MEMORANDUM

Date: May 22, 2015

To: Jim Lane, City Council Member, City of University Heights

From: Tom Jackson, Director, National Development Council

RE: Gap Financing Analysis for Proposed One University Place Mixed-Use Development

Pursuant to its agreement with the City, the National Development Council (NDC) has analyzed a request for tax increment financing for the development of a project site located at the northwest corner of the intersection of Melrose Avenue and Sunset Street. The request was made by a team, led by Jeff Maxwell, Maxwell Construction, Kevin Monson, Neumann Monson Architects, and Justin Doyle, Blackbird Investments (hereinafter, "the Developer"), that proposes to develop the site for mixed residential, retail and commercial uses (the "Project").

As the Developer has worked with the City over the past year to refine the design and associated unit mix for the Project, NDC has reviewed cost estimates, sale projections and pro forma statements of operating revenues and expenses for each scenario. Beginning with its engagement by the City in April 2014, NDC's evaluation of the Project has been conducted through on-site meetings, phone conversations and email correspondence with the Developer and City representatives.

The Developer's current proposal includes:

- 104 residential condominiums, including three one bedroom and 101 two bedroom units, of which:
    - 24 units will be located on the upper floors of a three-story mixed-use building to be constructed at the front (south) of the Project site along Melrose Avenue;
    - 80 units are planned for a four-story residential structure at the rear (north) of the site;
    - 26 condominiums are expected to be sold during a period starting with construction and ending prior to the third year of operations following project completion; and,
    - 78 units will be available for sale after the third year of operations, but are treated as rental properties for the purpose of this analysis.

- 16,600 square feet of leasable commercial and civic space, located at street level in the front building.
- 166 indoor parking spaces located beneath the two buildings and 108 surface spaces between them.

Documentation provided by the Developer to support its request for gap financing includes:

- A Development Budget based on:
  - Preliminary designs by Neumann Monson Architects, Iowa City, Iowa; and,
  - Construction cost estimates provided by McComas Lacina Construction of Iowa City, Modus Engineering, Des Moines and Iowa City, and Neumann Monson Architects, Iowa City.
- Proforma Statements of Operating Revenues and Expenses;
- Net Sales Revenue Projections for the 26 residential condominiums that are scheduled to sell in the first three years of operations;
- An appraisal report prepared by Jonathan K. Westercamp of Appraisal Associates Company of Cedar Rapids, dated October 10, 2014;
- A loan proposal (preliminary term sheet) from Lincoln Savings Bank for construction, permanent and TIF Rebate financing dated April 13, 2015; and,
- The Development Team's personal financial statements.

Documents that have not yet been available for review include:

- An update to the October 2014 appraisal report identifying the Project's as-complete fair market value and projected stabilized net operating income given the current design, number of units, unit mix and retail/civic space.

Given its document review and extended follow-up discussions, NDC's analysis suggests that the Developer's request for the City to rebate a portion of the property tax increment generated by the Project is reasonable. These Tax Increment Financing (TIF) rebates, $248,337 in the middle of Year 2 of operations and $496,675 in Years 3-15, will assist the Developer in securing private financing necessary to fill a $4 million gap between the Project's costs and available debt, equity and sales proceeds.

The maximum $496,675 in annual TIF rebate in Years 3-15 of the Project's operations is net of City, County and School protected levies that are projected by the Developer to total $61,387 in the first full year of the property tax increment. The full increment following the expiration of the rebates is projected, given modest property value escalation, to total over $640,000 per year.

A commitment of TIF rebates totaling $6,705,112 by the City over a period of 13.5 years, with a discounted present value of $4,000,000 (6.5% rate), will balance financing sources with projected uses, as follows:

Total Project Costs	**$39,314,945**	**100.00%**
Permanent Financing Sources		
Projected Bank Loan	$15,638,948	39.78%
TIF Rebate Loan	$4,000,000	10.17%
Residential Condo Sales (by Year 3)	$9,250,025	23.53%
Deferred Developer Fee	$1,092,238	2.78%
Developer Equity	$9,333,734	23.74%
Total Permanent Sources	**$39,314,945**	**100.00%**

The projected Project costs, operating revenues and expenses supplied by the Developer, as modified since April 2014 and analyzed by NDC, support a recommendation for gap financing for the following reasons:

1) The estimated permanent bank debt attracted to the Project, $15,638,948, has been maximized given the Developer's projected operating proforma and underwriting criteria (1.25 debt coverage ratio, 75% loan to value) proposed by the prospective lender's preliminary term sheet.
    a. The interest rated modeled in NDC's analysis is slightly higher than the minimum 4.85% identified in the lender's loan proposal – but is frozen at 5.0% for the full 25 year amortization period. Maintaining rates as low as 5.0% over the next 25 years is unlikely, but the actual rates can't be accurately projected and the low projection reduces the Project's financing gap.
    b. The maximum projected loan amount is also influenced by the capitalization rate. This rate has been identified in other Iowa City-area market analyses as being in the 5.5-10.0% range for mixed-use and residential projects, depending on their location, proposed uses, and other factors. NDC's analysis projects a capitalization rate at a strong 6.75% given the Project's proposed mix of residential and commercial/office uses, its proximity to the hospitals (major employment centers) and University Heights' strong residential market. The final capitalization rate will be set by the as-complete appraisal update ordered by the senior lender or lenders prior to the closing of construction, permanent and TIF Rebate financing into the Project.

2) The anticipated presales and sales of 26 residential units provide $9,250,025 in financing that reduces debt, equity and gap financing requirements.
    a. The condominiums are projected to sell for an average of $275 per square foot in the front, mixed-use building and $300 per square foot in the rear, residential-only building.
    b. The appraisal report anticipated square foot sales of $300-$325 per square foot based on an earlier design that included a wider range of unit sizes and was unfeasible given the magnitude of the projected financing gap. The range used in NDC's analysis is between the Developer's initial proposal for some units and the appraisers range and represents an average that should support early sale incentives.
    c. While all of the residential units will be offered for sale, NDC's analysis accepts the Developer's projection of the sale of 26 units prior to the end of Year 3 of operations. Accelerated sales at the $275-$300 per square foot rate are projected to increase the financing gap for the Project while sales at a higher square foot rate after the Project has stabilized do not have the same negative impact.
3) At $9,333.734 in developer equity:
    a. The Developer will earn a projected 8.00% Internal Rate of Return (IRR) on net cash flows after estimated taxes.
    b. An IRR of 8.0% is significantly below the 10.5% to 12.5% discount rate identified as a market return in the appraisal report identified above, but is reasonable given the strength of the Iowa City area's residential market and the Project's primarily residential uses.
4) The deferral of $1,092,238 of the developer fee is modeled to provide an additional source of financing.
    a. The Project's costs include a Developer Fee of $2,350,291, which is approximately 6.0% of the Total Project Costs and 7.0% of depreciable costs.
    b. The fee, paid and deferred, will be at risk if cost overruns during predevelopment and construction exceed current projections or if operating income is insufficient to provide repayment from cash flow.

Conclusion: the Project as presented demonstrates that $4 million in gap financing supported through a TIF rebate totaling $6,705,112 over a period of 13.5 years is reasonable. If the terms of the selected senior debt and updated project costs are substantially different from what the Developer has projected, NDC will review this evaluation as requested by the City.