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TO: **Common Council and Referral Committees/Commissions**

FROM: **Matthew B. Mikolajewski**

SUBJECT: **State Street Campus Garage – Mortenson Development – Development Agreement Memo (Legistar #74679)**

DATE: **November 22, 2022**

If approved by the Common Council, the Development Agreement with Mortenson Development for the redevelopment of the State Street Campus Garage (Legistar #74679) will begin a series of pre-construction and construction activities that will ultimately lead to approximately 220 new units of private housing, 80 private parking spaces, about 500 public parking spaces, and an inter-City bus terminal. This memo summarizes what will occur following approval and execution of this Development Agreement.

Prior to Closing (January 2024)

The "Closing" is the date that Mortenson Development pays $18 million to the Parking Utility (in escrow), and in exchange, the City sells the Lake Street component of the State Street Campus Garage to Mortenson Development. It is the date when the City moves from planning to implementation; the City must be fully committed to seeing the project through at this point, or be subject to some of the penalties outlined below. Prior to Closing, the City retains full ownership of the property and both parties (City and Mortenson Development) have the opportunity to terminate the Development Agreement.

Through 2023, the City and Mortenson Development will complete the following major milestones, as outlined in Section 3.1 of the Development Agreement. The public component of the project includes the construction of all parking, the bus terminal, and the external façade of the private apartments that line the parking structure. The private component of the project includes completion of the ground floor housing program, liner apartment units and construction of the apartment tower above. Items to be completed prior to Closing include:

- The City will complete (and pay for) all design work for the public components of the project and Mortenson Development will complete (and pay for) all design work for the private components of the project; each will secure all land use approvals and building permits to proceed.

- The City and Mortenson Development will need to negotiate and prepare condominium documents, which will structure the City's ongoing partnership with Mortenson Development (or assigns) regarding the relationship between the private and public components of the property (maintenance, etc.) in perpetuity.

- The City and Mortenson Development will need to negotiate and prepare the Purchase Agreement and the Ground Lease that will govern the conveyance of the development site.

- The City will bid the construction of the public components of the project and will select a general contractor to construct these public components. In this era of rapidly increasing construction costs, this is an important "safety valve" for the City; we will know exactly how much the project will cost to construct prior to Closing.

- We will execute and be ready to record a land use restriction regarding affordable housing units (described further below).

- Mortenson Development will need to provide evidence that they have funding to construct the private component of the project; the City will need to do the same for the public component.

- The Construction Management and Escrow Agreement (described further below) will be signed.

- On or before January 31, 2023 the City and Mortenson Development must agree to the following:

    - City staff and Mortenson Development will finalize the scope associated with the "Release Milestone," which is the date that the City will have completed enough construction work on the public parking structure that Mortenson Development is able to start construction of the private apartments above.

    - Given the highly-integrated, mixed-use nature of the project, the City will be hiring Mortenson Construction to serve as construction manager to assist with the oversight and integration of the public and private components of the project. Exhibit D describes this arrangement further. By January 31, 2023, we will need to agree to a fee amount.

Following Closing

- At the time of closing (January 2024), the City will legally transfer ownership of the entire property (Lake Street side of State Street Campus Garage) to Mortenson Development. We will then immediately execute the pre-negotiated lease (for $1) with Mortenson Development to regain control of the site to start construction of the public component of the project.

- The City will demolish (at our cost) the existing Lake Street side of the State Street Campus Garage and complete any necessary environmental remediation; we will begin construction of the public component.

- On or before January 1, 2025, we will be required to meet the to be defined "Release Milestone" noted above. Generally, this will mean that all major structural work of the public component will be completed, but interior finish (lighting, mechanicals, etc.) will not be.

- Certain construction costs will be reimbursed by Mortenson Development to the City and vice versa at this time in accordance with Exhibit E.

- Mortenson Development will proceed with construction of the private components as the City finishes the public components.

- The City will be required to secure a Certificate of Occupancy for the public and private parking by May 1, 2026, but this deadline will be extended day for day if the private development does not have its Certificate of Occupancy by that date.

- Mortenson Development will sell the City the condominium that now contains the completed public component of the project for $1.

- During the closing months of construction, the City will reconstruct (at the City's cost) Hawthorne Court. Prior to construction, the City will design a new one-way northbound Hawthorne Court with a wider (likely 7-feet) dedicated pedestrian zone.

Escrow Agreement

At Closing, Mortenson Development will pay the Parking Utility $18 million for the property by disbursing funds into escrow via an Escrow Agreement. The Escrow Agreement will then govern how funding is then distributed to the Parking Utility. Mortenson Development must insure that the entire project is completed by the summer of 2026 to accommodate the student leasing schedule. Failure to do so would likely delay the project by an entire year, which would have a negative impact on Mortenson Development's financing obligations.

The Escrow Agreement is a way to insure that the City's public component of the project remains on schedule, and reserves the funding needed by Mortenson Development to finish the public component of the project should it stall. As such, the following distribution of the $18 million to the Parking Utility is proposed:

- $500,000 after completion of utility work
- $4,000,000 after completion of foundation work
- $7,500,000 at completion of the "Release Milestone"

- $6,000,000 upon issuance of Certificate of Occupancy for the public parking component of the project if the Release Milestone had been achieved by January 1, 2025 <<< or >>>

- $6,000,000 minus financial damages to Mortenson Development upon issuance of Certificate of Occupancy for the public parking component of the project if the Release Milestone had NOT been achieved by January 1, 2025.

Affordable Housing

Exhibit F of the Development Agreement outlines two approaches to affordability. Option B provides greater affordability than Option A; however, Option B would only provide the City with a $15 million air right payment compared to the $18 million in Option A. The resolution calls for the City to proceed with Option A.

Option A will provide 100 affordable beds. Approximately 68 beds would be discounted by 10% with the remaining 32 beds discounted by 25%. As noted in Exhibit B, the City will execute a 30-year Land Use Restriction Agreement ("LURA") with Mortenson Development to preserve this affordability over this

period of time. The LURA calls on Mortenson Development to execute a Memorandum of Understanding with UW-Madison's Office of Financial Aid to refer students receiving financial aid to these affordable units.

Project Benefits to the City

The project contemplated in this Development Agreement will replace a heavily used Parking Utility owned garage nearing the end of its useful life with 500 public parking spaces. The Parking Utility should receive an $18 million air rights payment from the Developer and will have access to $15 million of tax increment generated, in part, from the private development component constructed above. As a result, approximately 2/3 of the $48 million cost of construction will be borne by non-Parking Utility sources.

The development will have a positive impact on the urban fabric of Downtown. Lake Street will be enlivened with apartments wrapping the parking structure behind. The 220 units of housing above will add residents to this block and generate tax revenue decades into the future. Downtown will be served by an inter-City bus terminal. Finally, Hawthorne Court will be activated and reconstructed in a safer manner than the dark alley that exists today.

Risks to the Parking Utility and City

While safeguards for the Parking Utility and City have been built into this Development Agreement, there is the potential for the project to not go as planned, which could negatively impact the Parking Utility and City. Upon executing this Development Agreement, the City will invest a couple million dollars in design work in preparation for bidding the project. If the bids come in high, the City and Parking Utility may need to decide whether to invest more in the project or forgo the funding already spent on design. During this period of time, Mortenson Development will also have some ability to withdraw from the transaction if they are unable to secure financing and/or the costs for the private component appear to be too high.

Once the Project Closing occurs (January 2024), the City must proceed expeditiously with demolition and construction of the structural elements of the public component to meet the January 1, 2025 Release Milestone. Failure to do so could result in the escrow fund penalties noted above.

If the "City fails to use diligent, commercially reasonable efforts to prosecute construction of the Parking Ramp," Mortenson Development would also have the option to complete construction, bill the City the cost, and/or assume ownership of the public component of the project. This is at the far end of the possibility spectrum, and would only occur if the City failed to remedy the delay as outlined in the Development Agreement.

Assuming the public component of the project moves forward on-budget and on-time, there remains outstanding risk associated with the private component. The floor of the apartment tower and the roof of the parking garage are effectively the same. If Mortenson Development fails to construct the apartment tower, the City could be left with a costly delay related to the re-opening of the parking structure as it attempts to find another developer to finish the apartment tower.

With the demolition of the parking structure in early 2024, the Parking Utility will be without this revenue stream for about 2.5 years. Any project delay following demolition will delay future income streams to the Parking Utility from this new garage.