

City of Madison TIF Report
W. Johnson Lending, Inc. / Hovde West Johnson, LLC
June 4, 2013

Background

Hovde West Johnson, LLC (“Borrower”) has proposed a \$70,000,000, 478,000 gross square foot mixed-use redevelopment project to develop 255 apartment units, 331 parking stalls, approximately 24,000 gross square feet of office and retail or other uses (“Project”) on property generally located at 309 West Johnson and 316 West Dayton (“Property”) pictured in **Figure 1 at right**.

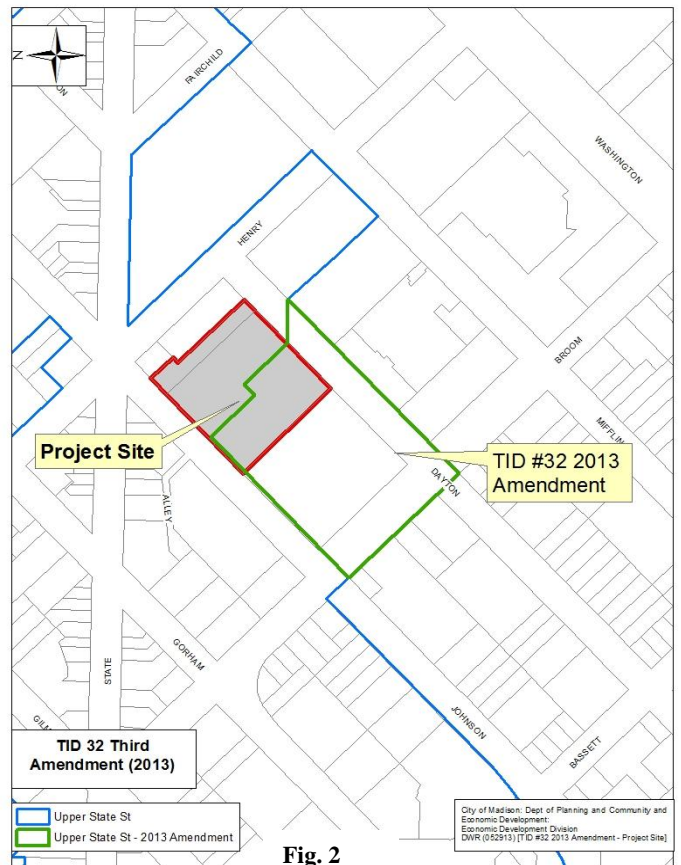


Fire Administration Component. The Project also includes the temporary relocation of the Fire Administration staff and the sale of the Fire Administration site to Borrower for \$1,787,000.

Borrower shall construct a 30,000 gross square foot Fire Administration office condominium and a 25-stall Fire Administration parking condominium (“Fire Administration Condominium”) as a component of the Project. The Fire Administration Condominium will be sold to the City at cost, for approximately \$5,209,000. Build-out of this condominium space is estimated at approximately \$8,582,000. A Purchase and Sale Agreement and its amendment authorizing this transaction were adopted by Common Council on November 27, 2012 (RES-12-00873) and May 21, 2013 (RES-13-00376) respectively.

The Purchase and Sale Agreement was executed on December 10, 2012. On May 21, 2013, Common Council adopted a resolution (RES-13-00378) authorizing a lease for temporary Fire Administration space.

TID Boundary Amendment. Most of the Project site is located in TID #32 (State Street). The City is currently proposing a third boundary amendment to TID #32 to incorporate the Fire Administration building site, adopted by the Common Council on May 21, 2013 (RES-13-00372). The map of the proposed TID #32 boundary amendment is depicted in **Figure 2 at right**.



TIF Law Prohibition on Funding Public Buildings. TIF Law prohibits TIF funding of public buildings. In compliance with the law, the Fire Administration Office and Parking condominium costs were omitted from the gap analysis. The City shall purchase the Fire Administration condominiums with City funds other than TIF.

HUD Financing – City Disbursal to Borrower. The Borrower is pursuing financing from the U.S. Housing and Urban Development Administration (“HUD”) to partially finance the Project. For income tax purposes and HUD regulations, Borrower requests that the City disburse the TIF Loan to W. Johnson Lending, Inc., (“Lender”), which will then immediately loan the proceeds to Borrower. Staff determined that this structure was acceptable. In the event HUD financing is denied, Borrower shall utilize private sector financing.

Gap Analysis

Project Cost Analysis. Borrower owns the 309 W. Johnson site debt-free and includes it as a project cost and equity at an estimated \$3,687,000 value. Staff determined that this estimated value of land is within an acceptable range of values. The total cost of all assembled land, soil testing and remediation was approximately \$7,185,000. Approximately \$625,000 of the total land cost was allocated to the Fire Administration Condominium purchase price. The net land cost attributable to the Project is therefore approximately \$6,560,000 or \$25,725 per unit, within an acceptable range of cost for this land use and construction style.

Hard construction cost is estimated at \$44,719,000 or about \$175,000 per unit, also an acceptable range for this land use and construction style.

Parking construction cost is estimated at \$8,101,000. Similarly, about \$637,000 of the parking cost was allocated to the Fire Administration condominium representing 25 stalls to be in full compliance with TIF Law. Staff found parking costs to be within an acceptable range.

Financing Analysis. Borrower will inject \$8,830,000 of equity in the form of cash, land purchases and value in land. This conforms to the TIF Policy requirement that Borrower’s equity investment equals or exceeds TIF loan assistance. HUD will provide a permanent loan of approximately \$49,000,000 to construct only the apartment component and the residential parking. Borrower will secure approximately \$8,450,000 of private financing to construct the commercial component and Fire Administration Condominium.

Causes of Gap. Although costs are within acceptable market ranges, the Project economics attract a finite amount of investment, limited by rents and values. When project cost exceeds investment, a gap results. In order to bridge the gap, the Borrower must either reduce cost, increase investment or both.

In this case, reducing land cost is not feasible in market terms, i.e. generally landowners do not sell their property below market rates. Reducing parking cost is also problematic as the density of the project and other issues require that parking be situated beneath the building— thus adding structural elements and engineering to its cost. Reducing the number of parking stalls may reduce cost but will render the project less attractive to tenants, reducing rents, value and then investment. Reducing the density will likewise reduce its overall cost, but also the Project’s rental income, resulting in a lower value and less investment, thus creating more of an investment-related gap.

Borrower’s \$8,830,000 investment is at about its maximum, yielding about a 15-16% internal rate of return (although as noted on Page 3 concerning Equity Participation, Borrower will increase equity by a modest amount thus reducing the return). An additional \$3,400,000 investment would erase the gap, but would dramatically decrease the return, prompting the Borrower to seek more attractive investments.



HUD will finance only \$49,000,000 of the Project targeted at the apartment component, so Borrower must seek additional private financing that is limited by the Project cash flow and other bank underwriting requirements.

Although land and parking are the “usual suspects” in terms of high cost in comparison to development in outlying areas, gap in general is ultimately due to a lack of private leverage to pay for these higher costs, requiring other public funds such as TIF to bridge the gap. Initially, staff found that both the investment and cost were thereby at reasonable limits, resulting in an initial \$3,400,000 gap. However, as explained in the following paragraph Borrower is able to decrease the gap slightly through a modest increase of investment.

Negotiation of Pre-Payment of Equity Participation

HUD regulations may prevent Borrower from paying the City an Equity Participation Payment upon sale or transfer of the Project or in 2030, preceding the full repayment of the HUD loan. Therefore, Borrower is pre-paying the estimated Equity Participation Payment to the City as a \$375,000 reduction in the amount of the original \$3,400,000 TIF Loan request, resulting in a \$3,025,000 TIF Loan to Borrower.

The pre-payment is calculated as the present value of a \$1,900,000 Equity Participation Payment estimated to be paid in 2030, less a \$350,000 credit representing the estimated future value of foregone profit from the sale of the Fire Condominium to the City, compounding at 7% until 2030. The remaining \$1,550,000 is discounted at 7% from the year 2030. The City and Borrower negotiated the resulting \$538,000 figure to \$375,000. The conveyance of the Fire Units to the City does not trigger payment of the Equity Participation Payment.

Project Data

Total Land Area	53,796 SF
Building Area	478,000 gross SF
Apartment Units	255
Structured Parking Stalls	331

309 W. Johnson	Cost (Rounded)
Land	(\$6,560,000)
Hard Construction	(44,719,000)
Parking Construction	(7,476,000)
Soft Cost	(6,850,000)
TOTAL COST	(\$65,605,000)

Sources and Uses	
Loan – HUD	\$49,000,000
Loan for Commercial Component	\$4,375,000
Equity	\$9,205,000*
Total Sources	62,580,000
Less: Uses	(65,605,000)
GAP	(\$3,025,000)

*Increased by \$375,000 to reflect Equity Participation pre-payment.



TIF Loan Security

The TIF Loan shall be evidenced by a note bearing 0% interest from the City to Borrower in the amount of \$3,025,000. The City shall receive a second mortgage in favor of the City of Madison to secure the loan. Principals of Borrower, namely Eric D. Hovde and Steven D. Hovde shall provide personal guaranty of the TIF Loan. Borrower shall provide an increment guaranty. In the event the Project is sold or transferred to a tax exempt entity ("Buyer"), Buyer pays the amount of tax last levied upon the sale or transfer of the project until 2030.

Other Considerations

- 1. 50% Rule Exception.** The TIF Loan represents approximately 52% of the present value of the estimated tax incremental revenues generated by the Project and requires a minor exception to TIF Policy that no more than 50% be made available to a project ("50% Rule").
- 2. Loan Disbursed Prior to TID Certification.** The TIF Loan may be disbursed prior to the TID boundary amendment being certified by the Wisconsin Department of Revenue, anticipated in the first quarter of 2014.
- 3. Joint Review Board Approval.** Although the City may disburse prior to TID boundary amendment certification, the TIF Loan is contingent upon approval of the TID boundary amendment by the TIF Joint Review Board. Although not anticipated, a Joint Review Board denial of the TID boundary amendment would nullify the TIF loan to the Borrower.
- 4. Requires amendment to 2013 Capital Budget, Internal Borrowing.** Funding of the \$3,025,000 of TIF Loan proceeds to this Project also requires a budget amendment to the City of Madison 2013 Capital Budget. The resolution requests authorization for internal borrowing until such time as it may be repaid through the subsequent annual general obligation borrowing.

