

MILWAUKEE COUNTY FISCAL NOTE FORM

DATE: March 9, 2016

Original Fiscal Note

Substitute Fiscal Note

SUBJECT: Transfer of the Kahler Building, the 2015 East Addition and portions of the Saarinen Building to the Milwaukee Art Museum as well as the sale of the O'Donnell Park parking structure improvements.

FISCAL EFFECT:

- | | |
|---|--|
| <input type="checkbox"/> No Direct County Fiscal Impact | <input type="checkbox"/> Increase Capital Expenditures |
| <input type="checkbox"/> Existing Staff Time Required | <input type="checkbox"/> Decrease Capital Expenditures |
| <input checked="" type="checkbox"/> Increase Operating Expenditures
(If checked, check one of two boxes below) | <input type="checkbox"/> Increase Capital Revenues |
| <input type="checkbox"/> Absorbed Within Agency's Budget | <input type="checkbox"/> Decrease Capital Revenues |
| <input checked="" type="checkbox"/> Not Absorbed Within Agency's Budget | |
| <input type="checkbox"/> Decrease Operating Expenditures | <input type="checkbox"/> Use of contingent funds |
| <input type="checkbox"/> Increase Operating Revenues | |
| <input type="checkbox"/> Decrease Operating Revenues | |

Indicate below the dollar change from budget for any submission that is projected to result in increased/decreased expenditures or revenues in the current year.

	Expenditure or Revenue Category	Current Year	Subsequent Years
Operating Budget	Expenditure	\$355,000	See Explanation
	Revenue		
	Net Cost	\$355,000	See Explanation
Capital Improvement Budget	Expenditure		
	Revenue		
	Net Cost		

DESCRIPTION OF FISCAL EFFECT

In the space below, you must provide the following information. Attach additional pages if necessary.

- A. Briefly describe the nature of the action that is being requested or proposed, and the new or changed conditions that would occur if the request or proposal were adopted.
- B. State the direct costs, savings or anticipated revenues associated with the requested or proposed action in the current budget year and how those were calculated. ¹ If annualized or subsequent year fiscal impacts are substantially different from current year impacts, then those shall be stated as well. In addition, cite any one-time costs associated with the action, the source of any new or additional revenues (e.g. State, Federal, user fee or private donation), the use of contingent funds, and/or the use of budgeted appropriations due to surpluses or change in purpose required to fund the requested action.
- C. Discuss the budgetary impacts associated with the proposed action in the current year. A statement that sufficient funds are budgeted should be justified with information regarding the amount of budgeted appropriations in the relevant account and whether that amount is sufficient to offset the cost of the requested action. If relevant, discussion of budgetary impacts in subsequent years also shall be discussed. Subsequent year fiscal impacts shall be noted for the entire period in which the requested or proposed action would be implemented when it is reasonable to do so (i.e. a five-year lease agreement shall specify the costs/savings for each of the five years in question). Otherwise, impacts associated with the existing and subsequent budget years should be cited.
- D. Describe any assumptions or interpretations that were utilized to provide the information on this form.

A. Approval of the attached resolution would authorize transfer of the Kahler Building, the 2015 East Addition, and portions of the Saarinen Building to Milwaukee Art Museum (MAM), as well as sale of the O'Donnell Park parking structure improvements (but not the underlying land) to the Art Museum, and related actions, consistent with the attached term sheet.

B. There are \$355,000 in current year direct costs related to the agreement.

The \$355,000 includes \$165,000 for outside expenses that are necessary to perform the due diligence analysis and fiscal analysis on the agreement. These costs include outside counsel fees (for the County and the WMC), financial advisory fees, engineering fees and any other fees that are necessary to facilitate the due diligence work and financial analysis on the transaction.

The \$355,000 also includes \$190,000 related to the first year of a 10-year payment plan associated with an arbitration settlement of \$1.9 million. The arbitration settlement relates to disputes between the County and the MAM in the implementation of the capital projects that were agreed to as part of the 2013 Development Agreement.

¹ If it is assumed that there is no fiscal impact associated with the requested action, then an explanatory statement that justifies that conclusion shall be provided. If precise impacts cannot be calculated, then an estimate or range should be provided.

² Community Business Development Partners' review is required on all professional service and public work construction contracts.

C. Four Primary Financial Drivers of the Proposed Agreement

- a. The net income the County is giving up of transferring the O'Donnell Park Parking Structure to the MAM.
- b. The benefit the County receives by transferring responsibility for the capital improvements and maintenance of the Kahler Building and portions of the Saarinen Building to the MAM.
- c. The extension and reduction of the current operating contribution agreements between the County and both the MAM and the WMC.
- d. The annual payments as part of the arbitration settlement.

Comparison between the Status Quo and the Proposed Agreement

In order to quantify the impact to the County of the transaction, the Office of the Comptroller has developed two scenarios (Scenario #1 Status Quo, Scenario #2 Proposed Agreement). Each of the scenarios comes with a series of cash flows over the course of the 80 year time period that was analyzed. These fiscal impacts were adjusted on a net present value basis with a discount rate of 5%. This was done in order to more accurately assess the fiscal impact to the County. The higher, or less negative, the total net present value amount; the greater the benefit to the County.

The following tables represent our estimates of the impact on cash flow for the proposed agreement. The table below is based on the 2014 estimates for the sale of O'Donnell Park to Northwestern Mutual. The numbers for the first three rows are slightly different due to the calculations beginning in 2016 versus 2014. The table below shows the overall net present value on the Proposed Agreement is -\$22.4 million, which is \$17.1 million greater than the estimated -\$39.5 million net present value associated with maintaining the Status Quo. The table also includes the full cash basis for the two options. The full cash basis shows the total cash flows from each of the options without adjusting the amounts for the time value of money. The cash flow for Scenario #1 Status Quo is -\$271,057,987 and the cash flow for Scenario #2 Proposed Agreement is -\$29,746,381.

	Scenario #1 Status Quo		Scenario #2 Proposed Agreement		NPV Difference
	Net Present Value Basis	Full Cash Basis	Net Present Value Basis	Full Cash Basis	
O'Donnell Operating Income	\$15,343,122	\$25,292,075	\$0	\$0	(\$15,343,122)
O'Donnell New Debt Service	(\$6,073,048)	(\$19,983,731)	\$0	\$0	\$6,073,048
O'Donnell Existing Debt Service	(\$5,421,493)	(\$6,728,381)	(\$5,421,493)	(\$6,728,381)	\$0
Kahler Improvements	(\$20,119,043)	(\$166,364,880)	\$0	\$0	\$20,119,043
Saarinen Improvements	(\$9,603,207)	(\$82,892,050)	\$0	\$0	\$9,603,207
Kahler/Saarinen Interest Costs	(\$1,856,314)	(\$6,693,020)	\$0	\$0	\$1,856,314
MAM Operating Contribution	(\$7,465,011)	(\$8,800,000)	(\$10,757,626)	(\$14,800,000)	(\$3,292,615)
MAM Arbitration Settlement	(\$1,000,000)	(\$1,000,000)	(\$1,540,486)	(\$1,900,000)	(\$540,486)
WMC Operating Contribution	(\$3,298,177)	(\$3,888,000)	(\$4,631,687)	(\$6,318,000)	(\$1,333,510)
Total Net Present Value	(\$39,493,171)	(\$271,057,987)	(\$22,351,292)	(\$29,746,381)	\$17,141,879

Our office reviewed the current revenues generated for parking at O'Donnell Park, and adjusted the 2014 projections used above. The net impact of this change is a reduction in the overall savings from the Proposed Agreement of \$5.1 million. The table below shows the overall net present value on the Proposed Agreement is -\$22.4 million, which is \$12.0 million greater than the estimated -\$34.4 million net present value associated with maintaining the Status Quo. The table also includes the full cash basis for the two options. The full cash basis shows the total cash flows from each of the options without adjusting the amounts for the time value of money. The cash flow for Scenario #1 Status Quo is -\$262,589,497 and the cash flow for Scenario #2 Proposed Agreement is -\$29,746,381.

	Scenario #1 Status Quo		Scenario #2 Proposed Agreement		NPV Difference
	Net Present Value Basis	Full Cash Basis	Net Present Value Basis	Full Cash Basis	
O'Donnell Operating Income	\$20,477,623	\$33,760,565	\$0	\$0	(\$20,477,623)
O'Donnell New Debt Service	(\$6,073,048)	(\$19,983,731)	\$0	\$0	\$6,073,048
O'Donnell Existing Debt Service	(\$5,421,493)	(\$6,728,381)	(\$5,421,493)	(\$6,728,381)	\$0
Kahler Improvements	(\$20,119,043)	(\$166,364,880)	\$0	\$0	\$20,119,043
Saarinen Improvements	(\$9,603,207)	(\$82,892,050)	\$0	\$0	\$9,603,207
Kahler/Saarinen Interest Costs	(\$1,856,314)	(\$6,693,020)	\$0	\$0	\$1,856,314
MAM Operating Contribution	(\$7,465,011)	(\$8,800,000)	(\$10,757,626)	(\$14,800,000)	(\$3,292,615)
MAM Arbitration Settlement	(\$1,000,000)	(\$1,000,000)	(\$1,540,486)	(\$1,900,000)	(\$540,486)
WMC Operating Contribution	(\$3,298,177)	(\$3,888,000)	(\$4,631,687)	(\$6,318,000)	(\$1,333,510)
Total Net Present Value	(\$34,358,670)	(\$262,589,497)	(\$22,351,292)	(\$29,746,381)	\$12,007,378

The narrative on the following pages describe the major components and assumptions that make up the two scenarios.

Scenario #1 Status Quo (-\$34.4M Net Present Value)

O'Donnell Park Parking Structure

Scenario #1 Status Quo (Scenario #1) assumes that the County continues to operate the O'Donnell Park Parking Facility as is. The County would continue to receive the net income from the O'Donnell Parking Facility until the end of its estimated useful life² at which time it is assumed that the County would finance the demolition of the facility and the land would be turned into greenspace.

The area (southwest quadrant) designated as "Area 1" on Exhibit A would not be encumbered by any restrictive covenants; however, any future change on the "Area 1" would require full consideration and approval by the Milwaukee City Council and the Milwaukee County Board. This could allow for development to be performed on that portion of the property. This analysis assumes that "Area #1" would not be sold by the County.

Using projections based on the 2014 estimates that were done as part of the proposed sale to Northwestern Mutual, the net present value from County's continued operation of and improvements to the O'Donnell Facility is \$3.8 million. The \$3.8 million is the difference between the net present value of the Facility's operating income (\$15.3 million) and the net present value of the debt service expenses (-\$11.5 million) that result from improvements to the Facility.

Scenario #1 includes an estimated net present value from County's continued operation of and improvements to the O'Donnell Facility, based on current revenue estimates, of \$9.0 million. The \$9.0 million is the difference between the net present value of the Facility's operating income (\$20.5 million) and the net present value of the debt service expenses (-\$11.5 million) that result from improvements to the Facility.

Kahler and Saarien Building Capital Improvements

In July 2013, the County entered into lease agreements (2013 Lease Agreements) with both MAM and WMC.³ The initial term for the 2013 Lease Agreements expire in 2022; however, three automatic extensions result in the agreement continuing until 2097.⁴ Scenario #1 assumes that the County would continue to be responsible for the capital improvements to the Kahler and Saarinen Buildings until 2097. A September 2015, report from Graef Engineering indicated that the estimated value of the improvements to the Kahler and Saarinen (excluding Pedestal building) buildings over the 80 year time period to be \$28.8 million.⁵ The Office of the Comptroller adjusted the figures for inflation and also added estimated interest costs that the County would incur as a result of issuing debt to finance the improvements⁶. *Scenario #1 includes an estimated net present value of the County retaining responsibility for the capital improvements at the Kahler and Saarinen Buildings of -\$31.6 Million.*

² It is estimated that the O'Donnell Parking Structure has approximately twenty years of useful life remaining.

³ File 13-647

⁴ The 2013 leases continue unless the institutions give the County written notice of termination.

⁵ Graef Engineering Report. The 3% discount rate used is a net real return rate. It is the net of an assumed investment rate minus an assumed inflation rate. This net rate is used because costs in the estimate are not adjusted for inflation. This is a typical manner of doing life-cycle cost estimating.

⁶ The estimated inflation percentage used is 2%. The County's estimated borrowing costs is based on a 3% estimate.

Current Operating Contribution Agreements with MAM and WMC

The 2013 Lease Agreements each included ten year (2014-2023) operating contributions with both the MAM and the WMC. The lease agreement with MAM includes an annual \$1.1 million operating contribution. The lease agreement with WMC includes an annual \$486,000 annual operating contribution. Scenario #1 assumes that these contributions would end in 2023. *Scenario #1 includes an estimated net present value of the contributions that the County must continue to provide to MAM and WMC under the 2013 lease agreements of -\$10.8 million.*

Arbitration Settlement with MAM

In July 2013, the County entered in a Development Agreement with both MAM and WMC. The Development Agreement provided the terms for the parties to complete various capital projects. Throughout the implementation of the agreement disagreements arose, which led the parties to enter into arbitration. Scenario #1 assumes that, absent the Proposed Agreement, the arbitration settlement between the County and MAM would be \$1 million and would be paid in full in 2016; *therefore the estimated net present value of the arbitration settlement is -\$1.0 million.*

Scenario #2 Proposed Agreement (-\$22.4M Net Present Value)

Transfer of the O'Donnell Park Parking Structure to MAM

Scenario #2 Proposed Agreement (Scenario #2) calls for the O'Donnell Park property to be split into two condominium units. The County would retain ownership over condominium unit #1. This unit would include all of the O'Donnell Property land. The MAM would take ownership over condominium unit #2. This unit would include all improvements on the Land, including without limitation, the Parking Structure, the Pavilion, sidewalks, driveways, utilities, airspace, landscaping and lawn. The condominium unit #2 would be transferred to the MAM free and clear of any encumbrances. This includes approximately \$5 million of general obligation debt and approximately \$90,000 remaining on a 2007 Guaranteed Energy Savings Performance Contracting Loan that would remain obligations of the County.⁷

The transfer of the O'Donnell Park Parking Structure to the MAM would result in the loss of the Facility's net operating income to the County. It is assumed that the MAM would be responsible for the demolition or rebuilding of the facility after it reaches the end of its useful life. *Scenario #2 includes an estimated net present value associated with the transfer of the O'Donnell Facility of -\$5.4 million.*

⁷ A legal opinion has been received from Quarles and Brady (the County's Bond Counsel) that indicates that the transfer of the O'Donnell Park Parking Structure will not have an impact on the tax status of the County's obligations that were issued to finance the improvements to the O'Donnell Park Parking Structure. The opinion is included in this File.

Transfer of the Kahler Building (including East Addition) and Portions of the Saarinen Building to MAM

The Proposed Agreement will transfer the Kahler Building (including the East Addition), and the space within the Saarinen Base Building currently occupied by MAM ("Saarinen Space") to the MAM. The Saarinen Building includes a Base Building, a Pedestal Building, a North Parking Lot, and an Under-Bridge Storage facility. The Saarinen Base Building (which essentially comprises the Saarinen Space) is primarily occupied by MAM with the exception of the North Lobby, Veterans Courtyard, elevators, stairwells and various storage and maintenance offices which are occupied by the War Memorial Center (the "WMC Spaces in the Saarinen Building"). The Pedestal building is entirely occupied by the WMC and was not included in the Graef analysis that estimated the value of the improvements to the Saarinen Building. The North Parking Lot is entirely occupied by WMC with the exception of MAM's loading dock and access as defined in the current lease agreement. The Under-Bridge Storage facility is primarily occupied by WMC with the exception of various mechanical shelters.

The County will retain ownership of the land where the Kahler and Saarinen sit. The County will also retain ownership of the exterior, structural and mechanical elements of this unit will continue to be owned by the County and leased to WMC under the existing terms of the WMC lease.

The MAM will assume responsibility of the capital maintenance and repair of the Kahler Building and Saarinen Space that is currently the County's responsibility according to the 2013 Lease⁸ between the MAM and the County. A September 2015, report from Graef Engineering indicated that the estimated value of the improvements to the Kahler and Saarinen buildings (excluding pedestal building) to be \$28.8 million.⁹ However, since the County may still maintain responsibility for improvements for portions of the Saarinen Building that were part of the \$28.8 million; the \$28.8 million estimate may be lower. Scenario #2 assumes that the County will no longer bear any fiscal responsibility for the improvements at the Kahler and Saarinen building (excluding pedestal building); therefore, *the estimated net present value is \$0.*

⁸ File 13-647

⁹ Graef Engineering Report. The 3% discount rate used is a net real return rate. It is the net of an assumed investment rate minus an assumed inflation rate. This net rate is used because costs in the estimate are not adjusted for inflation. This is a typical manner of doing life-cycle cost estimating.

Extension and Reduction of the current operating contribution agreements between the County and both the MAM and the WMC

The Proposed Agreement calls for a ten year extension (2024-2033) of the operating contribution agreement that was included as part of the 2013 Lease Agreements between the MAM and the County and the WMC and the County.

The total support from the County to the MAM during the ten year extension is \$5,000,000. The total support will be divided into annual payments of \$500,000. The annual operating contribution during the first ten years (2014-2023) of the 2013 Lease Agreement is \$1.1 million.

The total support from the County to the WMC during the ten year extension is \$2,440,000. The total support is divided into a declining schedule of annual payments¹⁰. The annual operating contribution during the first ten years (2014-2023) of the 2013 Lease Agreement is \$486,000.

Scenario #2 includes an estimated net present value of the contributions that the County must continue to provide to MAM and WMC under the 2013 lease agreements and under the Proposed Agreement of -\$15.4 million.

Annual Payments to MAM from Arbitration Settlement

The Proposed Agreement includes a settlement amount of \$1.9 million of the payment that the County will make to the MAM. The \$1.9 million will be spread equally over ten years and will be made in quarterly installments along with the operating contribution. The arbitration settlement relates to disagreements that occurred as part of the ongoing capital projects that were included in the 2013 Development Agreement.¹¹ *The estimated net present value of the \$1.9 million arbitration settlement included in Scenario #2 is -\$1.5 million.*

- D. The assumptions used in this Fiscal Note are identified throughout the Fiscal Note as references to the corresponding section.

¹⁰ See Appendix A of the Term Sheet for the complete schedule of contributions.

¹¹ File 13-647

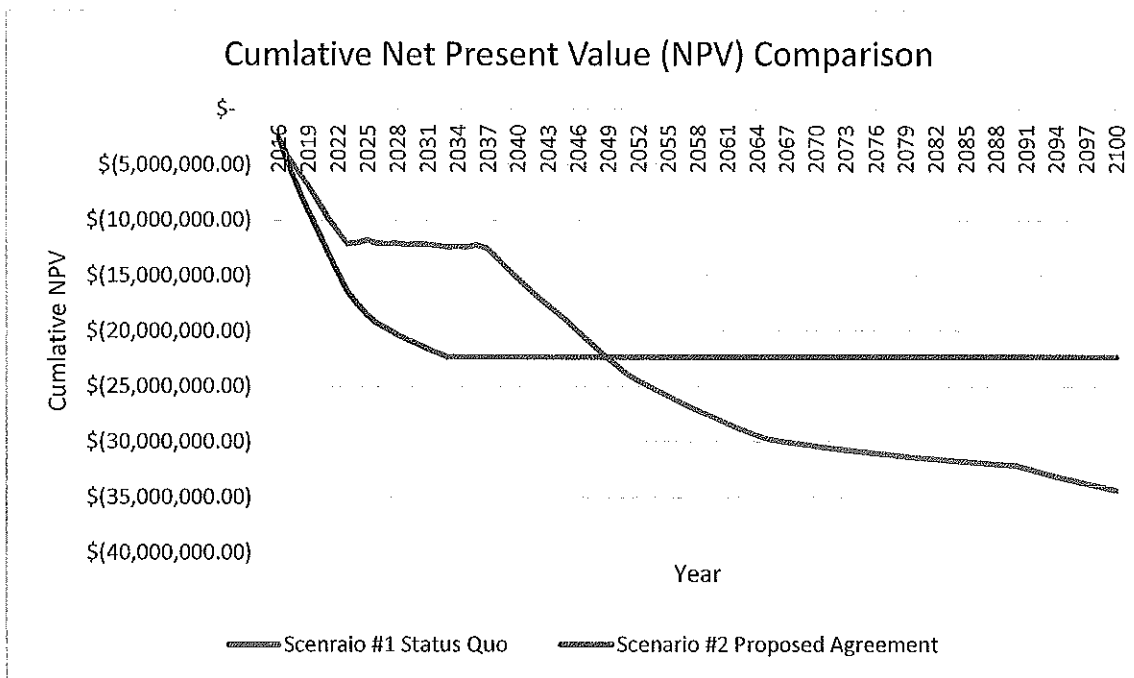
E. Conclusion/Risk

The overall net present value on the Proposed Agreement is \$12.0 million greater than the estimated net present value associated with maintaining the Status Quo. This net present value calculation was done over the course of the 80 year time period that was analyzed.

The risk associated with the transaction is that the County is giving up value in the near term for anticipated value in the long term. The positive cash flows from the O'Donnell Facility will be lost in 2017. As a result, there is an estimated annual negative net operating impact to the Parks Department of between \$1.0 and \$1.5 million. Policymakers will have to determine if other sources of revenue can make up for the income loss to Parks or if expenditure reductions will need to be made.

The long term cost avoidance from having MAM take over the responsibility for Capital Improvements at the Kahler Building and portions of the Sarrien Building will require diligence from future County policy makers and staff.

The difference between the near term negative impact and the long term positive impact can be seen in the table below. The table illustrates the cumulative net present value of maintaining the Status Quo compared to the Proposed Agreement. The breakeven point on the transaction is estimated to be in thirty-three years (2049).



Recommendation

The Proposed Agreement should include requirements for the MAM to appropriately maintain the Kahler building and Saarinen Space up to certain standards and to make the MAM responsible for removing the O'Donnell parking structure after its useful life. The Term Sheet has been modified to include the following provision:

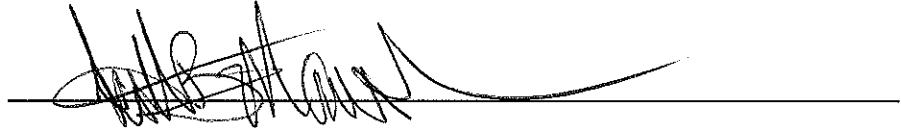
Maintenance Standards: Commercially reasonable provisions will be added to the condominium documentation regarding (a) MAM's maintenance of the condo units that MAM owns, and (b) MAM's responsibility to remove the O'Donnell parking structure after its useful life, as determined by MAM.

These standards should be monitored throughout the course of the agreement with reports presented to the County Board and Office of the Comptroller to ensure that maintenance standards are being adhered to.

In addition, the Office of the Comptroller is continuing to work with outside consultants to verify the value of the projected improvements being included as part of the Proposed Agreement. A revised fiscal analysis will be presented once it is complete.

Department/Prepared By Justin Rodriguez – Office of the Comptroller

Authorized Signature



Did DAS-Fiscal Staff Review? Yes No

Did CDBP Review?² Yes No Not Required