

March 10, 2023

To Mayor Brindle and Members of the Westfield Town Council

Now that the One Westfield Place financial projections and other details have been released I wanted to share with the Council my observations, analysis and questions.

Many residents have asked for peer analysis of the project financials. Please note that I have over 35 years experience in the investment analysis of office, apartment and retail projects for three industry-leading employers: 1) the institutional real estate division of a major life insurance company based in Newark, 2) New Jersey's largest real estate investment trust concentrated in office and apartment investments and 3) the real estate industry group of a Wall Street bond rating agency.

I ask that the Mayor and Council, your project consultants and Mr. Powell of Nassau Capital Advisors review this analysis before the March 14 Town Council meeting review this memo and attachments and be prepared to comment at the meeting prior to the votes on the Redevelopment Agreement and the Financial Agreements.

The central question in the Nassau Capital Advisors report to the Westfield Town Council is "Would the project be built without a PILOT discount from conventional taxes?"

My first observation is that there are eight (8) separate financial agreements for eight (8) distinct projects with separate LLCs and financings. These projects will start and finish at different times and may have different equity partners. The loans for residential projects will have different terms than for office projects.

Why weren't individual projects evaluated for their feasibility with and without a tax break? Residential construction has been very profitable for developers paying conventional taxes throughout Northern New Jersey. It seems hard to believe that tax breaks are needed for any residential projects on prime locations in our affluent community, especially these sites with significantly enhanced buildable area from the recent zoning change.

Comments on Nassau Capital Advisors' Report

A local government body analysis to assess the financial feasibility of a project and applications for tax breaks should use the more optimistic of the developer's assumptions or market rate assumptions. Typically, the developer's assumptions in connection with an application for a tax break will be conservative and the developer will be confident in exceeding these assumptions. The government consultant should model a likely scenario, not a more conservative scenario. Conservative assumptions will result in conservative long term internal rates of returns (IRR) and other measures of profitability.

I would like to review some of Mr.Powell's commentary on assumptions as written in the Nassau Report.

1. **Nassau Report:** "Regarding the 3 bedroom and penthouse units in the fifty-five+ residential rental buildings in the West Zone, the Redeveloper assumed rents of \$4.00 per square foot for these very large units; **I have reduced that projected rent to \$3.60 psf** to reflect a more competitive pricing of these units."

Nassau described the planned OWP Apartments as a Very High Finish Quality and presented the following residential rent comps:

Project	Finish Quality	Monthly Rent PSF Range
The Upton, Short Hills	Very High	\$3.52 - 4.51
The Clarus, Maplewood	High	\$3.78 - 4.29
Metro Lofts, Morristown	High	\$3.66 - 4.23
Benjamin, Ridgewood	High	\$3.52 - 4.51

A review of Vermella Garwood's website on March 7 showed asking monthly rents of \$3.26 to \$4.08 psf. For similar reasons that Westfield home prices are greater than home prices in Garwood and other neighboring communities, Westfield luxury apartment rents should also warrant a premium versus similar projects in neighboring communities.

The West Zone residential units will be very high quality and have limited competition in the large size category of 2BR+, 3BR and penthouse units. Apartment rental rates are generally higher in upper floors than lower floors. The West Zone Apartments will offer 5th floor and 6th floor units, unlike the compatible projects listed above. The Developer's assumption of \$4.00 per sq. ft. seems reasonable.

2. **Nassau Report:** "**Assumed residential vacancy rates and rent escalations in our model are more conservative** than recent, independently-verified market results, as summarized in worksheet 2 of the models ("Office and Apt. Comps"). As noted in the worksheet, over the past 10 years vacancy rates in apartments in Northern NJ have been consistently below 5% per year. I have utilized a more conservative 6.5% vacancy rate."

The Nassau analysis actually uses an even more conservative 7.5% residential vacancy rate, in conflict with the actual text in their report. Nassau should use a long term residential vacancy rate closer to 5.0% but not higher than 6.5%.

3. **Nassau Report:** "Also note that while our projected rent escalations are 2.5% per year, actual apartment rent growth in Northern New Jersey over the past 10 years has averaged 2.9% annually, and 4.3% annually for the past 3 years."

I note that the Nassau exhibit on rent growth also shows **apartment vacancy rates for Northern New Jersey for multi-family of 10 units or more built after 1990**. These average annual growth rates are:

Most recent 1 year	3.90%
Most recent 3 year average	4.70%
Most recent 5 year average	4.60%
Most recent 10 year average	4.60%

I also note that these rental rate increases have occurred during a period of low CPI inflation, which has averaged 2.5% between 2010 and 2023.

I believe a 3.0% or higher residential rent average annual escalation is more likely over the long run than 2.5% given the uniqueness of the product and its highly desirable location, just a short walk to downtown shops and restaurants and to the train station and bus stops.

4. **Nassau Report:** “The interest rate on permanent loans for various components of the Project is assumed in our model to be 6.0% with a 30-year amortization schedule. **The Redeveloper has assumed the interest rate on permanent loans will be 5.5%...In addition, I have assumed conservatively the permanent loans would be sized based on a projected debt service coverage of at least 120% of net operating income, at the 6.0% fixed rate.**

Nassau’s more conservative financing assumptions increase the amount of equity required and reduce annual net cash flows, each variable resulting in lowering the long-term IRR for the combined projects.

A very significant assumption in the IRR analysis is the starting land cost for the West Zone. Nassau references a \$32.4 million cost basis but does not provide an explanation or support. We don’t know if this is a historical undepreciated cost number or the land value presented to equity investors and construction lenders based on values after the recent zoning change.

Much of the value creation for a developer comes during the zoning and approval process prior to construction. The West Zone development process begins with an vacant old department store structure on land zoned for business/retail use, subject to 40’ maximum building and 40% lot coverage. The owner’s choice is to sell or to develop. **The starting point for an IRR analysis should be the market value of a site in its “as-is” condition.** In the spreadsheet attachment to this memo, I show how land value increased from about \$10.5 million pre zoning change to nearly \$32.4 million post zoning change. The increase in value comes from increasing rentable area by about 75% by my estimates, from about 235,000 sf to 409,000 sf, of which 296,000 sf is newly approved residential development. Prime residential land sells for \$80 to \$100 per rentable sq. ft. while office/retail buildable rights sell for closer to \$40 per. sq. ft.

Conclusion: The IRR analysis should begin with “as-is” pre zoning change value of about \$10.5 million, not \$32.4 million.

I have attached an Excel IRR analysis which begins with Nassau’s annual cash flow and IRR analysis for the West Zone with conventional taxes. See table below.

INTERNAL RATE OF RETURN ATTRIBUTION ANALYSIS	IRR	Change by Step	Cumulative Change
Nassau Capital Base Case w Conventional Taxes	7.25%		
Market Analysis Adjustments:			
1. Adjust vacancy from 7.5% to 6.5% per SWD and Powell text	7.48%	0.23%	0.23%
2. Add extra 0.5% growth rate per year on residential, 3.0% vs 2.5%	8.20%	0.72%	0.95%
3. SWD's \$4.00 psf rent vs 3.60 rent on large apts, at 3.0% growth	9.28%	1.08%	2.03%
4. Use \$10.5MM pre zoning change land value vs. \$32.4MM	12.21%	2.93%	4.96%
IRR with these four (4) Market Adjustments	12.21%		
Value Creation during zoning, design, construction and lease-up			
Development Period IRR - Yield to First Stabilization Year (2030)	13.94%	1.73%	6.69%

Conclusion: The Nassau feasibility analysis uses conservative assumptions which result in an artificially low IRR.

The central question in the Nassau Capital Advisors report to the Westfield Town Council is **“Would the project be built without a PILOT discount from conventional taxes?”**

My conclusion is that the four (4) residential projects in the West Zone totaling 296,500 rentable sq. ft. and the one (1) residential project in the North Zone totaling 35,000 rentable sq. ft. **would absolutely be built based on conventional taxes and without a PILOT tax break,** whether by this developer or any other experienced residential developer.

I look forward to your comments and any questions.

Sincerely,

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