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**Office of the Comptroller**

September 11, 2019

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

RE: File 190774, TID 98 – The Ikon  
Amendment 1

Dear Committee Members:

File 190774 would approve Amendment 1 to the Tax Incremental District (TID) 98 (the District) project plan and term sheet. The Comptroller's office has reviewed the project plan, feasibility study and term sheet, and has had discussions with Department of City Development (DCD) and Assessor's office staff. This analysis is based on the information provided to date, including pro forma net operating income projections and a Field Research Evaluation Report.

The District was created in 2019 to assist in the redevelopment of the former Sears and Milwaukee Mall building into an 80-room boutique hotel, restaurant, retail/commercial space, parking, and adjacent 24,600 square foot conference center (the Project). The Project will be undertaken by HG Sears, LLC (the Developer).

Total costs for the Project are currently estimated to be in excess of \$36,000,000. The original project plan file authorized a \$4,000,000 loan to the Developer and \$15,000 for administrative costs. This file authorizes an additional \$5,000,000 to be added to the loan to the Developer, \$500,000 for commercial corridor programs, \$500,000 for public infrastructure improvements, and \$97,500 for administrative costs. The below table shows the estimated Project costs for the District.

<b>Estimated District Financed Project Costs</b>	
Original Loan to Developer	\$ 4,000,000
Amendment 1 Loan to Developer	5,000,000
Public Infrastructure Improvements	500,000
Commercial Corridor Programs	500,000
Administration (\$7,500 x 15 year)	112,500
<b>Total Estimated Project Costs</b>	<b>\$ 10,112,500</b>



The below table shows the total estimated Project costs for the IKON Hotel.

<b>Estimated Total Project Costs</b>	
Rehab & New Construction	\$ 21,267,050
Developer's Fee/Overhead	3,500,000
Soft Costs	3,466,400
Interim Costs	2,370,000
Land & Buildings	1,900,000
Development Reserves	1,478,289
Site Work	883,500
Architectural	882,800
Syndication Costs	345,000
Financing	240,000
<b>Total Estimated Project Costs</b>	<b>\$ 36,333,039</b>

The additional \$5,000,000 loan to the Developer from Amendment 1 will be the "last in" source of financing and will not be available to the Developer until the remainder of the Developer's funding is secured. The below table shows the total estimated sources of funds for the Project.

<b>Estimated Sources of Funds</b>	
Opportunity Zone	\$ 13,500,000
Tax Increment Financing	9,000,000
Historic Tax Credits	7,000,000
Pace	3,000,000
First Mortgage	2,000,000
Deferred Developer Fee	1,833,039
<b>Total Estimated Sources of Funds</b>	<b>\$ 36,333,039</b>

The Developer is still working to secure Opportunity Zone and First Mortgage funding as of the writing of this letter.

In addition to increasing the funding to the Developer, Amendment 1 would also change the Developer loan terms. The original loan required the Developer to repay the loan to the City at 4.5% interest over the course of 20 years, with the first two years of the loan being interest free, years three to five requiring interest payments only, and principal and interest payments thereafter. This Amendment changes these terms to a 20 year, 0% interest loan. The Developer will only repay the principal on the loan, and such principal payments will be reduced in each year by the amount of increment revenue generated by the District (e.g., if the Developer repayment is \$500,000, and the District generated \$100,000 in incremental tax revenue, the Developer would repay \$400,000 in principal). The Developer payments to the City will be in the following amounts.

<b>Developer Repayment Terms</b>	
Years 1-2	-
Year 3 (includes payment of incremental property taxes)	\$ 250,000
Years 4-5 (includes payment of incremental property taxes)	500,000
Years 6-20 (includes payment of incremental property taxes)	850,000

After the loan payment in year 20 there will be a payoff projection calculated for the District. If the District is projected to pay off by year 23, any remaining loan principal will be forgiven. If the District is not projected to pay off by year 23, Developer repayment will continue at \$850,000 (including incremental property taxes) until the District has satisfied its obligations.

The City is assuming the full risk the Developer will not be able to repay the City's \$9,000,000 loan. If the Developer does not generate sufficient income to repay the loan, the District will not breakeven and the City will take possession of the Property. In the past, for this type of project, the City has utilized a "developer-financed" approach, which would shift the risk of the District not breaking even from the City to the Developer.

### **Is This Project Likely to Succeed?**

From a financial perspective, there is significant risk the District will not breakeven and the City will not recover its \$10,000,000 investment. The recovery of the City's investment hinges on the Developer's ability to repay the \$9,000,000 loan to the City.

DCD's feasibility study, which uses a constant 2.785% property tax rate and 1% inflation rate over the life of the District, forecasts the District will fully recover the project costs, plus interest, after receipt of the 2044 levy (year 26). DCD's feasibility study assumes the Developer will be able to repay the City in full for the \$9,000,000 loan.

The Developer hired a third party consultant, Hospitality Marketers International, Inc., to perform a field research evaluation report. This report included a preliminary operational pro forma analysis which showed the Developer would have sufficient cash flow to repay the City's \$9,000,000 loan.

It should be noted the report is based on several assumptions which were derived from both the consultant's knowledge of the market and discussions with certain community organization leaders. In the view of the Comptroller's office, some of these assumptions are aggressive. The most notable example is the projected food and beverage revenue.

The consultant's report states "It appears that the proposed Full-Service Upscale hotel is projected to perform significantly above the industry average for Full-Service hotels" in regards to food and beverage revenue. The report projects that food and beverage revenue will account for 52.5% of the hotel's overall sales, which is more than double the industry average rate of 25.8%. The consultant reasons that the lower number of hotel rooms and the significant focus on the event space drive this assumption. In fact, the consultant's report assumes 184 events will occur each year at the hotel, which averages to one event every other day. If the industry average rate for food and beverage revenue is used for projecting operating performance, it appears the Developer will not generate sufficient cash flow to repay the City's loan.

The consultant report also identifies the risk that the projections contained in the report will not materialize. From the report: "There is one main area of risk and/or concern regarding the following preliminary projections in this report. As was discussed previously in this report, the location for the proposed... IKON Hotel... is in an area that is reinventing itself. Several area/community organizations are working hard to implement programs/initiatives to improve the area and to attract new businesses as well as residents to 'live, work, and play' in the Lindsay Heights market area. Discussions with the developer and other leaders in the community indicated that this project is viewed as a key piece of this market's rejuvenation. The projections in this report are dependent on the rejuvenation of this overall market area resulting in the continued development of the area to support the hotel operation in this location."

While the third party report indicates the Developer will be able to repay the City's loan, the Comptroller's office believes that some of the operating assumptions in the report are aggressive. In addition, there remains the risk the Developer will not be able to secure the additional funding necessary to complete the Project and the City will take possession of the property. Therefore, the Comptroller's office believes there is significant risk the City will not recover its financial investment in this District.

**Is the Proposed Level of City Financial Participation Required to Implement the Project?**

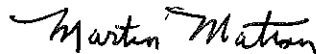
The District allows the City to provide incentive to the Developer to complete the Project. It appears the Project would likely not be completed without the City's financial participation, and without the District, the City would need to find other sources of funding for the commercial corridor programs and public infrastructure improvements. The redevelopment of the property would increase the City's tax base.

**Conclusion**

The District provides incentive for the Developer to redevelop the former Sears and Milwaukee Mall building, which would increase the City's tax base. A third party consultant performed a field research evaluation report which indicated the Developer would generate enough cash to repay the City's \$9,000,000 loan, and therefore DCD projects the District could payoff by year 26. However, the Comptroller's office believes there is significant risk the City will not recover its \$10,000,000 total investment in the District, and the District will not be able to breakeven from a financial perspective. If the Developer is not able to repay the City's loan, or if they are not able to secure the remaining financing necessary to complete the project, the City could ultimately take possession of the Property.

Should you have any questions regarding this letter, please contact Joshua Benson at extension 2194.

Sincerely,



Martin Matson  
Comptroller

CC: Dan Casanova  
Lori Lutzka

MM/JB