

MEMORANDUM

To: Mayor and City Council, City of Webster Groves

From: Larry Marks & Katie Medlin, Development Strategies

Date: June 18, 2021 (revised September 28, 2021)

Subject: Douglass Hill TIF Pro Forma Analysis

EXECUTIVE SUMMARY

SG Collaborative has submitted a revised pro forma that shows the impact of TIF incentives on the proposed redevelopment project located adjacent to Downtown Old Webster. This analysis shows that the project, with TIF assistance, would generate generally acceptable financial returns that would attract investment.

General Site Economics

- SG Collaborative is requesting a TIF for infrastructure with an approximate value of \$35 million, as of this analysis. This TIF amount represents roughly 11 percent of total costs, which is lower than most developments that require significant land assemblage. These funds will then be allocated to the construction of new infrastructure in the Douglass Hill District. Without this investment in public infrastructure, it is unlikely that that the District could attract significant private investment or result in a change of use that would generate fiscal benefit to the City of Webster Groves. As the plans may change through the review process, the amount of assistance may change as well.
- In addition to the TIF, the Developer plans to introduce a CID that will include a one percent sales tax on all retail sales in the District.
- The Developer may elect to utilize other economic development tools, including a special assessment imposed by the CID, to provide “tax certainty” for owners and lessees within the project, but the assessments would not materially impact the amount of TIF requested.
- The current pro forma does not include any consideration for workforce housing as part of its total 614 apartment units at this time. Using traditional financing vehicles, the inclusion of workforce housing would further reduce the financial returns for the project due to the lower rents that workforce housing achieves. The development team is aware that workforce housing will be required, and is exploring other financing vehicles and partnerships to facilitate that without further impacting the project’s feasibility.
- The current pro forma includes the costs to acquire a new fire truck that will be capable of serving seven story buildings. In addition, the costs to acquire the existing Webster Groves School District property and construct a new storage facility are included. The pro forma assumes that the school district will provide the property on which the new structure would be built.
- The Developer’s pro forma shows the overall XIRR—which is an Excel function calculating the internal rate of return with cash flows assigned to specific dates and typically gives a more accurate result than a standard internal rate of return calculation (IRR)—of the project with TIF is roughly ten percent. This rate of return is on the low end of what is considered acceptable. The Developer has stated that they and their

investors are willing to accept the return.

- Without TIF, the project is expected to have an XIRR of 1.6 percent, per the Developer's pro forma.

DISCLAIMER OF LIABILITY FOR ANY INACCURACIES CONTAINED HEREIN

These projections are based on currently available information and assumptions, in the form of a pro forma provided by the Developer. Development Strategies (“DS”) believes they constitute a reasonable basis for its preparation. **These projections are not provided as predictions or assurances that a certain level of performance will be achieved.** The actual results will vary from these projections and those variations may be material. Because the future is uncertain, there is risk associated with achieving the results as described herein. **DS assumes no responsibility for any degree of risk involved.** Neither this document nor its contents may be relied upon for the following purposes: any official statement for a bond issue and/or consummation of a bond sale, any registration statement, prospectus, loan, or other agreement or document related to bond issuance, without prior review and written approval by DS. The above list is provided as an example and is not meant to be exhaustive.

DS neither verified nor audited the information that was provided by other sources. **Information provided by others is assumed to be reliable, but DS assumes no responsibility for its accuracy or certainty.**

INTRODUCTION

To forecast the future financial performance of a development project, a developer typically creates a pro forma that details the costs to develop and operate a project, along with the expected revenues from ongoing operations and the eventual sale of a property. Typically, the pro forma will be forecasted over multiple years, ending at the eventual disposition or sale of the property. Periodic cash flows are then analyzed to determine the internal rate of return, or IRR. A host of assumptions are included in a pro forma to forecast this future financial performance.

The purpose of this memo is to generally review the submitted revised pro forma for the Douglass Hill project, and opine on the estimated financial returns of the project. This memorandum will describe the key assumptions, issues, and methods that are used to estimate the financial returns for each Redevelopment Project Area and the project as a whole.

This memo is focused on the Developer's estimate of financial feasibility of the proposed project and the need for the requested development incentives. The memorandum does not include analysis of financial feasibility of development that may occur on parcels that may be sold to other developers, such as the office or townhome sites.

KEY ASSUMPTIONS

Program

The Developer proposes the following program, which is included in the pro forma analysis:

DEVELOPMENT PROGRAM

	RPA 1	RPA 2	RPA 3	TOTAL
Office (SF)	-	117,700	-	117,700
Restaurant (SF)	4,225	12,150	6,875	23,250
Retail (SF)	4,225	12,150	6,875	23,250
Apartments (Units)	418	108	88	614
Condos (Units)	48	-	48	96
Townhomes (Units)	16	-	-	16
Parking	669	173	211	
Projected Commencement*	2021	2023	2024	
Projected Completion	2023	2024	2025	

**Denotes the commencement of the 23-year TIF period only.*

The Developer expects to sell the parcels intended for the development of the office and townhome components to other developers who specialize in those product types. These property sales are reflected in the Developer's pro forma. In addition, it should be noted that the pro forma assumes that all residential units will be market rate.

Construction Assumptions

SG Collaborative has assumed that the construction of the main infrastructure components will take approximately one year. The development of the apartment/condominium components for each RPA will last roughly 1.5 years from the commencement of construction. Additionally, it is assumed that the office building construction will last around 1.5 years. These timelines appear to be in line with similar projects in the area.

The pro forma assumes that construction costs will be spread equally across the assumed months to build each component. In reality, it is likely that the construction costs will fluctuate monthly. This has a minor impact on the overall estimated returns.

Cost Assumptions

The Developer has provided high-level cost estimates for various components of the project, including the land acquisition, hard construction costs, soft construction costs, and interest reserve costs. Below is a table describing the high-level costs by RPA:

TOTAL PROJECT COST (in 2021 Dollars)					
ITEM	INFRASTRUCTURE COSTS (IN MILLIONS)	RPA 1 PROJECT COSTS (IN MILLIONS)	RPA 2 PROJECT COSTS (IN MILLIONS)	RPA 3 PROJECT COSTS (IN MILLIONS)	TOTAL PROJECT COSTS (IN MILLIONS)
INFRASTRUCTURE	\$31.8	\$0.0	\$0.0	\$0.0	\$31.8
ACQUISITION	\$20.2	\$0.0	\$0.0	\$0.0	\$20.2
OFFICE*	\$0	\$0.0	\$39.4	\$0.0	\$39.4
APARTMENTS/CONDOS/ TOWNHOMES*	\$0	\$136.5	\$31.7	\$56.6	\$224.8
INTEREST RESERVE	\$2.0	\$3.4	\$0.8	\$1.4	\$7.6
TOTAL	\$54.0	\$139.9	\$71.9	\$58.0	\$323.8
TOTAL TIF REQUESTED					\$35.0
RATIO OF TIF TO PROJECT COST					10.8%

Please note that for the calculations of the returns of each individual RPA, the land acquisition costs are allocated amongst each individual RPA. For the calculation of the overall project return, the land acquisition cost is assumed to be part of the initial infrastructure work.

Apartment Operations & Sales

In order to estimate the future financial returns, the pro forma includes an estimate of the expected revenues and costs to operate the project, along with an estimate of the net proceeds of the sale of any portion of the project in the future. The future sales price is based on an estimate of the future net operating income of the property, divided by a capitalization rate.

The Developer has assumed gross rents for market rate units in the District ranging from \$2.25 to \$2.39 per square foot, to account for construction of the later phases of the apartments. All apartment units in the development pro forma are assumed to be market rate at this time, but the Developer is aware of the City's desire for workforce housing and intends to incorporate those costs into the pro forma. While the addition of workforce housing—and the lower rents it generally entails—will negatively impact the returns of the project, the Developer is exploring financing structures and partnerships that would allow the inclusion of the workforce housing while maintaining the overall profitability of the project.

In addition, the Developer has assumed a lease-up rate of 20 units per month for all of the units. Once stabilized, it is assumed that the property will consistently be 95% occupied. These assumptions are in line with similar higher-end developments in the area.

The Developer has assumed operating expenses totaling roughly 35 to 37 percent of the effective gross apartment rental income. While on the higher side, this is not out of line with similar properties.

Finally, the pro forma includes an assumed 5.25 percent capitalization rate, which is used to calculate the eventual sales price of the property based on the net operating income. At present, multifamily properties are trading at about five percent according to information provided by Stifel Nicolaus. The Developer states that it has no plans to sell the apartments, so the capitalization rate is only a reference point.

Retail Operations & Sales

For the retail portion of the project, the Developer has assumed rents of \$25 per square foot, which is reasonable for the type of development proposed. The project further assumes that it will take eight to fifteen months to fill retail spaces once they are completed. Once occupied, it is assumed that the retail spaces will remain at 95 percent occupancy.

It is assumed that the cost to operate the retail space will claim nearly 33 percent of the effective gross retail income once stabilized. The pro forma assumes an exit capitalization rate of 5.25 percent. Retail and office properties, when leased by strong, national brands, can trade between 5.5 and 6.5 percent according to information provided by Stifel Nicolaus.

Condominium Sales

SG Collaborative assumes that the average sales price per condominium would be roughly \$690,000. It is assumed that around 62 percent of the units will be pre-sold, or sold within the first few months of completion. After that initial completion, approximately one unit will be sold per month.

Townhome Parcel Sale

At this point in time, SG Collaborative is exploring selling the townhome parcel to a developer that specializes in that product type. They assume that the parcel will sell for \$640,000, or \$40,000 per projected townhome unit. Assuming that the land cost represents between 9 and 11 percent of the eventual sales price, this would translate

into an ultimate sales price of approximately \$350,000 to \$450,000 per townhome, which seems reasonable given similar properties in the area.

Office Parcel Sale

In addition to the townhome parcel, it is assumed that a developer who specializes in office building development will purchase the office parcel. Based on current market conditions for prepared sites suitable for office development, SG Collaborative assumes that the parcel will sell for roughly \$4.2 million, which is roughly ten percent of the projected total development cost.

Financing Assumptions

The Developer assumes that equity contributions for various portions of the development will run between 27 and 35 percent of total development costs, which is a reasonable range for the variety of products that are proposed for the development.

Divestment Assumptions

SG Collaborative is currently projecting that all of the buildings that they construct directly will be sold by the middle of 2029.

KEY CONSIDERATIONS

Because the proposed development requires significant investment of roughly \$54 million in infrastructure and land costs, it is assumed that the entirety of the proposed TIF amount of \$35 million will be allocated to those costs. In calculating the impact of the TIF on the overall financial feasibility of the project, it is important to remember that these significant costs, which will be contemplated concurrently with RPA 1, allow for the development of the entire area. Thus, the Developer has elected to calculate the individual returns for each RPA without allocating those infrastructure costs to a single project area.

The impact of the infrastructure costs is shown in the calculation of the overall return of the entire project, which is roughly ten percent. This return is on the lower side of acceptable, and the Developer has indicated that they and their investors are willing to accept it.

OVERALL PRO FORMA FINDINGS

RPA 1

The overall IRR for RPA 1, including the cost of land but excluding the impact of infrastructure costs, is roughly 7.2 percent on an annual basis. This return is low for equity investment as a standalone project, but returns on the subsequent RPAs should also be considered. Please note that in the table on page 5, the land costs are included in the infrastructure column due to the method used to calculate the overall returns of the project. The annualized calculations use the standard IRR function in lieu of the more accurate XIRR function utilized by the Developer. The Developer's pro forma shows an overall XIRR of 7.5 percent on a monthly basis.

RPA I		2021	2022	2023	2024	2025	2026	2027
Project Costs (Does not include Interest Reserve)	\$	-	\$ 80,145,135	\$ 61,474,573	\$ 1,934	\$ -	\$ -	
Projected Cash Flow After Debt Service (Does not include Infrastructure Costs)								
Project Inflow	\$	-	\$ -	\$ 1,275,057	\$ 7,655,483	\$ 2,502,084	\$ 2,797,382	\$ 48,577,981
Project Outflow	\$	-	\$ (46,355,083)	\$ -	\$ -	\$ -	\$ -	\$ -
Combined Cash Flow After Debt Service	\$	-	\$ (46,355,083)	\$ 1,275,057	\$ 7,655,483	\$ 2,502,084	\$ 2,797,382	\$ 48,577,981
IRR		7.2%						

RPA 2

The overall IRR for RPA 2, including the cost of land but excluding the impact of infrastructure costs, is roughly 10.1 percent on an annual basis. This return is within the acceptable range for investment. Please note that in the table on page 5, the land costs are included in the infrastructure column due to the method used to calculate the overall returns of the project. The Developer's pro forma shows an overall XIRR of 10.5 percent on a monthly basis.

RPA II		2021	2022	2023	2024	2025	2026	2027	2028
Project Costs (Does not include Interest Reserve)	\$	-	\$ -	\$ 20,567,203	\$ 18,047,082	\$ -	\$ -	\$ -	\$ -
Projected Cash Flow After Debt Service (Does not include Infrastructure Costs)									
Project Inflow	\$	-	\$ -	\$ -	\$ -	\$ 576,177	\$ 817,320	\$ 886,561	\$ 19,832,956
Project Outflow	\$	-	\$ -	\$ (13,922,772)	\$ -	\$ -	\$ -	\$ -	\$ -
Combined Cash Flow After Debt Service	\$	-	\$ -	\$ (13,922,772)	\$ -	\$ 576,177	\$ 817,320	\$ 886,561	\$ 19,832,956
IRR		10.1%							

RPA 3

The overall IRR for RPA 3, including the cost of land but excluding the impact of infrastructure costs, is roughly 18.5 percent on an annual basis. This return is within the acceptable range for investment. Please note that in the table on page 5, the land costs are included in the infrastructure column due to the method used to calculate the overall returns of the project. The Developer's pro forma shows an overall XIRR or 18.9 percent on a monthly basis.

RPA III		2021	2022	2023	2024	2025	2026	2027	2028	2029
Project Costs (Does not include Interest Reserve)	\$	-	\$ -	\$ -	\$ 24,834,894	\$ 35,211,562	\$ -	\$ -		
Projected Cash Flow After Debt Service (Does not include Infrastructure Costs)										
Project Inflow	\$	-	\$ -	\$ -	\$ -	\$ 1,962,242	\$ 9,168,684	\$ 1,589,123	\$ 866,498	\$ 16,505,880
Project Outflow	\$	-	\$ -	\$ -	\$ (16,664,693)	\$ -	\$ -	\$ -	\$ -	\$ -
Combined Cash Flow After Debt Service	\$	-	\$ -	\$ -	\$ (16,664,693)	\$ 1,962,242	\$ 9,168,684	\$ 1,589,123	\$ 866,498	\$ 16,505,880
IRR		18.5%								

Overall Project

The pro forma for the overall project includes the impact of the infrastructure spending. The construction of this significant infrastructure, combined with the relatively high purchase cost for land, have a significant impact on the pro forma. With TIF, the Developer is reporting an XIRR return of roughly ten percent for the total project, which is within the targeted 10 to 15 percent return.

Please note that the Developer's pro forma for the entire project assumes that the land purchase is part of the overall infrastructure portion of the project. Thus, the overall cost of the entire project is slightly different because of the way in which the pro forma treats the timing and financing of that land purchase. **Including infrastructure costs**, the return of the overall project is roughly 9.2 percent on an annual basis. The Developer's pro forma shows an overall XIRR of 9.9 percent on a monthly basis.

TOTAL TIF										
	2021	2022	2023	2024	2025	2026	2027	2028	2029	
Project Costs (Does not Include Interest Reserve)	\$ 25,838,880	\$ 98,258,055	\$ 75,119,878	\$ 39,473,567	\$ 35,211,562	\$ -	\$ -	\$ -	\$ -	\$ -
Projected Cash Flow After Debt Service (Does not Include Infrastructure Costs)										
Project Inflow	\$ -	\$ -	\$ 2,048,820	\$ 7,853,603	\$ 5,036,298	\$ 14,981,572	\$ 57,721,085	\$ 25,482,643	\$ 18,002,888	
Project Outflow	\$ (16,948,483)	\$ (42,829,322)	\$ (11,386,852)	\$ (15,603,178)	\$ -	\$ -	\$ -	\$ -	\$ -	
Combined Cash Flow After Debt Service	\$ (16,948,483)	\$ (42,829,322)	\$ (9,338,032)	\$ (7,749,574)	\$ 5,036,298	\$ 14,981,572	\$ 57,721,085	\$ 25,482,643	\$ 18,002,888	
IRR	9.2%									

Without TIF, the project is forecast to have an IRR of 1.5 percent on an annual basis. At this rate, the project would not be feasible. The Developer's pro forma shows an overall XIRR of 1.6 percent on a monthly basis.

TOTAL TIF										
	2021	2022	2023	2024	2025	2026	2027	2028	2029	
Project Costs (Does not Include Interest Reserve)	\$ 25,838,880	\$ 98,258,055	\$ 75,119,878	\$ 39,473,567	\$ 35,211,562	\$ -	\$ -	\$ -	\$ -	\$ -
Projected Cash Flow After Debt Service (Does not Include Infrastructure Costs)										
Project Inflow	\$ -	\$ -	\$ 2,048,820	\$ 7,853,603	\$ 5,036,298	\$ 14,981,572	\$ 57,721,085	\$ 25,482,643	\$ 18,002,888	
Project Outflow	\$ (25,838,880)	\$ (68,938,925)	\$ (11,386,852)	\$ (15,603,178)	\$ -	\$ -	\$ -	\$ -	\$ -	
Combined Cash Flow After Debt Service	\$ (25,838,880)	\$ (68,938,925)	\$ (9,338,032)	\$ (7,749,574)	\$ 5,036,298	\$ 14,981,572	\$ 57,721,085	\$ 25,482,643	\$ 18,002,888	
IRR	1.5%									

CONCLUSION

Overall, the proposed Douglass Hill redevelopment project has a positive pro forma. While the current overall return with TIF is on the lower side of acceptable, the Developer has expressed that they are comfortable with that level of return.