



Office of the Comptroller

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April 27, 2007

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

RE: Proposed TID 69 – New Avenue  
Commerce Center

Dear Committee Members:

The file authorizes the creation of Tax Incremental District (TID) 69, New Avenue Commerce Center (NACC), which is a proposed retail development located on North Avenue between 24<sup>th</sup> and 25<sup>th</sup> Streets. The proposed project includes 44,000 square feet of retail space for a Lena's Food Market grocery store and 31,000 square feet of additional "inline" retail space. The proposed project also includes the potential development of two outlots that could either be sold or leased to third parties, generating additional income for the project. The boundaries of the proposed TID are North Avenue (south), Meinecke and Medford (north), 24<sup>th</sup> Street (east) and 25<sup>th</sup> Street (west).

"Developer" is North Avenue Commerce Center Phase III, LLC, a single purpose, for-profit limited liability company formed by Irgens Development Partners, LLC, Williams Development Corporation and an affiliate of Lena's Food Market. Proposed TID assistance includes a grant of \$950,000 to assist with the real estate development of the NACC, a "start up" grant of \$150,000 to Lena's Food Market, and \$727,000 in public infrastructure and site improvements, which includes sewer relocation work, street and sidewalk construction, and extraordinary site remediation. In addition to these project costs, capitalized interest and DCD administration costs are \$348,000. Total TID funding for the proposed project is \$2.2 million. Total project costs, both private and public, are \$9.8 million. The sources of funding and their uses are as follows:

SOURCES		USES	
		<u>Private Real Estate Development</u>	
New Market Tax Credit Loan	\$ 7,100,000	Construction and Architecture	\$ 5,321,084
City Bond Proceeds	2,174,785	Land Acquisition and Site Work	1,804,848
Developer Equity	519,528	Soft Costs and Other	1,443,597
			<u>8,569,529</u>
		Lena's Start Up Assistance	150,000
		<u>Public Improvements &amp; Other</u>	
		Public Improvements	727,076
		Capitalized Interest and Administration	347,708
			<u>1,074,784</u>
<b>TOTAL SOURCES</b>	<u><b>\$9,794,313</b></u>	<b>TOTAL USES</b>	<u><b>\$ 9,794,313</b></u>

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

We have reviewed the feasibility study conducted by S.B. Friedman and Company and have independently calculated the cash flow projections for the project to determine the TID's feasibility. Based on similar assumptions on assessed values, property value growth, tax rates and debt service, we have projected that the TID could recover project costs by 2031, the 25<sup>th</sup> year of the project.

One of the risks facing the proposed Project could be a lack of demand for the "inline" retail space. Unlike the grocery store component, which is to be occupied by Lena's Food Market, no tenants have been secured for the "inline" retail space although Developer has asserted that it has received "letters of intent" from two prospective tenants. The risk is that the retail center will be assessed on an income valuation approach, so a vacancy rate above the 10% allowance could result in the TID not recovering project costs. In testing the sensitivity of the proposed District to this lease-up risk, it is estimated that at least 55% of the "inline" retail space must be leased in order for the TID to recover project costs, based on an assumed gross rent of \$17.50 per square foot.

An additional risk to the project could be construction risk. As much of the public infrastructure such as sewer abandonment and relocation must occur prior to Developer proceeding with construction, there is the risk that a delay in the installation of public infrastructure and site preparation could result in a delay in construction of the real estate development. Higher costs could result if contractors do not hold their construction bids throughout the delay, which could potentially jeopardize the Project. As the City's money is "first in the door" for these public improvements, the Development Agreement should require the customary completion guarantee, otherwise the public infrastructure may be placed in service and site prep completed with no means of recovering these costs.

We have also noted that the proposed TID will impact TID 21 as the boundaries of the proposed TID overlap a portion of TID 21. As a result, the value of TID 21 will be capped for those properties within the overlapping boundaries. However, the impact on TID 21 will be minimal as the affected properties are tax exempt vacant land. Furthermore, TID 21 is not expected to recover its project costs without receiving an infusion of revenue from another district and could benefit from a TID amendment such as the proposed Project. However, the statutory termination date of TID 21 is 2020, which is an insufficient time horizon for the recovery of the proposed TID's costs, projected to be 2031.

**Is the Proposed Level of City Assistance Required for Project Success?**

In assessing whether the TID assistance is necessary, we analyzed the three components of the TID – the public improvements, the grant to the developer, and the "start up" grant to Lena's Food Market.

With respect to the public improvements, these project costs are for facilities the Developer would typically require prior to construction, but not finance. The removal of old sewer lines, the installation of streets, street lighting, signals, and other infrastructure, as well as site preparation serve a public purpose. It can be argued that these improvements are necessary to allow private development to proceed.

As for the grant to the developer, S.B. Friedman and Company calculated the internal rate of return to Developer at 19.8%, which is reasonable given the risks associated with the Project, but on the high end of S.B. Friedman's acceptable range of 15% to 20%. It should be noted that this rate of return only includes cash flows from the grocery and "inline" retail spaces. Should a sale or lease of either of the two outlots occur, the rate of return to Developer will exceed 20%. Recognizing this upside potential, the Term Sheet contains two provisions allowing the City to receive a portion of the Developer's return, for the portion exceeding 18%, proportional to the City's participation in the real estate development. While one could argue that developer compensation is excessive in a scenario where either outlot is sold or leased, the City is guaranteed participation in Developer's rate of return in the event that the Project's success exceeds 18%.


The TID also provides a “start up” grant of \$150,000 to Lena’s Food Market to assist with the payment of a loan for fixtures and equipment. We note that this is a new type of subsidy being proposed for funding with TIF proceeds and may set a precedent. It should also be noted that the need for this assistance has not been assessed and is therefore impossible to determine whether this component of TID assistance meets the “but for” test. Should the Common Council wish to provide this subsidy, we recommend that the need for such assistance first be determined, to provide assurance the \$150,000 is truly filling a financial gap. Also, as the grant is tied the repayment of a loan and equates to approximately 3 years of loan repayments, it is recommended that this grant be discontinued should the need no longer exist as documented by sales revenue exceeding a certain threshold, such as \$300 a square foot in sales.

**Conclusions and Recommendations**

The proposed TID is located in close proximity to a number of other redevelopment efforts including, TID 21 (North Avenue Commerce Center), TID 65 (North 20<sup>th</sup>/West Brown) and TID 66 (Metcalfe Park Housing). In spite of these efforts, the area has witnessed a decline in commercial activity over time. In addition, the entire TID consists of vacant and underutilized land, which was vacated for the construction of the Park West freeway. As the proposed project builds upon prior city efforts, we recommend the Common Council approve TID 69, recognizing the lease-up risk and construction risk associated with the project. This recommendation is contingent upon two recommendations:

- 1) The Term Sheet is amended so that payment of the \$150,000 grant terminate when grocery store sales reach an annualized amount of \$300 per square foot determined by averaging the prior six months of sales. For future projects “start up” assistance should only be provided upon determination and documentation of need.
- 2) The Development Agreement requires a completion guaranty from developer to protect the City from construction completion risk.

Sincerely,



W. Martin Morjes  
Comptroller

Cc Richard Marcoux  
James Sceherer

WMM/CDK/4-25-07