

MEMORANDUM

TO: Tricia Hobbs, Senior Economic Developer
FROM: Jason Aarsvold, Ehlers
DATE: August 21, 2024
SUBJECT: Sofidel Expansion and Financial Assistance Request

The City of Duluth (the “City”) received a request for financial assistance from Sofidel America Corp. for expansion of its facility located at 100 North Central Avenue. Sofidel proposes expansion of its converting facility and adding additional warehousing/shipping capacity. The facility will grow to approximately 586,000 sq. ft. and enhance production capacity while also increasing employment in the City.

The Sofidel project meets the requirements necessary for the City to establish an Economic Development TIF district. Sofidel is requesting 9 years of tax increment payments, which is the maximum number of available years in an Economic Development TIF District. The assessed valuation of the property is expected to increase from \$8.5 million up to approximately \$111 million. Based on our estimates, the project is expected to generate a present value of approximately \$14.3 million in tax increment over the 9-year life of the district.

The purpose of this memorandum is to evaluate whether Sofidel’s request is necessary for financial feasibility. Since this facility will be owned by the company, this analysis treats the Sofidel project as an independent income producing real estate venture that might be built by a third party (developer) and leased back to the business. In this scenario, we explored whether the project costs and end sources of funds (rent paid by the business) would meet typical market returns to attract private financing from a bank and developer equity.

If this project were to be delivered by a developer on a for-lease basis to Sofidel, the developer may be expected to provide 25 percent equity to obtain debt financing for the remaining 75 percent of project costs. In addition, a developer would anticipate receiving between 7% and 7.5% percent Yield on Cost return in investment. A Yield on Cost rate of return is simply the annual net operating income from the project divided by the total projects costs. A 7% to 7.5% percent Yield on Cost is a typical threshold to attract enough debt and equity to get a project built.

Sofidel’s cost for expanding/constructing the buildings is just over \$102 million. This excludes any allocation for land acquisition and the cost of equipment, since equipment would not generally be part of the real estate lease. The table on the following page compares the sources and uses for the project as proposed without any City assistance to a version that does include the requested assistance.

SOURCES	WITH ASSISTANCE		WITHOUT ASSISTANCE	
	Amount	Pct.	Amount	Pct.
Developer Financing - 1st Mortgage	66,075,257	64.53%	76,800,257	75.00%
Developer Financing - TIF PAYGO	14,300,000	13.96%	0	0.00%
Developer Equity	22,025,086	21.51%	25,600,086	25.00%
TOTAL SOURCES	102,400,343	100.00%	102,400,343	100.00%

USES				
	Amount	% of Cost	Amount	% of Cost
Acquisition Costs	0	0.00%	0	0.00%
Construction Costs	71,000,343	69.34%	71,000,343	69.34%
Utilities	12,400,000	12.11%	12,400,000	12.11%
Professional Services	3,000,000	2.93%	3,000,000	2.93%
Site Improvements	10,000,000	9.77%	10,000,000	9.77%
Extraordinary Site Work (piles, etc.)	6,000,000	5.86%	6,000,000	5.86%
Machinery and Equipment	0	0.00%	0	0.00%
TOTAL USES	102,400,343	100.00%	102,400,343	100.00%

Based on the total development costs and proposed financing for this project, we estimate a business (like Sofidel) would need to pay a lease rate of approximately \$12.50 per square foot without any assistance for a developer to achieve an average 7% return for this project over 9 years (the anticipated term of tax increment payments). According to a 3rd party market analysis from CoStar Group, the average industrial market lease rate in Duluth is \$8.73 per square foot.

This analysis indicates Sofidel would need to pay a lease rate that is higher than the market rate to occupy the property, demonstrating assistance for the project may be warranted. If we assume a developer received the requested \$14.3 million in assistance, Sofidel would need to pay a lease rate of approximately \$8.70 per square foot for the developer to achieve an average 7 percent yield on cost return for this project within 9 years. This is consistent with average industrial market lease rate in Duluth. Therefore, if the City chooses to provide the requested assistance, we believe it will help facilitate the project and not unduly enrich the business.

Please contact me at 651-697-8512 if you have any questions or require further information.