ITEM # 31
DATE: 04-12-22

COUNCIL ACTION FORM

SUBJECT: **TAX INCREMENT FINANCING REQUEST FOR SMALL LOT INDUSTRIAL DEVELOPMENT SUBDIVISION LOCATED AT 2105 & 2421 DAYTON AVENUE**

BACKGROUND:

At the March 22, 2022, meeting, the City Council reviewed the request from the developers who own 72.99 acres along Dayton Road for a Tax Increment Financing (TIF) incentive of up to $2.6 million to help pay for infrastructure components of a 13 small lot industrial subdivision.

At this meeting, City staff presented its recommendations for the terms and conditions for a development agreement which had been negotiated with the developer over a number of weeks of discussions. As is the case with most negotiations there was give and take by both parties regarding terms that could be agreed to in a final document. At the time of writing the Council Action Form on March 18, 2022 the staff believed both parties were in agreement with the proposed terms. It was hoped that the City Council would review proposed terms at the March 22 meeting and direct staff to finalize a development agreement for Council approval at an upcoming meeting.

At the March 22 meeting, however, the developer indicated that he just became aware of the meaning of the inclusion of an "annual appropriation clause" and voiced his concern about including this clause in the proposed development agreement. This clause allows the City to annually appropriate an agreed upon payment of the TIF rebate to the developer for each year identified in an agreement. However, it does not obligate future City Councils to appropriate the funds in a future budget if it does not decide to do so.

If this language is not included, then the TIF agreement binds the Council for the life of the TIF to make the rebate payments to the developer, and therefore the amount of the payments is considered the same as a debt and would be a factor both in the City's credit rating and legal capacity to take on future debt. This appropriation provision was recommended by the City's bond attorney more recently in the City's TIF developer rebate agreements to ensure the commitment to rebate the future incremental tax receipts to the developer is not considered debt. A check of state records indicates this type of appropriation clause is being used more recently by other cities as well.

The developer is concerned that the clause would allow a future City Council to take action to eliminate the rebate in any given year and deny the revenue that the developer had relied upon to use for repayment of the cost of upfronting the

subdivision infrastructure.

In an attempt to solve this impasse, the City Council directed staff to continue to negotiate with the developer regarding this one issue, the annual appropriation clause. Based on input the City Council received from the developer, it is believed if this one issue can be resolved, the remaining recommended terms from the staff are satisfactory and a formal development agreement can be created for both parties to approve.

THREE TYPES OF TIF FINANCING MODELS:

To understand the implications of including or excluding an appropriation clause in the TIF agreement, it is necessary to understand the different models of TIF incentive. There are three basic models for a city to deploy a TIF incentive for a developer:

Model 1: TIF Used to Generate Revenues to Reimburse the City for the Cost of Basic Subdivision Infrastructure that will be Owned by the City

This model is used by a city to pay the cost to install the basic subdivision infrastructure that is traditionally a cost incurred by the developer. These elements typically include components such as streets, water, sewer, electric improvements.

Under this scenario, the city takes on the responsibility of constructing and paying for these elements with the justification that these improvements will become city facilities. Typically, bond or utility funds are “borrowed” to upfront the payment for the cost of these infrastructure elements with the incremental TIF revenues generated from the project used as funding sources to repay the installation costs.

The City has participated in this TIF model when partnering with the developers of the Community Industrial Park on South Bell Avenue and the ISU Research Park.

Model 2: TIF Revenue Used to Fill a Gap in the Developer’s Project Pro-Forma by Rebating the Incremental Tax Revenues to the Developer

Under this model the subdivision-related infrastructure improvements are not needed. Therefore, the City rebates the incremental tax revenues generated by A new project to a developer to fund the projected financing gap for a project (mostly vertical improvements) as evidenced by their project pro-forma statement.

Examples of this model utilized by the City include the Kingland and Barilla projects.

Model 3: TIF Used to Generate Revenues to Reimburse the Developer For the Cost of Basic Subdivision Infrastructure that will be Owned by the City

In this model, the developer pays to install the basic City subdivision infrastructure elements, and the incremental TIF revenues generated from the project are used to repay the developer for those costs.

This is the model being requested by the developer for this small lot industrial development. The City has had no prior experience with this approach.

It is important to note that in the case of Model 2 and 3, the obligation required in a development agreement to rebate the TIF revenues to the developer becomes a debt on the part of the City that counts against the City debt capacity. The inclusion of an annual appropriation clause in the development agreement for these two rebate strategies eliminates this obligation as a debt to the City.

<u>RATIONALE FOR FOREGOING AN APPROPRIATION CLAUSE:</u>

After further conversations with the developer, City staff has agreed to recommend to the City Council that the requirement for an annual appropriation clause be excluded from the final agreement. The rationale for this exclusion is based on the following points:

First, it appears that the City Council still believes that the creation of small industrial lots is an important goal that is worthy of offering a TIF incentive. It is important that this specific incentive help address a priority of the Council and is not just offered in response to a developer's request for assistance.

Second, assuming that the City Council is willing to offer a TIF incentive for this project, the more traditional Model 1 (whereby the City would upfront the cost of installing the basic public subdivision infrastructure of streets, water, sewer, and streetlights reimbursed with the incremental property tax receipts from the buildings constructed in the subdivision) would have been supported by City staff. **Had Model 1 been selected, it would have resulted in the total amount of these infrastructure costs being charged against the City's debt capacity.**

Third, by pursuing Model 3 without the appropriation clause (as requested by the developer), the City is still using TIF to pay for the basic City public subdivision infrastructure. These costs will still count against the City's debt capacity, but the risk for receiving repayment from TIF proceeds is shifted from the City to the developer.

Therefore, in this particular situation, the elimination of an annual non-appropriation clause can be supported. Once built, the basic public subdivision infrastructure will be owned by the City and, like in Model 1, the TIF rebate obligation will become a debt of the City, thus reducing our debt capacity.

Staff is sensitive to the implications this decision to eliminate the non-appropriation clause may have for future TIF projects, such as the pending Lincoln Way redevelopment project. It should be emphasized that what is being proposed for the Lincoln Way development is different. In that project, no basic public subdivision infrastructure is needed, and a TIF incentive is being

requested to fill a projected project funding gap as a catalyst project, similar to the Kingland experience.

TIF INCENTIVE:

As reported previously, the Staff had hoped to place into the final agreement the maximum amount of TIF incentive that will be offered to the developer. Based on the information that was presented, the appropriate amount would be $2.6 million. Because of the uncertainty of construction prices and material delivery delays, the developer was rightfully concerned with committing to a final total at this time. Therefore, it was agreed during our most recent discussions that the best course of action would be to wait until the developer takes formal bids for the public subdivision infrastructure sometime in early this summer at the time of preliminary plat approval to finalize our development agreement with a maximum TIF incentive total when the actual costs are known. **As a result of this change, a final agreement will not be brought before the City Council for approval until early summer.**

The TIF rebate to developer will be for actual cost or up to the maximum amount agreed to after the bids are accepted for installing the street, water, sewer, streetlights, etc. within the subdivision as well as the turning lanes along Dayton Road, whichever is less, with verification by City Staff after review of actual bills.

PROPOSED DEVELOPMENT AGREEMENT TERMS:

City Staff has negotiated many of terms that have been successfully included in previous TIF Developer Agreements for both Models 1 and 2. Because of the uniqueness of Model 3, the final terms of a development agreement will be different from those reflected in previous TIF agreements. A full list of terms and conditions was included in the March 22nd Report. A summary of the major terms are as follows:

Subdivision Size
A 72.99 acre site (of which 50 acres are developable) with13 total lots of which 7 lots will be less than 3 acres and 6 lots will be more than 5 acres.

TIF Duration
The developer will be entitled to receive the TIF revenues up to maximum amount agreed to or until June 2035, whichever comes first.

Spec Building Construction Timeline
The first spec building must be completed by September 2023. Subsequent spec buildings must be completed within 18 months of lease, sale, or occupancy of previous spec building.

Spec Building Size
Each spec building must have a minimum of 10,000 square feet.

Spec. Building Value
Each spec building must have a minimum shell value of $500,000.

Penalties For Failure To Complete Spec Building As Required for Time, Value, and Size
Failure to complete the spec buildings as required for completion time, minimum size, and minimum value will require a $15,000 penalty for first time and $20,000 penalty for each subsequent failure.

Agricultural Classification
Agricultural classification will be allowed only for the six large lots over 5 acres, unless sold to a third party.

Industrial Tax Abatement
The Industrial Tax Abatement, for uses that qualify, will be available for the 6 lots greater than 5 acres. Property owners will not be allowed to seek tax abatement on the 7 lots less than 3 acres.

Land Price Ceiling
There will be a sale price cap of $2.50 per sq. ft. ($108,900 per acre) for every lot in the subdivision, with an allowed increase in the sale cap of 5% every July 1st beginning on July 1, 2023.

Minimum Improvement Value
The assessed value of every principal building constructed must equal to, at least, $350,000 or more per acre of the individual site.

Use Limitations
The is a prohibition of principal uses of outdoor storage, mini-storage, and salvage.

Design
The final agreement will Include design parameters as covenants related to building materials, with a focus on views from the street.

ALTERNATIVES:

1. If the City Council believes the proposed terms highlighted above are satisfactory and the amount of the incentives being offered through TIF and Industrial Tax Abatement are justified, then direct Staff to prepare a development agreement that includes these terms for approval in early fall.

2. Direct Staff to prepare a development agreement that reflects terms other than those highlighted above.

3. If the City Council believes the amount of incentives being offered through TIF and Industrial Tax Abatement are excessive in relation to the magnitude of

benefit received from this project, decide not to move ahead to prepare a development agreement for a TIF incentive related to this project.

Under this alternative, the developer still will be allowed to proceed with the development of this subdivision with the assistance of an Industrial Tax Abatement incentive.

CITY MANAGER'S RECOMMENDATION:

With the exclusion of the annual appropriation clause, the staff and developer now are in support of all the other the major terms highlighted above. Therefore, it is the recommendation of the City Manager that the City Council support Alternative #1 and direct staff to prepare a development agreement that includes these terms for City Council approval in early fall.

It should be emphasized that when the actual costs related to the basic subdivision improvements are determined by the developer this summer through their bidding process, both the City Council and developer will have the opportunity to decide at that time whether or not the projected costs warrant continuing to proceed with the project.