City of Milwaukee

Office of the Comptroller

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Members of the Zoning, Neighborhoods
& Development Committee
200 East Wells Street, Room 205
Milwaukee, WI 53202

RE: Proposed TID 66 – Metcalfe Park Homes

Dear Committee Members:

File 060893 authorizes the creation of Tax Incremental District (TID) 66, also known as Metcalfe Park Homes, and approves the related Project Plan and Term Sheet for the proposed district. The proposed TID is bounded by North 27th Street on the east, North 39th Street on the west, West Meinecke Street on the south, and West Center Street on the north. The primary objective of the proposed district is the development of 30 new single family homes on vacant scattered sites throughout the proposed district, which will be supported in part by equity generated through Low Income Housing Tax Credits (LIHTC). A second objective of the proposed TID is the maintenance and refurbishment of existing homes through the creation of a forgivable loan pool, which will provide funds to existing property owners.

The uses and sources of funds are as follows:

Uses:	
New Home Construction	$ 5,336,010
Existing Home Rehabilitation Loan Pool	500,000
Contingency and DCD Administration	75,000
Capitalized Interest	147,500
Total Estimated Costs	$ 6,058,510
Sources:	
Low Income Housing Tax Credit Equity	2,436,010
TID Funds	1,622,500
WHEDA First Mortgage	1,200,000
WHEDA Second Mortgage	400,000
City HOME Funds	400,000
	$ 6,058,510

The Developer for the new single family units is Metcalfe Park Homes Owner Initiative LLC – a partnership between the Milwaukee Urban League and Gorman & Company. The Developer will be responsible for constructing the units and managing them as part of a 15 year lease/purchase program. Under a lease/purchase approach, the developer constructs and leases homes to households that cannot obtain a mortgage for income and credit reasons and works with the households to overcome barriers to the final acquisition. In general, the length of time that homes are leased depends upon the length of time required to establish a down payment and/or resolve credit issues, typically six months to two years with the purchase occurring after the lease period. The Metcalfe Park Homes Owner Initiative will have a program period of 15 years due to the use of LIHTC, which restricts units as low income qualified housing for a minimum of

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15 years. For this reason, the program may be perceived as a 15 year low income rental program, with the potential of homeownership after the 15th year to whomever leases the property at the end of that year. The proposed project is modeled after a very successful program operated by the Cleveland Housing Network, which applied a similar lease/purchase approach in neighborhoods comparable to Metcalfe Park.

Under the proposed lease/purchase arrangement, the Developer will lease units to qualified tenants who are required to sign and comply with a "contract of care" addendum along with the lease agreement. The "contract of care" addendum places additional maintenance responsibilities with the tenant as part of the homeowner training component of the project. Tenants are also required to attend credit counseling and homeownership classes. Upon two years of complied occupancy, a tenant will be eligible to enter into an agreement which gives the tenant the option to purchase the unit at the end of the 15th year[1]. At the conclusion of the 15th year, properties with exercised options will be transferred from the ownership LLC to the Milwaukee Urban League for sale to purchasers[2]. The average projected purchase price for a unit is estimated to be $99,000 after the 15th year, which is $30,000 below the average projected fair market value of $129,000. On average, purchasers will realize $30,000 in home equity, which approximates the 20 percent needed to finance the remaining $99,000 through a conventional mortgage. In addition, it is anticipated that the average $99,000 purchase price will result in a monthly mortgage payment of $1,000[3], which is the projected average monthly rental payment in the 15th year. Finally, the program provides a tenure incentive in the form of a discount applied to the purchase price in the 15th year of $1,000 per year for each year of participation in the program, up to $10,000.

In addition to the 30 units of new construction, the proposed TID includes $500,000 for a neighborhood loan pool to provide resources to property owners of existing properties in the proposed district. The program is similar to the program established for Lindsay Heights and will be administered by DCD housing staff. Loans of up to $10,000 are available to be forgiven over a five year period based on occupancy. For landlords, loan forgiveness will depend on the absence of complaints or outstanding taxes. In addition, landlord participation will be limited to those with no delinquent property taxes and no building code violations on all properties owned in the City.

Is the Project Likely to be Successful?

We have reviewed DCD's forecast of cash flows for the proposed district and have independently calculated the cash flow projections for the project to determine the TID's feasibility. Using DCD's assumptions on assessed values and tax rates, and reflecting the City's carrying costs, we have concluded that the TID is likely to recover project costs by 2021, the 16th year of the project.

While the TID is likely to recover its expenditures, the project development itself is <u>not</u> self sustaining. The risk of insufficient tax increment has been significantly reduced by extending the TID boundaries over a broad geographical area. Approximately 6 percent of the incremental value in the district is due to the 30 lease/purchase units, with an additional 9 percent due to the Dr. Wesley Scott project – a recent development converting the former Milwaukee Urban League headquarters into 80 affordable units by the Milwaukee Urban League and Gorman & Company. With nearly 85 percent of the proposed district's incremental value outside of these projects, the "natural" growth in the value of these other properties over time will have the most impact on the TID's ability to recover project costs.

We have noted that the proposed TID's boundaries overlap the boundaries of TID 15 and TID 21. This effectively caps the value of the properties in the overlapping boundaries for TID 15 and TID 21 with the capped value serving as the new base value for the affected properties in TID 68. This will negatively

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[1] For tenants entering the program in the 14th or 15th year, one year of compliant residency will be required to enter into an option agreement for home purchase.

[2] LIHTC requires properties to be transferred to a qualified non-profit for pre-determined purchases.

[3] Monthly mortgage figure includes principle, interest, taxes and insurance and assumes a 30 year mortgage with a 7.2% interest rate.

impact the feasibility of TID 15 and 21. However, DCD staff asserts that the impact will be marginal as the number of affected properties is fewer than 10 and their value modest relative to the value of the districts.

Is the Proposed Level of City Assistance Required for Project Success?
In assessing whether the TID assistance is necessary, the questions is whether the project would occur "But For" the TID assistance. Viewing the project overall, had the project received a 9% LIHTC allocation the need for City assistance wouldn't exist as the amount of equity attracted to the project would have been sufficient to cover project costs. However, this didn't occur. The project received a 4% LIHTC allocation. Therefore, in assessing need, we reviewed project costs and developer return to ensure neither is excessive. In terms of project costs, per unit development costs are $185,000 per unit, which is in line with homes constructed for similar projects such as City Homes, Lindsay Heights and the Legacy Project. In assessing return to the developer it is noted that as a project utilizing LIHTC, the Developer virtually has no equity in the project. Developer's equity stake in the project is .01 percent with the equity syndicate Alliant Capital providing the remaining 99.99 percent. Therefore Developer's compensation is analyzed as a percent of costs rather than return on equity.

Developer compensation is generated from a developer fee and property sales. The developer fee is $593,000, $200,000 of which is deferred, with the deferred portion being generated from the project's cash flows. Compared to net project costs, the developer fee is 11.5%, which is reasonable given WHEDA's guideline of 12% for new construction LIHTC projects with 25 or more units. The fee is to be split 90% / 10% between Gorman & Company and Milwaukee Urban League. In addition, property sales that occur after the 15th year are estimated to generate approximately $300,000, or $10,000 per unit, with all of these proceeds going to the Milwaukee Urban League. These proceeds are net of out-of-pocket costs such as closing and brokerage costs as well as the WHEDA first and second mortgages, Home funding, and an amount up to $425,000 to be repaid to the City. Finally, Gorman & Company will receive 6% of net revenues for property management and LIHTC compliance reporting, with half of this fee going to the equity investor. In terms of the equity investor, the internal rate of return is 8%, which includes one half of the property management fee. DCD staff asserts that this is in line for this type of project.

Conclusions and Recommendations
While the project itself is not self sustaining, the TID is likely to recover its expenditures due to the broad boundaries of the project. Furthermore, while there are risks to the project, they are mitigated. Construction completion, lease-up and tax credit compliance risk have been addressed through contractual commitments between Gorman & Company and Alliant Capital that are typical for LIHTC projects. A completion guarantee mitigates construction completion risk and an operating deficit guarantee addresses lease-up risk. Furthermore, tax credit compliance risk is mitigated with the involvement of Gorman & Company with their substantial experience in developing and managing LIHTC projects. While it is noted that neither of the Developer partners have an equity investment in the project, both partners have a stake in the project as the deferred development fee and the potential property sale proceeds provide significant incentives to Gorman & Company and the Milwaukee Urban League, respectively. For the project as a whole, there is always the potential that the units will continue to be leased after the 15 year period and will never become owner occupied. As this "risk" can never be addressed fully, Developer and DCD staff should be commended for utilizing an innovative approach in an area in need of public investment. We recommend approval of the proposed TID.

Sincerely,

W. Martin Morics
Comptroller

Cc Richard Marcoux, , Maria Prioletta