



Office of the Comptroller

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February 27, 2007

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

RE: File 060961 - Proposed TID 69: 735 N. Water St. Project

Dear Committee Members:

File #060961 authorizes the creation of Tax Incremental District (TID) 69, 735 N. Water Street Project, and approves the related project plan and term sheet. The proposed TID is intended to assist Developer, Compass Properties (Compass), redevelop 731 and 735 North Water Street. The proposed District includes only the properties at 731 and 735 North Water Street and the adjoining riverwalk. Total TID funding is \$3.8 million with total TID project costs of \$22.2 million. Uses and sources of the proposed project are:

<u>USES</u>		<u>SOURCES</u>	
Riverwalk	\$ 1,351,297	City Grant Funded Developer Loan	\$ 3,765,372
Cornice Repair	1,318,861	Developer Equity and Loans	18,446,092
Admin, Contingency & Other	1,095,214		
Total Public TID Costs	3,765,372		\$ 22,211,464
Office Construction	7,873,871		
Residential Construction	5,311,265		
Soft Costs	5,260,956		
Total Developer Costs	18,446,092		
TOTAL PROJECT COSTS	\$ 22,211,464		

Through a \$1.3 million cornice repair, the proposed TID would provide for preservation of the architectural character of the 735 North Water Street building as well as certain riverwalk improvements including ADA accessibility. The DCD relied on the Concord Group to prepare a cost estimate for this work which our Office did not review. DCD indicates that the riverwalk in question received no prior City assistance. Estimated riverwalk costs modestly exceed the City's riverwalk and dockwall policy limits of \$2,000 per linear foot and \$800 per linear foot, respectively. However, this funding policy pertains only to the construction of new riverwalk, not the rehabilitation of existing riverwalk segments which presumably should cost less than an entirely new riverwalk. Our Office did not examine the reasonableness of the proposed riverwalk rehabilitation and enhancement costs. In exchange for the City's \$3.8 million TID contribution, Compass will provide a 99 year facade easement for 735 North Water and a public access easement for the existing riverwalk segment.

Is the Project Likely to be Successful

The success of the project is contingent on construction completion and adequate and sustained lease-up of the office component of the project. As such, the return on investment of the entire project must be sufficient to attract private equity and debt financing to the proposed project. We have recalculated Developer's rate of return, ignoring Compass' 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 additional return due to the proposed project. Given this, the internal rate of return to Compass is estimated at 16.1% before taxes which is sufficient for a project of this type. We therefore conclude that it likely for Compass to attract the debt and equity financing commitments necessary for the timely completion of the proposed project. Still, the importance of Compass obtaining all project financing commitments prior to any City cash disbursement to this project is essential.

Regarding the likely success of the project once completed, there does exist occupancy risk for the office space - risk inherent in all downtown class B office space with which this office space is likely to compete. In the past, vacancy rates for such office space in downtown Milwaukee have fluctuated from rates at or below 70% to well over 90%. The excellent location of this

building, however, works to mitigate occupancy risk for the office space. In summary, once all private debt and equity financing commitments have been finalized, the proposed project has a reasonable likelihood of success.

Is the City's \$3.8 million TID investment necessary for the proposed project to proceed?

Both DCD staff and the DCD consultant (SB Friedman & Company) state that the TID financed improvements are likely to generate little if any additional income for the property and therefore do not improve either the sale value of the improved property or the Developer's return on investment¹. The sole focus of commercial lenders and potential investors is on the cashflows generated by the project. Since the proposed TID improvements do not enhance cashflows, they will not enhance Compass' ability to attract project financing. Therefore, the proposed TID improvements are likely to have no bearing on the Developer's decision to proceed with the proposed project. Since these improvements are not necessary for the economics of this project, the proposed TID does not meet the "but for" test historically analyzed by our office and as stated in the City's TIF Guidelines ... "TIF assistance will be limited to the amount necessary to make a project financially feasible."

DCD staff asserts that the primary objectives of the proposed TID is the preservation of the historical character of downtown through the restoration of facades as stated in the City's Downtown Plan as well as providing public access to the riverwalk segment in accordance with the City's riverwalk and dockwall funding policy. In addition to these concerns, the use of TID financing saves the City of Milwaukee taxpayer a portion of the cost of these improvements because the TID effectively transfers cost to taxpayers outside the city of Milwaukee through Milwaukee County, Milwaukee Area Technical College and the Milwaukee Metropolitan Sewerage District. This cost transfer results in an approximate city taxpayer savings of about 13 cents on the dollar and can provide economic justification for proceeding. Unfortunately, this 13% "discount" is offset by the added financing costs related to a proposed use of a developer loan to the City to finance TID costs. Since the TID fails the economic "but for" test as there is no resulting financial benefit, TID financing may not be the most appropriate mechanism to fund the proposed private and public improvements. The added cost of the (DCD consultant assumed) 6% rate charged by the TID developer loan versus the 4% rate for City GO debt negates any taxpayer benefit from using the TID. In addition to not meeting the economic "but for" test, there is also no financial benefit to the City of Milwaukee taxpayer to justify the use of TID funds. Further, no excessive development risk appears to be present in this project to justify the higher cost of developer loan financing. There is no economic justification for developer financing for this project unless the developer can obtain financing at an interest rate at or below that of City GO borrowing.

Conclusions and Recommendations

1. The proposal does not meet the economic "but for" test discussed in previous TID letters and included in the City's TIF Guidelines. Alternatively, other City of Milwaukee financing sources should be explored to finance this project. If the Common Council wishes to proceed with this proposed TID, the project should be financed through City GO debt financing. To finance this project through a developer loan as recommended by DCD is likely to cost an additional \$650,000 over the life of the loan and negates the economic advantage of using TIF financing.
2. Alternatively, the Term Sheet and Development Agreement should be amended so that the interest of the developer loan be no greater than the City's cost of funds.
3. Should the Common Council proceed with this proposed TID, no TID funds should be released until the DCD Commissioner and the City Comptroller have approved their release. Such a release would be contingent upon Developer providing documentation supporting private debt and equity commitments sufficient to support the proposed project. Should required conditions be included in these financing commitments, such conditions should be satisfied prior to release of any City TID funds.

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

Sincerely,



W. Martin Morics
Comptroller

Cc Richard Marcoux, Allison Rozek, James Scherer, Emma Stamps
CDK/mjd/2-16-07

¹ "Costs associated with the cornice replacement and riverwalk... would not add substantially to the income generating potential of the property." Gap Analysis fo the North Water Street Property, S.B. Friedman & Company, January 29, 2007.