2 November, 2021

PROJECT PRO FORMA REVIEW – UPDATE SUMMARY

Village of Elm Grove

School Sisters of Notre Dame - Proposed Tax Increment District #3

EHLERS
PUBLIC FINANCE ADVISORS

Prepared by:

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2 November 2021

Mr. Dave DeAngelis
Village Manager
Village of Elm Grove
13600 Juneau Blvd
Elm Grove, WI 53122

RE: TID 3 School Sisters of Notre Dame (the "Project")
Mandel Group – Developer
<u>Project Update</u>

Dear Dave,
Further to our several meetings with the Village, Ehlers, and Mandel, the following is a summary of the updated project proposal submitted by Mandel on 20 October, along with our recommendations thereto. These changes were due mostly to the higher assessed valuation than what was used in the developer's original analysis, changes to financing, timing of certain project milestones, and inclusion of the single-family home values in this analysis. The overall project (unit count and mix, number of homes, and infrastructure work) remain the same, though all components are now included under this analysis.

Several changes from our prior analysis include:

- Full cost of the water main extension – past the SSND Project and into the Village downtown – are included in the TIF cash flows. Also included herein are the incremental additions to value from the 21 single family home sales.

- Project cost increased by approximately $700K for additional contingency and operating reserves, due to the upfront assistance now provided at occupancy of the apartments, rather than at construction commencement, as originally contemplated.

- Increase in upfront TIF request from $5.5M to $5.95M for higher property taxes/operating expenses, as the assessor estimate of $230K/unit exceeds developer's initial model of $210K/unit.

- Previously, developer had assumed a straight split of incremental tax revenue, and did not account for Village GO debt. Village debt obligations have priority over PAYGO TIF assistance, extending the term of the MRO assistance.

- Timing and treatment of land transactions between the School Sisters and several Mandel entities. In the prior analysis, we assumed Mandel was receiving a large sales price to reduce equity. After further discussions, it was clarified that the sales to the single-family developer would be mostly a pass-through of the price that Mandel would pay to the School Sisters, plus partial reimbursement for the infrastructure improvements benefitting those parcels. Otherwise, those unrecovered costs would likely cause a further increase in the developer's TIF ask.

- While not materially affecting the financial performance of the proposed structure, the Village has requested that Mandel provide a guaranty of minimum value for the apartments for the duration that the annual TIF assistance is provided.

Two assumptions from our prior evaluation are re-emphasized here:

- Mandel may sell the Project at an undetermined date, but likely be a longer term hold. Conventional real estate analysis assumes a sale after a 10 year investment period, which we have assumed in our investment return calculations. It is suggested that the developer is prohibited from selling the Project until all Village debt obligations are satisfied.

- Included in the return calculation is the sale of the remaining TIF payments to be provided to developer in the years after the Project itself is sold. The present value of those remaining payments is added to the Project sale price to determine the overall internal rate of return (IRR).

EHLERS SUMMARY CONCLUSION RE: "BUT FOR" TEST

The 'But For' test remains in effect after these updates: it is clear that the project would not be able to attract the appropriate investment capital without some level of TIF participation, and at the levels contemplated in this analysis, there would be no undue enrichment to the developer.

- The Project will incur certain extraordinary costs, adding significantly to the Project budget, including:
    - demolition and environmental abatement,
    - historic buildings renovation/refurbishment,
    - structured underground parking, which more than doubles the cost of surface parking spaces
    - significant utility and earthwork, including extending the water main.

- As noted in the Values/Returns section below, the developer/investor return metrics without such TIF assistance would cause the Project to be economically infeasible, and the Project would not be undertaken.

PROJECT BUDGET / OPERATIONS

Total project costs increased from $97.4M to $98.1M, to address additional contingency and operating reserves per discussion above.

Market rents for the large apartments remained at an average of $1.92 per square foot, which were in line with market comparisons.

Real estate taxes were increased from the developer's original submittal, though were adjusted in the Ehlers prior analysis. These are based on an estimated assessed value of $230K/unit, whereas Mandel's initial estimation was $210K/unit. The expense ratio remained in the same low 30% zone, which is within market ranges, and replacement reserves are more conservative than the normal reserves of $250-300/unit.

TAX INCREMENT FINANCING STRUCTURE

The developer initially requested municipal TIF assistance of either a) $11M to be provided as an up front advance, or b) $5.5M provided up front, along with a developer-funded, or Pay As You Go (PAYGO) option, where the developer receives a portion of the annual property taxes they've paid in order to supplement the development costs. The latter scenario was pursued by the Village. The developer's updated financial request, *as adjusted by Ehlers to account for the bond issues*, are summarized as follows:

Developer Request

Original Request	$5.5M up front + 72.5% of property tax increment on PAYGO basis $10.4M MRO
Current Request	$5.95M up front + available increment after Village GO bond payments $10.7M MRO
Original GO – Upfront	$5.91M taxable GO bond for developer up front assistance
Current GO - Upfront	$6.26M increased by contingency, higher property tax & operating expenses
Original GO – Water	$2.425M tax-exempt bond to extend service to Project property line only
Current GO – Water	$3.565M includes extension of water main past Project to Village downtown

Annual PAYGO incentive payments of the residual tax increment receipts - after debt service on the Village's two bond issuances - would be made per a Municipal Revenue Obligation agreement (MRO) to provide a net present value utilizing a 5% discount rate. The amount of annual incremental value remained flat in the original analysis, but is currently being inflated by 2.25% annually to remain consistent with developer's Project cash flows.

Furthermore, in this version, the incentive payments (up front or PAYGO) do not commence until the Project receives a certificate of occupancy, which is one year delayed from the prior request. In consideration of Mandel providing a minimum value guaranty, the Village will not require collecting two years debt service on the G.O. bonds.

Under the revised scenario, both bond issues pay off within 20 years; however, the tax-exempt (water main) bonds are projected to pay off in 2041, though the taxable (upfront assistance) bonds, issued a year later, are expected to be repaid by 2043. The developer MRO payment is expected to be satisfied within 17 years, or 2039.

Schedules indicating these calculations for development assumptions, tax increment projections, and TID cash flow results are attached.

Ehlers Adjusted Request

Other options for the PAYGO terms were evaluated, and in particular, structures for $9.8M MRO ($6.0M NPV), $9.0M MRO ($5.6M NPV) and $7.5M MRO ($4.89M NPV) were analyzed. The $9.8M MRO structure was deemed to be most appropriate, and is summarized as follows.

In either instance, the two bond issues were still satisfied within the same 20 year terms. The $9.8M MRO, however, is satisfied within 16 years, or 2038, due to the lower notional amount. The TID cash flow for this structure is attached for comparison (development assumptions and tax increment projections remain the same as for the updated $10.7M model).

VALUES / RETURNS

Under current ownership, the SSND property has been exempt from property taxes. Once the property is acquired in early 2022, it will become taxable. Apartment construction is expected to commence in Summer 2022 and be completed in Fall/Winter 2023; after reaching stabilized operations in 2024, the full $54.5M apartment value will be in place. A 6.25% capitalization rate was used in this determination, which is in line with current market pricing.

The sale of the improved single family lots in 2023 will be recorded upon completion of infrastructure and takedown/sale of the parcels to the single-family developer. This transaction has been estimated amount of $160K per lot, or $3.36M, including reimbursement of a portion of the infrastructure and site work attributable to the single family homes, which roughly equals the amounts expended by the developer. It is anticipated that 3 homes will be developed and sold per year for 7 years, adding an additional $640K in value per home over the land value ($800K value all-in). Therefore, between the apartments and separate homes, the total incremental value expected to be produced is a very conservative $71.3M.

There are generally two metrics used in evaluating income-producing properties: cash-on-cash ("COC") and internal rate of return ("IRR"). COC is simply the annual cash flows to developer (after debt service) divided by equity in the Project, and is utilized for longer investment periods. The IRR accounts for the discounted time value of money, so it considers the initial equity investment, the annual cash flows, and the sales proceeds at the end of the holding (investment) period. Commercial practice is to evaluate a 10 year hold, which is used in this analysis to calculate the IRR. As noted earlier, Mandel indicated their likely investment period could be longer.

It is important to understand that the ownership structure in commercial projects such as this provides separate and distinct cash flows to the investors and the developer, often referred to as a waterfall. Generally, the investors are to receive a preferred return payment on their equity before *any* funds flow to the developer, usually around 7-8%. After that "pref" level has been reached, the additional annual cash flows and eventual sales proceeds run through the various calculations in the waterfall, and are split between investors and developer at a predetermined ratio, usually 50/50 or 60/40. The developer return will serve as compensation for conceptualizing and bringing the various disciplines of Project together, gaining necessary approvals, taking on construction, interest rate, and lease-up risk, and also providing any guarantees required by lenders or municipalities. Therefore, due to these subsequent divisions of cash flows, the investor IRR is frequently lower than that generated at the overall project level.

Generally, the expected COC at stabilization for similar projects is approximately 7-8%, and increases to a range of 8-12% over time. Under the developer's updated request for assistance, once permanent financing begins full amortization, the SSND project generates a COC of 8.06%, and reaches 12% in the last year of the initial 10 year term. The expected overall returns for IRR on multifamily developments are usually 12-18%. Per the developer's proposal, the adjusted IRR for the deemed sale of the Project at the end of Year 10, after payment of the mortgage loan and return of equity, is around 12.30% at the project level. This is on the lower end of the expected range noted above.

After numerous iterations, we found that the Ehlers adjusted scenario for $9.8M MRO provided the necessary investor return, *yet reduced the Village's contribution to the Project by almost $1M*. In this version, the COC remains the same as the incremental value and annual incentive payments are assumed to remain the same during the 10 year period. However, due to the shorter PAYGO payment stream and lower NPV, the overall IRR reduces to 12.29%, and achieves an investor return of exactly 12.0%, which is the developer's minimum target return to investors. Further scenarios considered a $9.0M and $7.5M MRO, however, that would only produce an investor IRR below 12%, which is lower than required to raise equity capital. Upon evaluating the alternate scenarios, it was determined that the $9.8M MRO would be most applicable. These projections can be summarized below:

Developer Request	
$10.7M MRO ($6.4M NPV)	
COC high 10 yrs	12.03%
COC Avg 10 yrs	8.82%
Project IRR 10 yrs	12.30%
Investor IRR	12.17%
Future value MRO	$10,700,000
MRO Expiry	2039
TOTAL NPV incl Upfront:	$11,492,045

Ehlers Revision	
$9.8M MRO ($6.0M NPV)	
COC high 10 yrs	12.03%
COC Avg 10 yrs	8.82%
Project IRR 10 yrs	12.18%
Investor IRR	12.0%
Future value MRO	$9,800,000
MRO Expiry	2037
TOTAL NPV incl Upfront:	$11,111,374

Ehlers recommends the $9.8M MRO structure should be considered, which would allow developer to raise the required amount of equity.

However, in either scenario, without the TIF assistance to this Project, the COC would be less than 7.8% at best, and the IRR would be lower than 10%; both metrics are at levels that would not attract investment capital, as noted for the 'but for' consideration.

We trust that the analysis provided will assist you to evaluate making the expenditures and providing TIF incentives as discussed herein. Please let us know if you have any questions or comments regarding the subject, and thank you for engaging us to assist you in this endeavor.

Respectfully,

Frank Roman	Todd Taves
Economic Development Consultant	Senior Municipal Advisor