RE Private Equity 2023 – Gillespie

# Bonnie Road: Somerset, NJ

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**Investment Strategy:**

- **Overview:** Purchase Flex/Industrial building (160,000 sqft, 2000 Build) for $10M. The property has 24' clear height, 24 loading doors, and 40'x40' column spacing. 23,995 (or 15%) of the property is office space. 100% Occupied by 3 tenants, leases expiring in Dec 2020 but intend to renew. Asking price $9.7M, guidance to offer $10M (83% of replacement cost).
- **Strategy:** Lease renewal play. Purchase and renew leases at market rent (currently $5.15psf, market dictates $5.43psf based on a blend of Comparable Leases, Warehouse and Office Market averages, and tradeout data).
- **Returns:** With our initial investment of $2,240,000 (77.6% LTV), we can expect a 23.20% Levered IRR with a 2.56x Equity Multiple on a 7% exit cap rate. Since we are buying the property for $10M, at the end of the 5-year hold period we forecast selling it for $13.072M. Our leveraged After-Tax Cash Flows (ATCF) for years 1-5 are as follows: $216K, $214K, $212K, $210K and $147K.

**Primary Attributes:**

- **Strong Location:** The property, situated in Somerset County, provides easy access to one of the most densely populated regions in the United States. It is pinned between all major NJ thoroughfares, highlighted by its proximity to Princeton and Rutgers research corridors, underscoring the research and development influence of the area. It is also near one of the nation's largest ports, and within a 30 miles radius of millions of consumers and over 100,000 businesses. The industrial market in New jersey, and specifically in this submarket, is overall very strong.
- **Desired Building Quality and Type:** The warehouse has a modern and aesthetic exterior made up of stone, glass and aluminum façade. Furthermore, the operational versatility of the asset has proven to be desirable to sale and front office tenants, as well as traditional warehouse users. Additionally, the property has many energy-conserving features such as enhanced skylights, motion detectors and photo sensors, and water-saving plumbing fixtures. These help the building's marketability to tenants but also substantially decrease operating costs.
- **In place Appurtenances:** Financed by current tenants, the building contains racking and storage mechanisms that add value to future tenants and are affixed to the property. In the case the appurtenance is unwanted, there is a lease clause that requires the current tenant to pay for the removal.

**Primary Risks:**

- **Tenant Turnover:** Risk of tenants not renewing their lease once building is owned, leading to leasing commissions and tenant improvement allowances.

  **Mitigant:** Model assumes small tenant with 5-year lease will not renew, incurring $96,000 of expense (TI & Leasing). This leads to insignificant change in IRR, if other tenants renew. The mitigant if larger tenants turnover or transition is more costly is to push sale to year 6, only decreasing IRR by 200bps.
- **Low Market Rent:** If current tenants push back on mark to market process, returns will go down. All three have invested in the property and have expressed the intent to stay in the building. Current net absorption is positive, with less than 10% local vacancy (trending down for micro market reports)

  **Mitigant:** Prepare to offer leasing renewal concessions or offer more tenant improvement allowances.
- **Market Vacancy and Statistics:** Current market vacancy rates are 10.8% (Central New Jersey), and submarket vacancy of 7.8% (Somerset submarket).

  **Mitigant:** Maintain positive relationships with current tenant base and work to point out the location, ease of staying in the building, and employee upsides of tenants staying put.
- **Potential Buyer Risk:** Properties of this financial size are difficult to sell, as they are too large for private investors, and too small for institutional investors. Victor will not have the ability to seller-finance without obtaining his own, conventional financing.

  **Mitigant:** Begin sales process in year 5, immediately after new lease extension. Establish relationships with local lenders to connect potential buyers to.

- **CapEx Capital Call:** The building lacks any forecasted capital expenditures, and investors are not contributing to a capital reserve fund. If there are unplanned improvements needed, Victor will need to reach out to investors and raise additional funds.

  **Mitigant:** A structural reserve fund of $32k per year is set aside. Investors should be wary that they may need to contribute if expenditure exceeds the forecasted $32k.

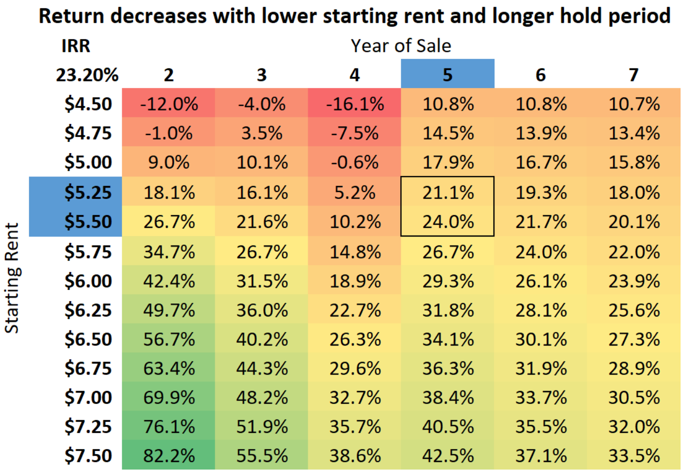
## Pricing:

- **Purchase Price:** $10,000,000. Based on the favorable terms and high projected returns, pricing above asking ($300k) allows us to win the bid. Appraised value at $10.5M, replacement cost at $12M, shows value above $9.7M.
- **First Renewal Rent Price:** Looking at recent signed comparable leases, the weighted average rent PSF was $7.28. The market broker info had weighted average rent at $4.65, however, this includes large tenants (average is 118,000). Smaller units rent for more psf, therefore was less helpful than recent leases. We also calculated rents if they were escalated 3% compounding annually over the previous 5 year term. New, 2021 market rent, and methodology below.

| Tenant | Square Footage | Current Rent | 3% Escalated Rent | 2021 Market |
|---|---|---|---|---|
| A | 79,875 | $4.80 | *$5.56* | $4.95 |
| B | 29,757 | $5.36 | *$6.21* | $5.75 |
| C | 50,368 | $5.58 | *$6.47* | $6.00 |
| Totals | 160,000 | $5.15 | *$5.97* | **$5.43** |

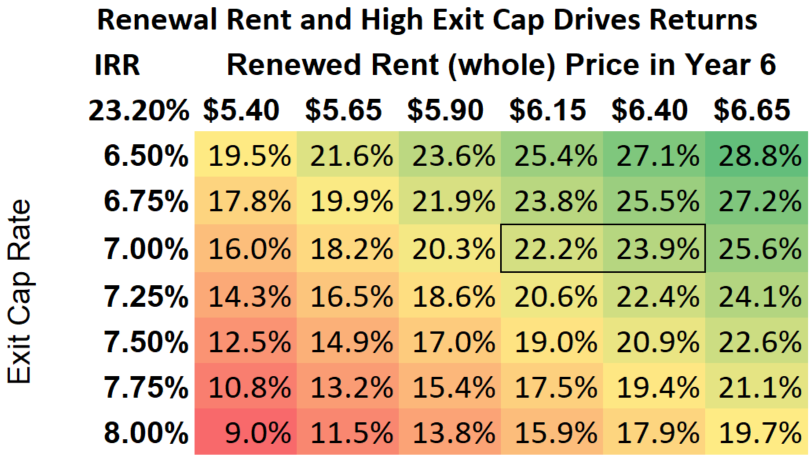
- **Year 6 Rent Renewal Price:** We calculated an annual rent escalation of 3% over the 5-year hold period and applied that eventual increase to our year 6 rents, when rent renews.
- **Exit Sales Price:** $13,072,000 in year 5 based on exit cap of 7% and year 6 NOI.

## Sensitivity Analysis:



**Return decreases with lower starting rent and longer hold period**

| IRR | Year of Sale | | | | | |
|---|---|---|---|---|---|---|
| 23.20% | 2 | 3 | 4 | 5 | 6 | 7 |
| $4.50 | -12.0% | -4.0% | -16.1% | 10.8% | 10.8% | 10.7% |
| $4.75 | -1.0% | 3.5% | -7.5% | 14.5% | 13.9% | 13.4% |
| $5.00 | 9.0% | 10.1% | -0.6% | 17.9% | 16.7% | 15.8% |
| $5.25 | 18.1% | 16.1% | 5.2% | 21.1% | 19.3% | 18.0% |
| $5.50 | 26.7% | 21.6% | 10.2% | 24.0% | 21.7% | 20.1% |
| $5.75 | 34.7% | 26.7% | 14.8% | 26.7% | 24.0% | 22.0% |
| $6.00 | 42.4% | 31.5% | 18.9% | 29.3% | 26.1% | 23.9% |
| $6.25 | 49.7% | 36.0% | 22.7% | 31.8% | 28.1% | 25.6% |
| $6.50 | 56.7% | 40.2% | 26.3% | 34.1% | 30.1% | 27.3% |
| $6.75 | 63.4% | 44.3% | 29.6% | 36.3% | 31.9% | 28.9% |
| $7.00 | 69.9% | 48.2% | 32.7% | 38.4% | 33.7% | 30.5% |
| $7.25 | 76.1% | 51.9% | 35.7% | 40.5% | 35.5% | 32.0% |
| $7.50 | 82.2% | 55.5% | 38.6% | 42.5% | 37.1% | 33.5% |



**Renewal Rent and High Exit Cap Drives Returns**

| IRR | Renewed Rent (whole) Price in Year 6 | | | | | |
|---|---|---|---|---|---|---|
| 23.20% | $5.40 | $5.65 | $5.90 | $6.15 | $6.40 | $6.65 |
| 6.50% | 19.5% | 21.6% | 23.6% | 25.4% | 27.1% | 28.8% |
| 6.75% | 17.8% | 19.9% | 21.9% | 23.8% | 25.5% | 27.2% |
| 7.00% | 16.0% | 18.2% | 20.3% | 22.2% | 23.9% | 25.6% |
| 7.25% | 14.3% | 16.5% | 18.6% | 20.6% | 22.4% | 24.1% |
| 7.50% | 12.5% | 14.9% | 17.0% | 19.0% | 20.9% | 22.6% |
| 7.75% | 10.8% | 13.2% | 15.4% | 17.5% | 19.4% | 21.1% |
| 8.00% | 9.0% | 11.5% | 13.8% | 15.9% | 17.9% | 19.7% |