MARINERS COVE
SUMMARY OF DEVELOPER NEGOTIATIONS AND FINANCIAL ANALYSES
MAY 26, 2022

I. AIMCO Proposal (April 2020)

- 99-year lease term including options
- No minimum investment
- Inclusionary units developed off-site
- No ground rent escalation beyond rent schedule in existing ground lease
- Ground rent adjusted in calendar years 2041, 2071, and 2093.
- Table 1 compares estimated ground lease payments for existing project vs. AIMCO proposal vs. SDHC counterproposal vs. AIMCO counterproposal

II. SDHC Counterproposal (November 2020)

- 75-year lease term
- Minimum $350 M investment
- Inclusionary units developed off-site
- Ramp-up rent escalation at 10%/year during first 10 years, annual increase based on CPI every year thereafter
- Ground rent adjusted every 10 years based on appraisal beginning in Year 11, consistent with Council Policy 700-10 for market-rate adjustments on flat rate leases.
- Refer to Table 1 for comparison of estimated ground lease payments

III. KMA Financial Analysis (February 2021)

- Existing situation (500 units + $25 M rehabilitation) yields 6.6% unleveraged IRR
- AIMCO proposal yields 8.1% unleveraged IRR
- SDHC counterproposal yields 7.8% unleveraged IRR
- Industry target returns for stabilized properties:
  - Real Estate Research Report (RERC), First Tier Properties, Fourth Quarter 2021: San Diego – 6.6%
  - PricewaterhouseCoopers (PwC), Fourth Quarter 2021: Pacific Region – average 6.38%
- Both the AIMCO proposal and SDHC counterproposal generate returns approximately 1.5% higher than these targets, which allows a spread for development risk

IV. London Moeder Associates (LMA) Response (February 2022)

- Using KMA financial models, LMA prepared multiple projections for AIMCO proposal vs. SDHC counterproposal for different time periods
- LMA did not alter any KMA assumptions regarding development costs, market rents, affordable rents, operating expenses, etc.
- LMA concurred with KMA estimates of unleveraged IRRs of 8.1% for AIMCO proposal and 7.8% for SDHC counterproposal
    - LMA believes that these returns are substandard, as measured by National Council of Real Estate Investment Fiduciaries (NCREIF) Property Index (NPI)
    - LMA believes that the minimum required return for AIMCO should be 8.5% or higher
- LMA also estimated leveraged IRRs (assuming 70% loan-to-cost debt) of 9.4% for the AIMCO proposal and 9.2% for the SDHC Counterproposal
    - LMA believes that these returns are substandard, based on an assumed industry target of 14%-16% (no empirical data provided)

V. KMA and LMA Follow-up Discussions (March 2022)

- KMA and LMA exchanged e-mail correspondence and participated in a Zoom meeting to discuss various inputs and assumptions in the KMA and LMA financial models
- KMA and LMA both noted that the pro forma assumptions used in both the KMA and LMA analyses date back to April 2020
- KMA provided LMA with RERC and PwC reports to substantiate industry target returns
- LMA believes the RERC and PwC returns should be adjusted for "asset appreciation" required by investors assuming the development risk, thereby indicating a minimum target IRR of 8.5%

VI. AIMCO Counter Proposal (April 2022)

- An additional five (5) units at 60% AMI added to project
- Lease term of 55 years + one 20-year option
- No increases in ground rent during redevelopment/construction
- Annual CPI increase to ground rent to resume after project reaches stabilization
- Ground lease adjustment (appraisal) occurs in Year 2041 and at beginning of option period
- AIMCO did not provide updated financial pro forma and cash flow projection reflecting Counterproposal
- AIMCO continues to make good faith efforts to add 100 residential units on the Barnes Tennis Center site which will include 10 affordable units

- Refer to Table 1 for comparison of estimated ground lease payments

VII. Turner & Townsend (T&T) Development Cost Estimate and LMA Updated Costs and Revenues (May 2022)

- Unit count confirmed at 772 units
- T&T construction cost estimate dated 5/8/21 reflects Type V construction over single-level below grade garage and podium. Product type is not consistent with indications from AIMCO that project has been re-designed to a wrap-product.
- Direct costs escalated at 7.5% per year for 2.5 years to reflect 2025 construction start
- Indirect costs escalated at 2.0% per year for 2.5 years to reflect 2025 construction start
- Market rent estimates from 2020 increased by 13.6% based on San Diego County average rent increase between 2020 and 2021
- Affordable rents from 2020 recalculated to 2022 estimates
- No ground rent escalation beyond rent schedule in existing ground lease
- Ground rent adjusted in calendar years 2041 and 2071
- Unleveraged IRR estimated at 7.8%

VIII. LMA Updated Costs and Revenues (May 2022)

- LMA adjusts utility allowance assumptions
- LMA adds prevailing wages at 15% to development cost estimate
- Unlevered IRR estimated at 6.7%

IX. KMA Sensitivity Test (May 2022)

- KMA conducted sensitivity test estimating developer return based on optimistic cost and income assumptions, in particular:
  - Construction costs reduced by 10%
  - Cost escalation at 5.0%/year for 2.5 years to construction start
  - Annual income escalation at 3.5%
- KMA sensitivity test resulted in unleveraged IRR at 7.7%