

Date: January 29, 2007

Subject: North Water Street Economic Feasibility Study

From: S. B. Friedman & Company

To: James Scherer, City of Milwaukee Department of City Development
Allison Rozek, City of Milwaukee Department of City Development

S. B. Friedman & Company (“SBFCo”) has been engaged by the City of Milwaukee Department of City Development (“DCD”) to evaluate the necessity and feasibility of providing tax increment financing (“TIF”) assistance to Compass Properties (“the Developer”) in conjunction with the redevelopment of 731 & 735 North Water Street. This memorandum outlines SBFCo’s methodology and findings related to the likely levels of incremental property taxes to be generated, as well as the potential amortization of debt associated with City-funded improvements. A separate memo addresses the need for TIF assistance.

Project Overview

Compass Properties has proposed the redevelopment of 731 North Water Street and 735 North Water Street. Currently, the property consists of a 15-story historic office building, containing approximately 300,000 square feet of commercial space, at 735 North Water Street, and a six-story commercial building at 731 North Water Street. Approximately 40 percent of 735 North Water Street is currently unoccupied, while 731 North Water Street is entirely vacant.

The proposed improvements to 735 North Water Street include installation of fire suppression systems, a connection to the Milwaukee Skywalk system, façade renovations, and the creation of a new restaurant space. The redevelopment program for 731 North Water Street includes asbestos removal and abatement, conversion of the building to an elevator-driven parking garage, construction of seven luxury condominiums above the existing building, and the creation of four boat slips along the Milwaukee River. The total cost of these improvements is approximately \$18.4 million.

In addition, Compass Properties has proposed to repair the cornice at 735 North Water Street. This cornice is a significant architectural feature of the building, which was formerly the headquarters of the First National Bank of Wisconsin, but has become unstable and poses a safety hazard. The Developer has also proposed to perform repairs and add ADA accessibility to the riverwalk that is adjacent to the two properties. Based on a review of construction costs provided by the Concord Group (included as an attachment to this memo), a subcontractor to SBFCo, the total cost of these improvements is about \$3.8 million before contingencies. The City is contemplating providing TIF assistance to the project equivalent to 100% of the projected riverwalk cost plus the incremental cost of repairing the cornice versus removing it. The total proposed City funding amount is summarized in Table 1 on the following page.

Table 1: Summary of Proposed City TIF Funding

Estimated cornice repair cost [1]	\$ 2,414,075
Less estimated cornice removal cost [1]	(\$ 1,095,213)
Net cornice-related assistance to be provided	\$ 1,318,861
Estimated riverwalk cost [1]	\$ 1,351,297
Contingency (15%) [2]	\$ 400,524
Allowance for City inspections [2]	\$ 61,414
Allowance for City administrative costs [2]	\$ 125,000
Total	\$ 3,257,097

Note: numbers may not add due to rounding

[1] Source: Concord Group

[2] Source: City of Milwaukee

In return for City assistance, the Developer intends to grant a façade easement to the City and will provide a public access easement along the currently private Riverwalk.

Projected Incremental Property Taxes

In order to assess the feasibility of financing the proposed improvements through tax increment district (TID) revenues, *SBFCo* has prepared projections of the incremental property tax revenues generated by the redevelopment project. *SBFCo* has assumed that a mixed-use TID will be created in 2007 encompassing the two properties. Other key assumptions are outlined below.

- **Inflation Rate:** Assessed values for both the residential and commercial portions of the project are assumed to increase at an annual rate of 2.5 percent. This is consistent with a survey of the change in assessed values between 2005 and 2006 for comparable office properties in Milwaukee.
- **TID Base Value:** Based on Milwaukee City Assessor's Office data, the 2006 assessed values of 731 & 735 North Water Street are \$1 million and \$11 million, respectively. Therefore, it is assumed the total assessed value of the two buildings in 2007 will be \$12.3 million due to inflation. Because the enclosed projections of TID amortization potential rely solely on incremental real property value, personal property is also excluded from this base value calculation.
- **Phasing of Improvements:** It is assumed that construction will take place entirely within 2007. However, the additional value generated by the commercial portion of the project is phased over four years, to allow for lease-up of vacant office space at a rate of 30,000 square feet of office space per year. This is less aggressive than the lease-up assumptions made by the Developer in its application for TIF assistance, which calls for lease-up of all vacant space within two years. In addition, it is assumed that five of the seven residential condominiums in the project will be sold in 2008, and that the remaining two will be sold in 2009. This is consistent with assumptions made by Compass Properties in its application for TIF assistance.

- **Assessed Values:** In order to estimate the assessed value of 735 North Water Street after redevelopment, *SBFCo* conducted research into the assessed value of comparable Class B office buildings in Downtown Milwaukee. On average, buildings surveyed were assessed at a value of \$70 per square foot. Based on this research, the assessed value of 735 North Water Street is estimated to be \$20.7 million after improvements and lease-up. No personal property valuation assumptions were included in this calculation.

Because the parking garage contemplated in the redevelopment proposal for 731 North Water Street will be expensive to operate and is projected to generate little net operating income, the assessed value of the existing building is estimated to remain unchanged after redevelopment. The residential condominiums to be constructed above the existing building at 731 North Water Street are assumed to be assessed at full market value. The Developer estimates that the average sale price of these units will be \$425 per square foot. However, in order to develop a conservative estimate of the potential valuation of these units, *SBFCo* reviewed data provided by the Milwaukee Assessor's Office regarding the sale prices of new condominiums in Milwaukee's Fourth Aldermanic District. The average sale price per square foot for such units was approximately \$325 in 2006. This figure has been used to estimate the assessed value of new residential units in the redevelopment project.

- **Tax Rate:** Based on historic data, the property tax rate for the City of Milwaukee is assumed to continue declining from the 2005 assessment year rate of 2.45 percent. It is assumed to stabilize at 2.00 percent in 2013.

Based on these assumptions, the total undiscounted proceeds of the TID are estimated to be \$15.2 million over 27-year maximum statutory life of a rehabilitation TID. The net present value of this revenue, discounted at five percent, is approximately \$6.7 million. This projection of TID revenues is presented in Table 2 at the end of this memo.

Debt Amortization

SBFCo evaluated the ability of a TID established at 731 & 735 North Water Street to amortize debt associated with the proposed improvements. At the request of the Department of City Development, *SBFCo* created scenarios for two potential financing structures:

- A developer-financed TID; and
- A developer-financed TID where the City's TID-backed financial obligation to the developer is "taken out" after 5 years through the use of City general obligation bonding.

These scenarios reflected the following key assumptions:

- Up-front monetization of about \$3.1 million to include all items in Table 1 except the \$125,000 allowance for City administrative costs;
- Up to 10% of incremental property taxes reserved each year by the City to cover administrative costs, up to a total of \$125,000;
- 6.5 percent interest rate on Developer-financed costs;

- 4.5 percent interest rate on municipal bonds issued to “take out” Developer financing;
- Negative amortization on outstanding repayment obligations if the annual increment is less than interest owed in a given year; and
- Prepayment of as much outstanding principal as possible in each year.

Based on these assumptions, *SBFCo* has projected that the proposed TID at North Water Street would fully amortize the Developer funding obligation (as well as provide \$125,000 for City administrative costs) by 2022, or TID Year 16. If the City opts to refund the Developer financing using general obligation-backed bonds at the end of the 5th year, the TID is projected to close out one year ahead of the full Developer financing scenario (2021, or Year 15). Table 3 at the end of this memo shows these two amortization scenarios.

As shown in Table 3, the total projected interest cost to the City is about \$2.7 million under the full Developer financing scenario, and \$2.1 million under the option using Developer financing with a City takeout. The takeout scenario thus allows the City a substantial savings on interest costs relative to full Developer financing while still retaining the main advantage of Developer financing over full City general obligation bonding—avoidance of risk in the construction and early operating years of the project. These risks are derived from the potential that:

- The Developer will be unable to complete the proposed project due to cost overruns or other construction-related issues;
- The project will not be as successful as anticipated in attracting additional office and retail tenants or residential buyers; and/or
- The initial assessed valuation of the properties will lag behind anticipated levels after project completion.

If the City secures its pledge of TIF funds to the Developer solely with incremental property taxes during the early years of the project, these risks are transferred to the Developer. Because a Developer-financed TID does not carry the full faith and credit backing of the City of Milwaukee, it is higher-risk than standard City bonds and therefore would likely carry a higher interest rate. Based on input from the City of Milwaukee and a review of the interest rates associated with funding obligations backed solely by TIF in Chicago, *SBFCo* assumed that this interest rate would be about 6.5%. After the highest-risk portions of the project are complete (construction and initial lease-up and sellout), it may be in the City’s best interests to refinance the developer repayment obligation with general obligation bonds in order to reduce its interest costs.

City of Milwaukee: North Water Street

Table 2: North Water Street TID Projections

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TID Year	Assessment Year	Base AV [1]	Current AV	Incremental AV Above Base	Tax Rate	Tax Revenues Collected (Jan. 31)
1	2007	\$ 12,300,000	\$ 12,300,000	\$ -	2.32%	\$ -
2	2008	\$ 12,300,000	\$ 15,023,856	\$ 2,723,856	2.26%	\$ -
3	2009	\$ 12,300,000	\$ 23,941,700	\$ 11,641,700	2.20%	\$ 61,583
4	2010	\$ 12,300,000	\$ 29,565,775	\$ 17,265,775	2.14%	\$ 256,251
5	2011	\$ 12,300,000	\$ 32,907,070	\$ 20,607,070	2.09%	\$ 370,003
6	2012	\$ 12,300,000	\$ 33,729,747	\$ 21,429,747	2.03%	\$ 429,938
7	2013	\$ 12,300,000	\$ 34,572,991	\$ 22,272,991	2.00%	\$ 435,289
8	2014	\$ 12,300,000	\$ 35,437,315	\$ 23,137,315	2.00%	\$ 445,460
9	2015	\$ 12,300,000	\$ 36,323,248	\$ 24,023,248	2.00%	\$ 462,746
10	2016	\$ 12,300,000	\$ 37,231,329	\$ 24,931,329	2.00%	\$ 480,465
11	2017	\$ 12,300,000	\$ 38,162,113	\$ 25,862,113	2.00%	\$ 498,627
12	2018	\$ 12,300,000	\$ 39,116,166	\$ 26,816,166	2.00%	\$ 517,242
13	2019	\$ 12,300,000	\$ 40,094,070	\$ 27,794,070	2.00%	\$ 536,323
14	2020	\$ 12,300,000	\$ 41,096,421	\$ 28,796,421	2.00%	\$ 555,881
15	2021	\$ 12,300,000	\$ 42,123,832	\$ 29,823,832	2.00%	\$ 575,928
16	2022	\$ 12,300,000	\$ 43,176,928	\$ 30,876,928	2.00%	\$ 596,477
17	2023	\$ 12,300,000	\$ 44,256,351	\$ 31,956,351	2.00%	\$ 617,539
18	2024	\$ 12,300,000	\$ 45,362,760	\$ 33,062,760	2.00%	\$ 639,127
19	2025	\$ 12,300,000	\$ 46,496,829	\$ 34,196,829	2.00%	\$ 661,255
20	2026	\$ 12,300,000	\$ 47,659,249	\$ 35,359,249	2.00%	\$ 683,937
21	2027	\$ 12,300,000	\$ 48,850,731	\$ 36,550,731	2.00%	\$ 707,185
22	2028	\$ 12,300,000	\$ 50,071,999	\$ 37,771,999	2.00%	\$ 731,015
23	2029	\$ 12,300,000	\$ 51,323,799	\$ 39,023,799	2.00%	\$ 755,440
24	2030	\$ 12,300,000	\$ 52,606,894	\$ 40,306,894	2.00%	\$ 780,476
25	2031	\$ 12,300,000	\$ 53,922,066	\$ 41,622,066	2.00%	\$ 806,138
26	2032	\$ 12,300,000	\$ 55,270,118	\$ 42,970,118	2.00%	\$ 832,441
27	2033	\$ 12,300,000	\$ 56,651,871	\$ 44,351,871	2.00%	\$ 859,402
	2034					\$ 887,037
Total Proceeds (2007-2028)						\$ 15,183,205
Net Present Value (2007) @ 5.00%						\$ 6,748,656

[1] Projected 2007 value

Source: *S. B. Friedman & Company*, Milwaukee Department of City Development

City of Milwaukee: 735 N Water Street Project

Table 3: Projected Amortization of TID under Developer Financing and Developer Financing/City Takeout Scenarios

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Developer Financing Assumptions

Cost of Improvements		\$	2,670,159
Contingency	15%	\$	400,524
City Inspection Fee Allowance	2%	\$	61,414
Total Proceeds to Project		\$	3,132,097
City Admin Cost Allowance (not monetized up-front)		\$	125,000
Interest Rate	6.50%		
City Administration Fee (as Percent of TID Revenues)			10.00%

City Financing Assumptions

Takeout at end of Year	5
Interest Rate on Bonds	4.50%

Year of TID	Calendar Year	Annual Inc. Tax Revenues	City Carve-out for Admin Fee	Increment Available for Amortization	Scenario 1: Developer Financing- Full Duration				Scenario 2: Developer Financing w/City Takeout in Year 5				
					Principal Outstanding	Interest Due	Principal Amortization	Amortized	Principal Outstanding	Interest Due	Principal Amortization	Financing Type	Amortized
1	2007	\$ -	\$ -	\$ -	\$ 3,132,097	\$ 203,586	\$ (203,586)	NO	\$ 3,132,097	\$ 203,586	\$ (203,586)	Developer	NO
2	2008	\$ -	\$ -	\$ -	\$ 3,335,683	\$ 216,819	\$ (216,819)	NO	\$ 3,335,683	\$ 216,819	\$ (216,819)	Developer	NO
3	2009	\$ 61,583	\$ 6,158	\$ 55,425	\$ 3,552,502	\$ 230,913	\$ (169,329)	NO	\$ 3,552,502	\$ 230,913	\$ (169,329)	Developer	NO
4	2010	\$ 256,251	\$ 25,625	\$ 230,626	\$ 3,721,832	\$ 241,919	\$ 14,332	NO	\$ 3,721,832	\$ 241,919	\$ 14,332	Developer	NO
5	2011	\$ 370,003	\$ 37,000	\$ 333,003	\$ 3,707,500	\$ 240,988	\$ 129,015	NO	\$ 3,707,500	\$ 240,988	\$ 129,015	Developer	NO
6	2012	\$ 429,938	\$ 42,994	\$ 386,944	\$ 3,578,485	\$ 232,602	\$ 197,337	NO	\$ 3,578,485	\$ 161,032	\$ 268,906	City	NO
7	2013	\$ 435,289	\$ 13,223	\$ 422,066	\$ 3,381,148	\$ 219,775	\$ 215,514	NO	\$ 3,309,578	\$ 148,931	\$ 286,358	City	NO
8	2014	\$ 445,460	\$ -	\$ 445,460	\$ 3,165,634	\$ 205,766	\$ 239,694	NO	\$ 3,023,221	\$ 136,045	\$ 309,415	City	NO
9	2015	\$ 462,746	\$ -	\$ 462,746	\$ 2,925,941	\$ 190,186	\$ 272,560	NO	\$ 2,713,806	\$ 122,121	\$ 340,625	City	NO
10	2016	\$ 480,465	\$ -	\$ 480,465	\$ 2,653,380	\$ 172,470	\$ 307,995	NO	\$ 2,373,181	\$ 106,793	\$ 373,672	City	NO
11	2017	\$ 498,627	\$ -	\$ 498,627	\$ 2,345,385	\$ 152,450	\$ 346,177	NO	\$ 1,999,509	\$ 89,978	\$ 408,649	City	NO
12	2018	\$ 517,242	\$ -	\$ 517,242	\$ 1,999,209	\$ 129,949	\$ 387,294	NO	\$ 1,590,860	\$ 71,589	\$ 445,654	City	NO
13	2019	\$ 536,323	\$ -	\$ 536,323	\$ 1,611,915	\$ 104,774	\$ 431,549	NO	\$ 1,145,207	\$ 51,534	\$ 484,789	City	NO
14	2020	\$ 555,881	\$ -	\$ 555,881	\$ 1,180,366	\$ 76,724	\$ 479,158	NO	\$ 660,418	\$ 29,719	\$ 526,163	City	NO
15	2021	\$ 575,928	\$ -	\$ 575,928	\$ 701,208	\$ 45,579	\$ 530,350	NO	\$ 134,255	\$ 6,041	\$ 134,255	City	YES
16	2022	\$ 596,477	\$ -	\$ 596,477	\$ 170,859	\$ 11,106	\$ 170,859	YES	\$ -	\$ -	\$ -	Amortized	YES
17	2023	\$ 617,539	\$ -	\$ 617,539	\$ -	\$ -	\$ -	YES	\$ -	\$ -	\$ -	Amortized	YES
18	2024	\$ 639,127	\$ -	\$ 639,127	\$ -	\$ -	\$ -	YES	\$ -	\$ -	\$ -	Amortized	YES
19	2025	\$ 661,255	\$ -	\$ 661,255	\$ -	\$ -	\$ -	YES	\$ -	\$ -	\$ -	Amortized	YES
20	2026	\$ 683,937	\$ -	\$ 683,937	\$ -	\$ -	\$ -	YES	\$ -	\$ -	\$ -	Amortized	YES
21	2027	\$ 707,185	\$ -	\$ 707,185	\$ -	\$ -	\$ -	YES	\$ -	\$ -	\$ -	Amortized	YES
22	2028	\$ 731,015	\$ -	\$ 731,015	\$ -	\$ -	\$ -	YES	\$ -	\$ -	\$ -	Amortized	YES
23	2029	\$ 755,440	\$ -	\$ 755,440	\$ -	\$ -	\$ -	YES	\$ -	\$ -	\$ -	Amortized	YES
24	2030	\$ 780,476	\$ -	\$ 780,476	\$ -	\$ -	\$ -	YES	\$ -	\$ -	\$ -	Amortized	YES
25	2031	\$ 806,138	\$ -	\$ 806,138	\$ -	\$ -	\$ -	YES	\$ -	\$ -	\$ -	Amortized	YES
26	2032	\$ 832,441	\$ -	\$ 832,441	\$ -	\$ -	\$ -	YES	\$ -	\$ -	\$ -	Amortized	YES
27	2033	\$ 859,402	\$ -	\$ 859,402	\$ -	\$ -	\$ -	YES	\$ -	\$ -	\$ -	Amortized	YES
	2034	\$ 887,037	\$ -	\$ 887,037	\$ -	\$ -	\$ -	YES	\$ -	\$ -	\$ -	Amortized	YES
TOTALS		\$ 15,183,205	\$ 125,000			\$ 2,675,604	\$ 3,132,097			\$ 2,058,008	\$ 3,132,097		

Source: S. B. Friedman & Company, Milwaukee Department of City Development

Note: These projections are based on estimates, assumptions, and other information developed from research of the market, knowledge of the industry, and meetings during which we obtained certain information. Some assumptions inevitably will not materialize, and unanticipated events and circumstances may occur; therefore, actual results achieved during the period covered by our analysis will necessarily vary from those shown here and the variations may be material.



CORNICE REPLACEMENT					
Provide cantilever scaffolding at all elevations, set-up and remove	1	LS	410,000	410,000	
Scaffold rental per day	270	EA	1,080	291,600	
Crane / hoist	1	LS	100,000	100,000	
Remove and catalog existing terra cotta pieces	2,400	EA	150	360,000	
Provide new terra cotta pieces including molds, shipping and installation	484	EA	600	290,400	
Repair and reinstall existing terra cotta pieces	1,916	EA	125	239,500	
Allowance for miscellaneous repair/replacement	1	LS	40,000	40,000	
Remove and rebuild 3 wythe thick brick back-up wall	2,530	SF	95	240,350	
Repair / replace steel angles and channels	3,220	LF	40	128,800	
Cutback roof, patch and repair	460	LF	75	34,500	
Remove and reinstall lighting and conduit	1	LS	15,000	15,000	
Remove temporary netting	1	LS	20,000	20,000	
SUBTOTAL				2,170,150	
GENERAL CONDITIONS / BOND / INSURANCE (8%)					173,612
CONTRACTOR'S OVERHEAD/PROFIT (3%)					70,313
Note: Contingency removed from Concord estimate by SBFCo because of 15% contingency applied elsewhere by City of Milwaukee					
ESTIMATED TOTAL CONSTRUCTION COST				2,414,075	



RIVERWALK REPAIR					
Remove existing concrete topping slab	6,836	SF	6	41,016	
Replace waterproof membrane	6,836	SF	5.50	37,598	
Repair structural slab and support structure	2,000	SF	25	50,000	
New concrete topping slab, scored	6,836	SF	8.50	58,106	
Remove, refinish and reinstall steel railing	428	LF	75	32,100	
Remove and replace EIFS north elevation	1,296	SF	25	32,400	
Clean existing concrete walls to remain	1	LS	5,000	5,000	
Remove and replace stone veneer and CMU backup on west elevation	1,900	SF	175	332,500	
Remove and replace concrete sill on west elevation	190	LF	450	85,500	
Remove and replace windows on west elevation	786	SF	95	74,670	
Remove and reinstall planters	4	EA	2,500	10,000	
Elevator including limestone enclosure	2	EA	225,000	450,000	
SUBTOTAL					1,208,890
GENERAL CONDITIONS / BOND / INSURANCE (8%)					96,711
CONTRACTOR'S OVERHEAD/PROFIT (3.5%)					45,696
Note: Contingency removed from Concord estimate by SBFCo because of 15% contingency applied elsewhere by City of Milwaukee					
ESTIMATED TOTAL CONSTRUCTION COST					1,351,297