STAFF REPORT

TO: Mayor Keis and Members of the City Council

FROM: Chris Heineman, City Administrator

DATE: May 11, 2022

RE: Updated Financial Analysis and Revenue Projections for proposed Tax Increment Financing Housing (TIF) District (Twin Lakes Apartments)

BACKGROUND

The City of Little Canada has received an application for financial assistance through Tax Increment Financing (TIF) to assist with financing a portion of the extraordinary development costs related to the construction of a new 60-unit multifamily workforce housing project. City staff is working with Baker Tilly Municipal Advisors to analyze and evaluate the level of financial assistance required to make this project feasible.

At the City Council workshop on April 27, Mikaela Huot from Baker Tilly reviewed the developer's request for assistance and explained the justification for financial assistance. Ms. Huot also explained two potential options for assistance, including the creation of a new Housing Tax Increment Finance District or utilizing Temporary Spending Authority for unobligated tax increment as authorized by the Minnesota Legislature in 2021.

Since that meeting, staff has learned that the Ramsey County Housing Redevelopment Authority (HRA) has recommended funding in the amount of $1,500,000 for the Twin Lake 60-unit multi-family housing project proposed by Reuter Walton. The Ramsey County Board of Commissioners will consider the recommended awards at the upcoming meeting on May 17, 2022. This will close the funding gap substantially and leaves approximately $1,000,000 of additional funds needed.

The attached memo provides further analysis of the Temporary Spending Authority. According to the analysis, the City of Little Canada has approximately $2.254 M of unobligated funds from all of the City's districts available for a Temporary Transfer Authority. The proposed project and the unobligated funds meets all of the requirements for use of this source of funding. Huot will be in attendance at the workshop to provide additional details and answer questions.

Memo – Updated Draft

To:	Members of the City Council of the City of Little Canada Chris Heineman, City Administrator Corrin Wendell, Community Development Director
From:	Mikaela Huot, Director
Date:	May 11, 2022
Subject:	Updated Financial Analysis for proposed Tax Increment Financing Housing (TIF) District (Twin Lakes Apartments)

Background

The City of Little Canada has received an application for financial assistance through Tax Increment Financing (TIF) to assist with financing a portion of the extraordinary development costs related to the construction of a new 60-unit multifamily affordable housing project comprising of 1, 2 and 3-bedroom units with income and rent limits restricted to 60% area median income (54 units) and 30% area median income (6 units). The total development cost of the project is approximately $19 million and will be financed with a combination of debt financing (supported by project cash flow and tax increment revenues), tax credits, deferred developer fee and Ramsey County grant funding.

Developer Request for Assistance

The developer has identified a financial gap of approximately $1,000,000 and has requested assistance from the City to fill that gap. Tax increment revenues from a Tax Increment Financing District is a source that could assist to close the financial gap. The project costs that cannot be supported solely by the project alone typically justify the need for public financial assistance as it would allow the project to proceed as proposed with reduced rents related to the affordable housing project and to provide appropriate funding sources for financing of the extraordinary project costs. The developer has stated in discussions with City staff that the receipt of City financial assistance is necessary for the project to proceed based on current financing limitations and has provided supporting financial information illustrating the financial gap.

The total development costs from the developer's financial materials is illustrated in the table below.

Sources	Amount	Uses	Amount
Debt	$8,165,000	Acquisition	$240,000
Equity (Tax Credits)	$7,794,854	Construction	$13,656,631
Ramsey County	$1,500,000	Professional Fees	$1,138,636
TIF	$1,000,000	Developer Fee	$2,280,000
Deferred Developer Fee	$466,826	Syndicator Fees	$45,000
NOI During Construction	$121,678	Financing Costs	$1,388,510
		Reserves	$299,581
Total	$19,048,358	Total	$19,048,358

Tax increment financing has been identified as a tool that could either be provided as pay-as-you-go from a new housing tax increment district as reimbursement for eligible costs, or as upfront funding source through the temporary transfer authority and structured as a potential loan with interest repayment. The developer will use traditional affordable housing funding sources including tax credit equity and debt to finance initial project costs

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 developer's initial project costs through the issuance of bonds or as an internal loan. Future tax increment would be collected 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 tax increment 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 tax increment revenues. With internal financing, the City reimburses the loan with future revenue collections and may risk not repaying itself in full if tax increment revenues are not sufficient.

The developer's initial request for assistance was through the establishment of a new tax increment financing housing district as a pay-as-you-go note. This method would provide additional annual cash flow to the project and subsequent increased debt financing amount as the remaining funding source to close the financial gap. A pay-as-you-go note would require the establishment of a 26-year housing district with semi-annual payments made to the developer for up to $1.0M of principal payments plus interest at a rate of approximately 4.5%. Additional details related to the tax increment revenue estimates from a new housing district are included under Tax Increment Revenue Assumptions

Upon further review of the City's existing tax increment districts, the City of Little Canada has a unique alternate option of providing up-front assistance to the developer to fill the approximate $1.0M gap. The temporary transfer authority is described in further detail below, and requires terms and conditions that would be outlined in a TIF Assistance Agreement. This option ***would not*** require the establishment of a new TIF district and rather than capturing the increased tax capacity, the proposed housing project would instead added to the general tax base for the City, County and School District. The developer has indicated this option would be treated as a loan with an interest component. Terms of potential loan repayment are still being discussed but initial terms may include interest only payments for 17 years with a balloon payment in year 17 which would coincide with the developer's anticipated capital investment/refinancing. Other options include some principal and interest repayment in earlier years, subject to availability of cash flow and minimum debt coverage requirements. If this option is preferred, further analysis on potential repayment terms would occur following the workshop.

Temporary Transfer Authority
In 2021, the Legislature enacted expanded, temporary authority to transfer unobligated tax increments for purposes of assisting private development consisting of the construction or substantial rehabilitation of buildings and ancillary facilities, if doing so will create or retain jobs in the state. Proposed amidst the COVID-19 pandemic, the enacted law is narrower than initially proposed and is similar to 2010 legislation that temporarily expanded the use of TIF with the aim of stimulating economic recovery after the Great Recession.

Authority and Purpose
The new law temporarily permits the City to elect, by resolution, to transfer unobligated increment for certain specified purposes. The new law does not, however, override requirements to pay bonds to which increments are pledged.

Any transfer under this provision must be for the purpose of assisting private development that meets all the following criteria:

1. It consists of the construction or substantial rehabilitation of buildings and ancillary facilities;
2. It creates or retains jobs in the state, including construction jobs; and
3. Construction commences before December 31, 2025 and the project would not have commenced before that date without the assistance.

Developments that would already commence construction prior to December 31, 2025, or those that do not add or retain jobs in the state, would not be permitted beneficiaries of the transfer. Transfers must provide the assistance in one or both of the following ways:

1. By providing improvements, loans, interest rate subsidies, or assistance in any form to the private development; or
2. By making an equity or similar investment in a corporation, partnership, or limited liability company that the authority determines is necessary to make construction of a development financially feasible.

In order to demonstrate compliance with the new provision, an authority may wish to include affirmation of the qualifications in the written resolution electing to make the transfer. The authority also should keep documentation that demonstrates that the development created or retained jobs in the state and that commencement of construction by December 31, 2025, depended on the transfer.

Approvals and Spending Plans
Prior to approving the use of this temporary transfer authority by resolution, the City must also create a written spending plan that authorizes the City to provide the assistance or make the investment that makes the development qualify. The plan must detail the use of transferred increment. The OSA recommends identifying planned expenditures using the same categories identified in TIF plans and TIF reporting (e.g., acquisition, site preparation, financing costs, etc.), except for a category for administrative expenses, because administrative expenses are not included in the permissible uses of the transferred increment in the new law.

Parameters and Limitations
The authority to transfer increments under this provision expires on December 31, 2022. Amounts being transferred under this provision must be transferred from the fund or account in which tax increments are segregated and into a separate fund or account by December 31, 2022. All transfers must be spent by December 31, 2025.

Transfers from a TIF district in calendar years 2021 and 2022 are limited to a maximum transfer equal to the excess of the district's unobligated increment. Under the provision, unobligated increment includes any increment not required for payment of obligations due during the six months following the transfer on outstanding bonds, binding contracts, and other outstanding financial obligations of the district to which the district's increment is pledged. Therefore, the transfer of increment for 2021 is limited to the eligible balance of tax increment at the end of 2020, less amounts needed to pay bonds, pay-as-you-go notes, and interfund loans due from January 1, 2021, to June 30, 2021. Similarly, the transfer of increment for 2022 is limited to the eligible balance of tax increment at the end of 2021, less amounts needed to pay bonds, pay-as-you-go notes, and interfund loans due from January 1, 2022, to June 30, 2022.

Increment that is improperly retained, received, spent, or transferred is not eligible for transfer under this authority. Therefore, the 2020 and 2021 balances of tax increment should be carefully evaluated prior to making transfers in 2021 and 2022, respectively. For example, excess increment calculated for 2019 that might remain in the TIF fund after it should have been returned by September 30, 2020, would not be eligible for transfer, nor would any subsequent excess increment be eligible for a transfer after it should have been returned. Likewise, if a district receives tax increment after it should have decertified under the Six-Year Rule, such amounts of increment would also not be eligible for transfer.

Unspent Transfers
Increment not spent by December 31, 2025, must be returned to the fund(s) of the contributing TIF district(s). The distribution of returned amounts need not be proportional to the amount contributed, but the amount returned to each TIF district must not exceed the amount transferred from the district.

The spreadsheet on the following page provides an overview of the initial financial analysis for each of the City's existing Tax Increment Financing District to determine the estimated available amounts of unobligated funds that could potentially be available pursuant to this legislation. Current estimates of unobligated funds from all of the City's districts is approximately $2.254M. None of the districts are reporting excess increment and are not projected to have excess increment.

City of Little Canada, Minnesota

Excess Increment Calculation Reporting

		TIF 2-1	TIF 3-2	TIF 3-3	TIF 5-1	TIF 6-1	TIF 7-1	TIF 7-2
Decertification date		12/31/2016	12/31/2022	12/31/2029	12/31/2025	12/31/2039	12/31/2045	12/31/2029
District Type		Redevelopment	Redevelopment	Housing	newal & Renovation	Redevelopment	Redevelopment	Econ Dev
Projected Available Balance as of 12/31/2022	*2,254,135*	*1,102,109*	*70,401*	*786,692*	*154,402*	*-*	*136,895*	*3,636*
		From 2020 Annual Reports	From 2020 Annual Reports	From 2020 Annual Reports	From 2020 Annual Reports	From 2020 Annual Reports	From 2020 Annual Reports	From 2020 Annual Reports
Excess Increment Calculation								
Tax increment generated by the district since certification		3,272,626	8,138,337	2,563,976	2,048,326	330,585	-	-
Multiply the above amount by 1.2		3,927,151	9,766,004	3,076,771	2,457,991	396,702	-	-
Total costs authorized by the TIF plan to be paid or financed with tax increment		5,633,500	15,900,000	5,432,259	6,502,200	2,288,000	7,969,930	321,471
Based on the calculation above, the Excess Increment Calculation Report is:		**NOT REQUIRED**	**NOT REQUIRED**	**NOT REQUIRED**	**NOT REQUIRED**	**NOT REQUIRED**	**NOT REQUIRED**	**NOT REQUIRED**
Excess Increment Calculation Report								
Total tax increment generated by the district since certification		3,272,626	8,138,337	2,563,976	2,048,326	330,585	-	-
Subtract total tax increment returned to the county		-	425,648	-	-	-	-	-
Subtotal A		3,272,626	7,712,689	2,563,976	2,048,326	330,585	-	-
Total costs authorized by the TIF plan to be paid or financed with tax increment		5,633,500	15,900,000	5,432,259	6,502,200	2,288,000	7,969,930	321,471
Subtract authorized costs that have been or will be paid from sources other than		-	-	-	-	-	-	-
Subtract principal and interest payments due after the year ended December		-	-	-	-	-	-	-
Add transfers of increment made prior to December 31, 2020, used to pay for		-	-	-	-	-	-	-
Subtotal B		5,633,500	15,900,000	5,432,259	6,502,200	2,288,000	7,969,930	321,471
Excess increment (Subtract subtotal B from subtotal A)		(2,360,874)	(8,187,311)	(2,868,283)	(4,453,874)	(1,957,415)	(7,969,930)	(321,471)
Subtract any of the authorized uses of excess increment listed below:		-	-	-	-	-	-	-
Prepayment of any outstanding bonds		-	-	-	-	-	-	-
Discharge of the pledge of tax increment for any outstanding bonds		-	-	-	-	-	-	-
Payment into an escrow account dedicated to the payment of any outstanding		-	-	-	-	-	-	-
Excess increment after subtractions of authorized uses:		(2,360,874)	(8,187,311)	(2,868,283)	(4,453,874)	(1,957,415)	(7,969,930)	(321,471)

* Excess increments after subtractions must be returned to the county for distribution to the city, county, and school districts in which the TIF district is located within nine months after the end of the year (by September 30)

Tax Increment Revenue Assumptions
To estimate the amount of available TIF revenues generated by the proposed project through the establishment of a new tax increment financing district, certain assumptions were made based on the value of the project, construction schedule, and anticipated financing terms.

- Total existing estimated market value (Base Value) of $294,000
    - Parcel ID: 313022310002
    - Base value as of Jan. 1, 2021
    - Original net tax capacity (ONTC) of $2,205
    - Assuming reclassification as residential rental low-income 4d
        - 0.75% first $100,000 and .25% value above $100,000
- Estimated total market value upon completion
    - Estimated $200,000/unit
    - 60 total units
    - $12,000,000 total taxable value
- Incremental value based on difference between existing and new land/building value
- Construction commences in 2022 and is completed in 2023
    - Project values 100% complete for assess 2024 and taxes payable 2025
    - Delay first increment until payable 2025
- Net present value (discount) rate of 4.5%
- 2.5% annual market value inflation

Preliminary Revenue Projections	
Existing Base Land Value	$294,000
Estimated Total Taxable Value	$12,000,000
Estimated annual available increment (full buildout)	$68,815
Total gross tax increment (26 years)	$2,146,816
City retainage (10%)	$214,684
Net amount available for development (90%)	$1,932,132
Estimated Present Value Revenues (26 Years) at 4%	$1,020,328

Pro forma Analysis of Proposed Development / But-For Test
Upon approval of a TIF district and project, the City must make several findings, including the “but for” test: that the proposed development would not reasonably be expected to occur solely through private investment within the reasonably foreseeable future. The developer has demonstrated that but for the provision of tax increment financing, the project as proposed would not occur. The developer has provided financial information including total sources and uses of funds and 15-year operating cash flow proforma demonstrating a financial gap of approximately $1,000,000 gap due to reduced rents of the project at both 60% area median income (54 units) and 30% area median income (6 units). The reduced operating revenues resulting from the restricted rents limits the ability of the project to support the total development costs with existing sources of revenue.

Based on the developer’s stated position relative to the need for tax increment financing assistance, the City could make its “but for” finding and provide tax increment assistance. We recommend, however, that the City review the provided assumptions to consider if the project meets the but-for test and, if so, what an appropriate level and type of TIF assistance may be based on the information submitted by the developer. Following thorough evaluation of the project as provided allows the City to be prepared to make an informed “but-for” decision based on the likelihood of the project needing assistance, as well as the appropriate level of assistance. As stated previously, the developer’s request for financial assistance of $1,000,000. Based on current revenue projections, it would the entire term of a new housing TIF District to support repayment.

To complete the but-for analysis, we reviewed the developer’s total sources and uses of funds and 15-year operating proforma, showing a result if the developer received the assistance as pay-as-you-go (reimbursement for TIF eligible costs) and showing a result if the developer did not receive assistance. Our analysis of the proformas included a review of the development budget, projected operating revenues and expenditures, and the project's capacity to support annual debt service payments. The purpose of evaluating the operating proformas is to understand the potential cash flow performance to assist with making the determination that 1) tax increment assistance is necessary and 2) an appropriate level of assistance will be provided.

An additional measure of project need and financial feasibility is the Debt Coverage Ratio (DCR), which is a calculation detailing the ratio by which operating income exceeds the debt-service payments for the project. If the DCR is greater than 1.0 it indicates the project has operating income that is greater than the debt-service payment by some margin; conversely if the DCR is less than 1.0 it indicates the project is incapable of meeting its debt-service payment and would need to seek additional revenue sources in order to pay its debt. Typical lending standards will require a DCR of greater than 1.0 as a measure of cushion in the event actual revenues and expenses are different than projected.

The amount of debt financing available for the project is based on net operating income (NOI), which is lease revenues less operating expenses. Due to the reduced revenues generated by the affordable housing units (6 30%-units), the annual cash flow of the project will be limited and requires additional funding sources beyond the traditional debt and equity as debt repayment is based on payments to be made to the lender with available cash flow. Public funding including tax increment revenues from the City and other public agencies (grants) provides the additional sources required to close the financial gap resulting from the reduced project revenues.

Thank you for the opportunity to be of assistance to the City of Little Canada. We will be prepared to discuss the financial analysis and project financing components in greater detail at the May 11 City Council Workshop. Please contact me at 651.368.2533 or Mikaela.huot@bakertily.com with any questions or comments.

Projected Tax Increment Report

City of Little Canada, Minnesota
Tax Increment Financing (Housing) District
Twin Lakes Apartments: Reuter Walton Housing project
Preliminary Revenue Projections: 60 Units valued at $200,000/unit for $12M

Annual Period Ending (1)	Total Market Value [1] (2)	Total Net Tax Capacity [2] (3)	Less: Original Net Tax Capacity [3] (4)	Retained Captured Net Tax Capacity (5)	Times: Tax Capacity Rate [4] (6)	Annual Gross Tax Increment (7)	Less: State Aud. Deduction 0.360% (8)	Subtotal Net Tax Increment (9)	Less: Admin. Retainage 10.00% (10)	Annual Net Revenue (11)	P.V. Annual Net Rev. To 08/01/23 4.50%
12/31/22	294,000	2,205	2,205	0	119.498%	0	0	0	0	0	0
12/31/23	294,000	2,205	2,205	0	119.498%	0	0	0	0	0	0
12/31/24	294,000	2,205	2,205	0	119.498%	0	0	0	0	0	0
12/31/25	12,000,000	60,000	2,205	57,795	119.498%	69,064	249	68,815	6,882	61,933	55,683
12/31/26	12,300,000	60,750	2,205	58,545	119.498%	69,960	252	69,708	6,971	62,737	53,977
12/31/27	12,607,500	61,519	2,205	59,314	119.498%	70,879	255	70,624	7,062	63,562	52,332
12/31/28	12,922,688	62,307	2,205	60,102	119.498%	71,820	259	71,561	7,156	64,405	50,743
12/31/29	13,245,755	63,114	2,205	60,909	119.498%	72,785	262	72,523	7,252	65,271	49,210
12/31/30	13,576,899	63,942	2,205	61,737	119.498%	73,775	266	73,509	7,351	66,158	47,731
12/31/31	13,916,321	64,791	2,205	62,586	119.498%	74,789	269	74,520	7,452	67,068	46,304
12/31/32	14,264,229	65,661	2,205	63,456	119.498%	75,828	273	75,555	7,556	67,999	44,925
12/31/33	14,620,835	66,552	2,205	64,347	119.498%	76,893	277	76,616	7,662	68,954	43,594
12/31/34	14,986,356	67,466	2,205	65,261	119.498%	77,985	281	77,704	7,770	69,934	42,310
12/31/35	15,361,015	68,403	2,205	66,198	119.498%	79,105	285	78,820	7,882	70,938	41,069
12/31/36	15,745,040	69,363	2,205	67,158	119.498%	80,252	289	79,963	7,996	71,967	39,871
12/31/37	16,138,666	70,347	2,205	68,142	119.498%	81,428	293	81,135	8,114	73,021	38,713
12/31/38	16,542,133	71,355	2,205	69,150	119.498%	82,633	297	82,336	8,234	74,102	37,594
12/31/39	16,955,686	72,389	2,205	70,184	119.498%	83,869	302	83,567	8,357	75,210	36,513
12/31/40	17,379,578	73,449	2,205	71,244	119.498%	85,135	306	84,829	8,483	76,346	35,469
12/31/41	17,814,067	74,535	2,205	72,330	119.498%	86,433	311	86,122	8,612	77,510	34,459
12/31/42	18,259,419	75,649	2,205	73,444	119.498%	87,764	316	87,448	8,745	78,703	33,482
12/31/43	18,715,905	76,790	2,205	74,585	119.498%	89,127	321	88,806	8,881	79,925	32,538
12/31/44	19,183,802	77,960	2,205	75,755	119.498%	90,525	326	90,199	9,020	81,179	31,625
12/31/45	19,663,397	79,158	2,205	76,953	119.498%	91,958	331	91,627	9,163	82,464	30,743
12/31/46	20,154,982	80,387	2,205	78,182	119.498%	93,426	336	93,090	9,309	83,781	29,889
12/31/47	20,658,857	81,647	2,205	79,442	119.498%	94,932	342	94,590	9,459	85,131	29,062
12/31/48	21,175,328	82,938	2,205	80,733	119.498%	96,475	347	96,128	9,613	86,515	28,263
12/31/49	21,704,711	84,262	2,205	82,057	119.498%	98,056	353	97,703	9,770	87,933	27,489
12/31/50	22,247,329	85,618	2,205	83,413	119.498%	99,677	359	99,318	9,932	89,386	26,740
						$2,154,573	$7,757	$2,146,816	$214,684	$1,932,132	$1,020,328

(1) Total estimated market value based on $200,000/housing unit
preliminary and subject to further review. Includes 2.5% annual market value inflator
(2) Total net tax capacity based on residential rental low income (4d) classification: 0.75% first $100,000 value and 0.25% value above $100,000
(3) Original net tax capacity based on 2021/2022 existing property value
(4) Total local combined tax rate available for proposed taxes payable 2022