AGENDA

NORTH MIAMI CITY COUNCIL

REGULAR COUNCIL MEETING **TUESDAY, APRIL 10, 2018**
7:00 P.M.

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TAB H

DISCUSSION REGARDING THE ONE FIFTY ONE AT BISCAYNE GROUND LEASE.
Sponsored by: City Administration

One Fifty One at Biscayne

Land Lease Present Value Estimation

February 26, 2018

This analysis is based on the information provided and presents the pertinent data and conclusions up to the date of this memo. If the status of any of the pertinent facts and assumptions change, the conclusions reported here may be changed accordingly.

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February 26, 2018

Larry M. Spring, Jr., CPA
City Manager
776 NE 125th Street
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Dear Mr. Manager:

In accordance with our retention, we have estimated the present value of the ground lease between the City of North Miami ("City"/"Landlord") and One Fifty One at Biscayne Landing Condominium Association ("Tenant").

It is our opinion that the value of the lease between the City and its Tenant for the remaining 186-year term is:

$9,901,672

stated in terms of present value, based upon the terms outlined within the lease . This figure considers appropriate rates of interest and increases in land value (inflation). The basis for our opinion is below:

Subject Property Description

The site is comprised of two (2) parcels. One parcel is a 4.32 acre parcel of land located approximately a quarter mile east of U.S. Route 1, 3.5 miles east from the GGI and 1 mile west of the Biscayne Bay at the southeast intersection of Royal Oak Lane and NE 151st St., North Miami Beach, FL. Aerial photographs found on the Miami-Dade County Property Search website suggest that the site is improved with asphalt paving, a swimming pool and tennis courts.

Adjacent to the east side boundary of the aforementioned parcel is a 5.3696 acre parcel of land that is improved with three structures, including two 25-story residential towers containing 373 dwelling units as well as a structured parking facility containing an unspecified number of parking spaces. The development was constructed in 2007 and 2008 and (based on photos of units found on the Internet) are of high quality. CoStar shows that eight (8) condo units containing an average 1,879 SF each are currently listed for sale at an average asking price of $179/SF or (in aggregate) $2.7 million.

The shape of the each of the subject sites is irregular. According to the zoning map found on the City of North Miami website[1], the subject sites are zoned PD2, Mixed-Used Medium.

[1] http://www.northmiamifl.gov/docs/NorthMiami_ZoningMap_07112017.pdf

Ownership & Pertinent Encumbrances

Title to the subject parcels is held by the City of North Miami, Florida as of the date of this evaluation.

A ground lease dated October 18, 2005 encumbers the 5.3696 acre subject parcel that is improved with the residential towers and parking garage. The lease presently provides the Landlord a base rent of $1,500 per dwelling unit per year, due January 1 of each year through 2104, after which the rent increases to $12,000 per dwelling unit per year, due January 1 of each year through 2203, with the last year of the lease (January through November 2204) requiring one payment at the start of the year of $10,500 per dwelling unit. In addition, the lease presently provides that the Landlord share 50% of commercial space revenue (presumably rental revenue), the details of which are not available as of the evaluation date. In addition, the lease provides that the Tenant pays all expenses that might accrue to the land occupant, including property taxes. At the expiration of the ground lease or in the event of default by the Tenant (as defined in the ground lease), the subject site and improvements thereon are "surrendered" to the Landlord.

A ground lease encumbering the 4.325 acre site, dated October 31, 2011, provides the Landlord a one-time rent of $100 for use of the land by the Tenant for a period extending from June 1, 2011 through November 25, 2204 (i.e. there are no periodic base rental payments). In addition, the lease provides that the Tenant pays all expenses that might accrue to the land occupant, including property taxes and its prorated share of maintaining and monitoring methane wells located on the subject site. At the expiration of the ground lease or in the event of default by the Tenant (as defined in the ground lease), the subject site and improvements thereon are "surrendered" to the Landlord.

Valuation Method

The Landlord holds title to the subject land and is the leased fee holder of the ground lease, having traded the right to possess and use its land to the Tenant in return for rent and other considerations through the expiration of the ground lease. Much like a bond, the base rental payments due each January compensate the Landlord and obligate the Tenant. Also like a securitized bond or mortgage, the subject ground leases provide that the Landlord can take possession and make use of the land and real improvements thereon in the event that the Tenant defaults on its obligation or at termination of the ground lease (known as a "surrender" by the Tenant).

Consequently, there are two components for valuing the Landlord's interest in the ground leases:

1. The periodic income (i.e. rent) and;
2. The real property (land and improvements) to be received upon surrender by the Tenant

An important assumption of this analysis is that the Tenant is not in default or imminently in default under either of the subject ground leases, such that the Landlord cannot reasonably expect to take possession and have the right to use the subject land and improvements until the expiration of the ground lease in November 2204. In short, because the Landlord cannot possess the subject land and improvements for over 186 years from the evaluation date, we might expect that the periodic payments of rent ($559,500 in Base Rent alone until 2105) should comprise the majority of value of the Landlord's leased fee interest.

Periodic cash flows of base rent and the share in commercial space revenue[2] due the Landlord plus

[2] As of the date of valuation, we do not have sufficient data to incorporate the potential revenue from Commercial Net Profits

the projected value of land and improvements in 2204 are imputed to their present value as of the evaluation date using a discount rate that is intended to capture the risk associated with the collection of each projected future cash flow.

Discount Rate Discussion

Among the considerations necessary for selection of an appropriate discount rate are the following:

- The credit supporting the expected collection of periodic cash flows;
- The amount of market demand among investors for ownership of the ground lease (i.e. how readily could the Landlord find buyers aka market liquidity);
- The rate of appreciation of the subject land sites;
- The rate of depreciation of the real property improvements

It is important to note the impact of the diminishing return associated with long-term analysis of periodic cash flows. A discount factor that is multiplied by the non-discounted cash flow looks like this:

$$\textbf{Discount Factor} = 1 \div (1 + \textbf{Discount Rate})^{(\text{Period of Cash Flow})}$$

Each projected annual cash flow is imputed to the evaluation date using this formula and the value is the sum of each of these imputed computations. A such, at a discount rate of 6% or above, the discount factor effectively equals zero by the 93rd year +/- from the evaluation date. This implies that the most critical of factors in selecting the discount rate is the credit quality of the cash flows and the market liquidity, since projected land value and physical depreciation are not materially impactful until beyond the 93rd year.

Discount Rate Indicators

There are no active indices for discount rates for very long-term ground leases on sites securitized by multifamily residential improvements like the subject. However, inferences from alternative investment securities are useful for triangulating what an investor in the subject ground leases might use to discount the projected cash flows.

The Federal Reserve Bank of St. Louis provides two useful references on its popular online financial database, FRED[3]. The ICE BofAML US Corporate bond indices[4] provides the difference in prevailing yield-to-maturities between corporate bonds and like- term U.S. Treasury Bonds.

Traded corporate bonds are not securitized like the subject, which would make them more risky as an investment, all else being equal. However, such bonds have a relatively broader pool of investors, giving the market for these instruments more liquidity than that of leases. One could view the lack of security, but the high liquidity of the corporate bond market warranting their uses as a good proxy for ground leases that are well-securitized, but have inferior liquidity.

As of the evaluation date, the trailing 3-year average indicated spread for BBB-rated corporate debt is 1.83% and for AA-rate debt 0.83% over like term T-Bonds. As of the evaluation date, the yield on the 30-year Treasury Bond is approximately 3.15% and adding a spread of 1.33% suggests an expected discount rate for the ground lease might reasonably approximate 4.5%.

[3] https://www.stlouisfed.org/
[4] https://fred.stlouisfed.org/series/BAMLC0A3CAEY

There are also surveys of commercial mortgage yields that can illuminate how lenders are pricing their longer-term collateralized loans. The interest in the subject ground lease is arguably best understood by viewing rates on loans to stabilized multifamily properties as well as to stabilized credit-tenant leased properties. One such survey of loan rates is the Fantini & Gorga Master Money Matrix[5]; respondents to the 1Q18 survey indicate pricing of 2.25% to 2.50% of spread over like-term Treasury bonds for permanent multifamily property loans and 1.50% to 2.50% of spread for permanent loans to credit tenant leased properties. The secondary market for these loans is modestly more liquid than that for ground leases, but these loans also have less collateral coverage (typically 70% to 100% LTV) than most long-term ground leases. Using the 30-year Treasury Bond yield of 3.15% as the reference rate added to a spread rate of 2.5% inferred from the mortgage surveys results in a proxy discount rate of 5.65% for the interest in the subject.

The interest in the ground lease is a low risk investment. **In a period of 18 to 23 years the Landlord will have collected cash flow from basic rent alone to provide a pay back on the market value of its land (if that value is in the range of $10 million to $13 million), with another 163 to 168 years of more cash flows due.** The Landlord's investment is exceptionally well collateralized. Few (if any) investments are available in the traded securities market that likely offer the Landlord a similar low risk profile at a yield much above 5% or 6%. The only caveat to this view is how deep the market is for the Landlord's interest, which is difficult to ascertain without direct conversations with likely market participants.

Given the aforementioned considerations, a discount rate of 6% is applied to the projected cash flows under the ground lease (absent any potential cash flows from Net Commercial Profits). No discount rate is derived for the projected value of the land as this component is not surrendered until year 2204, at which point a present value discount factor is most likely equal to zero.

Credit

We have no reason to expect default on future rent payments due to the Landlord. A payment history demonstrates that the Tenant consistently meets its obligation under the ground leases. Furthermore, the value of the improved subject property is effectively the collateral the Landlord has for extending possession and use of its land to the Tenant. If the fee simple interest in the underlying land has a value of $20 to $30 per square foot of land or $8.4 million to $12.7 million and the improved subject property at $300,000 to $350,000 per dwelling unit or $112 million to $131 million, then effectively the Landlord's interest is collateralized at a loan-to-value ratio of 7.5% to 9.7% (i.e. it is over-collateralized, making it a very secure investment relative to most collateralized bonds).

Market Liquidity

While there is an active market for collateralized bonds with long-term maturities, the size of that market narrows considerably when the security to be traded is a lease. Interpretation of laws regarding how leases are treated, particularly in bankruptcy proceedings, are not as crystallized as they are for bonds. This relative vagueness keeps many bond buyers out of the market for leases. The more narrow the number of participants in a market, the higher of a discount rate that is likely applied to an investment, all else being equal.

[5] http://www.fantinigorga.com/publications.html

Land Appreciation

The best we might expect for long-term land appreciation, absent a more detailed analysis of supply and demand constraints, is an expected rate of general inflation, which is commonly underwritten as 2.5% to 3.0% per year. The land component of the interest value is likely the most speculative element of the analysis, as land values tend to increase and decrease by wide margins with macroeconomic cycles. While land supply constrained markets like that in North Miami might see less volatility in land values (vs in less densely populated regions), developers' demand for land tends to come only after existing improved properties have stabilized and vanishes quickly once existing improved properties' occupancy levels begin to decrease. If the Landlord expects to take possession of the subject sites in 2204, there is no guarantee whether land values at that time will be surging up or careening down.

Physical Depreciation

The Landlord will have the right to take possession of and use the improvements on the subject site as of the expiration of the grounded leases. The subject improvements have a "useful life[6]". High rise buildings like those found at the subject site are typically built with some of the most durable materials in modern construction, yet few market underwriters are likely to assume the improvements would have a useful life beyond 120 years (most are likely to underwrite 80 years or so from the date of initial certificate of occupancy).

The improved value component is important because the market value of the subject property is a strong source of credit for the interest in the ground lease today; but as the physical improvements depreciate with age, this credit quality will lessen, all else being equal. Still, even if the subject improvements are depreciated fully over 100 years from the evaluation date, a vast majority of the value of the interest is likely to accrue to the Landlord within the first 20 to 25 years from the evaluation date, likely providing plenty of securitized collateral value during this time.

Estimation of Market Value

Exhibit I illustrates the discounting of annual cash flows under the subject ground lease (from base rent only) from March 1, 2018 (evaluation date) through January 1, 2204. The estimated market value of the subject ground lease is $9.9 million as of the evaluation date.

Respectfully Submitted,

THE SHARPTON GROUP, P.A.

[6] Generally defined as the age at which the depreciated market value of the physical improvements is equal to the capitalized cost of the annualized upkeep of those improvements

EXHIBIT I: ANNUAL DISCOUNTED CASH FLOW

One Fifty One Biscayne DCF			
Payment Date	**Period of Cash Flow**	**Base Rent**	**Present Value of Cash Flow**
Mar-2018			
Jan-2019	0.75	$559,500	$535,575
Jan-2020	1.75	$559,500	$505,260
Jan-2021	2.75	$559,500	$476,660
Jan-2022	3.75	$559,500	$449,680
Jan-2023	4.75	$559,500	$424,226
Jan-2024	5.75	$559,500	$400,213
Jan-2025	6.75	$559,500	$377,560
Jan-2026	7.75	$559,500	$356,188
Jan-2027	8.75	$559,500	$336,027
Jan-2028	9.75	$559,500	$317,006
Jan-2029	10.75	$559,500	$299,063
Jan-2030	11.75	$559,500	$282,134
Jan-2031	12.75	$559,500	$266,165
Jan-2032	13.75	$559,500	$251,099
Jan-2033	14.75	$559,500	$236,886
Jan-2034	15.75	$559,500	$223,477
Jan-2035	16.75	$559,500	$210,827
Jan-2036	17.75	$559,500	$198,894
Jan-2037	18.75	$559,500	$187,636
Jan-2038	19.75	$559,500	$177,015
Jan-2039	20.75	$559,500	$166,995
Jan-2040	21.75	$559,500	$157,542
Jan-2041	22.75	$559,500	$148,625
Jan-2042	23.75	$559,500	$140,212
Jan-2043	24.75	$559,500	$132,276
Jan-2044	25.75	$559,500	$124,788
Jan-2045	26.75	$559,500	$117,725
Jan-2046	27.75	$559,500	$111,061
Jan-2047	28.75	$559,500	$104,775
Jan-2048	29.75	$559,500	$98,844
Jan-2049	30.75	$559,500	$93,249
Jan-2050	31.75	$559,500	$87,971
Jan-2051	32.75	$559,500	$82,991
Jan-2052	33.75	$559,500	$78,294
Jan-2053	34.75	$559,500	$73,862
Jan-2054	35.75	$559,500	$69,681
Jan-2055	36.75	$559,500	$65,737
Jan-2056	37.75	$559,500	$62,016
Jan-2057	38.75	$559,500	$58,506
Jan-2058	39.75	$559,500	$55,194
Jan-2059	40.75	$559,500	$52,070
Jan-2060	41.75	$559,500	$49,122
Jan-2061	42.75	$559,500	$46,342
Jan-2062	43.75	$559,500	$43,719
Jan-2063	44.75	$559,500	$41,244

One Fifty One Biscayne DCF			
Payment Date	Period of Cash Flow	Base Rent	Present Value of Cash Flow
Jan-2064	45.75	$559,500	$38,910
Jan-2065	46.75	$559,500	$36,707
Jan-2066	47.75	$559,500	$34,629
Jan-2067	48.75	$559,500	$32,669
Jan-2068	49.75	$559,500	$30,820
Jan-2069	50.75	$559,500	$29,076
Jan-2070	51.75	$559,500	$27,430
Jan-2071	52.75	$559,500	$25,877
Jan-2072	53.75	$559,500	$24,412
Jan-2073	54.75	$559,500	$23,031
Jan-2074	55.75	$559,500	$21,727
Jan-2075	56.75	$559,500	$20,497
Jan-2076	57.75	$559,500	$19,337
Jan-2077	58.75	$559,500	$18,242
Jan-2078	59.75	$559,500	$17,210
Jan-2079	60.75	$559,500	$16,236
Jan-2080	61.75	$559,500	$15,317
Jan-2081	62.75	$559,500	$14,450
Jan-2082	63.75	$559,500	$13,632
Jan-2083	64.75	$559,500	$12,860
Jan-2084	65.75	$559,500	$12,132
Jan-2085	66.75	$559,500	$11,445
Jan-2086	67.75	$559,500	$10,798
Jan-2087	68.75	$559,500	$10,186
Jan-2088	69.75	$559,500	$9,610
Jan-2089	70.75	$559,500	$9,066
Jan-2090	71.75	$559,500	$8,553
Jan-2091	72.75	$559,500	$8,069
Jan-2092	73.75	$559,500	$7,612
Jan-2093	74.75	$559,500	$7,181
Jan-2094	75.75	$559,500	$6,775
Jan-2095	76.75	$559,500	$6,391
Jan-2096	77.75	$559,500	$6,029
Jan-2097	78.75	$559,500	$5,688
Jan-2098	79.75	$559,500	$5,366
Jan-2099	80.75	$559,500	$5,062
Jan-2100	81.75	$559,500	$4,776
Jan-2101	82.75	$559,500	$4,505
Jan-2102	83.75	$559,500	$4,250
Jan-2103	84.75	$559,500	$4,010
Jan-2104	85.75	$559,500	$3,783
Jan-2105	86.75	$4,476,000	$28,550
Jan-2106	87.75	$4,476,000	$26,934
Jan-2107	88.75	$4,476,000	$25,409
Jan-2108	89.75	$4,476,000	$23,971
Jan-2109	90.75	$4,476,000	$22,614
Jan-2110	91.75	$4,476,000	$21,334
Jan-2111	92.75	$4,476,000	$20,127

One Fifty One Biscayne DCF			
Payment Date	Period of Cash Flow	Base Rent	Present Value of Cash Flow
Jan-2112	93.75	$4,476,000	$18,987
Jan-2113	94.75	$4,476,000	$17,913
Jan-2114	95.75	$4,476,000	$16,899
Jan-2115	96.75	$4,476,000	$15,942
Jan-2116	97.75	$4,476,000	$15,040
Jan-2117	98.75	$4,476,000	$14,188
Jan-2118	99.75	$4,476,000	$13,385
Jan-2119	100.75	$4,476,000	$12,628
Jan-2120	101.75	$4,476,000	$11,913
Jan-2121	102.75	$4,476,000	$11,239
Jan-2122	103.75	$4,476,000	$10,602
Jan-2123	104.75	$4,476,000	$10,002
Jan-2124	105.75	$4,476,000	$9,436
Jan-2125	106.75	$4,476,000	$8,902
Jan-2126	107.75	$4,476,000	$8,398
Jan-2127	108.75	$4,476,000	$7,923
Jan-2128	109.75	$4,476,000	$7,474
Jan-2129	110.75	$4,476,000	$7,051
Jan-2130	111.75	$4,476,000	$6,652
Jan-2131	112.75	$4,476,000	$6,276
Jan-2132	113.75	$4,476,000	$5,920
Jan-2133	114.75	$4,476,000	$5,585
Jan-2134	115.75	$4,476,000	$5,269
Jan-2135	116.75	$4,476,000	$4,971
Jan-2136	117.75	$4,476,000	$4,689
Jan-2137	118.75	$4,476,000	$4,424
Jan-2138	119.75	$4,476,000	$4,174
Jan-2139	120.75	$4,476,000	$3,937
Jan-2140	121.75	$4,476,000	$3,715
Jan-2141	122.75	$4,476,000	$3,504
Jan-2142	123.75	$4,476,000	$3,306
Jan-2143	124.75	$4,476,000	$3,119
Jan-2144	125.75	$4,476,000	$2,942
Jan-2145	126.75	$4,476,000	$2,776
Jan-2146	127.75	$4,476,000	$2,619
Jan-2147	128.75	$4,476,000	$2,470
Jan-2148	129.75	$4,476,000	$2,331
Jan-2149	130.75	$4,476,000	$2,199
Jan-2150	131.75	$4,476,000	$2,074
Jan-2151	132.75	$4,476,000	$1,957
Jan-2152	133.75	$4,476,000	$1,846
Jan-2153	134.75	$4,476,000	$1,742
Jan-2154	135.75	$4,476,000	$1,643
Jan-2155	136.75	$4,476,000	$1,550
Jan-2156	137.75	$4,476,000	$1,462
Jan-2157	138.75	$4,476,000	$1,379
Jan-2158	139.75	$4,476,000	$1,301
Jan-2159	140.75	$4,476,000	$1,228

One Fifty One Biscayne DCF			
Payment Date	Period of Cash Flow	Base Rent	Present Value of Cash Flow
Jan-2160	141.75	$4,476,000	$1,158
Jan-2161	142.75	$4,476,000	$1,093
Jan-2162	143.75	$4,476,000	$1,031
Jan-2163	144.75	$4,476,000	$972
Jan-2164	145.75	$4,476,000	$917
Jan-2165	146.75	$4,476,000	$865
Jan-2166	147.75	$4,476,000	$816
Jan-2167	148.75	$4,476,000	$770
Jan-2168	149.75	$4,476,000	$727
Jan-2169	150.75	$4,476,000	$686
Jan-2170	151.75	$4,476,000	$647
Jan-2171	152.75	$4,476,000	$610
Jan-2172	153.75	$4,476,000	$576
Jan-2173	154.75	$4,476,000	$543
Jan-2174	155.75	$4,476,000	$512
Jan-2175	156.75	$4,476,000	$483
Jan-2176	157.75	$4,476,000	$456
Jan-2177	158.75	$4,476,000	$430
Jan-2178	159.75	$4,476,000	$406
Jan-2179	160.75	$4,476,000	$383
Jan-2180	161.75	$4,476,000	$361
Jan-2181	162.75	$4,476,000	$341
Jan-2182	163.75	$4,476,000	$321
Jan-2183	164.75	$4,476,000	$303
Jan-2184	165.75	$4,476,000	$286
Jan-2185	166.75	$4,476,000	$270
Jan-2186	167.75	$4,476,000	$255
Jan-2187	168.75	$4,476,000	$240
Jan-2188	169.75	$4,476,000	$227
Jan-2189	170.75	$4,476,000	$214
Jan-2190	171.75	$4,476,000	$202
Jan-2191	172.75	$4,476,000	$190
Jan-2192	173.75	$4,476,000	$179
Jan-2193	174.75	$4,476,000	$169
Jan-2194	175.75	$4,476,000	$160
Jan-2195	176.75	$4,476,000	$151
Jan-2196	177.75	$4,476,000	$142
Jan-2197	178.75	$4,476,000	$134
Jan-2198	179.75	$4,476,000	$127
Jan-2199	180.75	$4,476,000	$119
Jan-2200	181.75	$4,476,000	$113
Jan-2201	182.75	$4,476,000	$106
Jan-2202	183.75	$4,476,000	$100
Jan-2203	184.75	$4,476,000	$95
Jan-2204	185.75	$3,916,500	$78
Total		**$495,157,500**	**$ 9,901,672**