

COUNTY OF MILWAUKEE
INTEROFFICE COMMUNICATION

DATE: April 15, 2021

TO: Supervisor Marcelia Nicholson, Chair, Milwaukee County Board of Supervisors

FROM: Stuart Carron, Director, DAS-Facilities Management Division
Prepared by: Peter Nilles, Facilities Planning & Development, DAS-FMD

SUBJECT: **An informational report from the Director, Department of Administrative Services, Facilities Management Division (DAS-FMD), regarding a financial analysis of the Marcia P. Coggs Human Services Center**

Previous Legislation

File 20-485 From the Director, Facilities Management Division (DAS-FMD), Department of Administrative Services providing an informational report regarding an assessment of the Marcia P. Coggs Human Services Center

Issue

The Marcia P. Coggs Human Services Center (Coggs) is a County-owned facility that generates a significant amount of lease revenue, but also incurs a significant operating expense and has large looming capital requirements. The future of Coggs will be influenced to a large degree by three significant facility planning efforts currently underway:

- Relocation of DHHS staff to support its “No Wrong Door” vision
- County Administrative Space Strategic Facility Plan
- The possibility of the property’s anchor tenant relocating

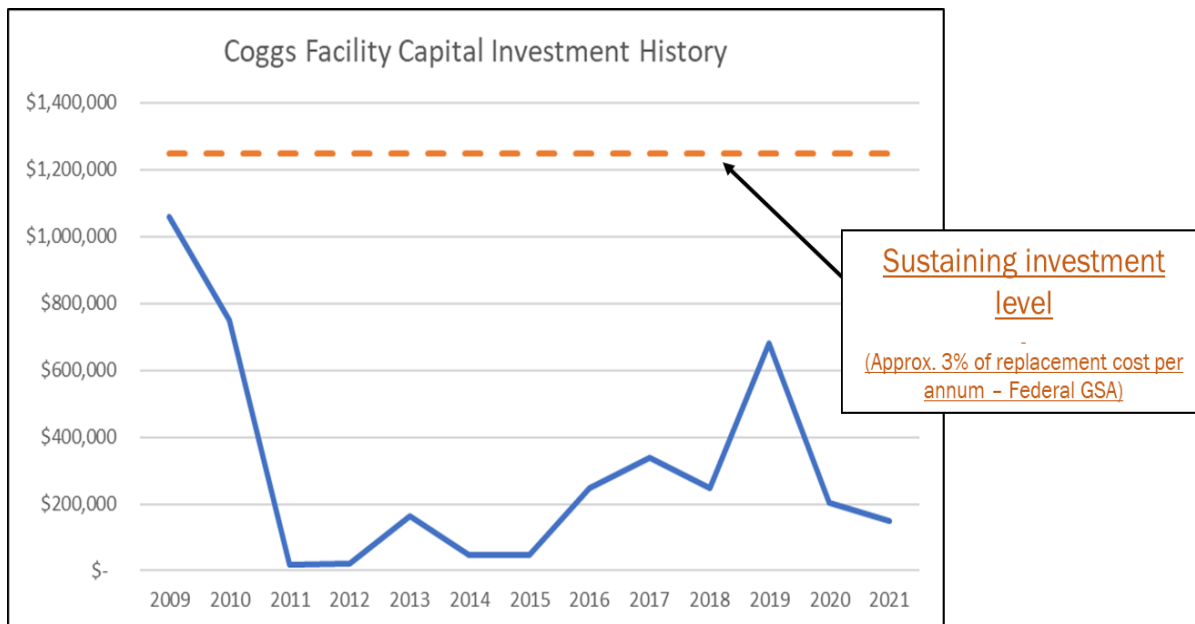
Because of these events it is necessary to consider all possible future scenarios for the Coggs facility. This report summarizes the financial aspects of a series of strategic planning scenarios, and is intended to inform both strategic planning efforts.

Background

In the 1950’s & 60’s Milwaukee County strategy/philosophy was to own property in certain neighborhoods for stabilization of some assets and to stimulate local economy. Examples include the Medical Examiner’s Office, the City Campus Building, and Coggs. These buildings sometimes had previous uses (hospital/department store/warehousing) that were changed with County occupancy. In general, although at times providing convenient neighborhood access, there was no visible economic impact on a given area. After 50+ years of applied use the buildings are or have been more expensive to maintain than alternate spaces.

Coggs is located at 1220 West Vliet Street, was built in 1920 and previously was a department store prior to acquisition by the County in 1963. Coggs contains approximately 156,000 square feet of administrative offices and customer services functions on floors one through three and a portion of the basement. Milwaukee County (DHHS) currently occupies all of the third floor. The State of Wisconsin Department of Health Services occupies the first and second floors and a portion of the basement, under a lease with Milwaukee County. In this space the State operates the MILES and MECA programs, which manage the income maintenance and child care subsidy programs for Milwaukee County. Because it occupies a majority of the facility, the State is considered the anchor tenant of the building. Revenue from the State’s rental payment is approximately \$3.2M/year, which more than offsets the building’s operating cost of approximately \$1.6M/year.

The Coggs facility has been under-invested in for a long time, and consequently it has developed a long list of deferred maintenance requirements. For the 13 year period of 2009-2021, the capital repairs and replacements in the building have averaged just \$314,000 per year. This includes emergency repairs, and the amount compares unfavorably to the Federal guideline for sustaining buildings of \$1.25M per year. The investment backlog and current estimate of capital requirements over the next 20 years now stands at approximately \$46M.



County Board report 20-485, previously submitted and reviewed in July 2020, provided some details on the current status and program considerations for the future of Coggs. Key points from that report included:

1. Accessibility is a key issue with tenants, and overall costs to address range between \$500,000 and \$1,000,000.

2. Under the second phase of the 'No Wrong Door' project, DHHS may vacate Coggs completely, or may continue to occupy the third floor. That 'Phase 2' decision is pending additional analysis and funding.
3. Recent discussions with the State indicate that they are evaluating reducing, not increasing, their footprint.
4. A County Administrative Space Strategic Facility Plan currently underway may identify County occupiers other than DHHS and provide savings from closing other facilities. Results of that study are expected mid-year.
5. Renovations on the order of \$4.5M per floor may be required to establish a sustainable office environment for occupants.
6. Options to sell or lease out Coggs if County no longer occupies it do exist but may not be financially attractive. Further analysis is needed.
7. In general, the Department of Administrative Services feels that the decision to embark on a new strategic facility for DHHS is independent of our outlook and eventual plan for the Coggs building. Should DHHS vacate the third floor, all options remain on the table:
 - a. Re-occupation by a different County entity
 - b. Lease available space out to the State or other third party
 - c. Disposition via sale (potentially after use as swing space to facilitate the replacement of the Public Safety Building)

Now, in addition to the DHHS relocation and the Administrative Space Strategic Facility Plan, we are presented with the possibility of the State down-sizing and relocating. In March the State issued an RFP to reduce footprint and potentially relocate to 50,000 SF of leased office space elsewhere in Milwaukee County. This is roughly half of their current footprint, and the outcome would be a significant loss in revenue from the building anchor tenant. This RFP has been issued in parallel with the Governor's recommendation for funding a new State Office Building at 27th and Wisconsin, which could also incorporate the State DHS programs and leave Coggs without an anchor tenant. The State DHS is clearly evaluating its options.

Analysis

Due to the fluidity of the current situation, the Milwaukee County Department of Administrative Services, Facilities Management Division and Economic Development Division staff have undertaken a financial analysis of various future scenarios for Coggs. We analyzed nine total scenarios, ranging from status quo to disposal, with various occupancy mixes. A description of the scenarios is shown below, and the base assumptions and data for the analyses are shown in the Appendix to this report.

SCENARIOS:

Various levels of County and State occupancy are assumed under three basic ownership premises: County retains ownership, County sells the building but becomes a tenant under lease (SALE-LEASEBACK), and County vacates and sells. The nine scenarios are as shown in Table 1 below:

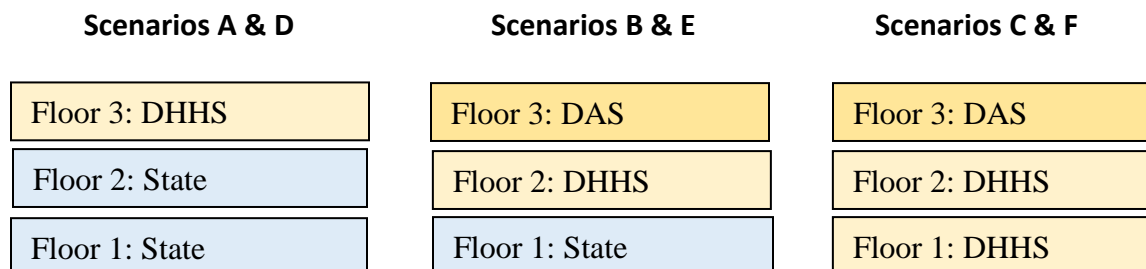
TABLE 1 COGGS FUTURE SCENARIOS

Scenario	Description	County occupancy	State occupancy
A	COUNTY OWNS, State remains as-is (<i>status quo</i>)	50k SF	100k SF
B	COUNTY OWNS – State reduces footprint by 50%	100k SF	50k SF
C	COUNTY OWNS – County 100% occupies	150k SF	0
D	SALE-LEASEBACK - County retains 50kSF under lease, State remains as-is	50k SF	100k SF
E	SALE-LEASEBACK - County retains 100kSF under lease, State reduces footprint by 50%	100k SF	50k SF
F	SALE-LEASEBACK - County retains 150kSF under lease, State vacates	150k SF	0
G	DISPOSAL - County vacates and sells with current State lease in place	0	100k SF
H	DISPOSAL - County vacates and sells with long-term State lease in place	0	100k SF
I	DISPOSAL – County and State both vacate	0	0

All scenarios (except DISPOSAL) start with the presumption that DHHS continues to occupy the 3rd floor, and that the DHHS ‘No Wrong Door’ project Phase 1 occurs in outside leased space (the costs associated with Phase 1 are NOT included in this analysis).

In all scenarios, as the State occupancy is reduced, we assume backfilling from
 a) DAS departments relocated from 633 W Wisconsin leased space, then
 b) DHHS Phase 1 leased space
 and harvest the savings from eliminating rent in these other locations.

The building stacking for the scenarios therefore may look like this:



Financial Analysis & Comparison

To compare the future scenarios financially, the net present value (NPV) of costs over a 20-year period is calculated. Table 2 summarizes the estimated NPV of the nine future scenarios for Coggs. For each scenario, the present value of 20 years of Net Operating Cost, Capital Requirements (cash and bond) and the Total NPV are shown.

Table 2
FINANCIAL COMPARISON OF COGGS FUTURE SCENARIOS
20-year NPV in 000's

Scenario	NPV of Net Operating Costs	Capital Requirements		TOTAL 20-year NPV
		Bond	Cash	
A COUNTY OWNED, State maintain same footprint (Status Quo)	\$33,180	-\$25,990	-\$10,780	-\$3,590
B COUNTY OWNED, State occupancy reduced by 50%	\$14,800	-\$30,400	-\$12,900	-\$28,400
C COUNTY OWNED, no State occupancy	\$5,600	-\$31,300	-\$13,700	-\$39,400
D SALE-LEASEBACK, State maintain same footprint	-\$46,100	-\$5,240	-\$2,450	-\$53,800
E SALE-LEASEBACK, State occupancy reduced by 50%	-\$41,400	-\$7,940	-\$3,850	-\$53,200
F SALE-LEASEBACK, no State occupancy	-\$24,700	-\$10,650	-\$5,250	-\$40,600
G DISPOSAL under current State lease terms	-\$3,900	-\$2,530	-\$5,110	-\$11,600
H DISPOSAL assuming renegotiated long-term lease with State	-\$5,500	-\$2,530	-\$5,110	-\$13,200
I DISPOSAL assuming Coggs unoccupied	-\$3,900	-\$2,530	-\$5,110	-\$11,600

'Net Operating Cost' is the net of operating expenses less income and savings. Operating expenses include typical operating and maintenance costs such as labor, utilities, repairs and maintenance. Income and savings include rental revenue, savings from closing other leased facilities, and proceeds from a potential sale of Coggs in those scenarios where the County would no longer own Coggs. Capital requirements are the sum of cash capital projects plus debt service on bonded capital investments. The total NPV is the present value sum of the Net Operating Cost plus Capital Requirements over the next 20-years.

Key points from this financial comparison include:

1. In Scenario A, net operating costs are positive since revenue from the State lease more than offsets the annual operating costs. Capital requirements over the 20-year analysis period offset this positive cash flow and make the overall prospect a nearly break-even proposition.
2. In Scenario B, net operating costs remain positive since revenue from the State lease plus savings from closing other leased facilities offsets the annual operating costs. Capital requirements over the 20-year analysis period overtake the positive net operating costs and significantly increase the total costs.
3. In scenario C the State is assumed to terminate their lease and vacate, so there is no rent revenue to offset operating costs. Rent savings from closing other facilities barely cover the on-going operating costs. Capital costs rise as retrofitting the building for full County occupancy is required.
4. In SALE-LEASEBACK Scenarios D, E and F, operating cost rise significantly as the capital costs born by the new building owner/landlord are shifted back to the County as additional rent under the lease. While the risk of managing the capital requirements shifts to the landlord, the cost does not. Worse, the costs shift from the ability to bond for capital improvements to 100% operational funds (tax levy). SALE-LEASEBACK is determined to be the least favorable approach to the future of Coggs.
5. In DISPOSAL Scenarios G, H, and I, capital infusion is halted, but costs to relocate DHHS to alternate leased facilities is added. The State lease is assigned to the new building owner. In Scenario H, additional funds are required to secure the State in a long-term lease prior to disposal of the building.

While scenario A appears to be the most favorable, it is also thought to be the least likely. The County has limited ability to determine the State's course of action, and current indicators are that the State will most likely down-size, and potentially also relocate. In the coming months we may know more as the State evaluates responses to its RFP for new space.

Overall, DISPOSAL scenarios are financially favorable to retaining ownership of the building. These scenarios assume that disposal action is taken before significant capital investments are required in the facility (i.e. within the next two years).

The financial benefits of disposal must be weighed against the intangible benefits of retaining the building, such as shown in Table 3 below.

Table 3
Pros and Cons of Retaining Ownership of the Coggs Facility
(principally with respect to DHHS requirements)

PROS	CONS
Location proximate to both central County functions as well as constituents	\$46M investment required over next 20 years
Zoning is in place for on-going public service	Timelines for making needed investments may get elongated as the facility competes for capital against other County priorities
The public is familiar with the facility and its location	No track record for investing in County assets at sustainable levels
Investments are made in a County asset	Parking constrained for both public and employees
Location near future PCS and related partners	Safety and security concerns

Market Value

The market value of the property under various scenarios has been estimated based on input from our real estate advisors as well as a property appraisal that was conducted in 2019. There are basically two possible disposal methods: a) County could sell Coggs and lease space back space as necessary to continue to occupy (SALE-LEASEBACK scenarios D, E and F), or b) vacate and sell Coggs (DISPOSAL scenarios G, H and I).

With either method, the market value of the property is potentially maximized if there are long-term occupancy commitments by its tenants (either the State or County).

The State of Wisconsin’s current month-to-month lease arrangement does not provide a prospective buyer with a guaranteed income stream, which negatively impacts the current market value of Coggs. Therefore, the market value in selling Coggs may be enhanced by stabilizing tenancy within the building. This includes establishing a long-term lease with the State, structuring a long-term rental obligation by the County or combining these two options.

The existing cell tower leases at Coggs contribute revenue and market value to the building but expire in under ten years. Assuming the leases are extended at their current rates, the discounted cash flow is estimated to add \$820,000 to the market value.

In this financial analysis, it appears that under any scenario D through I, market-based rents from tenants and cell towers would be insufficient to offset the operating costs and capital requirements of the building such that a positive NOI (net operating income) can be generated for the new owner. As such it is very difficult to estimate the market value of the property. The value used for the purposes of these financial models is the low end of range, equivalent to its land value of approximately \$1.3M.

A property appraisal conducted in 2019 recommended a much higher value based on capitalization of the rental income streams (the income approach). However, that analysis did not take into account the building's significant capital investment requirements. Beyond this, due to the COVID-19 pandemic, there have been real estate market disruptions and there are several variables that will remain unknown in the near future. These unknowns will have an impact on any speculation as to the market value of the property due to increases or decreases in commercial office space demand. How the market would react to the sale of the building is difficult to gauge, so at this point estimating market value at the low end of range is probably prudent.

Conclusion

While the Coggs facility has served the County and its citizens well for over 57 years, this analysis indicates that it may be nearing the end of its useful life. Mounting maintenance requirements and the potential loss of the anchor tenant (and the building's revenue source) make it imperative that the County evaluate its alternatives. Despite intangible benefits of the location, this financial analysis shows that the County must weigh these benefits and the requirements to continue to fund them against other competing priorities. Ultimately policy-makers need to determine the most sustainable facility solution for the County and its citizens. This report should help inform that decision process.

Future Activities

DAS-FMD Facilities Planning and Development and DAS-Economic Development staff will continue to collaborate with DHHS leadership on the future location(s) of staff to support DHHS's "No Wrong Door" vision. DAS-FMD staff will also continue managing the County Administrative Space Strategic Facility Plan project, and will provide an informational to the County Board summarizing findings and recommendations later this year. DAS-FMD and DAS-Economic Development staff will also track the State's outlook and continue to look for opportunities to better position the County for a long-term strategy regarding disposition of Coggs.

Recommendation

This report is informational, and no action is required.

Stuart Carron

Stuart Carron
Director, Facilities Management Division
Department of Administrative Services

cc: David Crowley, County Executive
Mary Jo Meyers, Chief of Staff, Office of the County Executive
Kelly Bablitch, Chief of Staff, County Board
Sherri Jordan, Interim Director, Department of Administrative Services
Shakita LaGrant-McClain, Director, Department of Health & Human Services

APPENDIX

Data and assumptions used in the financial analysis

All scenarios start with the presumption that DHHS continues to occupy the 3rd floor, and that the DHHS 'No Wrong Door' project Phase 1 occurs in outside leased space (the costs associated with Phase 1 are NOT included in this analysis).

In all scenarios, as the State occupancy is reduced, we assume backfilling from

- c) DAS departments relocated from 633 W Wisconsin leased space, then
- d) DHHS Phase 1 leased space

and harvest the savings from eliminating rent in these other locations.

All scenarios except Disposal scenarios include the following capital project investments:

- Improvements to improve accessibility, estimated at \$1,000,000
- Capital renewals/replacements as defined by the FCAP report (\$46M over 20 years)
- Tenant improvements of County-occupied space for long-term re-use by County where possible (assuming 50,000 square feet per floor; approx. \$4.5M per floor)

In order to run financial calculations, the following base assumptions were made:

- Inflation Rate for operating expenses and rent rates: 3%
- Net Present Value Discount Rate: 3.5%
- NPV Term: 20 years
- Capitalization Rate (Cap Rate): 12.5%
- Usable Square Feet: 150,000 (50,000 square feet per floor)
- Total tenant improvement (TI) costs (based on assumptions made as part of DHHS administration relocation planning): \$111.07 per square foot
 - TI construction cost: \$80 per square foot
 - Professional services for tenant improvements (design and project management): \$5.33 per square foot
 - Furniture, fixtures and equipment (FFE): \$25.74 per square foot
- Tenant improvements and accessibility upgrades completed in 2022 if State of Wisconsin maintains occupancy, 2025 if State of Wisconsin relocates elsewhere
- County lease cost (in sale-leaseback scenarios): varies based on capital requirements