

## City of Lee's Summit

View High Sports Complex Project

Financial Analysis | FINAL





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Columbia Capital is an SECregistered investment adviser and a registered municipal advisor. Columbia Capital provides advice as a fiduciary to its clients.



### INTRODUCTION

3D Builders KC, LLC, a Missouri limited liability company (the "Developer"), has requested an incentive package from the City of Lee's Summit, Missouri (the "City") for the development of its View High Sports Complex Project: an indoor and outdoor multi-sports complex composed of a 180,000 square foot indoor complex and a 90,000 square foot outdoor complex (the "Project"). The complex includes basketball courts, volleyball courts, soccer fields, pickleball courts and several other auxiliary facilities. There will be an additional two-acre pad site for potential future development. As of April 24, 2025, the Developer is constituted as an active limited liability company according to the records of the Missouri Secretary of State with a principal office location within the City.

The City engaged Columbia Capital Management, LLC ("Columbia") to provide a financial analysis (the "Analysis") of the Plan. The City's primary desire for our Analysis is to understand the need for incentives through "but-for" evaluation. The Analysis assumes the following incentives will be available to the Project:

- A Chapter 100 sales and use tax exemption on construction materials
- A Chapter 100 Real Property Tax Abatement at 100% for 25 years
- A 1% community improvement district (CID) sales tax for 27 years
- A tax rebate of 1.50% of the City's 2.75% sales tax for 25 years

The Developer reports a \$49,300,000 total development cost budget for the Project. Per the Developer's assumptions, we assume the Project will be completed in August of 2026.

## RELATIONSHIPS

Columbia Capital Management, LLC (the "Financial Advisor") is a registered municipal advisor and serves as the City's financial advisor. The City engaged the Financial Advisor to provide a financial evaluation of the Project. The Financial Advisor is not now, nor has ever been, engaged by the Developer or its related entities to provide it with similar services. The reader's interests may vary from those of the City's.

## RELIANCE

This Analysis is not a projection of the likelihood of success of the Project. In preparing this analysis, the Financial Advisor relied upon certain data and information supplied to it by the Developer, delivered to the City and provided to it separately.

Except where noted herein, the Financial Advisor has relied upon this data and information without independently verifying the veracity or reliability of such information. The Analysis may not be used, except in the context of the City's review of the Developer's request for incentives. The Analysis assumes all components of the Project are developed as described herein.

As with any work of this kind, the Analysis is almost exclusively forward-looking. The reader should note that small changes in modeling inputs could have significant impacts on modeled financial outcomes. The reader must consider this Analysis in light of contractual arrangements that the City would expect to undertake with the Developer to formalize the development components of the Plan and their anticipated timing for completion.

## THE PROJECT

The Project would be located on approximately 15.2 acres at 3350 NW Ashurst Dr., Lee's Summit, Missouri, near Longview Lake. There is currently a church located on the property owned by the United Methodist Church and we understand the City has rezoned the property to allow for the Project. The Project is an indoor and outdoor multi-sport complex that includes the following:

| view ringh Sports Entertainment i roject                 |                                       |  |  |
|--|---------------------------------------|--|--|
| 180,000 sf Indoor Complex                                | 90,000 sf Outdoor Complex             |  |  |
| • 1 FIFA regulation-size soccer field                    | • 1 FIFA regulation-size soccer field |  |  |
| • 8 basketball courts                                    | • 5 pickleball courts                 |  |  |
| • 12 volleyball courts                                   |                                       |  |  |
| • 5,000 sf physical rehab office                         |                                       |  |  |
| • 7,500 sf strength, speed and agility training facility |                                       |  |  |
| • 5,500 sf sports club/facility office space             |                                       |  |  |
| • 1,350 sf soccer club merchandize store                 |                                       |  |  |
|  |                                       |  |  |

#### View High Sports Entertainment Project

- 2,300 sf café
- 10,000 sf family entertainment center

In addition, the Project includes a two-acre retail pad site for future development. The Developer reports its intention to complete all work by August 2026. The Developer hired a third party, Sports Facilities Advisory, to provide pro forma net operating income projections, which we used in our modeling. We understand this firm specializes in projects similar to the Project; we found their report was very thorough.

## DEVELOPMENT BUDGET AND PROJECT COST

The Developer provided the following budget for the Project:

| ESTIMATED USES OF FUNDS    | TOTALS        |
|----------------------------|---------------|
| Land Acquisition           | \$ 1,335,000  |
| Hard Cost                  | 34,154,800    |
| Field and Sports Equipment | 2,046,095     |
| Furniture Fixtures         | 1,494,357     |
| Soft Cost Construction     | 2,090,263     |
| Soft Cost Operation        | 3,079,378     |
| Contingency                | 5,100,107     |
|                            |               |
| Totals                     | \$ 49,300,000 |

## CAPITAL STACK

Due to the pay-as-you-go nature of the CID and tax rebate incentives, the Developer will be obligated to finance the total development cost of the Project ahead of reimbursement being generated. The Developer reports its expectation that the project will have a 70% loan-to-cost ratio.

| ESTIMATED SOURCES OF FUNDS |               |  |
|----------------------------|---------------|--|
| Debt (70%)                 | \$ 34,300,000 |  |
| Equity (30%)               | 15,000,000    |  |
| TOTAL SOURCES              | \$ 49,300,000 |  |

The Developer provided us with a letter of interest from Community National Bank with a requested borrowing amount of \$31,500,000 and a preliminary interest rate of 7.75%. The Developer did not provide us with and we did not review evidence of the Developer's capacity to provide the \$15 million in equity to the Project, or to fund the difference between the \$31,500,000 potential loan amount and the \$34,300,000 debt anticipated in the capital stack.

# EVALUATING THE APPROPRIATENESS OF INCENTIVES AND DEVELOPER'S RATE OF RETURN CALCULATIONS

The City's ultimate desire for any commercial property is that it be developed to its highest and best use. An efficiently used site will maximize the City's future tax receipts from the Project and will provide the community with access to amenities and experiences that might not be available today. Ideally, a private developer would produce such an outcome without public subsidy in the project.

**Philosophical Approach.** Most modern urban redevelopment suffers from challenges that increase project costs and reduce investor returns versus similar projects on "greenfield" sites (undeveloped properties with no impediments to development). Demolition and site preparation, environmental remediation, new or revitalized public utilities, and parking and transportation infrastructure improvements are the common drivers of these higher costs. Philosophically, cities desire to "level the playing field" between more expensive infill sites and less costly greenfield sites through the payment of incentives to infill developers. Cities desire to provide incentives that will equalize the profitability of an infill site and a greenfield site. The challenge for all cities is the asymmetry of information available to assess what, exactly, is this "perfect" level of incentive. Developers often have a desired minimum amount of incentives in mind, but cities are forced to guess this number. A key

risk for a city in this challenging dance is that it ends up over-incentivizing the infill project by agreeing to pay the developer a subsidy amount higher than the developer would have accepted to move forward with the project.

In order to assess the value to the Developer of the incentives requested, it is important first to try to quantify their value. All financial projections suffer from a very fuzzy crystal ball. The potential end-of-life of the incentives requested for the Project is more than 27 years from now. The risk of this uncertainty generally falls mostly to the Developer—that is the reason it demands a rate of return on the Project that substantially exceeds a "risk free" rate of return.

The City is also at risk, however, in this transaction. By granting incentives, it is making an affirmative decision to cause a project to develop at this site that the market itself will not support. Further, it agrees to continue to support that project financially for the better part of three decades. There is an opportunity cost to the City to forgo a portion of the incremental property taxes from the Project during the life of the abatement (although it is impossible to know what that opportunity cost is without knowing what might have been developed on this site instead of the Project).

**"But-For" Test.** Many local governments include a policy requirement that a project seeking incentives satisfy a "but-for" test. The but-for test is simple in theory: but-for the presence of the incentives, the project would not proceed. As described above, urban infill development faces significant barriers to attracting private capital versus less costly, more certain greenfield developments.

In practice, the but-for test is hard to apply. A city does not know the intentions of the developer and the developer has an incentive (and depending on its corporate structure, potentially a duty) to maximize its return from the investment in a project. The but-for calculation generally relies on a comparison of the developer's return on investment, both with and without incentives, against market rates of return for similar projects. These types of analyses are blunt instruments, at best. Legitimate debates persist about calculation inputs, cashflow discounting rates and calculation mechanics at the end of the analysis period. Additionally, these analyses are often performed using concept plan-level project cost information, generic assumptions about sources of project income (lease rates, property sale proceeds), and speculative estimates of potential drivers of new tax revenues (post-construction equalized assessed valuation, in this case). The result is that a developer of a project and a city providing the incentives for that project can draw very different conclusions from the same set of analytical inputs.

**Required Return.** As described above, the City's interest (presuming it desires to see the Developer construct the Project) is to provide just enough incentive to cause the Developer to proceed with the Project—but not a penny more. Where the parties have diametrically opposing interests (the Developer wants to maximize its incentives grant while the City wants to pay none), we look to calculate the Project's internal rate of return ("IRR") with and without incentives, and then compares those rates with market rates of return for similar projects.

Based upon a recent third-party report published by a real estate company active in the Kansas City market, "capitalization rates" for various types of projects are provided in the table below. The capitalization rate or cap rate—an indicator of value relative to stabilized net operating income (NOI)—is a commonly used metric of real estate pricing. Cap rate is a measure of property value per dollar of current net income. Cap rate is useful as a basic valuation measure so an investor can see how a specific project's valuation compares to other, similar projects. IRR is similar to the concept of "net present value," and captures the rate of return earned on an investment during a specific time frame, assuming a reinvestment of cash flows at the same return rate. As a result, we can use the cap rate as a proxy for the market rate of return required to induce the Developer to invest in the Project versus another development elsewhere, although we do note that most Developers would seek to "go in" to a project at a rate higher than current cap rates in order to provide some conservatism and to provide room for spread compression: the idea that it might be able to exit at a more favorable (lower) capitalization rate than where it entered the project.

The nature of this project makes it difficult to confidently identify the appropriate capitalization rate as the data available does not specifically cover this type of project. We assume the nature of this project produced more risk than office and retail projects, so we have assumed a capitalization rate of 8.5% in our modeling.

|                    | Capitalization |
|--------------------|----------------|
| Kansas City Market | Rates 4Q24     |
| Office             | 8.3%           |
| Industrial         | 7.4%           |
| Retail             | 7.0%           |
| Multifamily        | 5.9%           |

**Leveraged vs. Unleveraged Returns.** A cap rate is measure of a project's economic productivity in reference to its sale price. It implicitly assumes the reference project is funded with 100% equity. In this way, it is possible to compare cap rates across projects of different characteristics in different locations. As such, cap rates provide a useful benchmark for us to assess the appropriateness of a return of a subject property.

An unleveraged IRR or project IRR is a rate of return calculation assuming the subject property is funded 100% by developer equity. Because unleveraged IRR ignores the financing structure of the project, the metric permits comparisons across disparate projects and regions, against competing investments (say, stocks or bonds) and, importantly, versus cap rate benchmarks.

Most modern development projects have some sort of commercial financing, creating leverage: a dollar of equity is matched with three dollars of bank financing, for instance, to generate the four dollars necessary to construct a project. Depending upon market conditions and use mix at the project, it is typical to see loan financing at 55-75% of the capital stack.

Leveraged IRR or equity IRR, then, measures a project's rate of return against only a developer's equity contribution to the project. Typically, leveraged IRR is materially higher than equity IRR. Because financing structures differ materially from project to project and region to region, there are no industry benchmarks for "market" IRR. Instead, we need to look across asset classes to assess what risk-weighted returns might be expected from equities, high-yield fixed income, etc.

Our expectations for a project like this would be a need to show leveraged IRR in the 12-15% range, but this is subject to significant variability.

**Modeled IRR.** Based upon the information provided to us by the Developer and the City, our conclusions regarding the Project's estimated unleveraged and leveraged IRRs are shown in the tables below. As is typical in these calculations, our model assumes a hypothetical sale of the Project ("reversion") after 10 years, in this case assuming an eight and one-half (8.5) percent cap rate, with recognition of projected but unrealized incentives after reversion discounted to that date at six (6) percent.

| Unleveraged        | Rate of |
|--------------------|---------|
| (Project) Return   | Return  |
| Unincentivized IRR | 2.1%    |
| Incentivized IRR   | 8.9%    |
| Market Return      | 8.5%    |
|                    |         |
| Leveraged (Equity) | Rate of |
| Return             | Return  |
| Unincentivized IRR | -17.5%  |
| Incentivized IRR   | 8.3%    |
| Target Return      | 12-15%  |

The results of our IRR analysis are mixed. Although the unleveraged return with incentives exceeds an expected market return, the leveraged results are relatively low. We expect this is the result of a potentially overly-aggressive assumption by the Developer on the level of debt and the high cost of that debt.

To illustrate the sensitivity of IRR under various scenarios, we have provided two additional scenarios below: (a) net operating income at 125% of the Developer's projections; and (b) total development cost (TDC) at 80% of the Developer's projection. We note that some of the materials provided to us presented a lower TDC, with one projection as low as \$43.6 million.

|                    |           | Sensitivity | Sensitivity |
|--------------------|-----------|-------------|-------------|
| Unleveraged        | As        | NOI at      | TDC at      |
| (Project) Return   | Presented | 125%        | 80%         |
| Unincentivized IRR | 2.1%      | 5.5%        | 5.5%        |
| Incentivized IRR   | 8.9%      | 11.5%       | 12.9%       |
| Market Return      | 8.5%      | 8.5%        | 8.5%        |

|                    |           | Sensitivity | Sensitivity |
|--------------------|-----------|-------------|-------------|
| Leveraged (Equity) | As        | NOI at      | TDC at      |
| Return             | Presented | 125%        | 80%         |
| Unincentivized IRR | -17.5%    | -1.4%       | 0.4%        |
| Incentivized IRR   | 8.3%      | 15.0%       | 17.0%       |
| Target Return      | 12-15%    | 12-15%      | 12-15%      |

The sensitively analysis suggests that some combination of higher NOI and lower TDC could result in a leveraged IRR in-line with current market returns. It also provides the City with some confidence that the Project is unlikely to be over-incentivized under most combinations of the Project's ultimate cost and its financial performance over time.

## CONCLUSIONS AND RECOMMENDATIONS

Based upon the information available to us and subject to the limitations noted in the foregoing paragraphs, our conclusions and recommendations are as follows:

- subject to the concerns and conditions noted herein, the Developer has presented sufficient information to permit the City to evaluate the potential rate of return of the Project as proposed
- on an unleveraged basis, the Project appears to require incentives in order to produce a market rate of return
- on a leveraged basis the Project's returns appear to be lower than an estimated market rate of return, likely due to the Developer's high loan-to-cost assumption and the current interest rate environment

We encourage the City to consider requiring in the development agreement:

- before any eligible costs can be certified for reimbursement and to remain in good standing under the Chapter 100 documents, the Developer to provide evidence (such as a fully credit-approved commitment letter) of its having secured debt in an amount not less than \$34,300,000 (which evidence might be provided to the City's financial advisor to avoid concerns about public disclosure)
- before any eligible costs can be certified for reimbursement and to remain in good standing under the Chapter 100 documents, the Developer to provide evidence of its having secured or provided the amount of equity required in the commitment letter (which evidence might be provided to the City's financial advisor to avoid concerns about public disclosure)
- Developer's certification of eligible project costs (using such definitions in the CID Act) in order to secure reimbursement of costs from the City's sales tax rebate
- Developer's certification of actual total development costs of approximately \$49,000,000, with incentives clawbacks imposed if actual costs are materially less than this amount

- Detailed performance requirements related to development of the components of the Project, including some or all of those listed in the table above, subject to clawbacks if the Project is not developed as proposed
- Detailed Project delivery time constraints, subject to clawbacks or other remedies if delays occur