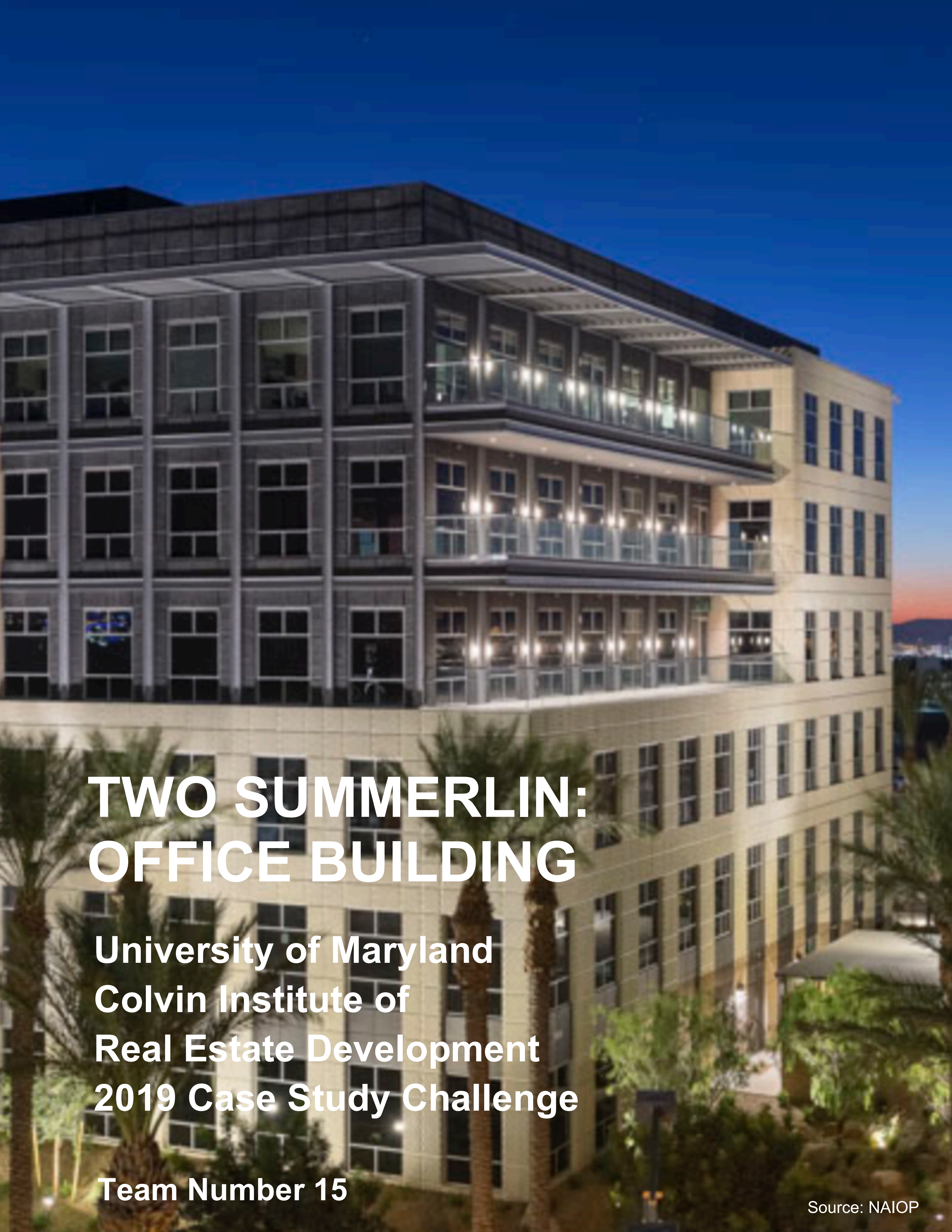

TWO SUMMERLIN: OFFICE BUILDING

University of Maryland
Colvin Institute of
Real Estate Development
2019 Case Study Challenge

Team Number 15

Source: NAIOP

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Executive Summary

Welcome to "**Two Summerlin**" in Las Vegas, Nevada; our team's project for the 2019 Colvin Case Study Challenge. Two Summerlin is in an emerging Central Business District (CBD) area surrounded by Downtown Summerlin and Red Rock Casino. Two Summerlin is the anchor for the Urban Core. The project was completed in August 2018 and cost $49 million. The building is a Class A LEED Silver Office Building that was recognized by NAIOP's Southern Nevada Chapter with the 2019 Spotlight Honor Award in the Spec Office Buildings.

Two Summerlin was 80% preleased before completion and is now 98% leased. Two Summerlin's average rent is $3.20 per square foot, and the tenants include Howard Hughes Corporation, WeWork, Avision Young, RSM US, Aristocrat Technology, JRS Hospitality, and Greenberg Traurig, LLP.

Two Summerlin is a six-story office building with 153,000 total square feet on a 3.79-acre parcel that is adjacent to the National Bank Hockey Arena, the Aviator Baseball Stadium, Red Rock Casino, and Downtown Summerlin. It is easily accessible from all areas of Las Vegas via the 215-county highway or the Summerlin Parkway.

Two Summerlin is the first standalone office development for Howard Hughes Corporation since the company split from General Growth Property. Two Summerlin is a massive success for the Howard Hughes Corporation since they were able to deliver the office building on time and budget with a higher-performing NOI.

The Howard Hughes Corporation has learned a number of lessons through the development of Two Summerlin. However, they believe this office space is a success and would not have done the project any other way. Howard Hughes Corporation was able to provide the right product at the right time while anchoring the Urban Core of the Summerlin Master Plan Community.

Howard Hughes Overview

Howard Hughes Corporation

Howard Hughes Corporation (HHC) split off from General Growth Property in 2009 after filing bankruptcy. The Howard Hughes corporation became a preeminent independent developer, and the name was a tribute to the purchaser of the land in western rim of Las Vegas that is known as Summerlin.

Howard Hughes Corporation specializes in Master Plan Communities. Typically, Howard Hughes Corporation will acquire land then sale a portion of the land to a new home builder to build residential houses. Then Howard Hughes Corporation uses the proceeds to develop the vertical develops for the Master Plan Community.

Howard Hughes Corporation recently put up for sale two billion dollars' worth of assets with their new leadership. Howard Hughes Corporation plans to allocate money backed to its larger project like Summerlin. Woodlands and Summerlin are two of the best Master Plan Communities that Howard Hughes has developed.

Summerlin

Howard Hughes bought the Summerlin land in 1952 and held on to it for over 30 years before developing into Summerlin Master Plan Community. Along the way, Mr. Hughes helped protect Red Rock Canyon by exchanging the land that is protected by the National Land Conservation. In 1990 the Summerlin Parkway was completed and connected Summerlin to Las Vegas. Then ten years later, in 2000, the construction of the 215 through Summerlin began and would make Summerlin easy access from the airport and the Las Vegas strip.

By 2006 Red Rock Casino Resort & Spa would open, attracting more consumers to the area. In 2007 Summerlin was #1 Best place to live and play by National Geographic adventures. By 2012 Summerlin had more than 100,000 residents. In 2014 Downtown Summerlin opened on October 9. In 2016 the NHL Practice Facility broke ground. In 2018, the Baseball Stadium opened, and Howard Hughes Development's team completed Two Summerlin.

Photo of Summerlin Source: Howard Hughes Corporation

Development Team

Developer: Howard Hughes Corporation

Howard Hughes Corporation (HHC) was founded in 1913. HHC currently is a primary real estate developer in the United States. NYSE listed HHC in 2019 has a total asset of 7.5 billion dollars. The primary operation area of HHC includes single-family houses, apartments, shopping malls, multi-family, offices, and hotels. HHC is well known as a Master Plan Community developer, which is developing and managing Woodland TX, Summerlin NV, Columbia MD, and Bridgeland TX. Columbia and Woodland were rated as the best cities to live in the US.

Project Architect: EV&A Architects

VCC has over 30 years of experience in the commercial real estate construction industry. It is a full-service construction company. As a commercial contractor, VCC has built numerous large projects across the country and all product types. VCC was rated among the top 100 construction companies in the United States. Additionally, VCC has built One Summerlin, which is the sister property of Two Summerlin.

General Contractor: VCC General Contracting

EV&A architects is a Las Vegas-based company that has multi-years' experience of building design. EV&A primarily provide building design service and internal design service for commercial real estate projects. EV&A has several engineers and designers who hold LEED Certification, and EV&A has designed many LEED Certified high-efficiency commercial properties. The company in the Las Vegas area is famous for its excellent building design and client-first operating philosophy.

Leasing Agents: Randy Broadhead, SIOR & Amy Lance, CBRE

Randy Broadhead has more than twenty-nine years of experience in commercial real estate in Las Vegas. Mr. Broadhead specializes in office sales, leases, and land sales. Mr. Broadhead has been awarded as a top 5 producer for more than 20 years. Mr. Broadhead is a member of the National Association of Industrial and Office Properties (NAIOP), Society of Industrial and Office Realtors (SIOR), and was the President of SIOR in 2008.

Amy Lance is part of the region’s top-producing teams that specialize in office space. Ms. Lance is responsible for marketing, day to day client account operations, lease negotiations, and working directly with their clients to meet the client’s leasing needs. Ms. Lance is a member of NAIOP and CBRE Cares – Stay in School “eMentoring” Project.

Market Study

Primary Market Area and Demographic Trend

Two Summerlin recently opened in the master-planned community of Downtown Summerlin near Las Vegas, and is the local headquarters of The Howard Hughes Corporation, a national developer of residential, office and retail properties. Although Downtown Summerlin is one of the company's developments, Two Summerlin is the next element of its corporate master plan build-out for the community.

Two Summerlin offers much-needed corporate office inventory for the Las Vegas Valley and was 80 percent preleased prior to its opening in August 2018. Building amenities include state-of-the-art technology such as a water-cooled, variable-volume mechanical system that produces high-efficiency cooling and heating, LED lighting and high-speed wireless technology. Fourth- through sixth-floor balconies provide views of the Las Vegas Strip and the Red Rock Canyon mountains.

Competitive Properties Analysis and Market rate Comparable Properties

The Howard Hughes Corporation solicited Two Summerlin's design through a request-for-proposal process and a design competition that attracted national and local architecture firms. The winning design, by Nevada-based Ed Vance & Associates Architects (EV&A), offered high-design yet budget-conscious construction along with knowledge of the area. Matthew Burns, EV&A's project manager, was responsible for design, construction administration and commissioning.

SWOT Analysis

Strengths	Weaknesses
• Rare Class A Office Building around the Summerlin Area • Green element of building	• Grey shell condition, High cost for tenant improvements
Opportunities	**Threats**
• Californians moving to Las Vegas since Las Vegas has a better business environment • Being a significant landmark • Setting the Standard for office buildings	• Economic Downturn • Too many new office buildings may be built in the future due to the high demand • Default risk of WeWork • Sino-US Trade Tension

Risk Analysis

Risk 1 Tenant Default Insurance (Except WeWork)

In general, besides WeWork, HHC chose excellent tenants. The main tenants are all top companies in their industry. Their business is stable, and the performance is strong. The default risk is extremely low with high probability to complete the contract.

Risk 2: WeWork

According to the tenant analysis, we believe WeWork has a high risk of default. The breach of contract in the short term will cause a significant impact on Two Summerlin's 2020 NOI. Usually, it takes half a year for the landlord to find a new tenant. WeWork's annual rent is about 2 million dollars plus the commission and tenant improvement incurred for a new tenant. Therefore, we expect a WeWork default will likely bring $2-3 million in losses. Based on the 100% occupancy rate of the sister property One Summerlin, we believe it will not be too hard for HHC to find new tenants to occupy the space WeWork leased. Therefore, WeWork default will not lead to space vacant in the long term and affect the property value.

Risk 3: Economic Downturn

The US economy has continued to recover since 2008. It has maintained a good upward trend for many years. However, the growth rate of the US economy in 2019 has slowed down. Even though the Fed cut interest rates for three consecutive quarters, it has not achieved significant results. The GDP growth fell to under 2% reaching the lowest level since 2009. Based upon a number of economic indicators, the risk of an economic downturn and even an economic recession in the next few years is High.

Risk 4: Sino-US Trading Station

The trade war began in April 2018, and it has been about one and a half years since then. The trade volume between China and the United States has decreased significantly, and the number of Chinese tourists to the United States has declined. The primary industries in Las Vegas are tourism, gambling and conventions. Many of its exhibitors are Chinese companies, and most of the casino's international clients are also China Tourists. Therefore, Sino-US trading sanctions may have an impact on the Las Vegas economy, business environment, and employment, which will affect the value of the commercial real estate.

Risk 5: Other Operations Insurance Parking Lot

Two Summerlin has only 424 private parking spaces, with a ratio of only 3:1000. Moreover, its primary tenant, WeWork is a shared office mode, meaning greater parking demand. The maximum capacity of WeWork can reach 500 people. Since public transportation is inconvenient in Summerlin, the demand for driving is high. Two Summerlin could face a severe shortage of parking that could affect leasing. Parking is medium risk since HHC does not have a clear plan to add parking.

Return Analysis

IRR

Based on the information in the 2018 annual report of HHC, we found that the interest rate of the permanent loan is 4.1%. Then, based on the default risk of WeWork and the consequential loss, we did a 10% risk provision for the average 2.5 million potential loss, which is 250,000 dollars for 2020. Then, we got the projected NOI from 2020 to 2025: 3.7million, 4.1million, 4.2million, 4.3million, 4.5million, and 4.6 million. Then, we calculated the terminal value of 61 million based on 4.6 million projected 2025 NOI and 7.5% exit capitalization rate. Then, based on the total development expense of 49.5 million and a loan amount of 33.4 million, we calculated the after-tax equity internal rate of return for 20%.

ROE

Based on 21% corporate income tax rate and 25% capital gain tax, we found the ROE for Two Summerlin from 2020 to 2024 is 14%,16%,17%,17%, 48%. On a compounded basis, the average annual ROE is 16%

NPV

Based on a 7.8% discount rate and a 7.5% exit cap rate, we calculated the NPV of Two Summerlin is 8.8 million and reflects a 55% return of 16.1 million equity investment.

Sensitivity Analysis

We have tested a wide range of possible discount rates and a possible exit cap rates, we determined Two Summerlin has a 77% possibility of generating a positive before tax NPV. We believe our forecast of 7.8% discount rate and a 7.5% Exit cap rate is reasonable and truly reflects the market condition and the capital investment of HHC.

Sensitivity to Exit Cap Rate

Several factors can change the exit cap. Firstly, changes in interest rate policy will affect exit cap, usually lower interest rates will lead to property price increase as the cost of capital for buying a property is reduced. Higher property prices will lower the market average cap.

Secondly, the change in property tax policy will cause a substantial change in the price of the property. California will vote on new commercial property tax law or phase 11 in 2020, which will require reassessing home prices every three years. Analysts believe the phase 11 could lead to 11 billion dollars commercial property tax increase per year and will shrink the commercial property value. Since the business activities in Nevada are less than business activities in California, if Nevada wants to follow the pace of California and change the commercial property tax law, we believe the property value will shrink even more than California.

Thirdly, the market sentiment will affect the property value and cap rate. A buyer dominated market will reach a high cap rate while a seller dominated the market will result in higher property value and pull down the cap rate.

Finally, the economic conditions could affect property value and cap rate.
Economic conditions have always had a significant impact on commercial real estate prices. When the economy is expanding rapidly, the property price will

rise. On the other hand, when the economy slows down or even declines, the price of the property will fall and even fall sharply.

We calculated every 0.5% change in the exit cap rate could impact up to $5 millions of Two Summerlin's terminal value.

According to the market analysis reports, we found that the average cap rate of a 5 to 7-year-old Class A office building in the Las Vegas market is about 7.5%. Based on the given information, we predict that the exit cap will be approximately 7.5% in 2024.

Sensitivity to Discount Rate

We use project WACC as a discount rate, which is the cost of debt plus the cost of internal capital use. According to the 2018 annual report, the debt cost of this project is 6 %, and the weight is 67. 5 %. We calculated Internal capital costs by CAPM. The calculation of the CAPM Method based on the average market return minus risk-free rate then multiply by company beta, then plus the risk-free rate. We chose 11% as the market return since it is the average return of SP 500 over the last ten years. We found the risk-free rate, which is a 10-year treasury bill, is 1.9%, and a beta of HHC is 1.06, according to MarketWatch. Based on these data, we calculated the cost of equity is 11.55%, with a weight of 32.5%. Finally, we calculated the project WACC at 7.80%.
We found that every 0.5% change in discount could lead to a $700,000 change in equity return.

We believe our measure of project discount rate/ WACC of 7.8% is accurate and can reflect the true cost of capital incurred in this project.

WeWork Common Area Source: WeWork.com

Site Description

Downtown Summerlin

Summerlin Map Source: Howard Hughes Corporation

Howard Hughes bought the Summerlin Development land in 1952 for $3 per acres. He purchased the 25,000 acres and held on to it for over 30 years before he started to develop it into Summerlin Master Plan Community. Along the way, Mr. Hughes made land exchanges to her protect Red Rock Canyon. In 1990 the Summerlin Parkway was completed and connected Summerlin to Las Vegas. Then ten years later, in 2000, the construction of the 215 freeway through Summerlin began and would make Summerlin easy access from the airport and the Las Vegas strip. By 2006 Red Rock Casino Resort & Spa would open, attracting more consumers to the area, and in 2007 Summerlin was #1 Best place to live and play by National Geographic adventures.

By 2012 Summerlin had more than 100,000 residents, and in 2014 Downtown Summerlin opened. Downtown Summerlin has 106 acres of Fashion, Dining & Entertainment. The first office/retail building, One Summerlin, and Downtown Summerlin achieved Silver LEED certification setting the standard for this area. In 2016 the NHL Practice Facility, National Bank Arena, broke ground, and the Baseball Stadium was soon to follow in 2018. These developments help create the Commercial Core for the Summerlin Master Plan Community.

Two Summerlin

Howard Hughes Corporation constructed Two Summerlin on an 8.71-acre parcel in the Downtown Summerlin area. The development team decided to divide the parcel into two separate parcels, and the office building and parking garage occupy a 3.79 parcel. The second half of the parcel was allocated to the National Bank Arena since their lease started before the building of Two Summerlin. The office building has a parking garage and a shared open lot with the Arena.

Since the lot is near Red Rock Canyon, the land was not level and had caliche. The location of the parking garage had a 10-foot fall. The slope required Howard Hughes Corporation to install a retaining wall, and they were able to conceal the level change with the parking garage walls.

Development Vision

Parameters of Design

Howard Hughes had in mind that they were creating an Urban Core for the Summerlin Master Plan Community. The Urban Core already had the anchors of the Aviators baseball stadium, the National Bank Arena, and Downtown Summerlin. Two Summerlin is the anchor for the Urban Core of the Master Plan, it needed to match the rest of the community.

Two Summerlin is the first standalone office building by Howard Hughes Corporation. Howard Hughes Corporation put out a request for proposal to create a contest for the selection of the architect. The design process was laid out for acceptable yields in the Las Vegas market.

Choosing an Architect

The three things Howard Hughes Corporation considered when looking for the architect of Two Summerlin was the design of the product, the creativity of the team, and the opportunity to have multiple eyes on the site that was about to be developed. This helped Howard Hughes Corporation to see multiple points of view and work toward their desired outcome.

EV&A was awarded the contract and suggested angling the building to take advantage of the Red Rock Canyon on the west side of the building and the Las Vegas Strip on the east side of the building. EV&A designed an outdoor event plaza for tenants to schedule their events. The Balconies take in the views on both the Red Rock Canyon and the Las Vegas Strip Views.

Two Summerlin Balconies Source: NAIOP.org

EV&A was able to provide a tilt-up building that is considered Class A. Based on the past development of One Summerlin, which is attached to retail in the Downtown Summerlin Complex, a glass curtain wall was costly, and Howard Hughes wanted a way around spending the extra money. They were able to use a precast concrete exterior screen, glass, and steel that was cost effective. EV&A created a Class A office building that worked well with the Desert environment. The precast panels help with reducing cooling costs and increasing tenant comfort in the summer months.

Two Summerlin Precast Panels Source: NAIOP.org

Planning and Entitlements

Planning Within the Master Plan Community

Being part of a Master Plan Community, Howard Hughes Development team had to work closely with Howard Hughes Corporation for the Master Plan Community. For the development team, this meant to have wider sidewalks than the code required, the color scheme to be approved to match the other projects in the CBD, and the landscaping had to match the master plan community.

The community did not push back on the development. Howard Hughes did send out a mailer to the houses within a thousand feet of the building. Two Summerlin is in the core of the CBD, and there's not many houses in this area.

Studies Performed

In 2016 when Howard Hughes Corporation was planning Two Summerlin, the geotechnical report came back with caliche. The caliche was repaired by a hard dig to break up the sedimentary rock to be able to build on the land.

Howard Hughes Development performed an external market study for the lender. Two Summerlin was 80% preleased before opening and did not have any issues with financing. The development team provided Corn-shell space to the tenants, and the CFO was issued upon the completed tenant improvements, 3-5 months later.

Two Summerlin Site

Source: Howard Hughes Corporation

Building Analysis

Common area analysis
Compared to other class A office, Two Summerlin only has a minimal common area, including elevators, hallways, and stairs. There is no lobby and reception in the building. The only highlight is an outside picnic area. Two Summerlin provides a lawn for tenants to hold events. Tenants only need to reserve the space in advance, and then they can use the lawn to hold events for free. Although the facility is not perfect, the limited common area leads to a low load factor. The tenant will have more usable areas, and a highly usable area ratio compared to other class A office. The usable area/rentable area ratio is 87% in Two Summerlin. Based on the office market condition of Las Vegas, we believe a low load factor could help Two Summerlin to attract and retain tenants.

Office space
Two Summerlin has a total of 6 floors of office space; each floor has about 24,500 square feet of rentable area. The building has been separated as 15 units to fulfill tenants' needs. Most of the first floor is used as the new local headquarters of Howard Hughes Corporation, while Avison Young occupied the rest area on the first floor. The second and third floors are leased to WeWork corporation. The fourth floor is leased to GT and other tenants, the fifth floor is leased to CLA and other small tenants, and the sixth floor is leased to RSM US and other small tenants.

Two Summerlin EV&A Source: NAIOP.org

Parking
Two Summerlin currently has two parking lots. The main parking lot is a three-story parking building with 424 spaces. The parking building is electrically gated, and vehicles must swipe a parking pass to park inside the lot. Also, Two Summerlin shares a surface parking lot located on the south of the building with the newly built hockey facility. The surface lot has about 500 spaces. We calculated the attached parking space ratio, and we found it only has about three independent parking spaces per 1,000 square feet of rentable area. It is lower than the market average parking space ratio of 4:1000.

Tenant Analysis

WeWork, 50,000 SQFT occupied
Founded in 2010, the New York-based WeWork Corporation is a shared workspace giant. As a popular new economy company, WeWork has secured ten rounds of funding by different venture investors in the last nine years, with total funding over $13 billion. Also, earlier this year, WeWork reached a $47 billion valuation, even beyond Google and Uber when those companies were nine years old. Softbank is the largest shareholder of WeWork. The business model of WeWork

is to lease large office space from the office building landlord, mostly in the local high-end office buildings. After the renovation of the space, it will re-rent as shared and fixed workstations to its clients, mainly small businesses. WeWork provides Meeting Rooms, mail, and other value-added services for its clients. The concept is to enable more people to work in high-end office buildings and maximize the use of Class A office space. WeWork tried to create more workstations within a typical office and then sublease and profit from it. However, this business model has been unable to create a positive operating cash flow for the past nine years. Also, the company expand rapidly over the last five years, signed many of lease contracts, and has been unable to find enough customers to rent the workstations in the WeWork office. So, the company has been losing money for nine years, and the amount of losses has been expanding. Finally, the operating issues were exposed when the company prepared an IPO in the third quarter of this year.

Since there was no profit model, and it was facing a cash flow crisis, the investors were discouraged, forcing WeWork to give up its IPO plan. Now, according to media reports, WeWork's cash reserves are about $500 million, which can support WeWork to operate for only two months. According to media reports, the board of directors of the company is negotiating new financial support with its largest shareholder, Softbank.

According to reports, Softbank's plan provides the company with a $1.5 billion equity investment and $5 billion of debt at a valuation of $8 billion. The valuation provided by Softbank is far from the previous estimate of $47 billion, and the company has been unable to reach an agreement with Softbank. We are convinced that WeWork’s default risk is high.

Howard Hughes Corporation 15,000 SQFT occupied

HHC is one of the leading real estate developers in the United States. The company has a history of more than 100 years, and now the main business is the development and management of MPC (master planned communities). The primary source of income is still land sales and home sales. The company's total assets are about $ 7.5 billion, and its net assets are about $ 3.4 billion. The profitability of the past three years has shown a downward trend, and the asset-liability ratio is rising, according to HHC's annual reports. Summerlin is the only MPC that HHC is developing. HHC holds about 25000 acres of land in Summerlin. It has developed downtown Summerlin, Baseball Stadium, and many single-family homes. The annual home sale revenue in the Summerlin area is about $100 million dollars.

Based on the financial analysis of the company for the past three years, we believe that although the company's profitability declines and the debt ratio increases, the company's cash is sufficient.

The operating cash flow continued to be positive, and the ability to perform the lease contract was strong. In summary, the company's default risk is low.

CLA 9,000 SQFT occupied

Founded in 1960, CLA is the 8th largest accounting firm in the United States and currently has about 6100 employees. In 2018, the company’s revenue reached

$865 million. We believe the company has an extremely low default risk.

RSM 10,600 SQFT occupied

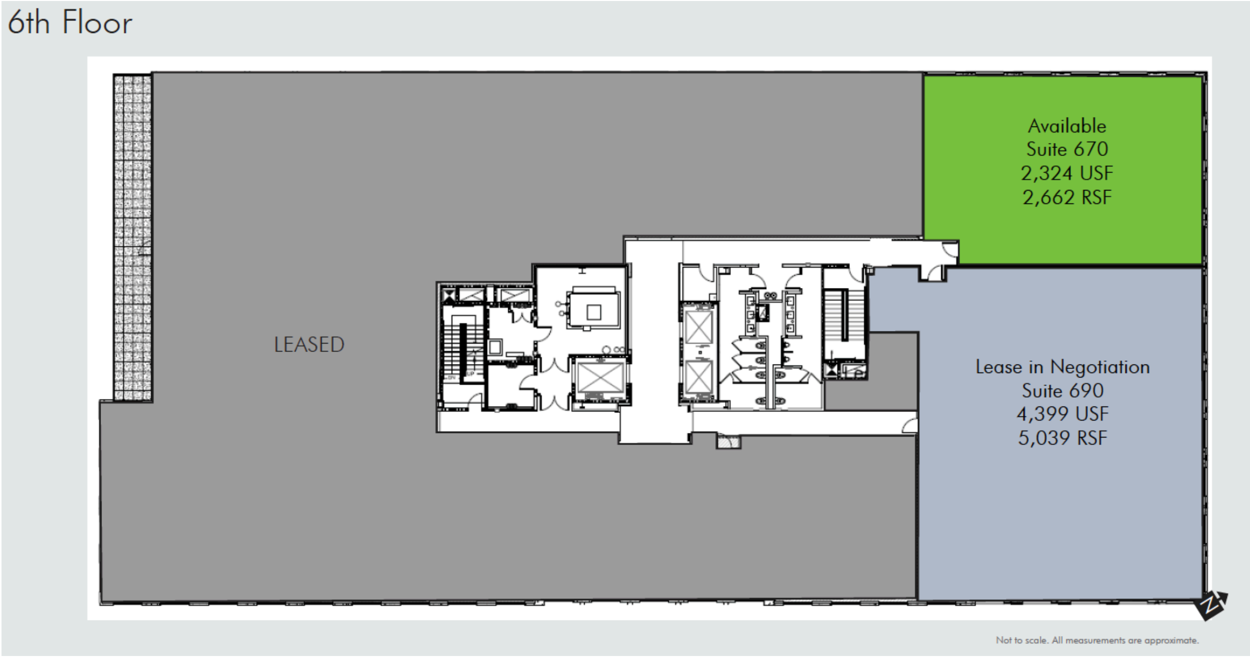
RSM is the 5th largest accounting firm in the United States. The company provides auditing, tax, and advisory services for the mid-market in the United States. The company has offices in 86 cities in the country, with a total of 9,000 employees. We judged that the company has strong ability to perform and has extremely low default risk

Greenberg Traurig (GT) 16,100 SQFT occupied

Founded in 1967, GT was named the largest law firm in the United States in 2017 and currently has approximately 2,100 lawyers. The company has 31 offices in the United States. We believe that the company has a strong ability to perform and has an extremely low default risk.

Aristocrat Technology 13,600 SQFT occupied

Aristocrat headquarters is in Australia and was founded in 1953. The company is one of the world's largest manufacturers of casino games. On the Sydney Stock Exchange, Aristocrat is listed, with a market value of about 20 billion Australian dollars or 14 billion US dollars. The company's profit in 2018 was about 630 million Australian dollars or 450 million US dollars. This is the office headquarters of the company in North America. According to its 2018 annual report, the company has a strong cash flow. We judge that the company has a strong ability to perform, and the risk is extremely low.



Two Summerlin Layout of Sixth Floor

Source: Howard Hughes Corporation

Capital Formation & Development Finance

Develop Expense

The building development budget was $49.5 million, while the actual development cost was $49.3 million. The project completion within the budget reflects an excellent internal control process and coordination among the teams.

Land Acquisition and Land Value

Howard Hughes Corporation acquired the land used for Two Summerlin in the 1950s for $2.50 per acre. It is part of a total of 25,000 acres of land acquired by Howard Hughes in West Las Vegas in the 1950s, which is known as Summerlin today. Per the data from the 2018 annual report of Howard Hughes Corporation, a total of 4 acres of land used, was assigned the value of $3,037,000 or $760,000 per acre.

Construction Financing

On October 19, 2017, Howard Hughes Corporation closed a $64.6 million construction loan from two development projects in Summerlin. There was $33.4 million within the construction loan used for the Two Summerlin project. The loan matures in 2022, with two one-year extension options, has an interest rate of prime rate plus a 0.5% premium currently totaling 5.9%. From the information on Valuepenguin.com, the interest rate is in the middle level, while the maturation is much more extended than the traditional construction loan. The remaining $16.1 million funds were raised from internal sources.

Refinancing

After the construction completed in Q3 2018, Howard Hughes Corporation retired the $33.4 million construction loan. HCC immediately refinanced the project with a permanent loan with a 4.1% interest rate and to improve its cash flow.

Tenant Improvements

The tenant improvement allowance, on average, is $55.00 per square foot. Based on the rentable area of 145,000 square feet, the total tenant improvement expense is about $8 million.

Commission

The average commission is around 2% of the base rent for the first year. The total commission is about $110,000.

Lease

Howard Hughes Corporation charges $3.20 per square foot per month. The lease type is a gross lease, which means all of the operating expenses are non-recoverable. All of the lease agreements include a 3% annual increase.

Operation Expense

Based on our estimate, the total operating expense, which includes utilities, maintenance, insurance, and property tax, is about $11.00 per square foot per year. The operating expense will increase by 3% per year to reflect inflation.

Interest expense

The interest expense is $1,369,400 per year for the $33.4 million loan.

Sustainability

Building Material

Two Summerlin chose as much recyclable material as possible to build the office tower. Howard Hughes Corporation used drought-tolerant landscaping, recyclable construction material, and eco-friendly porous building materials.

Energy Efficiency

The building is using high efficiency plumbing fixtures to conserve water, a special type of glass to control the sun light, and high efficiency HVAC system to provide a comfortable environment to tenants while reducing much of energy consumption.

Waste Management

During the construction, VCC implementing a construction great waste management plan that at a minimum identified the materials to be diverted from disposal and whether they would be sorted on-site or commingled. Calculations were done by weight or volume, and they had to be consistent throughout the project.

The selected waste management provider was required to provide documentation to VCC on a monthly basis. This included a summary log of all construction waste generated by type, the quantities of each type that were diverted and sent to a landfill, and the total percentage of waste diverted from landfill disposal. The waste-management provider was also required to provide waste-hauling tickets for each load removed from the project site.

Air Quality Management

VCC created and executed a great air quality management strategy. Construction was sequenced in such a way that porous building materials were protected from exposure to moisture and stored in a clean area prior to installation. This was accomplished by using temporary enclosures to protect the material from moisture, the timing of applying fireproofing to prevent unnecessary moisture exposure, and the use of a temporary vapor barrier such as single-ply roofing, which could later be incorporated into a final roof system. In addition, the general contractor ensured other areas-maintained compliance including HVAC protection, source control of emitting products and equipment, pathway interruption and housekeeping.

Two Summerlin Entrance View Source: EV&A Architect

Development Impacts

Local Residents

Two Summerlin provides the Summerlin Community with the 145,000 square feet of office space to local businesses in the valley. The extra square footage provides at least 450 job opportunities to residents, and shorter commute time for Summerlin residents. The additional jobs will supplement in the future with the future apartment and housing developments near the Urban Core of Summerlin's Master Plan Community.

Business Environment

Two Summerlin leased nearly half of the office space to law firms and accounting firms, which we believe will improve the business environment of professional firms in Summerlin. The office acts as an anchor to a CBD and will lead to more businesses moving their offices to this area. Summerlin has many professional firms, just like the concept of Wall Street Financial District, and entertainment nearby for after work hours.

Summerlin Future Development Map Source: Howard Hughes

Make a better Master Plan Community

The concept of Master Plan Community suggests people can live, work, and entertain within the CBD. In Summerlin, there are a lot of single-family homes and apartments for living. Downtown Summerlin has multiple entertaining features for the businesses in the area but has had limited office space for working in this area. Two Summerlin helps contribute to the lack of office space and allows businesses to move closer to their homes.

Two Summerlin also provides easy access to and from the freeway and public transit. The tenants can get to work with ease and have plenty of options for dining while in this area.

Operating Issues

Two Summerlin faced several operating issues because the office building was a new development and differed from HHC's experience in the past. Two key issues were parking and the timeline.

Parking

The main operating issue for Two Summerlin is the parking. The building is 98% leased, and WeWork is a considerable tenant. WeWork uses approximately 500 parking spaces per month, more than expected when signing the lease. Two Summerlin also shared the open parking with the National Bank Arena, and their parking overflows into the office's surface parking daily. The National Bank Arena host the Golden Knights practices, college tournaments, and lessons.

Timeline

The aggressive timeline was necessary because Howard Hughes Corporation's lease was ending. HHC was paying high rent and wanted to vacate as soon as possible. Another issue was moving in while moving out of the previously leased space. The coordination was an issue and the tenant improvements took five months instead of three.

Two Summerlin Interior

Source: Howard Hughes Corporation

Lessons Learned

Two Summerlin's development process went smoothly. However, the team learned a couple of things while developing. The Howard Hughes Development teamed learned about the Las Vegas Office Market, the site conditions, and building in the desert.

Learning the Market

Kyle Sutherland, Senior Director, Development at Howard Hughes Corporation, learned about the Las Vegas Market through developing Two Summerlin. Mr. Sutherland's previous developed experience was in San Diego. He learned how to work in the market to obtain Class A office space while keeping the cost low.

Soil

Another issue Howard Hughes Development had was the caliche. The hard rock caused the entire parcel to be a hard dig effort. The caliche led to an increased cost that the Howard Hughes Development team planned for in the proforma.

Analysis for the Desert Environment

Howard Hughes Development performed an analysis of the structure to keep cost low for Class A in our Desert Environment and an analysis on the necessary cooling system for the desert heat. Mr. Sutherland also learned more about NPC Systems to help with high winds and lower quality air days.

Two Summerlin Marketing Exterior Source: NAIOP.org

Conclusion

Two Summerlin made good business sense, and the Howard Hughes Corporation was able to capitalize on their opportunity. Howard Hughes's Development team was able to complete the project on time and on budget with a better NOI than was in the original Proforma.

The Las Vegas Office Market is growing. The Howard Hughes Corporation capitalized on the changing market and created a core to its Summerlin Master Plan Community. Their tenants enjoy the easy access to the freeway, the Red Rock Canyons, and views of the Las Vegas Strip while having many shops and restaurants nearby to entertain. It is also a plus to be next to the National Bank Arena and the Aviators Stadium.

Two Summerlin was an excellent investment for the Howard Hughes Corporation. Kyle Sutherland, from the Vertical Construction team, stated, "They would not change a thing. This project happened at the right time in the market." This performance could lead to an additional office building in the future in the Summerlin Master Plan Community.

Project Summary

Project Location	Las Vegas, Nevada	
Project Name	Two Summerlin Class A Office Building	
Type of Site	Suburban	
Development Type	Ground up/new development	
Transportation Modes	Car Transit Pedestrian (sidewalk) Bicycle (bike path or lane)	
Uses	Office Common space	153,000 sf
Number of Floors	6	
Parking (Type of Parking)	Structured, Surface	
Major Tenants		
The Howard Hughes Corporation	(Floor 1) - 14,600 RSF	
WeWork	(Floors 2-3) - 49,876 RSF	
Aritocrat Technology	(Floor 4) - 13,541 RSF	
JRS Hospitality	(Floor 5) - 8,152 RSF	
Greenberg Traurig, LLP	(Foorl 6) - 16,361 RSF	
Leasing Rate	$3.10-$3.20/RSF/Month	
Site Dimensions		
Total Acreage	8.71 acres - 379,490 sf	
Total Sq. Ft.	153,000	
Development Team		
Developer	The Howard Hughes Corporation	
Project Architect	EV&A Architects	
Interiors Architect	EV&A Architects	
General Contractor	VCC General Contracting	
Leasing Agents	**Randy Broadhead**, SIOR & **Amy Lance**, CBRE	
Timeline		
Land Acquisition	The owner has owned the land for over 30 years	
Project Completed	August 2018	
Development Cost	$30 million	

Two Summerlin Project Summary Source: NAIOP.org

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Appendix A

Interview with Kyle Sutherland, Senior Director, Development at Howard Hughes Corporation
Date: Oct. 24, 2019

1. Overview
    a. Howard Hughes Corporation sales land to residential builder, generate NOI commercial development (vertical Development)
    b. Woodland is more developed than Summerlin
    c. Took 14 months to build July 2017 – August 2018
    d. Provide Corn shell – lobby and elevator to tenants
    e. CFO – once completed
        i. Took 3-5 months to complete TI
    f. 98% leases
    g. Did an external market study → more for the lender?
    h. 3.79 acres for office and parking
    i. Geotech – caliche – onsite hard dig
2. What is important about the location of Two Summerlin.
    a. It is one of the anchors to the urban core that they are developing.
3. Why did you have a contest for the architect of Two Summerlin?
    a. They wanted to have multiple RFP and multiple eyes of the sight for the creativity of the project.
4. Can you describe the site?
    a. The site is 3.79 acres. It was subdivided because the baseball stadium lease started prior to construction.
5. Being in a Master Plan Community, what was the guidelines you had to follow?
    a. Larger sidewalks than required by the city
    b. Color scheme has to match Summerlin Master plan Community
    c. Approval by the Master Plan Community
    d. Anchor to the Urban Core for the CBD
6. What were some of the attractions to class A office?
    a. Lack of Class A office building
    b. Updated products
    c. Market and location
7. What are the common areas?
    a. Minimal shared space
    b. Outdoor event space for event for tenant to rent
8. Parking for Two Summerlin
    a. Garage has 400 spaces to serves the office
    b. Overflow parking shared with the hockey arena
    c. Built hock arena first
9. Did you finance locally?
    a. Bank of Nevada
    b. Developer Equity
    c. Tax credit for LEED property taxes
10. How did you perform vs your proforma?

    a. On time and on budget, but better NOI
11. What are the impacts on the community?
    a. Relation to active Urban Core
    b. Helps sales, help restaurants at Downtown Summerlin
    c. Business attracted to Las Vegas → no state tax
    d. Commercial core and sent out 1,000 mailers
12. How does Howard Hughes Corporation give back?
    a. Supporting local little league teams
    b. Howard Hughes Cares
    c. Volunteering times are excused time off
13. Did you have any operating issues?
    a. Tenant coordination became an issue with tenant improvements taking 3-5 months.
    b. Higher AC in summer months
    c. Parking with the hockey arena and WeWork
14. Design goals
    a. Views, angle building
    b. Design process for acceptable yield
    c. EV&A Tilt building – cost consensus rectangular building
15. How did you come up with the contest for the Architect?
    a. It was more of an RFP – Classic 3 bids
    b. Howard Hughes Corporation was looking for three things with the design – the product, Creativity of the team, and opportunity to have multiple eyes on the site.
16. Do you see an expansion in Summerlin Master Plan community with more Office Space?
    a. There's a possibility
    b. Currently there's minimal Class A – which means lower taxes
17. What are some of the lessons you learned?
    a. Learned market through this project
    b. Analysis of structure
    c. NPC system
    d. Work in market to get Class A
    e. Analysis on cooling system
    f. No regrets- Right products and Right time

Appendix B

	Sensitivity Analysis													
8,788,393	5.00%	5.50%	6.00%	6.50%	7.00%	7.50%	8.00%	8.50%	9.00%	9.50%	10.00%	10.50%	11.00%	11.50%
5.3%	29,128,910	24,277,975	20,235,529	16,814,998	13,883,114	11,342,148	9,118,803	7,157,028	5,413,228	3,852,985	2,448,767	1,178,284	23,300	(1,031,251)
5.80%	28,174,571	23,437,183	19,489,359	16,148,893	13,285,636	10,804,147	8,632,844	6,716,989	5,014,006	3,490,285	2,118,935	878,191	(249,759)	(1,279,626)
6.3%	27,245,929	22,618,913	18,763,066	15,500,427	12,703,879	10,280,204	8,159,488	6,288,268	4,624,962	3,136,740	1,797,341	585,504	(516,167)	(1,522,040)
6.80%	26,342,166	21,822,451	18,056,021	14,869,043	12,137,347	9,769,877	7,698,341	5,870,515	4,245,781	2,792,071	1,483,733	299,998	(776,125)	(1,758,671)
7.30%	25,462,493	21,047,107	17,367,618	14,254,205	11,585,565	9,272,743	7,249,025	5,463,390	3,876,160	2,456,006	1,177,868	21,458	(1,029,825)	(1,989,691)
7.80%	24,606,152	20,292,217	16,697,272	13,655,396	11,048,073	8,788,393	6,811,173	5,066,567	3,515,807	2,128,284	879,514	(250,326)	(1,277,454)	(2,215,265)
8.30%	23,772,409	19,557,142	16,044,420	13,072,117	10,524,428	8,316,431	6,384,434	4,679,731	3,164,439	1,808,652	588,443	(515,556)	(1,519,190)	(2,435,553)
8.80%	22,960,558	18,841,264	15,408,518	12,503,888	10,014,204	7,856,478	5,968,468	4,302,577	2,821,785	1,496,866	304,438	(774,424)	(1,755,209)	(2,650,708)
9.30%	22,169,920	18,143,987	14,789,043	11,950,245	9,516,989	7,408,167	5,562,948	3,934,813	2,487,582	1,192,692	27,290	(1,027,121)	(1,985,676)	(2,860,879)
9.80%	21,399,837	17,464,739	14,185,490	11,410,741	9,032,385	6,971,142	5,167,556	3,576,155	2,161,577	895,902	(243,205)	(1,273,826)	(2,210,754)	(3,066,211)
10.30%	20,649,677	16,802,965	13,597,371	10,884,945	8,560,009	6,545,064	4,781,987	3,226,331	1,843,526	606,279	(507,243)	(1,514,715)	(2,430,599)	(3,266,841)
10.80%	19,918,829	16,158,131	13,024,215	10,372,441	8,099,491	6,129,601	4,405,948	2,885,077	1,533,192	323,611	(765,013)	(1,749,957)	(2,645,362)	(3,462,905)
11.30%	19,206,704	15,529,722	12,465,570	9,872,827	7,650,475	5,724,437	4,039,153	2,552,138	1,230,348	47,693	(1,016,697)	(1,979,716)	(2,855,188)	(3,654,532)
11.80%	18,512,732	14,917,241	11,920,998	9,385,715	7,212,615	5,329,263	3,681,329	2,227,270	934,773	(221,672)	(1,262,472)	(2,204,149)	(3,060,218)	(3,841,847)

Appendix C

	from which page in 10k	22	36		f30	f30	
year	Property	EAR	NOI	OE ratio	Loan Amo	Interest rate	
	one hughes	8467	6263	26.03%	52000	4.30%	
	two hughes	8306	5862	29.42%	48000	4.20%	
	1735 hughes	10795	7512	30.41%	117417	3.14%	
	3831 technology forest drive	3150	2316	26.48%	22000	4.50%	
	4 waterway square	8735	6730	22.95%	35151	4.88%	
	columbia office properties	1954	1366	30.09%			
	onemall north	2766	1844	33.33%	14463	3.74%	
	one summerlin	7512	5510	26.65%	275900	4.65%	
	3 water square	8613	6814	20.89%	50327	3.94%	
	10-70 columbia corporation center	22242	13288	40.26%	100000	3.36%	
	Average			28.65%		4.1%	

Notes:

- Operating expense ratio are calculated based on the data found in page 22 and 36 of company 2018 10K
- The interest rate is calculated by averaging interest rate of the 9 office properties owned by HHC
- We believe Two Summerlin maintained a 67% LTV, because it matches HHC's debt ratio, and close to the 65% LTV of downtown Summerlin which is close to the property and owned by HHC.
- The company is using 25 years straight line depreciation schedule by calculating the difference of accumulated depreciation of several office properties owned by HHC.

Appendix D

Projected Cash Flow and return	Invested amount	2020E	2021E	2022E	2023E	2024E	2025E/terminal
Base Rent		5,568,000	5,735,040	5,907,091	6,084,304	6,266,833	6,454,838
Operating Expense		1,595,329	1,643,189	1,692,484	1,743,259	1,795,557	1,849,423
Vacancy Loss		250,000					
NOI		3,722,671	4,091,851	4,214,607	4,341,045	4,471,276	4,605,415
Interest Expense		1,369,400	1,369,400	1,369,400	1,369,400	1,369,400	
Depreciation		1,980,000	1,980,000	1,980,000	1,980,000	1,980,000	
Tax		78,387	155,915	181,693	208,245	235,594	
Terminal value						61,405,530	
Development Cost	(49,500,000)						
Financial Activities	33,400,000					(33,400,000)	
Capital Gain Tax						7,001,382	
Net terminal value						21,004,147	
Net Cash Flow	(16,100,000)	2,274,884	2,566,537	2,663,513	2,763,400	23,870,430	
IRR(after Tax)	20%						
NPV	8,788,393						
ROE		14%	16%	17%	17%	48%	