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ADVISORS IN PUBLIC/PRIVATE REAL ESTATE DEVELOPMENT

MEMORANDUM

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To: Ken MacNab, Town Manager
Town of Windsor

From: Keyser Marston Associates, Inc.

Date: January 31, 2020

Subject: Review of Preliminary Financial Analysis of Proposed Civic Center Development

In accordance with your request, Keyser Marston Associates, Inc. (KMA) has reviewed the preliminary financial information that the Robert Green Company (RGC) has submitted regarding the development of a new civic center, luxury hotel and residential complex on the Windsor Town Green. The purpose of this evaluation is to provide information for the Town staff and Council to be used in selecting a preferred development concept from a range of alternatives that are being considered. The preferred development concept must meet two feasibility thresholds: 1) that it will generate a sufficient return to the private investment community to secure funding for the project; and 2) that it will generate sufficient new revenue to the Town to fund the cost of developing a new civic center.

Pursuant to the terms of the Exclusive Negotiation Agreement (ENA) with the Robert Green Company, the selection of a preferred concept will complete Phase I of the ENA and will enable Robert Green and the Town to move forward with engineering studies, preparing refined cost estimates, meeting with public partners, such as the Windsor Unified School District (WUSD), and securing financing and equity funding for the project. Consistent with the project's conceptual stage, the economic data and assumptions are preliminary and will be refined based on the due diligence efforts to be undertaken in Phase II.

A. Preliminary Development Concepts

The Robert Green Company (RGC) has been actively engaged in planning efforts for the project, including undertaking extensive site planning work to develop the alternative concepts, conducting public meetings, meeting with property owners, evaluating market conditions, and preparing financial projections for both the private and public components of the project. There are three primary alternatives that have been

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considered and evaluated. They vary with respect to both private and public uses. The relocation plan for public uses is a key issue for each of the alternatives and the ultimate success of the project.

	Alternative A	Alternative B	Alternative C
Private Development Program	151- key hotel	151-key hotel and 60 for-sale residential units and parking	151-key hotel and 60 to 87 for-sale residential units and parking
On-site public facilities	Town Hall	None	Most robust includes all existing uses except for Huerta Gym
Final Site requirements	Town and Windsor Unified School District properties	Town and Windsor Unified School District properties	Town and Windsor Unified School District properties Telfer "East" and "West" property
Relocation Requirements	Temporary relocation for Town offices Permanent relocation for Library, Huerta Gym and Police Station	Permanent relocation of all public facilities	Temporary facility for police station, administrative services and parks and recreation department Permanent relocation of Huerta Gym
Role of the Robert Green Company	Lease the Town's property and develop the hotel.	Lease property from the Town for the hotel development and acquire property for the residential development.	Lease property from the Town for the hotel development and acquire property for the residential development.
Role of the Town	Provide temporary relocation for Town Hall, build the Town Hall and provide for the permanent relocation of other public facilities. Negotiations with Winsor Unified School District for the acquisition of their property	Provide for the permanent relocation of all public facilities. Negotiations with Winsor Unified School District for the acquisition of their property	Purchase Telfer properties and develop, new public facilities on site Negotiations with Winsor Unified School District for the acquisition of their property
Funding for Public Facilities	Objective is to leverage ground rent and new public tax revenues (hotel tax, property tax, and property tax in-lieu of motor vehicle license fees to pay for 100% of the relocation and public facility development costs.	Same as Alternative A.	Same as Alternative A.

This project is complex in that feasibility must be achieved for both the private development components, funding for the public components is driven by the success of the private components and there are multiple land owners and stakeholders involved in the transaction.

The Town has retained appraisals of properties that would need to be acquired and has developed cost estimates for temporary relocation and the construction of new public facilities. RGC has provided KMA with copies of its preliminary financial projections for each of the alternatives, development cost estimates, site plans, and information on residential pricing. Given the conceptual stage of the planning process, some aspects of the financial estimates must be kept confidential until the project has secured an equity investor. However, sufficient information is available to provide an order of magnitude understanding of the general feasibility of the alternatives and key risk factors. Additional detail will be available as precise development cost estimates are prepared for both the private and public development components.

B. Approach to Measuring Financial Feasibility

1. Hotel and Residential Component

The preliminary financial feasibility of the private development alternatives has been evaluated based on a review of estimated development costs, operating projections, the financing plan for the project and the financial returns that are estimated to be generated by each concept using a range of standard metrics, such as annual net income relative to development costs and the rate of return to equity investors throughout a standard hold period. KMA has reviewed preliminary performance projections relative to published surveys of investor requirements as well as RGC's specific requirements.

2. Public Facilities

The feasibility of each alternative's public facility concept has been evaluated relative to the objective to fully fund the public facilities from leveraging the ground lease revenues and on-going public tax revenues to be generated by the hotel and residential components. The Town's estimates of costs have been compared to the magnitude of projected ground lease revenues, hotel tax revenues and General Fund property tax revenues to be generated by the project.

During Phase II of the ENA, a range of public financing tools for leveraging the public revenues without any risks to the Town' assets will be fully explored.

C. Analysis of Relative Feasibility of the Private Development (Hotel, Retail, and Residential) Alternatives

1. Development Costs

As proposed, the hotel will be a luxury resort with 151 guest rooms and a full-complement of amenities including a signature restaurant with outdoor seating, a resort pool, 9,300 square feet of meeting space, and a spa. In addition to amenities within the hotel, the project will include an additional restaurant, a cafe and approximately 6,600 square feet of retail space. The total gross square footage of the hotel is estimated at 146,000 square feet. Based on their experience, RGC has estimated direct construction costs at approximately $475 per gross square foot or $466,000 per guest room.

The residential units will average 1,300 square feet of livable space or 2,400 gross square feet per unit, including common areas. Units will range in size from 1 to 3 bedrooms. RGC has estimated the cost of constructing the residential units at $915,000 per unit or $378 per square foot.

Soft costs are estimated to account for approximately 27% of total development costs.

The direct and soft cost estimates appear to be reasonable based on the development costs of other high-end hotels and residential developments.

Based on these estimates, the cost of each alternative is estimated to range from $102 million to $219 million.

	Alt. A	Alt. B	Alt. C (87 units)
Total Development Costs	$102 million	$170 million	$219 million

2. Hotel Market Conditions and Anticipated Operating Performance

The proposed hotel will offer a degree of luxury that is currently not available in Windsor. Hotels in the Sonoma/Napa wine country that RGC has identified as being most comparable to the proposed hotel include the Andaz Napa, Bardessano and Vintage House in Yountville and Hotel Healdsburg in Healdsburg.

Based on data published by STR[1] the average daily room rate for those hotels during 2019 was $474 per night. The peak monthly room rate was reached in September, with an average daily rate of $589. Annual occupancy averaged 75%. The difference

[1] STR is a firm that tracks and records hotel performance data throughout the world. It is the standard data source used by the hospitality industry.

between the luxury hotel market and the entire hospitality market is highlighted by the consideration that the average daily rate of all lodging establishments in Sonoma County in 2018, including budget motels, approximated $180.

RGC in consultation with the hotel operator Montage has prepared operating projections for the proposed hotel. If the proposed hotel were to open this year, RGC estimates the hypothetical ADR at $420 per night. The rate is less than the average rate of $474 per night being achieved by the comparable hotels in the heart of the wine country in recognition of Windsor's location. During the first three years of operation, the room rate and occupancy rate of new hotels typically increase at an accelerated rate and reach stabilization during the fourth operating year. Upon stabilization in approximately 2026/ 2027) the hotel's occupancy rate is estimated to average 77% and the average daily rate is anticipated to approximate $579 per night.

The residential units will be designed so that they can be leased to nightly hotel guests. RGC has estimated that these homes could achieve a currently nightly rate of $748. The projections assume that approximately 45% of the residential units would desire to participate in the hotel leasing program, that the participating units would achieve an average annual occupancy rate of 60% and that the hotel would retain 55% of the rental income from the units.

RGC has proposed to base ground lease payments to the Town based on the performance of the hotel. As proposed, upon stabilization, the Town will receive 4% of annual room sales (from both the core hotel and the residential units rented as part of the hotel pool of rooms) and 2% of other hotel revenues. Based on the estimated underlying value of the property to be leased for the hotel, it appears that this ground lease structure will likely yield a market rate return on the Town's property[2].

Based on these operating assumptions, RGC has estimated the magnitude of annual net operating income that the hotel and retail component will generate under each alternative. The projection of annual net income upon projected stabilization:

Alternative	Projected Net Operating Income after ground lease payments
A	$8.2 million
B	$10.2 million
C	$10.6 million

[2] A precise evaluation will be possible once the Town's property is appraised and the boundaries to be leased are established. A market rate ground lease typically ranges from 6% to 10% of the fee simple value of the property.

3. Residential Sales

RGC has not completed a market study specific for the proposed project but has retained a third-party consultant to evaluate the pricing for its Healdsburg resort. Based on that market study as well as the prices being achieved by other hotel/residential developments, RGC has estimated that the residential units will achieve an average sales price of $1.4 million or $1,075 per square foot. While this projected price is significantly higher than the general residential market in Windsor, it is consistent with the experiences of other comparable luxury resort properties and does not appear to be unreasonable.

4. Financing Plan

RGC has estimated that approximately 65% of the project's development costs will be funded with debt and that 35% will be funded with equity. This ratio is consistent with industry standards.

5. Preliminary Indications of Feasibility of Alternatives

As noted previously, the project is in the conceptual phase of planning and engineering studies and other due diligence efforts need to be undertaken as well before the project can be underwritten by prospective financial partners and a feasibility fully evaluated. Given that caveat, the preliminary development economics of each alternative have been evaluated to assess the relative feasibility of each of the alternative development concepts.

There are several different metrics that are used to evaluate the financial feasibility of real estate projects, including the stabilized annual income relative to the cost of development, the profit upon completion and sale, and the present value of annual returns and sales proceeds over a standard holding period for the asset. The relevancy of the metrics vary by the type of real estate projects and for hotel projects, the present value of the project's net cash flow to equity over the holding period is a very pertinent metric given that hotels usually take four operating years to reach stabilization.

The performance projections Alternative A indicate that it significantly falls short of industry standard returns with respect to several metrics. For example, the projected return on cost during the first full operating year is projected to be 4%, which is significantly less than the current standard threshold of 6% for first tier hotels in the San Francisco Bay Area. This alternative's feasibility is challenged by the lack of a residential component. Given the trends in the resort hospitality market, having a residential component is critical to the success of the project. RGC has determined that Alternative A will not meet the feasibility threshold requirements of the investment community and has determined that it is not a feasible alternative. Based on our review, we would concur with this assessment.

Alternatives B and C are projected to perform significantly better than Alternative A because of the addition of residential component. Alternative C with 87 units is projected to outperform Alternative B with only 60 units. Both alternatives are estimated to fall slightly short of the 6% return on cost metric. Alternative C, however, is projected to best meet the industry standards for return to investor equity over the holding period and RGC is willing to move forward with that Alternative. We concur that the development economics of Alternative C are generally consistent with the return requirements for feasibility and represents the Alternative with the highest probability of being successful in securing debt and equity commitments to move forward.

D. Financial Feasibility of Civic Center Facilities

As detailed in a memorandum dated January 22, 2020, the Town has engaged in a robust effort to estimate the cost to acquire property, provide temporary relocation for public facilities, and construct replacement facilities. Based on that assessment as well as the public facilities program identified by RGC for Alternative C, it appears that the cost to relocate and rebuild the public facilities is in the range of $55 million to $60 million.

One of the key goals of this project is to fund the relocation and development of the public facilities solely from the tax revenues and ground lease revenues to be generated by the project. The project will generate a tremendous amount of annual tax revenue to the Town of Windsor. The Town collects a 12% tax on hotel room sales, which is projected to generate over $4 million of annual revenue to the Town upon stabilization of the hotel under Alt. C. Additionally, the project will generate additional property tax and property taxes in lieu of motor vehicle license fee revenues which are estimated to total approximately $400,000 per year upon stabilization. As proposed, ground lease payments to the Town will be based on 4% of hotel room revenues and 2% of other revenues generated by the hotel. Upon stabilization, ground lease revenues under Alternative C are estimated at $1.5 million per year. The combined sum of ground lease and tax revenues are estimated to reach $5.8 million per year by the hotel's 4th operating[3] year under Alt C.

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[3] In addition to their regular apportionment of property taxes, cities and counties receive property tax revenues in lieu of vehicle license fees (VLF). In 2004, the State legislature permanently reduced the VLF rate from two percent to 0.65 percent and compensated cities and counties for their revenue loss with a like amount of property taxes, dollar-for dollar. Each agency's property tax in-lieu of VLF allocation increases annually in proportion to the growth in assessed property valuation in that city our county. The $200 million project will increase the assessed value of property in the Town of Windsor and will therefore increase the amount of property taxes in-lieu of VLF revenue that the Town's General Fund will receive.

For purposes of this initial feasibility analysis, the ground lease and public tax revenues to be generated by each alternative have been evaluated over a 30-year operating period.

	Alt A.	Alt. B.	Alt. C.
Year 4 ground lease	$1.3 million	$1.4 million	$1.5 million
Year 4 TOT	$2.9 million	$3.6 million	$3.9 million
Year 4 property taxes	$0.2 million	$0.3 million	$0.4 million
Total Year 4 public revenues	$4.4 million	$5.3 million	$5.8 million
Total public revenues over 30-year term	$171 million	$203 million	$222 million
Est. Funding capacity of 30 years of revenue, assuming an 8% discount rate	**$47.4 million**	**$56 million**	**$61 million**

This projection indicates that it is likely that Alternative C will generate sufficient revenues to the Town to fund the entire public facilities program. An important work effort during Phase II of the negotiation period will be to explore the various public financing tools (and possibly private financing options) that are available to leverage these funds and the amount of upfront capacity that can be supported. One key challenge will be to address the timing difference between when the funds are needed for improvements and when the tax revenue and ground lease revenue will actually start to flow, which may result in a need for “bridge” financing to cover the gap in timing. Additional important issues are the coverage factor that a lender will place on the ground lease and tax revenue stream because of the uncertainty of the performance of a hotel and the collateral that might be required to secure funding. These issues will be addressed in Phases II and III of the ENA. In any event, the Town will negotiate provisions that protect and insulate the Town from any potential negative effects resulting from a subpar performance of the hotel.

E. Preliminary Findings

- The proposed project is complex and challenging because of numerous factors:
  - There are two key components of the project: 1) rebuilding the civic center and 2) developing a pioneering luxury resort complex;
  - multiple properties must be acquired,

- construction must be carefully phased to reduce the costs of the civic center and not disrupt the hotel;
- financing for the civic center is directly tied to the performance of the hotel;
- the project must enhance the experience of both existing residents and visitors; and
- multiple stakeholders and agencies must collaborate to effectuate the project.

▪ RGC's development cost estimates are consistent with the costs of other luxury hotel and residential projects.

▪ The proposed luxury hotel resort will be a new and untested product in Windsor. While the projected performance of the hotel and the residential components are consistent with the performance of luxury properties in the heart of the wine country, there are no existing comparable hotels in Windsor that are achieving the nightly room rates that are being projected for the proposed project.

▪ The proposed ground lease payments by RGC equal to 4% of hotel room revenues and 2% of all other revenues generated by the hotel appear to be consistent with the underlying fair market value of the property.

▪ The estimated financial returns to be generated by Alternative A (no residential units) and B (only 60 residential units) fall significantly short of industry standard returns required to support new hotel equity investment. Alternative C, with 87 residential units, is projected to generate returns that are likely to be sufficient to attract equity investors and lenders to provide funding for the project. Additionally, it appears that Alternative C will generate sufficient public revenues to fully fund the cost of the new Civic Center.

▪ Based on this review, KMA recommends that the Town proceed with Alternative C as the preferred Alternative.

▪ The financial analyses undertaken to date are estimates based on the experience of the RGC team and KMA. During Phase II of the ENA, significant due diligence will be undertaken to refine cost estimates and the financial evaluation of the preferred alternative. RGC will commence engineering studies, refine operating projections, and will seek-out the level of interest of lenders and equity partners in the project. Through this effort, the financial feasibility of the project will be solidly understood by the completion of Phase II.

F. Next Steps

Once a preferred alternative is identified, then Phase II of the ENA will commence. During Phase II will be a period of extensive analysis of:

- Project development costs,
- The debt and equity capacity of the project to fund the hotel, residential and retail components;
- The portion of the site to be leased to RGC and the structure of ground lease payments;
- The portion of the site to be acquired by RGC and the amount of the purchase price;
- The amount and timing of public tax revenues to be generated by the project;
- The optimal public or private financing tool for financing the civic center with the public tax revenues to be generated by the project; and
- A detailed development and phasing plan for the entire project.

During Phase II, the Town and RGC will work diligently to formulate mutually acceptable business and other terms for the successful development of the Civic Center Property. Once completed, the draft terms will be submitted to the Town Council for its consideration. The proposed development terms may include, without limitation, the following elements:

1. Identification of any parcels within the Civic Center Property which must be acquired, and designation of Town and/or Developer to acquire such parcels.
2. Identification of any parcels within the Civic Center Property to be conveyed by Town to Developer, whether such parcels are to be sold or ground leased, the purchase price or rent amounts, and other terms of the sale or lease of property.
3. Requirements for demolition of existing improvements and relocation of existing residents, tenants, businesses and other users of the Civic Center Property.
4. Requirements for analysis of, determination of cost of remediation of, and performance of remediation of the environmental condition of portions of the Civic Center Property.
5. A narrative scope and description of each of the private improvements to be constructed and developed, which may include a hotel and ballroom, restaurant, for-sale or rental residential units, parking, and other improvements.
6. A narrative scope and description of each of the public improvements to be constructed and developed, which may include a Town Hall, public library, gymnasium, public parking, and other public improvements.
7. A schedule of performance of the development requirements.

8. Requirements for selection of the operator of each of the private improvements, including Town approval standards.
9. A plan for public and private financing of individual components of the development, and Town contributions to the Project, if any.
10. Use, operating and maintenance requirements for the private improvements.
11. Other terms and conditions necessary for the development of the Project in accordance with the Preferred Development Alternative.