



Office of the Comptroller

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

Files 011240, 011469, Creation of TID 49
Cathedral Place & Agreement Authorization

Committee Members:

Files 011240 & 011469 would establish a Tax Increment District (TID) #49 – Cathedral Place and authorize City officials to enter into a development and co-operation agreement for the project. The development would be located on the eastern half of the square block bounded by North Jackson Street on the east, East Wells on the north, and East Mason Street on the south. A mixed residential condominium, office, retail and parking complex totaling about 300,000 square feet is planned. The developer is Cathedral Place LLC. About 53 percent of this area would be leased for office usage, 20 percent for condominiums, eight percent retail and the remainder parking and common area. An adjoining 940 stall parking structure would accommodate tenants and customers of Cathedral Place as well as the general public. The parking structure would be owned by the City Redevelopment Authority (RACM).

Including the parking structure, the estimated total cost of Cathedral Place is \$65.3 million. The developer would raise the estimated \$42 million for the residential, office and retail portion of the project. RACM would plan to issue \$23.3 million in RACM revenue bonds to finance the parking structure. The RACM bonds would be repaid with a combination of net parking revenues and tax increments. The City would have to appropriate the funds annually to allow for the transfer of tax increments to RACM.

The final RACM/City financing structure has not yet been established. Currently two alternate approaches are being considered. Under one alternative, in order to make the RACM bonds marketable, the City is being asked to provide a **“moral obligation pledge”**. Such a City pledge would replenish RACM bond reserves should these reserves be depleted due to future financial problems with the parking structure operations. While not a legal obligation, a moral obligation pledge requires the City to commit now to consider the future appropriation of funds necessary to cure a possible future RACM bond default. Should no default condition occur, the City incurs no cost. **Because it minimizes the City’s financial risk and operational involvement, this is the preferred City financing alternative in the view of both DCD and the Comptroller.**

Alternatively, the DCD proposes that the City lease the parking structure from the Redevelopment Authority, with annual City lease payments equal to the debt service due on the RACM bonds. Should the lease option be necessary, the City would have to make another annual appropriation to support the lease payment. The City of Milwaukee and RACM would also need to address capital repairs, parking rates and other operating details of the structure under this alternative.

Is Cathedral Place Likely to be Successful?

The success of the RACM parking structure and the TID itself is highly dependent on the both the operating success of the adjoining private development and the final development cost to RACM.¹ While many will park in the RACM structure for purposes unrelated to Cathedral Place, the parking facility cannot generate sufficient revenues unless Cathedral Place is successful. In addition, since the TID depends on property tax increments as well as parking revenues, Cathedral Place must achieve and maintain sufficient occupancy to assure the successful closure of the TID.

Probably the best testimony to the future market reception to Cathedral Place is the expectation of substantial private financing. **The developer's ability to raise \$42 million in private financing through a combination of mortgage debt and equity investment financing speaks well for the future success of Cathedral Place.** The developer-project manager is also a major long-term investor in Cathedral Place, providing a financial incentive for the continued success of the project.

In addition, the DCD has incorporated a number of safeguards in the proposed financing limiting the City and RACM's financial risk:

- All private financing commitments for Cathedral Place must be finalized prior to any draws on the RACM financing.
- A "Not-to-Exceed" cost of the parking structure to RACM. Any cost increase not initiated by RACM and not offset by savings will be borne by the developer.
- "Support Payments" to RACM made by the Parking Manager in the event that parking revenues and TID increments are insufficient to pay the RACM debt service. Further, these Support Payments are to be guaranteed by the developer-investor. These payments are to be repaid only with future parking cashflows, tax increments or upon sale of the parking structure by RACM.
- RACM will be in charge of setting parking rates annually based on market rates in surrounding structures.
- The Parking Manager will receive no management fee, simply passing through the "out-of-pocket" costs incurred to RACM.

With a strong anchor office tenant and successful pre-leasing commitments, Cathedral Place should produce sufficient tax increments to successfully retire the District by 2020 to 2023.. Estimated parking rates are very aggressive. However, **both the demand generated by the new development and the current high level of parking demand in the area do provide a reasonable expectation of financial success for the parking structure.**

¹ The issue of the desirability of the City/RACM owning and operating a major parking structure is beyond the scope of this analysis. Also, given the time available, we did not attempt to determine the extent of any positive or adverse impacts on existing downtown office, retail or parking structures as the result of Cathedral Square.

Is the Proposed Level of City/RACM Financing Necessary to Allow Cathedral Place to Proceed?

We have been given summary figures regarding estimated private debt and equity investment as well as projected investor cashflows. These indicate an initial year cash-on-cash return of only about five percent. However, these estimates do not include the gains realized from the sale of 30 residential condominiums which can be expected to have a major impact on investor return. Detail construction cost estimates and cashflow projections for the private portion of Cathedral Place were not available.

The public portion of the Cathedral Place development is substantial, at about 36 percent (\$23.3 million/\$65.3 million). However, **it is unlikely that a private developer would be able to raise sufficient capital to finance a substantial share of the parking structure as well as the remainder of the development.** Moreover, **if the City of Milwaukee's participation is limited to the dedication of future tax increments and a moral obligation pledge to enhance a RACM bond issue, the exposure of the City taxpayer would be minimal.**²

Our Office supports the "moral obligation pledge" approach to the Cathedral Park financing to enhance the RACM revenue bond issue and complement the dedication of tax increments. **Should the RACM bond underwriters feel that the moral obligation pledge alone is insufficient to market the bonds, we would recommend that the Comptroller and the City's financial advisor perform an independent review to confirm that more extensive City involvement is required as well as to reach agreement on the nature of that involvement.** Further, given the current "in-process" status of the financing arrangements, we would recommend adoption of the above Files contingent upon Comptroller review and approval of the final financing structure and related contracts and agreements.

Sincerely,



W. Martin Morics
Comptroller

Cc Julie A. Penman
Daniel J. McCarthy

² This City risk minimization is further strengthened by the Developer's Support Payments Agreement discussed in this letter.