City of Milwaukee

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

RE: File 060420; TID 64-Direct Supply Inc. Project

Committee Members:

File #060420 would authorize the creation of Tax Incremental District (TID) #64, known as the Direct Supply Inc. Project. The File would also approve a Project Plan and the terms of a Development Agreement for the proposed District. TID #64 will assist Direct Supply, Inc. (DSI) and its landlord, KJ Greentree LLC, to upgrade and expand their current facilities, which consist of nine buildings located between 7221 West Green Tree Road and 6655 North Industrial Road.

Direct Supply provides supply chain management to nursing homes and long-term care facilities, by linking these facilities to suppliers of products such as medical equipment and furnishings. The company also operates a web based procurement system, which streamlines procurement and compliance reporting for foodservice and pharmacy transactions. In addition, Direct Supply provides customized interior design, furnishings and kitchen equipment and also operates a web-based facility management system for tracking equipment, repairs and building maintenance.

The developer for the project is Greentree LLC with Direct Supply as its tenant. Phased over the period 2006-2016, the Project Plan proposes construction of seven, two to four story connector buildings among Direct Supply's existing buildings, all of which are located to the south of Green Tree and Industrial Roads. In addition, the Project Plan calls for DSI acquisition and development of properties to the north of Green Tree and Industrial Roads for parking, green space and potential additional office space. One of these properties is currently a City owned and operated DPW sanitation facility. TID project costs are directly related to extraordinary costs of implementing the expansion plan, including the need to acquire and relocate adjacent businesses, remediate and encapsulate contaminated property, and provide for extraordinary foundations to build on what is a former unregulated fill site.

The phasing of this project will provide Direct Supply the flexibility to expand its operations as needed. Construction of the first connector building is planned to begin this year. **If fully implemented, this multi-phase project would generate up to 1,354 new jobs by 2015 and provide an additional 498,000 s.f. to Direct Supply's existing 200,000 s.f of office space.** In addition to jobs, the project would result in significant physical improvements that could be catalyst for further improvements in the area.

Total estimated project costs are $92.7 million, of which $13.3 million are TID project costs financed by the developer through a developer loan to the City. Also included is $4.7 million in direct City expenditures to finance one half of the $9.4 million estimated cost of relocating DPW's sanitation facility at Industrial Road.

Sources		Uses	
Direct Supply Inc./KJ Greentree LLC	$74,658,000	Connector Building Construction	$74,658,000
City TID Funding	13,342,000	DPW Site Relocation	9,400,000
City Funding - G.O. Borrowing	4,700,000	Acquisition, Demo and Extraordinary Costs	6,692,000
		DPW Access Road & Street Vacation	1,700,000
		Administrative Costs	250,000
	92,700,000		$92,700,000

The developer will advance an estimated $13.3 million plus interest in TID funding including any Project cost overruns. The City would authorize a conditional Monetary Obligation (developer loan) of an estimated $13.3 million plus inflation to reimburse the developer for project costs, plus interest at 6% per year. Financing costs at a 6% interest rate would add an additional $16.2 million, for a total of $29.5 million plus inflation. The developer loan would be repaid as an annual reimbursement to the developer but only to the extent of the property tax revenue generated each year. Thus, City repayment takes the form of a long term abatement or forgiveness of all DSI property taxes generated until the earlier of when the monetary obligation is satisfied or the year 2033 when the TID must be closed. Expenditures eligible for reimbursement would be approved by DCD monthly at which time interest will begin to accrue. With an option to purchase City property by DSI, the Project would also require an estimated $4.7 million in GO borrowing to finance the City's share of the cost of relocating a DPW transfer station sometime during the period 2009-2015.

Is the Proposed Project Likely to be Successful?

The proposed $13.3 million in TID costs are financed through a probable 30 year property tax abatement to Direct Supply. Given the projected tax increments from the DCD feasibility study, this project is not likely to generate any new property tax revenue *to the benefit of the general taxpayer* for the foreseeable future. Instead, **with a goal of 1,354 new jobs, TID success depends upon the extent of DSI job creation.** A major strength of the proposed agreement is that the timing of TID expenditures, and DSI's tax abatement, are sequenced to the timing of planned new DSI jobs.

	Cumulative Employment Gain		Cumulative City Project Costs	
2006	102	7.5%	$1,529,014	8.5%
2007	202	14.9%	2,654,014	14.7%
2008	298	22.0%	4,929,015	27.3%
2009	397	29.3%	5,206,015	28.9%
2010	497	36.7%	5,231,015	29.0%
2011	931	68.8%	6,416,454	35.6%
2012	931	68.8%	7,245,454	40.2%
2013	931	68.8%	7,878,454	43.7%
2014	931	68.8%	17,703,454	98.2%
2015-2020	1,354	100.0%	$18,032,454	100.0%

The extent of jobs created will therefore largely determine the length of the proposed DSI property tax abatement. This is enforced through a "claw-back" provision based on the number of jobs created by DSI. Should Direct Supply's employment fall below its projected employment[1] at any year end through 2010, and 2015 and 2020 thereafter, the City's loan will be reduced pro-rata based on the proportion of employment falling below the target. Unfortunately, the "claw-back" provision includes a 12 month "right to cure" period, which significantly weakens this provision particularly beyond 2015 and reduces Direct Supply's incentive to reach and maintain its stated employment goals.

The cash flow analysis conducted by DCD staff shows that the district will generate $26.6 million through 2033, $3 million less than the $29.5 million in TID project and financing costs. The DCD

[1]DSI employment is anticipated to increase from 636 currently to 1,989 in 2015.

analysis assumes full implementation of the project plan. Should actual construction costs fall below the full development cost, the proposed District may fully recover it costs. Moreover, as a developer financed TID, **the developer assumes all the risk of recovering project costs, so there is no risk to the City regarding a successful TID close-out.**

The recent growth history of DSI and its willingness to finance the vast majority of project expenditures including $13.3 million in TID costs are major strengths supporting this project. Since there is no guarantee that the 1,350+ job goal will be achieved, the proposed phased development approach provides an essential safeguard to both DSI and the City. **Together, these factors lead to the conclusion that the project is likely to be successful. However, a stronger developer loan "clawback" provision would promote achievement of the major TID goal – job creation.**

Is the Proposed level of City of Milwaukee Assistance Needed to Implement the Project?
In addition to the property tax abatement offered by the City through a $13.3 million developer loan, the City is also being asked to provide an option to purchase a currently operating DPW sanitation site from 2009 through 2016, forcing DPW to relocate these facilities should DSI exercise the option. The term sheet includes the provision that reimburses the City for holding costs related to maintaining control of an alternate location. However, the City has not yet found an alternate location. Total DPW relocation costs are expected to total $9.4 million plus inflation to be equally shared by the City and DSI. Any costs beyond this total would be borne by the City.

As long as the City establishes with certainty that the DPW relocation can be accomplished on time and at a cost not likely to exceed $9.4 million, the proposed cost sharing arrangement seems an appropriate way to provide DSI the needed option to accommodate its planned growth at the Industrial Road site. In summary, both the TID developer financed costs and the potential City $4.7 million in debt financed costs would seem justified assuming the City has provided for the alternate location by the time it commits to the DSI option to purchase.

Conclusion & Recommendations
The DSI project holds the promise of creating over 1,350 well paying jobs over the next 10 years. DSI's proposal to expand its growing operation within the City provides a great opportunity for both the company and the City to develop substantial, well paying job opportunities on the City's northwest side. While it is uncertain that the proposed TID 64 will be retired before the statutory required deadline of 2033, **the developer, not the City, has assumed the primary risk if the proposed District does not fully recover its costs.** While there is no expected general taxpayer property tax revenue benefit from this project in the foreseeable future, the DSI planned increase of the 1,350 jobs clearly supports these City commitments.

Through the developer financing mechanism, the DCD has transferred most of the development risk to the developer/DSI while incorporating a "clawback" incentive to meet annual job creation goals. However, as mentioned, the one year "cure period" significantly weakens the clawback. Employment levels are controllable by DSI. Should DSI choose for business reasons to fail to add the jobs they targeted, then the company should see its City tax subsidy promptly reduced. The Common Council can always consider action to suspend the "claw-back" if conditions merit.

Recommendation #1: Remove the one year "cure period" from the City "clawback" provision to promote DSI achieving the job creation objectives of this project.

A major project exposure from the City's perspective is inclusion of a proposed DSI option beginning in 2009 to purchase a major, currently operating DPW sanitation site. **The DPW has made no provision**

for finding an alternate site. The City will be required to budget at least $4.7 million plus inflation in GO borrowing - matched by DSI up to $4.7 million plus inflation - to accomplish this move. Should DSI exercise this option to purchase, the City is at risk of incurring an escalating cost well above the $4.7 million plus inflation to timely acquire an alternate site and vacate the property to meet its obligations under the proposed DSI agreement.

Recommendation #2: To avoid a potentially exorbitant future acquisition cost, the City should consider making its DSI option to purchase the DPW site contingent on the City's procuring a site or acquiring its own option to purchase an alternate site.

A third recommendation made by our Office was apparently rejected by the developer/DSI: To include a term sheet provision that reimburses the City for any out of pocket costs the City incurs in relocating its DPW sanitation facilities in the event that Direct Supply relocates outside of the City (or is acquired and moves outside the City) within five years of the City relocation.

Should you have any questions regarding this letter, please contact me immediately.

Sincerely,

Michael J. Daun

W. Martin Morics
Comptroller
Cc Richard Marcoux, James Scherer, Emma Stamps
7/20/06 Md/Ck