Memo

To:	Tom Daniel, Andrew Shapiro, Salem, MA	From:	Alex Phillips Drew Leff
File:	Salem Superior Courthouse and County Commissioners Building Reuse study	Date:	September 28, 2017 Revised November 3, 2017

The Salem Redevelopment Authority (SRA) and the City of Salem (City) have engaged Stantec to determine the feasibility of private redevelopment of the now-vacant Salem Superior Court (SSCB) and County Commissioners (CCB) buildings. The proposed redevelopment would include both public reuse, specifically, offices and facilities for the Essex County Registry of Deeds (ROD), as well as private reuse.

Legislation has been enacted to:

- Allow ROD to make use of a portion of the buildings,
- Provide a mechanism for transferring both buildings to the SRA to enable it to solicit a developer who will redevelop the buildings for both ROD and private uses,
- Provide for the Commonwealth to reimburse the developer for the cost of redevelopment,

The study's primary objective is to determine whether a development project can be conceived that is sufficiently attractive to engender bids in response to an SRA developer solicitation.

In addition, as part of this feasibility analysis, Stantec has estimated the cost to the Commonwealth of redeveloping space in the Salem Superior Court building for use by ROD.

The analysis models several scenarios to determine whether a feasible scenario exists wherein the ROD could occupy a large portion of the SSCB, and leave both the remainder of the space within the Superior Court, and the CCB, available for private development, either office or residential use. Alternatively, if it is infeasible for private users to use the remainder of the space within the SSCB, we have modeled a scenario with ROD and/or other state agencies using the balance of the SSCB, or mothballing it for future use, while developing the CCB for private use.

Because both buildings are historic, redevelopment costs, particularly within the SSCB with its special interiors, are likely to be greater than conventional ground-up development. Given that the buildings are on the Historic Register, it would be helpful for the project's economic performance to use Federal and State Historic Tax Credits. While the tax credits cannot be directly utilized by a tax-exempt owner, such as a public agency, the private developer may be able to create a legal structure to allow the use for Tax Credit purposes.

The Two Buildings

Both the Superior Court Building and the County Commissioners Building are on the National Register of Historic Places. The Superior Court was built in two phases between 1861-1891. It totals 39,500 gross square feet, and is of the Romanesque Revival style. The building contains some architecturally significant spaces, including the Essex Law Library, a double-height space with a massive fireplace and a catwalk around the perimeter of the room. Some of the building's historic courtrooms also have architecturally significant features such as vaulted ceilings. It is desired to retain some public access for these spaces upon renovation, and as such it has been proposed that a public agency might make a good tenant. The Essex County Registry of Deeds needs new offices and could reuse these spaces. The County Commissioners' Building (15,600 gross square feet) was constructed in 1841. While the Greek Revival style exterior must be restored, in general, no special character of the interiors has been retained. The structure is in good shape, and the building could be repurposed for either office or residential uses.

The two buildings are presently connected via an entryway and elevator link. It is anticipated that this connection will have to remain intact upon redevelopment due to the significant cost of adding an additional ADA-compliant entry and elevator shaft. Aside from this connecting link, we are proposing that the buildings will need to effectively serve as two distinct facilities, with the ROD occupying the entire Superior Court building, and private uses occupying the County Commissioners building. This will simplify redevelopment concerns. First, for the purposes of the real estate conveyance to DCAMM, maintaining two distinct buildings simplifies identifying which costs apply to ROD's use and which apply to the private use. Second, it simplifies issues of security and separation between the public and private spaces. And finally, mixing uses in the Superior Court building could be costly and complicated.

The Legislation

Legislation (MGL Ch. 462) has been enacted to provide for conveyance of the former Superior Court Building and the adjoining County Commissioners Building to the Salem Redevelopment Authority and in turn the SRA would convey an improved condominium portion of the property back to the Commonwealth for use by the Essex County Registry of Deeds (ROD). In this analysis, we have assumed that the SRA would identify a master developer for the entire property, and that developer would renovate a portion of the property to meet the ROD's requirements, and would renovate the balance of the property for other uses. Once renovated, the developer would convey a condominium interest to the Commonwealth, on behalf of the Secretary of State. The ROD, which is an entity of the Secretary of State, would have the Commonwealth purchase or lease the condominium at a price financially equivalent to the cost of redeveloping their space and their share of common area for which the condominium has rights. The issue of defining the developer's cost is critical because a developer will need to be reimbursed not only for their Hard Costs and Soft Costs, but also reasonable compensation for their overhead and time spent on the project, their cost of capital and risk. This is an important point: The SSCB is much larger and costlier to develop than the CCB and unless the developer can cover its true costs, the profit from the CCB redevelopment cannot offset any costs incurred in the development of the SSCB and still make the combined project financially attractive. The legislation states that the amount paid annually is at the discretion of the Secretary of State. For the purposes of modeling for this analysis, we have assumed that the Commonwealth's annual responsibility is equal to their share of costs, which are calculated as:

- Commonwealth's fair share of Debt Service (including principal and interest payments)
- Commonwealth's fair share of Equity repayment (at a 7% return to the equity investor)

These costs would be defined in advanced and fixed throughout the duration of the Commonwealth's rental from a private developer. It would be financially infeasible if the Secretary of State were not to commit to approve these annual "rental" payments. A developer, and its lender, will need to know that debt service will be paid and they will receive sufficient funds to cover their equity investment and provide a reasonable return on equity for the work done for the Commonwealth space in order to mitigate their risk on the project.

The developer would be selected through a competitive process and to the extent that there is value created in the development of the additional portion of the building greater than the cost of capital and a reasonable return on investment for both portions, the developer will be able to bid a sum to purchase the property. That sum would be divided between the Commonwealth and SRA as described in MGL Ch. 462. As shown in the analysis below, it is unlikely that there will be significant residual value attributed to the building shell and land for this project.

The Essex County Registry of Deeds

While the legislation describes the Registry of Deed to occupy 18,000-20,000 SF of space, it does not distinguish between Gross SF, Rentable SF or Net (Usable) SF. Given the inefficiency of the building, it would not be surprising that 20,000 NSF translates into over 30,000 GSF (NSF = 60 to 70% of GSF). The ROD requirement as laid out in the Goldman Reindorf study, utilizes approximately 34,000 GSF (59% NSF/GSF) of the 39,500 total GSF in the Superior Court Building. But the Registry use of the Superior Court building provides for preservation of the most important historic elements and public access to them. As discussed later in the analysis, while ROD may not have program requirements for the remaining approximately 5,500 GSF of the SSCB; it would be difficult to use that space for private tenants. Our calculations for Gross, Rentable and Usable are slightly different from Goldman Reindorf, and can be found at the end of this report.

Remnant office space in SSCB

With the majority of the SSCB developed for the ROD, it would be infeasible to convert the excess space in the SSCB for residential use. Marketing the space for apartments, given that it is surrounded by ROD use, would be difficult. Further, to bring all of the pipe chases needed for residential kitchens and bathrooms through the ROD space is impractical and costly.

While the remaining space could be physically adapted as office space, the developer may be reluctant to market and manage such a small amount of office space, if the CCB were converted to residential use. The remnant space is too small to manage efficiently and the likelihood of finding a tenant is risky.

If a developer converted the CCB to office it might not be an issue to manage a few more office spaces, however, a.) the remnant office space on the second floor requires the tenant to allow ROD staff to egress through the tenant's space in case of emergency, and b.) commercial use of the CCB does not appear to be economically feasible. Office demand is weak in Salem. The remnant space might be more successfully used by other state agencies or affiliated users. We anticipate very limited interest from the development community if they are required to manage a small amount of office space in addition to a residential building. Further, the rent that a private office tenant will be willing to pay for that space is likely insufficient to cover debt service and achieve required developer and equity returns.

Federal and State Historic Tax Credits

Redeveloping historic buildings and substantially restoring their original character can be expensive. The use of Historic Tax Credits (HTC) can be vital to reduce the potential impact of these development costs by providing another two sources: Federal and State HTC—which can replace equity. The use of HTC can convert an infeasible project to a feasible one for a private developer. However, there are some obstacles to using both Federal and State HTC with the proposed program.

Tax-exempt uses, like ROD, are generally not eligible for Federal HTC, however there have been many projects that have received Federal HTC with tax-exempt users as tenants. The transactions need to be structured properly to meet the IRS requirements, even then not all such projects qualify. There are a few issues relating to the specific SSCB and CCB that must be considered:

1. The rehabilitation must meet National Park Service standards which will primarily call for a historically faithful restoration of the building exteriors and sometimes key interior spaces. In the CCB there is little left of the original interior. We would expect that only the front entry with its dramatic staircase will need to be restored. However, with the SSCB, there are several important interiors, particularly the Law Library, possibly some of the courtrooms and perhaps the entryway and stairs that connect the original SSCB and its later addition. We believe that a renovation like that described in the Goldman/Reindorf study would comply with these restoration standards. In fact, ROD's use can retain and make publicly accessible some of the important interior spaces, particularly the Law Library. We anticipate that there will be preservation restrictions that limit the ability to alter certain spaces. The impact of these restrictions may increase construction costs and financial risk. Preservation restrictions may also limit certain reconfigurations of space, which could make for less efficient or less desirable spaces for future tenants.

2. The reconveyance of the SSCB to the Commonwealth cannot occur during the first five years of use, if Tax Credits are used without financial penalties. The ROD would need to lease their space during that period. After that period, the HTC investors position can be rolled up with a small compensation (approximately 5% return on their investment). As the Commonwealth would ultimately prefer to own the space they use, they could rent their space for a period of five years. Upon Year 6, the Commonwealth could purchase the condominium interest of their portion of the development without compromising the tax credits.

3. However, the biggest issue is whether the developer can create a "Qualified Lease" for the ROD facility. With a qualified lease, the tax-exempt use cannot exceed 50% of the property. Throughout this analysis, we have made the case that if DCAMM and the SRA want to entice a private developer to redevelop the two buildings, the developer will not want to take on the management of excess space within the SSCB—it doesn't make economic sense. However, one method of making the ROD lease "qualified" is to reduce ROD's use to less than approximately 27,350 GSF. However, based upon the Goldman Reindorf study, this would be extremely difficult to do. If it could be accomplished so as to free up the entire 1861 component of the SSCB, that portion might be converted to residential use. Because of the historic nature of the SSCB, it is not as efficient as traditional office construction. Therefore, it may be very difficult to reduce the ROD uses to this figure. We were not able to

determine a way of doing that. Furthermore, if the ROD does not occupy the full SSCB and a developer is not receiving a return on their investment in the remnant portion, it is unlikely this would be a viable project. Please see the section above regarding Remnant Office Space in SSCB for further discussion of this topic.

4. The other option for a tax-exempt entity to qualify for HTCs is to have a "disqualified" lease. Under this scenario, the project must meet four tests:

   a. The Tax-exempt party's lease must be greater than 20 years,

   b. Tax-exempt bonds cannot be used to finance the development,

   c. A fixed or determinate sales price cannot be established, and

   d. The transaction cannot be a sale/leaseback.

The biggest issue relates to test c., with the disqualified lease, as it is difficult to structure a purchase price as specified in the legislation. And second, relating to item d. is the entity occupying the facility previously, and the entity leasing the property after the renovation, the same entity, and hence a sale/leaseback: In other words, because the Superior Court and The Essex County ROD are both entities of State government, they are likely considered to be the same entity, which would make redevelopment of this space ineligible for Federal Historic Tax Credits. It will need to be determined whether the fact that the Superior Court has been out of the buildings for a significant period may ameliorate the issue of putting an affiliated entity back into that space.

Even if the SSCB does not qualify for Federal HTC, the CCB condominium, given that it could be interpreted as a separate building, may still be able to use them. Further, both buildings should qualify for Massachusetts HTCs. We have analyzed a few different scenarios.

The balance of this report will provide a discussion of the financial analysis, our pro forma models, assumptions, and conclusions.

Proformas and Assumptions

We reviewed past studies, in particular the June 2015 VJ Associates Feasibility Estimate developed for DCAMM as a part of the Goldman/Reindorf Study, and the March 2017 Faithful & Gould cost estimate, which was completed as a part of the Perry Dean Rogers Partners Architects' Salem Courts Mothballing Study, also prepared for DCAMM. From our experience, we have seen that the cost for development undertaken by State agencies is significantly higher than private development. Public projects require payment of prevailing wages, use of filed sub bids and rules that make it much more expensive. Soft costs carried by public agencies are significantly greater, as well. Also, a private developer might not go to quite the same level of restoration, but still sufficient to meet National Park Services standards. We took the cost estimates from these past studies as a baseline, and adjusted the square foot unit costs based on our best professional judgement with the following major considerations:

- Reduced line items that went above and beyond what would be required for National Park Service rehabilitation of an Historic building

- Identified which items from the Perry Dean mothballing study could be applied to future construction
- Distinguished between costs for Superior Court building and County Commissioners' building
- Distinguished between costs for residential and office uses
- Made a 5% adjustment to account for filed sub bids not being required of the private developer.

The previous studies assumed that the work would be completed by DCAMM. If the Commonwealth were to redevelop the properties, there would be cost premiums due to Commonwealth requirements in construction. We believe a developer could complete this project at a lower cost. We have assumed that a developer will construct the space for the Commonwealth, as well as the space the developer would retain. The developer would build and finance the project, and the Commonwealth would lease its space from the developer for an annual rent that covered the developer's cost, plus some compensation for the developer's risk, time, and efforts[1]. Our findings follow.

Construction Costs. A variety of factors go into the construction cost estimates that were ultimately used for this analysis.

Based on adjustments of the VJ study, we developed a new baseline for Total Direct Costs across the two buildings. From the Mothballing Report, we identified savings that may reduce a developer's cost based on work to be done by the Commonwealth. The Superior Court building has significantly more architecturally and historically significant elements that will require additional care, attention, and therefore cost. To account for this, we applied an adjustment to the construction costs to differentiate between the Superior Court and County Commissioners buildings.

Because the cost estimates were based on an office use, we identified a premium to be applied for converting the County Commissioners' building to residential use.

Our analysis then applies traditional mark-ups, soft costs, and a developer fee, all of which are calculated as percentages of Hard Costs. Once added together, we come away with Total Project Costs for the entire project and for two scenarios – one with both the Superior Court Building and the County Commissioners' building used for all office use, and one which allows for residential use in the County Commissioners' building.

Our general process followed the steps below:

> Step 1: Cost Estimates from 2015 VJ Study **($432/sf**)– extraneous items and an adjustment for private development+ escalation to today's dollars = new baseline **($347/sf)**

[1] The additional compensation on top of "cost" would need to be reviewed by counsel and judged to be consistent with the legislation. If we cannot include for some such additional return for the developer's services, we anticipate it will affect potential interest in pursuit of this project.

Step 2: Identify items from 2017 Faithful & Gould mothballing estimates that will reduce costs of full rehab **($32/sf)**

Step 3: Reduce New Baseline by Mothballing Savings **($315/sf)**

Step 4: Increase cost for Superior Court construction **($335/sf)** and decrease cost for County Commissioners' building construction **($265/sf)**

Step 5: Apply premium for residential conversion of County Commissioner's building **($25,000/unit or $16/sf)**

➔ **Steps 1-5 establish Direct Cost figures**

Step 6: Adjust all Hard Costs to account for the savings a developer would realize for not requiring a filed sub-bidding process **(less 5% in all cases)**

Step 7: Include traditional mark ups including general conditions, general requirements, bonds & insurances, building permit, contractor fee, and estimating, CMR, Design, and Escalation contingencies. **($150/sf in all office scenario; $152/sf when CC building is Residential use)**

➔ **Step 5 – Step 6 + Step 7 = Hard Cost**

Step 8: Apply 25% soft costs. These include a 4% Developer's Fee. **($116/sf in all office scenario; $118/sf when CC building is Residential use)**

Step 9: Add Hard Costs and Soft Costs to calculate **Total Project Costs**.

In all, the Total Project Costs (TPC) are thus approximately **$570/SF or $31.4M** for all office use, and **$578/SF or $31.8** when County Commissioners' building is residential use.

Critical to this analysis is that the above figures are all assuming construction costs based upon prevailing wages (typically union construction). This distinction could be the difference between a feasible project for a developer and no project.

Assumptions

1. Rental Rates. Rental rates in this market are not particularly strong, and the market demand for office space is in question. Based on CoStar data, we have assumed that an office user will pay $16/rentable sf triple net to use the County Commissioners building. We believe that residential uses could support $34.80/rentable sf/year ($2.90/sf/month) in the same space. In both instances, we have carried a vacancy allowance, and for residential use we include an operating expense of $8,000 per unit.

2. Commonwealth Costs: The Developer will rehabilitate and build out the ROD space but the Commonwealth will be responsible for the cost for their space. The Development Cost attributed to the Superior Court Building is 76% of the Total Project Costs in the all-office scenario, and 75% in the scenario with residential use in the County Commissioners' building.

We've estimated the annual rent as needing to cover both ROD share of debt service as well as a share of required equity contribution and an appropriate return.

a. Debt: The Commonwealth will pay the portion of the debt service attributed to their space, or 75-76% of the total annual debt service, which includes both principal repayment and interest payments. The Commonwealth will also be responsible for paying the additional debt service associated with not being able to obtain Federal Historic Tax Credits on their portion. This is explained more fully in 3.a. below, Sources of Funds, Historic Tax Credits.

b. Equity: As the developer will be required to put some amount of equity into this project, the Commonwealth will also be required to pay for this portion of the capital stack. While there isn't an "interest rate" on equity, a developer will expect a reasonable return, minimally 7%[2], for their cost of equity capital, and risk on the project. In other words, a developer would need to be compensated for their time and investment into this project. To calculate this figure, we again have allocated a portion of the equity based on the percentage of project costs associated with the Superior Court building (again, 76% in the all-office scenario and 75% in the residential County Commissioners' building scenario), and added on an annual payment, equivalent to 7% of the developer's equity investment annually to provide for their required return on that equity.

The total costs to the Commonwealth are detailed below in the Financial Analysis section. There, the report lays out annual costs, which include debt service payment, equity payments, and estimated operating expenses. The report also details costs to the Commonwealth to purchase their condominium interest from the developer in Year 6.

3. Sources of Funds:

a. Historic Tax Credits. In all cases, ideally both Federal and State Historic Tax Credits would be utilized. However, as discussed above, we think it highly unlikely we'll be able to take advantage of the Federal HTC for the SSCB. We are projecting approximately $1.5 Million in Federal Historic Tax Credits for the CCB. While the project is eligible for up to nearly $5 Million in State Historic Tax Credits as well, we are concerned this is too high an allocation and are therefore assuming only $3 Million in State Historic Tax Credits. The difference in the overall HTC draw will fall upon the Commonwealth. The increased cost to the Commonwealth is approximately $4.8 million. This amount would be added to the debt service for which the Commonwealth is responsible. Because the Commonwealth would be required to pay for those increased costs, it does not affect a developer's return on equity for the

[2] We have included a 7% return on equity, which is on the low end of the range a developer might expect. Standard returns on equity are somewhere above 10%, accounting for the risk involved with that equity investment. In this case, the Commonwealth is guaranteeing their tenancy, and that the 7% return will be paid, rather than a developer having market risk, absorption risk, etc. Therefore, a developer may be willing to accept a slightly lower than standard Return on Equity because the Commonwealth (Registry of Deeds) is a confirmed, credit tenant.

project. But the Commonwealth would need to determine if that overall cost is too great to go forward with the ROD lease and purchase.

b. Housing Development Incentive Program (HDIP). State HDIP subsidies are available to Gateway cities to support market rate housing. We have also allowed for high, medium, and low scenarios for HDIP funding for the residential units in the CCB. The high scenario brings in $1.7 M in HDIP funding, or 25% of qualifying costs; the medium scenario allows for $1M in HDIP funding, and the low scenario does not include HDIP.

c. Equity. We are assuming a developer would put in 5% of TPC in equity.

d. Traditional Debt. The remaining project costs would be covered by traditional debt financing.

4. Fees: The analysis accounts for a 4% developer's fee as a part of the soft costs. This is a standard developer's fee, though may be slightly low for an historic project.

Financial Analysis

The financial analysis aims to answer two main questions: What are the potential returns to a developer and are they sufficient for them to undertake the project? And, what are the costs to the Commonwealth? The pro forma calculates the expected return to a developer based on estimated development costs, and rental rate assumptions, as well as anticipated Tax Credit equity and mortgage rates. This has been broken out in two key ways: by building, and by time.

Developer's Return on Equity and Project Viability Calculations

The return on equity for the Superior Court building, the Commonwealth's responsibility, is stated: 7% for Years 1-5, and 10% upon sale in Year 6. The return on equity for the County Commissioners building varies greatly across scenarios. A simple measure for developer interest will be projected Return on Equity across the entire project in a stabilized year, and we expect they will be satisfied with anything over about 12%. The summary charts follow:

Reference: Salem Superior Court and County Commissioners' Building Redevelopment Feasibility

Office Scenario

Analysis - Office Use			**NOT VIABLE**
Total Equity			$1,570,420
Equity Attributed to COM			$1,208,127
Return on Equity (COM)	***7%***	***Annual PMT***	**$84,569**
Return on Equity SC Building Year 6			**10%**
Equity attributed to Private			$362,293
CF after DS years 1-5 CC Building			($83,761)
Return on Equity - CC Building Years 1-5			**-21.12%**
Year 6 CF after DS			($49,379)
Return on Equity - CC Building Year 6			**-13.63%**
Return on Equity Overall Years 1-5			**0.05%**

Residential Scenario

Analysis - Residential Use, $1M HDIP			**NOT VIABLE**
Total Equity			$1,592,295
Equity Attributed to COM			$1,208,127
Return on Equity COM	***7%***	***Annual PMT***	**$84,569**
Return on Equity SC Building Year 6			**10%**
Equity attributed to Private			$384,168
CF after DS years 1-5 CC Building			$31,495
Return on Equity - CC Building Years 1-5			**8.20%**
Year 6 CF after DS			$60,505
Return on Equity - CC Building Year 6			**15.75%**
Return on Equity Stabilized Year			**7.29%**

Prevailing Wage Requirement

Given that the largest component of the project is being leased and then sold to the Commonwealth, it has been determined that the labor must be procured with the stipulation that prevailing wages must be paid. It would be difficult to rehabilitate the SSCB with primarily union

Reference: Salem Superior Court and County Commissioners' Building Redevelopment Feasibility

trades while constructing apartments in the CCB with primarily non-union trades under an open shop contractor. If the developer felt that they could use open shop or union participation limited to a couple of key trades, the developer would likely be able to demonstrate adequate returns for feasibility.

Commonwealth Costs

The model also addresses the Commonwealth's costs. The following table outlines the annual costs and the future acquisition costs to the Commonwealth where the CCB is utilized as residential, where Federal HTCs are not included for the Commonwealth portion:

Commonwealth Annual Costs	
COM Share of Debt Service/Annum	$1,271,000
Operating Expenses est. $10/sf	$363,000
7% Return on Developer's Equity for COM Space/Annum	$85,000
Total Annual Rent and Operating Expenses	**$1,719,000**
Commonwealth Acquisition Costs	
Sale Proceeds – Balance of Mortgage	$19,057,000
Equity Repayment	$1,208,000
Return on Equity @ 10%	$121,000
Cost of Tax Credits	$217,000
Total Purchase Price to COM	**$20,603,000**

Some savings may be recognized if the Commonwealth and Developer jointly opt to and build out only as shell space and not use this remnant spaces within the SSCB on the 2nd and 3rd floors. We estimate that approximately 5,500 SF can be left in this condition, and are not needed for ROD use. This would reduce Total Development Costs by around $300/GSF, for a total savings of $1,650,000 in Total Development Cost. Closing off this remnant space will also provide the Commonwealth over $29,000 in annual savings in operating costs from the above.

Alternative Scenarios

Because it was difficult to make the original program work, financially we also analyzed the feasibility of an all-residential project in both the SSCB and the CCB, where the Secretary of State/ROD use is not a part of this redevelopment. Based on Open Shop construction, a developer's return may be approximately 8.7% for such a project, which would contain 32 residential units. If a project could achieve $1M in State HDIP subsidies, it could generate a market acceptable return on equity of over 13.5%. At this level of return, a developer may pursue the opportunity, and have the potential to provide some percentage of affordable units and bid a small sum for the property.

We have not completed a full financial analysis of a hotel scenario because it would require a physical analysis of the use the space as well as the economics. It was outside of the scope of the assignment. The buildings certainly have the character that would lend themselves to development of a boutique hotel. The hotel might be able to take advantage of some of the special spaces in the SSCB. We estimate that one might accommodate approximately 85 rooms. We also spoke to local developers who thought that a hotel redevelopment would be difficult in these properties. It is unlikely that a critical mass of rooms could be developed successfully.

Redevelopment for institutional uses, such as museums, academic, etc., are dependent upon the developing organization's appetite for such an expense. Because this would not be a "developer" project, the concept of return on equity is not the measure of feasibility. Redevelopment for institutional use would likely be costly in order to accommodate the unusual spaces. We have not completed a financial analysis of this scenario.

Conclusions

The feasibility of a residential development project in the portions of the buildings not used by ROD is unlikely. If the ROD takes the full Superior Court building, and the County Commissioners building is redeveloped for residential use, a developer may achieve only a 4.4% return on equity for the overall project in the stabilized year. Developers would not find this an attractive opportunity and would not bid on this project. The residential option is, however, financially superior to office development.

Our financial analysis shows that office is not feasible based upon current market rents in Salem. However, it is conceivable that a single tenant could be found that might be willing to pay a premium for this particular location and unique space, and we therefore would not exclude office as a use in a potential bidding process, but acknowledge the likelihood of that being successful is remote. Our financial analysis was completed on simpler, more market viable solutions, but we would not recommend excluding the possibility of office redevelopment if a developer so chooses if a bidding process occurs.

The cost to the Commonwealth of providing this space in this location is $47/rentable sf on a rental basis (debt service + equity payments + operating expenses) and $522/gross sf on a sale basis.

There are a lot of questions regarding Commonwealth costs as they relate to the use of Tax Credits. Because the SSCB redevelopment is likely ineligible for Federal HTCs, the cost to the Commonwealth is significantly more. Without Federal Historic Tax Credits, the Commonwealth's Annual Expenses may be as much as $1.7M, compared to $1.4M if FHTCs are available. If by nature of the ROD use in the SSCB, Federal Historic Tax Credits may not be used for either building, it is unlikely a developer would pursue this project.

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Reference: Salem Superior Court and County Commissioners' Building Redevelopment Feasibility

Square Footage Adjustments

Gross Square Footage	The entire square footage of the building, accounting for thickness of walls, chases, etc.
Rentable Square Footage	The amount of space that a tenant rents, including circulation, restrooms, and an allocation of common area.
Usable Square Footage	The amount of space that a tenant uses, in an office scenario this includes work stations and offices, but not circulation.

The approximate calculations based upon the SSCB are as follows:

- Gross x 92% = Rentable (this number can be as much as 93-96% of gross in new office buildings using the BOMA definitions
- Rentable x 65% = (Net) Usable

So, for the SSCB, **39,500 GSF** x 92% = **36,340 RSF**. Subsequently 36,340 RSF x 65% = **23,621 USF.**

Definitions of Terms

Direct Costs	All subcontractor labor, materials, and equipment plus OH&P
Hard Costs	Direct Costs plus: General Conditions, General Requirements, Estimating Contingency, Bonds & Insurances, Building Permit, Contractor Fee, Design Contingency, Escalation Contingency, Adjustment for Filed Sub-Bids
Soft Costs	Design work and other items not included in Hard Costs above; calculated as a percentage of Hard Costs
Total Project Costs	The Sum of Hard Costs and Soft Costs

The table below shows the calculation and line items included for the Residential Scenario.

Reference: Salem Superior Court and County Commissioners' Building Redevelopment Feasibility

Uses of Funds			
Estimated Construction Cost			
SUPERIOR COURT BUILDING			
Hard Costs	*$335.00*	*/SF*	$13,785,500
General Conditions	*12%*		$1,654,260
General Requirements	*3%*		$413,565
Estimating Contingency	2.10%		$289,496
Bonds & Insurances	*2.80%*		$385,994
Building Permit	*1.20%*		$165,426
Contractor Fee	*2.50%*		$344,638
Design Contingency	*10.00%*		$1,378,550
Escalation Contingency	*14.00%*		$1,929,970
Adjustment for No Filed Sub-Bids	-5%		($1,017,370)
SUBTOTAL HC SC BUILDING			**$19,330,028**
Superior Court Soft Costs	25%		$4,832,507
TDC SUPERIOR COURT	$611.71	*/SF*	**$24,162,535**
COUNTY COMMISSIONERS BUILDING			
Hard Costs	*$281.00*	*/SF*	$4,383,600
General Conditions	*12%*		$526,032
General Requirements	*3%*		$131,508
Estimating Contingency	2.10%		$92,056
Bonds & Insurances	*2.80%*		$122,741
Building Permit	*1.20%*		$52,603
Contractor Fee	*2.50%*		$109,590
Design Contingency	*10.00%*		$438,360
Escalation Contingency	*14.00%*		$613,704
Adjustment for Filed Sub-Bids	-5%		($323,510)
SUBTOTAL HC CC BUILDING			**$6,146,684**
CCB Soft Costs	25%		$1,536,671
TDC COUNTY COMMISSIONERS	$492.52	/SF	**$7,683,355**
TOTAL PROJECT COSTS	*577.97*	*/SF*	**$31,845,890**

To: Tom Daniel
Andrew Shapiro

From: Alex Phillips
Drew Leff

Date: October 18, 2017;
Revised November 3, 2017

File: Salem Superior Court and County Commissioners Building Reuse Study - Update

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Reference: Salem Superior Court and County Commissioners Building Reuse Study - Update

Attachment: Slides addressing Federal Historic Tax Credit (FHTC) and Housing Development Incentive Program (HDIP) assumptions.

This analysis has sought to answer two key questions. 1) What are the costs to the Commonwealth to be able to occupy this space for the Essex County Registry of Deeds? And 2) Is there a conceivable development project that is sufficiently attractive to engender bids in response to a Salem Redevelopment Authority developer solicitation process?

Following the presentation of findings on September 29th, further analysis was completed to address Commonwealth Costs as well as developer's potential returns depending on yields from Federal Historic Tax Credits as well as HDIP funding.

On September 29th, we presented one development scenario that assumed the following:

- Essex County Registry of Deeds to occupy entire Salem Superior Court building (SSCB)
- Residential use in the County Commissioners building (CCB)
- Ineligibility for Federal Historic Tax Credits on the Superior Court building; full draw of FHTCs for the County Commissioners Building; $3M in State Historic Tax Credit funding for the overall project
- HDIP funding of $2M

The attached slides compare the impacts of a full FHTC draw for the SSCB with the above-described scenario, on the costs to the Commonwealth. If a lease could be structured such that construction costs on the SSCB are eligible for FHTCs, a cost reduction to the Commonwealth would be recognized. With the use of FHTCs, the annual cost to the commonwealth could be reduced to $1.4M/year from $1.7M. The cost to purchase the property in year 6 would decrease from $20.6M to $16.9M. Regardless of cost to the Commonwealth in these scenarios, note that neither option is a viable development scenario in terms of return to an investor.

The final slide summarizes the viability of the various scenarios depending upon the amount of HDIP awarded for this project. The first chart notes whether the scenario is feasible, and the second shows the return on equity for the developer. As HDIP only applies to residential use, the office scenario is

Reference: Salem Superior Court and County Commissioners Building Reuse Study - Update

shown as n/a when HDIP is ben utilized. While the maximum potential HDIP eligibility is $2M, the maximum potential for this project is only $1.7M. Thus, the best case scenario represents a $1.7M HDIP draw, the middle case is for a $1M draw, and the worst case is no HDIP funding directed towards this project.

A developer would likely require a 12% ROE or above to consider moving forward with this project. The only feasible scenario analyzed is an all-residential project, which can utilize full Federal and State HTCs, and achieve substantial HDIP funding. If HDIP is not applied to such a project, construction costs would have to be reduced by 5%, or rental rates would have to be $3/sf for this to become feasible. Each of these assumptions represent risk that would be taken on by a developer.

Please see the attached slides for summary findings on the effects of FHTCs on Commonwealth Costs and of HDIP on developer feasibility.

Alexandra Phillips
Project Manager

c.c. Drew Leff
Gail Rosenberg

Salem Superior Court Building Adaptive Re-Use Analysis –

- ROD in SSCB // Residential in CCB
- Total Project Costs = $31,846,000
- $1M in HDIP

No Federal HTCs

COM Annual Equity PMT	$85,000
COM Annual Debt Service PMT	$1,271,000
COM Annual OpEx @$10/sf	$363,000
COM Total Annual Costs (Years 1-5)	**$1,719,000 ($47/sf)**
Balance of Mortgage	$19,057,000
Equity Repayment	$1,208,000
Return on Equity (@ 10%)	$121,000
Cost of Tax Credits	$217,000
TOTAL PURCHASE PRICE to COM (Year 6)	**$20,603,000 ($522/sf)**

Full use of Federal HTCs

COM Annual Equity PMT	$85,000
COM Annual Debt Service PMT	$1,007,000
COM Annual OpEx @$10/sf	$329,000
COM Total Annual Costs (Years 1-5)	**$1,421,000 ($43/sf)**
Balance of Mortgage	$15,093,000
Equity Repayment	$1,208,000
Return on Equity (@ 10%)	$121,000
Cost of Tax Credits	$448,000
TOTAL PURCHASE PRICE to COM (Year 6)	**$16,870,000 ($427/sf)**

Note: Neither scenario is viable from a developer's perspective as overall returns are under what would be required in both cases.

	Full HDIP	$1M HDIP	No HDIP
ROD and Office	n/a	n/a	Not feasible
ROD and Residential	Not feasible	Not feasible	Not feasible
All Residential	Feasible	Feasible	Not feasible*

	Full HDIP	$1M HDIP	No HDIP
ROD and Office	n/a	n/a	0.67% ROE
ROD and Residential	10.07% ROE	7.29% ROE	3.47% ROE
All Residential	18.42% ROE*	13.54% ROE*	8.66% ROE**

**A 12% minimum return on equity is needed for a project to be considered feasible.*

***Construction costs would have to be reduced by 5%, or rental rates would have to be $3/sf for this to become feasible*