

SOUTH HADLEY ELECTRIC LIGHT DEPARTMENT
CONSTRUCTION v. LEASE: CASH FLOW COMPARISON
OCTOBER 15, 2014

The accompanying financial analysis has been prepared by the management of SHELD to evaluate the projected cash outflows resulting from the two most probable / plausible options available to replace the Department's operating facilities. The current operating facilities are no longer viable and their continued use presents risk to our ratepayers and our employees. This is a long-term analysis which covers a twenty-five year period and considers the capital costs involved with occupancy of a facility under both options. It does not attempt to deal with ongoing operational costs, which for purposes of this analysis only, have been assumed to be comparable.

The two most probable / plausible options are:

- a. Construct a new operating facility on the land SHELD already owns.
- b. Enter into a long-term lease for a portion of the property located at 28 Gaylord Street.

The following reflect the significant assumptions employed under each option:

Construction

- a. Total construction cost of: \$10,000,000
- b. Total finance acquisition cost of: \$120,000
- c. Finance period: 20 years
- d. Cost of borrowing: 3.75%
- e. Value of property at end of the analysis period: \$10,000,000

Source of Assumptions - Construction

Total construction costs were supplied by Reinhardt Associates based on the design work completed to date. Finance costs, rates, and periods were supplied by MMWEC, with whom we would expect to finance the construction. Value of the property at the end of the analysis period was assumed to be equal to the initial construction costs.

Lease

- a. Base annual rent: \$200,000
- b. Base rent assumes landlord financed improvements: \$700,000
- c. Additional annual rent attributable to required improvements: \$300,000
- d. Additional rent assumes additional landlord improvements: \$2,800,000
- e. Annual rent escalation: 1.50%
- f. Value of lease at end of the analysis period: \$0

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Source of Assumptions – Lease

While much information has been provided by management on the Gaylord Street property, data on annual rents has not. Therefore, it was necessary to estimate the annual base rent, additional rent, and rent escalation used in this analysis. These estimates were derived using common real estate valuation methods, data from the Town's property tax records, and market data from at least two independent sources. The objectives of these estimates were to arrive at fair market rental amounts for the property in question. The estimates so derived are considered to be conservative.

The required improvement cost estimate was supplied by Reinhardt Associates based upon their review of available information on the property and site inspection.

It is highly unlikely that SHELD would be offered terms / annual rents at any level other than fair market value. The property in question is in financial distress and currently under the control of a court appointed receiver.

As a sanity check, the terms / annual rents specified in the lease with Patriot Care were input into the model developed to estimate the rent numbers used in our analysis. The results showed that the rent calculated in the model was significantly lower than the actual terms specified in the lease with Patriot Care. This supports the positions that the estimates used in the analysis are conservative and that the Gaylord Street property management would not enter into a lease at an amount below fair market value.

Conclusion

Net cash outflows from the lease, assuming either base rent (\$200,000) or base rent plus additional rent (\$500,000) are greater than net cash outflows from construction. In the case of base rent plus additional rent, net cash outflows are about 3.5 times greater than net cash outflows from construction over the 25 year analysis period. The single largest factors in this analysis is that, at the end of the analysis period, the Department will own a substantial and valuable asset which can be utilized, potentially, for an additional 25 – 50 years or sold if it is deemed no longer suitable. Cash outflows from construction terminate after 20 years; cash outflows from the lease continue for the duration of occupancy.

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The following table summarizes the results of the cash flow analysis:

SUMMARY OF NET CASH OUTFLOWS			
		Construction	Lease
Minimal Improvements	(\$700,000)	\$ 4,105,000	\$ 5,995,000
Required Improvements	(\$3,500,000)	\$ 4,105,000	\$ 14,990,000

Notes:

While SHELLED might be able to function in the proposed lease space, the property has significant operational limitations. The property cannot support future expansion should the need arise.

Ownership of the facilities and single occupancy of the property are much preferable to the lease arrangement as SHELLED would be able to respond to changing conditions without the need to consider either lessor restrictions and or common tenant rights.

SHELD
Construction v. Lease
Minimal Office Improvements
For the 25 Year Period Ending 2041

Cash Flow Comparison

Construction

Estimated Construction Cost	\$	10,000,000
Estimated Bonding Costs (based on \$300,000 for \$25,000,000)	\$	120,000
Total Funds Borrowed	\$	10,120,000
Period of Borrowing (Years)		20
Cost of Borrowing (MMWEC: 3.25% - 4.00%)		3.75%

Lease

Annual Rent (see calculations & assumptions)	\$	200,000
Lease / Inflation Escalation Factor		1.50%

	<u>Construction</u>	<u>Lease</u>
Net Cash Outflows	<u>\$ 4,104,750</u>	<u>\$ 5,996,075</u>

SHELD
Fair Market Rental Value - Minimal Office Improvements
2014

Estimated FMV - Adjusted Total			\$ 1,588,591	
MA Real Estate Assessed Percentage			<u>100.00%</u>	
Estimated Assessed Value			1,588,591	
Weighted Average Capitalization Rate			<u>8.48%</u>	
Net Operating Income / per Sq. Ft.			<u>134,712</u>	<u>4.30</u>
Expenses		<u>Assumption</u>		
Reserves - Major Repairs	Per Sq. Ft.	0.50	15,650	
Real Estate Taxes	FMV	18.65	29,627	
Management	Per Month	200	2,400	
Miscellaneous	\$ / Year	2,000	<u>2,000</u>	
Effective Gross Income			<u>184,390</u>	
Vacancy Credit		9.00%	18,236	
NNN Annual Rental			<u>\$ 202,626</u>	
Rounded			<u>\$ 200,000</u>	

SHELD
Fair Market Rental Value - Minimal Office Improvements
2014

Market Assessment of 28 Gaylord Street - Alpha Building

Subject property consists of two buildings. One building is subdivided into three spaces, one of which has been offered for SHELD use. The space offered for SHELD use consists of 8,500 sq. ft. of office space and 22,800 sq. ft. of warehouse space. Occupancy of this space is predicated upon the assumption that the landlord would be willing to invest the funds necessary to bring the property into compliance with SHELD's needs. Minimal office improvements envisioned:

Estimated / Updated FMV	
Total Assessed Value	\$ 3,822,700
Rental Sq. Ft.	31,300
Total Sq. Ft.	134,652
Allocated / Rental	888,591
Minimal Improvements	700,000
Adjusted Total	\$ 1,588,591

Market Data

Per RoyaltyRate.com (Nat'l, 2nd qtr 2014)

	Rates	NOI	OAR	NOI / Sq Ft
Class A & B Office				
Effective Rent \$/sq. ft.	18.65			
Vacancy Rate %	14.80			
Expense Ratio %	58.91			
NOI \$/sq. ft.	6.85	58,225		1.86
OAR %	7.90		2.15	
Class A & B Industrial				
Effective Rent \$/sq. ft.	4.06			
Vacancy Rate %	9.40			
Expense Ratio %	39.22			
NOI \$/sq. ft.	3.34	76,152		2.44
OAR %	8.70		6.34	
Calculated Proportionate Totals		134,377	8.48	4.30

Per Local Appraiser (09/26)

	Rate Range	
NOI \$/sq. ft. - Office	6.00	6.00
NOI \$/sq. ft. - Mfg / WH	3.00	4.00
OAR %	7.75	9.04

SHELD
Construction v. Lease
Required Improvements
For the 25 Year Period Ending 2041

Cash Flow Comparison

Construction

Estimated Construction Cost	\$	10,000,000
Estimated Bonding Costs (based on \$300,000 for \$25,000,000)	\$	120,000
Total Funds Borrowed	\$	10,120,000
Period of Borrowing (Years)		20
Cost of Borrowing (MMWEC: 3.25% - 4.00%)		3.75%

Lease

Annual Rent (see calculations & assumptions)	\$	500,000
Lease / Inflation Escalation Factor		1.50%

	<u>Construction</u>	<u>Lease</u>
Net Cash Outflows	<u>\$ 4,104,750</u>	<u>\$ 14,990,174</u>

SHELD
Fair Market Rental Value - Required Improvements
2014

Estimated FMV - Adjusted Total			\$ 4,388,591	
MA Real Estate Assessed Percentage			<u>100.00%</u>	
Estimated Assessed Value			4,388,591	
Weighted Average Capitalization Rate			<u>8.48%</u>	
Net Operating Income / per Sq. Ft.			<u>372,152</u>	<u>11.89</u>
Expenses	<u>Assumption</u>			
Reserves - Major Repairs	Per Sq. Ft.	0.50	15,650	
Real Estate Taxes	Tax Rate	18.65	81,847	(2014)
Miscellaneous	\$ / Year	2,000	2,000	
Management	Per Month	200	<u>2,400</u>	
Effective Gross Income			<u>474,050</u>	
Vacancy Credit		9.00%	46,884	
NNN Annual Rental			<u>\$ 520,934</u>	
Rounded			<u>\$ 500,000</u>	

SHELD
Fair Market Rental Value - Required Improvements
2014

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Subject property consists of two buildings. One building is subdivided into three spaces, one of which has been offered for SHELD use. The space offered for SHELD use consists of 8,500 sq. ft. of office space and 22,800 sq. ft. of warehouse space. Occupancy of this space is predicated upon the assumption that the landlord would be willing to invest the funds necessary to bring the property in compliance with SHELD's needs. Reinhardt has has estimated required improvements to be:

	Estimated / Updated FMV
Total Assessed Value	\$ 3,822,700
Rental Sq. Ft.	31,300
Total Sq. Ft.	134,652
Allocated / Rental	888,591
Required Improvements	3,500,000
Adjusted Total	\$ 4,388,591

Recap of Fair Market Rental Model Calculations
 Comparison of Rent - Model v. Actual
 2014

	SHELD			Patriot Care	
	Model	Model	Model	Model	Actual Lease
Landlord Funded Improvements	0	700,000	3,500,000	0	0
Net Operating Income					
Total	75,352	134,712	372,152	111,145	135,000
Per square foot	2.41	2.99	8.27	2.47	3.00
NNN Annual Rent					
Total	123,049	202,626	520,934	177,880	244,350
Per square foot	3.93	4.50	11.58	3.95	5.43
Rounded to	120,000	200,000	500,000		