

MEMORANDUM

TO: Sean Sullivan, Economic Development Manager
 FROM: Jason Aarsvold, Ehlers
 DATE: July 13, 2023
 SUBJECT: Presbyterian Homes TIF Request

The City of Ramsey (the “City”) received a financial assistance request from Presbyterian Homes (the “Developer”) to construct a rental housing community located at 14501 Nowthen Blvd NW. The project will be built in two separate phases. Phase 1 will include construction of a 280-unit general occupancy apartment with at least 20% of the units occupied or held for occupancy by persons and families whose incomes do not exceed 50% of area median income (AMI). Phase 2 will include 160-unit senior (62+) apartment and 20 (62+) rental park homes and with at least 20% of the units occupied or held for occupancy by persons and families whose incomes do not exceed 50% of AMI.

The Developer’s initial request for TIF assistance was just over \$22 million for the project. After a review of values with the county assessor, legislative changes to the affordable housing tax classification rate and other project specifics, Ehlers determined the project could not generate that amount of increment. The Developer’s request was subsequently reduced as outlined below.

Phase 1 TIF Request

The Developer requested \$7.3 million in tax increment financing (TIF) to make Phase 1 financially feasible. Ehlers conducted a thorough review of the Developer’s current pro forma based on industry standards for construction, land, and project costs, affordable rental rates and operating expenses, developer fees, available funding sources, underwriting criteria, and project cash flow. Based on the results of the pro forma analysis, we conclude the project would require \$5.632 million in TIF assistance to achieve financial feasibility, which is a projected 20 years of TIF payments. The Developer determined they can proceed with the recommended level of assistance. The table below depicts the proposed sources and uses for the project.

SOURCES			
	Amount	Pct.	Per Unit
First Mortgage	54,922,742	61.8%	196,153
TIF Mortgage (Note)	5,632,000	6.3%	20,114
Equity	28,306,318	31.9%	101,094
TOTAL SOURCES	88,861,060	100%	317,361

USES			
	Amount	Pct.	Per Unit
Acquisition Costs	3,500,000	3.9%	12,500
Construction Costs	71,243,193	80.2%	254,440
Professional Services	5,583,334	6.3%	19,940
Financing Costs	3,394,570	3.8%	12,123
Developer Fee	3,432,156	3.9%	12,258
Cash Accounts/Escrows/Reserves	1,707,807	1.9%	6,099
TOTAL USES	88,861,060	100%	317,361

Phase 1 Project and Pro Forma Analysis:

- **Project Financing:** The Developer proposes to finance Phase 1 with a combination of debt and equity. The project assumes 68% debt financing (including the TIF portion) and 32% equity. The proposed financing is acceptable for the project.
- **Total Development Costs (TDC):** The TDC of the project is nearly \$88.9 million or \$317,361 per unit. Projects like this one are generally ranging between \$250,000 and \$325,000 per unit so the Phase 1 building is within the market range.
- **Land Acquisition Costs:** The proposed land acquisition cost is \$3.5 million or approximately \$12,500 per unit. We would expect the cost of land to be between \$7,000 and 15,000 per unit, so this land purchase price is acceptable for the project.
- **Rents:** 20% of the units (56 total) will be set aside for those with incomes at or below 50% of area median income (AMI), which qualifies the project for inclusion in a Housing Tax Increment Financing district. The projected affordable rents are inflated for occupancy in 2026 and acceptable for the project. Market rate rents are projected at \$2.70 per sq. ft. which is the high end of the market for Ramsey.

The affordable rent and income limits are set by the United States Department of Housing and Urban Development (HUD) on an annual basis. The following tables include the current rent and income limits.

Income Limits by Household Size (2023)								
	1	2	3	4	5	6	7	8
30%	26,100	29,820	33,540	37,260	40,260	43,230	46,230	49,200
50%	43,500	49,700	55,900	62,100	67,100	72,050	77,050	82,000
60%	52,200	59,640	67,080	74,520	80,520	86,460	92,460	98,400

Maximum Gross Rents by Bedroom Size (2023)							
	Studio	1	2	3	4	5	6
30%	652	699	838	969	1,080	1,192	1,304
50%	1,087	1,165	1,397	1,615	1,801	1,988	2,173
60%	1,305	1,398	1,677	1,938	2,616	2,385	2,608

- **Operating Expenses:** The operating expenses of approximately \$6,606 per unit per year are higher than the typical range of \$3,500 to \$4,500 per unit per year (before management fees, property taxes, and replacement reserves). These operating expenses include the management fee, however, and are acceptable for the project.
- **Reserves:** The annual deposit to replacement reserves are proposed to be at \$275 per unit per year. Typical deposits to the replacement reserve range between \$250 - \$450.

- Developer Fee: The developer fee of \$3,432,156 is 3.9% of total development costs. This is within the typical industry range of 3-5% for rental projects. The proposed fee is within the typical range.
- Return on Investment – The project’s *average* yield on cost return on investment (net operating income / total development costs) with 20 years of TIF assistance is 7%. Developers typically need a yield on cost of between 6.5% to 7% for feasibility. Since the project reaches this level within 20 years, we conclude TIF payments can stop at this point.

Phase 2 TIF Request

The Developer requested \$4.68 million in tax increment financing (TIF) to make Phase 2 financially feasible. Based on the results of the pro forma analysis, we conclude the project would require \$3.631 million in TIF assistance to achieve financial feasibility, which is a projected 20 years of TIF payments. The Developer determined they can proceed with the recommended level of assistance. The table below depicts the proposed sources and uses for the project.

SOURCES			
	Amount	Pct.	Per Unit
First Mortgage	40,297,092	58.8%	223,873
TIF Mortgage (Note)	3,631,000	5.3%	20,172
Equity	20,705,611	30.2%	115,031
Fundraising	3,905,000	5.7%	21,694
TOTAL SOURCES	68,538,703	100%	380,771

USES			
	Amount	Pct.	Per Unit
Acquisition Costs	2,070,000	3.0%	11,500
Construction Costs	51,214,567	74.7%	284,525
Professional Services	9,236,520	13.5%	51,314
Financing Costs	2,424,672	3.5%	13,470
Developer Fee	2,332,227	3.4%	12,957
Cash Accounts/Escrows/Reserves	1,260,717	1.8%	7,004
TOTAL USES	68,538,703	100%	380,771

Phase 2 Project and Pro Forma Analysis:

- Project Financing: The Developer proposes to finance Phase 2 with a combination of debt and equity. The project assumes 64% debt financing (including the TIF portion) and 30% equity. The remaining portion will come through fundraising efforts. The proposed financing is acceptable for the project.
- Total Development Costs (TDC): The TDC of the project is nearly \$68.5 million or \$380,771 per unit. Projects like this one are generally ranging between \$250,000 and \$325,000 per unit. The cost of the 20 park homes brings up this cost, however. The Phase 2 buildings are within the market range.
- Land Acquisition Costs: The proposed land acquisition cost is \$2.07 million or approximately \$11,500 per unit. We would expect the cost of land to be between \$7,000 and 15,000 per unit, so this land purchase price is acceptable for the project.

- Rents: 20% of the units (36 total) will be set aside for those with incomes at or below 50% of area median income (AMI), which qualifies the project for inclusion in a Housing Tax Increment Financing district. The projected affordable rents are inflated for occupancy in 2026 and acceptable for the project. Market rate rents are projected at \$2.68 per sq. ft. which is the high end of the market for Ramsey.
- Operating Expenses: The operating expenses of approximately \$8,712 per unit per year are higher than the typical range of \$3,500 to \$4,500 per unit per year (before management fees, property taxes, and replacement reserves). These operating expenses, however, include the management fee as well as some housekeeping and wellness activities and are acceptable for the project.
- Reserves: The annual deposit to replacement reserves are proposed to be at \$350 per unit per year. Typical deposits to the replacement reserve range between \$250 - \$450.
- Developer Fee: The developer fee of \$2,332,227 is 3.4% of total development costs. This is within the typical industry range of 3-5% for rental projects. The proposed fee is within the typical range.
- Return on Investment - The project's *average* yield on cost return on investment (net operating income / total development costs) with 20 years of TIF assistance is 7%. Developers typically need a yield on cost of between 6.5% to 7% for feasibility. Since the project reaches this level within 20 years, we conclude TIF payments can stop at this point.

Recommendation:

Based on our review of the Developer's pro forma and under current market conditions, the proposed development may not reasonably be expected to occur solely through private investment within the near future. Due to the costs associated with developing the property and constructing housing with affordable rents, this project is only feasible, in part, through public assistance.

TIF assistance should be provided on a "pay-as-you-go" (PAYGO) basis. With PAYGO TIF assistance, the City does not provide any funding up-front. Instead, the City enters into an agreement to provide tax increment payments that are generated solely from the project's actual increased property taxes. The Developer uses those tax increment payments to obtain additional debt and/or support returns on investment. If the tax increment is insufficient to pay the \$2.7 million in total TIF notes, the City does not make up the shortfall.

Please contact me at 651-697-8512 if you have any questions or comments.