



Main Office:
120 West Avenue, Suite #303
Saratoga Springs, NY 12866
Phone: 518.899.2608
Fax: 512.777.5045

Regional Offices:
Boston, MA
Richmond, VA
Portland, ME
Brattleboro, VT

MEMORANDUM

To: Greater Litchfield Preservation Trust
From: Dan Stevens, Camoin 310
Date: 10/24/2019
Re: **Financial Feasibility Analysis – Litchfield Courthouse Redevelopment**

Introduction

This memo provides the results of the financial feasibility analysis for redeveloping the former Litchfield County Courthouse. The purpose of the analysis is to understand the viability of four (4) redevelopment options from a private developer perspective. A “favorable assumptions” scenario was examined for each, indicating how the feasibility outcome and funding gap would change if the concept performs better than expected. The analysis also identifies the size of the funding gap that would have to be filled by external sources for a successful project to occur (i.e. for a developer to receive a reasonable return on their investment and, therefore, be interested in the project). The analyzed concepts include:

- **A1:** Hotel with 13 Suites and Restaurant
- **A2:** Hotel with 10 Suites and Restaurant (Assumed to be eligible for historic tax credits)
- **B1:** Residential with 10 Units
- **B2:** Residential with 8 Units (Assumed to be eligible for historic tax credits)

For each concept a “baseline” scenario and a “favorable assumptions” scenario was considered as follows:

- **Baseline Scenario:** This scenario assumes that the project “performs” as expected, particularly with respect to rental rates and revenue generation, given the results of the market analysis study. The Baseline Scenario should be considered a conservative but realistic assumption.
- **Favorable Assumptions Scenario:** This scenario provides an “optimistic” analysis to understand how the feasibility determination may be different if the project exceeds performance expectations. For the residential scenario, this includes higher apartment rents being achieved, potentially due to higher-end or luxury finishes being incorporated into units. For the hotel scenario, this includes a higher room rate and higher occupancy levels that may be achievable with new tourism promotion, events held on the green or in town, etc.

To examine the financial feasibility of the reuse concepts, two key development metrics were examined through a development pro-forma analysis of each concept:



Internal Rate of Return (IRR): IRR is a measure of a developer's return on investment from a project. The minimum IRR threshold for a project varies on the type of project and the developer. If the IRR is below the anticipated threshold (see assumptions section of this memo) then a developer will be unlikely to undertake the project and it is considered infeasible.

Debt Service Coverage Ratio (DSCR): This metric provides an understanding of whether a project is likely to be "bankable" or eligible for traditional bank financing. Banks require projects to generate enough revenue to cover debt payments, plus an additional "buffer" amount. If the project does not have enough operation income (after expenses) to satisfy the bank requirements, the project will most likely be infeasible.

Key Findings

The key findings of the analysis include are as follows:

- A hotel concept is more likely to be a financially feasible reuse option compared to residential reuse due primarily to the significantly greater rent per SF achievable from a lodging use compared to residential.
- Redevelopment will almost certainly require additional funding sources, such as public subsidy/assistance. The only analyzed scenario found to be financially feasible is a hotel/restaurant concept (A2) that receives historic tax credits *and* performs better than expected.
- The financial feasibility gap (with expected market performance) ranges from approximately \$867,000 to \$1.72 million for the hotel/restaurant concept and from \$1.6 million to \$2.3 million for the residential concept (after historic tax credits are factored into the eligible concepts).
- In general, the concepts that are eligible for historic tax credits have a smaller funding gap and are therefore more financially feasible than maximizing rentable square feet. That is, the tradeoff in rent revenue is more than offset by the benefit of the historic tax credits.
- The estimated development cost falls in the \$3.5 million to \$3.75 million range. Despite similar construction costs, the fair market value of the hotel concepts are generally in the same range as the construction costs; however, a residential project is expected to have a significantly lower fair market value than its development cost due to much lower rent revenue potential.

Key Findings: Concept A: Hotel with Restaurant

Baseline Scenario (expected conditions): Average Room Rate = \$140/night; Occupancy Rate = 60%

Favorable Assumptions Scenario: Average Room Rate = \$200/night; Occupancy Rate = 65%

Concept A1, which maximizes the number of hotel suites but is assumed to not qualify for historic tax credits, is estimated to have a development cost of \$3.75 million. The fair market value (based on an income valuation approach) of the completed project is estimated to be \$3.17 million under expected



performance. Under favorable assumptions, the fair market value is estimated to be \$4.95 million. The developer IRR result falls below the threshold of 16% under both scenarios. The Debt Service Coverage Ratio is about 1.20, indicating that in each case the project would be “bankable” for traditional bank financing. The feasibility funding gap is \$1.72 million under expected conditions and \$542,000 under favorable assumptions. This is the additional subsidy/assistance that would be needed for a private developer to undertake the project.

Concept A2 effectively “trades” three suites to maintain the courtroom space, which is assumed to make the project eligible for state and federal historic tax credits. The construction cost for this concept is slightly lower at \$3.6 million. The estimated historic tax credit is estimated to be approximately \$1.09 million. The fair market value of the completed project is estimated to be \$3.81 million under expected performance assumptions while under favorable performance assumptions the fair market value is \$4.11 million. The developer IRR under the “baseline” scenario representing expected performance is well below the 16% threshold; however, the IRR under favorable assumptions exceeds the threshold indicating that the project would be feasible for a developer, if the favorable assumptions were to prove true. Both scenarios are “bankable.” The funding gap for the baseline scenario is \$867,000.

		Baseline Scenario	Favorable Assumptions Scenario
		<i>Average Room Rate = \$140/night</i>	<i>Average Room Rate = \$200/night</i>
		<i>Stabilized Occupancy Rate = 60%</i>	<i>Stabilized Occupancy Rate = 65%</i>
Concept A1 - Hotel with Restaurant	Est. Construction Cost	\$3.75 M	\$3.75 M
	Fair Market Value <i>(post construction)</i>	\$3.17 M	\$4.95 M
	Developer IRR <i>target = 16%</i>	-1.10%	8.9%
	Debt Service Coverage Ratio <i>target = 1.20</i>	1.84	1.66
	Feasibility Funding Gap	\$1.72 M	\$542,000
	No historic tax credits (13 Suites)		
Concept A2 - Hotel with Restaurant	Est. Construction Cost	\$3.60 M	\$3.60 M
	Est. Historic Tax Credit Benefit <i>State + Federal</i>	+\$1.09 M	+\$1.09 M
	Fair Market Value <i>(post construction)</i>	\$3.81 M	\$4.11 M
	Developer IRR <i>target = 16%</i>	-3.7%	19.9%
	Debt Service Coverage Ratio <i>target = 1.20</i>	1.91	1.7
	Feasibility Funding Gap	\$867,000	\$0
With historic tax credits (10 Suites)			

Concept B: Residential

Baseline Scenario (expected conditions): Residential Rate = \$1.60/SF

Favorable Assumptions Scenario: Residential Rate = \$2.00/SF

Concept B1 has 10 residential units and is assumed to not qualify for historic tax credits. The development cost is estimated to be \$3.48 million, slightly lower than the hotel concept development costs. The



estimated fair market value of \$1.49 million is significantly lower than that of the hotel concepts due to the lower rental revenue. The developer IRR is substantially below the required threshold of 15%; however, the project’s Debt Service Coverage Ratio is considered “bankable.” The feasibility funding gap is \$2.29 million under expected performance (baseline scenario) or \$2.0 million under favorable assumptions (higher apartment rents).

Concept B2 has 8 residential units and maintains the courtroom space, which is assumed to make it eligible for historic tax credits. The estimated construction cost of \$3.46 million is similar to Concept B1. The potential historic tax credit benefit is estimated to be \$1.01 million. The fair market value is estimated to be \$1.49 million. The developer IRR under expected performance conditions (baseline scenario) and under favorable assumptions is below the developer IRR target of 15%. Each scenario is considered “bankable” with a debt service coverage ratio exceeding the target threshold of 1.20. The feasibility funding gap is \$1.6 million under the baseline scenario and \$1.33 under the favorable assumptions scenario.

		Baseline Scenario	Favorable Assumptions Scenario
		<i>Res. Rental Rate = \$1.60/SF</i>	<i>Res. Rental Rate = \$2.00/SF</i>
Concept B1 - Residential No historic tax credits (10 Units)	Est. Construction Cost	\$3.48 M	\$3.48 M
	Fair Market Value <i>(post construction)</i>	\$1.49 M	\$1.49 M
	Developer IRR <i>target = 15%</i>	-14.6%	-11.0%
	Debt Service Coverage Ratio <i>target = 1.20</i>	1.27	1.35
	Feasibility Funding Gap	\$2.29 M	\$2.00 M
Concept B2 - Residential With historic tax credits (8 Units)	Est. Construction Cost	\$3.46 M	\$3.46 M
	Est. Historic Tax Credit Benefit <i>State + Federal</i>	+\$1.01 M	+\$1.01 M
	Fair Market Value <i>(post construction)</i>	\$1.49 M	\$1.49 M
	Developer IRR <i>target = 15%</i>	-3.1%	-0.97%
	Debt Service Coverage Ratio <i>target = 1.20</i>	3.91	2.94
	Feasibility Funding Gap	\$1.60 M	\$1.33 M



Analysis Assumptions

The following assumptions were used in the financial feasibility analysis. The assumptions were derived from the market analysis along with other sources including Realty Rates, which provides key inputs based on national surveys of real estate developers and investors.

Development Cost Assumptions:

- Property acquisition cost (all concepts): \$100,000
- Concept A1: \$3,749,525
- Concept A2: \$3,732,275
- Concept B1: \$3,477,425
- Concept B2: \$3,477,425

Construction costs based on following assumptions provided by Crosskey Architects:

- Restaurant: \$300/SF
- Hotel space: \$200/SF
- Residential: \$200/SF
- Gift shop/gallery: \$200/SF
- Wine bar: \$200/SF
- Other: \$175/SF
- Elevator: \$125,000

Operating/Performance Assumptions:

Concept A: Hotel and Restaurant:

- Restaurant lease rate of \$20/SF NNN
- Annual income and expense increase of 2% annually
- Stabilized hotel occupancy rate of 60% (65% under favorable assumptions scenario)
- Average room rate of \$140/night (\$200/night under favorable assumptions scenario)

Concept B: Residential:

- Apartment rental rate of \$1.60/SF (\$2.00/SF under favorable assumptions scenario)
- 5% loss from vacancy

Financing Assumptions:

Concept A: Hotel and Restaurant:

- Reversion Capitalization Rate: 8.5% (Realty Rates)
- Loan to Value Ratio: 65% (Realty Rates)
- Construction Loan Rate: 10% (Realty Rates)
- Mortgage Loan Rate: 6%; 30-year loan (Realty Rates)

Concept B: Residential:



- Reversion Capitalization Rate: 8.0% (Realty Rates)
- Loan to Value Ratio: 70% (Realty Rates)
- Construction Loan Rate: 9.0% (Realty Rates)
- Mortgage Loan Rate: 5%; 30-year loan (Realty Rates)

Historic Tax Credits:

- For the alternative scenarios assumed to be eligible, it is assumed that 65% of total development cost will be eligible for tax credits, based on our team's experience with similar projects.

Feasibility Thresholds:

Concept A: Hotel and Restaurant:

- Developer Internal Rate of Return (IRR): 16% (Realty Rates; HVS)
- Debt Service Coverage Ratio: 1.20

Concept B: Residential:

- Developer IRR: 15% (Realty Rates)
- Debt Service Coverage Ratio: 1.20