



MEMORANDUM

To: Duluth Housing and Redevelopment Authority
From: Tammy Omdal, Managing Director
Jessica Green, Managing Director
Date: February 20, 2024
Re: Tax Increment Financing (Housing) District for Welch Place

This memorandum provides an overview of the proposed establishment of Tax Increment Financing (Housing) District for Welch Place (the “TIF District”). The Duluth HRA (the “HRA”) will consider approval of the TIF District on February 27, 2024, subject to City approval. The Duluth City Council will hold a public hearing and consider approval of the TIF District on May 13, 2024.

Proposed Development

The HRA received an application for Tax Increment Financing Assistance from Center City Housing Corp. (the “Developer”). The Developer is requesting tax increment financing assistance to assist with the financing of affordable housing units. The proposed development within the TIF District will include two apartment buildings (together, the “Development”). The first building, Wadena West Apartments, is projected to contain 60 affordable housing units with a goal to place in service at the end of 2025. The second building, Welch Place Apartments, is projected to contain 30 affordable housing units with a goal to place in service at the beginning of 2026. Both buildings will be included within the TIF District to generate tax increment. The Developer is requesting the tax increment generated by both buildings within the TIF District be used to provide financial assistance to the second building, Welch Place Apartments.

The Development, inclusive of a total of 90 rental housing units, will be located on Lots 1 through 18, inclusive of Block 168, and Lots 1 thru 28, inclusive, Block 169, WEST DULUTH 7th Division (the “Property”) and will include 24 units affordable to households at or below 30% of the Area Median Income (AMI) and 66 units affordable to households at or below 60% of the AMI.

The request by the Developer is for the establishment of an affordable housing TIF district to capture the increase in property taxes (tax increment) from the Development for a maximum period of 26 years to assist with the financing of the affordable housing units for Welch Place. The Developer requests that the tax increment generated from both Wadena West and Welch Place be used to provide tax increment financing assistance to the Developer for Welch Place.

The Developer's estimated cost for Welch Place is approximately \$13.7 million (see Exhibit A). 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 Development 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 returns needed to secure the necessary financing and equity. The TIF will provide a source of local public subsidy which is anticipated to help the Developer to obtain financing from the Minnesota Housing Finance Agency (MHFA) for Welch Place.

Public Financial Assistance

The Developer is proposing to provide low-income housing. The rental income from the Development will not be sufficient to cover costs. Other sources of revenue are needed for the project to be financially feasible. The Developer is seeking public financial assistance from MHFA, the City, and the HRA. The assistance requested from the HRA is pay-go tax increment financing assistance.

The Developer is requesting the HRA to provide TIF assistance for a duration of 26 years. The estimated present value of the tax increment revenue to be generated over this duration is approximately \$600,000.

The terms for assistance from the HRA to the Developer are as follows:

- 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 \$600,000 of qualified costs for the Project plus interest at rate not to exceed 5.0% from the date of issue per annum to the earlier of maturity or prepayment. Total payment to the Developer is estimated at approximately \$1,097,000, 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 mean 90.0% of the tax increment generated from the Property within the TIF District and distributed from the County to the HRA.
- 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 a proposed 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 Development.

Review of Application for Assistance

Northland conducted a review of the Developer’s application for financial assistance dated January 21, 2024, along with other information provided by the HRA and Developer. Northland reviewed project cost estimates to ensure anticipated sources and uses for the Project were properly included. Based on the pro forma prepared by Northland using information provided by the Developer and information prepared independently by Northland, Northland finds that the Development may not reasonably be expected to occur solely through private investment within the reasonably near future. The conclusion is supported by the following:

- The \$13.7 million of project cost for Welch Place is to be funded from a combination of MHFA and City funding, equity, and anticipated project rebates. The present value of the future payments on the TIF Note reduces the effective cost of the Project by approximately \$600,000. Based on estimated net operating income, the effective return without the public financial assistance is not at a level the Project could proceed.
- The estimated taxable market value of the Development within the TIF District is inclusive of Wadena West and Welch Place. Taxable market value for Wadena West is estimated at approximately \$9.2 million and Welch Place at approximately \$4.6 million after completion of the Development.
- The net tax capacity for the TIF District after completion is estimated assuming 100% of the units within the TIF District, estimated to be 90 rental units, qualify for the classification of “low-income rental property” or “4d” classification.
- The estimated cost per unit is approximately \$457,000 for Welch Place. Welch Place is to include 30 rental housing units. Welch Place is a lower density project that will result in a higher cost per unit because the soft costs are spread over fewer units. The construction costs for Welch Place, just like soft costs, are higher on a per unit basis due to lower density. Welch Place will be funded as a

LIHTC 4% Bond project. These types of projects are more expensive because of the syndication fees, 100% of the Bond interest is escrowed for a full 24 months, financing fees are higher, and the project has construction and bridge loan interest.

- The estimated average gross monthly per unit rent for Welch Place, in the first stabilized year, is estimated at approximately \$897 per month. 100% of the units within the TIF District, including Welch Place and Wadena West, will be affordable at or below 60% of AMI. The annual total gross rental income for Welch Place is estimated at \$329,195 in the first year of the TIF District, before adjusting for estimated apartment vacancy and rental loss of 7%.
- The total annual expense, operating and non-operating for Welch Place, is estimated at \$5,251 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 total annual expense for Welch Place is projected to exceed total income with and without TIF. The Developer will need to identify other sources of revenue to close the approximate annual average "gap" of \$15,000 (based on first 15 years of the TIF District).

Process for Approval of Establishment of TIF District

Exhibit C 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 May 13, 2024.

**Exhibit A
Duluth HRA
Welch Place
30 Unit Residential Apartment Building
Developer Sources and Uses of Funds**

	Total	% of Total	Per Unit
Sources of Funds			
Syndication Proceeds (Equity)	\$3,950,861	28.8%	\$131,695
City of Duluth HOME	\$300,000	2.2%	\$10,000
HOME MF	\$4,000,000	29.2%	\$133,333
Housing Infrastructure Aprp Homeless	\$5,238,000	38.2%	\$174,600
Other Sales Tax & Energy Rebates	\$227,247	1.7%	\$7,575
Total Sources of Funds	\$13,716,108	31.0%	\$457,204
Uses of Funds			
Acquisition or Refinance	\$43,400	9.29%	\$1,447
New Construction	\$7,973,106	1707.14%	\$265,770
Rehabilitation		0.00%	\$0
Contractor Fees	\$851,188	182.25%	\$28,373
Contingency	\$441,215	94.47%	\$14,707
Environmental Abatement	\$75,000	16.06%	\$2,500
Professional Fees	\$1,220,804	261.39%	\$40,693
Developer Fees	\$1,700,000	363.99%	\$56,667
Syndicator Fees	\$50,000	10.71%	\$1,667
Financing Costs	\$894,350	191.49%	\$29,812
TOTAL MORTGAGEABLE	\$13,249,063	2836.79%	\$441,635
Reserves and Non-Mortgageable	\$467,045	3028.28%	\$471,447
Total Use of Funds	\$13,716,108		

Number of Units

30

Notes:

1. Welch Place is a lower density project that will result in a higher cost per unit because the soft costs are spread over fewer units.
2. Construction costs for Welch Place, just like soft costs, are higher on a per unit basis due to lower density.
3. Welch Place will be funded as a LIHTC 4% Bond project. These types of projects are more expensive because of the syndication fees, 100% of the Bond interest is escrowed for a full 24 months, financing fees are higher, and the project has construction and bridge loan interest.

Exhibit B
City of Duluth
Tax Increment Financing (Housing) District (Welch Place)
Projected Tax Increment Financing (TIF) Cash Flow

TIF District Year	Taxes Payable Year	Taxable Market Value (TMV)	Tax Capacity	Captured Tax Capacity for TIF	Original Tax Rate ²	Available TIF from District	TIF Retained by HRA	Net TIF Available	PV Net Available TIF
1	2027	11,362,500	28,406	27,853	123.98%	34,408	3,441	30,967	28,289
2	2028	13,771,350	34,428	33,875	123.98%	41,848	4,185	37,663	61,036
3	2029	13,909,064	34,773	34,219	123.98%	42,273	4,227	38,046	92,523
4	2030	14,048,154	35,120	34,567	123.98%	42,703	4,270	38,432	122,796
5	2031	14,188,636	35,472	34,918	123.98%	43,136	4,314	38,823	151,904
6	2032	14,330,522	35,826	35,273	123.98%	43,575	4,357	39,217	179,891
7	2033	14,473,827	36,185	35,631	123.98%	44,017	4,402	39,615	206,799
8	2034	14,618,566	36,546	35,993	123.98%	44,464	4,446	40,018	232,671
9	2035	14,764,751	36,912	36,358	123.98%	44,916	4,492	40,424	257,547
10	2036	14,912,399	37,281	36,727	123.98%	45,371	4,537	40,834	281,463
11	2037	15,061,523	37,654	37,100	123.98%	45,832	4,583	41,249	304,459
12	2038	15,212,138	38,030	37,477	123.98%	46,298	4,630	41,668	326,569
13	2039	15,364,259	38,411	37,857	123.98%	46,767	4,677	42,090	347,827
14	2040	15,517,902	38,795	38,241	123.98%	47,241	4,724	42,517	368,266
15	2041	15,673,081	39,183	38,629	123.98%	47,721	4,772	42,949	387,918
16	2042	15,829,812	39,575	39,021	123.98%	48,205	4,820	43,384	406,812
17	2043	15,988,110	39,970	39,417	123.98%	48,694	4,869	43,825	424,978
18	2044	16,147,991	40,370	39,816	123.98%	49,187	4,919	44,269	442,444
19	2045	16,309,471	40,774	40,220	123.98%	49,686	4,969	44,718	459,237
20	2046	16,472,566	41,181	40,628	123.98%	50,190	5,019	45,171	475,383
21	2047	16,637,291	41,593	41,040	123.98%	50,699	5,070	45,629	490,907
22	2048	16,803,664	42,009	41,456	123.98%	51,213	5,121	46,092	505,833
23	2049	16,971,701	42,429	41,876	123.98%	51,731	5,173	46,558	520,183
24	2050	17,141,418	42,854	42,300	123.98%	52,255	5,226	47,030	533,980
25	2051	17,312,832	43,282	42,729	123.98%	52,785	5,279	47,507	547,245
26	2052	17,485,960	43,715	43,161	123.98%	53,319	5,332	47,987	559,999
TOTAL =						1,218,534	121,853	1,096,681	559,999

Key Assumptions for Cash Flow:

- 1 Taxable market value (TMV) annual growth assumption = 1.00%
- 2 Original Tax Capacity Rate estimated based on Taxes Payable Year Prel 2024.
- 3 Election for captured tax capacity is 100.00%.
- 4 Base Tax Capacity is calculated based on a TMV = \$73,800.
- 5 Present Value (PV) of Net Available TIF calculated based on semi-annual payments and rate of 5.0%, estimated dated date of 1/1/2026.
- 6 Analysis assumes an election to delay receipt of first increment to year 2027, for the earliest year for first collection of tax increment.
- 7 Tax capacity estimated based on 4d(1) classification. Analysis assumes 100% of the units within TIF District will qualify for 4d(1) classification. Class 4d(1) property has a classification rate of 0.25%.
- 8 TMV includes value for 30 rental housing units for Welch Place and 60 rental housing units for Wadena Wes