

MEMORANDUM

TO: Common Council

FR: Joe Gromacki, TIF Coordinator

DATE: June 6, 2017

SUBJECT: TIF REPORT – Royster Corners, LLC

Background

In 2010, Ruedebusch Development and Construction, Inc. (“RDC”) purchased the vacant Royster fertilizer plant at the northwest quadrant of Cottage Grove Road and Dempsey Street (**Figure 1**).

RDC proposed to construct a multi-phased residential and commercial project with Phase I including a 20,500 square foot condominium space to house the Pinney Library branch (“Project”).

In 2012, the City provided a \$425,000 BREWD grant to RDC along with a \$1.5 million WI DNR “Ready for Reuse” grant to remove environmental contamination from the site to prepare it for redevelopment. This work was completed in May of 2013.

In 2013, the City created TID #44 for the purpose of funding public works improvements in the vicinity adjacent to the Project (Figure 2). Subsequently, RDC sold a parcel to Stone House Development. The City provided \$400,000 of TIF assistance to Stone House to develop affordable housing and invested \$3.1 million of TIF-funded street improvements on Cottage Grove Road and other areas within the TID boundary.

Gap Analysis Process

The gap analysis process determines whether there is a gap between the project cost and the amount of capital it can attract given its estimated value. A TIF Application serves as the Developer’s set of numerical assumptions to justify its TIF request. It is TIF staff’s role to test those assumptions based upon market experience and observable, comparable market data such as cost per square foot, cost per residential unit, cost per parking stall, soft cost percentages, interest costs, loan to value ratio, rent per square foot and many others in order to objectively verify a financing gap.

The gap analysis process is also impacted by TIF Law which prohibits TIF from paying for certain project costs such as parks fees or the cost of public buildings, such as a community center or library. In order to comply with TIF Law, TIF staff must remove such costs from the project and determine that they are paid for by non-TIF funds.

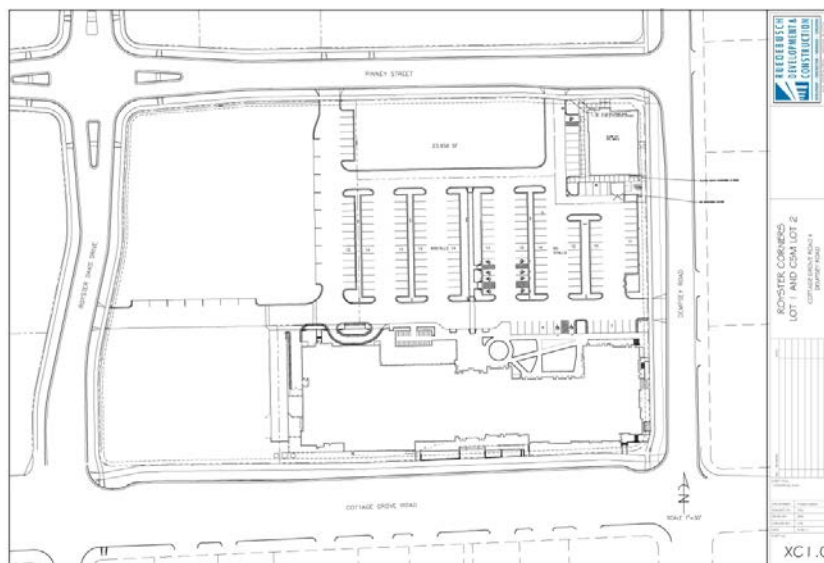


Figure 1

Multiple TIF Applications

RDC submitted seven versions of their TIF application between May, 2015 and January, 2017. The amount of TIF requested varied greatly and generally ranged between \$922,000 for the first version to \$2,973,000 for the seventh and final version. Subsequently, RDC accepted \$820,000 of TIF assistance, in lieu of the \$2,973,000 requested in the final version.

In cases where multiple TIF requests are submitted over time, the numerical trend of the project assumptions is a useful data set for analysis. TIF staff chose to demonstrate, by comparison, the final TIF Application (Version 7) against its preceding versions looking for RDC's most common approaches to the assumptions suggesting a gap. Due to its significant dissimilarity to the other six versions, Version 1 (requesting \$922,000 of TIF) was set aside. TIF staff focused its analysis on Versions 2 through 7.

Core Project Components

The core project being considered was comprised of the following components:

86 market rate apartments
 16,600 square feet of office
 20,500 square feet Library condominium (TIF ineligible)
 146 parking stalls (underground and surface)

TIF Requests

The amounts of the respective TIF requests were as follows:

Version 2: \$2,354,000
 Version 3: \$2,154,000
 Version 4: \$2,386,000
 Version 5: \$2,424,000
 Version 6: \$1,598,000
 Version 7: \$2,973,000

Analysis of Developer's Project Assumptions Suggesting Gap

In each of these versions, TIF staff adjusted the following RDC project assumptions:

1. **Land Banking of Future Phases**—RDC allocated excess land cost, namely land cost for future development phases, in the Phase I development cost, a device commonly referred to as “land banking.” TIF underwriting practice does not allow land banking for future phases for two reasons: 1) TIF may be insufficient to recover the cost if future phases of the project do not occur; and 2) Future phases would benefit from pre-paid land that may not have required TIF assistance, thus violating the “but for” standard in TIF Law.

Adjustment: TIF staff adjusted the project so that only Phase I land cost (not including the library and library parking) were allocated to the project.

2. **Ineligible Library Costs**—Land cost attributable to the library parking was included in the project cost as well as the cost of constructing library parking. As stated earlier, library costs are prohibited by TIF Law.

Adjustment: TIF staff adjusted the project to omit the library parking cost as these costs were covered in the purchase price between the City and RDC for the Pinney Library branch condominium.

3. **Ineligible Park Fees**—Park fees were included in the total project costs. They are an ineligible TIF cost per TIF Law.

Adjustment: TIF staff adjusted the project to omit the park fees.

4. **Excess Parking Stalls Increased Cost**—Project costs included the construction of excess surface parking stalls, achieving a parking ratio of 4 parking stalls per 1,000 square feet of commercial space that inflated parking cost. Past TIF underwriting practice recognizes a maximum of 3 parking stalls per 1,000 SF.

Adjustment: TIF staff adjusted the project to allocate the cost of parking meeting a ratio of 3 parking stalls per 1,000 square feet of commercial.

5. **High Parking Construction Cost**—Underground and surface stall parking construction costs were higher than observed for comparable projects. TIF staff adjusted this cost to match market conditions.

Adjustment: TIF staff adjusted the project to meet market cost for parking construction.

6. **Low Market Rents**—RDC listed market residential rental rates at \$0.92 / SF. Market rates for residential in this area range from \$1.10 - \$1.20. Commercial rents were dropped from \$18.00 to \$12.00 per square foot. The impact of lower rents reduces value, which in turn reduces the amount of loan attracted to the project, which artificially creates a gap.

Adjustment: TIF staff adjusted residential and commercial rents to match market conditions.

7. **Low Parking Rents**—Underground parking rental rates were below market rate, at \$35 per month, per stall. Estimated parking rates ranged between \$55 per month and \$70 per month.

Adjustment: TIF staff adjusted parking rents to \$55 per month to match market conditions.

8. **Lower Bank Loan**—The forecasted permanent bank loan amount was lower than standard. RDC calculated the loan based upon a 70% loan to value (LTV) ratio. Standard practice is a minimum of 75% LTV.

Adjustment: TIF staff adjusted the loan assumption to reflect market conditions.

9. **Environmental Remediation**—RDC met with TIF staff on November 3, 2015 and stated that it would require an additional \$750,000 of TIF to remove road construction fill that RDC authorized to be deposited on the site. The fill was later found to contain contamination. RDC asserted that the City bore the financial responsibility for the fill.

Adjustment: TIF staff rejected this assumption.

Measuring Developer Equity and TIF Assistance

In the gap analysis process, TIF staff must also measure whether a Developer has invested a reasonable amount of equity into the Project. The most reliable method is to determine if the cash flows generated by the project over time yield an internal rate of return (IRR) ranging between 10 and 12% on the Developer's equity investment.

The IRR range provides some inherent flexibility, similar to the City's 55% Gateway policy, wherein IRRs that fall within this range satisfy the equity analysis measurement as part of gap analysis. If a Developer invests a reasonable amount of equity, attracts a reasonable amount of construction financing and yet adjusted project costs still exceed the total amount of private funding, a gap exists.

In practice, an IRR above 12% signals that the Developer must pledge more equity into the project. An IRR below 10% signals that the Developer has provided the maximum amount of equity possible and either 1) has other sources of profit; 2) has other investment objectives such as retaining a key tenant or establishing a market presence in a new area; or 3) believes that the project will perform better in the long-term. Several recently-approved TIF-assisted projects have assumed IRRs less than 10% to achieve one or more of those objectives.

However, the IRR range used by TIF staff is solely an equity measurement tool. It does not obligate the City to provide TIF assistance in order to improve a project's IRR if it falls below the maximum 12%. For example, if a Developer demonstrates a 10% IRR from maximum equity and debt leverage, she has demonstrated reasonable amount of equity investment. The City is not obligated to increase the IRR by replacing some of her equity with TIF to increase the IRR to 12%.

RDC's Equity Investment

In all of the six versions considered, RDC assumed (per the application) an IRR ranging between 7% and 10%. RDC's equity yielded a 10% IRR in Version 7—falling within the standard range of equity.

Based upon historical, lower IRR assumptions proposed by RDC, and RDC subsequently accepting significantly less TIF assistance than request, TIF staff concludes that it is unlikely that RDC was concerned with IRR in requesting \$2,973,000 of TIF assistance.

Nevertheless, the \$820,000 of TIF assistance accepted by RDC and authorized in the attached resolution would reduce RDC's equity and yield an 11% IRR.

TIF Report

The following TIF Report is provided in compliance with Section 3.1 (8) of TIF Goals, Objectives and Process and Section 1 (9) of TIF Loan Underwriting Policy, adopted by the Common Council on February 25, 2014:

(a) **Amount Requested (as of 1/5/17) :** \$2,973,000

(b) **Type of Project:** Redevelopment

(c) **Analysis Method:** Gap Analysis

(d) **Tax Credits:** Not Applicable

(e) **Estimated Assessed Value and Tax Increments:**

Estimated Assessed Value	\$17,502,000
Total Est. Tax Increments	\$7,761,000
Avg. Annual Tax Increment	\$390,000
TIF Supportable at 100%	\$3,308,000
Estimated Time to Recover TIF Loan	6 years

(f) **TID Condition:**

TID #44 is a 27-year, blighted area TID created in 2013. The TID 44 Project Plan authorized approximately \$6,264,000 of expenditures. To date, TID #44 has expended \$3,627,000. In 2016, TID #44 generated \$201,000 of positive tax increment. In 2017 it is estimated to generate approximately \$807,000. The TID currently has an annual debt service obligation of approximately \$301,000 of

principal and \$88,000 of interest. The proposed Project is located within the TID #44 boundary (Figure 2).

TID 44 Projections:

Year Created	2013
Unrecovered Cost	\$3,627,000
Cash Balance – December 31, 2015	\$857,000
Est. Annual Increment w/o Project (2017)	\$807,000
Est. Increment Generated by Project (Beginning in 2020)	\$390,000
TIF Loan to Project	\$820,000
Estimated Cost Recovery w/ New Project	6 years

(g) TIF Policy Compliance

Developer Equity--Developer equity is approximately \$3,178,000, assuming \$820,000 of TIF assistance is provided. This amount is in compliance with TIF policy that equity equal or exceeds the amount of TIF provided.

55% Gateway--The \$820,000 TIF Request is 25% of TIF.

Self-Supporting Projects—The Project generates tax increment sufficient to repay the TIF loan and a portion of the TID’s infrastructure costs.

Guaranty—Principals of RDC are providing a personal guaranty of both increment and the loan agreement terms and conditions.

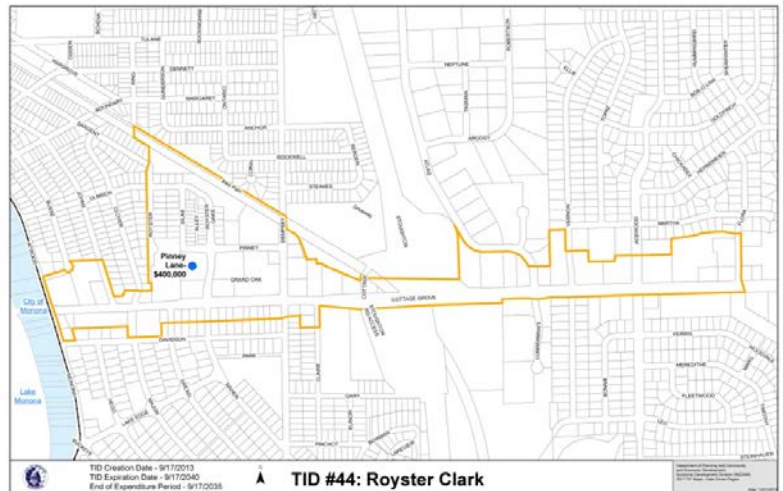


Figure 2

(h) Other Applicable—None.

(i) Amount of TIF to Be Considered

TIF Requested	\$2,973,000	
TIF Accepted by Developer	\$820,000	25% of TIF

(j) Developer’s TIF Policy Goals Statement— TIF Policy requires that Developer provide a statement (Figure 3) as to how the project addresses the following TIF Policy Goals:

- 1) Per Sections 1 and 3.4 of “TIF Goals, Objectives and Process”, how does the Project meet City and TID’s goals?
 - A) Grows the City’s property tax base
 - B) Fosters the creation and retention of family-supporting jobs
 - C) Encourages the re-use of obsolete or deteriorating property
 - D) Encourages urban in-fill projects that increase density consistent with the City’s Comprehensive Plan
 - E) Assists in the revitalization of historic, architecturally significant or deteriorated buildings or enhancement of historic districts.
 - F) Creates a range of housing types, specifically encouraging affordable housing

- G) Funds public improvements that enhance development potential and improve City's infrastructure
- H) Promotes superior design, building materials and sustainability features
- I) Reserves sufficient increment for public infrastructure in both TID Project Plan and TIF underwriting

(k) TIF Policy Exceptions—None requested.

(l) Known Labor Agreement, Law Violations--None indicated.

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.

City of Madison TIF Application
Developer's TIF Policy Goal Statement

A. Growing the property tax base

The property identified as part of Royster Corners is a currently vacant former industrial site. Following completion of the improvements of Royster Corners, the property's value is anticipated to increase by more than \$30 million dollars.

B. Fostering the creation and retention of family-supporting jobs

In addition to living wage jobs created during the construction of Royster Corners, Royster Corners' third party tenants are estimated to create an additional 122 permanent jobs to this long-standing vacant industrial site.

C. Encouraging adaptive re-use of obsolete or deteriorating property

Royster Corners is the redevelopment of the former Royster-Clark fertilizer plant and is being done in accordance with the Royster-Clark Special Area Plan adopted by the City of Madison and dated October 20, 2009.

D. Encouraging urban in-fill projects that increase (or decrease where appropriate) density consistent with the City's Comprehensive Plan.

The use and density of the project as proposed is consistent with the Comprehensive Plan's recommendations for the site and the Royster-Clark Special Area Plan.

E. Assisting in the revitalization of historic, architecturally significant, or deteriorated buildings, or enhancement of historic districts, especially landmarked and contributing buildings. n/a

F. Creating a range of housing types and specifically encouraging the development of workforce and affordable housing, especially housing that is for those earning much less than the area median income. Royster Corners will include approximately 86 age-restricted (55 and over) multi-family units and 102 market-rate multi-family units. In addition, other infrastructure and amenities of Royster Corners will be enjoyed by approximately 70 adjacent WHEDA financed multi-family units and 41 future single-family detached residences.

G. Funding public improvements that enhance development potential, improve the City's infrastructure, enhance transportation options, and improve the quality and livability of neighborhoods. This project is an urban infill project allowing additional employment opportunities within 4 miles of the City's downtown core in compliance with recently adoptive neighborhood and special area plans encouraging multi-modal transportation use that enhance the quality and livability of near downtown residential neighborhoods. In addition the project utilizes underground parking structures within some buildings to reduce surface parking lots and related parking congestion in the surrounding near east neighborhoods.

Promoting superior design, building materials and sustainability features in the built environment. The proposed development has been endorsed by the City's Urban Design Commission, the planning staff and neighborhood interests.

The following sustainability features are included in the design:

- Daylighting Controls
- Motion Sensory Lighting Control
- LED Lighting
- High Efficiency Hot Water Heaters

City of Madison TIF Application

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- Energy efficient building envelope
- Low Flow Plumbing Fixtures
- Programmable Thermostats
- High Efficiency Heating/Cooling
- Geothermal Heating and Cooling for the Library.
- Low VOC Paints/Carpets
- Green Roof

H. Reserving sufficient increment for public infrastructure in both TIF project plans and TIF underwriting. The percentage of increment requested is less than 55% of the anticipated increment generation for Royster Corners.