City of Milwaukee
Downtown Projects: Strategic Analysis

MILWAUKEE

Submitted to:
Milwaukee Department of City Development

June 6, 2007

S. B. Friedman & Company
Real Estate Advisors and Development Consultants

S. B. Friedman & Company
Real Estate Advisors and Development Consultants

221 N. LaSalle St., Suite 820 • Chicago, Illinois 60601-1302 • 312/424-4250 • Fax: 312/424-4262 • www.FriedmanCo.com

June 6, 2007

Joel Brennan
Assistant Executive Director-Secretary
Redevelopment Authority of the City of Milwaukee
809 North Broadway
Milwaukee, WI 53201

Dear Mr. Brennan:

S. B. Friedman & Company (*SBFCo)* is pleased to present this strategic analysis of Downtown market and financial feasibility considerations for the development of condominiums, retail, office, and rental apartments. This study is a companion to the report produced by HVS International (a sub-consultant to *SBFCo* on this assignment) to evaluate hotel market conditions in light of eleven projects proposed in the Downtown area.

The limitations of our engagement are included as an appendix to this report.

We appreciate the opportunity to work with the City of Milwaukee. Please do not hesitate to contact me with any questions.

Sincerely,

Tony Q. Smith, AICP
Practice Leader

City of Milwaukee
Downtown Development Strategic Analysis

CONTENTS

Chapters

S. B. Friedman & Company
221 North LaSalle Street, Suite 820
Chicago, Illinois 60601-1302
Phone: (312) 424-4250
Fax: (312) 424-4262
E-mail: sbf@friedmanco.com
Web: www.friedmanco.com

1. Introduction and Proposed Project Profiles

S. B. Friedman & Company (*SBFCo)* was retained by the Redevelopment Authority of the City of Milwaukee (RACM) to assist in evaluating market and strategic aspects of a group of mixed-use redevelopment projects including hotel components proposed in and around Downtown Milwaukee and the Park East. Currently, at least 11 such projects are proposed. Several project sponsors have approached the City of Milwaukee for some form of direct financial support or other assistance intended to enhance financial feasibility.

A companion study, performed by Hospitality Valuation Services (HVS), Inc. specifically evaluates the strategic and economic aspects of the hotel components of these proposals, and has been released under separate cover.

SBFCo's report focuses on:

- Strategic, market, and financial considerations attendant to the non-hotel real estate product types proposed within the 11 projects, including condominiums, office, retail, and rental residential.

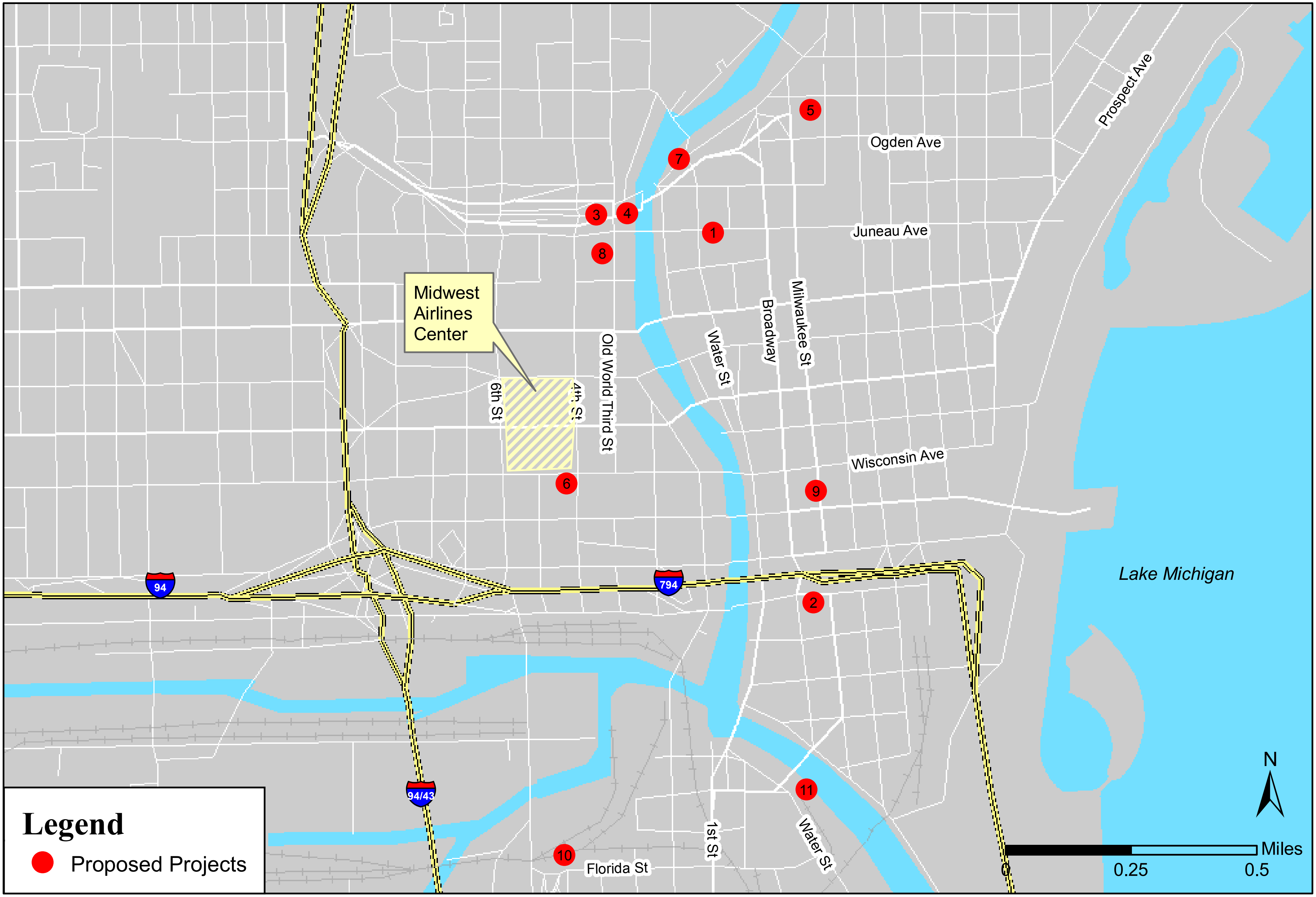
- Potential policy frameworks for evaluating financial requests in support of redevelopment projects of the types proposed.

This report is presented as an analytical framework for assisting the City in its decision-making process. However, it does not constitute a specific review of the financial feasibility or financing gap of any of the individual proposals currently under discussion. A further description of the limitations of *SBFCo*'s engagement is provided as the Appendix of this report.

Proposed Projects

Based on information provided by the City of Milwaukee, the proposed mixed-use projects currently under consideration are summarized below. The map on the following page illustrates the locations of the projects.

1. Development Opportunity Corporation (DOC)
    - Location: N. Water Street & E. Juneau Avenue
    - Neighborhood: Downtown (Water Street)
    - Hotel Type: Extended Stay
    - Hotel Flag: Staybridge Suites
    - Number of Rooms: 135
    - Additional Uses:
        - 30 condominiums
        - 17,000 sq. ft. retail



City of Milwaukee
Milwaukee Downtown Development Strategic Review

S. B. Friedman & Company
Real Estate Advisors and Development Consultants

Proposed Projects

Source: Redevelopment Authority of the City of Milwaukee

2. Weas Development
    - Location: N. Broadway & E. St. Paul Avenue
    - Neighborhood: Third Ward
    - Hotel Type: Boutique Full Service
    - Hotel Flag: Marriott Renaissance Club Sport
    - Number of Rooms: 165
    - Additional Uses:
        - 8,000 sq. ft. retail
        - 75,00 sq. ft. fitness center

3. Ruvin Development – Kimpton
    - Location: Old World 3rd Street & W. Juneau Avenue
    - Neighborhood: Park East
    - Hotel Type: Full Service
    - Hotel Flag: Kimpton
    - Number of Rooms: 184
    - Additional Uses:
        - 70 condominiums
        - 17,000 sq. ft. retail
        - 106,000 sq. ft. office
        - Spa

4. Ruvin Development – Aloft
    - Location: Old World 3rd Street & W. Juneau Avenue
    - Neighborhood: Park East
    - Hotel Type: Boutique Focused Service
    - Hotel Flag: Aloft
    - Number of Rooms: 120
    - Additional Uses:
        - 75,000 sq. ft. office (anchor tenant identified)

5. RSC Development Group
    - Location: N. Jefferson Street & E. Ogden Avenue
    - Neighborhood: Park East
    - Hotel Type: Boutique Focused Service
    - Hotel Flag: Hyatt Place
    - Number of Rooms: 148
    - Additional Uses:
        - 126 Apartments
        - 80,000 sq. ft. retail

6. Ghazi
    - Location: N. 4th Street & W. Wisconsin Avenue
    - Neighborhood: Downtown Central Business District
    - Hotel Type: Boutique Focused Service
    - Hotel Flag: Not yet identified
    - Number of Rooms: 150
    - Additional Uses:
        - 200 Condominiums
        - 100,000 sq. ft. entertainment focused retail

7. MLG Development
    - Location: N. Water & E. Knapp Streets
    - Neighborhood: Park East
    - Hotel Type: Not yet identified
    - Hotel Flag: Not yet identified
    - Number of rooms: 60
    - Additional Uses:
        - 32 Condominiums
        - 50,000 sq. ft. retail
        - 332,000 sq. ft. office

8. Moderne
    - Location: Old World 3rd Street & W. Juneau Avenue
    - Neighborhood: Park East
    - Hotel Type: Extended Stay
    - Hotel Flag: Element
    - Number of Rooms: 120
    - Additional Uses:
        - 80 Condominiums
        - 20,000 sq. ft. retail
        - Spa

9. Badger Pacific
    - Location: N. Milwaukee Street & E. Wisconsin Avenue
    - Neighborhood: Downtown (Easttown)
    - Hotel Type: Boutique
    - Hotel Flag: Not yet identified
    - Number of Rooms: Not yet identified

10. Dixon
    - Location: S. 5th and W. Florida Streets
    - Neighborhood: Walker's Point
    - Hotel Type: Independent Boutique (Motorcycle Theme)
    - Hotel Flag: Iron Horse

- Number of Rooms: 100
- Additional Uses:
  - Spa
  - On-site restaurant

11. Schultz
    - Location: 236 S. Water Street
    - Neighborhood: 5th Ward
    - Hotel Type: Not yet identified
    - Hotel Flag: Not yet identified
    - Number of Rooms: 100
    - Additional Uses:
      - 220 Condominiums
      - 10,000 sq. ft. retail

Several of the projects listed above involve sites that are currently owned by government entities. The projects sponsored by Ruvin (#2 and #3), RSC (#5), and MLG (#7) are located wholly or partially on land held by Milwaukee County within the former Park East Freeway corridor. The Ghazi proposal (#6) is located on land owned by RACM, while MLG (#7) would require the City to vacate a public right-of-way.

Several of the project sponsors have approached the City of Milwaukee to date, formally or informally, to request some form of assistance. These requests have included:

- Direct financial assistance from tax incremental districts (TIDs);
- Write-down of the cost of City-owned land;
- Long-term below-market master leases of City-owned parking structure spaces to address parking demand created by various proposed project components;
- Market-rate leases of City-owned parking structure spaces; and
- Relief from maximum height requirements included in zoning regulations.

The cost of building structured parking appears to be a common financial challenge, and is one of the most common reported reasons for project sponsors to seek financial assistance.

2. Condo Market Profile

Of the eleven projects discussed in Chapter 1 of this report, at least six include condominium components, ranging from 30 to 220 units. An additional proposal (RSC/#7) includes a small for-sale townhome component and included condominiums in a prior iteration.

In recent years, the Downtown area has experienced substantial redevelopment activity. Areas such as the Third Ward and Walker's Point have seen extensive rehabilitation and adaptive re-use of existing structures, while the Beerline B has been characterized by new construction. Much of this development activity has been concentrated in the for-sale residential sector, which has represented the driving force behind the renaissance of Downtown Milwaukee.

For-sale residential also represents an important driver for redevelopment from a financial feasibility standpoint. On a per-square foot basis, condominiums represent the most valuable real estate product type present in Downtown Milwaukee, and market-rate for-sale projects have generally been able to proceed without City assistance on sites without extraordinary barriers to development. Further, the price points achievable in condo projects appear sufficient to allow developers to build structured parking without encountering financing gaps as a result.

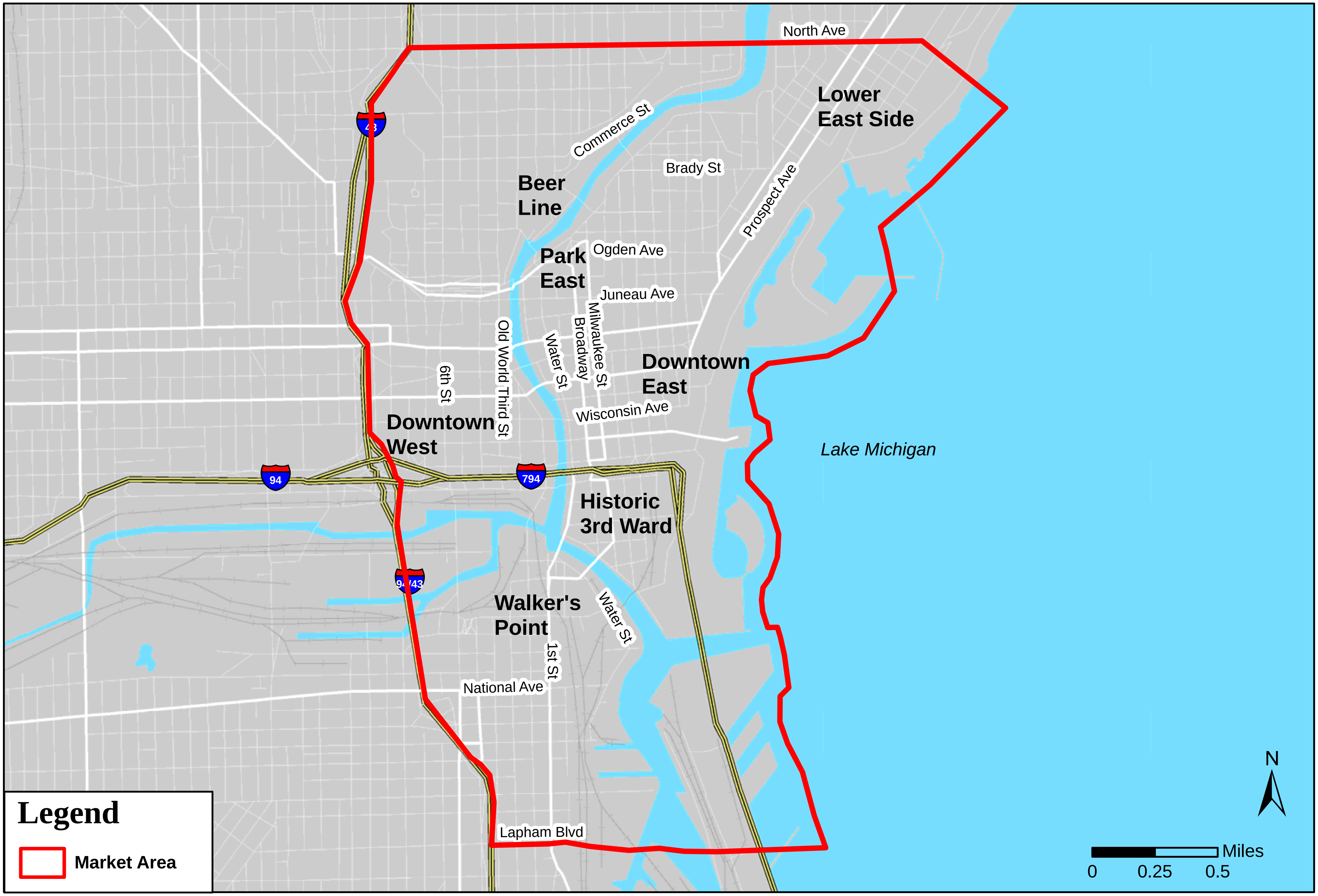
It should also be noted that the 2005 Economic Feasibility Study for the Park East TID budget amendment concluded that a buildout dominated by for-sale residential development would be the most reasonable scenario upon which to base future incremental property tax revenue projections.

This chapter evaluates the overall Downtown Milwaukee condominium market in light of recent development and absorption trends, the current "pipeline" of projects under construction and in the planning stages, and the potential outlook for condo development in the coming years.

Recent, Current, and Planned Market Activity

For the purposes of this report, we have analyzed condominium development in and around Greater Downtown—an area roughly bounded by North Avenue to the north, Interstate 43 to the west, Lake Michigan to the east and Lapham Boulevard to the south. The map on the following page describes this area. This market area includes such sub-markets as:

- Beerline
- Park East
- Historic Third Ward
- Walker's Point
- East Side (southern portions only)
- Traditional Central Business District



City of Milwaukee
Milwaukee Downtown Development Strategic Review

S. B. Friedman & Company
Real Estate Advisors and Development Consultants

Downtown Condo Market Area

These areas are all located relatively close to the traditional central business district as well as shopping, dining, and entertainment. Based on interviews with developers and brokers, many prospective buyers treat these sub-markets as relatively cohesive and fungible except in cases where they are seeking a unit with a specific amenity such as a boat slip.

BUYER PROFILE

Nationally, the market for for-sale multi-family and attached downtown housing has been driven by empty nester and young professional households. Empty nesters are typically defined as households in which the householder is approximately 55 years of age or older and has no children living at home. Young professional households are generally headed by people aged 25 to 34 years old who have no children or perhaps a young child. Both of these demographic segments have a propensity to purchase units in multi-family projects located near work, shopping, dining, and entertainment as a lifestyle choice.

Interviews with brokers and developers indicate that the condo market in Downtown Milwaukee follows this trend of appealing primarily to empty-nester and young professional households. Generally speaking, larger and more expensive Downtown units have been sold to empty nesters who are frequently downsizing from a single family detached home in favor of increased convenience, a more leisure-oriented lifestyle, and reduced maintenance requirements. These households tend to have substantial equity and other assets that they can use to purchase Downtown condominiums. Young professionals are often making first home purchases and tend to buy smaller, lower priced units. Anecdotal evidence from brokers and developers suggests that these buyers tend to originate from throughout the 4-county region (Milwaukee, Waukesha, Ozaukee, and Washington counties) with an emphasis on Milwaukee County.

PAST MARKET PERFORMANCE AND DELIVERY OF UNITS

In order to evaluate condo market conditions, *SBFCo* analyzed historical construction, marketing, and sales activity for the period from 2001 to 2006. In addition, we reviewed projects currently marketing and under construction. These data were combined to provide time-series data on such factors as:

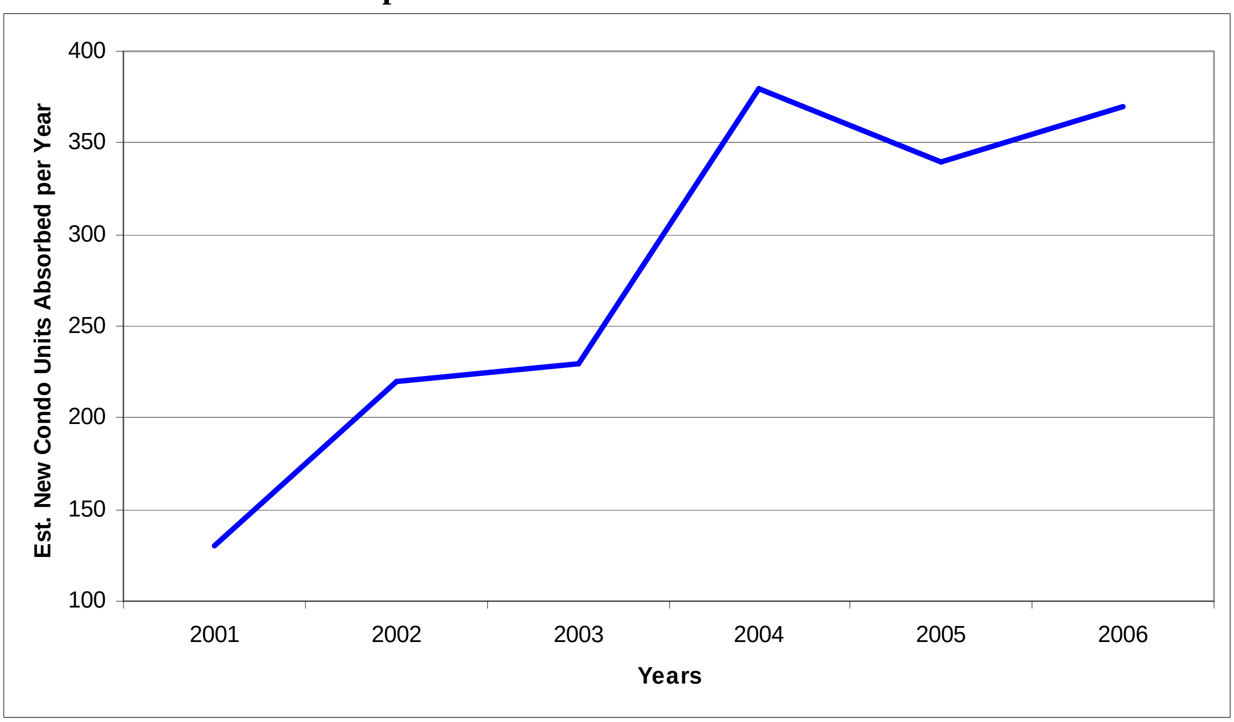
- Overall condo market size
- Annual absorption trends
- Current level of "pipeline" units existing and under construction

This data was developed based on information provided by the Department of City Development, updates to prior *SBFCo* research, and calls to brokers and developers. *SBFCo* is not aware of any centralized tracking source for information on unit reservations and sales in newly developed condominium projects. The Multiple Listing Service (MLS) provides data primarily on re-sale activity. Similarly, data from the Milwaukee City Assessor's Office on condominium transaction excludes many first-time sales of units by developers. Therefore, broker and developer calls represent the primary source of information on new unit sales. As a result, the quality of this information is somewhat variable depending on the availability of data for specific projects and the willingness of brokers and developers to supply details. However, *SBFCo* believes that this information represents a generally accurate picture of the performance of the condo market, particularly in recent years.

This research yields the following key observations:

- Approximately 50 projects with a condominium component were active in the Downtown market between 2001 and 2006, representing a total of about 2,000 new units
- Average sizes for active projects (or major phases for multi-phase projects) have generally increased over time, from an average of about 30 units in 2001 to about 70 units in 2006
- Annual absorption of new units (including conversions) grew over this period from an average of about 200 units per year over the 2001-2003 period to about 360 units per year for the 2004-2006 period. The chart below illustrates estimated annual absorption for this overall period.
- Based on reported sales to date and projected closing activity, total absorption in 2007 appears likely to equal or exceed the 2004-2006 pace of 360 units per year.
- The estimated number of significant projects (8 or more total units) actively marketing new units with substantial sales volume generally ranged from 9 to 13 in each year.

Estimated Annual Absorption of New Condos in Downtown Milwaukee 2001-2006



Source: *S. B. Friedman & Company* calls with brokers and developers

Overall, these observations point to a growing and maturing condominium market over the 2001-2006 period. It is important to note that the overall size of the new condo market, as represented by annual absorption, grew substantially over this time frame. This is particularly positive in light of increased competition from resale units. As more new product is introduced to the market in each year, the overall pool of potential resale units increases. While *SBFCo* did not conduct original research on the Downtown condominium resale market, market summaries prepared by other analysts in conjunction with specific projects[1] suggest that size of the resale market has increased from approximately 150 transactions in 2002 to about 500 sales in 2006. The fact that sales of new units have remained constant or increased over this same period indicates that the overall size of the Downtown condo market continues to grow.

Based on broker/developer interviews, *SBFCo* estimates the unsold inventory of new units in projects that have completed construction at about 220 units. Based on the 2004-2006 new product absorption rate of about 360 units per year, this unsold inventory appears to represent about 7 months of supply.

Based on the average of 11 projects substantially active each year in the market between 2004 and 2006 and the average overall new unit absorption of 360 units per year, the market-wide average per-project monthly sales pace is estimated at about 2.5 to 3 units per month. This estimate is similar to data on individual project absorption rates indicated by other analyst reports reviewed by *SBFCo.*

It appears that about 14 projects are currently marketing substantial numbers of units with potential for 2007 occupancy, suggesting that the level of competition is greater this year than in the prior 3-year period.

UNITS UNDER CONSTRUCTION

SBFCo analyzed projects that are currently under construction or nearing the start of construction and evaluated the impact they may have on the Downtown market in coming years, both in terms of overall market volume and competitiveness. Based on information provided by developers, brokers, and the City, we catalogued the condo projects currently under construction in Downtown. Based on pre-sales to date and recent sales performance of condo projects, we projected annual absorption levels within the Downtown.

There are approximately 15 projects (of which 14 are of a significant size) currently under construction in the Downtown area including approximately 1,080 units. Units range in size from approximately 700 square feet to over 3,500 square feet for some penthouse units. Base prices are reported to start at approximately $170,000 per unit, with median sales prices at about $270,000. Asking prices per square foot cluster between $250 and $400. The figure below summarizes the under construction projects and the map on the following page describes their locations within the market area.

[1] Items reviewed include market studies for the Terraces at River Bluff and Ruvin proposal (3rd and Juneau)

Downtown Condo Projects Currently Under Construction

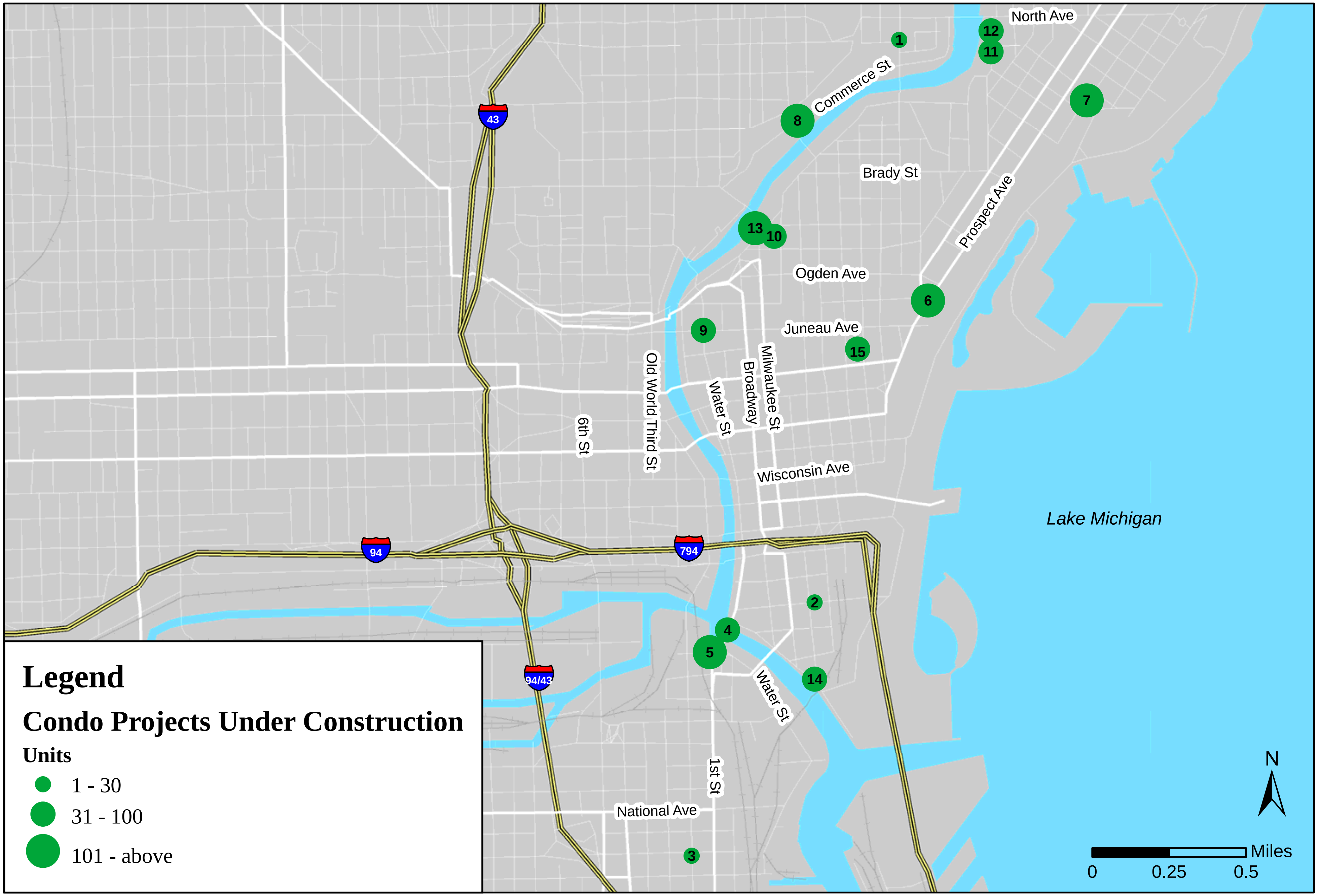
Map ID #	Project Name	Total Units
1	Humboldt Ridge Condos	4
2	Warehouse 525	22
3	Roxwell Lofts	21
4	River Renaissance	72
5	First Place on the River	154
6	Lake Bluff	110
7	Park Lafayette (Tower 1)	141
8	The Edge Condos	133
9	The Residences on Water	31
10	The Flatiron	38
11	Cambridge River North	48
12	2201 N Cambridge	81
13	The North End Phase 1	120
14	Domus	61
15	City Green	44
	TOTAL	**1,080**

Source: *S. B. Friedman & Company* developer calls and RACM

According to calls made to the developers and brokers of these projects in April and early May 2007, many are achieving solid presale rates. For the projects where presales numbers were available, overall approximately 41% of these under-construction units had been presold.

Based on projected construction timing and typical absorption rates, many of these projects are likely to be selling and delivering significant numbers of units in 2008. By our estimates there may be as many as 14 to 15 projects marketing substantial numbers of units in 2008, including The Residences on Water by Development Opportunity Corporation (noted as Project #1 in the first chapter of this report). This represents an increase over the 2004-2006 average of 11 active projects.

This expansion in the number of simultaneously active developments creates some risks for developers contemplating new proposals. The increase in competition could result in a slower per-project average absorption rate unless the market for new units expands enough to maintain the current per-project average sales pace. In order to meet the historical market-wide per-project absorption rate of 2.5-3 units per month estimated for 2004-2006, Downtown demand for new units would need to grow from about 360 units per year to 420-540 units per year.



City of Milwaukee
Milwaukee Downtown Development Strategic Review

S. B. Friedman & Company
Real Estate Advisors and Development Consultants

Condo Projects Under Construction

Source: *S.B. Friedman & Co.* Developer Calls, Redevelopment Authority of the City of Milwaukee

PLANNED PROJECTS

SBFCo gathered available information on projects that are currently contemplated but do not yet appear to have approvals and/or a defined time frame for delivery. With the exception of Development Opportunity Corporation (Project #1), the five projects specifically considered in this study with proposed condominium projects were classified within this Planned Projects category.

This analysis of planned projects revealed 18 proposals totaling about 2,300 units, with probable delivery dates extending from 2009 though 2012 or later. These projects are concentrated in the Park East and on the east side of the river in the southern end of the East Side neighborhood. It should be noted that for the purposes of this calculation, the Pabst Brewery redevelopment is considered a single project of 250 units.

This inventory of planned projects represents varying levels of available detail and certainty. Some, such as the latter portion of Mandel Group's The North End project, represent later phases of projects that are currently underway. As such, they appear more likely to occur in approximately the form and time frame anticipated. Others, such as the for-sale residential component of the Pabst Brewery redevelopment and projects specifically considered in this report such as Ghazi (#6) and MLG (#7), are still taking shape. These less-defined proposals may encounter timing and programming changes, particularly if the condo market changes substantially in the coming years.

Excluding the Residences on Water (DOC/#1) group of projects specifically treated in this report that contain condo components (Ruvin/#3, Ghazi/#6, MLG/#7, Moderne/#8 and Schultz/#11) represent a total of about 600 proposed units, with Ghazi/#6 and Schultz/#11 representing 70% of these units.

If all planned projects proceed in approximately their currently proposed form, they represent about 6 years of condo supply, assuming new unit absorption remains at approximately its current pace of about 360 units per year. This would likely cause a significant oversupply of units. However, it is likely that some of the proposals will encounter delays due to financing gaps, construction lender pre-sale requirements, or other factors.

FUTURE SCENARIOS AND CONSIDERATIONS

Based on *SBFCo*'s analysis of active and under-construction projects, it appears that the Downtown condo market will grow more competitive in 2008. It is projected that about 15 projects will be marketing substantial numbers of units for occupancy in 2008, marking an increase from the 2007 estimate of 14 projects and the 2004-2006 average of 11 projects.

This increased level of activity will likely cause the market-wide average absorption per project to fall on the margins, assuming the total annual market for new condos in the Downtown remains constant. The figure below describes the estimated monthly average per-project absorption rates under three different competitive scenarios.

Average Monthly Absorption per Project Under 3 Competition Scenarios

	Scenario 1	Scenario 2	Scenario 3
Projects Active	11	13	15
Total Annual New Unit Demand in Downtown	360	360	360
Estimated Sales/project/month	2.7	2.3	2

Source: *S. B. Friedman & Company*

Slower per-project absorption could threaten to delay construction starts (through extended pre-sale periods before construction can start), increase developer interest carry costs on construction loans, and/or dilute equity returns by delaying the return of capital to investors. In turn, this may cause developers to undertake smaller projects and/or incorporate other real estate products to mitigate condo market risk. This rationale may be driving the extensive mixing of uses found in many of the eleven proposals treated in this report.

However, as indicated in the table above, a modest increase in the number of active projects such as the one projected for 2008 would on average have only a marginal impact on the sales performance of any individual proposal. Projects with distinctive features, a strong marketing program, and attractive pricing could likely achieve better-than-average absorption rates, even in a market with increased competition.

In addition, the total size of the market for new units has a substantial impact on the likely performance of individual projects. Key factors that may change the average new unit absorption of 360 units per year observed for 2004-2006 include:

- **Continued Improvement in Downtown Milwaukee's Image.** The expansion of the Downtown condo market since 2001 suggests that Downtown living is becoming more of a mainstream lifestyle choice within the Milwaukee region. In addition, increased investment and population in the Downtown neighborhoods is likely to allow more amenities, particularly retail, to develop. This will further enhance the appeal of Downtown condo living.

- **Demographic Changes.** Projected household trends by age and income group are discussed in the next section of this chapter. The most relevant trends are the projected changes in households within the young professional and empty-nester age cohorts with income levels sufficient to afford typical market prices of Downtown condos.

- **Resale Market and Appreciation Rates.** Although discussions with brokers and developers suggest that investor activity among the Downtown Milwaukee condo market is fairly minimal, many condo purchasers, particularly young professionals, intend to resell their units within several years of initial purchase. If appreciation rates diminish, and/or the overall housing market slows, the reduced resale potential may discourage some buyers from purchasing units.

Demographic Analysis

SBFCo analyzed demographic trends and projections for selected age, income, and geographic areas in order to understand how future conditions projected between 2006 and 2011 may compare to those experienced from 2000 to 2006. *SBFCo* purchased data for this analysis from ESRI, a nationally recognized demographics provider.

TARGET MARKET DEFINITION

Condominium units under construction in the Downtown area are priced from $170,000, with a typical median price point of about $270,000. Using this median unit price of $270,000 and the assumption that households will be able to spend approximately 30% of their income on housing including taxes and assessments, *SBFCo* calculates that households will generally need to earn approximately $100,000 per year or more to buy a new condo in the Downtown area. For this reason, *SBFCo* focused particularly on households within the young professional and empty nester age ranges earning over $100,000 per year.

Certain factors may cause purchasers in lesser income brackets to also participate in the market for new condo units, particularly the buyer’s accumulated equity in an existing home that can translate into a substantial down payment (more prevalent among empty-nesters). Also, the aggressiveness of the loan-to-value ratios allowed by lenders may allow certain households to “over-spend” on housing relative to their income. However, this general assumption about the market gives some insight into the approximate household incomes required to purchase new condominiums Downtown.

Based on discussions with developers, *SBFCo* believes that the majority of Downtown condo buyers come from Milwaukee County, with most of the others coming from the balance of metro Milwaukee. As a result, *SBFCo* considered Milwaukee County the primary market area for the purposes of this analysis, and designated the balance of the 4-county region (Ozaukee, Washington, and Waukesha counties) as the secondary market area.

Based on these factors, *SBFCo* analyzed demographic projections based on three sets of limiting criteria:

- The primary age cohorts that have driven and will continue to drive demand for Downtown condominiums are empty nester households age 55 and above and young professionals age 25 to 34

- Households must earn over $100,000 per year to be able to afford Downtown condos and be included in the pool of potential buyers

- Primary market area defined as Milwaukee County, secondary market area defined as Waukesha, Ozaukee, and Washington Counties

MILWAUKEE COUNTY

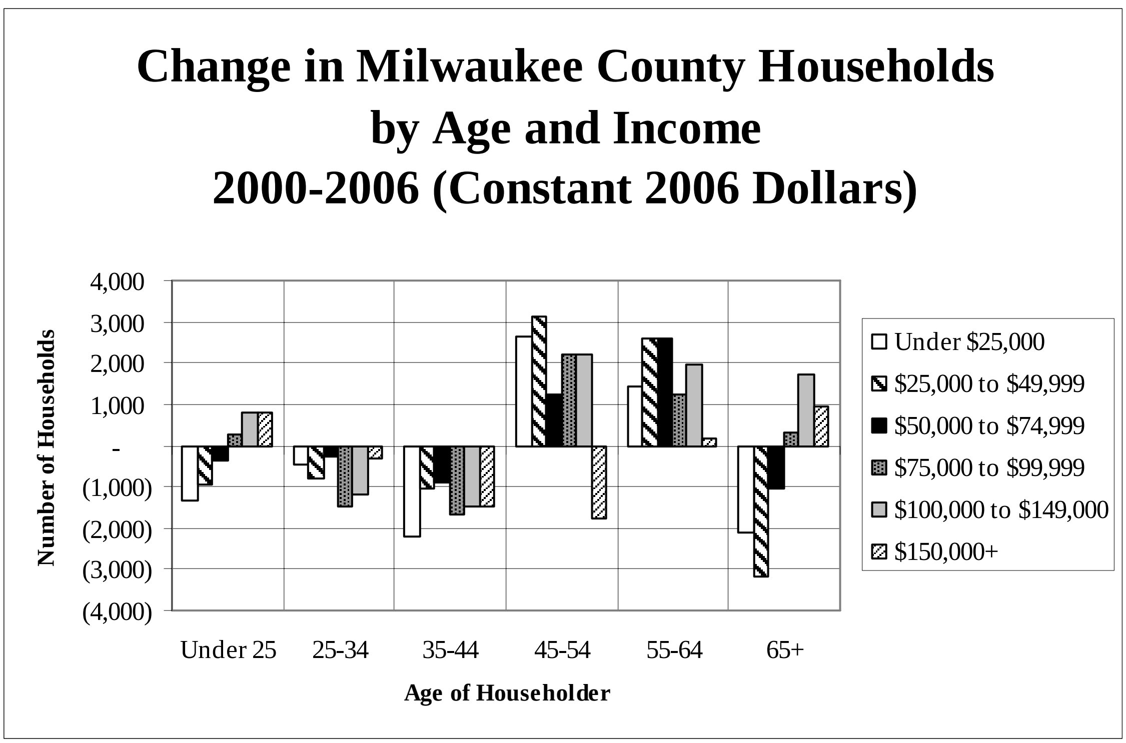
Within any housing market, the potential buyer pools for a given housing product are comprised of:

- Net new households resulting from natural population increases and/or in-migration; and

- Households already living in the market who elect to move within the analysis period.

SBFCo therefore analyzed the absolute size of, and estimated change in, the targeted cohorts as limited by age and income in the manner described above for Milwaukee County. This analysis examined historical change for the period 2000-2006 (during which the performance of the Downtown condo market is known), and projected future change between 2006 and 2011.

The charts below summarize estimated historical and projected future change in these cohorts, with income expressed in constant 2006 dollars.



Source: ESRI, *S.B. Friedman & Company*

Key observations for the 2000-2006 period include the following:

- Young professionals earning over $100,000 per year declined by approximately 1,500 households from 2000 to 2006, or approximately 250 households per year. It is encouraging that the Downtown condo market increased in size even while this demographic movement was occurring.

- As the “baby boom” demographic moved more squarely into the empty-nester age bracket, households headed by people 55+ years old and earning over $100,000 per year increased by approximately 4,700 from 2000 to 2006, or an average of 790 households per year.

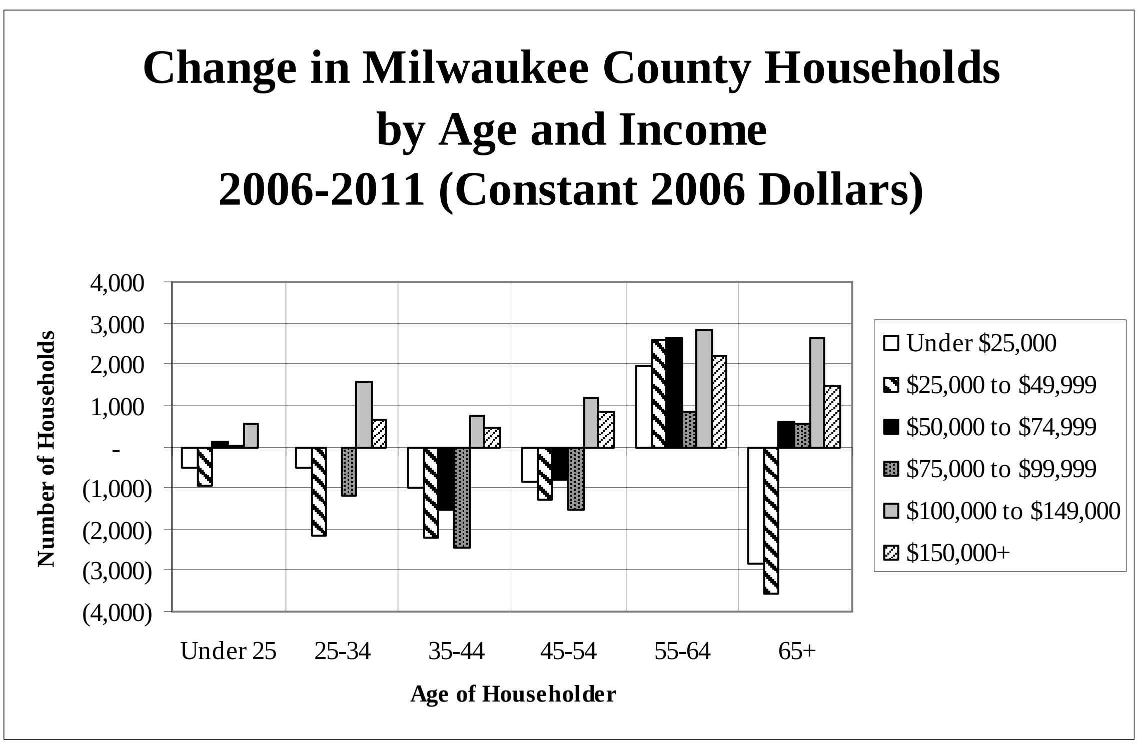
- As shown in the table below, the absolute size of the prime cohorts likely to buy condos in Downtown Milwaukee increased by about 3,200 units between 2000 and 2006, a 15% overall growth and a compound annual rate of about 2.4%. This occurred despite very limited overall county-wide growth of about 760 households.

Milwaukee County Households Earning $100,000+ in Key Condo-buying Age Cohorts: 2000-2006

	2000	2006	Total Growth	Annual Growth
Young Professional	7,250	5,753	(1,497)	(250)
Empty Nester	13,866	18,611	4,745	791
Total	**21,116**	**24,364**	**3,248**	**541**

Source: ESRI, *S. B. Friedman & Company*

The chart below shows projected household change in Milwaukee County from 2006 to 2011.



Source: ESRI, *S.B. Friedman & Company*

Key observations for the 2006-2011 projection period include the following:

- From 2006 to 2011, households in the young professional age ranges of 25-34 earning over $100,000 per year are projected to grow by approximately 2,250 households, or 450 per year. This implies a growing pool of potential buyers for new Downtown condominiums.

- From 2006 to 2011, empty nester households (55+ years of age) earning over $100,000 or more per year are projected to grow by approximately 9,000 households, or 1,800 per year. This implies a rapidly growing pool of potential buyers for new Downtown condominiums with amenities well suited to empty nesters.

- As shown in the table below, the absolute size of the prime cohorts likely to purchase Downtown condos is projected to grow by 47% over the 5-year period from 2006 to 2011, for a compound annual growth rate of about 8%. Overall, this translates into about 2,300 households per year, as compared to the 2000-2006 rate of 540 households per year.

- Overall, county-wide growth is projected to again remain modest, at about 1,290 households in all age and income groups combined.

Milwaukee County Households Earning $100,000+ in Key Condo-buying Cohorts: 2006-2011

	2006	2011	Total Growth	Annual Growth
Young Professional	5,753	8,003	2,250	450
Empty Nester	18,611	27,742	9,131	1,826
Total	**24,364**	**35,745**	**11,381**	**2,276**

Source: ESRI, *S. B. Friedman & Company*

Within Milwaukee County, the historic and projected household trends for likely buyers of condominiums in Downtown Milwaukee appear significantly stronger in the near future than they have been in recent years. Assuming the lifestyle trends that have caused these demographics to favor condo living in recent years continue, the Downtown market will have strong demographic support in the coming years.

OZAUKEE, WASHINGTON, AND WAUKESHA COUNTIES

Based on interviews with Downtown developers, the secondary market area for Downtown condominium units was defined as Ozaukee, Waukesha and Washington counties. These counties make up the rest of metro Milwaukee. *SBFCo* analyzed recent and projected change in these counties in similar fashion to Milwaukee County.

The tables below show similar analyses of the absolute size of the young professional and empty-nester cohorts for these three suburban counties. This data exhibits similar patterns to those found in Milwaukee County. However, the young professional cohort experienced a lesser rate of decline in the 2000-2006 period.

Ozaukee, Washington and Waukesha County Households Earning $100,000+ in Key Condo-buying Cohorts: 2000 to 2006

	2000	2006	Total Growth	Annual Growth
Young Professional	6,759	6,037	(722)	(120)
Empty Nester	15,347	24,556	9,209	1,535
Total	**22,106**	**30,593**	**8,487**	**1,414**

Source: ESRI, *S. B. Friedman & Company*

Ozaukee, Washington and Waukesha County Households Earning $100,000+ in Key Condo-buying Cohorts: 2006 to 2011

	2006	2011	Total Growth	Annual Growth
Young Professional	6,037	9,406	3,369	674
Empty Nester	24,556	36,085	11,529	2,306
Total	**30,593**	**45,491**	**14,898**	**2,980**

Source: ESRI, *S. B. Friedman & Company*

It should be noted that estimated household growth in the three suburban counties was more substantial than Milwaukee County from 2000 to 2006 (20,800 households), and is projected to continue at a slightly slower rate from 2006-2011 (17,300 households).

In general, these demographics also suggest favorable underlying conditions for future development of dense for-sale residential in greater Downtown Milwaukee, particularly as Downtown's reputation as an exciting, high-amenity lifestyle choice continues to improve.

CONCLUSIONS AND RECOMMENDATIONS

Overall, it appears that the Downtown condominium market is stable or growing. Based on the number of planned units and reported pre-sale activity to date on projects under construction, this product type is likely to remain popular with developers. Condos continue to be the highest-value product type in the Downtown area, and an important driver of the renewal and expansion of the City's core.

Market Conclusions

SBFCo's analysis suggests that the average annual absorption rate of about 360 units per year observed in the 2004-2006 period represents the approximate size of the market for new product. The substantial growth in re-sales over the 2001-2006 period suggests an expanding overall market.

Demographic projections over the coming years appear favorable for continued growth in the size of the overall Downtown market. In the aggregate, this factor is likely to outweigh shorter-term concerns over the softening national housing market.

However, the volume of units and projects currently under construction and in planning stages substantially exceeds that of recent years. Depending on the ultimate timing and programming of larger planned projects (including those specifically considered in this study), the market for new product appears likely to become more competitive in the coming years. Coupled with an expanding inventory of re-sale units, this suggests that typical per-project absorption rates may decline marginally over the short to medium term. Current national concerns over appreciation rates and a softening housing market may dampen the prospects for new projects in the short term. However, Milwaukee's condo market appears to be less oriented to speculative buyers and second-home investors than other Downtown markets such as Miami and Chicago. As a result, it is likely to be relatively resilient to "housing bubble" concerns.

Due to their continuing viability, condos are likely to remain a vital component of redevelopment activity in the Downtown area, particularly for cleared new-construction sites such as much of the land in the Park East. Chapter 6 of this report analyzes potential Park East buildout scenarios based on potential long-term absorption rates.

Recommendations

In order to respond to the increasingly competitive market, developers proposing new for-sale projects could:

- Explore opportunities to introduce an array of products such as townhomes that compete for a different buyer profile

- Reduce the overall size of newly proposed projects and/or break projects into more modest phases that can be sold out in a reasonable time frame

- Carefully target new projects to price points that do not overlap too heavily with the planned and under-construction units likely to be delivered at roughly the same time

In recognition of the strength of the condo market, the City of Milwaukee has in recent years enforced a policy of avoiding TID-based gap financing assistance for market-rate residential projects in the Downtown area, as articulated in the Milwaukee Tax Incremental Financing District Guidelines ("TIF Guidelines"). This is possible because achievable price points for new units have been sufficiently high to cover costs of construction and land acquisition while offering developers sufficient profit expectations to justify their risk. However, TIDs have been used to fund public infrastructure improvements in conjunction with such projects. Based on current development activity, this policy appears justified in that numerous projects are proceeding without City gap financing.

As the City considers mixed-use projects with a residential component, it should remain mindful of the following points:

- **Potential for Cross-Subsidy.** If configured and priced appropriately, for-sale residential offers potential to cross-subsidize other components of mixed-use projects, at least partially offsetting financing gaps observed for other product types such as retail and hotel. These financing gaps are discussed in the chapters of this report that cover other land uses.

- **Risk of Competitive Impacts on Existing Projects.** If the City provides gap financing to mixed-use projects with a condo component, it may be indirectly impacting the absorption rates for active projects and the amortization of existing City TID commitments. In particular, this could be an issue in the Park East, where two large new-construction for-sale projects are underway (The North End and the Pabst Brewery redevelopment). Both of these projects are vital to the amortization of their respective TIDs (#48 and #67, respectively). Additional for-sale units in the Park East might compete more directly with these projects than with the general condo market because of their similar new-construction character and proximate location.

3. Retail Uses

Retail floor-plates ranging in size from approximately 8,000 to 100,000 square feet are proposed as an element of eight of the eleven potential development projects. These uses can be highly complementary to upper-floor residential, office, or hotel uses, and may enhance the overall attractiveness and marketability of the projects. In addition, the land use codes governing the development of the Park East require minimum thresholds of transparent ground-floor window areas and minimum depths of “street activating uses” (e.g., uses that provide visual interest for pedestrians) on certain street frontages. While these requirements do not appear to directly mandate retail uses, they are generally most compatible with ground-floor retail.

SBFCo evaluated the retail components of the proposed projects to determine whether they are likely to produce substantial positive economic and/or community development impacts, and thus be more likely to justify City consideration for financial assistance. Retail projects could potentially achieve these goals if they:

- Directly draw spending from areas outside the City of Milwaukee (such as through unique tenancy or co-tenancy)

- Indirectly increase the attractiveness of Downtown, thus making it more attractive for visitors/conventioneers

- Substantially contribute to the revitalization of an area and/or preservation of key assets, thus creating community development benefits

Projects with Smaller Retail Components

The size of the retail component in the majority of the proposed projects is such that it could be considered to have an ancillary character. The majority of the current proposals have retail components of less than 25,000 square feet. This scale is commensurate with several smaller storefront tenants and/or small neighborhood-serving anchors such as restaurants, drug stores, or small food stores. These types of uses can complement and enhance residential, office, and/or hotel uses, but are unlikely to constitute a major destination in and of themselves. Market potential and demand for such smaller storefront space tends to be somewhat site-specific, and can also vary greatly based on the critical mass generated by other uses within and around a project. Overall, the retail components falling below the 25,000 square foot threshold described above do not appear likely to generate substantial economic activity or create substantial competitive impacts on existing retail uses.

Projects with Larger Retail Components

Two proposals, the Ghazi project at 4th and Wisconsin and the RSC project at Jefferson and Ogden, have somewhat larger proposed retail components.

- **RSC Proposal.** The RSC proposal for Block 26 of the Park East corridor incorporates approximately 80,000 square feet of retail, including physical accommodations for two drive-through facilities (coffee shop and bank). Based on *SBFCo*'s current understanding of the physical characteristics of the proposal and current tenant discussions, the likely composition emphasizes convenience and neighborhood-serving uses such as fast food, "fast casual" dining, and other storefront retail. Discussions are reportedly underway with a small entertainment anchor with a bowling/nightlife concept. Although the proposed anchor tenant might have a somewhat broader draw than the smaller stores, it appears unlikely that this would function individually as a regional draw or contribute to a "critical mass" of entertainment uses that might cause an influx of spending from areas outside the City.

  RSC has also gained control over the site immediately to the west (Block 22), and has indicated plans to develop larger-scale retail. Potential tenants include "big box" stores, a large-scale fitness center, and a bowling alley. This scale of retail would likely require some degree of on-site structured parking. As plans for this block are currently less defined than those for Block 26, it is difficult to determine the economic impacts that this additional development might produce. Large-scale retail could capture some spending from City residents who are currently traveling to suburban locations for certain purchases. A major entertainment use such as a bowling alley could provide some complement to the Water Street corridor. A fitness center would likely function as an amenity for local residents and employees. Based on the information available, these uses would produce at most a limited economic impact by potentially capturing some sales activity currently exported to suburban communities. Depending on the specific tenant type, they would also compete to some degree with existing retailers in the Downtown area and elsewhere in the City.

- **Ghazi Proposal.** The Ghazi proposal on the 4th and Wisconsin site incorporates about 100,000 square feet of retail with an emphasis on a range of dining options and entertainment/nightlife uses. The proposal appears to be in the conceptual stages at this time, and therefore it is difficult to assess in detail. However, as noted in the HVS report, these uses could add needed dining and entertainment options directly across Wisconsin Avenue from the Midwest Express Center, enhancing the attractiveness of the overall experience to a typical conventioneer. If these dining and entertainment options function as a "critical mass," they could improve demand for convention and meeting space, thus generating additional visits to Milwaukee and attendant economic activity.

  It should also be noted that the proposed Ghazi retail program holds potential to enhance the viability of the adjacent Shops of Grand Avenue. The Ghazi retail program may have potential to directly complement the current apparel, casual dining, and service focus of the Grand Avenue tenant mix by adding entertainment and restaurant tenants to the area. Current Shops of Grand Avenue management recently announced a plan to invest additional capital into physical upgrades and a repositioning of certain tenancies—a strategy that may enhance the synergies with the Ghazi project. Further, the principals of the two entities have reportedly begun initial conversations to coordinate their leasing strategies.

Parking Costs

In general, the need to provide parking for retail uses appears likely to have substantial impacts on development economics and feasibility for new mixed-use projects in Downtown Milwaukee. For example, many of the 300+ parking spaces earmarked for retail in the RSC proposal are located in structures, with a substantially higher construction cost per space than interior surface or street parking. In general, current prevailing retail rents, reportedly in the $25 per square foot (net) range in the Downtown area, do not appear sufficient to cover the construction cost of retail space plus substantial amounts of dedicated structured parking. Potential strategies for addressing this issue include the following:

- Scale the retail components of mixed-use projects so that they are able to rely on street parking for a more substantial percentage of the overall spaces

- Cross-subsidize ancillary retail uses with upper-floor development, particularly for-sale residential, that appears able to generate enough revenue to cover some degree of structured parking construction

- Position larger-scale retail uses to rely on shared parking facilities (on or off-site) to spread the cost of parking construction across a greater range of uses that may produce peak parking demands at different times of day

Conclusions and Recommendations

Overall, it appears that Ghazi (#6) is the only retail proposal of the group specifically considered here that may generate substantial revitalization and economic impacts. These impacts would likely be felt most strongly in the nearby vicinity of the project, through enhancement of the overall convention experience and creation of a complementary "critical mass" with the Shops at Grand Avenue. It the Ghazi project proceeds, the City should work with the developer to ensure that the project continues to emphasize entertainment and dining of a type complementary to these two adjacent facilities.

The potential impacts from the RSC (#5) proposal are difficult to evaluate at this time because the bulk of the potential retail is located on a block for which the proposed concept is not yet developed in detail. However, it appears that the primary tenancies on Block 26 would be convenience and neighborhood-based, with some potential for an entertainment and/or big box component on Block 22. The potential for economic impact appears limited to the big box and entertainment categories, which would be most likely to concentrate on Block 22. This impact would be at most modest in scale, and predicated on recapturing expenditures currently being made by City residents and Downtown employees in suburban locations. It does not appear likely to function as a driver of new Downtown visitor or shopper traffic.

RSC's proposed programming also represents a departure from the residential-based character envisioned for the Upper Water Street District in the Park East Redevelopment Plan. The inclusion of larger-scale retail in this proposal appears to create financial pressure on the project, causing a reported financing gap.

In general, it appears that large-scale retail development may cause financial impacts on mixed-use Downtown development projects due to the associated parking construction costs. These impacts are most likely to be felt on larger projects, where parking demands significantly exceed available street spaces, and on projects that are somewhat geographically isolated from shared public garages and/or other developments with complementary parking needs (i.e. land uses with different "peak" parking demands).

As a rule, the City should avoid providing financial assistance to address financing gaps created by retail and/or its associated parking unless the retail is of a type and scale that would be likely to cause substantial area revitalization, draw additional visitors to Downtown Milwaukee, and/or greatly complement/reinforce other key Downtown assets. As proposed, it appears that Ghazi (#6) fits this profile. Projects that do not meet these criteria should optimally be considered for assistance only under the following circumstances:

- Other project components create a compelling rationale for public financial participation;
- The size of the retail component is reduced to the minimum level necessary to activate the street and adequately complement other proposed uses in a mixed-use project; and
- Any retail-related structured parking is used to maximum efficiency.

4. Office Uses

At least four of the eleven proposed projects under consideration include proposed office components. However, the RSC project's proposed office component is fairly minimal (approximately 8,000 rentable square feet). Of this group of projects, only one (Ruvin #4) has announced a prospective anchor office tenant—the advertising agency Cramer-Krasselt. This would involve a relocation from the firm's current space at 733 North Van Buren Street on the east side of the Downtown central business district.

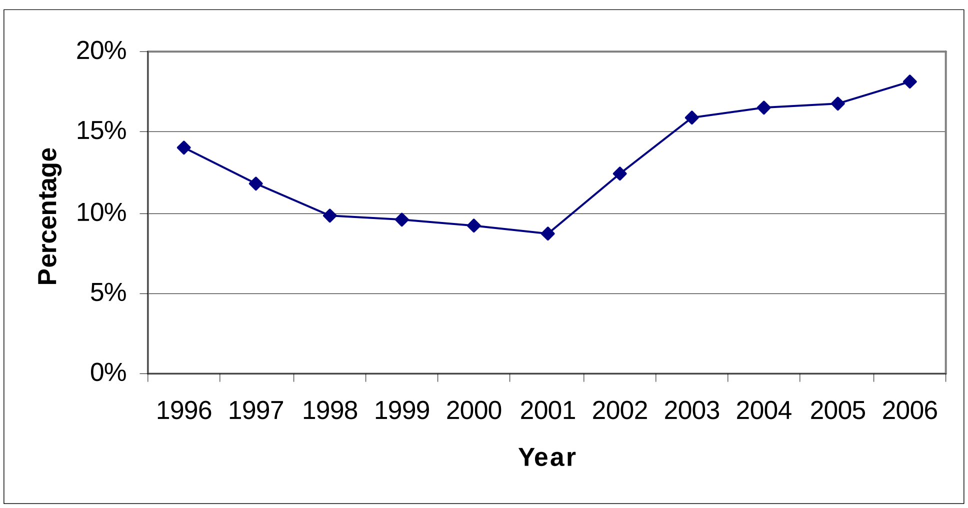
In this section, we discuss:

- General market conditions for Downtown office space
- Financial challenges associated with new office development in Downtown
- Potential competition between new City-supported office development and recent City TID investment in support of the Pabst Brewery project
- Key policy considerations regarding contemplated financial assistance to office projects

General Market Conditions

Time series office market data for Class A and B office for the period between 1996 and 2006 was obtained from RFP Commercial, Inc. (RFP) and summarized in the chart below. RFP's Downtown market area represents sub-set of the overall Downtown market, including all buildings located east of the Milwaukee River. It therefore excludes some Downtown space, such as the Schlitz Park development. However, this data represents the most consistent time series information on Downtown vacancy that *SBFCo* has located.

Downtown Milwaukee Class A & B Historic Vacancy Rates



Source: RFP Commercial and *S. B. Friedman & Company*

Since 1996, the regional Class A and B office markets have broadly reflected the nationwide economic cycle of growth in the 1990s and decline in the early 2000s. The chart above summarizes the annual vacancy rates for Downtown Class A and Class B office space between

1996 and 2006. As shown in the chart above, strong national economic growth in the late 1990s was paralleled by relatively low vacancies in the Downtown Milwaukee office market.

Following the start of the national economic downturn in 2001, vacancy in Downtown has increased steadily and is currently at its highest percentage in over a decade. This suggests that a lack of available space is not constraining Downtown employment.

Based on interviews conducted by *SBFCo* in 2006, there has been little natural growth in overall Downtown office demand from existing tenants in recent years, and little is anticipated due to a general lack of major firms in a high-growth mode. The anticipated completion of the Marquette Interchange construction project in late 2008 may improve Downtown's overall regional competitiveness and image. In addition, niche opportunities for small scale, loft style rehab office space may exist, especially on the edges of Downtown in neighborhoods such as Walker's Point, the Historic 3rd Ward, and the redeveloping Pabst Brewery. These types of spaces generally appeal to smaller, image-oriented service businesses such as advertising, marketing, architectural, and certain law firms.

Downtown rents range up to $16 per square foot net plus parking costs and are anticipated by the RFP study to be flat in the near term. Interviews indicate that rents have declined in absolute terms in recent years, especially in buildings that are not in the upper echelon of properties.

While the overall Downtown vacancy rate has increased in recent years, there has been positive net absorption Downtown from 2003 to 2006, as shown in the figure below:

Downtown Milwaukee Class A & B Net Absorption 2003 to 2006

	2003	2004	2005	2006	Net Absorption 2003 - 2006
Vacancy Rate	15.88%	16.54%	16.76%	18.09%	
Net Absorption	147,203	(41,941)	48,077	(52,492)	100,847
Total Space	6,198,467	6,197,232	6,309,113	6,309,113	
Implied Occupied Space	5,214,150	5,172,209	5,220,286	5,167,794	

Source: RFP Commercial and *S. B. Friedman & Company*
Note: area definition only includes buildings located east of the Milwaukee River

Recent Downtown office developments have tended to occur only under the following circumstances:

- **Attraction of a Major Tenant from Outside Downtown.** The most recent significant example of this type is the addition of Manpower Inc.'s world headquarters to the Schlitz Park complex. This development is expected to enter the Downtown market in 2007, causing an increase of about 300,000 square feet in both Class A/B inventory and occupied space. In addition, proposed Downtown projects have recently competed for major regional tenants such as GE Healthcare's major new facility, which ultimately was developed in the Milwaukee County Research Park in Wauwatosa. The development of the 875 East Wisconsin building also recently attracted Roundy's Supermarkets, Inc. headquarters from outside Downtown.

- **Moving of an Existing Downtown Tenant.** A review of recent market activity indicates that newly developed buildings, such as Cathedral Place and 875 East Wisconsin, have been successful in recent years in part by moving existing Downtown tenants into new space as their leases expire. A major tenant within Cathedral Place is law firm Whyte Hirschboeck Dudek S.C., which moved from another Downtown location. Artisan Partners and Ernst & Young also moved from Downtown locations into 875 East Wisconsin. The recently contemplated 42-story Lake Pointe Tower project was discussed as a potential relocation site for Robert W. Baird headquarters, but Baird recently renewed its lease in the 777 East Wisconsin (U.S. Bank) building.

It appears that at least in the near term, any substantial office proposals will continue to be driven by pre-leasing commitments from the two types of tenants described above. The Ruvin proposal involving the relocation of Cramer-Krasselt follows this pattern.

Financial Feasibility and Parking Challenges

The cost of constructing parking is one of the primary factors causing financial challenges for new office development in Downtown Milwaukee. Market research by *SBFCo* indicates that most if not all suburban office parks in the region offer free parking, with most cars parked in surface lots. Some projects have limited enclosed executive parking in these suburban locations.

Due to a lack of land availability and denser development patterns, Downtown office buildings must frequently park employees in structured parking decks. Currently, the rent premiums attainable for Downtown space do not appear large enough to make up for the more expensive structured parking format. The City owns four Downtown parking decks, and leases some of the spaces in these decks to developers to support Downtown buildings. However, the City has committed the bulk of the spaces available for long-term lease.

Several proposed Downtown area office projects, most notably the Manpower Inc. headquarters, have recently requested City assistance primarily to cover the cost of building a parking structure. Unless net rents escalate substantially from their current levels, it is likely that this trend will continue. However, the cost of providing structured parking can vary substantially from project to project, primarily based on the following factors:

- **Parking Structure Design**. The large, rectangular stand-alone structure built for the Manpower project represents the more cost-efficient end of spectrum for enclosed parking. Facilities with more elaborate exterior skinning, irregular shapes, or more complex integration with other building components are likely to cost more to build on a per-space basis.

- **Potential for Shared Use.** In some circumstances, it may be possible to make the same inventory of parking spaces available for office users during prime demand periods (weekdays during working hours) and other users such as restaurants and entertainment facilities during off-peak hours. This can help to reduce the overall required parking ratio of spaces per square foot of office space, thus reducing the size and cost of the parking facilities to be built. This approach requires complementary uses to be located in close proximity, and may be incompatible with certain anchor office tenants' desire to have full-time dedicated spaces.

- **Potential to Leverage Existing Facilities.** In some cases, the City may be able to lease existing parking assets to support proposed projects. While Downtown Milwaukee parking lease rates reportedly do not tend to cover the construction costs of parking facilities, this may be a way to maximize usage of existing assets, while reducing the overall need to build new parking with City assistance.

City Investment in Pabst Brewery Project

The City has agreed to bond about $13.5 million on an up-front basis in support of the redevelopment of the Pabst Brewery. This initial TID funding is helping the master developer introduce new infrastructure and address site deficiencies such as environmental contamination. The master developer intends to make physical improvements to get the site into a marketable condition, and then convey individual blocks and buildings to end developers. The City's funding commitment to the project also allows the master developer to access additional funding up to about $15.5 million in conjunction with specific land sales and development proposals. However, additional City funding is only to be provided if the Developer demonstrates that the level of development commitments is sufficient to amortize the City's entire TID commitment. Therefore, only the City's $13.5 million up-front commitment is currently "at risk."

The development program at the Pabst Brewery is expected to change over time as specific end users come forward with proposals. However, the master developer's conceptual plans for the project area include about 573,000 square feet of office space. This office development opportunity is comprised of buildings targeted for adaptive re-use and a cleared full-block site with potential for new construction.

It is important to note that City assistance to the Pabst project was provided solely to address site deficiencies, and does not address the financial challenges of providing structured parking for office or retail uses. The Pabst Brewery developer is currently attempting to develop a 1,200-space shared parking structure at its own cost to serve multiple uses within the complex. City assistance to other office proposals in the nearby vicinity to offset structured parking costs could therefore inhibit the ability for the Pabst project to compete on an economic basis for tenants.

Economic feasibility analyses performed by *SBFCo* on behalf of the City included a projection of the overall amortization of the Pabst Brewery TID. This projection discounted the master developer's office program somewhat, assuming the development of approximately 330,000 square feet of office space on the site between 2009 and 2017. However, even in reduced form, this office development represents a significant component of the overall re-use potential of the Pabst site and the potential for payback of the City's $13.5 million at-risk investment. Particularly in light of this substantial public investment, it important for the City to consider potential impacts on the Pabst site if it provides financial assistance to other projects that are likely to compete directly for tenants or market share.

Conclusions and Recommendations

The Downtown office market has seen increasing vacancies in recent years while successfully absorbing some new product. The costs of structured parking make building unsubsidized new office space in Downtown at current rent levels difficult if not impossible in the near term. It is economically vital for the City that Downtown Milwaukee remain a major office center and compete effectively for new employment generators. However, new multi-tenant Downtown office buildings have recently been possible at least in part because they have relocated tenants from existing Downtown buildings. City participation in office deals creates a risk that major Downtown tenants will develop an expectation of public financial assistance to facilitate a periodic "re-shuffling" of employers within the same submarket. Further, it creates the potential for heightened conflict between existing building owners and prospective developers of new space. As noted in the City's existing TIF Guidelines, it is a specific policy goal to work toward establishing the Downtown office market as being self-sustaining without TIF assistance.

The City should consider undertaking a detailed analysis of the current configuration and quality levels of the existing inventory of Downtown office space. This analysis could assess how vacancies are currently distributed across the Downtown buildings and whether large enough blocks of contiguous high-quality space are available to attract new high-profile tenants. This type of analysis would help create a strategic basis for making decisions about:

- How best to encourage the consistent introduction of newer, more attractive space into the Downtown market to maintain and increase the competitiveness of this submarket.

- Where and how new office space should be concentrated to raise the profile of the Downtown submarket, reinforce clustering of employment, and build on amenities.

In the absence of a more formal framework of this type, the City should be judicious when considering whether to provide financial assistance for Downtown office projects. Considerations that could justify some level of City support for office development include whether:

- Project support is needed to attract a new employer to the City

- Project support is needed to retain a key employer whose space needs cannot be reasonably met in the existing Downtown inventory

- The proposed project would substantially contribute to the periodic upgrading of the Downtown Milwaukee office inventory to include the technology infrastructure, amenities, and floorplans needed to compete regionally and nationally

- The proposed project is strategically located to reinforce the strength and attractiveness of the existing office core

- The parking strategy for the proposed project is efficient and cost-effective

- The proposed project would not directly and substantially threaten the payback of an existing City investment such as the TID support for the Pabst Brewery redevelopment

- More dated buildings in the Downtown inventory, particularly those directly impacted by a specific proposal, have adequate potential for re-use by a different class of tenant or conversion to a different use, such as residential

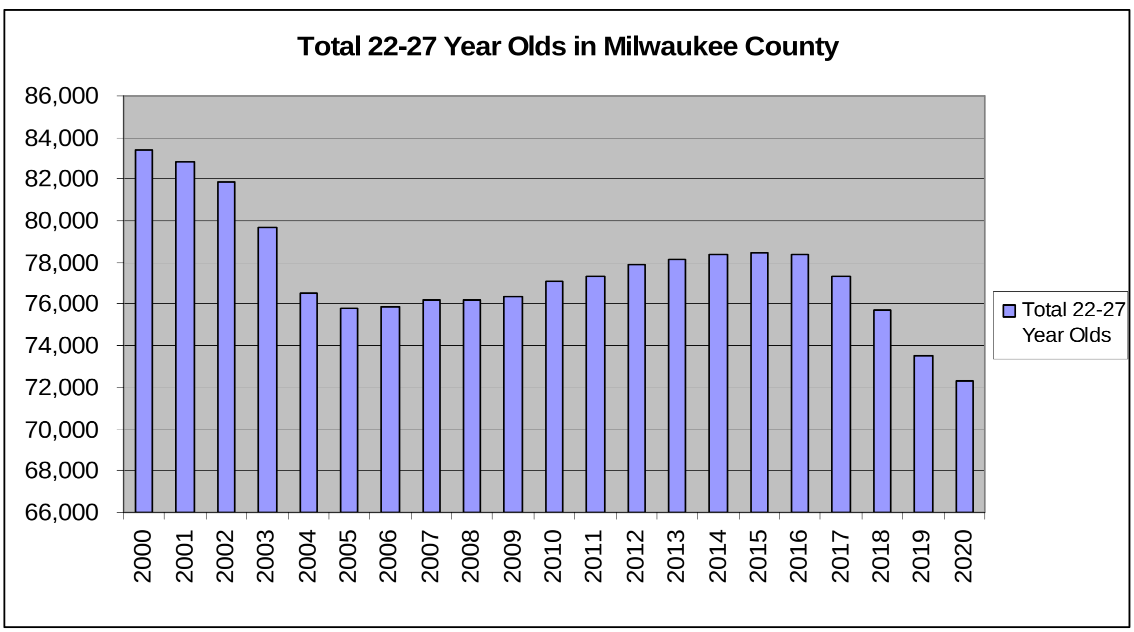
5. Rental Apartments

Only one of the proposed mixed-use redevelopment concepts (#5: RSC) currently incorporates a rental residential component.

Based on recent overview-level research by *SBFCo* and discussions with developers, rental residential appears to exhibit positive market performance in the Downtown area. A sampling of Downtown rental projects conducted by *SBFCo* in 2006 yielded strong occupancy rates, averaging 97%, as summarized in the table on the following page.

The market prospects for apartments are likely to be further enhanced in the coming years by two general trends:

- **Entry of the "Boom Echo" Cohort.** Nationally, the children of the post-World War II "baby boom" generation are entering the apartment market in greater numbers as they reach the age range of 22-27. This trend is generally projected to occur between 2005 and 2015, and has fueled increased national investor interest in purchasing existing apartment complexes. As a result, cap rates on apartments have trended downward, reflecting higher sale prices and investor expectations of higher occupancies and rents in future years. The chart below illustrates estimated and projected population trends for the 22-27 age cohort in Milwaukee County. As shown in the chart, this cohort is anticipated to grow through 2015.



Source: Woods & Poole Economics, Inc.

Sample Rents and Occupancies for Downtown Apartments

Development	Neighborhood	Year Built/ Rehabbed	Total Units	Occupied Units	Occupancy Rate	Average Unit Size (all units)	Average Rent (all units)	Average Rent per SF (all units)
Boston Lofts	West Town	2003	72	72	100%	1,581	$ 1,812	$ 1.15
East Point Commons	East Pointe	1992	188	180	96%	1,060	$ 1,346	$ 1.27
Gaslight Lofts	Third Ward	2004	138	137	99%	1,163	$ 1,533	$ 1.32
Jefferson Block	Third Ward	2003-2005	217	217	100%	1,345	$ 2,458	$ 1.83
Juneau Village Towers	East Town	1995	598	568	95%	840	$ 1,018	$ 1.21
Lake Bluff at East Pointe	East Pointe	1998	110	106	96%	1,240	$ 2,022	$ 1.63
Library Hill	East Town	2000	139	131	94%	861	$ 1,037	$ 1.20
The Franklin at East Point	East Pointe	1999	114	111	97%	1,027	$ 1,404	$ 1.37
Trostel Square	Brewers Hill	2002	99	98	99%	977	$ 1,228	$ 1.26
				Minimum	94%	840	$ 1,018	$ 1.15
				Maximum	100%	1581	$ 2,458	$ 1.83
				Average	97%	1122	$ 1,540	$ 1.36
				Median	97%	1060	$ 1,404	$ 1.27

Source: *S. B. Friedman & Company* and building operators

- **Condo Conversions.** Condo conversions have been popular in recent years in conjunction with national trends favoring condominium living, including favorable demographics (particularly growth in empty nester cohorts), lifestyle trends, and low home mortgage interest rates. Locally, this is exemplified by high-profile conversion projects such as the Blatz and Lake Bluff apartment complexes. While the Blatz in particular has exhibited rapid absorption into the condo market, this trend is shrinking the stock of available apartments in the Downtown area, thus further tightening the market.

However, the chief problem facing Downtown apartment development appears to be the rents that can be attained. Although occupancies are high, discussions with parties active in the industry indicate that the renter pool is perceived to be highly price sensitive, limiting the rate at which landlords can raise rents. In turn, the limitations on attainable rents may make the economics of developing market-rate apartments challenging.

The table below evaluates the economics of a hypothetical apartment project attaining rents in line with the Downtown market.

Hypothetical Apartment Development- All Numbers Expressed per Square Foot

Monthly Rent		$ 1.50
Annualized		$18.00
Less Assumed Vacancy	5%	$ 0.90
Less Assumed Expenses & Taxes	35%	$ 6.30
Net Operating Income		**$10.80**
Divided by Cap Rate	7%	
Implied Value		**$154.30**
Typical Downtown Condo Values		**$250-350**

The hypothetical example above would be expected to attain a value of approximately $154 per square foot at completion. For comparison purposes, recent condominium projects in the Downtown area appear to be generally attaining sales prices in the $250 to $350 per square foot range. Therefore, unless a developer can construct a market-viable apartment complex at a substantially lower cost (on the order of 50-70% less) than condos, it will be difficult to attain financial feasibility while still paying market price for land and achieving a reasonable rate of profit.

Discussions with local real estate professionals also confirm that development of market-rate apartments in Downtown Milwaukee is not generally feasible in the current rent environment. It is likely to be particularly difficult to construct market-rate units in areas where structured parking is required by virtue of zoning regulations and/or site configuration. While condominiums generally require at least one dedicated enclosed parking space per unit to meet market expectations, apartment product is more likely to remain attractive to renters even if some or all parking is at-grade and not covered. It may generally be easier and more cost-effective to provide parking for rental apartments on sites where the ground floor of an existing structure with a large floorplate can be re-used, or where the site is configured to allow surface parking without creating a major negative impact on the building's relationship to the street.

Several non-market-rate rental apartment projects have recently been proposed or completed in the Downtown area with the assistance of various federal tax credit programs. Gorman & Company, Inc. a Madison-based developer, recently completed the Park East Enterprise Lofts with the assistance of federal Low-Income Housing Tax Credits (LIHTC) and the Historic 5th Ward Lofts with a combination of LIHTC and Historic Tax Credits (HTC). Both of these projects contain a mixture of market-rate and affordable units. Mandel Group has recently sought tax credits to assist in the economics of an apartment component of the North End project in the Park East. In addition, a LIHTC and HTC-supported rental building is proposed within the Pabst Brewery complex, again with a partial market-rate component.

Conclusions and Recommendations

Overall, it appears that the Downtown rental apartment market is healthy and likely to improve in the future. Without financial assistance, however, new construction of market-rate product will probably be constrained by the financial feasibility challenges discussed above. Project-specific opportunities to add rental apartments may arise, particularly for re-use of buildings that can achieve eligibility for federal historic preservation-related tax credits.

Rents should escalate in the coming years as demographic conditions continue to improve. This may improve the financial feasibility of market-rate apartment development in the Downtown area.

The City's TIF Guidelines currently indicate that TID assistance will not generally be considered in the form of "gap financing" for market-rate housing in the Downtown area. A divergence from this policy would allow new supply to enter the market in advance of the rent increases that would otherwise be necessary to justify this type of development.

It should also be noted that land prices for market-rate apartment development sites, at least in the near term, are unlikely to be based on the economics of apartment construction. Rather, they would likely reflect recent acquisition costs for condo sites, which have been in the range of $30 per square foot in the Park East. If developers begin to move away from condominiums in favor of for-rent residential based on market considerations, the costs of undeveloped land should theoretically change to reflect the different economics of apartment development.

Further, if the City chooses to assist market-rate rental projects with gap financing, it should consider a policy of making such assistance available only in the form of loans, as opposed to grants. This appears justified by the underlying strength of the Downtown apartment market.

6. Park East Land Absorption Analysis

Six the eleven proposed mixed-use redevelopment concepts are located in or adjacent to the Park East. The Park East is also the single largest area of available land for development in the Downtown. This chapter contains a projection of the range of time frames over which the most prominent development parcels in the district might be expected to build out under predominantly market-driven conditions. This in turn facilitates comparison with the amount of development-ready land that has recently entered the market in the Park East area.

Because market-rate for-sale residential development has been the dominant real estate product type in the Downtown market and the vicinity of the Park East in recent years, this projection is based on observed absorption rates for this land use in the Downtown market.

Key Assumptions

This scenario is based on the following key assumptions:

- The primary land inventory available for development in the Park East area was estimated at 35 acres and includes:

    - Portions of the following blocks (as defined in the Park East Renewal Plan and Development Code documents adopted in June 2004): 1, 2, 4, 6, 7, 8, 10, 12, 13, 16, 17, 19, 22, 26, totaling approximately 24 acres

    - The Flatiron and The North End sites totaling approximately 6 acres

    - Block 1 and the southern portion of Block 4 of the Pabst Brewery site (areas most likely to accommodate for-sale residential), totaling approximately 4 acres.

  The properties included in this total are all major vacant parcels within the Park East TID, other sites likely to be readily developable (such as surface parking lots), and the portions of the Pabst Brewery site deemed most likely for condo development per the developer's conceptual plan.

- In order to account for other land uses consuming a portion of the available land in the area, we have assumed that one-third of the primary land inventory will be consumed by non-residential uses. Therefore, the land area analyzed represents two-thirds of the total calculated above.

- The future annual market demand for new condominium units on the Downtown area was assumed to continue at the average estimated pace from 2004 to 2006—approximately 360 units per year. As discussed in a prior section, there are multiple factors that could speed up or slow down this estimate.

- The existing inventory of unsold and under-construction units (excluding units programmed within the North End and Flatiron projects) is approximately 740 units or, roughly two years of inventory at an annual absorption pace of 360 new units per year.

- The average density of buildout within the Park East mirrors that of The North End project's condominium density, 80 units per developable acre.

Range of Buildout Estimates

This analysis tests the potential Park East land consumption under three market capture scenarios:

- **Scenario 1** assumes that after the current stock of unsold and under-construction units in the Downtown area is exhausted, the Park East captures 100% of the annual new unit demand of 360 units per year—a highly aggressive assumption intended to define the fastest end of the range of possible outcomes

- **Scenario 2** assumes 50% capture of Downtown-wide new unit demand, representing a potentially aggressive but feasible capture rate depending on the number of new projects introduced in the district

- **Scenario 3** assumes 33% capture of Downtown-wide new unit demand, representing a feasible and potentially conservative capture rate

The tables below summarize the key assumptions and indicates that, under the range of scenarios described above, it would likely require between 7 and 18 years for the Park East area (including the for-sale residential blocks of the Pabst project) to build out with condominium uses.

Base Assumptions

Estimated Total Developable Land in the Park East Area	35
Assumed % of Park East Area Land to be Developed with Condos	67%
Estimated Density of Condo Projects (units per acre)	80
Estimated Total Condo Unit Potential for Park East Area	1,847
Estimated Annual Demand for New Downtown Condo Units	360

Buildout Time Frames

	Scenario 1	Scenario 2	Scenario 3
Assumed % of Total Downtown Condo Market Captured by Park East Area	100%	50%	33%
Assumed Number of Condo Units Absorbed in Park East Area per Year	360	180	119
Estimated Years to Absorb 67% of Land in the Park East Area with Condos	5	10	16
Estimated Years of Condo Product Available or Under Construction in Downtown	2	2	2
Total Years to Absorb 67% of Land in the Park East Area with Condominium Development	**7**	**12**	**18**

This buildout time frame could conceivably be shortened under a number of circumstances, such as if:

- The overall market for new condos continues to expand in the Downtown area
- Lower-density residential products such as townhomes are introduced in certain portions of the Park East
- Non-residential land uses consume more than the assumed one-third of available land area

Conclusions

The above exercise provides some context as to the rate at which market demand might arise for the land inventory available in the Park East area. There is currently a significant amount of development underway in the Park East area, including two major multi-phase projects (The North End and the Pabst Brewery). The for-sale residential portions of these projects encompass over 10 acres.

This suggests that the current pace of development in the Park East is fairly substantial within the context of the total size of the Downtown market. The fact that at least five additional proposals with some programmatic overlaps are currently under consideration in the Park East indicates that the amount of prepared land simultaneously offered for development in this area may exceed current market capacity.

With respect to other proposed or future proposed projects in the Park East area, the City should consider the following:

- The buildout of the Park East is likely to be a long-term proposition, and expectations should be calibrated to the overall capacity of the market to absorb substantial amounts of development-ready land.

- The City should carefully consider the potential for overlaps between proposals, particularly within the Park East area. The large available land inventory and potential for public assistance may cause too many competitive conflicts between simultaneous projects.

- If the City decides there is a compelling strategic reason to consider subsidizing a project with gap financing in the Park East, the potential competitive impacts on projects such as The Brewery in which the City has an existing investment should be evaluated and mitigated if possible.

- If there is no compelling strategic reason to subsidize project other than to catalyze development activity in the Park East, it may be more desirable to allow market demand to drive the pace of buildout.

It is also important to note that this inventory of development-ready land adjacent to Downtown Milwaukee represents a substantial economic development resource—one that would be difficult and costly to replicate. A measured pace of development on the Park East-area land would allow the City to reserve some acreage for large-scale economic development initiatives in the future, such as expansions of Downtown activity generators or the introduction of additional major employers.

7. Conclusions and Recommendations

The current group of proposals under consideration by the City presents a number of complicated and intertwined policy questions regarding economic development strategy, the use of public resources, and the interaction between government policy and private markets. The City's consideration of these proposals is also strongly linked to its overall strategy for facilitating the beneficial development of the Park East.

Our conclusions are organized around the following questions:

- How do the different land use components of the proposed projects compare in terms of their potential economic impacts and their need for City assistance?
- Is there a broader rationale for the City to provide development subsidies in the Park East to create and maintain development momentum?
- What policy precedents may City assistance create, particularly with gap financing assistance to new-construction projects in the Park East?
- What policies should the City consider for evaluating requests for assistance in the Downtown area?

Land Use Types: Impacts and Financing Gaps

The preceding chapters of this report have individually treated all major land uses encompassed in the eleven proposed projects with the exception of hotels, which are specifically analyzed in HVS International's companion report. The key conclusions relating to specific land uses are summarized below:

- **Condominiums.** Condos currently appear to be the sole real estate product type that can consistently develop in the Downtown area (including associated parking) under market-rate conditions without City assistance. They can play an important "cross-subsidization" role in mixed-use projects, allowing these developments to proceed with little or no City assistance. The Residences on Water Street project (DOC/#1) appears to be an example of this phenomenon. The continued development of condos in the Downtown promises to bring added population, retail spending, and activity to the area, but the direct economic impacts associated with each individual project are likely to be minimal. The current City policy of avoiding gap financing for market-rate condo projects appears to be justified based on these points.
- **Retail.** In general, small-scale retail development in the Downtown area appears feasible on appropriate sites as a ground-floor use within mixed-use buildings. Larger-scale retail appears likely to encounter financial feasibility challenges if the associated parking is required to be developed in structures. Retail is an important amenity for other land uses, but in general does not generate major economic impact on its own, and therefore should

not be a prime candidate for City assistance. Of the eleven projects specifically treated in this report, only Ghazi (#6) appears to contain a retail component that would be likely to create substantial economic benefit. This retail proposal has potential to improve the quality of the convention experience and provide a beneficial supporting presence to the Shops at Grand Avenue.

- **Office.** In general, office development in the Downtown area faces substantial economic challenges due to prevailing net rents that do not tend to cover the construction costs of new space and its associated parking. City assistance for proposed office projects should be considered on a case-by-case basis, predicated on potential economic impacts, as articulated further in the specific chapter on Office uses. In particular, projects bringing new employment to the City may merit assistance. However, major catalytic projects that enhance Milwaukee's competitiveness or achieve other important economic development objectives may also warrant consideration.

- **Apartments.** Although the Downtown apartment market appears healthy and likely to improve, market-rate projects do not generally appear economically feasible at this time based on prevailing rents. The City may choose to support new apartment development as a way of diversifying Downtown housing stock and meeting pent-up demand. This approach would likely serve to limit the growth in rental rates, making it less likely that prevailing market rents will achieve levels that may justify new construction. Apartment development is likely to have similarly limited direct economic impacts to condo projects.

Subsidies to Promote Development Momentum

The Park East represents a substantial amount of developable land advantageously located in the Downtown area. The value and potential of this resource is further enhanced by the City's investments to date to provide infrastructure and prepare sites for development. However, the fact that little physical change has occurred to date on the large, publicly owned sites in the core of the district has caused some observers to suggest that the City may lose momentum and suffer image problems if extensive development does not begin on this land in the near term.

It should be noted that, excluding the Manpower headquarters, four substantial development projects have begun physical construction activity in and immediately adjacent to the Park East within the past year:

- The Flatiron;
- The Residences on Water;
- The North End; and
- The Pabst Brewery redevelopment.

Collectively, these projects represent substantial investment (about $400 million in total projected development value) and development momentum in the area. As analyzed in Chapter 6 of this report, the market-driven pace of development in the Park East suggests an overall absorption time frame of roughly 7 to 18 years, assuming a predominantly for-sale residential buildout. Even with the potential for major non-residential uses on some blocks, this represents a significantly more gradual pace of land consumption than the schedule on which publicly-owned sites have been made available to the market. The fact that there are significant overlaps in the programming of the current proposals for County-owned Park East land further reinforces the idea that the pace of public land disposition exceeds true market demand.

Although TID assistance can help projects overcome financial feasibility challenges, it does not typically expand the underlying size of the market. The City should therefore be mindful of the risk that publicly assisted projects in the Park East may cause supply of certain real estate products (including prepared development sites) to outpace demand. This could in turn hurt the viability of individual projects, including developments that the City has previously assisted with at-risk general obligation bonding.

In particular, the Pabst Brewery redevelopment proposal represents a more challenging development opportunity than most sites in the Park East due to its adaptive re-use driven character, substantial site deficiencies, and infrastructure needs. The City-assisted development strategy calls for the developer to prepare development-ready building shells and cleared sites and market these opportunities to third-party end developers. The development program at the Pabst sites calls for many of the same land uses currently under discussion in the Park East, including for-sale and rental residential, office, and retail. The availability of City assistance for competing projects in the Park East could hinder the already challenging Pabst redevelopment process, putting at risk the overall viability of the project and the approximately $14 million in City funding already committed.

It should also be noted that the assistance provided to the Pabst Brewery project was not predicated on offsetting the cost of structured parking, but rather to bring the bring the site to a development-ready condition. Therefore, City assistance for competing projects on development-ready sites in the Park East to address parking costs would represent a higher level of subsidy than that provided to the Pabst project, creating a potential fairness issue.

Potential Policy Precedents

The publicly owned land in the Park East is generally comprised of development-ready sites in a strong location with available infrastructure, facilitated by prior City investment of more than $20 million and total public investment of about $47 million. The publicly funded improvements to date represent a core use of TID financing—to assist with site preparation and infrastructure to facilitate the redevelopment of land.

The current mixed-use proposals for the Park East provoke the policy question: is public assistance warranted and required to facilitate market-rate development on prepared sites in one of the highest-value areas of the City of Milwaukee?

If the City elects to provide gap financing in this context, it runs the risk of:

- Indirectly subsidizing the land prices paid by developers for Park East land, thus artificially inflating land values and increasing the likelihood that future projects will face financing gaps;

- Creating a precedent that TID assistance may be available for projects in higher-value areas of the City for reasons other than for public infrastructure or to correct extraordinary site deficiencies.

It is important that any City assistance provided as "gap financing" in the Park East be based on a specific policy rationale that can be used to provide clear direction to the real estate community. Otherwise, it may serve as precedent to encourage land speculation based on the expectation of TID assistance for other projects in the future.

Potential Policy Guidelines for Providing Assistance

In addition to the TID Guidelines that currently influence staff evaluation of projects, *SBFCo* recommends that the City consider the following policy guidelines as it evaluates how best to facilitate Downtown development in the coming years:

- If the City elects to provide gap financing to Park East projects, it should consider taking a more pro-active stance in defining its desired timing and programming of development. City assistance could be provided only to projects that explicitly fit within its Master Plan goals for the McKinley Avenue, Lower Water Street, and Upper Water Street districts of the Park East. Alternatively, the City could delineate the location(s) in the Park East where it would be willing to invest in an efficient, centralized parking facility to support highly catalytic development such as employment-generating office uses on surrounding sites.

- Particularly in evaluating potential support of development-ready sites, the City should evaluate whether the developer's land acquisition cost is commensurate with the mix of uses proposed. Because Downtown zoning tends to be flexible as to land use, market prices for development sites would be expected to be set based on the highest-value developable use. In recent years, this product has tended to be condominiums. However, if perceived softening of the condo market prompts developers to propose lower-value product types such as office, hotel, apartments, or retail, land acquisition costs should reflect this lower value. Otherwise, City assistance would have the effect of artificially inflating land prices.

- In light of the potential for competition between the numerous active and proposed Downtown projects, the City should consider selecting the appropriate TID financing vehicle based on the specific market risk characteristics of the proposed project. For example, a project that appears somewhat speculative could warrant a developer-financed TID agreement to allow the City to minimize its exposure to development risk. After such a project was completed and achieved stabilization, the City could "take out" its obligation to repay the developer using lower interest general obligation bonding.

- In some cases, particularly for product types with strong market conditions such as apartments, the City may consider providing TID financing in the form of loans, as opposed to grants.

- The City should continue incorporating an "up-side participation" in development agreements for Downtown projects receiving public assistance, particularly if TID assistance is being provided to mitigate market conditions, as opposed to site deficiencies.

The City may also want to consider undertaking a detailed analysis of the current configuration and quality levels of the existing inventory of Downtown office space, as described in greater detail in Chapter 4 of this report. This could serve as a basis for an intentional strategy of supporting an appropriate amount of continuous reinvestment to ensure that Downtown maintains and increases its competitiveness as an employment center.

Appendix: Limitations of Our Engagement

Our report is 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. The sources of information and bases of the estimates and assumptions are stated in the report. 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 described in our report, and the variations may be material.

The terms of this engagement are such that we have no obligation to revise the report to reflect events or conditions that occur subsequent to the date of the report. These events or conditions include, without limitation, economic growth trends, governmental actions, additional competitive developments, interest rates, and other market factors. However, we will be available to discuss the necessity for revision in view of changes in the economic or market factors affecting the proposed project.

Our study did not ascertain the legal and regulatory requirements applicable to any project, including zoning, other state and local government regulations, permits, and licenses. No effort was made to determine the possible effects of present or future federal, state, or local legislation, including any environmental or ecological matters.

Furthermore, we neither evaluated management's effectiveness for any project, nor will we be responsible for future marketing efforts and other management actions upon which actual results will depend.

Our report is intended solely for the City of Milwaukee’s information and should not be relied upon by any other person, firm, corporation, or for any other purposes. Neither the report nor its contents, nor any reference to our Firm, may be included or quoted in any offering circular or registration statement, appraisal, sales brochure, prospectus, loan, or other agreement, or in any document intended for use in obtaining funds from individual investors. The report summarizes preliminary findings which are subject to modification based on additional research and analysis.