PUBLIC FINANCE ADVISORS

MEMORANDUM

TO: Board Members, Grand Rapids Economic Development Authority

FROM: Rebecca Kurtz and Schane Rudlang, Ehlers

DATE: April 8, 2024

SUBJECT: Financial Analysis for the HWY35 Properties, LLC Project

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HWY35, LLC through their subsidiary HWY35 Properties, LLC (collectively "Developer") has purchased a 138 acre, six-parcel site at 502 Co. Rd. 63, also known as the former Ainsworth site. The Developer intends to rehabilitate the site and lease 345,000 square feet of existing building space, primarily for cannabis related businesses ("Project"). HWY35, LLC will be seeking licensing from the Minnesota Office of Cannabis Management to perform and/or manage the cannabis business operations. The Developer has applied to the City of Grand Raids (the "City") and the Grand Rapids EDA ("GREDA") to receive $2,000,000 of tax increment financing assistance ("Assistance") for the purchase and site development costs. Ehlers reviewed the request for Assistance which is summarized herein.

Financial Review

Ehlers evaluated the need for Assistance by analyzing the Developer's sources and uses, budget, and financial projections, generally known as a proforma. We reviewed the Project based on industry standards for construction, land, and project costs; operating expenses; underwriting and financing criteria; and cash flow.

The analysis focused on the gap related to the acquisition and site development costs of $14.5 million. HWY35 Properties purchased the site from a non-related entity for $4.5 million. Site development costs are estimated to be $10 million.

The tenant HWY 35 will complete the improvements to the current building estimated at an additional $50.7 million plus an estimated $5 million for working capital. The estimated total project cost is $71.15 million.

The financing sources for this project are unique given the underlying nature of the tenant's business. Investors will purchase promissory notes that will convert to shares in HWY35 LLC, if and when State licensing occurs and if the investors meet the requirements enacted by the State, which are unknown today. There are several tiers or tranches of investor shares which would receive varying returns. The Sources and Uses related to the acquisition and site improvements are summarized below.

SOURCES		
	Amount	Pct.
Developer Financing - Other Loans	$ 3,300,000	23%
Developer Equity - A-Shares and B-Shares	$ 9,200,000	63%
TIF Assistance	$ 2,000,000	14%
TOTAL SOURCES	**$ 14,500,000**	**100%**

USES		
	Amount	Pct.
Acquisition Costs and Closing Fees	$ 4,500,000	31%
Site Costs	$ 10,000,000	69%
TOTAL USES	**$ 14,500,000**	**100%**

The Developer Equity in the form of shares above at 63% of project costs is higher than a typical development where equity requirements are 20-50% depending on the type of project. Higher equity requirements are common for projects that represent higher risk. Higher risk is typically commensurate with higher investment returns, which the Developer is targeting with this project.

Given the complexities discussed above, Ehlers focused the financial review of the Project considering the lease rates that the underlying tenant or tenants would pay in the building and looking at traditional revenues and expenses for an industrial building, which in essence the project really is – although with a novel industrial/manufacturing focus.

Yield on Cost is a standard financing metric used to determine project feasibility which divides Total Development Costs ("TDC") by Net Operating Income ("NOI") and is independent of equity and loans. Because of Yield on Cost being independent of debt and equity, it is appropriate to use to analyze this unique project. Yield on Cost at the rent levels that the Developer is assuming are at the low end of the normal market range with Assistance and would be at the higher end of normal with 20% higher rents. Without assistance, Yield on Cost would be well below market ranges. Therefore, the assistance amount of $2 million is justified to bring Yield on Cost to within a normal, financeable, range.

Recommendation

Based on our review of the Developer's proforma and under current market conditions, the proposed development may not reasonably be expected to occur solely through private investment within the near future. We conclude a present value of up to $2.0 million of TIF Assistance is warranted, which would be paid out via a pay-as-you-go TIF Note over 8-12 years.

Please contact either of us at 651-697-8500 with any questions.