIS

The 5th Street Apartments are proposed to include the following characteristics:

- 105,000 Gross sf, 6-story building 68,892 rentable sf configured as follows:

Units	Use	SF
15	2 bed	14,535
50	1 bed	39,210
5	office	2,575
105	Storage Units	12,572

- Parking for 90 cars. One floor of parking partially underground and one above ground parking garage level above that
- The corner of Jerry St and 5th will have a storefront design and false storefront windows
- 12 Washers and dryers (2 sets per floor)
- 5th floor rooftop gym and equipment including rubber flooring and TV'S
- 5th floor rooftop amenities including Astro Turf grass, hot tubs, swimming pool, fire pits, mushroom heaters, and barbeques.

SCOPE OF REVIEW

To benchmark the proposed project to the market, DRP reviewed and provided independent research regarding the following assumptions:

- Land market values
- Market rental rates
- Commercial mortgage loan rates and terms
- Commercial construction loan rates and terms
- Market survey investment criteria and yield indicators
- Feasibility gap estimates, if any

Methodology used by DRP entails evaluating construction costs, rental rates, and market performance based on the developer's proposed project specifications.

Review Goals

- Provide a third-party objective evaluation to identify potential feasibility gaps in the proposed redevelopment project.
- Evaluate the amount of up-front or annual public investment amounts needed to bridge market feasibility gaps.

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PROJECT ASSUMPTIONS

The following chart compares the as-proposed development proforma assumptions with DRP's market-derived assumptions which indicate generally prevailing market conditions. Every development project is unique and every developer has their own construction style and investment hurdle rates. The chart below compares these assumptions.

MODEL ASSUMPTIONS	Market-Based*	Developer-Proposed	Comments
Residential Rent			
1-Bedroom	$1,500/mo	$1,600/mo	
2-Bedroom	$2,000/mo	$2,550/mo	
Commercial Rent			
Office	$22/sf/yr	$22.00/ sf/yr	
Storage Units	$75/mo	$75/mo	
Lease Terms			
Residential	1	1	
Commercial (yrs)	1	1	
Expenses			
Residential	$5,000/unit/yr	na	
Office	$2/sf/yr		
Storage Units	$0		
Vacancy	5.0% + 2% economic loss	5.0% combined vacancy and economic loss	DRP assumes stabilized vacancy by end of operating year 2
L:V Ratio	70.00%	70.00%	For construction and perm financing
Interest	5.5%	6.0%	For perm financing
Amortization	25 yrs	25 yrs	For perm financing
Construction Loan Rate	6.00%	6.00%	Interest only
Growth Rate			Developer provided single-year analysis
Market Rent	2.00%	na	Assume that in the long-run, both market rents and operating expenses are subject to overall rates of inflation estimated to be 2%
Operating Expenses	2.00%	na	
Development Costs	$19,250,000	$19,272,977.50	Review of developer's budget
*DRP market research			

Estimated Feasibility Gap

To evaluate overall feasibility and potential feasibility gaps DRP developed a cash flow analysis assuming a 10-year hold with sale of the asset at the end of the hold period.

Based on investor surveys and market data reviewed by DRP, the following target rates are used to proxy investment hurdle rates of return. In other words, it is assumed the cash flow projections must yield rates within the following ranges to be considered attractive to the market:

Cash-on-Cash	Income after debt service as % of equity	10% to 20% (minimum 10%)
Internal Rate of Return (IRR)	Annual revenue and asset sale over 10 years as return on development costs	9% to 12% (minimum 9%)

A sensitivity analysis is used to evaluate potential feasibility gaps against market indicated hurdle rates, as illustrated in the table below. The gap is estimated in current 2017 dollars. While a10% cash-on-cash return is considered a minimum, most developers seek at least a 14% to 16%. return on their equity. The analysis below indicates **a feasibility gap of about $2.5 million to $3.25 million**, depending on the developer's risk tolerance.

MARKET-BENCHMARKED GAP ANALYSIS market-derived rent, expenses, market performance, and market financing terms		
Estimated Gap (2017$)	Cash-on-Cash	IRR
Target Range	10% to 20%	9% to 12%
$0	6.2%	7.3%
$2,000,000	9.5%	8.8%
$2,500,000	10.9%	9.3%
$2,750,000	11.8%	9.5%
$3,000,000	12.9%	9.7%
$3,250,000	14.2%	9.9%
$3,500,000	15.7%	10.2%

Gap Funding Analysis

The range identified above is benchmarked to market parameters. However, individual sites and projects have unique characteristics that contribute to development costs and investment performance. Specific and notable characteristics to the 5thStreet Apartments include:

- The competitive market outlook is changing as multifamily construction continues in Castle Rock, particularly in the downtown core. Current market demand and the near-term outlook is strong, however rental rates may be negatively impacted by new units coming on line, most imminently in the Riverwalk project.
- The 5th Street Apartment's location is just outside "main street" defined by Wilcox Street. This location provides a lower-key setting that will appeal to a market niche, but will compete with

projects coming on line in higher-profile locations. This is not believed to impact demand for the proposed apartments, but does imply risk to rental rates achievable.

- 5th floor rooftop amenities are planned to include 2 hot tubs, a small swimming pool, an outdoor workout area, and grill/picnic/lounge areas. These amenities are estimated to cost around $100,000 in hard costs. While these amenities will service tenants well, it is unclear how much rent premium will actually be realized.
- The project will also include storage units and 5 office spaces. These amenities carry designated rent and is anticipated will perform well.
- The Land costs are high in today's market and the developers paid a premium above solely land value in that there the two lots purchased had existing buildings with inherent value. The developer's paid $750,000 for land that would be worth an estimated $570,000 if vacant. While a change in use is not unreasonable, there are additional costs in demolishing the buildings and clearing the site.
- Construction costs continue to rise as competition for materials and labor endures.

IN CONCLUSION

The 5th Street Apartments will bring new housing units to existing housing demand. Currently there is low risk in achieving full occupancy. However, in an already high-priced rent environment there is risk in obtaining rent premiums on amenities, as well as maintaining market share with competing projects being planned.

In the market a range of 14% to 16% would most likely be sought for this project. Based on the project as described herein, it is estimated that a market-based 14% cash-on-cash return is appropriate for this proposed development.:

- **In current dollars, the feasibility gap is estimated at $3,250,000**

As with all investors, this particular developer has its own internal investment criteria, hurdle rates, and performance projections which may or may not match the market parameters used herein. The suggested ranges of gap funding will necessitate negotiation to determine the specific level acceptable to the City and the developer.

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PROJECT SUMMARY

Property Summary		Construction Loan Summary	
No. Units	Various	Loan : Cost Ratio	70%
Rentable SF	68,910	Contruction Loan Term (mos)	12
Total Construction Cost	$19,250,000	Construction Interest Rate	6.00%
Construction per Square Foot	$279	Construction Loan Amount	$13,475,000
Construction Equity	$5,775,000	Construct Loan Per RSF	$195.54
ConstructionDebt	$13,475,000		
		Perm Loan Summary	
		Perm Loan : Value Ratio	70%
Proforma		Perm Loan Amount	$13,592,349
Year Stabilized	3	Perm Loan Ammortization (yrs)	25
Stabilized NOI	$1,359,235	Perm Interest Rate	5.50%
Stabilized Cap Rate	7.00%	Perm Loan Yearly Payment	$1,001,627
Stabilized Proforma Value	$19,417,642	Perm Term	10
Stabilized Value Per RSF	$282	Perm Loan Balance	$10,215,470
Value upon Completion	$14,689,652	Loan Fees/Closing Costs	2.0%
Reversion Cap Rate	8.00%		
Growth Rate	3.00%		

GAP FUNDING - applied to contruction year equity	$3,250,000	**Feasibility Indicators (10 yr hold)**		Market Target Rate
		Cost/Value*	99.1%	*Stabilized Year
		Return on Equity (leveraged cash-on-cash)*	14.2%	10% to 20%
		IRR on Project (unleveraged)	9.9%	9% to 12%

OPERATING PROFORMA

Proforma Year		CONSTRUCT	1	2	3	4	5	6	7	8	9	10
Investment												
Construction Equity		(5,775,000)										
Construction Debt		(13,475,000)										
Construction Cost		**(19,250,000)**										
Operating Income												
Net Income from Property Operations		$0	$1,028,276	$1,333,654	$1,359,235	$1,387,822	$1,415,284	$1,442,431	$1,472,768	$1,501,911	$1,530,719	$1,562,913
GAP Funding		*$3,250,000*	*$0*	*$0*	*$0*	*$0*	*$0*	*$0*	*$0*	*$0*	*$0*	*$0*
NOI		**$3,250,000**	**$1,028,276**	**$1,333,654**	**$1,359,235**	**$1,387,822**	**$1,415,284**	**$1,442,431**	**$1,472,768**	**$1,501,911**	**$1,530,719**	**$1,562,913**
(less) Construction Loan Interest Payment			($808,500)	($808,500)								
(less) Perm Loan Payments			($1,001,627)	($1,001,627)	($1,001,627)	($1,001,627)	($1,001,627)	($1,001,627)	($1,001,627)	($1,001,627)	($1,001,627)	($1,001,627)
Operating Cash Flow		**$3,250,000**	**($781,851)**	**($476,473)**	**$357,608**	**$386,195**	**$413,657**	**$440,804**	**$471,141**	**$500,284**	**$529,092**	**$561,286**
Refinance/Gross Reversion Proceeds												$19,923,002
(less) Closing Costs	2.00%											($398,460)
(less) Loan Balance												($10,215,470)
Net Refi/Reversion Proceeds												**$9,309,072**
Unleveraged Cash Flow (NET OF CONST GAP FUNDING)		**($16,000,000)**	**$1,028,276**	**$1,333,654**	**$1,359,235**	**$1,387,822**	**$1,415,284**	**$1,442,431**	**$1,472,768**	**$1,501,911**	**$1,530,719**	**$21,087,455**
Leveraged Cash Flow (NET OF CONST GAP FUNDING)		**($2,525,000)**	**($781,851)**	**($476,473)**	**$357,608**	**$386,195**	**$413,657**	**$440,804**	**$471,141**	**$500,284**	**$529,092**	**$9,870,358**
Rates of Return Analysis												
Return on Equity (cash-on-cash)			-30.96%	-18.87%	14.16%	15.29%	16.38%	17.46%	18.66%	19.81%	20.95%	390.91%
IRR on Project (unleveraged)		9.94%										
IRR on Equity (leveraged)		15.85%										
Return on Cost			5.34%	6.93%	7.06%	7.21%	7.35%	7.49%	7.65%	7.80%	7.95%	8.12%