City of Milwaukee

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

RE: File 050073 TID 58 – PabstCity

Committee Members:

File 050073 would create Tax Increment District 58 – PabstCity. The File would also approve a Project Plan and the terms of a cooperation and redevelopment agreement between the City and the developer, Juneau Avenue Partners, LLC ("the Developer"). The terms provide a $39 million dollar grant to the PabstCity for public improvements, environmental remediation, site preparation, and rehabilitation work on the existing structures within the development. An additional $2 million is also proposed for inclusion in the TID for City directed job training for targeted Milwaukee residents and general City administrative costs. Financing costs will add up to an additional 10% for an estimated total of $45 million.

The Developer proposes the rehabilitation of the former Pabst Brewery site including 8 to 9 of the existing buildings formerly part of the Pabst Brewery. The Project is located on approximately 35 acres just east of I-43 and south of the former Park East Freeway. As is indicated in the Project Feasibility Study, the Developer proposes about 1.1 million square feet of development including nearly ½ million square feet of entertainment, restaurant and other retail activity, about 380,000 square feet (250 units) of apartments and condominiums, over 250,000 square feet of office space and 3,800 parking stalls in three parking ramps with some on street parking.[1]

Two development firms make up the Juneau Avenue Partners, LLC development team: Wispark, a development arm of WE Energies and the Ferchill Group, a Cleveland based developer. Wispark has been a major developer in a number of Milwaukee area developments, most prominently the Grand Avenue–Saks, Inc. redevelopment project. The Ferchill Group has been active in the Midwest and elsewhere on a number of large commercial real estate developments.

The PabstCity development budget totals $317 million including the recent addition of a proposed $2 million in City funds to be administered by the City for job training and City project administration. Financing sources are as follows:

Construction Loan - First Mortgage	$137.6 million	43%
New Markets Tax Credit Equity	$ 62.5 million	20%
Equity Investors	$ 55.9 million	18%
City Grant including City administered funds	**$ 41.0 million**	**13%**
Proceeds from sale of a new Parking Garage	$ 16.0 million	5%
Other	$ 4.0 million	1%
TOTAL	$317.0 million	100%

[1] One proposed parking garage is being developed apart from this project financing and a separately owned Office/Gift Shop/Blue Ribbon Hall is to be developed by a different owner-developer.

IS THE PROJECT LIKELY TO BE SUCCESSFUL?

This question can be divided into two related questions:

1) Will the PabstCity Project attract sufficient new business to support the development without a material adverse impact on surrounding existing businesses?
2) Will the PabstCity Project generate revenues to repay the City for its $41 million contribution?

1) Will the PabstCity Project attract sufficient new business to support the development without a material adverse impact on surrounding existing businesses?

During the extensive private and public discussions about this Project, one general point of agreement is that by its sheer size, the PabstCity Project brings with it both substantial opportunity and inherent development risk. There is no question of PabstCity's potential with 488,000 square feet of retail/entertainment development and more than $2.7 million in potential annual property tax revenue. Although this Office has not examined the job related impact of this development, the proposal asserts that "...up to 1,100 new jobs will be created..." and "...nearly 1,000 construction workers will participate in job site activities."[2]. Further, no serious competing development proposal(s) for the former Pabst Brewery site has surfaced. This is likely due to the nearly 20 years of general decline and neglect on the site. Hence the cost to the City of leaving this property in its declining state without active redevelopment in place is no doubt significant and growing with each passing year.

The development team possesses several significant strengths. The Ferchill Group has substantial development and property management experience in a wide variety of commercial and residential properties in the Midwest. Wispark brings a strong record of development investment throughout southeastern Wisconsin, Illinois, Minnesota and California. In the city of Milwaukee, Wispark recently played the prominent role in a $40 million renovation of the Boston Store and adjacent Grand Avenue structures.

While considering those significant strengths, PabstCity is not without material development risk. One significant risk is that of lease termination by an anchor tenant. Under the proposed agreement, three anchor tenants[3] have signed letters of intent to lease PabstCity facilities for 10-20 years. However, within the first ten years, all of the final leases will have contingency provisions allowing anchor tenants to terminate or not open based on occupancy levels and/or revenue thresholds. While an apparent reality of the marketplace, these are risks to both the City and all private investors in PabstCity.

The Comptroller engaged the firm of C.H. Johnson Consulting, Inc. (CHJC) to examine the proposal, comparing PabstCity to other "urban lifestyle centers" operating in Louisville, St. Louis, Baltimore, Indianapolis, Phoenix and elsewhere. In addition, using available sales data from similar developments surveyed, and tenants within those facilities, CHJC projected tenant[4] sales under three possible PabstCity tenant mix scenarios. CHJC then projected the Net New Sales[5] generated for each tenant mix. "Net New Sales" provides a general estimate of the extent of new sales triggered by PabstCity versus sales shifts from existing area businesses to PabstCity. The CHJC Report is included under separate cover in the Common Council File.

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[2] "Redevelopment of Milwaukee's Historic Pabst Brewery –Tax Incremental Financing Application", The Ferchill Group, January 25, 2005, Section B pg. 1.

[3] Anchor tenants include the House of Blues, multi-screen movie theatre and major entertainment center (Gameworks or industry equivalent).

[4] The restaurant, entertainment, commercial lessees of the PabstCity buildings.

[5] "Net new spending"= Increased spending by the regular visitors, spending by new visitors and recaptured spending by locals. This sales total removes all Pabst sales which are merely shifts from existing area businesses to the PabstCity businesses.

CHJC concludes the following:

1) While the location of PabstCity can work, "...it will be dependent upon destination visits because it does not have a central (downtown) location..."[6] compared to many successful developments surveyed. According to CHJC, this factor makes the lease-up of PabstCity space to high quality tenants crucial to the success of the project, but also inhibits the ability of such a lease-up.
2) As the project is currently proposed, "The majority of (PabstCity) tenants may not be new to the market, and...will not significantly expand Milwaukee's offerings"[7].
3) "Substitution spending (estimated spending shifts beginning in 2008 from existing area businesses to PabstCity) is expected to account for half of total (PabstCity) spending..."[8].

The Department of City Development (DCD) strongly disagrees with this assessment. As these are primarily Project market demand issues, our Office is in no position to critically evaluate these conclusions. However, as these issues are essential to the City's ultimate decision on this project, the consultant conclusions were deemed worthy of disclosure and full discussion. **In any event, the potential adverse local economic impact of a sales shift from other area businesses to PabstCity remains an unavoidable risk.**

2) **Will the PabstCity Project generate revenues to repay the City for its $41 million contribution?**

Should the PabstCity Project proceed to full operational status by 2007 as planned, this TID should be successfully retired by 2028-2030. Given substantial development uncertainty, City officials proposed that the Developer provide the City a tax increment guarantee which would reimburse the City any year that the actual tax increment would fall below a predetermined City debt repayment schedule on the $39 million City grant. The Developer accepted this guarantee proposal, albeit on a 30 year repayment schedule – the maximum statutory life of a TID and probably substantially longer than the actual City borrowing term. Should the Developer not make a payment under the guarantee provision in any year, the City would have a second mortgage lien on the development and could also make a special assessment charge against the development[9]. As a result, **in spite of the significant development risks, City government is generally well protected against the risk of insufficient property tax increments over a 30 year period. Therefore, the PabstCity Project should generate sufficient revenues to successfully retire this TID.**

IS THE PROPOSED $41 MILLION SUBSIDY[10] TO THE PABSTCITY PROJECT NECESSARY FOR THE PROJECT TO SUCCEED?

In assessing the Developer's need for $39 million of City grant funds (+$2 million City administered funding), the estimated construction cost, projected financial results and future sale price of PabstCity must be examined.

The DCD's construction consultant (Vistera Construction Services, Inc.) concluded that **the proposed construction budget was "...within a normal industry range..."[11] for a project of this type.**

Regarding projected financial results/sale price, both the DCD financial consultant (SB Friedman & Company-"Friedman") and DCD staff performed a thorough and complete analysis of the Developer's projections of future PabstCity operations and value at sale. This analysis included extensive sensitivity

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[6] "Proposed Economic Development Project", CH Johnson Consulting, May, 2005, Section 4, pg 1.
[7] Ibid, Section 4, pg. 18.
[8] Ibid, Section 4, pg, 18.
[9] The City Attorney is currently exploring the legal right of the city to impose such a special assessment.
[10] Consists of $39 million grant to Developer, $2 million to DCD for job training and project administration.
[11] "Proposed PabstCity Redevelopment Project", S.B. Friedman & Company, pg 4.

("what if ?") analysis of potential changes to crucial future assumptions (loan-vs-equity funding levels, future rents, terminal capitalization rate, etc.). Friedman's initial review submitted to the Developer on April 5. 2005 challenged certain Developer assumptions and also found omissions. These changes substantially lowered the TIF need from $39 million to about $21-$25 million.

On April 12, 2005, the Developer responded, incorporating most of Friedman's changes, but also indicating that its assumption of receiving over $20,000,000 in Historic Tax Credits was no longer valid. This change had the impact of restoring the reductions made possible through the Friedman changes, returning the City grant amount to $39 million. Given the enormous financial impact of this change on the need for City assistance, on April 21st the Comptroller requested documentation from the Developer regarding its efforts to date to acquire Historic Tax Credits and why the Developer changed this key assumption at this time. The Developer acknowledged receipt of our letter but has yet to respond.

With differences remaining between the City and the Developer regarding certain financial assumptions and the issue of Historic Tax Credits unresolved, the City proposed the concept of a "Downward - Reset" provision. Under this provision, the City-Developer agreement would be based on the Developer's requested $39 million grant. However, certain provisions were added that, depending on the final financing, could reduce *but not increase* the City grant amount. The events that would trigger a City grant reduction would be: non-City Project funding exceeding the projection, lower cost financing replacing higher cost financing, the Project obtaining Federal Historic Tax Credits and construction contracts/costs lower than projected. If any of the above occurs, the City would realize 85% of the savings achieved, the Developer, 15%. The DCD is also pursuing City profit participation if Project returns are sufficiently above the Developer's financial projections and upon sale or refinancing of the development. The Developer has not yet agreed to such City profit participation.

The Developer did not feel it appropriate to lower its $39 million grant request. However, City negotiators and the Developer agreed to the **Downward - Reset provision**. Given that most of assumptions at issue will be resolved once final financing is in place, the **Downward - Reset contained in the proposed term sheet provides the City with an opportunity to claim 85% of any savings resulting from specific Project financing changes or cost reductions favorable to the Project occurring after the City – Developer Agreement is signed.**

The DCD has also incorporated a number of prior conditions for the release of City grant funds which protect the City's investment. These include DCD Commissioner approval of all final Project plans, specifications, Budget and anchor tenant leases, evidence that all non-City funding sources necessary to complete the Project are committed; and City Residence Preference Program and EBE requirements committed to by the Developer. The Developer must also guarantee substantial completion of the entire Project by March 31, 2008. Finally, should any taxable Project property become tax exempt, an annual payments-in-lieu-of taxes will be made.

Conclusions - Recommendations

The PabstCity proposal is by far the largest TID proposal ever considered by this Committee and the Common Council. The proposed $41 million TID is twice as large as any previous City of Milwaukee sponsored TID and greater than the previous seven City TIDs combined. Given existing City financial constraints and other competing needs, **this level of expenditure will necessarily result in the deferral or elimination of other worthwhile City projects or a sizable increase in City debt. Hence we strongly urge your careful consideration of the above in your Committee's deliberations.**

DCD staff and its consultants have done a thorough job of limiting City financial risk in the proposed term sheet while holding open the possibility of City grant reduction if Project financing or costs are more favorable than current developer assumptions. Both the underlying development opportunities and risks associated with this Project are substantial. The risk of doing nothing is likewise significant. The information in File 050073 including this letter should assist your Committee and the Common Council in making this difficult decision.

Should your Committee and the full Council wish to proceed, we make two recommendations:

1) City officials, the Developer, our Congressional delegation, community leaders and interested preservation advocates should join together to seek appropriate Federal historic designation for this vital community project. Given the \$10-\$20 million potential taxpayer savings through the acquisition of Historic Tax Credits for PabstCity, a full scale effort is essential.
2) DCD should retain sufficient staffing to properly monitor full Developer compliance with the complex term sheet requirements to be detailed in the final Development Agreement. This Development agreement holds the potential for substantial City savings. Thorough due diligence will be required of DCD staff to maximize this potential.

Should you have any questions regarding this letter, please contact me at your convenience.

Sincerely,

W. Martin Morics
Comptroller

Cc Commission Richard Marcoux,
Joel Brennan
James Scherer
Ms. Emma Stamps

Mjd/6-1-05