



MICHAEL J. ROBERTS

NABIL N. EL-HAGE

Lance Johnstone: Developing 3000 North Broad

It was April, 2007 and Lance Johnstone and Corey Galloway were meeting, as they often did, at the Rainbow Cafe, a small coffee shop in North Philadelphia. The two men were reviewing the latest piece of news that threatened to derail their real estate development a few blocks north, at 3000 North Broad Street. Johnstone was a former NFL defensive end, who had played 5 seasons with the Minnesota Vikings and 6 with the Oakland Raiders. He had participated in an executive education program for NFL Players at Harvard Business School in 2005, where he had met Galloway, the proprietor of a business consulting firm in New York. Johnstone had been interested in real estate development for several years, and was seriously looking at property near his hometown, in downtown Philadelphia. He was particularly drawn to the area near Temple University, his alma mater, which suffered from a shortage of student housing.

Shortly after returning from HBS in the spring of 2005, Johnstone purchased the parcel of property at 3000 North Broad Street for \$185,000, with the intention of developing residential housing. He called his new friend Galloway, who agreed to help in return for some of the upside and a small retainer, and the two began working on developing a business case, working through the zoning and regulatory hurdles, obtaining financing, and purchasing the adjacent parcel of property from the city of Philadelphia. By early 2007, they had a fairly solid plan, approved by the city, as well as a general contractor on board, and a bank loan of \$1.9 million which, together with \$800,000 or so in funds Johnstone was prepared to commit, would cover the projected total cost of the project of \$2,700,000. This included a \$2,075,000 construction budget, "soft" costs of \$368,000 and the land (\$257,000, including the additional adjacent lots purchased from the city). Initially, Johnstone had very ambitious plans to pursue a \$20 million-plus development, but after looking at the numbers and discussing the project with Galloway, they agreed to pursue a pilot project and use this 3000 North Broad as the foundation for Johnstone's pursuit of later, more significant developments.

In April of 2007, however, the plan was dealt a blow when the bank pulled out of the loan commitment, citing the general contractor's ("GC") inability to pull together a detailed back-up for the capital budget they were loaning against. The men had worked to line up another bank, and had received a commitment from Clarion National Bank – but for only \$1.7 million, rather than the \$1.9 million the Franklin Federal Bank had committed. A few weeks later, the project was dealt another blow when the "final" construction budget came in at \$2,500,000, or \$425,000 higher than originally

Senior Lecturer Michael J. Roberts and Professor Nabil N. El-Hage prepared this case. HBS cases are developed solely as the basis for class discussion. Cases are not intended to serve as endorsements, sources of primary data, or illustrations of effective or ineffective management.

Copyright © 2008 President and Fellows of Harvard College. To order copies or request permission to reproduce materials, call 1-800-545-7685, write Harvard Business School Publishing, Boston, MA 02163, or go to <http://www.hbsp.harvard.edu>. No part of this publication may be reproduced, stored in a retrieval system, used in a spreadsheet, or transmitted in any form or by any means—electronic, mechanical, photocopying, recording, or otherwise—without the permission of Harvard Business School.

planned. Over the next week, the men scrambled to work with the contractor to try to get the budget back to a viable number, and succeeded in lowering it to \$2,200,000.

Thus, with the revised construction budget and the lower loan, the men now faced an equity financing requirement of \$1,125,000, or \$325,000 higher than originally anticipated.

Johnstone and Galloway faced a choice. In Johnstone's words: "We can pull the plug, or try to make this work." The funding gap has gone from \$800,000 which I was prepared to fill, to well over \$1 million, which I am not. We need to decide whether the project still makes financial sense at these investment levels, and if so, whether to raise more money from outside equity investors – with whom we have had some discussions – or continue on without the money we need in hopes of getting all the pieces to fall in place at the end. Galloway described more fully what this last option entailed:

The bank has said they'd be willing to go to \$1.9 million if we can "prove" that the financial projections are realistic - the evidence they want to see is a signed lease at the rental rates we are forecasting. Similarly, the contract we have with the GC calls for a 10% "holdback" on the contract until a certificate of occupancy is issued – basically when the project is done. By then we will have signed leases and some deposits. So, if we proceed on the current basis, we can make up this \$325,000 shortfall with a combination of the holdback – which we won't have to pay until we have some deposits, and the additional \$200,000 we will get from the bank.

Background: Lance Johnstone

Johnstone grew up in Philadelphia, and went to Temple University, a short distance from his family home. He played linebacker in college, earning All Big East honors and was a second round draft pick, joining the Raiders, who were then in the process of moving from LA to Oakland. Johnstone realized that – even if successful - he would need to plan for his post-playing career: "I always thought that the NFL was more like a Head-start as opposed to the end-game." When he lived in Oakland, Johnstone made a few small real estate investments: "I would buy a house in need of some work, do the work, live in it for a while, then sell it – I did that twice in Oakland and then again in Minnesota after I was traded to the Vikings in 2001." After 5 years with the Vikings, Johnstone was considering retiring, but was picked up for one more year by the Raiders, and went back to Oakland. "By then, my knee was giving me problems. I was playing hurt, and by the end of 2006, I knew I didn't want to play anymore." Johnstone retired at the conclusion of the 2006 season.

Johnstone had continued to return to Philadelphia in the off season to see his family, and believed there was a real opportunity to invest in real estate development projects near Temple.

Pursuing a Project in Philadelphia

In 2002 and 2003, with retirement on the horizon, Johnstone seriously turned his attention to finding a project in Philadelphia that he could develop. "I walked up and down the street near Temple, writing down addresses, looking up the owners, talking to people at Temple about their plans." Johnstone tried this approach for a couple of years, and had a few leads. Invariably, however, once mini-camps and training camps started up, all momentum would be lost as he turned his energies back to football.

Background: The Temple Area Real Estate Market

Temple was a University of 34,000 students located in North Philadelphia. The school had a well-regarded medical school and a large hospital, part of an even larger medical complex, some 1.5 miles from the main campus. These two areas were connected by North Broad Street, one of Philadelphia's major streets. From a real estate perspective, Temple was regarded as something of an "oasis" in a part of the city that had suffered significant decay. Indeed, the 1.5 mile stretch of North Broad between the two Temple campuses featured a large number of vacant and crumbling buildings, as well as a fair number of vacant lots, where the city had demolished buildings it deemed blighted, in hopes that this would clear the way for new development. So far these hopes had largely gone unfulfilled. Yet, Temple provided housing for less than 10% of its 8,600 graduate and professional students. A large new medical facility was rising on the medical school campus, planned for completion in 2009, and representing a \$160 million investment by the university. Another \$250 million of projects were slated by the university to come on line between 2006 and 2011.

Johnstone and Galloway studied the rental rates for apartments in the area (see Table A below) and also looked at occupancy rates. The university and City center areas were generally popular living communities, with occupancy rates of 92% and 97%, respectively. As Johnstone and Galloway examined the distribution of rental rates and apartment types, it was clear to them that there was a demand for more "luxury" units that could command a premium price. The men decided to charge \$2,500 for a 3 bedroom and \$2600 for a 4-bedroom "luxury townhome rentals".

Table A Philadelphia Rental Rates 2005

Type of Apartment *	Studio	1 BR	2 BR	3 BR
All Temple Area Apts.	\$534	\$557	\$940	\$1,396
Renovated Temple Area Apts.	\$604	\$774	\$1,010	\$1,481
All Philadelphia Apts.	\$670	\$797	\$1,053	\$1,548

The men examined the demographics of the area, compared with the national averages (see Table B below).

Table B Local vs. National Demographics

Local Demographics	No. Broad	National Average
Median Age	35.9 years	37.41 years
Median Household Income	\$18,961	\$39,728
Percentage of Single Households	81.9%	44.72%
Percentage of Married Households	18.1%	55.27%
Percentage Families (households with children)	64.3%	69.28%
Average Household Size	2.62 people	2.57 people
Percentage College or Better	7.9%	25.99%
Percentage White Collar	40.9%	47.07%
Avg. Household Total Consumer Expenditures	\$34,396 / year	\$41,554 / year
Total Crime Index	6.6	3.47
Culture Index	160.0	93.56

3000 North Broad was located about 2/3 of the way between the two campuses, a bit closer to the medical facilities. Johnstone knew from his research that Temple was 4,000 beds "short" of providing its students with housing:

They don't provide housing for juniors and seniors, nor do they have any grad student housing. They decided a while ago they wanted to spend their money on their own infrastructure, and let the "market" develop the student housing. But, this hasn't happened, - at least in the North Broad neighborhood - as the situation around their campus has frightened developers away.

When Johnstone returned from the Harvard program in the spring of 2005, he was more committed than ever to finding and developing a property. He continued his research on available real estate, and soon focused on 3000 North Broad. These 3 vacant lots struck him as attractive, given their corner location, their proximity - 2 blocks - to the existing medical complex and the new medical facility. Moreover, these 3 lots were next to 2 lots (3006 and 3008 North Broad) that the city owned, and Johnstone was confident that he could purchase these lots as well. Believing in the basic premise he had been researching for several years, Johnstone purchased the 3 lots for \$185,000 in July of 2005. He quickly initiated discussions with the city to buy the adjoining two lots. The process took longer than expected: "There was an amazing amount of red tape and complexity. At one point, the city fired the whole redevelopment authority, and we had to start from scratch." But, by June of 2006, the other two lots had been purchased as well.

During the rest of 2006 and early 2007, Johnstone worked to move his plan forward. One piece of the puzzle was getting a partner: "I knew I had a lot to learn and wasn't as comfortable with the business and finance end as I wanted to be. I had met Corey up at Harvard and we hit it off, so when I wanted some help I called him"

Background: Corey Galloway

Corey Galloway grew up in Brooklyn, NY and attended American International College, graduating in 1991. He pursued an MBA degree at Pace University in New York, and then joined MTV and then Sesame Workshop, where he worked for 13 years, ultimately serving as director of operation in their respective divisions. In 2005, Galloway left the entertainment business and formed his own consulting firm, Legacy Growth Partners. Legacy focused on matching business development opportunities with wealthy individuals, including professional athletes. Galloway had enrolled in the 3 year "Owner President Management" Program at Harvard Business School. During that session, Galloway and Johnstone met at the School, when Johnstone was attending an executive education program HBS run by the NFL.

Pursuing 3000 North Broad

Johnstone and Galloway struck a deal in which Galloway would receive a 5% interest in the project, as well as an additional 5% of equity as a success fee for his efforts. Galloway began to help Johnstone develop a business case and construction plan for the property. The men formed an LLC - Urban Renaissance Group (URG) to pursue the project. Johnstone described an example of the kind of issues they faced:

We decided to use a prefabricated building format. Well, when we went before the zoning board, the head guy just said no. No explanation, no suggestions, just no. It was clear the

problem was that this type of building obviously uses less of the city's union labor force, as most of the work is done outside the city. So, I went around to everyone, made the case that the buildings were built with union labor here in Pennsylvania, that we needed a project like this to get this part of the city going, and that it would have a lot of follow-on benefits to prove out the case for building in this neighborhood. In this and many other cases I was able to use my network to help move things ahead. I never asked anyone for anything they couldn't rightfully do – but I think my name helped get the calls returned, helped us at least get a meeting to make our case.

The men engaged an architect, a general contractor, a legal team to help push the project through the various stages of city approvals and permitting. "It was a much more time consuming process than we'd envisioned." Still, some good did come out of it. There were incentives to develop in this part of the city, including a 10-year abatement on property taxes, which helped make the project more viable.

As their efforts took shape, the development became a plan for 10 duplex units – two 4-bedroom units and eight 3-bedroom, for a total of 32 bedrooms and 17,250 square feet of living space.

Based on these rough plans and a per square foot building cost estimate, a construction budget of \$2,075,000 million was developed. This meant the capital budget for the entire project was as follows:

Construction:	\$2,075,000
Land	\$257,000
<u>Soft costs</u>	<u>\$368,000</u>
TOTAL:	\$2,700,000

See **Exhibit 1a** for a more detailed budget, including breakdown of estimated "soft" costs, **Exhibit 1b** and **1c** for financial projections and **Exhibit 1d** for the men's calculations of prospective financial returns.

Franklin Federal Bank

Galloway worked to line up bank financing. Johnstone described some of the difficulties: "One of the things they hammered into us at Harvard was not to sign a personal guarantee. So, I told Corey, 'no personal guarantee.'" Galloway continued: "When I approached the banks, I told them there were a couple of conditions, that there was no point in talking if they needed a personal guarantee. For most banks, this was a deal-killer, but we made some progress with Franklin Federal Bank, and ultimately came to terms with them in early 2007." Franklin Federal Bank's approach to determining how much to lend was to value the project based on the investment, and then to loan 70% of that value. Thus, against the \$2,700,000 budget, the bank was willing to lend \$1,900,000. (Note that the bank had "rounded up" the mathematical result of \$1,890,000 to the \$1,900,000 figure.) However, the bank was quite stringent in its demand that the General Contractor (GC) provide a detailed line item budget for the construction project, in order to allow it to make the proper evaluation of the capital cost. The bank set a firm deadline of April 1, which came and went without the GC providing such a budget. "We really felt let down. We were new at this, but we figured the GC would know what the bank wanted and be able to deliver it. They kept stalling and ultimately, said they just

couldn't do it until they had "final" drawings from the architect." Thus, April 1 came and the bank pulled its loan commitment.

Clarion National Bank

Galloway scrambled to find another source of debt financing, and was able to bring Clarion National Bank along fairly quickly. "We had 95% of the paperwork done, so it was not too difficult. The only issue was the actual valuation of the project. Instead of looking at the project on a "cost" basis, Clarion National tried to value it using both comparables and cash flow. We worked with the appraiser, but the problem was that there were no comparables. We were the first residential development in this area in 12 years. Their other approach was to look at the rent roll and the cash flow margin. They wanted to see that our cash flow margin left us at least a 50% cushion – that is, that monthly cash flow would be 50% higher than the required monthly payment. And, when they tried to do this, based on our rent roll, they didn't believe our rent projections."

For all these reasons, Galloway and Johnstone were not too surprised when the bank came through with a lower loan amount, \$1.7 million rather than \$1.9 million. Moreover, as rates had moved up during this time period, the interest rate was now 7.25%, 50 basis points (1/2 of 1%) higher than the original Franklin Federal loan. (See Exhibit 3 for bank term sheet.)

Meanwhile, in late April of 2007, with the construction drawings now 90% complete, the GC came back with a revised estimate of the building costs of \$2.5 million. "We were stunned. The GC said they just couldn't do the accurate estimate prior to having these drawings." Johnstone & Galloway set to work, pushing back on the GC trying to get the budget back in line with their original estimates.

With available bank credit down by \$200,000 and the budget increased by nearly \$500,000, there was now a requirement for almost \$700,000 of additional equity capital. Johnstone and Galloway set to work, pushing back on the contractor and attempting get the budget down closer to the original figure. "We locked them in the room for 3 days and said we just had to bring the number down. By the time we were done, the revised budget stood at \$2.2 million. This still left a \$325,000 gap." (See Exhibit 2 for financial scenario corresponding to new assumptions of 7.25% interest, \$1.7 million loan, \$2.2 million construction budget.)

Thus, as April drew to a close the men wrestled with how to close this \$325,000 gap. As they pushed back on the bank, the bank agreed that it would reevaluate its appraisal as the project got closer to completion and there was more data – ideally a signed lease – to justify a higher rent roll and therefore a higher valuation. The other possible source of funding that Galloway was tempted to utilize was the "retention" on the contract with the GC. In essence, this provided that the developers - URG – could hold back 10% of every progress payment until the building had received its certificate of occupancy. This would take place when the building was fully completed and ready to be occupied – by which point Johnstone and Galloway believed they would have leases in place, and deposits from tenants, and could use those funds to make the last payments to the contractor.

Equity Financing

Johnstone had entered into discussions with an investment group organized by another player he met at the HBS program: "Daniel was also from Philadelphia and when we started talking about my plans, he said he had worked with a group and to give him a call if anything ever materialized. I did,

and we had some pretty serious discussions early on when I was pulling this together. He had a group of investors who offered to invest \$500,000 (See Exhibit 4 for draft terms) but I was hoping to avoid having outside equity investors, and was wary of the control they might exert." Note that this term sheet was for a \$500,000 investment that was originally contemplated to supplement \$300,000 of Johnstone's funds, to equal the \$800,000 in equity funds originally contemplated. Obviously, now that the total funding requirement was higher, the terms of this deal would have to be re-cut if it proceeded.

* * *

Johnstone and Galloway reviewed their options. They felt they had too much invested to back out now, and all of the changes in the real estate market since they'd begun had been positive ones. Temple's new medical facility had broken ground and there was a flurry of construction activity. There continued to be a shortage of rental apartments in the area. But they wanted to be sure the numbers made sense.

Exhibit 1a 3000 North Broad Capital Budget and Financing (July 31 fiscal year)

<u>Capital Budget / Uses of Funds</u>		<u>Financing / Source of Funds</u>	
Land	257,000	Loan	1,900,000
Construction	2,075,000	Equity	800,000
		Total Financing	2,700,000
Soft Costs			
Insurance	5,000	Loan Amount	1,900,000
Survey	3,000	Interest Rate	6.75%
Permits	5,000	Term - Years	30
Legal	45,000	Total monthly mortgage payment	(12,323)
Market and feasibility study	7,500		
Marketing and Promotion	25,000		
Loan Fee	15,000		
Title Insurance	3,000		
Government Relations	2,000		
Architect/ Engineering Fees	20,000		
Taxes	3,000		
Capitalized Interest*	75,500		
Project Management	50,000		
Contingency 5% of project budget	109,000		
Total Soft Costs	368,000		
<u>Total Capital Cost</u>	<u>2,700,000</u>		

*Note: Capitalized interest is for the time period before the loan converts from interest only to a constant pay mortgage

Source: Company

Exhibit 1b Annual Financial Statements for Years 1 through 10

Rental Revenue Assumptions		# units	Rent/Unit	Total Rent
4 Bedroom	2	4 bed	2,400	4,800
3 Bedrooms	8	3 bed	1,800	14,400
Gross Rent			4,200	19,200
Vacancy Rate			5.0%	
Growth Rate in Monthly Rent			3.0%	

Notes: assumes rental begins in Jan 08 and Units are full in Feb
 Depreciation calculated straightline over 27.5 years

Income	Ann'l Assump	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 8	Year 9	Year 10
Gross rent		124,800	244,431	251,764	259,317	267,097	275,110	291,864	300,620	309,638
Vacancy		6,240	12,222	12,588	12,966	13,355	13,755	14,168	15,031	15,482
Net rent		118,560	232,210	239,176	246,351	253,742	261,354	277,271	285,589	294,156
Expense										
Repairs	7,560	4,095	7,560	7,560	7,560	7,560	7,560	7,560	7,560	7,560
Electric	3,780	2,048	3,780	3,780	3,780	3,780	3,780	3,780	3,780	3,780
Taxes	-	-	-	-	-	-	-	-	-	-
Insurance	10,000	5,417	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000
Management Fee	22,680	12,285	22,680	22,680	22,680	22,680	22,680	22,680	22,680	22,680
Total Projected Expense		23,844	44,020	44,020	44,020	44,020	44,020	44,020	44,020	44,020
Operating Income		94,716	188,190	195,156	202,331	209,722	217,334	233,251	241,569	250,136
Depreciation		53,182	98,182	98,182	98,182	98,182	98,182	98,182	98,182	98,182
Net Income		41,534	90,008	96,974	104,150	111,540	119,152	135,069	143,387	151,955
Depreciation		53,182	98,182	98,182	98,182	98,182	98,182	98,182	98,182	98,182
Cash Flow Before Debt Service		94,716	188,190	195,156	202,331	209,722	217,334	233,251	241,569	250,136
Interest		74,617	126,820	125,354	123,785	122,108	120,313	118,394	114,145	113,955
Principal		11,646	21,060	22,526	24,095	25,773	27,567	31,540	33,736	33,925
Total Debt Service		86,264	147,880	147,880	147,880	147,880	147,880	147,880	147,880	147,880
Cash Flow After Debt Service		8,452	40,309	47,276	54,451	61,842	69,454	85,370	93,688	102,256
Debt Outstanding at Year End		1,888,354	1,867,294	1,844,767	1,820,672	1,794,900	1,767,333	1,737,846	1,706,306	1,636,486

Exhibit 1c Analysis of Potential Returns

Equity Invested	800,000
Assumed Valuation Multiple*	12
Year 5 Valuation	2,516,663
Debt outstanding	1,794,900
Equity Value	721,763
Year 10 Valuation	2,898,825
Debt Outstanding	1,672,571
Equity value	1,226,254

Cash Flows by Year	0	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10
Cash Flows	(800,000)	8,452	40,309	47,276	54,451	61,842	69,454	77,294	85,370	93,688	102,256
5 year exit scenario - IRR		3%				783,605					
10 year exit scenario - IRR		10%				61,842	69,454	77,294	85,370	93,688	1,328,510

* Valuation assumed to be at a multiple of Cash Flow before financing charges
Value in exit year includes both annual cash flow and equity value in terminal year

Source: Company

Exhibit 2a 3000 North Broad Capital Budget and Financing (July 31 fiscal year)

Capital Budget / Uses of Funds		Financing / Source of Funds	
Land	257,000	Loan	1,700,000
Construction	2,200,000	Equity	1,125,000
		Total Financing	2,825,000
Soft Costs			
Insurance	5,000	Loan Amount	1,700,000
Survey	3,000	Interest Rate	7.25%
Permits	5,000	Term - Years	30
Legal	45,000	Total monthly mortgage payment	(11,597)
Market and feasibility study	7,500		
Marketing and Promotion	25,000		
Loan Fee	15,000		
Title Insurance	3,000		
Government Relations	2,000		
Architect/ Engineering Fees	20,000		
Taxes	3,000		
Capitalized Interest*	75,500		
Project Management	50,000		
Contingency 5% of project budget	109,000		
Total Soft Costs	368,000		
Total Capital Cost	2,825,000		

* Note: Capitalized interest is for the time period before the loan converts from interest only to a constant pay mortgage

Source: Company

Exhibit 2b Annual Financial Statements for Years 1 through 10

Rental Revenue Assumptions			Rent/Unit	Total
	# units			
4 Bedroom	2	4 bed	2,400	4,800
3 Bedrooms	8	3 bed	1,800	14,400
Gross Rent			4,200	19,200
Vacancy Rate			5.0%	
Growth rate in rent			3.0%	

Notes: assumes rental begins in Jan 08 and Units are full in Feb 08
 Depreciation calculated straightline over 27.5 years

124,800.0

Income	Ann'l Assump	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year	Year 8	Year 9	Year 10
Gross rent		124,800	244,431	251,764	259,317	267,097	275,110	283,363	291,864	300,620	309,638
Vacancy		6,240	12,222	12,588	12,966	13,355	13,755	14,168	14,593	15,031	15,482
Net rent		118,560	232,210	239,176	246,351	253,742	261,354	269,195	277,271	285,589	294,156
Expense											
Repairs	7,560	4,095	7,560	7,560	7,560	7,560	7,560	7,560	7,560	7,560	7,560
Electric	3,780	2,048	3,780	3,780	3,780	3,780	3,780	3,780	3,780	3,780	3,780
Taxes	-	-	-	-	-	-	-	-	-	-	-
Insurance	10,000	5,417	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000
Management Fee	22,680	12,285	22,680	22,680	22,680	22,680	22,680	22,680	22,680	22,680	22,680
Total Projected Expense		23,844	44,020	44,020	44,020	44,020	44,020	44,020	44,020	44,020	44,020
Operating Income		94,716	188,190	195,156	202,331	209,722	217,334	225,175	233,251	241,569	250,136
Depreciation		55,644	102,727	102,727	102,727	102,727	102,727	102,727	102,727	102,727	102,727
Net Income		39,072	85,463	92,429	99,604	106,995	114,607	122,448	130,523	138,841	147,409
Depreciation		55,644	102,727	102,727	102,727	102,727	102,727	102,727	102,727	102,727	102,727
Cash Flow Before Debt Service		94,716	188,190	195,156	202,331	209,722	217,334	225,175	233,251	241,569	250,136
Interest		71,726	122,002	120,715	119,332	117,846	116,248	114,530	112,684	110,699	110,527
Principal		9,453	17,162	18,449	19,831	21,318	22,916	24,634	26,480	28,465	28,637
Total Debt Service		81,179	139,164	139,164	139,164	139,164	139,164	139,164	139,164	139,164	139,164
Cash Flow After Debt Service		13,537	49,026	55,992	63,167	70,558	78,170	86,011	94,087	102,405	110,972
Debt Outstanding at Year End		1,690,547	1,673,385	1,654,936	1,635,105	1,613,787	1,590,871	1,566,237	1,539,757	1,511,292	1,480,693

Source: Company

Exhibit 2c Analysis of Potential Returns

Equity Invested	1,125,000
Assumed Valuation Multiple*	12
Year 5 Valuation	2,516,663
Debt outstanding	1,613,787
Equity Value	902,876
Year 10 Valuation	2,898,825
Debt Outstanding	1,511,292
Equity value	1,387,533

Cash Flows by Year	0	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10
Cash Flows	(1,125,000)	13,537	49,026	55,992	63,167	70,558	78,170	86,011	94,087	102,405	110,972
5 year exit scenario - IRR		1%				973,434					
10 year exit scenario - IRR		8%									
	(1,125,000)	13,537	49,026	55,992	63,167	70,558	78,170	86,011	94,087	102,405	1,498,506

* Valuation assumed to be at a multiple of Cash Flow before financing charges
 Value in exit year includes both annual cash flow and equity value in terminal year

Source: Company

Exhibit 3 Draft Terms and Conditions

**DRAFT TERMS AND CONDITION
NOT A COMMITMENT TO LEND; FOR DISCUSSION PURPOSES ONLY**

BORROWER(S): Urban Renaissance LP

PRINCIPAL(S): Lance Johnstone, Corey Galloway

AMOUNT: \$1,700,000 Construction Line of Credit, converting to permanent mortgage (herein known as "Credit Facility")

TOTAL COMMITMENT: \$1,700,000

AVAILABILITY: Line of Credit will be funded upon presentation of invoices from contractor for work completed and in place according to the schedule of construction and approved by Bank construction consultant and based upon inspections.

TERM: One year (1), interest only converting to fully amortizing thirty (30) year Permanent Mortgage Loan, at such time as total amount of commitment has been advanced and all construction is complete and certificates of occupancy have been obtained.
SHOULD CONSTRUCTION BE COMPLETED SOONER THAN ONE YEAR, TOTAL COMMITMENT CAN BE CONVERTED TO FIXED RATE PERMANENT MORTGAGE AT THAT TIME

USE OF PROCEEDS: Construct series of apartment units

FINANCING FEE:

Application Fee:	\$ 750.00
Commitment Fee (1% of loan amount):	<u>19,000.00</u>
Total Fee	\$19,750.00

CLOSING FEE Reasonable closing costs. All costs incurred to close this transaction shall be borne by the Borrower.

INTEREST RATE: During the interest only period, rate will float at Clarion National Bank ("CNB") Prime (currently 7.25%) until Line of Credit convert to Permanent Mortgage Loan, which will be at a Fixed Rate of at the then prevailing 10 year Treasury rate plus 300 basis

points. Indicative rate is 7.25%. The interest rate on the Credit Facility will be reset every five years indexed to 10 year Treasuries plus 300 basis points.

PREPAYMENT:

During the term of the Permanent Mortgage Loan if the Permanent Mortgage Loan is prepaid in whole or in part Borrower will pay to Bank a prepayment premium equal to three percent (3.0%) of the principal prepaid in the first year of the Permanent Mortgage Loan; three percent (3.0%) in the second year of the Permanent Mortgage Loan; two percent (2.0%) in the third year of the Permanent Mortgage Loan; two percent (2.0%) in the fourth year of the Permanent Mortgage Loan; and one percent (1.0%) in the fifth year of the Permanent Mortgage Loan. this prepayment premium formula will be renewed every five (5) years.

COLLATERAL:

Blanket First Mortgage on 3000-3008 North Broad Street, Philadelphia, PA; Assignment of Leases and Rents; security interest in the fixtures and equipment.

**ADDITIONAL
COLLATERAL:**

\$100,000 Certificate of Deposit placed at CNB until such time as the Borrower achieves a 1.25x debt service coverage. Debt Service Defined as Net Operating Income plus Debt Payments plus Depreciation divided by Debt Payments. Calculation measured annually.

**APPRAISAL/
INSPECTIONS:**

A Loan to Value Ratio not greater than 70% of the collateral value.

Appraisal performed by an appraiser pre-approved by CNB. The cost of the appraisal is TBD and shall be borne by the Borrower.

**BANK'S
CONSULTANT:**

Bank shall have the right to retain, at Borrower's expense, an independent architect or engineer ("Bank's Consultant") to review and advise the Bank with respect to all plans and specifications, construction and architectural contracts, change orders, governmental permits and approvals, and other matters related to the design, construction, operation and use of the Project, to monitor the progress of construction and to review on behalf of Bank.

Source: Company

Exhibit 4 Proposed Term Sheet for Equity Investor for 3000-3008 N. Broad Street

Note: this term sheet was developed during a stage in planning when it was contemplated that Lance Johnstone might raise outside equity rather than contribute the \$800,000 project cost himself.

- Total estimated capital – \$500,000.00 (Five Hundred Thousand Dollars and zero cents) to be drawn on upon final agreement.
- Form of investment – 500,000 membership units, to be organized as LLC.
- Valuation of the company is \$3,000,000.
- Each member will receive cumulative preferred dividend at 15%, compounded annually and disbursed monthly.
- Proportional allocation of voting rights initially and ultimately until entity is liquidated or Investor chooses to exit after 5 years. Managing partner will have at least majority voting rights.
- Deferment of Dividends on membership interest – Dividend will be deferred 6 months or until the property is fully rented.
- Preferences on liquidation – Preferred (investor) member receives amount invested plus accrued dividends.
- “Put” – Investor may redeem investment of their membership interest after 5 years.
- Profit distributions – The first \$800,000 of net distributions will be allocated back to the Managing Partner (Lance Johnstone) and to the Investors in proportion to their original equity contributions (\$300,000 from Johnstone and \$500,000 from Investors, in this scenario). After the initial investment is recouped, distributions will be made in accordance with the following formula: Investor receives next \$250,000 of distributions. After these \$1,050,000 of distributions, next \$1,000,000 of distributions are split 50% to Managing Partner, 50% to Investor. Any distributions after this point are split 70% to Managing Partner, 30% to Investor.
 - Example – Property is sold in 5 years for \$3,000,000 (leaving 1,205,100 after payment of outstanding mortgage debt). And, annual cash flows total \$203,732 for first 5 years. This equals \$1,408,833. First \$800,000 goes back to equity contributors, leaving \$608,833. In addition, assume all 15% of preferred dividend paid at end of 5 years, an additional payment of \$75,000 to investors, leaving \$533,833. Investor receives first \$250,000 of this, leaving \$283,833 to be split 50% - 50% to Managing Partner and Investor.

Source: Company