



Department of City Development

Housing Authority
Redevelopment Authority
City Plan Commission
Historic Preservation Commission
NIDC

Rocky Marcoux
Commissioner

Martha L. Brown
Deputy Commissioner

Date: April 30, 2007
To: Zoning & Neighborhood Development Members
From: Joel Brennan *JB*
Re: RSC Park East Proposal

Attached you will find a brief memorandum from SB Friedman regarding the RSC proposal for Block 1 in the Park East Corridor. While the item pertaining to this matter was introduced at the last Common Council meeting, the language in the resolution was not made available until approximately April 26. Upon viewing the language in the resolution, I asked for SB Friedman for an initial review of the project, and that is what you will find attached.

Please be aware that a full analysis of this project would typically cost between \$30,000 and \$50,000 and take several weeks. Under the TID guidelines formed over the past few years, the cost for that third party analysis rests solely with the developer. In the event that a TID is eventually adopted, the developer can recoup the costs of that review through the administrative line item in the TID; if a TID is not adopted for the project, no money will be returned to the developer.

Also, you should be aware that SB Friedman increasingly takes on the role of assisting in negotiations on TID projects rather than simply analyzing numbers. With limited city and RACM staff, the perspective that SB Friedman brings from their work on projects around the country provides invaluable assistance in getting the best result for the city and the optimal return for Milwaukee taxpayers.

The attached initial review summarizes the project and provides initial observations about the identified financial gap. For example, the analysis identifies a \$4.3 million gap in the apartment component of the project and correctly points out that the use of TID to subsidize that residential gap will reverse a decade-long policy of not directly subsidizing the downtown market-rate residential market.

The memo concludes with the following paragraph:

“Overall, it appears that the Developer’s reported financing gap for the proposed project is driven primarily by the mix of uses in the development program, as opposed to any underlying infrastructure or site deficiencies. A program emphasizing for-sale residential product types such as condominium and townhomes, potentially with ancillary retail, would likely be feasible on the project site without public financial assistance.”

Please feel free to contact me at x5820 with any questions you may have.

Date: April 28, 2007
To: Joel Brennan, Redevelopment Authority of the City of Milwaukee
From: S. B. Friedman & Company
Subject: **Initial Review of Park East Block 1 Proposal**

Per your request, S. B. Friedman & Company (“SBFCo”) has performed an initial review of the programmatic and financial parameters of the Park East Square project as presented in a December 8, 2006 TID assistance request submitted by RSC & Associates (“Developer”).

This review includes the following elements:

- Summarization of the proposed development program, including the allocation of parking among project components
- Description of the Developer’s estimated financing gap
- Allocation of this gap among the various components of the project
- Initial observations regarding the development program and apparent drivers of the reported financing gap

It does not constitute a full analysis of the Developer’s cost, revenue, or financing assumptions, nor does it evaluate the amount of the Developer’s TID request or the appropriateness of the resulting project returns.

Development Program

The proposed project, located in Block 1 of the Park East Corridor, carries an estimated cost of about \$77.7 million. The proposed development program includes five uses—rental apartments, for-sale townhomes, retail, office, and hotel. The program is comprised of:

- 124 rental apartments
- 5 townhomes
- 73,700 rentable square feet of retail space
- 7,700 rentable square feet of office space
- 148-room hotel (Hyatt Place)
- 458 structured and interior surface parking spaces
- 29 on-street parking spaces

The Developer allocates the 487 total proposed parking spaces among the development components as follows:

Table 1: Development Program and Parking Allocation

	Units/Sq Ft.	Allocated Parking	Parking Ratio
Rental Apartments	124 Units	124	1 Spc/Unit
Townhomes	5 Units	10	2 Spc/Unit
Retail/Office	81,400 SF	326	4 Spc/1,000 SF
Hotel	148 Rooms	27	0.2 Spc/Room
Total		487	

Financing Gap

The Developer's December 8 submittal indicates a purchase price of about \$2.7 million for the development site from Milwaukee County, as well as a request for about **\$9.5 million** in TID gap financing from the City of Milwaukee (see Tab 2 of 12/8/06 RSC Proposal). This request is based on a projected stabilized return on cost of -2.95% without assistance and 9.33% on cost with the full requested TID contribution.

The proposal further breaks down the need for TID assistance into individual calculations of development costs, revenues, and financial returns for each of the four revenue-generating components of the project (apartments, townhomes, retail/office, and hotel), allowing comparisons of the relative performance of these separate elements. For these individual component calculations, the Developer has allocated project-wide costs such as land acquisition and site preparation in proportion to the square footage of each component. Parking construction costs are then assigned to the revenue-generating components of the project based on the allocation of spaces described in Table 1.

Based on this breakdown, *SBFCo* calculated the implied need for gap financing associated with each individual revenue-generating component of the project, as shown below in Table 2.

Table 2: Allocation of Requested TID Assistance Among Project Components

	Cost including Allocated Parking	Projected Stabilized Value	Stabilized Return on Cost	Implied Allocation of TID Request	Return with TID Assistance
Rental Apartments	\$25.0 MM	\$23.0 MM	- 7.9%	\$ 4.3 MM	9.3%
Townhomes	\$ 2.7 MM	\$ 3.5 MM	+28.8%	\$-0.5 MM	9.3%
Retail/Office	\$27.5 MM	\$25.0 MM	- 8.9%	\$ 5.0 MM	9.3%
Hotel	\$22.5 MM	\$23.8 MM	+ 5.9%	\$ 0.8 MM	9.3%
Total/Overall	\$77.7 MM	\$75.4 MM	- 3.0%	\$ 9.5 MM	9.3%

Source: 12/06 RSC Development proposal and *S. B. Friedman & Company*

Note: Numbers may not add due to rounding

This analysis indicates the following:

- Per the Developer's estimates, the smallest component of the proposed project, the townhomes, is projected to be the most profitable, with a return on cost of almost 30%
- On an individual basis, all other project components indicate a pre-TID return of less than the Developer's targeted rate of 9.3%
- The rental apartment and retail/office components have a projected stabilized value that is less than their respective construction costs (including associated parking), resulting in negative returns on cost
- The hotel component is projected to achieve a positive return without TID assistance, but appears to require modest TID assistance to achieve the Developer's target rate of return

It should be noted that the return projections associated with individual project components are sensitive to the allocation of parking construction cost among these components. Upon initial review, the distribution of parking between the hotel and retail/office components (27 versus 326 spaces) currently appears to favor the economics of the hotel component, and may represent less parking than a hotel of the proposed size might require in this location. If additional spaces were reallocated to the hotel to yield a parking ratio of 0.5 spaces per rentable room (74 spaces) and the retail/office parking allocation reduced accordingly, the hotel component return before TID assistance would decrease from +6% to about -1%, while the retail/office return would improve from about -9% to about -4%.

Initial Observations

Based on initial review of the development program and projected financing gap/TID request, our initial observations are as follows:

- **For-Sale Residential Component.** The only development component that does not carry a reported financing gap is the townhomes. This is consistent with the general character of current and recent development in the Park East and Beerline neighborhoods, which has been dominated by for-sale condominiums and townhomes. If expanded and/or complemented with condominiums, the townhome component could work to further offset the financing challenges associated with the other elements of the project. Additional townhomes on the project site might also represent a desirable alternative to the for-sale condominium product being developed on several sites in and around the Park East.
- **Apartment Component.** While market-rate apartment occupancy rates in Downtown Milwaukee are reportedly strong, prevailing rents are not generally at a level that covers the cost of new construction. This is borne out in the Developer's projections. As shown in Table 2, the implied financing gap for the apartment component is \$4.3 million. This suggests that the provision of TID assistance to the proposed project would represent a

divergence from the City's current policy of avoiding gap financing for market-rate residential development in the Downtown area.

- **Retail/Office Programming and Parking Costs.** The projected rents for the retail and office square footage do not appear sufficient to cover the costs of constructing the associated parking. This is due to the primarily structured parking format, with an estimated overall development cost of over \$30,000 per space. However, the RSC submittal indicates that the overall square footage of these components has been expanded between the July 2006 proposal and the current version. The size of the retail and office components—and their increase in square footage since the Developer's initial project proposal—appear to contribute substantially to the projected financing gap.
- **Hotel Component.** Based on the Developer's projections, the hotel component carries a modest financing gap. However, the Developer's limited parking allocation of approximately one parking space for every five rooms causes this component to carry a relatively small share of the overall parking construction cost.

It is not yet clear how the proposed hotel component would interact from a market competition standpoint with existing nearby hospitality properties or the other proposed mixed-use hotel projects in Downtown Milwaukee. Issues of this type will be addressed by the study currently being conducted on behalf of the City of Milwaukee by HVS, Inc. and *SBFCo*.

Overall, it appears that the Developer's reported financing gap for the proposed project is driven primarily by the mix of uses in the development program, as opposed to any underlying infrastructure or site deficiencies. A program emphasizing for-sale residential product types such as condominiums and townhomes, potentially with ancillary retail, would likely be feasible on the project site without public financial assistance.