MRB group

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Engineering, Architecture & Surveying, D.P.C.

November 7, 2022

Ms. Cherisse Vickers, Executive Director
City of Newburgh IDA
City Hall, Third Floor
83 Broadway
Newburgh, NY 12550

Via email: IDADirector@cityofnewburgh-ny.gov

RE: TEST OF REASONABLENESS FINDINGS V NOV 7 2022
191 WASHINGTON STREET, LLC

Dear Cher:

The City of Newburgh Industrial Development Agency (the "IDA") is considering aiding a real estate development project in the City of Newburgh (the "City") as proposed by 191 Washington Street, LLC (the "Developer"). The proposed project includes the rehabilitation of a former school building and the construction of two new buildings into market-rate apartments, a brewery, and commercial space (the "Project"). The IDA engaged MRB Group to provide certain advisement and analysis including the completion of a cost-benefit analysis (CBA) of the Project that conforms to the requirements of Section 859-a(5) of General Municipal Law and the completion of a "reasonableness test" of the assistance being requested by the Developer.

The CBA and Test of Reasonableness analysis were delivered to the IDA on or around August 18, 2022. Subsequently, the Developer made a number of adjustments to its IDA application for assistance, such changes potentially having a material impact on the Test of Reasonableness findings. On October 19, 2022, the IDA directed MRB Group to update its CBA and Test of Reasonableness. The CBA has been delivered under separate cover and this letter serves to update our summary of the analysis and findings of the reasonableness test.

Scope of Analysis

To conduct this test of reasonableness, the IDA required the Developer to submit to MRB Group a pro forma financial analysis of the Project. MRB Group analyzed the Developer's submitted information and requested level of assistance. We compared the assumptions used in that pro forma analysis against other sources. As necessary, we adjusted the pro forma assumptions and calculated a new anticipated return or range of returns.

The analysis focused on two key outputs: (1) whether the Project would meet bank financing conditions, such as meeting minimum Debt Service Coverage Ratios (DSCR), and (2) whether the Project's pre-tax cash flow internal rate of return (IRR) would be in excess of normal returns for the area and project type. We benchmarked the projected IRR against returns listed in RealtyRates.com's "Investor Survey" to determine reasonableness.

Discussion

MRB Group requested certain pro forma financial projections, which the Developer provided in spreadsheet format (the "Projections"). The Projections included comprehensive details on the Project's:

- Sources of capital, including financing terms and conditions.
- Construction budget, including hard, soft, carrying and other costs.
- Operating revenues and expenses, including proposed PILOT terms.
- Cash flows, debt service requirements and owner returns.

For the original analysis dated August 18, 2022, MRB Group reviewed the above, asked for and received certain clarifications, and participated in two phone consultations with the Developer. After each call, the Developer provided revised Projections based on the discussions and based on our requested items for clarification. Following the IDA's request on October 19, 2022 to update the analysis, MRB Group requested and received revised pro forma financials from the Developer, which we reviewed and then discussed with the Developer in another phone consultation. To preserve confidentiality, we do not disclose the exact figures provided by the Developer and the discussions therein. However, below we note the major changes that the Developer made in its assumptions since the original August 18, 2022 analysis:

- Assessment – the Developer is using a slightly lower assumed real property tax assessment value.
- Financing structure – the Developer decreased the financial leverage of the Project by decreasing the amount of financing and increasing the amount of equity in the capital stack.
- Project cost – the Developer revised slightly downward to total Project cost.
- PILOT – the Developer made adjustments to the percentage abatement of the PILOT.

We took the information and assumptions contained within the revised Projections and benchmarked them against market data. The table below shows some of the benchmark reference values we used to evaluate the Projections, such benchmarks provided by RealtyRates.com.

Reference Values for Pro Forma Analysis

Metric	Min	Max	Average
Interest Rate - Construction	3.95%	9.95%	6.99%
Interest Rate - Permanent	2.64%	6.92%	4.82%
Debt Service Coverage Ratio*	1.10	1.86	1.43
Loan-to-Value Ratio*	55%	90%	73%
Amortization*	15	40	26
Equity Dividend Rate	6.03%	14.31%	10.58%
Capitalization Rate	n/a	n/a	7.55%

*Metric with respect to permanent financing.
Source: RealtyRates.com's "Investor Survey" 2nd Quarter 2022.

The definitions of the terms used in the table can be found below.

- Amortization: Years required at the specified interest rate to pay off the entire mortgage, including principal and interest, with a level payment.
- Capitalization Rate: The rate of return on a real estate investment property based on the net income that the property is expected to generate.
- Debt Service Coverage Ratio (DSCR): Ratio of annual mortgage payment, including interest and principal, to total net operating income (NOI, defined below).
- Equity Dividend: The dollar return to the equity component: Net Operating income - Debt Service = Equity Dividend.
- Equity Dividend Rate: Rate of return to the equity component: NOI - Debt Service = Equity Dividend / Equity Investment = Equity Dividend Rate.
- Loan-to-Value Ratio: The amount borrowed divided by the appraised value of the property, expressed as a percentage.
- Net Operating Income (NOI): Income net of all operating costs including vacancy and collection loss but not including debt service.[1]

The table below shows the comparison of the Developer's Projections to the benchmark reference values from above:

[1] Definitions provided by RealtyRates.com and Investopedia.com

Comparison of Developer Assumptions to Reference Values

Metric	Developer Assumption is:
Interest Rate - Construction	Within range
Interest Rate - Permanent	Within range
Debt Service Coverage Ratio*	Within range
Loan-to-Value Ratio*	Within range
Amortization*	Within range
Equity Dividend Rate	Within range
Capitalization Rate	Under average

*Metric with respect to permanent financing. DSCR in Year 1.

Source: RealtyRates.com's "Investor Survey" 2nd Quarter 2022.

As shown, all of the above values, except Capitalization Rate, used in the Projections were within the benchmark reference ranges[2]. The Capitalization Rate is used in financial analysis to estimate the future "exit price" of the Developer from the Project upon sale which, in this case, occurs in Year 18. The lower the Capitalization Rate, the higher the assumed sale price. Therefore, the Developer's lower assumption for this metric potentially overstates their exit price and therefore potentially <u>overstates</u> the Developer's return. Because of this, we are comfortable keeping the assumption as-is.

We also examined a number of other factors used in the Projections, including the assumed:

- Rental prices for the residential units,
- Rental rates and terms for the commercial tenants,
- Operating expenses,
- Escalation factors for income and expenses,
- Hard, soft and other costs in the construction budget.

The rental rates for the residential units were above market for Newburgh, but reasonable compared to rates in other markets in the Hudson Valley. The commercial rental rates and terms were generally consistent with the market. Operating expenses, escalation factors and the construction budget all appear to be consistent with similar projects.

Consistent with the revised IDA Application, we used the abatement schedule as shown in the table below. The column labeled "Proposed % of Impr. Taxable" references the amount of the "Improvement Value" of $8,800,000 that would be included in the calculation of the amount due under the PILOT agreement. So, for example, in Year 5, the Developer would pay a PILOT payment based on the full current $1,000,000 assessment plus 8.0% of the value of improvements.

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[2] RealtyRates.com does not provide a range for the Capitalization Rate, only an average.

Proposed PILOT Schedule

Year	Current AV	Improvement Value	Proposed % of Impr. Taxable	Impr. Value in PILOT	Total Value Subject to PILOT
Year 1	$1,000,000	$8,800,000	0.0%	$0	$1,000,000
Year 2	$1,000,000	$8,800,000	2.0%	$176,000	$1,176,000
Year 3	$1,000,000	$8,800,000	4.0%	$352,000	$1,352,000
Year 4	$1,000,000	$8,800,000	6.0%	$528,000	$1,528,000
Year 5	$1,000,000	$8,800,000	8.0%	$704,000	$1,704,000
Year 6	$1,000,000	$8,800,000	10.0%	$880,000	$1,880,000
Year 7	$1,000,000	$8,800,000	12.0%	$1,056,000	$2,056,000
Year 8	$1,000,000	$8,800,000	15.0%	$1,320,000	$2,320,000
Year 9	$1,000,000	$8,800,000	20.0%	$1,760,000	$2,760,000
Year 10	$1,000,000	$8,800,000	25.0%	$2,200,000	$3,200,000
Year 11	$1,000,000	$8,800,000	30.0%	$2,640,000	$3,640,000
Year 12	$1,000,000	$8,800,000	40.0%	$3,520,000	$4,520,000
Year 13	$1,000,000	$8,800,000	50.0%	$4,400,000	$5,400,000
Year 14	$1,000,000	$8,800,000	75.0%	$6,600,000	$7,600,000
Year 15*	$1,000,000	$8,800,000	100.0%	$8,800,000	$9,800,000

*First year of full taxes.

This results in estimated PILOT payments as shown below.

PILOT Revenue

Year	Total Value Subject to PILOT	Tax Rate	Estimated PILOT Revenue
Year 1	$1,000,000	$50.671186	$50,671
Year 2	$1,176,000	$51.684609	$60,781
Year 3	$1,352,000	$52.718302	$71,275
Year 4	$1,528,000	$53.772668	$82,165
Year 5	$1,704,000	$54.848121	$93,461
Year 6	$1,880,000	$55.945083	$105,177
Year 7	$2,056,000	$57.063985	$117,324
Year 8	$2,320,000	$58.205265	$135,036
Year 9	$2,760,000	$59.369370	$163,859
Year 10	$3,200,000	$60.556757	$193,782
Year 11	$3,640,000	$61.767893	$224,835
Year 12	$4,520,000	$63.003250	$284,775
Year 13	$5,400,000	$64.263315	$347,022
Year 14	$7,600,000	$65.548582	$498,169
Year 15	$9,800,000	$66.859553	$655,224
	TOTAL		$3,083,555

Source: Applicant, MRB

Using these revised assumptions, we modeled the return-on-equity of the project by estimating cash flows to/from the equity investor(s) with a hypothetical exit in year 18. The exit price was estimated using the terminal year NOI and the capitalization rate described above, from which we subtracted out the remaining debt principal outstanding and presumed costs of sale. This provided a simplified Internal Rate-of-Return (IRR). We compared this IRR to the benchmark reference rate shown above for Equity Dividend Rate and found it to be within the range of the benchmark.

We also calculated the Debt Service Coverage Ratio (DSCR) using the Projections and found that it is close to the average DSCR in the marketplace.

Summary of Findings

We find that the Applicant's requested assistance, including the sales tax exemption, the mortgage recording tax exemption and the PILOT abatement schedule, as amended, provides the Developer a reasonable, risk-adjusted return and the Project's DSCR is adequate for financing purposes.

Thank you for this opportunity to assist the Newburgh IDA.

Sincerely,

R. Michael N'dolo
Director of Economic Development