

12 - Acquisition Cost Proposal



Developer will obtain the land from the City either by a purchase, or a long term ground lease aggregating at least 75 years. Developer prefers to purchase the land but will consider a long term ground lease.

There are two separate private components of the project for purposes of obtaining and paying for the land.

CONDOMINIUM PORTION

For the condominium portion, the developer will purchase the fee interest in that portion of the site/air rights. The purchase price will be 10% of the net sales proceeds of the condominium units, with a floor of **\$900,000**. The plan is for 12 units, with anticipated sales prices ranging from \$750,000 to \$1,250,000. Therefore, the potential price to the City for this portion could be significantly higher than the floor (~\$1.0 million). Cash payment will be made to the City upon sale of each unit.

HOTEL/RETAIL PORTION

For the hotel/retail portion developer is willing to either purchase the land/air rights, or take a long term (75 years) Ground Lease. In order to assure financability of the hotel the purchase price and/or Ground Rent will be subordinated to the first mortgage financing, which will be no more than 65% of Project Costs. For this reason, the purchase price will be in the form of a self liquidating Purchase Money (PM) mortgage, 20 year term, and 6% interest.

The PM/Ground Rent will be based on the Residual Value of the Land. Residual Value is determined by taking the net operating income in the (3rd) stabilized year, and capitalizing that on a 8% cap rate, and attributing 10% of that finished Project Value to land. Given the NOI of \$3,487,837, the Residual Land Value is projected at \$4,359,796. The offer for a purchase therefore, would be \$4,359,796, payable in annual installments on the self liquidating PM at **\$340,000** per year.

On a Ground Rent basis, developer's offer is 8% of the Residual Value, or **\$348,784** per year. This Ground Rent will be increased by 10% every 10 years.

The aggregate capitalized consideration for the City for the site is therefore a minimum of **\$5,259,796**.

In addition to these direct payments developer proposes to share with the City a mutually agreed portion of the subsidy value of any Incentives. While developer anticipates being able to finance the project on a conventional basis (see section 13), feasibility will be greatly enhanced if developer can access some of the available or potentially available discretionary Incentives programs, such as Renovation Zone Bonds, HUD 108 loans, and/or state or federal grants or loans.

The Project is clearly financable, even in the current market. However, because the project cannot be started until the completion of the DDA Garage, final firm commitments will not be obtained until approximately three months before the start of construction. On the one hand, this enhances financability as both construction and permanent financing are becoming easier to obtain. At the same time, because current interest rates are at historic lows we have based our financing projections on conservative assumptions of interest rate and loan to value ratios.

The financing team is led by Roosevelt & Cross, which will be responsible for raising or providing the capital for the hotel/retail component and the Conference Center. Roosevelt & Cross is one of the leading underwriters for not-for-profit projects like the Conference Center.

The financing process has already begun and development budgets, pro formas and the preliminary underwriting analysis by Roosevelt & Cross completed. Discussions with Institutional Lenders will commence upon the preliminary designation by the City, and formal applications will be made upon completion of legally binding Land Disposition Agreements. We anticipate obtaining a preliminary commitment for the construction loan by April 2011, and having a firm commitment no later than August, 2011.

Attached herewith is the Development Budget. The overall project cost is in the range of \$54 Million, other than land, of which \$40 Million is for the hotel/retail complex (including the open space and related amenities); \$9 Million for the Conference Center; and \$5 Million for the residential condos.

Since this is a mixed use project, the financing will be structured in three separate but related components.

HOTEL/RETAIL

The Net Operating Income (“NOI”) is projected at \$3.5 Million for the (3rd) stabilized year. Using a conservative cap rate of 8%, the project would have an appraised value in the range of \$43.5 Million. Using an equally conservative Loan to Value Ratio of 65%, this component could support a mortgage in the range of \$28 Million (assuming the subordination of the City’s Ground Rent or Purchase Money Mortgage as set forth in Section (12)).

Assuming interest at 7.5% and a term of 25 years, debt service would be \$2,483,010. After payment of debt service and the City Ground Rent/PM, the cash available for Return on (\$12 Million) equity would be \$656,043, or 5.5% cash on cash (this is before reserves and depreciation). This is a low cash on cash return. However, we believe the likely increases in NOI over the years, and the long term value of a first class hotel operation in conjunction with the Conference Center, will provide sufficient inducement for the equity.

The feasibility of both the loan and equity financing can be enhanced through Economic Development Incentives. A key Incentive could be Renovation Zone Bonds (if the same are still available at the time of start of construction), which could reduce the interest rate by 150 basis points and thereby generate in the range of \$320,000 additional for return on equity (subject to sharing a portion of that savings with the City).

CONFERENCE CENTER

As indicated in Section 12, the Conference Center would be owned by the City, or a 501 (c) (3) controlled by it. That enables us to utilize much more attractive financing options, primarily tax exempt bonding and potential Grants or soft loans from the State. The key to this financing, though, is to have a creditworthy issuer so that the bonds can be sold on a Full Faith and Credit basis, but with a firm revenue stream that would *be* the source of payments.

The primary proposition of the Developer is that this project will be built around the most important economic development facility for Ann Arbor, the Conference Center. Since Conference Centers rarely generate enough revenue to cover debt, since they are public purpose facilities, these facilities are usually built with public sector funding. It is clear that a Conference Center of this size and quality cannot be paid for from the hotel/retail component. At the same time, we do not want to have

any costs imposed on the City for this Center. Our proposal therefore is to utilize a portion of the tax and other revenue streams that would be generated from the private portion of the project, to cover the costs of the Conference Center. That way the community obtains a most valuable asset, but without any out of pocket costs.

The specific proposal is to have the costs of the Conference Center paid for by proceeds of a Full Faith and Credit (or its equivalent) bond, issued by the City or other appropriate issuer. The debt service on this bond would be covered from a number of income streams generated for the City by the private portion of the project. These are (i) Ground Rent/PM payments - \$350,000 a year plus; (ii) real estate taxes on the hotel/retail - average of \$250,000 plus; (iii) real estate taxes on the condo portion - average of \$75,000 a year; and (iv) an up front payment of \$900,000 plus from condo sales. This would provide an annual income stream of at least **\$675,000** to cover the debt service on the bond after the up front capital payment of \$900,000.

The \$900,000 plus payments would be used as direct contribution towards the development costs of the Conference Center. The remaining costs, or \$8 Million, would be covered by the bonds. Assuming a 30 year term, 5.5% (tax exempt) interest, the annual payments on the bonds (including reserves) would be in the range of **\$545,000**. The \$675,000 generated annually from the project would therefore provide a 1.24 coverage for the bond, and leave the City with a minimum of **\$130,000** a year net real estate tax revenue. Neither sales tax revenue, nor Hotel Occupancy Tax revenues will be required to support this bond.

These economics could be improved considerably, all for the benefit of the City, if we are able to obtain incentives, through state or federal programs for this component. For example, if we could obtain a Build America Bond allocation, and have the federal government reimburse the City for 35% of the interest costs, the effective interest rate would be reduced to 3.6% and the debt service reduced to **\$436,460**. That would enable a 1.55 coverage from the sequestered income streams and leave the City with annual net real estate tax revenue of **\$238,540**.

RESIDENTIAL CONDOS

This portion will be financed in the traditional manner, which is a combination of construction loan financing (for approximately 65% of project costs), and short term investor financing (35%). We anticipate that given the limited amount of units, their connection with the hotel and the services that will be provided, and the strong market from alumni, we will be able to pre-sell most if not all of the units, which will simplify financing.

