EHLERS
LEADERS IN PUBLIC FINANCE

Memo

To: Sean Sullivan, Economic Development Manager

From: Jason Aarsvold, Ehlers

Date: 11-30-2022

Subject: Home2 Suites – Request for Assistance

The City of Ramsey received a request for assistance to construct an 82 room Home2 Suites within the COR area on City-owned land. The developer is requesting the City write-down the cost of the land to $1 and provide a pay-as-you-go (PAYGO) TIF note in the amount of $306,000 to make the project financially feasible.

You requested that Ehlers review the developer's proposal to determine whether the request is reasonable and within industry standards. Ehlers conducted a thorough review of the developer's budget and operating pro forma to ensure all development costs, anticipated revenues, and expenditures were represented appropriately. The table below depicts the sources and uses of funds for the project as proposed by the developer.

SOURCES	Amount	Pct.	Per Room
First Mortgage	9,910,943	64.3%	120,865
TIF PAYGO Note	306,000	2.0%	3,732
Developer Equity	5,189,978	33.7%	63,292
TOTAL SOURCES	**15,406,921**	**100%**	**187,889**

USES	Amount	Pct.	Per Room
Acquisition Costs	1	0.0%	0
Construction Costs	11,806,644	76.6%	143,983
Permits/Fees	73,800	0.5%	900
Furniture, Fixtures, & Equipment	1,830,240	11.9%	22,320
Professional Services	437,495	2.8%	5,335
Financing Costs	451,078	2.9%	5,501
Developer Fee	353,663	2.3%	4,313
Cash Accounts/Escrows	454,000	2.9%	5,537
TOTAL USES	**15,406,921**	**100%**	**187,889**

Analysis

Generally, this project meets the expectations of a limited service, or upper midscale, hotel project as it relates to the financing structure, projected revenues, developer fee, and on-going operational costs. Following are our findings from the analysis completed for the project:

- The Developer proposes to finance the entire hotel project with a combination of equity and debt. The proposed financing includes 32.7% equity and 66.3% debt in the form a first mortgage and the PAYGO portion of the developer loan. For a project of this nature, we would expect to see an equity contribution of at least 25%. The developer indicates the first mortgage would include a 25-year term with 6.75% interest. While these terms are within industry standards and are used for the analysis, we were not given an actual lending commitment to review.

- The total development cost (TDC) for this project is $15.4 million or $187,889 per room, assuming no payment for the land. Based on our experience with similar projects, we would expect total development costs to range between $175,000 and $200,000 per room with a payment for land. The development costs are within an acceptable range, but we did not receive a detailed breakdown for review.

- The developer fee of $353,663 is 2.3% of total development costs. For a project of this nature, we would expect to see a developer fee of no more than 5%. The proposed fee is acceptable.

- The developer proposes an Average Daily Rate (ADR) of $130 in year one with a 61% percent occupancy assumption. This increases to an ADR of $138 by year three with a 68% occupancy assumption. The projected ADR is consistent with a third-party market analysis prepared for the project and is, therefore, an acceptable assumption for this project.

- The total operating costs are projected at just over $20,626 per room and represent 58% of effective gross income. The proposed operating costs are within industry standards.

- The project's *average* cash on cash return (annual cash flow / equity) without any assistance is 5.1% in year three and increases to 7.5% by year 8. Hotel developer/ owners would like to see a cash-on-cash return of 8% to 10%.

Recommendations

In summary, the lower than average projected return on investment means the project does demonstrate a need for assistance. Providing the requested land write-down and PAYGO note will help facilitate development of the hotel without unduly enriching the developer.

We estimate the project will generate approximately $105,000 annually (at full build-out) in tax increment within the COR TIF district. Some of that increment can be directed to repay the City's land write-down through and inter-fund loan, and some can be used to repay the PAYGO TIF note. We propose using 40% of the increment generated to repay the City's inter-fund loan with the remaining 60% directed to the PAYGO note payments.

Based on this structure, we estimate the PAYGO note could be repaid with 6.5 years of payments, assuming an interest rate on the note of 5%. This, coupled with the land write-down, would push the project's average cash on cash return to 8.8% by year 8 (at which point the TIF payments would stop). Repayment of the City's land though an interfund loan would take an estimated 10.5 years assuming the City charges the maximum interfund land interest rate of 5%.