Memo

To:	Ken Ondich, City of New Prague Joshua Tetzlaff, City of New Prague
From:	Mikaela Huot, Director, BTMA
Date:	October 7, 2024
Subject:	Preliminary Tax Abatement Revenue Projections and Financial Analysis for Proposed New 155-Unit Multifamily Market Rate Housing Project

Executive Summary

The City of New Prague (the "City") has received a request for tax abatement assistance from Yellow Tree (the "developer") to assist with financing a portion of the costs associated with construction of an approximate 155-unit multifamily residential rental market rate housing development in the City. The total development cost of the project has been estimated to be $39,870,000. The City received preliminary taxable value estimates from Scott County for the project that range from $34,875,000 - $37,200,000 and would result in total taxes of $449,432 and $479,394, respectively. The developer requested tax abatement assistance from the City (and inquired as to possible participation of the County and School District) that would provide additional cash flow to the project as necessary to meet minimum debt coverage and equity returns. The developer initially requested up to 100% of the annual tax abatements based on City share of taxes, that may be adjusted both on an annual basis, as well as potential participation from other taxing entities. Potential participation from one or more other taxing entities could reduce the request of City's share of tax abatement. Additional analysis and discussion with other taxing entities has resulted in a proposed tax abatement (City only) of up to 75% share of City taxes. 75% of the City's share of taxes is estimated to be approximately $138,193 per year and $2,072,894 over 15 years.

Tax abatement is a financing tool the City may consider utilizing to provide cash flow assistance to the project. The incremental taxes generated from the new development may be rebated back to the developer based on each taxing entity's share of taxes. Subject to specific terms of granting a tax abatement and participating entities, all or a portion of the taxes paid by the developer would be rebated back and limited to a total number of years and/or amount. Each taxing entity chooses to participate on its own following a public hearing that is noticed more than ten days prior to the public hearing.

Prior to granting a tax abatement, the City will need to determine that the benefits gained equal or exceed the cost to the City and the abatement is in the public interest. There is not a statutorily required 'but-for test; however, many communities consider incorporating a determination that the project as proposed would not proceed without public assistance (meeting the "but-for" test) as well as consideration of increased market value of the property to be developed. When reviewing requests for financial assistance it is important to understand how the level of financial assistance would impact the ability of the project to proceed as proposed and maximize new value created on the current project site.

Review of the sources and uses and operating proforma based on the developer assumptions with pay-as-you-go assistance as compared to no assistance provides an understanding of financial feasibility for this project and need for public assistance. The purpose of the analysis is to test the level of assistance that may be needed using those assumptions and if the recommended structure is reasonable while remaining consistent with the City's objectives for providing assistance.

Based on the financial analysis and available financing assumptions, without financial assistance, the project does not appear to be feasible due to the projected cash flow projections. Without assistance, the projected cash flow is less than what would be necessary to support the level of debt financing and equity investment required for this type of project. The analysis indicates that the provided financing structure without assistance would not be financially viable without one or more of the following: 1) reduction in project costs 2) additional annual cash flow (tax abatement revenues, reduced financing rates or equity returns), and/or 3) additional funding sources. With annual public assistance through tax abatement, the project is projected to be more financially feasible by providing additional cash flow to the project. Public assistance is projected to have a positive impact on what the projected returns for the project could be as compared to no assistance.

The purpose of the memorandum is to provide a summary of the financial review of the development project costs and sources of revenue and operating pro forma as provided by the developer to provide preliminary tax abatement revenue projections based on up to 75% participation levels by the City and assist the City with understanding if public assistance is necessary. The other taxing entities have indicated they do not wish to participate so any tax abatement assistance would be based on city share only. Should the City choose to provide assistance, annual tax abatement revenues generated by the project would be remitted back to the developer to provide additional cash flow.

Developer Request for Assistance

The developer has requested assistance from the City through tax abatement with an estimated annual amount of approximately $299,650 based on taxes due of $399,534. The total development costs are approximately $39,870,000. Upfront funding sources to support development costs include construction financing and developer equity. The primary loan is approximately 70% of total funding sources and investor equity would be 30%. We would expect to see the primary debt financing percent in the range of 60-75%, subject to availability of net operating income with the remaining sources as secondary mortgage, equity or grants, as applicable. The overall project performance without assistance is lower than what lenders and investors would tolerate, thus resulting in a financial gap. Due to the current market environment and interest rates, annual debt service payments are higher with increased interest costs and lower overall funding amounts.

Total project costs that cannot be supported solely by the project alone could justify the need for public financial assistance and allow the project to proceed as proposed. In addition, current market conditions of increased interest rates requiring reduced debt financing and increased equity amounts have resulted in higher funding gaps. Tax abatement from the City would provide an additional funding source to the project that would facilitate the developer being able to obtain an appropriate level of upfront debt and equity funding and meet minimum debt coverage and investor return metrics. Summary of the sources and uses of funds is illustrated in Table 1 below.

The recommendation for a reasonable level of public assistance is balanced by a combination of public benefit and projected financial cash flow performance of the project, public policy guidelines/considerations and potential financial parameters as further outlined below:

- Return on Investment: *(City benefits)*
- Purchase price and other development costs: *(reasonable ranges and supported by project)*
- Public to private investment: *(public participation limit of 10%)*
- Public assistance and private equity: *(public does not exceed private equity)*
- Extraordinary costs: (*new development)*
- Financial gap: *(limit on private debt and equity)*
- Market conditions *(financing limitations)*

- Term of assistance: (*up to 15-20 years)*
- Other identified public improvements: *(case by case basis to be determined)*

Sources and Uses of Funds

The proposed total development cost of the project is estimated to be $39,870,000 and is summarized below.

Table 1: Sources and Uses of Funds

Sources			Uses		Percent	Per Unit
Bank Loan	27,909,000	70.00%	Land	1,100,000	2.76%	7,097
Equity	11,961,000	30.00%	Construction	32,550,000	81.64%	210,000
Grants	-	0.00%	Construction Continge	1,000,000	2.51%	6,452
Deferred Developer Fee	-	0.00%	Soft Costs	1,270,000	3.19%	8,194
			Construction Loan Inte	1,800,000	4.51%	11,613
			Closing Costs	500,000	1.25%	3,226
			Operating Reserve	250,000	0.63%	1,613
			Developer Fee	1,400,000	3.51%	9,032
			Other		0.00%	-
					0.00%	-
					0.00%	-
					0.00%	-
Total	**39,870,000**	**100.00%**	Total	**39,870,000**	**100.00%**	**257,226**

Operating Assumptions

The developer provided a breakdown of the projected revenues from the individual unit types for the residential housing units based on number of bedrooms (studio, 1, 1+, 2, 2+ and 3-bedrooms). The estimated range is rents for each unit type of $1,275, $1,400, $1,650, $1,900, $2,200 and $2,300. The estimated operating revenues and expenditures include 3% annual inflationary increases and 5% stabilized vacancy rates (revenues). Total operating expense ratio for the residential project component is approximately 40% annually. Assumptions utilized for the operating proforma are generally reasonable as compared to industry standards and may warrant additional analysis as the project proceeds.

Tax Abatement Analysis

The following assumptions were used to estimate the amount of projected tax abatement revenues based on the respective taxing entity participants:

- Total project area
  - Parcel ID: 24.113.0050
- Total estimated base value of $131,200
  - Assumed existing land value would be calculated as 'base'
- Estimated total taxable value upon completion (including base)
  - $34,875,000 classified as residential rental
- Maximum term of tax abatement
  - 15 years with 3 taxing entity participation (City, County and School District)
  - 20 years with 1 or 2 taxing entity participation
- Anticipated term of tax abatement based on initial review
  - Up to 15 years with 75% City only
  - Sliding scale (reduced percentages in future years anticipated for all scenarios subject to further analysis and discussion)
- Construction commences in 2025 and completes in 2026

    - 100% assessed in January of 2027 for taxes payable in 2028
- Tax rates, class rates and future market values remain constant
    - Tax rates
        - City share: 42.427%
        - County share: 26.126%
        - ISD #721 share: 20.264%
    - 1.25% class rates for residential rental
    - 0% annual market value inflator

Table 2: Tax Abatement Revenue Estimates

Tax Abatement Revenue Projections	
Total Estimated Taxable Value	$34,875,000
Scenario 1: City Only Participation 75% 15 Years	
City Share Total Estimated Annual Revenue Full Buildout	$138,193
County Share Total Estimated Annual Revenue Full Buildout	
School Share Total Estimated Annual Revenue Full Buildout	
Total Gross Revenues	$138,193
Estimated City Share (15 Years)	$2,072,895
Estimated County Share (15 Years)	$0
Estimated School District Share (15 Years)	$0
Total over 15 Years	$2,072,895

There is a statutory limit on the total amount of property taxes that may be abated by a political subdivision. The City's annual property tax abatement may not exceed (1) ten percent of the net tax capacity of the political subdivision for the taxes payable year to which the abatement applies, or (2) $200,000, whichever is greater. We estimate the total City share of tax abatement from this project could be up to $184,257 with 100% participation based on a taxable value of $34,875,000. We recommend consideration for both existing abatements and potential future abatements as it relates to the City's maximum participation level on an ongoing basis. The City's 2024 taxable net tax capacity is $11,371,733 allowing for the City's total tax abatement capacity of approximately $1,137,173.

Project Financing

There are generally two ways in which assistance can be provided for most projects, either upfront or on a pay-as-you-go basis. With upfront financing, the City would finance a portion of the applicant's initial project costs through the issuance of bonds or as an internal loan. Future tax abatements would be levied for collection by the City and used to pay debt service on the bonds or repayment of the internal loan. With pay-as-you-go financing, the developer would finance all project costs upfront and would be reimbursed over time for a portion of those costs as revenues are available.

Pay-as-you-go-financing is generally more acceptable than upfront financing for the City because it shifts the risk for repayment to the developer. If revenues are less than originally projected, the developer receives less and therefore bears the risk of not being reimbursed the full amount of their financing. However, in some cases pay as you go financing may not be financially feasible. With bonds, the City would still need to make debt service payments and would have to use other sources to fill any shortfall of revenues. With internal financing, the City reimburses the loan with future revenue collections and may risk not repaying itself in full if revenues are not sufficient. The City has historically financed projects as pay-as-you-go for reimbursement to the developer of eligible costs. The request for assistance as related to this project would be as annual reimbursement/remittance based on a determination of a certain percentage of pledged annual abatements.

Conclusion

The developer has requested financial assistance as related to construction of a new 155-unit multifamily housing project that would include studios, 1 bedroom, 1 plus den, 2 bedrooms, 2 plus den and 3-bedroom units. The total development cost for the project is $39,870,000 and the request for financial assistance is annual tax abatement assistance with an estimated annual amount of $299,650. The project would be funded by approximately 70% debt (based on LTC ratio) with remaining sources being private equity or public assistance. The project has a financial gap and is seeking financial assistance from the City to close it. Through submission of the tax abatement request and supporting financial information, the developer has indicated that the project would not occur as proposed without financial assistance from the City due to below market rates of equity returns and debt financing.

Following analysis of the developer's financing assumptions and considering current market environment, without financial assistance, the project would not be financially feasible. However, the level of public assistance as requested is projected to have positive impact on the project performance. Without any public assistance, the projected debt coverage ratios are projected to be below industry standards. The analysis indicates that the provided financing structure would not be financially viable without one or more of the following: 1) reduction in project costs 2) additional annual cash flow (tax abatement revenues, reduced financing rates or equity returns), and/or 3) additional funding sources.

With public assistance through tax abatement assistance with additional annual cash flow, the project is projected to achieve higher debt coverage and returns. The project is projected to have sufficient cash flow after debt service and a structure that provides additional annual revenues. There are ranges of what would be considered market returns and are generally subject to the project type, market indicators, investor demands and financing structure. The level of public assistance is expected to have positive impact on projected returns for the project.

Considered parameters for level of public assistance include the following:

- Return on Investment: *(City benefits)*
- Purchase price and other development costs: *(reasonable ranges and supported by project)*
- Public to private investment: *(public participation limit of 10%)*
- Public assistance and private equity: *(public does not exceed private equity)*
- Extraordinary costs: *(new development)*
- Financial gap: *(limit on private debt and equity)*
- Market conditions *(financing limitations)*
- Term of assistance: (*up to 15-20 years)*
- Other identified public improvements: *(case by case basis to be determined)*

The developer has requested tax abatement from the City as a method of providing additional cash flow revenues required to achieve financial feasibility. Assistance may be provided through a pledge of annual tax abatement to provide additional cash flow to support debt repayment, enhance cash flow and increase the developer's return. We typically review both the annual (upon stabilization) and longer-term (10-year period) investment returns to understand financial performance and verification of need for public assistance, as well as identifying those costs considered extraordinary to the project.

Thank you for the opportunity to be of assistance to the City of New Prague. Please contact me at 651-223-3036 or mikaela.huot@bakertilly.com with any questions or to discuss.

Definition of Tax Abatement

Any political subdivision, including statutory cities, home rule charter cities, towns, counties, and school districts, is authorized to abate property taxes on selected parcels or defer the payments of the taxes and abate the interest and penalty that otherwise would apply, if:

- The benefits gained equal or exceed the cost to the political subdivision or the abatement phases in a property tax increase, and
- The abatement is in the public interest because it will:
  - increases or preserves the tax base;
  - provides employment opportunities;
  - provides or helps acquire or construct public facilities;
  - helps redevelop or renew blighted areas;
  - helps provide access to services;
  - finances or provides for public infrastructure;
  - phase in a property tax increase on the parcel resulting from an increase of 50% or more in one year on the estimated market value of the parcel, other than an increase due to improvement of the parcel; or
  - stabilize the tax base through equalization of property tax revenues for a specified time period with respect to a taxpayer whose real and personal property is subject to valuation under Minnesota Rules, chapter 8100.

Cities, counties, and school districts as combined jurisdictions may grant an abatement for no longer than 15 years (8 year maximum if no initial duration is specified), or for no longer than 20 years if two or fewer jurisdictions participate.

No back-to-back abatements. Eight years must pass before a new abatement can be applied.

In any given year, the total amount of property taxes abated by a political subdivision for all parcels may not exceed the greater of (1) 10% of the net tax capacity of the political subdivision for the taxes payable year to which the abatement applies, or (2) $200,000.

The State will not reimburse school districts for lost taxes resulting from abatement.

Property in a tax increment financing district is not eligible for abatement; however, a tax abatement can be established following a tax increment district (as the proposed financing structure for this project).

Projected Tax Abatement Report

City of New Prague, Minnesota
Proposed Tax Abatement Assistance
155 Unit Apartment Complex
Draft Abatement Revenues: $34.875M new taxable value

Annual Period Ending (1)	Total Market Value [1] (2)	Total Net Tax Capacity [2] (3)	Less: Non-Abated Net Tax Capacity [3] (4)	Retained Captured Net Tax Capacity (5)	Times: Tax Capacity Rate [4] (6)	Estimated Annual Property Taxes (7)		Maximum Tax Abatement City * 42.43% (8)		Maximum Tax Abatement County * 26.13% (9)		Maximum Tax Abatement School * 20.26% (10)	Estimated Project Abatement (11)
12/31/28	34,875,000	435,938	1,640	434,298	91.649%	398,031	75%	138,193	0%	0	0%	0	138,193
12/31/29	34,875,000	435,938	1,640	434,298	91.649%	398,031	75%	138,193	0%	0	0%	0	138,193
12/31/30	34,875,000	435,938	1,640	434,298	91.649%	398,031	75%	138,193	0%	0	0%	0	138,193
12/31/31	34,875,000	435,938	1,640	434,298	91.649%	398,031	75%	138,193	0%	0	0%	0	138,193
12/31/32	34,875,000	435,938	1,640	434,298	91.649%	398,031	75%	138,193	0%	0	0%	0	138,193
12/31/33	34,875,000	435,938	1,640	434,298	91.649%	398,031	75%	138,193	0%	0	0%	0	138,193
12/31/34	34,875,000	435,938	1,640	434,298	91.649%	398,031	75%	138,193	0%	0	0%	0	138,193
12/31/35	34,875,000	435,938	1,640	434,298	91.649%	398,031	75%	138,193	0%	0	0%	0	138,193
12/31/36	34,875,000	435,938	1,640	434,298	91.649%	398,031	75%	138,193	0%	0	0%	0	138,193
12/31/37	34,875,000	435,938	1,640	434,298	91.649%	398,031	75%	138,193	0%	0	0%	0	138,193
12/31/38	34,875,000	435,938	1,640	434,298	91.649%	398,031	75%	138,193	0%	0	0%	0	138,193
12/31/39	34,875,000	435,938	1,640	434,298	91.649%	398,031	75%	138,193	0%	0	0%	0	138,193
12/31/40	34,875,000	435,938	1,640	434,298	91.649%	398,031	75%	138,193	0%	0	0%	0	138,193
12/31/41	34,875,000	435,938	1,640	434,298	91.649%	398,031	75%	138,193	0%	0	0%	0	138,193
12/31/42	34,875,000	435,938	1,640	434,298	91.649%	398,031	75%	138,193	0%	0	0%	0	138,193
						$5,970,465		$2,072,894		$0		$0	$2,072,894

[1] *Total estimated market value based on preliminary value estimate following review by County Assessor*
very preliminary and subject to further review. Includes 0% annual market value inflator
[2] *Total net tax capacity based on rental class rate of 1.25%*
[3] *Original net tax capacity based does include existing land value*
[4] *Local tax capacity rate for the City of New Prague, Scott County and ISD 721 for taxes payable 2024*