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TO: Craig Glendenning, CPA, County Auditor, Howard County, MD

FROM: TischlerBise, Inc.

DATE: September 20, 2016

SUBJECT: Analysis of Howard Hughes Corporation's TIF Application for Columbia Town Center

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EXECUTIVE SUMMARY

TischlerBise, Inc. was retained by the Howard County, MD Auditor to evaluate a variety of analyses associated with Howard Hughes Corporation's (HHC) proposed Columbia Town Center development. These analyses include an application provided by HHC, TIF projections and a fiscal impact analysis completed by MuniCap, Inc., an economic impact analysis by CohnReznick, and a market analysis performed by RCLCO.

TischlerBise, Inc.'s, qualifications for reviewing the HHC TIF Application are based on the firm's almost 40 years of experience providing fiscal, economic, and planning consulting services to public and private sector clients. TischlerBise's experience in the area of fiscal impact analysis is unsurpassed, having prepared more fiscal impact analyses and fiscal impact models than any other firm in the country.

Our project manager for this assignment, Carson Bise, AICP, has 25 years of fiscal, economic, and planning experience and has conducted fiscal, economic, and impact fee evaluations in 37 states. Mr. Bise has developed and implemented more fiscal impact models than any other consultant in the country. The applications which Mr. Bise has developed have been used for evaluating multiple land use scenarios, specific development projects, annexations, urban service provision, tax-increment financing, and concurrency/adequate public facilities monitoring.

Mr. Bise has written and lectured extensively on fiscal impact analysis and infrastructure financing. His most recent publications are *Fiscal Impact Analysis: Methodologies for Planners*, published by the American Planning Association, a chapter on fiscal impact analysis in the book *Planning and Urban Design Standards*, also published by the American Planning Association, and the International City/County Management Association (ICMA) IQ Report, "Fiscal Impact Analysis: How Today's Decisions Affect Tomorrow's Budgets." Mr. Bise is also featured in the recently released American Institute of Certified Planners (AICP) CD-ROM Training Package entitled, *The Economics of Density*.

Mr. Bise currently serves on the Board of Directors of the Growth and Infrastructure Finance Consortium and recently Chaired the American Planning Association's Paying for Growth Task Force. He was also named an Affiliate of the National Center for Smart Growth Research and Education at the University of Maryland in College Park.

The Columbia Town Center project represents a key redevelopment opportunity for Howard County. The project appears consistent with *The Downtown Columbia Plan Master Plan, an amendment to PlanHoward 2030* (adopted in 2010) which calls for a large amount of additional nonresidential development, a "park once" environment, and consideration for the use of TIF to finance infrastructure improvements if deemed necessary to project feasibility. TischlerBise believes the project will likely have a net positive fiscal impact on the County, particularly given the large number of property-based tax resources available to municipal and county governments in Maryland. However, the question is, how large will that impact be and what sort of public subsidy (e.g., TIF package) does it justify?

This executive summary contains a brief overview of our key findings. Please note that TischlerBise was narrowly scoped to review the above-mentioned documents, not to revise them or offer alternative analysis. Therefore, our findings offer critiques of certain methodologies employed, note disparities among analyses, and speculate on potential impacts of changed assumptions, but they do not offer comprehensive alternative calculations.

In addition, it is important to note that with any development of this size, planning efforts and negotiations between the public and private stakeholders take long periods of time, draw together various consultants and subject matter experts, and entail iterative analysis. For example, one of the key themes the reader will notice throughout this paper is that TischlerBise notes disparities in the opinions of various consultants regarding both the market and assessed values of various types of land uses, most notably rental apartments (a key driver of the development program). Since our technical role is primarily to evaluate the methodologies employed in the fiscal and economic impact analyses and TIF projections, we draw attention to these differences but avoid recommending one over the other, since it is the nature of the process that *many assumptions* are made that will shape analytical outcomes. However, we believe the analyses supporting a project of this magnitude and potential impact to the County should be further vetted and that key assumptions—for example, market values—should align in the market analysis, TIF projections, fiscal and economic impact analysis, and pro forma. Short of that, inconsistencies should be at least explained.

With those notes, we offer the following findings:

- **The Proposal Includes Appropriate Use of Tax Increment Finance Bonds.** The County's comprehensive planning documents support the potential use of TIF to encourage development in Downtown Columbia. Given the desire for intensive development on a small tract of land in a car-dependent region, the need for structured parking is likely. Though structured parking is often financed privately without preventing the financial feasibility of the larger development (it may be feasible due to the increase in land and building value precipitated by the presence of a parking deck), public subsidy is sometimes required. However, as noted below, it is unclear whether a comprehensive "but for" analysis that *includes a full pro forma analysis of the proposed development's cash flows over time, both with and without TIF bonding,* has been conducted. Publicly available documents only assert that the developer may achieve a rate of return of 7.53% with TIF funding. Simple comparisons of surface and structured parking with unchanged land and building values are not sufficient. A more detailed analysis is warranted and could be provided in such a manner that does not compromise the developer's proprietary information.

- **The TIF Projections May Use Overstated Assessed Values.** TischlerBise found relatively few data points were used to derive the average assessed value of various residential unit types in the TIF projections. For instance, for apartments MuniCap uses only four comparable properties, one of which is located in Annapolis, which is not part of the submarket identified by RCLCO in the project's market analysis. Without this data point, the assessed value per square foot drops from $207 to $194. Although assessed values were reviewed by the County Assessor and comparable properties may be sparse in the submarket, this $13 decrease is rather large given the fact that multifamily rental properties (including the Metropolitan units) represent approximately 43% of the built square footage of the entire project. In other words, market rental units are an important driver of the development's value, so the addition of more data points from other comparable properties is warranted. Other questions about market and assessed values are contained herein.
- **The Need for a Special Tax Is Not Highlighted Adequately.** Various documents from the Howard County Finance Department (available on the County website) note that the tax increment will be the primary security for TIF bonds and that the implementation of special taxing districts will provide "additional security in the event that the Project is delayed, the development plan is altered, market conditions change, the assessed values of the Project are lower than anticipated, the ad valorem tax rate is materially lowered, or for any other reason that might cause tax increment revenues to be lower than projected." In reality, the project, as currently construed, *plans* for the use of a Special Tax to supplement regular property tax revenues. Special tax totals roughly $46.1 million for the Crescent area developments and is planned to cover approximately $30 million in debt the County plans to float in order to support the construction of a new elementary school to serve the Columbia West area. Though a credit may be applied to the special tax if the increment exceeds a certain amount, it is important to be transparent about the fact that this is a unique structure for TIF and that special taxes are planned for from the very beginning of the project to offset the costs of non-TIF capital improvements.
- **The Economic Impact Analysis Uses an Old Development Program and May Overstate Induced Impacts.** The economic impact analysis referenced by HHC in its application and appended as an exhibit to said application was completed by CohnReznick in June 2015 and analyzes the impacts of a much larger development than that for which HHC has applied this spring. In fact, it is our understanding that the current proposal is for three million fewer square feet and considerably less parking. This is important because overall square footage is used to calculate temporary employment in construction jobs and the direct and indirect employment and induced impacts from the development. In addition, the market values used in the economic impact analysis are much higher than those in MuniCap's fiscal impact analysis (discussed in further detail below) and RCLCO's market analysis for the project (discussed throughout this memorandum). For instance, CohnReznick uses significantly higher apartment rents than RCLCO identifies in its market analysis or that MuniCap inputs into its fiscal impact analysis, thereby also raising the question as to whether household incomes and induced spending impacts are overstated. If the public wishes to have a more refined understanding of potential economic impacts, this analysis may need to be redone with the submitted development program and reevaluated market value assumptions.

- **Inflation of Costs and Revenues May Obscure the True Scale of Fiscal Impacts.** MuniCap chose to inflate all the results of its fiscal impact analysis using an annual inflation factor of three percent annually (for a total of 273% over 34 years). In general, TischlerBise avoids inflating fiscal results because inflation rates are unpredictable, particularly given the fact that some costs, such as salaries, increase at different rates than other operating and capital costs, such as contractual and building construction costs. These costs, in turn, almost always increase in relation to the appreciation of real estate, thus affecting the revenue side of the equation. While this approach may be necessary to account for bond interest impacts in the TIF projections, using constant dollars in the fiscal impact analysis avoids these issues and allows for more useful comparisons of impacts over long periods. For example, an alternative analysis provided by MuniCap at Howard County Council's request inflates costs and revenues using a purported two percent annual inflation factor and results in a County surplus that is half as much as the amount cited in the fiscal impact analysis report initially submitted for HHC's application.
- **The Fiscal Impact Analysis May Overstate Several Revenue Impacts.** In general, MuniCap's revenue projections are very thorough and well-reasoned. However, TischlerBise questions several components based on their assumptions regarding residential assessed value. First, we question the high *assessed* values used to calculate the tax increment for the TIF projections. These same assessed values per square foot are used to calculate the property taxes and property taxes surpluses available to the County (after debt service and other costs) in the fiscal impact analysis, so overestimating assessed value could overstate property tax surpluses available to the County to cover costs incurred by the development. Second, Maryland's tax structure is such that *market* value projections are critical to an accurate fiscal impact analysis. Local recordation tax revenues and transfer tax revenues are based on market value (sales cost). Therefore, we feel it may be beneficial to run multiple scenarios that provide fiscal impact analysis for various achieved values, both market and assessed. Finally, TischlerBise questions the personal income taxes calculations. When projecting market values, MuniCap conducts an income capitalization methodology as an alternative to the comparables methodology. Though comparables were used to determine market value and the projected tax increment, MuniCap uses the rent projections (for rental units) and the sales projections (for for-sale condominiums and townhomes) to project income rates in each type of unit. As noted below, we feel this could overstate personal income receipts.
- **Average Costing in the Fiscal Impact Analysis Fails to Capture the Timing of Operating Costs.** MuniCap predicts 96% of the total budget will be impacted by this development. We understand this methodology was vetted in-house and consistent with other staff-conducted analyses. However, it is possible this methodology actually *overstates* the costs associated with the development. Either way, this is a conservative approach to costing. More important is the fact that MuniCap uses an average costing methodology (explained below) to calculate operating costs. While average costing may accurately estimate total costs over longer periods of time, the "lumpiness" of operating costs over shorter time periods is not reflected. For example, expenditures related to hiring new staff will not occur as development demands new service; rather, the County will have to hire new staff prior to their capacity being 100% required. Therefore, expenditures will not track perfectly with development demand, but will instead be

"lumpy" as these new costs are incurred. TischlerBise would prefer to analyze operating costs using a case-study-marginal costing approach (explained below) which would more accurately reflects the upfront costs of staffing up for new development that will be borne by the County.

- **The Fiscal Impact Analysis May Understate Capital Costs.** MuniCap utilizes a case study approach to capital costs associated with the development. The analysis examines the costs of a new library, fire station, police command center, interchange, arts center, transit center, and public school and attempts to determine existing excess or deficient capacity. However, though these costs align with anticipated bonding timing, costs are accounted for in the analysis using an development share approach, including only the costs directly related to demand created by the development. This methodology may fail to accurately reflect the true impact of the development on the County. Though the County may have existing need for some of the infrastructure, such as the fire station or library, and construction would occur whether or not the proposed development is realized, it is not clear whether it would commit to constructing all of these capital projects were it not for the Columbia Town Center proposal. Thus, a full accounting of the investments (as opposed to a development share) the County will make as a result of the development should be included.
- **Multiple Scenarios Should Be Evaluated.** In its TIF projections, MuniCap assumes residential absorption over 10 years (through 2025) and commercial absorption over 14 years (through 2029). These rates are aligned with the results of RCLCO's market analysis. However, RCLCO notes that the office space market is crowded in the Howard County/western Anne Arundel County submarket, and that an economic downtown will almost certainly occur over the next 34 years and possibly slow absorption paces, lower rental rate growth, and increase vacancies for residential and commercial development. Should absorption occur at a slower rate, what will be the fiscal impact? Scenario testing should be conducted to answer this question. For instance, the County may consider testing the net fiscal impact of lower rents or slower absorption rates for the two largest drivers of the development, market-rate rental apartments and office space. Though these scenarios may still yield net positive fiscal results, the margin may be lower and could provide another data point for decision making.

The Pro Forma Provided to TischlerBise is Extremely High Level. TischlerBise was provided a pro forma conducted by MuniCap based on HHC's internal analysis. This pro forma does not provide rates of return for the project with and without the TIF, which is important to evaluating the development's financial feasibility with and without public assistance and a critical piece of the "but for" test. Moreover, the pro forma is essentially a snap shot of income versus revenue in one year. An evaluation of cash flows *over time* is missing. In other words, after the initial investment (development cost) is made, how will net operating income change over time? When will the company divest and sell the property? A true rate of return takes into account time, total investment, and the net cash flow over that period. Instead, this pro forma is a static evaluation that essentially applies a capitalization rate to determine the stabilized net operating income for one year. For a project of this complexity, with cash flows that will be irregular for a long period

before finally stabilizing, a full discounted cash flow analysis is needed to yield a credible and reliable valuation.[1]

PROJECT OVERVIEW

HHC requests establishment of a Development District in Columbia Town Center which would encompass 136 acres and include the Crescent neighborhood and parts of the Warfield, Symphony Overlook, Lakefront Core, and Lakefront neighborhoods. In addition, HHC requests approximately $128 million in tax increment financing to pay for public improvement costs, including road and intersection improvements, water and sewer expansions, and structured parking construction.

After considering available revenues and the policy direction of the *Downtown Columbia Plan*, County staff and/or consultants determined that approximately $128 million of these costs are eligible for TIF financing and is considering authorizing maximum proceeds of up to $90 million for improvements in the Crescent neighborhood (District #1) as part of the first stage of development. These funds would be dispersed in two issuances of thirty-year TIF bonds. The first issuance would be comprised of two series planned for 2016 and 2017 and provide approximately $61 million in support of infrastructure needed for the Crescent Area 1 phase of the development (described in greater detail below). The other phase of development in Crescent Areas 2 and 3 would require a second issuance of approximately $17 million, for a total cost of $86 million. It is anticipated that Districts #2 and #3 would also require TIF-funded infrastructure improvements for a total of approximately $42 million.

In addition, HHC requests creation of a Special Taxing District, comprised of the entire 60-acre, single parcel Crescent neighborhood, to support further infrastructure development and ensure debt service coverage should the tax increment fail to produce enough revenue to float the TIF bonds. Additional Special Taxing Districts in other parts of the Development District are proposed to support additional bonding as subsequent phases of development come to fruition. In addition, this request includes approximately $30 million in debt to finance construction of an elementary school. The bond will be paid off over all three phases of the Crescent neighborhood development. Issuance of this bond appears to be the major reason for the need of a planned special tax.

HHC proposes a mixed-use development with the following program:

- 2,444 market-rate apartment units (of which 817 are already under construction at the Metropolitan, discussed below);
- 377 affordable units to be priced at a variety of levels of affordability;
- 234 condominiums and 88 owner-occupied townhomes;
- 3.5 million sq. ft. of office space;
- 205,000 sq. ft. of retail space (of which approximately 44,000 sq. ft. is already under construction at the Metropolitan, discussed below);
- 161,000 sq. ft. of restaurant space (both full-service and fast food);

[1] A subsequent examination of HHC's internal analysis revealed analysis of rates of return both with and without TIF assistance but still with only a one-year time horizon.

- 250 key hotel (149,000 sq. ft.);
- 70,000 sq. ft. of civic space; and
- 18,649 parking spaces (11,904 in privately financed garages, 5,851 in publicly financed garages, and 894 surface parking spaces).

Construction has already begun on 200,000 square feet of office space in the northern portion of the Crescent area. In addition, HHC is currently finishing work on its Metropolitan development, an 817-unit mixed-use development with approximately 44,000 square feet of retail space which falls within the proposed Development District but not within the proposed Crescent Special Taxing District. HHC requests that the County include revenues from the Metropolitan (located in the Warfield neighborhood) in its considerations in order to increase potential revenues for TIF financing.

OVERVIEW OF TAX INCREMENT FINANCING

Introduction to TIF

Tax increment financing (TIF) is a tool through which a public entity attempts to encourage redevelopment and economic development in an underutilized area by earmarking incremental property tax revenue in that area to fund infrastructure improvements designed to ease the cost of development or attract capital investment. Frequently, infrastructure is funded with bond issues that are guaranteed by future revenue growth devoted to pay them back. From some perspectives, this makes TIF projects self-financing. However, this is not entirely accurate, as some tax revenues that would be received by a General Fund or other earmarked funds are diverted to a special TIF fund for a specific period of time, and thus, are not necessarily available for general expenditures. After a specified time period, the TIF district designation ends and all property tax revenues are funneled back to their original government entities.

TIF is most frequently used as a method for financing the infrastructure needed to attract development to an underutilized site. Typical improvements relate to roadway widening, modernizing, or construction or construction of sidewalks, extension of transit lines and needed stations or stops, and other multimodal transportation projects to improve connectivity; water and sewer system improvements (e.g. main installation or sanitary lift station construction); storm water trunk lines extension; and telecom ductbank installation. In general, the widely-held theory behind TIF is that the proceeds from TIF revenue bonds should only be used to make the improvements “but for” which the development would not occur.

Proposed TIF Funding

HHC requests $85.8 million of TIF funding for the Crescent district portion of the development (Districts #1A, #1B, and #1C). Together with issuance costs, interest, reserve fund requirements, and other costs, the total cost of issuing these bonds will be $113.8 million. Districts #2 and #3 will also require TIF-funded infrastructure improvements for a total of $41.9 million ($53.4 with total issuance costs). Total all-in costs are $127.7 million in TIF bond principal ($167.2 million with issuance costs). As noted above, HHC requested closer to $150 million in public financing for the project, but County staff and/or consultants

recommend only $127.7 million. As currently construed, the developer estimates the total cost of the Columbia Town Center development will be $2.34 billion, $2.17 billion of which will be funded through private investment.

As noted above, the County's planning documents appear to endorse consideration of the use of TIF to encourage development in Downtown Columbia. Given the desire for a dense development on a small tract of land in a car-depending region, the need for structured parking is likely. Although structured parking is often financed privately without preventing the financial feasibility of the larger development, public subsidy is sometimes required for larger projects if surrounding land uses do not produce enough revenue to offset the additional cost of structured parking compared to surface parking. However, as noted below, it is unclear whether a comprehensive "but for" analysis—including a pro forma analysis of the proposed development both with and without TIF bonding—has been conducted. Publicly available documents only assert that the developer will achieve a rate of return of 7.53% even with TIF funding. A more detailed analysis is warranted and could be provided in such a manner that does not compromise the developer's proprietary information.

TIF PROJECTIONS ANALYSIS

Overview

In general, TischlerBise found the TIF projections conducted by MuniCap, Inc. to be accurate and well-constructed. However, we would like to highlight a few general notes related to 1) the calculation of assessed values and 2) the use of a special tax to supplement normal property tax revenues.

Calculation of Market Values

In order to determine the tax increment that will be available to support the payment of debt service on the TIF bonds needed to finance initial infrastructure improvements, MuniCap conducted an analysis of prevailing assessed values (using comparables and income capitalization rates) for all residential and nonresidential land uses that will be constructed as part of the proposed development. Next, it appears the lower of these rates was selected (perhaps to build some conservatism into the analysis), which in all cases was the rate derived as an average of all comparables. An "inflation rate" was applied and the resulting figure was paired with construction and absorption rates to determine the taxable base in the TIF district.

TischlerBise found this methodology appropriate and the Office, Retail/Restaurant, and Hotel/Conference Center assessed values to be reasonable. However, we would like to draw attention to the scarcity of data points used in deriving average assessed values for various residential unit types.

For instance, for apartments MuniCap uses only four comparable properties: two in Odenton, one in Hanover, and one in Annapolis. RCLCO identifies the Columbia Town Center development as part of the Howard County/western Anne Arundel County market, so the inclusion of the properties in Odenton and

Hanover is reasonable. However, it can be argued that Annapolis is an entirely different market. In fact, without this data point, the assessed value per square foot drops to $194 (as opposed to $207 with the Annapolis property). This is a rather large decrease given the fact that multifamily rental properties (including the Metropolitan units), represent approximately 43% of the built square footage of the entire property. It may be that these comparables were chosen more for build quality and surrounding amenities than for location. It appears the County Assessor was consulted, so these figures have been vetted by someone with a deep knowledge of the regional market. Nevertheless, because market rental units are an important driver of the developments property, we argue the addition of more data points from other local, comparable properties may be warranted.

Similarly, for condominiums MuniCap includes a multitude of unit comparables, but it appears all are from only four developments. Moreover, only one of these developments is located in Columbia, while the rest are located in Silver Spring and have much higher assessed values. In fact, if you use just the two Columbia units as a value basis, the assessed value per square feet would be $215 (as opposed to $271). It may be that MuniCap believes the properties in Silver Spring are more representative of the build quality and targeted market of the Columbia Town Center project, but it is important to remember that the primary market is Howard County and western Anne Arundel County. Silver Spring would fall within a larger secondary market and units located there may not be fair comparables, given its adjacency to DC and the presence of good Metro access.

Moreover, RCLCO's market analysis notes that the median condominium and townhouse resale price per square foot in 2015 in Columbia was $164. This value, though probably expected to increase as sales prices increase to pre-Recession levels, is much lower than the assessed value used in the analysis. In fact, the latter value is even higher than the median resale price per square foot for single family homes in Columbia in 2015 ($193). Again, MuniCap assert that these units will be of a higher quality than comparables in Columbia, but it is important to note that RCLCO notes that "rebounding sales volumes have yet to translate to rising prices." This land use is not a huge driver of overall development value (only 351,000 gross square feet of a total of 8.5 million), but it is worth pointing out these disparities in the analyses.

Finally, for townhomes inputs are drawn from three developments: two in Ellicott City and one in Elkridge, resulting in an average assessed value of $227 per square foot. Again, TischlerBise notes that the median condominium and townhome resale price per square foot in 2015 in Columbia, MD was $164 according to RCLCO's market analysis. Like condominiums, townhouses account for only a small amount of gross built square footage (132,000 square feet), but it bears repeating that this analysis could benefit from a broader suite of possible market comparable, or the consultant could have at least included an accompanying footnote explaining the consultant and Assessor's rationale for choosing particular properties.

Special Tax and General Obligation Bonds

Various documents from the Howard County Finance Department (available on the County website) note that the tax increment will be the primary security for the bonds and the bonds sized such that the increment will be sufficient to pay debt service and that the Special Taxing District acts to provide

"additional security in the event that the Project is delayed, the development plan is altered, market conditions change, the assessed values of the Project are lower than anticipated, the ad valorem tax rate is materially lowered, or for any other reason that might cause tax increment revenues to be lower than projected."

In reality, the project, as currently construed, *plans* for the use of Special Tax. Roughly $46.1 million of special tax revenue for the Crescent area developments is necessary to cover $30 million debt the County plans to float in order to support construction of an elementary school to serve the area. In other words, it is not a question of if the City will have to levy the special tax on the district: it is already expected from project conception. While it is common practice to put a special tax district in place to cover debt service and other costs in the even the increment is insufficient, it is less common to plan to use special tax revenues passed during the TIF process to cover other debt. While land owners in the District will have to accept the levying of a special tax, it is important to be transparent about the fact that special taxes are planned for from the very beginning of the project and that special taxes could impact future owners and development feasibility.

ECONOMIC IMPACT ANALYSIS

Overview

CohnReznick completed a full economic impact analysis in July 2015 using IMPLAN software (published by IMPLAN Group, LLC). IMPLAN is an industry-accepted product that is most useful for calculating indirect impacts of development through the use of multipliers that can be used to calculate indirect jobs and dollar outputs created by jobs directly related to a specific development (i.e., "spin-off" effects). However, it can also be used to calculate direct jobs expected at a development. IMPLAN utilizes U.S. Bureau of Economic Analysis National Income and Product Accounts data to calculate labor income and numbers of jobs by industry and indexes these numbers against U.S. Census Bureau data for specific localities.

For the most part, TischlerBise found the study methodology to be sound. However, as noted in this section, the analysis should probably be redone with the revised development schedule and newly available information from the TIF projections conducted by MuniCap and RCLCO's market analysis.

Revised Development Schedule

Since this study was conducted, it appears the development program has changed significantly, as seen in the table below.

Figure 1: Development Schedule Comparison

	CohnReznick		Current Proposal	
Land Use	*Square Feet*	*Units/Keys/Spaces*	*Gross Square Feet*	*Units/Keys/Spaces*
Residential	6,630,404	5,721	4,501,344	3,960
Commercial Office	4,300,000		3,429,300	
Retail	1,174,997		365,381	
Hotel	384,000	640	149,100	250
Civic/Cultural	196,450		70,000	
Structured Parking		20,396		18,649
Total	**12,685,851**		**8,515,125**	

As shown in the above figure, the current proposal is for more than three million fewer square feet and considerably fewer parking spaces. This is important for two reasons. First, overall square footage is used to calculate temporary employment in construction jobs. Second, the total square footage for each nonresidential land use is the critical input for calculating the direct employment impacts from the development, and as a result, the indirect and induced impacts as well. With a more detailed development schedule, CohnReznick could also conduct a more detailed analysis of retail impacts, since a hypothetical mix was developed for the purposes of the analysis.

Market Values

Another reason the economic impact analysis probably overstates the positive economic impact of the development is that the market values used in the analysis are much higher than those in MuniCap's fiscal impact analysis (discussed in further detail below) and RCLCO's market analysis for the project (discussed throughout this memorandum). For instance, CohnReznick uses a rent estimate of $2,500 per month for apartments, whereas MuniCap's fiscal impact analysis assumes a rent of $2,015 (which may still be too high). In addition, RCLCO notes that the monthly rent for a Class A unit in the first quarter of 2015 in the greater Columbia market was $1,863, lending further support for the notion that $2,500 may overstate supportable rents. This is an important input for the analysis because these rents are fed into the model to estimate household incomes and calculate induced spending impacts. TischlerBise has similar concerns about sales prices of condominiums, which CohnReznick pegs at $500,000, even though RCLCO notes prices in Columbia fall within the mid-$200,000s.

FISCAL IMPACT ANALYSIS

Overview

In general, a fiscal impact evaluation analyzes revenue generation and operating and capital costs to a jurisdiction associated with the provision of public services and facilities to serve new development—residential, commercial, industrial, or other. Maintaining fiscal health in the face of a large-scale development depends on several factors. Perhaps most important in the near term are the costs of new

infrastructure and expanded public services, which depend on the current use of existing infrastructure. Because of these costs, projects that require new infrastructure are unlikely to improve fiscal health in the short run. In the long run, the balance of revenue increases and service costs related to operations and maintenance may prove to be the most important influencing factors on the fiscal impact of a development.

It is important to note that fiscal impact analysis should be viewed as one piece of the puzzle when analyzing a potential development. Other issues of importance include public planning efforts around the site, environmental implications, economic development goals, and equity and social justice impacts.

CohnReznick completed an extremely high-level fiscal impact analysis for the proposed development (dated July 26, 2015). It is our understanding that the scope of their engagement limited the breadth of this analysis. Even though this analysis is included with the Economic Impact Analysis as part of the project application, we focus our attention on MuniCap's fiscal impact analysis (dated May 25, 2016).

TischlerBise finds MuniCap's analysis to be fairly comprehensive. However, we do question a number of decisions that shape the analysis, including 1) applying an inflation "factor" to both revenues and expenditures, and by different rates year-over-year; 2) using assessed and market values in the revenue projections that are significantly higher than those cited in the RCLCO analysis; 3) utilizing average costing for operating costs and only holding four percent of the operating budget as fixed; and 4) using average costing for capital costs. Finally, we argue that the analysis needs additional scenario testing to understand the impacts of potential market changes highlighted in RCLCO's market analysis.

Use of Inflation

MuniCap chose to inflate all the results of its fiscal impact analysis using an annual inflation factor of three percent. By Year 34, this factor inflates figures by 273%. In general, TischlerBise avoids inflating fiscal results because inflation is unpredictable. This is particularly the case given that some costs, such as salaries, increase at different rates than other operating and capital costs, such as contractual and building construction costs. These costs, in turn, almost always increase in relation to the appreciation of real estate, thus affecting the revenue side of the equation. While use of an inflation factor may be important to the TIF projections to account for bond interest impacts, for instance, using constant dollars avoids these issues for a fiscal impact analysis. Additionally, it allows for more useful comparisons of impacts over the period under consideration. For instance, an alternative analysis provided by MuniCap at Howard County Council's request shows net revenues and projected county capital costs through 2050 using a two percent inflation factor (196% versus 273% through 2050). This more modest inflation rate results in a County surplus (revenues, less operating and capital expenditures) of $288,447,997 as opposed to $511,849,765. In other words, the County surplus is cut nearly in half.

Revenues Calculation

In general, MuniCap's revenue projections are very thorough and well-reasoned. However, TischlerBise questions several components based on assumptions related to the market value of residential. As noted above, we draw attention to the high *assessed* values used to calculate the tax increment for the TIF

projections. These same assessed values per square foot are used to calculate the property taxes and property tax surpluses available to the County (after debt service and other costs), so overestimating assessed value could overstate property tax surpluses available to the County to cover costs incurred by the development in the fiscal impact analysis. Moreover, Maryland's tax structure is such that market *value* projections are critical to an accurate fiscal impact analysis. Local recordation tax revenues and transfer tax revenues are based on market value (sales cost). Therefore, we feel it may be beneficial to run multiple scenarios that provide fiscal impact analysis for various achieved values, both market and assessed (detailed below).

TischlerBise also questions the personal income taxes calculations. As noted above, when projecting market values, MuniCap conducts an income capitalization methodology as an alternative to comparables. Though comparables were used to determine market value and the projected tax increment, MuniCap uses the rent projections (for rental units) and the sales projections (for for-sale condominiums and townhomes) to project income rates in each type of unit.

For market rate rental units, the monthly rent per unit (apparently provided by the developer and reviewed with the State Department of Assessments and Taxation) was assumed to be $2,015 for 877 square feet, or $2.30 a square foot. However, RCLCO's analysis notes that competitive properties achieve rental rates of $1.36 to $2.02 per square foot on a monthly basis, and the Metropolitan development reset top-of-market rents at $2.02 in April 2014. The Metropolitan rates, the study notes, are 15% to 30% higher than older Downtown Columbia buildings. Thus, it appears the projected rents for future apartments is much higher than what is present in the Downtown area. While the current Metropolitan rates could be teaser rates to increase occupancy, details on this assumption are not included in the analysis.

This is also important because the monthly rent payment is assumed to be 36% of monthly income (based on the Federal Housing Administration's Debt Ratio Guidelines), or $5,596, which feeds into the net taxable income and what the County would take in in income tax. Thus, if the new units rented for the same rates as the Metropolitan development constructed by HHC, rent for an 877 square foot unit would be $1,772 a month. By our calculations, using the FHA's Debt Ratio Guidelines, this would translate into a monthly income of $4,922, or $674 dollars a month less than what MuniCap projects. If the same exemption adjustments are maintained, net income tax per unit would be $1,574 per unit (as opposed to $1,833) and $5,132,814 for all market rate units (as opposed to $5,975,788, a difference of approximately $843,000 per year). Since all affordable unit rents are derived from the market rate rent, the total estimated income tax generated from those units would have to be adjusted down as well (though the impact would be much smaller).

Again, we understand these rents may be intended to reflect the quality of life that will be available once the entire development is constructed. However, it bears repeating that these rents vary significantly from what the Downtown Columbia rental market bears today. Though this revenue difference will not make or break the net fiscal impact of the development, it is worth noting that small tweaks to assumptions can have outsized, magnified effects on results.

We have similar concerns for the personal income tax projections calculated for condominium and townhome units. A similar process is followed for this calculation as with the rental units (although affordability is 29% of monthly income and the calculation includes consideration for property taxes, insurance, and various mortgage deductions etc.). What is important here, however, is that the assumed market value is $406,195 for condominiums and $353,941, which are both much higher than average prices in 2014 ($240,000, shy of the peak price of $264,900 in 2007) according to RCLCO. RCLCO acknowledges these prices might reflect a lack of new inventory, which would support higher prices on new units, but if this is not the case, personal income receipts could be lower than the $818,662 projected annually.

Costing Methodology

This section evaluates MuniCap's costing methodology for determining the proposed development's impact on the expenditure side of the fiscal impact "equation." TischlerBise first describes the two most commonly used techniques for costing in fiscal impact analysis: average costing and marginal costing. Next, we describe the strengths and weaknesses of each methodology. Finally, we analyze MuniCap's methodology and point out the ways in which it may skew operating and capital cost estimates.

Techniques

There are two dominant methodologies for conducting fiscal impact analysis: average costing and marginal costing. The average-cost approach is simpler and more popular; costs and revenues are calculated based on the average cost per unit of service multiplied by the demand for that unit. Average-cost approaches assume a linear relationship and do not consider excess or deficient capacity of facilities or services over time. A per capita relationship—in which the current cost of service per person in a community is considered to be the standard for future development—is an example of an average-cost approach.

The most popular average-cost technique is the per capita multiplier. This is obtained by dividing the budget for a particular service, such as parks, by the current population, yielding an estimated service cost per person. Under the per capita approach, it is assumed that each service level will be maintained into the future and that each additional resident will generate the same level of costs to the jurisdiction as each existing resident currently generates. For example, if a parks department budget was $450,000 and the population of the town 45,000, then the average cost would be $10 per capita. This figure is then used to estimate additional costs resulting from new development. The per capita approach is easy to use but has the disadvantage of being less accurate than other approaches if local officials want to look beyond broad levels of overall costs and expenditures. An example of the average-cost technique is shown in Figure 2.

Figure 2: Example of an Average-Cost Methodology

Insert Budget:		FY 2003 General Fund	Unincorporated Service	Special Revenue	Total All Funds	Per Capita Amount
572	Parks/Recreation				$0	$0.00
572	Parks/Recreation				$0	$0.00
572	***Parks/Recreation***	**$482,120**	**-$39,800**	**$16,315,170**	***$16,757,490***	$18.36
572	Parks/Recreation				$0	$0.00
573	Cultural Services	**$3,136,122**	**$9,070,409**	**$5,692,760**	$17,899,291	$19.61
576					$0	$0.00
579	Other Culture/Recreation			**$9,966,613**	$9,966,613	$10.92

Marginal-cost approaches uses locally based case information to describe the unique characteristics of a jurisdiction's operating departments and capital facilities. This marginal cost approach assumes that every community is unique and that the assumptions regarding levels of service and cost and revenue factors should reflect what is occurring in that community. Department representatives are interviewed about existing public facilities and service capacities. Local information on excess park capacity, for example, makes it possible to predict when new facilities, programs, or personnel may be needed. This method also allows communities to include more detail if desired (e.g., to make estimates based on the costs of specific facilities and programs, such as pools, softball leagues, or tennis courts).

Although over the long term, average- and marginal-cost techniques will produce similar results, the real value of fiscal analysis is in the two- to 10-year period, when a community can incur significant costs. Marginal-cost analysis is most useful in this time frame. However, average-cost techniques are generally simpler to use, so for relatively small development projects with modest impacts or impacts that are realized over a long time frame, they may be preferred. An example of the marginal-cost methodology is shown in Figure 3.

Figure 3: Example of a Marginal-Cost Methodology

PARKS AND RECREATION STAFFING INPUT Category	Base Year FTE Positions	Project Using Which Demand Base?	Current Demand Units Served Per Position	% Estimate of Available Capacity	Remaining Capacity/ Initial Hire Threshold	Estimated Service Capacity Per Position
Environmental Technician	5	UNINCORP POPULATION	137,791	75%	103,343	132,049
Equipment Operator	38	UNINCORP POPULATION	18,130	75%	13,598	18,014
General Crew Leader	2	FIXED	0	0%	0	0
General Manager	4	FIXED	0	0%	0	0
Head Custodian	6	FIXED	0	0%	0	0
Landscape Gardener	6	FIXED	0	0%	0	0
Managers, Divisions/Programs	7	FIXED	0	0%	0	0
Multitrades Worker	39	RECREATION SF	7,363	75%	5,522	7,317
Painter	1	FIXED	0	0%	0	0
Park Manager	20	PARK ACRES	124	75%	93	123
Park Ranger	78.2	PARK ACRES	32	75%	24	32

MuniCap's Approach

Though MuniCap does not include an explanation of its methodology in this fiscal impact analysis, TischlerBise found that the results of the costing portion of the analysis mirror those found in another fiscal impact analysis MuniCap conducted for the City for two housing scenarios (those in the *Downtown Columbia Plan* and those recommended by HHC, Columbia Downtown Housing Corporation, and the

Housing commission), dated September 17, 2015. In the latter report, which includes a narrative, MuniCap notes that it conducted extensive interviews with County personnel (confirmed during an in-person meeting with MuniCap staff) and employs a hybrid average/marginal costing approach.

The approach is a hybrid of average and marginal costing because some items from departmental budgets are included based on interview input from County staff, but costs are calculated on a per resident, per employee, per student, per trip, or per road mile basis (or a combination thereof). Though TischlerBise would have liked to have seen what was deemed fixed in the analysis, for the most part, MuniCap's costing methodology is comprehensive. Moreover, as discussed later in this section, MuniCap includes an analysis of capital costs.

Operating Costs

For this analysis, MuniCap utilized an operating costs methodology employed on previous analyses conducted by City staff. Consideration of $968,644,091 worth of Fiscal Year 2016 approved budget items is included in the analysis, close to 96% of the total budget ($1,012,304,050). This means that only around four percent of the budget was deemed fixed or not impacted by development, which is ample coverage of potential costs associated with development. In fact, it is unusual to see such a small percentage of items as fixed, so it is possible MuniCap actually *overstates* the costs associated with the development. However, this methodology builds some degree of conservatism into the analysis and so should not be of great concern.

One larger concern with this analysis of operating costs is that while total costs over time may be represented appropriately, the "lumpiness" of operating costs over shorter time periods is not. For instance, MuniCap calculates police costs by taking the impacted portion of the Department of Police budget ($104,298,710) and dividing it by the current county population (for residential demand) and current vehicle trips generated by nonresidential development (for nonresidential demand). This is a perfectly acceptable approach for calculating the average costs of service delivery, and it wisely takes into account the fact that the greatest demand for police calls for service from nonresidential development will not be generated by employees, but by visitors to those spaces (e.g. vehicle trips to retail destinations,). This methodology results in a cost per capita of $219.20 and per trip of $55.78.

However, police services are not delivered incrementally. Once a certain amount of new development occurs in Columbia Town Center, new staff will have to be hired. Assume the cost of one new patrol office is $90,000, including salary and benefits, and that two new patrol officers are needed once 500 people take up new residence in Columbia Town Center. The total cost, as calculated using the average costing approach, would be $109,600 (500 x $219.20), whereas a marginal cost approach would peg the cost higher at $180,000 (2 x $90,000), reflecting the fact that the two officers are needed even if the costs from development do not yet cover their salaries and benefits. This example (the results of which will vary based on police patrols, levels of service, and the cost of salary and benefits) demonstrates the difference between marginal and average costing: marginal costing more accurately reflects the upfront costs of staffing up for new development that are borne by a municipality. Because this analysis utilizes average costing, it likely misses some of "lumpiness" associated with these operating costs.

Capital Costing Methodology

MuniCap utilizes a hybrid case study/marginal cost approach to capital costs associated with the development. The following capital costs are included in the analysis:

- Library ($40 million);
- Fire Station ($30 million);
- Police Command ($19 million);
- Interchange ($75 million);
- Arts Center ($20 million);
- Transit Center ($9.5 million); and
- Public Schools ($25.5 million).

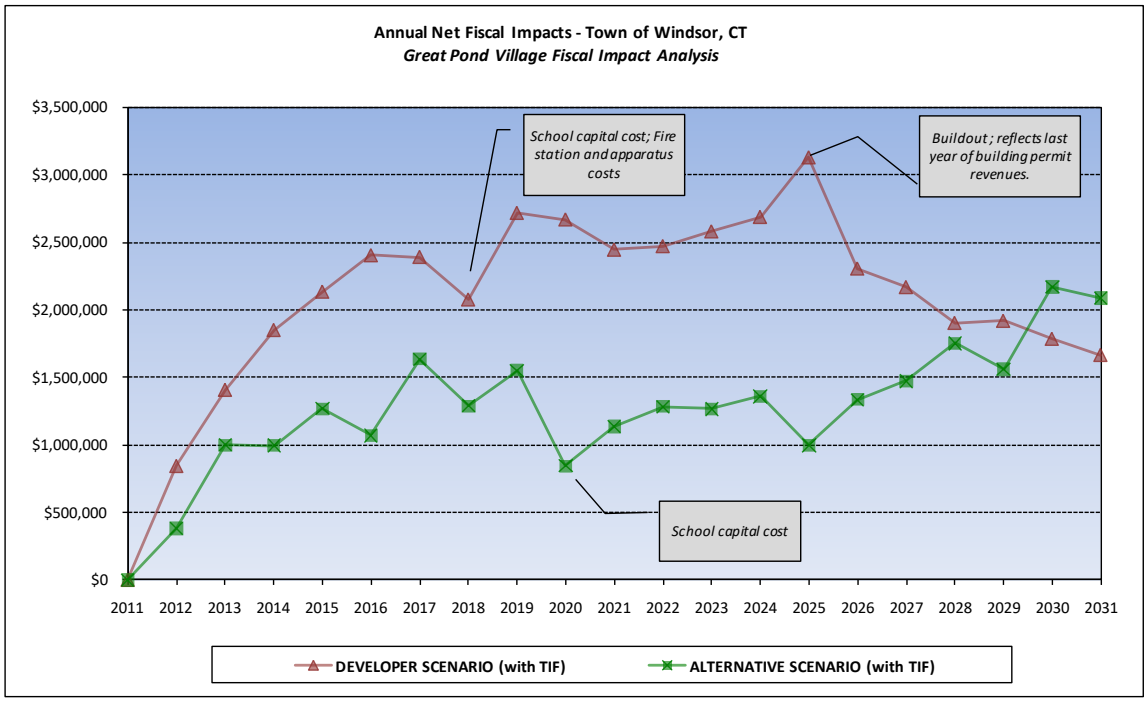
While it appears these costs are included in a fashion that aligns with proposed bonding timelines, they are accounted for in the analysis using an average costing approach. For instance, transit center costs are allocated on a per service population (a measure of population and jobs) basis, so $9.5 million is divided by the current county service population (426,805), yielding a cost per capita of around $22.26 (or, amortized over 20 years, of $1.71). This figure is then multiplied by the projected increase in population (16,174), resulting in a total cost for the development of around $360,016 (rounded). Only this amount, and not the $9.5 million, is accounted for on the cost side of the fiscal impact equation. This process is repeated for all the capital costs described above, yielding a total cost resulting from development of $71,323,666, or around 33% of total capital costs ($218,997,154).

The problem with this approach is that it does not accurately reflect the true impact of the development. Though the County may build the Library and Fire Station even without the proposed development in order to meet existing need, it is unclear whether the County would commit to constructing all of these capital projects were it not for the development proposal. In other words, the analysis needs a narrative describing what would happen if the County closed the doors to development tomorrow and did not allow the Columbia Town Center project to move forward. Would it still construct the new transit center? What about the police command or the interchange?

If these projects would be constructed even if the development did not more forward, an average costing approach that only allocates the development's share of the project may be appropriate. However, if the development is necessitating the infrastructure investment, it is our opinion that the entire cost should be reflected in the analysis. This is because a fiscal impact analysis is not a balance sheet of the revenues from development and the costs demanded by development. Instead, it is a true accounting of the impact of a development on a community's fiscal "bottom-line." Thus, a full accounting of the investments a local government will make as a result of a development should be included, reflecting the "lumpiness" and costs of these infrastructure investments.

This "lumpiness" reflected in the results of a TischlerBise analysis of two scenarios for a TIF-financed project in Connecticut (Figure 4). The reader can see net positive fiscal impacts decrease when the local municipality is forced to float bonds to pay for new capital facilities (a school and a fire station, in this case).

Figure 4: Example of "Lumpy" Capital Costs



NEED FOR ALTERNATE SCENARIOS

MuniCap conducted a number of analyses of alternative scenarios to "stress-test" assumptions related to the capital costs and whether projected revenues would cover debt service requirements, and provided TischlerBise with a large number of debt service coverage tests it conducted. These alternatives were not included in the final fiscal impact analysis report

The key takeaways from this process appear to be that reducing initial capital cost estimates from $247.5 million to somewhere between $212 and $220 million, coupled with the issuance of $30 million in general obligation bonds and public receipt of the some parking operating income, were important to achieving a net fiscal positive result for the project. In addition, MuniCap also ran scenarios on TIF bond sizing, delaying development on 311,000 square feet of office space and 12,000 square feet of retail, and the timing of school bonding, for example.

In its final TIF projections, MuniCap assumes residential absorption over 10 years (through 2025) and commercial absorption over 14 years (through 2029), presumably based on developer input. These rates are in-line with the results of RCLCO's segmentation analysis in the market analysis. However, in its market analysis, RCLCO notes that supply competition for for-sale units could be stiff. Their analysis also warns, "On a cautionary note, the competitive market for urban or urban-lite office settings is becoming more crowded." They continue, "Maple Lawn, Konterra (now leasing its first building), and Arundel Preserve a threat to Columbia Town Center's position as the urban alternative to a generic business environment." Finally, the study concludes, "an economic downturn should be expected" within the development period "and planned for accordingly," noting that a downturn would result in "slower absorption paces, lagging

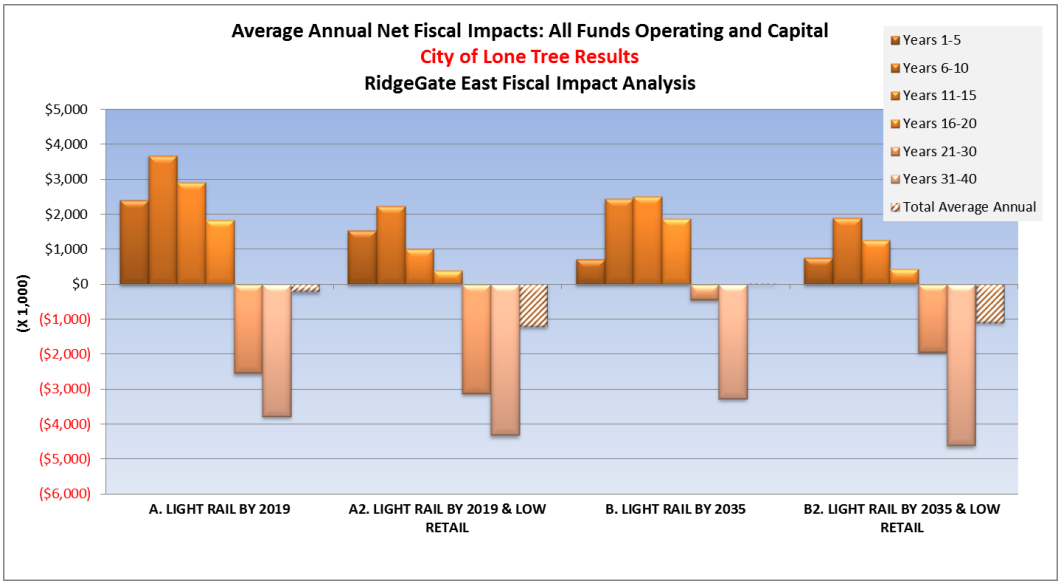
rental rate growth, and high vacancies." Should absorption occur at a slower rate, the special tax will be available to provide additional funds to cover the cost of debt service. However, the question is, what will be the long-term fiscal impact?

The Columbia Town Center project is adding a large amount of built square footage to the region over a long period of time. It is our experience that a development of this scale may change in size, land use mix, or timing in response to shifting market conditions. Giving the warnings from RCLCO, we feel a development with this much import to the County's fiscal and economic health should be evaluated with multiple scenarios informed by the included market analysis. For instance, the County should consider testing the net fiscal impact of lower rents or slower absorption rates for the two largest drivers of the development, market-rate rental units and office space. Though these scenarios may still yield net positive fiscal results, the margin between revenues and costs may be lower, thereby allowing the County to better evaluate the risk associated with the development.

Figure 5 shows an example of an alternative scenario analysis for a fiscal impact analysis TischlerBise completed in Colorado. Four scenarios were evaluated based on two key alternatives: the approval of a proposed light rail stop serving the development within a decade and the construction of lower amounts of retail than in similar types of development in Colorado. These two alternatives were picked because they reflected both sides of the fiscal impact equation. The light rail, while benefiting the development's marketability, represented a key driver of service demand for the municipality, thereby impacting the cost side of the equation, whereas the retail intensity impacted one of the key revenue sources, sales tax, in a state where local municipalities do not receive property tax. As is evident in these scenarios, delaying the construction of the light rail until 2035 and maximizing retail construction was the only scenario that yielded a net positive fiscal impact to the municipality, but only by the narrowest of margins.

Figure 5: Example of Market-Driven Alternative Scenario Analysis

	SCENARIO			
Category	**A. Light Rail By 2019**	**A2. Light Rail By 2019 & Low Retail**	**B. Light Rail By 2035**	**B2. Light Rail By 2035 & Low Retail**
Total Revenues	$498,883	$446,757	$377,756	$315,223
Total Expenditures	$507,963	$495,444	$377,186	$359,127
TOTAL	**($9,080)**	**($48,688)**	**$569**	**($43,905)**
Average Annual (40-Yr Avg)	*($227)*	*($1,217)*	*$14*	*($1,098)*
Revenue to Expenditure Coverage	*98%*	*90%*	*100%*	*88%*



PRO FORMA ANALYSIS

In addition to our evaluation of the fiscal and economic impact analyses and TIF projections, TischlerBise was asked to provide a high-level evaluation of the pro forma analysis conducted by MuniCap, Inc for the Crescent Area I. Typically, the pro forma analysis is crucial to the "but for" test used in evaluating TIF project proposals, since this test states that the projects should be eligible for TIF only if they will not be financial feasible without this form of public infrastructure finance.

Because MuniCap's analysis is based on HHC's assumptions, the pro forma is deemed to contain proprietary information, and TischlerBise was required to sign a non-disclosure agreement. Therefore, the following analysis is limited to a high-level evaluation of the pro forma and its relative merits.

Once again, this analysis contains different market rents for apartments than are found in the other analyses associated with the application. However, a bigger problem is that the pro forma analysis does not include the true rates of return for the development with and without the TIF. Instead, MuniCap develops a "projected market yield" for the project, based on capitalization rates for each type of land use as provided by the State's Department of Assessments and Taxation. This rate is then used to determine a total project cost based on projected development net operating income. The difference between this figure and the actual projected costs is then purported to be the estimated subsidy required. The process is repeated with a small "profit margin" added to the yield. Without two return rates for the development with and without the TIF, it is difficult to evaluate the project's financial feasibility under the two conditions.

Moreover, this analysis is missing an evaluation of net operating income *over time*. Instead, as we understand it, the pro forma analysis is constructed using a snap-shot approach, showing revenue in *one year* versus *total* development costs. In other words, it is a static evaluation that essentially applies a capitalization rate to determine the net operating income. A true pro forma asks, after the initial investment (development cost) is made, how will net operating income change over time? When will the company divest and sell the property, if ever? That sort of analysis would include assumptions about time, total investment, and the net cash flow over that time period that are crucial to a project with a phased development schedule. The Columbia Town Center projection has cash flows that may be irregular for a long period before finally stabilizing, and, as we understand it, the developer plans to hold the property for a long time. Therefore, only a full discounted cash flow analysis will yield a credible and reliable valuation and rate of return benchmark. [2]

[2] As noted above, a subsequent examination of HHC's internal analysis revealed analysis of rates of return both with and without TIF assistance but still with only a one-year time horizon.