LEE'S SUMMIT
LAW DEPARTMENT
OFFICE OF THE CITY ATTORNEY

November 8, 2022

TO: **Mayor Baird and City Council**

FROM: **David Bushek**

RE: **Summary of Discovery Park TIF Plan**

The first part of this memorandum presents new information that has become available after the TIF Commission hearing or as a result of the TIF Commission hearing.

TIF Commission Recommendation: On October 17, 2021, the Commission voted 7-2 to approve Resolution 2022-1 which made the following recommendations to the City Council:

A. adopt an ordinance to make the required statutory findings and adopt the TIF Plan, provided that such recommendation is contingent upon receipt of a report from Columbia Capital which materially concurs with developer's rate of return conclusion;

B. approve the TIF Plan;

C. designate the Redevelopment Area as a redevelopment area as provided in Section 99.805(12);

D. approve the Redevelopment Projects by ordinance as described in the TIF Plan, provided that Developer provides sufficient data to the City to demonstrate that each separate Redevelopment Project is financially feasible to be undertaken with TIF assistance based on data that is provided to the City for each Redevelopment Project;

E. designate Discovery Park Lee's Summit, LLC, as the developer of record and enter into a TIF contract with the developer for implementation of the TIF Plan; and

F. include provisions in the TIF contract which provide for the phased reimbursement of Reimbursable Project Costs based on the production of the non-residential land uses within each Redevelopment Project Area, in order to incentivize the developer to construct the non-residential land uses within each Redevelopment Project Area.

One significant point of discussion at the TIF Commission hearing was that review of the TIF Plan by Columbia Capital, the City's financial advisor, was not yet fully complete at the time of the Commission hearing. The second part of recommendations "A" above was specifically added by motion of the Commission to make sure that Columbia Capital's report was available for the City Council meeting and concurred with the Developer's rate of return analysis. If the second part of recommendation Otherwise, the Commission would recommend against approval of the TIF Plan.

There were two dissenting votes to the TIF Commission resolution. Joe Willerth, a City representative, voted against the resolution based on the concern that the Commission should have continued the Commission public hearing and conducted further review of Columbia Capital's report, after it became available, rather than referring the Plan to the City Council on October 17th. Jim Staley, representing the Library District and other taxing districts, voted against the resolution based on the Library District's standing policy against using TIF for residential projects. Mr. Staley expressed general support for the project but said he was required to vote against the TIF Plan due to the Library District policy.

At the TIF Commission meeting, two representatives of the Lee's Summit R-7 School District (LSR7) discussed a request by LSR7 that Developer dedicate or make available an approximately 15-20 acre parcel of land for the location of a new elementary school within the Redevelopment Area. Developer responded by acknowledging that LSR7 and the Developer have held discussions about this request, and that they will continue to discuss this request. City staff has meet with LSR7 representatives after the TIF Commission hearing to continue discussing this issue.

Report from City's Financial Advisor: Following the TIF Commission meeting, Columbia Capital was able to complete their analysis based on additional information received from the Developer about the planned schedule of development and the development assumptions used by Developer. Columbia Capital has provided the following observations, conclusions and recommendations.

Development Budget and Project Costs – Observations

- There are more than 60 individual project components identified in the Plan totaling about 80 discrete uses.
- Developer provided detailed costing for only the residential components for Phase 1; all other estimates are generic on a per square foot/per unit basis.
- If cost escalation continues at the same pace in 2023 and beyond, the Developer may not be able to construct according to its development plan or expected timing.

Capital Stack – Observations

- Developer reports its expectation that its bank lenders will provide financing at not more than 65-70% loan-to-value. We believe this to be a reasonable assumption.
- Developer has provided only three bank letters of interest and two conditional bank commitment letters.
- Together, these banks have provided the Developer/related entities with approximately $275 million of financing on projects over the last five years, approximately 40% of the amount of the financing projected to be needed for the Project.
- Developer did not provide Columbia Capital with and we did not review evidence of the Developer's capacity to provide the more than $285 million in equity to the project.

Appropriateness of Incentives and Rate of Return Calculations -- Observations

- Analyses are often performed using concept plan level project cost information, generic assumptions about sources of project income, and speculative estimates of potential drivers of new tax revenues.
- Dramatically rising interest rates during 2022 are already weakening demand for most asset classes (save, maybe, for multifamily).
- A developer would likely need to see project (unleveraged) returns of seven (7) to eight (8) percent to undertake a similar project.
- The Project appears to produce below-market returns on an unincentivized basis even if Project costs occur six months later than expected in all cases or if the Developer's hypothetical exit from the Project could occur at cap rates about 50 basis point stronger than early 2022 values.

- The Project would likely not require incentives if net operating income were materially higher than forecast or if development costs were materially lower than forecast.

Findings, Conclusions and Recommendations

Findings

- Developer's financial modeling of Project costs appears to be mathematically reliable.
- Developer's modeling of TIF, CID and hotel sales tax reimbursement appears to be mathematically reliable.
- A key weakness of the Developer's model is that it developed its own construction estimates and does not have third-party validation of these estimates. If Developer's modeled total development costs are overstated by more than 15-20%, all other things equal, the Project would likely not need incentives.
- Development assumptions for residential uses, other than in Phase 1, and for all commercial uses are generic.
- Developer's assumed operating expenses for its residential uses are overstated by approximately five (5) percent per year. This alone is not enough to change the but-for conclusion, but if Developer's modeled net operating income is understated by more than 20-25%, all other things equal, the Project would likely not need incentives.
- Developer did not present us with term sheets to finance any portion of the Project, including Phase 1 which, according to the Developer's testimony to the Commission, will soon be under construction.
- It is reasonable for the Commission and the City to question whether the Developer has the capacity to obtain $666 million in bank debt and to provide $285 million in equity over the next eight to ten years to permit the Project to materialize.
- A substantial proportion of the development planned for the Project is identified in the speculative Phase 4, not scheduled to start construction until 2028. We think it is reasonable for the Commission and the City to contemplate the Project as not ever including any of the development in Phase 4 and, thus, to assess the desirability and viability of Phases 1 to 3 of the Project on their own.

Conclusions

- Developer has presented sufficient information to permit the Commission to evaluate whether the Project as proposed is financially feasible.
- Developer has provided sufficient information to permit the Commission to determine that, as presented, the Plan, as modified by the October 20 afternoon modeling, would not provide a market rate of return and, therefore, meets the statutory but-for test.
- Columbia Capital's return assumptions are materially the same as the Developer's. A chart from the Report compares the Developer's and Columbia Capital's rate of return calculations, showing that the calculations are materially the same:

	Developer's Model	CCM's Model	CCM • RPA 1	CCM • RPA 2	CCM • RPA 3	CCM • RPA 4
Unincentivized IRR	4.2%	4.4%	3.6%	3.3%	5.0%	6.0%
Incentivized IRR	7.6%	7.9%	6.2%	10.6%	8.0%	10.8%
Target Return†	**7-8%**	**7-8%**	**7-8%**	**7-8%**	**7-8%**	**7-8%**

† The target return amount is Columbia Capital's estimate of the required market return for the Project

Recommendations

- The City should require new financial analysis for each phase of the Project, ideally including third-party support for construction cost estimates and potential net operating income projections.

- The City should impose finite limits on the amount of reimbursement that can be generated by the Developer from such phase.
- The City should require that certain levels of commercial development be required to "unlock" the Developer's access to reimbursement in each phase.

Additional Considerations

- The City should evaluate whether it should include Phase 4 in any approvals it gives to the Project, given that phase's proposed schedule (commencement in 2028). Given how this developer intends to finance the project—on a building-by-building basis across a number of banks—the City's action to postpone approvals on Phase 4 should not be as impactful on the Developer's ability to finance earlier phases.
- The City should evaluate whether to reject the Developer's request for reimbursement of hotel sales tax receipts as a way for the City to hedge its risk that commercial development does not occur at the times or in the amounts projected in the Plan.

<u>Changes to the TIF Plan</u>: Following the TIF Commission hearing, Developer made the following changes to the TIF Plan. Notice of these changes was mailed to the taxing districts and published in the Lee's Summit Tribune not less than 10 days prior to November 8, 2022:

- Revisions of the Plan text and Budget pages to uniformly reflect that Redevelopment Projects 1 and 4 will have structured parking and Redevelopment Projects 2 and 3 will have surface parking.

- Due to Fire Code requirements associated with construction of the residential structures in Redevelopment Project 1, the number of apartment units will decrease by approximately 140 units.

- The commercial square footage in Redevelopment Project 1 will be reduced by 21,500 square feet. Commercial development will increase in Redevelopment Project 4 by at least 21,500 square feet, shifting at least the same amount of commercial space from Redevelopment Project 1 so that the overall amount of commercial space for the Redevelopment Area as a whole will not be reduced.

- Revisions to the Schedule to reflect that Redevelopment Project 1 will commence in May 2023 and is expected to be completed in October 2026, and that Redevelopment Project 3 will commence in May 2024 and is expected to be completed in December 2027.

- Revisions to the Redevelopment Project 1 budget page to correct a math error associated with the total On-Site Costs.

- Revisions to the data in the revenue projections and cost benefit analysis which are consistent with the changes described above.

This is a chart from page 3 of the Columbia Capital report which summarizes the changes to the TIF Plan after the TIF Commission meeting:

CHANGES FROM COMMISSION PRESENTATION		
Item	**Original Project**	**Revised Project**
Total Development Cost	$956.5 million	$951.0 million
Projected Incentives	$212.2 million	$227.4 million
Incentives as % of Dev Cost	22.1%	23.9%
Residential Units	2,930	2,797
Commercial Space (sf)	660,500	665,300
Structured Parking Stalls	1,520	1,860

Below is the original information from the memorandum that was delivered to the TIF Commission, except where *noted* based on changes that occurred after the conclusion of the Commission hearing.

<u>Developer</u>: Discovery Park Lee's Summit, LLC (the "Developer")

<u>Current Property Owner</u>: Developer for Redevelopment Project Areas 1, 3 and 4, and Jack Rich *et al.* as to Redevelopment Project Area 2. Developer has indicated it has a contract to purchase the Redevelopment Project Area 2 property and plans to close on the property on October 24, 2022.

<u>Property</u>: The proposed Redevelopment Area contains approximately 265 acres and is located between NE Colbern Road and NE Douglas Street on the north, I-470 on the south, NE Douglas Street on the east, and Main Street on the West, in Lee's Summit, Missouri.

<u>Redevelopment</u>: The four Redevelopment Projects are proposed to consist of a mixed-use development project containing approximately 660,500 square feet of retail, office, entertainment and hospitality space and/or other related commercial uses, approximately 2,930 luxury multi-family units and approximately 1,520 structured parking stalls, along with associated public improvements that would serve the Redevelopment Area. The development by Redevelopment Project Area is:

- <u>Redevelopment Project Area 1</u> – approximately 80,800 square feet of commercial space, approximately 1,185 luxury multi-family units, approximately 690 structured parking stalls and approximately 230 hotel rooms.

- <u>Redevelopment Project Area 2</u> – approximately 126,500 square feet of commercial space.

- <u>Redevelopment Project Area 3</u> – approximately 224,000 square feet of commercial space, approximately 332 luxury multi-family units.

- <u>Redevelopment Project Area 4</u> – approximately 234,000 square feet of commercial space, approximately 1,280 luxury multi-family units and approximately 830 structured parking stalls.

***Note*:** The information above was updated after the TIF Commission meeting.

<u>Property Investment and Valuation</u>:

- Current County assessed valuation of Redevelopment Area: $10,290

- Total Project Costs: about $951 million (***Note*** revised amount after TIF Commission hearing)

- Projected assessed valuation of TIF Project Area after full build-out: about $132 million

<u>Sources of Funds</u>: The project budget is set forth in *Exhibit 5* of the TIF Plan (***Note*** as revised):

Redevelopment Project Costs

Component	Total	Private	TIF Reimbursable	CID Reimbursable	Hotel Tax Reimbursable	Total Reimbursable
Land Acquisition	$26,189,078	$26,189,078	–	–	–	–
Grading, retaining walls and site prep	$17,783,315	–	$17,783,315	–	–	$17,783,315
Sanitary Sewer	$3,539,635	–	$2,823,600	$716,035	–	$3,539,635
Water	$3,235,767	–	$2,519,732	$716,035	–	$3,235,767
Stormwater	$8,326,276	–	$8,326,276	–	–	$8,326,276
Roadway	$8,829,125	–	$7,065,473	–	$1,763,652	$8,829,125
Blue Parkway Road Improvements	$5,000,000	–	–	$5,000,000	–	$5,000,000
Surface Parking & Curbs	$13,568,700	–	$13,568,700	–	–	$13,568,700
Site Utilities	$3,837,300	–	$3,837,300	–	–	$3,837,300
Hardscapes / Landscapes	$16,384,365	–	$16,384,365	–	–	$16,384,365
Signage / Monumentation	$702,510	–	$702,510	–	–	$702,510
Public Improvements	$4,450,000	–	–	$4,450,000	–	$4,450,000
Transmission lines	$6,759,160	–	$6,759,160	–	–	$6,759,160
Total On-Site Costs	$92,416,153	–	$79,770,431	$10,882,070	$1,763,652	$92,416,153
Vertical Improvements	$697,334,855	$679,337,288	$17,997,567	–	–	$17,997,567
Parking Garage	$38,278,800	–	$38,278,800	–	–	$38,278,800
General Conditions	$6,057,353	$4,000,000	$2,057,353	–	–	$2,057,353
Total Building Construction	$741,671,008	$683,337,288	$58,333,720	–	–	$58,333,720
Professional Fees	$27,598,706	–	$27,598,706	–	–	$27,598,706
Financing Costs	$30,685,575	–	$30,685,575	–	–	$30,685,575
Commissions/Marketing	$4,700,000	$4,700,000	–	–	–	–
Development Fees	$6,210,000	$6,210,000	–	–	–	–
Contingency	$21,562,171	$19,562,171	$2,000,000	–	–	$2,000,000
Total Professional Costs	$90,756,452	$30,472,171	$60,284,281	–	–	$60,284,281
Grand Total	**$951,032,692**	**$739,998,537**	**$198,388,432**	**$10,882,070**	**$1,763,652**	**$211,034,154**
Incentives as % of Development Costs	**22.19%**	**(21.78% less Blue Parkway Road Improvements)**				

Developer has also provided a breakdown of the Reimbursable Project Costs between public and private costs:

Component	Private improvements	Public Improvements	Total Reimbursable
Grading, retaining walls and site prep	–	$17,783,315	$17,783,315
Sanitary Sewer	–	$3,539,635	$3,539,635
Water	–	$3,235,767	$3,235,767
Stormwater	–	$8,326,276	$8,326,276
Roadway	–	$8,829,125	$8,829,125
Blue Parkway Road Improvements	–	$5,000,000	$5,000,000
Surface Parking & Curbs	$13,568,700	–	$13,568,700
Site Utilities	–	$3,837,300	$3,837,300
Hardscapes / Landscapes	–	$16,384,365	$16,384,365
Signage / Monumentation	–	$702,510	$702,510
Public Improvements	–	$4,450,000	$4,450,000
Transmission lines	–	$6,759,160	$6,759,160
Total On-Site Costs	$13,568,700	$78,847,453	$92,416,153
Vertical Improvements	$34,399,078	–	$34,399,078
Parking Garage	$23,088,800	–	$23,088,800
General Conditions	–	$2,057,353	$2,057,353
Total Building Construction	$57,487,878	$2,057,353	$59,545,231
Professional Fees	$11,039,482	$16,559,224	$27,598,706
Financing Costs	$12,274,230	$18,411,345	$30,685,575
Contingency	–	$2,000,000	$2,000,000
Total	$94,370,291	$117,875,375	$212,245,665
Public Improvements %		**56%**	
Private Improvements %		**44%**	

Note – The table above was prepared before the TIF Commission hearing and may no longer match precisely with the project budget in Exhibit 5 as it was revised after the TIF Commission hearing.

Ownership and Development Structure

- Current Ownership: Redevelopment Project Areas 1, 3 and 4 are currently owned by the Developer, and Redevelopment Project Area 3 will be purchased by Developer.

- TIF Project Area: The Redevelopment Area includes four TIF Redevelopment Projects, which will be activated in connection with the development of each Project Area. TIF collection will begin when each Redevelopment Project ordinance is approved, and may last for a maximum of 23 years.

TIF Reimbursement and Financing Structure:

Developer is requesting reimbursement from two revenues sources:

1. TIF Revenue – PILOTs and EATs

- PILOTs: 75% of the PILOTs in the TIF Redevelopment Project area will be captured and used to repay Reimbursable Project Costs according to the budget set forth in Exhibit 5 of the TIF Plan.

25% of the PILOTs will be declared as surplus on an annual basis and released to the taxing districts according to their levy rates as required by the TIF Act for surplus PILOTs distributions.

- EATs: 50% of the EATS will be captured and used to pay reimbursable project costs. The remaining 50% will flow to the sales taxing districts as normal.

- Hotel Tax Reimbursement: The City's 1% general sales tax which is generated by each hotel will be deposited in the Special Allocation Fund and used to pay Reimbursable Project Costs.

- Reimbursable Project Costs: TIF revenue is proposed to reimburse about $8.04 million in project costs, all for the structured parking.

2. Community Improvement District – 1% Sales Tax

- Developer is requesting that a community improvement district (CID) be used to imposed a 1% sales tax on taxable retail sales throughout the Redevelopment Area.

- The Blue Parkway and Colbern Road CID is already in place over Redevelopment Project Areas 3 and 4, along with other property to the west and count of Redevelopment Project Areas 3 and 4. Developer is proposing to expand the boundaries of that CID to include Redevelopment Project Areas 1 and 2, and use the resulting sales tax revenues from within the Redevelopment Area as a whole to fund public improvement costs for the Redevelopment Area.

- The City is currently due approximately $5 million in reimbursement from the CID for costs that were advanced by the City to fund improvements to Blue Parkway at the western entrance to Unity Village in 2012. Based on pre-negotiations with City staff, the TIF Plan includes $5 million in reimbursement to the City from CID revenues, and the captured portion of the CID revenues, that would be generated within Redevelopment Project Areas 3 and 4.

TIF Financing Options: Reimbursement will start as pay-as-you go. Bonds may be issued at the City Council's discretion and as provided in the TIF contract to finance Redevelopment Project Costs.

Benefit to Taxing Districts: The Cost-Benefit Analysis attached to the TIF Plan as *Exhibit 8* shows the projected tax revenues to be generated by the project for each taxing district if the project does not occur and if the project does occur with the use of TIF.

Basis of Reimbursement and the "But For" Test:

- The basis of the reimbursement request is that reimbursement needed to achieve a rate of return that is sufficient to cause Developer to undertake the project.

- The cash flow and rate of return analysis based on Developer's calculation in *Exhibit 9*. Columbia Capital, as the City's financial advisor, is evaluating this issue for the City.

Comparison to City's Economic Development Policy: The City's Economic Development Policy Guidelines state that typically incentives using TIF will be an amount not to exceed 25% of the total private development costs. The TIF assistance is about **20.8%** of the total project costs. Developer has separately identified the Reimbursable Project Costs that are only public in nature, and that budget page is include in the meeting packet. The public improvements represent approximately 56% of the total Reimbursable Project Costs, and approximately **12.4%** of the total project costs. (***Note*** calculations revised after TIF Commission hearing.)

<u>Required Findings</u>: The following is a list of the findings required to be made by the City Council with a recommendation from the TIF Commission, along with references to the pages in the TIF Plan where supporting information may be found:

- **Blight:** The Redevelopment Area must be a blighted area, as such term is defined in Section 99.805(1), RSMo, as follows:

  > an area which, by reason of the predominance of insanitary or unsafe conditions, deterioration of site improvements, or the existence of conditions which endanger life or property by fire and other causes, or any combination of such factors, retards the provision of housing accommodations or constitutes an economic or social liability or a menace to the public health, safety, or welfare in its present condition and use.

  The City Council found that Redevelopment Project Areas 3 and 4 is a blighted area pursuant to The Urban Redevelopment Corporations Law as set forth in Chapter 353 of the Revised Statutes of Missouri through the adoption of Ordinance No. 7163 on March 22, 2012. The definition of "blighted area" under Chapter 353 matches the definition of "blighted area" under the TIF Act and therefore the previous finding by the City Council satisfies the TIF Act requirement as to the property within Redevelopment Project Areas 3 and 4, and further that the blighting conditions within such area have not been cured by redevelopment since the date of the blight finding in 2012.

  The TIF Plan is accompanied by a Blight Study dated September 6, 2022 which is set forth as Exhibit 3 of the TIF Plan, demonstrating that the Redevelopment Area is a blighted area as such term is defined in Section 99.805(1), RSMo, due to insanitary and unsafe conditions and the deterioration of site improvements and that the property is an economic liability as well as a menace to the public health, safety and welfare in its present condition and use. The TIF Plan is also accompanied by an affidavit which is set forth in Exhibit 12, signed by the Developer, attesting to the conditions of the Redevelopment Area which qualify the area as a blighted area.

- **But-For Test:** The proposed redevelopment must satisfy the "but for" test set forth in Section 99.810, RSMo, in that the Redevelopment Area has not been subject to growth and development through investment by private enterprise and would not reasonably be anticipated to be developed without the adoption of tax increment financing. *Exhibit 11* states that the rate of return for the project without incentives is 5.5%, and the rate of return with incentives is 8.9%. The TIF Plan is accompanied by an affidavit, signed by the Developer, attesting to the "but for" test (*Exhibit 12*). Columbia Capital has provided an independent report which verifies these conclusions, but with slightly different calculations that are not materially different than Developer's calculations. (***Note*** updated after TIF Commission hearing for Columbia Capital Report.)

- **City Financial Advisor Review**: Columbia Capital has provided an independent report which verifies these conclusions, but with slightly different calculations that are not materially different than Developer's calculations. (***Note*** updated after TIF Commission hearing for Columbia Capital Report.)

- **Relocation Plan**: The TIF Plan includes as *Exhibit 4* a Relocation Assistance Plan as required by the TIF Act.

- **Cost-Benefit Analysis:** A cost-benefit analysis is required showing the economic impact of the TIF Plan on each taxing district and political subdivision within the Redevelopment Area if the project is built pursuant to the TIF Plan or is not built. A cost-benefit analysis has been provided in *Exhibit 8* to the TIF Plan.

- **Financial Feasibility:** There must be evidence that the proposed project is financially feasible for the Developer to construct with TIF assistance. Developer has provided *Exhibit 9* as evidence that the project is financially feasible to undertake with public assistance. Columbia Capital is reviewing this issue for the City.

- **TIF Plan Contents:** The TIF Plan must contain the following information, and the page and exhibit references below indicate where the information may be found in the TIF Plan:

    - A general description of the program to be undertaken to accomplish its objectives (*Pages 1-3, 11*).

    - The estimated redevelopment project costs (*Page 11 and Exhibit 5*).

    - The anticipated sources of funds to pay the costs (*Page 11-12 and Exhibits 7*).

    - Evidence of the commitments to finance the project costs (*Exhibit 11 and supplemental letters delivered by Developer*).

    - The anticipated type and term of the sources of funds to pay costs (*Pages 15*).

    - The anticipated type and terms of the obligations to be issued (*Pages 15*).

    - The most recent equalized assessed valuation of the property within the Redevelopment Area which is to be subjected to payments in lieu of taxes and economic activity taxes pursuant to Section 99.845, RSMo (*Page 15 and Exhibit 6*).

    - An estimate as to the equalized assessed valuation after redevelopment (*Page 16 and Exhibit 6*).

    - The general land uses to apply in the Redevelopment Area (*Pages 11, 17*).

    - Estimated dates for the retirement of obligations incurred to finance redevelopment project costs, and said dates are not more than twenty-three (23) years from the adoption of an ordinance approving a Redevelopment Project within the Redevelopment Area (*Page 20 and Exhibit 6*).

    - Estimated dates of completion of the redevelopment project (*Exhibit 6*).

- **Plan Requirements:** The TIF Plan must also meet the following requirements, and the page and exhibit references below indicate where the information supporting these requirements may be found in the TIF Plan:

    - The TIF Plan is in conformance with the Comprehensive Plan for the development of the City as a whole (*Pages 19*).

- A Relocation Assistance Plan has been developed for relocation assistance for businesses and residences, and the relocation of any business or residents in the Redevelopment Area, if necessary, will take place in accordance with the Relocation Assistance Plan (*Page 20 and Exhibit 4*).

- The TIF Plan does not include the initial development or redevelopment of any gambling establishment (*Page 21*).

- The areas selected for the Redevelopment Project include only those parcels of real property and improvements thereon which will be directly and substantially benefited by the Redevelopment Project improvements (*Exhibit 1*).

* * *