City of Milwaukee

Department of City Development
News Release

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DOWNTOWN MARKET STUDY SUMMARY

Late March, the Mayor asked the Department of City Development to undertake an analysis of the existing retail, residential, hotel and office markets in the downtown and near downtown areas. This project comes in the wake of more than 10 hotel proposals and several requests for city assistance on mixed use projects in the downtown area. At a time when several publicly-owned parcels are under option from the County in the Park East Corridor and large projects are proposed, it is critical to gain information about the existing markets as a predictor of the success of proposed projects and their impacts on the existing market.

The Redevelopment Authority commissioned this analysis through its development consultant, SB Friedman. SB Friedman updated much previous work done in relation to the Park East and sub-contracted with HVS, a nationally-recognized hotel consultant, to perform a separate hotel analysis. Outlined below are the major findings from these two reports.

SB Friedman Downtown Market Analysis

Overall Conclusions (Chapter 7)

The Park East area is seeing over $400 million in development through projects underway, and absorption rates suggest a development horizon of 12 – 18 years for the entirety of the Park East. Overlaps in programming of current proposals indicate that the pace of selling public land exceeds market demand. In the Park East especially, the city needs to evaluate whether the proposed set of uses on a site artificially inflates the market price and causes the city to subsidize land acquisition.

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Condominiums continue to be the sole type of real estate that can consistently be developed in a new construction format without city assistance. Small-scale retail as part of residential projects can feasibly occur, but larger retail projects generally have financing gaps. The retail aspects of the Ghazi proposal may merit city financial assistance because of the potential for positive impact on the convention center and Grand Avenue Mall. Office development faces significant challenges because net rents do not cover costs of construction and associated parking. The apartment market is healthy but significant amounts of new product are unlikely to be introduced under current market conditions due to the relationship between construction costs and the rents that developers can expect to command.

Park East Absorption (Chapter 6)

Under assumptions based on current market conditions, the Park East Corridor will fully develop over a period of 12 years (reasonably aggressive scenario) to 18 years, utilizing 2/3 residential development as the benchmark. Current development within the Park East Corridor (Pabst, North End, Flatiron, Staybridge Hotel) represents substantial momentum and $400 million in long-term development.

The overlap in programming for the proposals on publicly-owned RFP sites suggests that the amount of land currently offered for sale exceeds the current market capacity. A measured pace of development in the Park East Corridor will allow the city to strategically consider future headquarters locations for major employers as part of the economic development strategy for the Park East Corridor.

Condominium Market Profile (Chapter 2)

Buyers tend to be existing Milwaukee County residents who are “empty nesters” (over 55 with kids gone) and young professionals (25 to 34 with no kids or a young child) with a household income approaching $100,000 or greater. The annual absorption of new units has been at a rate of about 360 units per year in the market for the past four years, even as re-sales on existing units have steadily increased. Downtown projects currently under construction represent an increase over the past several years, and demand would need to grow in order for individual projects to meet the monthly absorption rates observed for the past several years.

Although it is highly unlikely that all proposed units will eventually be constructed, the group of projects currently proposed or under construction includes more than 2,300 units, or about a 6-year supply for the market. Demographic changes in the next several years appear favorable for the continued growth of the Downtown condominium market, and the continuing city policy of not subsidizing the downtown condominium market appears justified and will continue to be so for the foreseeable future.

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<u>Office Market Profile (Chapter 4)</u>

Downtown vacancy in class A & B office space is about 18%, the highest in a decade, suggesting that a lack of space is not hindering employment. However, the City may wish to study the distribution of vacancy in more detail to evaluate whether large enough blocks of attractive new space exist to allow downtown to compete effectively. Most recent office development has involved moving a regional employer downtown (Manpower, Roundy's) or moving an existing tenant into a new project (Ernst & Young, Whyte Hirschboeck). Current rents (up to $16 per square foot net) are not sufficient to finance structured parking.

The Pabst Brewery Redevelopment, to which the city has contributed $13.5 million in upfront assistance and committed an additional $15.5 million of contingent funding, is currently programmed with more than 300,000 square feet of office space. The City's investment could be put at risk with unwarranted or unwise subsidy of other downtown office space. It should also be noted that the subsidy to the Pabst project was not provided to assist with structured parking construction. The Pabst development team is pursuing the development of a parking structure without city assistance, using historic tax credits on the project.

<u>Retail Market Profile (Chapter 3)</u>

Most of the retail proposed among the projects "in the pipeline" falls below 25,000 sq. ft. and should be able to be absorbed as "neighborhood retail" that supports the largely residential development that accompanies it. The 4th & Wisconsin and RSC projects represent the largest amounts of retail (both in excess of 80,000 sq. ft.). Based on what has been provided so far, only the 4th & Wisconsin proposal appears to have a real chance to enhance the overall downtown retail portfolio. Generally, downtown retail rents ($25 per sq. ft. net) are not enough to support significant structured parking.

<u>Rental Apartment Market (Chapter 5)</u>

The downtown apartment market is strong, with occupancy averaging 97%, and demographic trends suggest that the target market for downtown apartments is growing. While the market is healthy, the current prevailing per square foot rents are not generally high enough to cover the costs of constructing new market-rate apartments and their associated parking.

The City may want to consider modest gap financing of apartments (in the form of loans) in order to allow new supply to enter the market as an alternative to waiting for rents to escalate to an extent to make market-rate apartment development financially feasible. Land prices continue to be based on highest value use (condominiums at $30 per square foot) and costs should theoretically be adjusted downward for apartment development; otherwise, the city will be indirectly subsidizing land acquisition costs.

HVS Hotel Analysis

Overall Conclusions

According to the consultant, 70% occupancy represents the threshold at which a hotel newly entering the market would likely have only limited impact on existing Downtown hotel occupancy rates. Occupancy in downtown hotels is not likely to hit that mark until 2010 or 2011. With regard to specific proposals, the 4th and Wisconsin site has great strategic importance and should be developed with high amount of city involvement and, if necessary, city financial participation. Two potential avenues for 4th and Wisconsin development appear most beneficial to convention potential: a) Developing significant entertainment-based retail cluster to improve convention environment, as embodied in the current Ghazi proposal or b) Developing a significant (300+) room block in conjunction with a Convention Center expansion.

The consultant's findings indicate that, aside from the project proposed at 4th and Wisconsin, virtually none of the others are likely to have substantial positive economic impact on the downtown marketplace.

Analysis of Specific Proposals (Chapter 3)

According to HVS, the 4th & Wisconsin proposal has the greatest likelihood of generating additional economic benefit because of its strategic location proximate to the Midwest Express Airlines Convention Center and the Grand Avenue Mall. In addition, preservation proposals (like Dixon or Badger) may be candidates for subsidy in the form of loans because of the direct public benefit resulting from preservation and the potential localized (block-by-block) revitalization potential. A key sentence in the report reads that "…Aggregate occupancy level of 70% is generally an indicator that the market is ready to absorb new supply…" but the competitive set has not yet reached that threshold.

Supply and Demand Analysis (Chapter 4)

The national trends in hotel occupancy and rate have been strong over the past few years (2004 – 2006). In the Milwaukee downtown hotel subset reviewed for this report (7 hotels and 2015 rooms), rate and Revenue per Available Room (RevPAR) have been increasing over the last six years, while occupancy took a slight dip in 2006 after five years of slight increase.

In the report, HVS breaks the market down into three segments – commercial (41% of room demand), meeting & group (40%), and leisure (19%). Commercial demand (driven by corporate travel) is projected to grow 2.5 – 3% over the next three years before leveling off at 1% growth; meeting & group is projected to grow by 1% a year over the next five years; leisure is projected to grow by 2% a year for three years and level off at 1% a year after that. The combined market growth is projected at 2% a year for the next two years and then increasing at about 1% a year for the foreseeable future.

Using its expertise and industry standards, HVS estimates unaccommodated demand at 6.5% or about 31,300 room annual room nights. While variations in peak and seasonal demands make it impossible for one hotel to absorb all of this demand, this would equate to an 85-room hotel sold out every night throughout the year to accommodate the demand we are currently missing out on in the downtown.

HVS estimates the impact of introducing 150 additional rooms in the competitive set by 2009 and shows that it will eat into the overall occupancy by 2.5% (reduce from 69.3% in 2008 to 66.8% in 2009). This estimate is further refined in Appendix B, which concludes that a 150-room hotel would be competitive and could achieve high occupancy and average rate, but that would come at some expense to the existing market, at least until overall occupancy in the market reached 70%.

HVS also estimates the impact of introducing 250 directly competitive rooms to the market and shows that it would eat into the overall occupancy by 5.6% (69.3% to 63.7%) and substantially harm the existing hotels.

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