Executive Summary

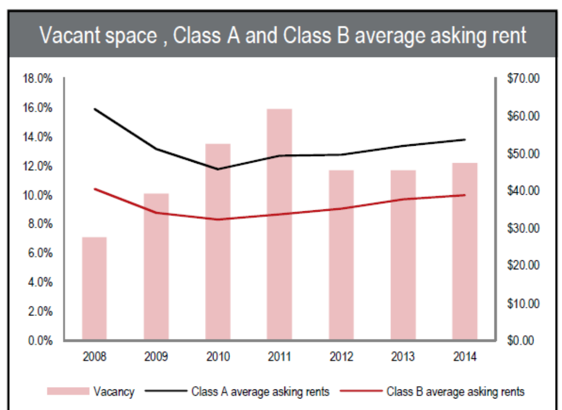
- We **RECOMMEND** acquiring 45 Milk Street for $18 million, with additional funding for a $2 million renovation
- In our Base Case scenario, we could achieve a 20% 5-year IRR and 2.5x multiple; with more pessimistic assumptions, this might decline to a 15% IRR
- In Downside cases, multiples in the 1.2x – 1.5x range are plausible
- There is room to boost the property's occupancy rate from 74% to 80-85%, increase rents to the market rate of $38 / SF, and bring it in-line with comparable properties
- The qualitative factors also support the deal, since the Boston office market is fast-growing with a diversified tenant base, and since many companies are relocating from Cambridge to the CBD area or expanding in the CBD area
- For the numbers *not* to work, asking rents would have to fall 25% below median rates for similar properties in the area, or fewer than 30% of existing tenants would have to renew their leases

Market Overview

- **Demographics:** Massachusetts median per-capita income is ~30% higher than the national average, the labor force is growing at 2-3% per year, and the household formation rate is double the population growth rate

- **Jobs:** High-tech jobs have grown by 10% and life-sciences jobs have grown by 34% over the last ten years, offsetting declines in the financial and legal sectors and further diversifying the employment market

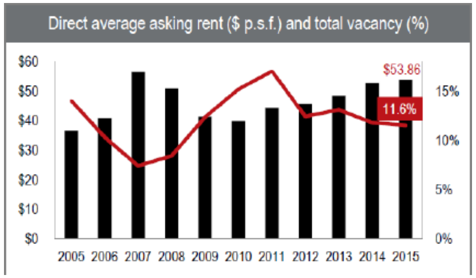
- **Vacancy Rates and Rents:** Currently a ~12% vacancy rate for offices in the Boston area, with a median $42.07 / SF asking rent for Class B properties (up from ~$34.00 in 2010)



- **Leasing Activity:** 10-20 million square feet per year in 2011 – 2014, with 12+ million expected this year

Occupancy Rates

- **Key Deal Driver:** We assume that 3 new major tenants sign leases in Year 4 in the Base Case, with 4 major new tenants in Year 3 in the Upside Case
- **Result:** The Occupancy Rate increases from 74% to 80% or 85%, which we view as plausible because:
- **Peak Vacancy Rate:** 17% in the last downturn:



- **Comparable Properties:** Most have an 85-90% Occupancy Rate:

Comparable Properties for 45 Milk Street:

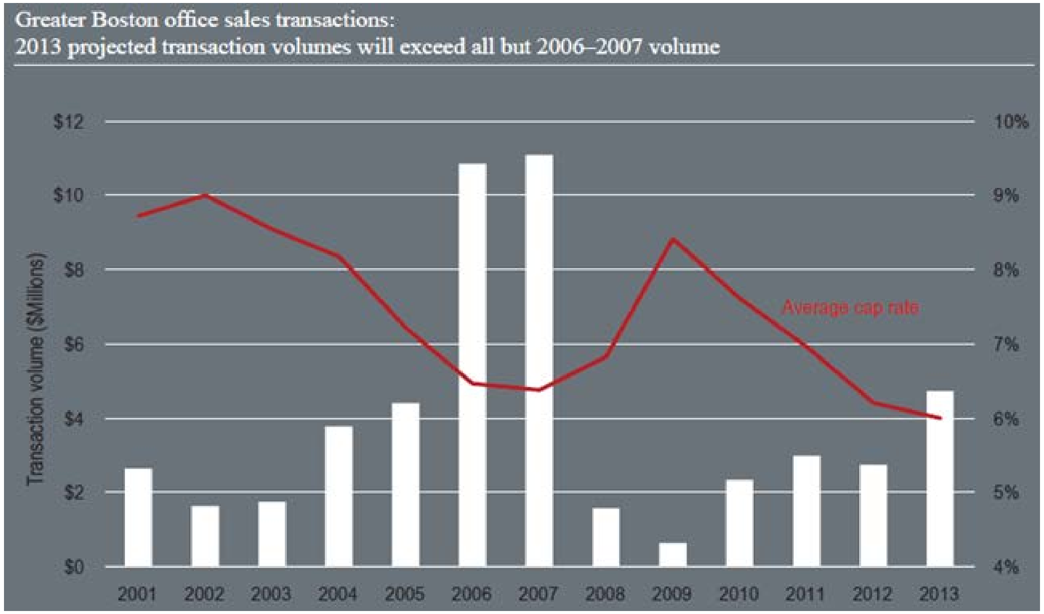
Property / Address:	Neighborhood:	Building Class:	# Rentable Square Feet:	# Square Feet Available:	Year Built:	Asking Rent per SF per Year: Low:	Asking Rent per SF per Year: High:	Occupancy Rate:
50 Franklin Street	Downtown	B	51,260	5,415	N/A	$ 38.00	$ 57.39	89.4%
44 School Street	Downtown	B	63,240	1,288	1915	34.50	36.00	98.0%
1 Winthrop Square	Downtown	A	114,343	8,712	1873	41.00	41.00	92.4%
200 High Street	Downtown	B	95,000	7,000	N/A	31.50	31.50	92.6%
55 Court Street	Downtown	B	62,651	710	1967	36.00	36.00	98.9%
184 High Street	Downtown	B	55,000	989	1872	38.00	38.00	98.2%
141 Tremont Street	Downtown	B	60,000	8,712	1972	38.00	45.00	85.5%
109-115 Broad Street	Downtown	B	52,133	4,200	1888	40.00	40.00	91.9%
100 Franklin Street	Downtown	B	117,630	4,811	1908	25.00	35.00	95.9%
21 Custom House	Downtown	B	91,500	12,913	1988	41.00	46.00	85.9%
10-24 School Street	Downtown	B	112,739	9,081	1925	42.00	42.00	91.9%
1 Liberty Square	Downtown	B	157,585	3,576	1926	43.00	43.00	97.7%
133 Federal Street	Downtown	B	111,000	9,730	1960	40.00	40.00	91.2%
45 School Street	Downtown	B	106,508	3,600	N/A	35.00	35.00	96.6%
Total or Average:			**1,250,589**	**80,737**	**1927**	**$ 38.27**	**$ 41.75**	**93.5%**
Median:			**93,250**	**5,113**	**1925**	**$ 38.00**	**$ 40.00**	**92.5%**

Rent and Rent Escalations

- **Key Deal Driver:** We assume that renewal tenants will agree to a $38 / SF rate upon renewal and that new tenants will also pay that rate; the current weighted-average rate is $36.72
- We view this escalation as plausible because the median "low" asking rate is $38 / SF (see the previous slide)
- **Comparable Properties:** Many are just as old as 45 Milk Street, if not older, and some have not had major renovations recently
- **Potential Issues:** Eaton Vance, the 3rd biggest tenant by RSF, is paying $35.50 / SF; Vistaprint, the 6th biggest tenant, is also paying $35.50 / SF
- **Result:** This does represent a major risk factor, especially if market rents fall, or decline and recover, in the holding period
- **Mitigants:** We may need to offer higher concessions to certain renewal tenants or offer them to new tenants

Cap Rates

- **Key Deal Driver:** We assume that due to the renovation, the Exit Cap Rate declines from 8.4% – 8.8% to 7.0% – 7.8%
- **Peak-to-Trough Cap Rates for Boston Office Sales:**



- **Historical:** High of 8.4%, then 9.0% before that; lows of 6.5% and 6.0%
- **Our View:** A 100 bps decline following a major renovation and occupancy/rental rate improvement seems plausible, even with a downturn

Other Factors

- **Comparable Property Data:** We lack expense ranges for similar properties in the area; we also do not have Cap Rates for the sales comps
- **Other Terms:** We do not have a good sense for TIs/LCs, turnover downtime, or the months of rent abatement standard for Class B properties
- **Tenant Detail and History:** We lack detailed lease histories for each suite and tenant, and we have nothing on each tenant's credit profile, financial strength, industry dynamics, etc.
- **Competitive Properties:** CBD pipeline is largely multifamily at the moment; only 8 competitive developments (representing 2.4 million RSF) are currently underway in the area
- **Longer-Term Data:** Most market data only goes back 4-5 years or to the last market bottom – it would be ideal to go much further back, especially to observe peak-to-trough rents over multiple cycles

Valuation

- The acquisition price of **$18 million** represents a bargain for the property:
  - **Going-In Cap Rate:** 8.4% – 8.8% vs. 6.5% in the broader office market
  - **$ / RSF:** $157 vs. $443 median for the sales comps; *minimum* was $258
  - **BUT:** No Cap Rates for the sales comps, so this may be misleading
- Even *with* the $2 million renovation included, the Going-In Cap Rate is still 7.5% – 8.0% and the $ / RSF is still $174

Comparable Property Sales for 45 Milk Street:

Property / Address:	Neighborhood:	Building Class:	# Rentable Square Feet:	Year Built:	Year Last Renovated:	Sale Date:	Sale Price:	Price per RSF:
141 Tremont Street	Downtown	B	70,291	1965	2003	2015-01-29	$ 27,000,000	$ 384.12
313 Congress Street	Seaport	B	75,794	1910	2006	2015-01-14	33,550,000	442.65
326 330 Congress Street	Seaport	B	39,000	1899	2010	2015-01-14	17,475,000	448.08
59 63 Franklin Street	Downtown	B	35,628	1899	2001	2015-01-12	27,650,000	776.07
24 32 Farnsworth Street	Seaport	B	92,000	1915	2005	2015-01-09	25,496,185	277.13
24 Federal Street	Downtown	B	75,600	1910	2009	2014-11-04	47,100,000	623.02
22 40 Chauncy Street	Downtown	B	152,958	1899	2007	2014-07-29	39,524,500	258.40
171 Tremont Street	Back Bay	B	22,190	1907	2000	2014-07-01	16,400,000	739.07
321 325 Summer Street	Seaport	B	110,000	1911	2011	2014-03-10	34,922,440	317.48
Median:			**75,600**	**1910**	**2006**	**2015-01-09**	**$ 27,650,000**	**$ 442.65**

Operational Cases

- To analyze this investment, we considered three operational scenarios: the Base Case, the Downside Case, and the Upside Case
- **Primary Differences:**
  - **Base Case:** Three new tenants are found for currently vacant space in Year 4, boosting the Occupancy Rate from 74% to 80%; rent and expenses grow at 2.5% – 3.5% over 5 years
  - **Downside Case:** No new tenants are found, so the Occupancy Rate remains at 74%; rent and expenses grow at 2.0% – 3.0% over 5 years, with higher TIs, LCs, and rent abatement months
  - **Upside Case:** Four new tenants are found for currently vacant space in Year 3, boosting the Occupancy Rate from 74% to 85%; rent and expenses grow at 3.0% – 4.0% over 5 years, with lower TIs, LCs, and turnover downtime (6 months vs. 9 months in the other cases)
- **Other Assumptions:** 70% or 75% lease renewal probability, 6-year average lease term, expenses are tied to historical figures, and rents are tied to in-place rates with the $38 / SF market rate for new and renewal tenants

Base Case Pro-Forma Model

- NOI increases from $1.5 million to over $2.0 million, with slightly higher margins:

		Historical:	Projected:					Stabilized:
Property Pro-Forma:	*Units:*	**FY14**	**FY15**	**FY16**	**FY17**	**FY18**	**FY19**	**FY20**
Revenue:								
Base Rental Revenue @ Market Rates:	$	$ 4,357,384	$ 4,509,892	$ 4,667,739	$ 4,784,432	$ 4,904,043	$ 5,026,644	$ 5,152,310
Absorption & Turnover Vacancy:	$	(108,052)	(105,194)	(184,416)	(224,936)	(236,069)	(130,709)	(184,557)
Free Rent (Abatement):	$	(128,073)	(59,456)	(30,449)	(83,008)	(117,088)	(39,277)	(60,855)
Scheduled Base Rental Revenue:	$	**4,121,260**	**4,345,243**	**4,452,873**	**4,476,488**	**4,550,885**	**4,856,658**	**4,906,898**
Expense Reimbursement Revenue:	$	22,934	23,736	24,567	25,181	25,811	26,456	27,117
Potential Gross Revenue:	$	**4,144,193**	**4,368,979**	**4,477,440**	**4,501,669**	**4,576,696**	**4,883,114**	**4,934,015**
General Vacancy:	$	(1,145,791)	(1,250,690)	(1,227,400)	(1,258,085)	(1,071,608)	(1,078,091)	(1,105,043)
Effective Gross Revenue:	$	**2,998,402**	**3,118,289**	**3,250,041**	**3,243,584**	**3,505,088**	**3,805,023**	**3,828,972**
Operating Expenses:								
Management Fees:	$	(89,952)	(93,549)	(97,501)	(97,308)	(105,153)	(114,151)	(114,869)
Utilities:	$	(286,670)	(296,703)	(307,088)	(314,765)	(322,634)	(330,700)	(338,968)
Association Fees:	$	(172,002)	(178,022)	(184,253)	(188,859)	(193,581)	(198,420)	(203,381)
Janitorial Fees:	$	(200,669)	(207,692)	(214,962)	(220,336)	(225,844)	(231,490)	(237,277)
Repairs and Maintenance:	$	(321,070)	(332,308)	(343,939)	(352,537)	(361,351)	(370,384)	(379,644)
Property Taxes:	$	(389,871)	(403,517)	(417,640)	(428,081)	(438,783)	(449,752)	(460,996)
Insurance:	$	(45,867)	(47,473)	(49,134)	(50,362)	(51,622)	(52,912)	(54,235)
Total Operating Expenses	$	**(1,506,102)**	**(1,559,264)**	**(1,614,516)**	**(1,652,248)**	**(1,698,967)**	**(1,747,810)**	**(1,789,370)**
Net Operating Income (NOI):	$	**1,492,300**	**1,559,025**	**1,635,524**	**1,591,336**	**1,806,122**	**2,057,213**	**2,039,602**
Less: Replacement Reserve:	$	(45,867)	(47,473)	(49,134)	(50,362)	(51,622)	(52,912)	(54,235)
Cash Flow After Replacement Reserve:	$	**1,446,433**	**1,511,553**	**1,586,390**	**1,540,974**	**1,754,500**	**2,004,301**	**1,985,367**
Tenant Improvements (TIs) & Leasing Commissions (LCs):								
Tenant Improvements (TIs):	$	(80,888)	(57,771)	(41,812)	(97,686)	(132,907)	(46,544)	(74,117)
Leasing Commissions (LCs):	$	(133,486)	(82,818)	(47,285)	(116,039)	(270,784)	(125,643)	(103,543)
Total TI and LC Costs:	$	**(214,374)**	**(140,589)**	**(89,097)**	**(213,725)**	**(403,691)**	**(172,186)**	**(177,660)**
Adjusted Net Operating Income (NOI):	$	**1,232,059**	**1,370,963**	**1,497,293**	**1,327,249**	**1,350,809**	**1,832,115**	**1,807,707**

Downside and Upside Cases

- NOI reaches **$2.5 million** in the stabilized year in the **Upside case**, while it increases to only **$1.7 million** in the **Downside case**

- **Downside Case Pro-Forma Model:**

		Historical:	Projected:					Stabilized:
Property Pro-Forma:	***Units:***	**FY14**	**FY15**	**FY16**	**FY17**	**FY18**	**FY19**	**FY20**
Revenue:								
Base Rental Revenue @ Market Rates:	$	$ 4,357,384	$ 4,488,106	$ 4,622,749	$ 4,715,204	$ 4,809,508	$ 4,905,698	$ 5,003,812
Absorption & Turnover Vacancy:	$	(108,052)	(101,836)	(182,639)	(221,681)	(231,519)	(127,564)	(179,238)
Free Rent (Abatement):	$	(128,073)	(110,033)	(56,810)	(155,535)	(124,807)	(67,178)	(95,820)
Scheduled Base Rental Revenue:	$	**4,121,260**	**4,276,237**	**4,383,301**	**4,337,988**	**4,453,182**	**4,710,956**	**4,728,754**
Expense Reimbursement Revenue:	$	22,934	23,622	24,330	24,817	25,313	25,819	26,336
Potential Gross Revenue:	$	**4,144,193**	**4,299,858**	**4,407,631**	**4,362,805**	**4,478,495**	**4,736,775**	**4,755,090**
General Vacancy:	$	(1,145,791)	(1,244,648)	(1,215,570)	(1,239,881)	(1,264,679)	(1,289,972)	(1,315,772)
Effective Gross Revenue:	$	**2,998,402**	**3,055,210**	**3,192,061**	**3,122,924**	**3,213,817**	**3,446,803**	**3,439,318**
Operating Expenses:								
Management Fees:	$	(89,952)	(91,656)	(95,762)	(93,688)	(96,415)	(103,404)	(103,180)
Utilities:	$	(286,670)	(295,270)	(304,128)	(310,211)	(316,415)	(322,743)	(329,198)
Association Fees:	$	(172,002)	(177,162)	(182,477)	(186,126)	(189,849)	(193,646)	(197,519)
Janitorial Fees:	$	(200,669)	(206,689)	(212,890)	(217,148)	(221,490)	(225,920)	(230,439)
Repairs and Maintenance:	$	(321,070)	(330,703)	(340,624)	(347,436)	(354,385)	(361,472)	(368,702)
Property Taxes:	$	(389,871)	(401,567)	(413,614)	(421,887)	(430,324)	(438,931)	(447,709)
Insurance:	$	(45,867)	(47,243)	(48,661)	(49,634)	(50,626)	(51,639)	(52,672)
Total Operating Expenses	$	**(1,506,102)**	**(1,550,291)**	**(1,598,155)**	**(1,626,129)**	**(1,659,505)**	**(1,697,756)**	**(1,729,418)**
Net Operating Income (NOI):	$	**1,492,300**	**1,504,919**	**1,593,906**	**1,496,795**	**1,554,312**	**1,749,047**	**1,709,900**
Less: Replacement Reserve:	$	(45,867)	(47,243)	(48,661)	(49,634)	(50,626)	(51,639)	(52,672)
Cash Flow After Replacement Reserve:	$	**1,446,433**	**1,457,676**	**1,545,245**	**1,447,161**	**1,503,686**	**1,697,408**	**1,657,228**
Tenant Improvements (TIs) & Leasing Commissions (LCs):								
Tenant Improvements (TIs):	$	(80,888)	(71,864)	(50,932)	(118,427)	(102,816)	(54,533)	(87,972)
Leasing Commissions (LCs):	$	(133,486)	(109,891)	(62,300)	(146,045)	(238,233)	(142,384)	(128,294)
Total TI and LC Costs:	$	**(214,374)**	**(181,756)**	**(113,231)**	**(264,471)**	**(341,049)**	**(196,918)**	**(216,266)**
Adjusted Net Operating Income (NOI):	$	**1,232,059**	**1,275,921**	**1,432,014**	**1,182,690**	**1,162,637**	**1,500,490**	**1,440,962**

Transaction Assumptions

- **Total Purchase Price:** $20 million (including the $2 million renovation)
- **LTV:** 70%, with 70% Senior Loans and 30% Mezzanine
- **Exit Date:** 2019-12-31 (5-year holding period)
- **Exit Cap Rate:** 7.00% in Upside Case, 7.25% in Base Case, and 7.75% in Downside Case
- **Senior Loan:** L + 350 bps (LIBOR floor of 0.50%), with 10-year amortization, 2-year interest-only period, and 5-year maturity
  - **TI / LC Holdback:** 5% of Senior Loan, with $1.50 / RSF per year released in the first 2 years, followed by $0.75 / RSF per year thereafter
- **Mezzanine:** 10% fixed interest rate with 5-year maturity
- **Returns Splits:** 80% / 20% between GPs and LPs up to 10% IRR, with 70% / 30% between 10% and 15% IRR, and 60% / 40% above 15% IRR

Acquisition Sources and Uses of Funds:

Sources of Funds:	Total:	$ / RSF:	% LTC:	Initial Draw:
Senior Loan - Drawn:	$ 9,561,370	$ 83.38	46.6%	$ 9,561,370
Senior Loan - TI / LC Holdback Portion:	503,230	4.39	2.5%	-
Mezzanine:	4,313,400	37.62	21.0%	4,313,400
Yi Ti Capital (GPs) - Equity:	1,232,400	10.75	6.0%	1,232,400
Limited Partners (LPs) - Equity:	4,929,600	42.99	24.0%	4,929,600
Total Sources:	**$ 20,540,000**	**$ 179.13**	**100.0%**	**$ 20,036,770**

Uses of Funds:	Total:	$ / RSF:	% LTC:	Initial Costs:
Acquire Property & Pay Off Existing Debt:	$ 18,000,000	$ 156.97	87.6%	$ 18,000,000
Brokerage Fees & Closing Costs:	540,000	4.71	2.6%	540,000
Renovation Costs & Other Project Costs:	1,496,770	13.05	7.3%	1,496,770
TI / LC Holdback:	503,230	4.39	2.5%	-
Total Uses:	**$ 20,540,000**	**$ 179.13**	**100.0%**	**$ 20,036,770**

Returns in the Base Case

- A 15-20% IRR seems plausible, even if there is little-to-no-reduction in the Exit Cap Rate:

Sensitivity Analysis - 5-Year Leveraged IRR and Exit Cap Rate vs. LTV (Scenario #1 - Base Case)

			LTV Ratio:								
			60.0%	62.5%	65.0%	67.5%	70.0%	72.5%	75.0%	77.5%	80.0%
Exit Cap Rate and Property Value Upon Exit:	$ 23,995,320	8.50%	13.2%	13.6%	14.0%	14.5%	15.1%	15.7%	16.5%	17.3%	18.4%
	24,722,450	8.25%	14.3%	14.8%	15.3%	15.8%	16.4%	17.2%	18.0%	19.0%	20.1%
	25,495,027	8.00%	15.5%	16.0%	16.5%	17.1%	17.8%	18.6%	19.6%	20.6%	21.9%
	26,317,447	7.75%	16.6%	17.2%	17.8%	18.5%	19.2%	20.1%	21.1%	22.3%	23.7%
	27,194,695	7.50%	17.8%	18.4%	19.1%	19.8%	20.7%	21.6%	22.7%	24.0%	25.5%
	28,132,444	7.25%	19.0%	19.7%	20.4%	21.2%	22.1%	23.1%	24.3%	25.7%	27.3%
	29,137,174	7.00%	20.3%	21.0%	21.8%	22.6%	23.6%	24.7%	26.0%	27.4%	29.2%

- The returns look more problematic if we are not able to achieve the $38 / SF market rents for renewal and new tenants:

Sensitivity Analysis - 5-Year Leveraged IRR and Exit Cap Rate vs. Market Rent (Scenario #1 - Base Case)

			Market Rent:								
			$ 30.00	$ 32.00	$ 34.00	$ 36.00	$ 38.00	$ 40.00	$ 42.00	$ 44.00	$ 46.00
Exit Cap Rate and Property Value Upon Exit:	$ 23,995,320	8.50%	(6.3%)	0.8%	6.4%	11.1%	15.1%	18.6%	21.8%	24.6%	27.3%
	24,722,450	8.25%	(4.1%)	2.6%	8.0%	12.5%	16.4%	19.9%	23.0%	25.8%	28.5%
	25,495,027	8.00%	(2.0%)	4.4%	9.6%	14.0%	17.8%	21.2%	24.3%	27.1%	29.7%
	26,317,447	7.75%	0.0%	6.2%	11.2%	15.5%	19.2%	22.6%	25.6%	28.4%	30.9%
	27,194,695	7.50%	2.0%	7.9%	12.8%	17.0%	20.7%	23.9%	26.9%	29.6%	32.2%
	28,132,444	7.25%	4.0%	9.7%	14.4%	18.5%	22.1%	25.3%	28.3%	31.0%	33.5%
	29,137,174	7.00%	6.0%	11.5%	16.1%	20.1%	23.6%	26.8%	29.7%	32.3%	34.8%

The Downside Case

- For reference, a 5-year IRR of ~9% corresponds to the minimum 1.5x multiple we are targeting
- Even if Cap Rates do not *decline*, we still avoid *losing money*:

Sensitivity Analysis - 5-Year Leveraged IRR and Exit Cap Rate vs. LTV (Scenario #2 - Downside Case)

Exit Cap Rate and Property Value Upon Exit:			LTV Ratio:								
			60.0%	62.5%	65.0%	67.5%	70.0%	72.5%	75.0%	77.5%	80.0%
	$ 20,116,467	8.50%	4.4%	4.3%	4.2%	4.0%	3.9%	3.7%	3.5%	3.2%	2.9%
	20,726,057	8.25%	5.7%	5.7%	5.6%	5.6%	5.5%	5.5%	5.4%	5.4%	5.3%
	21,373,746	8.00%	7.0%	7.0%	7.1%	7.1%	7.2%	7.3%	7.4%	7.5%	7.7%
	22,063,222	7.75%	8.3%	8.4%	8.5%	8.7%	8.9%	9.1%	9.3%	9.6%	10.0%
	22,798,662	7.50%	9.6%	9.8%	10.0%	10.3%	10.5%	10.9%	11.3%	11.7%	12.3%
	23,584,823	7.25%	10.9%	11.2%	11.5%	11.8%	12.2%	12.7%	13.2%	13.8%	14.5%
	24,427,138	7.00%	12.3%	12.6%	13.0%	13.4%	13.9%	14.5%	15.1%	15.9%	16.7%

- Once again, the real problem occurs if the $38 / SF rent level is not achieved (and, to a lesser extent, if turnover downtime creeps toward 2 years):

Sensitivity Analysis - 5-Year Leveraged IRR and Exit Cap Rate vs. Market Rent (Scenario #2 - Downside Case)

Exit Cap Rate and Property Value Upon Exit:			Market Rent:								
			$ 30.00	$ 32.00	$ 34.00	$ 36.00	$ 38.00	$ 40.00	$ 42.00	$ 44.00	$ 46.00
	$ 20,116,467	8.50%	(31.2%)	(16.6%)	(7.8%)	(1.3%)	3.9%	8.2%	12.0%	15.3%	18.3%
	20,726,057	8.25%	(26.3%)	(13.7%)	(5.5%)	0.6%	5.5%	9.8%	13.4%	16.7%	19.6%
	21,373,746	8.00%	(22.1%)	(10.9%)	(3.4%)	2.4%	7.2%	11.3%	14.9%	18.1%	21.0%
	22,063,222	7.75%	(18.4%)	(8.4%)	(1.3%)	4.3%	8.9%	12.8%	16.3%	19.5%	22.3%
	22,798,662	7.50%	(15.0%)	(5.9%)	0.8%	6.1%	10.5%	14.4%	17.8%	20.9%	23.7%
	23,584,823	7.25%	(11.9%)	(3.5%)	2.8%	7.9%	12.2%	16.0%	19.3%	22.3%	25.1%
	24,427,138	7.00%	(8.9%)	(1.2%)	4.8%	9.7%	13.9%	17.6%	20.9%	23.8%	26.5%

The Numbers, In Short

- The numbers work extremely well in the Base Case, even if there is no Cap Rate decline or we are not able to use a 70% LTV ratio
- This is driven almost entirely by a decline in the General Vacancy rate:

		Historical:	Projected:					Stabilized:
Key Metrics and Ratios:	*Units:*	FY14	FY15	FY16	FY17	FY18	FY19	FY20
Effective Gross Revenue % Base Rental Revenue:	*%*	*68.8%*	*69.1%*	*69.6%*	*67.8%*	*71.5%*	*75.7%*	*74.3%*
General Vacancy % Base Rental Revenue:	*%*	*26.3%*	*27.7%*	*26.3%*	*26.3%*	*21.9%*	*21.4%*	*21.4%*
Absorption & Turnover Vacancy % Base Rental Revenue:	*%*	*2.5%*	*2.3%*	*4.0%*	*4.7%*	*4.8%*	*2.6%*	*3.6%*
Free Rent % Base Rental Revenue:	*%*	*2.9%*	*1.3%*	*0.7%*	*1.7%*	*2.4%*	*0.8%*	*1.2%*
Potential Gross Revenue - Growth Rate:	*%*	*N/A*	*5.4%*	*2.5%*	*0.5%*	*1.7%*	*6.7%*	*1.0%*
Effective Gross Revenue - Growth Rate:	*%*	*N/A*	*4.0%*	*4.2%*	*(0.2%)*	*8.1%*	*8.6%*	*0.6%*
TIs & LCs % Effective Gross Revenue:	*%*	*7.1%*	*4.5%*	*2.7%*	*6.6%*	*11.5%*	*4.5%*	*4.6%*
NOI Margin %:	*%*	*49.8%*	*50.0%*	*50.3%*	*49.1%*	*51.5%*	*54.1%*	*53.3%*
Adjusted NOI Margin:	*%*	*41.1%*	*44.0%*	*46.1%*	*40.9%*	*38.5%*	*48.1%*	*47.2%*

- In the Downside Case, we do not always achieve the targeted 1.5x multiple, but we do maintain at least a 1.2x multiple in most scenarios
- The real problem is the risk of the $38 / SF market rental rate not being achieved, especially in the Downside Case
- A decline in in-place and market rental rates, or a decline and a recovery, also represent risk factors

Risk Factors

- **Over 50% of In-Place Revenue Expires by Year 4:** Leases corresponding to over 40% of the property's RSF expire within 4 years
  - **Mitigants:** Higher concessions; examine tenants' renewal histories
- **Asking Rents and Rent Growth May Be Weaker Than Expected:** We might not be able to win rental rates at the same level as newer properties in the area; the IRRs look far worse at rents below $38 / SF
  - **Mitigants:** Incentivize tenants with higher TIs or free months of rent, or promise lower escalations in exchange for $38 / SF base rate
- **The Renovation May Not Work as Intended:** In the Downside case, we examine what happens if no new tenants are found and the Occupancy Rate remains the same at 74%
- **Lenders May Not Back the Deal:** The DSCR falls below 1x in all the operating cases due to the high number of lease expirations in Year 3
  - **Mitigants:** Negotiate for a Senior Loan with no amortization, or lower amortization, in exchange for a higher interest rate

Lease Expiration Risk

- Each of the property's biggest tenants comprises only 7-8% of RSF, but leases for over **<u>50%</u>** of in-place revenue expire within the first 4 years:

Lease Expiration Schedule:

Year of Lease Expiration:	Rentable Square Feet:	Percent of Building:	# Tenants:	Annual In-Place Revenue @ Current Rates:	% Total In-Place Revenue:	Annual Potential Revenue @ Market Rates:	% Total Potential Revenue:	Year End Date:	Calendar Year:
Vacant	30,152.4	26.3%	8	$ -	-	$ 1,145,791	26.3%		1900
Year 1	-	-	0	-	-	-	-	2015-12-31	2015
Year 2	11,334.1	9.9%	2	410,351	13.2%	430,695	9.9%	2016-12-31	2016
Year 3	25,879.0	22.6%	3	949,361	30.6%	983,403	22.6%	2017-12-31	2017
Year 4	8,869.0	7.7%	1	332,586	10.7%	337,020	7.7%	2018-12-31	2018
Year 5	7,757.8	6.8%	2	292,754	9.4%	294,798	6.8%	2019-12-31	2019
Year 6	16,568.1	14.4%	3	603,077	19.4%	629,587	14.4%	2020-12-31	2020
Year 7	8,291.8	7.2%	1	310,113	10.0%	315,088	7.2%	2021-12-31	2021
Year 8	5,815.8	5.1%	1	205,299	6.6%	221,002	5.1%	2022-12-31	2022
Year 9	-	-	0	-	-	-	-	2023-12-31	2023
Year 10	-	-	0	-	-	-	-	2024-12-31	2024
Total:	**114,668.0**	**100.0%**	**21**	**$ 3,103,541**	**100.0%**	**$ 4,357,384**	**100.0%**		

- **Impact:** If **no** existing tenants renew and it takes 9 months to find new ones, the IRR drops to 6-13% (and turns negative in the Downside Case)
- **Mitigant #1:** Offer higher rent abatement months or TIs to encourage renewals
- **Mitigant #2:** Examine renewal histories and see how much of a risk it really is
- **Mitigant #3:** Offer lower rental escalations in exchange for renewals and longer contracts

Rent and Rental Growth Risk

- Lower-than-expected rental *growth* is not a huge risk (1% lower rent and expense growth → 1-2% lower IRR), but not achieving the $38 / SF market rate is a big risk
- **Mitigant #1:** Incentivize tenants with higher TIs or more free months of rent
  - **Impact:** Doubling the months of rent abatement reduces IRRs by 2-3% across different Exit Cap Rate levels, but we still *avoid losing* money if the LTV ratio is at least 70%
  - **Impact:** Doubling TIs barely makes a difference – the IRR drops by only ~1% across different ranges
- **Mitigant #2:** Promise lower escalations in exchange for the $38 / SF market rate upon renewal and for new tenants
  - **Impact:** Escalations of 1.5% (Years 1 – 2) and 1.0% (Years 3 – 5) rather than 3.0% and 2.0% reduce the IRR substantially (7-8%), but we might be able to lock in the rental rate by promising less as well

Lender and Credit Risk

- Lenders may not back this deal because the DSCR drops below 1.0x, particularly in the Downside Case:

		Historical:	Projected:					Stabilized:
Key Metrics and Ratios:	*Units:*	FY14	FY15	FY16	FY17	FY18	FY19	FY20
Effective Gross Revenue % Base Rental Revenue:	%	68.8%	68.1%	69.1%	66.2%	66.8%	70.3%	68.7%
General Vacancy % Base Rental Revenue:	%	26.3%	27.7%	26.3%	26.3%	26.3%	26.3%	26.3%
Absorption & Turnover Vacancy % Base Rental Revenue:	%	2.5%	2.3%	4.0%	4.7%	4.8%	2.6%	3.6%
Free Rent % Base Rental Revenue:	%	2.9%	2.5%	1.2%	3.3%	2.6%	1.4%	1.9%
Potential Gross Revenue - Growth Rate:	%	N/A	3.8%	2.5%	(1.0%)	2.7%	5.8%	0.4%
Effective Gross Revenue - Growth Rate:	%	N/A	1.9%	4.5%	(2.2%)	2.9%	7.2%	(0.2%)
TIs & LCs % Effective Gross Revenue:	%	7.1%	5.9%	3.5%	8.5%	10.6%	5.7%	6.3%
NOI Margin %:	%	49.8%	49.3%	49.9%	47.9%	48.4%	50.7%	49.7%
Adjusted NOI Margin:	%	41.1%	41.8%	44.9%	37.9%	36.2%	43.5%	41.9%
Interest Coverage Ratio - NOI:	x		1.85 x	1.94 x	1.76 x	1.87 x	2.15 x	N/A
Interest Coverage Ratio - Adjusted NOI:	x		1.57 x	1.74 x	1.39 x	1.40 x	1.84 x	N/A
Debt Service Coverage Ratio (DSCR) - NOI:	x		1.85 x	1.94 x	0.83 x	0.87 x	0.14 x	N/A
Debt Service Coverage Ratio (DSCR) - Adjusted NOI:	x		1.57 x	1.74 x	0.65 x	0.65 x	0.12 x	N/A
Debt Yield - NOI:	%		10.5%	11.1%	10.4%	10.8%	12.2%	N/A
Debt Yield - Adjusted NOI:	%		8.9%	10.0%	8.2%	8.1%	10.4%	N/A

  - **Mitigant:** Negotiate for 30-year amortization or no amortization in exchange for a higher interest rate
  - **Impact:** With L + 500 bps and 30-year amortization, the DSCR stays above 1.0x even in the Downside Case; the IRR falls by ~1.5%

The Worst Case Scenario

- If **no** new tenants are found, <u>and</u> **no** existing tenants renew their leases <u>and</u> it takes us 9 months to find a new tenant for each suite:

Sensitivity Analysis - 5-Year Leveraged IRR and Exit Cap Rate vs. LTV (Scenario #2 - Downside Case)

			LTV Ratio:								
			60.0%	62.5%	65.0%	67.5%	70.0%	72.5%	75.0%	77.5%	80.0%
Exit Cap Rate and Property Value Upon Exit:	$ 16,787,713	8.50%	(8.5%)	(9.6%)	(11.0%)	(12.6%)	(14.6%)	(17.0%)	(20.1%)	(24.1%)	(29.6%)
	17,296,432	8.25%	(6.8%)	(7.7%)	(8.9%)	(10.3%)	(11.9%)	(13.9%)	(16.3%)	(19.5%)	(23.7%)
	17,836,945	8.00%	(5.1%)	(5.9%)	(6.9%)	(8.0%)	(9.3%)	(10.9%)	(12.9%)	(15.4%)	(18.6%)
	18,412,331	7.75%	(3.4%)	(4.1%)	(4.9%)	(5.8%)	(6.9%)	(8.1%)	(9.7%)	(11.6%)	(14.1%)
	19,026,075	7.50%	(1.8%)	(2.3%)	(2.9%)	(3.6%)	(4.5%)	(5.5%)	(6.7%)	(8.1%)	(10.0%)
	19,682,147	7.25%	(0.1%)	(0.5%)	(1.0%)	(1.5%)	(2.2%)	(2.9%)	(3.8%)	(4.9%)	(6.2%)
	20,385,080	7.00%	1.6%	1.3%	0.9%	0.6%	0.1%	(0.4%)	(1.0%)	(1.8%)	(2.6%)

- However, we don’t find this scenario plausible because the property would have to turn into a <u>disaster</u> for this to happen

- A more plausible “worst case” scenario might be no new tenants and a 30% lease renewal probability instead:

Sensitivity Analysis - 5-Year Leveraged IRR and Exit Cap Rate vs. LTV (Scenario #2 - Downside Case)

			LTV Ratio:								
			60.0%	62.5%	65.0%	67.5%	70.0%	72.5%	75.0%	77.5%	80.0%
Exit Cap Rate and Property Value Upon Exit:	$ 18,214,322	8.50%	(2.2%)	(2.8%)	(3.5%)	(4.3%)	(5.2%)	(6.4%)	(7.7%)	(9.4%)	(11.5%)
	18,766,271	8.25%	(0.8%)	(1.3%)	(1.8%)	(2.4%)	(3.2%)	(4.0%)	(5.1%)	(6.4%)	(8.0%)
	19,352,717	8.00%	0.7%	0.3%	(0.1%)	(0.6%)	(1.1%)	(1.8%)	(2.6%)	(3.5%)	(4.7%)
	19,976,998	7.75%	2.1%	1.9%	1.6%	1.2%	0.9%	0.4%	(0.1%)	(0.8%)	(1.6%)
	20,642,898	7.50%	3.6%	3.5%	3.3%	3.1%	2.8%	2.6%	2.2%	1.8%	1.4%
	21,354,722	7.25%	5.1%	5.0%	5.0%	4.9%	4.8%	4.7%	4.6%	4.4%	4.2%
	22,117,391	7.00%	6.6%	6.6%	6.7%	6.7%	6.7%	6.8%	6.8%	6.9%	7.0%

Conclusions

- We **RECOMMEND** doing the deal and acquiring 45 Milk Street for $18 million with $2 million in additional funding for the renovation
- The valuation represents a bargain price, the IRR is easily 15-20% in the Base Case, and even in the Downside Case we can still earn a 1.2-1.5x multiple
- The fast-growing Boston market and CBD submarket both support the deal, as does the opportunity to improve the property's occupancy rate and average rental rates
- The biggest risks are if rents fall and if we cannot achieve the market rate of $38 / SF, but there are ways to mitigate these risks
- We could provide more free months of rent, higher TIs, or promise lower escalations to tenants in exchange for agreeing to this market rate
- Of these alternatives, higher concessions are likely the most feasible way to mitigate risk, given their relatively low impact on IRR across all cases