Real Estate Valuation and Feasibility Analysis

Course: REAL1-GC.1055.002

Final Case Study

Fall 2023

The Trophy Development JV

Situation

You are a senior portfolio manager for a $25 billion core fund – the largest of the 10 funds that your firm manages. Since it is the largest fund at the firm, the judgement you exercise over your fund's activities strongly influences the way current and potential future investors view your entire firm. The responsibility you have to the success of your entire firm is almost as meaningful as that of the CEO of the firm.

The core fund invests across numerous investment types: residential, retail, office, hospitality and industrial, so your team has the experience diverse enough to handle almost any real estate situation. The other funds at your firm handle a significant volume of value added and opportunistic investing. Development accounted for approximately 65% of all of the 70 investments and 40% of all the equity capital your firm approved over the last 12 months. You are on the investment committee, so were personally involved in reviewing and approving all of those investments. You have a high level of comfort with analyzing the valuation and feasibility of development ventures.

One of the commercial properties your fund owns in New York is 529 Broadway. It is located at Spring Street and Broadway – at the heart of the high street retail corridor in SoHo, which the hottest up and coming shopping neighborhood in New York. You always had a feeling that something transformational would happen with the property due to its irreplaceable location. Outside investor interest in the asset has increased dramatically over the last couple years as the lease for the ground floor retail tenant reaches the end of its term in approximately two years. The vice president of commercial asset management complains about getting several calls every week from brokers and operators reach out to try to buy the property.

One of the most active acquirers of prime retail properties approaches you at a conference and pleads with you to consider a JV to redevelop the asset. Intrigued, you meet with him to discuss his plan. He wants to partner with you to demolish the property and build a new 5-story building with retail on all floors or retail at lower floors and offices above. He has recently acquired several properties in the neighborhood, so has a good feel for the tenants in the market. Although he has no specific leads for this property, he mentions several large publicly traded consumer brands with strong credit that he believes would be inclined to build a flagship store in this location.

After the meeting, you return to your office and think through how to respond to the inquiry. He was throwing around valuation of $150 million, which is 80% higher than the $90 million value in the most recently appraisal you have for the property. You love the proposition of your fund owning a trophy asset in this location and believe your internal team has the skill to help structure a deal that works for both sides. Moreover, you feel strongly that you would not be doing right by your investors to allow the property to simply remain so far below its highest and best use.

Property Summary

529 Broadway is a 17,500 SF, 2-story commercial building located at the intersection of Spring Street and Broadway in New York's SoHo neighborhood. The property was built in 1940 as a shoe factory. Your firm acquired the asset in 1986 shortly after it was converted to its current use with retail on the first floor and a restaurant on the second floor. The property boasts 50 feet of frontage on Broadway and 150 feet along Spring Street. Approximately 8,750 SF is located on grade, 8,750 SF on the second floor. Zoning allows for a maximum floor area ratio (FAR) of 5, which allows for a maximum of 43,880 SF to be built above grade on the site.

The building is located in the heart of SoHo surrounded by designer boutiques, cafes, galleries, and popular restaurants. All of the tenants at the building can be vacated over the next two years, which is approximately the time needed to design and secure approvals for a new development project. It is a perfect opportunity for a developer.

Market Summary

The year is 2013 and property in New York has significantly appreciated over the last three years as rents and investor interest have increased dramatically since the "Great Recession." Perhaps the strongest appreciation has occurred in the high street retail sector as a significant number of investors have speculated that rents will double or even triple over the coming years. The hottest locations in New York are Fifth Avenue, Madison Avenue, Times Square and SoHo. Prime assets always command the highest premium when sold in the marketplace – often benefiting from speculation on market rents, rent growth and exit cap rates.

Market rents along Broadway have seen a meaningful spike over the last three years. Leases in 2010 were being signed at less than $300/SF and now are comfortably in the $500-600/SF range with asking rents for the best retail space over $1,000/SF. Since rents have driven up so dramatically, there has been a meaningful shakeout of legacy tenants who can no longer pay asking rents. Although no good statistics exist, it seems that between 15-20% of spaces are either vacant or available as landlords continue asking higher and higher rents every quarter. Some landlords, your operator included, feel they are making money by waiting to lease their space since leasing space would preclude them from participating in what higher rents the market may command in the near future.

Sponsorship

The operator has been in business for over 12 years. Its founder previously worked on Wall Street raising equity capital for private equity funds. With her skill at raising capital, she started buying retail property in New York and eventually built a meaningful property acquisition and leasing business. Over the last 5 years, she has invested in 18 existing loft buildings in SoHo.

Her plan is always to re-tenant the retail at record breaking levels. She has successfully executed that plan on almost half of her acquisitions in SoHo and has meaningful conviction that her leasing firm can keep it going. Her strong preference is to sell the asset at completion, so she has generated significant net worth. She always re-invests the money into additional projects.

Directions: Evaluate the opportunity to partner with the operator on the development of a new property at 529 Broadway. Please create an Excel model and presentation to explain your thoughts. The presentation should be approximately 5-7 minutes and consist of 5 or fewer slides (PDF or PowerPoint only – no Excel). The presentation should be as if you are pitching the investment to an equity investor and should include an overview of the valuation process and resulting pricing and returns (yield on cost, unleveraged and leveraged IRR, acquisition and exit pricing). One page should be dedicated to the top 3-5 risks and how you would mitigate those risks to make the project feasible. Students may work alone or in groups of two/ three students. If you work in a group, you may not work with someone who you have done so yet. Brevity is encouraged – the best work is concise and to the point. Please email your presentation slides and model by noon the day of your presentation.

1) What do you believe is the market price for the property today (before the development project) and after you execute the business plan, depending on your highest and best use analysis? Please justify the price by performing a "yield on cost" calculation using the below General Assumptions below. Please prepare a projected cash flow where you calculate the projected unlevered and levered returns (IRR, COC and equity multiple). Please assume the investment has an opportunistic profile, so would require 35% profit margin. Please calculate your required yield on cost based upon where you believe cap rates are after reviewing the sales comps.

2) Identify the key risks related to this investment and perhaps how one might mitigate those risks to make the investment feasible.

3) What special considerations (i.e. benefits, risks) results from the operator's involvement in the JV? How might you structure the JV to align the interests of the operator with the fund?

4) Do you recommend moving forward with the project? What additional diligence would you like to have on the project or market to help you decide whether you are comfortable moving forward with the project?

General Note: All of the information needed to evaluate the case has been provided. Do not feel compelled to do further research on the market, talk to developers, find information on the actual investment or even visit the property. If you think assumptions are needed to complete the case but are not provided, please make an assumption that you think is reasonable. Grading will not be affected as long as assumptions made are reasonable and analysis is directionally correct. The intent of the case is to go through the valuation process vs. focus on assumptions that cannot be found without further market information than has been provided.

Honor Code: You should ideally work on the Final Project alone or in groups of two or three, and not collaborate with students of any other group. You are subject to the Honor Code in this assignment, meaning you can sign a statement saying, “I have neither given nor received information on this assignment.”

General Assumptions

Property Size – 52,500 SF (8,750 SF per floor across cellar through 5th floor)

Rents – Use the comparable rents to underwrite what you expect to be achieved at the property.

Rent Growth. Expectations for rent growth range from 3% to over 5% per year over the long-term.

Vacancy – Although there no good statistics on retail store vacancy in SoHo, estimates range from 15 to 20%.

Tax Reimbursements – Retail tenants reimburse their share of taxes over a base year.

Operating Expenses – Underwriting should assume operating expenses of approximately $5/SF. Management fee will be 3% of EGR and real estate taxes should be 25% of EGR.

Investment Costs – In addition to the price, the joint venture is expected to spend $500/SF on hard cost, $200/SF for soft costs and $50/SF on closing costs.

Financing – Lenders have been willing to provide loans of 50% of stabilized value for up to 10 years at 4.0% interest without amortization.

Exit Assumptions – Use the comparable sales to underwrite what you expect to be achieved is the property were sold today. You expect cap rates to gradually expand 1% over the next 10 years. The cost of selling would be 3.5% of the exit price

Exhibit A - Property Photo

Exhibit B – Proposed Development Rendering

Exhibit C – Map of SoHo

Exhibit D – Site Plan

Exhibit E – Current Asking Rent along SoHo's Broadway Corridor

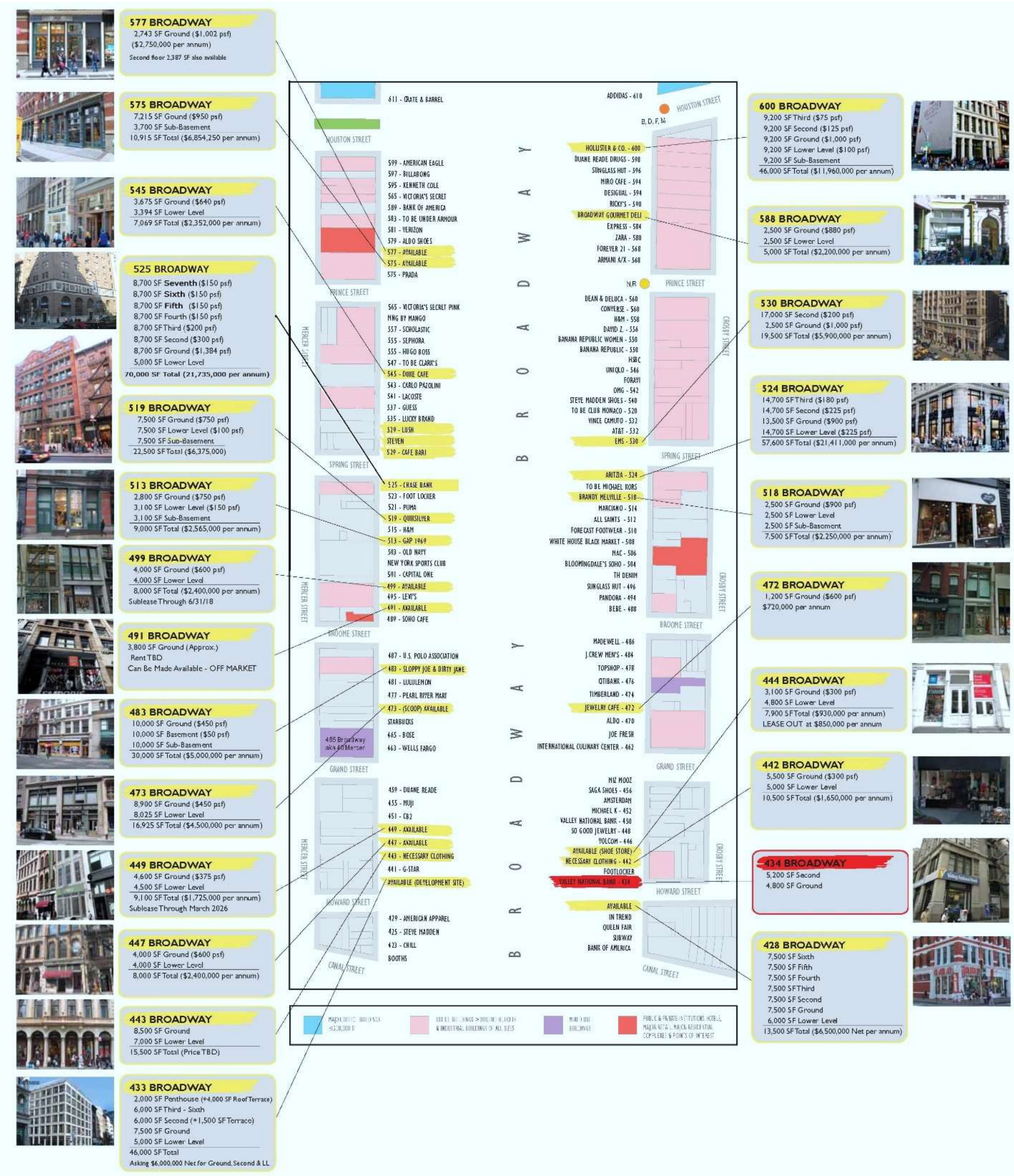

Exhibit F – Operating Expense Comps

Operating Expense Comps	444 Broadway Total $	444 Broadway PSF	623 Broadway Total $	623 Broadway $ PSF
Sq. Ft. (actual, per lot size)		34,720		39,113
Property Insurance	$10,483	$0.30	$11,810	$0.30
Total Insurance	$10,483	$0.30	$11,810	$0.30
Electric	$30,315	$0.87	$13,690	$0.35
Electric Meter Reading	$735	$0.02	$735	$0.02
Oil	$35,000	$1.01	$39,428	$1.01
Water & Sewer	$41,200	$1.19	$46,413	$1.19
Total Utilities	$107,250	$3.09	$100,266	$2.56
Electrical repairs	$600	$0.02	$0	$0.00
Fire Life Safety	$4,205	$0.12	$0	$0.00
Boiler	$1,545	$0.04	$1,740	$0.04
Pest Control	$900	$0.03	$0	$0.00
Intercom/Locks/Keys	$350	$0.01	$350	$0.01
Building Repairs	$2,000	$0.06	$2,253	$0.06
HVAC	$6,250	$0.18	$0	$0.00
Elevator Maintenance	$14,450	$0.42	$4,070	$0.10
Elevator Consultant	$1,650	$0.05	$1,650	$0.04
R & M - Supplies	$660	$0.02	$744	$0.02
Total Repairs & Maintenance	$32,610	$0.94	$10,807	$0.28
Office Supplies	$200	$0.01	$200	$0.01
Telephone	$3,600	$0.10	$1,800	$0.05
Postage, Fed Ex, Etc	$840	$0.02	$850	$0.02
Dues & Fees	$992	$0.03	$1,000	$0.03
Gratuities	$250	$0.01	$250	$0.01
Computer Software	$50	$0.00	$50	$0.00
Filing Fees	$5,541	$0.16	$5,550	$0.14
Total General Expenses	$11,473	$0.33	$9,700	$0.25
Tax Certiorari	$350	$0.01	$350	$0.01
Accounting Fees	$6,000	$0.17	$6,000	$0.15
Insurance Consultant	$1,538	$0.04	$1,500	$0.04
Total Professional Fees	$7,888	$0.23	$7,850	$0.20
Superintendent	$1,200	$0.03	$3,000	$0.03
Total Independent Contractors	$1,200	$0.03	$3,000	$0.08
Total	$170,904	$4.92	$143,432	$3.67

Exhibit G – Sale Comps

No.	Property Name Location	Net Rentable Area (SF)	Year Built	Sale Date	Grantor/ Grantee	Price	Price/NRA	NOI/SF	OAR	Occupancy at Sale	Financing
1	**680 Madison Avenue** Between 61st & 62nd Streets Madison Avenue, Manhattan	33,389	2013	Dec-12 **Contract**	Extell Development and Angelo, Gordon & Co. / Thor Equities	$277,000,000	$8,296.15	N/A	N/A	0%	Cash
	Comments:	The property consists of a 2-story retail condominium containing 33,389 square feet. The retail is at the base of a condominium conversion planned by Gary Barnett's Extell Development and Angelo, Gordon & Co. The property is currently vacant and available for lease. The redesigned retail space will have a first floor that has larger windows and doors and an asking price of $1,800 per square foot. The second floor, which has the majority of the total retail space, will have high ceilings and an asking price of $350 per square foot. The owners expect to attract between five and eight luxury fashion boutique retail tenants. The property is located within the Special Madison Avenue Preservation and the Upper East Side Historical Districts, which is subject to rules administered by the New York City Landmark Preservation Commission. Previously, the property was under contract to Vornado Realty Trust for $280 million; however, the deal fell through.									
2	**151 Wooster Street** B/w West Houston & Prince Streets SoHo, Manhattan	14,821	1889 2008	Sep-12	Alfa Development Management LLC / Tenants in Common Thor Properties LLC, Yaron Jacobi & Uzi Ben Abraham	$25,000,000	$1,686.80	$48.43	2.87%	100%	Cash
	Comments:	The property consists of the multi-tenant retail condominium units located on the ground floor, second floor and basement of 151 Wooster Street, a pre-war 8-story mixed-use condominium building containing retail and residential space. The property is currently leased to three retail tenants: Cassina, Frau USA and Desiron. Cassina leases 2,957 on the ground floor and basement. Frau USA leases 6,204 on the second floor. Desiron leases 5,660 on the ground floor and basement. Cassina and Frau USA Corp. are subsidiaries of Poltrona Frau Spa and their leases were signed in February 2010 and expire in February 2024. Cassina/Frau USA currently pays base rent of $623,988 or $68.11 per square foot for all three levels. The lease with Desiron was signed in March 2003 and expires in February 2013. Desiron currently pays base rent of $331,547 or $58.58 per square foot for both levels. The current overall capitalization rate increases to 5.72 percent in year two of the holding period.									
3	**702 Madison Avenue** S/W/C East 63rd Street Madison Avenue, Manhattan	19,100	1900 / 1987	Aug-12	The Bank of New York Mellon / Friedland Properties	$140,000,000	$7,329.84	N/A	N/A	0%	Cash
	Comments:	The property consists of a 3-story retail building containing 19,100 rentable square feet (inclusive of 6,723 SF basement and sub-basement) on a 7,512 square foot parcel of land. The majority of the property (92.7%) is currently owner occupied by The Bank of New York Mellon who will vacate the building. The remaining ground floor and basement space is occupied by Domenico Vacca (1,400 SF). The Domenic Vacca lease expires in March 2015 which will be terminated by the owners. The ground floor comprises the private banking area for Bank of New York Mellon, the lobby conference rooms and a small retail suite leased by Domenico Vacca. Domenico Vacca occupies the southern portion of the building along with the basement. The lobby contains marble floors and decorative crown molding. The second floor is completely demised with office space and utilized by Bank of New York Mellon. The third floor comprises a corporate apartment with a living room/dining room, kitchen, two bedrooms and three bathrooms. The lower and sublower levels comprise retail space, storage space and building mechanicals. The property contains 61,505 square feet of excess development rights and is located within the Special Madison Avenue Preservation and the Upper East Side Historical Districts, which is subject to rules administered by the New York City Landmark Preservation Commission.									
4	**666 Fifth Avenue** N/W/C West 52nd Street Upper Fifth, Manhattan	112,660	1957 / 1999	Jun-12	Crown Acquisitions / Carlyle Group / Kushner / Vornado Realty Trust	$707,820,000	$6,282.80	$280.14	4.46%	100%	Cash
	Comments:	Sale of a 5-level (inclusive of lower level, grade, 2nd floor and 3rd floor) retail condominium unit totaling 112,660 square feet of net rentable area within 666 Fifth Avenue. The property contains 13,893 square feet on the ground floor, 25,222 square feet on the 2nd floor, 56,563 square feet on the 3rd floor, and 16,982 square feet on the basement and sub basement levels. The grantor is joint venture of Kushner Properties, the Carlyle Group and Crown Acquisitions. The grantee is Vornado Realty Trust. The property is fully leased to Swatch, Abercrombie & Fitch and Uniqlo. Abercrombie & Fitch leases 21,741 square feet on the ground floor, 2nd floor and sub-basement through January 2024. Uniqlo leases on the sub basement, ground floor, 2nd floor and 3rd floor 89,023 square feet through March 2026. Swatch leases 1,896 square feet of grade space. In addition, there is 73,846 square feet leased from the Office Condominium to the Retail Condominium (Lot 1103), which is located on the sub basement, 2nd and 3rd floors and master leased to Uniqlo. The current overall capitalization rate increases to 5.02 percent by year six of the holding period.									

Exhibit G – Sale Comps (Cont'd)

No.	Property Name / Location	Net Rentable Area (SF)	Year Built	Sale Date	Grantor/ Grantee	Price	Price/NRA	NOI/SF	OAR	Occupancy at Sale	Financing
5	**699-703 Fifth Avenue** S/W/C East 55th Street Upper Fifth, Manhattan	24,700	1904	Jun-12	Crown Acquisitions / Richemont Group	$380,000,000	$15,384.62	$236.92	1.54%	100%	Cash
	Comments:	Sale of the retail condominium unit within the St. Regis Hotel. The property has ground level frontage on Fifth Avenue and East 55th Street. The seller is an investment group comprised of Crown Acquisitions, Goldman Properties and The Feil Organization. Current tenants include Bottega Veneta, Pucci and De Beers. The property previously sold in November 2009 to Crown Acquisitions for a purchase price of $117,000,000. The overall capitalization rate stabilizes to 4.5 percent.									
6	**465 Broadway (40 Mercer Street)** N/W/C Grand Street SoHo, Manhattan	14,002	2006	Jun-12	GLL Real Estate Partners / Savanna	$57,000,000	$4,070.85	$186.04	4.57%	67%	Cash
	Comments:	The property consists of the multi-tenant retail condominium units located on the ground floor and basement of 465 Broadway (aka 40 Mercer Street), a modern 14-story mixed-use condominium building containing retail and residential space. The property is currently leased to four retail tenants: Wachovia Bank, Vivienne Tam, Dermalogica and Bose. There is one vacant retail space on the lower level totaling 4,663± square feet available for lease. All of the property's leases are due to expire by 2018. The property previously sold in March 2010 to GLL Real Estate Partners from Hines Interest Limited Partnership for $41.9 million.									
7	**350 West Broadway** B/w Broome & Grand Streets SoHo, Manhattan	11,137	2009	May-12	R&F 350 West Broadway (c/o RFR Holdings, LLC) / AH 350 Retail LLC	$16,000,000	$1,436.65	$66.66	4.64%	100.00%	Cash
	Comments:	Sale of a 2-level retail condominium unit located within 350 West Broadway, a 10-story mixed-use luxury residential building. The unit contains 5,862 square feet on the ground floor (53%) and 5,275 square feet (47%) on the second floor. The second floor also contains an outdoor terrace that is approximately 1,390 square feet. The property was 100 percent leased by Nordstrom, Inc. through August 8, 2013 as of the contract date. The tenant operates a Treasure and Bond store at the property. The property contains one 8-year renewal option that contains above market renewal terms. The property is being purchased based upon an overall capitalization rate of 4.64 percent.									
8	**57-63 Greene Street** B/w Broome & Spring Streets SoHo, Manhattan	8,354	1900 1988	Feb-12	Aion Partners / Thor Properties	$17,200,000	$2,058.89	$92.77	4.51%	100%	Cash
	Comments:	Sale of a 2-level (inclusive of basement) retail condominium unit located within 57-63 Greene Street, a 6-story, residential condominium building. At the time of sale, the property was 100 percent leased to Bang & Olufsen, Cyrus Co. and Raul Carrasco. According to the seller, in place rents are significantly below current market rent levels. The property was purchased based upon an overall capitalization rate of 4.51 percent.									
9	**387 West Broadway** B/w Broome & Spring Streets SoHo, Manhattan	8,896	1929 2003	Jan-12	VNO 387 West Broadway LLC / 73 Wooster Street Condominium LLC	$15,000,000	$1,686.15	$105.25	6.24%	100.00%	Cash
	Comments:	Sale of one asset within a 5-property Manhattan commercial portfolio sold by Vornado Realty Trust consisting of three properties in SoHo, one on the Upper East Side and one in Union Square. 387 West Broadway comprises the sale of a ground floor, block-through retail condominium unit within a 4-story residential building. The retail unit contains is demised with two retail suites including a 5,193 square foot (58%) suite with frontage along West Broadway and a 3,703 square foot (42%) suite with frontage along Wooster Street. The property was 100 percent leased by two tenants at the time of sale: Reiss and CKSK. The retailer Reiss occupied the West Broadway suite through April 2020 with an in-place rent of $166 per square foot. The retailer CKSK signed a 5-year lease in June 2011 for the Wooster Street suite with an initial rent of $75 per square foot.									