

DATE: September 13, 2016
TO: Noelle Mackay, City of Burlington, Vermont
FROM: Abe Farkas, Matthew Craigie,
SUBJECT: BURLINGTON TOWN CENTER – DEVELOPER CAPABILITY AND PRO FORMA REVIEW

Background and Purpose

ECONorthwest was engaged in 2015 to advise the City of Burlington, Vermont regarding the redevelopment of the Burlington Town Center (BTC). The BTC is a substantially sized urban mall located in the core of downtown Burlington. In 2013, the BTC was purchased by a private developer, who has since initiated a plan for a major reconstruction of the mall facility, including a significant expansion of the commercial space at the property, the addition of a multifamily residential component which includes both affordable and student housing as well as market rate units, creation of structured parking, and a reopening of currently vacated city streets. While the project is designed for two phases, the focus is on phase one which includes 90% of the square footage as well as all the public right of way improvements.

ECONorthwest regularly provides analysis and consulting services for public/private redevelopment projects around the country, and has significant experience working on either side of these deals, be it with public agencies or private real estate developers. ECONorthwest's reputation is based on its objective approach to each project and its unbiased recommendations to its clients.

The primary goal of this project is to assess the private developer's development capacity to successfully execute the redevelopment of the BTC, and also to vet the feasibility of the redevelopment plan. This memorandum summarizes ECONorthwest's work to date, which includes: review of preliminary development documents, preliminary development financial pro forma, anticipated development costs, and documentation pertaining to the private developer's experience, capability, and the financial capacity of the development team.

ECONorthwest has just received a copy of a third party feasibility study regarding the BTC and is in the process of reviewing its methodology and findings. A subsequent memorandum will address ECONorthwest's assessment of this study and its alignment with the developer's development assumptions and projections.

The reader should note that while the private developer has been forthcoming in disclosure of project documentation, and background information, ECONorthwest is only able to comment on information received and cannot speculate on, or make assumptions about, aspects of the project, or the developer's history or capacity for development whereby ECONorthwest has not received or reviewed the proper documentation. Furthermore, it is important for the reader to recognize that all of the project related projections (e.g. costs, rents, revenue, returns...) are preliminary development estimates and subject to change. This is typical of any development

project, as market conditions, legislative actions, and other unforeseen actions and events can arise at any time and have an impact on the project.

Development Capability of the BTC Project Team

The Burlington Town Center redevelopment is being spearheaded by Devonwood Investors LLC, a private developer and property owner based in New York City, with an office in Burlington. Devonwood purchased the BTC property in 2013 with the plan to reposition and redevelop the mall. Leading the project at Devonwood is Mr. Donald Sinex, Senior Managing Director. Mr. Sinex has over 35 years of experience in real estate finance and investment including the purchase, repositioning, and redevelopment of significant projects.

Mr. Sinex is the primary partner in the BTC project and oversees all aspects of its execution, including; developing the project scope, team, and finances, assembling capital partners, negotiating contracts, and representing the project to public agencies and private partners. Prior to forming Devonwood Investments in 1997, Mr. Sinex worked for JMB Realty, a large commercial real estate development and investment firm based in Chicago. He was a senior executive and managed the New York City office of JMB. While at JMB, Mr. Sinex was personally involved in numerous projects at the same scale or larger than the BTC project. These include mixed use, retail, and office properties in New York, Boston, and the Washington DC area. Mr. Sinex provided a sample list of these projects, the last of which was complete 10 years ago. A list of Mr. Sinex's projects was sent to the City previously.

All of the substantial projects that Mr. Sinex managed while at JMB Realty involved careful and lengthy coordination with local and regional government bodies in order to gain approvals, entitlements, and meet public sector project related goals. It should be noted that all of these projects were privately financed, and the BTC is the first project that Mr. Sinex has been involved with that uses public dollars as a project source, in this case tax increment finance dollars.

In addition to the projects he managed at JMB Realty, Mr. Sinex has been the owner and operator of the BTC since the acquisition of the property in 2013.

Mr. Sinex has shown a commitment to work with ECONorthwest to provide information regarding his creditworthiness and the creditworthiness of his development partners prior to signing a binding development agreement with the City. ECONorthwest inquired about Mr. Sinex's finances, tax history, and other documentation regarding his personal financial capacity to execute the BTC project. ECONorthwest was not provided with most of this documentation, however, the BTC project is primarily funded through non-recourse debt, and is collateralized by existing assets (mainly, the existing BTC itself). For these reasons, Mr. Sinex's personal finances and tax history are not necessarily a strong indicator of a potential for project default.

Furthermore, it is not unusual for real estate developers to use little of their own personal equity in development deals. In the case of the BTC, Mr. Sinex provided equity in the

acquisition of the mall property. He leveraged that investment by using that land to secure more equity via a ground lease for the new larger mixed use development to a third party. The ground lessor is an established entity that has a long history of providing equity in exchange for ground lease payments.

Feasibility of the Development Plan

This section evaluates the financial performance of the proposed redevelopment project. The primary objective of this task is a review of the developer's preliminary pro forma analysis to verify the basic assumptions (e.g. costs, rents), understand the developer's projected returns and structure of returns to capital partners (equity providers), and also to ultimately gauge the risk profile of the proposed development and understand how the developer intends to ameliorate this risk thorough pre-leasing, guarantees, contracts, or other measures.

In a forthcoming memorandum, ECONorthwest will comment on the third party feasibility study and how its findings compare or contrast with the developer's own financial projections.

Pro Forma Review

ECONorthwest reviewed Devonwood's financial pro forma dated August 29th, 2016. Key takeaways from our review include the following:

The BTC financial pro forma contains:

- a reasonable project cost given the scale and complexity of the project;
- project financial sources (equity and debt) that are in line with proposed projects uses;
- conservative commercial and residential rental rates that are aligned with their market segments;
- conservative project expenditure projections;
- a favorable but achievable loan interest rate given preliminary tenant commitments;
- and, positive project returns to investors that adequately exceed industry standards.

Financial Assessment

The Burlington Town Center redevelopment is not a speculative development project. Meaning, rather than taking a "wait and see" approach to fill the new proposed spaces, the developer has been actively recruiting tenants to be a part of the project. To date, the developer has a number of Letters of Intent (LOIs) from a several interested candidate tenants. ECONorthwest has reviewed these documents and will also be reviewing lease agreements as they are signed in the next few weeks. The candidate tenants are primarily large institutional users that should be capable of paying the rents required to support the new space and who are also likely to sign long term leases. Having LOIs in hand, especially with credit tenants is a strong hedge against development risk. It should be noted that while a significant portion of space has achieved LOI status, the developer needs to convert these LOIs into leases and continue seeking tenants to fill these remaining empty spaces.

Examining a project's pro forma requires an understanding of the inputs and outputs of the financial model in the context of the local real estate market. Inputs include projected costs, rents, interest rates, and other temporal metrics that affect the cash flow of the project over time. The outputs include the cash flow itself and the projected returns to the various capital and equity partners.

The pro forma inputs for the BTC appear to be conservative in relation to ECONorthwest's understanding of the local market. To give one example of this moderate approach, the pro forma is able to achieve appropriate returns using office rents that are at, or below, current market rates. This indicates sensitivity to a potential market fluctuation and is a positive indicator of the developer's thoughtfulness about building a project that is more likely to be a success should some of the model inputs change as the project moves forward.

Development costs are one of the most important inputs in a financial pro forma. The basic relationship between project costs and rents is one of the strongest indicators of project outcomes. The developer has chosen a general contractor (GC) to construct the project. This contractor is a well-respected local firm with experience completing larger scale complex projects. The GC has provided the development cost numbers used in the pro forma. Given their reputation and experience, these cost numbers are likely accurate to local market conditions. Furthermore, the developer is negotiating a contractual structure with the GC that contains measures to control cost overruns (a guaranteed maximum prices), and guarantees project completion. Overall, the project costs appear to be sound and carefully considered by the developer.

Another key input into a financial pro forma is the interest rate on the primary project loan. The BTC pro forma uses a comparably lower interest rate. When questioned about the rate, the developer indicated that his proven experience and existing relationships with lenders as well as the nature of the tenants he's in the process of attracting, enable him to secure lower interest rate.

Key Findings

ECONorthwest continues to have a productive dialogue with Mr. Sinex regarding his real estate development experience and capability. In an additional forthcoming memorandum, ECONorthwest will comment on a third party feasibility study that has been commissioned to shed further light on the relationship between the developer's projections and Burlington area market conditions such as absorption rates for office and residential space, and current market rents for new multifamily and commercial buildings.

The following are a few of the key findings from our investigation into the development capability of Devonwood Investors LLC and also regarding our assessment on the developer's pro forma based on information ECONorthwest has reviewed to date:

- The project developer, Mr. Sinex, has considerable real estate development experience with large scale complex projects in three east coast cities and has developed strong

working relationships with financial institutions as well as experience navigating through the development approval process.

- Based on preliminary construction costs provided by an experienced local contractor, conservative rent projections provided by the developer and informed by his current experience in the market, as well as conservative projections of expenses into the future, the project appears to be able to provide market rate returns capable of attracting sufficient equity and debt to construct phase one of the project.
- The developer has approached the project with appropriate caution. Key indicators of this careful approach include; the high level of pre-leasing activity, the conservative financial pro forma model, preliminary arrangements for a ground lease to provide necessary additional equity, and the proposed contractual structure with the general contractor.
- Given the project's location, proposed mix of uses, and projected amenities, in addition to the financial factors cited above, it should be able to achieve financially viable performance.