

Agenda

Minnetonka City Council and Economic Development Advisory Commission

Special Meeting, Monday, August 14, 2017

**5:00 P.M.
Council Chambers**

1. Call to Order
2. Roll Call:
 - A. City Council: Acomb-Wiersum-Bergstedt-Wagner-Ellingson-Allendorf-Schneider
 - B. EDAC: Happe-Isaacson-Jacobsohn-Johnson-Johnston-Knickerbocker-Yunker
3. Business Items:
 - A. Shady Oak Road Redevelopment financial requests
Recommendation: Review and provide feedback
4. Adjournment

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Joint City Council and Economic Development Advisory Commission
Agenda Item #3A
Meeting of August 14, 2017

Brief Description	Shady Oak Redevelopment financial requests
Recommendation	Review and provide feedback

Background

In March 2015, the city purchased the properties at 4312 Shady Oak Road and 4292 Oak Drive Lane as a result of Hennepin County's Road Reconstruction project on Shady Oak Road. The city currently owns and manages the commercial building at 4312 Shady Oak Road and a residential building at 4292 Oak Drive Lane.

To prepare for redevelopment, the city hosted a series of meetings to gain input on development of the properties from January to April of 2016. The residents and business owners surrounding the project site in both Minnetonka and Hopkins were invited to three neighborhood meetings to introduce the project and gather issues/concerns/expectations from the surrounding neighborhood. In addition to the meeting with the neighborhood, the city hosted a developer's roundtable for an invited group of developers to gauge interest and ideas on redevelopment options. Lastly, a project update was given at a city council meeting regarding development options for the property. The complete meeting notes are posted on the city's website here: <http://eminnetonka.com/current-projects/planningprojects/1490-shady-oak-rd-redevelopment>

With the input of the neighborhood and the development community, the city solicited interest from developers for potential options for redeveloping the 4312 Shady Oak Road (commercial) property. The solicitation for developers did not identify only housing, but indicated the city's willingness to include commercial, retail, and/or residential. The goal of the process was to prepare and form a feasible redevelopment plan that would be reviewed by the city, neighborhood and local stakeholders.

On November 14, 2016, the city council conducted developer interviews and selected Ron Clark Construction to continue negotiations. The city is currently engaged in negotiations with Ron Clark to redevelop the property. The negotiations are not complete and no agreement has been established with the developer. However, the developer formally submitted its land use application on July 24 and requested city and Economic Development Authority (EDA) financial assistance.

Redevelopment Plan Overview

Ron Clark Construction is proposing a 49-unit, three-story building with a flat roof and two-story components at each end, located at 4312 Shady Oak Road (commercial site). The developer has provided a number of iterations of a site plan as well as changes to the architectural plans. The city council packet will include the revised concept plans that were received July 24, 2017. The proposed redevelopment project includes:

- Three-stories over structured parking
- Resident community room, exercise room, onsite manager, outdoor play area
- 100 percent workforce housing with income levels at 60% Area Median Income (AMI), with rent limitations at 50% AMI for the first 10 years. After 10 years, 100 percent of the units will have rents that have rent limitations at 60% AMI for the remaining 20 years of the affordability period.
- Mix of one, two and three bedroom units
- Rents between \$800 and \$1200 per month (cap of 30% of income on household rent payment)
- Supports workforce housing for local employees such as retail, administration, and health care positions.

EDAC Subcommittee Feedback

On August 1, 2017, Economic Development Authority Commission (EDAC) Commissioners Isaacson, Yunker, and Jacobsohn met as a subcommittee to review the assistance request of \$1.379 million in tax increment pooling as a deferred loan, referencing the attached Council Policy 2.14 on TIF pooling assistance as a guide. The EDAC subcommittee expressed that the request for assistance was reasonable and concluded that it met the following criteria:

- The project supports reinvestment in an identified village center and addresses the goals set out in the comprehensive plan;
 - A comprehensive plan modification is required as part of the development request.
- The project is in a high priority “village area” as identified in the Comprehensive Guide Plan.
- The project includes affordable housing units, which meets the city’s affordable housing standards; and overall affordability is greater than 20% of the units.
 - The developer is proposing that all 49 units are affordable at 60% of AMI.
- If the proposed project receives funds from other sources, the pooled dollars would be the last source utilized unless it impacts other sources.
- “But for” city assistance, the project would not occur.

In addition, commissioners requested that staff analyze the available cash flow of the project to determine if there would be any additional cash flow available to repay the deferred loan over time. A summary of the cash flow analysis is provided in the attached memo from Ehlers, the city’s financial consultant.

City Financing Request

The city's legal counsel, Julie Eddington at Kennedy & Graven, drafted the attached term sheet that was developed based upon the requests for city assistance by the developer. This term sheet will be used as a guide in the drafting of a redevelopment agreement, which will be reviewed by the full EDAC and city council at future meetings. Additionally, the city's financial advisor at Ehlers, Stacie Kvilvang, reviewed the financial request. Both Ms. Eddington and Ms. Kvilvang will be available at the meeting to provide an overview and analysis of the financial request.

Highlights of the term sheet are listed below:

Purchase of Land

The developer will purchase the land on or before August 31, 2019 at a price of \$734,400. The purchase price is consistent with the appraised value of the property.

Requested Financing Assistance from City and EDA

The developer has asked the city to consider a deferred loan not to exceed \$1.379 million to assist with financing. Staff is proposing utilizing TIF pooling dollars from the Boulevard Gardens TIF district as the source of funding for this request. Ms. Kvilvang reviewed this request and prepared the attached memo that includes analysis of the request and a recommendation. The following is a summary of Ehlers' recommendation that is included in the memo:

- Provide up to \$1.209 million (rather than \$1.379 million) in TIF pooling assistance, structured as a deferred loan with a cash flow note.
- After repayment of the deferred developer fee potentially to occur in year six, allow the first \$30,000 of cash flow to be paid to the developer, whereby the city would collect 50% of available cash flow thereafter through the term of the note.
- Overall, the city should not assume that repayment on the note will happen over time. Under these terms, if the project performs better than anticipated, the city will receive repayment on the note sooner than anticipated.

The assistance requested from the developer would result in a per unit cost of approximately \$822 per year over a 30 year affordability period based on total assistance of \$1.209 million. The per unit assistance on previously approved housing redevelopment projects ranges from \$673 per unit/per year to \$3,968 per unit/per year.

The developer also indicated it would like to apply for grant funding through the Metropolitan Council's Livable Communities Demonstration Account (LCDA), to assist with project costs and seek other equity sources that do not impact Minnesota Housing Finance Agency (MHFA) tax credit scoring. Any grant assistance received would be utilized to reduce the amount of city assistance.

Demolition and Cleanup

The developer intends to coordinate with the city on the submission of a grant application to assist with the funding for the costs of demolition and contamination clean-up on the site. Any grant applications that would be made to the Department of Employment and Economic Development/Hennepin County/Metropolitan Council must be approved through a resolution of support by the city council. If grants are not obtained for such costs, the city and developer will work cooperatively to review and modify the project budget in order to pay for the demolition and clean up.

Income and Rent Restriction Covenants

Given that the developer is requesting TIF pooling assistance and utilizing tax credit financing through the MHFA, there are certain income and rent restriction requirements the developer must follow. The developer is proposing to make all 49 units affordable to those at 60% AMI or less. Historically, it has also been the city's position to also require that the rent limits on those affordable units also be set at 50% of AMI. Additionally, it has historically been the city's position to require a minimum of 30 years of affordability. Both of these items are called out on the term sheet.

As an example, rents are anticipated to be \$800 - \$1,200 per month (depending on the size of the unit). At 60% AMI, the maximum estimated annual income allowable for one person is approximately \$36,000 (\$17.30/hourly). For a four-person household, the estimated annual income allowable is approximately \$51,000 (\$24.50/hourly). In similar developments in Minnetonka, residents indicated employment in retail, administrative, and health professional careers.

Land write-down

In addition to the deferred loan for TIF pooling, staff is proposing to write down the cost of the land for the developer in the amount of \$515,889. Staff is proposing that the city be reimbursed with TIF pooled funds from Boulevard Gardens. This will assist the city in recuperating costs relating to the purchase and carrying costs of the land.

Upcoming Meetings

- August 24, 2017 Planning Commission meeting to review land-use request
- September 7, 2017 EDAC Special Meeting to review development agreement
- September 25, 2017 City Council/EDA Meeting to final action on requests

Recommendation

The proposed project will help meet the city's affordable housing goals outlined in the 2008 Comprehensive Guide Plan, the city's 2011-2020 affordable housing goals, and new housing construction needs identified in the Southwest Corridor Housing Strategy.

Staff is requesting that the EDAC and city council review the term sheet and financial request and provide feedback to staff. An introduction of the land-use related requests will follow the joint EDAC and city council meeting at a regular council meeting.

Submitted through:

Julie Wischnack, AICP, Community Development Director
Merrill King, Finance Director

Originated by:

Alisha Gray, EDFP, Economic Development and Housing Manager

Supplemental Information:

Ehlers Memo
Draft Term Sheet
TIF Pooling Policy



Memo

To: Julie Wischnack, Community Development Director
Alisha Gray, Economic Development and Housing Manager

From: Stacie Kvilvang & James Lehnhoff, Ehlers

Date: August 14, 2017

Subject: Shady Oak Apartments

Ron Clark has proposed to construct a 49-unit, non-age restricted apartment community on City-owned property at 4312 Shady Oak Road. They have requested \$1.379 million in financial assistance from the City from its Boulevard Gardens TIF account. You requested we provide background information on the source of these funds, what they can be used for, explanation on 9% federal low-income-housing tax credits (LIHTC) and an analysis of the financial need of the project.

Boulevard Gardens TIF (District 1-2)

Boulevard Gardens is a redevelopment TIF district that was established in 1996 to facilitate a mixed-use development consisting of retail, affordable family and senior rental units, and condominium/townhomes. This District received its first tax increment revenue in 1997 and will decertify on December 31, 2022.

In 2010, the City modified the TIF District's plan to allow up to 35% of the TIF generated from the District to be utilized for affordable housing. The City completed this modification to provide a source of financing to assist the City in providing affordable housing. In 2012, The EDA committed \$1,025,000 to Community Housing Coalition for The Ridge, a 64-unit affordable apartment community located on I-394. Currently there is a balance of approximately \$3,138,000 in the account and it is expected that the District will receive approximately \$650,000, annually, from 2017 – 2022 (approximately \$7M total available).

These funds are limited on what they can be utilized for. Essentially, the funds can only be expended on rental projects and more specifically, LIHTC eligible rental housing. The assistance provided to any project cannot exceed the qualified basis of the tax credits, as defined under section 42(c) of the Internal Revenue Code, less the amount of any tax credits allowed. In this instance, the project has approximately \$11.28 million in eligible basis for tax credits, but is only receiving approximately \$9.285 million in tax credits. That leaves approximately \$2 million in eligible costs where the City could use increment from this district to provide financial assistance to the project.

Low income housing Tax Credits (LIHTC)

The LIHTC program was created in the Tax Reform Act of 1986 and is the Federal government's primary tool to incentivize the construction of new affordable housing in the United States. The purpose of the LIHTC program is to encourage private investment in affordable rental housing. The investor (which are often banks or insurance companies) provide cash (equity) to developers of affordable housing and, in exchange, receive an offset on their federal tax bill—LIHTC is not a grant nor is it a Section 8 program. These investors expect that the project they invest in will perform at a level that generates adequate cash flow to repay the mortgage, their annual asset management fee and any deferred developer fees within a specified time frame (typically 10 years). If the project doesn't perform or fails to comply with Federal regulations, the investor can lose their tax credit.

Each year, the Federal government allocates a limited number of LIHTCs to each state. The Minnesota Housing Finance Agency (MHFA) is charged with creating and overseeing the process for allocating the LIHTC in most of the State. In the spring of each year, MHFA issues their "Super RFP" that details the process to compete for what is known as the "9% LIHTC" and other "soft" funding sources. The applications are typically due in June and this is a one-time opportunity to receive LIHTCs on an annual basis. MHFA announces the awards each year at the end of October.

Because 9% LIHTCs are so scarce and thus highly sought after and competitive, MHFA has created a strict scoring process to rank the submitted funding requests. In 2016, only one in five requests received 9% LIHTCs. MHFA scores applications on a number of priorities, including:

1. **Funding Contributions and Financial Readiness**
2. **Lowest Income Tenants**
3. **Bedroom Count**
4. **Workforce**
5. **Households Experiencing Homelessness**
6. **Location**
7. **Cost Containment**

The more priorities a project meets, the higher the scoring and greater chance it will receive a 9% LIHTC allocation (projects often compete down to the last possible point). By showing committed funds from the City and requesting **NO** additional dollars from MHFA, the chances of the project being funded in 2018 significantly increase.

Analysis of Financial Need

Ehlers conducted a thorough review of the developer’s budget and operating pro forma to ensure all development costs, anticipated revenues, and expenditures are represented appropriately and accurately. The table below depicts the proposed sources and uses for the project.

SOURCES			
	Amount	Pct.	Per Unit
First Mortgage	1,797,000	14%	36,673
Minnetonka Deferred Loan	1,379,100	11%	28,145
Tax Credits	9,285,818	73%	189,506
Deferred Developer Fee	237,417	2%	4,845
TOTAL SOURCES	12,699,335	100%	259,170

USES			
	Amount	Pct.	Per Unit
Acquisition Costs	734,400	6%	14,988
Construction Costs	9,826,780	77%	200,547
Professional Services	499,700	4%	10,198
Financing Costs	349,309	3%	7,129
Developer Fee	1,045,000	8%	21,327
Cash Accounts/Escrows/Reserves	244,146	2%	4,983
TOTAL USES	12,699,335	100%	259,170

Generally, this project meets the expectations of a 9% LIHTC rental project with regards to the financing structure, projected revenues, on-going operational costs and developer fee. Following are our findings relating to the analysis completed for the development:

- LIHTC projects typically never have any developer equity in the project. The equity comes from the LIHTC investor. The developer only receives a development fee (payment for time and expenses into the project), of which a portion is usually deferred to fill a gap in the financing, and they receive payment over time if there is any cash flow. Typically, 9% LIHTC projects that have rents at the proposed 50% level only provide enough annual cash flow to pay back the deferred developer fee and little to no future cash flow is expected for “profit” purposes.
- Developer is requesting \$1,379,000 in a deferred loan from the City, which is 11% of the overall project financing and is only very slightly higher than what we see in most 9% LIHTC projects (typically not more than 10%). We are of the opinion that the first mortgage amount can be increased to reduce the City’s level of participation.
- The developer’s fee is only 8% of total development costs, which is lower than they could charge for their time, effort and overhead on developing the project and obtaining land use approvals and financing for the project (typical range for LIHTC projects is 10% to 15%). However, the lower fee helps the overall project financially and they are deferring 23% of the developer fee to be paid out of cash flow over the next 10-years, which is typical. However, we are of the opinion that slightly more of the fee can be deferred in order to reduce the City’s participation.
- The total development costs for this project are approximately \$12.7 million, or \$260,000/unit. These costs have increased per unit from their first application due to reducing the size of the project by 5 units and adding a flat roof based upon input, which increased costs by \$195,000.

Based upon the above referenced comments, the updated sources and uses are as follows:

SOURCES			
	Amount	Pct.	Per Unit
First Mortgage	2,035,000	16%	41,531
Minnnetonka Deferred Loan	1,209,000	9%	24,673
Tax Credits	9,285,818	73%	189,506
Deferred Developer Fee	246,918	2%	5,039
TOTAL SOURCES	12,776,736	100%	260,750

USES			
	Amount	Pct.	Per Unit
Acquisition Costs	734,400	6%	14,988
Construction Costs	9,826,780	77%	200,547
Professional Services	499,700	4%	10,198
Financing Costs	349,309	3%	7,129
Developer Fee	1,045,000	8%	21,327
Cash Accounts/Escrows/Reserves	321,547	3%	6,562
TOTAL USES	12,776,736	100%	260,750

Please note the overall project budget increased by approximately \$77,000 due to tax credit fees that were not in the original submission. As noted, we reduced the City's loan by \$170,000 to \$1,209,000 and increased the deferred developer fee by \$9,501 (can defer this much more and still have it paid off within 11 years).

Recommendation

Based upon our review of the developer's pro forma and current market conditions, the proposed development will not reasonably be expected to occur solely through private investment within the reasonably near future. Due to the costs associated with redeveloping the property and constructing housing with affordable rents, this project is feasible only through assistance, in part, from the City's contribution.

We recommend providing a Cash Flow Note (Note) to the project for \$1.209 million. This will assist them in obtaining more points from MHFA, which increases their scoring and the likelihood they will be awarded 9% LIHTC in the June 2018 round (basically assure the housing gets developed). The Note will be structured to allow the first \$30,000 of cash flow, after the deferred developer fee is repaid, to be paid to the developer and anything above that will be split 50/50 between the developer and the City for repayment on the Note. Any balance outstanding on the Note at refinancing and/or sale for the property will be repaid at that time.

Based upon typical underwriting of 5% vacancy and 2% annual increase in revenue and 3% increase in expenses, it is expected that the deferred developer fee is repaid in year eleven (11). However, annual cash flow is only anticipated to be approximately \$23,000/year starting in year twelve (12), leaving no available cashflow for repayment on the City's Note. If the project performs at a 2% vacancy (more typical for the City's market), then the deferred developer fee will be repaid in year six (6). Annual cash flow starting in year seven (7) is anticipated to be approximately \$43,000/year. Based upon the terms noted above, the first \$30,000 will go to the developer. The remaining \$13,000 will be split 50/50 between the City and the developer.

Overall, the City should not assume that repayment on the Note will happen over time. However, if the project performs better than anticipated and no unforeseen capital repairs are needed, there is a mechanism in place for the City to receive repayment on the Note sooner than anticipated.

**City of Minnetonka
Shady Oak Redevelopment Term Sheet
(Draft 8-7-2017)**

Purchase of Land

- Developer to purchase commercial property and small sliver of adjacent resident property (for utilities) on or before August 31, 2019 at a price of \$734,400
- If Developer does not obtain tax credits through application submitted on or before June of 2018, land purchase and construction deadlines may be extended by one year
- Once tax credits are awarded, City to commence relocation of existing tenants

Demolition Funding and Performance

- City/EDA and Developer will work cooperatively to re-apply for Tax Base Revitalization Account (TBRA) grant from Hennepin County and other grants that could assist with the costs of demolition and contamination clean up
- Developer to perform demolition of buildings and cleanup of contamination within buildings and soils with grant funds
- If grants are not obtained for such costs, the parties will work cooperatively to review and modify the project budget in order to pay for the demo and clean up; City has not agreed to pay for costs of demolition or contamination clean up

Minimum Improvements

- Developer to build multifamily building with 49 units
- Start construction by August 31, 2019
- Complete construction by August 31, 2021
- Developer must hire experienced property manager and City may require removal of manager if public safety issues occur and are continuing
- Developer will require property manager to monitor public safety violations of tenants and repeated public safety violations by tenants will require eviction of tenant
- Park dedication fees will be required per City Code

Declaration of Restrictive Covenants

- 100% affordable to individuals or families earning 60% or less of area median income
- 100% of units will have maximum rent that does not exceed 30% of 50% of area median income for the first 10 years. After 10 years, 100% of units will have maximum rent that does not exceed 30% of 60% of area median income (per MHFA guidelines)
- Declaration effective until the later of (i) thirty years; or (ii) repayment of TIF loan

TIF Loan and Other Funding Sources

- Provide TIF loan to the Developer in the maximum amount of approximately \$1,200,000 from Boulevard Gardens TIF District
- In cooperation with the Borrower, the City/EDA will apply for a Livable Communities Demonstration Account (LCDA) grant from Met Council to help fund the costs of the project
- Developer shall request funds from other public entities to provide required equity (State, County, etc.) if applying for and receiving such funds will not negatively affect the Minnesota Housing QAP scoring for the project
- If needed equity can be found elsewhere, the TIF loan will be reduced accordingly
- Principal of TIF loan shall be payable over time from a percentage of project's surplus cash over and above the first \$30,000 of surplus cash (percentage to be determined)

- Principal of the TIF loan must be paid in full at the later of (i) thirty years; or (ii) the maturity of the mortgage loan obtained by Developer
- Principal of TIF loan shall be due and payable upon sale of property by Developer or refinancing of the mortgage loan obtained by Developer (EDA shall have option to review terms of refinancing and consent to refinancing without a full payoff of the TIF Loan)
- Any grants received other than the TBR grant or other grants received for the demo and cleanup process described above will decrease the amount of the TIF Loan

Land Write-Down

- The costs to the City to acquire the land were substantially more than the current expected market value of the property of \$734,000. The increased costs were due to a higher purchase price and the costs of relocation benefits, payments for environmental testing, property taxes, and professional services. The City would like to be compensated for the land write down in the amount of \$515,889 through the use of pooled TIF from the Boulevard Gardens TIF District

Policy Number 2.14
Tax Increment Financing Pooling Funds

Purpose of Policy: This policy establishes evaluation criteria that guide the city council in consideration of use of tax increment financing pooling funds

Introduction

Under the Minnesota Statutes Chapter 469, at least 75 percent of tax increment in a redevelopment tax increment financing (TIF) district must be spent on eligible activities within the district, leaving up to 25 percent of the funds to be pooled and therefore eligible to be spent outside of the district, but within the project area.

An exception to the pooling funds is for affordable rental housing. The city may allow the pooling allowance to be increased to 35 percent, which can then go to finance certain affordable housing projects. The project may be located anywhere in the city, and not limited to the project area. Each financed project must be rental housing that is eligible for federal low income housing tax credits. The amount of the assistance is also limited to any amount that satisfies tax credit rules.

The council is aware that use of such TIF pooled funds may be of benefit to the city and will consider requests for pooled funds subject to this council policy. The council considers the use of these funds to be a privilege, not a right.

It is the judgment of the council that TIF pooled funds is to be used on a selective basis. It is the applicant's responsibility to demonstrate the benefit to the city, and that they should understand that although approval may have been granted previously by the city TIF pooled funds for a similar project, the council is not bound by that earlier approval.

Evaluation Criteria

The city will use the following criteria when evaluating a development proposal requesting the use of TIF pooled funds:

- The project supports reinvestment in an identified village center and addresses the goals set out in the comprehensive plan for that center.
- Priority will be provided for projects that are within a "regional" village center or support transit areas.
- Weight will be given when the proportion of affordability is greater than what is customary in other tax increment financed projects in the city, overall affordability of 20% of units (usually at 60% AMI for rental).
- The project may request both tax increment financing and pooling dollars as long as the project has provided data that "but for" the additional pooling dollars, this project would not occur.

- If the project is receiving funds from other sources, the pooled dollars would be the last source utilized unless it impacts other sources.

Other Provisions

- A project will not normally be given financing approval until all city planning and zoning requirements have been met. Planning and zoning matters may be considered simultaneously with preliminary approval of the financing.
- The city is to be reimbursed and held harmless for any out-of-pocket expenses related to the TIF pooling funds, but not limited to, legal fees, financial analyst fees, bond counsel fees, and the city's administrative expenses in connection with the application. The applicant must execute a letter to the city undertaking to pay all such expenses.
- The applicant will be required to enter into a development agreement with the city outlining the terms of the use of TIF pooled funds.

Adopted by Resolution No. 2011-039
Council Meeting of May 16, 2011