



MEMORANDUM

To: City of Princeton
From: Tammy Omdal
Date: December 17, 2020
Re: Tax Increment Financing Assistance for Housing Project

The City is proposing to enter into two agreements with Rum River Residential Suites, LLC to provide tax increment financing assistance for the construction of two apartment buildings, constructed in two phases, to include approximately 49 rental units in each of the two buildings (the "Project"). The Project is proposed to be market rate with an affordable component.

The City Council approved the establishment of Tax Increment Financing District No. 9-2 (the "TIF District") on September 24, 2020 (Resolution No. 20-53) providing the City the authority to consider assistance for the Project.

The first building will be located along First Street and the second building will be located just behind the first building, on a site that is owned by the Developer. The first building is proposed to be completed and at 50% occupancy by 2022 and full occupancy by 2023. The second building is proposed to be completed and at 50% occupancy by 2024 and full occupancy by 2025. The Developer's plan and timing is contingent on receiving public financial assistance to assist with the affordable component of the market rate buildings, among other items.

The cost for the Project (inclusive of 98 units, both buildings) is estimated at approximately \$15.4 million in today's dollars. The Developer's request for public financial assistance is to assist with the extraordinary costs, including land and site improvements, and the cost to be provide the affordable housing units. The Developer has represented that it will not undertake the Project as proposed without public financial assistance.

It is Northland's opinion that the Project as proposed, which includes indoor parking, is unlikely to occur but for the proposed public financial assistance, inclusive of the tax increment financing. Without the assistance, the Project is not expected to achieve the level of debt service coverage and returns needed to secure the necessary private financing and equity.

Public Financial Assistance

Due to the extraordinary costs associated with acquisition and development of the Project, the Developer is seeking public financial assistance from the City in the form of pay-go tax increment financing assistance. The financial assistance will come from the tax increment revenue generated within the TIF District.

Exhibit A provides a summary of the estimated potential tax increment cash flow from the TIF District and assistance to the Developer, based on certain assumptions. State law provides that the increase in property taxes from the captured tax capacity (from the increase in market value) applied against the local tax capacity rates may be captured to assist the Project. Referendum market value taxes and the State of Minnesota property tax for commercial property (not applicable for residential property) are not captured for tax increment financing.

To reimburse the eligible costs incurred by the Developer, the agreement for Phase I provides that the Developer will purchase a Tax Increment Financing Revenue Note (the "TIF Note") in maximum principal

amounts of \$1,379,000. The agreement for Phase I provides for a maximum principal amount of \$1,151,000 for the TIF Note.

The TIF Notes are not a general obligation of the City. The TIF Notes are payable solely from net available semi-annual tax increments from the Project. Net available semi-annual tax increments is estimated to be based on 90% of the tax increment collected from each of the two buildings within the TIF District.

The TIF Note will bear simple, non-compounding interest from the date that the City determines paid invoices, as paid by the Developer, in compliance with the terms of an agreement, at a rate of 4.25% from the date of issue per annum.

Review of Need for Assistance

Northland conducted a review of the Developer's application for financial assistance and pro forma as submitted to the City. Northland reviewed project cost estimates to ensure all anticipated sources and uses for the Project were properly included. Based on our review of the pro forma and under current market conditions, we find that the Project, as proposed, may not reasonably be expected to occur solely through private investment within the reasonably near future. Due to the costs associated with construction of the affordable housing units (among other extraordinary costs), the Project as proposed is feasible only through assistance, in part, from tax increment financing. This conclusion is supported by the following:

- The Developer plans for the estimated \$15.4 million cost for the Project to be funded from a combination of debt, equity, and deferred construction management and developer fees. The present value of the estimated future tax increment revenue from the TIF Note payments to the Developer reduces the effective cost of the Project by \$2,530,000. Based on estimated net operating income, the effective return without the public financial assistance is not at a level the Project, as proposed, would proceed.
 - The total average cost per housing unit is estimated at approximately \$157,000 (in today's dollars) for the construction of the 98 units, including the cost of the parking. Each building for the Project will include 13 studio units, 22 one-bedroom units, and 14 two-bedroom units. Based on Northland's experience with similar projects and given the location of the Project, we would expect total development costs to range between \$97,000 and \$160,000 per unit. The total per unit project cost is generally within this range.
 - The estimated average gross monthly rent per unit for the first building, in the first stabilized year of the Project, is estimated at approximately \$1,054 per month (in year 2023). The Project is estimated to include three stories, with indoor and surface parking. Monthly average gross rents are estimated at \$636-\$950 for the studios, \$1,075 for a one-bedroom unit to \$1,200 for a two-bedroom unit. A minimum of 20% of the units are planned to be affordable at 50% of the average median income (AMI) for Mille Lacs County as of fiscal year 2020 is \$72,600). The annual total gross rental income for the first building is estimated at approximately \$620,000 in the first year of stabilized occupancy, before adjusting for estimated apartment vacancy and rental loss of 5%.
 - The total annual expense, operating and non-operating, is estimated at \$5,125 per unit (after completion of both buildings). This includes a 5% management fee and approximately \$265 per unit (2%) for replacement reserve. This includes an estimated average \$3,091 per unit for real estate taxes. The contribution to reserves is reasonable and the projected total annual expense is within industry standards.
 - The estimated average debt service coverage with tax increment financing is estimated to average 1.19X during the first five years of stabilized operations, and without tax increment assistance the
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average is 0.95X. The coverage for the mortgage without the tax increment is not at a level that we would expect the Project, as proposed, to proceed. The financing of this type of project would be expected to be at a minimum of approximately 1.2X coverage.

- The deferred construction fee and developer fee is projected to be paid within the first ten years of operations. The beginning balance is estimated at \$1,025,000, and the pro forma assumes this balance will be repaid with interest.
- The estimated annual cash on cash return (net annual operating income divided by total development project costs) with tax increment financing is estimated to average 5.4% during the first five years of stabilized operations and 4.2% without tax increment assistance. The cash on cash return is reasonable for this type of project and the proposed source of financing.

City Council Action

Should the City Council agree with the conclusions reached and wish to have the project proceed then the City Council will need to consider approval of the following:

- Resolution Authorizing Modification to Tax Increment Financing Plan for Tax Increment Financing District No. 9-2 and Execution of Development Agreements

The proposed resolution includes modification to the Tax Increment Financing Plan for the TIF District in order to adjust the estimated line item project costs within the adopted budget for the TIF District. The proposed modification does not change the total budgeted project costs for the TIF District. Exhibit B provides information on the proposed modification to the budget for the TIF District.

EXHIBIT A
City of Princeton
Tax Increment Financing District No. TIF District No. 9-2 (Housing)
Biggs Apartment Project

										ESTIMATED CASH FLOW FOR TIF NOTE, BASED ON CERTAIN ASSUMPTIONS					
										PHASE I	PHASE II	Total			
										90.0%	4.25%	90.0%	4.25%	90.0%	4.25%
TIF District Year	Taxes Payable Year	Taxable Market Value (TMV)	Tax Capacity	Less Base Tax Capacity ³	Captured Tax Capacity ³	Original Tax Rate ¹	Total Available TIF (after State Fee)	Present Value of Total Available TIF ⁵	TIF Retained by City	TIF to Developer (Principal) ⁴	TIF to Developer (Principal) ⁴	TIF to Developer (Principal) ⁴	TIF to Developer (Principal) ⁴		
1	2023	2,664,375	33,305	(1,229)	32,076	174.09%	55,641	54,279	5,564	50,077	48,355	50,077	48,355		
2	2024	5,355,394	66,942	(1,229)	65,714	174.09%	113,991	162,217	11,399	102,592	143,340	102,592	143,340		
3	2025	8,073,256	100,916	(1,229)	99,687	174.09%	172,923	321,154	17,292	103,754	235,444	51,877	46,052		
4	2026	10,818,163	135,227	(1,229)	133,998	174.09%	232,442	528,527	23,244	104,599	324,474	104,599	135,083		
5	2027	10,872,254	135,903	(1,229)	134,674	174.09%	233,615	730,833	23,361	105,127	410,269	105,127	220,877		
6	2028	10,926,615	136,583	(1,229)	135,354	174.09%	234,794	928,194	23,479	105,657	492,946	105,657	303,554		
7	2029	10,981,248	137,266	(1,229)	136,037	174.09%	235,978	1,120,731	23,598	106,190	572,617	106,190	383,226		
8	2030	11,036,155	137,952	(1,229)	136,723	174.09%	237,168	1,308,562	23,717	106,726	649,393	106,726	460,001		
9	2031	11,091,335	138,642	(1,229)	137,413	174.09%	238,365	1,491,802	23,836	107,264	723,378	107,264	533,987		
10	2032	11,146,792	139,335	(1,229)	138,106	174.09%	239,567	1,670,564	23,957	107,805	794,675	107,805	605,283		
11	2033	11,202,526	140,032	(1,229)	138,803	174.09%	240,776	1,844,956	24,078	108,349	863,380	108,349	673,988		
12	2034	11,258,539	140,732	(1,229)	139,503	174.09%	241,991	2,015,086	24,199	108,896	929,587	108,896	740,196		
13	2035	11,314,831	141,435	(1,229)	140,207	174.09%	243,211	2,181,058	24,321	109,445	993,389	109,445	803,997		
14	2036	11,371,405	142,143	(1,229)	140,914	174.09%	244,438	2,342,973	24,444	109,997	1,054,871	109,997	865,480		
15	2037	11,428,262	142,853	(1,229)	141,625	174.09%	245,670	2,500,930	24,567	110,552	1,114,119	110,552	924,727		
16	2038	11,485,404	143,568	(1,229)	142,339	174.09%	246,910	2,655,026	24,691	111,109	1,171,213	111,109	981,822		
17	2039	11,542,831	144,285	(1,229)	143,057	174.09%	248,155	2,805,356	24,816	111,670	1,226,232	111,670	1,036,841		
18	2040	11,600,545	145,007	(1,229)	143,778	174.09%	249,407	2,952,012	24,941	112,233	1,279,252	112,233	1,089,860		
19	2041	11,658,548	145,732	(1,229)	144,503	174.09%	250,664	3,095,083	25,066	112,799	1,330,344	112,799	1,140,952		
20	2042	11,716,840	146,461	(1,229)	145,232	174.09%	251,928	3,234,656	25,193	112,034	1,379,000	23,136	1,151,000		
TOTAL =							4,457,636	3,234,656	445,764	2,106,876	1,379,000	1,813,431	1,151,000	3,920,307	2,530,000

- Key Assumptions for Cash Flow:
- 1 Original Tax Capacity Rate estimated based on Taxes Payable Year 2020.
 - 2 Election for captured tax capacity is 100.00%.
 - 3 Captured Tax Capacity is net of Base Tax Capacity calculated based on TMV = \$98,300.
 - 4 Present value (PV) is calculated based on semi-annual payments, 4.25%, and date of 1/1/2023.
 - 5 Payment dates to the Developer are August 1 and February 1. February 1 payment is made from the second half tax settlement collected in the prior year.

EXHIBIT B
City of Princeton
Tax Increment Financing District No. TIF District No. 9-2
Projected Tax Increment
Briggs Apartment Project

	Total	Modification No. 1
Estimated Tax Increment Revenues (from tax increment generated by the district)		
Tax increment revenues distributed from the county	\$7,684,000	\$7,684,000
Interest and investment earnings	\$50,000	\$50,000
Sales/lease proceeds	\$0	\$0
Market value homestead credit	\$0	\$0
Total Estimated Tax Increment Revenues	\$7,734,000	\$7,734,000
Estimated Project/Financing Costs (to be paid or financed with tax increment)		
Project costs		
Land/building acquisition	\$1,000,000	\$1,000,000
Site improvements/preparation costs	\$0	\$3,331,000
Utilities	\$0	\$0
Other public improvements	\$0	\$0
Construction of affordable housing	\$3,583,000	\$252,000
Small city authorized costs, if not already included above	\$0	\$0
Administrative costs	\$509,000	\$509,000
Estimated Tax Increment Project Costs	\$5,092,000	\$5,092,000
Estimated financing costs		
Interest expense	\$2,642,000	\$2,642,000
Total Estimated Project/Financing Costs to be Paid from Tax Increment	\$7,734,000	\$7,734,000
Estimated Financing		
Total amount of bonds to be issued	\$5,092,000	\$5,092,000