CONFIDENTIAL AND DELIBERATIVE DRAFT

THE BOROUGH OF GARWOOD IN THE COUNTY OF UNION, NJ

SOUTH AVENUE TRANSIT ORIENTED REDEVELOPMENT AREA PROJECT

ACACIA ASSESSMENT REPORT

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ACACIA
FINANCIAL GROUP, INC.

6000 Midlantic Dr., Suite 410 North
Mount Laurel, NJ 08054
t: 856-234-2266
f: 856-234-6697

www.acaciafin.com

Background of the Project

On June 10, 2014, the Borough of Garwood (the "Borough") Council (the "Council") adopted a Resolution authorizing the Garwood Planning Board (the "Board") to conduct an investigation and to prepare a report to determine whether certain properties, known as Block 401, Lots 1, 2, 3, 4, and 5 and Block 403, Lots 1, 2, 3, 4, 5, 6, 19, 20, 21 and 22 (the "Subject Properties"), referenced as the South Avenue –Transit Oriented Redevelopment Properties, satisfy the criteria to be determined to be in need of redevelopment, and accordingly have been designated a Condemnation Redevelopment Area in accordance with the Local Redevelopment and Housing Law ("LRHL"). Based on the findings of the investigation, and testimony on the condition of the Subject Properties, the Board voted in favor of adopting the findings of the report. Subsequent to the Board's action, the Council formally recognized the report's findings and the action taken by the Board by adopting a resolution which formally placed the South Avenue – Transit Oriented Redevelopment Properties within a Condemnation Redevelopment Area as defined in the LRHL.

Although the South Avenue – Transit Oriented Redevelopment Area includes the Subject Properties, this portion of the evaluation revolves around the first phase which involves only five (5) of the South Avenue – Transit Oriented Redevelopment Properties, specifically for Block 401, Lots 1, 2, 3, 4 and 5 (the "Project Properties").

The Borough determined to exercise the powers of redevelopment and serve as the redevelopment entity responsible for carrying out the redevelopment projects in the Project Properties. The Borough has appointed 490 South Avenue Urban Renewal, LLC a New Jersey limited liability company, having its offices at c/o Russo Development, LLC as the Redeveloper (the "Redeveloper"). The Redeveloper has agreed to undertake and make good faith effort to develop the Project Properties. In accordance therewith, the Redeveloper presented a proposed plan for the Project Properties which includes residential units (market rate and COAH units), retail and office space (the "Project").

Role of Acacia Financial Group, Inc.

Acacia Financial Group, Inc. ("Acacia") was retained by the Borough in December 2016 to advise the governing body and provide a review and analysis of real estate development proposals, financial agreements, tax abatements and PILOT requests, specifically in connection with the above aforementioned Project. The services requested of Acacia are set forth below:

a. Evaluate, including in writing if requested, any and all financial issues related to redevelopment or rehabilitation. For example, this may include an analysis of proformas submitted by prospective developers or an analysis of proposed PILOT schedules.
b. Evaluate and advise the Borough with respect to any other financial issues presented to the Borough, including but not necessarily limited to the prospective issuance of bonds, notes or other obligations.
c. Attend meetings with Borough officials and other interested parties as requested by the Borough.
d. Make such public presentations and shall issue such written reports as may be requested by the Borough.

Based on initial discussions with the Borough Council, it was requested by the Borough that Acacia review the financial proforma of the Redeveloper for the aforementioned Project and provide feedback as to whether the cash flow proforma could support a reduction in Project density.

Redeveloper's Proposal & Observations

Upon commencement of Acacia's engagement, Acacia requested a multitude of information from the Redeveloper in order to evaluate the cash flow proforma and assumptions. In summary, the Redeveloper's proposal was to construct 315 market units, consisting of 283 market rate units and 32 COAH units. Retail space of 16,452 and a six floor parking garage with 521 covered parking spaces was also included in the Project. The estimated construction cost was $80,920,000 and the estimated developer equity was $20,230,000 which equated to a total permanent financing amount of $60,690,000. The Redeveloper assumed the borrowing rate to be estimated at 5% with a maturity of 30 years. This proposal assumed the Project operation would commence in the year 2020. Acacia's observations of the financial proforma are summarized below.

Borough of Garwood – Project Cash Flow
South Avenue Redevelopment Plan

Current Analysis

- 315 Total Market Units
  - 283 Market Rate Units
  - 32 COAH Units
- $80,920,000 Estimated Construction Cost
- $20,230,000 Estimated Developer Equity
- Total Permanent Financing amount = $60,690,000
- Assumed Borrowing rate of 5% over 30 Years
- Assumed 2020 Operation Commencement

Current Project Returns (Base Case)

Base Case					
	Year 1	Year 2	Year 3	Year 4	Year 5
Return on Project Cost:	1.58%	1.69%	1.79%	1.89%	1.98%
Return on Construct. Cost:	2.11%	2.25%	2.38%	2.51%	2.64%
Return on Investment:	6.88%	7.34%	7.76%	8.19%	8.62%

Estimated IRR[1]: 9.05%

Observations

1. Base Case IRR is relatively low
   a. Typically in the range of 10-20% or higher in certain cases
2. Assumed borrowing rate of 5% is aggressive; any increase to borrowing rate diminishes return and the potential success of project
3. Construction costs appear low when compared with other projects of similar size; an increase in costs will diminish returns

Example:

Increased Borrowing Rate of 6%					
	Year 1	Year 2	Year 3	Year 4	Year 5
Return on Project Cost:	1.00%	1.11%	1.21%	1.31%	1.40%
Return on Construct. Cost:	1.34%	1.48%	1.61%	1.74%	1.87%
Return on Investment:	4.36%	4.83%	5.25%	5.67%	6.10%

Estimated IRR[1]: 6.95%

Differential from Base Case					
	Year 1	Year 2	Year 3	Year 4	Year 5
Return on Project Cost:	(0.58%)	(0.58%)	(0.58%)	(0.58%)	(0.58%)
Return on Construct. Cost:	(0.77%)	(0.77%)	(0.77%)	(0.77%)	(0.77%)
Return on Investment:	(2.52%)	(2.51%)	(2.51%)	(2.52%)	(2.52%)

(1) Internal Rate of Return (IRR): Interest rate at which the net present value of all cashflows from a project or investment equal zero. IRR is used to evaluate the attractiveness of a project or investment.

In addition, the Redeveloper's proposal assumed a PILOT to the Borough in the annual amount equal to 10% of Annual Gross Revenues plus a 1% administrative fee. The Year One (1) projected PILOT payment to the Borough was $736 thousand (after payment to the County of Union (the

"County") of 5%, in accordance with state statute, and less the land tax credit. A summary of the proposed PILOT payments is shown below.

Proposed Pilot Analysis[(1)]

- 10% of Annual Gross Revenues ("AGR") for 30 Years

(Dollars in Thousands)	Year 1	Year 15	Year 30	Aggregate Total Over 30 Years
PILOT Amount ($):	$736	$935	$2,740	$31,570
Redeveloper ROI[(2)]:	6.88%	13.10%	20.25%	

Estimated IRR[(3)]: 9.05%

(1) Assumes 95% Municipal Share of PILOT less Land Tax Credits and applies the minimum applicable tax formula.
(2) Return on Investment (ROI): Net benefit or return divided by the investment amount, used to evaluate the efficiency of the investment.
(3) Internal Rate of Return (IRR): Interest rate at which the net present value of all cashflows from a project or investment equal zero. IRR is used to evaluate the attractiveness of a project or investment.

Acacia's Assessment of the Project - Phase I

As requested by the Borough, Acacia evaluated the Redeveloper's proposal by creating a functioning model that calculated the estimated Project returns in order to assess whether the Project density could be reduced. Acacia ran several scenarios which demonstrated (as outlined in the charts below) that the Project returns were likely not to support a reduction in units without further changes to the Project scope, as the internal rate of return was relatively low and would further decrease with a reduction of market rate units.

Borough of Garwood – Project Cash Flow
South Avenue Redevelopment Plan

Reduction in Project Scope of 15 Market Rate Units and 2 COAH Units

- 298 Total Project Units
  - 268 Market Rate Units
  - 30 COAH Units
- Assumes pro-rata reduction in project costs (related equity and debt service) and a reduction in certain operations

Estimated Returns

	Year 1	Year 2	Year 3	Year 4	Year 5
Return on Project Cost:	1.55%	1.65%	1.74%	1.84%	1.93%
Return on Construct. Cost:	2.06%	2.20%	2.32%	2.45%	2.57%
Return on Investment:	6.24%	6.65%	7.02%	7.40%	7.78%

Estimated IRR[1]: 8.11%

Differential from Base Case					
	Year 1	Year 2	Year 3	Year 4	Year 5
Return on Project Cost:	(0.03%)	(0.04%)	(0.05%)	(0.05%)	(0.05%)
Return on Construct. Cost:	(0.05%)	(0.05%)	(0.06%)	(0.06%)	(0.07%)
Return on Investment:	(0.64%)	(0.69%)	(0.74%)	(0.79%)	(0.84%)

Reduction in Project Scope of 31 Market Rate Units and 4 COAH Units

- 280 Total Project Units
  - 252 Market Rate Units
  - 28 COAH Units
- Assumes pro-rata reduction in project costs (related equity and debt service) and a reduction in certain operations

Estimated Returns

	Year 1	Year 2	Year 3	Year 4	Year 5
Return on Project Cost:	1.50%	1.60%	1.69%	1.78%	1.86%
Return on Construct. Cost:	2.01%	2.14%	2.25%	2.37%	2.49%
Return on Investment:	5.59%	5.95%	6.28%	6.60%	6.93%

Estimated IRR[1]: 7.07%

Differential From Base Case					
	Year 1	Year 2	Year 3	Year 4	Year 5
Return on Project Cost:	(0.08%)	(0.09%)	(0.10%)	(0.11%)	(0.12%)
Return on Construct. Cost:	(0.10%)	(0.11%)	(0.13%)	(0.14%)	(0.15%)
Return on Investment:	(1.29%)	(1.39%)	(1.48%)	(1.59%)	(1.69%)

(1) Internal Rate of Return (IRR): Interest rate at which the net present value of all cashflows from a project or investment equal zero. IRR is used to evaluate the attractiveness of a project or investment.

In addition, not assuming any reduction in density, Acacia performed sensitivity analyses on the proposed PILOT payments detailing increases in the percentage of Annual Gross Revenues and the effect on the internal rate of return to the Redeveloper. As shown below, increases in the PILOT payment has similar effects to that of reducing the density of the Project for the Redeveloper.

Scenario 1(1)

- 10% of AGR for First 10 Years
- 13% of AGR for Next 10 Years
- 15% of AGR for Last 10 Years

(Dollars in Thousands)	Year 1	Year 15	Year 30	Aggregate Total Over 30 Years
PILOT Amount ($):	$736	$1,266	$2,740	$40,058
Redeveloper ROI(2):	6.88%	11.25%	11.68%	

Estimated IRR(3): 8.28%

Scenario 2(1)

- 15% of AGR for 30 Years

(Dollars in Thousands)	Year 1	Year 15	Year 30	Aggregate Total Over 30 Years
PILOT Amount ($):	$1,159	$1,486	$2,740	$46,347
Redeveloper ROI(2):	4.92%	9.23%	10.53%	

Estimated IRR(3): 6.37%

(1) Assumes 95% Municipal Share of PILOT less Land Tax Credits and applies the minimum applicable tax formula.
(2) Return on Investment (ROI): Net benefit or return divided by the investment amount, used to evaluate the efficiency of the investment.
(3) Internal Rate of Return (IRR): Interest rate at which the net present value of all cashflows from a project or investment equal zero. IRR is used to evaluate the attractiveness of a project or investment.

On January 24, 2017, Acacia met with the Council to provide our findings and discuss the implications of a smaller project or larger PILOT. Based on these discussions and recognizing that reductions in density may affect the amount of PILOT ultimately paid to the Borough, it was requested that redevelopment counsel, McManimon, Scotland & Baumann, LLC ("Redevelopment Counsel") and Acacia would meet with the Redeveloper to discuss any possibilities of reducing the amount of market units for the Project.

Following this meeting, the Redeveloper provided a revised proposal which reduced the market units to a total of 298 which consisted of 268 market rate units and 30 COAH units. In order to accomplish this change in density the Redeveloper additionally proposed (i) removing one floor in the parking garage (reduction from 6 floor garage to a 5 floor garage) with 423 covered parking spaces; (ii) minor revisions and/or clarifications to the redevelopment agreement; and (iii) eliminating the 1% annual administrative fee on the PILOT. This reduction reduced the total project cost to an estimated $78 million.

Acacia updated the cash flow proforma to assess the Project returns of the new proposal. In February 2017, the revised proposal was submitted to the Borough for review and discussion and the Borough made the determination to move forward with the Redeveloper's reduced density proposal.

The following chart compares the differences in the two proposals received by the Redeveloper along with Acacia's estimated calculations on the PILOT revenue to the Borough and the estimated return on investment to the Redeveloper.

Borough of Garwood – Russo Revised Density Proposal
South Avenue Redevelopment Plan

Previous Proposal

Units
- 315 Total Market Units
  - 283 Market Rate Units
  - 32 COAH Units

Parking
- 6 Floor Parking Garage
  - 521 parking spaces

Retail Space
- 16,450 Retail Square Feet

Pilot
- 10% of Annual Gross Revenues

  Plus
- 1% Administrative Fee

(Dollars in Thousands)	Year 1	Year 15	Year 30	Aggregate Total Over 30 Years
PILOT Amount ($):	$736	$935	$2,740	$31,570
Redeveloper ROI[1]:	6.88%	13.10%	20.25%	

Estimated IRR[2]: 9.05%

Revised Proposal

Units
- 298 Total Project Units
  - 268 Market Rate Units
  - 30 COAH Units

Parking
- 5 Floor Parking Garage
  - 423 parking spaces provided
  - Only 415 spaces required
    - Studio Unit: 8 spaces/1 BR Unit: 155 spaces/2 BR Unit: 194 spaces/

    3 BR Unit: 12 spaces/Retail Spaces: 46 spaces

Retail Space
- 16,450 Retail Square Feet (including the support areas)

Pilot
- 10% of Annual Gross Revenues
- Elimination of 1% Administrative Fee

(Dollars in Thousands)	Year 1	Year 15	Year 30	Aggregate Total Over 30 Years
PILOT Amount ($):	$689	$875	$2,708	$29,965
Redeveloper ROI[1]:	6.17%	11.64%	9.26%	

Estimated IRR[2]: 8.05%

(1) Return on Investment (ROI): Net benefit or return divided by the investment amount, used to evaluate the efficiency of the investment.
(2) Internal Rate of Return (IRR): Interest rate at which the net present value of all cashflows from a project or investment equal zero. IRR is used to evaluate the attractiveness of a project or investment.

Assessment of the Project - Phase II

At the Borough's direction, Redevelopment Counsel has been working with the Redeveloper on finalizing the redeveloper's agreement and financial agreement for the Project. The Redevelopment Agreement sets forth the specifics of the Project which states that the Redeveloper agrees to implement and complete the redevelopment of the Project Properties which shall consist of: a four (4) story mixed-use, residential, retail and office space structure with a maximum density of two hundred ninety-eight (298) residential units, including a maximum of fifteen (15) studio apartments and no three (3) bedroom market rate units and a minimum of 16,450 square feet of gross (inclusive of loading, corridors, trash room etc.) retail/restaurant/café space on the first floor with: (i) 268 market rate units with 8 studios, 149 one-bedroom units, and 111 two bedroom units; (ii) 30 COAH units with a distribution of 6 one-bedroom units, 18 two-bedroom units, and 6 three-bedroom units; (iii) a minimum of 469 parking spaces including a minimum of 50, on-site shared parking spaces and a minimum of 18 off-site public parking spaces; (iv) procurement of all applicable governmental approvals for all Project improvements; (v) financing, design, construction and completion of all Project improvements; (vi) marketing of the Project to facilitate financing, leasing sale and occupancy of the improvements and; (vii) payment of the Borough costs in accordance with the Redevelopment Agreement.

On June 5, 2017, the Redeveloper submitted a revised application for long term tax abatement which contained updated cash flow modeling reflecting the draft Redevelopment Agreement (the "June 5th Revisions"). The June 5th Revisions included additional retail space from 16,450 to 18,910 and an increase in the parking spaces (as outlined in the Redevelopment Agreement but different from the numbers last reviewed by Acacia). The June 5th Revisions assumed the project cost increased to $80.4 million and annual gross revenues was projected to be higher. Based on this, the PILOT at 10% of Annual Gross Revenues was also projected to increase. The below chart outlines the differences in the June 5th Revisions and details Acacia's projections for PILOT revenue and Redeveloper return on investment. Please note that the assessed valuation on the property is assumed to be $14,442,300 (based on 45,000 per unit) and in year 30 the PILOT payment calculates to 80% of taxes due on the assessed valuation as that would be greater than 10% of Annual Gross Revenues based on the 30 year projections, meeting the minimum applicable tax formula. The PILOT calculation would need to be completed on an annual basis to determine the dollar amount given in each year.

Borough of Garwood – Russo Revised Density Proposal
South Avenue Redevelopment Plan

Previous Proposal

Units
- 298 Total Project Units
  - 268 Market Rate Units
  - 30 COAH Units

Parking
- 5 Floor Parking Garage
  - 423 parking spaces provided
  - Only 415 spaces required
    - Studio Unit: 8 spaces/1 BR Unit: 155 spaces/2 BR Unit: 194 spaces/
    3 BR Unit: 12 spaces/Retail Spaces: 46 spaces

Retail Space
- 15,046 Retail Square Feet (including support areas)

Pilot
- 10% of Annual Gross Revenues
- Elimination of 1% Administrative Fee

(Dollars in Thousands)	Year 1	Year 15	Year 30	Aggregate Total Over 30 Years
PILOT Amount ($):	$689	$875	$2,708	$29,965
Redeveloper ROI[1]:	6.17%	11.64%	9.26%	

Estimated IRR[2]: 8.05%

Revised Proposal – June 5th Revisions

Units
- 298 Total Project Units
  - 268 Market Rate Units
  - 30 COAH Units

Parking
- 5 Floor Parking Garage
  - 469 parking spaces provided

Retail Space
- 18,910 Retail Square Feet (including support areas)

Pilot
- 10% of Annual Gross Revenues
- Elimination of 1% Administrative Fee

(Dollars in Thousands)	Year 1	Year 15	Year 30	Aggregate Total Over 30 Years
PILOT Amount ($):	$734	$933	$2,560	$31,082
Redeveloper ROI[1]:	7.11%	12.86%	12.41%	

Estimated IRR[2]: 9.01%

(1) Return on Investment (ROI): Net benefit or return divided by the investment amount, used to evaluate the efficiency of the investment.
(2) Internal Rate of Return (IRR): Interest rate at which the net present value of all cashflows from a project or investment equal zero. IRR is used to evaluate the attractiveness of a project or investment.

Based on the elevated return on investment, shown in the June 5th Revisions and demonstrated above for years 15 and 30, the Redeveloper was approached with suggested revisions to the proposed financial agreement.

	(Dollars in Thousands)			
	June 5th Revisions		**Final PILOT Proposal**	
	Proposed % of AGR	Estimated Amount of PILOT	% of AGR	Estimated Amount of PILOT
Year 1	10%	$734	10%	$734
Year 5	10%	$786	10%	$786
Year 10	10%	$856	10%	$856
Year 15	10%	$933	10%	$933
Year 20	10%	$1,016	11%	$1,136
Year 25	10%	$1,106	11%	$1,239
Year 30	10%	$2,560	12%	$2,560
Estimated Total Over 30 Yrs:		*$31,082*		*$32,842*
IRR [1:]		*9.01%*		*8.90%*
		Increase in PILOT over 30 Yrs:		$1,760

(1) Internal Rate of Return (IRR): Interest rate at which the net present value of all cashflows from a project or investment equal zero. IRR is used to evaluate the attractiveness of a project or investment.

The Redeveloper ultimately agreed to make an amendment to the proposed financial agreement (prior to introduction by Borough Council) which increased the annual PILOT percentage to 11% of annual gross revenues in years 16-25 and then increased to 12% in years 26-30. As shown in the comparison chart above, this provides estimated results of an increase of $1.8 million in PILOT payments over the life of the thirty (30) year financial agreement to the Borough. Additionally, it reduces the projected internal rate of return to the Redeveloper to below 9%.