Business expansion, retention and attraction

Memorandum

To: Tompkins County Industrial Development Agency

From: Heather McDaniel

Date: June 1, 2017

Re: Harold's Square Determination of Financial Need

The City of Ithaca Community Investment Incentive Tax Abatement Program (CIITAP) allows an applicant to "request an enhanced property tax abatement that begins at 100% in year one and decreases in equal increments over ten (10) years if the applicant can demonstrate financial need as determined by a review by IDA administrative staff of the project pro forma and demonstration of an annual return on investment less than 20% in each of the first five years."

The applicant for the Harold's Square project, has requested the enhanced abatement and provided me with the construction budget and assumptions, a ten-year operating pro forma, the assumptions used to develop the pro forma including rent rolls, and a calculation of a leveraged return on investment. I reviewed the documentation, requested some clarifications and additional information, I have determined that:

1. The developer's financial projections are reasonable.

2. The developer's assumptions are reasonable.

3. The developer's Return on Investment is less than 20% in each of the first five years.

It is my recommendation that the applicant has demonstrated financial need as outlined in the CIITAP guidelines and is eligible for the enhanced abatement. Following is a brief review of my analysis:

<u>Development Costs</u>

I received and reviewed a copy of the development costs. The constructions costs are projected at $170 and $200 per square foot for the retail and resident portions, respectively. These costs are in line with other residential and retail development in the downtown core. The acquisition cost includes carried costs by David Lubin since he first purchased the buildings for the project. The acquisition cost is reasonable compared to recent acquisitions downtown. Soft costs include architectural and engineering, legal, closing costs and other miscellaneous soft costs. The construction contingency is 5% which is standard in the industry. A developer fee is included as part of the capitalized project costs to preserve cash flow in the first few years after construction and meet bank requirements for the debt coverage ratio.

<u>Operating Pro forma</u>

I received and reviewed a ten-year operating pro forma and related material detailing the assumptions used to develop the pro forma. The residential rental rates are slightly above current market rate apartments including Gateway Commons and the Carey Building. The projected stabilized rental vacancy rate is similar to other downtown projects – developers are assuming very little vacancy in the tight downtown market. The retail vacancy rate is initially over 25% which is reasonable considering current retail vacancies on The Commons and the length of time the developer has been trying to pre-lease the space. The expenses include an accurate estimate of real estate taxes paid if the 10 year abatement is approved. A management fee of 4% is fairly standard.

Return on Investment

The applicant provided a leveraged return on investment analysis that I reviewed and determined to be reasonable. I also calculated a standard return on equity calculation (net operating income minus projected debt service divided by equity invested.

The net operating income was determined to be reasonable based on the analysis of the operating pro forma. The debt service assumptions are reasonable based on my discussions with the applicant and recent discussion/knowledge about commercial real estate financing.

In all cases, the return on investment is below the 20% annually required by the CIITAP application to demonstrate financial need.

Return on Investment

Return On:	**Year 1**	**Year 2**	**Year 3**	**Year 4**	**Year 5**
$ Leveraged	-1.5%	6.3%	7.8%	9.4%	11.1%
Equity Invested	-1.5%	6.3%	7.4%	8.2%	8.9%