Advancing Communities

November 7, 2024

Ms. Cherisse Vickers, Executive Director
City of Newburgh IDA
City Hall, Third Floor
83 Broadway
Newburgh, NY 12250

Re: Test of Reasonableness Findings – Scobie Industrial Partners LLC

Dear Cher,

The City of Newburgh Industrial Development Agency (the "IDA") is considering providing assistance to a real estate development project in the City of Newburgh (the "City") as proposed by Scobie Industrial Partners LLC (the "Developer"). The proposed project is located at 5 Scobie Drive in the City of Newburgh (the "Site") and includes the construction of a 125,000 square foot speculative Class A industrial building on 15 acres of land (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.

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.
- Operating revenues.
- Cash flows, debt service requirements and owner returns.

MRB Group reviewed the above, asked for and received certain clarifications, and participated in several phone calls and email consultations with the Developer. To preserve confidentiality, we do not disclose the exact figures provided by the Developer and the discussions therein. However, we took the information and assumptions contained within the Projections and benchmarked them against market data. The table below shows some of the benchmark reference values we used to evaluate the revised Projections, such benchmarks provided by RealtyRates.com.

Reference Values for Pro Forma Analysis			
Metric	Min	Max	Average
Interest Rate - Construction	9.50%	15.45%	12.51%
Interest Rate - Permanent - All Industrial	5.60%	10.33%	7.56%
Interest Rate - Permanent - Distribution Only	5.36%	7.83%	6.72%
Debt Service Coverage Ratio*	1.10	2.05	1.44
Loan-to-Value Ratio*	50%	87%	70%
Amortization*	15	40	25
Equity Dividend Rate**	6.64%	13.84%	9.88%
Capitalization Rate	n/a	n/a	9.43%

*Metric with respect to permanent financing. **See note in narrative.
Source: RealtyRates.com's "Investor Survey" 3rd Quarter 2024.

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.

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

Comparison of Developer Assumptions to Reference Values	
Metric	Developer Assumption is:
Interest Rate - Construction	n/a
Interest Rate - Permanent - All Industrial	Within range
Interest Rate - Permanent - Distribution Only	Within range
Debt Service Coverage Ratio*	Within range
Loan-to-Value Ratio*	Within range
Amortization*	Within range
Equity Dividend Rate	Within range
Capitalization Rate	Below Average

*Metric with respect to permanent financing.
Source: RealtyRates.com's "Investor Survey" 4th Quarter 2023.

The Developer is only representing a single permanent loan to finance the Project. Therefore, the assumed construction interest rate is not applicable in this case. MRB Group made certain adjustments to the Projections, including adjusting upwards the assumed rental price (see "Important Note on Rent Price Adjustment" below) and capitalization rate to be more in line with the market data. We also adjusted the Developer's presumed exit in year 15 to account for the remaining principal on the debt. Finally, we

added into year 2 the estimated inflow of cash related to the Developer selling the assumed NYS Brownfield Cleanup Tax Credits generated as a result of the Project. The other benchmarks including interest rate, debt service coverage ratio, and amortization terms represented by the Developer are all within range of the data from RealtyRates.com.

Initially, we noted that the construction budget appeared to be significantly higher than similar projects on a per square foot basis. After discussion, the Developer indicated there will be significant environmental remediation associated with this project including the need to construct the foundation on piles. Therefore, we are comfortable with the Developer's estimated construction budget.

Using these assumptions, and the pro forma Projections received from the Developer, we modeled the levered internal rate of return (IRR) of the project by estimating cash flows to/from the Developer. As noted above, the Developer is assuming an exit price in year 15 that we estimated using the terminal year NOI and the adjusted capitalization rate as described above, from which we subtracted out the remaining debt principal outstanding. This provides a simplified Internal Rate-of-Return (IRR). We compared this IRR to the benchmark reference rate shown above for the Equity Dividend Rate. We find that the Developer's return is within the reference range.

Important Note on Rent Price Adjustment

Of important note for this analysis is that the Developer's assumed lease terms are "Triple Net" (NNN), which means that the tenant will pay a base rent (the "Base Rent") amount to the Developer, plus additional rent (the "Additional Rent") in amounts sufficient to cover the NNN charges. The Additional Rent, or NNN charges, include the cost of insurance, property taxes and common area maintenance. As such, the Developer is ultimately not the *direct* beneficiary of the presumed PILOT agreement, the tenant is, since the tenant is paying Additional Rent to cover the cost of the PILOT payments.

The future tenant, however, would naturally choose a location based on the total rent payments due, namely the combination of the Base Rent and the Additional Rent. Therefore, if a PILOT agreement were to be in place, the amount of the future Additional Rent would decrease and the Developer would be able to charge a higher Base Rent, all other things equal, and still be competitive in the marketplace. This is why MRB adjusted the assumed rental price in the Developer's projections upwards – the Developer will be able to charge more Base Rent.

MRB found that, when modeling the Projections at a rent price point without the benefit of the requested PILOT, the Project would not provide an IRR within the benchmarks from RealtyRates.com. With the assumed increase in Base Rent that the requested PILOT could allow, the Developer's IRR is within the benchmark range.

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, provides the Developer a reasonable, risk-adjusted return and the Project's financials appear to be adequate for financing purposes.

Thank you for this opportunity to assist the Newburgh IDA.

Sincerely,

R. Michael N'dolo
Director of Economic Development