

Memo

To: April Kroner, Community Development Director
From: Jason Aarsvold and Keith Dahl, Ehlers
Date: June 12, 2019
Subject: Strand Theater Renovation Project – Analysis of TIF Request

The City of Manitowoc (the “City”) received a Tax Increment Financing (TIF) Application from Strand Adventures, LLC requesting TIF in the amount of \$113,750. The developer’s application detailed a proposal for the renovation of the Strand Theater, a 22,500 square foot historic movie theater, into a multi-zone family activity and recreation center (the “Project”) with a total development cost of \$1,392,165.

This memo has been prepared by Ehlers, at the request of the City, to evaluate whether the requested TIF assistance is necessary for financial feasibility and compare it to typical market-based expectations.

Our approach to this analysis treats the Project as if it were an independent income producing real estate venture built by a third-party developer and leased back to the business. The intent is to establish whether the project costs and end sources of funds (rents) would meet typical market returns to attract private financing from a lender and equity from a developer. The table below provides a synopsis of the sources and uses associated with the Project.

SOURCES		
	Amount	Pct.
First Mortgage	972,500	69.86%
Developer Equity	419,665	30.14%
TOTAL SOURCES	1,392,165	100.00%

USES		
	Amount	Pct.
Acquisition Cost	70,000	5.03%
Construction Cost	730,165	52.45%
Professional Services	592,000	42.52%
TOTAL USES	1,392,165	100.00%

For this transaction, we assumed the developer would provide 30 percent equity in order to obtain debt financing for the remaining 70 percent of project costs. A developer investing this amount of equity for this type of project would anticipate receiving an annual 10 percent Cash-on-Cash (“COC”) return. A 10 percent COC is an industry standard for this type of project and is simply the annual net cashflow from the project (after expenses and debt service) divided by the initial equity investment.

Based upon the total development costs and assumed financing for the Project, a business would need to pay a lease rate of approximately \$6.25 per square foot without any TIF assistance for a developer to achieve a 10 percent COC return. Lease rates for this type of space in the City range between \$5.00-\$6.00 per square foot depending on configuration, age, and size. The lease rate a developer would need to charge the business without TIF assistance is generally higher than the market rate.

If we assumed a lease rate of \$6.00 per square foot, which is at the higher end of the market range, it appears providing TIF assistance over a 11-year period would be sufficient to achieve a COC return on investment average of just over 10%. Based on the City's TIF projections, 11 years of TIF payments totals approximately \$70,000, assuming payment of 95% of the tax increment annually.

Based on our review of the Project and market trends, we conclude providing TIF assistance in the amount of \$70,000 will help facilitate the project and not unduly enrich the Developer. We recommend you provide this assistance in the form of a Pay-As-You-Go (PAYGO) note. Pay-As-You-Go TIF requires the Developer to seek its own financing secured by all or a portion of the tax increments generated by the project. In this scenario, the City does not provide the funding up front, but enters into an agreement to provide tax increment payments from the increased taxes from the project up to a specific dollar amount over a pre-determined period of time. The developer assumes the risk of repayment in this scenario.

Should you have any questions, please do not hesitate to contact either of us at 651-697-8512 or 651-697-8595.