City of Milwaukee

Office of the Comptroller

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August 30, 2001

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

RE: File 010226
TID 45 – Wilson Commons Project

Committee Members:

File 010226 would approve the creation of TID 45 (the Wilson Commons Project), the related Project Plan and the terms of a Development Agreement to implement the Plan. We have examined the Project Plan, Feasibility Study, term sheet and discussed the Project with DCD staff, and are basing our analysis on this information.

The Project Plan proposes the demolition of all existing buildings on the site of the former DePaul Rehabilitation Hospital on South 13th and West Waterford Avenue, adjacent to Wilson Park on the city's southeast side. The existing facility has been vacant since 1996. Proposed as "Wilson Commons", the development envisions construction of 243 rental housing units aimed at seniors. Plans are to provide a 152 one and two bedroom apartment units - The Senior Living Center - including 31 "affordable" apartments. Rents would range from $600-$1,200 monthly. Additionally, seventy-four primarily one-bedroom apartments, including 37 affordable units would be part of a residential care complex also providing numerous support services (meals, laundry, etc.). Rents for these apartments would range from $1,000-$1,600 monthly. Also, 17 townhouse units for seniors would be rented at rates of about $1,500 monthly.

Project costs are estimated at $24.7 million with the City of Milwaukee providing $1.46 million – principally for demolition and various infrastructure improvements. The developer-owner will be Tarantino & Co, LLC. The DCD indicated its confidence in this developer in terms of both its success with this type of development and its long term commitment to own and manage the facilities.

Financing is proposed as follows:

1st Mortgage	$17.6 million
Owner Equity	$ 3.6 million
City contribution	$ 1.5 million
Developer Fee Remaining in Project	$ 2.0 million
TOTAL	$24.7 million.

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Is This Project Likely to Be Successful?

In addition to an experienced developer, **the project structure and budget have been carefully prepared with the objective of protecting the City's financial interests while assuring overall project success.** Although a consultant's final report was not yet available as of the date of this letter, the DCD indicated that its construction consultant reviewed the project design and budget, concluding that the plans are both reasonable and the budget adequate to complete construction. As equity investor, the developer is providing $3.6 million of its own cash and an additional $2 million in development services to the project. The City will also have a construction completion guarantee from the developer, and $3 million of investor or first mortgage loan funds escrowed or expended prior to the use of City funds. In addition, one-half of the cash portion of the development fee ($332,450) will not be paid to the developer until lease-up. These factors provide important financial incentives toward successful project completion. Furthermore, any cost savings in the project will be shared equally with the City.

Ultimately, the success of the project is dependent on the demand for this type of rental housing by the elderly. While it is beyond the scope of our Office to predict this demand, **the fact that the developer and a first mortgage banker are willing to provide over $21 million (86% of total budget) speaks strongly for the prospect of long-term success.**

Is the Proposed Level of City Financial Participation Required to Implement the Project?

The City proposes to finance its TID contribution through a $1.46 million loan from the developer. Based on the term sheet, this loan would currently be made to the City at about a six percent annual rate. This rate is substantially higher than the 4.3 percent annual interest rate the City could acquire through conventional General Obligation debt. Annual repayment of the loan would be limited to that year's property tax increment. Based on a successful construction and leasing of the units, DCD projects that the City would be able to fully repay the $1.46 million loan and successfully close the TID by 2009. The TID could last until 2022, providing the developer with substantial additional time to get his loan repaid through tax increments. However, loan repayment is totally dependent on the success of the development. Unlike other developer loans made to the City in prior TIDs, this TID does not contain any significant existing property improvements within its boundaries which assure success of the TID. Hence if the development fails, the City would not be required to repay as would be required with GO debt.

Based on DCD projections, the developer would receive a "cash-on-cash" return of 10 percent by 2005. Based on these same projections, when considering a 15 year owner investment period including the proceeds on the sale of the development in 2015 and Federal taxes, the developer's after-tax return would total about 14-16[1] percent. This is reasonable given the level of investment and risk associated with this project. Without the City's contribution, the developer's after tax return drops to 8.4 percent – insufficient to attract the needed private investment. **While we believe the lower cost City GO financing more appropriate, we conclude that the proposed $1.46 million City loan from the developer is required to make the project possible.**

[1] Our analysis of after-tax returns did not consider the possible application of any low income tax credits in this project.

There are certain safeguards we would recommend which the DCD and developer are apparently already in agreement. These are: having no prepayment penalty on the City loan; formal commitment or escrowing of both the first mortgage loan and the private equity prior to the use of City funds; and using the method of calculating the City loan interest rate as in TID 39. We would also suggest that the Council establish in the 2002 City budget, a fixed dollar limit on the level of City of Milwaukee developer loan obligations. Currently, the DCD is limited only by Council approval on a loan-by-loan basis without any budgetary limits.

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

Sincerely,

W. Martin Morics
Comptroller
Mjd/8-30-01