January 9, 2025

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

Re: Test of Reasonableness Findings – Shaw Building, L.P.

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 Shaw Building L.P. (the “Developer”). The proposed project is located at 24 – 42 Johnes Street in the City of Newburgh (the “Site”) and involves the rehabilitation of the historic Shaw Building and the construction of a new mixed-use building on the same site. In total, the proposed project will create 53 residential mixed-income apartments and 8 ground floor commercial spaces that will include 6 artist studios and two retail commercial units (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. MRB Group compared the assumptions used in that pro forma analysis against industry-standard benchmarks from RealtyRates.com.

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

MRB Group reviewed the above and asked for and received certain clarifications via 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 Apartments	5.05%	9.35%	7.30%
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 Projections to the benchmark reference values from above:

Comparison of Developer Assumptions to Reference Values

Metric	Developer Assumption is:
Interest Rate - Construction	Below Range
Interest Rate - Permanent - All Industrial	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.

As shown, all of the above values, except the Construction Interest Rate and Capitalization Rate, used in the Projections were within the benchmark reference ranges.[1] The Capitalization Rate is used in financial

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

analysis to estimate the future "exit price" of the Developer from the Project upon sale which, in the case, is modeled in Year 15 of operations. 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 overstates the Developer's return. As such, 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 residential units
- Rental rates and terms for commercial tenants
- Operating expenses
- Escalation factors for income and expenses
- Hard, soft, and other costs in the construction budget

The rental rates for a portion of the residential units will be subject to an income restriction. Five of the Project's 53 total units will be for households earning at or below 80% Area Median Income (AMI). The remaining 48 units will be market-rate with no form of income restriction. Comparing the estimated monthly rent estimates with the local market prices, we conclude the proposed rental rates are reasonable. The commercial rental rates and terms were also generally consistent with the market. Operating expenses, escalation factors, and the construction budget all appear to be consistent with similar projects.

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