

MEMORANDUM

TO: Board of Estimates
FR: Joe Gromacki, TIF Coordinator
DATE: June 7, 2010
SUBJECT: TIF Report Concerning BioLink Incubator Proposal to Remove Pre-Lease and Letter of Credit Underwriting Conditions

On May 23, 2009, TIF staff provided the BOE with a report (attached) that outlined underwriting issues and suggested methods to better secure the \$2 million loan requested by MDC for the construction of the proposed \$6 million BioLink bio-ag incubator. Those recommendations included a 50% pre-lease requirement and a \$2 million letter of credit prior to disbursement of the TIF loan.

On June 2, 2010 Office of Business Resources (OBR) staff drafted a resolution, introduced from the Common Council floor, proposing a waiver of the pre-lease condition. A subsequent memo from OBR notes that the letter of credit condition would also be waived.

TIF staff has analyzed the BioLink proposal and finds that the solutions presented by the borrower, Madison Development Corporation, do not improve the cash flow and loan security issues outlined in the May 23, 2009 memo. After applying some sensitivity analysis, staff finds that the MDC BioLink project is still unable to generate positive cash flows when, as MDC proposes, the BioLink staff is laid-off and rents reduced to operate as a flex-space facility. The following are main points to consider in your deliberations:

- 1) The \$2.0 million TIF Loan is still unsecured. The City has a second mortgage position behind the federal Economic Development Administration's \$4.5 million first mortgage. The property could be valued between \$2.5 and \$4 million. In the event of foreclosure, the City cannot recoup its investment through the sale of the asset.
- 2) The borrower does not have financial resources to make up cash flow losses. Unlike the developers of University Square (50% lease-up) and Arbor Gate (65% lease-up), MDC does not have the financial backing to pay for shortfalls when they occur. The rents (\$34/SF for lab/office and \$28/SF for greenhouse) are still unproven in the Madison market. As you will note in the spreadsheet, 50% or more of pre-leasing helps the project's cash flow in the short run. A letter of credit or **corporate sponsorship that is common in many of these types of incubators** protects the project and the City of Madison in the long run, when unforeseen events, such as losing a tenant, need for repairs or tenant improvements occur.
- 3) The proposed rescue strategy does not work. To emphasize this point, the attached spreadsheet demonstrates what happens when a modest-sized, 3,000 SF tenant graduates in five years. In 2015, the project loses \$203,000, thus triggering the planned lay-off and rent reductions. As you will note, the project never really recovers enough cash flow to replace either the staff or services vital to an incubator. In short, it is no longer an incubator. The end result of the proposed rescue strategy will be rent concessions to existing tenants or more lost tenants. The project converting into more or less a specialized office flex space with an attached 15,000 SF greenhouse. It is unclear what action the EDA would take, as first mortgage holder, in the event of this change of operations.
- 4) There are likely cost overruns due to the construction of specialized lab space and a greenhouse. The proposal does not provide for either tenant improvements or contingencies that occur when lab space, medical space etc. is constructed. In the case of the Arbor Gate project \$10 million of the \$32.5 million hard cost (about 30%) was required to construct to state and federal standards the medical facilities portion of the project. If more funds are required, no source is identified.

Conclusion

Although the public purpose objectives of a MDC BioLink incubator are laudable, TIF staff recommends caution concerning this proposal to waive the primary conditions of the TIF Loan and suggests that the City of Madison is better protected and the ongoing operation and success of the facility better ensured, if those pre-conditions remain in place.

June 2, 2010

City of Madison
MDC - BioLink Incubator Proposal

Updated TIF Staff Analysis

General Data

Site Area	114,000 SF
Building Area	31,000 SF
Net Leasable Area	30,000 SF
No. of Parking Stalls	50 stalls
Building/Site Ratio (Coverage)	1/4
Building Efficiency %	97%
Time Until Placed in Service	18 - 24 months
	27%

Note: Delay in Construction due to EDA funding cycle beginning June 2009

Rents

Office, Conf., Lab, Flex Space	15,000 SF	gross lease
Green House	15,000 SF	gross lease
Rent Escalator %	3.5%	
Expense Inflation %	3.5%	
Vacancy at Stabilization	20.0%	

GROSS RENT POTENTIAL

	\$510,000
	\$420,000
	<u>\$930,000</u>

Anchor Tenant

Orbitec 5,000 SF \$34/SF 3-3 YR lease

\$75/SF TI Build-Out = \$375,000, \$625,000 of M&E, FFE

Value Estimates

Mill Rate 0.019358

Per Applicant

Est. Taxes (per Applicant) \$80,000
Est. Value (per Applicant) \$4,132,658

Comparables - Industrial

Low	AV/SF	Est. Value
High	\$45.00 per SF	\$1,395,000
	\$80.00 per SF	\$2,480,000

Updated TIF Staff Analysis

Project Cost	Adjusted	Cost Per SF	% of Hard Cost
Land Cost			
Hard Cost			
Construction	(4,845,000)	(166) per SF	0.00%
Parking, Landscaping, Signage	(200,000)	(9) per SF	3.47%
Total Hard Cost	(5,045,000)	(163) per SF	4.34%
Soft Cost			
Developer Fee	0	0.00	0.00%
Architect	(175,000)	(585)	3.96%
Contingency	(218,750)	(709)	10.00%
Construction Overhead	(92,000)	(285)	1.88%
Soils/Geotech Testing	(3,000)	(10)	0.06%
Appraisal	(3,500)	(11)	0.07%
Legal	(20,000)	(65)	0.40%
Engineering	(5,000)	(16)	0.10%
Building Permits	(20,000)	(65)	0.40%
Taxes/Insurance	(22,000)	(71)	0.44%
Accounting	0	0.00	0.00%
Surveying	(3,000)	(10)	0.06%
Misc.	(7,500)	(24)	0.15%
Environmental	(1,500)	(5)	0.03%
Title	(3,000)	(10)	0.06%
Total Soft Cost	(564,250)	(18.20)	11.18%
Total Project Cost	(\$5,609,250)	(\$180.94)	

Note 1: Valued at \$573,000 donated by City in lieu of cash.

Note 2: Amounts same as original application but project is 10,000 SF larger.

Note 3: 4% is thin contingency for high tech space. Arbor Gate medical portion Tenant improvements were \$10 million of the \$32.5 million hard cost.

Note 4: If actual project is \$300,000 over budget, no source of funds.

Updated TIF Staff Analysis

Note 1: Reflects actual gross rent based upon rents in TIF Application.

Note 2: Increasing building from 21,000 to 31,000 SF requires longer absorption. 2nd yr. 34% occupied.

Note 3: Five-year lease expires, lose a 3,000 SF tenant in 2015. 10% of leaseable area. Plan: Laidoff staff, cut rents to new tenants dropping from \$34/SF to est. \$15/SF for otc./flex space.

Note 5: Staff laid off as proposed. Annual absorption is about 6,000 SF (24,000 SF by 4 yrs.) However, borrower leases up 3,000 SF @ \$15/SF.

Note 6: Due to service cuts; incubator tenants leave or seek rent concessions. Lose another 3,000 SF tenant.

Note 8: Project now has 18,000 SF leased at \$34/SF and 6,000 SF at \$15/SF.

1st Tenant Lost		2nd Tenant Lost	
Lost Tenant:	3,000 SF	3,000 SF	3,000 SF
Lost Rent/SF	\$ 34.00 /SF	\$ 34.00 /SF	\$ 34.00 /SF
Repl. Tenant	3,000 SF	3,000 SF	3,000 SF
Repl. Rent	\$ 15.00 /SF	\$ 15.00 /SF	\$ 15.00 /SF

CASH FLOW

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
Income															
Gross Rent Potential	\$930,000	\$962,550	\$996,239	\$1,031,108	\$1,065,803	\$1,100,500	\$1,135,200	\$1,170,000	\$1,204,800	\$1,239,600	\$1,274,400	\$1,309,200	\$1,344,000	\$1,378,800	\$1,413,600
Other	1,680	1,680	1,680	1,680	1,680	1,680	1,680	1,680	1,680	1,680	1,680	1,680	1,680	1,680	1,680
Gross Potential Income	\$931,680	\$964,230	\$997,919	\$1,032,788	\$1,067,483	\$1,102,180	\$1,136,880	\$1,171,680	\$1,206,480	\$1,241,280	\$1,276,080	\$1,310,880	\$1,345,680	\$1,380,480	\$1,415,280
Vacancy %	(708,800)	(635,283)	(498,120)	(206,222)	(278,732)	(151,800)	(120,000)	(122,400)	(126,684)	(131,118)	(135,707)	(140,457)	(145,373)	(150,461)	(155,727)
Less: Vacancy	224,880	328,947	499,800	828,566	652,055	608,880	481,280	491,280	508,416	526,152	544,508	563,607	583,171	603,523	624,588
Effective Gross Income	(80,000)	(82,800)	(85,688)	(88,697)	(91,802)	(95,015)	(98,340)	(101,782)	(105,345)	(108,932)	(112,848)	(116,798)	(120,885)	(125,116)	(128,496)
Operating Expense															
Property Tax	(15,000)	(15,525)	(16,068)	(16,631)	(17,213)	(17,815)	(18,439)	(19,084)	(19,752)	(20,443)	(21,159)	(21,900)	(22,666)	(23,459)	(24,280)
Water & Sewer	(180,000)	(186,300)	(192,821)	(199,569)	(206,544)	(213,784)	(221,266)	(229,010)	(237,026)	(245,322)	(253,908)	(262,795)	(271,982)	(281,512)	(291,365)
Gas & Electric	(5,000)	(5,175)	(5,356)	(5,544)	(5,738)	(5,938)	(6,146)	(6,361)	(6,584)	(6,814)	(7,053)	(7,300)	(7,555)	(7,820)	(8,093)
Insurance	(90,000)	(93,150)	(96,410)	(99,786)	(103,277)	(106,892)	(110,633)	(114,506)	(118,513)	(122,661)	(126,954)	(131,397)	(135,996)	(140,756)	(145,683)
Maintenance & Repair	(18,000)	(18,000)	(18,000)	(18,000)	(18,000)	(18,000)	(18,000)	(18,000)	(18,000)	(18,000)	(18,000)	(18,000)	(18,000)	(18,000)	(18,000)
Tenant Replacement Reserve	(388,000)	(400,950)	(414,353)	(428,226)	(442,584)	(457,444)	(472,824)	(488,743)	(505,219)	(522,272)	(539,922)	(558,169)	(577,026)	(597,946)	(618,874)
Subtotal - Op. Expense	(1,000,000)	(1,032,825)	(1,066,318)	(1,100,886)	(1,136,639)	(1,173,615)	(1,211,853)	(1,251,385)	(1,292,232)	(1,334,437)	(1,378,032)	(1,423,139)	(1,470,000)	(1,518,889)	(1,569,910)
Administrative Expense															
CEO Salary	(150,000)	(155,250)	(160,684)	(166,308)	(172,128)	-	-	-	-	-	-	-	-	-	-
CEO Benefits (30%), MDC Overh	(90,000)	(93,150)	(96,410)	(99,786)	(103,277)	-	-	-	-	-	-	-	-	-	-
Orbicle Consulting Contract	(70,000)	(72,450)	(74,986)	(77,610)	(80,327)	-	-	-	-	-	-	-	-	-	-
Travel, Conferences, Professional	(20,000)	(20,700)	(21,425)	(22,174)	(22,950)	-	-	-	-	-	-	-	-	-	-
Computer, Tele, Data Services	(30,000)	(31,050)	(32,137)	(33,262)	(34,426)	(35,631)	(36,878)	(38,168)	(39,504)	(40,887)	(42,318)	(43,799)	(45,332)	(46,919)	(48,561)
Subtotal Admin. Expense	(380,000)	(372,600)	(385,641)	(399,136)	(413,108)	(427,661)	(442,824)	(458,743)	(475,504)	(493,219)	(511,032)	(529,999)	(549,132)	(569,466)	(590,106)
TOTAL EXPENSE	(748,000)	(773,550)	(799,994)	(827,364)	(855,692)	(884,915)	(914,977)	(945,928)	(977,768)	(1,010,479)	(1,044,564)	(1,080,169)	(1,117,432)	(1,156,477)	(1,200,000)
Net Operating Income (NOI)	(528,120)	(521,320)	(524,155)	(529,713)	(536,837)	(545,100)	(554,642)	(565,463)	(577,587)	(590,932)	(606,604)	(624,741)	(645,507)	(669,041)	(700,310)
Other Funds															
EDA Grant	310,000	310,000	310,000	310,000	310,000	310,000	310,000	310,000	310,000	310,000	310,000	310,000	310,000	310,000	310,000
Dept. Commerce Grant	100,000	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Dept. Commerce Loan	100,000	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Total Other Funds	510,000	310,000	310,000	310,000	310,000	310,000	310,000	310,000	310,000	310,000	310,000	310,000	310,000	310,000	310,000
Debt Service - DCOM Loan	(13,120)	(13,637)	(14,178)	(14,743)	(15,334)	(15,951)	(16,594)	(17,264)	(17,962)	(18,688)	(19,442)	(20,224)	(21,036)	(21,878)	(22,751)
Cash Flow	(13,120)	(13,637)	(14,178)	(14,743)	(15,334)	(15,951)	(16,594)	(17,264)	(17,962)	(18,688)	(19,442)	(20,224)	(21,036)	(21,878)	(22,751)
Cumulative Cash	(13,120)	(18,757)	(24,885)	(31,416)	(38,370)	(45,741)	(53,535)	(61,753)	(70,495)	(79,772)	(89,596)	(100,000)	(111,000)	(122,599)	(134,800)

Note 4: Loss of 3,000 SF tenant causes \$203,000 loss.

Note 7: Even with cost cuts, cash flow is not sufficient to recover losses or replace staff and services. Project slowly becomes a flex-space as proposed. 15,000 SF greenhouse will be problematic during flex-space lease-up.

Updated TIF Staff Analysis

Loss. _____