



Memo

To: Patrick Brama, Economic Development Manager/
Assistant City Administrator

From: Jason Aarsvold, Ehlers

Date: July 10, 2017

Subject: Analysis of Request for Assistance – PSD, LLC Business Park

The City received a proposal from PSD, LLC to develop a business park on property located south of Bunker Lake Boulevard between Puma St. and Armstrong Blvd. At full build-out in its first phase, PSD anticipates a business park that includes 4 buildings of approximately 60,000 square feet each. The first 56,000 square foot building would start construction immediately as a speculative venture without a tenant in place and be completed in 2018.

Citing the high costs associated with developing the property, the higher building quality, and market risk, the developer is requesting nine (9) years of Tax Increment Financing (TIF) assistance from the City. Nine years is the maximum duration for an economic development district and we estimate the district would generate \$218,000 in present value, or \$282,000 in total value over the life of the district. This memo evaluates the need for TIF assistance based on our analysis of the developer’s project budget and projections, generally known as a pro forma.

Ehlers conducted a thorough review of the developer’s budget and operating pro forma to ensure all development costs, anticipated revenues, and expenditures are represented appropriately. The table below depicts the proposed sources and uses for the project.

SOURCES		
	Amount	Pct.
Developer Financing - 1st Mortgage	3,889,786	80.00%
Developer Equity	972,447	20.00%
TOTAL SOURCES	4,862,233	100.00%

USES			
	Amount	% of Cost	Per Bldg. Sq. Ft.
Acquisition Costs	454,766	9.35%	\$8
Construction Costs	3,616,300	74.38%	\$65
Professional Services	450,000	9.26%	\$8
Financing Costs	91,166	1.87%	\$2
Developer Fee	250,000	5.14%	\$4
TOTAL USES	4,862,232	100.00%	\$87

Generally, this project meets the expectations of an industrial building as it relates to the total development costs, financing structure, projected revenues, and developer fee. Following are our findings relating to the analysis completed for the development:

- The developer is proposing permanent financing for 80% of the project costs and will bring 20% in equity, or approximately \$972,000. This financing structure is in line with typical industrial projects.
- The total development costs for this project are approximately \$4.86 million, or \$87 per square foot. Based on our experience with industrial projects, this is slightly higher than expected. This increased cost is attributable to the architectural building enhancements, added infrastructure and site work necessary for the project. We have reviewed a bid from the contractor for construction of this building and determined the costs is acceptable.
- The developer fee of \$250,000 is 5.1% of total development costs. For a project of this nature, we would expect to see a developer fee between 3% and 5%. The fee is at the higher end of this range.
- Proposed rents are \$6.25 per square foot. We would expect to see rents of between \$7.00 and \$10.00 per square foot for office space and \$3.00 to \$5.00 per square foot for warehouse space. As a blended rate, \$6.25 per square foot is consistent with the surrounding market area.
- The projected cash-on-cost return on investment (net cash flow / total project costs) in year three (3) is 6.67% without assistance and 7.37% with assistance. Industrial developers are typically seeking a cash-on-cost return of between 7% and 9%. With the requested assistance, this project falls at the low end of the typical industry threshold for returns on investment.

Recommendations

Based on our review of the developer's pro forma and current market conditions, the proposed development may not reasonably be expected to occur solely through private investment within the reasonably near future. Due to the cost of land acquisition, site and public improvements and utilities in conjunction with achievable lease rates in the market, this project is feasible only through assistance, in part, from City contributions.

We conclude that providing a Pay-As-You-Go TIF note in the amount of \$218,000 will help the developer secure its first mortgage financing and facilitate construction of the project in the near term, while ensuring the return on investment does not exceed typical industry standards.

Pay-As-You-Go financing requires the developer to seek its own financing secured by the tax increments generated by the project. In this scenario, the City does not provide any funding up front, but enters into an agreement to provide tax increment payments from the project's increased taxes up to \$218,000 over a 9-year period. If the tax increments are insufficient to repay the note, the City does *not* make up the shortfall. The developer has indicated that they are willing to move forward based upon the proposed TIF assistance.

Please contact me at 651-697-8512 with any questions.