

MEMORANDUM

TO: Board of Estimates

FR: Joe Gromacki, TIF Coordinator

DATE: March 23, 2009

RE: **Gap Analysis Report Concerning \$2 Million TIF Assistance for BioLink Incubator**

Executive Summary

Staff's preliminary analysis concludes that the proposed BioLink incubator has a funding gap of \$2.0 million for the 21,000 SF proposal and \$2.5 million for the 31,000 SF version. Provided that the Common Council wishes to proceed further to fund TIF assistance to either version of this project, the following underwriting issues and recommendations should be considered:

1. Unsecured Mortgage – Terms of EDA First Mortgage

Using the applicant's highest possible estimated value of \$4.1 million for the 31,000 SF proposal, EDA will take a first position of \$3.5 million. That leaves the City approximately \$600,000 of collateral to cover a \$2.0 million transaction (including donated land and \$1.4 million construction loan). Similarly, the 21,000 SF project would generate a value somewhere between about \$1.4 and \$2.8 million. Either way, the City's TIF loan would be unsecured.

Moreover, EDA's first mortgage contains clawback provisions that are at this time unknown to the City. Staff is uncertain if the City would be required to repay the EDA's \$3.5 million grant in the event of a default on the EDA grant agreement.

Recommendation: Funding shall be contingent upon the City's review of the terms and conditions contained in the EDA grant agreement and mortgage. City accepts that its mortgage interest is unsecured.

2. Need for Working Capital to Fund Perpetual Operating Deficits

The business plan states that \$930,000 of EDA funds, if approved, could cover the operating deficit in Years 1 and 2 but not thereafter. The project cannot sustain itself financially without approximately \$3.5 of working capital funds (in addition the \$2 million TIF loan). Although \$930,000 of EDA funds may be used to cover this deficit in years 1 and 2, beginning in Year 3 the project forecasts a perpetual operating loss averaging \$200,000 per year with no source of working capital. By TIF Law, such deficits are ineligible for TIF assistance.

The business plan indicates that 58% or \$351,000 of the estimated \$605,000 annual operating expense is dedicated to the employment of officers to manage the facility. This is a cost that is uncharacteristic of a real estate project and contributes to the ongoing deficit.

Recommendation: Any TIF loan shall be contingent upon applicant providing evidence that a working capital line of credit, corporate sponsorship, or other form of funding to address the operating deficit is in place prior to disbursement of TIF funds and the City of Madison shall be held harmless for fiscal responsibility for such deficits. In addition, the City shall require that project be 50% pre-leased prior to disbursing TIF funds.

3. Potential to "Flip" Project to Third Party

On several occasions and in the business plan, it has been stated that the project may "flip" i.e. transfer from MDC to an un-named third party. The University Research Park and other entities have been suggested and in some cases approached. The EDA mortgage states that such a transfer could require MDC to repay either the \$2.5 million (21,000 SF facility) or the \$3.5 million (31,000 SF facility) EDA grant.

Recommendation: The TIF Loan Agreement shall include a clawback wherein the property shall not transfer without the written approval of the City of Madison. In the event of a default of this provision, MDC shall repay the City's TIF loan. Again, the City of Madison should be held harmless from any default or repayment of the EDA grant.

4. Non-Recourse Loan

The applicant desires a non-recourse TIF loan, meaning MDC will be held harmless for the indebtedness throughout the life of the loan and there will be no increment guaranty. The City of Madison does not provide non-recourse loans.

Recommendation: The loan shall require a corporate guaranty with default and remedy provisions. Applicant shall be required to provide a nominal increment guaranty (approximately \$30,000 for the 21,000 SF facility or \$60,000 for the 31,000 SF facility).

5. Lack of Management Experience – Unclear Role of Orbitec

The applicant, MDC, has no verifiable experience in managing a business incubator of any kind. Further, the business plan reflects a vague administrative role for Orbitec through a \$70,000 annual consulting contract but does not provide information as to why Orbitec was chosen and by whom, or any information concerning this company's ability to take on the financial and management responsibility of the incubator.

City staff have requested but have not received financial statements from Orbitec that would demonstrate the company's ability to assist in management.

Recommendation: TIF funds shall be provided upon receipt of a letter of intent indicating 1) Orbitec's management responsibilities, 2) its intent to lease space in the BioLink facility and 3) its intent to enter into a consulting/management contract with MDC.

6. Estimate of Required TIF Policy Exceptions

Approval of this proposal would require several exceptions to current TIF Policy:

1. The 50% Rule (estimated between 500% to 700% of TIF)
2. "But for" standard. (Only the language pertaining to exhausting all other financing sources, the probability of economic success.)
3. Equity Greater or Equal to TIF (No equity in project.)
4. No Application Fee (Doesn't have it)
5. Self-Supporting Projects (TID supports project, not project)
6. Simultaneous Land Use, TIF Application (There is no land use application)
7. Term Sheet (Insufficient time to provide a term sheet for BOE and Council consideration)
8. Equity Participation Payment (would need to be waived)

Recommendation: Council would have to adopt the above TIF Policy exceptions pursuant to providing this TIF assistance.