



MEMORANDUM

To: City of Pelican Rapids
From: Tammy Omdal
Date: June 11, 2019
Re: Tax Abatement Assistance for Housing Project

The City of Pelican Rapids (the "City") received a request from D.W. Jones, Inc. (the "Developer") for Tax Abatement for the proposed development of an approximate 36-unit multifamily rental housing facility at an estimated cost of \$4.8 million, to be owned by Colony Housing LLC ("the Project"). The Developer plans to request Tax Abatement from Otter Tail County (the "County") and from Independent School District No. 548 (the "School"), together the "Taxing Jurisdictions".

The Developer submitted a request to the Taxing Jurisdictions for Tax Abatement in year 2016. The Taxing Jurisdictions approved the request and adopted resolutions in year 2016 authorizing the Tax Abatement. The Project did not proceed as planned and was not constructed based on the original anticipated timeline. There has been no Tax Abatement certified for the Project.

The Developer is now ready to proceed with the Project, with financing identified, and is requesting the respective Taxing Jurisdictions rescind the original Tax Abatement resolutions and adopt new resolutions for the maximum term of 15 years and provide a combined not to exceed \$642,000 in Tax Abatement assistance. The Developer will enter into a Tax Abatement and Financial Assistance Agreement (the "Agreement") with the City (or the Taxing Jurisdictions, respectively) to provide for the terms of assistance. The Developer is requesting reimbursement of \$480,000 of project costs from Tax Abatement from the Taxing Jurisdictions, payable over a maximum term of 15 years with 4.65% interest. The total estimated Tax Abatement payments, principal and interest, will not exceed the \$642,000. The Developer is seeking to mortgage the Tax Abatement with a lender to provide proceeds for construction.

Background of Developer

D.W. Jones was established in 1976 specializing in helping families find affordable housing throughout central and northern Minnesota. The Developer has developed 46 rental properties totaling 1,518 rental units with full management services. Based on information reviewed by Northland, it is our opinion that the Developer has the resume, experience, and capacity to complete the Project.

Tax Abatement Assistance

Due to the extraordinary costs associated with development of the proposed site for workforce housing, the Developer is requesting Tax Abatement assistance from the City, County, and School. The request for assistance is to make the Project financially feasible for the Developer with respect to

estimated return on equity and debt service coverage. This memorandum provides a review of the need for the requested assistance based on Northland's analysis of the Developer's pro forma for the Project.

In addition to Tax Abatement, the Developer is seeking conveyance of the land from the City to the Developer at a reduced cost (i.e., \$1.00). The Project will be supported by \$710,000 of grant funding from the State of Minnesota Housing Finance (MHFA) Workforce Housing Development Program (the "Program"). The Program targets communities in Greater Minnesota where a shortage of housing makes it difficult for businesses to attract the workers they need. The Program is a competitive grant program that offers financial assistance to build market-rate residential rental properties for workers. Units of local government, non-profits or the benefiting businesses must contribute \$1 for every \$2 provided by the Program. The Program funding does not allow for any income restrictions. Without the local match, the Project is not eligible for the Program.

Northland conducted a review of the Developer's pro forma to ensure all anticipated sources and uses for the Project were properly included and consistent with industry standards. Exhibit A provides information on the sources and uses of funds for the Project. Based on our review of the pro forma and under current market conditions, we find that the Project may not reasonably be expected to occur solely through private investment within the reasonably near future. Due to the costs associated with the Project (including payment of anticipated special assessments for construction of public infrastructure) and construction of the workforce housing units, this project is feasible only through assistance, in part, from Tax Abatement assistance.

Source of Tax Abatement Revenue

The source of funds for the Project includes Tax Abatement, among other sources. The Tax Abatement for the Project is proposed to come from the City, County, and School, respectively. To allow for the maximum term of 15 years for the Tax Abatement, each of the respective Taxing Jurisdictions will need to hold a public hearing. Following the respective public hearings then each Taxing Jurisdiction may consider a resolution rescinding the original Tax Abatement (approved in 2016) and consider adopting a resolution with updated terms for the Tax Abatement. The terms in the individual resolutions for each of the jurisdictions will set the maximum amount and number of years for the Tax Abatements to be collected by each of the jurisdictions. Exhibit B provides information on the proposed amount of Tax Abatement for each Taxing Jurisdiction.

After approval of the resolutions, the Taxing Jurisdictions may consider final terms for assistance, including amounts to be provided and payment dates. The final terms within the Agreement must be consistent with the terms within the adopted resolutions.

Review of Need for Developer Assistance

Based on our review of the pro forma for the Project, and under current market conditions, we find that the Project may not reasonably be expected to occur solely through private investment within the reasonably near future. Facts supporting this finding are as follows:

- As shown in Exhibit A, the Developer is proposing to finance 58.9% of the Project from a mortgage, 8.3% from equity, 14.8% from the MHFA Program, and 10.3% from local contributions
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from Tax Abatement. The Developer is anticipating the conveyance of the land from the City at no cost. As shown in Exhibit C, the estimated present value of the combined tax abatement assistance reduces the effective cost of the project by an estimated \$480,000. Tax Abatement is needed to assist with the costs of the construction of the housing units and public infrastructure to increase the Project's annual income to provide return on equity and debt service coverage.

- The total estimated cost for the Project is \$4.8 million or \$133,476 per unit for 36 units. Based on Northland's experience with similar projects and given the location of the Project, we would expect total development costs to range between \$130,000 and \$160,000 per unit. The total estimated costs are within this range.
 - The total budget for the Project includes \$114,516 of financing costs, which is approximately 2.4% of total uses of funds. The contractor fee is \$412,543 or 8.6% of the total. For a project of this nature, we would expect to see the fee to be less than 10%. The proposed financing fee and contractor fee are both within the expected thresholds.
 - The estimated average monthly net rent for the total units is \$861 per month. The Project is estimated to include four (4) studio-units, twelve (12) one-bedroom units, seventeen (17) two-bedroom units, and three (3) three-bedroom units. Monthly average net rents will range from \$475 for a studio-unit to \$1,150 for a three-bedroom unit. The total income assumptions for the Project are reasonable.
 - The total expenses, operating and non-operating (including utilities), are projected at approximately \$5,530 per unit. The projected operating costs for the Project are within industry standards for the Project as proposed.
 - The budget does not provide a contribution to replacement reserve. We would typically expect this type of project to include a provision for contribution to replacement reserve. This may be an item the City will want to include in the Agreement.
 - As shown in Exhibit C, the Developer's estimated effective return after Project completion is 8.4% with Tax Abatement and 7.5% without assistance. The estimated average return with the Tax Abatement is reasonable for what we might anticipate for this type of project. We would anticipate an average effective return between 8-10%. Other factors may influence the Developer's expected effective return from the Project.
 - The estimated annual cash on cash return (net annual operating income divided by total development project costs) with tax abatement assistance is estimated to average 6.0% in the first ten years of operations, and 4.7% without tax abatement assistance. See Exhibit D for details on the calculation of the estimated cash on cash return. The cash on cash return of 6.0% with the tax abatement assistance is reasonable for the Project.
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EXHIBIT A

**City of Pelican Rapids, Minnesota
The Colony
36 Unit Residential Apartment Building
Developer Sources and Uses of Funds for Construction**

	Total	% of Total	Per Unit
Sources of Funds			
Mortgage	\$2,830,000	58.9%	\$78,611
Tax Abatement Paygo Mortgage	\$494,319	10.3%	\$13,731
City of Pelican Rapids Contributions/Reimbursen	\$373,600	7.8%	\$10,378
DEED Workforce Housing Program	\$710,000	14.8%	\$19,722
Equity/Developer Contributions	\$397,203	8.3%	\$11,033
Total Sources of Funds	\$4,805,122	100.0%	\$133,476

Uses of Funds			
Land Acquisition (Special Assessments Only)	\$710,001	14.8%	\$19,722.25
Construction	\$3,350,213	69.7%	\$93,061
Professional Fees	\$154,415	3.2%	\$4,289
Financing Fees	\$114,516	2.4%	\$3,181
Contractor Fee (Developer Fee was eliminated)	\$412,543	8.6%	\$11,460
Contingency	\$33,434	0.7%	\$929
Operating Reserves	\$30,000	0.6%	\$833
Total Uses of Funds	\$4,805,122	100.0%	\$133,476

Number of Units 36

Tax Abatement Assistance for Housing Project
June 11, 2019
Page 5

EXHIBIT B

City of Pelican Rapids, MN
The Colony
36 Unit Residential Apartment Building
Calculation of Annual and Cumulative Tax Abatement by Taxing Jurisdiction
All figures are estimated

Parcels Subject to Abatement: PIDs 760002100040001 and 760002200160004

Property Tax Rates
City of Pelican Rapids, MN 79.0019%
Otter Tail County 40.8349%
School District (SD 548) 14.7866%
Total Pay 2019 Tax Rates 134.621%

Abatement Year	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
% of Construction Completed	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%
Build Year	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033
Assessment Year	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034
Taxes Payable Year	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034	2035
Total Taxable Market Value	\$3,601,750	\$3,621,769	\$3,639,878	\$3,658,077	\$3,676,367	\$3,694,749	\$3,713,223	\$3,731,789	\$3,750,448	\$3,769,200	\$3,788,046	\$3,806,986	\$3,826,021	\$3,845,152	\$3,864,377
Base Tax Capacity	\$71	\$71	\$71	\$71	\$71	\$71	\$71	\$71	\$71	\$71	\$71	\$71	\$71	\$71	\$71
New Tax Capacity	\$45,047	\$45,272	\$45,498	\$45,726	\$45,955	\$46,184	\$46,415	\$46,647	\$46,881	\$47,115	\$47,351	\$47,587	\$47,825	\$48,064	\$48,305
Captured Net Tax Capacity	\$44,976	\$45,201	\$45,427	\$45,655	\$45,883	\$46,113	\$46,344	\$46,576	\$46,809	\$47,044	\$47,279	\$47,516	\$47,754	\$47,993	\$48,234
Annual Abatement															
City of Pelican Rapids, MN	\$35,531	\$35,709	\$35,888	\$36,068	\$36,248	\$36,430	\$36,612	\$36,796	\$36,980	\$37,165	\$37,353	\$37,540	\$37,728	\$37,916	\$38,105
Other Tail County	\$18,692	\$18,786	\$18,880	\$18,975	\$19,070	\$19,165	\$19,261	\$19,358	\$19,454	\$19,552	\$19,650	\$19,748	\$19,846	\$19,944	\$20,042
School District (SD 548)	\$6,650	\$6,683	\$6,717	\$6,751	\$6,784	\$6,818	\$6,852	\$6,887	\$6,921	\$6,956	\$6,991	\$7,026	\$7,061	\$7,096	\$7,131
Combined Total	\$60,873	\$61,178	\$61,485	\$61,794	\$62,102	\$62,413	\$62,725	\$63,041	\$63,355	\$63,673	\$63,995	\$64,316	\$64,638	\$64,960	\$65,282
Cumulative Total Abatement Year to Date															
City of Pelican Rapids, MN	\$35,531	\$71,240	\$107,128	\$143,196	\$179,444	\$215,874	\$252,486	\$289,282	\$326,262	\$363,427	\$376,930	\$376,930	\$376,930	\$376,930	\$376,930
Other Tail County	\$18,692	\$37,478	\$56,358	\$75,333	\$94,403	\$113,568	\$132,829	\$152,187	\$171,641	\$191,193	\$194,827	\$194,827	\$194,827	\$194,827	\$194,827
School District (SD 548)	\$6,650	\$13,333	\$20,050	\$26,801	\$33,585	\$40,403	\$47,255	\$54,142	\$61,063	\$68,019	\$70,547	\$70,547	\$70,547	\$70,547	\$70,547
Combined Total	\$60,873	\$122,051	\$183,536	\$245,330	\$307,432	\$369,845	\$432,570	\$495,611	\$558,966	\$622,630	\$642,304	\$642,304	\$642,304	\$642,304	\$642,304
Present Value of Cumulative Total Abatement Year to Date at 4.85% Rate															
City of Pelican Rapids, MN	\$32,662	\$64,012	\$94,104	\$122,988	\$150,712	\$177,324	\$202,867	\$227,385	\$250,918	\$273,507	\$281,345	\$281,345	\$281,345	\$281,345	\$281,345
Other Tail County	\$17,182	\$33,675	\$49,506	\$64,702	\$79,288	\$93,287	\$106,725	\$119,624	\$132,004	\$143,888	\$145,997	\$145,997	\$145,997	\$145,997	\$145,997
School District (SD 548)	\$6,113	\$11,980	\$17,612	\$23,039	\$28,208	\$33,188	\$37,968	\$42,557	\$46,962	\$51,190	\$52,657	\$52,657	\$52,657	\$52,657	\$52,657
Combined Total	\$55,957	\$109,668	\$161,223	\$210,709	\$258,207	\$303,799	\$347,560	\$389,566	\$429,884	\$468,584	\$480,000	\$480,000	\$480,000	\$480,000	\$480,000

Key Assumptions

1. Taxable market value annual growth assumption = 0.50%
2. Tax rates are assumed to remain constant at Pay 2019 for purpose of preliminary estimates of future tax abatement.
3. Base Taxable Market Value = \$6045
4. Pro-rated value based on 50% of Pay 2019 TMY of parcel number.
5. Assumption for New Taxable Market Value = \$3,601,750 based on 36 units at \$100,164 per unit
6. Present value is based on semi-annual payments.

Present value is calculated based on semi-annual payments, stated rate in the schedule above, and beginning on date of (1/1/2020)

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EXHIBIT C

City of Pelican Rapids, Minnesota

The Colony

36 Unit Residential Apartment Building

Estimated Effective Return on Equity With and Without Tax Abatement Assistance ²

Scenarios	A	B
	Without Tax Abatement	With Tax Abatement
Effective Annual Gross Income before Tax Abatement	\$361,350	\$361,350
Estimated First Year of Tax Abatement after Project Completion		\$60,873
Effective Annual Gross Income After Abatement	\$361,350	\$422,223
Total Costs	\$4,805,122	\$4,805,122
Net Present Value (NPV) of Tax Abatement at 4.0% ¹		\$480,000
Total Costs Less NPV of Tax Abatement	\$4,805,122	\$4,325,122
Effective Return	7.5%	8.4%

Notes:

1/ This amount represents the estimated present value of payments from City (County and School) to the Developer to reimburse costs of constructed the housing, discounted at a rate of 4.65%. A Development Assistance Agreement will need to define the costs to be reimbursed and terms of payment. Total estimated payments to the Developer is \$642,304, payable over a maximum term of 15 years at a rate of 4.65%. The Note will be payable semi-annual with interest pursuant to terms in the Development Assistance Agreement. The Note is payable from tax abatement revenue only and is not a general obligation of the City (County or School). The Note shall terminate after 15 years or when principal is repaid, whichever occurs first. Payment on the TIF Note shall be based on the actual tax abatement revenue collected and will vary from the estimated amounts included here.

2/ All figures are estimated.

Tax Abatement Assistance for Housing Project

June 11, 2019

Page 7

EXHIBIT D

City of Peñon Rapids, Minnesota
The Colony
36 Unit Residential Apartment Building
Review of Developer Pro Forma

	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
Income	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034
Rental Income															
Gross potential (rental and parking)	389,100	396,711	404,473	412,388	420,459	428,690	437,084	445,645	454,374	463,276	472,355	481,613	491,055	500,683	510,502
Less: vacancy (7% rental, 10% parking)	(27,750)	(29,497)	(30,057)	(30,629)	(31,212)	(31,806)	(32,411)	(33,028)	(33,658)	(34,300)	(34,954)	(35,621)	(36,301)	(36,994)	(37,701)
Total rental income	361,350	367,214	374,415	381,759	389,248	396,885	404,673	412,616	420,716	428,977	437,401	445,992	454,754	463,689	472,801
Other income (net)															
Effective gross income	361,350	367,214	374,415	381,759	389,248	396,885	404,673	412,616	420,716	428,977	437,401	445,992	454,754	463,689	472,801
Expenses															
Operating															
Management fee	68,000	70,040	72,141	74,305	76,535	78,831	81,196	83,631	86,140	88,725	91,386	94,128	96,952	99,850	102,856
Property taxes	18,068	18,429	18,797	19,173	19,557	19,948	20,347	20,754	21,169	21,592	22,024	22,465	22,914	23,372	23,840
Replacement reserves	67,485	67,823	68,163	68,504	68,847	69,192	69,538	69,886	70,236	70,588	70,941	71,296	71,653	72,012	72,373
Total expenses	153,552	156,292	159,101	161,983	164,938	167,970	171,081	174,272	177,545	180,905	184,352	187,889	191,519	195,245	199,069
Net Operating Income (NOI)	207,798	210,922	215,314	219,776	224,309	228,915	233,593	238,345	243,171	248,072	253,049	258,103	263,235	268,444	273,733
Plus Tax Abatement reimbursement	60,873	61,178	61,485	61,794	62,102	62,413	62,725	63,041	63,355	63,673	19,665	-	-	-	-
Net Operating Income After Tax Abatement	268,671	272,100	276,799	281,570	286,411	291,328	296,318	301,386	306,526	311,745	272,714	258,103	263,235	268,444	273,733
Debt service															
First mortgage	193,810	193,810	193,810	193,810	193,810	193,810	193,810	193,810	193,810	193,810	193,810	193,810	193,810	193,810	193,810
Tax abatement mortgage	46,504	46,504	46,504	46,504	46,504	46,504	46,504	46,504	46,504	46,504	46,504	46,504	46,504	46,504	46,504
Total Debt Service	240,314	240,314	240,314	240,314	240,314	240,314	240,314	240,314	240,314	240,314	240,314	240,314	240,314	240,314	240,314
Cash Flow After Debt Service	28,357	31,787	36,485	41,256	46,097	51,014	56,004	61,072	66,212	71,431	32,401	17,790	22,921	28,131	33,419
Cash on cash with Tax Abatement (NOI / TDC)	5.59%	5.66%	5.76%	5.86%	5.96%	6.06%	6.17%	6.27%	6.38%	6.49%	5.68%	5.37%	5.48%	5.59%	5.70%
Cash on cash without Tax Abatement (NOI / TDC)	4.32%	4.39%	4.48%	4.57%	4.67%	4.76%	4.86%	4.96%	5.06%	5.16%	5.27%	5.37%	5.48%	5.59%	5.70%
Annual debt coverage	111.80%	113.23%	115.18%	117.17%	119.10%	121.23%	123.30%	125.41%	127.55%	129.72%	113.48%	107.40%	109.54%	111.71%	113.91%
Total development cost (TDC)	4,805,122	4,805,122	4,805,122	4,805,122	4,805,122	4,805,122	4,805,122	4,805,122	4,805,122	4,805,122	4,805,122	4,805,122	4,805,122	4,805,122	4,805,122

Notes:

- 1/ Estimate of real estate taxes by Northland is based on estimate prepared by Northland Securities. Other estimates, unless noted, are based on the Developer's preliminary pro forma as provided to the City.
- 2/ Tax Abatement Mortgage is based on \$494,319 at 4.65% rate.