RFP 8253-0-2012/DWR

CAPITOL EAST DISTRICT DEVELOPMENT
800 BLOCK OF EAST WASHINGTON AVE

MADISON, WISCONSIN

Response to Supplemental Questions

April 1, 2013

CD SMITH CONSTRUCTION SERVICES MANDEL GROUP Engberg Anderson

Q.1. In the financial information that you provided you have indicated that you will be requesting that the City waive the Park Fee in Lieu of Dedication of $470,000. Is this number in the TIF Request ($9,501,888) that you proposed?

A.1. The TIF request of $9,501,888 is not impacted by the request to waive Park Fees In Lieu of Dedication (which we projected at $470,000). Rather, the overall projected cost of the development is reduced by the waived fee amount, after which the sources of funding are allocated. The reasoning behind the waiver request is contained in our previously submitted sealed materials. To confirm this request of waiver, it would be helpful for us to verify the calculation of this fee with City of Madison Planning Staff, to determine if our calculation is consistent with policy interpretation.

Q.2. Your TIF request exceeds 100% of the estimated increment generated by your project by approximately 37% (this assumes that the Park fee was included within your TIF Request). What would be eliminated from your proposal to reduce the amount of TIF requested to no more than 100% of the estimated increment ($6,916,000)?

A.2. We believe that we have sized our transaction within the TIF limits outlined in the RFP. It was, and remains, our objective to size the public investment request at an amount not greater than that which would be supported solely from the improvements on the 800 block.

We are informed that the City's analysis of our proposal suggests a substantially lower amount of supportable TIF. The first step needs to be a comparison of our respective approaches to calculating the TIF, so that we can understand the algorithm utilized by the City. Therefore, we need to understand if the tax revenue projections, cost of debt, and other variables used by the City are different than those we projected.

Once we fully understand the elements of the formula used by the City in calculating supportable TIF, we can pursue refining the balance of our capital structure. The return on investment of individual components can be investigated further to determine the impact of financing alternatives. For instance, the housing component in our RFP submission is conventionally financed. The availability of tax-exempt debt and the inclusion of 20% affordable units will change the amount of TIF support for that component of our proposal.

Also, please note that the cost structure we have presented is carefully considered but is a first estimate prepared without the benefit of detailed plans and specifications. Further detail of costs will be on an "open book" basis, and we expect that we will be structuring a final TIF agreement based upon the minimum amount of TIF necessary and as referenced above to be supported solely from improvements of Block 800.

Once a final financing structure is agreed to, as an integral component of a final TIF structure, we would expect to have a "right-sizing" provision under which the City would share in savings that may materialize from the construction and lease-up budgets once the project reaches stabilization. The share of savings would be paid out upon project completion and stabilization, and represent an early redemption of TIF bonding.

At this time, we do not believe it is prudent to begin considering changes to the design proposal. We have spent considerable time analyzing the balance of uses on the property and the design of improvements, which resulted in the highest density and undoubtedly highest value alternative. Rest assured that we will share with the City our financial projections, debt terms and equity/investor return projections, to reach an agreed-to set of parameters that will be respected in the final detailing of the capital structure.

We will, as a matter of course, engage in a value engineering/budget refinement exercise as the project gains further definition. At each stage of the process we would expect to share with the City, on an open book basis, our cost projections derived from each stage of this process. As though costs are refined, we would expect an ongoing refinement and redefinition of the capital structure, inclusive of the TIF component.

We have proposed a parking quantity that is substantially greater in level of service as compared to the other proposals. However, we feel this to be necessary based on our interpretation of the intention of the RFP. We will work with the city to insure that the amount of parking provided at the Project is appropriate, and is equitably addressed in all three proposals.

A reduction in parking count, if feasible and advisable, would reduce the overall cost of the parking component and would likely increase operating efficiencies of the ramp by forcing a higher efficiency of use. This result would reduce the level of financial support necessary from the residential and commercial condominiums. This in turn would reduce the level of TIF support projected for residential and commercial development, as well as the sizing of a bond issue to purchase and own the parking. We want to be careful in reducing the parking count primarily for our own leasing requirements, but at the same time we don't want to oversize the parking based on an inaccurate interpretation of the RFP.

In terms of financial feasibility of individual project components, we feel that our projections of income, expense, and capitalization are appropriate. As everyone's expectations are to further refine the components of the Project, we expect to fine tune the numbers of the Project to meet an agreed financial model. We have gone through this same process on many complicated, mixed use, public/private developments, and know that margins are going to tighten in all respects. We would encourage the committee and Staff to contact financial consultants and municipal officials in other cities where we have completed developments to confirm our style of working with municipalities and the overall integrity of the partnership process which we deliver.

Our initial financial forecast was intended to be an opening dialogue, not a final structure. We would expect to refine our TIF request and financial structure as the process continues. However, we are committed that the final TIF request will not exceed the estimated increment. We understand that the City will have an algorithm by which they will size the TIF; we want to make sure we understand it so that we can drive toward the right solution.

Q.3. Provide more detail on the ownership and operation of the parking ramp (parking fees, hours, potential long term tenants, operating and maintenance costs). Do you anticipate having an option or be required to purchase the parking ramp once the debt on the ramp is retired?

A.3. We have proposed a public ownership structure for the parking ramp to provide for the stated public purposes as well as to make the most cost-effective parking solution available to all users within the project. We have proposed to assume construction risk and turnkey the ramp on a GMP basis, inclusive of construction financing. The takeout would be in the form of bond proceeds, with ownership residing with the Community Development Authority. The CDA would lease the ramp to the City of Madison, which would contract directly with our residential and commercial ownerships for blocks of parking. This would provide underwriting for the bonds, allow for use of lower cost financing (determination of private vs. public purpose will ultimately determine how much lower) and exemption from property taxes.

We would balance the number of stalls leased, reserved, and shared based on final analysis of use patterns, shared parking opportunities, tenant requirements and public use requirements of the City. Operationally, the lowest level of the ramp is set aside to predominantly serve the grocery component during store hours. The uppermost level will have reserved and separately secured residential parking. Middle levels will provide shared parking and public use opportunities, subject to reserved parking requirements of office and commercial tenants.

As to the long-term ownership of the ramp, we understand that the City has entered into agreements on other public/private ventures whereby the developer has the right to acquire the ramp upon full amortization of the debt. Upon full amortization, we would want to make sure that the ramp remains in public ownership and control or, in the alternative, that we have the right to acquire it. The parking is vital to the long-term health and value of the adjoining residential and commercial uses. The exact terms of any transfer of ownership would be based on the economics of operation, long term capital needs, etc.

Q.4. What letters of intent do you have regarding the leasing of commercial/retail space within your project?

A.4. Our team typically does not use letters of intent (LOI), as they are a non binding contract and provide no benefit in early development negotiations. We do have numerous interested tenants for our commercial/retail space. Our business leases office space throughout the United States. Last year alone we leased over 500,000 SF of new office space. For a specific example please see the recent article in FORBES magazine which demonstrates how we are helping the City of Milwaukee and their mixed use entity, the Water Council.
http://www.forbes.com/sites/joannmuller/2013/03/27/the-capital-of-water/

Q.5. What letters of intent do you have for short and long term debt financing of the project?

A.5. All of the project soft costs and hard construction costs will be financed internally by C.D. Smith Construction, Inc. (CDS) during the initial stages of the project. At the time of tenant occupancy CDS will work with various lending institutions to provide long term debt. Additional financial information can be provided to the City for verification. The City is also welcome to contact the National Exchange Bank & Trust for verification of the financial strength in place to complete such a project. The bank president, Mike Burch can be reached at 920.921.7700.

Q.6. Do you have market studies on the commercial (office/retail) and residential markets that support your rent projections? If so, please provide a copy.

A.6. On a macro basis, marketability of our residential component is based on the overall performance of the market, our careful analysis of trending demographics, and the evolution of Madison's job market. As to overall performance of the market, we are tracking metrics such as vacancy and rent growth, as well as the flow of new additions to supply.

There is a healthy uptick in the number of new deliveries planned and underway throughout the Isthmus and Campus. As we are able, we glean information as to lease-up success. We will further shop competitive supply, as we currently do in the outlying submarkets, to refine our positioning when appropriate. For our RFP response, we have sized our residential development at 200 units, which is the minimum size necessary to achieve operating efficiencies of a full service rental community. If we were successful in securing financing that supports a 20% affordable component, we would consider increasing the size to provide a total of roughly 240 units. Our experience with "80/20" developments is that the affordable units will be preleased 100% before first deliveries, and are not a factor in ability to attract demand for the market-rate units.

Given the number of units being delivered at Constellation, we have not attempted to overwhelm this submarket with more units than we feel prudent. We do not believe it is advisable to drive too much density of any one land use. A lease-up which requires an average of slightly less than 20 units a month is, from our experience and perspective, appropriately sized.

As to how our residential fits with Constellation and future phases, we desperately want and need Constellation to be successful. As a midrise project, and with Breese Stevens Field to our north, we feel that our building profile will actually help Constellation by preserving longer views to the northeast. By our rough assessment, approximately 1/3 of the units in Constellation will enjoy a view toward the Capitol. A good portion of the remaining units on upper floors will be advantaged by views over our development to the northeast.

Q.7. What are the projected per square foot rents for each of your residential unit types and for the committed and uncommitted commercial/retail space in your project?

A.7. Residential: The following table illustrates our preliminary mix, sizing, and pricing of living units. The "trended" rents indicate expected rents as of opening (2015). These rents take into account a normalizing of the rental market in terms of supply/demand and rent increases – in other words a gradual cooling off of the conditions apparent in today's market. With the quality and quantity of proposals on the table for downtown, the Isthmus, and near west submarkets, we expect a very competitive market for our proposed units upon delivery.

For purposes of preliminary underwriting, we are using today's untrended average rents of $1.50/RSF for residential space. Parking, utilities, etc. are a la carte. Slight deviations in the numbers above vs. those contained in our sealed financials are due to further refinement of our program and unit mix.

Q.8. Provide more details on the square footages and proposed price points for any owner occupied residential units.

A.8. We have specifically excluded owner-occupied units from our mix, as we feel that this higher density solution will not provide the best opportunity for appreciation of value of owner occupied housing. As long-term owners of our assets, we continually invest in their upkeep, improvement, and in capital repairs and replacements. As a hands-on ownership, we can provide substantially more stability and "skin in the game" as compared to a token number of residential for-sale units. In the appropriate market, with the appropriate expectation of value, density and use, we feel that for-sale opportunities will once again emerge as a valid alternative for both developers and buyers.

Q.9. Please provide a summary of the numbers, types (full time, part time) and estimated wage rates for the employees to be employed by your commercial (office/retail) tenants. Will the employees of project tenants be able to afford to live in the project? How will you address local hire during the construction of the project?

A.9. Residential affordability has to do with per-capita income as well as household income. The mix of units we are providing allows for a wide range of household types including single professionals, couples, roommates, etc. Studio units are included due to the trend of Gen Y renters to want their own "digs" regardless of size. We have been very successful in Milwaukee developing and absorbing highly refined, high-finish studio units in our downtown portfolio, where we are achieving rents of $2.20/SF. This size unit extends the affordability of a "luxury" product to a much lower household income such as, entry level office employment.

The wage rate structure in service, retail and food/beverage establishments leaves many of these employees unable to afford new market-rate apartments. Statistics indicate general wage rates of $25,000-30,000 for these types of positions. We have two ways of addressing this; either we can succeed in securing financing for an affordable development or, in the alternative, these households end up as roommates instead of singles. Up to 90 of our units could be considered as potential roommate units. The better solution for these types of households is to provide employment in immediate proximity to their homes, allowing them to shed ownership of and reliance upon a car.

The inclusion of office space in our proposal provides a concentration of higher-paying employment, which can readily afford new market rate housing. This is a distinguishing feature of our proposal which we feel will provide a true and complete mixed-use experience for workers and residents alike.