



MEMORANDUM

To: Duluth Housing and Redevelopment Authority
From: Tammy Omdal, Managing Director
Jessica Green, Managing Director
Date: August 9, 2022
Re: Tax Increment Financing (Housing) District for The Residence

This memorandum provides an overview of the proposed establishment of Tax Increment Financing (Housing) District for The Residence (the "TIF District"). The Duluth HRA (the "HRA") approved establishment of TIF District, subject to City Council approval, on July 26, 2022. The Duluth City Council will hold a public hearing and consider approval of the TIF District on October 10, 2022.

Proposed Development

The HRA received an application for Tax Increment Financing Assistance from Merge, LLC (the "Developer"). The Developer is requesting tax increment financing (TIF) assistance to assist with the financing of a 4-Story, 90,000 gross square foot apartment complex with approximately 80 units comprising a mix of one-bedroom and two-bedroom units (the "Project"). The Developer plans for 60% of the apartment units to be affordable to households at or below 80% of the area median income (AMI) and 40% of units at 60% AMI. The Project is located at 3401 Grand Avenue in the City (the "Property").

The request by the Developer is for the establishment of an affordable housing TIF district to capture the increase in property taxes from the development for a maximum period of 25 years to assist with the financing of the affordable housing units.

The Developer's estimated cost for the Project is approximately \$23.7 million (see Exhibit A) based on the "Financial Model" report from the Developer. The Developer's request for public financial assistance is to assist with the extraordinary costs of redevelopment and construction of the affordable housing units. The Developer has represented that it will not undertake the Project as proposed without the approval of the TIF.

It is Northland's opinion that the Project is unlikely to occur within the reasonably foreseeable future but for the public financial assistance, inclusive of the tax increment financing. Without public financial assistance, the Project is not expected to achieve the level of debt service coverage and returns needed to secure the necessary private financing and equity.

Public Financial Assistance

Due to the extraordinary costs associated with acquisition and development of the Project, the Developer is seeking public financial assistance from the HRA in the form pay-go tax increment financing assistance, among other sources from the City. The tax increment revenue is proposed to come from the establishment of the "TIF District" within the existing Redevelopment Project Area No. 1.

The "Financial Model" provided by the Developer includes a request for \$3.0 million in TIF assistance from the HRA for the Project and \$4.0 million in other governmental loans/grants from the City. Based on Northland's analysis of the financial information provided by the Developer, the following terms for assistance are proposed:

- Maximum term of 26 years for TIF assistance to the Developer in the form of issuance of a TIF pay-go revenue note (the "TIF Note") to reimburse up to \$3,000,000 of qualified costs for the Project plus interest at rate to be set at the lesser of the Developer's actual mortgage financing rate, estimated for planning purposes to be 4.0% from the date of issue per annum to the earlier of maturity or prepayment. Total payment to the Developer is estimated at approximately \$5,300,000, including both principal and interest. The TIF Note will be payable solely from net available semi-annual tax increments. Net available semi-annual tax increments shall be based on 90.0% of the tax increment collected from the Project within the TIF District. The TIF Note shall bear simple, non-compounding interest from the date that the HRA has determined paid invoices, as paid by the Developer, in compliance with the terms of an Agreement to be executed.
- Proposed terms will be subject to a Contract for Private Redevelopment (the "Agreement") between the Developer and the HRA.

Exhibit B provides a summary of the estimated tax increment cash flow from the TIF District available to reimburse the Developer for qualified costs for the Project.

Review of Application for Assistance

Northland conducted a review of the Developer's application for financial assistance dated May 9, 2021, along with other information provided by the Developer, including the "Financial Model" dated as of May 20, 2022. Northland reviewed project cost estimates to ensure all

anticipated sources and uses for the Project were properly included. Based on the estimated pro forma (shown in summary in Exhibit C), Northland finds that the Project may not reasonably be expected to occur solely through private investment within the reasonably near future. This conclusion is supported by the following:

- The \$23.7 million of project cost is to be funded from a combination of debt (52.5%), equity (30.6%) and other governmental loans/grants from the City (16.9%). The present value of the future payments on the TIF Note reduces the effective cost of the Project by approximately \$3 million. Based on estimated net operating income, the effective return without the public financial assistance is not at a level the Project would proceed.
- The tax increment estimated to be available is calculated based on an estimated \$11.8 taxable market value for the Project. The tax capacity of this value is calculated assuming 33 of the 80 total rental units for the Project qualify for the classification of “low-income rental property” or “4d” classification, with the remaining units falling under the non-homestead residential – apartments classification. For purpose of estimating the tax capacity for the low-income units, the first tier of valuation is assumed at \$100,000. The first tier has a class rate of 0.75%, and the class rate above the first tier is reduced to 0.25% for each unit. The Department of Revenue certifies the limit each November 1 for the upcoming assessment year.
- The total estimated cost per unit is \$295,822 for the construction of the Project, based on an estimated 80 housing units. Based on Northland’s experience with similar projects and given the location of the Project and current market conditions, we find the estimated cost per unit to be reasonable.
- The estimated average gross monthly rent for units, in the first stabilized year of the Project, is estimated at approximately \$1,148 per month. A minimum of 40% of the units will be affordable at or below 60% of AMI. The annual total gross rental income for the Project is estimated at \$1,102,104 in the first year of stabilized occupancy and the first year of TIF, before adjusting for estimated apartment vacancy and rental loss of 5%.
- The total annual expense, operating and non-operating, is estimated at \$5,867 per unit. This includes management fee and replacement reserve. This average cost per unit appears to be reasonable compared to Northland’s experience with other similar projects.
- The estimated average debt service coverage with tax increment financing is estimated to average 1.30X during the first ten years of stabilized operations, and without financial assistance the average is 1.06X. The coverage for the mortgage without the tax increment is not at a level that we would expect the Project, as proposed, to proceed.

- The cash-on-cash return (net operating income divided by total equity) is projected to reach an estimated 3.9% by year ten of stabilized operations with financial assistance, and 1.3% without assistance. For purpose of the analysis, the impact of the Developer monetizing the TIF Note is not included. Instead, the analysis assumes the Developer provides up-front equity.
- The cash-on-cost return (net operating income divided by total development cost) is projected to reach an estimated 4.2% by year ten of stabilized operations with financial assistance, and 3.4% without assistance.

Process for Approval of Establishment of TIF District

Exhibit D includes a calendar of key dates related to the establishment of the TIF District by the HRA and the City. The calendar is based on the City holding a public hearing on October 10, 2022.

EXHIBIT A
Duluth HRA
The Residence
80 Unit Residential Apartment Building
Developer Sources and Uses of Funds for Construction

	Total	% of Total	Per Unit
Sources of Funds			
First Mortgage	\$12,418,393	52.5%	\$155,230
Equity ¹	\$7,247,330	30.6%	\$90,592
APRA Funds	\$4,000,000	16.9%	\$50,000
Total Sources of Funds	\$23,665,723	100.0%	\$295,822
Uses of Funds			
Acquisition	\$97,821	0.41%	\$1,223
Construction of building	\$21,514,801	90.91%	\$268,935
Architecture & engineering	\$717,160	3.03%	\$8,965
Construction interest and Financing costs	\$446,663	1.89%	\$5,583
Fees and permits	\$889,278	3.76%	\$11,116
Total Uses of Funds	\$23,665,723	100.00%	\$295,822

Number of Units 80

Notes:

1/ Developer plans to monetize the TIF revenue note. For purpose of analysis of request the TIF revenue is assumed to provide a pay-go revenue source to the Project. The present value of the future tax increment cash flow is estimated at \$3,000,000 or future value of approximately \$5,300,000 (based on 4.0% rate).

Exhibit B
City of Duluth
Tax Increment Financing District No. The Residence (Housing)
The Residence
Projected Tax Increment Financing (TIF) Cash Flow

TIF District Year	Taxes Payable Year	Taxable Market Value (TMV)	Tax Capacity	Original Base Tax Capacity	Captured Tax Capacity for TIF	Original Tax Rate ²	Available TIF from District	PV Available TIF	TIF Retained by HRA	PV TIF to HRA	Net TIF Available	PV Net Available TIF
1	2025	12,154,000	118,042	3,474	114,569	146.65%	167,413	155,696	16,741	15,570	150,672	140,126
2	2026	12,518,620	120,841	3,474	117,367	146.65%	171,503	309,002	17,150	30,900	154,353	278,102
3	2027	12,894,179	123,724	3,474	120,250	146.65%	175,715	459,974	17,572	45,997	158,144	413,976
4	2028	13,281,004	126,693	3,474	123,219	146.65%	180,054	608,667	18,005	60,867	162,049	547,800
5	2029	13,679,434	129,751	3,474	126,277	146.65%	184,523	755,133	18,452	75,513	166,071	679,619
6	2030	14,089,817	132,901	3,474	129,428	146.65%	189,126	899,423	18,913	89,942	170,213	809,480
7	2031	14,512,512	136,146	3,474	132,672	146.65%	193,868	1,041,587	19,387	104,159	174,481	937,428
8	2032	14,947,887	139,488	3,474	136,014	146.65%	198,751	1,181,673	19,875	118,167	178,876	1,063,505
9	2033	15,396,324	142,930	3,474	139,456	146.65%	203,781	1,319,726	20,378	131,973	183,403	1,187,754
10	2034	15,858,213	146,475	3,474	143,001	146.65%	208,961	1,455,792	20,896	145,579	188,065	1,310,213
11	2035	16,333,960	150,127	3,474	146,653	146.65%	214,297	1,589,914	21,430	158,991	192,867	1,430,923
12	2036	16,823,978	153,888	3,474	150,415	146.65%	219,793	1,722,134	21,979	172,213	197,814	1,549,921
13	2037	17,328,698	157,762	3,474	154,289	146.65%	225,454	1,852,493	22,545	185,249	202,909	1,667,244
14	2038	17,848,559	161,753	3,474	158,279	146.65%	231,285	1,981,031	23,129	198,103	208,157	1,782,928
15	2039	18,384,016	165,863	3,474	162,389	146.65%	237,292	2,107,786	23,729	210,779	213,562	1,897,008
16	2040	18,935,536	170,096	3,474	166,623	146.65%	243,477	2,232,795	24,348	223,280	219,130	2,009,516
17	2041	19,503,602	174,457	3,474	170,983	146.65%	249,849	2,356,094	24,985	235,609	224,864	2,120,485
18	2042	20,088,710	178,948	3,474	175,474	146.65%	256,412	2,477,718	25,641	247,772	230,770	2,229,946
19	2043	20,691,371	183,574	3,474	180,100	146.65%	263,171	2,597,701	26,317	259,770	236,854	2,337,931
20	2044	21,312,113	188,339	3,474	184,865	146.65%	270,134	2,716,076	27,013	271,608	243,121	2,444,468
21	2045	21,951,476	193,246	3,474	189,772	146.65%	277,305	2,832,875	27,731	283,287	249,575	2,549,587
22	2046	22,610,020	198,301	3,474	194,827	146.65%	284,691	2,948,128	28,469	294,813	256,222	2,653,316
23	2047	23,288,321	203,508	3,474	200,034	146.65%	292,300	3,061,867	29,230	306,187	263,070	2,755,680
24	2048	23,986,970	208,870	3,474	205,397	146.65%	300,136	3,174,120	30,014	317,412	270,122	2,856,708
25	2049	24,706,580	214,394	3,474	210,920	146.65%	308,207	3,284,915	30,821	328,492	277,387	2,956,424
26	2050	25,447,777	220,083	3,474	216,610	146.65%	316,520	3,394,281	31,652	339,428	284,868	3,054,853
TOTAL =							6,064,020	3,394,281	606,402	339,428	5,457,618	3,054,853

Key Assumptions for Cash Flow:

- 1 Taxable market value (TMV) annual growth assumption = 3.00%
- 2 Original Tax Capacity Rate estimated based on Taxes Payable Year 2022.
- 3 Election for captured tax capacity is 100.00%.
- 4 Base Tax Capacity is calculated based on a TMV = \$277,900.
- 5 Present Value (PV) of Net Available TIF calculated based on semi-annual payments and rate of 4.0%, estimated dated date of 1/1/2024.

EXHIBIT C
Duluth HRA
The Residence
80 Unit Residential Apartment Building
Preliminary Estimated Pro Forma

Calendar Year Year of TIF District Project Year	2025 1	2026 2	2027 3	2028 4	2029 5	2030 6	2031 7	2032 8	2033 9	2034 10
Gross Income (before TIF)	1,120,184	1,148,188	1,176,893	1,206,315	1,236,473	1,267,385	1,299,070	1,331,547	1,364,835	1,398,956
Less Expenses	(469,384)	(483,443)	(495,503)	(507,898)	(520,634)	(533,721)	(547,171)	(560,992)	(575,194)	(589,789)
Net Operating Income (NOI)	650,800	664,746	681,390	698,418	715,840	733,664	751,899	770,555	789,641	809,167
Plus Tax Increment Financing (TIF) Revenue	150,672	154,353	158,144	162,049	166,071	170,213	174,481	178,876	183,403	188,065
NOI with TIF	801,471	819,099	839,534	860,467	881,911	903,877	926,380	949,431	973,044	997,232
Debt Service	482,460	718,157	718,157	718,157	718,157	718,157	718,157	718,157	718,157	718,157
Capital outlay net of use of reserves	-	-	-	-	-	-	-	-	-	-
Net Cash Flow	319,011	100,942	121,377	142,310	163,754	185,721	208,223	231,274	254,887	279,075
Net Cash Flow after Payment on Deferred Developer Fee	319,011	100,942	121,377	142,310	163,754	185,721	208,223	231,274	254,887	279,075
Cash-on-Cost with TIF (NOI / TDC)	3.4%	3.5%	3.5%	3.6%	3.7%	3.8%	3.9%	4.0%	4.1%	4.2%
Cash-on-Cost without TIF	2.7%	2.8%	2.9%	3.0%	3.0%	3.1%	3.2%	3.3%	3.3%	3.4%
Cash-on-Cash with TIF (NOI / Equity)	4.4%	1.4%	1.7%	2.0%	2.3%	2.6%	2.9%	3.2%	3.5%	3.9%
Cash-on-Cash without TIF	2.3%	-0.7%	-0.5%	-0.3%	0.0%	0.2%	0.5%	0.7%	1.0%	1.3%
Debt coverage with TIF ²	1.66	1.14	1.17	1.20	1.23	1.26	1.29	1.32	1.35	1.39
Debt coverage without TIF ²	1.35	0.93	0.95	0.97	1.00	1.02	1.05	1.07	1.10	1.13

- Notes:
- 1/ Total Development Cost (TDC): 23,665,723
 - 2/ Par amount of TIF note is estimated at \$3,000,000, 26 year term, 4.0% rate, payable from 90% of the tax increment derived from the property.
 - 3/ Total Developer Equity: 7,247,330
 - 4/ Developer plans to monetize the TIF note, which will reduce the equity contribution.

Exhibit D

Duluth Housing and Redevelopment Authority St. Louis County, Minnesota

For the proposed Modification to the
Redevelopment Plan for Project Area No. 1 and
the proposed establishment of
Tax Increment Financing (Housing) District for The Residence

As of August 12, 2022

May 2022						
Sun	Mon	Tue	Wed	Thu	Fri	Sat
1	2	3	4	5	6	7
8	9	10	11	12	13	14
15	16	17	18	19	20	21
22	23	24	25	26	27	28
29	30	31				

June 2022						
Sun	Mon	Tue	Wed	Thu	Fri	Sat
			1	2	3	4
5	6	7	8	9	10	11
12	13	14	15	16	17	18
19	20	21	22	23	24	25
26	27	28	29	30		

July 2022						
Sun	Mon	Tue	Wed	Thu	Fri	Sat
					1	2
3	4	5	6	7	8	9
10	11	12	13	14	15	16
17	18	19	20	21	22	23
24	25	26	27	28	29	30
31						

August 2022						
Sun	Mon	Tue	Wed	Thu	Fri	Sat
	1	2	3	4	5	6
7	8	9	10	11	12	13
14	15	16	17	18	19	20
21	22	23	24	25	26	27
28	29	30	31			

Date	Action	Responsible Party
May 11	Application for TIF received Project information, property identification numbers, fiscal impacts and maps for drafting documentation distributed to City, Northland and Fryberger Confirm whether building permits have been issued on the property to be included in the TIF District	HRA
June 22	Draft Modification to Redevelopment Plan for Project Area No. 1 and TIF Plan for TIF District (together, the "Plans") distributed to HRA staff and City staff for review and comment Financial evaluation memo distributed to HRA staff and City staff for review and comment	Northland



Date	Action	Responsible Party
July 26	<p>HRA considers the Plans, resolution adopting the Plans and an interfund loan in connection with the TIF District, requests City Council call for Public Hearing</p> <p><i>Northland and Fryberger provide packet information by July 19</i></p>	<p>HRA Board Action, Northland, Fryberger</p>
August 24	<p>County Commissioner to receive letter giving notice of potential housing TIF district (at least 30 days prior to publication of public hearing notice).</p>	<p>Northland</p>
September 9	<p>School Board Clerk and County Auditor to receive copy of draft Tax Increment Financing Plan (the "TIF Plan") with information on fiscal/economic implications (at least 30 days prior to public hearing) and County receives information for review of county road impacts</p> <p><i>*The County Board, by law, has 45 days to review the TIF Plan to determine if any county roads will be impacted by the development. If HRA staff and City staff conclude that the proposed TIF district will not require unplanned county road improvements, the TIF Plan will not be forwarded to the County Board 45 days prior to the public hearing. Please be aware the County Board could claim that tax increment should be used for county roads, even after the public hearing.</i></p>	<p>Northland</p>
September 13	<p>Planning Commission reviews Plans and considers a resolution affirming the Plans conform to the general plans for development and redevelopment of the City as a whole</p> <p><i>Application materials due August 9th for packets – City staff to handle Fryberg to provide resolution information by Friday, September 2nd</i></p>	<p>Planning Commission Action, City Staff</p>
September 24	<p>Publication of hearing notice and map in the Duluth News Tribune (at least 10 days but not more than 30 days prior to hearing).</p> <p><i>Notice submitted to newspaper by 4:00 pm September 22nd by Fryberger</i></p>	<p>Fryberger</p>
September 26	<p>City Council calls for public hearing to be held on October 10, 2022, holds pre-business subsidy meeting, and considers Community Benefit Plan.</p> <p><i>Fryberger to provide Resolution Calling for Hearing by July 15 Subsidy Report sent to City Clerk by September 16th</i></p>	<p>City Council Action, Fryberger, City Staff</p>
October 10	<p>City Council holds public hearing at 7:00 PM on the modification to the Redevelopment Plan for Project Area No. 1 and the proposed Establishment of the TIF District and considers a resolution approving the Plans</p> <p><i>Northland and Fryberger provide packet information September 30th</i></p>	<p>City Council Action, Northland, Fryberger</p>
October 25	<p>HRA considers Development Agreement, resolution adopting the Agreement</p> <p><i>Northland and Fryberger provide packet information by July 19</i></p>	<p>HRA Board Action, Northland, Fryberger</p>
November 1	<p>City may issue building permits</p>	<p>City</p>

Date	Action	Responsible Party
By June 30, 2023	Request for certification of TIF District sent to county auditor Plans submitted to the MN Department of Revenue, Office of the State Auditor	Northland

Notes:

1. An action under subdivision 1, paragraph (a), contesting the validity of a determination by an authority under section 469.175, subdivision 3, must be commenced within the later of: (1) 180 days after the municipality's approval under section 469.175, subdivision 3; or (2) 90 days after the request for certification of the district is filed with the county auditor under section 469.177, subdivision 1.
2. Unless stated otherwise on this page, the Duluth Housing & Redevelopment Authority (HRA) Board of Commissioners meets on the last Tuesday of each month at 3:30 p.m. in the King Manor community room, on the second floor. King Manor is located at 222 East Second Street.
3. Planning Commission Meeting Time and Place: Second Tuesday of every month Council Chamber, City Hall, at 5:00 p.m.
4. Council meeting dates are set by the City Council and are noticed here: <https://duluthmn.gov/city-council/city-council-meetings-events/meeting-schedule/>

