

May 6, 2010

City of Madison TIF Report
Edgewater Hotel Project (Landmark X, LLC)

PROJECT COST

Proposed

Land Acquisition	(8,000,000)	\$5 MM for Hotel, \$3 MM for land from NGL
Demolition/Remediation	<u>(1,200,000)</u>	Demo of 1970's addition accommodating PAC
Total Land Cost	\$(9,200,000)	
 <u>Hard Cost</u>		
Hotel Construction	(39,950,000)	Note: \$210,000 per unit, \$165 per GSF – Hotel Only
Site Work	(3,700,000)	Note: \$19,000 per unit,
Parking	(8,000,000)	Note: \$42,000 per unit, \$33/GSF, \$22,000 per stall
Public Access Component (PAC)	<u>(17,700,000)</u>	Note: \$93,000 per unit, \$73/GSF
Total Hard Cost	(69,350,000)	
Soft Cost	<u>(11,950,000)</u>	Note: \$2.7 MM attributable to PAC
TOTAL PROJECT COST	\$(90,500,000)	

Cost Analysis:

Land: The land cost (\$8 million or per \$66/SF) is well beneath land costs for this area which have ranged higher than \$120/SF.

Hard Cost: Staff evaluated hard cost in two ways—1) as a stand-alone hotel without the PAC; and 2) as proposed including the Public Access Component (PAC). As construction includes renovation of the existing hotel (107 units) and construction of 83 new units, the hard cost per unit was calculated using the maximum 190 units.

The stand-alone hotel project demonstrates a \$39.9 million hard cost and \$8 million for parking or approximately \$47.9 million. The Project would cost \$198/SF or about \$252,000 per unit.

With the PAC, the total hard cost was considerably higher than normal, \$69.3 million. This equates to \$286/SF or \$365,000 per unit. Arguably, comparison to suburban hotel product with surface or above ground structured parking would demonstrate that unit cost is significantly higher than normal, but as a higher-market, urban redevelopment project, with underground parking and the PAC as a lakefront amenity, staff finds no argument that this cost is untenable.

PAC: Staff has no cost data concerning a structure similar to the PAC for comparison. Therefore, staff commissioned an independent engineering firm to verify that costs were in line with the construction materials, methods and engineering required for this type of structure. The consultant's report will be made available for Council review.

Parking: Staff found parking costs to be within an acceptable range for this construction type--355 underground stalls of parking at three levels (\$8 million or \$22,535 per stall). Staff confirmed this range with the recent estimates provided by the Madison Parking Utility.

Soft Cost: \$11.95 million -- 17% of hard cost (\$69.3 million) which is within an acceptable range. No developer fee charged. \$2.7 million of soft cost (about 3.9% of hard cost) is attributable to the PAC. Project management fee (3.6% of hard cost) is acceptable for a complicated project.

Sources of Capital

If sources of capital were sufficient to cover project cost, no gap would exist. Staff evaluated the proposed sources based on previous and current financial market conditions.

Equity	\$43,675,000	Considerable equity—48% of cost
Loan	<u>\$30,825,000</u>	Represents a debt coverage ratio of 1.75
Total Sources	\$74,500,000	

Loan Sizing: Loans are typically sized based upon the cash flow potential of the project—that is the amount of cash flow that covers each dollar of debt (i.e. “cash flow coverage ratio”) determines the size of the loan. Pre-recession, this ratio might require about \$1.20 of cash flow to cover a dollar of debt repayment. The current market reflects a much harsher coverage—in the neighborhood of \$1.70 and higher for each dollar of debt payment.

The \$30.8 million loan to the project represents a net operating income (NOI) at stabilization of approximately \$4.3 million covering approximately \$2.6 million of annual debt payments. A payment of \$2.6 million, projected at 25 years at 6.5% interest results in a \$30.8 million loan. The sizing of the loan is therefore reasonable and consistent with the market place.

Equity: To staff’s knowledge, Developer has maximized its equity investment—48% of cost, and about 90% of the City’s projected \$44.8 million assessed value for the Project. After debt payment of \$2.6 million, Developer would have about \$700,000 profit toward recouping its \$43 million investment. Assuming revenue growth of 3-5% per year (for example \$700,000 grows to \$735,000 in the next year, etc.). this indicates that Developer also assumes a long-term investment strategy.

Gap Analysis

Land Area	121,664 SF
Building Area	241,969 SF
Unit Count	83 new + 107 existing = 190 Total
Parking	355 stalls
Estimated Value @ Stabilization	\$44,800,000
TIF Available @ 100%	\$7,400,000
Sources of Capital	\$ 74,500,000
Less: Project Cost	<u>(\$90,500,000)</u>
GAP	(\$16,000,000)

Cause of Gap

As stated above, staff believes that Developer has leveraged the maximum possible of private financing sources for the Project, given the land use conditions (i.e. density, height, historic, setback and other regulations) placed upon it. Most costs appear to be in line with market conditions, except for the Public Access Component (PAC). If constructed without the PAC, the Project would not need TIF assistance. Therefore, staff concludes that the PAC is the primary cause for gap in the Project. Arguably, the Developer would not construct the Project without the PAC as it would no longer offer the lakefront amenity to qualify it as a full service hotel with numerous amenities.

TIF Policy Conformance

The Project conforms to several TIF Objectives, Strategies and Policies as indicated in the chart below. In particular, the Project creates jobs, eliminates blighting conditions and enhances public access to the lakefront. In addition, Developer has committed \$43 million of equity to the project, almost three times the amount of TIF investment.

Goal 1: Support Economic Development	Objective (1)	Job creation in “high need” area	Blight finding is 52% in the amended TID area. Existing hotel demonstrates deteriorating, obsolete building stock
Goal 2: Support Neighborhood Revitalization	Objective (2)	Historic revitalization	Renovation of historic 1940’s Edgewater Hotel.
	Strategy (1)	Improve public infrastructure	Although privately owned, the conservation easement over the PAC restores public access to the lakefront
	Strategy 2(d)	Provide assistance to business that create a significant number of living wage jobs	Project proposes 230 to 240 full-time equivalent jobs created
	Policy 1.1 (e)	Project is eligible as business attraction, retention or expansion.	Retains existing business
	Policy 4.1 (7)	Equity is greater than TIF assistance provided per policy	Developer injecting \$43 M of equity vs. \$16 M of TIF assistance.
	Policy 4.1	Every financial alternative is to be exhausted prior to the use of TIF...	Equity is almost 3 times the amount of TIF loan. Uses several tax credit programs and private investment.

TIF Policy 4.1 (15) -- Prepayment of Equity Participation

In lieu of a future equity participation payment to the City upon sale or a date certain, Developer agrees to prepay the \$16 million Equity Participation Payment by deeding a conservation easement to the City at closing that demonstrates a cost-based value of at least \$16 million. Developer’s cost-based appraisal of the conservation easement shall be reviewed with an independent appraiser commissioned by the City. City easement rights enable the City to re-establish lakefront access to the public, with mutually-agreed limitations, at no cost or liability to the City taxpayer.

TIF Policy Exceptions

The Project also requires three exceptions to TIF Policies: 4.1 (8) the 50% Rule; 4.1 (10) the Self-Supporting Rule and 4.1 (12) Personal Guaranty. They apply as follows to the Project:

- 1. Policy 4.1 (8) 50% Rule—No more than 50% of the tax increment generated by a project may be made available to that project as TIF assistance.** The incremental value of the Project, as estimated by the City Assessor’s Office, would generate sufficient tax increment to support a TIF Loan of approximately \$3,300,000 if the 50% Rule was applied. The proposed loan amount significantly exceeds the limit of this policy. Approval of an exception to policy that allows 100% of the tax increment generated by the Project would support approximately \$6,600,000 of the \$16,000,000 TIF Loan.
- 2. Policy 4.1 (10) Self-Supporting Rule—This rule prohibits using tax increment from other property with in a TID to supplement a particular project.** In this case, excess tax increments generated by other properties within the existing and amended TID #32 boundary would support the remaining \$9,400,000 of the TIF Loan. TID #32 is currently generating sufficient tax increment, estimated at \$1,500,000 per year. Combined with an estimated \$900,000 of increment generated by the Project, staff forecasts that tax increments will be sufficient to repay the entire \$16,000,000 TIF Loan by approximately 2019. The City has previously utilized a similar repayment structure for both the Block 89 and Marcus Hilton at Monona Terrace projects.

- 3. Policy 4.1 (12) Personal Guaranty**—TIF Policy requires that a principal of Developer provide a Personal Guaranty in the total amount of the loan to guaranty that all the conditions of the Development Agreement are met. In the case of a default, the City could take action to receive full repayment of its loan. This is not to be confused with the Tax Increment Guaranty, which requires full repayment each year of the TIF Loan. A Personal Guaranty places an individual in charge to address defaults such as not keeping the building in good working order or changing the use function or use of the building so that it would violate the declared public purpose of the loan (i.e. changing from a hotel to an amusement park).

Public Policy Rationale for TIF Policy Exceptions

The Project demonstrates the following public policy reasons to grant the exceptions outlined herein:

- 1) The Project restores public access, with some limitation, to the lakefront that currently does not exist in the current development at no cost or liability to the City for its maintenance, repair or operation.
- 2) The Project proposes to create 230 to 240 full-time equivalent jobs.
- 3) The Project renovates and modernizes a historic structure while preserving its architectural character.
- 4) The project retains an historic Downtown business.
- 5) The Project adds approximately \$45 million of new tax base.
- 6) A similar precedent was established with the \$12.7 million TIF Loan to Marcus Hilton at Monona Terrace loan in 1998. The Marcus Hilton project also provided a public access linkage to the \$60 million Monona Terrace project and lakefront. TID 25 increment and donor increment from TIDs 6 and 14 helped to repay a TIF loan that is still outstanding. The \$30 million TIF Loan to Block 89 was also the recipient of increment from TID 25 and donor increment from TIDs 6 and 14 and 15 toward the public purposes of developing downtown parking and retaining jobs. It is unlikely that a similar project in future could claim precedent for this policy exception—i.e. a historic hotel, located on the lakefront, restoring access to the lakefront, retaining a Downtown business and creating 230 to 240 full-time equivalent jobs.
- 7) The positive growth in TID 32 and the tax increments generated will repay the Project debt and close the TID by 2019, a nine-year payback that is considerably shorter than two other major projects granted these exceptions. Barring no further major expenditures in TID #32, the district could close in 2019 with a lifespan of about 16 years. Comparatively, the Marcus Hilton and Block 89 Projects, located in TID 25, are on a much longer repayment schedule (approximately 27 years), resulting in TID 25 being open for its full 27-year life.