



Boston Redevelopment Authority

Harbor Tower Garage

Market Research

June 15, 2015



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I. Engagement Overview: Harbor Tower Garage Market Research

Introduction:

Real Estate Fiduciary Services, LLC (REFS) is pleased to present the following report summarizing Harbor Tower Garage Market Research.

Background:

REFS was engaged by the Boston Redevelopment Authority (“BRA”) pursuant to a Request for Proposal issued in March 2013, and a BRA Board memorandum dated May 16, 2013 to provide consulting services, which on this occasion includes market research related to likely investor return expectations for a development asset such as the current proposal for the Harbor Tower Garage location.

Engagement Objective and Scope:

The primary purpose of this engagement was to assist the BRA in obtaining a better understanding of investor return expectation on development assets similar to the current Harbor Tower Garage site proposal.

Engagement Approach:

REFS work plan included, but was not limited to, the following.

- Project planning.
- Meeting with the Developer and representatives.
- Meetings with BRA Staff.
- Conduct in-depth interviews with a variety of market participants, including appraisers, developers, investment managers, investors and mortgage lenders.
- Provide written report summarizing findings.



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II. Situation

- Developer has proposed a 1.3 million square foot, \$1.04 Billion mixed use development.
- Developer asserts that the project as designed will yield an institutional investor a 10 year unlevered IRR of 11.4% and further asserts that this level of expected return is required by the market in order to obtain desired financing.
- Developer has prepared a model based on NCREIF Property Index¹ returns adjusted for inflation and risk to support this return estimate.
- An alternative development model has also been discussed during this timeframe. This alternative model is 25% smaller in scale than that currently proposed by the developer. The developer has estimated, using a revised version of the calculation described above, that the smaller scale project would produce an unlevered IRR of 10.2% over the holding period and asserted that such an expected return cannot be financed in the current market

REFS was asked whether a mixed use project, with an expected return of 10.2% has a reasonable probability of being financed in the current market.

¹ The National Council of Real Estate Investment Fiduciaries (NCREIF) is an association of institutional real estate professionals who address vital industry issues and promote research. NCREIF produces several quarterly indices that show real estate performance returns using data submitted to us by our Data Contributing Members. The NCREIF Property Index (NPI) is a quarterly index tracking the performance of core institutional unlevered property returns in the U.S. (www.ncreif.org)



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III. REFS Activities

- In conjunction with BRA Staff, met with Developer and their consultant to gain an understanding of and analyze NCREIF Property Index model developer was using.
- In conjunction with BRA Staff, met with another Boston-based developer, and discussed both highest and best use and the notion that a smaller scale-lower density development could work on the site.
- Surveyed market re: required returns. Conversations held with:
 - Investors-2 large mid-west Pension funds
 - Investment Manager-1 substantial Boston Investor; 1 North American investor
 - Appraisers-1 large institutional focused; 1 hotel specialist
 - Mortgage Broker

The Chart below summarizes results of these discussions. The Dollar weighted calculations on the right hand side of the chart represent return calculations using the developer's cost allocations by property type and the minimum required return estimates REFS developed during its market research. (**Appendix 1**) This result suggests that the proposed 25% smaller version of the project, with a 10.2% projected return, has a reasonable probability of obtaining financing in the current market.

Harbor Towers Development			
Required Return Calculations			REFS Calculation
Property Type	Capital (\$ Mil)	Developer Proposal	Minimum Required Return
Office	\$ 535.5	10.3%	8.00%
Retail	\$ 56.6	11.3%	9.98%
Hotel	\$ 219.0	10.8%	9.40%
Condo	\$ 224.0	14.6%	9.49%
	\$ 1,035.1	11.4%	8.73%



- The information in the chart above is supported by REFS review of various industry publications regarding capital availability broadly and interest in Boston specifically. Industry publications included, but were not limited to:
 - 2015 Emerging Trends-published by Urban Land Institute and PricewaterhouseCoopers
 - 2015 Integra Realty Resources Real Estate Value Trends



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IV. REFS Observations and Conclusions:

- The NCREIF adjusted model produced by the Developer is deficient in several significant aspects resulting in its diminished usefulness:
 - The NCREIF Property Index database is comprised of operating properties only.
 - The calculation relies on the All US figures. It should be noted that the Northeast total return since inception was 9.86% vs. 9.15% for the total US. Using Northeast figures only would have resulted in a different return calculation.
 - The calculation does not consider various holding period of investment components. This would result in a return of approx. 10.8% vs. the 11.4% put forth
- The Investor Required Return is likely less than the 11.4% asserted by the Developer and is more comparable to the 10.2% projected return we were asked to evaluate:
 - Discussions with a small sample of investors, investment managers, appraisers, mortgage brokers and lenders indicate all would potentially accept a double digit return over the specified holding period.
 - Returns required by investors will in part be determined by the terms of the joint venture agreement. Preferred returns, claw backs, % of ownership can all impact the required return in a meaningful manner.
 - Institutional capital availability remains strong going into 2015. Investors plan to place \$40-50 billion in new capital in real estate. Boston benefits from a strong reputation as a gateway city and attracts significant non-US capital which is not included in the capital estimate above.

REFS believes this supports an expectation that a project with expected returns between 10 and 10.5% has a reasonable probability of getting funded.

REFS Conclusion:

Based on the calculation review described above, discussions with industry participants and a review of selected industry publications, it is REFS opinion that the Harbor Tower Garage project with a reduced project size version as we discussed and a projected return of 10.2% has a high probability of obtaining funding in the current market.



Boston Redevelopment Authority					
Expected Return Summary					
Appendix 1					
Source	Office	Retail	Hotel	Condo	Invested Dollars-weighted average
Allocated Investment (\$mil)	535.5	56.6	219	224	
Developer	10.3%	11.3%	10.8%	14.6%	11.4%
Investor-Large Midwest Pension Fund					<10% Investor was reluctant to provide specific data points regarding return criteria. However, representative was quite clear that investments with return expectations over 10% generally received "a serious look".
Investor-Large Midwest Pension Fund	Approx. 10%				Not in market presently. Described most recent deal as office development in NYC with expected returns in the high single digits.
Institutional Investment Manager					
unlevered IRR-stabilized	7.00%	7.00%	7.00%	7.00%	
development premium	3.00%	3.00%	3.00%	3.00%	
condo sale premium				3.00%	
Adjusted	10.00%	10.00%	10.00%	13.00%	10.65%
Institutional Investment Manager					
development unlevered IRR	8-10%	12%	n/a	8-8.5%	
condo sale premium			n/a	3.00%	
Adjusted	8-10%	12%	10.80%	11-11.5%	10.60% Use Developer return for Hotel; use high figure in each range 9.46% Use Developer return for Hotel; use low figure in each range
National Institutional-focused Appraisal Management Firm					
Average	9.22%	9.98%	9.40%	9.49%	9.36%
Hotel Appraiser			14-16%		
Mortgage Banker					
unlevered IRR-stabilized	6.25%	n/a	8.25%	5.25%	
development premium	3.00%	n/a	3.00%	3.00%	
condo sales premium				3.00%	
Adjusted	9.25%	11.30%	11.25%	11.25%	10.22% use developer figure for Retail

Note:

Many respondents did not participate in either all of the elements contained in the proposed mixed-use project. In some cases we adopted developer information to prepare part of a calculated result. Therefore, the table above represents REFS analysis of responses received to effectively provide a comparison to the projected return we were provided.