



MEMORANDUM

Date: May 4, 2018

To: Diane Stoddard, Assistant City Manager, City of Lawrence
Britt Crum-Cano, Economic Development Coordinator, City of Lawrence

From: Jeff Jewell, Director, National Development Council

RE: 700 New Hampshire- Interim Review and Update

The National Development Council (NDC) is providing this summary of the request for development incentives requested by the Applicant (hereinafter, the “Developer”) for a mixed-use project at 700 New Hampshire (the “Project”). NDC has analyzed materials submitted in a request by the Developer for a Tax Increment Financing property and sales tax rebate (the “Rebate”). The development program has changed significantly in the last two months because two levels of underground parking were removed and tenant improvement budgets were reduced. The most recent development program and parking detail is below:

- 1 level of underground parking with approximately 112 spaces
- Proposed contribution to off-street parking (44) and street parking (14)
- A first floor, 43,094 ft² grocery store operated by a franchisee of the Price Choppers Brand
- 72 rental units with 11 of these units sold to the Lawrence Housing Authority for affordable housing:
 - The unit mix is currently configured as:
 - Studio: 11 units
 - One bedroom: 19 units
 - Two bedroom: 31 units
 - Affordable studio: 2 units
 - Affordable one bedroom: 4 units
 - Affordable two bedroom: 5 units

In a conversation on April 20, 2018 the Developer indicated they identified an external source of financing for the grocery store equipment, which was budgeted at \$3,250,000. For this analysis, this amount has been removed from the following project budget summary. The development program presented on April 20, 2018 assumes a New Markets Tax Credits (NMTCs) allocation of \$9.5 million and removal of the grocery store equipment costs:

Table 1- Uses and Sources	
Uses	Cost
Land	\$4,432,490
Underground garage & other infrastructure	\$4,762,215
Construction	\$11,608,080
Soft Costs	\$2,446,382

Financing Costs	\$700,000
Development Fee	\$800,000
NMTC fees funded at closing	\$711,837
IRB Sales Tax Exemption	(\$650,000)
Total Uses	\$24,811,004
Sources*	
Cost	
Projected Bank Loan	\$9,722,832
NMTCs (net)	\$9,055,000
Equity	\$4,238,036
Proceeds from sale	\$1,795,136
Total Sources	\$24,811,004

*Assumes a \$9,500,000 NMTC allocation, TIF revenue and IRB exemption

Permanent loan and NMTC funding source amounts will change depending upon final underwriting criteria and credit pricing and will affect amount of financing sources and developer returns. The developer is pursuing additional NMTCs beyond the \$9,500,00 and final allocation amounts will affect the debt and equity capital levels, which will provide the City an opportunity to revisit and potentially restructure its incentive amounts.

Project Parking

The Developer plans to accommodate a portion of the project’s parking demand with off-street and on-street parking spaces, as well as the construction of an underground garage. By reducing the amount of structured parking on the property, the Developer has reduced project costs but externalized some of the project’s likely parking demand onto the existing downtown system. In the latest program, the Developer has presented the following parking dedicated to the project on site:

Table 2- Project Parking Detail	
Item	Parking Spaces
Underground garage	112
Off-street	44
On-street	16
Total Parking for Project and on-street	172

As the program has evolved, the Developer and City of Lawrence have had preliminary discussions on an off-site parking solution. Given there is likely some parking demand that would not be accommodated on-site, the Developer has proposed that a portion of the TIF property and sales tax rebate be retained by the City to address expanded solutions for parking in downtown Lawrence. The Developer has proposed a payment to the City of approximately \$100,000 annually for resources to increase parking in downtown.

TIF- Uses and Sources

As presented, the Developer will privately finance the construction of the underground parking garage and request the City allocate 100% of future TIF proceeds towards reimbursement of these project costs (\$6,773,574) with an annual set-aside (approximately \$100,000) for the City to fund downtown parking improvements.

Table 3- TIF Eligible Uses and Anticipated Costs	
Item	Cost (\$)
Land apportioned to underground parking	\$1,122,082
Underground garage & eligible infrastructure	\$5,651,492
TIF Project - Underground Parking Garage & Eligible Infrastructure (project site)	\$6,773,574

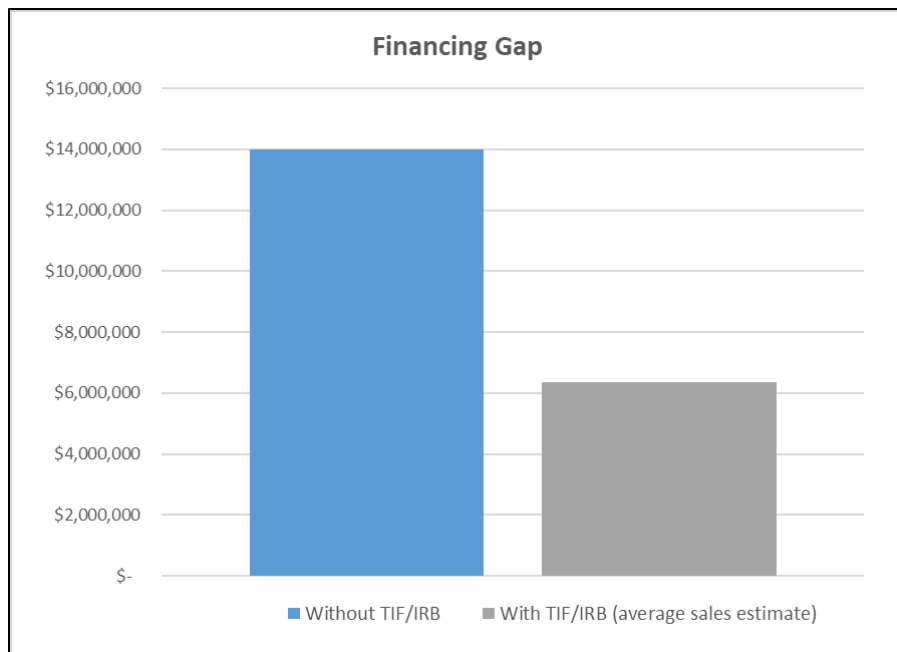
These improvements would be funded with a rebate of sales and property tax from the project. To support assumptions regarding sales tax revenue, the Developer commissioned a third party market study to forecast grocery store sales at this particular location. The study posited two scenarios: the first scenario (typical) is based on expected consumer response, new store operations and competitive reaction and the second scenario (very good) assumed extraordinarily good consumer acceptance, aggressive pricing, assortment and service levels by the grocery operator. The analysis noted that the very good scenario was not likely. The grocery store operator also completed an internal assessment and projection of the potential sales. The typical scenario and grocery store projections, in addition to property taxes, are highlighted below:

Table 4- TIF Revenue Projections					
	Annual TIF Sales Taxes		Property Taxes	Total TIF Revenues	
	Market Study Projections: Average Sales (Low Estimate)	Grocery Store Projections (High Estimate)		Low Estimate	High Estimate
Year 1	\$351,195	\$417,690	\$182,696	\$533,891	\$600,386

The market study ascertained that, at least in the short-term, a majority of the downtown store's sales would come from a redistribution of existing grocery store customers.

Analysis and Discussion

The Developer is requesting the creation of a TIF and an IRB exemption in order to close the project's financing gap. A financing gap is defined as the difference between projected costs (uses) and the debt and equity (sources) a project can reasonably attract. The chart below approximates the financing gap with and without the TIF and IRB exemption:



Based upon the preliminary analysis and information available to date, the project likely would not proceed without the creation of a TIF or the IRB exemption. Based upon the existing project information, the Developer will effectively achieve no return (.3%) on invested capital without the TIF and/or IRB exemption. At this level, the project will not be able to attract the equity capital needed to close the project financing gap. **Given anticipated underwriting criteria and assuming a cash on cash return to the developer of 10%, the TIF rebate and IRB exemption allows the project to secure an additional \$7,650,000 of debt and equity capital.** This figure represents the approximate difference in the sources of capital between a project that receives a TIF rebate and IRB exemption and one that does not. In most instances, NDC's estimates of the Developer's returns are greater than the Developer's estimates for the following reasons:

- Reduced equity requirement due to IRB exemption
- Lower debt service levels due to lower loan amounts in NMTC structure: \$6,424,850 vs. \$6,217,457 and lower interest rates of 2.75% vs. 3.5%
- Slightly greater property tax TIF rebate
- Greater sales proceed estimates due to differences in loan payoff amounts

Additional analysis of developer return will be undertaken as more details around the project become finalized. These returns will be balanced and commensurate with the appropriate market rate of return for comparable projects and more detailed in future reports.

It should be also noted that this project is within a census tract recently designated by the State of Kansas as an Opportunity Zone. Opportunity Zones allow for the deferral and potential exemption of capital gains taxes in exchange for investments in projects located within certain census tracts. This new federal tax incentive program will translate into less expensive sources of equity capital for viable projects. As more guidance from the federal government becomes available surrounding the

establishment of these investment funds, the City and Developer will explore this possibility as an additional financing source for the project.

Impact of Affordable Housing Requirement and Grocery Store Use

Without the allocation of TIF revenue, the project would face a funding shortfall. Part of the explanation behind a likely gap is the difference between the cost to construct a building and the fair market value as derived from its income potential. A commercial property's income is the primary determinant of its value and, subsequently, its ability to attract sources of capital (debt and equity). In weaker markets or when a potential use does not generate sufficient income to attract the capital needed to construct that use, a financing gap is encountered. With this potential project, the affordable housing units and grocery store uses reduce the project's overall fair market value and contribute to the funding gap.

The City's affordable housing requirement reduces potential rental revenue to the project. The eleven units reserved as affordable units result in a cumulative net operating income reduction of approximately \$88,000 annually. This reduces project borrowing capacity by approximately \$990,000 and the amount of equity attracted to the project by \$146,000 for a cumulative total impact of \$1,136,000.

The grocery store use, similarly, also contributes to a portion of the project's financial gap because it has less income potential than a more traditional office/retail/restaurant use. Under a typical development scenario, the grocery store would attract approximately \$3,325,000 of debt and equity capital. If the garage costs were included, the project's cost would be approximately \$12,800,000 to \$13,560,000. This would represent a funding shortfall of between \$9,475,000 to \$10,235,000. If the project were utilized as a mixed use space instead, it would attract approximately twice as much debt and equity capital (\$6,800,000) and cost approximately the same. This difference of approximately \$3,400,000 in financing sources between the grocery store and office use partially explains a portion of the financing gap. Taken together (\$1,136,000 and \$3,400,000), these programming elements contribute to a portion of the funding shortfall.