What We Learned from OWP Financials 02.25.23

- Unit Sizes of Apartments and Townhouses - Market and Affordable Housing
- Rental Rates, Operating Expenses, PILOT Taxes, Property Taxes, Vacancy Rates Used by Property Type
- Land Values assumed and Construction Costs

Limitations of the Nassau Capital Financial Projections

- Project Costs, Land Values, Loan Amounts and Equity are commingled by each zone (West and North/South), not by individual building, making it difficult to judge relative profitability but making it easier for Nassau Capital to conclude that a PILOT tax break is necessary to achieve adequate returns.
- Because each zone's projections have bundled cost numbers for land and construction costs, it is difficult to determine relative profitability (10-year IRR returns) of residential vs. office/retail.
- We believe that residential is more profitable, has lower risk and has a higher probability of execution within the projected time frame
- The corollary is our belief that office is less profitable, has higher risk and has a lower probability of execution within the projected time frame,
- Certainly, the vast majority of market reports and business reporting indicates that the apartment market continues to be strong and vibrant while the New Jersey office market has been weak for two decades, even before hybrid work trends have reduced the demand for office space
- Investment returns (10 year IRR) are highly sensitive to the starting land value used. Nassau report calculates the 10 year IRR with Property Taxes at 7.5% and the 10 year IRR with PILOT taxes at close to 10.0%. Nassau says that 10.% is an adequate return to attract capital and that 7.5% is not. Therefore, the PILOT program is justified. As mentioned above, this is the result of how the project is designed as an all or nothing decision. As shown here, the first phase West Zone does not justify a PILOT. It's only with the drag of risky, less profitable South Office projects in later phases that show the low IRR result.

Significant findings about the West Zone projections

- We expected a large mark-up in land value of the Lord & Taylor land they have owned due to the Feb. 14 zoning change (75% more buildable area and the additional allowed use of residential)
- We had estimated the land value increase from around $8 million pre-zoning change to as much as $23 million post zoning change
- The projections show a $32 million land value used as the starting point for the 10-year IRR projections. A higher starting land value, all other things being equal, will decrease 10-year IRR returns and help justify a tax break.
- In this case, the zoning change represents a double dip for HBC: first, they realize the significant increase in land value on day one, and that helps justify the 30-year tax break
- West Zone revenues are heavily weighted to residential (67%) compared to residential's low (9.5%) proportion of North/South Zone. The West Zone gets built first and has a high probability of execution and a high return because it is primarily residential. HBC will achieve its financial goals in the first few years and will only build in the South Zone if and when it becomes profitable.

West Zone Apartment Units are very large compared to comparables

- The West Zone's average apt. Unit size is 1,819 sf and average monthly rent is projected to be $7,276.
- The most common unit will be a 3BR of $2,500 with projected monthly rent of $8,995. There will be 43 units of this size.
- With the preponderance of large, expensive 2BR+,3BR and penthouse apartments, these apartments are clearly a high luxury product aimed at the very wealthy. Even though the majority are age-restricted for one dweller at 55 and over, the large units may lead to more high school age children than anticipated. Also, if they find it hard to fill every unit with 55 & over residents, what would prevent the developer coming back to the council in the future to drop the requirement to age 50? There is a long term risk that these units house more school age children than projected.
- The West average unit size compares with four comparable properties with average unit sizes between 992 sf in Morristown to 1,172 sf in Ridgewood,

Below is the summary of unit

Rentable Area and Rents PSF in 2022/2023					
WEST ZONE					
Residential	**Number**	**Unit Size (SF)**	**Total SF**	**Ann. Rent PSF**	**Mo. Rent $**
Market Rate Apts					
1 BR	14	950	13,300	$4.00	$3,800
2 BR	30	1,215	36,450	$4.00	$4,860
2BR+	23	1,620	37,260	$4.00	$6,480
3 BR	43	2,499	107,457	$3.60	$8,996
Penthouse	7	2,620	18,340	$3.60	$9,432
Total Market	117		212,807		
Affordable Housing					
1 BR	4	750	3,000	$1.29	$968
2 BR	12	1,000	12,000	$1.13	$1,125
3 BR	5	1,200	6,000	$1.10	$1,320
Total AH	21		21,000		
Market Rate					

Townhouses					
3 BR	26	2,181	56,706	$3.50	$7,634
Affordable Townhouses					
Small	4	900	3,600	$1.45	$1,305
Medium	2	1,200	2,400	$1.25	$1,500
Total AH	6		6,000		
Total Residential - West Zone	170		296,513		

Rentable Area and Rents PSF in 2022/2023					
North/South Residential	**Number**	**Unit Size (SF)**	**Total SF**	**Ann. Rent PSF**	**Mo. Rent $**
Market Rate Apts					
1 BR	18	600	10,800	$3.75	$2,250
2 BR	8	800	6,400	$3.75	$3,000
3 BR	3	1,167	3,501	$3.75	$4,376
Total Market	29		20,701		
Affordable Housing					
1 BR	1	600	600	$1.62	$972
2 BR	3	800	2,400	$1.44	$1,152
3 BR	2	1,000	2,000	$1.32	$1,320
Total AH	6		5,000		
Total North Residential	35		25,701		

Why Mayor Brindle needs the PILOT more than HBC and how Nassau Capital's assumptions can influence the decision.

- It is reasonable to assume it would be very profitable to build residential on the Lord & Taylor site without a tax break, under the old zoning or the new zoning allowances. HBC owns the land already. Their choices were to sell the property "as is" or build on the unused "as of right" building capacity of the parcels.

- The Council's Finance Chair has been very open that the fastest and surest way for the Council to fund capital projects is through a PILOT, to raise revenues at a higher share than the usual 16% municipal share of new taxes. The PILOT route gives the Council the option for a PILOT to claim up to 95% of the PILOT revenues from new construction for municipal use for up to 30 years from project opening (or 35 years from the beginning of construction)
- To justify use of the PILOT, Nassau had to conclude that the project would only be built if it received the PILOT tax break as shown in these projections. To ensure this conclusion, Nassau built a model based on this particular design:
  - combined seven distinct buildings of three property types to be built over 7-10 years into a single 10-year investment analysis.
  - Used a very high land value on current owned West Zone land to reduce projected 10-year returns.
  - Used high assumed property tax costs (e.g., in 2032, $11.19 psf in the West Zone, $13.27 psf in the North/South Zone and $12.01 psf Combined) to reduce returns in the base case property tax model.
  - Combined profitable/low risk and unprofitable/high risk buildings into one single analysis to depress overall base case returns.

Rent Comparables Used in this Analysis.

- Five office rent comparables were picked from leases signed between 2014 and 2020 in the Morristown and Short Hills markets, which are different from Westfield due to superior highway access. No rent comparables were used from the Union County, Metropark, Garden State Parkway or Rt 78 office markets.
- Deloitte signed a long-term lease for a new Morristown building just before the onset of Covid in 2020 and moved in during 2022. This was a relocation and downsizing of Deloitte's Northern NJ regional office from Parsippany where they were for the last 20 years. The rent comp says the rent begins at $42 per sq. ft. NET, where the tenant pays additionally for the full building operating expenses and PILOT taxes. The broker told me they are paying in the $52 gross rent psf range, which assumes a $10 psf add-on for building operating expenses and taxes (the $10 psf add-on for PILOT and operating expenses seems low.)
- Valley Bank is moving its headquarters from Wayne in 2024 to a new purpose built building in Morristown across from Headquarters Plaza and the Hyatt Regency hotel. The rent comp starts at $40 psf net. With operating expenses and taxes, gross rents will be in the low $50s psf. The new CEO of the bank is from the Morristown area.
- The Fox Rothschild law firm signed a 15 year lease in Morristown in 2014 that goes to 2029. The rent now in year 9 on this lease is around $42 NET psf, the equivalent of low to mid $50s psf.
- Two 20,000 sf leases were signed or commenced in 2021 at 51 JFK Parkway in Short Hills, at the intersection of Rt. 24 and JFK Parkway for about $42 psf net, or in the low $50psf gross range.
- These are some of the highest rents signed in the Suburban Northern New Jersey market in many years at some of the very best locations in Morristown and Short Hills.
- Office market research reports from multiple sources show average asking Class A office rents on a gross basis ranging from $27psf in Union County, $30psf along Rt. 78, $34psf in Newark, Short Hills and Morristowm, $39 at Metropark, and $42 along the

Jersey City Waterfront. This shows ample availability in Class A buildings ranging from $27 to $42 psf gross.
- The proposed gross rent in current $ for the Lord & Taylor building is around $53psf (Net rent of $35psf plus $10psf building operating and $8psf PILOT).
- The proposed gross rent in current $ for the South Avenue buildings are around $58psf (Net rent of $38psf plus $10psf building operating and $10psf PILOT).
- The Nassau model for 2032 shows gross rent in place at the Lord & Taylor office building at $72.30 psf. Discounted back to 2023 at 2.5% per year, adjusted gross rent for today would be about 30% less or $52 psf.
- The Nassau model for 2032 shows gross rent in place at the South Avenue office buildings at $82.18 psf. Discounted back to 2023 at 2.5% per year, adjusted gross rent for today would be about 30% less or $58 psf.

Sale of Town Land

Will be two separate transactions:
- North Subdivided Parcel $2,200,000
- South Subdivided Parcel 8,900,000

  Combined $11,100,000

  What happened to the $10 million price for the South Avenue land?

  Prices per buildable sq. ft.
- North Subdivided Parcel $2,200,000 divided by 27,800sf equals $79 psf.
- South Subdivided Parcel $8,900,000 divided by 222,000sf equals $40 psf.
- West Zone land $32,000,000 divided by 410,00sf equals $80 psf

Comment on land values:

The town is offering HBC the option to buy the North/South land at today's office land value of $40 psf and residential land value of $80 psf.

Using the same assumptions, the West Zone land should be valued at closer to $28 million than $32 million. The calculations are: 300,000 of residential at $80 psf (or $24 million) and roughly $100,000 sf of office/retail at $40 psf ($4 million). Before the zoning change, the West Zone land would have supported at most 250,000 sf of office/retail development at $40 psf land value or about $10 million. The zoning change instantly created $18 to $22 million of additional land value for HBC.

PILOT vs. Property Taxes				
years 1-32				
	West Zone	**North/South Zone**	**Combined**	
Property Taxes	175,000,000	139,900,000	314,900,000	
Gross PILOT Costs	124,000,000	109,000,000	233,000,000	
Tax Break to Developer	51,000,000	30,900,000	81,900,000	

Net PILOT Revenues to Town	119,940,000	101,960,000	221,900,000	
Town = 16.22% of Property Taxes	28,385,000	22,691,780	51,076,780	
Council looks only at Municipal portion	91,555,000	79,268,220	170,823,220	
Schools would get 60% of Taxes	105,000,000	83,940,000	188,940,000	
PILOT vs. Property Taxes				
in stabilized year 2032				
	West Zone	**North/South Zone**	**Combined**	
Property Taxes	4,248,807	3,314,581	7,563,388	
occupied sf area	379,859	249,800	629,659	
Property Taxes psf	$11.19	$13.27	$12.01	
Gross PILOT costs	3,136,200	2,376,600	5,512,800	
occupied sf area	379,859	249,800	629,659	
PILOT costs psf	$8.26	$9.51	$8.76	
PILOT as a % of Prop Taxes 2032	73.8%	71.7%	72.9%	
	West Zone	**North/South Zone**	**Combined**	**Comment**
Property Taxes, years 1-32	175,000,000	140,000,000	315,000,000	
Gross PILOT costs, years 1-32	130,000,000	110,000,000	240,000,000	
Tax Break (Savings) to Developer	**45,000,000**	**30,000,000**	**75,000,000**	$45 million benefit in the high probability first phase
Nassau Analysis - 32 years				

Net to town at 95% of PILOT			$221,000,000	
Municipal share (16.22%) of Prop Taxes			$47,700,000	
Additional Proceeds to Municipality before $73 million debt service on bonds			**$173,300,000**	Apples and oranges comparison, ignores the option of building with regular Property Taxation
School Taxes that would accumulate over 32 years, if built with regular Priopert Taxes, 60% of total to schools	**$105,000,000**	**$84,000,000**	**$189,000,000**	This is what should happend with a diversified tax base. All properties pay into the full tax pool to share in all costs.