How Much is Enough?
Protecting Local Resources in Publicly Financed Development Projects

Jason Aarsvold, Senior Municipal Advisor
James Lehnhoff, Municipal Advisor

1/24/2018
We need a million dollars to build....!
Overview

• Types of Local Public Financing

• Why
  – is a developer asking for assistance?
  – would a local government provide assistance?

• Protecting Local Resources

• Project Examples
Types of Local Public Assistance

• Tax Increment Financing (TIF)
• Tax Abatement
• Fee Waivers/Discounts (utility connections, building permits, park dedication)
• Land donations or write-downs (selling land at a below market price and/or less than the city paid to acquire the property)
• EDA / HRA Levy funds
• Local revolving loan funds
• Constructing Infrastructure Improvements
• Grants
Why is a Developer Asking for Assistance?

- **Gap!**

- **What does it mean to have a financial gap?**
  - Insufficient cash flow to…..
    - Support the level of **deb t** needed to build the project and/or
    - Provide high enough investment returns to attract **equi ty** to build the project
  - Either insufficiency results in a **financial gap**

- **Why might there be a financial gap?**
  - Unproven market, low market rents, and/or affordable rents
  - Extraordinary development costs
    - Land
    - Environmental remediation
    - Structured parking
    - Infrastructure
Why is a Developer Asking for Assistance?

• Who cares?
  – Developer
  – Investors
  – Banks/Lenders
  – City

• Why does it matter?
  – Making Money
  – Risk Mitigation
  – Loan repayment
  – Opportunity Cost
  – Reality of Implementing Plans
Why would a local government provide assistance?

• Fundamentally: Existence of financial barriers preventing the private market from developing a site in accordance with City vision.

• Cities participate to overcome these barriers for:
  – Job creation
  – Tax base growth and diversification
  – Redevelopment of blighted areas
  – Downtown Revitalization
  – Improving Housing Availability and Choice
  – Pollution Control and/or Cleanup
  – Improvements in Quality of Life
Protecting Local Resources
Best Practices: Planning for Success

• Ideally…..have a plan!

• Helps get staff and policymakers on the same page

• Provides the foundation for success

• Ensures you are prepared to act when opportunity arises - flexibility

• Sets priorities
Best Practices: Planning for Success

• Adopt policies that establish parameters for public involvement in economic development projects

• **Business Subsidy Policy** *(required per MN statutes 116J.993 - 116J.995)*
  – Local development goals
  – Developer Fee Policy

• **Application for Assistance**
  – Application fee
  – Specifies the necessary information to review a request for assistance

• Other policies based on identified needs
Key Questions in Public Financing Assistance

• Non-financial:
  – How does the project advance community’s goals?
  – What other projects are competing for funding (and attention)?

• Financial ("but for" test):
  – Does the project have a financial gap?
  – If so, how big is the gap?
  – Does the community have the resources or desire to assist with some or all of the gap?
Best Practices: Pro forma Analysis

• Review developer’s application and financial information (pro forma)
  – In depth analysis to ensure all project costs, revenue, operating expenses, and financing assumptions are within industry standards
  – Maximize private sources of funding

• Set recommended level of any public assistance based on finding in the analysis
  – Is there a gap?
  – What is the minimum amount of assistance needed to make a project financially feasible?
What is a Pro Forma?

• Latin for “for the sake of form” or “as a matter of form”

• In Real Estate Development
  – Method for calculating financial results
  – No single template
  – Generally accepted process and calculation methods

• Go/No-go Analysis
  – Does the project “pencil out”
  – How is the project forecasted to perform over time?
  – Is there a gap? If so, how big is the gap?
  – Is the project a good investment?

• Every development project has (or should have) a pro forma
## What is a Pro Forma?

### Stabilized Year Income

<table>
<thead>
<tr>
<th>Year</th>
<th>2019</th>
<th>2020</th>
<th>2021</th>
<th>2022</th>
<th>2023</th>
<th>2024</th>
<th>2025</th>
<th>2026</th>
<th>2027</th>
<th>2028</th>
<th>2029</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Rent</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Gross Potential</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Less: Vacancy</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total Rental Income</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Garbage</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Laundry</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Operating Costs</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Administrative</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Marketing</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Property Taxes</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Debt Service - Series A</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Debt Service - Series B</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total Expenses</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net Operating Income</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Effective Gross Income</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

### Other

- **Vacancy**: 7%
- **Rents**: 201,421
- **Pro Forma**: $201,421
- **TIF Payments**: 5.10% of EGI
- **Annual TIF**: $2,729,929
- **Return on Equity**: $3,798,986

### Debt Service

- **Coverage**: 139.52% (NOI/TDC) and 139.52% (NOI/DCF)

### Effective Gross Income

- **Total Rental Income**: $2,753,736
- **Effective Gross Income**: $3,526,127

### Operating

- **Total Costs**: $33,311,172
- **Total Operating**: $33,300
- **Management and Other Costs**: $554,400
- **Reserves**: $17,500
- **Insurance**: $998
- **Assisted Living**: $68,163
- **Laundry**: $13,366
- **Dietary**: $974
- **Housekeeping**: $19
- **Security**: $14
- **Property Taxes (2% Inflation)**: $933,600
- **Operating Costs**: $3,528,127
- **Management Fees**: $104,038

### Annual TIF and Return on Equity

- **Return on Equity**: 149.35%
- **Annual TIF**: 6.84%
- **Effective Gross Income**: 149.35%

### Definitions

- **Pro Forma**: A financial projection.
- **Return on Equity**: A measure of profitability.
- **TIF Payments**: Tax Increment Financing payments.
- **Effective Gross Income**: A measure of financial performance.

### Additional Notes

- **Gross Potential**: $2,088,811
- **Less: Vacancy**: $205,449
- **Stabilized Year**: 2019 - 2029
- **Annual TIF**: $2,729,929
- **Return on Equity**: 149.35%
- **Effective Gross Income**: 149.35%
Project Examples
Project: St. Joseph – Housing W / Services

- **47** units of senior apartments (with services)

- Total project costs of approximately $5.7 million
Key Questions in Public Financing Assistance

• Non-financial:
  – How does the project advance community’s goals?
  – What other projects are competing for funding (and attention)?

• Financial ("but for" test):
  – Does the project have a financial gap?
  – If so, how big is the gap?
  – Does the community have the resources or desire to assist with some or all of the gap?
TIF Request – Developer Application

• Create new housing TIF district
  – 26-year term
  – Qualifies for TIF based on anticipated incomes

• TIF Note
  – Developer requested 25 years of TIF - $1.4 Million over 25 years ($828,000 present value at 4.49% interest rate)
Analysis of TIF request

• Review of Developer’s Pro Forma
  – Financing structure, project costs, revenue and operating projections meet expected industry standards
  – Projected cash-on-cash return on investment (ROI) in year 3 is 1.7% without assistance
  – Industry standard ROI is 8% to 12% to attract investment
  – Analysis confirms assistance is needed for financial feasibility
Analysis of TIF request

• How much assistance is necessary?
  – Projection shows the project achieving an acceptable ROI (9.75%) by year 14, meaning TIF payments should no longer be required.
  – 14 years of TIF is estimated at $722,000 ($530,000 present value at 4.49% interest rate)
  – The developer agreed to move forward with a 14 year Pay As You Go TIF Note
Project: Industrial / Manufacturing

- 60,000 Sq. Ft. Industrial Project
- $4.1 Million Total Development Cost
Developer proposes to construct building for local business, but local rents cannot support needed return on investment

Developer applies to public agency for assistance

Agency reviews developer pro forma and identifies funding options
  – TIF or abatement
  – DEED funding
## Project: Industrial / Manufacturing

### SOURCES

<table>
<thead>
<tr>
<th></th>
<th>With No Assistance</th>
<th>With Assistance</th>
</tr>
</thead>
<tbody>
<tr>
<td>First Mortgage</td>
<td>3,276,000</td>
<td>2,926,000</td>
</tr>
<tr>
<td>City and DEED Assistance</td>
<td>0</td>
<td>350,000</td>
</tr>
<tr>
<td>Developer Equity</td>
<td>819,000</td>
<td>819,000</td>
</tr>
<tr>
<td><strong>TOTAL SOURCES</strong></td>
<td><strong>4,095,000</strong></td>
<td><strong>4,095,000</strong></td>
</tr>
</tbody>
</table>

### USES

<table>
<thead>
<tr>
<th></th>
<th>With No Assistance</th>
<th>With Assistance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Acquisition Costs</td>
<td>400,000</td>
<td>400,000</td>
</tr>
<tr>
<td>Construction Costs</td>
<td>3,000,000</td>
<td>3,000,000</td>
</tr>
<tr>
<td>Professional Services</td>
<td>270,000</td>
<td>270,000</td>
</tr>
<tr>
<td>Financing Costs</td>
<td>300,000</td>
<td>300,000</td>
</tr>
<tr>
<td>Real Estate Taxes</td>
<td>25,000</td>
<td>25,000</td>
</tr>
<tr>
<td>Developer Fee</td>
<td>100,000</td>
<td>100,000</td>
</tr>
<tr>
<td><strong>TOTAL USES</strong></td>
<td><strong>4,095,000</strong></td>
<td><strong>4,095,000</strong></td>
</tr>
</tbody>
</table>
### Project: Industrial / Manufacturing

<table>
<thead>
<tr>
<th>INCOME</th>
<th>With No Assistance</th>
<th>With Assistance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rent - Space 1 (30,000 sq. ft. @ $4.50 / sq. ft.)</td>
<td>135,000</td>
<td>135,000</td>
</tr>
<tr>
<td>Rent - Space 2 (15,000 sq. ft. @ $4.50 / sq. ft.)</td>
<td>67,500</td>
<td>67,500</td>
</tr>
<tr>
<td>Rent - Space 3 (15,000 sq. ft. @ $4.50 / sq. ft.)</td>
<td>67,500</td>
<td>67,500</td>
</tr>
<tr>
<td><strong>TOTAL INCOME</strong></td>
<td><strong>270,000</strong></td>
<td><strong>270,000</strong></td>
</tr>
<tr>
<td>First Mortgage Debt Service</td>
<td>241,410</td>
<td>215,618</td>
</tr>
<tr>
<td>Net Income</td>
<td>28,590</td>
<td>54,382</td>
</tr>
<tr>
<td><strong>Total Return on Equity</strong></td>
<td><strong>3.49%</strong></td>
<td><strong>6.64%</strong></td>
</tr>
</tbody>
</table>
Jason Aarsvold  
Senior Municipal Advisor  
651-697-8512  
jaarsvold@ehlers-inc.com

James Lehnhoff  
Municipal Advisor  
651-697-8552  
jlehnhoff@ehlers-inc.com