September 14, 2011

Mark Finigan
Assistant City Manager
City of Key West
525 Angela St
Key West, Florida 33040

VIA EMAIL

RE: SENIOR HOUSING - GROUND LEASE COMMENTS

Dear Mark,

Per your request, following are my comments on the proposed ground lease between the City of Key West and Family Pride Corporation. I would like to make the disclaimer that Senior Capital Advisors was not engaged to handle the negotiation of the ground lease, so my comments assume that there is some general level of agreement by the parties with respect to the major terms. Also, my comments mostly relate to how the ground lease may impact the financing (debt and equity) of the project and how the terms relate to industry norms and practices.

Unfortunately, I will not be able to attend the upcoming City Council meeting on September 19th due to a previous engagement. However, please feel free to call or email me with any questions or comments.

- Preamble
  - "Phase II may contain independent living units." This could be interpreted to mean that it may only contain independent living units, so I think it should say "may also contain" or some similar verbiage.
  - Making Phase II contingent on landlord approval may be an issue for an equity investor. Instead, perhaps approval could be only contingent on certain operating targets for Phase I, such as occupancy; developer being current with debt service; in compliance with terms of the ground lease, etc.
- 3 – Term
  - 3.3 – Having a term of only 49 years will present a huge obstacle for most, if not all, construction and permanent lenders and some equity investors. The term should be moved back to the original period of 99 years, with Phase II being co-terminus. A 99-year term is the industry standard for ground leases and gives lenders a much better comfort level.
  - 3.3 – No need for the Option Periods if the term reverts to the original period.
- 4 – Rent
  - 4.2 – The rent language should be only on a per unit basis, without reference to the 42 market rate units since the actual number could go up or down. The current language only contemplates an increase in market rate units. Alternately, the language could be changed to say "for example . . . ".
  - 4.1, 4.2 and 4.3 – With respect to the rent levels, It is SCA's opinion that the initial 10-year period of rent at $1 per year is more than enough time for the Developer to stabilize the

Senior Capital Advisors
12640 N Bayshore Dr | North Miami, FL 33181
C 305-606-8662 | F 305-735-5074
www.srcapadvisors.com
Licensed Real Estate Broker | Licensed Mortgage Broker

property, secure permanent financing and earn something approaching a reasonable return on the equity investment. This assumes that construction costs do not increase substantially and that low- and moderate-income residents will still have some form of reimbursement program available. The land value on a per-unit basis appears to be appropriate given the fact that the project will contain low- and moderate-income units which present several serious concerns for any owner/operator. The market rate units will need to subsidize the low- and moderate-income units, and will, therefore, lower the profit margin and debt service coverage ratios. This concern becomes amplified in the event reimbursement programs, such as Medicaid, are further reduced. It should be noted that such cuts have already been announced; however, full details are not yet known.
    - 4.9 – Does this section mean that Landlord terminate the lease at any point in time? If so, it will not be financed by any lender or equity investor.
- 5 – Use
    - 5.1 – There is no mention of the workforce housing units.
    - 5.1 – Is the language prohibiting restriction of location for low- and moderate-income units appropriate given that there will be top floor units that will rent for much more money than the other units? This additional rental income is critical in maintaining profit margins and ultimately the financial well being of the project.
    - 5.1 – The idea that a "change in use" is a default may be fine, but what exactly constitutes a change in use? If an adult day care service is added would that be considered a change of use? What if the workforce housing units were eliminated and some independent living units were added?
    - 5.2 – The first instance of the word "consultant" in line 5 of the paragraph should be changed to "consult".
    - 5.3 – Non-compliance issues for ALFs will typically fall under the auspices of Florida's AHCA, so it would probably be appropriate for this agreement to defer to whatever guidelines are imposed by that agency.
- 8 - Assignment and Subleasing
    - 8.1 – Restricting the Tenant's ability to change management, by allowing the Landlord to withhold consent for any reason or no reason, should be an issue for the Tenant in that it would restrict the Tenant's ability to sell at some point. Notwithstanding Section 19 (Leasehold Mortgagee), this section may be an issue for the equity investor and lender. Typically, lenders and investors may want/need to push for a change in management if the current manager is underperforming or not acting in an appropriate manner, or if the lender or investor is forced to take over. This provision should likely be stricken or at least modified so that it is subordinate to the potential for sale or takeover by a lender or investor. In other words, the restriction or right of approval on the part of the Landlord should only come into play in the event that there is no change in control of the leasehold.
- 12 – Insurance
    - 12.2 – Limits appear to be high compared with industry norms. Coverage for ALFs is typically more in the range of $1M per occurrence and $3M aggregate for both general

liability and professional liability. Larger limits not only cost the operator more, but can sometimes attract nuisance suits which further drive up legal and other costs.

- 12.2 – In the last paragraph, "adjusted upward, it," should be changed to "adjusted upward, if".

- 20 – Default
  - 20.6 – Assigment of Rents; Receiver: The assignment of rents provision may run afoul of a lender's mortgage documents which are largely non-negotiable.

Sincerely,

Bruce M. Gibson, Principal
Senior Capital Advisors, Inc.