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The Honorable Meenakshi Srivivasan, Chair
NYC Board of Standards and Appeals
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Reference:
Calendar 74-07-BZ
6-10 West 70th Street
New York, NY

Several elements of the Congregation Shearith Israel (CSI) application for zoning variances appear to be incomplete, misleading, or in error. In particular, because the proposed development produces a significant financial return, CSI has submitted analyses showing modest developer returns of 9% and 12%, for example. Implicitly, BSA is being asked to consider these as 'reasonable'.

But the corresponding actual developer returns are 59% and 63% using the financial data provided by CSI. Further, the application material fails to note the additional and substantial financial returns to CSI itself of 16% and 28%.

The following notes attempt to provide a more objective view.

Terms

The abbreviation F/F refers to two Freeman/Frazier letters dated 21 December 2007 and 11 March 2008 abbreviated December '07 and March '08.

References to the new CSI space as a 'school' or as a 'community center' in CSI submissions is misleading since the space consists of a new entrance and addition to the synagogue proper, income-producing rental space, and does not provide facilities to the general community. The term 'Annex' is used instead.

Valuation Basis

In principle, the value of development rights is determined by agreement between willing buyers and sellers. That, in turn, depends on the purpose of the development and its economics. The various valuations presented by Freeman/Frazier on behalf of CSI present no bids or developer certification for the 6-10 West 70th property. Rather, they back into a value-based acquisition costs for other properties that are claimed to be similar but provide no attendant economics that would justify the value. Because the estimates submitted by CSI are notional constructs extrapolated from other situations, they can be examined for reasonableness.

The values are being submitted on behalf of a seller, not a buyer or developer, and so can be vetted for bias. For reasons described under the headings Central Park Views, and Return on Investment, it is clear that the acquisition rate of \$750/ft² is unreasonably high.

One consequence of asserting high acquisition costs is that the CSI analyses show all but the desired plans to be uneconomic when, in reality, they are not.

Central Park Views

On page 4 of the December '07 submission, a 48% premium was assigned to R10A zone value compared to R8B because of Central Park views. In the March '08 submission, the premium is reduced to 40%. Both are too high. While the two derivations are very different, they both arrive at the same, (presumably) desired value of \$750/ft²

The premium applies to direct Central Park views as found on residential properties that front on Central Park West. Residences in those buildings can see the full width of Central Park, from Central Park West to the East Side, and have entrances on Central Park West and have Central Park West addresses. These amenities do not apply to **any** of the proposed residences.

The premium should be discounted to adjust for the real situation. Even the highest residences in the CSI plan do not have an unrestricted view of Central Park. Their view is restricted by the synagogue; residents must look over the peak that is about 82 feet above ground. For the 8th floor, the first sight of the Park ground level would be about 1100 feet into the Park, a fractional view. The lower floors provide only an oblique view around the synagogue and and past other buildings.

The later, 40%, premium should be adjusted to take reality into account. The percentage views are estimated as:

Floor	View
5	15%
6	20
7	30
8	65
PH	<u>80</u>
Average	42%

The premium for actual Park views becomes 42% of 40%, or 16.8%, and a consequential lowering of the valuation from \$750/ft² to the R8B average of \$590/ft² x 1.168 = \$689/ft².

This valuation, however, does not fully recognize the reality that the residences are really West 70th properties with oblique views of Central Park, not dissimilar

to those of nearby residences. Full recognition would result in a still lower premium.

Cost Deconstruction

The McQuilkin Associates attachment to the March '08 letter allocates costs between the Annex ('school') and residences. It appears to assume that the residences are built on air rather than acknowledging that they share costs for demolition, paving, excavation, foundation, (unspecified) masonry and terrazzo, and (perhaps) HVAC with the Annex. Without knowing the allocation rationale, it is quite possible that the costs allocated to the residential portion are understated.

This has two consequences. First, CSI would be, in effect, subsidizing or investing in, the residential development. For a given level of developer profit, the acquisition price is raised by the subsidy, and the cash flow to CSI is increased. Second, this amounts to a hidden conversion of an investment in the residential construction into a rights sale. This has tax implications, and in another context, might be considered money laundering if found to be deliberate. An objective review of cost allocations is needed.

Return on Investment

The developer's Annual Return on Investment (ROI) values reported in the F/F letters wildly understate the true values because they use an artificial method for estimating acquisition costs, and because they ignore the effects of financial leveraging by a developer. The reported ROIs are false.

Schedule A of the March '08 letter shows the developer investment in the Proposed Development with Courtyard to be \$27,809,000. The actual number is \$4,039,520 including transaction tax. The F/F figure shows the developer investing the entire acquisition and construction costs out of his own pocket when, in fact, they are funded by a loan of about \$24,770,000 as shown on Schedule B. A developer does not earn a return on money he has not advanced; his Return on *Investment* is based on his *investment*, not someone else's.

The acquisition value of site rights is, in reality, determined by a developer's desired ROI, after recognition of relatively fixed revenue, construction cost, taxes, risks, et al. Values determined by comparison with purportedly similar sites around town are interesting but not dispositive because the development and subsequent use economics of those sites are not known.

Rather than assuming a notional acquisition price, an economic acquisition price can be determined as the amount a developer can pay while achieving its desired ROI. Such derivation must include the actual leveraging detailed in the F/F letters as is shown in the following three tables. (See the Attachment for more details on the derivations.)

For the Courtyard option, the ROI using the CSI-derived (seller) acquisition price of \$13,384,000 is 59%, not the reported 8.58%.

Proposed Development with Courtyard		
From Freeman/Frazier letter 11 March 2008	Assumed notional acquisition price	\$13,383,000
	Reported ROI, ignoring the effect of the actual leveraging used.	8.58%
From Attachment	Desired developer ROI	59%
	Resulting acquisition price, taking the leverage actually used into account.	\$13,384,049
<p>This table demonstrates two things. An acquisition price of about \$13,383,000, produces a true developer ROI of 59%, not the reported 8.58%. Also, the economic acquisition price can be derived assuming a target developer ROI, and that the two interact. Note that the 59% requires zoning variances.</p>		

A return of 59% might or might not be justified by the risks of: construction, finance, marketing, and general economic environment. The purported return of 8.58% before income tax (perhaps 6% after tax) would seem unlikely to attract an arms-length developer. It does however, correctly point out that the Courtyard option is less profitable than the earlier Revised Proposed Development without the courtyard.

The essential problem here is determining what is reasonable. BSA is being asked to make that judgment based on questionable assumptions, incomplete information, and invalid analysis, It is certain, however, the real ROI for this option is much greater than 8.58%.

The Revised Proposed Development has a real developer ROI of 63% rather than the reported 12%, even assuming the CSI-derived, notional acquisition price of \$14,816,000.

Revised Proposed Development		
From Freeman/Frazier letter 21 December 2007	Assumed notional acquisition price.	\$14,816,000
	Reported ROI, ignoring the effect of leveraging actually used.	12.19%
From Attachment	ROI assuming same costs assumptions, but taking leverage into account.	63%

Considering various risks, the Freeman/Frazier ROI of 12% before income tax (perhaps 8% after tax) would seem unattractive to a developer, and yet CSI asserts this to be a viable option. The 63% developer ROI obtains only with zoning variances. This may not be consistent with the BSA standard for 'reasonable'.

Even the revised As of Right option of the 21 December 2007 letter produces a 'reasonable' 12% ROI at an economic, not hypothetical, acquisition price.

Revised As of Right		
From Freeman/Frazier letter 21 December 2007	Assumed notional acquisition price	\$14,816,000
	Resulting ROI ignoring the leveraging actually used.	0%
From Attachment	Desired developer ROI	12%
	Economic acquisition price, taking leverage into account.	\$2,193,336
The As of Right option cannot be rejected by CSI as unprofitable since it can produce the same 12% as for the Revised Proposed option presented as acceptable. It may not produce the desired Annex development subsidy, but it can be profitable.		

The figures in these tables do not prove that one or another ROI is correct. But they do support the view that:

- The CSI ROIs are not based on real development costs, standard project finance analysis methods, or their own financing plans. Why?
- The options rejected by CSI because of low ROIs may, in fact, be profitable,
- The residential right acquisition price used by CSI may have been generated to cover the estimated construction costs for and profit on the Annex, rather than real project economics.
- Acquisition price values are the result of, and depend on, zoning variances rather than inherent site values. The variances themselves provide added value rather than simply accommodating an inherent site problem.

Programmatic Needs

CSI has asserted that their programs require an Annex of 18,133 sq.ft. Part of this area is for rental classrooms and other income-producing area. CSI has also stated that the residential portion of the project is required to fund construction of the Annex. The immediate conclusion is that the residential development is necessary to develop certain long-term income-producing property. But CSI has not provided an income forecast for rental income so, as far as one can tell, that income itself might be sufficient to fund the Annex development, without the proposed residences. Therefore, until more is known, the claim that the residential development is required is not substantiated.

More directly, the income-producing portion of the property also contributes to the need for zoning variances in that the 'required' classroom space pushes height and depth requirements that do not fit within existing zoning when the residential implications are also considered. Under the guise of programmatic needs, CSI is in fact requesting variances for a pure, very profitable real estate development.

While it may be conventional for a variance applicant to simply assert requirements without revealing support, the circular logic chain in this instance from larger classrooms - to greater Annex area and height - to variances for residential income - to fund construction of the larger classrooms, begs for more support.

The claim on page 2 of the AKRF letter dated 11 March 2008 that increased capacity "would serve approximately 60 toddlers" up from the current 20, is similarly circular. Of course more space would serve more toddlers. Still more space would serve still more toddlers ad infinitum. Without some grounding in reality it's hard to know where to stop. Perhaps enrollment is actually expected to decrease, and CSI is preparing to compensate by expanding rental income.

Annex Site Value

Page 5 of the December '07 letter, stated that the site value for the Annex is zero. Both letters derive a value of \$750/sq.ft. for the residential portion of the development.

Exactly the same methodology yields a value of \$13,600,500 for the Annex, not zero. The Annex is, after all, built on the same site so, after adjusting downward for lack of views and upward for necessary and unique value of the development to the synagogue (no other site would do), the same \$750/ft² value can be used for the Annex. For its 18,134 ft² a value of \$13,600,500 obtains.

The importance of this real figure is that it explicitly nullifies the F/F method used in arriving at the residential rights value of \$14,816,000 for the Revised Proposed Development in the December '07 letter. Although the Courtyard option has been submitted more recently, the Revised Proposed option is still on the table.

Although the BSA has requested financials for the residential slice only, the reality is that the apportionment of costs and assumptions between the slices significantly affect the result. An alternate analysis showing the effect of the Annex on the Residences, including profitability on Annex construction, can be expected to arrive at different results.

Once zoning variances are granted there is nothing in the CSI submissions that prohibit alternate financial arrangements that would be affected by the value of Annex rights.

Moreover, the reported residential rights acquisition prices of \$14,816,000 or \$13,384,000 exceed the stated cost for Annex construction of \$11,551,000. The excesses of \$3,265,000 or \$1,833,000 are pure profit on a real estate development. This profit, of between 28% and 16% on the Annex development, derives from, and depends on, zoning variances.

Programmatic Link

CSI has stated that the residential variance requests are justified as necessary to fund the Annex portion of the development. But the proposed residences do not support programmatic needs; they generate fungible income that can be used for any purpose, as can other CSI income. As events unfold, the residential income may or may not be applied to Annex construction. There is no necessary link. The variance requests are not actually tied to programmatic needs.

The CSI argument is, at its core, an argument that any commercial income can be justified by any non-profit organization to fund any purpose. A variance grant obtaining from such a link might be consistent with BSA policy but it is at odds with the non-profit requirements of the federal tax code. An inappropriate cost

allocation constituting an implicit investment in the residential development is similarly a problem.

Precedent

Regardless of whether the finding that zoning variations for 6-10 West 70th are not a binding precedent, (Friedman & Gotbaum letter, 11 March '08, page 4) is valid or not, that finding is not binding on the BSA or subsequent applicants either.

Hardship

The Freeman/Frazier letter of 11 March 2008, page 4, describes a 'hardship' in connection with the As of Right Development, but has not claimed that the site itself has created a hardship as required by section 72-21(a) of the Zoning Resolution.

A project idea or concept cannot create "unique physical conditions...inherent in a particular zoning lot" that might justify a variance. The particular As-of-Right configuration put forth by CSI is an example of a straw man, a non-sensical idea that cannot be built because it is inappropriate to the site. If it were to be considered legitimate, one could also propose building a Broadway theater on the site, then claim hardship without zoning variances. Any such hardship is self-induced, as prohibited by section 72-21(d), by choice of development project rather than arising from the lot zoning.

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ATTACHMENT: ROI DERIVATIONS

Derivation of rights Acquisition Prices and Annual ROIs, assume the figures presented in from the Freeman/Frazier letters, including a 28-month overall schedule with overlapping construction and sales.

They use the 75% to 90% leveraging reported in Schedules A and B of the F/F letters, leaving the developer to invest 10% to 25% of his own funds in construction, interest, and acquisition, but then fail to take that leveraging into account when calculating ROI. For example, in the table below, the Courtyard 90% leverage column lists the developer contribution (investment) to the full project cost for acquisition and construction costs.

The soft construction costs exclude construction loan interest, which is shown on a separate line. Carrying costs and transaction taxes are paid directly by the developer but are not leveraged. The Acquisition price was then found as the amount that would result in the Annual ROIs shown in the table.

Returns on Developer Investment With and Without Leveraging

	Revised Proposed Dev, Dec '07		Proposed with Courtyard Mar '08		Revised As of Right Dec '07	
	As Reported w/o leverage	With 85% leverage	As Reported w/o leverage	With 90% leverage	As Reported w/o leverage	With 75% leverage
Revenue	\$38,510,000.00		\$34,039,000.00		\$11,866,000.00	
	Investments \$					
Construction,Hard	(7,488,000)	(1,117,200)	(7,398,000)	(739,800)	(3,722,000)	(930,500)
Construction,Soft	(4,081,000)	(612,150)	(4,010,000)	(401,000)	(2,979,000)	(744,750)
Interest	(2,353,000)	(352,973)	(2,353,000)	(235,315)	(1,358,000)	(339,500)
Acquisition Price	(14,816,000)	(2,222,433)	(13,384,000)	(1,338,405)	(14,816,000)	(548,334)
Carrying Costs	(664,000)	(664,000)	(664,000)	(664,000)	(470,000)	(470,000)
Taxes	(748,000)	(748,000)	(661,000)	(661,000)	(230,000)	(230,000)
Total Investment	(29,402,000)	(5,716,756)	(27,809,000)	(4,039,520)	(23,345,000)	(3,263,084)
Profit	\$8,360,000	\$8,399,629	\$5,569,000	\$5,568,801	(\$11,709,000)	\$913,664
Annual ROI	12.19%	63.00%	8.58%	59.00%	0.00%	12.00%
Notes	(1) The F/F figures deduct transaction tax from gross profit, not added to investment, resulting in slightly higher reported returns. (2) The acquisition price in the As of Right with leverage is \$2,193,336. (3) Other small differences arise because of rounding to nearest thousand. (4) The Total Investment reported by CSI for the Revised Proposed configuration of \$29,402,000 excludes the \$748,000 tax expense, so the sum of the outlays is greater than \$29,402,000.					