# MEMORANDUM

To: Ben Pratt; Town of Erie Urban Renewal Authority

From: Andrew Knudtsen and Tim Morzel; Economic & Planning Systems

Subject: 730 Briggs Street TIF Request Review; EPS #203137

Date: December 28, 2020

This memorandum provides a summary of a review for tax increment financing (TIF) submitted to the Town of Erie Urban Renewal Authority (TOEURA) by the developers of 730 Briggs Street (the "Developer") in order to assist with the development of a new mixed-use building (the "Project") in Old Town Erie. Economic & Planning Systems (EPS) was retained by the URA to complete a review of the request for TIF submitted by the Developer and to assist the URA in estimating future TIF revenues generated by the Project. The following provides a summary of the analysis and key recommendations. A detailed summary of this analysis is included in the project pro forma, which is attached to this memorandum (Attachment A).

## Development Program

The proposed development program is currently planned as a two-story, mixed-use office and retail building located to the northwest of the intersection of Briggs Street and Cheesman Street. Current designs include 3,626 square feet on the first floor and 4,302 square feet on the second floor. The total building area is estimated at 7,928 square feet, shown in **Table 1**.

While the specific mix of retail and office tenants is not yet known, individual spaces are currently listed for lease at $24 per square foot (NNN). The Developer has stated that this is an initial listing rate that is likely higher than what the market will support. While the Developer has stated that they expect actual lease rates to range from $22 to $22.50 per square foot (NNN), EPS has applied an estimated lease rate of $23 per square foot (NNN). This estimate reflects current market conditions and reflects anticipated lease rates used in recently reviewed comparable projects (105 Wells Street and others).

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**Table 1. Program Overview**

| Description | Gross SF | % of Total | Average Rent NNN |
|---|---|---|---|
| 1st Floor | 3,626 | 46% | $23.00 |
| 2nd Floor | 4,302 | 54% | $23.00 |
| **Total** | **7,928** | **100%** | **$23.00** |

Source: Developer; Economic & Planning Systems

## Existing Use

The proposed Project is currently contemplated to occupy the eastern half of two parcels located to the northwest of the intersection of Briggs Street and Cheesman Street (730 Briggs Street and 215 Cheesman Street), which were both subdivided to accommodate future development, as shown in **Figure 1**. The eastern half of 215 Cheesman is currently vacant and the eastern half of 730 Briggs provides access and parking for the building located on 215 Cheesman Street, as shown in **Figure 2**.

Based on the most recent assessment, the total value of both parcels is estimated at $617,700. The value of the redeveloped portion of the two parcels is estimated at $90,000, which is based on the current land value of the two parcels and an assumption that the Project will occupy roughly 50 percent of the total parcel area.

**Figure 1. Development Parcels, 730 Briggs Street and 215 Cheesman Street**

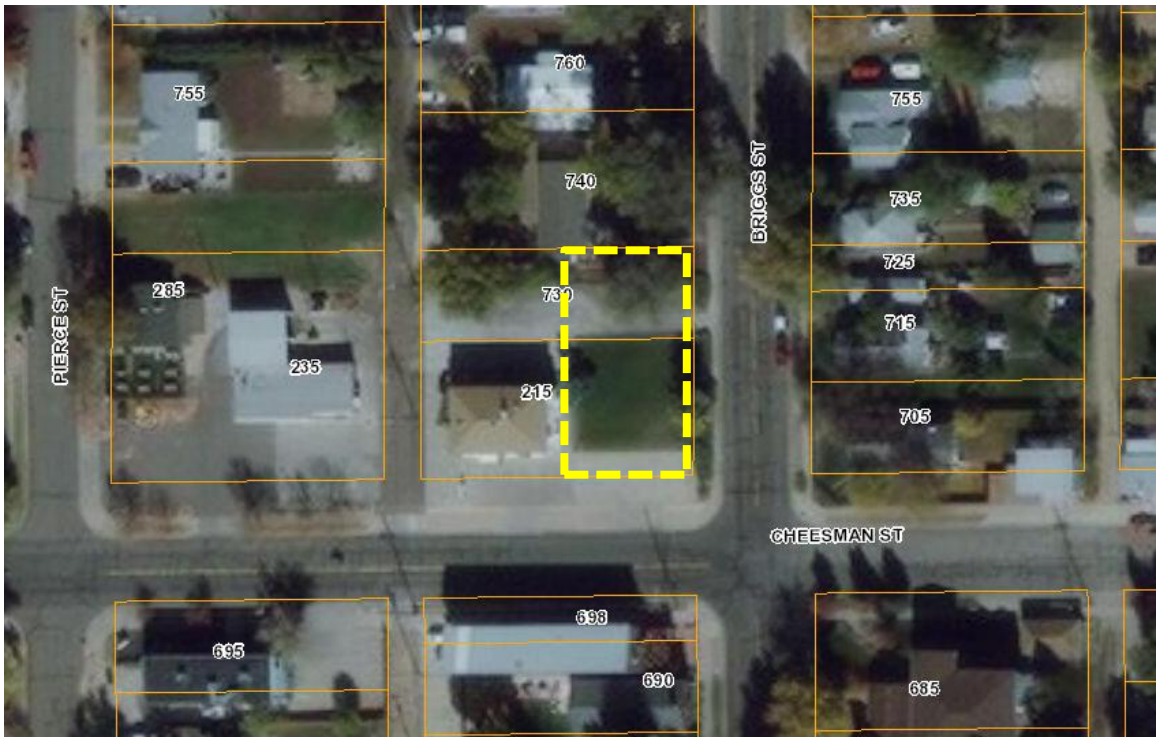

**Figure 2. Parcel Image**


## Development Cost

Total construction costs are estimated at approximately $2.63 million or $332 per square foot. These costs account for land value, hard construction costs, and soft costs, as discussed in greater detail below.

### *Land Value*

The Developer originally acquired both parcels in the 1980's and has maintained ownership since that time. To account for the current value of the property, EPS applied three approaches to estimate land value. The first reflects the Assessor's estimate of land value. Land values for 730 Briggs Street, 215 Cheesman, and a number of other comparable properties throughout Old Town Erie generally range from $9 per square foot to $13 per square foot of land, as shown in **Table 2**. Due to the fact that the Assessor typically relies on relatively conservative assumptions in determining land and improved value, EPS has applied a factor of 150 percent or 1.5X to estimate land value. Based on that adjustment, land value is estimated at $15.22 per square foot.

The second approach relies on a basic estimate of land value based on a residual land value calculation. This methodology incorporates the proposed development program, rental rates, construction costs, and reasonable project return hurdle rates, in order to estimate the residual value of the land. Without additional project subsidy, the two redevelopment parcels have a residual land value of negative $300,600.

The final approach reflects information gathered through broker interviews for more conventional commercial sites located in the larger Erie market. Based on these interviews, brokers cited a land value ranging from $18 per square foot to $20 per square foot for well situated commercial pads with strong traffic visibility. Due to the fact that the two redevelopment parcels are not located on a major corridor and have limited visibility, EPS has discounted these values by 20 percent. The resulting land value is estimated at $15.20 per square foot.

Applying a rough estimate of land value of $15 per square foot to the estimated land area of the eastern half of the two parcels of approximately 9,365 square foot results in an estimated land value of $140,000, which is reflected in the total cost estimates.

**Table 2. Estimate of Land Value**

| Description | Land SF | Land Value | Val. per SF |
|---|---|---|---|
| **APPROACH #1** | | | |
| **Assessor Land Value** | | | |
| 730 Briggs St | 7,492 | $67,500 | $9.01 |
| 215 Cheesman St | 11,238 | $112,500 | $10.01 |
| 150 Well St | 22,500 | $225,000 | $10.00 |
| 555 Briggs St | 7,500 | $67,500 | $9.00 |
| 525 Briggs St | 7,500 | $75,000 | $10.00 |
| 545 Briggs St | 3,750 | $37,500 | $10.00 |
| 515 Briggs St | 18,750 | $243,750 | $13.00 |
| **Average** | | | **$10.15** |
| **Adjustment** | | | **150%** |
| **Adjusted Value** | | | **$15.22** |
| | | | |
| **APPROACH #2** | | | |
| **Residual Land Value Approach** | | | |
| Building Area | | | 7,928 |
| Rental Rate (NNN) | | | $23.0 |
| Vacancy | | | 5.0% |
| NOI | | | $21.85 |
| Construction Cost per SF | | | $314 |
| Yield on Cost | | | 6.95% |
| Target YOC | | | 7.90% |
| Residual Land Value | | | -$300,589 |
| **Residual Land Value per SF** | | | **-$40.08** |
| | | | |
| **APPROACH #3** | | | |
| **Broker Interviews** | | | |
| Finished Retail Pad (Low) | | | $18.00 |
| Finished Retail Pad (High) | | | $20.00 |
| **Average** | | | **$19.00** |
| **Site Discount** | | | **20.0%** |
| **Adjusted Value** | | | **$15.20** |

Source: Weld County Assessor; Economic & Planning Systems

### *Hard Costs*

Project hard costs are based on estimates submitted by the Developer. Total hard costs are estimated at approximately $1.7 million or $220 per square foot. Hard costs for multi-story mixed-use commercial buildings generally range from roughly $175 per square foot to $200 per square foot. While the estimated hard costs for this project are roughly 10 to 20 percent higher than the typical range, they appear to be reasonable and reflect the following market conditions and unique building characteristics:

- Greater market volatility and cost uncertainty
- Two to three sides of street frontage with facade requirements
- Design changes that were required in order to accommodate the floodplain which result in reduced building square footage and higher costs on a per square foot basis.

Tenant improvements are estimated at $50 per square foot, which aligns with recent comparable projects evaluated by EPS.

### *Soft Costs*

Soft costs include a range of cost items comprised of plan check and building permit fees, use tax, architecture and engineering fees, legal fees, overhead, contingency, general project design, and insurance. For most projects, soft costs range from 20 to 30 percent of hard costs or 15 to 25 percent of total project costs. Estimated soft costs for this project are estimated at 18.7 percent of hard costs (including TIs) and 13.6 percent of total costs and appear to be reasonably estimated.

### *Total Costs*

As noted, total construction cost is estimated at roughly $2.49 million ($314 per square foot) and total project cost, which includes land, is estimated at $2.63 million ($332 per square foot), as shown in **Table 3**. While total project costs are roughly 10 to 20 percent higher than a more typical range of $275 to $300 per square foot, specific costs items appear to be reasonable base on the market conditions and unique building characteristics described above.

## Project Revenues

As previously noted, annual project revenues are based on an estimated rental rate of $23 per square foot for the first floor and second floor space. Applying this rental rate and a 5 percent vacancy factor to the total net rentable building area of 7,928 square feet results in estimated annual net operating income of just over $173,000 per year.

**Table 3. Total Cost Summary**

| Description | | | Total | per GBA 7,928 | % of Total | % of HC&TI |
|---|---|---|---|---|---|---|
| **LAND COSTS** | | | | | | |
| **Land Cost** | | **$ 140,000** | | **$ 18** | **5.3%** | **N/A** |
| Land Value | | $ 140,000 | | $ 18 | 6.3% | N/A |
| **TOTAL LAND COST: MODEL INPUT** | | **$ 140,000** | | **$ 18** | **5.3%** | **N/A** |
| **Hard Costs** | | | | | | |
| **General Hard Costs** | | **$ 1,740,369** | | **$ 220** | **66.1%** | **81.4%** |
| Procurement and Contracting Requirements | | $ 34,825 | | $ 4 | 1.3% | 1.6% |
| General Requirements | | $ 128,470 | | $ 16 | 4.9% | 6.0% |
| Existing Condtions | | $ 16,865 | | $ 2 | 0.6% | 0.8% |
| Concrete | | $ 174,866 | | $ 22 | 6.6% | 8.2% |
| Masonry | | $ 220,142 | | $ 28 | 8.4% | 10.3% |
| Metals | | $ 224,000 | | $ 28 | 8.5% | 10.5% |
| Wood, Plastics and Compsites | | $ 6,623 | | $ 1 | 0.3% | 0.3% |
| Thermal and Moisture Protection | | $ 116,172 | | $ 15 | 4.4% | 5.4% |
| Openings | | $ 109,870 | | $ 14 | 4.2% | 5.1% |
| Finishes | | $ 209,197 | | $ 26 | 7.9% | 9.8% |
| Specialties | | $ 930 | | $ 0 | 0.0% | 0.0% |
| Equipment | | $ - | | $ - | 0.0% | 0.0% |
| Furnishings | | $ - | | $ - | 0.0% | 0.0% |
| Special Construction | | $ - | | $ - | 0.0% | 0.0% |
| Conveying Equipment | | $ 85,826 | | $ 11 | 3.3% | 4.0% |
| Fire Suppression | | $ 19,679 | | $ 2 | 0.7% | 0.9% |
| Plumbing | | $ 50,000 | | $ 6 | 1.9% | 2.3% |
| Heating, Ventilation and Air Conditioning | | $ 84,856 | | $ 11 | 3.2% | 4.0% |
| Integrated automation | | $ - | | $ - | 0.0% | 0.0% |
| Electrical | | $ 81,183 | | $ 10 | 3.1% | 3.8% |
| Communications | | $ - | | $ - | 0.0% | 0.0% |
| Electrical Safety and Security | | $ - | | $ - | 0.0% | 0.0% |
| Earthwork | | $ 149,319 | | $ 19 | 5.7% | 7.0% |
| Exterior Improvements | | $ 27,546 | | $ 3 | 1.0% | 1.3% |
| Utilities | | $ - | | $ - | 0.0% | 0.0% |
| Transportation | | $ - | | $ - | 0.0% | 0.0% |
| Waterway and Marine Construction | | $ - | | $ - | 0.0% | 0.0% |
| **TOTAL HARD COSTS: MODEL INPUT** | | **$ 1,740,369** | | **$ 220** | **66.1%** | |
| **Tenant Finishes** | | | | | | |
| **General TI Cost** | | **$ 396,400** | | **$ 50** | **15.1%** | **18.6%** |
| Tenant Finishes | $50 per sf | $ 396,400 | | $ 50 | 15.1% | 18.6% |
| **TOTAL TENANT FINISHES: MODEL INPUT** | | **$ 396,400** | | **$ 50** | **15.1%** | **22.8%** |
| **Soft Costs** | | | | | | |
| **General Soft Costs** | | **$ 356,564** | | **$ 45** | **13.5%** | **16.7%** |
| Plan Check, Bldg Permit, County & Use Tax | | $ 5,000 | | $ 1 | 0.2% | 0.2% |
| General Liability and Builders Risk Insurance | | $ 21,898 | | $ 3 | 0.8% | 1.0% |
| Overhead and Fees | | $ 140,981 | | $ 18 | 5.4% | 6.6% |
| Weather Related Premiums (allowance) | | $ 17,623 | | $ 2 | 0.7% | 0.8% |
| Pricing Contingency | | $ - | | $ - | 0.0% | 0.0% |
| General Project Design | | $ 171,062 | | $ 22 | 6.5% | 8.0% |
| **TOTAL SOFT COSTS: MODEL INPUT** | | **$ 356,564** | | **$ 45** | **13.5%** | **16.7%** |
| **TOTAL CONSTRUCTION COST** | | **$ 2,493,333** | | **$ 314** | **94.7%** | **N/A** |
| **TOTAL COST** | | **$ 2,633,333** | | **$ 332** | **100.0%** | **N/A** |

Source: Developer; Economic & Planning Systems

## Development Feasibility

In determining whether or not a project requires public subsidy in order to move forward, it is necessary to complete what is commonly referred to as a "but-for" analysis. This approach tests whether or not a given project will be able to achieve required market returns that reflect the given risk associated with an individual project "but-for" the investment of public revenues. This analysis relies on a comparison of a project's financial performance to the rate of return required by the market. The calculation of the public subsidy for a given project is based on the amount of public revenues that need to be invested into the project to increase the project's return to a level that aligns with what the market requires. In order to determine the feasibility of this project, EPS has evaluated the financial performance of the project using two approaches that include the yield on cost approach and the time series approach.

- **Yield on Cost Approach** – The first approach relies on an evaluation of the static performance of each component (i.e. retail and office) of the project and is referred to as the project's yield on cost (YOC). Stabilized NOI is divided by its construction cost to calculate the YOC. The performance of the Project is then compared to required rates of return calibrated for the Erie market and each development type. For the purposes of this analysis, a YOC hurdle of 7.50 percent is applied to the retail component and a YOC hurdle of 8.30 percent is applied to the office component. The weighted average for the Project as a whole is estimate at 7.90 percent. Based on the comparison of the performance of the Project to the market requirements, the Project has an estimated gap of approximately $440,600 (detailed in greater detail in the Appendix of this memo).

- **Time Series Approach** – The second approach used to estimate project feasibility relies on an estimate of the Project's net cash flow over time and is referred to as a times series evaluation of project returns. The Project's net cash flow reflects annual estimates of total project cost, ongoing rental revenues, operating costs, and revenues generated through Project disposition in Year 10 (a standard assumption in real estate feasibility analysis). The internal rate of return (IRR) of annual project cash flow generated between Year 0 (project construction) and Year 10 (project disposition) is then compared to an estimated required rate of return that is also calibrated to reflect the Erie market and the development types proposed for construction. For the purposes of this analysis, an IRR hurdle rate of 11.0 percent is applied to all future project cash flows.

Under the YOC approach the Project gap is estimated at $440,600 and based on the time series approach the Project gap is estimated at $517,500, as shown in **Table 4**. Following an evaluation of both these approaches, EPS estimates that the Project has a financing gap of approximately $480,000.

**Table 4. Project Performance and Gap**

| Description | Amount |
|---|---|
| **YIELD ON COST APPROACH** | |
| Stabilized Net Operating Income | $173,227 |
| Total Construction Cost | $2,633,333 |
| **Yield on Cost** | **6.58%** |
| | |
| **Target Hurdle Rate** | **7.90%** |
| **Project Gap** | **-$440,589** |
| **TIME SERIES APPROACH** | |
| Internal Rate of Return w/out Subsidy | 7.85% |
| Internal Rate of Return Target Hurdle Rate | 11.00% |
| **Project Gap** | **-$517,457** |
| **Average of Two Approaches** | **-$479,023** |

Source: Economic & Planning Systems

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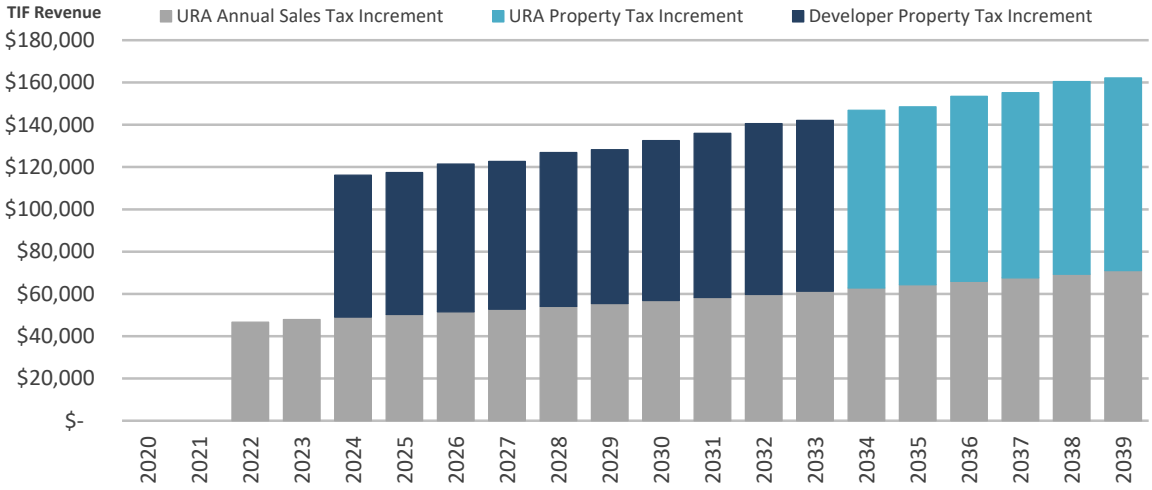
## Public Revenue Sources

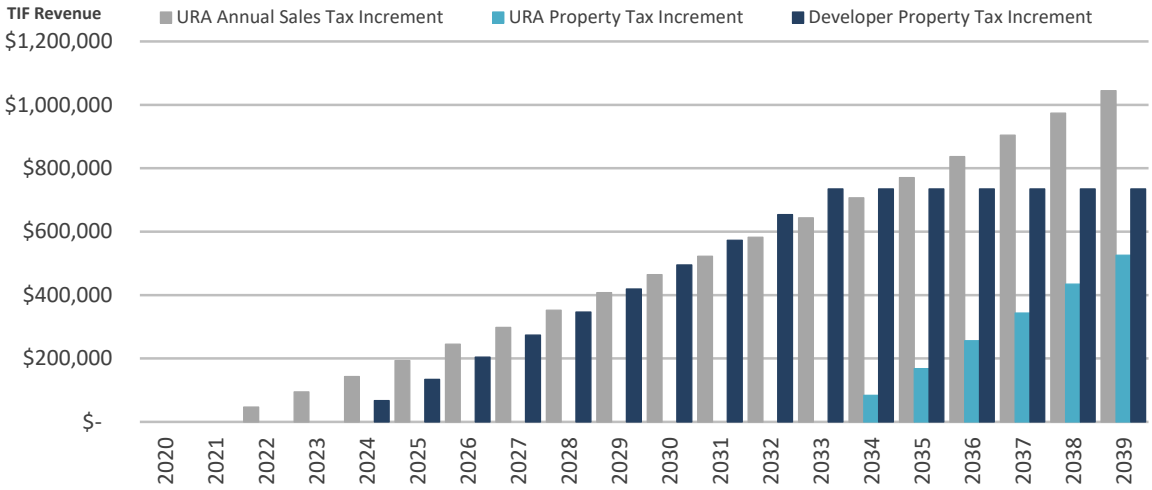
The Old Town Urban Renewal Area was established in 2013 and based on a 25-year term that will expire in 2038. During this time, the Project is expected to generate both property and sales tax increment. In order to fill the funding gap, the Developer has requested property tax increment to close the Project gap. At stabilization, annual property tax increment is estimated at roughly $70,000 per year and is estimated to increase at a rate of 2.0 percent per year. To close the Project gap of roughly $480,000, EPS has discounted necessary future TIF revenues to a present value using a 5.0 percent discount rate. In order for the present value of future TIF revenues to match the current gap the Project will require 100 percent of future TIF revenue through 2033 or 2034, as shown in **Figure 3** through **Figure 5**. The nominal value of these revenues is estimated at roughly $735,000 to $819,000, depending on the sharing period. Total URA and City revenues through the end of the TIF term are estimated at roughly $1.6 million or roughly 69 percent of total TIF revenues generated by the Project.

**Figure 3. Annual Property Tax and Sales Tax Increment, 2020-2039**



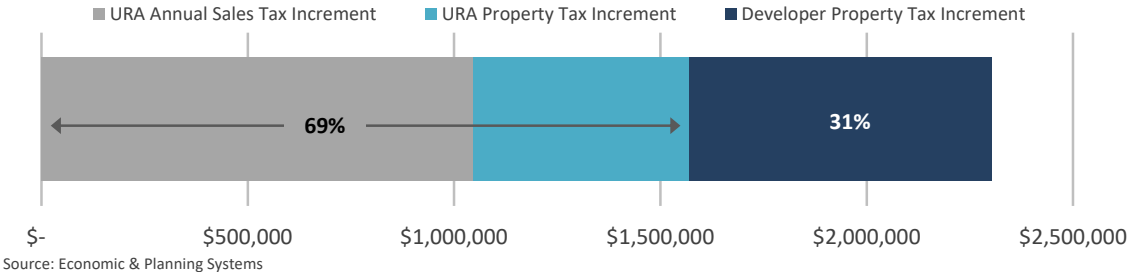

Note: URA property tax increment in 2039 reflects a 1-year lag between end of the URA term and tax revenues generated in 2038.
Source: Economic & Planning Systems

**Figure 4. Cumulative Property Tax and Sales Tax Increment, 2020-2039**




Note: URA property tax increment in 2039 reflects a 1-year lag between end of the URA term and tax revenues generated in 2038.
Source: Economic & Planning Systems

**Figure 5. Total Property Tax and Sales Tax Increment, 2020-2039**




Source: Economic & Planning Systems

Incorporating the property tax revenue generated by the Project through 2033 improves the financial performance of the Project. The present value of TIF revenues received by the Project are estimated at $485,000 (based on a 5.0 percent discount rate) and have a nominal value of $734,600. This level of investment in the Project increases stabilized annual revenues from roughly $173,200 per year to $240,400 per year, increases YOC from 6.58 percent to 8.04 percent, and increases the IRR from 7.85 percent to 10.74 percent, as shown in **Table 5**. These rates of return are estimated to be within the range of what the market requires as a required rate of return for this type of project and should allow the Project to move forward.

**Table 5. Project Return With and Without Public Investment**

| Description | W/out Public Investment | W/ Public Investment | Change |
|---|---|---|---|
| Stabilized Net Revenues | $173,227 | $240,382 | $67,155 |
| Yield on Cost | 6.58% | 8.04% | 1.47% |
| Internal Rate of Return | 7.85% | 10.74% | 2.89% |

Source: Economic & Planning Systems

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