



Memo

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

From: Jason Aarsvold, Ehlers

Date: July 12, 2017

Subject: Analysis of Request for Assistance – PSD, LLC – Adrenaline Sports Center

The City received a proposal from PSD, LLC (the “Developer”) 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. PSD proposes to develop one of these buildings primarily for Adrenaline Sports Center. Adrenaline would occupy approximately 56,000 square feet of the 64,000 square foot building. The remaining space would be available for lease to other tenants.

Citing the high costs associated with developing the property, the higher building quality, the reduced rent potential from Adrenaline Sports Center and the risk associated with the project, the developer is requesting \$250,000 from the city to make the project financially feasible. The project is not a qualified use within an economic development tax increment financing (TIF) district. Therefore, TIF cannot be used for this project. Instead, the City identified existing economic development funds that could be used to finance the project.

As proposed, the City would pay this assistance over a three-year period, commencing one year after the project is complete. This means that payments of \$83,333 per year would be made beginning 2019 through 2021 based on the current project schedule.

This memo evaluates the need for City 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	4,316,717	80.00%
Developer Equity	1,079,179	20.00%
TOTAL SOURCES	5,395,896	100.00%

USES			
	Amount	% of Cost	Per Bldg. Sq. Ft.
Acquisition Costs	450,846	8.36%	\$7
Construction Costs	4,096,300	75.92%	\$64
Professional Services	450,000	8.34%	\$7
Financing Costs	98,750	1.83%	\$2
Developer Fee	300,000	5.56%	\$5
TOTAL USES	5,395,896	100.00%	\$84

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 \$1,079,179. This financing structure is in line with typical industrial projects.
- The total development costs for this project are approximately \$5.4 million, or \$84 per square foot. This total development cost is within industry standards for a project of this nature.
- The developer fee of \$300,000 is 5.6% 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 \$6.00 per square foot. This rate is consistent with what Adrenaline has agreed to pay for the space it will be leasing.
- The projected cash-on-cost return on investment (net operating income / total project costs) by year five (5) is 7.05% without assistance and 7.97% with assistance. Year five is chosen for this analysis as it is the year after the City payments end. Industrial developers are typically seeking a cash-on-cost return of between 7% and 9%. With the requested assistance, this project falls within the typical industry threshold for returns on investment.

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Recommendations

Based on our review of the developer's pro forma and current market conditions, we conclude that providing \$250,000 over a three-year period 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.

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