

## 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.