

# MEMORANDUM

TO: Board of Estimates  
FR: Joe Gromacki, TIF Coordinator  
DATE: January 23, 2017

**SUBJECT: TIF REPORT – 134 S. Fair Oaks (Stone House Development)**

## Background on TIF Policy Exceptions

TIF Policy states that in the event that a project requires one or more exceptions to TIF Policy, that staff presents the proposed exceptions to the Board of Estimates (BOE) in closed session, prior to drafting a Term Sheet and introduction of a TIF authorizing resolution. The following report and its recommendations are intended to assist BOE in determining whether the proposed project qualifies for an exception to TIF Policy.

## Project Description

Stone House Development (“Developer”) proposes to construct a mixed use project consisting of 80 apartment units, 68 of which are designated as affordable and 12 designated as market units and 2,250 square feet of commercial space located in a brick building currently situated on the site. The project is located at 134 S. Fair Oaks in Tax Incremental District (TID) #37 (**Figure 1**). The site was formerly used as a landscape nursery.

The Common Council adopted RES-16-00854 authorizing \$1,350,000 of Affordable Housing Initiative funds for the project on November 28, 2016. The TIF Application and fee were received on November 11, 2016.

## Purpose of BOE Consideration

Developer is seeking an exception to TIF Policy to exceed the 55% Gateway provision which stipulates that TIF assistance shall not exceed 55% of the increment generated by the project.

## TIF Report

The following TIF Report is provided in compliance with Section 3.1 (8) of TIF Goals, Objectives and Process and Section 1 (9) of TIF Loan Underwriting Policy, adopted by the Common Council on February 25, 2014:

**(a) Amount Requested by Developer**

\$470,000 (75% of TIF)

**(b) Type of Project**

Redevelopment



**Figure 1**

**(c) Analysis Method**

Gap Analysis

**(d) Tax Credits:**

Impact (WHEDA tax credits)	\$7,935,000
WHEDA Self-Score	226 of 284

**(e) Estimated Assessed Value and Tax Increments:**

Estimated Value	\$4,492,000
Total Estimated Tax Increments	\$1,289,000
Average Annual Tax Increment	\$101,000

**(f) TID Condition:**

At its creation, the TID 37 Project Plan authorized approximately \$20,867,000 of expenditures. As of the most recent audit dated December 31, 2015, TID #37 has expended \$6,556,447 allowed under the adopted project plan. TID #37 is currently averaging approximately \$227,000 in tax increments per year. TID #37 has approximately \$3.2 million of outstanding debts.

TID #37 is currently barely meeting its debt service obligations, and the district has been unable to accrue any tax increment cushion in the event that the various development projects do not meet value growth expectations.

Year Created	2006
Years to Recover Cost	17 yrs
Avg. Annual TID Increment (To Date)	\$227,000
Unrecovered Cost	\$3,259,828
Estimated Cost Recovery To Date	14 yrs
Estimated Cost Recovery With New Project	13 yrs*

\*This assumes the project receives a \$300,000 loan and generates incremental revenue peaking at approximately \$100,000 in year five of the TIF loan.

**(g) TIF Policy Compliance**

**Developer Equity**--Developer equity is \$415,000 of deferred developer fee with an expectation to receive \$7,935,000 of Low Income Housing Tax Credit equity from an investor. In total, this amount is in compliance with TIF policy that equity equal or exceeds the amount of TIF provided. Principals of Developer are providing a personal guaranty.

**Affordable Housing Project Requirements**—TIF assistance may be provided to a residential real estate project in which no less than 40% of the units are affordable to households making less than or equal to 40% of Area Median Income, said units made affordable for a period of not less than 30 years. Developer has proposed that 68 of the 80 units (85%) will be made affordable and therefore complies with this standard.

**55% Gateway**--The \$470,000 TIF Request is 75% and does not comply with the 55% Gateway. Developer requests an exception to this TIF Policy.

**Application Process**—TIF Policy requires that “TIF Applicants shall provide the City with all necessary documents to complete a thorough review of the application.” After several requests Developer has not provided the City with its assumptions concerning the recovery of the deferred developer fee,.

**(h) Other Applicable**

- |  |                                    |
|--|------------------------------------|
| 1) Quantity of living wage jobs created and/or retained            | <b>N/A</b>                         |
| 2) Quantity of affordable housing units and level of affordability | <b>68 units, 30% to 60% of AMI</b> |

**(i) Amount of TIF to Be Considered**

Staff believes that the project cash flow demonstrates a greater ability to support private debt. The debt coverage ratio as proposed was 1.6 for a \$4.1M residential loan. At 1.37, Developer could borrow \$4.5 M, and eliminate the gap. A typical residential project would have a debt coverage ratio of around 1.2.

TIF Eligible	\$343,000	55% of TIF
Total TIF Requested	\$470,000	75% of TIF
<b>TIF Recommended:</b>	<b>\$343,000</b>	<b>55% of TIF</b>

**(j) Developer's TIF Goals Statement—** TIF Policy requires that Developer provide a statement (**See Figure 2**) as to how the project addresses the following TIF Policy Goals:

- 1) Per Sections 1 and 3.4 of "TIF Goals, Objectives and Process", how does the Project meet City and TID's goals?
  - A) Grows the City's property tax base
  - B) Fosters the creation and retention of family-supporting jobs
  - C) Encourages the re-use of obsolete or deteriorating property
  - D) Encourages urban in-fill projects that increase density consistent with the City's Comprehensive Plan
  - E) Assists in the revitalization of historic, architecturally significant or deteriorated buildings or enhancement of historic districts.
  - F) Creates a range of housing types, specifically encouraging affordable housing
  - G) Funds public improvements that enhance development potential and improve City's infrastructure
  - H) Promotes superior design, building materials and sustainability features
  - I) Reserves sufficient increment for public infrastructure in both TID Project Plan and TIF underwriting

134 S. Fair Oaks Avenue

TIF Policy Goals

Section 1 –

*A. Growing the property tax base*

The site currently is currently a plant nursery. The current assessed value is \$541,000. The apartment building when fully occupied will have an assessed value in excel of \$5,000,000.

*D. Encouraging urban in-fill projects that increase density consistent with the City's Comprehensive Plan.*

The site is located in close proximity to a neighborhood of single family homes built forty plus years ago. It is a viable location due to its proximity to schools, retail establishments and recreational opportunities.

*F. Creating a range of housing types and specifically encouraging the development of workforce and affordable housing, especially housing that is for those earning much less than the area median income.*

The project will contain 80 units of rental housing with 68 of the units restricted to individuals and families earning far less than the area median income. The breakdown is as follows: 20% of the total units will be set aside for people whose incomes are at or below 30% of the Dane County median income; 40% of the total units will be set aside for people whose incomes are at or below 50% of the Dane County median income; and 25% of the total units will be set aside for people whose incomes are at or below 60% of the Dane County median income.

*H. Promoting superior design, building materials, and sustainability features in the built environment.*

The project will involve the new construction of a four story building and reuse of an existing prewar, one story building. High quality materials such as brick and cementitious siding will be utilized and extensive landscaping will be incorporated.

**(k) TIF Policy Exceptions**

**55% Gateway**—No more than 55% of the TIF generated by a project shall be provided to the project without prior authorization of the Board of Estimates in closed session.

**(l) Known Labor Agreement, Law Violations****None indicated.****Staff Comments:**

TIF staff has noted several inconsistencies in the facts presented by Developer. TIF staff has been unsuccessful in obtaining additional detail from Developer that would rectify these discrepancies. Staff's observations are as follows:

1. **Developer's Uncertainty Concerning the Gap**—Initially, Developer reduced its TIF request from \$570,000 representing 91% of TIF to 70%, or about \$437,000 without consulting its numbers. In staff's experience, this is unusual behavior. It suggested that some of the proposed gap is discretionary, such as a developer fee or construction contingency that may or may not be used. Later Developer's revised TIF Application requested \$470,000 or 75% of TIF.
2. **Recovery of Deferred Developer Fee**—Initially, Developer stated that \$300,000 of the gap was attributable to the cost of renovating the existing brick structure on the site as a commercial space to meet zoning requirements. As it is staff's experience that WHEDA does not include such commercial cost in their underwriting, this portion of the proposed gap appeared reasonable.

However, the remaining \$270,000 of the proposed gap was not explained, although the amount was identical to the amount of deferred developer fee being proposed at that time. Such deferrals are often required by WHEDA. Generally, when such fees are deferred, the developer is allowed to recover the fee through excess cash flow over a period of time. Due to the numerical coincidence that the unsubstantiated gap precisely equaled the amount of deferred fee required, staff requested the Developer's assumptions concerning the repayment of the deferred fee from cash flow and assumptions concerning the monthly drawdown of various funding sources during the construction period.

This data would help to identify whether TIF is being used to recover the deferred fee ahead of schedule or for some other cost. It is staff's belief that the information being sought was reasonable and available and would have either confirmed or refuted staff's hypothesis about a potential double-paying of the deferred fee with TIF.

Developer subsequently revised its application, requesting \$470,000 of TIF and proposing to defer \$415,000 of its fee. In either case, and after several requests, Developer did not provide staff with the requested assumptions. Staff is therefore unable to draw a conclusion.

3. **Inconsistency With Affordable Housing Initiative (AHI) Application**--On January 13, 2017 staff discovered that Developer's application for Affordable Housing Initiative (AHI) funds, administered by the Community Development Division, displayed significantly different cash flow assumptions than those presented in the TIF Application.

In particular, the AHI application (which also proposed 80 units) displayed a higher project cost and expenses and stated that the project would not demonstrate positive cash flow until Year 10. However, the TIF Application stated a positive cash flow in year one of approximately \$100,000 per year, growing at a steady rate thereafter. Both the TIF and AHI applications proposed to defer \$415,000 of the developer fee.

- 4. Undersized Bank Loan**—Although Developer proposed an identical \$4.1M private mortgage (for the residential only) for both the AHI and TIF applications, TIF staff discovered that the debt coverage ratio (DCR) of this loan was 1.53—much higher than standard. This suggested that the project could borrow more bank funds to reduce gap.

Staff estimates that several combinations of increasing or decreasing the deferred fee and bank loan would enable Developer to reduce the gap to a level either below or equal to the 55% Gateway.

The complication is that the WHEDA scoring system requires that developers defer fees, even though tax credit investors and banks do not. Developer will have to make such adjustments mindful that it has an impact on its WHEDA score to gain tax credit approval.

**Staff Recommendation:** The Project has not demonstrated a gap that exceeds \$343,000 or 55% of TIF. Staff recommends that TIF assistance should not exceed this amount. Therefore, the Project has not demonstrated a need for an exception to the 55% Gateway policy.