

**REAL ESTATE ECONOMIC ANALYSIS OF PROTOTYPICAL REUSE AND
DEVELOPMENT ALTERNATIVES FOR THE HUNTLEY OUTLET CENTER SITE**

Report to

VILLAGE OF HUNTLEY

From

GRUEN GRUEN + ASSOCIATES

Urban Economists, Market Strategists & Land Use/Public Policy Analysts

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CHAPTER I: INTRODUCTION AND CONCLUSIONS

INTRODUCTION

The Village of Huntley retained Gruen Gruen + Associates (GG+A) to evaluate potential reuse and redevelopment alternatives for the 75-acre Huntley Outlet Center property (the "site") which is currently for sale. The intent of the real estate economic analysis presented in this report is to discipline the consideration of potential reuse or redevelopment options by identifying the likely feasibility of prototypical development alternatives that may be presented to the Village. For example, one developer has already approached the Village indicating potential interest in acquiring the site, demolishing the existing improvements, and creating "pad sites" to resell to developers for the development of industrial, commercial, and hotel uses.

To complete this preliminary analysis, GG+A interviewed several developers and real estate brokers and reviewed relevant secondary data sources to develop estimates of amounts of building space, development and operating costs, obtainable rents and prices, and investment and financial parameters likely to be associated with the prototypical development alternatives.

As illustrated below in Map I-1, the site provides great visibility and accessibility to Interstate 90 but does not possess direct frontage on Route 47. The recently built Weber distribution center is located immediately east of the site.



Map I-1: Location of Site



Although this report is not a direct evaluation of the developer expression of interest that is not sufficiently fleshed out to permit a specific evaluation, we have completed an initial real estate economics analysis of prototypical industrial, hotel and commercial development envelopes that are consistent with the uses proposed for redevelopment. The prototypes evaluated include:

1. 100,000-square-foot industrial building on 8.0 acres of land;
2. 120-room limited service hotel on 2.0 acres of land; and



3. Commercial outlots of 1-2 acres in size.

METHODOLOGY

The residual land value methodology utilized to evaluate the prototypical industrial and hotel development alternatives presented in this report is similar to what is often referred to as an income approach, and provides an estimate of the amount of money a developer could afford to pay for the site or a portion of it given an estimate of the net cash flow that results from the development, operation, and eventual sale of the property. The residual land value given a required Internal Rate of Return (“IRR”) is used as the financial yardstick to estimate feasibility. A project is feasible if a developer can achieve a return on the developer/investor equity that meets a hurdle rate commensurate with the associated risk. In essence, we asked the following question:

How much could a prospective developer-investor pay for land, develop the identified prototypical use options, and earn an IRR that is commensurate with the risk of the investment?

This report presents the prototypical development envelopes, development cost estimates, space market findings (and revenue and operating cost estimates), and investment and capital market inputs underlying the residual land value analysis.

For the initial commercial outlot analysis, we rely on several interviews with brokers marketing property in the area and the review of “comparable” land sales and interviews. While not yielding as much insight about the relative feasibility and supportable land value of future development, we use this “shortcut” until we obtain more information about development costs and obtainable prices or sales for potential commercial outlot uses.

PRINCIPAL FINDINGS & CONCLUSIONS

Industrial Use

The market for industrial use(s) at the site is likely to be highly competitive. More than 250 acres of vacant, already improved industrial land exists close to the Route 47 interchange. Furthermore, assuming demand were to exist in the near-term, supportable land values are unlikely to be high enough to justify demolition of the existing outlet mall buildings and development of speculative industrial space. As described in this report, based upon the initial review of current market and cost conditions, we estimate a residual land value of approximately \$3.00 per square foot of land for a prototypical 100,000-square-foot industrial building.¹ This is before considering demolition costs

¹ If a larger industrial user could be attracted, the residual land value may improve as industrial development costs tend to decline by about 30 percent for buildings in the 500,000-square-foot range. The market is likely to be limited for this large of a user.



that would apply to a redevelopment of the site.² Finished industrial sites adjacent to the Weber distribution center are reportedly being offered for sale at \$4.25 per square foot of land, which is roughly consistent with our estimate of the supportable residual value for unfinished industrial land.

Hotel Use

Interviews with developers and brokers and the proximity of the site to Interstate 90 and the four-way interchange suggest that a limited-service hotel use may be a feasible candidate for redevelopment. Our initial real estate economic analysis of a prototypical 120-room hotel on two acres of land is consistent with this hypothesis. We estimate that this type and scale of use may be able to support a land value of approximately \$9 per square foot, assuming a market deep enough to generate room night demand needed to sustain a new hotel. A limited-service hotel use requires only a few acres of land.

Commercial/Retail Use

Competitive disadvantages or constraints for the development of commercial outlot uses include the following:

- the site does not provide direct access to or frontage on Route 47, which has considerably more traffic than does Freeman Road; and
- the Route 47 corridor still includes vacant land capable of accommodating future retail and commercial development.

The interviews and review of past sales suggest that prevailing prices in the Route 47 corridor can be expected to range from approximately \$400,000 to \$600,000 for a finished "pad" of one to two acres in size. Outlot sales within the past three years along Route 47 have generally ranged from \$5.00 to \$7.00 per square foot of land or approximately \$400,000 to \$500,000 for 1.4 to 2.1 acres of land.

The developer that has expressed interest in the site has estimated total internal roadway and utility improvement costs of approximately \$95,000 per acre of developable land or about \$2.20 per square foot of land. In addition, demolition costs were estimated at \$2.0 million or approximately \$1.40 per square foot of developable land. (Note that the estimates were not provided for individual land uses - retail land improvement costs tend to be higher than industrial costs, for example). Assuming per our interviews and review of recent sales comparables a finished outlot price of \$6.00 per square foot of land, we estimate that the residual land value supported by the commercial outlot prototype is likely to be below \$2.00 per square foot of land. This reflects demolition, roadway and utility improvement costs of approximately \$3.60 per square foot of land plus soft costs and an equity

² Correspondence between Village staff and a proposed land developer of the site indicates potential demolition costs of \$2,000,000 or more. Assuming the site will yield approximately 50 acres of developable land, this would equate to a cost of approximately \$1 per square foot of land.



return totaling an additional \$0.80 per square foot of land. The difference between the finished outlot price (\$6.00) and estimated land development costs (\$4.40) equates to a land value of approximately \$1.60 per square foot of land.

Inferences Drawn from Results of Real Estate Economic Analysis

Based on the results of the preliminary real estate economic analysis described in this report, several inferences can be drawn:

- At least in the short run, the current owner or prospective buyer may find it more profitable to continue to wring out whatever income the partially occupied Huntley Outlet Center (assuming the remaining tenants are obligated and do continue to operate their stores and pay rent) may generate rather than demolishing the Huntley Outlet Center;
- Accordingly, the reservation price or minimum price for which the owner of the Huntley Outlet Center may accept for the property may be higher than what buyers can afford to pay to redevelop the property for the uses described in this report, as envisioned by the developer which has approached the Village to express interest in the property; and
- Therefore, it would not be surprising if the Village was requested to provide incentives, fee waivers, etc., to offset an acquisition price higher than what will permit feasible reuse of the property for industrial and highway-oriented commercial uses.



CHAPTER II: ANALYSIS OF PROTOTYPICAL INDUSTRIAL USE

INDUSTRIAL MARKET CONTEXT AND COMPETITIVE FACTORS

The North Kane County industrial submarket of which the site is apart contains about 30 million square feet of industrial space according to Jones Lang Lasalle. The submarket contains about three percent of the regional industrial space inventory. Table II-1 below summarizes current vacancy rates and asking rents by type of industrial space.

Table II-1: Industrial Market Conditions, 2nd Quarter 2015

	Inventory # Square Feet	Vacancy Rate %	Average Asking Rents ¹ \$ Per Square Foot
NORTH KANE COUNTY:			
Warehouse/Distribution	17,954,450	8.2	5.90
Manufacturing	6,593,625	16.3	5.60
General Industrial	5,198,749	4.8	6.50
<i>Total</i>	<i>29,746,824</i>	<i>9.4</i>	<i>5.87</i>
CHICAGO MARKET TOTAL:			
Warehouse/Distribution	634,277,212	8.9	4.90
Manufacturing	322,835,041	6.6	4.55
General Industrial	150,567,728	4.5	5.69
<i>Total</i>	<i>1,107,679,981</i>	<i>7.6</i>	<i>4.78</i>
¹ "Total" or gross asking rents.			
Sources: Jones Lang Lasalle, Chicago Industrial Statistics, 2Q 2015; Gruen Gruen + Associates.			

The overall vacancy rate in the North Kane County submarket is reported at 9.4 percent which is about two percentage points higher than the regional industrial vacancy rate of 7.6 percent. Manufacturing buildings in particular exhibit a very high vacancy rate above 16 percent in the submarket. Average asking gross rents range from a low of \$5.60 per square foot for manufacturing buildings to a high of \$6.50 per square foot for general industrial buildings. Overall gross industrial rents currently average \$5.87 per square foot. Local rents are approximately \$1.00 per square foot higher than average rents throughout the entire Chicago industrial market. CB Richard Ellis reports average net industrial rents in the North Kane County submarket of \$4.70 to \$4.95 per square foot. This implies typical taxes and operating expenses equal to about \$1.00 to \$1.25 per square foot.

Interviews and secondary data confirm that the local industrial market is predominately comprised



by smaller firms and users. The Huntley zip code area, for example, contains about 160 firms in the Construction, Manufacturing, Wholesale Trade, and Transportation and Warehousing industry sectors. About 75 percent of these firms contain fewer than 10 employees.³ The 757,000 square foot Weber distribution center recently constructed near the site is not representative of the scale and type of industrial product for which most sources or types of demand for industrial space in the market is likely to exist. Interviews suggest that had Weber not already located its headquarters operations in Huntley, it may have likely selected a location on a more preferred national distribution route (e.g., I-55 or I-80). Interviews, however, suggest that the site may be attractive to smaller, regional distributors given its location halfway between Rockford and Chicago. The recently completed Route 47 interchange improvements and the widening of Interstate 90 are certainly key competitive advantages for trucking-intensive industrial users not previously present.

Although the site affords great interstate accessibility and visibility, a considerable amount of entitled and improved industrial land exists close or closer to the Interstate 90-Route 47 Interchange. Examples of industrial land alternatives include the following:

1. Huntley Corporate Park on the west side of Route 47, with 240 acres of fully-improved land offering visibility to and frontage on Interstate 90;
2. Four sites adjacent to the Weber distribution center totaling 30 acres of improved industrial land; and
3. Hampshire Woods Business Park at the Route 20 and I-90 interchange west of the site, including 18 available acres of improved industrial land with a second phase of 81 acres (unimproved) also being marketed for sale.

The improved industrial sites adjacent to the Weber distribution center are reportedly being offered for sale at \$4.25 per square foot. Improved sites in the Hampshire Woods Business Park are being marketed for sale at \$2 to \$3 per square foot. The marketing materials for the Huntley Corporate Park suggest that "land prices up to 50% lower than locations within Elgin and the surrounding area equate to a 10-20% lower overall project cost." The large amounts of improved industrial land available in the vicinity of the site and corresponding low land prices suggest that industrial market conditions will be highly competitive for the foreseeable future.

REAL ESTATE ECONOMIC ANALYSIS

Building Space Development Assumptions

Table II-1 below summarizes the amount of building space and associated land for six industrial buildings constructed within the past 10 years near the site.

³ U.S. Census Bureau, Zip Code Business Patterns data, 2014.



Table II-2: Industrial Floor-Area-Ratio Examples

Name / Location	Land Area # Acres	Building Area # Square Feet	Floor-Area- Ratio
13701 George Bush Ct, Huntley Corporate Park	8.93	89,940	0.23
13851 Prime Pointe Ct, Huntley Business Park	9.48	141,588	0.34
12901 Jim Dhamer Dr, Huntley Corporate Park	14.26	114,308	0.18
13151 Executive Ct, Huntley Pointe Corporate Park	2.88	22,450	0.18
14100 Weber Dr, Weber Distribution Center	57.58	757,000	0.30
13700 George Bush Ct, Huntley Corporate Park	2.40	40,050	0.38
Sources: Rutland Township Assessor; Gruen Gruen + Associates.			

The six industrial buildings range in size from as small as 22,450 square feet to as large as 757,000 square feet. The sites on which the buildings were constructed range from 2.4 acres to nearly 58 acres with corresponding floor-area-ratios generally ranging from 0.18 to 0.38. The average floor-area-ratio of the six industrial building examples summarized above is 0.28.

Table II-2 below summarizes the prototypical industrial development building space characteristics used for purposes of the real estate economic analysis.

Table II-3: Prototypical Industrial Use Assumptions

	Industrial Use
Amount of Building Space	100,000 square feet
Buildable Land Area	8.0 acres
Floor-Area-Ratio	0.29
Source: Gruen Gruen + Associates	

For purposes of this analysis, we assume a prototypical industrial building containing 100,000 square feet of building space on eight acres of developable land. This equates to a floor-area-ratio of 0.29.

Development Cost Estimate

The product type is assumed to be a modern, high-quality warehouse building, including T-five lighting systems, 30+ foot clear heights, ESFR sprinklers, and ample overhead door and loading dock facilities. Table II-4 below presents a development cost estimate, excluding land acquisition and demolition of the existing outlet mall facilities.



Table II-4: Development Cost Estimate for Prototypical Industrial Use

Item	Per Square Foot of Building Area \$	Total \$
Sitework and infrastructure costs @ \$3.00 per square foot of land	10.45	1,045,440
Building hard construction costs	40.00	4,000,000
Tenant improvement costs	5.00	500,000
Soft costs @ 15% of hard costs	8.32	831,816
Total development cost, before land and financing	63.77	6,377,256
Source: Gruen Gruen + Associates		

Based upon information GG+A obtained from industrial developers and a review of recent industrial development proformas for comparable projects in the broader region, we estimate a total development cost of approximately \$64 per square foot for the prototypical industrial use. This includes an assumption about sitework and infrastructure costs of \$3 per square foot of land or about \$10.50 per square foot of building space and building hard construction costs (i.e. "vertical" costs) of \$40 per square foot of building space. Note that demolition costs are not included in the prototypical costs summarized above. We also include tenant improvement costs equal to \$5 per square foot (associated primarily with the build-out of interior office space). We assume soft costs equal to 15 percent of hard construction costs or approximately \$8.30 per square foot. Accordingly, total development costs before costs of the demolition of existing improvements and excluding land acquisition and financing costs for the prototypical 100,000 square foot building are estimated at \$6,377,000.

Market (Revenue) Estimate

The real estate economic analysis of the prototypical industrial use is modeled from the perspective of a low-risk, build-to-suit deal. In other words, we assume one tenant would occupy the entire building immediately following construction. Based upon our interviews and review of prevailing industrial rents in the market area, we estimate an annual net lease rate of \$5.25 per square foot and assume two percent annual escalation. We also include leasing commission expenses of \$1.50 per square foot.



Financial and investment Parameters

Table II-5 summarizes the financial and investment terms stipulated for the real estate economic analysis of the prototypical industrial use.

Table II-5: Financing and Investment Parameters for Prototypical Industrial Use

Equity as Percent of Total Project Cost	25.0%
Internal Rate of Return (IRR) Requirement	12.0%
Sale Year for IRR Calculation	Year 10
Permanent Mortgage Loan Rate	5.0%
Mortgage Amortization Term	25 Years
Year Mortgage Taken Out	Year 2
Construction Loan Financing Costs – Annual Interest Rate	5.0%
Construction Loan Fee	1.0%
Capitalization Rate at Sale Year	8.0%
Sales Expenses as Percent of Sales Price	3.0%
Sources: Urban Land Institute Capital Markets Report; Berkadia Commercial Mortgage LLC; Gruen Gruen + Associates.	

Financial parameters include equity and debt terms, construction and permanent loan arrangements, the Internal Rate of Return (IRR) hurdle rate, and sale capitalization rates. Based on interviews with developers, review of capital markets secondary data, and our prior experience, we assume an equity investment of 25 percent of project costs. We estimate an IRR target or hurdle rate of 12 percent and a holding period of 10 years. We assume a one year construction period and a resulting construction loan period of one year. We estimate a construction loan interest rate of 5.0 percent and a loan fee of one percent. We assume a permanent mortgage loan is obtained in year two to take out or retire the construction loan at an annual interest rate of 5.0 percent with a loan amortization schedule of 25 years. We estimate a capitalization rate, or buyer's required yield on the purchase of the developed property, of 8.0 percent. We assume expenses associated with the sale of the property total three percent of the transaction value.

RESULTS OF REAL ESTATE ECONOMIC ANALYSIS

The real estate investment results of constructing, marketing, and operating the postulated prototypical development alternative were simulated on GG+A's real estate cash flow model REALISM™. As indicated above, based on the postulated revenue and cost assumptions, we calculated a land residual value that would permit an investor in the project which contributed 25 percent equity to earn a 12 percent IRR if the investor held the development for 10 years. As



market factors, interest rates and construction costs change over time, the type of development that can optimize supportable land values will change. The motivations of bidders for a particular site are also affected by the specific needs of each bidder. Bid prices can be above or below the "simulated" residual land value, depending upon expectations about the future and the level of competition for the land. Nevertheless, the investment simulation provides a basis for drawing conclusions about supportable land value and the feasibility of redevelopment. Table II-6 summarizes the results of the real estate economic analysis for the prototypical industrial use.

Table II-6: Residual Land Value Supported by Prototypical Industrial Use

	100,000 Square Foot Building / 8.0 acres
Residual Land Value	\$950,891
Residual Land Value Per Square Foot of Land	\$2.73
Total Project Value	\$7,475,359
Equity Investment	\$1,868,840
Permanent Loan	\$5,606,519
Annual Debt Service	\$397,796
Internal Rate of Return (IRR) in Year 10	12.00%
Source: Gruen Gruen + Associates	

These figures present a perspective for evaluation rather than a cardinal array of hard forecasts. The results are limited by the development potential, market, financial, and other underlying assumptions outlined above. The results of the analysis indicate that the 100,000-square-foot prototypical industrial development alternative would produce a residual land value of approximately \$951,000. This equates to an estimated residual land value of \$2.73 per square foot of land (assuming a 0.29 industrial floor-area ratio). In other words, the investor-developer could pay about \$120,000 per acre for the land needed to site the development and earn a 12 percent annual return on investment. Equity for the project would total about \$1.9 million and the permanent loan would total about \$5.6 million for a total project value of \$7.5 million. Annual debt service would approximate \$398,000.

The residual land value estimate is sensitive to changes in rents and development costs. For example, if rents are 10 percent higher and development costs are 10 percent lower, holding all other factors the same, the residual land value would increase to over \$2,000,000 (over \$6 per square foot). If, however, rents are 10 percent lower and development costs are 10 percent higher, the residual land value would turn negative. That is, the land would need to be given to the developer at no cost plus an upfront payment of about \$467,000 would be needed in order for the developer to realize a 12 percent return on the equity investment.



CHAPTER III: ANALYSIS OF PROTOTYPICAL HOTEL USE

HOTEL MARKET CONTEXT AND COMPETITIVE FACTORS

Table III-1 summarizes the occupancy rate and average daily rate for the northwest suburban hotel market reported by the hotel consultant Horwath HTL in 2014.

Table III-1: Northwest Suburban Hotel Market Trends

	2010 Estimate	2013 Estimate	2016 Forecast
Hotel Inventory Occupancy Rate	54.6%	59.3%	63.0%
Average Daily Rate (ADR)	\$72.20	\$80.29	\$90.75
Sources: Horwath HTL, Special Markets Report, Chicago; Gruen Gruen + Associates.			

Occupancy rates of 65 percent or higher are typically considered a benchmark for supporting the feasible development and operation of a new hotel. The anticipated growth in occupancy rates and daily rates from low figures in 2010 suggest that with continued economic recovery, increase in the amount of employment-generating land uses in the vicinity of the site, a highly visible and accessible location such as the site may be able to support the development of a new limited service hotel. An interview with a active broker in the area indicates the broker has had several inquiries recently from non-local hotel developers seeking to enter the market area with limited service product.

REAL ESTATE ECONOMIC ANALYSIS

Building Space Development Assumptions

Table III-2 summarizes prototypical development parameters for a sample of limited service and extended stay hotel brands.



Table III-2: Limited Service and Extended Stay Hotel Prototypes

	Rooms #	Gross Building Area # Square Feet	Average Room Size # Square Feet	Parking # Spaces	Land Area # Acres	Floor- Area- Ratio
Fairfield Inn & Suites	108	54,414	504	110	1.85	0.68
La Quinta	104	56,914	547	104	1.73	0.76
Courtyard by Marriot	124	67,484	544	130	2.38	0.65
SpringHill Suites	128	71,386	558	128	2.19	0.75
Sources: Franchise Booklets; Gruen Gruen + Associates.						

The example prototypes summarized above, all of which include 4-story buildings, range in size from approximately 54,400 gross square feet to 71,400 gross square feet. The room counts range from 104 to 128, with average room sizes generally approximating 500 to 560 gross square feet of building space per hotel room. Parking is generally provided at a 1:1 ratio to rooms. The size of the prototype sites range from about 1.7 acres to 2.4 acres with floor-area ratios ranging from 0.68 to 0.76.

With a limited-service or extended stay hotel as the most likely product candidate, we use the following prototypical hotel use assumptions for purposes of the real estate economic analysis.

Table III-3: Prototypical Hotel Use Assumptions

	4-Story Hotel Use
Hotel Rooms	120
Average Room Size	550 Gross Square Feet
Total Gross Building Area	66,000 Gross Square Feet
Floor-Area-Ratio	0.76
Land Area	2.0 Acres
Source: Gruen Gruen + Associates	

We assume a 4-story 120-room limited service hotel could be developed on a 2-acre hotel pad site.

Development Cost Estimate

Table III-4 summarizes an estimate of development costs for the prototypical hotel use excluding land acquisition and financing costs and demolition costs of existing improvements. These initial estimates are made based upon a review of HVS International's 2014/15 U.S. Hotel Development



Cost Survey and do not specifically pertain to the location of the site.

Table III-4: Development Cost Estimate for Prototypical Hotel Use

Item	Per Key \$	Total \$
Sitework and infrastructure costs	5,000	600,000
Building hard construction costs	60,000	7,200,000
Furniture, fixtures and equipment (FF&E) costs	10,000	1,200,000
Soft costs @ 15% of hard costs	11,250	1,350,000
Total development cost, before land and financing	86,250	10,350,000
Sources: HVS International; Gruen Gruen + Associates.		

We assume sitework and building hard construction costs of \$65,000 per key or \$7.8 million in total. (Note this equates to sitework and hard costs of approximately \$120 per square foot of building space). We include additional capital costs for furniture, fixtures and equipment (FF&E) equal to \$10,000 per key or \$1.2 million in total. We assume soft costs at 15 percent of hard and FF&E costs or \$11,250 per key and \$1.35 million in total. Total limited service hotel development costs are estimated at \$86,250 per key or \$10.35 million in total for the prototypical 120-room hotel use.

Market (Revenue) Estimate

Table III-5 summarizes the market and operating assumptions stipulated for the analysis of the prototypical limited-service hotel use (which reflects the assumption that rates will continue to improve).

Table III-5: Hotel Revenue and Expense Assumptions

Average Daily Room Rate	\$100.00
Annual Occupancy Rate - Year 1, Years 2+	50.0%, 70.0%
Total Operating Expense as Percent of Gross Revenue ¹	70.0%
Annual Revenue and Expense Escalation	2.0%
¹ Includes departmental expenses, undisturbed expenses (utilities, marketing, admin., property maintenance, etc) and fixed owner chargers such as management fees, franchise fees, insurance, and taxes.	
Sources: Smith Travel Research, HOST Report; Gruen Gruen + Associates.	

Based upon a review of the closest nearby limited-service hotels in the I-90 corridor, we assume an average daily rate of \$100. (Note this rate assumption may be optimistic given the average daily rate



throughout the northwest suburban hotel market is projected at approximately \$90 for 2016, as previously noted). We assume an occupancy rate of 50 percent in the first operating year and 70 percent each year thereafter. Based upon Smith Travel Research survey data for limited-service hotels in the Midwest, we include total operating expenses equal to 70 percent of gross revenues. This includes departmental expenses, building operating expenses, and fixed owner charges such as management and franchise fees. Additionally, we assume that revenues and expenses both grow at two percent annually.

Financial and Investment Parameters

Table III-6 summarizes the financial and investment terms stipulated for the real estate economic analysis of the prototypical limited-service hotel use.

Table III-6: Financing and Investment Parameters for Prototypical Hotel Use

Equity as Percent of Total Project Cost	25.0%
Internal Rate of Return (IRR) Requirement	16.0%
Sale Year for IRR Calculation	Year 10
Permanent Mortgage Loan Rate	5.0%
Mortgage Amortization Term	25 Years
Year Mortgage Taken Out	Year 2
Construction Loan Financing Costs – Annual Interest Rate	5.0%
Construction Loan Fee	1.0%
Capitalization Rate at Sale Year	9.0%
Sales Expenses as Percent of Sales Price	3.0%
Sources: Urban Land Institute Capital Markets Report; Berkadia Commercial Mortgage LLC; Gruen Gruen + Associates.	

Again we assume an equity investment of 25 percent of project costs. Given the development of a hotel use is likely to entail greater risk than an industrial use, we estimate an IRR target or hurdle rate of 16 percent for a hotel use and a holding period of 10 years. We assume a one year construction period and a resulting construction loan period of one year. We estimate a construction loan interest rate of 5.0 percent and a loan fee of one percent. We assume a permanent mortgage loan is obtained in year two to take out or retire the construction loan at an annual interest rate of 5.0 percent with a loan amortization schedule of 25 years. We estimate a capitalization rate, or buyer's required yield on the purchase of the developed property, of 9.0 percent for the hotel use (again, given the heightened risk relative to an industrial use, we assume a higher capitalization rate). We assume expenses associated with the sale of the property total three percent of the transaction value.



RESULTS OF REAL ESTATE ECONOMIC ANALYSIS

The real estate investment results of constructing, marketing, and operating the postulated prototypical hotel development alternative again were simulated on GG+A's real estate cash flow model REALISM™. As indicated above, based on the postulated revenue and cost assumptions, we calculated a land residual value that would permit an investor in the project which contributed 25 percent equity to earn a 16 percent IRR if the investor held the development for 10 years. Table III-7 summarizes the results of the real estate economic analysis for the prototypical hotel use.

Table III-7: Residual Land Value Supported by Prototypical Hotel Use

	120-Room Hotel / 2.0 acres
Residual Land Value	\$748,318
Residual Land Value Per Square Foot of Land	\$8.59
Total Project Value	\$11,337,662
Equity Investment	\$2,834,415
Permanent Loan	\$8,503,246
Annual Debt Service	\$603,326
Internal Rate of Return (IRR) in Year 10	16.00%
Source: Gruen Gruen + Associates	

The results of the analysis indicate that the prototypical 120-room hotel development alternative would produce a residual land value of approximately \$748,000. This equates to an estimated residual land value of \$8.59 per square foot of land (assuming a 0.76 hotel floor-area ratio).⁴ In other words, the investor-developer could pay about \$375,000 per acre for the land needed to site the development and earn a 16 percent annual return on investment. Equity for the project would total about \$2.8 million and the permanent loan would total about \$8.5 million for a total project value of \$11.3 million. Annual debt service would approximate \$603,000.

⁴ According to the Kane County Assessor, a 1.83 acre site in the Capitol Corporate Center business park located at the I-90 and Randall Road interchange in Elgin sold in 2009 for approximately \$14 per square foot for a hotel use (Candlewood Suites).



CHAPTER IV: ANALYSIS OF PROTOTYPICAL COMMERCIAL OUTLOT USE

INTRODUCTION

This chapter presents an analysis of a prototypical commercial outlot use that would be improved to a pad-ready condition and then sold to a freestanding food or commercial user. This approach is what the developer which expressed interest in the site to the Village would do, as opposed to developing the commercial building itself and seeking users to lease space in the building.

RETAIL MARKET CONTEXT AND COMPETITIVE FACTORS

Our initial interviews with brokers and developers suggest some potential demand for commercial pad sites with visibility to I-90 and access to the new interchange. Without a large retail anchor, the type of commercial outlot users likely to consider the site can be expected to be "highway-oriented" in nature, or in other words, uses that rely heavily upon interstate travelers and impulse stops.

One competitive disadvantage for commercial uses is that the site does not provide direct access to or frontage on Route 47, which has considerably more traffic than does Freeman Road. Another constraint, similar to land supply conditions that will likely affect the viability of an industrial use, is that the Route 47 corridor still includes vacant land capable of accommodating future retail and commercial development. The Huntley Grove and Regency Square developments on Route 47, just north of the interchange, both still include several outlots available for sale or ground lease. Interviews suggest that additional retail development directly on Route 47 will likely need to take place before any significant scale of commercial/retail use can be supported on the site. The local market is also still quite small in comparison to the trade area served by the Randall Road retailing agglomeration just east of Huntley which includes more than three million square feet of retail space.⁵

REAL ESTATE ECONOMIC ANALYSIS

Our interviews suggest that prevailing prices in the Route 47 corridor can be expected to range from approximately \$400,000 to \$600,000 for a finished "pad" of one to two acres in size. Table IV-1 below summarizes a sample of outlot land sales along Route 47 over the past several years.

⁵ Within three miles of the site, according to Pitney Bowes estimates, the population totals less than 26,000 people.



Table IV-1: Route 47 Commercial Outlot Sales

	Size # Acres	Date Sold	Sale Price \$ Total	Sale Price \$ Per Square Foot
Taco Bell	1.00	3/1/2006	725,000	16.64
Harris Bank	2.32	7/1/2009	1,275,000	12.62
Jimmy John's/Little Ceasars/Rookies Building	1.85	9/1/2012	487,817	6.05
McDonald's	1.38	11/1/2013	400,000	6.65
Aldi	2.09	2/1/2014	500,483	5.50
Source: Gruen Gruen + Associates				

Finished outlot sales have ranged from approximately \$5.50 to \$16.60 per square foot of land along Route 47. However, sales made within the past three years have all been below \$7.00 per square foot of land or approximately \$400,000 to \$500,000 for 1.4 to 2.1 acres of land. This is consistent with the obtainable pricing estimate by provided by a broker/developer active in the Route 47 corridor north of the site.

The developer that has expressed interest in the site has estimated total internal roadway and utility improvement costs of approximately \$95,000 per acre of developable land or about \$2.20 per square foot of land. In addition, demolition costs were estimated at \$2.0 million or approximately \$1.40 per square foot of developable land. Note that the estimates were not provided for individual land uses (retail land improvement costs tend to be higher than industrial costs, for example).

Table IV-2 presents a comparison between these estimated land development costs and obtainable pricing for finished commercial outlot sites.



Table IV-2: Estimated Residual Land Value for Commercial Outlot Use

	Commercial Outlots \$ Per Square Foot of Land
Finished Pad-Ready Outlot Sale Price	6.00
Land Development Costs:	
Internal Roadways & Utility Improvements	(2.40)
Demolition of Existing Outlet Mall	(1.20)
Land Development Soft Costs @ 15%	(0.54)
Return on Equity ¹	(0.26)
Total Land Development Cost	(4.40)
Residual Land Value	1.60
¹ Assumes equity investment equals 25 percent of costs and that 25 percent annual return on equity investment is required to be feasible.	
Source: Gruen Gruen + Associates	

Assuming per our interviews and review of recent sales comparables a finished outlot price of \$6.00 per square foot of land, we estimate that the residual land value supported by the commercial outlot prototype is likely to be below \$2.00 per square foot of land. This reflects demolition, roadway and utility improvement costs of approximately \$3.60 per square foot of land plus soft costs and an equity return totaling an additional \$0.80 per square foot of land.



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