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February 3, 2016

By Hand Delivery

Jonathan E. Farnham, Ph.D.
Executive Director
Philadelphia Historical Commission
City Hall, Room 576
Philadelphia, PA 19107

Re: 1906-1916 Sansom Street – Updated Financial Hardship Analysis

Dear Dr. Farnham:

As you know, we represent 1911 Walnut Street, LLC (Southern Land Company), the owner of the above-referenced property, which was the subject of one of the financial hardship applications submitted by Southern Land on October 29, 2015. We understand that the Historical Commission's independent consultant, Real Estate Strategies, Inc. ("RES"), has requested additional information regarding the reuse scenarios Southern Land studied for 1906-1916 Sansom Street in its original application. Specifically, RES requested that Southern Land analyze an alternate residential apartment scenario that assumes a greater number of smaller apartments in the building.

In response to RES's request, we enclose herewith twenty two (22) copies of an Updated Financial Hardship Analysis for 1906-1916 Sansom Street, prepared by EConsult Solutions. As documented in this updated analysis, the alternate residential apartment scenario is not financially feasible.

Please let us know if you or RES require any additional information regarding Southern Land's applications. Thank you again for your consideration, and we look forward to presenting the applications to the Commission.

Very truly yours,

Neil Sklaroff

Enclosures

cc: Mr. Dustin Downey
David M. Gest, Esquire

DMEAST #24342729 v1

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February 2, 2016

Jonathan E. Farnham, Ph.D.
Executive Director
Philadelphia Historical Commission
Room 576, City Hall
Philadelphia, PA 19107

Re: Updated Financial Hardship Analysis for 1906-1916 Sansom Street

Dear Dr. Farnham,

Econsult Solutions, Inc. (ESI) has prepared this supplemental letter report to respond to a question from Real Estate Strategies, Inc., the Historical Commission's independent consultant, regarding how the projected financial performance of 1906-1916 Sansom Street would change if, instead of the originally anticipated 18 units in the residential apartment scenario, the project instead included 36 units. The result of our analysis, described in the balance of this letter, is that the proposed alternative is not financially feasible. Thus the conclusion of our October 28, 2015 letter report, that there is no use to which these buildings may be reasonably adapted given the cost of renovations and the revenues that can be expected by those uses, remains unchanged. Table 1 summarizes the financial results of our analysis for 1906-1916 Sansom, including the new "Micro-Apartment" reuse scenario.[1]

Table 1: 1906-1916 Sansom – Summary of Value Created ($M)

	1	2	3	4	5
1906-1916 Sansom	Apartment	Condominium	Office	Hotel	Micro Apartment
Cost	$21.6	$22.9	$20.5	$21.6	$21.6
NOI	$0.3	$6.1	$0.3	$0.7	$0.4
Completed Project Value -2015	$4.1	$5.1	$4.0	$7.3	$5.0
Value Created	-$17.5	-$17.8	-$16.4	-$14.3	-$16.6

This letter reflects information available to us at the time of submission. Should additional information come to light, we reserve the right to revise our analysis.

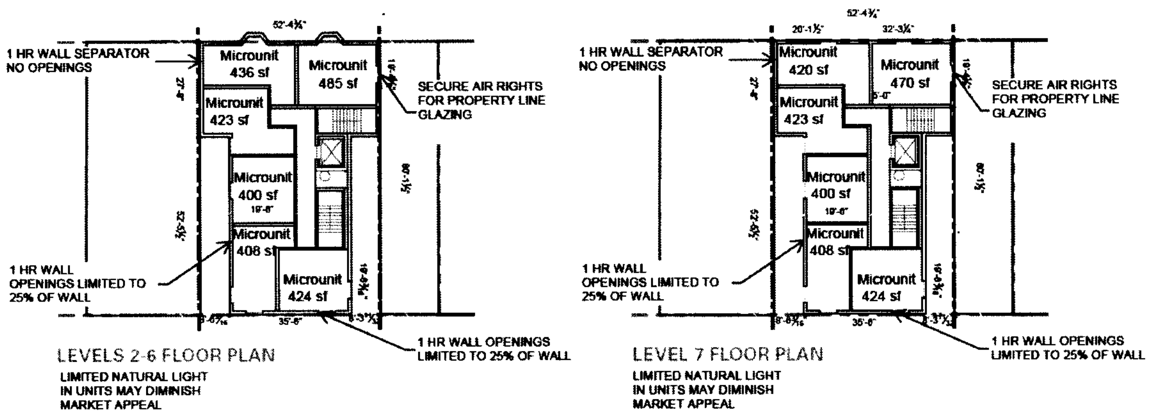
Micro Apartment Analysis

The "Micro Apartment" scenario is very similar to the "Apartment" Scenario for 1906-1916 Sansom Street (also known as the Warwick) analyzed in our October 28, 2015 letter report. The difference is that rather than including 3 units per floor, for a total of 18 units, the Micro Apartment scenario includes 6 units per floor, for a total of 36 units. As a result of the increased number of units the individual units have become smaller. The average unit on floors 2-6 has shrunk from 859 square feet to 429 square feet, and on floor 7 from 848

[1] Numbers in tables may not add precisely due to rounding.

square feet to 424 square feet. The central idea behind a micro apartment, from a landlord's perspective, is that it should be possible to charge more per square foot, and so overall rent for a given building area should increase. There is an important balancing act that the developer must work through when creating micro apartments. If the apartments are too small or poorly configured, then they will not be very attractive and will not rent, and so the hoped-for increase in rent per square foot will not be realized. In addition, micro apartments cost more to develop per square foot because of extra electrical, plumbing, and other work needed compared to fewer, larger units.

Figure 1: 1906-1916 Sansom – Micro Apartment Layout



The floorplans depicted in Figure 1, provided by SCB architects, depict the most feasible configuration of micro apartments in the building. These floor plans illustrate two immediate causes for concern about whether the micro-apartments could be rented – the odd configuration of several units and the limited amount of natural light in several of the units. Three of the units are not square, and thus potentially offer inefficient layouts. Further, the windows in some units are small and oddly placed, potentially forcing inefficient layouts while at the same time forcing the units to be darker than renters prefer.

Micro apartments offer very little space to tenants, and new micro apartments commanding premium rents are typically in amenity-rich buildings. The amenities compensate somewhat for the lack of private square footage, and elevate the rent of the units. For example, the Avenir, which was recently converted from Class B offices to apartments, including numerous micro apartments, offers a rich amenity package. According to the Avenir's website, these amenities include:

- Fitness center & cardio experience
- Screening room
- Conference & think suites
- Resident lounge
- Indoor bike storage & cycle stations
- Individual storage
- Package collection
- Full-time concierge

Another example is the Sansom, between 16th and 17th Streets on the north side of Sansom Street. This building is new construction, and opened in 2013. The small units were purpose built to be micro apartments, and are laid out efficiently. They also have large windows, allowing natural light. The amenities include:

- Secure Interior Bicycle Parking
- Large Residents Lounge
- Private Lobby
- Outdoor Terrace
- 24/7 Doorman
- State-of-the-art Fitness Center

Both of these buildings offer substantial amenities. The renovated 1906-1916 Sansom would offer none of these amenities due to the significant space limitations in the building.

Rental Rates

Our analysis of the regular rental market assumes rents of $30 per square foot. Small units at the Avenir have asking rents of $37 per square foot. Depending on the length of the lease, small units at the Sansom have an asking rent of $31 to $47 per square foot. Other small units have asking rents of $25 per square foot to $44 per square foot. For purposes of this analysis, we have assumed *achieved* rents at 1906-1916 Sansom of $36 per square foot in 2015. Note that this assumption is probably too high because 1906-1916 Sansom will not offer the same amenities, natural light and efficient configuration as the identified comparables.

Table 2: 1906-1916 Sansom – Rents at Other Small Units

Building	Square Feet	Beds	Baths	Monthly Rent	Rent per Square Foot	Annual Rent
260 S. 21 Street, 1f	450	studio	1	$950	$2.11	$25
126 S. 22nd Street, 1f	400	studio	1	$950	$2.38	$29
The Sansom	668	1	1	$1,742	$2.61	$31
1825 Spruce Street, 3r	500	1	1	$1,400	$2.80	$34
The Avenir	424	studio	1	$1,331	$3.14	$38
The Sansom	490	studio	1	$1,629	$3.32	$40
2131 Walnut Street	461	1	1	$1,600	$3.47	$42
115 S. 21st Street	476	1	1	$1,750	$3.68	$44
The Sansom	390	studio	1	$1,529	$3.92	$47

Development Cost

The development cost for micro apartments at 1906-1916 Sansom is clearly more expensive than the development cost for the originally modeled apartment scenario for 1906-1916 Sansom because of the need to install additional electrical, HVAC, and plumbing equipment for the additional units. As a conservative measure, we have assumed the same cost as in the originally modeled apartment scenario, but in reality the development costs would exceed this figure. However, if the micro apartment scenario is not financially feasible with the lower construction cost of the regular sized apartment units, then it will not be financially feasible with the higher construction cost for the micro units.

Financial Analysis

Our financial analysis shows that the Net Present Value (at 10%) of this investment is -$11.1 million. The Internal Rate of Return is not defined. The Value Created is -$16.6 million. Please see the Appendix for the detailed pro forma analysis. We estimate the net operating income for the mirco apartment scenario at approximately $360,000, up from the approximately $300,000 net operating income under the apartment scenario.

Table 3: Summary of Financial Analysis – Micro Apartments ($M)

Sources and Uses	
Uses	
Land Costs	$2.1
Hard Cost (minimum)	$15.6
Soft Costs	$3.9
Tenant Fit-Out Costs	$0.0
Total Uses	$21.6
Sources	
Owner Equity	$6.5
Loan	$15.1
Total Sources	$21.6
Financial Summary	
Net Operating Income (first year)	$0.4
Operating cash flow (first year)	-$0.5
Net Present Value (10%)	-$11.1
Internal Rate of Return	Not Defined
Value Created	-$16.6

Conclusion

The expense of renovating and adapting 1906-16 Sansom for use as a residential rental property with micro apartments would result in insurmountable financial challenges for the developer. The cost of renovating 1906-16 Sansom is greater than can be justified by profits earned by the micro apartment use.

Robustness Analysis

We have also updated the same robustness analysis that we conducted in Appendix 2 of our October 28, 2015 letter report. This analysis tests the robustness of the financial results presented in the hardship application by exploring a number of alternative financial assumptions, including:

- If there was no land cost or acquisition cost associated with the property;
    - As described in the October 28, 2015 letter report, we estimate that 1906-16 Sansom has land costs of $2,100,000, based upon the appraisal analysis conducted by Coyle, Lynch & Company.

- If 1906-16 Sansom were eligible for Federal and State Historic Tax Credits;
    - As described in the October 28, 2015 letter report, we believe that historic tax credits would not be available for this property, based on the historic rehabilitation analysis performed by Civic Visions LP.
- If development costs were 20% less than estimated; and
- If rental rates and sales prices were 20% greater than calculated.
    - The final two tests were chosen for sensitivity purposes only.

We also addressed the financial ramifications of all of these alternative assumptions together.

The results of the robustness analysis are shown in Table 4 below, which shows the value created in each alternative reuse scenario. The first column shows the baseline scenario, and matches the values in the main body of the October 28, 2015 report and this letter. The next four columns show the effect of each individual assumption change, with all other assumptions the same as in the baseline. The final column shows the results when all four assumptions are changed at the same time. (i.e. - $0 land cost, assumes federal and state historic tax credits, development cost at 80% of estimated value, and rents / sales at 120% of estimated value.)

In each case, the value created is negative. In addition, the NPV is negative for all alternatives and the IRR is undefined for all alternatives. Therefore, no reuse scenario – including the micro apartment scenario – is financially feasible under these alternative reuse assumptions.

Table 4: Value Created for Alternative Scenarios ($M)

	Base Scenario	$0 Land Cost	Federal and State HTC Eligible	Development Cost at 80%	Rents / Sales at 120%	*Cumulative*
1906-1916 Sansom						
Apartment	**-$17.5**	-$15.4	-$13.4	-$13.6	-$16.6	-$7.3
Condominium	**-$17.8**	-$15.7	-$13.4	-$13.6	-$16.8	-$7.0
Office	**-$16.4**	-$14.3	-$12.6	-$12.8	-$15.7	-$6.8
Hotel	**-$14.3**	-$12.2	-$10.2	-$10.4	-$14.2	-$5.0
Micro Apartment	**-$16.6**	-$14.5	-$12.5	-$12.7	-$15.6	-$6.3

Please feel free to contact us with any questions regarding our analysis.

Regards,

Peter A. Angelides

Peter Angelides, Ph.D., AICP
February 2, 2015

Appendix

1906-1916 Sansom - Micro Apartments - Revenue and Cost Calculations

All Residential

Revenue	2015	2016	2017
Square Feet - Retail			970
Rent per Square Foot - Retail			$54
Rent			$52,478
Square Feet - Residential			15,425
Rent per Square Foot - Residential			$37
Rent			$577,734
Total Revenue (excluding vacancy)			$630,212
Operating Expenses			
Administrative, Maintenance and Other	30%		$189,064
TOTAL			$189,064
Operating Income			$441,148

Capital Costs	HTC Eligible	Not HTC Eligible	Total
Hard Costs	$0	$15,562,460	$15,562,460
Soft Costs	$0	$3,890,615	$3,890,615
Construction Total	$0	$19,453,075	$19,453,075
	0%		

Federat Historic Tax Credit Percentage	20%
Federat Historic Tax Credit	$0
Multiplier	1.0
Federal Tax Credit Value for Pro Forma	$0
Pennsylvania Historic Tax Credit	$0

Appendix

1906-1916 Sansom - Micro Apartments - Pro Forma

Year		2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
		1	2	3	4	5	6	7	8	9	10
Operating Revenue											
Rent	-	-	-	577,734	589,289	601,075	613,096	625,358	637,865	650,622	663,635
Vacancy	5%		-	(28,887)	(29,464)	(30,054)	(30,655)	(31,268)	(31,893)	(32,531)	(33,182)
Other			-	-	-	-	-	-	-	-	-
TOTAL REVENUE	-	-	-	548,847	559,824	571,021	582,441	594,090	605,972	618,091	630,453
Operating Expenses											
Maintenance, Administrative, Tax, and Other	-	-	-	189,064	192,845	196,702	200,636	204,648	208,741	212,916	217,175
Total Operating Expenses	-		-	189,064	192,845	196,702	200,636	204,648	208,741	212,916	217,175
Net Operating Income				$359,784	$366,980	$374,319	$381,805	$389,442	$397,230	$405,175	$413,279
Interest	6%			$905,229	$905,229	$905,229	$905,229	$905,229	$905,229	$905,229	$905,229
Operating Cash Flow				-$545,445	-$538,250	-$530,910	-$523,424	-$515,788	-$507,999	-$500,054	-$491,951
Owners Equity		-$3,232,961	-$3,297,620								
Sale of property											$6,887,976
Repayment of loan											-$15,087,153
Cash Flow		-$3,232,961	-$3,297,620	-$545,445	-$538,250	-$530,910	-$523,424	-$515,788	-$507,999	-$500,054	-$8,691,127
NPV	10%	-$11,131,450									
IRR		Not Defined									
Year 1 Debt Coverage Ratio				40%							

Sources and Uses

Uses			
Land Costs		$2,100,000	$2.1
Hard Cost		$15,562,460	$15.6
Soft Costs		$3,890,615	$3.9
Tenant Fit Out Costs		$0	$0.0
Total Uses		$21,553,075	$21.6
Sources			
Owner Equity	30%	$6,465,923	$6.5
Loan	70%	$15,087,153	$15.1
Total Sources		$21,553,075	$21.6

Financial Summary

Net Operating Income (first year)	$359,784	$0.4
Operating cash flow (first year)	-$545,445	-$0.5
Net Present Value (10%)	-$11,131,450	-$11.1
Internal Rate of Return	Not Defined	Not Defined
Value Created	-$16,597,375	-$16.6