

JAMES E. MULFORD
21 WEST 76TH
NEW YORK, NY 10023

The Honorable Meenakshi Srivivasan, Chair
NYC Board of Standards and Appeals
9th Floor
40 Rector Street
New York, NY 10006

Reference:
Calendar 74-07-BZ
6-10 West 70th Street
New York, NY

This letter supplements the Return On Investment Section of my letter of 25 March 2008. The numeric results are essentially the same, but the method is more fully explained for those less familiar with economic analysis. The earlier Attachment is similarly expanded into appendixes to provide more detail.

The abbreviation F/F refers Freeman/Frazier & Associates and their letters on behalf of Congregation Shearith Israel (CSI) dated 21 December 2007 and 11 March 2008.

SUMMARY

The material below presents the profitability and related development rights acquisition costs for four alternative site uses put forth by CSI. It shows that two of them, Revised Proposed Development and Proposed Development with Courtyard, are enormously profitable but depend on zoning variances. Two others, Revised As of Right CF/Residential and as-of-right All Residential F.A.R. 4.0. are also profitable but do not require variances.

The results are based only on figures provided by F/F on behalf of CSI, and the BSA definition of return (generally called Return on Investment (ROI)). No other material, expert opinion, external data, or findings are necessary to support these conclusions. Well, not quite. The ability to add, subtract, multiply, and divide is required.

The figures for a developer as reported by F/F and the correctly calculated ROIs are:

Configuration	Returns reported by F/F, %	ROIs Using BSA Instructions, %
Revised Proposed	12	69
Proposed Dev. w/Courtyard	9	69
Revised AoR CF/Residential	-	15
All Residential (AoR) F.A.R. 4.0	8	30

Since the as-of-right options produce a 'reasonable' return preventing a finding under 72-21(b) they also represent the minimum variance required under 72-21(e)

RETURN ON INVESTMENT

BSA Requirements

Board of Standards and Appeals BZ application instructions, Item M (5) for financial feasibility, requires an applicant to submit figures for: acquisition costs, construction financing, equity, net profit, and return, among other items. It defines return (commonly called Return on Investment (ROI)) as "percentage return on equity (net profit divided by equity)".

The F/F Schedules present certain of the items as required in a BSA application, but do not identify equity, one of the essential components of ROI. See Appendix I for derivation of Equity for each of the site uses.

The next four sections compare the figures presented by F/F to ROIs as defined by the BSA.

Revised Proposed Development (December '07)

Schedule A of the December '08 letter shows a project profit of \$8,360,000. The F/F Schedule A reports an annual return, mislabeled "ROI" of

$$\text{Profit/Total Investment} = (\$8,360,000 / \$29,402,000) \times (12/28) = 0.1219 \text{ or } 12.19\%$$

(The 12/28 factor adjusts the 28-month profit to an annual one.)

However, 'Total Investment' is not equity. Equity is the amount the developer itself contributes to fund the project, excluding the financing provided by others. For this alternative, the equity is actually \$5,158,301 (see Appendix I for details), leading to an ROI of 69%

$$\text{ROI} = \text{Profit/Equity} = (\$8,360,000 / \$5,158,300) \times (12/28) = 69.46\%$$

The Proposed configuration is enormously profitable, based on two assumptions.

- 1) It uses the same, notional acquisition cost of \$14,816,000 as proposed by F/F even though it is neither a market rate nor an economic one. See Appendix II for comments.
- 2) Zoning variances are required and contribute to realization of the high return.

Proposed Development with Courtyard (March '08)

Applying the same procedure as for the Revised Proposed Development, the corresponding results are

$$\text{Profit/Total Investment} = (\$5,569,000 / \$27,809,000) \times (12/28) = 8.58\%$$

$$\text{ROI} = \text{Profit/Equity} = (\$5,569,000 / \$3,441,900) \times (12/28) = 69.34\% \text{ }^1$$

The assumptions of the Proposed configuration apply to this alternative as well, except that the notional acquisition cost is \$13,384,000.

Revised As of Right CF/Residential (December '07)

F/F does not present a return figure for this configuration because they claim it produces a loss. The 'loss' obtains because their analysis loads the project with the notional \$14,816,000 acquisition cost. But that cost is derived from the impossible sliver tower configuration², which cost could not be sustained for this CF/Residential alternative. See Appendix II for further comment.

A more realistic acquisition cost can be derived from the economics of the configuration itself, by assuming: all of the construction and other costs presented in the F/F schedules, a desired ROI of 15%, their 23-month schedule, and a relatively low 75% external financing (leverage) of 75%. The results are

$$\text{Acquisition cost} = \$2,265,052$$

$$\text{ROI} = \text{Profit/Equity} = (\$841,948 / \$2,928,513) \times (12/23) = 15.00\%$$

This configuration produces a reasonable developer ROI and assumes construction of the Community Facility, but does not require variances for the residential component. In addition to the developer profit of \$841,948, this alternative produces an even larger profit to CSI of \$2,265,052.

All Residential F.A.R 4.0 (December '07)

This as-of-right alternative could be built and is economic. It demonstrates that the site itself does not produce a hardship, based on the F/F figures. To be conservative, the desired ROI is set at a higher 30%

$$\text{Acquisition cost} = \$11,754,191$$

$$\text{ROI} = \text{Profit/Equity} = (\$5,955,809 / \$8,508,298) \times (12/28) = 30.00\%$$

¹ If as has been stated, CSI is its own developer, this **ROI rises to 144%**. The difference obtains because both the F/F figures and the leverage figures based on it are for an independent developer that ignores the additional profit realized by CSI itself on the Community Facility.

² As of Right with Tower Development documented in the December '07 letter.

This configuration also produces a 'reasonable' developer ROI, but does not require variances.

Observations

Two different as-of-right uses of the site are profitable under BSA definitions. They required no, and therefore minimal, variances. With zoning variances, CSI's proposed developments are enormously profitable.

* * * * *

If BSA would like more information about the material presented, or would find it helpful to have the spreadsheets that produce the cited results, just give me a call.

James E. Mulford
21 West 76th Street
New York, NY, 10023
(212) 697-6078

APPENDIX I:
DETAILS ON EQUITY AND ROIS

EQUITY

Equity is the amount invested by the developer. In general, it is the total project cost less the amount financed or borrowed. Leverage is the amount borrowed divided by total project cost (See Simple Leverage Example, Appendix II).

The table shows the amounts borrowed and project costs (in thousands) provided by F/F, and the resulting leverage. The last row shows the rounded values of leverage used in the following sections.

	Revised Proposed	Proposed, Courtyard	AoR CF/ Residential	All (AoR) Residential
Amount borrowed	\$24,770	\$24,770	\$17,156	\$25,103
Lender fee	<u>248</u>	<u>248</u>	<u>172</u>	<u>251</u>
Total borrowed (TB)	25,018	25,018	17,328	25,354
Total project cost (TPC)	29,402	27,809	23,345	34,159
Leverage (TB/TPC)	85%	90%	74.2	74.2
Leverage used below	85%	90%	75%	75%
Percent Equity	15%	10%	25%	25%

The equity used in the calculations for the Proposed configurations includes the unexplained Transaction Taxes shown on the F/F Schedules A, and also contains small rounding differences.

The equity used below for the as-of-right configurations is based on economic acquisition costs derived from the F/F revenue and costs, rather than from an external notional considerations. Consequently, the equity implied by the F/F figures are omitted from the the summary table:

	Revised Proposed	Proposed, Courtyard	AoR CF/ Residential	All (AoR) Residential
Total project cost	29,402	27,809	23,345	34,159
Total borrowed	25,018	25,018	17,328	25,354
Difference	4,384	2,791	n/a	n/a
Unexplained tax	748	664	230	734
Equity	5,132	3,455	*	*
Equity used below	\$5,158	\$3,442	\$2,929	\$8,508

* See ROI site tables below for equity based on an economic acquisition cost rather than the notional F/F figures.

ROI TABLES

Each of the following four sections displays the project revenue, costs, total investment (each taken from the F/F schedules), plus equity and resulting ROIs, along with explanations where necessary. The right hand columns show the pieces that constitute equity.

The unexplained taxes shown on F/F Schedules A are handled differently in the detail columns. The F/F Schedule A does not list the tax as a project cost; the leveraged approach adds the tax as a developer expense, which has the effect of significantly lowering the ROI because it is already deducted from the F/F-reported profit.

Both Proposed options use the notional acquisition costs from the F/F presentations, so that their reported results and the correctly-calculated ROIs have the same basis.

Revised Proposed Development

Cost Item	Project Cost	Project Economics	Developer Equity, 85% Leverage
REVENUE		\$38,510,000	
Construction costs, hard	\$7,488,000		\$1,123,200
Construction cost, soft	4,081,000		612,150
Loan interest	2,353,000		352,950
Acquisition cost	14,816,000		2,222,400
Carry costs	664,000		99,600
Transaction taxes			<u>748,000</u>
TOTAL INVESTMENT		(29,402,000)	5,158,300
Transaction taxes		<u>(748,000)</u>	
PROFIT (Return)		\$8,360,000	
ROI = Return/Equity = (\$8,360,000 / \$5,158,300) x (12/28) = 69.46%			

Proposed with Courtyard

Cost Item	Project Costs	Project Economics	Developer Equity, 90% Leverage
REVENUE		34,039,000	
Construction costs, hard	\$7,398,000		739,800
Construction cost, soft	4,010,000		401,000
Loan interest	2,353,000		235,300
Acquisition cost	13,384,000		1,338,400
Carry costs	664,000		66,400
Transaction taxes			<u>661,000</u>
TOTAL INVESTMENT		(27,809,000)	3,441,900
Transaction taxes		<u>(661,000)</u>	
PROFIT (Return)		5,569,000	

ROI = Return/Equity = (\$5,569,000 / \$3,441,900) x (12/28)= 69.34%

Revised AoR, CF/Residential

Cost Item	Project Cost	Project Economics	Developer Equity, 75% Leverage
REVENUE		\$11,866,000	
Construction costs, hard	\$3,722,000		\$930,500
Construction cost, soft	2,979,000		744,750
Loan interest	1,358,000		339,500
Acquisition cost	2,265,052		566,263
Carry costs	470,000		117,500
Transaction taxes			<u>230,000</u>
TOTAL INVESTMENT		(10,794,052)	2,928,513
Transaction Taxes		<u>(230,000)</u>	
PROFIT (Return)		\$841,948	

ROI = Return/Equity = (\$841,948 / \$2,928,513) x (12/23)= 15%

All Residential F.A.R 4.0

Cost Item	Project Cost	Project Economics	Developer Equity, 75% Leverage
REVENUE		\$37,787,000	
Construction costs, hard	\$11,808,000		\$2,952,000
Construction cost, soft	4,860,000		1,215,000
Loan interest	1,987,000		496,750
Acquisition cost	11,754,191		2,938,548
Carry costs	688,000		172,000
Transaction taxes			<u>734,000</u>
TOTAL INVESTMENT		<u>(31,097,191)</u>	8,508,298
Transaction Taxes		<u>(734,000)</u>	
PROFIT (Return)		\$5,955,809	

ROI = Return/Equity = (\$5,955,809 / \$8,508,298) x (12/28)= 30%

The tables for the two as-of-right uses of the property demonstrate that it is possible to derive an economic acquisition price in lieu of an actual market bid, without reference to other property which cannot be proved to be relevant.

Appendix II

LEVERAGE and OBSERVATIONS

This appendix describes the use of financial leveraging using a simple example, then notes other issues related to F/F figures. Nothing in these observations was used to produce the numbers in the body of the letter or in Appendix I.

Simple Leverage Example

Leveraging is almost universally used in development and other real estate projects because it increases developer return and provides capital the developer may not have. It is a fundamentally sound practice because it separates the function of providing capital from the project management process, each requiring different skills and resources.

Here's how it works, in general. For a one year project with construction and management costs of \$100, a developer arranges to borrow \$90, give or take. For this facility he pays fees and interest that are included in the costs.

As expenses arise, the developer periodically draws down the loan to pay them. By the end of the project, the developer will have disbursed \$100, \$90 from the loan and \$10 of his own funds.

To find the developer's return, assume he receives \$115 from sale of the developed property. From this, he repays the loan with \$90, uses \$10 to replenish his own resources, and is left with \$15 free and clear above all costs, his profit. He has earned \$15 on a \$10 investment. Expressed as a percentage this is 150%.

Leveraging amplifies return on a profitable project but amplifies downside effects, too. If actual costs rise only 5% in this example to \$105, the developer will have laid out \$15 (without an additional loan) for a return of only \$10, an ROI of 67%. The 5% rise in costs caused a 55% reduction in ROI. A still greater cost overrun or reduced payout can result in loss or even inability to repay the loan.

In a leveraged transaction involving an owner, a developer, and a lender, each takes a slice of the economic benefit. If an owner were to take on more than one role, he would receive profit from each.

Acquisition Costs

In reality, acquisition cost of site rights is determined by the market negotiation between buyer and seller. An estimate of that number can be derived analytically given other project costs, revenue, and an assumed developer's desired ROI.

The ROIs for the as-of-right configurations use the latter method.

On the other hand, the acquisition costs presented by F/F on behalf of CSI used neither method. They have been created by CSI using figures determined by comparison with purportedly similar sites around town. They are one-sided assertions. The results are interesting but not dispositive because the development and subsequent use economics of those sites are not presented. They do not reflect the value of the West 70th site to a developer; they are not real. There is no reason to believe that they would materialize in practice.

Acquisition Rate

The rate of \$750/ft² used in F/F analyses to calculate an acquisition cost is inappropriate because it does not derive from any of the proposed developments. It derives from the As of Right with Tower (sliver tower) option that is not under consideration because it is not feasible. It cannot be built for any of several reasons including that it apparently violates at least two guidelines needed for Department of Buildings approval. (See Alan Sugarman letter of 25 March 2008, page 8.)

Should the BSA sanction the use of a synthetic value derived for an impossible as-of-right construction, it would be arbitrary. It will have created real estate value where none exists. Consequently, it cannot make a 72-21(b) finding of reasonable return on that basis.

The absurdity of applying a rate derived from a configuration that cannot be built to a configuration that can be built, is easy to demonstrate. First, such a value cannot be realized, by anyone, ever. There can be no right to something that doesn't exist and cannot exist. A developer or owner cannot claim such a right.

Second, the property cannot be worth the result of a purely abstract calculation for, if so, there would be no limit. No matter that a seller, for example, claims 'fair' value. There is no grounding in reality.

Third, no matter how long the analysis trail from an imaginary rate to a return on investment, that return is similarly imaginary and useless.

Any assertion that this technique is a standard, conventional, or an accepted or engrained practice is vulnerable, open to challenge. To the extent that decisions are made on fiction, they are arbitrary, even if intended to somehow be fair.

As-of-Right Value

The term 'as-of-right' can easily be misunderstood. It simply describes the use of a property that conforms to existing zoning, without variances. It does not itself convey an economic right to receive a particular value for the space that could theoretically be constructed on a site, but that is not to be and cannot be built. The term itself does not carry an economic right.

ROI Method

The question arises of why the ROI figures submitted by F/F were false. It cannot be ignorance since they claim extensive experience in BSA presentations and the BSA instructions are easy to read.

Could it be that they were intended to falsely indicate that as-of-right configurations are unprofitable? CSI and their lawyers would surely not permit deception on their behalf.

The question remains unanswered, a mystery.

For reader convenience,
pro forma F/F Schedules A and B
are attached.

SCHEDULE A: ANALYSIS SUMMARY - COMPARISON OF PROPOSALS

	PROPOSED DEVELOPMENT WITH COURTYARD	PROPOSED DEVELOPMENT WITH COURTYARD W/O PENTHOUSE
BUILDING AREA (SQ. FT.)		
BUILT RESIDENTIAL AREA	20,863	20,309
SELLABLE AREA	15,243	13,454
CAPITAL INVESTMENT SUMMARY		
ACQUISITION COST	\$13,384,000	\$13,384,000
HOLDING & PREP. COSTS	\$0	\$0
BASE CONSTRUCTION COSTS	\$7,398,000	\$6,547,000
SOFT CONSTRUCTION COSTS	\$6,363,000	\$6,210,000
	<u>\$27,145,000</u>	<u>\$26,141,000</u>
PROJECT VALUE		
SALE OF UNITS	\$36,212,000	\$30,400,000
(less) SALES COMMISSIONS	6% (\$2,173,000)	(\$1,824,000)
EST. NET PROJECT VALUE	<u>\$34,039,000</u>	<u>\$28,576,000</u>
PROJECT INVESTMENT		
ACQUISITION COST	\$13,384,000	\$13,384,000
HOLDING & PREP. COSTS	\$0	\$0
BASE CONSTRUCTION COSTS	\$7,398,000	\$6,547,000
SOFT CONSTRUCTION COSTS	\$6,363,000	\$6,210,000
CARRYING COSTS DURING SALES PERIOD	\$664,000	\$664,000
EST. TOTAL INVESTMENT	<u>\$27,809,000</u>	<u>\$26,805,000</u>
RETURN ON INVESTMENT		
ESTIMATED PROJECT VALUE	\$34,039,000	\$28,576,000
(less) EST. TOTAL INVESTMENT	(\$27,809,000)	(\$26,805,000)
(less) EST. TRANSACTION TAXES	(\$661,000)	(\$555,000)
EST. PROFIT (loss)	<u>\$5,569,000</u>	<u>\$1,216,000</u>
DEVELOPMENT/SALES PERIOD (MONTHS)	28	28
ANNUALIZED PROFIT (loss)	\$2,387,000	\$521,000
RETURN ON TOTAL INVESTMENT	20.03%	4.54%
ANNUALIZED RETURN ON TOTAL INVESTMENT	<u>8.58%</u>	<u>1.94%</u>

NOTE : ALL \$ FIGURES ROUNDED TO NEAREST THOUSAND

SCHEDULE B : DEVELOPMENT COSTS

		PROPOSED DEVELOPMENT WITH COURTYARD	PROPOSED DEVELOPMENT WITH COURTYARD W/O PENTHOUSE
DEVELOPMENT COST SUMMARY			
ACQUISITION COSTS		\$13,384,000	\$13,384,000
HOLDING & PREP. COSTS:		\$0	\$0
BASE CONSTRUCTION COSTS		\$7,398,000	\$6,547,000
TENANT FIT-OUT COSTS		\$0	\$0
EST.SOFT COSTS		\$6,363,000	\$6,210,000
EST. TOTAL DEV.COSTS		\$27,145,000	\$26,141,000
ACQUISITION COSTS :			
Land Purchase Price		\$13,384,000	\$13,384,000
TOTAL LAND VALUE		\$13,384,000	\$13,384,000
HOLDING & PREP. COSTS:		\$0	\$0
BASE CONSTRUCTION COSTS :		\$7,398,000	\$6,547,000
EST.CONST.LOAN AMOUNT :		\$24,770,000	\$24,770,000
EST.CONST.PERIOD(MOS) :		24	24
EST. SOFT COSTS :			
Builder's Fee/Developer's Profit	3.00%	\$814,000	\$784,000
Archit.& Engin. Fees	8.00%	\$592,000	\$524,000
Bank Inspect.Engin.		\$34,000	\$34,000
Construction Management	5.00%	\$296,000	\$262,000
Inspections, Borings & Surveys			
Laboratory Fees	LS	\$5,000	\$5,000
Soil Investigation	LS	\$10,000	\$10,000
Preliminary Surveys	LS	\$5,000	\$5,000
Ongoing Surveys	LS	\$10,000	\$10,000
Environmental Surveys/Reports	LS	\$2,000	\$2,000
Controlled Inspection Fees	LS	\$45,000	\$45,000
Legal Fees			
Dev.Legal Fees		\$150,000	\$150,000
Con.Lender Legal		\$62,000	\$62,000
End Loan Legal		\$0	\$0
Permits & Approvals			
D.O.B. Fees	25.53%	\$124,000	\$120,000
Cond/Co-op Offering Plan		\$30,000	\$30,000
Other		\$40,000	\$40,000
Accounting Fees		\$5,000	\$5,000
Consultant Fees		\$0	\$0
Appraisal Fees		\$8,000	\$8,000
Marketing/Pre-Opening Expenses			
Rental Commissions	25.00%	\$0	\$0
Sales Expenses & Advertising		\$198,000	\$198,000
Financing and Other Charges			
Con.Loan Int. @ Loan Rate =	9.50%	\$2,353,000	\$2,353,000
Rent-up Loan Int. @ Loan Rate =	7.00%	\$0	\$0
Con.Lender Fees	1.00%	\$248,000	\$248,000
End Loan Fee	1.00%	\$0	\$0
Construction Real Estate Tax		\$445,000	\$445,000
Rent-up Real Estate Tax		\$0	\$0
Title Insurance	0.33%	\$90,000	\$86,000
Mtge.Rec.Tax	2.75%	\$681,000	\$681,000
Construction Insurance	1.00%	\$111,000	\$98,000
Water and Sewer		\$5,000	\$5,000
Other		\$0	\$0
TOTAL EST.SOFT COSTS		\$6,363,000	\$6,210,000

NOTE : ALL \$ FIGURES ROUNDED TO NEAREST THOUSAND