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Jonathan E. Farnham, Ph.D.  
Executive Director  
Philadelphia Historical Commission  
Room 576, City Hall  
Philadelphia, PA 19107

Dear Dr. Farnham:

In accordance with our engagement letter, Real Estate Strategies, Inc. (“RES”) has prepared this letter report summarizing the findings of our analysis of a financial hardship application submitted to the Philadelphia Historical Commission (the “Commission”). The application by Universal Community Homes (“the Applicant”) proposes the partial demolition of the historic Royal Theater located at 1524-34 South Street in Philadelphia, Pennsylvania (the “Royal” or the “Property”). The building was placed on the Philadelphia Register of Historic Places in 1980. The Royal is also listed on the National Register of Historic Places.

The following paragraphs provide background information in connection with the financial hardship application, a description of the RES assignment, the procedures and analyses that were completed during the course of the assignment, and a summary of our findings and conclusions. The standard terms and conditions applicable to our work with the Commission are also included.

**BACKGROUND**

The Commission has received an application from the Applicant, a Pennsylvania not-for-profit corporation, requesting approval to demolish much of the Royal, a historic building located at 1524-34 South Street, Philadelphia, Pennsylvania. The submission by the Applicant contains an Affidavit and Exhibits that include supporting documentation pursuant to the financial hardship provisions of the Philadelphia Historical Commission Rules and Regulations. The Applicant is seeking approval to demolish the existing structure, with the exception of the north façade facing South Street, and to redevelop the Property and the vacant lots to the east and west of the Property (the “Adjoining Lots”). The proposed

redevelopment would preserve the façade and construct a new four-story mixed-use building with commercial and residential uses.

The Royal is an existing classic revival-style structure constructed in 1919 by businessman Abraham Wax to serve as an entertainment venue for the African-American community. Designed by architect Frank E. Hahn, the historical significance of the 1,200 ± seat Royal, in addition to the classic revival-style north façade, results from the Property having been the foremost theater serving Philadelphia's African-American community and anchoring the southwest central neighborhood. The Royal hosted a wide array of performances, from Jazz concerts to amateur shows for children and movie screenings and concerts.

The Property stretches from South Street on the north to Kater Street on the south. It includes five foot walkways along the east and west sides of the structure for use by patrons exiting the theater.

During the 1960's, the proposal to develop a cross-town expressway along South Street caused numerous businesses to close and many residents to vacate nearby neighborhoods. The disinvestment along South Street negatively impacted the Royal and the theater closed its doors in 1970. The building has remained vacant since that time.

In March 1998, the Preservation Alliance for Greater Philadelphia (the "Alliance") purchased the Royal and issued a Request for Proposals in an attempt to find a developer who would preserve it. The Alliance entered into an agreement of sale on the Property; however, the sale was not consummated with the selected developer because the estimated development cost for the intended use did not result in an economically feasible project. In 2000, the Alliance sold the Property and Adjoining Lots to the Applicant, but placed a façade easement on the Royal's north façade. The Applicant's plans called for using the Royal as a centerpiece of a cultural district along South Street west of South Broad Street.

A time line included in the financial hardship application documents a number of unsuccessful attempts by the Applicant to pursue development partnerships commencing during 2001. None was successful because the uses proposed were determined to be financially infeasible. In 2012, the Applicant listed the Property for-sale with a real estate broker. The Applicant received purchase offers and accepted the highest offer. The successful proposer could not develop a plan for the Property that was economically feasible without demolishing the structure. The offer was withdrawn

The financial hardship application submitted to the Historical Commission proposes the retention of the north façade of the Property along South Street and restoring it to its original appearance. The application proposes demolition of the balance of the Royal. The Applicant, in partnership with Dranoff Properties ("Dranoff"), proposes to develop a new four-story mixed-use project on the Property and the Adjoining Lots. As proposed, the

development will include 7,125 square feet of commercial space along South Street, 45 residential apartment units, and underground parking for 20 cars.

The Affidavit in the financial hardship application seeks a determination of financial hardship, stating that “the application and its supporting documentation demonstrate that the sale of the property is impracticable, that commercial rents cannot provide a reasonable rate of return and that other potential uses are foreclosed as required by Section 14-2007 of the Philadelphia Code and its regulations.”

## **ASSESSMENT METHODS**

The Commission retained RES to analyze information supplied by the Applicant, to evaluate the documentation included in the financial hardship application, and to provide recommendations addressing the Applicant’s request for a financial hardship determination. As a basis for our analysis, RES has performed the following tasks:

- Conducted a review of the documentation supplied by the Applicant including the Affidavit, Exhibits, and other materials to gain an understanding of the basis for the requested financial hardship determination.
- Inspected the interior and exterior of the Royal, the Adjoining Lots, and the surrounding area to understand the context in which potential redevelopment alternatives would operate if implemented.
- Met with or interviewed representatives of the Applicant, Dranoff, the Alliance, South of South Street Neighborhood Association, South Street West Business Association, Center City Residents Association, private developers and other interested parties to ask about other uses that might have been considered for the Property and to obtain additional information and a better perspective about the history of the Royal and redevelopment options for the Property.
- Interviewed a representative of the Pennsylvania Historical and Museum Commission (“PHMC”) regarding the restrictive covenant placed on the Property on October 30, 2008, which limits the Applicant’s ability to alter the structure for 15 years without PHMC’s prior approval.
- Analyzed supplemental information provided by representatives of the Applicant.
- Reviewed redevelopment alternatives for the Property that have been proposed previously and assessed the financial analysis prepared by Econsult Solutions (“Econsult”), including the assumptions used and the completeness of the analysis.
- Surveyed market rents for residential apartments and commercial lease rates and terms in the area surrounding the Royal to further test the assumptions in the Econsult analysis.

- Asked Econsult to conduct sensitivity analyses related to some of their assumptions and analyzed the results.
- Researched the development potential of the Property for other potential uses that might be considered.
- Developed conclusions regarding the existence of a financial hardship and the compliance of the submission with requirements specified in the Philadelphia Historical Commission Rules and Regulations.

## FINDINGS AND CONCLUSIONS

Analyses by RES have resulted in a determination that the redevelopment of the Royal is not economically feasible without significant public subsidies. The above procedures, which have included market analysis, financial analysis, and interviews, have not produced an economically feasible reuse strategy for the Royal.

To reach this conclusion, RES researched potential reuse strategies for the Property that expanded on, and tested the strategies presented in the Affidavit and Exhibits. The uses considered by Econsult included multiple redevelopment scenarios. RES concurs with the result, which is that no scenario will generate an economically feasible reuse of the Property. From a development perspective, the reuse potential of the Royal is adversely affected by a number of factors. While the intensity of the effect on financial performance varies based on the use proposed, the following issues have some effect on all potential uses tested.

- **Issues with the Location of the Property** – While the Royal has frontage on South Street, which is a growing commercial corridor in Philadelphia, the Property is situated midblock rather than having a corner location with high visibility from two streets. Similarly, the location will not command premium pricing, which further impacts the economic feasibility of potential retail, restaurant, and related commercial uses. Further, the lack of off-street parking has been, and continues to be a major deterrent for developers considering new uses of the Property.
- **Condition of the Building** - Rehabilitation costs are very high because of the deteriorated condition of the building, the need to address the sink hole in the auditorium, the buckling east wall, and other issues affecting the integrity of the structure. In addition, all major systems must be replaced. The volume of the interior and limitations on the amount of useable space produce high operating expenses related to heating and cooling.
- **Configuration of the Building** - Alternative uses involving commercial offices or residential units would require creating windows along the east, west and south facades, thereby altering the historic integrity of these walls and probably rendering the structure ineligible for Historic Preservation Tax Credits. The loss of these credits

creates a larger financial gap and the resulting development is even less feasible. Although the site for the Royal includes five feet along the east and west sides of the building, development on the Adjoining Lots would negatively impact any light in the building and further diminish the marketability of residential units. The auditorium is large in size and has features such as a sloping floor and high ceilings that can be addressed. However, addressing these features also increases construction costs associated with alternative uses. For theater-related uses other than a single-screen or double screen movie theater, the stage is too small, which further limits its development potential. When combined with the secondary location, all of these factors result in excessive costs and extensive risks associated with redeveloping the building.

As a result of these issues the income generated by any potential new use in the Econsult analysis, as measured by the Net Present Value (“NPV”) of the income stream, is insufficient to cover the costs of the rehabilitation and the ongoing expenses associated with maintenance and operation of the Property. This is apparent from the Econsult analysis of reuse scenarios because, depending on the scenario, the value of the completed project is estimated to range from -\$7.4 million to -\$12.8 million.

Based on independent research by RES and our knowledge of real estate market conditions in Philadelphia, RES asked Econsult to address several matters. The following describes the matters raised and their resolution.

- **Acquisition and Predevelopment Costs** - Table 2 (page 6) in the Econsult report details \$561,410 of acquisition and predevelopment costs associated with acquiring and maintaining the building during the time frame from 2000 to 2014. These costs are included in the total development costs that are the basis for the NPV calculations. One line item, which dates from 2007, is \$127,000 for costs associated with Stabilization For Cast Piping and Roof Drainage. The RES interview with PHMC indicated that a \$50,000 matching grant was provided to the Applicant in 2008 to reimburse the organization for work performed to stabilize the roof and prevent further leaks into the building. RES questioned whether the total of \$561,410 for acquisition and predevelopment costs was net of the \$50,000 PHMC grant. Since Econsult was not able to determine whether the grant had been included, the seven potential reuse scenarios were tested with predevelopment costs reduced by \$50,000. In all seven scenarios, the effect of this reduction was nominal and each potential reuse scenario still resulted in a negative NPV.
- **Sensitivity Testing, Residential Rents** - For Scenario 4 – Residential (page 15), Econsult assumed an average residential rent of \$21 per square foot for the Royal based on the average of a selection of area rental apartments. Absent a description of the comparable rental properties used in the analysis, RES could not verify that the average represented new rental apartments that might be developed at the Royal. Further, our market research indicated that a higher per square foot rent might be

achievable. We asked Econsult to test a rent of \$28 per square foot in their model for Scenario 4. For this sensitivity testing, Econsult also reduced the predevelopment costs by the \$50,000 PHMC grant. The result for Scenario 4 was that the negative NPV was reduced from -\$5.9 million to -\$4.2 million, which still would be economically infeasible.

- RES also asked Econsult about the NPV of a scenario assuming that the Property were reconfigured with a smaller amount of retail space along South Street and three floors of residential apartments in the rear portion of the building. This configuration likely would result in higher rents for the retail space since it would be a smaller space with greater frontage along South Street. It also would include another floor of net useable space for residential units. RES agrees with Econsult's response that since Scenario 4 – Residential, was not economically feasible, developing a small retail component at comparable rents would not result in reuse that is economically feasible.
- **Construction Cost Assumptions** - RES asked the development team to provide the construction cost estimates developed by Allied Construction that were used to estimate development costs of all Econsult scenarios. Our objective was to test these estimates against industry standards. We were advised that the construction cost estimates were developed during in-person meetings and conversations with Allied Construction and other members of the development team and that Econsult did not have a written report documenting the costs.

Since construction costs were not available for analysis, RES asked Econsult to conduct a sensitivity analysis of the effect of lower construction costs by reducing the hard cost estimates in the scenarios by 20 percent. The purpose of this testing was to determine whether lower costs might result in a feasible development scenario. Econsult prepared the analysis, which also included reducing the development soft costs by 20 percent because they were calculated as a percentage of total hard costs. Even with these lower costs, the results still produced negative values that ranged from -\$4.8 and -\$9.2 million, depending on the reuse scenario. Therefore, even with a 20 percent reduction in construction hard and soft costs, the reuse scenario contemplated in each of the Econsult scenarios still was economically infeasible.

## **TERMS AND CONDITIONS**

Except as specifically provided herein, RES has not ascertained the legal and regulatory requirements that might be applicable to the Property or to a potential redevelopment. This letter report is based on estimates, assumptions and other information developed from research of the market, our knowledge of the real estate industry and other factors, including information provided by the Philadelphia Historical Commission. The sources of information and bases of the estimates and assumptions are stated in this report. Some

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assumptions inevitably will not materialize, and unanticipated events and circumstances may occur; therefore, actual results will vary from those described herein, and the variations may be material.

Further, RES has not evaluated management's effectiveness nor are we responsible for future marketing efforts and other management actions upon which actual results will depend. This letter report is intended for use by the Philadelphia Historical Commission in evaluating the financial hardship application and supporting documentation for the historic Royal Theater property located at 1524-34 South Street in Philadelphia. We have no responsibility to update this report to account for events and circumstances occurring after completion of our work, which is the date of this report.

If you have any questions or would like to discuss our findings, please call me at (610) 240-0820.

Very truly yours,

A handwritten signature in black ink that reads "Margaret B. Sowell". The signature is written in a cursive style with a prominent initial "M".

Margaret B. Sowell, CRE  
President