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MEMORANDUM – FOR SEPTEMBER 4, 2018 CITY COUNCIL MEETING

TO:	Members of the City Council Chris Heineman, Community Development Director Nate Carlson, Economic Development Coordinator
FROM:	Mikaela Huot, Vice President/Consultant
DATE:	September 4, 2018
SUBJECT	Public Hearing Regarding Proposed Establishment of Tax Increment Financing (Economic Development) District (Strobel & Werner Holdings – Aurora Pharmaceutical Expansion Project)

Summary

On Tuesday, September 4, the City Council will hold a public hearing regarding the proposed establishment of a Tax Increment Financing (Economic Development) District and approval of the Tax Increment Financing Plan for the Strobel & Werner Holdings – Aurora Pharmaceutical Expansion Project. The purpose of establishment of the proposed Tax Increment Financing (TIF) District is to assist with the construction of an approximately 25,000 square foot 3-story expansion to an existing building. The City anticipates selling property to the business to allow for additional space for installation of improvements and facilitate subsequent construction of the building expansion. There are significant site improvement costs associated with the proposed expansion. This project will accommodate Aurora Pharmaceutical's business growth in the community. In addition to building construction costs, the project will include the construction of a retaining wall, transformer relocation, relocation and construction of a pond, and moving utility easement.

Background:

The business submitted a request for TIF assistance related to the proposed construction of an approximate 25,000 square foot building expansion. We have been provided with an estimated taxable value of the building expansion of approximately $1,128,500 as incremental value. Assistance has been requested for financing a portion of the costs associated with construction of the project. The business has proposed the approximate $1.7 million project will be funded by a combination of debt and equity private financing and City assistance of approximately $231,336 to fill the gap. The business' submitted information provides that the request for assistance would be pay-as-you-financing as reimbursement for extraordinary development costs. The business has indicated the receipt of City financial assistance is necessary for the project to proceed to finance a portion of the project costs.

Tax Increment Revenue Assumptions

- Economic Development TIF District
  - Maximum term of 9 years
  - 10% withheld for administrative expenses
- Base value of land
  - PID: 22.01.3.02.001
  - Payable 2019 land and building value: $4,935,900
- New incremental building value captured
  - Estimated total value of $1,128,500 (provided by County)
- Construction commences in 2018
  - Construction 25% complete by December 31, 2018 and 100% complete by December 31, 2019
  - 25% assessed in January of 2019 for taxes payable in 2020 and
  - 100% assessed in January 2020 for taxes payable in 2021
- 2018 tax rates remain constant through term (Rates Provided by Rice County)
  - City : 57.164%
  - County: 40.264%
  - School: 33.023%
  - Other: 3.403%
  - Total 133.854%
- Class rates remain constant through term
  - Commercial-industrial
  - 1.5% value up to $150,000 and 2% value above $150,000
- 2% annual market value inflator assumed

Aurora Pharmaceutical Expansion	Tax Increment
Estimated Gross Revenues	$267,183
City Retained Amount	$26,719
Estimated Net Revenue available for project costs	$240,464
Total Present Value Revenue 5% discount rate	$179,420
Requested Amount of Assistance	$231,336
Total Estimated Principal Amount of TIF Note	$169,939
Total Estimated Interest on TIF Note	57,040
Estimated Total Assistance Provided	$226,979

The estimated gross revenues in the chart above represent the projected total amounts available to the City for the proposed term. The City has the ability to withhold up to 10% of the projected tax increment revenues for administrative or other eligible expenses of the district; therefore, the projected total net revenues of the TIF District equal 90% of the gross amount. It is important to note the projections include the payable 2018 tax rate. For tax increment districts, the current tax rate at the time of district establishment is 'frozen' for the life of the district. To the extent that tax rates increase in future years, the property owner pays the amount that is generated by the actual tax rate however the amount of tax increment generated would be limited by the frozen tax rate, thus creating 'excess increment' that is held by the County for redistribution to the local taxing entities. Conversely, should future tax rates decrease, the property owner pays the amount due based on actual tax rates, resulting in lower taxes paid and lesser amount of tax increment revenue generated. Any adjustments to future market values of properties within a TIF District are not limited and may result in increased or decreased taxes.

All revenues derived from a tax increment district shall be used in accordance with the tax increment financing plan. Typical eligible costs of economic development tax increment districts include acquisition, demolition, site preparation, public improvements including utilities such as water, storm water, and sewer, streets and sidewalks, foundations and footings, parking and related administrative expenses. Additional costs may be reviewed to be determined as eligible for reimbursement with tax increment revenues.

Project Financing

There are generally two ways in which assistance can be provided for most projects, either upfront or on a pay-as-you-go basis. With upfront financing, the City would finance a portion of the business's initial project costs through the issuance of bonds or as an internal loan. Future tax increment would be collected by the City and used to pay debt service on the bonds or repayment of the internal loan. With pay-as-you-go financing, the business would finance all project costs upfront and would be reimbursed over time for a portion of those costs as revenues are available.

Pay-as-you-go-financing is generally more acceptable than upfront financing for the City because it shifts the risk for repayment to the business. If tax increment revenues are less than originally projected, the business receives less and therefore bears the risk of not being reimbursed the full amount of their financing. However, in some cases pay as you go financing may not be financially feasible. With bonds, the City would still need to make debt service payments and would have to use other sources to fill any shortfall of tax increment revenues. With internal financing, the City reimburses the loan with future revenue collections and may risk not repaying itself in full if tax increment revenues are not sufficient. The business' financial information includes pay-as-you-go financing as annual reimbursement, which significantly limits any financial exposure to the City. The business would only be reimbursed for actual incurred project costs, subject to availability of revenues, and based on terms of an agreement between the City and business.

Reviewing Need for Financial Assistance

There are several methods available to determine if a project would proceed "but for" the assistance. An analysis comparing the rates of return with and without assistance is a common method used to analyze the "but for" test. However, in some cases, a review of the project's sources and uses of funds and operating cash flow performance is done to determine if an operating gap exists or if the project performance is not expected to meet minimum financing requirements and assist with determining that a project meets the "but for" test. If, following the review, it is determined that the project has a shortage of debt, cash, and/or equity based on the projected value of the project upon completion and net operating income available to support debt service, it can be determined that the project would not proceed "but for" the assistance.

Conclusion

The City has received an application for tax increment financing assistance that involves the construction of an expansion to an existing building in the City. The applicant has provided financial information related to the construction of the project indicating that financial assistance is necessary to provide financial feasibility and allow for the project to occur. With assistance the project is expected to generate returns that the business has indicated are sufficient to allow the project to proceed with tax increment necessary to obtain financing and allow the project to proceed. Generally, an overall reduction in project costs, and/or increase in revenues may assist with achieving greater market feasibility and potentially reduce the need for tax increment financing assistance.

Prior to establishing a TIF District, a finding must be made that the project will not proceed as proposed without the use of tax increment financing, referred to as the 'but-for' test. Following review of the information provided by the business including the application for tax increment assistance, a determination will be made that the portion of project costs proposed to be financed by tax increment revenues of the TIF District cannot be supported by the new project solely, thus requiring the need for tax increment assistance.

A TIF District must be established within a Project Area. The boundaries of the Tax Increment Financing District (TIF District) are within the City's existing Master Development District. Multiple steps need to be followed to establish a tax increment financing district, including notifications to the County and School District, publication of a public hearing notice, and the holding of a public hearing. Also included in the establishment process is the work session to discuss the draft TIF Plan for the TIF District. Publication of the hearing notice for the TIF District creation will be included in the Wednesday, August 22 Northfield News newspaper. The public hearing to consider this project is Tuesday, September 4, 2018. The public hearing date is the time in which City Council would take any public comment, and after the hearing, consider the adoption of a resolution approving the TIF District and Project Area.

The proposed assistance also constitutes as a business subsidy with additional requirements as defined in the Tax Increment Development Agreement between the City and of Northfield and Strobel & Werner Real Estate Holding Company, LLC.

Attachments: Project Qualifications: Definition of Economic Development Districts

Tax Increment Financing (TIF) District – Economic Development

Tax Increment Financing (TIF) uses the increased property taxes generated by new real estate development within a tax increment financing district to pay for certain eligible costs associated with the development. The value that is "captured" (i.e., the increase in value over the year the TIF district was established) generates property taxes. These "incremental" taxes go to the development authority or the city authority rather than to the city, county, school district, or other taxing jurisdictions that normally share in the total property tax bill

For our preliminary analysis we anticipate that the proposed project would qualify under the Tax Increment statute as an economic development district and the project is in the public interest because:

- It will discourage commerce, industry, or manufacturing from moving their operations to another state
- It will result in increased employment
- It will result in preservation and enhancement of the tax base

Revenue derived from tax increment from an economic development district may not be used to provide improvements, loans, subsidies, grants, interest rate subsidies, or assistance in any form to developments consisting of buildings and ancillary facilities, if more than 15 percent of the buildings and facilities (determined based on square footage) are used for a purpose other than:

- the manufacturing or production of tangible personal property, including processing resulting in the change in condition of the property;
- warehousing, storage, and distribution of tangible personal property, excluding retail sales;
- research and development related to the activities listed in clause (1) or (2);
- telemarketing if that activity is the exclusive use of the property;
- tourism facilities;
- space necessary for and related to the activities listed in clauses (1) to (5) or
- a workforce housing project that satisfies the requirements.