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Blue Back Square Proposal
Analysis of the Excess Return Issue

The Scope of Services of the Consulting Services Agreement included an analysis of the risk that the Town, through absorption of some development costs, would create an opportunity for excessive returns for the developer and developer's investors. **The Town has not subsidized excess returns for the developer, even using the developer's somewhat optimistic projections.**

The developer's detailed monthly cash flow projections of costs and operating income were reviewed. The projections were not in final form; costs have yet to be quoted as contracts and some rent and expense numbers are being revised. However, this consultant conducted some checks of costs against construction estimating manuals and discussed local market rents and expenses with landlords, and concluded that there is no likely large upside to the projected returns from either cost savings or operating income. The developer's projections are of adequate detail and show a financial structure that is realistic in the projections for a development loan.

The developer's projections indicate a barely feasible leveraged equity return, of 20.5%, over the development period, but the amount of projected equity in Blue Back Square is relatively large and thus somewhat lower returns would be expected. The developer's projections also showed the equity funding 50% of cost until fully disbursed, versus the 100% of first costs that is more typical. That delayed equity funding, backed by letter of credit or similar instrument, would tend to slightly increase equity returns. Neither of these small differences from normal deal structuring practice would cause large return changes and they are largely offsetting. These projections assumed only the condominiums in building D were built and sold. Since the Town will require the second residential phase of 60,000 SF to be built, I adjusted the pro forma for more condominiums at the same unit prices. The developer's four-year development yield would then increase to 22.9%. This is not excessive as the market for leveraged development yields is in the 20% to 25% range.

The cash flow projections were also analyzed using "standard" financial structures with more aggressive debt financing and mezzanine or joint venture equity structures, for which comparables can be quoted in the markets. The developer's projections would be feasible in a mezzanine financing, giving an **investor yield of 17.8%** versus a market range of 15% - 20%. The deal would also work as an equity joint venture with the investor having a 21.4% return, but only if the investor negotiated a larger than usual share of the residual value. The "market " for ventures is in the 20% - 25% range and this deal does not seem to offer excess returns to a development partnership.

The returns on cost, at completion of development, with cost then being net of condominium sales proceeds and interim income applied to the loan, were also analyzed. Stabilized (4th year) return on cost was projected at 11.7% and return on equity at 21.4%. Neither of these pro forma returns is excessive. The developer's operating numbers are optimistic, thus it is doubtful that returns to equity will be re-projected upward as the numbers are finalized. My own underwriting indicates returns will be less than adequate for a leveraged development risk. There are also substantial risks that actual leasing results and interest rate increases would reduce the developer's equity returns below "market" levels.

This consultant also analyzed the impact of development cost savings on development period returns and concluded that even with an analyzed 10% construction cost reduction, the developer would not get excess returns. A cost saving of that magnitude is considered very unlikely based on comparisons with published construction costs and the design of the project. However, developer's costs have not been fully quoted by a contractor and the Town should make sure that firm costs are disclosed to the Town. The Town could negotiate a reduction in the amount of Town Improvements that the Town must fund if developer achieves cost savings. A construction lender will need to see documentation of firm construction costs before closing, which could give the Town an opportunity to renegotiate it's share of costs.

See Exhibit A for a full analysis of different costs, operating income and interest rates on stabilized returns and development period returns for the developer and an equity investor. Exhibit A provides a matrix of returns that should cover a good range of outcomes.

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Joseph W. Springman, Member

Most Likely Case: a second residential phase is also built and sold.

The developers spread sheet did not Include the second residential phase. JWS added the second phase using the same unit costs and prices as the first residential phase_ The second phase was started three months after the first.

	Two Residential Phases Developer's Pro-Forma JWS Interest Calculations	Two Residential Phases Consultant's Pro-Forma JWS Interest Calculations
Development (48 mo.) 1RR	22.90%	13,90%
Stabilized Loan Balance	49,092,300	49,753,650
Stabilized Net Equity Invested	24,705,497	25,421,235
Stabilized Cost	73,797797	75,174,885
Pro-Forma N.O,1.	8,564,673	7,424,000
Debt Service, 6.75% interest	3,313,730	3,358,371
FADS	5,350,943	4,065,629
Stabilized Return on Equity	21.7%	16.0%
Stabilized Return **on Cost**	11.7%	9.9%

Interest Rate Risk:		
Debt Service: 8%. 25 year Debt	4,546,828	4,608,081
Service Coverage	1,91	1.61
Stabilized Return on equity	16.7%	11.1%

Market Return Comparison (Development Period, 48 month, Investor Yield)			
Met2anine Structure:	Investor Return	17.8%	12.6%
	Market Range	15% to 20%	15% to 20%
Equity Joint Venture **Deal:**	Investor Return	21.4%	13.6%
	Market Range	20% to 25%	20% to 25%

Conclusion: Second residential phase reduces investment with sale proceeds and offers better equity returns, but within **market range.** With less investment there is less interest rate risk, even with downside protections. Either a mezzanine or venture "reacher **deal** would work, if an investor accepted the developer's pro-forma, but not with the more conservative projected income.

Contusion: The Town has not created excess return opportunity for the developer.

Deveroper Upside Case: Developer realizes 10% savings on hard construction costs

This upside case uses the two residential phase model from **page** 2 but with lower stabilized debt and equity costs.

	Two Residential Phases Developer's Pro-Forma ,)WS Interest Calculations	Two Residential Phases Consultant's Pro-Forma J **WS** Interest Calculations
Development **(48** mo.) IRR	25.00%	13.90%
Stabilized Loan Balance	49,043,859	49,705,208
Stabilized Net Equity Invested	21,615,976	22,082,756
Stabilized Cost	70,659,835	71,787,964
Pro-Forma N.o.t,	8,664,673	7,424,000
Debt Service, **6.75%** interest	3,310,460	3,355,102
FADS	5,354,213	4,068,898
Stabilized Return on Equity	**24.8%**	**18.4%**
Stabilized Return on Cost	12.3%	**10.3%**
Alternate; Use higher interest rates and 25 **year amortization** to **evaluate** stabilized **returns:**	**4,301,419**	4,359,423
FADS	**4,363,254**	3,064,577
Stabilized Return on Equity	**20.2%**	13.9%
Debt Service: 80%, 25 year	**4542342**	4,603,594
Fads	**4,122,331**	2,820,406
Stabilized Return **On Equity**	191%	12.8%

Market Return Comparison	(Development Period, 48 month, **investor Yield)**		
Mezzanine Structure:	Investor Return	**19.2%**	14.1 %
	Market Range	**15%to20%**	15%to20%
Equity Joint Venture Deal:	Investor Return,	**23.6%**	**16.0%**
	Market Range	**20%** to **25%**	**20%** to

Note: Even with a 10%cost savings and the developer's aggressive pro forma projections, the development period yield for the equity investor would not exceed market ranges, using typical deal structures. Stabilized yields would be high, but not excessively so when more normal historical interest rates are used to project debt service.

Using the consultants income projections, the returns are, even with cost savings, below 'market", but are solid returns, even if not fully risk adjusted.

Conclusion: The Town has not created excess return opportunity for the developer.

J. W. SPRINGMAN **Company,** LLC **Client: Town of West Hartford** Date: April 28, 2003

Exhibit A to Report on Blue Back Square Proposal Developer Returns Analyses

Base Case Developer prepared a spread showing itemized monthly cash flow projections for the 36 month development and the stabilized year pro-forma The developer's spread sheet contained detailed asumptions for capital costa, rents and expenses.
The developer's spread sheet contained a minor error in the capital funding logic, which was repaired.
JWS rewrote a separate interest accrual section and added a development period IRR analysis.
Stabilized return an cost and return on equity calculations were added
JWS prepared alternate pro-forma projections based on local market **feedback_**
Only one residential phase is built in this analysis.

	One Residential Phase Developer's Pro-Forma Developer Interest Calculations	One Residential Phase Developer's Pro-Forma JWS Interest Calculations	One Residential Phase Consultant's Pro-Forma JWS Interest Calculations
Development (48 mo.) IRR	20.30%	20.5	10.50%
Stabilized Loan Balance	53,517,284	**53,136,068**	**54,037,522**
Stabilized Net Equity Invested	26,000,998	26.000,994	**26.467.774**
Stabilized Cost	79,518,282	79,137,062	80,505,296
Pro-Ferree N.O.i.	8,664,673	8,664.673	7,424,000
Debt Service, **6.75%** interest	3,612,417	3,586,685	3,647,533
FADS	5,052,256	5,077,988	3,776,467
Stabilized Return on **Equity**	19.4%	19.5%	14.3%
Stabilized Return **on** Cost	10.9%	10.9%	9.2%

Interest Rate Risk:		
Debt Service: 8%. 25 year Debt	**4,921,353**	**5,004,644**
Service Coverage	**1.76**	**1.48**
__ Stabilized Return on Equity	**14.4%**	**9.1%**

Market Return Comparison (Development Period, 48 month, Investor Yield)

Mezzanine Structure:	Investor Return	16.3%	11.0%
	Market Range	15% to 20%	15% to 20%
Equity Joint Venture Deal:	Investor Return	19.0%	**10.5%**
	Market Range ___________________	20% to 25%	**20% to 25%**

Conclusion: The property returns are slightly lower than needed to structure a typical joint venture, but would likely get mezzanine financing if the investor would accept the pro-forma. The performance of the investment at higher debt service and lower projected income indicates that it is conservatively financed with adequate equity and is not a disaster under lower income and higher debt service.