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Economic and Development Services

MEMORANDUM

To:	Cheryl Twete Portland Development Commission
From:	Eric Hovee
Subject:	Review of NMI Residential/Mixed-Use Financial Pro Formas
Date:	June 25, 2003

At the request of the Portland Development Commission (PDC), E. D. Hovee & Company (EDH) has reviewed block-by-block financial pro forma projections prepared for North Macadam Investors (NMI) in connection with proposed South Waterfront Central District apartments and condominiums. This memorandum contains the results of this review and is organized to cover:

Summary of Findings
Purpose & Approach
Pro Forma Review & Comments
Independent Feasibility Testing (with financial pro formas attached)
Policy Implications

SUMMARY OF FINDINGS

This review assesses the reasonableness of financial projections made by North Macadam Investors (NMI) for approximately 10 net buildable acres of residential/mixed-use development. Principal findings of this analysis follow:

- *Site costs* are estimated by NMI to average $95 per square foot of buildable site area including cost of site acquisition, infrastructure (including LID), financing through build-out and net profit (or return). Our review suggests that NMI has applied an appropriate methodology for site cost allocations based both on return on investment and comparable Central City land transactions adjusted for FAR.
- *Development costs* identified by NMI for high-rise condominium and apartment also appear to be reasonable. This conclusion is based on a review of building space programming together with resulting construction and soft (indirect) costs.
- Market rate *apartments* represent a form of high-rise development for which there is little Portland metro experience in recent years. To achieve financial feasibility, NMI likely will

need to exceed *top of market* rents currently experienced for the Central City area. NMI pro formas of *reasonable return* rents indicate a willingness to proceed despite what might be regarded as relatively modest returns on invested equity. However, there is *upside* potential if North Macadam successfully captures market rate rental clientele heretofore not experienced in the Portland metro area.

- *Condominium* pricing also reflects or perhaps exceeds top of market sales values, albeit with more comparable experience – particularly in the Pearl District. There is some risk that sales pricing and absorption expectations may not be achieved as currently planned, although this risk appears to be less than for market rate apartments. While Central City condo sales have continued at a brisk pace, project risks are increased if the economic downturn is prolonged, interest rates increase and/or if OHSU expansion plans are not realized as proposed.
- *Financing* projections of NMI appear reasonable – albeit somewhat conservative given the current interest rate environment. Proceeding with initial phases of development at the earliest opportunity would be advantageous for project feasibility.
- *Independent feasibility testing* has been conducted for two 24-floor Central District residential projects – the 245-unit Block 27 condominium development and a 280-unit apartment project on Block 35. With *base case* market conditions of $305 per square foot condo sales values and $2.10 per square foot monthly rentals, the condo project lies within but the apartment project falls below potentially acceptable return levels suggested by NMI pro formas.

  At condo values increased to just over $313 per square foot and pro forma rents of $2.38 per square foot monthly, both developments would better achieve conventional underwriting criteria – appealing to a broader set of investor and financial interests. This feasibility testing assumes a return to a more typical financial market environment with somewhat higher interest, capitalization and return rates than has been experienced in the last couple of years.

A *threshold question* posed by this review is whether and to what degree the City of Portland needs to protect against adverse marketability and financial conditions that might be experienced by the developer – in the event that development, absorption and pricing do not materialize as projected. This review indicates that continuation of strong Central City housing market conditions offers the opportunity to successfully develop and market North Macadam condominiums with unparalleled river access and views in a new neighborhood adjoining downtown Portland. Depth of the market for high-end Central City apartment living has yet to be fully tested – but recent developments such as Kearney Plaza and Museum Place (under construction) indicate resurgent interest.

To the developer, the risks associated with not achieving pricing and absorption expectations are *best case*, a slower pace of development and build-out. *Worst case*, there is the risk that a project defaults if lease-up or sales does not materialize. However, as long as each building development is staged based on successful marketing of a comparable prior project (as in the Pearl/River District), this risk is held to one or two development projects at a time.

To the City of Portland, the risks of developer slow down or default include: a) tax increment revenues below forecast; b) adverse publicity and image for a major community initiative; and c) achieving public policy goals but at a slower pace than currently projected. Financial risks can be mitigated by conservative increment projections with phasing of public improvements to actual development activity and resulting TIF cash flow. These revenue risks together with concerns for community expectations and public policy goals appear to be accounted for and reasonably addressed by the stipulations of the Development Agreement as currently proposed between the City, NMI, RCI and OHSU.

PURPOSE & APPROACH

The purpose of this review is to assess the reasonableness of financial projections made for residential and residential/mixed use projects proposed for the Central District of North Macadam (also known as the South Waterfront area immediately south of downtown Portland).[1]

Financial Variables Assessed: Reasonableness of financial projections have been assessed in terms of such variables as:

- Construction, land value and other development costs
- Income and expense projections for rental portions of the selected residential projects
- Sales revenue and associated revenue for condominium development
- Financing conditions including interest rate and term, equity/debt financing, implied capitalization rate and return on investment

Other variables or indicators for review may be suggested as a result of additional review and discussion with the City's core negotiating team and/or representatives of NMI.

Methodology: To conduct this review, E. D. Hovee & Company has:

- Met with representatives of PDC and NMI to discuss pertinent background information.
- On a confidential basis, reviewed financial pro formas together with pertinent market information prepared by or for representatives of NMI.
- Made contacts with knowledgeable Portland area real estate and financing interests – to obtain current information for the development program and financial variables indicated.
- Prepared an initial memorandum in December 2002 providing preliminary comments for review and discussion with PDC and the Core Negotiating Team.

The initial memorandum has been revised based on comments received from these parties and representatives of NMI. This update also incorporates changes in NMI development program assumptions together with independently prepared financial pro forma analysis to assess the reasonableness of return on investment conclusions reached by NMI.

Limitations of Analysis: A total of 31 acres comprises land secured for open space, public rights of way and planned development for North Macadam's Central District by the entities of North Macadam Investors (NMI), River Campus Investors (RCI) and Oregon Health Sciences University (OHSU) – acting individually or in joint partnership. The focus of this analysis is restricted to the portion that will be the responsibility of NMI. After deducting the RCI/OHSU portions, public dedicated land, and private easements, the remaining net buildable area available for NMI development nets out to approximately 9.96 acres.

As a condition of conducting this review, E. D. Hovee & Company has agreed to maintain the confidentiality of project or site specific market and financial information. Consequently, with the exception of independently prepared pro formas, our findings and observations are reported in aggregate form – by product type.

The findings and observations contained in this report are those of E. D. Hovee & Company. They should not be construed as representing the opinion of any other party without their express approval of the contents herein – whether in whole or part.[2]

PRO FORMA REVIEW & COMMENTS

As noted at the outset, this review has been organized to assess the reasonableness of financial pro forma projections information provided by NMI regarding site costs, development costs, rental apartment income and expenses, condominium unit pricing and expenses, and development financing. For each pro forma item considered, we start with the information provided by the NMI followed by E. D. Hovee & Company (EDH) comments.

Site Cost: Land cost figures provided by NMI include expenses of initial site acquisition, development of required infrastructure, and financing through the period of land absorption:

- Overall initial site acquisition cost indicated by NMI is in the range of $17 per square foot of legal lot area. Acquisition cost attributed to the 9.96 acres of net buildable NMI site area equates to $33 per square foot – after adjusting for site area originally purchased that is not developable.[3]
- Site development costs (primarily infrastructure together with LID and associated development management fees) add $34 per square foot.[4]
- NMI financing costs are just under $5 per square foot. This represents interest charges on financing of site planning, preparation and infrastructure through to the point of completed land transactions for building construction.

The resulting average finished land cost calculates to $72 per square foot of net buildable area. Land value attributed to each site/building specific pro forma averages in the range of $95 per square foot (assuming residential development of Block 34B); yielding an imputed gross land profit in the range of $23 per square foot.

This profit is viewed by the developer as return on invested equity over a 5 to 10 year potential land hold period. For purposes of this analysis, land costs are funded approximately 56% by interim financing and 44% by invested equity.[5] The (undiscounted) return on developer equity (ROE) ranges from 15% with a five-year absorption period down to 7-8% if buildout occurs over a longer 10-year period.

EDH Comments: Perhaps the most significant question raised by our analysis has related to the developer's approach to *land pricing* – due to the complexity of the land cost, infrastructure, absorption, and financing factors cited above.

Drawing from NMI land cost per unit, unit counts and project FAR, we have calculated land cost on a per square foot basis.[6] For the residential blocks, imputed land cost for the NMI prepared pro formas averages $94 per square foot of legal lot area – ranging from $63 to $124 per square foot. Buildable lot area equates to 85% of legal lot square footage. This increased the initially calculated average land cost to $107 per square foot of net buildable land (excluding the hotel site).

Subsequent revised overall land development budgeting provided by NMI indicates an average assigned land cost of $95 per square foot of net buildable area. This average land value includes the hotel site and Block 34B (previously planned as a park site but now indicated for residential).[7]

As noted, the land cost figures provided include expenses of initial site acquisition, development of required infrastructure, and financing through the period of land absorption. Included in the land value estimate (or *going in* cost to a specific building project) is a return on and of invested equity (or profit potential). This return is separated from the return associated with the subsequent development of building structures because different entities may be involved in the land development versus individual site and building development transactions.

The actual financial return on land and site development that is realized depends on the length of the absorption period. Quicker build-out increases the return; slower build-out reduces the return realized on the land investment.

With the most rapid construction schedule, NMI would conduct residential development over a roughly five-year schedule – with project completion phased from late 2004 through mid-2008. With a later completion schedule, residential build-out could extend through end of 2019 (i.e. a 9-10 year period). This schedule can be expected to vary depending on market demand and financing conditions at the time each new project is constructed.

For this analysis, the reasonableness of land value assumptions (for ready-to-build sites) is assessed from the dual perspectives of return on investment and comparable developments:

- As noted, NMI has calculated return on equity over sample five, eight and ten year absorption periods. We have augmented this analysis to assess the *internal rate of return* (IRR) associated with the return on *plus* the return of equity invested. As might be expected, if build-out is realized within a five-year time period, NMI can expect to benefit in the form of a reasonable but not unduly high return in the range of 11-12% on its investment. If absorption stretches over 10 years, returns would be much less attractive – dropping to an IRR of 6-7%.[8]
- Supportable land values also have been assessed from the perspective of *comparable* Central City sites – relative to floor area ratio (FAR). The $95 per square foot finished value assigned to NMI buildable area equates to approximately $15 per square foot for each increment of 1.1 FAR – with average FAR of 6.34 planned across all buildable parcels.[9] This is within the range of comparable Central City transactions.[10]

In summary, determining a reasonable basis for supportable site cost can be challenging due to issues of detailed cost verification and market demand influencing the *land hold* period.

Our review suggests that NMI has applied an appropriate methodology for site cost allocations with reasonable returns projected consistent with the level of risk inherent in land development. Going in land values averaging $95 per square foot of buildable area appear reasonable based both on this independent return on investment evaluation and a review of comparable Central City land transactions adjusted for FAR.

Development Cost: Key assumptions of the NMI development team's projections include:

- Development of more than 2,700 residential units – comprising over 1,350 condo/ownership units together with 704 market rate, 400 affordable and 250 student housing units. *Note:* Of this amount, just under 1,780 units currently are shown for the NMI property which is the primary focus of this analysis.[11]
- Residential *density* averaging 160 units per acre – ranging from 105 to 268 units per acre of gross land area.[12]
- Inclusion of approximately 1.5 million square feet of OHSU-related research lab and office space – on the RCI/OHSU portions of the Central District development.[13]
- Development of over 300,000 square feet of net rentable retail-related commercial space – essentially adding an overall average 12% to net usable residential space of 2.6 million square feet.[14]
- Residential/mixed-use *floor area ratios* averaging 5.16:1 based on NMI gross site area or 6.42:1 based on net buildable area.[15]
- *Land costs* initially calculated by NMI on a per residential unit basis – ranging from $18,000 to $20,000 per apartment unit to $25,000 per condo unit.[16]
- *Residential unit sizes* averaging just over 1,000 square feet per unit – at 960 square feet per apartment/rental and 1,090 square feet per ownership unit.[17]
- All-in *apartment construction* pricing of $117 per gross square foot (GSF) building area for wood frame construction (no longer considered) and $144 per GSF for concrete construction.[18] *Note:* Building area includes residential, retail and parking space.
- All-in *condominium construction* pricing of $165 per GSF for concrete construction.[19]
- *Building efficiency* of 80% for both apartment and condo units – representing the ratio of net income producing to gross building square footage.
- *Soft costs* equal to 25% of hard costs.

EDH Comments: On a preliminary basis, *construction* cost information provided by NMI was reviewed with the cost estimating firm of Rider Hunt Levett & Bailey. A more detailed cost review was not readily possible because the NMI provided information was limited to land cost, soft costs and total construction costs (covering residential, retail and parking as a single line item). While the *all-in* costs appeared to be within a reasonable range based upon initial review, our observation was that greater line item detail would allow for more thorough evaluation.

Subsequent to an initial December 2002 review, EDH prepared illustrative financial pro formas for a representative early phase condominium and an apartment development – as provided with the appendix to this report. We have estimated *all-in* condominium costs at 5-6% less than the NMI provided figure. Our estimated apartment development cost also is under the NMI estimate by 1-2%.

Per square foot cost savings are being achieved, in part, due to recent NMI proposed increases in the number of residential units planned for the blocks reviewed. Variance in the range of about 5% or less indicates that NMI's estimates are well within a reasonable range of cost – particularly at this preliminary planning stage.

It is noted that, with the exception of a wood frame apartment alternative (no longer considered), concrete represents the most expensive construction type available – with relatively limited application to date for condo units and even less for apartment units in the Portland metro market. However, concrete construction provides superior suppression of noise between units, extends the useful life of the project, and should command some form of (as yet relatively untested) rent premium in the Central City apartment market.[20]

Finally, the NMI soft costs estimates of 25% are lower than for some projects which can range to 30-35% of construction costs. However, the scale of high rise development proposed could allow for efficiencies in costs ranging from design fees to some permitting fees. Consequently, we have applied the NMI 25% cost figure for purposes of the financial pro formas provided by the Appendix.

In summary, the development costs identified by NMI for high-rise condominium and apartment development appear to be reasonable and are consistent with the pro formas provided with this report.

Apartment Income & Expense: Project proponents provide separate pro formas based on what NMI terms *current market* versus *reasonable return* rents:

- *Current market* rents of $1.72 per square foot for wood frame mid-rise units and $2.10 for concrete high rise units – yielding cash-on-cash returns of less than 5% (for concrete high rises), a level of return that the developers suggest may be too risky to proceed with the project. *Note:* After initial consideration, NMI is no longer proposing wood frame construction.
- *Reasonable return* rents of $2.02 per square foot annually for wood mid-rise units and $2.37 for concrete high rises – to obtain a *reasonable* rate of cash-on-cash return in the range of 6%-8% depending on the particular block and design of the building.

In both sets of pro formas, a 5% normalized vacancy factor is applied. Operating expenses are projected at 25% of combined net residential and retail rents. Parking is provided at a ratio of one space per unit – with no added parking calculated by NMI for on-site retail space.[21] *Note:* The parking ratio has been increased by NMI to 1.1 for the prototype project (Block35) reviewed in this report.

Retail rental rates are set at just over $18.50 per square foot annually for the current market scenario and $21.00 for the reasonable rent scenario. As is typical within the Portland market, retail rental rates indicated are triple net (nnn), with tenants paying expenses.

EDH Comments: Both rental and condo pricing were derived by NMI from a market analysis conducted by Hobson Ferrarini in August 2002.[22] As acknowledged by the Hobson Ferrarini report, current Central City area apartment pricing is well below but also is a "poor indicator" of rental rates that the North Macadam area might command. Pricing recommended for concrete units is 20% above a Pearl District base price and more than 80% above today's downtown high-rise base price.

To arrive at its recommended North Macadam apartment pricing, Hobson Ferrarini applied a series of five adjustment factors to existing downtown high-rise and Pearl District comparables – covering location, high-rise construction, age, self-contained community, and cache.

The North Macadam rent premiums applied range from 10-30% per factor reviewed, although no explicit market justification for these adjustments was indicated in the summary market report reviewed. Rather, the adjustments reflect primarily the professional judgement of the market consultant based on its experience within the Portland metro market.[23]

Limited verification of Central City rents reported in the Hobson Ferrarini analysis has been completed for this review. Rents have been found to be generally in line with those reported.[24] The highest rent currently realized in Pearl District rental projects appears to be in the order of $1.93 per square foot (for one bedroom units at Kearney Plaza), parking excluded. However, rents for this project may be influenced by its unique position as the Pearl's only recently constructed rental project.[25]

It is noted that the NMI pro formas apply the Hobson Ferrarini rent figures for the *reasonable return* rent scenario, but then proceed to discount rents by 15-18% for what are termed as *current rent* calculations.

The most significant question raised is whether and under what conditions North Macadam apartments can actually achieve the rent levels indicated. With over 700 market rate apartment units planned, the added inventory will substantially exceed recent new construction of market rate apartments elsewhere in the Central City area.[26] NMI's decision to reduce the number of market rate apartments from about 1,100 initially planned to the 700 range appears prudent based on these market observations.

Operating expenses for apartments have been projected by NMI at 25% of gross operating income. At current market rents of $2.10 per square foot per year, this equates to annual residential operating expense of $5,200 per unit – without limited property tax abatement.[27]

PDC indicates that, with availability of limited property tax abatement, Central City apartment operating costs typically are more in the range of $3,000 per unit annually. This figure also covers an allowance for replacement reserves.

In order to achieve high end rents applied in its pro formas, NMI anticipates that it will also need to provide more tenant services than are found in the Portland market but are common to higher end apartments elsewhere on the west coast as in Seattle and Los Angeles. Examples include 24 hour lobby security, concierge services, staffed pool and exercise facilities or memberships in nearby heath club facilities.[28] Based on these planned tenant services and an assumption that apartments are eligible for limited property tax abatement, the NMI operating expense projection of $4,400 per unit appears supportable.

In summary, the NMI apartment pro formas appear realistic for the current market scenario. However, market depth is uncertain as these rents reflect new *top of market* conditions for the

Central City currently – with only limited product being marketed to date at comparable rent levels. The reasonable rent scenario requires setting a new and yet higher market standard – reflecting location amenities and unique proximity to OHSU personnel. Per unit operating expense projections also are above what the Central City market has experienced to date for tax abated properties but appears warranted with a higher level of tenant services anticipated to support higher rental rates (as has been assumed with the pro forma financial projections provided at the conclusion of this report).

Condominium Pricing & Expense: For concrete condo units, the NMI development team has also prepared separate pro forma scenarios based on *current market* versus *reasonable return* pricing:

- *Current market* sales pricing of $305 per square foot for residential and $219 for retail space – yielding returns on net revenue in the range of less than 8%. These returns are viewed by the NMI development team as too risky to proceed.
- *Reasonable return* sales pricing in the range of $325 per square foot for residential and $247 for retail – yielding returns of up to the 12-14% range for loft product. Lower returns in the range of 10-13% are indicated for traditional condos. While on the low side, these returns are viewed by NMI as "probably adequate" for the project to proceed.

Selling costs (for sale of both condo residential and retail units) are assumed at 3% of gross sales pricing. Initial planning indicated that on-site parking would be provided at a ratio of 1.2 spaces per unit. Updated concepts from NMI suggest increasing the parking ratio to 1.3, consistent with the pro forma condo example provided with this report.

EDH Comments: As with apartments, the Hobson Ferrarini report applies the five amenity factors indicated above to support a recommended North Macadam sales price of $326-$352 per square foot. North Macadam pricing would be 80% above per square foot pricing of existing downtown area high rises, 60% above comparable downtown waterfront product, and 30% above Pearl District condo unit pricing. NMI applies Hobson Ferrarini pricing in its reasonable return scenario, discounting sales prices by 6% to what are described as current market conditions.

The sale of retail units implicitly assumes an ability to capitalize per square foot rents comparable to what is assumed with the apartment developments – with rents of just over $18.50 per square foot under current market conditions and $21.00 with the reasonable return scenario.[29]

Limited fieldwork conducted by our firm essentially confirms the general price range for existing Central City condos indicated within the Hobson Ferrarini analysis. The current top of the market for Pearl District projects is represented by Streetcar Lofts, with average square foot pricing of $294.[30] In Northwest Portland, Westover Condominiums entered the market in 1999 priced between $331 and $366 per square foot. South of Burnside, Fountain Plaza (KOIN Center) resales over the past two years have been perhaps the city's highest, in the range of $350-$385 per square foot.

These high end projects generally include at least one to two off-street parking spaces per unit.[31] In recent Central City condo developments, units in the top price ranges are more likely to offer two parking spaces per unit.[32]

Selling costs of 3% indicated by NMI pro formas appear low; typical projects allocate 5-7% of gross sales. However, NMI indicates that this amount covers direct commissions only; an additional 2% for marketing cost is included with the overall project soft cost.[33]

Our assessment is that NMI likely will more readily achieve its reasonable return pricing targets for condo units than for apartments. Greater ability to achieve desired condo pricing is suggested by proven strength (and depth) of new Central City condo versus market rate apartment development. North Macadam also should benefit from direct river proximity and views – creating added market interest willingness to pay from top-end buyers. However, as with apartments, there is some risk that sales pricing projections may not be achieved.

In summary, NMI condominium pricing appears to reflect or possibly exceed top of market sales values, albeit with more comparable experience than for apartments – particularly in the Pearl District. There is some risk that sales pricing and absorption expectations may not be achieved as currently planned, though this risk appears less than for apartments. While Central City condo sales have continued at a brisk pace, project risks are increased if the economic downturn is prolonged, interest rates increase and/or if OHSU expansion plans are not realized as proposed.

Financing: For its residential/mixed use projects, the NMI team has projected:

- Permanent financing at 8% interest over 30 years (rental properties only)
- Debt service coverage ratio of 1.20 required for financing (rental properties only)
- Loan to cost ratio in the range of 70% – with 30% equity (for construction financing with both rental and owner products and for permanent financing of rental development)

EDH Comments: These financing assumptions reflect typical underwriting constants, and are more conservative than current market conditions. Permanent office financing rates recently have been quoted been as low as 6.25% with multi-family rates below 6.00%.[34] Consequently, NMI pro formas can be viewed as conservative – allowing for the possibility that loan terms will likely return to more typical (higher) rates by the time of project development.[35]

A debt service coverage ratio (DCR) of 1.20 would be required today by the financial market's most aggressive lenders (e.g. Freddie Mac). Higher DCRs (around 1.25 or 1.30) may be more commonplace when interest rates drop, as in the current market. However, a more aggressive DCR of 1.20 appears reasonably compatible with the relatively conservative 8% interest rate assumption.

Loan to cost ratios (for permanent financing) in the range of 70%-72% appear somewhat conservative, but are controlled by the debt service coverage requirements. Financial institutions indicate that multi-family projects typically see loan to value (LTV) ratios of 80% for multi-family and 75% for office, with some lenders going as high as 85%. However, industry norms may not be as applicable, as these are not typical multi-family / mixed use projects due to the high densities and relatively below norm returns on investment.[36]

In summary, based on review conducted for this analysis, the NMI financing projections appear reasonable – if not conservative. Proceeding with initial phases of development at the earliest opportunity would be advantageous to secure the favorable interest rates that are presently available, and increasing the project's profitability. Increased interest rates could adversely affect the ability to achieve financing for later phase development – but rates significantly above 8% are not anticipated for at least the near term unless there are major external shocks to the nation's economy.

INDEPENDENT FEASIBILITY TESTING

A preliminary draft of the market and financial review described above was provided in December 2002 – for initial review and discussion with PDC and the Core Negotiating Team. Subsequent to this discussion, further contacts were made over the January – June 2003 time period with representatives of NMI. Purposes of these contacts have been to assure reliability of information presented, update information as the development program has been refined, and request added information as deemed appropriate.

Specific topics for which further developer provided information and discussion was deemed appropriate have included:

- More detailed development cost breakouts – particularly focused on the *going in* components of land acquisition and site development costs.
- Key market absorption and pricing assumptions – via independent feasibility testing.

Sample Apartment & Condo Feasibility Testing: In consultation with PDC and NMI, two project concepts were selected for more detailed feasibility assessment:

- *Block 27 Condos* – 245 units on 24 floors with over 70,200 square feet of ground level retail and 1.3 parking spaces per unit, on a 58,049 square foot (1.33 acre) site.
- *Block 35 Apartments* – 280 units on 24 floors apartment with 7,500 square feet of ground level retail space and 1.1 parking spaces per unit, on a 50,655 square foot (1.16 acre) site.

Pro Forma Approach: This feasibility testing is conducted by preparation of financial *pro formas* for each of the two development sites/concepts as planned by NMI. Each *pro forma* involves a comparison of development costs with returns to investor equity recognized upon project completion and subsequent occupancy of residential and retail space – whether rented or sold.

This analysis benefits from pro formas already prepared for the subject blocks by NMI, albeit with some recent program modifications. Consequently, the sample pro formas we have prepared draw from NMI information together with supplemental market, cost and financial data as compiled in the course of this independent review.

For each residential product type, two pro formas have been prepared – a *base market* and a *reasonable return* option. Assumptions common to both pro forma runs and distinct to the two options are summarized as follows.

Both Pro Formas:

- Use EDH prepared construction costs for residential, retail and parking uses.

- Apply NMI provided data as reasonable for building program, site cost and indirect development cost.
- Calculate operating expenses for apartments @ $4,400 per year assuming availability of limited property tax abatement.

Base Market Option:

- Apply NMI current market figures of $305 per square foot condo pricing and $2.10 per square foot monthly apartment rents.
- Also apply current market retail pricing based on triple net (nnn) rental rate of $18.50 per square foot.
- Use NMI financing assumptions for purposes of calculating cash-on-cash return to equity (for the apartment project).

Reasonable Return Option:

- Increase sales values for the condo project to the point required for a minimum 15% return on development cost.
- Increase rent rates for the apartment development to the long-term level required for at least a 12% pre-tax cash-on-cash return.

The condo and apartment returns with the reasonable return scenarios exceed what NMI may view as minimally acceptable in the current market environment of low interest and capitalization rates. The reasonable return rates applied with these illustrative pro formas reflect an assumption that multi-family financing may return to more typical financial market conditions requiring higher rates of return.[37] Given the early stage risk of what may be viewed as pioneering high rise apartments for the Portland market, higher returns would also achieve greater market acceptability with financial underwriters as well as other prospective developers/investors that might build on NMI's behalf.

Pro Forma Results: Detailed pro forma worksheets are provided with the Appendix attached to this memorandum report. Overall observations are noted as follows:

- With the *base market option,* condo sales would generate a return on net revenue of 9.3%; close to the 10%+ range that NMI would view as "probably adequate" for the project to proceed. The apartment project yields a 5.1% cash-on-cash return to investor equity which is below the reasonable 6%-8% range indicated by NMI.
- To achieve the *reasonable return option*, condo sales prices would be increased by close to 3% and apartment rents by 13% from what is indicated with the base market option. Condo feasibility is particularly influenced by relatively minor changes in sales pricing.

Sensitivity to Current Economic Downturn: While Portland Central City housing development has fared well through the economic recession to date, the size of the Central District residential proposal raise questions about absorption and financial performance – especially if economic recovery in Oregon is substantially delayed. To test the effects of varied assumptions on financial feasibility, a variety of sensitivity testing could be conducted.

One set of factors – reduced rents and sales values – could be occasioned by a slow market combined with significant new residential product available for rent and sale. Just a 5% reduction in pricing may have a substantial effect on financial feasibility – particularly for the condo units.

A 5% condo sales pricing reduction from the base market figure of $305 to $290 per square foot results in the return on development cost being cut from 10.2% to 5.7%. If the need to reduce sales price to this level was viewed as likely before construction started, the project most probably would be considered not feasible.

For *apartment* units, the effect of a 5% reduction in pricing on returns realized is not as dramatic because the returns associated with base market development are already below the range that NMI or most private development firms would consider as adequate. If rents were reduced from the base market expectation of $2.10 per square foot monthly to $2.00, the anticipated cash on cash return drops from 5.1% to 4.1%.

Sensitivity to Limited Property Tax Abatement: A second sensitivity test can be addressed to the question of the effect of not providing 10-year limited property tax abatement. This option is applied to the rental apartment concept only. NMI has estimated property tax costs at approximately $800 per unit annually. Consequently, the effect of receiving limited tax abatement would be to increase operating expenses from about $4,400 to $5,200 per unit annually.

For the *base case* option, the effect of removing limited property tax abatement is to reduce the cash-on-cash return to 4.3% from 5.1%, substantially below the 6-8% range indicated as acceptable by NMI. For what we have termed as a broader market test of *reasonable return*, required rents in the range of $2.47 per square foot rather than $2.38 would appear adequate to achieve a project with 12% cash-on-cash return.

Feasibility Testing Summarized: Base case market conditions of $305 per square foot condo sales values and $2.10 per square foot monthly rentals indicate that both projects achieve traditionally sub par returns, but with the base market condo pro forma more acceptable to NMI. At condo sales values increased to $313 per square foot and pro forma rents of $2.38 per square foot monthly, these developments would appear to better achieve conventional underwriting criteria both short and long-term – appealing to a broader set of investor and financial interests.

POLICY IMPLICATIONS

A *threshold question* posed by this review is whether and to what degree the City of Portland needs to protect against adverse marketability and financial conditions that might be experienced by the developer – in the event that development, absorption and pricing does not materialize as projected. To the extent that *downside* conditions are of material interest to the City, then additional due diligence review and/or appropriate stipulations in the proposed Central District Development Agreement could be warranted.

This financial review indicates that continuation of strong Central City housing market conditions offers the opportunity to successfully develop and market North Macadam condominiums offering unparalleled river access and views in a new neighborhood adjoining downtown Portland. The depth of the market for high-end Central City apartment living has yet to be fully tested – but recent developments such as Kearney Plaza and Museum Place (under construction) indicate clear resurgent interest.

To the developer, the risks associated with not achieving pricing and absorption expectations are *best case*, a slower pace of development and build-out. *Worst case*, there is risk that a project defaults if lease-up or sales simply do not materialize in a reasonable time frame. However, as long as each development is staged based on successful marketing of a comparable prior project (as in the Pearl/River District), the risk is limited to one or two residential/mixed use development projects at a time.

For the City of Portland, a key policy question posed is whether failure to achieve the project performance anticipated with resultant financial consequences to the developer would be of material consequence to the City. One possible perspective is that so long as there are no substantial adverse fiscal consequences to the City (as the property is still on the tax rolls), any negative financial consequences to the private developer need not be a public policy concern.

An alternative perspective is that failure to perform as projected could have material consequences of concern to the City and PDC in three respects: a) tax increment revenues reduced below forecast, b) adverse publicity and image for a major community initiative; and c) achieving public policy goals but at a slower pace than is currently projected.

Tax revenue risks can be ameliorated to at least some extent by conservative (or worst case) increment projections and phasing of public improvements to actual development activity and TIF cash flow. Meeting community expectations and public policy goals is best engendered by a perspective that reflects flexibility to adapt to changing market conditions and a Development Agreement providing clear benchmarks for public and private sector performance.

The Development Agreement that has been proposed for PDC and City Council consideration does provide a series of stipulations intended to offer the development flexibility needed while minimizing potential risks to public sector investment. Provisions aimed to reduce the City's financial exposure that have been negotiated between the parties include:

- *Schedule Adjustments* – as might be agreed by the parties or from unavoidable delay.
- *Funding Provisions* – providing for reprioritization including reduction in TIF and/or LID amounts if external funding is not received.
- *Phase 1 Contingent Projects* – with clear specification of the initial public and NMI/RCI/OHSU projects expected to be completed by the end of 2007.
- *Phase 2 & 3 Contingent Projects* – providing more schedule flexibility but based on a process of tentative and then binding project commitments, with no City/PDC obligation to proceed "unless and until" private parties are proceeding with development and public projects are funded.
- *Basic Contingencies* – related primarily to Phase 1 projects, for which contingencies must be satisfied by March 31, 2004 (unless extended by unavoidable delay).
- *Street Improvement in Event of Termination* – linking construction to adequacy of TIF generation.

- *Public Project Contingencies* – linking City/PDC performance for Phase 1 street improvements, tram, streetcar extension, neighborhood park acquisition, greenway improvements, site acquisition to specific actions of NMI, RCI and/or OHSU (depending on the public project under consideration).
- *Project Risks* – identified to include adverse market conditions with provisions for termination if no agreement or amendment is reached.
- *Remedies* – with provisions for PDC to recover monetary damages or discontinue its obligations due to failure of private performance, ability to make *gap payments* for Phase 1 improvements when TIF revenues are below projection, and option for PDC purchase of sites not developed in accordance with the agreement, at a price adjusted to reflect public contribution to any land value increase.

While this report does not purport to be a legal analysis, these stipulations appear to address a wide range of economic and financial risks that could be faced by the City and PDC – while providing the flexibility necessary for NMI as developer to respond to unforeseen market or other conditions as they arise. Of particular importance will be the ability for both public and private parties to execute Phase 1 commitments as currently described and scheduled.

Early implementation takes advantage of the *window of opportunity* now available with the OHSU catalyst investments plus continued strong Central City residential demand and low interest rates. Initial development success also will build momentum for the realization of subsequent phase development as planned.

APPENDIX: SAMPLE FINANCIAL PRO FORMAS

The following four pages provide financial pro forma worksheets for two project concepts:

- *Block 27 Condos* – 245 units on 24 floors with over 70,200 square feet of ground level retail and 319 parking spaces (for 1.3 spaces per unit) on a 58,049 square foot (1.33 acre) site.
- *Block 35 Apartments* – 280 units on 24 floors apartment with 7,500 square feet of retail and 308 parking spaces (1.1 spaces per unit) on a 50,655 square foot (1.16 acre) site.

Two alternative pro formas have been prepared for each concept. The first *base market option* illustrates returns associated with current base level expectations regarding achievable market rate apartment rents, condo sales values, ground level retail rents and parking rates (as applicable). The second *reasonable return* option illustrates rental rates required to rates of return typically targeted for feasibility.

The financial pro formas are constructed pursuant to a worksheet format covering:

Both Condo & Apartment Projects:

A. *Project Characteristics* – including number and type of residential units, parking, density, net and gross building areas.

B. *Development Budget* – site costs (including purchase, infrastructure, holding, profit), construction (residential, retail, parking), and indirect (or soft) costs.

Condo Options Only:

C. *Project Revenue* – for residential/retail condo portions of the project anticipated for sale as applicable *less* sales expense.

D. *Net Profit* – project revenue less expense calculated in comparison with net revenue and development cost.

E. *Financial Incentive Need* – calculated as required to achieve a *reasonable return* of 15% gross profit margin (on development cost).

Apartment Options Only:

C. *Operating Budget* – providing projections of residential, retail and parking income at stabilized occupancy less vacancy and operating expenses. Resulting net operating income (NOI) is then further adjusted for debt service to arrive at projected annual cash flow.

D. *Permanent Financing* – showing anticipated debt and equity financing at an assumed loan term and interest rate.

E. *Return on Equity* – calculated as cash flow divided by project equity. Also shown is the incentive requirement (if any) needed to achieve a 12% *reasonable return* on equity.

These financial pro formas are provided for *illustrative purposes* only. Actual conditions undoubtedly will vary from preliminary conceptual estimates provided with this analysis.

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Condo Pro Forma (Block 27 with 24 Floor Concrete Construction)

Base Market Option

		Per Unit Estimate	Total Project Estimate	Comments
A.	**Project Characteristics**			
	Residential Units		**245**	Increased from prior program of 223 units
	- Townhouses		0	
	- Condominiums		245	
	Parking Spaces		**319**	
	- Residential	1.30	319	Adjusted up @ 1.3 spaces per du
	- Retail (per 1,000 sf)	0.00	0	
	Density (Units per Acre)		**184**	Approx 24 floors concrete construction
	Net Rentable Area (sf)		**333,777**	
	- Residential	1,076	263,510	
	- Retail		70,267	Includes 50,000 sf health club
	Gross Building Area		**539,844**	Residential units & structured parking
	- Residential		329,388	
	- Retail		87,834	
	- Parking		122,623	Below + above grade levels (@ 385 sf)
	Floor Area Ratio (FAR)		**8.1**	Excludes below grade parking
B.	**Development Budget**			
	Site Cost	$21,940	$5,375,000	NMI estimated @ $93 per square foot
	Residential Construction	$201,670	$49,408,000	Per square foot construction cost of $150
	Retail & Other Construction	$26,890	$6,588,000	Per square foot construction cost of $75
	Parking Construction	$29,030	$7,112,000	Per space construction cost of $22,330
	Indirect Development Costs	$64,400	$15,777,000	Estimated @ 25% of direct construction
	Infrastructure/Extra Cost Items	—	—	Included in site cost
	Total Development Cost	**$343,930**	**$84,260,000**	
C.	**Project Revenue**			
	Condominium Sales	$328,040	$80,371,000	Condo sales at $305.00 per square foot
	Retail Space Sales Value	$62,810	$15,388,000	Retail space value of $219.00 per sq ft
	less Sales Expense	($11,730)	($2,873,000)	Assumes sales expense of 3%
	Net Sales Revenue	**$379,130**	**$92,886,000**	
D.	**Net Profit**			
	Project Revenue *less* Expense	$35,210	$8,626,000	
	Return on Net Revenue		9.3%	As % of net revenue
	Return on Development Cost		10.2%	As % of development cost
E.	**Financial Incentive Need**			
	As Equity Infusion	$16,380	$4,013,000	For project breakeven @ 15% target return

Note: This financial pro forma is prepared for illustrative purposes only. Information is based on estimates that may vary from actual conditions and is therefore subject to change.

Prepared by: E. D. Hovee & Company

Date: 25-Jun-03

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CONDO PRO FORMA (Block 27 with 24 Floor Concrete Construction)

Reasonable Return Option

		Per Unit Estimate	Total Project Estimate	Comments
A.	**Project Characteristics**			
	Residential Units		**245**	Increased from prior program of 223 units
	- Townhouses		0	
	- Condominiums		245	
	Parking Spaces		**319**	
	- Residential	1.30	319	Adjusted up @ 1.3 spaces per du
	- Retail (per 1,000 sf)	0.00	0	
	Density (Units per Acre)		**184**	Approx 24 floors concrete construction
	Net Rentable Area (sf)		**333,777**	
	- Residential	1,076	263,510	
	- Retail		70,267	Includes 50,000 sf health club
	Gross Building Area		**539,844**	Residential units & structured parking
	- Residential		329,388	
	- Retail		87,834	
	- Parking		122,623	Below + above grade levels (@ 385 sf)
	Floor Area Ratio (FAR)		**8.1**	Excludes below grade parking
B.	**Development Budget**			
	Site Cost	$21,940	$5,375,000	NMI estimated @ $93 per square foot
	Residential Construction	$201,670	$49,408,000	Per square foot construction cost of $150
	Retail & Other Construction	$26,890	$6,588,000	Per square foot construction cost of $75
	Parking Construction	$29,030	$7,112,000	Per space construction cost of $22,330
	Indirect Development Costs	$64,400	$15,777,000	Estimated @ 25% of direct construction
	Infrastructure/Extra Cost Items	—	—	Included in site cost
	Total Development Cost	**$343,930**	**$84,260,000**	
C.	**Project Revenue**			
	Condominium Sales	$336,920	$82,545,000	Condo sales at $313.25 per square foot
	Retail Space Sales Value	$70,840	$17,356,000	Retail space value of $247.00 per sq ft
	less Sales Expense	($12,230)	($2,997,000)	Assumes sales expense of 3%
	Net Sales Revenue	**$395,530**	**$96,904,000**	
D.	**Net Profit**			
	Project Revenue *less* Expense	$51,610	$12,644,000	
	Return on Net Revenue		13.0%	As % of net revenue
	Return on Development Cost		15.0%	As % of development cost
E.	**Financial Incentive Need**			
	As Equity Infusion	$0	$0	For project breakeven @ 15% target return

Note: This financial pro forma is prepared for illustrative purposes only. Information is based on estimates that may vary from actual conditions and is therefore subject to change.

Prepared by: E. D. Hovee & Company

Date: 25-Jun-03

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APARTMENT PRO FORMA (Block 35 with 24 Floor Concrete Construction)

Base Market Option

		Per Unit Estimate	Total Project Estimate	Comments
A.	**Project Characteristics**			
	Residential Units		**280**	Increased from prior program of 232 units
	- Townhouses		37	
	- Apartments		243	Covers all units added to program
	Parking Spaces		**308**	
	- Residential	1.10	308	
	- Retail (per 1,000 sf)	0.00	0	
	Density (Units per Acre)		**241**	Approx 24 floors concrete construction
	Net Rentable Area (sf)		**250,714**	
	- Residential	869	243,214	
	- Retail		7,500	
	Gross Building Area		**431,972**	Residential units & structured parking
	- Residential		304,017	
	- Retail		9,375	
	- Parking		118,580	Below grade + 3 above grade levels
	Floor Area Ratio (FAR)		**7.5**	Excludes below grade parking
B.	**Development Budget**			
	Site Cost	$16,570	$4,640,000	NMI estimated @ $92 per square foot
	Residential Construction	$135,720	$38,002,000	Per square foot construction cost of $125
	Retail & Other Construction	$2,340	$656,000	Per square foot construction cost of $70
	Parking Construction	$23,710	$6,640,000	Per space construction cost of $21,560
	Indirect Development Costs	$40,450	$11,325,000	Estimated @ 25% of direct construction
	Infrastructure/Extra Cost Items	—	—	Included in site cost
	Total Development Cost	**$218,790**	**$61,263,000**	
C.	**Operating Budget**			
	Rental Income	$21,890	$6,129,000	Monthly rent averaging $2.10 per sf
	Retail Income	$500	$139,000	Annual rent averaging $18.50 per sf
	Parking Revenue	$1,120	$314,000	Average monthly per space fee of $85
	less Vacancy	($1,650)	($461,000)	Assumes 7% normalized vacancy
	Gross Operating Income (GOI)	$21,860	$6,121,000	
	Residential Expenses	($4,400)	($1,232,000)	Tax abated @ $4,400 per DU/year
	Retail Expenses		($13,900)	Estimated @ 10% of gross retail income
	Parking Expenses		($61,600)	Annual expense of $200 per space/year
	Net Operating Income (NOI)	**$17,460**	**$4,813,500**	
	Debt Service	($14,330)	($4,011,000)	Debt coverage ratio (DCR) of 1.20
	Annual Cash Flow	**$3,130**	**$802,500**	
D.	**Permanent Financing**			
	Debt Financing		$45,553,000	Based on 30 year loan @ 8% interest
	Equity Investment		$15,710,000	Results in equity to cost ratio of 26%
	Total Permanent Sources		**$61,263,000**	
E.	**Return on Equity**			
	Cash on Cash Return		**5.1%**	Cash-on-cash return (pre-tax)
	Incentive Need (added equity)		$9,022,000	For project breakeven @ 12% target return

Note: This financial pro forma is prepared for illustrative purposes only. Information is based on estimates that may vary from actual conditions and is therefore subject to change.

Prepared by: E. D. Hovee & Company

Date: 25-Jun-03

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APARTMENT PRO FORMA (Block 35 with 24 Floor Concrete Construction)

Reasonable Return Option

		Per Unit Estimate	Total Project Estimate	Comments
A.	**Project Characteristics**			
	Residential Units		**280**	Increased from prior program of 232 units
	- Townhouses		37	
	- Apartments		243	Covers all units added to program
	Parking Spaces		**308**	
	- Residential	1.10	308	
	- Retail (per 1,000 sf)	0.00	0	
	Density (Units per Acre)		**241**	Approx 24 floors concrete construction
	Net Rentable Area (sf)		**250,714**	
	- Residential	869	243,214	
	- Retail		7,500	
	Gross Building Area		**431,972**	Residential units & structured parking
	- Residential		304,017	
	- Retail		9,375	
	- Parking		118,580	Below grade + 3 above grade levels
	Floor Area Ratio (FAR)		**7.5**	Excludes below grade parking
B.	**Development Budget**			
	Site Cost	$16,570	$4,640,000	NMI estimated @ $92 per square foot
	Residential Construction	$135,720	$38,002,000	Per square foot construction cost of $125
	Retail & Other Construction	$2,340	$656,000	Per square foot construction cost of $70
	Parking Construction	$23,710	$6,640,000	Per space construction cost of $21,560
	Indirect Development Costs	$40,450	$11,325,000	Estimated @ 25% of direct construction
	Infrastructure/Extra Cost Items	—	—	Included in site cost
	Total Development Cost	**$218,790**	**$61,263,000**	
C.	**Operating Budget**			
	Rental Income	$24,820	$6,949,000	Monthly rent averaging $2.38 per sf
	Retail Income	$560	$158,000	Annual rent averaging $21.00 per sf
	Parking Revenue	$1,320	$370,000	Average monthly per space fee of $100
	less Vacancy	($1,870)	($523,000)	Assumes 7% normalized vacancy
	Gross Operating Income (GOI)	$24,830	$6,954,000	
	Residential Expenses	($4,400)	($1,232,000)	Tax abated @ $4,400 per DU/year
	Retail Expenses		($15,800)	Estimated @ 10% of gross retail income
	Parking Expenses		($61,600)	Annual expense of $200 per space/year
	Net Operating Income (NOI)	**$20,430**	**$5,644,600**	
	Debt Service	($16,800)	($4,704,000)	Debt coverage ratio (DCR) of 1.20
	Annual Cash Flow	**$3,630**	**$940,600**	
D.	**Permanent Financing**			
	Debt Financing		$53,423,000	Based on 30 year loan @ 8% interest
	Equity Investment		$7,840,000	Results in equity to cost ratio of 13%
	Total Permanent Sources		**$61,263,000**	
E.	**Return on Equity**			
	Cash on Cash Return		**12.0%**	Cash-on-cash return (pre-tax)
	Incentive Need (added equity)		$0	For project breakeven @ 12% target return

Note: This financial pro forma is prepared for illustrative purposes only. Information is based on estimates that may vary from actual conditions and is therefore subject to change.

Prepared by: E. D. Hovee & Company

Date: 25-Jun-03

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ENDNOTES

[1] Central District is the name given to the portion of North Macadam/South Waterfront proposed for development by Oregon Health Sciences University (OHSU), North Macadam Investors (NMI) and River Campus Investors (RCI).

[2] Information has been reviewed as provided to E. D. Hovee & Company by representatives of the Portland Development Commission and Central District (NMI) project proponents. While the information presented and reviewed appears to be reliable, E. D. Hovee & Company does not guarantee its accuracy. Also noted is that the information reviewed and provided herein is subject to change without notice.

This review should not be construed as representing a comprehensive analysis or as an audit – but rather as an overview assessment. Additional steps to obtain further information or conduct more detailed assessments may be suggested by PDC or the Core Negotiating Team.

[3] NMI/RCI purchased an estimated 10 acres from Pacific Richland and 18 acres from U.S. National Bank. Of this, approximately 14 acres (or about one-half) comprises net developable site area. Areas not developable include submerged lands, land dedicated for the Willamette Greenway street rights-of-way, access and loop road easements and building set-backs.

[4] Development cost data provided by NMI includes the NMI portion of Otak prepared infrastructure costs estimated for PDC and NMI/RCI. NMI applies a lower soft costs figure of 22% than the Otak estimate of 25%. Deducted from Otak are sidewalks as this is included separately with building specific pro formas.

Also included in the NMI estimate of site development costs are: development management fees (for acquisition, design and construction); land hold and carrying costs (including property taxes, insurance and purchase note interest not covered by the construction interest line item); soft costs beyond the Otak estimate (as for due diligence, entitlements, code revisions and programming) and additional contingency for the above noted items. It is noted that the Otak soft cost covers only construction design documents.

Also included with the infrastructure/development cost category is the anticipated LID cost for Central City Streetcar, Tram and Macadam Avenue. While LID costs are still being negotiated, the preliminary figure applied to the NMI portion of the site for this analysis is $2 million or $4.61 per square foot.

[5] Initial projections by NMI provided for a 60/40 split of debt to equity financing for land development. The additional $2 million LID cost is assumed for purposes of this analysis to be equity financed, changing the debt/equity allocation to 56/44. This allocation and the LID estimate are subject to further revision.

[6] Land cost can be calculated per square foot of legal lot area rather than per square foot of developable land. This approach is consistent with developer provided FAR calculations.

[7] If Block 34B is not allocated for residential use, required land value for remaining net buildable sites increases from an average of $95 to over $101 per square foot.

[8] IRR calculations assume full return of equity invested at the end of the absorption period.

[9] FAR calculations are from the North Macadam Central District FAR Analysis based on Otak Revised Map 3-26-03: Busby Program.

[10] A PDC-provided analysis of Central City area land values correlated with FAR indicates a range of values of: (a) $11-$16 per square foot of FAR for project with FARs ranging from 4:1 to 6:1; and (b) $7-$16 per square foot of FAR in a separate tabulation of land sales on sites with FARs ranging more widely from 4:1 to 9:1. The higher value properties (relative to FAR) of $15 or more all are located at sites involving residential/mixed-use development.

[11] The April 25, 2003 estimate of 2,707 units is substantially increased from an earlier estimate of 1,791 units – comprising 1,116 apartment/rentals and 675 condo/ownership units – derived from the *North Macadam Block Studies* of March 2002. Excluded from this count, to date, is the potential inclusion of another 112 condo units with proposed conversion of Block 34B from park to residential use.

[12] Residential densities (FARs) initially were taken from *North Macadam Block Studies*, prepared by H. Williams Advisors and Emmons Architects, March 19, 2002. Residential counts have been updated based on block phasing estimates as of April 25, 2003.

[13] The NMI/RCI office/lab space estimate of April 25, 2003 was 1.2 million square feet; this has been increased subsequently to 1.5 million.

[14] From the updated April 25, 2003 estimate of NMI/RCI.

[15] Calculated FAR is for Central District as of March 26, 2003 (Busby Program).

[16] Land cost assumptions are varied depending on the type of unit considered. Land costs are indicated at $18,000 per door (or unit) for wood frame and $20,000 per door for concrete units – both in the market and required rent scenarios. For condos, land pricing is indicated at $25,000 per door (or unit) in both the market rate and required sales scenarios. This is 25-40% above per unit pricing associated with rental units. In effect, this land pricing calculation assigns 100% of land cost to residential with no land cost assigned to the retail portion of each building structure. As NMI has altered its development program (providing increased density), total land costs per site have been held constant – bringing the average land price per unit down below these initial figures.

[17] For the prototype residential projects involving independent financial review (as per the Appendix), residential unit sizes are somewhat smaller at just under 870 square feet per apartment and just over 1,075 square feet per condo unit.

[18] All-in costs include site acquisition/development, construction and indirect/soft costs. Because an all-in development cost of $144 per square foot for concrete rental units appears to be a target price (covering land, construction and soft costs), construction costs in the NMI pro formas varies somewhat *as a residual item* with the site prototypes considered – from $104.48 to $106.67 per square foot.

[19] Because an all-in development cost of $165 per square foot for condo including loft units appears to be a target price (covering land, construction and soft costs), NMI estimated construction costs varies somewhat *as a residual item* with the site prototypes considered – from $120.78 to $122.97 per square foot.

[20] Steel framing could represent one possible value engineering alternative to consider – particularly for apartments. Assumed is use of fireproofed rated steel framing product. Steel provides durability and fire protection similar to concrete, but with cost savings in the range of up to 10%. However, suppression of noise transmission between units is not as effective with steel as concrete construction.

[21] No revenue is shown by NMI as directly attributable to parking. Consequently, parking related revenues are assumed to be embedded within retail and residential rental/sales rates.

[22] NMI has provided E.D. Hovee & Company the opportunity to review a summary portion of the August 2002 market report prepared by Hobson Ferrarini Associates.

[23] Based on discussion with Steve Ferrarini, February 2003, Hobson-Ferrarini conducted some unit-by-unit comparison with other Central City area properties. All comparisons made were within the Portland market, with no analysis of experience in other Central City areas. Further market justification, if desired, could involve comparison with other similar product – whether in or outside the Portland metro area – in which actual rents can be correlated with the factors indicated.

For one identified factor, cache, North Macadam would have a 10% price disadvantage compared to apartments now on the ground in the Pearl District. For all other factors, Hobson Ferrarini indicates that North Macadam should support a price premium compared to the other comparable Central City high rise and Pearl District apartment developments.

[24] Kearney Plaza reported rent ranges from $1.59 - $1.93 per square foot, with parking an additional $95 per month. Honeyman Lofts rents are lower, at $1.32 per square foot, with parking an additional $85 per month. It is noted that concrete unit recommended pricing for the Central District appears to be more in the order of 45% above base or average Pearl District prices (versus the 20% reported). The discrepancy decreases to 36% when a single space monthly parking fee is incorporated into monthly apartment rental costs.

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[25] Under construction is downtown's Museum Place, projected to come on line with residential rents in the range of $1.70 per square foot monthly.

[26] PDC's 2002 Central City Housing Inventory indicates that only 54 apartment units have been constructed since 1997 targeting households earning over 120% of Median Family Income. The completion of Kearney Plaza brings this number to 185. Development reported since 1997 includes Downtown and the River District subareas. Total Downtown and River District rental stock affordable to households earning above 120% of Median Family Income is estimated to be 468 units, based on PDC's Central City Housing Inventory and Kearney Plaza.

[27] Market rate, non-abatement rental projects are being projected for downtown and Central City area locations with operating expenses at up to $5,700 per unit.

[28] Working from the PDC base of $3,000 as a typical Central City operating expense with tax abatement, NMI adds on $500 per unit for round the clock lobby security, approximately $900 for on-site health club or membership for a total tax abated operating expense of $4,400 per unit. If the property is subject to full property tax, another $800 in operating expense would be added for a combined total of $5,200 per unit.

[29] Valuation indicated by the pro forma is consistent with the rents indicated, a 10% expense ratio and 9.5% cap rate.

[30] Pricing is adjusted by appreciating average 2001 asking prices by 8.6% (average West Portland 2002 appreciation, RMLS Action).

[31] Streetcar Lofts includes two spaces only for those units priced above $600,000. Fountain Plaza units include a single space with additional spaces available for rent.

[32] Projects include Tanner Place Condominiums, Quimby Townhomes, Westover Condominiums and Jake's Run.

[33] As of early 2003, NMI had not determined whether sales will be managed in-house or through a third party broker. In either case, the 3% selling cost figure indicated is intended to cover sales commissions.

[34] Rates quoted are as of December 2002 initial project research.

[35] Recent mid-2003 national economic conditions appear to be more supportive of a continued low interest rate environment lasting possible to mid/late 2004.

[36] Sources contacted have included John Peterson, Director of LJ Melody, and Jeff Lyon, Executive Vice President of National Mortgage.

[37] This is consistent with NMI financing interest rate assumptions of 8% and would be reinforced by a return to improved stock market conditions offering investors other financially viable alternatives to real estate.