Tax Increment Financing Study and Formulating Committee

Approved Minutes of Meeting

January 11, 2019

On January 11, 2019, the Tax Increment Financing Study and Formulating Committee (the "Committee") held a meeting in the Peabody Conference Room on the first floor of Lindsley Hall, 730 2nd Avenue, in Nashville, Tennessee. The meeting began at 1:00 P.M. The following individuals, constituting all of the members of the Committee were present in person:

Charles Robert Bone, Dr. Paulette Coleman, Brian Kelsey, Talia Lomax-O'dNeal, Bert Mathews, Bob Mendes and Richard Warren. Mr. Mendes chaired the meeting and called it to order. Mr. Warren served as Secretary.

The meeting was open to the public and there were several other people in attendance. The meeting was recorded on video and made available following the meeting on Channel 3 and the Metro YouTube channel.

Agenda

An agenda for the meeting was posted on the Committee's SharePoint site in advance of the meeting.

Approval of Minutes

The minutes of the previous meeting held on December 20, 2018, were unanimously approved on a motion from Mr. Bone seconded by Mr. Kelsey. They are now posted to the SharePoint site and marked as "Approved."

Panel Discussion of Why TIF is Necessary: Perspectives from the Private Sector

Mr. Mendes then introduced the panel for today's program which he moderated. The panelists included John Cannon, chief real estate lender for Pinnacle Bank, developer Ray Hensler of Hensler Development Group, LLC, and attorney Larry Papel of Nelson Mullins Riley & Scarborough LLP.

Mr. Mendes walked through the flow of funds on projects that receive TIF loans and referenced the Flow of Funds chart that is in the materials on the website. He also noted that while TIF loans have traditionally been done on a parcel by parcel basis it is now possible to do it on a district wide basis which raises new issues.

Mr. Mendes then asked the panelists what they see as the purpose of TIF.

Mr. Hensler responded that he has used it for infrastructure needs for projects,

Mr. Cannon noted that there are sometimes benefits to the larger community that TIF can pay for.

Mr. Papel sees it as an incentive tool to cause a particular type of project or features on a project to occur.

When asked for infrastructure examples, Mr. Hensler addressed the original infrastructure improvements done to assist in the redevelopment of the Gulch. When he developed the 1212 condominium project there were still overhead utilities on that portion of the street from where the city had previously stopped all the way down to McGavock Street. If there were no public money available for this infrastructure need, Mr. Hensler said that he would have had to have put the overhead utilities back up at his site and certainly could not have put the utilities for several adjacent tracts that will be redeveloped underground. Mr. Papel noted that this money is also used for sidewalks, larger water, gas and electricity connections, and similar infrastructure requirements.

Mr. Mendes noted that some people ask whether this is a private development cost or a public expense. Mr. Papel said that infrastructure is typically a public expense. Mr. Hensler explained in more detail how the burial of the utility lines benefitted several parcels beyond his site, including the W Hotel that a group including Mr. Papel is developing across the street from his project; there is already a vault under the street where the utilities for the hotel can be located.

Mr. Mendes asked how TIF is used as part of the basic capital stack to finance a project. Mr. Hensler noted that 15 years ago developers were reluctant to build in the downtown area and TIF was used as an incentive to encourage that, perhaps including an affordable housing component.

Mr. Mendes asked Mr. Hensler where you start to seek TIF. He responded that you try to avoid needing it. When the underground utility issue grew into a $5 million issue that affected multiple parcels he spoke with Joe Cain at MDHA and people in the Mayor's office to see if they had interest in helping to finance this. Mr. Mendes asked for more detail on this process which some people see as opaque. Mr. Papel noted that it is has always been administered by MDHA. There is an application and guidelines that have been online for at least five years. You ultimately consult with both MDHA and the Mayor's office. If you do not receive encouragement for the project, you then determine if the project can proceed without it or you move on to the next project.

Asked about the procedure in the 1980s and 1990s, Mr. Papel said that the first project that he used TIF on was the Hilton Hotel, responding to an RFP from the Fulton administration after an earlier developer was unable to develop a hotel there. This was before downtown blossomed so the city put about $6 million in to the project that was repaid over about 8 years from the increased property taxes generated by the new hotel.

Mr. Hensler responded to a question about what "blight" means, noting that he is not an expert on that.

Dr. Coleman asked if a project could not be done without TIF is it worth doing. She also asked if there should be a more comprehensive plan for how TIF should be used. Mr. Papel noted that the decision to award TIF is a political decision which may include requirements on the developer. Mr. Hensler noted that these criteria change over time as the community develops. He noted that the bar is higher today as there is a sense that incentives are not as necessary in areas of town that are seeing a lot of development.

Mr. Warren noted how TIF was utilized to incentivize the development of full service hotels around the new convention center that would sign room block agreements offering discounted room rates to people attending conventions. If a hotel would not sign a room block agreement, it did not receive TIF.

Mr. Hensler noted that the city is making value judgments as to where the city gets the most bang for the buck. Mr. Bone noted that they city is looking for the maximum return on its investment. In response to a question from Mr. Mendes, Mr. Hensler said that the perception in the development community is that TIF is very difficult to obtain.

Mr. Mendes then asked whether there is still a need for TIF in the Gulch. Mr. Hensler said you do not need to incentivize development but you should stay mindful of the city's infrastructure needs and the city needs these tools in the toolbox. The days of just plugging a hole in the capital stack for the basic project are over, at least in the core.

Mr. Mendes then asked Mr. Papel why TIF is denied. Mr, Papel responded that TIF is denied when the conclusion is that there is no need to incentivize a particular project. When asked if there is a full explanation given, he responded that since there is no appeal it does not really matter. Sometimes you get more of an explanation than others. Joe Cain from MDHA said that they receive some smaller applications, some of which are awarded TIF. A recent example was a residential project on Dickerson Road that was awarded. Most of the projects are larger, with Fifth and Broad being a good example.

Mr. Cannon responded to a question about how he underwrites a TIF loan and said that his bank does not aggressively pursue them but is open if it arises in the context of a project that they are financing. Mr. Papel noted that some banks make these loans and some do not. Mr. Cannon noted that there is no real estate collateral on TIF loans but they are predictable; the increment available is formulaic based on the increased property taxes that the project will produce. He prefers to make a TIF loan if he is also the senior construction lender so that he has some control over the construction process. There is always a guarantor to backstop the tax increment payments.

Mr. Mendes asked what the lender does if the tax increment payments are not sufficient to repay the loan. Mr. Cannon said that the lender pursues its rights under the guaranties. The incentive payments continue until the loan is repaid or the district expires.

Dr. Coleman asked why the term of the districts extend so long and are renewed. Mr. Mendes asked if there are only, say, 7 years left in the district would that effect the underwriting. Mr. Cannon said that you want to make sure that there is enough revenue there to repay the loan. Mr. Papel noted that the property taxes even come ahead of a deed of trust on the property so it is a secure source of repayments.

Mr. Bone noted that the Council has to approve the creation or extension of a district. Mr. Mendes noted that this is mostly driven by the Mayor's office since the Council lacks finance staff to challenge the assumptions they use that a district should be 25 years rather than 30 years.

Dr. Coleman said that there should be periodic review of these districts. Mr. Mendes said that he anticipates that this committee will eventually recommend some sort of periodic review and suggested that it would be possible for a district to continue to fund previously issued TIF loans but for the Council to instruct MDHA to make no new loans in a particular district.

Mr. Cannon explained the analysis that the lender makes to decide to approve a TIF loan – when will it start, how much will it be, how long it will take to repay, etc. Mr. Hensler noted that the lender has already calculated how much value it believes the project will create in underwriting the construction loan. Mr. Hensler walked through the numbers that will be taken into account in this process, from construction costs to the rent that will eventually be produced. Mr. Cannon noted that appraisals are used to validate the conclusion that the lender has reached.

Mr. Mendes then raised a criticism that he has heard from the community that this is an insider's club where you have to know someone. Mr. Hensler said that in his experience it is a merit based process and said that he did not know any of the governmental people well when his project was approved. Mr. Bone noted that for a time there were a lot of downtown residential projects because those were a priority of some mayoral administrations. He suggested that we need to look to break down barriers that prevent this tool from being used in other parts of town and for different projects.

Mr. Hensler noted that when Mayor Bredesen was in office he identified with a magic marker areas that he wanted the city to incentivize development. Dr. Coleman said there is dismay in the community that this is not done for other parts of town today and appears to have little chance of changing.

Mr. Mendes asked about the difficulty with small projects. He said that he has heard that the cost and complexity of TOF mitigates against that as does the need for a guarantor. Mr. Papel noted that the cost of issuance is about the same for a $500,000 loan as for a $5 million loan and the risk of failure is often greater for smaller projects.

Mr. Mendes then asked about the perception that there is very little diversity in TIF borrowers and asked what could be done to address that. Mr. Papel noted that they do tend to look alike financially. Mr. Bone noted that MDHA could sign a guaranty but Mr. Cain observed that they have limited resources available for that purpose since most of the funds in their budget are earmarked for particular programs. Mr. Mendes said that we may want to consider some type of guaranty by a governmental entity but it would require strong underwriting.

Mr. Mendes asked how do we determine the total amount of TIF that should be allotted, where the loans should be allotted, etc. Mr. Papel said that is a very difficult public policy question. There needs to be some predictability about how these transactions are structured or developers will not pursue them.

Mr. Mendes asked if any other committee members have any questions. Dr. Coleman asked if the panel had any recommendations for improvements. Mr. Papel said that the process could be more transparent and accessible. Mr. Cannon said that a lot of improvements could occur before it gets to the lender but the tool works well from a lender perspective.

Ms. O'dNeal notes that there are often diverse business enterprise ("DBE") requirements in these loans but they are difficult to monitor. Mr. Papel said there are often percentage DBE requirements and the developer and contractor regularly reports to MDHA. Ms. O'dNeal says that she wants to see an effective oversight. She asked what should happen if the goal is 20% and at the end of the project it was 10%. Mr. Hensler noted that there are a lot of moving parts, sometimes a subcontractor has to be replaced during the project and this can impact compliance.

Mr. Mendes then thanked the panel for a very informative presentation and excused them.

Questions from the Public

Mr. Kelsey noted that there had been a few questions received on the website from the public for which he had sought responses. One question asked how the city markets for diversified business goals and what percentage of African American businesses participate. MDHA responded that it makes referrals to its list of DBE contractors which includes those registered with Metro and the State. That list includes Small, Minority and Women owned businesses. The developer must submit a plan and demonstrate outreach to DBEs prior to beginning construction on a project. Of the last nine projects overseen by MDHA it has invested $16.5 million in TIF resulting in 29.7 million of work by DBE firms.

Another question was what enforcement mechanisms are available and if there are none, why not? MDHA responded that the Development Agreement is the enforcement tool and it requires the submission of goals at the beginning of the project as well as a final report itemizing what dollars were actually expended with DBE firms.

Discussion of the syllabus for future meetings

Next Meeting

The next meeting will be on January 23 at 1 P.M. also in the Peabody Conference Room in Lindsley Hall. The next topic was scheduled to be affordable housing but since Dr. Coleman will be gone then the committee agreed to move that topic to the next meeting on February 8. The Committee will meet from 1 to 3 P.M. on February 8 and February 22. On January 23 the committee will look at transit oriented development and what role TIF can play there; speakers could include Councilman Syracuse to discuss the Donelson project, Steve Bland and someone from out of town (Mr. Kelsey will look for someone from Austin and Mr. Mathews has a contact from Denver who is now at the National League of Cities). The committee also wants to add opportunities for public comment beginning in March. The first such meeting is tentatively scheduled for Wednesday, March 6, at 6:30 P.M. in the Council chamber.

There being no further business, the meeting was then adjourned at approximately 2:45 P.M.

Richard Warren, Secretary