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TO: Board of Estimates
Economic Development Committee
Mayor Soglin
Alder Rummel

FR: Aaron Olver

RE: Background on Union Corners Letter-of-Intent

DT: July 3, 2013

PURPOSE
This memo summarizes the terms and conditions in the letter-of-intent (LOI) executed between the City and Gorman & Company ("Gorman") for the acquisition and redevelopment of the Union Corners site and explains the rationale behind the proposed deal structure.

BACKGROUND
The Union Corners site was acquired by the City with Land Banking Fundsfor $3.3 million. The purchase was charged against Tax Increment District #37-Union Corners. TID #37 also funded holding costs, closing costs, remediation, and public infrastructure improvements (totaling roughly $3.1 million). TID #37 is projected to have unrecovered costs of approximately $5.5 million as of December 31, 2013. The TID's current obligations exceed the TID's ability to make debt service payments, making it critical that the City secure a generator and avoid incurring additional debt.

In 2012, the Union Corners Selection Committee conducted a competitive RFP process and recommended that the City select Gorman to develop the Union Corners site. Gorman's selection by UW Health as a partner to develop a new medical clinic was one critical factor in the committee's decision. Gorman proposes to construct a medical clinic of approximately 60,000 square feet with surface and structured parking in Phase 1. Gorman also proposes to construct future phases that could include residential, retail, commercial, restaurant and potentially a public branch library (Phases 2, 3, and 4).The executed letter-of-intent incorporates an understanding of not only the sale transaction, but also the City's financial contribution to assist the project.

BASIC DEAL STRUCTURE IN LETTER-OF-INTENT
- Gorman will submit a TIF application demonstrating a gap of at least $6 million.
- Upon confirming a gap, the City will convey the property to Gorman for $1 (in lieu of providing TIF loans)
- Gorman will provide a corporate guaranty that the City receives $6 million in tax increment from the redevelopment of Union Corners and that all other conditions of the loan agreement are met. (Note: A corporate rather than a personal guaranty is employed).
- In exchange for a guaranty of $6 million (which exceeds the City's$3.3 million basis in the land), the City will forgo an equity participation payment.
- The corporate guaranty may be apportioned among new Gorman entities as the phased development occurs.

- The City is protected by a PILOT (Payment in Lieu of Taxes) agreement in the event a tax-exempt entity acquires any portion of the project.
- The City has a reversionary right that provides that if development has not commenced on any or all phases within 5 years the City has the right to buy the phase(s) for $1. Gorman has the right to reconvey back to the City any undeveloped phases for $1 during the 5 year period.
- No additional TIF assistance is expected.

RATIONALE FOR THE DEAL STRUCTURE

TID #37 is not in a strong financial position. Its debt service payments currently exceed its annual revenues. Gorman initially proposed paying the City $7.8 million for the land and also proposed the City provide $14.8 million in TIF loans. Together, this would have paid off current obligations but increased the debt of TID #37 by a net of $7 million. In practice, the City would likely have negotiated a smaller TIF loan (potentially based on a lower purchase price), but the result would have been to increase the debt of TID #37.

Instead of incurring additional debt to provide a TIF loan, the City is proposing to convey the land for $1. This is similar to a land contract in which tax increment from development repays the City's cost in land. This has the effect of providing a TIF-supported subsidy to the developer without increasing the TID's debt.

Currently when a TIF loan comes before the Common Council, the Council is asked to weigh the benefit of the proposed development against the financial risk of incurring debt in a TID. In the case of TID #37, however, the City has already decided to incur a significant amount of debt resulting in existing financial risk. The chief benefit of this proposed deal structure is that it secures a generator (the UW Health clinic) without exposing the City to any additional debt (risk). UW Health selected Gorman as its partner. Since the clinic alone is projected to generate approximately $5.3 million of increment, securing this generator is particularly beneficial to stabilizing the TID.

SPECIFIC ITEMS OF INTEREST

This section discusses various specific provisions in the letter-of-intent.

<u>Precedent</u>

There are few agreements with a structure that reduces the land cost as a form of financial assistance. One agreement that was reviewed in the course of negotiations was the City's purchase of a former Super Saver site. In 2005, the City bought the Super Saver site with $1.5 million of TIF and $2 million of levy debt. The property was sold at a discount of approximately $2 million to support an affordable housing project undertaken by Gorman. The agreement did not include a personal guaranty or an equity participation payment.

<u>Purchase Price & Equity Participation</u>

The deal requires Gorman to provide a corporate guaranty that the City will receive at least $6 million of incremental revenue. In essence, we are selling the land for $6 million and financing the purchase at a 0% interest rate. Staff concluded that the project was more similar to a land contract than a traditional TIF loan. To avoid increasing debt and by setting the increment guaranty set at $6 million (relative to the City's $3.3 million purchase price for the land), staff agreed to propose waiving the equity participation payment.

To see why this is beneficial, you can compare this structure to a hypothetical scenario. Imagine that instead of adopting this structure, the City sold the site to Gorman for $4 million. Imagine also that the City approved a conventional $7.4 million TIF loan with an equity participation payment of $7.4 million due in 2033 (the last year of the TID's life). Such a deal would push the TID approximately $3.4 million deeper into debt in the short-term, but would offer the future $7.4 million equity participation payment. Assuming that the same development occurs, this scenario lowers the net present value of the City's benefit by roughly $1.5 million. The future equity participation payment is not sufficient to overcome the downside (not to mention risk) of incurring deeper debt in the short-run.[1]

Land Banking Guidelines

Land-banking guidelines require that the City sell property "at market value, with a goal that the City will be compensated at a level at or above the original cost of purchasing the property." This structure does not directly achieve this. However, by avoiding additional debt and securing a the key generator, this proposed structure increases the net present value of the Gorman development to the TID by $3.2 million relative to Gorman's original proposal.

Guaranty

This proposal requires Gorman to guaranty the City will receive $6 million in increment. The LOI permits a corporate rather than a personal guaranty. City TIF Policy requires a personal guaranty because they are stronger and more beneficial to the City than a corporate guaranty. While staff would have preferred to include a personal guaranty, this structure was the strongest guaranty also acceptable to the developer.

Because there are multiple phases and components to the development, Gorman felt it important to facilitate the creation of multiple entities with different investors and owners. The LOI is structured to accommodate the creation (and possible sale) of future entities. The LOI allows Gorman to assign a portion of the guaranty to each entity, but requires the entity to have a net worth sufficient to back the guaranty. Each entity will agree to maintain assets such that its net worth is greater than the then-outstanding balance of the note. Each entity will be required to provide annual financial statements to verify its net worth.

PILOT

The LOI requires a PILOT payment in the event that any property on the site is sold to a tax-exempt entity.

Reversionary Clause

The LOI requires Gorman to take the site down all at once. Since this will generate holding costs (e.g., payment of real estate taxes), it provides an incentive for Gorman to build out the entire site in a timely manner. To protect the City against the possibility of lack of development, the deal includes a reversionary clause. This allows Gorman to sell any undeveloped phase back to the City for $1 within 5 years. It also requires Gorman to sell back any phase that isn't developed within 5 years for $1.

The 50% Rule

Similar to the equity participation payment, the 50% rule is not really applicable. In a conventional TIF loan, the City projects the value a project will create and borrows up to 50% of that amount to support the private development that would not occur "but for" the financial assistance. In this case, the City has already incurred a significant amount of debt. The City is not seeking to recover debt loaned to a private developer, but instead is recovering 100% of the increment in order to repay TID #37's existing debt.

[1] One can, of course, concoct scenarios that make the City better off with a traditional structure. However, such scenarios would require the unlikely assumption that Gorman to agree to a market rate for land and a reduction in TIF assistance of approximately 40%.