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Office of Real Estate Services

To: **Mayor, Common Council**

From: **Aaron Olver**

Date: **August 21, 2014**

Subject: **ULI's Anchor Bank TIF Request**

Background
ULI has requested the City partner with them on their proposed Anchor Bank project by employing the type of financial transaction used to construct underground parking on their Block 89 project. This type of transaction is being called a CDA (Community Development Authority) lease revenue bond structure. A planning memo addressing land use considerations and detailed but preliminary financial analysis are attached. This cover memo attempts to summarize the situation.

Full Disclosure
These numbers represent a preliminary or conceptual assessment and will evolve as the project develops. There are a variety of opinions among staff about the merits of the CDA lease revenue bond structure and I don't speak for everyone.

The Challenge
Underground parking is very expensive to build. Since it isn't vastly more valuable to parking customers compared to other parking, it can be expected to have a large gap. An easy way to see this is by looking at the difference between ULI's project cost of parking ($28.7 million) and the value (approximately $12 million). I would therefore expect a TIF application for conventional financing to show a gap of $16 to 17 million (assuming the office and apartment components require no TIF).

Conventional TIF Financing
Because of the project's location, City support is likely to require a new TID. This TID is likely to be a single-purpose TID. Were the City to finance $16 to 17 million with a conventional TIF loan, it would consume approximately 95% or more of the projected increment in this single-purpose TID. I would not recommend this.

CDA Lease Revenue Bond Financing
In the CDA lease revenue bond model, the City finances most of the cost of construction of the parking through the CDA. It owns the ramp (making it tax exempt) and leases it back to the developer at the full cost of CDA's debt service. This lowers the financing costs for the developer. The City also allows the developer to pay some of debt service with a pay-as-you-go TIF credit. The result of this transaction is that the City expects substantially less TIF to go into the project. However, the City is taking on greater debt and is backing this debt with its full faith and credit. It is my view that policymakers must choose between making a decision to employ the CDA lease revenue bond structure and directing staff to fully assess and negotiate such a structure or asking the developer to redesign a different project.

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To: **Mayor, Common Council**

From: **Planning Division Staff**

Date: **August 21, 2014**

Subject: **Preliminary Assessment of ULI's proposed Anchor Bank project**

PRELIMINARY PLANNING DIVISON ASSESSMENT - Anchor Bank Proposal

This proposal would add nearly 90,000 square feet of new office space, approximately 96 apartment units, and 18,000 square feet of new ground floor retail/restaurant space. The proposal involves the replacement of 36 surface and 261 structured parking stalls with 548 underground parking stalls on five levels, for a net gain of 251 stalls. The new underground parking area would have only one vehicle access point, from Doty Street.

By relocating structured and surface parking underground (including under this block of Carroll Street), and streamlining access to one location, the proposal would activate the street-level on a total of five block faces of Carroll, Doty, and Hamilton Streets. Activation of the "outer loop" streets such as Doty Street has been particularly challenging over the decades, since these streets have historically served as parking and loading areas for buildings facing the Capitol Square. As noted on Page 81 of Downtown Plan (see below), activation of the outer loop is an important goal, and new zoning requirements help to ensure that it occurs with redevelopment:

> ***Outer Loop*** *- As property with frontage on the outer loop redevelops, particular attention should be paid to ensuring that buildings have active ground floor spaces, and street-facing facades with windows to allow for more "eyes on the street" and create a more inviting pedestrian environment. Parking structures should have liner buildings, at least on the ground floor.*

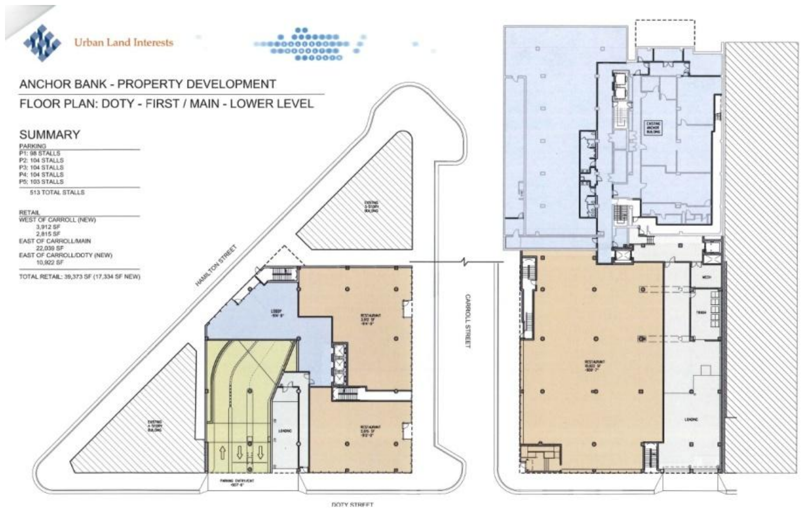
While exceeding the height recommendations in the Downtown Plan, the proposal respects the upper level stepback requirements to maintain the Hamilton Street view corridor from the Capitol building to Lake Monona. In its early stages, it appears that the proposed design for the mixed-use building at 115 S. Hamilton Street will relate well to the Landmark Buildings on either side of it, and complete this unique triangle block.

The proposal furthers many other objectives and recommendations in the Downtown Plan, including but not limited to the following:

- *Recommendation 34: Encourage development of additional retail, service and entertainment uses to support Downtown working and living*
- *Objective 3.1: Preserve views of, to, and from Downtown that reflect the natural topography and enhance views of the skyline, Capitol, lakes, and other important vistas*
- *Objective 3.2: Provide a dynamic and flexible mix of land uses and densities that enable ample opportunities for jobs, housing, retail, entertainment, and recreation in a compact urban environment.*
- *Objective 4.1: The Downtown Core is the center of Downtown, and should generally possess the highest intensity of development. A mix of office, employment, retail, government, residential, cultural, entertainment, and other uses should be pursued to retain the area's vibrancy, including beyond normal business hours.*
- *Objective 6.4: Provide a balanced approach to motor vehicle parking that meets the needs of businesses, residents, workers, and visitors, and actively pursue strategies that allow drivers to park once and use other modes to circulate within the Downtown*
- *Recommendation 153: Locate new and replacement parking underground as existing motor vehicle parking structures and surface lots are reconstructed… Private parking structure development should follow the same policies as public structures.*
- *Recommendation 166: Provide streetscape enhancements to selected Downtown streets to improve the design and aesthetics and to provide additional pedestrian amenities. Improve the outer loop in the near term focusing on aesthetic enhancements, pedestrian lighting, bump-outs, landscaping, benches, and safety improvements for pedestrians and transit users, including bus stop areas and shelters.*
- *Recommendation 184: Preserve and restore landmark buildings.*
- *Recommendation 198: Preserve triangle blocks and associated flatiron buildings and ensure that new development on parcels with acute angles follow that building form.*

Preliminary Financial Assessment
Urban Land Interests – Anchor Bank Project
August 25, 2014

Background



Urban Land Interests ("Borrower") has proposed a project including an expansion of the Anchor Bank office building located at and near 25 West Main Street ("property") to 187,000 square feet, construction of 44,000 of retail, construction of a residential tower of approximately 95,000 square feet, and development of a 550 underground parking structure ("project"). The project is only partially located within a TID (TID #25). However, given the age of TID #25, the competing requests to use the TID's cash balance, and the uncertainty around the Judge Doyle Square project, a new TID would likely be required.

The borrower is requesting the Community Development Authority ("CDA") finance and own the underground parking structure with a lease-revenue bond structure and a partial TIF credit against the lease. A similar structure was used to finance parking under Block 89 and under the Hilton Hotel. ULI's previous CDA lease revenue bond for the Block 89 parking structure was retired early, with the developer receiving the present value of the remaining TID credits and assuming responsibility for the remaining principal.

Should the City decide to accommodate this request, the City would conduct a blight study to try to identify an area for new 27-year blight-based TID and redevelopment district. Potential boundaries have not been determined at this time, but it is likely that such a TID would be single purpose.

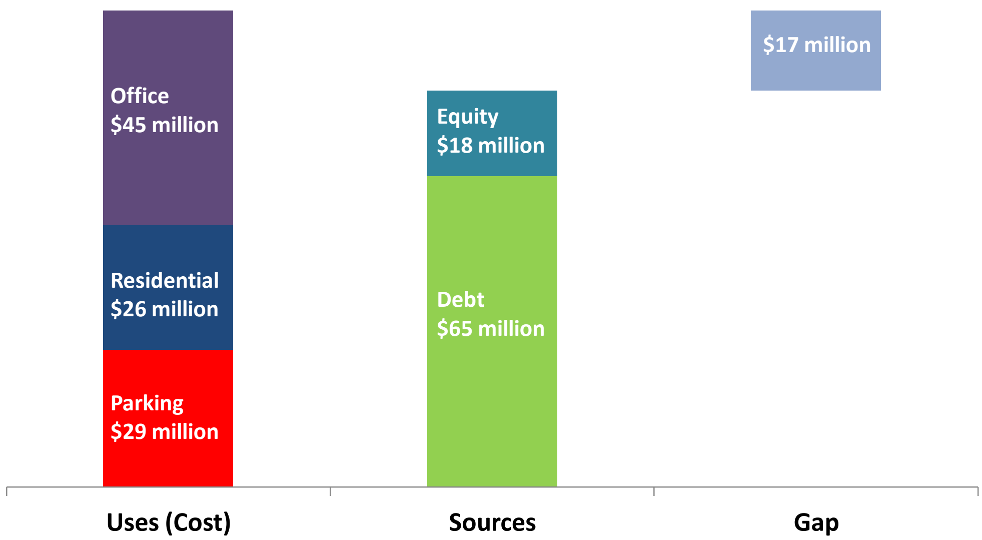
Financial Analysis

This memo is based on preliminary information and analysis. Before the Mayor and Common Council approve a formal agreement, additional information, analysis, and negotiation will have to occur. The purpose of this analysis to assess the feasibility of various financing options at a conceptual level. It is not a full blown TIF analysis.

Project Data

Total Land Area	49,112	Square Feet
Office Area	186,632	Square Feet
Retail Space	43,905	Square Feet
Residential	94,574	Square Feet
Parking Stalls	548	Stalls

Conventional Gap in ULI's Anchor Bank Project



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Option 1: Private Financing and Conventional TIF Loan

Estimated Assessed Value	
Office Bldg.	$ 46,349,000
Parking Ramp	$ 11,908,429
Apartments	$ 25,843,000
Total Value	**$ 84,100,429**
Sources of Capital	
Loans	
Office	$ 35,935,000
Apartments	$ 19,400,000
Parking	$ 9,571,091
Other (MGE, etc.)	$ 325,000
NOI of Block 89	$ 1,202,253
Equity	$ 16,332,252
Total Sources	**$ 82,765,596**
Less: Proposed Cost	$ (99,399,505)
Gap	**$ (16,633,909)**
TIF Assistance Requested	**$ 16,633,909**
% of TIF	95%
Total Equity Invested:	$ 16,332,252
Investment Period	25
Desired	10%
IRR (without reversion)	13%

Option 2: CDA Lease Revenue Bond Option with PAYGO TIF

Estimated Assessed Value	
Office Bldg.	$ 46,349,000
Parking Ramp	$ -
Apartments	$ 25,843,000
Total Value	**$ 72,192,000**
Sources of Capital	
Loans	
Office:	$ 35,935,000
Apartments:	$ 19,400,000
CDA Lease Revenue Bond	$ 26,705,000
Other (MGE, etc.)	$ 325,000
NOI of Block 89 Parking During Construction	$ 1,202,253
Equity	$ 15,832,252
Total Sources	**$ 99,399,505**
Less: Proposed Cost	**$ (99,399,505)**
Repayment of CDA Lease Revenue Bond	
Parking Operation Revenue	$ 15,598,802
Additional Parking Operation revenue from tax-free ramp*	$ 3,800,000
Additional Developer Equity	$ 2,926154
Gap	**$ 4,380,044**
TIF Assistance Requested**	**$ 4,380,044**
% of TIF	29%
TIF Including Foregone Parking Revenues	**$ 8,180,044**
% of TIF	47%
*City contributes $350,000 of tax increment per year, 22 years to support part of a $26.7M lease revenue bond.	
** City foregoes approximately $3.8 million of taxes with parking structure owned by CDA; this cash flow become additional parking operation revenue	
Investment Period (Years)	25
Desired Return	10%
IRR (without reversion)	12%

Discussion of Proposed Structure

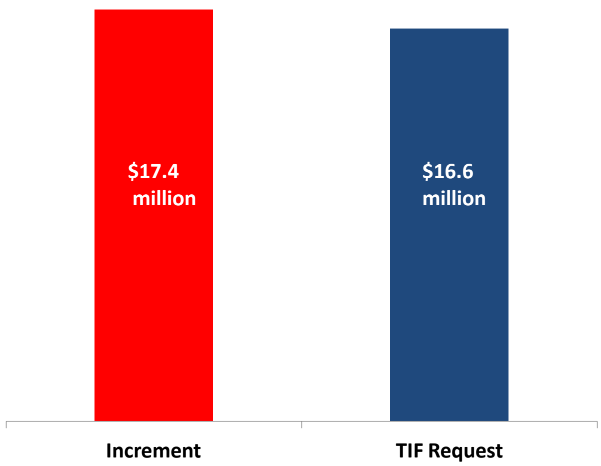
Underground parking is highly desirable from a land use point-of-view. Using unutilized space below ground allows street-level activation and the full development of air rights. However, underground parking is more expensive than above-grade structured parking but does not translate to vastly greater economic value. In this case, ULI projects that underground parking will cost approximately $28.7 million to construct (including a debt stabilization fund) and will only be worth approximately $12 million.

Staff explored a variety of mechanisms for tackling this financing challenge:

1. Conventional TIF Loan
   - A conventional TIF loan would use approximately 99% of the increment
   - With only the increment and a developer guaranty to rely on, this option would have substantial risk
2. CDA Ownership with no municipal revenue obligation and a pay-as-you-go and TIF credit
   - CDA ownership combined with debt that is not backed by the City would help by reducing the project gap by removing the parking from the tax rolls
   - There would be an equity gap estimated at $5.5 million even with a 90% pay-as-you-go TIF credit
3. Developer-Financed with Pay-As-You-Go Credit
   - With an 85% pay-as-you-go TIF credit, the borrower projects a deficit of somewhere between $6.2 million and $7.8 million depending on the lease for privilege in streets
4. CDA Lease Revenue Bond Structure
   - This option has been used on Block 89 parking and the Hilton hotel, the only below-grade parking built downtown since 1986
   - This option is discussed below

The following chart depicts the project under a conventional TIF loan:

Under conventional TIF, Project would use 95%



Note: Net Present Value of Increment assumes 7% discount rate, levy growth of 4%, property tax base growth of 6%

The CDA Lease Revenue Structure

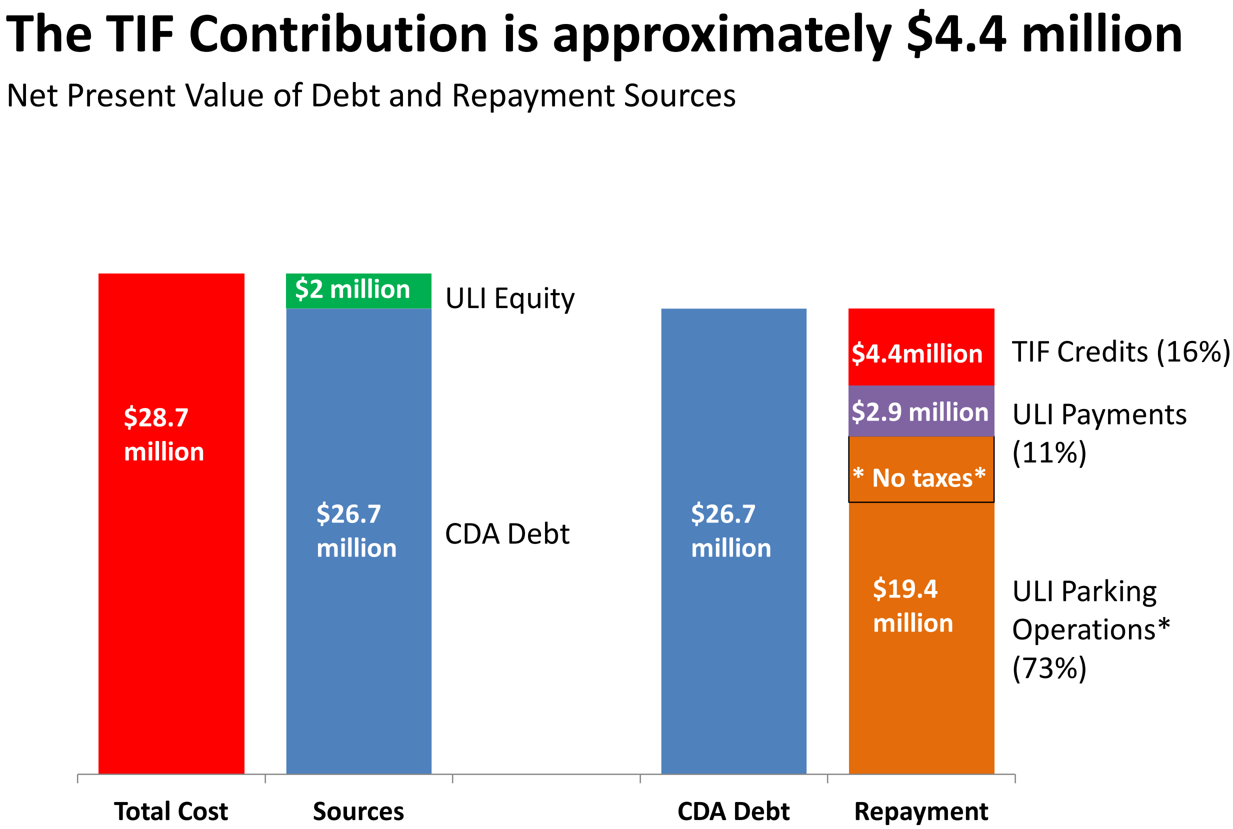
The CDA Lease Revenue Bond structure has the CDA own and finance the construction of an underground parking structure through the use of CDA revenue bond proceeds. The CDA's debt service is repaid through a combination of developer payments and TIF. The purpose of CDA financing is to address two issues:

1. Project cannot support pay property taxes on parking structure
2. Project cannot support enough equity and debt to finance parking through traditional market rate financing

In the proposed structure, the CDA would finance the construction of the parking structure (less $2 million of borrower equity). (The borrower would design and construct the parking structure, in accordance with an agreement, and convey it to the CDA upon completion for a guaranteed maximum price.) The CDA would own the parking structure and lease it to the City who would lease it to the borrower. The CDA would grant a mortgage in the principal amount of the bonds to the bond trustee, and assign to the trustee the payment of all rents it receives from the City. The amount of the lease payments would equal the principal and interest payments that the CDA owed. The City would issue a revenue obligation which would be held by the bond trustee as security and called if debt service payments on the bonds are not made. The borrower is responsible for paying back 100% of the CDA's loan through a variety of sources, including a TIF credit as follows:

Sources	**TOTAL (NPV)**	**ANNUAL** (stabilized year)
Up front Developer Equity	$2 million	-
Parking operations	$19.5 million	$1.2 million
TIF Credit	$4.4 million	$350,000
Annual developer deficit payment	$2.8 million	$327,000
TOTAL	$28.7 million	$1.9 million

The following depicts the preliminary projections:



* Approximately $3.8 million (net present value) of property taxes are also foregone through CDA ownership. This could be thought of as an additional public subsidy. Instead, this $3.8 million appears as additional parking operations cash flow that can be used by the borrower toward lease payments that retire the CDA's debt. Together, the TIF credit and the foregone taxes represent approximately 47% of the increment generated (had the parking structure been on the tax rolls). Excluding the foregone property taxes on the ramp, the TIF credit is approximately 29% of the increment generated.

In a traditional TIF loan the City typically incurs debt and uses tax revenue generated (increment) to repay the loan. In the proposed CDA lease revenue model, the City incurs greater debt and the developer pays the debt service with an agreed upon credit for some of the increment generated. As shown in the chart, the developer pays approximately 84% of the debt and TIF provides the remaining 16%.

In addition, the borrower is proposing that annual developer contribution be maintained at an annual level of at least $100,000. Should parking operations income climb to a level sufficient to reduce the annual shortfall to less than $100,000, the TIF credit would fall. In other words, once the annual shortfall is reduced to $100,000 the City would benefit from climbing parking income rather than the borrower.

Summary of Proposed Deal Terms

- ULI designs, constructs, and transfers the underground parking to the CDA for a guaranteed price
- ULI invest $2 million in up front equity
- CDA finances the remainder of ramp construction costs including a debt service stabilization fund funded through bond proceeds
- CDA/City lease the ramp to ULI for the full amount of the debt service
- ULI operates the ramp and retains all parking revenue (which are projected to cover over 70% of their required lease payments)
- City reduces lease by up to $350,000 per year based on a credit for TIF increment generated by the office and apartment projects
- ULI uses the income from parking operations to cover the majority of the debt service and invests additional equity each year to cover any remaining annual deficit
- The $350,000 TIF credit declines before the annual deficit is allowed to drop below $100,000 per year
- The lease is secured by a variety of measures (see below)

Features of CDA Lease Revenue Bond Structure Helping Project Feasibility
This structure lowers the project cost and increases the feasibility of underground parking thereby benefiting the project in the following ways:

- The City's credit allows the CDA to finance the debt at a lower interest rate
- The CDA ownership removes the project from tax rolls to lower costs (effectively a 100% credit on the parking structure portion of the project)

Risks of the CDA Lease Revenue Bond Structure
The primary risk of the CDA lease revenue bond structure is that the city borrows nearly the entire cost of the underground parking. While the borrowers expect private sources to cover 84% of the debt service, the City is liable for all of the debt service in the event of a default. The risk mitigation measures discussed below are therefore critical.

In addition, the structure removes the parking structure from the tax rolls during the life of the bond. While this lowers the costs, it also reduces the increment available to the Tax Increment District.

Mitigating CDA Lease Revenue Bond Risks
Urban Land Interests is a development company with deep experience in the downtown commercial market and appears to have substantial financial strength. They are experienced landlords/operators of parking structures, office, retail, and apartments. While the project's fundamentals and ULI's expertise and direct equity investment are the primary reasons for optimism, the City can take numerous steps to reduce the City's exposure to risk. To mitigate the potential risk of the CDA lease revenue bond structure, staff recommends the agreement include the following provisions:

1. The lease be structured as a net lease under which all obligations for repair, maintenance, and insurance are obligations of the borrower.
2. The sizing of the bond issue to include one million dollars of debt service stabilizations. The stabilization fund can be drawn on in case of developer default and afford the City enough time to consider restructuring the debt.
3. The debt is variable rate debt callable at any time.

4. The transaction contain cross-default provisions with the primary mortgage holder on the Anchor Bank office project. This means that if the borrower is in default on lease payments to the City, they are also in default with the first mortgage holder. This will ensure that in case of default the first mortgage holder will be involved immediately and will create a strong incentive to assure the continued availability of parking to the tenants by making the outstanding lease payments.
5. As only partial information is available at this time, the obligations of the agreement are contingent on Common Council approval and issuance of the bonds by the CDA. A more complete report on the financial status of the borrower will be provided to the Common Council and CDA prior to the issuance of the bonds.
6. The annual TIF credit be structured as “up to $350,000” or X% whichever is less based on performance of increment generation through the office and apartment projects.
7. ULI be required (and has agreed in concept) to secure any lease by pledging a portion of Block 89 parking revenues against any shortfall in the Anchor Bank parking operations and to supplement required annual deficit payments should the full TIF credit not be earned.
8. The City should consider accruing some or all of the excess increment generated by the project (the increment not credited against the lease payment) as an additional stabilization fund should the City wish to call the bonds early.

Additional Details To Be Negotiated
Should the City wish to consider a CDA lease revenue bond structure, there are a number of issues that have yet to be addressed at this conceptual stage. These include:

- The requirement or option for ULI to buy the parking structure when the CDA’s debt is retired and the terms as which the City will sell the structure to ULI
- Any operating considerations or interactions with the Parking Utility

Discussion and Options for Consideration
Based on preliminary analysis a traditional TIF loan does not appear to be feasible given the high cost of underground parking. A traditional TIF loan would consume approximately 95% increment generated in a TID that is likely to be single-purpose. The CDA lease revenue bond structure makes the project easier to finance for the developer and should reduce the public’s investment in the project through TIF. However, the CDA lease revenue bond exposes the CDA (and the City) to a larger amount of debt, backed by a municipal revenue obligation. At its core, the policy question is does the City value submerging the structured parking and more fully utilizing space above grade enough to consider the complex CDA lease revenue bond structure.

ULI is nearing the time they need to make a decision to close on the Anchor Bank property. The City’s willingness to consider a CDA lease revenue bond structure is a key factor in their decision making.

Options:

1. Introduce a resolution for Common Council consideration that finds a need to employ the CDA lease revenue bond structure, outlines conceptual requirements and risk mitigation steps, and directs staff to negotiate and develop a financing package using a CDA lease revenue bond structure
2. Direct staff to work with developer to redesign a project that does not require a CDA lease revenue bond structure