45-18 Court Square Investment Analysis – Final Assignment Memo
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Here we will summarize our proposal as if presenting to an investment committee.

1. **What price are we willing to pay for the property if our plan is to develop it for life science use?**

   Other than the given assumptions, we chose the following:

   Actual Investment Margin/YoC: We aimed for a YoC that most closely matched the 40% investment margin required for a speculative investment, and included leasing costs (LC and TI).
   Exit Cap Rate: Calculated by adding 0.1% for each hold year after initial acquisition, resulting in a cap rate expansion of 0.7% to 5.84% at exit.
   Land Cost: We backsolved for a $120 million ($456 PSF) land (or rather existing structure) acquisition value based on our required investment margin hurdle of 40% and all other development costs
   Total Development Cost: Using the $600 and $900 PSF construction costs for existing and new construction, and adding leasing costs plus land and acquisition costs, we arrived at a total development cost of $353 million.
   Rents: We analyzed the rent comps at existing life science properties in Manhattan and projected our market rents in line with market ($99 PSF compared to market average of $103.32 PSF when excluding the two low-end outliers). Despite our location in LIC, we believe these rents are appropriate since we will offer top-of the line, newly completed space with attractive incentives for relocation which "even the playing field" with a more desirable Manhattan location.
   Additionally, we've struck a deal with a prominent, credit life-science company to pre-lease 38% of our completed building. We decided to give our anchor tenant a slightly preferential rent ($96.50 PSF) plus an additional $50 PSF of TI. This allows us to de-risk the deal before we refinance, and helps attract additional tenants during the lease-up period (18 months).
   Hold Period: We determined a hold period of 7 years including the development period (stabilized hold period of 3.5 years) is ideal, given our ability to capture a near-2x equity multiple and sell our still-new product into a surging life science market, which may correct as supply starts coming online in the future.
   Market Cap Rate: We determined the average of all Boston-area sale cap rates to be a good proxy for NYC market cap rates given the dearth of local life-science sales.
   Absorption: A key factor holding back the potential growth of the life science industry in NYC is a lack of appropriate space on the market. *Utilizing the 100,00*0 SF of additional air rights to expand our proposed development will allow us to capitalize on the 200,000 of latent demand, and any projected future demand in the life-science market. We estimated an 18-month absorption period given the gap between the latent 200,000 of demand and our GLA of 263,000 SF. We believe the market will grow in the meantime to absorb the extra

space, and life science companies will be strongly drawn to the tax incentives of our development.

2. **What impact do the government incentives have on the rent the tenant is willing to pay, as well as the price we are willing to pay for the property?**

    i. We will be taking advantage of NYC and NY State government grants that provide $200/SF towards TIs for up to 100,000 SF of life science space, which will allow us to offer more lucrative incentives in the initial leasing period, lowering our risk and making us more comfortable with paying a higher figure for the land.
    ii. The 20-year property tax abatement is a major impact on the economics of this deal. Despite all leases being NNN, we stand to benefit from this incentive by making the effective cost to tenants significantly lower, making us more competitive to comparable properties in Manhattan and increasing our chances of a quick lease-up period.
    iii. The relocation assistance program that subsidizes tenants who move from Manhattan to the Outer Boroughs will give us an additional leasing edge in the market.
    iv. Overall, government incentives increase the certainty of lease-up and exert upward pressure on the rents we can charge, although we prefer to utilize a conservative underwriting for rents and capture any potential upside as a bonus.

3. **Evaluate whether it makes sense to increase the size of the property by utilizing the 100,000 SF of additional development rights at the property. What diligence or other considerations would be important to consider when evaluating whether to use the air rights?**

    a. Given the rent vs. construction cost economics, we believe it is accretive to utilize additional air rights. Our YoC would decrease by approx. 70 bps when the additional floor area is not built out.
    b. We would also consider how best to incorporate the additional space, whether expanding the building horizontally or vertically. Life science tenants prefer large floor plates, which are particularly hard to find in NYC.
    c. We must consider zoning stipulations at 45-18 Court Square, which would dictate how exactly we can add 100,000 SF to the existing property in terms of setbacks, building envelope, maximum height, etc.

4. **Considering the Scharf family has several potential options to dispose of the property, how might we structure our offer to make it appealing to them? Please include both highest & best use analysis as well as tax recommendations including the value saved for the parties involved.**

    a. We considered multiple alternatives for this site, conducting an in-depth analysis of a condo development scenario. This option produces a land value of approximately $85 million to produce an unlevered IRR of 10%, even with the optimistic sales price of

$1500 PSF. Our life science development produces a land value of $120 million, making our proposal the most competitive.

b. Given this valuation, there is scope to evaluate a ground lease or JV if the client deems these options preferable.

5. **Identify the key risks related to this investment and perhaps how we might mitigate those risks to make the project more feasible. Address the top 3-5 risks and how you would mitigate those risks to make the project feasible.**

Leasing/Tenancy Risk: Many life science companies are startups without established credit that typically sign short-term leases. This stands in contrast to the capital-intensive nature of lab buildouts. Significant capital outlays become far riskier when dealing with non-credit tenants without long-term commitments. Given the gap between latent demand of ~200,000 SF and our project offering of 263,000 SF, we are exposed to the risk that the LIC life-science market does not grow, and we aren't able to attract tenants (or at least the required quality of tenant) at the rate we predict.

Mitigation: We plan to take advantage of the projected growth of life science incubators, which allow startups to mature and eventually move in to larger, more permanent spaces. In established life science markets, incubator space has an efficacy rate of 2.5x, meaning that the current 80,000 SF could generate an additional 200,000 SF of demand. There is currently no "graduate" space available in NYC, and we aim to capitalize on this gap in the market.

Execution Risk: Life science development is highly specialized and costly. We could have a difficult time finding reliable contractors, architects and engineers who have experience in developing life science space, particularly in the NYC market

Mitigation: We plan to work with architects and contractors that have extensive experience in developing life science space, potentially those active in Boston or other more developed markets. We could also bring in a JV partner that can bring execution know-how (possibly someone like Taconic).

Competitive Market Risk: There is currently 2 million SF of life science space in NYC, which has been fully occupied for several years. As such, Manhattan is an established market, while existing life science markets in Boston, North Carolina, and California are industry leaders, and continue to grow. LIC is somewhat of a new frontier, which may not provide the same neighborhood-intrinsic characteristics as competing life-science hubs, and one which one cannot be sure tenants will get on board with. Even if tenants are attracted to the space, we will continue to compete with more established centers for the foreseeable future.

Mitigation: LIC's Court Square submarket has prime subway access, restaurant amenities, and community feel. 45-18 Court Square will be an entirely unique offering

which can be a catalyst for a future established market in the area tailored to the needs of our prospective tenants.

6. **Do we recommend moving forward with the project? What additional diligence would we like to have on the project or market to help us decide whether we are comfortable moving forward with the project?**

   a. We would recommend moving forward with acquiring 45-18 Court Square and developing a life science center because it is a prime opportunity to capture significant demand not currently being supplied in the market.
   b. We feel confident in our underwriting, including rents and construction costs, and are offering the seller an attractive value for their property that is also accretive to us as investors.
   c. We have identified a number of risks but have mitigation plans in place that make the likelihood of success one we can get comfortable around.

Additional Diligence:

1. Explore additional leasing data for existing life science buildings in NYC and understand what lease terms are most attractive and make the most sense for our property.
2. Determine parties involved in development. Talk with multiple architects, contractors, and engineers with experience in life science developments to determine who might be the best fit for our project.
3. Get a better understanding of potential competition in LIC – Consider any other life science developments in the pipeline and determine how this might affect the current supply/demand imbalance, and the long-term success of 45-18 Court Square.
4. Speak with local and national brokers with life science exposure to determine the viability of our project and associated rents and leasing projections.
5. Continue evaluating supply/demand dynamics and potential additions to the supply pipeline as other developers become aware of this opportunity.