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Members of the Zoning, Neighborhoods  
& Development Committee  
200 East Wells Street, Room 205  
Milwaukee, WI 53202

RE: File 091567-Proposed TID 70 Project Plan Amendment #1: 735 N. Water St

Dear Committee Members:

File 091567 would approve the first amendment to Project Plan as well as a revised term sheet for Tax Incremental District (TID) 70 - 735 N. Water Street Project. TID 70 was initially created in 2007 to provide a \$3.8 million grant to assist Compass Properties (Developer) in the preservation and redevelopment of 731 and 735 N. Water Street, the two properties comprising the District. Developer costs would total \$18.4 million. The original project plan included façade renovation (cornice repair) and facility improvements to the 735 N. Water building. It also envisioned the development of an elevator-driven parking garage and the construction of seven luxury condominiums (average proposed sales price of \$1.5 million) at 731 N. Water Street. Riverwalk improvements, including ADA improvements and four boat slips, also were included in the project plan. Total project costs estimated to total \$22.2 million.

The proposed Amendment #1 modifies the Project scope and plan of finance. The desired cornice repair has been accomplished by the Developer. The condominiums, parking and boat slips have been deleted. The project now includes the renovation of 731 N. Water Street to house Gold's Gym on floors 2 through 5, ground floor retail space, and office space on the 6<sup>th</sup> and possibly 7<sup>th</sup> floors. The Developer currently securing a 20-year lease with Gold's Gym. The revised Project Plan also calls for the installation of life safety upgrades and skywalk improvements at 735 N. Water. In addition, the revised plan includes the restoration of 480 linear feet of riverwalk and dockwall. ADA upgrades were completed in 2009. Total project costs of the revised plan are:

<u>USES</u>		<u>SOURCES</u>	
Riverwalk	\$ 1,554,000	City grant-Developer financed	\$ 1,500,000
735 N Water (includes skywalk)	1,500,000	City GO Debt	1,841,400
Admin & Capitalized Interest	287,400		
<b>Total Public TID Costs</b>	<b>\$ 3,341,400</b>	<b>Total Public TID Financing</b>	<b>\$ 3,341,400</b>
Office Construction	12,218,534	Developer Equity	4,474,358
Soft Costs	3,720,585	BID #8 Loan	250,000
		Recovery Zone Bond Financing	5,000,000
		Conventional Financing	6,214,761
<b>Total Developer Cost</b>	<b>\$ 15,939,119</b>	<b>Total Developer Equity and Loans</b>	<b>\$ 15,939,119</b>
<b>TOTAL PROJECT USES</b>	<b>\$ 19,280,519</b>	<b>TOTAL PROJECT SOURCES</b>	<b>\$ 19,280,519</b>

The City's TID participation combines a \$1.5 million City grant financed through a loan by the Developer and \$1.8 million in City GO debt. City Debt supports the riverwalk (\$1,554,000), financing costs (\$167,400) and

administration and other costs (\$120,000). This is similar to the financing originally proposed in 2007. However, to the City's advantage, the proposed structure requires the annual City GO debt service to be repaid first. The original structure had called for the repayment of both components proportionately throughout the life of the TID. The proposed Amendment #1 requires full repayment of the City's annual GO debt service prior to repayment of the Developer financed portion for that year. This places the Developer, not the City, in the primary risk position regarding repayment.

The \$1.5 million developer funded portion of the TID will assist Developer in the \$15.9 million renovation of 731 and 735 N. Water Street. The renovation program for these buildings includes the construction of a skywalk segment, asbestos removal, and life safety (including fire suppression) upgrades, and "grey box" renovation (unfinished interior renovation without HVAC) for the Gold's Gym and other potential tenants. Developer will provide its loan funds at an interest rate of 4%, an approximation of the City's current cost of funds. Loan interest due the Developer will accrue at this 4% rate but the Developer will receive an annual payment only after the annual debt service on the City's \$1.8 million plus any prior year shortfall in GO debt is repaid. The City debt obligation is projected to be fully repaid 2020, or year 14 of TID. Full amortization of the Developer's loan is projected by DCD to occur in 2030 -- the 24<sup>th</sup> year of the TID.

The City's GO portion of the TID will assist in construction of a 480' dockwall and riverwalk segment adjoining 731 and 735 N. Water Street. These costs have increased since the original budget of \$1.3 million was presented 3 years ago due to redesign and the extension of the riverwalk six feet over the water. This riverwalk segment is unique in that it involves the rehabilitation of existing dockwall and riverwalk, with the dockwall being part of the foundation of 731 N Water. As such, the steel sheeting dockwall that is typical of new dockwall and riverwalk construction is not contemplated. As the DCD riverwalk and dockwall policy only considered new construction with a steel sheet pile dockwall, this dockwall segment is considered outside of that policy. Nevertheless, the City's Riverwalk contribution now represents approximately 68% of the total cost of the riverwalk rehabilitation.

#### **Is the Project Likely to be Successful**

Success depends upon the Project generating sufficient cash flow through its lease revenue. Combined, 731 and 735 N. Water Street have 350,800 s.f. of space, of which 193,000 s.f. (55%) is currently leased (all at 735 N. Water Street). Of the remaining 157,800 s.f., the proposed TID assistance would enable immediate lease-up of another 38,000 s.f. (11%) at 731 N. Water Street for Gold's Gym and make more attractive the remaining 119,800 s.f. of un-leased space. The terms of the proposed Gold's Gym lease are \$18 per s.f. "triple-net" lease, with annual escalating payments.

We have reviewed the lease rate and lease-up assumptions by DCD through its consultant, S.B. Friedman & Company and have concluded that these assumptions are not unreasonable. Applying these assumptions yields lease revenue growth sufficient to recover all TID project and financing costs, prior to statutory maximum legal life of the TID of 27 years. Using these assumptions, our Office projects full amortization of the TID by 2030, or the 24th year of the TID with the City's GO funded portion of the TID amortized in 2020-the 14<sup>th</sup> year of the TID.

As in any commercial real estate venture at this time, projections of lease up, lease rates and vacancies are subject to significant uncertainty. Likewise, this Project brings with it significant lease up and cashflow uncertainty. This project would be placed in service in a commercial market that has languished over the past 1 ½-2 years. While considering these risks, we believe the proposed Plan Amendment and related changes provide this project with a reasonable prospect of success. In addition, the above approach taken by the DCD in mitigating the City's GO debt repayment risk further strengthens the proposed Project Plan Amendment.

#### **Is the City's \$3.4 million TID investment necessary for the proposed project to proceed?**

In evaluating the need for City assistance, we assessed the return on investment to the Developer. In doing so, we recalculated Developer's rate of return, excluding prior investment in the property and considering only the estimated cash flows related to the proposed project. This approach is appropriate as it ignores the developer's sunk

costs and calculates the return on Developer's new investment based only on the future return due to the proposed project. Given this, the internal rate of return to Compass is estimated at 10.9% before taxes. As previously proposed, the Project generated a 16.1% return before taxes, due to its high dependence on assumed condominium sales. Given this rate of return, we conclude the need for assistance is necessary for the project to proceed.

### **Recommendations**

We make the following recommendations:

1. The release of TID funds should be contingent upon Developer providing documentation supporting private debt and equity commitments sufficient to support the proposed project and consistent with the Project Plan;
2. The interest rate for the \$1.5 million Developer loan should be explicitly stated in the Term Sheet at 4%.
3. The Common Council resolution should include a TID project "not to exceed" amount of \$1,841,400 for the City GO portion of the project, of which \$167,400 is for capitalized interest.

Our understanding is that the DCD concurs with these recommendations. By the time that your Committee meets, the resolution and term sheet may already reflect these recommendations.

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

Sincerely,



W. Martin Morics  
Comptroller

Cc Richard Marcoux, Alyssa Remington, James Scherer  
CDKMjd 5-14-10