

November 1, 2005

Mayor Cheryl Farmer,
Honorable City Council Members
City of Ypsilanti
One South Huron
Ypsilanti, MI 48197

Re: Water Street Development Project

Dear Mayor Farmer and City Council Members:

The cumulative events of the past sixteen months have led me to conclude that the Water Street development project is experiencing problems from which it will be difficult to recover, and it is not clear that the current City Council or Staff has the ability to bring the project to a viable conclusion.

This letter is a critique of the City's recent strategies and defensive postures, and an inquiry into how the project arrived where it is today. Please accept my comments in the constructive light in which they are intended.

When a group of Ypsilanti residents first organized a list of concerns about the project in early 2003, I had hope that the City would address some of the concerns while the project was on its way to success. I said it then, and I'll repeat it now: I want the project to proceed and contribute to the fabric and finances of the community.

Through the winter and spring of 2003 our group of citizens met informally and individually with the Mayor, five of six City Council members, the City Manager, and Community and Economic Development staff to communicate our concerns in a low-key and professional manner. The response we received, while cordial, was limited in scope and, at times, condescending in nature. Staff and Council seemed more interested in defending the status quo than addressing the legitimate concerns of informed citizens. Based on this response, a letter was prepared by our group and distributed over the Internet to a short list of civic-minded residents.

Our letter, and the many conversations that preceded and followed it, discussed the design, financing, and long-term impacts of the project. I won't rehash those issues here, but I will comment that the list is as relevant today as it was over two years ago. If only my concerns were now limited to that original list.

Since 2003, the project has suffered a series of missteps and setbacks at a time when real progress was promised and needed.

One concern that runs consistently through my current letter is the ongoing pattern of response from City Staff and Council to setbacks the project has incurred. The City appears reluctant to admit that problems exist, let alone accept responsibility for them. This type of reaction, as demonstrated in the information given to the press, at community meetings, and on the City's website, ultimately diminishes the credibility of City officials and the public's confidence in the project. The glow of optimism is beginning to sound like false hope. There is reason to believe that the recent Water Street setbacks can be resolved, but the City

needs to be realistic and objective with the public even while it is drawing a positive picture of the future.

I fully realize that competent professionals make errors in judgment, and sometimes, outright mistakes. It's how they address these situations that speaks to their level of professionalism.

The issues discussed below are in sequential order as they have come up over the last sixteen months in the press and at community meetings. My commentary on these issues may sound familiar as I have briefly discussed some of them during the public participation portion of City Council meetings.

PROJECT BUDGET

On June 28, 2004, the Ann Arbor News reported that the City's costs for the Water Street project were going to be \$10 million over the original budget. The City's response was that the project was not over budget, it was just that some expenses had come up that were not anticipated (e.g., geotechnical remediation).

In every project I've ever worked on, this means over budget.

A MOVING TARGET The budget for property acquisition in 2001 was reported to be \$6-7 million (AA News 2001). The City's website currently reports that property acquisition expenditures are nearly \$13 million (website 9-17-05). Perhaps the City had proactively adjusted its project budget to account for this growth in costs, but at the time the City began acquiring property, the public believed the City was going to spend half as much as it eventually did.

As I understand it, the unanticipated geotechnical remediation work referenced above includes raising the project site grades out of the flood plain and creating more flood plain in Water Works Park to balance raising the ground at Water Street. The work also includes stabilizing the miscellaneous fill placed on the Water Street property over the last century so that homes can be built. The estimate for this work is \$5-7 million (website 9-17-05, community meeting 8-4-04). This work has not been completed. Environmental cleanup costs have also exceeded original budgets (AA News 6-28-04), and at least \$1 million in work remains.

In the Ann Arbor News article of June 28, 2004, City Staff explained that the environmental cost increases were due to discoveries made after the preexisting buildings were demolished. "It is a typical brownfield project," Staff explained, implying that you can't anticipate the escalation of expenditures. If Water Street was "typical," then why couldn't we have created a financial model from other "typical" projects and more accurately forecast a project budget? Why didn't Staff and our consultants recognize that industrial sites are often most polluted directly underneath older buildings? With common sense, or with reliance on past experience, the unanticipated could have been predicted.

Likewise, in the very early stages of the project, how did the City miss that there are extensive and deep fill areas on the site that will cost millions to stabilize? The fact that the site is located along the low side of a river bank and has a long history of industrial uses was a clue. Unfortunately, this issue was not discovered, or at least fully understood, during the early planning stages of the project.

Once the increasing project budget became a concern in 2004, the City put together a brief spreadsheet on their website which listed the primary project areas, how much the City had spent to date on each, the total anticipated expense for each line item, and the funding source. A quick comparison of the “spent to date” column and the “estimated total” column allowed the reader to determine the remaining costs for each line item. This was helpful for citizens to evaluate future project costs. Between September, 2004, and January, 2005, the “estimated total” line was dropped from the spreadsheet. As a result, citizens can no longer become informed about the long-term financial liability created by the project, which, whether paid for by the City or developer, will affect the financial success of the project.

EARLY SIGNS The first sign that the project was going to experience budget problems went largely unnoticed. It occurred when Staff requested that City Council authorize an increase in housing density in late 2001. A later Staff memo dated March 6, 2003, made it clear that the doubling of density was initiated by the City to increase the taxable value of the project, thus enabling the project to later repay the debt about to be incurred by the City. Apparently, the City knew as early as 2001 that project costs were going to grow and create a large enough debt to necessitate doubling the density, yet the City had only started to purchase property and had completed no demolition or environmental cleanup.

Did the density need to increase to serve another purpose?

Staff asserted that the increase had nothing to do with the requirements of the developer. Yet in an Ann Arbor News article of September 7, 2004, a Biltmore vice president claimed that the density was increased to ensure a profit for the developer. The project doubled in density and was designed to fit neither the scale or character of Ypsilanti, either to offset anticipated but undisclosed project cost increases or to help the developer make a profit by selling a larger quantity of less expensive units. Making a change this significant to the development plan indicates that either basic financial or market assumptions were wrong.

When changes this drastic were made this early in the project, alarm bells should have sounded to warn of impending problems.

DOES IT WORK TODAY? Many development projects exceed original stated budgets and go on to be financially successful. The processes of due diligence, discovery, and construction occasionally uncover unbudgeted expenses which impact the profitability or viability of a given project. For Water Street, the question is whether or not the costs incurred and to be incurred can be recouped to pay off the City’s debt. Our primary sources of debt repayment are the sale of the land to a developer and future tax revenues earmarked through Tax Increment Financing (TIF). Given the lack of response to the City’s recent Request For Proposals (RFP), many in the community are speculating that our financial requirements cannot be met.

In the end, the City will spend more money to acquire the property, clean it up, and make it buildable than originally budgeted, and this *will* impact the return we will get on the investment. If we ask the future developer to incur some of these costs, it will only mean that they will pay us less for the land. Either way we are spending more and getting less.

EXIT BILTMORE

On December 22, 2004, the City announced that it had halted negotiations with Biltmore and

would seek a new developer for Water Street. According to both the Ypsilanti Courier and the Ann Arbor News, the City terminated discussions with Biltmore for two reasons. First, the parties couldn't agree on who would pay for the remaining environmental cleanup. Second, Biltmore would not or could not construct commercial buildings along Michigan Avenue.

ENVIRONMENTAL COST SHIFT Let's tackle the environmental cleanup issue first. Until last fall, the strategy for structuring an agreement with Biltmore was to make the City responsible for financing the purchase of the properties, site demolition, environmental cleanup, and geotechnical remediation. In this approach, the City would turn over to Biltmore a "green" site ready to develop. This was detailed to the public in a community meeting held on June 3, 2003. The community meeting of August 4, 2004, reiterated this strategy, and the City's website confirmed the same in September, 2004.

Yet, sometime between September and December of 2004, the City decided that it could no longer accept responsibility for the cost of environmental cleanup.

If the City has not admitted to a budget problem and has known the basic costs anticipated for the demolition, geotechnical and environmental work for some time, why aren't we paying for the remaining work? If the City knew it couldn't fund this work we should not have proposed handing the site over to Biltmore as a green site. Perhaps the City needed Biltmore to begin land development before we borrowed more money. But from the developer's perspective, it's hard to understand why they would begin investing millions of dollars without solid assurances that the City could complete the work within the schedule and budget available.

The RFP issued in the spring of this year wasn't clear as to what the City would or would not fund. I suspect that this ambiguity contributed to the end of the relationship with Biltmore and led to a poor response to our new RFP.

Is the shift in responsibility because the City has reached its borrowing capacity and can no longer sell bonds to pay for project costs? According to the Ann Arbor News article of September 7, 2004, the City has a debt of \$27 million from Water Street and other projects such as water main replacement. In the same article, City Staff stated, "We will not issue more debts until there is cash flow to the City from the project." Is this because it isn't prudent to do so, or because we aren't legally or financially able to?

COMMERCIAL SPACE REQUIRED The second reason given for the break with Biltmore is the fact that Biltmore would not or could not construct commercial space in the project, which now must be built in lieu of homes due to the extra cost of remediating the contamination along Michigan Avenue to meet the more stringent environmental standards for residential use.

The Water Street plan that was part of the original RFP of 2001 specifically included 100,000–150,000 square feet of commercial space. This plan was generated with public input and was provided with the RFP as a starting point for moving forward.

Did Biltmore clearly state that they had no intention, or were incapable, of building commercial space when they submitted their proposal? If they did not make such an admission, then they would have implied that they were capable and willing to build the space, or that they would incorporate someone onto their team who could. I'm told that during the design charrette of January, 2002, Biltmore claimed that they were willing to build

commercial space on Michigan Avenue if they could find tenants. Now, suddenly, they're not capable of this?

Perhaps the City had agreed to eliminate all commercial space when they selected Biltmore because of their lack of expertise in this area. But if the City now remained committed to working with Biltmore, it is a logical step to allow a second developer to build the commercial frontage. Almost all large-scale developments are completed with more than one builder and/or developer on the team.

What a shame the City spent over three years negotiating a developer agreement with Biltmore, only to come up empty-handed. Still, I don't question the need to terminate the relationship with Biltmore. I just wish that the reasons given for it added up and didn't lead to more unanswered questions.

BILTMORE PAYOFF

On August 1, 2005, the Ann Arbor News reported that the City and Biltmore had reached an agreement to purchase the information that was developed by Biltmore in preparation for project construction. The City will pay Biltmore \$725,000 for the information which, according to the City, cost Biltmore over \$1.4 million. The City has made it clear that this payment is not a payoff to terminate the relationship without litigation, and that it will not have a negative impact on the project.

There are at least two statements by Staff recorded in the AA News article that are questionable:

MYTH NUMBER 1) “...[T]he money will come from state grants the City already has.”

My understanding is that those grants were given to the City for the purposes of studying the site, buying the property, and cleaning it up for redevelopment. Part of this money has already been used for these purposes, and, if available, more could be used for upcoming project requirements. Since we're giving the money to Biltmore, will the City need to borrow more to complete the project?

Every dollar the City spends adds to the difficulty of paying off the bond debt. This, then, delays tax money from the project actually getting to the general fund. And every dollar we spend puts the hurdle of the financial break-even point for the City that much higher.

Suppose the money to pay off Biltmore is sitting in an account that would have to be returned to the State of Michigan if we didn't spend it--aren't we still being reckless with taxpayers' money?

The point is not whether the City has the money to pay someone off, but how such an expenditure impacts the project's bottom line and the return we get as a City for our investment of public dollars.

MYTH NUMBER 2) “The additional data and studies will be valuable in moving the project forward.” The new developer will almost certainly create an entirely new plan for developing the property. In fact, the RFP issued this year specifically required all potential developers to create and submit the following:

- land use plan

- conceptual site plan
- landscaping/park/open space plans
- conceptual architectural elevations
- phasing plans
- the number, location, size range, and types of residential units

Part of the reason Biltmore is being replaced is that the plan they developed at the City's request is unbuildable due to environmental problems discovered too late in the game. Biltmore's plans were specifically geared toward a certain set of products they intended to sell and will not reflect a new developer's vision or products. You could sell the plans for a Buick to Ford and they still wouldn't build a Buick because it's not their product.

As a builder and developer, I find it difficult to believe that any developer will get much use out of what's been done to date. Of the information listed in the article (AA News 8-1-05), the following items the City is buying back will be of very limited value:

- site plans
- landscape and park planning
- architectural plans
- market analysis (which evaluated Biltmore's specific products only)

Note the similarity of this list to the list of information the RFP asked the interested developers to provide. Several items we are purchasing from Biltmore may be of some use-- engineering and survey work, geotechnical and environmental investigations and traffic evaluation--but I wonder what their market value is and how much of it will need to be substantially amended in light of a new development plan.

The City is not getting \$725,000 of value from the information being purchased from Biltmore.

IF THE TRUTH BE TOLD... I would not be as upset about paying Biltmore \$725,000 if our City would just tell it like it is--something like this: "We have to settle with the developer to avoid a large and time-consuming lawsuit. As a consolation prize, they are releasing some information that we can make use of as the project moves forward. The situation is unfortunate, but it's what we have to do to make sure the project is successful in the long term."

RFP RESPONSE

Severing ties with Biltmore was promoted in a variety of press publications as a positive opportunity to get a new and better developer. After all, the City now owned all of the property, and the development community would be more interested in the project than they were in 2001 because of the certainty of controlling the entire project site. This made a certain amount of sense at the time, although I couldn't escape the feeling that the over-enthusiastic response from the City was a way of covering up the problem of being four years into the project without either a developer lined up or a foundation in the ground.

UNRESPONSIVE RESPONSE As we can now see, all of the City's brave talk and optimism during the RFP process was unfounded. As referenced earlier, the RFP asked the responding developers to provide a reasonably thorough set of planning documents, as well as qualifications information and financial projections. A sizable number of developers

expressed interest. Three firms submitted a letter stating that they were interested in negotiating directly with the City. However, not one submitted a formal proposal that responded directly to the RFP.

I would actually feel more comfortable about our current situation had only a handful of developers picked up the RFP and a few submitted letters of interest. Instead, we know that at least 15 developers expressed initial interest in the project, evaluated the opportunity, and didn't respond as requested. This wasn't just a warning bell; this should be seen as a five-alarm fire with flames licking the night sky.

On August 20, 2005, the Ann Arbor News reported that three developers had submitted letters expressing interest in the project. While not inaccurate, the article did not point out that the contents of what was submitted failed to meet the requirements of the RFP. It wasn't until the Ypsilanti Courier ran an article on September 1, 2005, that the community understood the full truth about the RFP "responses." Still, Staff attempted to put a smile on the situation by "not acting surprised" at the poor response and proclaiming that the RFP process had value because the City needed to test our expectations in the market. The apparent answer to the City's test is that either the project doesn't work as currently planned, or the City doesn't know how to engage the development community to successfully solicit an adequate response.

The RFP test may have proven more valuable had the City understood market conditions, set reasonable expectations, and received a set of real proposals in response.

WHAT WE SHOULD REALLY EXPECT A review of an internal City document (published on a local blog) reveals a less cheerful assessment of the situation. In what was reported to be a memo to City Council members, the internal document stated that the "City also learned that the combination of the asked price (\$5 million), the City's reluctance to issue additional debt in support of the project, and market conditions that don't provide an adequate level of confidence that the project will sell at levels necessary for financial viability, converged to add a degree of risk that many developers were uninterested in accepting." At last, a frank and unembellished assessment of the project!

The internal memo goes on to say that "it may be necessary to begin to prioritize goals for the project to facilitate negotiations if the achievement of all goals becomes unattainable." In other words, we should prepare ourselves to accept less than what we wanted from the project. At this juncture, it seems the City may need to accept whatever proposal we can get from a developer that will keep the project afloat financially. The City's negotiating position is weak, and you can be certain that the three remaining developers who submitted the above-referenced letters are well aware of this fact.

IMPACT ON CITY FINANCES

The most recent disappointing news about Water Street has been buried in the landslide of the impending fiscal crisis in the City and the on-again, off-again debate over an income tax. In the midst of these concerns, the City published a "Fact Sheet" outlining "The Top Five Myths on City Finances," the first of which involved Water Street.

MYTH NUMBER ONE The suggestion that "[t]he Water Street Project is adversely affecting City finances" is, according to the City, false. However, when pressed at a recent town hall meeting, City Staff admitted that the City's purchase of Water Street properties had

temporarily reduced property tax revenues by \$40,000 annually. This impact is necessary to make the project work, and I won't argue otherwise. But the reduction in tax revenue does have an adverse effect on City finances, and to report that it doesn't is an outright misrepresentation of fact. For example, how many months of the year could Parkridge Community Center run on \$40,000? I learned an important lesson while preparing an Environmental Impact Statement for a federally funded project: all impacts need to be duly noted. You may certainly put the impact in its proper perspective--call it "insignificant" or "negligible" if that's the truth--but you have to be factually honest in your reporting.

FUTURE IMPACTS The recent "Fact Sheet" admitted that it will be 15 years before the project will contribute to the general fund of the City because the new tax revenue from Water Street will be used to pay off the project debt. In the community meeting held back in June of 2003, Staff reported that the general fund should see revenue from Water Street in about 10 years. I don't think the numbers are headed in the right direction.

This brings me to another point about impacts on City finances. The City has never given a reasonable answer to this question: how can the community afford to provide services to the new residents of Water Street if the general fund will not be supported by the project for at least 15 years? Apparently, the City is assuming that the Water Street residents will never need to call the police or fire department. (If you're curious, ask the police department if the new, highly-touted apartments on the City's north side have increased the demand on their services.) Even owner-occupied homes require police and fire services. In addition, the City will have new streets to snow plow and new parks to maintain. For 15 years after the first Water Street homeowners move in, the current citizens of Ypsilanti will be subsidizing the provision of basic services to these future residents. Isn't this an impact on City finances and a drain on the general fund?

Water Street should increase business traffic for our downtown and Depot Town merchants. Won't that generate more revenue for the City? In other circumstances it would, except our downtown and Depot Town are already in a TIF district, which means that any new revenue generated by an increase in downtown/Depot Town property values goes right to the DDA, and not to the general fund. The City will receive an incremental gain in revenue from the State in the form of revenue sharing due to increased population, but I don't see how this money could possibly cover our increased costs. And this new revenue won't come close to reinstating a Recreation Department or filling vacant positions at the Police Department.

I'm all for increasing business for our merchants, but Water Street won't help us provide basic services to our residents by adding to general fund revenue for a long time.

Lastly, should the unmentionable happen--that Water Street fails--the bonds that have been sold are backed by the full faith and credit of the City. That means that the taxpayers of Ypsilanti have guaranteed those loans, and we will be responsible for paying them off should the development not perform as hoped. State receivership will not wipe this slate clean. We have guaranteed these loans no matter what may be our hardship.

CONCLUSION

After reading this, you may have a hard time believing that I still support the redevelopment of the Water Street site. Despite the series of issues that have arisen, I still hold out hope that the City can redevelop the site in a way that fits our community and benefits us in the long term. I'd be less than truthful if I said that my sense of hope hasn't dimmed

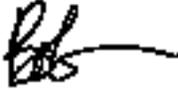
considerably over the last sixteen months, but we must continue to work toward a viable solution.

As Water Street moves forward, we need to keep the community informed in a way that respects and encourages real public dialogue. The best way of getting valuable input and interaction is to create and foster trust between the community and its government. Given the history outlined above, this will be difficult to achieve, but it can be done. The first step is to insure that the City is communicating with the public in a frank and transparent way. We need more honesty, more truth, and less spin.

For the moment, I have to place my trust in you as my elected representatives to do what is necessary to bring this project to a positive conclusion. As a group, you are ultimately accountable for the success or failure of the project.

Thank you for your time and consideration.

Respectfully,

A handwritten signature in black ink, appearing to read 'R. Doyle', with a long horizontal flourish extending to the right.

Robert R. Doyle
210 South Washington St.
Ypsilanti, MI 48197