



Office of the Comptroller

January 9, 2003

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

Re: File 020950 TID 32, Amendment
#4 Tristar Development

Committee Members:

Tax Increment District #32 was established in 1996 with the intent of providing a total of up to \$1,050,000 in "gap" loan funds. Such loans are intended to enable completion of project financing to the extent that private sources cannot entirely fund the project. The TID area is generally bounded by North 6th Street on the west to North Dr. Martin Luther King Jr. Drive on the east, to West Walnut Street on the south to West Vine–West Reservoir Streets on the north. To date, three loans totaling \$525,000 have been made under TID #32.

Tristar Development, a limited liability corporation, proposes the development of vacant land at 1846-48 North Martin Luther King Drive with improvements to an adjoining existing building and construction of a new two story commercial building providing nearly 13,000 sq. ft. of space. The two principals of the company, Noel Willaims and Rilla Williams, would also be the anchor tenants for the new building. Mr. Williams operates a public accounting practice while Mrs. Williams runs a day care center. Mr. Williams' accounting practice currently operates in a building adjacent to the proposed construction site. Both businesses would operate in the developed property. Amendment #4 proposes a TID loan of \$300,000 at a 5.25% interest rate over a period not to exceed 20 years.

The current development budget totals about \$1.7 million, financed as follows:

| | |
|---|---------------------|
| First Mortgage Loan from Park Bank..... | \$725,000 |
| City of Milwaukee TID Joint 2 nd Mortgage loan..... | \$300,000 |
| Borrower Equity contributions from existing land & building, cash contributions, "sweat equity"/ development fee..... | \$216,090 |
| Milwaukee Economic Development Corporation (MEDC) 20 Year Joint 2 nd Mortgage loan..... | \$200,000 |
| Helen Bader Foundation 3 1/2% interest loan..... | \$150,000 |
| Redevelopment Auth. (RACM) Remedation Grant... | \$ 97,000 |
| County Grant..... | \$ 15,000 |
| TOTAL..... | \$1,703,090. |

Including the \$97,000 RACM grant, City and its related agencies are financing about 35 percent of the total project cost. The MEDC Loan Committee has already approved its loan to the project as has the RACM Board approved its grant.

Is the Project likely to be Successful?

Annual property tax increments already being generated within the District will be sufficient to successfully retire this District including the proposed loan financing. The expected \$18,000-\$25,000 in additional annual increments from this project should lead to closure of TID 32 by 2015 or 2016 assuming a limit of \$1.05 million in total TID 32 loans as in the TID Project Plan.

The proposed project brings with it a number of strengths. Its location on Dr. Martin Luther King Jr. Drive would provide still another development in an area long targeted by the City. As owner-developer, Mr. and Mrs. Williams have operated profitable businesses over at least the last four years. These businesses are to be located in the development as the anchor tenants. A third tenant, the Yellow Cab Company, will also provide \$12,000-\$13,000 in additional rental income, bringing the committed occupancy to about 60 percent. Other tenants are being sought.

A number of important provisions have been incorporated into the loan terms of both the City's proposed loan and the other financing sources. Importantly, the first mortgage lender has also agreed to provide construction financing for the entire project. This means that the City and other parties' long term financing will not be required until the project is completed, insulating the City loan from any construction risks. The City and MEDC as well as the first mortgage lender have received the personal guarantees of the two principal investors. These investors are contributing nearly \$50,000 in cash, their development effort and equity in the existing commercial property on 1842 N. Martin Luther King Drive to the project, giving them a strong incentive to make the development work. As a further safeguard, there is a "due on sale" provision in the City loan agreement requiring immediate and full repayment of the City loan balance in the event of sale.

At our Office's request, MEDC has been willing to share the same subordinated position regarding its mortgage loan and that of the City eg, second position behind the first mortgage loan of Park Bank. MEDC has also agreed to reduce the interest rate on its loan to 5.25% per year, allowing the City to increase its original rate to that same 5.25% rate. This compares to an estimated 6%-6.5% City taxable borrowing rate.

The proposed \$300,000 City TID loan is not without material risks, however. The project cashflow projections assume a "steady-state" vacancy rate of only 10 percent. In this area of the city, it is not unusual for commercial structures to endure periods with vacancy rates substantially above 10 percent.

Also, assuming that the Bader Foundation does in fact require full repayment of its \$150,000 loan, debt service coverage¹ on the City - MEDC loans will range from about 117% to 130% of annual debt service. Generally, this type of loan would require at least 125% coverage. Should interest rates increase above the current projection, the Park Bank first mortgage loan rate will also increase, further reducing City loan debt service coverage. For example, should short term rates increase by 1 ¼%, coverage on the City - MEDC loan coverage would decrease to a range of 103% to 117%, materially increasing the chance for default on these loans.

Also, because the owner-developer entity for the property also constitutes the major tenants, the continued successful performance of both the day care center and accounting firm is essential to project success. Normally, the owner can replace a tenant of a faltering business. However, since the project owner and anchor tenants are essentially the same, a significant, continuing problem

¹ Debt Service coverage refers to the extent that available annual cashflow from operations exceeds the required annual debt service payment. For example, 125% coverage on a \$100,000 debt service payment requires that available operations cashflow total at least \$125,000.

with either of these businesses is likely to lead to City-MEDC loan repayment problems. Even with the strengths mentioned above, the risks inherent in the location of this development and the continued success of the two small businesses on which its success depends should be carefully weighed as your Committee considers Amendment #4.

Is the Proposed City Financial Assistance Necessary to Make the Project Possible?

Our analysis of the revised projected cashflows for this project show a before tax return of about 12 percent per year. Given the development risks associated with the type and location of the proposed project, this rate of return is clearly not excessive. While it is possible that MEDC could have financed the entire \$500,000 instead of \$200,000, it is also clear that **private financing sources would not provide a substantial share of either the City or MEDC loan funds.**

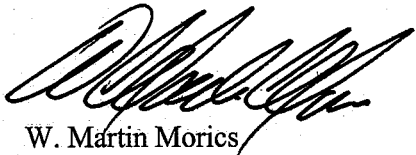
On balance, our Office concludes the following:

- the importance of continued development within the M.L. King Jr. Drive area,
 - the risk associated with allowing the vacant property to remain vacant,
 - the past success of the two owner-developer businesses locating in the development, and
 - the financial safeguards built into the loan agreement
- are all consistent with the approval of this loan.

The DCD should make certain that the actual executed loan agreements and supporting documents are consistent with the draft loan term sheets and commitment letters that have been made available to our Office to date.

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

Sincerely,



W. Martin Morics
Comptroller

Cc Julie A. Penman
Kimberly Montgomery
James Scherer

Mjd/01-07-03