

Memorandum

To: Mayor Soglin, Finance Committee, and Common Council

CC: Matt Mikolajewski

Joe Gromacki

Kevin Ramakrishna

From: Natalie Erdman

Date: 6/12/2017

Re: Additional TIF Information—Royster Corners, LLC

This memorandum is a follow up to the Royster Corners, LLC TIF Report which concluded with:

Staff Recommendation:

Given the proposed equity, adjusted construction loan and the adjustments to the other assumptions outlined above, TIF staff concludes that no gap exists in any version of the TIF Application. The Council's decision to provide TIF assistance to the Project would be guided by policy rather than by gap analysis. TIF staff recommends that the Common Council accept this TIF report and act within its authority to decide whether to provide TIF assistance to RDC for some other specified public purpose.

Based on the information provided herein, and given that the library is ineligible to receive TIF, the City Attorney's Office will not opine on the legality of providing this loan.

I have reviewed the TIF application, the TIF gap analysis and the TIF Report and would like to provide additional information that should be considered as part of the TIF review.

I find that a financial gap of \$820,000 is reasonable and supportable.

Financial projections and gap analysis are used to inform a decision. These financial tools are an attempt to predict the future and model developer's financial decisions including an estimate of return on investment. Many assumptions are made in the creation of a financial projection including but not limited to

construction costs, rents, expenses, inflation, and the terms under which a developer borrows money and raises equity. In some cases relatively small variations in assumptions can have significant impact on the projected financing gaps.

A comparison of the Ruedebusch Development and Construction, Inc. ("RDC") TIF Application dated January 2017 and the TIF Final Analysis dated May 11, 2017 is attached. RDC's financial projections indicate a gap of \$2,974,000. The TIF Final Analysis indicates no financial gap. A sensitivity analysis shows a gap of \$515,000 to \$1,085,000 is reasonable. In each case, all assumptions in the TIF Final Analysis were held constant and the one assumption as indicated was varied to identify the financing gap that occur as the assumption is tested.

Commercial Rents — Royster Corners includes 16,600 s.f. of retail space fronting on Cottage Gove Road. The Cottage Grove Road corridor is an unproven market for new retail space and few comparable developments exist. Market rents are difficult to objectively determine; however, discussions with local retail brokers indicated that \$18 per square foot may be achievable if the owner is willing to invest \$25 to \$35 per square foot to bring the space from a gray box to a white box. RDC projected a cost of \$25 per square foot or \$415,000 to bring the space to a white box. It is City of Madison practice to exclude tenant finish costs and brokerage commissions. Without funding for these costs it will be difficult to achieve rents in the mid – teens. If we assume that the landlord will receive rents equal to \$18 per square foot plus tenant's share of pro rata share of Common Area, Maintenance, Taxes and Insurance ("CAM") and will incur \$25 per square foot in build out along with reasonable brokerage fees a financing gap of \$515,000 would exist. If we assume that the landlord will received rent equal to \$15 per square foot along with tenant's share of ("CAM"), and incur \$25 per square foot in build out and reasonable brokerage fees a gap of \$1,040,000 exists.
(Financial Gap \$515,000 to \$1,040,000)

Residential Rents—If residential rents are projected based upon current market conditions of \$1.20 per square foot or \$1,080 per month for a 900 square foot apartment, a gap of \$985,000 exists.
(Financial Gap \$985,000)

Equity Contributed by Owner—RDC's application indicated that they will contribute \$3,182,000 in equity. Based on their application, they would receive a 7.98% cash on cash return at stabilization. They did not indicate an internal rate of return. The TIF Final Analysis increases developers investment/equity by \$810,000 to \$3,991,000 which produces a 10% internal rate of return and a 5.37% cash on cash return at stabilization. If RDC's investment/equity is held constant at \$3,182,000 in the TIF Final Analysis the developer's internal rate of return would be 12% and its cash on cash return at stabilization would be 7.25%. This change in assumptions produced a financial gap of \$808,000.
(Financial Gap \$808,000)

After reviewing the TIF Application, Gap Analysis, and TIF Report as well as participating in meetings with TIF staff and Ruedebusch Development and Construction, Inc. ("RDC"), I believe of \$820,000 is reasonable.

Benefits of Royster Corners Development

There are notable public benefits to the Royster Corners Development

Growth in Tax Base—The subject development will not only create significant new tax base, but it also has the potential to influence additional development (1) on the 20 acre underutilized Royster Clark site which has been the subject of a decade of City planning efforts and (2) the greater Cottage Grove Road corridor which has seen little private investment and has struggled to spur new commercial activity.

Re-use of an Obsolete or Deteriorated Property—For decades the Royster Clark property has been contaminated, vacant and a blight to the surrounding neighborhood. While an apartment building was successfully built on the property several years ago, further development has stalled. The subject development with its critical mass of commercial space, housing, and the library is a critical component to moving the remainder of the development forward.

Creation of a More Complete Neighborhood—The neighborhoods that surround the Royster Corners Development will benefit from the creation of a vibrant mixed use development with not only a library, but commercial space for retail services that could include an ice cream shop, a pet store, a sandwich shop and other convenience amenities. The Royster Corners development presents an opportunity to create a more complete and vibrant neighborhood.

Conclusion

State law doesn't require a gap finding for a community to invest in a development through TIF. A community can find that sufficient public benefit exists to warrant such an investment.

State law is clear that TIF cannot be used to fund community facilities. The City Attorney's Office has indicated that without a finding of gap for the non library portion of this development, it can't be sure that TIF is not being used to subsidize the Library.

Please consider the information in this memorandum as you consider the following:

- Based on the information above does a financial gap exist and should TIF be approved, or
- If a financial gap does not exist, should TIF be approved based on the public benefits being created, or
- No gap exists and the public benefits are not sufficient to justify TIF and the TIF should be denied?

Royster Corners Development

<i>Financial Gap Calculation</i>	<i>Application Dated 1/5/2017</i>	<i>TIF Final Analysis 5/11/2017</i>
Land Cost	\$1,575,000	\$1,357,000
Construction Cost w/Parking	\$14,903,000	\$14,630,000
Soft Costs	<u>\$2,408,000</u>	<u>\$2,037,000</u>
 Total Cost	 \$18,886,000	 \$18,024,000
 Loan	 \$12,730,000	 \$14,033,000
Equity	<u>\$3,182,000</u>	<u>\$3,991,000</u>
 Total Funding Sources	 \$15,912,000	 \$18,024,000
 <i>Projected Financial Gap</i>	 <i>-\$2,974,000</i>	 <i>\$0</i>
 <i>Valuation</i>		
Stabilized Net Operating Income	\$1,193,412	\$1,315,603
Cap Rate	7.50%	7.50%
 Value	 \$15,912,160	 \$17,541,373
Loan to Value	80.00%	80.00%
Justified Loan Amount	\$12,729,728	\$14,033,099
 <i>Cash Flow and Investment Return</i>		
Debt Service		
Interest Rate	6.00%	
Amortization	25	
Debt Service	-\$939,438	-\$1,097,763
 Excess Cash Flow after Debt Service	 \$253,974	 \$217,840
 Cash on Cash Return	 7.98%	 5.46%

Royster Corners Development

Projected Stabilized Operations	<i>Application Dated</i> <i>1/5/2017</i>		<i>TIF Final Analysis</i> <i>5/11/2017</i>	
Commercial Rent	\$12.00	\$203,204	\$18.00	\$310,872
Vacancy	5%	-\$10,160	5%	-\$15,544
Residential Rent	\$1.29	\$1,336,784	\$1.29	\$1,363,386
Vacancy	3%	-\$40,104	3%	-\$40,902
Parking Rent	\$55.00	\$64,634	\$55.00	\$65,920
Vacancy	3%	<u>-\$1,939</u>	3%	<u>-\$1,978</u>
 Effective Gross Income		 \$1,552,419		 \$1,681,754
Less:				
Operating Expenses		-359,007		-366,151
 Net Operating Income		 1,193,412		 1,315,603
 Cap Rate		 7.50%		 7.50%
		 \$15,912,156		 \$17,541,377

Note Developer uses 1% inflation of rent and expense--TIF Finaly Analysis use 2%