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Right Sizing Public Assistance

Tax Incremental Financing Need

U.S Treasury Rate Trends

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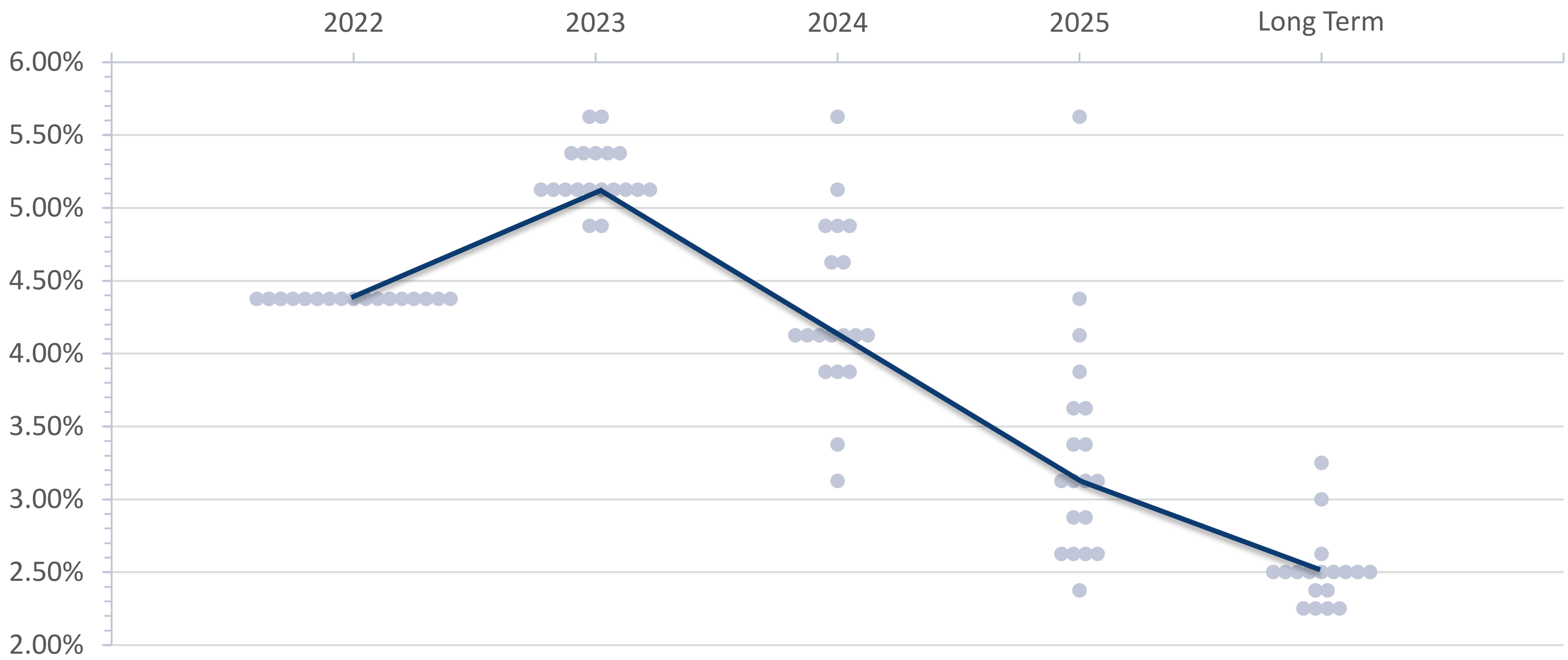
FOMC Summary of Rate Projections



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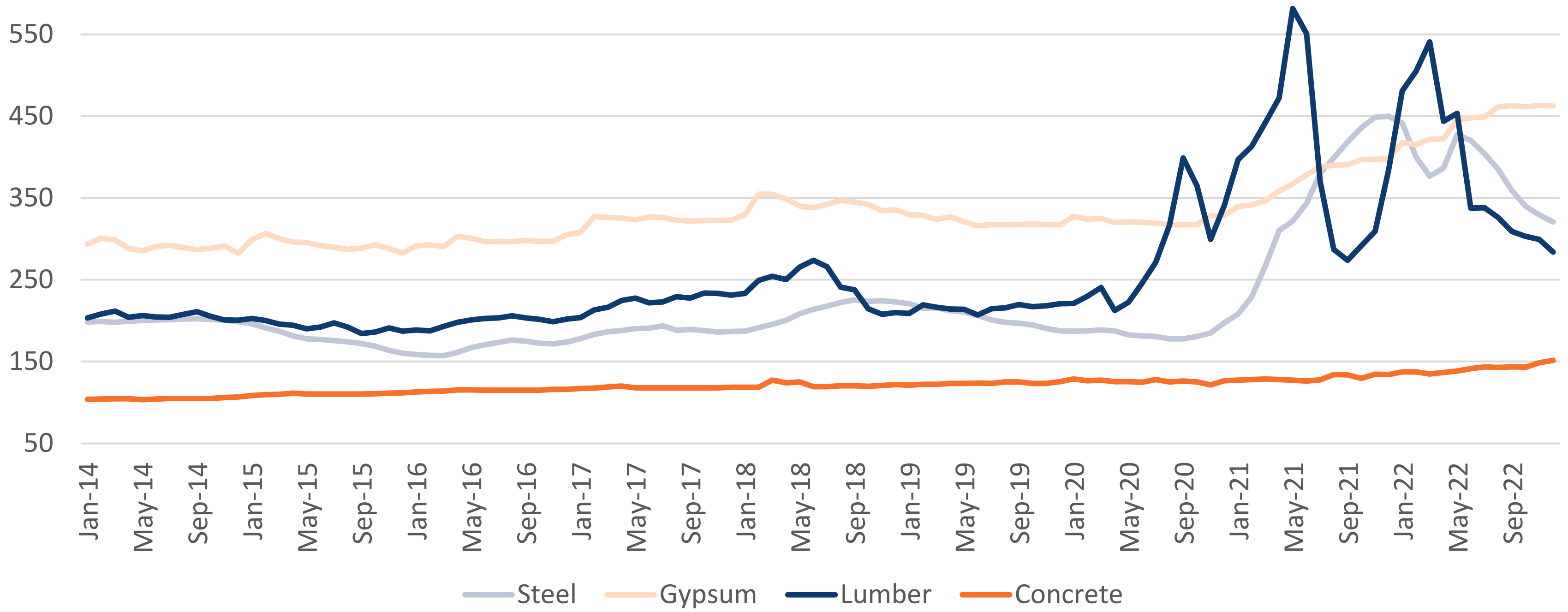
Construction Material Trends



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What Does This Mean?!?

26%

…Increase in construction cost from 2020. CBRE reports 2022 had a 14.1% increase year-over-year & 2021 had an 11.5% increase year-over-year. Historical average has been between 2% to 4% per year.

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It Also Means…

Communities must carefully evaluate all request for public assistance in order to protect local resources, BUT How much is enough?!

Promote Development. Protect Resources.

1. Develop strategic plan & policy
2. Analyze financial assistance requests carefully
3. Identify appropriate funding sources
4. Negotiate Lookback Provisions

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1. Develop Strategic Plan & Policy

- Identify community needs
- Prioritize focus for limited resources
- Consider available financing tools

The "But For" Test

- Standard applied by the JRB & key foundation of TIF program
- "But for" the use of TIF, development would not occur:
  - ✓ as proposed
  - ✓ within same time frame
  - ✓ with same level of value

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The "But For" Test: How Do You Prove It?

- Independent third-party review of developer's sources, uses & cashflows
- Challenged site
- Extensive public infrastructure costs
- Lack of economic development in community
- Ultimately, a JRB judgment call

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2. Analyze Assistance Requests: *pro forma*

Compare developer's numbers against industry standards

- Land acquisition
- Construction Costs
- Developer Fee
- Debt Assumptions
- Return on Investment

Ensure development components accounted for correctly

- Revenues
- Expenditures
- Debt service

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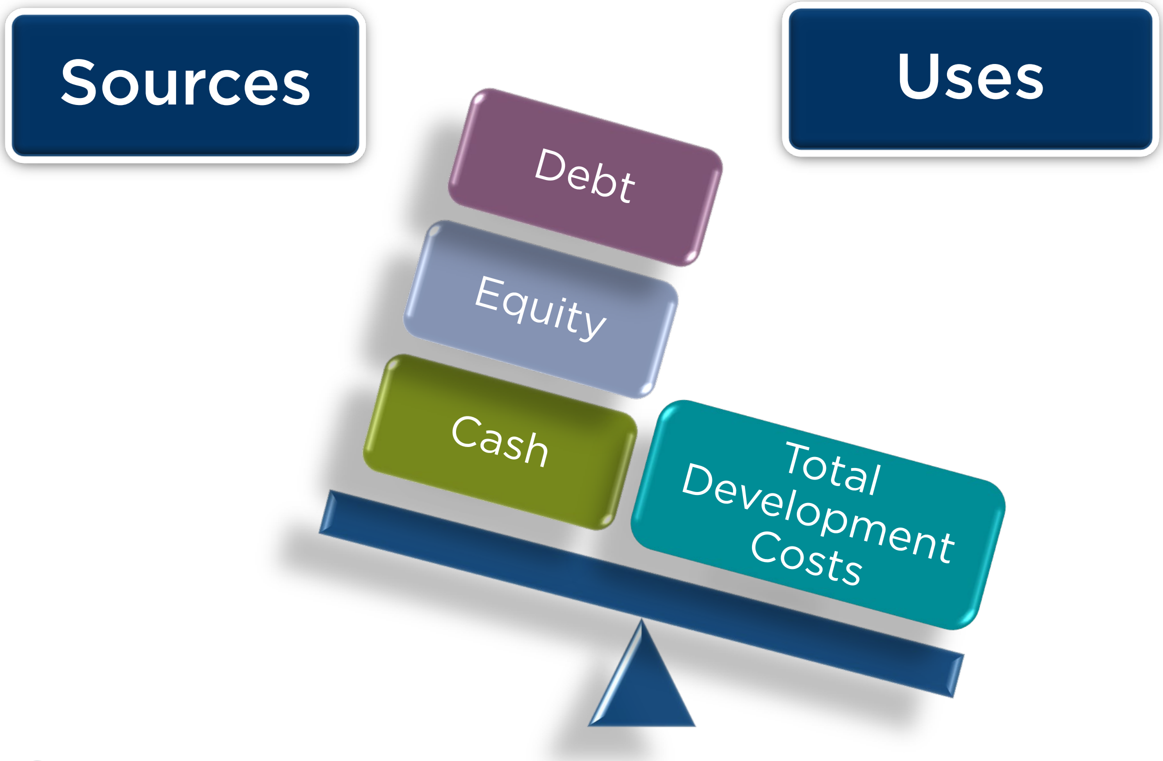
pro forma Analysis: The Goal

The Financial Gap: Sources & Uses



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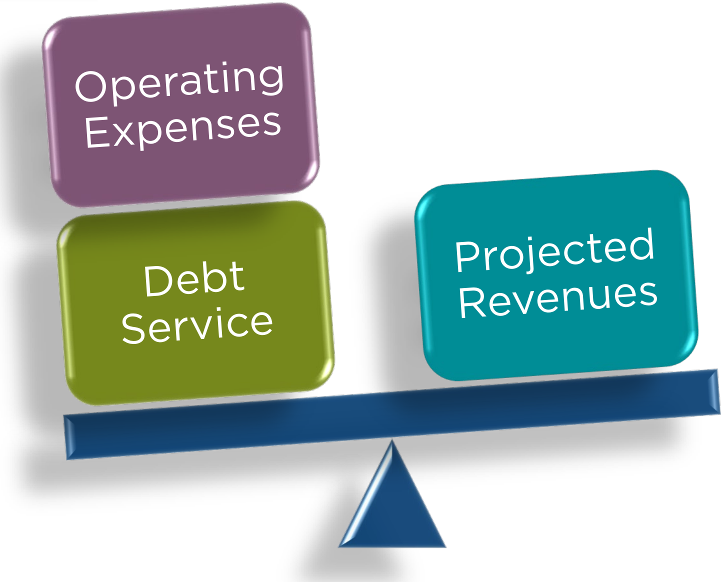
The Financial Gap: Ongoing Operations

Expenses

Revenue



Developer Transparency

- Project plans
- Budgets
- Forecasts & projections

Investment Return Metrics: IRR, COC & YOC

Metric	Definition	Typical Range
Internal Rate of Return	• Analyzes time value of money over a specific holding period • Estimates project profitability from initial equity investment by accounting for annual net cashflows, sale proceeds & debt repayment from a future sale	**12-18% at sale**
Cash-On-Cash	• Measures project net cash flow *(after debt service)* divided against the total amount of equity invested	**9-11% on average**
Yield-On-Cost	• Calculates net operating income *(before debt service)* divided by total development cost less upfront grants and deferred loans	**6-7.5% once stabilized**

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Return on Investment (ROI) Calculations

Cash-on-Cash
Net Cash Flow/Equity = ROI
Reasonable return generally 9%-11%

Yield-on-Cost
Net Operating Income/Total Development Costs = ROI
Reasonable return generally 6%-7.5%

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Cash-on-Cash ROI Examples

Initial Calculation	
Net Cash Flow	$80,000
Equity	$1,000,000
ROI	8%

Increase Net Cash Flow	
Net Cash Flow	$100,000
Equity	$1,000,000
ROI	10%

Decrease Equity	
Net Cash Flow	$80,000
Equity	$800,000
ROI	10%

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Yield-on-Cost ROI Examples

Initial Calculation	
Net Operating Income	$1,000,000
Total Development Costs	$20,000,000
ROI	5%

Increase NOI	
NOI	$1,400,000
TDC	$20,000,000
ROI	7%

Decrease TDC	
NOI	$1,000,000
TDC	$14,285,714
ROI	7%

3. Identify Appropriate Funding Sources

Tax increment financing (TIF)	Public funded infrastructure	Grants	Deferred loans
Local fee waivers	Existing fund balances	Public land contributions, write-downs	Local regulatory requirements (zoning, etc.)

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4. Negotiate Lookback Provisions

TOTAL DEVELOPMENT COST

RETURN ON INVESTMENT

SALE

River North Apartments

River North Apartments: Background

- Residential development request
- 81 market-rate apartments
- $2.8M requested assistance
- Rehabilitation district
- Challenged site conditions

River North Apartments: Goals & Challenges

Project Goals

- Rehabilitate blighted & underutilized railroad property
- Add to market-rate housing stock & population density to anchor downtown, foster growth

Project Challenges

- Construction entails extraordinary costs due to soils & high water table, required 2-level parking structure, geopiers
- City desire to reduce financial exposure of upfront cash request

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River North Apartments: *pro forma* Analysis

	Developer Request		
Sources	First Mortgage	$8,507,156	59.5%
	Equity	$3,000,000	21.0%
	Grant (Up Front)	$2,800,000	19.6%
	Total	$14,307,156	100.0%
	PAYGO (Future Value)	$0	
Uses	Acquisition	$105,340	0.7%
	Construction	$12,960,000	90.6%
	Professional Fees	$532,000	3.7%
	Financing	$223,816	1.6%
	Developer Fee	$486,000	3.4%
	Total	$14,307,156	100.0%

	Ehlers Analysis		
Sources	First Mortgage	$8,507,156	59.5%
	Equity	$4,400,000	30.8%
	Grant (Up Front)	$1,400,000	9.8%
	Total	$14,307,156	100.0%
	PAYGO (Future Value)	$1,400,000	
Uses	Acquisition	$105,340	0.7%
	Construction	$12,960,000	90.6%
	Professional Fees	$532,000	3.7%
	Financing	$223,816	1.6%
	Developer Fee	$486,000	3.4%
	Total	$14,307,156	100.0%

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River North Apartment: *pro forma* Analysis

Reasonable Return on Cost range: 6.0% - 7.5%

- Developer Yield on Cost 6.2%
- Ehlers' Desired ROI = not to exceed 6.5%
- TIF Assistance ends 2036 (15 years of 27-year TIF District)
- Ehlers' Yield-on-Cost 2036 = 6.2%

River North Apartments: Outcome

Upfront funds allowed for remediation of contaminated site along riverfront & development to proceed

Provided housing product to stabilize & invigorate developing downtown business district

Reduced City's financial risk by transferring half the incentive to Developer-funded (PAYGO) structure

Up-front incentive paid only upon achievement of milestones producing assessed value

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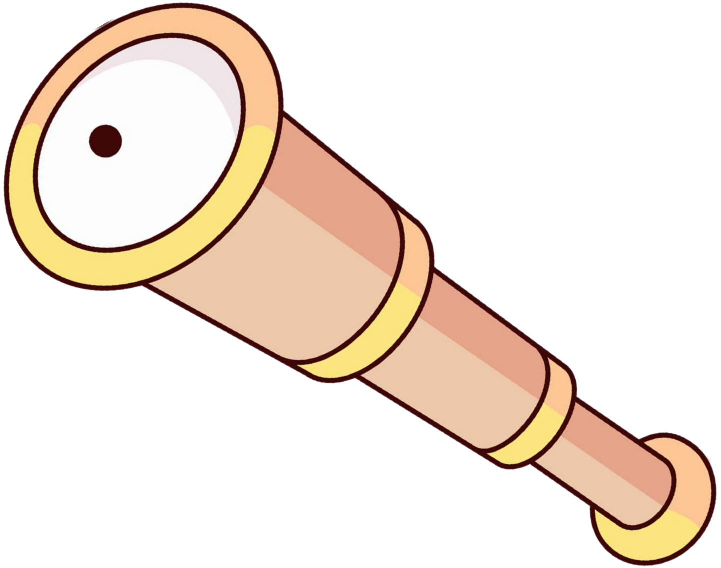
Lookback Analysis: MTC Mixed-Use Development

- Development agreement contained a Look-back clause for City to share in project return over a pre-determined profitability level in exchange for financial assistance
- Developer completed project & held for 18 months of operations before sale
- Development agreement set a specific IRR threshold before profit splits; short investment period requires XIRR analysis (monthly vs. annual IRR)



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Lookback Analysis: MTC Mixed-Use Development

Development Agreement used the term "audit" as part of look-back review.

- Implies significant set of confirmations beyond financial records (business policies, procedures, legal confirmations, etc.)
- Ehlers & City developed "Agreed-Upon Procedures" for outside accounting firm financial review
- Information included bank draws & equity contributions, rent rolls & operating reports from property manager & title company documents from project sale

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Lookback Analysis: MTC Mixed-Use Development

Ehlers evaluated overall project return vs 14.5% XIRR

→ Developer contended deferred developer fees were considered equity, thereby lowering IRR – BUT -

→ Bank statements proved 80% of fees were drawn from loan, per Development Agreement provisions

→ Once equity amount was determined, Ehlers needed to confirm investor & developer/sponsor returns

→ Development Agreement provided for $250K withholding from sale until look-back was completed

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Lookback Analysis: MTC Mixed-Use Development

Mequon Summary of Developer Returns

Total Project and Individual returns for investment period 6/2013 - 12/2016

XIRR RETURN ANALYSIS - MONTHLY BASIS - EQUITY PARTNERS

	Total Equity i	Proceeds	XIRR
Developer Calc:	(3,959,557)	5,678,462	11.21%
	incl $250K escrow paid; deferred fee as "equity"; Sponsor returns incl "K"		
Ehlers Calc:	(3,585,000)	5,678,462	14.57%
	cash equity only; incl $250K escrow; Sponsor returns incl "K" equity		
INDIVIDUAL			
A	(1,500,000)	2,348,750	14.00%
W	(1,485,000)	2,284,638	14.00%
E	(500,000)	791,250	14.00%
K (+ Sponsor profit)	(100,000)	168,442	16.04%
	(3,585,000)	5,593,079	
WiRED profits		37,798	
Schaeffer profits		47,584	
Total Distributions - check		5,678,462	
Amount required to reach 14.50% XIRR		5,666,300	
Total overage in earnings		12,162	
City 50% share of Clawback		6,081	

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Lookback Analysis: MTC Mixed-Use Development

- 14.57% calculated XIRR exceeded allowable 14.50%
- Total returns to equity exceeded max proceeds by $12,162
- City retained $6,081 from escrowed funds as upside split, returned $243,919 to developer group
- Lessons learned:
  - ✓ Be certain of terms used & info required in look-back clause!
  - ✓ Have qualified consultant perform analysis in conjunction with all project documents

Final Thoughts

- **Where there's a will, there's a way!**
  - ✓ Gain detailed understanding of developer's request
  - ✓ Demand developer transparency
  - ✓ **Complete *pro forma* analysis – *<u>always</u>***
  - ✓ Identify appropriate funding sources
  - ✓ Balance need for development & protection of local resources
- **Seek professional guidance**

Let's Talk!

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