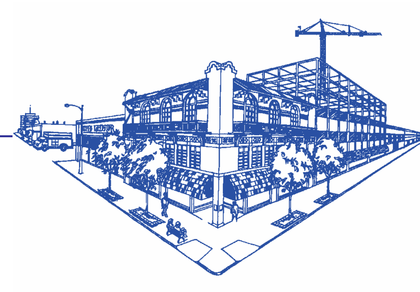
E. D. Hovee & Company, LLC

Economic and Development Services



MEMORANDUM

To:	Jason Robertson, Barney & Worth, Inc.
From:	Eric Hovee
Subject:	Downtown Olympia Action Plan – Development Opportunity Site Prototype Project Pro Forma (Revised)
Date:	March 30, 2009

As part of the Downtown Olympia Action Plan process, two development opportunity sites were initially identified for testing the market and financial feasibility of four mixed use urban development concepts. Based on initial analysis, this proforma analysis has been narrowed to one site with a revised development concept:

> ***Site 1b*** – an approximately ½ block (31,488 square foot) property situated on Jefferson Street between 4th and 5th Avenues with seven stories including 120 apartments on five levels over 18,776 square feet of ground level retail space and a 2nd floor 87 space parking garage.

Development concepts with site and floor plans and floor-by-floor building programs have been prepared and subsequently refined by SERA Architects in cooperation with Barney & Worth, Inc., and the City of Olympia.[1]

Pro Forma Analysis Approach

The purpose of a *pro forma* is to assess the financial feasibility of a real estate development project. An economic investment should generate market value at least equal to the cost of the development investment:

- *Market value* is defined as the net sales revenue from portions of a project sold (as with condo units) plus the capitalized net operating income of portions of the project available for rent on an on-going basis.
- *Development cost* is defined as the sum of property acquisition, demolition/site preparation, infrastructure/remediation and construction (hard costs) plus related project soft costs (as for permits and fees, construction financing and initial project marketing).

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Because the prototype projects have not yet been constructed, the pro forma represents a future projection based on assumptions regarding such key variables as development costs, sales and rental values, and on-going operating expenses. These assumptions typically are based on market information as to *going rates* for similar properties or development projects. Whenever possible, comparable data is drawn information provided for the immediate Olympia market area

PROJECT ASSUMPTIONS

Project assumptions are detailed by the first worksheet of the Appendix to this memorandum. For each variable considered, a range of possible – low, mid and high – market estimates is considered. Assumptions utilized with this initial pro forma analysis are summarized as follows:[2]

Development Cost Estimates:

- Property acquisition cost is based on current tax assessed valuation of the two prototype sites – which may or may not be a reliable predictor of either asking or final sale price.[3]
- Site demolition cost assumes removal of existing structures and site preparation assumes normalized level of expense without added allocation for on- or off-site infrastructure improvements.
- Our understanding is that the site may require remediation of contamination; however a definitive determination has not been made. On a preliminary basis, $300,000 has been budgeted for remediation. This estimate should not be viewed as a statement about perceived or real contamination and is subject to revision based on more detailed evaluation.
- Building construction (or hard) costs are based on the low-mid range of typical costs for the Puget Sound region.[4]

Operating Projections (for Income Producing Portions of the Prototype Project):

- Retail and residential rental rates reflect what we understand to be top-of-market conditions for the Olympia market.[5]
- Operating expense ratios reflect what we generally understand to be mid-market expectations – whether for Olympia or similar Pacific Northwest real estate investments.
- Capitalization rates (which reflect the relationship between net operating income and property value) are based on rates generally applicable for similar properties regionally and nationally – but are in some flux currently due to extremely challenging and uncertain conditions facing real estate financing both nationally and globally.

Development Incentives:

- No incentives were included with the initial analysis of four prototype development concepts and none of the concepts were indicated as financially feasible.
- Consequently, for this revised analysis it is assumed that the City of Olympia would make available an 8-year property tax freeze (meaning than only land value and not

improvements value would be taxed). The residential property tax abatement is pursuant to state legislation as amended (RCW 84.14). Because the abatement is available for only eight years rather than the effective life of the property, we have chosen to capitalize the value of the incentive rather than as an on-going reduction to operating expense.[6]

- While this is the only incentive considered with this pro forma, it is possible that other incentives might be considered – based on the Development ToolKit memorandum we have previously prepared (dated September 19, 2008).

PRO FORMA RESULTS

Detailed pro forma analysis is provided with the two pages of the Appendix at the end of this memorandum. The first page outlines development cost and financial assumptions applied with this analysis. The second page contains pro forma results.

Based on the assumptions utilized with this analysis, the Site 1B development concept (as revised) appears to be approach but not quite achieve project feasibility.

- *Without financial incentives,* the projected development cost of nearly $27.0 million exceeds valuation upon completion estimated at $25.8 million by approximately $1.2 million. In effect, only 96% of project cost is supported by market valuation, leaving a 4% funding gap.
- *With property tax abatement,* all but $46,400 of the remaining funding gap is eliminated. The capitalized value of the property tax abatement over 8 years is estimated at somewhat over $1.1 million.

Bottom line, Concept 1B (as revised) appears to be at a point that conceivably could achieve project feasibility. However, this should be viewed as a relatively high risk project due to the relatively untested nature of the downtown Olympia market for market rate housing, the need to secure top-of-market rents, lack of parking for every unit (let alone on-site retail), and the potential for costs to go above projection (especially given uncertainty regarding potential on-site contamination).

We would encourage the City of Olympia to test results of this pro forma with prospective development interests. Depending on feedback received, the City may need to consider added incentives. Examples might include provision of added off-site parking (at least for the early years of the project), participation in infrastructure and site remediation funding (if required), assistance with site assembly and owner coordination, and technical assistance as with refined design and financial analysis tailored to developer specifications.

E. D. Hovee & Company, LLC appreciates the opportunity to provide this preliminary financial pro forma evaluation. We would be happy to address questions and suggestions regarding any aspect of this report.

APPENDIX. PRO FORMA WORKSHEETS

Development Cost & Financial Assumptions
Olympia Downtown Development Opportunity Site 1B REVISED

	Range of Estimate Low	Mid	High	Comments
A. Development Costs				
Site Costs				
Property Acquisition Cost	$21.18	$21.18	$25.89	Tax assessed valuation per square foot of land area
Site Demolition	$5.00	$6.00	$7.00	Per sf existing buildings
Site Preparation	$4.00	$5.00	$6.00	Per sf land area
Infrastructure/Environmental	--	$300,000	--	Tentative allocation for contamination clean-up, to verify
Building Construction				Per gsf building area
Retail	$75.00	$120.00	$170.00	Low end vanilla shell, high end specialty w/TIs
Office	$130.00	$150.00	$180.00	Secondary low-mid rise office building
Multi Family Residential	$130.00	$160.00	$190.00	Wood frame for low/mid, concrete for mixed use
Parking Cost -- per SF	$70.00	$80.00	$90.00	Low for above grade, mid for high cost above grade or low cost below grade, high for mid cost below grade
Indirect/Soft Cost Rate	30%	35%	40%	Low-mid for residential, mid-high for office
B. Operating Projections				
Market Rate Rents				
Retail (per year)	$12.00	$18.00	$24.00	Triple net (nnn) rental rates
Apartment Rent (monthly)	$1.00	$1.40	$1.80	Low is current overall market, high for potential high rise
Parking (per month)	$80	$100	$120	Low - current lot rate; mid-high for more aggressive
Rental Space Vacancy	4%	7%	10%	Rental properties assume mid range
Operating Expense Ratios				
Retail	8%	10%	12%	Of gross operating income (nnn)
Office	25%	30%	35%	Of gross operating income (full service / gross)
Residential	$3,000	$3,500	$4,000	Assumes no property tax abatement
Parking (annual per space)	$200	$350	$500	Low - residential, mid - office, high - retail
Capitalization Rates	7.00%	7.50%	8.00%	Low - apartments, mid - retail/residential, high - office

Legend: [ ] indicates assumptions used with this pro forma analysis.
Note: Financial pro formas are intended for illustrative purposes only.
Actual project conditions will vary from estimates.
Prepared by: E. D. Hovee & Company, LLC.
Date: 30-Mar-09

Prototype Project ProFormas

Olympia Downtown Development Opportunity Site 1B REVISED
(Assuming Current Market Pricing)

	Site 1B REV Adjusted w/Tax Abate	Comments
Development Program		
Retail (GSF)	18,776	
Office	--	
Residential (GSF)	111,390	
Ground Floor Common SF	7,647	Lobby + parking/loading entrance
Subtotal (GSF)	137,813	
Structured Parking (GSF)	29,907	
Total Building Area (GSF)	167,720	
Residential (Rental units)	120	
Demolition (SF)	4,200	Per SERA Architects
Total Site Area (SF)	31,488	
Floor Area Ratio (FAR)	4.4	Includes above grade parking
Building Floors	7	Wood frame over concrete podium
On-Site Parking (spaces)	87	Structured on 2nd level
Financial Pro Forma		
Development Budget		
Property Acquisition	$666,800	Based on tax assessed valuation
Site Demolition	$25,200	Based on existing building area
Site Preparation	$157,400	
Infrastructure/Environmental	$300,000	Initial allocation, to be revised
New Building Construction	$17,651,500	
Parking	$2,093,500	
Indirect (Soft) Cost	$6,068,300	On direct construction
Total Development Cost	$26,962,700	For GSF building area
Cost per GSF	$161	
Operating Budget (Rental)		
Annual Gross Income	$2,576,100	From housing + retail tenants
less Vacancy	$(180,300)	On rental portions of property
Gross Operating Income	$2,395,800	
Less Expenses	$(461,900)	
Net Operating Income	$1,933,900	
Completed Valuation		
Capitalization Rate	7.50%	
Estimated Value:		
Rental Income Portion	$25,785,300	
Rental + Sales Portion	$25,785,300	
Cost % Supported by Value	96%	Before tax abatement incentive
Funding Gap ( )	$ (1,177,400)	Equals valuation *less* cost
Gap Adjusted for Tax Abate	$(46,400)	Adjusted w/ tax abatement

Notes: Tax abatement value is shown as a capitalized amount over an allowable 8-year time frame for market housing. This pro forma is for illustrative purposes only. Actual project conditions will vary from estimates.

Prepared by: E. D. Hovee & Company, LLC

Date: 30-Mar-09

END NOTES

1 While information for this financial pro forma analysis has been obtained from sources generally deemed to be reliable, estimates should be viewed as preliminary, are not guaranteed, and are subject to change without notice. The findings contained in this report are those of the author and should not be construed as representing the opinion of any other party prior to explicit approval, whether in whole or part.

2 Specifically noted is that no formal market analysis has been conducted for this preliminary pro forma feasibility assessment. More detailed market data compilation analysis would be recommended before project concepts for these or other sites that may be considered are finalized.

3 For this preliminary prototype analysis, no determination has been made as to whether the sites indicated are currently or potentially on the market and, if so, at what asking price. Rather, the intent of this analysis is to indicate prospective feasibility whether situated at the site indicated or another similarly sized and located property.

4 Construction cost estimates are from the international cost estimating firm Rider Levett Bucknall – as noted for the Seattle metro area as of late 2008 / early 2009.

5 Rental rate and sales value information has been provided to E. D. Hovee & Company, LLC by Barney & Worth, Inc. based on contacts with knowledgeable real estate and public agency representatives in the Olympia area.

6 Prior to the current economic downturn, developers have typically applied the tax abatement as a reduction to property operating expense, assuming that rent rate increases would be adequate to offset the abatement by the time of its expiration. However, if rents do not rise as projected, a substantial operating deficit can be encountered downstream, which has occurred in some markets involving historic and/or residential abatement programs.

With the current economic recession and uncertain recovery, there is even greater risk in assuming that rents can increase enough in just 8 years to offset the value of the abatement. For these reasons, the value of the incentive is calculated on a net present value basis, discounting the savings back to a present value at the cap rate over an 8-year period.