



**EHLERS**  
LEADERS IN PUBLIC FINANCE

# *How Much is Enough?* **Protecting Local Resources in Publicly Financed Development Projects**

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# Overview

- Types of Local Public Financing
- Why
  - is a developer asking for assistance?
  - would a local government provide assistance?
- Protecting Local Resources
- Project Examples



# Types of Local Public Assistance

- Tax Increment Financing (TIF)
- Tax Abatement
- Fee Waivers/Discounts (utility connections, building permits, park dedication)
- Land donations or write-downs (selling land at a below market price and/or less than the city paid to acquire the property)
- EDA / HRA Levy funds
- Local revolving loan funds
- Constructing Infrastructure Improvements
- Grants



# Why is a Developer Asking for Assistance?

- *Gap!*
- What does it mean to have a financial gap?
  - Insufficient cash flow to....
    - Support the level of **debt** needed to build the project and/or
    - Provide high enough investment returns to attract **equity** to build the project
  - Either insufficiency results in a **financial gap**
- Why might there be a financial gap?
  - Unproven market, low market rents, and/or affordable rents
  - Extraordinary development costs
    - Land
    - Environmental remediation
    - Structured parking
    - Infrastructure



# Why is a Developer Asking for Assistance?

- Who cares?
  - Developer
  - Investors
  - Banks/Lenders
  - City
- Why does it matter?
  - Making Money
  - Risk Mitigation
  - Loan repayment
  - Opportunity Cost
  - Reality of Implementing Plans



# Why would a local government provide assistance?

- Fundamentally: Existence of financial barriers preventing the private market from developing a site in accordance with City vision.
- Cities participate to overcome these barriers for:
  - Job creation
  - Tax base growth and diversification
  - Redevelopment of blighted areas
  - Downtown Revitalization
  - Improving Housing Availability and Choice
  - Pollution Control and/or Cleanup
  - Improvements in Quality of Life



# Protecting Local Resources





# Best Practices: Planning for Success

- Ideally.....have a plan!
- Helps get staff and policymakers on the same page
- Provides the foundation for success
- Ensures you are prepared to act when opportunity arises - *flexibility*
- Sets priorities



# Best Practices: Planning for Success



- Adopt policies that establish parameters for public involvement in economic development projects
- **Business Subsidy Policy** (required per MN statutes 116J.993 - 116J.995)
  - Local development goals
  - Developer Fee Policy
- **Application for Assistance**
  - Application fee
  - Specifies the necessary information to review a request for assistance
- Other policies based on identified needs



# Key Questions in Public Financing Assistance

- Non-financial:
  - How does the project advance community's goals?
  - What other projects are competing for funding (and attention)?
- Financial (*"but for" test*):
  - Does the project have a financial gap?
  - If so, how big is the gap?
  - Does the community have the resources or desire to assist with some or all of the gap?



# Best Practices: Pro forma Analysis

- Review developer's application and financial information (pro forma)
  - In depth analysis to ensure all project costs, revenue, operating expenses, and financing assumptions are within industry standards
  - Maximize private sources of funding
- Set recommended level of any public assistance based on finding in the analysis
  - Is there a gap?
  - What is the minimum amount of assistance needed to make a project financially feasible?



# What is a Pro Forma?

- Latin for “*for the sake of form*” or “*as a matter of form*”
- In Real Estate Development
  - Method for calculating financial results
  - No single template
  - Generally accepted process and calculation methods
- Go/No-go Analysis
  - Does the project “pencil out”
  - How is the project forecasted to perform over time?
  - Is there a gap? If so, how big is the gap?
  - Is the project a *good* investment?
- *Every development project has (or should have) a pro forma*



# What is a Pro Forma?

	Stabilized Year									
	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10	Year 11	Year 12
<b>Income</b>										
<b>Rental Income</b>										
Gross potential	2,808,811	2,864,987	2,922,287	2,980,732	3,040,347	3,101,154	3,163,177	3,226,441	3,290,864	3,357,445
Less: Vacancy	(196,617)	(200,549)	(146,114)	(149,037)	(152,017)	(155,058)	(158,159)	(161,322)	(164,563)	(167,872)
<b>Total Rental Income</b>	<b>2,612,194</b>	<b>2,664,438</b>	<b>2,776,172</b>	<b>2,831,696</b>	<b>2,888,330</b>	<b>2,946,096</b>	<b>3,005,018</b>	<b>3,065,119</b>	<b>3,126,281</b>	<b>3,189,573</b>
<b>Other Income</b>										
Garage	952,272	971,317	990,744	1,010,559	1,030,770	1,051,385	1,072,413	1,093,861	1,115,720	1,138,000
Misc	36,509	36,509	36,509	36,509	36,509	36,509	36,509	36,509	36,509	36,509
Storage	28,800	28,800	28,800	28,800	28,800	28,800	28,800	28,800	28,800	28,800
Internet	33,596	33,596	33,596	33,596	33,596	33,596	33,596	33,596	33,596	33,596
Less: Vacancy	(66,659)	(67,992)	(69,352)	(50,528)	(51,538)	(52,569)	(53,621)	(54,693)	(55,784)	(56,895)
<b>Total Other Income</b>	<b>984,518</b>	<b>1,002,230</b>	<b>1,020,297</b>	<b>1,058,936</b>	<b>1,078,136</b>	<b>1,097,721</b>	<b>1,117,697</b>	<b>1,138,073</b>	<b>1,158,450</b>	<b>1,178,825</b>
<b>Effective Gross income</b>	<b>3,596,712</b>	<b>3,666,668</b>	<b>3,796,469</b>	<b>3,890,632</b>	<b>3,966,466</b>	<b>4,043,817</b>	<b>4,122,716</b>	<b>4,203,192</b>	<b>4,284,731</b>	<b>4,368,398</b>

	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10	Year 11	Year 12
<b>Expenses</b>										
Operating Expenses	2,277,235	2,333,168	2,403,163	2,475,258	2,549,515	2,626,001	2,704,781	2,785,924	2,869,440	2,956,356
Management Fees	205,443	211,606	217,954	224,493	231,228	238,165	245,310	252,669	260,244	268,057
Property Taxes (2% Inflation)	205,449	209,558	213,749	218,024	222,385	226,832	231,369	235,996	240,707	245,504
Reserves	17,500	17,500	17,500	17,500	17,500	17,500	17,500	17,500	17,500	17,500
<b>TOTAL EXPENSES</b>	<b>2,705,627</b>	<b>2,771,832</b>	<b>2,852,366</b>	<b>2,935,275</b>	<b>3,020,628</b>	<b>3,108,498</b>	<b>3,198,959</b>	<b>3,292,090</b>	<b>3,387,967</b>	<b>3,486,674</b>
<b>NET OPERATING INCOME</b>	<b>891,085</b>	<b>894,836</b>	<b>944,103</b>	<b>955,357</b>	<b>945,838</b>	<b>935,319</b>	<b>923,756</b>	<b>911,102</b>	<b>897,310</b>	<b>866,113</b>
TIF PAYMENTS (0% inflation)	161,458	164,687	167,981	171,341	174,768	178,263	181,828	185,465	189,174	192,958
<b>ADJUSTED NET OPERATING INCOME</b>	<b>1,052,543</b>	<b>1,059,523</b>	<b>1,112,084</b>	<b>1,126,697</b>	<b>1,120,606</b>	<b>1,113,582</b>	<b>1,105,584</b>	<b>1,096,567</b>	<b>1,086,484</b>	<b>866,113</b>
Debt Service - Series A	628,763	628,763	628,763	628,763	628,763	628,763	628,763	628,763	628,763	628,763
Debt Service - Series B	125,650	125,650	125,650	125,650	125,650	125,650	125,650	125,650	125,650	125,650
<b>CASH FLOW AFTER FINANCING</b>	<b>298,130</b>	<b>305,111</b>	<b>357,671</b>	<b>372,285</b>	<b>366,193</b>	<b>359,170</b>	<b>351,171</b>	<b>342,154</b>	<b>332,071</b>	<b>237,350</b>
<b>NET CASH TO DEVELOPER</b>	<b>298,130</b>	<b>305,111</b>	<b>357,671</b>	<b>372,285</b>	<b>366,193</b>	<b>359,170</b>	<b>351,171</b>	<b>342,154</b>	<b>332,071</b>	<b>237,350</b>
<b>RETURN ON INVS.-ANNUAL (WITH TIF)</b>	<b>14.56%</b>	<b>14.56%</b>	<b>17.46%</b>	<b>18.18%</b>	<b>17.88%</b>	<b>17.54%</b>	<b>17.15%</b>	<b>16.71%</b>	<b>16.21%</b>	<b>11.59%</b>
<b>RETURN ON INVS.-ANNUAL (WITHOUT TIF)</b>	<b>6.67%</b>	<b>6.86%</b>	<b>9.26%</b>	<b>9.81%</b>	<b>9.35%</b>	<b>8.83%</b>	<b>8.27%</b>	<b>7.65%</b>	<b>6.98%</b>	<b>11.59%</b>
RETURN ON INVS.-AVERAGE (WITH TIF)	6.18%	9.36%	10.18%	11.51%	12.42%	13.06%	13.52%	13.83%	14.05%	13.99%
<b>CASH ON COST (WITH TIF)</b>	<b>8.16%</b>	<b>8.22%</b>	<b>8.62%</b>	<b>8.74%</b>	<b>8.69%</b>	<b>8.64%</b>	<b>8.57%</b>	<b>8.50%</b>	<b>8.42%</b>	<b>6.72%</b>
<b>CASH ON COST (WITHOUT TIF)</b>	<b>6.91%</b>	<b>6.94%</b>	<b>7.32%</b>	<b>7.41%</b>	<b>7.33%</b>	<b>7.25%</b>	<b>7.16%</b>	<b>7.06%</b>	<b>6.96%</b>	<b>6.72%</b>
<b>ANNUAL DEBT COVERAGE</b>	<b>139.52%</b>	<b>140.44%</b>	<b>147.41%</b>	<b>149.35%</b>	<b>148.54%</b>	<b>147.61%</b>	<b>146.55%</b>	<b>145.35%</b>	<b>144.02%</b>	<b>137.75%</b>

Income					
Rent	Monthly		Annual		Rent/Sq/Ft
	Rent	Units	Revenue	Sq/Ft	
Studio - Memory Care Aff	\$877	4	\$42,096	365	\$2.40
Studio - Memory Care	\$4,200	11	\$554,400	425	\$9.88
Studio - Memory Care	\$4,200	6	\$302,400	450	\$9.33
1 bedroom - Affordable	\$877	10	\$105,240	603	\$1.45
Assisted Living	\$3,950	34	\$1,611,600	603	\$6.55
Independent Living	\$2,300	5	\$138,000	897	\$2.56
<b>Total Rental Income</b>	<b>229,478</b>	<b>70</b>	<b>\$2,753,736</b>	<b>39,852</b>	<b>\$5.76</b>
<b>Other</b>					
Service Package			\$933,600		
Storage			\$36,509		
Other			\$28,800		
Misc			\$33,596		
<b>Total Other Income</b>			<b>\$1,032,505</b>		
<b>Gross Revenue</b>			<b>\$3,786,241</b>		
Vacancy Loss - Units			7%		
<b>Effective Gross Income</b>			<b>\$3,528,127</b>		

Expense		
	Total	Per Unit
<b>Operating Costs</b>		
Administrative	\$294,175	\$4,203
Marketing	\$69,966	\$999
Activities	\$104,038	\$1,486
Assisted Living	\$986,525	\$14,093
Dietary	\$427,500	\$6,107
Housekeeping	\$68,163	\$974
Laundry	\$1,336	\$19
Security	\$998	\$14
Insurance	\$48,431	\$692
Total Maintenance	\$330,050	\$4,715
<b>Total Operating</b>	<b>\$2,331,172</b>	<b>\$33,302</b>
<b>Management and Other Costs</b>		
Management Fees	\$179,836	\$2,569
Property Taxes	\$201,421	\$2,877
Reserves	\$17,500	\$250
<b>Total Expenses</b>	<b>\$2,729,929</b>	<b>\$38,998</b>
<b>Net Operating Income</b>	<b>\$798,199</b>	

Vacancy

Rents

Operating

Annual TIF

Return on equity

Return on Cost (NOI/TDC)

Debt Service Coverage



# Project Examples



# Project: St. Joseph – Housing W / Services



- **47** units of senior apartments (with services)
- Total project costs of approximately **\$5.7** million





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- Non-financial:
  - How does the project advance community's goals?
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- Financial (*"but for" test*):
  - Does the project have a financial gap?
  - If so, how big is the gap?
  - Does the community have the resources or desire to assist with some or all of the gap?



# TIF Request – Developer Application

- Create new housing TIF district
  - 26-year term
  - Qualifies for TIF based on anticipated incomes
  
- TIF Note
  - Developer requested 25 years of TIF - **\$1.4 Million** over **25** years (\$828,000 present value at **4.49%** interest rate)



# Analysis of TIF request

- Review of Developer's Pro Forma
  - Financing structure, project costs, revenue and operating projections meet expected industry standards
  - Projected cash-on-cash return on investment (ROI) in year 3 is 1.7% without assistance
  - Industry standard ROI is 8% to 12% to attract investment
  - Analysis confirms assistance is needed for financial feasibility



# Analysis of TIF request

- How much assistance is necessary?
  - Projection shows the project achieving an acceptable ROI (9.75%) by year 14, meaning TIF payments should no longer be required.
  - 14 years of TIF is estimated at **\$722,00** (**\$530,000** present value at **4.49%** interest rate)
  - The developer agreed to move forward with a 14 year Pay As You Go TIF Note



# Project: Industrial / Manufacturing

- 60,000 Sq. Ft. Industrial Project
- \$4.1 Million Total Development Cost



# Project: Industrial / Manufacturing

- Developer proposes to construct building for local business, but local rents cannot support needed return on investment
- Developer applies to public agency for assistance
- Agency reviews developer pro forma and identifies funding options
  - TIF or abatement
  - DEED funding



# Project: Industrial / Manufacturing

<b>SOURCES</b>		
	<b>With No Assistance</b>	<b>With Assistance</b>
First Mortgage	3,276,000	2,926,000
City and DEED Assistance	0	350,000
Developer Equity	819,000	819,000
<b>TOTAL SOURCES</b>	<b>4,095,000</b>	<b>4,095,000</b>

<b>USES</b>		
	<b>With No Assistance</b>	<b>With Assistance</b>
Acquisition Costs	400,000	400,000
Construction Costs	3,000,000	3,000,000
Professional Services	270,000	270,000
Financing Costs	300,000	300,000
Real Estate Taxes	25,000	25,000
Developer Fee	100,000	100,000
<b>TOTAL USES</b>	<b>4,095,000</b>	<b>4,095,000</b>



# Project: Industrial / Manufacturing

<b>INCOME</b>		
	<b>With No Assistance</b>	<b>With Assistance</b>
Rent - Space 1 (30,000 sq. ft. @ \$4.50 / sq. ft.)	135,000	135,000
Rent - Space 2 (15,000 sq. ft. @ \$4.50 / sq. ft.)	67,500	67,500
Rent - Space 3 (15,000 sq. ft. @ \$4.50 / sq. ft.)	67,500	67,500
<b>TOTAL INCOME</b>	<b>270,000</b>	<b>270,000</b>
First Mortgage Debt Service	241,410	215,618
Net Income	<b>28,590</b>	<b>54,382</b>
<b>Total Return on Equity</b>	<b>3.49%</b>	<b>6.64%</b>







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