



Office of the Comptroller

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July 15, 2011

Members of the Zoning, Neighborhoods & Development Committee
Milwaukee Common Council
City Hall, Room 205
Milwaukee, WI 53202

SUBJECT: File 101297 TID 48: North End Project – Phase II

Committee Members:

The File before the Committee authorizes \$7.3 million in additional TID spending, including a \$4.6 million loan to support the North End Project – Phase II, the release \$2.4 million in infrastructure grant funding that was previously authorized for the North End – Phase I, and \$300,000 in TID and loan administration costs. The file also approves the Term Sheet with Developer, USL Phase I Land and the Project Plan Amendment for TID 48.

The proposed Project includes a 155 unit apartment development with structured parking and ground level retail space. Twenty percent of the rental units will be affordable to those making 60% of the County median income or less. The Resolution includes a developer loan of \$4.63 million loan, which carries a 5.5% fixed rate with an 18 year term, amortized over 25 years. The first mortgage financing source for the Project is a loan through the Wisconsin Housing and Economic Development Authority (WHEDA) and equity investors, with remaining sources coming from the City TID loan, deferred developer fee and retail sales proceeds. These sources total \$36.71 million. In addition, \$2.37 million in TID grants would be provided for public infrastructure, plus \$300,000 in TID administration, bringing the total Project costs to \$39.38 million. Private development thresholds for subsequent public investment in the project per the current North End Development Agreement would be waived for this phase to allow for the subsequent \$2.37 million of public infrastructure improvements.

Sources

WHEDA Senior Bonds	\$26,185,000
B-bond Proceeds (equity).....	4,950,000
City of Milwaukee TID Loan	4,628,940
Equity -- Deferred Developer Fee	713,850
Retail Purchase Bonds	228,200
Total Private Project	\$36,705,989

City TID Other

2,670,000

Total Sources

\$39,375,989

Uses

Construction	\$25,023,622
Land and site Work	4,255,639
Financing Costs & Reserves	3,207,403
Soft Costs	2,791,626
Developer Fee	1,427,699
Total Private Project	\$36,705,989

Public Infrastructure & Admin

2,670,000

Total Uses

\$39,375,989

In 2006 the North End Project Plan anticipated a \$175,000,000 mixed use project with 483 residential units, 40,000 s.f. of retail space and a 326 stall parking structure to be built in phases through 2012 and \$8.5 million in City infrastructure assistance and job training. North End Phase I was approved in 2006 to include condominiums, apartments, retail and parking facilities. This approval was followed by an extended, severe national and local recession, driven by the collapse of real estate values. To date, 83 apartments, 12,655 sq ft of retail and a 115 parking stall structure have been constructed. At the time of City approval, Phase I was planned as a \$64 million private development. The actual Phase I development totaled about \$22 million. (See the attached letter from the Comptroller Members of the ZND Committee dated December 8, 2006.)

As the private development of the North End Phase I was far less than initially contemplated, there has been no "Subsequent City Investment" as the Phase I has not reached the private development threshold required under the Development Agreement. Also, no additional private development has been made beyond Phase I.

Is the Project Likely to be Successful?

As the proposed City TID assistance to the Project includes both a loan and a grant, evaluating the repayment of the City's investment involves assessing the extent that the Project will achieve sufficient rental/lease targets and the sale price estimates. This in turn requires that both the cash flow generated by the Project and the TID's incremental property tax revenues are examined.

In assessing the likelihood of loan repayment our Office has reviewed the cash flow projections of DCD's consultant, S.B. Friedman & Co., and Developer. These projected cashflows are derived in part from a market analysis¹ of apartment demand in the area of the Project site. Demographic projections drive the conclusion that a strong residential rental market will exist to support the rents required by this Project. Both Developer and DCD consultant cash flows show sufficient net cash from the Project to service the debt on the first mortgage (WHEDA) bonds and the City TID loan.

Regarding the overall status of the Park East TID including the North End Phase II proposal, projected cashflows show that all of the remaining years of the TID will be required to successfully retire TID 48. TID 48 was created in 2001 as part of the Park East Freeway spur new development. There are 18 years remaining of the 27 year life of the TID in which to recover costs. Other TID assisted projects within TID 48 also exist. There is currently \$32 million in authorized project costs, of which \$20 million has been borrowed. Projections show that the TID is likely to recover project costs in 2028, or the last year of the 27 year life of the TID.

In making this assessment, S.B. Friedman & Co. assumed additional value attributed to the North End – Phase II, the Moderne, and the Aloft Hotel, *but no additional value related to existing undeveloped parcels*. Other assumptions include 2 percent property value growth factor beginning in 2012, a declining tax rate stabilizing at 2% of assessed value. Debt assumptions appear reasonable, at 4.5% for tax exempt debt and 5% for taxable debt. The primary assumption by S.B. Friedman & Co. for feasibility purposes is that no additional development would occur beyond North End Phase II - a very conservative assumption. Our Office concurs that it is likely the TID will recover all project costs by 2028 -or sooner if other major development takes hold in TID 48.

Is the Proposed \$7.3 million in City TID Assistance needed to allow the Project to Proceed?

At issue is the extent that the proposed \$7.3 million in public funding is necessary to make the Phase II Project possible. In attempting to address this question, we look at Project costs and the expected financial return to both the Developer and other private investors.

Concord Group, a construction consulting firm employed by S.B. Friedman & Co., reviewed Developer's construction cost estimates and found them to be reasonable. The cost of Phase II has increased substantially due to the carrying costs associated with land acquired for this Phase approximately 10 years ago. As this Phase was substantially delayed due to the severe real estate recession, these carrying costs increased to become a substantial financing obstacle and have likely necessitated the inclusion of at least a portion of the \$4.6 million Developer loan portion of this proposal. While there is some disagreement on the extent of these costs as they affect this phase of the project, these carrying costs are real costs that the developer incurred.

The Developer fee is \$1,427,699, or 3.89% of \$36.7 million of total project costs. The Developer fee as a percent of project costs appears to be reasonable given the risks inherent in realizing this return. The Developer has agreed to defer one-half of this fee, or \$713,850, which is to be paid out of cash flows of the Project over time. The Developer's equity investment in Phase II is limited to this deferred fee. The developer's rate of return on this deferred \$713,850 fee is projected to total about 21% internal rate of return (IRR). However, the developer is not expected to realize

¹ "A Rental Housing Market Study of the Proposed Buildings Known as the North End Phase II"
Moegenburg Research, Inc., October 18, 2010.

significant annual cashflows from this Project. The Developer's return is essentially dependent on a projected \$43 million sale in year 15.

The non-developer equity of \$4.95 million is expected to generate an annual 12.5% after tax return. In contrast to the Developer, these investors are expected to realize annual cashflows throughout the life of the investment. In the current market this can be considered a reasonable rate of return.

Conclusions & Recommendations

Based on available market studies, we conclude that North End Phase II will perform sufficiently well to repay the City's loan. The repayment of City infrastructure outlays is also expected, although full infrastructure repayment may be affected by the overall success of TID 48. We conclude that the Developer return is acceptable given its dependence on risk of adequate future sale value. Likewise the non-developer returns are modest and therefore acceptable.

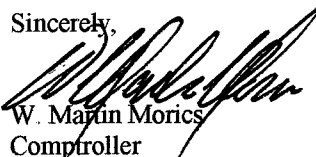
Since negotiations began with Developer on assistance to the Project, significant changes have been made to reduce the City's risk. An April, 2010 Developer's proposed Term Sheet included an \$8.0 million loan with a 27 year term with no scheduled principal amortization, with a 50% City sharing of net cash. The proposal before your Committee reduces the loan amount to \$4.63 million, reduces the loan term to 18 years, with loan repayment acceleration, an additional 10th year principal payment of \$300,000 and a \$500,000 bonus 'kicker' return to the City upon sale of the development if sufficient sale proceeds allow. There is also a personal guarantee by Developer, further reducing the City's risk of repayment.

The current Term Sheet also requires additional principal payments to be made to the City when the weighted annual average of interest payments (plus expenses) on the WHEDA loan are less the 5 percent. When this occurs, 50 percent of this interest savings, will be applied to the City TID loan annually. However, these additional payments will only occur after the first \$600,000 of "interest savings" is paid into a Debt Service Management Account (DSMA), created to absorb above budget interest rates. This provision further reduces the principal amount outstanding, shortening the amortization period.

In addition to the safeguards already in place, we recommend the following modifications to the existing term sheet and development agreement:

- 1) Designate that funds in the Debt Service Management Account are a first security interest of the City, allowing the City to apply these funds against the principal balance outstanding in the event of foreclosure.
- 2) The City Attorney has informed our Office that due to State law changes the City can no longer compel the Developer to pay prevailing wages on the Project. Consequently, the "prevailing wage" language in the Term Sheet has been removed. Nonetheless, we understand that it is the Developer's intention to pay prevailing wages as provided for in the current version of the term sheet. Should any Phase II contracts/subcontracts exclude the prevailing wage requirement, resulting budget reductions should be made to reduce the Project financing gap and the City's loan amount dollar-for-dollar. It is recommended that the term sheet be modified to incorporate a City review of all Phase II contracts prior to their execution to achieve a dollar-for-dollar budget and City loan reduction whenever the prevailing wage requirement is not included. Likewise, upon completion of construction, any actual dollar savings from the exclusion of prevailing wage requirements should inure to the City.

We believe that these modifications would further limit the City's risk exposure and provide potential savings. Should you have any questions regarding the above, please contact me.

Sincerely,

W. Martin Morics
Comptroller

Cc Commissioner Marcoux, James Scherer, Dan Casanova, Tom Gartner



Office of the Comptroller

December 8, 2006

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Deputy Comptroller

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Craig D. Kammholz
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Members of the Zoning, Neighborhoods
& Development Committee
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City Hall, Room 205
Milwaukee, WI 53202

SUBJECT: File 061021 – North End Project

Committee Members:

File 061021 would authorize up to \$8,459,000 spending for the purpose of supporting a proposed North End Project (“the Project”). Of this total, \$6.0 million would be new TID authorization while \$2.4 million was authorized for TID 48 by prior amendment. The File also approves the terms of a Development Agreement with USL Land LLC (“the Developer”) and the City of Milwaukee to construct the required riverwalk and other public infrastructure as well as complete right of way demolition and remediation. The above authorization would also include \$500,000 for job training, \$300,000 for City administration and a \$1 million contingency.

The DCD expectation is that the above infrastructure and riverwalk improvements will spur private development in the North End Project. The North End Project encompasses an eight acre site, currently planned for an estimated \$175,000,000 development including condominium, apartment and retail development including a two level parking structure. With the exception of the funds for required sewer-water utility work and job training, the City of Milwaukee would transfer TID funds to the Developer and the Mandel Group as co-project manager to construct or contract for construction of the planned improvements.

Concurrent with the above infrastructure work, the proposed North End real estate development would be staged in four sequential Phases over the years 2007-2012. Phase I includes two parts to be completed in 2007-2008. Phase I part one includes the construction of 73 condominiums, 12,500 sq ft of retail and a 326 stall parking structure including one floor of underground parking. Phase I part two adds 36 condominiums, 88 apartments and an additional 12,500 sq ft of retail. If the Project proceeds beyond Phase I, Phases II through IV would be completed by 2012 according to the Developer’s plan, adding 286 condominiums and 15,000 sq ft of retail space. Phase I would total \$64.2 million – 37% of the total North End Project.

Should the Project proceed to completion, the Developer estimates that 800-960 construction jobs would be created over the 5-6 year duration of the Project with 90-120 permanent retail jobs and at least 10 permanent property management jobs also created. The funding sources and uses for the infrastructure support work are shown below. Sources of private financing for building construction have not been finalized.

Sources

Developer plan ¹	\$ 5.9 mil
City of Milwaukee up front grant	\$ 2.4 mil
City of Milwaukee additional grants ²	\$ 5.3 mil
City of Milwaukee administered	\$ 0.8 mil

Total infrastructure rrvrwlk sources.....\$14.4 mil

Uses

Demolition/Environmental	\$4.4 mil
Public & Private infrastructure	\$3.7 mil
Riverwalk & Street Ends	\$2.7 mil
Dockwall, relocation, contingency	\$2.3 mil
Utility – sewer relocation	\$1.3 mil
Total infrastructure rrvrwlk uses	\$14.4 mil

¹ Developer evidences a \$4.7 million line of credit to support his land acquisition and certain site preparation costs.

² Additional City TID grants would be subject to Common Council approval.

Is the Project Likely to be Successful?

For the above infrastructure and riverwalk costs to be recovered through TID property tax increments, substantial private development must occur. There are important factors supporting the promise of future private development of the Project site. The Mandel Group involvement in the Project as its Developer and co-manager is a key strength. A pre-eminent locally based real estate developer, the Mandel Group is most recently identified with the luxury University Towers development. The Mandel Group has established itself as an outstanding residential and commercial developer in this area whose successes have reshaped the face of Milwaukee's downtown area. The Developer also indicates that it has already invested over \$5 million to acquire and maintain the North End site, with another \$4-5 million to accompany the City's initial TID grant. Therefore, recovering these "sunk" costs provides a strong Developer incentive to fully develop the site. In addition, the Developer has created a well conceived, four phase conceptual plan of its targeted \$175 million mixed use development.

Letters of interest from financial institutions have also been submitted. However, there are currently no building construction nor related financing commitments to support completion of the North End conceptual plan. This uncertainty prevents a conclusion regarding the likely implementation of the full conceptual plan. The Developer asserts that in order to obtain construction financing, it needs at least \$1.4 million in City funds now to clean up the site along with \$1 million infrastructure expenditures by the City.

The prior version of the Common Council resolution and Term Sheet resembled the approach used for the Brewery Project in that it required no initial construction commitments or Common Council approval once actual building construction commitments were acquired. The revised resolution and Term Sheet do retain the use of current borrowing authority to expend up to \$2.4 million to clean up and install initial infrastructure improvements without any firm construction commitment. However, the \$2.4 million has already been authorized for TID 48 and the clean-up work supported by these funds (and an additional \$4-5 million in Developer spending) is likely to amortize most if not all of the \$2.4 million in City TID costs even if development does not occur in the near future. In addition, the revised resolution and Term Sheet now require Common Council approval of subsequent City funding subject to a set of criteria that the Developer must meet. These criteria include sufficient TID tax increments, the consistency of the planned construction with the overall North End development plan as well as firm financing commitments and executed construction contracts. Should you approve this File, your Committee and the Common Council will have an opportunity to review and approve at a later time any TID spending beyond the initial \$2.4 million up to a maximum total TID expenditure of \$8.5 million.

Is the Proposed \$8.5 million in City TID Assistance needed to allow the Project to Proceed?

There is little doubt that the proposed \$8.5 million in infrastructure, riverwalk and other TID work as described above is reasonably matched to this \$175 million development. Since proposed TID funds are principally applied to streets, water-sewer and other public improvements or private improvements accessible to the general public, it is unlikely that the Developer would be in a position to substitute private funding for a significant portion of the proposed City TID funds.

As in the Brewery Project proposal your Committee recently approved, the predominant business risk to the City is not whether the proposed \$8.5 million will be needed, but whether it will be sufficient to accomplish the entire North End development as now envisioned. With no firm development or financing commitments, issues affecting the ultimate outcome of the Project cannot be answered. Yet unresolved are the possible acquisition of Federal New Market and Section 42 tax credits which could bring millions to the Project. Should these credits materialize, the nature of the Project and/or needed City participation could change. The extent and terms of investor and debt financing are also unknown. Adverse financing results here could lead the Developer back to the City.

Regarding Developer compensation, S.B. Friedman projects an \$18.8 million Developer fee and profit (10.7% of gross revenues)³. In the event of a private financing shortfall, whether the Developer would be willing to defer or reduce any of these fees, whether the Project would be downsized or whether the City would be approached for additional assistance to fill the gap is unknown. But because the requested TID funds are predominantly used for public infrastructure and other publicly accessible rights of way, these issues were not a part of the contract negotiations.

³ This Developer compensation level is within industry norms according to SB Friedman Co, the DCD development consultant. While past development fees/fee ratios for City assisted projects have at times been well below this level for smaller projects, we have no reason to disagree with the DCD consultant conclusion in this matter.

As the presentation unfolded at your prior meeting, the message was that should the City of Milwaukee grant the requested \$8.5 million, the North End Project mixed use development totaling about \$175 million would result. The Developer's excellent track record and North End investment to date speaks well of his commitment, ability and intent to perform. Unfortunately, the Developer has not as yet finalized any phase of its building construction financing. The possibility of private financing difficulties or tax credits altering the City's needed TID contribution exists. As a result, at this point no one can determine how much City assistance will be required to make full development a reality. However, the proposed Term Sheet limits the City's financial exposure to \$2.4 million. Any additional amounts would need to be approved by the Common Council based on specific, fully financed construction plans consistent with the conceptual development plan presented at your last meeting.

Conclusions & Recommendations

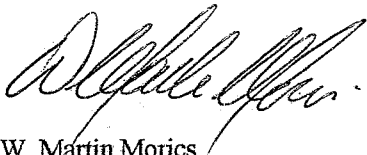
Our Office supports the impressive urban design plan authored by a leading Milwaukee developer in the Mandel Group and its USL LLC. In spite of the Project's lack of Developer construction financing commitments and a final plan of finance, the proposed Term Sheet limits the City exposure to \$2.4 million – an amount already authorized for TID 48, and requires Common Council approval beyond that point based on sound financial performance criteria. Based on the above, our Office supports the substitute resolution and this approach to the North End development.

We also make three recommendations for your consideration.

1. The DCD should closely monitor and periodically report to your Committee the actual extent and payroll impact of all construction and permanent jobs created by this Project.
2. Based on the prior ZND presentation, it is assumed that the requested \$8.5 million in City assistance will be sufficient to complete the North End conceptual plan. Should any additional future requests for City financial assistance be made for this Project, these requests would be made focusing on the *minimum* City funds needed ("financing gap")—that which the private sector and other grant sources cannot fill. Analysis would focus on the adequacy of proposed private debt and investor equity financing. Any such requests would need to be approved by the Mayor and Common Council.
3. As a \$6+ million addition to TID costs, this proposal seems sufficient to merit a TID amendment, requiring Joint Review Board approval. Currently there are no City policies to determine under what conditions a TID amendment should be required. While State TID laws are silent on this matter, a past City Attorney opinion suggested that a City policy be developed to guide this decision. This matter should be among those TID practices analyzed by your Committee in 2007.

Should you have any questions regarding the above, please contact me.

Sincerely,



W. Martin Morics
Comptroller

Cc Commissioner Marcoux, Joel Brennan, Tom Gartner, Allison Rozek, James Scherer, Emma Stamps