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City Council

Date: August 26, 2019

To: City Council

Through: Christopher J. Brady, City Manager

From: Jeff McVay, Manager of Downtown Transformation

Subject: Second Amendment to the Development Agreement and Government Property Improvement Lease for the second phase of the Encore project at the southeast corner of West 1st Avenue. **(District 4)**

Purpose and Recommendation

Consider the proposed Second Amendment to the Amended and Restated Development Agreement and a Government Property Improvement Lease (collectively, "the Agreements") between the City of Mesa and MHA III, LLC. The proposed Agreements facilitate the conveyance of approximately 1.6 acres of real property supporting the construction of no less than 72 units of market-rate residential in downtown.

Background

The Mesa City Council approved the Development Agreement on December 19, 2016 for the Encore development, a proposed residential, project, generally located at the southeast corner of West 1st Avenue and Macdonald.

This second phase of the development was originally designated as an affordable housing project contingent upon receiving Low Income Housing Tax Credit (LIHTC) from the Arizona Department of Housing. Because the Developer was unsuccessful in obtaining a 2017 allocation of tax credits, the Development Agreement allows the Developer to proceed with a market-rate housing project of similar scale and quality on the property. The Developer did not receive the tax credit and has, per the agreement, elected to construct a market-rate development by opening escrow on the property.

Consistent with their obligations in the Development Agreement, in August 2018 the Developer completed construction of the first market-rate multi-family project in downtown in more than 30 years (24-unit, three story market-rate development on Lot 2 adjacent to the second phase property). Based on the success of the first 24-unit project, the Developer is progressing with the development of the second phase of the market-rate project. The three building, 72-unit second phase project received zoning approval in April 2019 and the Final Plat for the project was recorded in August 2019. To support construction of the project, and consistent with the approved Development Agreement, the Developer has requested a Government Property Improvement Lease (GPLET). The proposed Second Amendment to the Development Agreement includes the additional provisions necessary to allow the City and Developer to enter the proposed Lease, which would provide an eight-year abatement of property taxes. Under the current Development Agreement, the Developer has the right to phase each of the three, second phase buildings, provided each building is completed within one year of the previous (final completion by December 2022). The proposed GPLET will accelerate the development of the second phase as one construction project, to be completed by June 2020.

Government Property Lease Excise Tax
In compliance with the GPLET Statutes (A.R.S. §§ 42-6201 *et seq.*), the City obtained a professional analysis of the economic impact of the Second Market Rate Project, attached as Exhibit A. That analysis confirms that the proposed project meets the statutory requirements for approval of a GPLET lease with an eight year property tax abatement: 1) the property is located within a designated Redevelopment Area and Central Business District, 2) the project will increase the value of the land by greater than 100%, and 3) the project is projected to generate greater revenues ($953,000) to the city, county, school district and state from sales and income taxes during the abatement period than the value of the property taxes abated ($719,000). The analysis further projects that during the abatement period, the project will generate $250,000 in direct revenues to the City, $9.2 million in indirect economic benefit, and directly and indirectly support eight jobs.

A primary concern with GPLET projects is the reduction in school district property taxes. To address this concern, the City and Developer have negotiated an “in-lieu” payment to the school districts (Mesa Public Schools, Maricopa Community Colleges, and East Valley Institute of Technology). The in-lieu payment is equal to the school district tax revenues that the 1.6 acres would generate, as vacant, over the course of the abatement period. After the first year, a four percent escalator was added to each year to account for typical property value increases. In total, the in-lieu payment equals $33,709.

In further compliance with the GPLET statutes (A.R.S. §§ 42-6201 *et seq.*), the City provided notice to the impacted taxing authorities at least 60 days in advance of Council consideration of this lease and also provided the independent economic benefit analysis to the impacted taxing authorities at least 30 days in advance of Council consideration. The greatest impacted taxing authority, Mesa Public Schools, has provided a letter in support of the proposed project and the proposed in-lieu payment.

Discussion

The following provides a summary of the primary deal points for the Second Amendment to the Amended and Restated Development Agreement and the Government Property Improvement Lease.

Description of Project:

1. Developer will construct at least 72 units of market-rate residential on the approximately 1.6 acres of property.
2. The development will consist of multiple buildings not less than three stories high

and each building with no less than 24 units.

3. Developer is exercising the option to purchase an additional 9,100 square feet to allow provision of on-site amenities (pool and clubhouse).

Terms of Agreements:

1. The project will be completed no later than June 30, 2020.
2. Developer will exercise the right to purchase approximately 9,100 square feet of land adjoining Lot 1 to provide sufficient land area for on-site amenities.
3. Developer will reimburse the City $3,100 for the cost of the Independent Economic Benefit Analysis.
4. Upon completion of the project, the developer will convey ownership of the land and improvements to the City for a period of eight years, at the end of which the City will transfer ownership back to the Developer.
5. The annual lease rate is $10,000, for a total of $80,000.
6. The purchase price of the property at the end of the term is $5,000.
7. Developer will make in-lieu payments to the school districts totaling $33,709 (MPS: $28,149, MCCD: $5,365, EVIT: $195)
8. During abatement period, Developer would annually in-lieu payments to the Downtown Mesa Association equal to Special Improvement District 228 assessment of the property and improvements, as if it were privately owned.

Fiscal Impact

At closing on the additional 9,100 square feet for on-site amenities, the City would receive approximately $72,000, and receive $85,000 under the lease terms.