

Creating a Policy Framework for Well-Structured TIF Deals

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Why Deal-Based TIF Policy is Important

- TIF laws generally give little direction on how to underwrite and justify assistance
- Controls the setting of precedents
- TIF can distort land markets and drain public resources if not handled properly
- Public financial risk should be managed systematically

Solid TIF Underwriting Sends a Message

- School districts and other taxing districts only benefit from TIF if the “but for” test is met
- Misunderstandings over “but for” a major threat to TIF as a tool
- Minimizes perception that TIF is a “handout”

Example

- Hypothetical 15-year TIF district
- Base taxable value of \$10 million
- Constant school district tax rate of 3%
- Annual property value increase of 2.5%
- Potential redevelopment project of \$40 million in taxable value starting Year 3

The Numbers from the School District's Perspective

25 year Projection	Scenario 1: No TIF + No Redevelopment	Scenario 2: No TIF; Redevelopment Occurs Anyway	Scenario 3: TIF + Redevelopment
Total Taxes Collected- on School District Portion of Tax Rate	\$10.2 MM	\$37.3 MM	\$37.3 MM
School District Tax Revenues	\$10.2 MM	\$37.3 MM	\$23.0 MM
Present Value of School District Revenues (@ 5%)	<u>\$ 5.4 MM</u>	<u>\$19.1 MM</u>	<u>\$9.9 MM</u>

Key Policy Questions

1. How to size the assistance
2. How to limit unintended consequences
3. How to understand and manage public risk

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How Much TIF Assistance is Enough?

- TIF Laws are often silent or vague on this point
- “But for” requirements sometimes legally required only at the district level
- Sizing the assistance therefore more of a policy consideration
- General consensus that TIF should primarily be need-based

How to Address “But For” at the Project Level

- Have a formal TIF application and review process
- Require applicant to justify the level of assistance requested via analysis of profit/returns, extraordinary costs, and public costs
- Review in detail and challenge key assumptions if needed

Example

Sources and Uses w/o TIF

SOURCES OF FUNDS

Construction Loan	\$	14,516,174
Equity	\$	5,466,208
TIF Assistance	\$	-
TOTAL SOURCES	\$	19,982,382

USES OF FUNDS

Land	\$	3,750,000
Environmental	\$	2,500,000
Other Site Costs	\$	1,853,000
Hard Costs	\$	8,692,812
Soft Costs	\$	2,562,247
Developer Fee	\$	624,322
TOTAL USES	\$	19,982,382

IRR on Cost	8.1%
IRR on Equity	10.5%

Sources and Uses with TIF-based grant

SOURCES OF FUNDS

Construction Loan	\$	14,516,174
Equity	\$	2,966,208
TIF Assistance	\$	2,500,000
TOTAL SOURCES	\$	19,982,382

USES OF FUNDS

Land	\$	3,750,000
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Hard Costs	\$	8,692,812
Soft Costs	\$	2,562,247
Developer Fee	\$	624,322
TOTAL USES	\$	19,982,382

IRR on Cost	10.0%
IRR on Equity	18.6%

Returns Analysis (with TIF)

	Year 0	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10
SOURCES											
NOI (less Reserves)	-	1,061,875	1,469,769	1,467,664	1,465,517	1,463,327	1,634,344	1,632,066	1,629,742	1,627,372	1,624,955
Reserve Payout		200,000									
Reversion											22,047,791
TOTAL		1,261,875	1,469,769	1,467,664	1,465,517	1,463,327	1,634,344	1,632,066	1,629,742	1,627,372	23,672,745
USES											
Debt Service		1,245,640	1,245,640	1,245,640	1,245,640	1,245,640	1,245,640	1,245,640	1,245,640	1,245,640	1,245,640
Debt Repayment											11,345,186
Equity Distributions		16,235	224,128	222,023	219,877	217,687	388,704	386,426	384,102	381,732	11,081,919
TOTAL	-	1,261,875	1,469,769	1,467,664	1,465,517	1,463,327	1,634,344	1,632,066	1,629,742	1,627,372	23,672,745
<i>Annual Debt Coverage</i>		0.85	1.18	1.18	1.18	1.17	1.31	1.31	1.31	1.31	1.30
Leveraged Cash Flow											
Equity Contributions	(2,966,208)	-	-	-	-	-	-	-	-	-	-
Equity Distributions	-	16,235	224,128	222,023	219,877	217,687	388,704	386,426	384,102	381,732	11,081,919
TOTAL	(2,966,208)	16,235	224,128	222,023	219,877	217,687	388,704	386,426	384,102	381,732	11,081,919
<i>Annual Cash-on-Cash Return</i>		0.5%	7.6%	7.5%	7.4%	7.3%	13.1%	13.0%	12.9%	12.9%	12.8%
Leveraged IRR	18.6%										
Unleveraged Cash Flow											
NOI	-	1,061,875	1,469,769	1,467,664	1,465,517	1,463,327	1,634,344	1,632,066	1,629,742	1,627,372	1,624,955
Reversion Proceeds	-	-	-	-	-	-	-	-	-	-	22,047,791
TIF Assistance	2,500,000	-	-	-	-	-	-	-	-	-	-
Total Project Costs	(19,982,382)	-	-	-	-	-	-	-	-	-	-
TOTAL	(17,482,382)	1,061,875	1,469,769	1,467,664	1,465,517	1,463,327	1,634,344	1,632,066	1,629,742	1,627,372	23,672,745
<i>Annual Yield on Cost</i>		6.1%	8.4%	8.4%	8.4%	8.4%	9.3%	9.3%	9.3%	9.3%	9.3%
Unleveraged IRR	10.0%										

Common Components of “Gap Analysis”

- Checking pro forma math and cash flows
- Independent construction cost review
- Reviewing project debt capacity
- Benchmarking “top line” revenue sources
- Benchmarking soft costs, developer fees, etc.
- Estimating profit and rates of return

Other Considerations

- Detailed review can also help with structuring process
- Avoids appearance of arbitrary assistance
- Can save significant municipal resources
- Back-end participations/“kickers”/up-side sharing

Key Policy Questions

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- 2. How to limit unintended consequences**
3. How to understand and manage public risk

Potential Unintended Financial Consequences of TIF Availability

- Encouraging land speculation
- Unduly enriching land-owners
- Creating a mind-set that TIF is an entitlement
- Setting precedent that will spill over to other deals

Mitigation Strategies

- Require an “as-is” appraisal to benchmark developer land cost in TIF pro forma
 - Adequately consider and reflect site defects
 - Land comps should generally not be from assemblages used in TIF projects
- Be prepared to walk away from a bad deal (or a good deal that turns into a bad one)

Mitigation Strategies, cont'd.

- Require a disciplined articulation of:
 - Public improvement costs vs. private “gap financing”
 - Normal project costs versus “extraordinary costs”
 - How and why the project differs from a standard market deal
- Educate elected officials, municipal staff, and developers early and often about TIF evaluation process and criteria

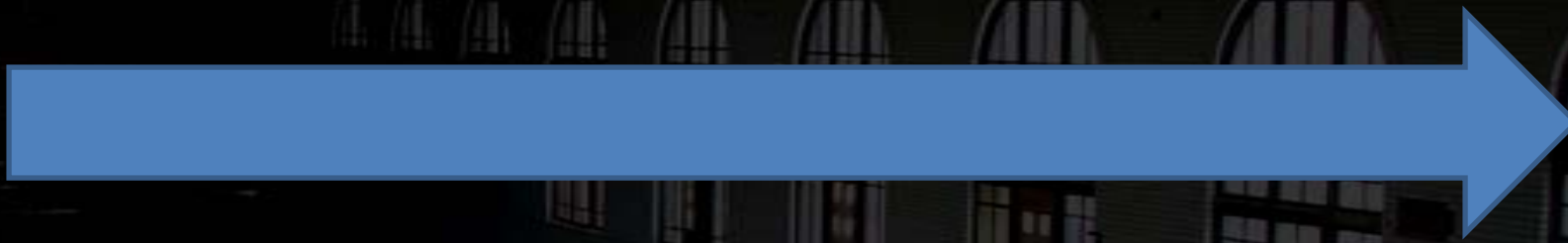
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Risk Spectrum: Funding Sources

Lesser risk

Greater risk



TIF revenues
from project
itself

TIF revenues
from broader
district(s)

Other municipal
revenue sources
(e.g., sales tax,
hotel tax)

Full municipal
faith and credit

Addressing Risk

Risk	Potential Mitigation Tool
Project won't be completed	<ul style="list-style-type: none">• Delay payout of TIF funds to completion• Pay out TIF funds after equity and pro rata with construction loan
Project won't be maintained/ operated consistent with original goal	<ul style="list-style-type: none">• Insert "dark day" clause in TIF payment agreement
Public land in transaction could be tied up in a failed project	<ul style="list-style-type: none">• Include time-based reverter clause in sale agreement• Limit use of land as collateral for private financing
Up-front cash TIF contribution is "at risk" until completion	<ul style="list-style-type: none">• Require developer to post a letter of credit

Conclusions

- In-depth analysis and understanding of every deal is critical
- Be consistent about how deals should be presented and analyzed by the applicant
- Be flexible enough to adapt to changing market/financing parameters
- Good news: strong TIF underwriting often pays for itself many times over



- Public-Private Partnerships
- Real Estate Financial Analysis
- Real Estate Market Analysis
- Area Plans & Implementation
- Developer Recruitment
- Tax Increment Financing (TIF)
- New Markets Tax Credits

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