

## MEMORANDUM

**TO:** Michael Zimmerman – Economic Development Director  
Misty Dodge – Finance Director

**FROM:** Keith Dahl – Ehlers  
Greg Johnson – Ehlers

**DATE:** February 6, 2023

**SUBJECT:** Avante Properties Tax Increment Financing (TID #13) Request and Recommendation

The City received a financial assistance request from Avante Properties (the “Developer”) to construct a mixed-use apartment building (“The Arlo”) at 5134 East Cheryl Parkway. The Developer requested a Municipal Revenue Obligation (MRO) Note in the principal amount of \$780,00 to offset soil correction and abatement work. The Arlo is proposed to be a 57-unit apartment with 2,310 square feet of retail space (the “Project”). The Project would consist of studio, 1, 2, and 3-bedroom units. Construction is proposed to start this spring with an anticipated development cost slightly over \$15 million or \$263,607 per unit.

This memo has been prepared by Ehlers, at the request of the City, in conjunction with a review of the Project, specifically the budget and pro forma based on general industry standards for construction, land acquisition, and project costs; as well as to ensure that all development costs, rental revenues, and expenditures have been appropriately accounted for and considered. General industry standards for purposes of this memo were determined by review of similar projects within Minnesota and Wisconsin over the last two years.

Based on our review, **we’ve concluded an MRO Note in the principal amount of \$780,000 is supported for the Project.** The tables below provide a synopsis of the sources and uses for the Project with the supported amount of public assistance.

SOURCES			
	Amount	Pct.	Per Unit
First Mortgage	11,500,000	77%	201,754
MRO Note	780,000	5%	13,684
Equity	2,745,619	18%	48,169
<b>TOTAL SOURCES</b>	<b>15,025,619</b>	<b>100%</b>	<b>263,607</b>

USES			
	Amount	Pct.	Per Unit
Acquisition Costs	274,610	2%	4,818
Construction Costs	13,726,009	91%	240,807
Professional Services	400,000	3%	7,018
Financing Costs	405,000	3%	7,105
Developer Fee	100,000	1%	1,754
Cash Accounts/Escrows/Reserves	120,000	1%	2,105
<b>TOTAL USES</b>	<b>15,025,619</b>	<b>100%</b>	<b>263,607</b>

## Pro Forma Analysis:

1. **Financing** – The Developer’s initial submittal contemplated financing the Project with a first mortgage that was approximately 80% of total development costs with an interest rate of 5.50%. Based on current underwriting conditions, interest rate and lender sizing constraints, the Developer may be too aggressive in sizing its first mortgage debt proceeds. For our analysis, we reduced the first mortgage to approximately 75% of total development costs and increased the interest rate to 6.00%. The remaining balance of the total development costs would be covered by equity and a privately financed MRO Mortgage.
2. **Total Development Costs (TDC)** – The TDC is approximately \$15 million or \$263,607 per unit. Under current market conditions, similar projects have generally ranged between \$270,000 and \$350,000 per unit. While the TDC per unit is slightly below the typical range we’ve seen within the last two years for similar projects in Wisconsin and Minnesota, we are starting to see price softening within the construction industry. The TDC per unit is reasonable under current market conditions.
3. **Acquisition Costs** – The acquisition cost is \$274,610, or \$4,818 per unit. Similar developments have ranged between \$5,000 to \$15,000 per unit. The land acquisition is slightly below the typical range, but the lower acquisition cost benefits the overall financial feasibility of the Project. The acquisition costs are reasonable for this project.
4. **Developer Fee** – The proposed developer fee is \$100,000 or 1% of TDC. For developments requesting City assistance, we typically see a developer fee between 3% to 5% of TDC.
5. **Residential Rents** – Proposed market rate rents range between \$1,469 per month for a studio unit to \$2,833 per month for a 3-bedroom unit. On a per square foot basis, market rate rents range between \$1.91 to \$2.65, averaging \$2.17. Based on review of a CoStar multi-family market report for similar developments in Fitchburg and the surrounding area, the proposed rents appear to be reasonable. On an average per square foot basis, other market rate apartments within the City ranged between \$1.88 and \$2.07.
6. **Commercial Rent** – The commercial rents will be structured as triple net leases, meaning the tenant is responsible for paying their respective expenses of the property including property taxes, insurance, and maintenance. The commercial rent that will be collected by the Developer will be \$25.97 per square foot for retail space. The proposed triple net rents appear to be reasonable for the market. Other retail spaces in the City and the surrounding area have triple net lease rates ranging between \$15.00 and \$30.00 per square foot.
7. **Operating Expenses** – The operating expenses on a per unit basis are \$3,527, which is within the typical market range of \$3,500 to \$4,500 per unit per year. Please note that this per unit expense is before management fees, property taxes, and replacement reserves. The management fee is 5% of the effective gross income (EGI) of the Project. The typical range for management fees range between 3% to 5% of EGI.

### Available Tax Increment:

The Project is currently contemplated to be located within the City's Tax Increment District (TID) #13 and the Developer requested 50% of the annual increment to pay the MRO Note. In consultation with the City Assessor, it is estimated the market value of the Project will be \$16,500,000 and is estimated to generate over \$300,000 of annual tax increment upon full build out. Based upon an annual 0.50% inflation factor, 50% of tax increment being available to the Developer, and a financing rate of 6.50%, the Project could support an MRO Note in the maximum principal amount of \$780,000 over an anticipated 8-year term. In total, principal and interest, public assistance to the Project would be \$1,037,000.

This would leave 50% of the annually collected tax increment available to the City over the term of the MRO Note and 100% of the annually collected tax increment after the MRO Note is paid. In total, the future value sum collected by the City over the remaining term of the TID could be approximately \$3,350,000. Attached for illustration purposes are cashflow projections of the Project's MRO Note and existing obligations of TID #13.

**Note:** The percentage of increment pledged to pay an MRO Note and the rate of financing are negotiable terms memorialized in a Developer Agreement.

### Projected Return on Investment:

As part of this analysis, we want to ensure that any public assistance in the project does not result in a return on investment greater than what is typical within the industry. Return on investment (ROI) is a performance measure used to evaluate development projects. There are a few common metrics used; however, we reviewed the project based on a review of yield-on-cost and an internal rate of return (IRR). The typical industry standard for yield-on-cost is 6.5 – 7.0% and internal rate of return in year 10 may range between 12 – 15%.

1. **Yield-on-Cost (YOC):** YOC is calculated by dividing the net operating income (before debt service) by the total development cost of the project less any upfront grants received for construction costs. YOC is a metric used by investors to ensure a project is not over or under leveraged since it removes debt service from the equation. In year of stabilization the YOC is 6.6%. During the anticipated 8-year duration of public assistance, the average annual YOC reaches 7.1%. If public assistance isn't provided, the YOC in stabilization would be 5.5% and the average over 8-years would be 6.2%.
2. **Internal Rate of Return (IRR):** IRR calculates the time value of money over a specific holding period. It estimates a project's profitability from its initial equity investment by accounting for annual net cashflows, sale proceeds, and debt repayment from a future sale. In year 10 of the Project the IRR is 14.96%. If public assistance isn't provided, the IRR would be 11.80%.

### Recommendation:

Based on our review of the Developer's pro forma and under current market conditions, the Project may not reasonably be expected to occur solely through private investment within the near future. The cost associated with development of the Project is only feasible, in part, through public financial assistance offsetting the soil correction work by the City. We conclude an MRO Note in the principal amount of \$780,000 with an interest rate the lesser of 6.50% or the Developer's actual rate of financing, and payable from 50% of the available tax increment over an anticipated term of 8 years is supported for this project.

Please contact Keith Dahl at 651-697-8595 or Greg Johnson at 262-796-6168 with any questions.

# City of Fitchburg, Wisconsin

## Tax Increment District # 13

### Development Assumptions

Construction Year		Actual	Arlo Project	Estimated Net New Construction (Kwik Trip)	Annual Total	Construction Year	
1	2018	3,033,000			3,033,000	2018	1
2	2019	2,387,900			2,387,900	2019	2
3	2020	8,413,500			8,413,500	2020	3
4	2021	3,548,400			3,548,400	2021	4
5	2022			3,440,000	3,440,000	2022	5
6	2023		4,125,000		4,125,000	2023	6
7	2024		8,250,000		8,250,000	2024	7
8	2025		4,125,000		4,125,000	2025	8
9	2026				0	2026	9
10	2027				0	2027	10
11	2028				0	2028	11
12	2029				0	2029	12
13	2030				0	2030	13
14	2031				0	2031	14
15	2032				0	2032	15
16	2033				0	2033	16
17	2034				0	2034	17
18	2035				0	2035	18
19	2036				0	2036	19
20	2037				0	2037	20
Totals		17,382,800	16,500,000	3,440,000	37,322,800		

Notes:

# City of Fitchburg, Wisconsin

## Tax Increment District # 13

### Tax Increment Projection Worksheet

Type of District	Mixed Use	Base Value	16,139,100
District Creation Date	September 11, 2018	Appreciation Factor	0.50%
Valuation Date	Jan 1, 2018	Base Tax Rate	
Max Life (Years)	20	Rate Adjustment Factor (after 2024)	-1.00%
Expenditure Period/Termination	15 9/11/2033		
Revenue Periods/Final Year	20 2039		
Extension Eligibility/Years	Yes 3	Tax Exempt Discount Rate	N/A
Recipient District	No	Taxable Discount Rate	N/A

Construction	Year	Value Added	Valuation Year	Inflation Increment	Total Increment	Revenue Year	Tax Rate	Tax Increment
1	2018	3,033,000	2019		3,033,000	2020	\$22.72	68,903
2	2019	2,387,900	2020		5,420,900	2021	\$22.68	122,922
3	2020	8,413,500	2021		13,834,400	2022	\$21.38	295,845
4	2021	3,548,400	2022		17,382,800	2023	\$20.20	351,213
5	2022	3,440,000	2023		20,822,800	2024	\$20.00	416,510
6	2023	4,125,000	2024	104,114	25,051,914	2025	\$19.80	496,092
7	2024	8,250,000	2025	125,260	33,427,174	2026	\$19.60	655,324
8	2025	4,125,000	2026	167,136	37,719,309	2027	\$19.41	732,075
9	2026	0	2027	188,597	37,907,906	2028	\$19.21	728,378
10	2027	0	2028	189,540	38,097,446	2029	\$19.02	724,700
11	2028	0	2029	190,487	38,287,933	2030	\$18.83	721,040
12	2029	0	2030	191,440	38,479,372	2031	\$18.64	717,399
13	2030	0	2031	192,397	38,671,769	2032	\$18.46	713,776
14	2031	0	2032	193,359	38,865,128	2033	\$18.27	710,171
15	2032	0	2033	194,326	39,059,454	2034	\$18.09	706,585
16	2033	0	2034	195,297	39,254,751	2035	\$17.91	703,017
17	2034	0	2035	196,274	39,451,025	2036	\$17.73	699,467
18	2035	0	2036	197,255	39,648,280	2037	\$17.55	695,934
19	2036	0	2037	198,241	39,846,521	2038	\$17.38	692,420
20	2037	0	2038	199,233	40,045,754	2039	\$17.20	688,923
<b>Totals</b>		<b>37,322,800</b>		<b>2,722,954</b>		<b>Future Value of Increment</b>		<b>11,640,693</b>

#### Notes:

Actual results will vary depending on development, inflation of overall tax rates.

NPV calculations represent estimated amount of funds that could be borrowed (including project cost, capitalized interest and issuance costs).

City of Fitchburg, Wisconsin

Tax Increment District # 13

Cash Flow Projection

Year	Projected Revenues				Expenditures												Balances			Year	
	Tax Increments	Investment income	Transfer from TID #9	Total Revenues	Municipal Revenue Obligation \$2,100,000 Phoenix Industries		G.O. Bonds Series 2021A \$1,515,000 Dated: 12/1/2021		Municipal Revenue Obligation \$780,000 Arlo (50% of increment applied)				Interest & Fiscal Charges		Capital Outlay	Total Expenditures	Annual	Cumulative	Principal Outstanding (MRO & Debt)		
					Annual Payment	Principal Outstanding	Principal	Interest	Principal	Est. Rate	Interest	Total Payment	Princ. Outstanding	Admin.							
2018		3		3		6%			6.50%				22,832	125		22,957	(22,954)	(22,954)		2018	
2019		32		32										1,235	540		1,775	(1,743)	(24,697)		2019
2020	68,903	33		68,936										18,148	427	26,629	45,204	23,732	(965)		2020
2021	122,922	24		122,946	165,697	2,050,000								5,786	438	20,100	192,021	(69,075)	(70,041)	2,050,000	2021
2022	295,845		1,515,000	1,810,845	210,300	1,960,000								25,000		1,802,000	2,037,300	(226,455)	(296,496)	3,475,000	2022
2023	351,213			351,213	209,750	1,865,000		42,244						25,000			276,994	74,219	(222,277)	3,380,000	2023
2024	416,510			416,510	213,750	1,760,000	95,000	42,244				780,000		25,000			375,994	40,516	(181,760)	3,960,000	2024
2025	496,092			496,092	212,300	1,650,000	80,000	38,444			50,700	50,700	780,000	25,000			406,444	89,648	(92,112)	3,770,000	2025
2026	655,324			655,324	215,400	1,530,000	85,000	35,244	70,805	6.50%	50,700	121,505	709,195	25,000			482,149	173,175	81,064	3,494,195	2026
2027	732,075			732,075	213,050	1,405,000	85,000	31,844	114,824	6.50%	46,098	160,922	594,371	25,000			515,815	216,260	297,323	3,169,371	2027
2028	728,378			728,378	215,250	1,270,000	90,000	28,444	121,475	6.50%	38,634	160,109	472,896	25,000			518,803	209,575	506,898	2,822,896	2028
2029	724,700			724,700	212,000	1,130,000	95,000	24,844	128,562	6.50%	30,738	159,301	344,333	25,000			516,144	208,556	715,454	2,459,333	2029
2030	721,040			721,040	218,150	975,000	95,000	21,044	136,114	6.50%	22,382	158,496	208,219	25,000			517,690	203,350	918,804	2,073,219	2030
2031	717,399			717,399	218,550	810,000	100,000	17,244	144,161	6.50%	13,534	157,696	64,058	25,000			518,489	198,909	1,117,714	1,664,058	2031
2032	713,776			713,776	218,350	635,000	155,000	13,244	64,058	6.50%	4,164	68,222	(0)	25,000			479,816	233,960	1,351,674	1,270,000	2032
2033	710,171			710,171	217,550	450,000	155,000	10,919						25,000			408,469	301,703	1,653,377	930,000	2033
2034	706,585			706,585	216,150	255,000	160,000	8,400									384,550	322,035	1,975,412	575,000	2034
2035	703,017			703,017	214,150	50,000	160,000	5,800									379,950	323,067	2,298,479	210,000	2035
2036	699,467			699,467	51,500	0	160,000	3,000									214,500	484,967	2,783,445	0	2036
2037	695,934			695,934													0	695,934	3,479,379	0	2037
2038	692,420			692,420													0	692,420	4,171,799	0	2038
2039	688,923			688,923													0	688,923	4,860,722	0	2039
Total	11,640,693	92	1,515,000	13,155,785	3,221,897		1,515,000	6,349,928	780,000		256,950	1,036,950		348,001	1,530	1,848,729	8,295,063				Total

Notes:

Projected TID Closure