16 August, 2023

PROJECT PRO FORMA REVIEW – UPDATE SUMMARY

Village of Elm Grove

Caroline Heights Apartments
School Sisters of Notre Dame
Tax Increment District #3

Prepared by:

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BUILDING COMMUNITIES. IT'S WHAT WE DO.

16 August 2023

Mr. Thomas Harrigan
Village Manager
Village of Elm Grove
13600 Juneau Blvd
Elm Grove, WI 53122

RE: TID 3 Caroline Heights Apartments (the "Project")
School Sisters of Notre Dame Site ("SSND")
Mandel Group – Developer
Project Update

Dear Tom,
Further to our several discussions with the Village, Ehlers, and Mandel, the following is a summary of the updated Project projections submitted by Mandel on 24 July 2023, and our subsequent engagement on 28 July. These changes from the October 2021 figures were due mostly to higher construction costs, higher interest rates, changes to financing terms, and timing of certain project milestones. The overall Project (unit count, number of homes, and infrastructure work) remain the same, which includes 237 luxury apartments of 1, 2 and 3 bedrooms, underground parking deck, and amenities consistent with such a development. In addition, the project will be surrounded by 21 high-end homes to be constructed by a third party single-family developer, which will also provide additional increment value. The changes can best be summarized in the following table, and further discussed below:

Category	2021	2023	% Change
Construction Hard Cost	$77,016,659	$90,134,635	17%
Total Project Cost	$98,094,910	$113,709,111	16%
Construction Loan Amount	$68,666,437	$64,000,000	(7%)
Construction Loan to Cost	70.0%	56.3%	(13.7%)
Interest Rates (avg) – Loan	4.25%	5.45%	28%
Investor Equity	$19,493,000	$37,370,000	92%
Bond Rates (avg) – Taxable	2.38%	5.39%	126%
Bond Rates (avg) – Exempt	1.95%	3.56%	82%
Bond Repayment Term	20 Years	20 Years	--
MRO Repayment Term	21 Years	18 Years	(2) Years
Number of 1 Bedrooms	38	43	13%
Number of 2 Bedrooms	139	161	16%
Number of 3 Bedrooms	60	33	(55%)
Average Square Footage	1,295	1,324	2.2%
Average Rent per Square Foot	$1.92	$2.18	13.5%
Average Monthly Rent	$2,482	$2,890	16.4%
Construction Commencement	6/1/2022	9/1/2023	15 Months
Construction Completion	12/1/2023	2/1/2025	14 Months

Several changes from our prior analysis include:

- Hard Costs increased by a net $13M due mostly to the marked increase in construction cost for supplies and labor; it is noted that the Developer also negotiated approximately $4.6M of reductions in trade costs, general conditions, construction fees and contingency, which offsets are reflected in this figure. Additionally, many soft costs have increased, including legal, consultants, and especially builder's risk insurance premiums, which have skyrocketed to over double the previous cost. (Note: in some states such as California and Florida, insurance companies are not even writing new policies)

- Increased financing costs for construction loan as well as municipal borrowings. As indicated in the chart above, rates on construction and/or municipal debt increased from 28% to almost double, in the case of the larger taxable issue. Village debt obligations have priority over pay-as-you-go TIF assistance, where the developer receives a portion of the annual property taxes they've paid in order to supplement the development costs. The PAYGO is evidenced by a municipal revenue obligation, or MRO, which specifies the terms for said payments.

- Lower construction loan proceeds combined with higher Project costs necessitated a 92% increase in required equity, from $19M to $37M. The cost of equity is higher than debt, which diminishes overall profitability and investor returns.

- While not materially affecting the financial performance of the proposed structure, the Village has requested that Mandel provide a guaranty of completion and minimum value for the apartments for the duration that the annual TIF assistance is provided.

Two assumptions regarding the Project are re-emphasized here:

- Mandel may sell the Project at an undetermined date, but likely be a longer term hold. Conventional real estate analysis assumes a sale after a 10 year investment period, which we have assumed in our investment return calculations, as has the Developer.

- Included in the return calculation is the sale of the remaining TIF payments to be provided to Developer in the years after the Project itself is sold, which MRO would be assigned to the Project's purchaser. The present value (ie, discounted) of those remaining payments is added to the Project sale price to determine the overall Project internal rate of return (IRR). Additionally, proceeds from the refinancing from construction to permanent loan are also reflected in the IRR calculations.

EHLERS SUMMARY CONCLUSION RE: "BUT FOR" TEST

The 'But For' test remains in effect after these updates: it is clear that the project would not be able to attract the appropriate investment capital without some level of TIF participation, and at the levels contemplated in this analysis, there would be no undue enrichment to the developer.

- The Project will incur certain extraordinary costs, adding significantly to the Project budget, including:
  - demolition and environmental abatement,
  - historic buildings renovation/refurbishment,
  - structured underground parking, which more than doubles the cost of surface parking spaces
  - significant utility and earthwork, including extending the water main.

- As noted in the Values/Returns section below, the developer/investor return metrics without such TIF assistance would cause the Project to be economically infeasible, and the Project would not be undertaken.

PROJECT BUDGET / OPERATIONS

Total project costs increased from $98.1M to $113.7M, per discussion above. Since the construction loan amount was reduced, a larger equity raise was required. Developer confirms that their equity raise is committed as well as construction financing, which is expected to close in September 2023.

Market rents for the large apartments increased from an average of $1.92 per square foot to $2.18, which were in line with select market comparisons of similar product type (affluent, empty-nester communities) found on CoStar. In addition, the larger unit sizes provided a higher rent per unit when compared to other projects. The combination of larger footprint while maintaining the square foot price results in a higher operating income.

The assessor is expected to utilize a slightly lower rent per foot in their valuation, in conformity with the broader Milwaukee metro apartment market. In addition, rents for the 386 parking spaces (1.6 stalls per unit) will also be reduced from Developer's projections until receiving verification of achieving such levels at similar projects in the Developer's portfolio. Lastly, in being consistent with the prior analysis, the Project's operating expense ratio will be marked up to the overall market ratio of about 39% (expenses / revenues). It is anticipated that because of the larger unit sizes, and certain efficiencies, the OpEx ratio will prove out lower than that utilized in the anticipated assessment.

Real estate taxes were decreased slightly from the developer's original submittal, primarily due to the lower mill rate used in the previous analysis. Property taxes are based on an estimated assessed value of $60.5M or $255K/unit, whereas our prior review assumed an initial estimation of $54.5M or $230K/unit. These values were prepared in agreement with the assessor's input, and consistent with the methodology utilized in 2021.

TAX INCREMENT FINANCING STRUCTURE

The 2021 Project approval eventually included provisions for a $925K tax-exempt bond to pay for certain infrastructure improvements in the Village, in accordance with recent legislation. A separate $8.675M taxable bond was projected to provide assistance for the extraordinary costs enumerated above. Lastly, an MRO of up to $9.8M was structured per Ehlers' recommendation to address the financial gap in the development. In this review engagement, the amounts of those three financial instruments have not changed, however, as noted earlier, increased interest rates have impacted the cost of providing such assistance. The amount of annual incremental value remains inflated by 2.25% annually to remain consistent with developer's Project cash flows. Incentive payments (up front or PAYGO) do not commence until the Project receives a certificate of occupancy.

Schedules indicating these calculations for development assumptions, tax increment projections, and TID cash flow results are attached.

VALUES / RETURNS

Until the property is sold to Developer, the SSND property has been exempt from property taxes. Once the property is acquired in Fall 2023, it will become taxable. Apartment construction is expected to commence in Fall 2023 and be completed in Q1 2025; after reaching stabilized operations in 2025, the full $60.5M apartment value will be in place. A 6.25% capitalization rate was used in this determination, which is in line with current market assessments.

The sale of the improved single family lots anticipated in 2024 will be recorded upon completion of infrastructure and sale to the single-family developer. This transaction has been estimated amount of $160K per lot, or $3.36M. It is anticipated that 3 homes will be developed and sold per year for 7 years, adding an additional $640K in value per home over the land value ($800K value all-in). Therefore, between the apartments and separate homes, the total incremental value expected to be produced is a very conservative $77.3M.

There are generally two metrics used in evaluating income-producing properties: cash-on-cash ("COC") and internal rate of return ("IRR"). COC is simply the annual cash flows to developer (after debt service) divided by equity in the Project, and is utilized for longer investment periods. The IRR accounts for the discounted time value of money, so it considers the initial equity investment, the annual cash flows, and the sales proceeds at the end of the holding (investment) period. Commercial practice is to evaluate a 10 year hold, which is used in this analysis to calculate the IRR. As noted earlier, Mandel indicated their likely investment period could be longer.

It is important to understand that the ownership structure in commercial projects such as this provides separate and distinct cash flows to the investors and the developer, often referred to as a waterfall. Generally, the investors are to receive a preferred return payment on their equity before *any* funds flow to the developer, usually around 7-8%. After that "pref" level has been reached, the additional annual cash flows and eventual sales proceeds run through the various calculations in the waterfall, and are split between investors and developer at a predetermined ratio, usually 50/50 or 60/40. The developer return will serve as compensation for conceptualizing and bringing the various disciplines of Project together, gaining necessary approvals, taking on construction, interest rate, and lease-up risk, and also providing any guarantees required by lenders or municipalities. Due to the various splits in Project cash flows, we are evaluating these results on a Project level only.

Generally, the expected COC at stabilization for similar projects is approximately 7-8%, and increases to a range of 8-12% over time. Under the Developer's Oct 2021 request, once permanent financing begins full amortization, the Project generates a COC of 8.06%, and reaches 12% in the last year of the initial 10 year term. The expected overall returns for IRR on multifamily developments are usually 12-18%. Per the Developer's projections at that time, the adjusted IRR for the deemed sale of the Project at the end of Year 10, after payment of the mortgage loan and return of equity, is around 12.20% at the project level. This is on the lower end of the expected range noted above.

After recasting the analysis with updated market realities, the Project generates a COC of only 8.04% at its highest, with an average of 6.07% over the 10 year period. The overall IRR calculates to 10.50% at the 6.25% market cap. However, see the footnote below which provides further color on the 12.44% return that is also noted. The Developer's minimum target return to investors is 12%. These projections can be summarized below:

Category	2021	2023	% Change
COC High 10 Years	12.03%	8.04%	(33%)
COC Average 10 Years	8.82%	6.07%	(31)
IRR 10 Years (1)	12.18%	12.44%	2%; (16%)
Future Value MRO	$9,800,000	$9,800,000	0%
MRO Expiry	2038	2045	7 Years

(1) While a cap rate of 6.25% is used for assessment purposes, and was utilized in the 2021 analysis, it is expected that the Project would command a more aggressive rate in a market sale after stabilization and appropriate marketing period. Therefore, a market cap of 5.50% is utilized for the 2023 IRR projection. Otherwise the sales results would return a 10.50% IRR, below investor expectations.

Without the $9.8M PAYGO TIF assistance to this Project, the COC would be less than 7.3% at best, and the IRR would be approximately 9.5%; both metrics are at levels that would not attract investment capital, as noted for the 'but for' consideration.

DEVELOPER/GUARANTOR REVIEW

Lastly, Ehlers was also asked to opine if the Developer has sufficient resources to provide for completion of the Project, and also if the Guarantor (Mandel Group, Inc. "MGI") has sufficient resources to satisfy the Assessment Valuation Completion Guaranty at a value of $41M. As has been demonstrated above, at a conservative valuation, the Project produces a value of $77.3M.

Mandel Group, Inc. is the operating company for the Developer. Its organization provides for the backbone of the group, including development, overhead, management, accounting, human resources, and so on. Ehlers met with the President and CFO of the company to review 2022 annual financials. We were not allowed to remove the statements, but were able to take notes. It is important to note that each project is organized as its own individual limited liability company and thus is not reflected on the MGI books.

Regarding resources sufficient to complete the project, while we weren't provided with bank term sheets or the PPM subscribers, the Developer has confirmed the commitment from its lender to close on the construction mortgage, which is anticipated to occur within the next several weeks. It was confirmed that the large equity raise has also been satisfied, mostly through a group of high net worth investors and family offices, including some new participants. In fact, one large institutional group was interested in the deal, but the equity had already been committed.

Per our brief financial review of MGI, we found that the company's Current Ratio (current assets / current liabilities) was 1.71, meaning there are more than enough short term assets such as cash and accounts receivable to satisfy those liabilities. Also, the debt-to-equity ratio, measuring long term payables against retained earning and capital contributions, measured 0.61 on a cost basis; at market values, that reduces to 0.27. Again, equity and earnings exceeds long term debt in a satisfactory manner. Cash on hand was in the low 7 figures, availability under bank lines of credit are in the mid-7 figures, and deferred development fees (not reflected on the MGI books) in the low 8 figures are also available to support the Project. In short, the company appears to be in a position, at least as at December 2022, to be able to satisfy the guaranty obligations.

We trust that the analysis provided will assist you to evaluate making the expenditures and providing TIF incentives as discussed herein. Please let us know if you have any questions or comments regarding the subject, and thank you for engaging us to assist you in this endeavor.

Respectfully,

Frank Roman
Economic Development Consultant

Todd Taves
Senior Municipal Advisor
Managing Director