The Galbreath Company
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→ Bill Snee

June 2, 1994

PLAINTIFF'S EXHIBIT AL-1160

Mr. Paul H. Kaut, Jr.
Aluminum Company of America
1501 Alcoa Building
Pittsburgh, PA 15219

RE: **Alcoa Building Disposition**

Dear Paul:

Enclosed is a draft of the report on the marketing of the Alcoa Building. Please give us your comments and we will prepare final copies for distribution.

As we discussed, a meeting to review our assumptions and analysis will probably be necessary for everyone to fully understand our recommendations.

We look forward to your comments.

Sincerely,

Daniel H. Sliger

slm

Enclosure

cc: G. Anderson
G. Dudley

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I. EXECUTIVE SUMMARY

As agent on behalf of Alcoa, The Galbreath Company has had numerous meetings with Paul Kaut, Galen Anderson, Don Burrell and Tom Meshanko, to discuss a variety of scenarios relative to leasing the Alcoa Building. These meetings have included assessments of the competitive office leasing market, reviews of basic modern tenant requirements and the relative marketing position of the Alcoa Building with respect to these issues. It is our belief that a successful leasing program will require a landlord cost of approximately $30 per square foot to renovate the space for tenants plus the cost of demolition and new HVAC systems. Our estimates for demo and HVAC modifications are $10 per square foot and would occur in two phases.

The first phase would occur at the outset of our leasing program to demo and retrofit the HVAC system on floors 2 thru 8 at an estimated cost of $875,000. The second phase would occur when Alcoa vacates the building and floors 9 thru 31 would be cleared out and retrofitted. The estimated cost of the second phase would be approximately $2,875,000.

Realizing the capital required to finance tenant construction will have roughly a four year payoff, the question was raised whether or not it is prudent to pursue an aggressive leasing program. This report will describe, from a practical and financial standpoint, the risks and rewards of leasing the building compared to a sale now without new leases. A key ingredient to our report is how to deal with the environmental issues described in the ICF Kaiser Phase I Environmental Report.

II. ASSUMPTIONS

It is our understanding that Alcoa desires to relocate to the North Side site as soon as is conveniently possible and to sell the Alcoa Building to a responsible and capable investor or user. Because a buyer was not found last year, it was then decided to lease the excess space in the building.

In keeping with the institutional quality of the building, The Galbreath Company recommended a leasing program to position the property with other Class A buildings. In particular, the former Porter Building represents a good example of how the building should be presented to the market. Fortunately, the Alcoa Building is not in need of the extensive remediation and renovations necessary at the Porter Building.

After analyzing the cost to lease the property and determining the payoff of the capital required to be at least four years, some question was raised to the

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practicality of the expenditures when there is a probability that Alcoa will not be an occupant or owner at that time.

III. LEASE VS. SALE EVALUATION

A. Lease Scenarios

As we consider options relating to leasing the building, space can either be leased "As Is" or can be renovated and leased as Class A space with the corresponding rent differential.

"As Is" space typically rents for $12 to $15 per square foot full service which is about equal to the current operating expenses and real estate taxes for the building. These transactions normally attract tenants desiring shorter lease terms (i.e. one to three years) and appeal to tenants with poor credit looking for a bargain. The other problem is finding the right piece to the puzzle. Since the space will be used without extensive alterations, it makes the search for a tenant who can use the existing configuration more difficult. In our opinion, leasing "As Is" space will lower the overall quality perception of the building and result in decreased attractiveness of the building to an investor. Qualified buyers for the property will be those with a long term investment perspective. Such a buyer will want to increase value and stimulate maximum rents through a renovation program. Existing tenants in first generation space would only be in the way and would contribute negatively to value.

Newly renovated Class A space for a building of this age will rent for $20 per square foot full service. As described earlier, tenant improvements, design fees and commissions will cost approximately $30 per square foot. Estimated cost for demolition and HVAC upgrades is $10 per square foot. Other capital expenditures will be necessary to upgrade the main lobby, add handicapped restrooms to meet ADA mandates and to remediate any hazardous materials which may exist in the building.

ASBESTOS REMOVAL NOT INCLUD: IN $30 OR $10 /FT² COST?

From a financial standpoint, leasing renovated space will require tenants to sign on for at least ten-year terms to justify the expenditure of roughly $40 per square foot. If operating expenses and real estate taxes can be lowered to $10 per square foot, and if tenant costs are amortized at 9% over a five-year lease term, the owner will have an annual negative cash flow of $3,500 per floor. Insisting on ten-year terms will limit our prospects. Ten-year terms under the same rates and costs will result in an annual return of $47,089 per floor.

To help evaluate a probable lease-up period with costs and rental income over a ten-year period, we have attached our Acquisition Analysis with leasing assumptions for your review. As you can see, we have assumed Alcoa will remain in the building for three years during which time we lease the excess space. Years one and four of the evaluation have a significant shortfall due to the two phases of base building work required. After Alcoa leaves, it then takes another three years of aggressive leasing to stabilize the property. In all, capital required to renovate and lease the building will amount to almost $14 million excluding lobby renovations, ADA work or asbestos abatement.

? will Class A. most Tenant require asbestos free environment?

With regard to remediation, it is our belief that space should be gutted and rebuilt to Class A standards with significant upgrades to the HVAC system. This will probably necessitate the removal of any asbestos located above the ceiling. The cost of remediation is a landlord capital expense and cannot be charged to tenants. Remediation costs will be in addition to the tenant construction and base building work previously described.

From a pay-back perspective, commencing a leasing program now in order to increase the value of the building, it will take until 2001 to command a price that warrants the capital required to reposition the Alcoa Building. Even then, net sale proceeds less capital expenditures will leave approximately $17 million. The net gain of $17 million will be reduced by the cost of remediation.

B. Sale Scenarios

The enclosed Acquisition Analysis reflects our assumptions and opinion on the existing market value of the property from an investment standpoint. We feel a price of $8 to $9 million is appropriate and attainable based on the uncertainty of a lease-up period and the capital required to reposition the property. Any remediation costs will reduce value. Aside from premium location, another positive characteristic of the property to an astute, qualified buyer is the potential for phasing renovations during Alcoa's lease back of space in the short term. This allows a running start on new leasing and the possibility of a nominal, but positive investment return in the early years.

The variables of price and lease-back term and rent obviously correlate directly. Our analysis assumes an Alcoa lease-back of 290,000 square feet for three years at $5.00 per square foot net. An all cash buyer, willing to close quickly at a price lower than the $8 to $9 million range and with a lower lease-back rent to Alcoa may be worthy of consideration.

The institutional capital markets are definitely returning to commercial real estate investment. The Pittsburgh market enjoys one of the most stable office occupancy trends in the country and is an appealing market for most national, and some international, institutional investors.

IV. TIMING/VALUE

In comparing the value of the building at the point of stabilization of cash flow in 2001 to what may be considered fair market value today, the proceeds are remarkably similar. If the building nets $17 million in 2001 and is discounted at 9%, it is worth $9.3 million today. If the property nets $14 million in 2001, it is equal to $7.65 million now.

V. CONCLUSIONS

A lease-up program is a labor intensive effort for both the agent and the in-house real estate team. As we have suggested, a period of seven years will be needed to stabilize the building. It is our assumption that Alcoa will relocate prior to 2001, leaving an asset of no long-term value to the company. On the contrary, a sale price of $7 to $9 million in the near future will result in a similar benefit to the company when a net present value is used to compare the proceeds to a sale in 2001.

VI. RECOMMENDATIONS

It is our belief that an immediate sale is the best alternative when compared to a leasing program. Alcoa should list the building with The Galbreath Company at an asking price of $10 million and be willing to remediate the building or credit to the buyer an agreed upon amount to cover the costs of remediation. Alcoa should lease back floors 9 thru 31 for three years at a triple net rate rent of approximately $5 per square foot. The sales and marketing program will aggressively target qualified buyer prospects through The Galbreath Company local and national databases.

what is this?