Selling 244 W. Lakelawn and the Risks to MCC If We Keep It

On September 11, 2013, a fire rendered Lothlorien Co-op uninhabitable. MCC as an organization must decide what to do with the property at 244 W. Lakelawn Pl. MCC's insurance company stops covering loss of rent after eight months and shortly thereafter, MCC will be begin losing $9,250 per month and will continue doing so until the 31 units are replaced.

The question is whether to rebuild Lothlorien at its original site of 244 W. Lakelawn Pl. and restore the units there or sell the property and purchase new housing to replace the 31 units at new properties. After a number of meetings discussing and analyzing the matter, the MCC Board voted on March 5, 2014 to authorize a referendum for selling the property that reads as follows:

> MCC commits to replacing the 31 units of housing lost to the fire at 244 W. Lakelawn. Because the costs of construction exceed the money actually available to MCC by almost $500,000, the MCC board recommends to the general membership that they approve the sale of the property at 244 W. Lakelawn, subject to the following conditions.
>
> - That the proceeds from the sale be used firstly to redevelop the 31 units of housing lost to the fire event
> - That MCC begin the development of replacement housing immediately and in earnest
> - That MCC sell the property for no less than the appraised value of $1,600,000
> - That MCC sell the property no later than May 11, 2014.

MCC's Coordinating Committee favors this sale for the following reasons:

- **By selling 244 W. Lakelawn, MCC can use the proceeds to replace all 31 units and still have roughly a half million dollars in surplus. Not selling 244 W. Lakelawn and restoring the 31 there instead would result in roughly a half million dollars of debt.**

- **MCC faces at least a $7.60 rent hike per person due to the increased insurance premiums MCC faces due to the fire. Taking out a loan to cover the difference between the insurance settlement and the would hike the rent at least another $12.64, resulting in a <u>$20.24 rent hike per person</u> for all contracted MCC members in the 2014-15 contract year.**

- **MCC's reserves will be dropping to precipitously low levels due to the costs associated with limiting damage to the house and lost revenues from rent. A half-million dollar loan will saddle MCC with additional expenses for at least the next 25 years. MCC's ability to recover its reserves would be limited, important maintenance projects delayed, and rents would remain at least $20 per month higher than they otherwise would the first five years and then reduce to $12 higher for the remainder of the period if interest rates do not increase or there are no other normal increases.**

<u>Half a million surplus vs half a million debt</u>

We have to replace the 31 units of housing—it's a simple case of using our assets to fund it or going into debt to fund it.

Michael Carlson, MCC's Maintenance Coordinator estimates a total repair cost of $816,920. This has been hotly disputed by opponents of the same, but ironically, an effort by Lothlorien to secure a bid for repair from another contractor yielded roughly the same results. Before sharing the details of the bid with MCC's Board, Lothlorien announced to the public that a bid from Daniels Construction would cost only $552,000, but a subsequent discussion between Michael and a project manager and field estimator for Daniels revealed that certain costs of construction were not taken into account, including 1) plans and permits, 2) the substantial scope of work described within the "Fire Referral" Inspection report, and which includes extensive masonry work, exterior repainting, door and window repairs and replacements, flooring replacements, industrial cleaning, cockroach elimination, and additional electrical and plumbing work; environmental remediation and 3) costs likely to discovered during construction, which include: a) additional cost of electrical work, b) restoration of plumbing systems that may be damaged from the fire or from the winter cold; c) restoration of heating systems that may be damaged from the fire or from the cold; d) further work mandated by the City's "Referral Inspection" report (which is distinct from the 'Fire Referral Inspection report I mentioned above) but which isn't part of the fire-damaged area, and e) lost income. The estimator asked for Michael's assessment of the total cost and immediately agreed that Michael's estimate was very close to what their estimate would be.

In January, MCC's insurer offered a cash settlement of $347,000, $30,000 of which has already been applied to stabilizing the property to prevent further damage. MCC is still disputing this amount, but resolution could take a very long time, and staff and board have agreed that the current amount is the best figure to work with at this time.

317,000	Revenue from primary Insurance settlement (minus $30,000 already applied to stabilization)
317,000	**Total known sources at this time**
816,920	Total estimated cost to repair damage at 224 W. Lakelawn
(499,920)	**Preliminary cash deficit**
(55,500)	Unresolved Lost income @ 6 months @ $9250/mo
(555,420)	**Income-adjusted cash deficit, minimum**
75,000	Prospective secondary insurance payment for lost income
(480,420)	**Unresolved cash deficit—money to be borrowed.**

The scenario looks very, very different when considering selling 244 W. Lakelawn and developing the 31 units elsewhere.

1,600,000	Minimum sale price for 244 W. Lakelawn*
317,000	Primary insurance payment
1,977,000	**New cash**
(1,240,000)	31 units replacement housing @ 40 k/unit
737,000	**Cash reserves**
(92,500)	Lost income @ 10 months @ $9250/mo
644,500	**Remaining cash**

* Per City of Madison “highest and best use” property appraisal from February 2014

Opponents of the sale have insisted that cost savings could come from a number of sources. We will list these and then explain why this is **revenue that can't be counted upon.**

> Property easements: MCC will be receiving roughly $188,000 from the City of Madison due to the placement of sewer lines on both Lothlorien's and Ambrosia's property. The problem with counting that as assets is that the costs of repairing damage incurred from the construction on easements for the two properties is unknown. Also, Ambrosia Co-op has inquired about using some of the easement money for rent abatement as the existence of construction directly on the property could affect the livability of Ambrosia during construction and result in vacancies.
>
> Lothlorien's balance of $18,288.60 in its UW Credit Union accounts: Lothlorien will likely need a significant amount of this to meet ongoing expenses and new expenses such as supplies, membershipping costs, vacancy allowance, etc..
>
> Lothlorien's House Operating Reserve Fund of $18,750—Half of this is money that MCC contributed to the fund itself and is part of MCC's reserves. Both Lothlorien and MCC will need to start contributing more to the fund upon its depletion.
>
> Tax credits for historical renovation: Actual historical renovation and restoration is much more expensive than simple repairs. Any tax credits are likely to be eaten up by such additional expenses. Furthermore, the application process for such funds is long and arduous and would only serve to delay construction—delays that MCC cannot afford.
>
> “244 W. Lakelawn will only increase in value if we don't sell it.” The days in which possession of a property automatically meant that it would increase in value are long gone. Condo development downtown expanded to the point where there was market oversaturation, resulting in enormous losses for developers. While there is currently a rush to develop apartments downtown due to the very low vacancy rate, there is no guarantee that this market will

also become oversaturated. If anything, the current rush to build would be a strong argument for selling the property now.

Volunteer labor: We don't know how much of the rebuilding can be achieved due to volunteer labor, as we don't know how much can be achieved by volunteers as opposed to professionals. We don't know how many volunteers would be available, when they would be available, or what the skill level of the volunteer pool would be. Volunteer labor also requires increased costs in training and supervision.

In essence, these are sources of revenue we <u>cannot</u> count upon. In addition, it's possible that total expenses of reconstruction could actually be higher. **Unless new clear evidence of cost savings emerges, it is a safe bet to assume that a vote against selling 244 W. Lakelawn is a vote for at least $20.24 in rent increases for the 2014-2015 contract year.**

<u>Depletion of reserves and resources for MCC</u>

MCC had reserves of $150,000 prior to the Lothlorien fire, but these have been significantly depleted and will be depleted further. MCC incurred $30,000 in expenses to stabilize the property and protect it from further damage. MCC stands to lose at least $55,000 due to lost revenue and perhaps at least $139,500 if the insurance company does not make a separate payment for lost revenue and the entirely of the $317,000 is applied to construction at 244 W. Lakelawn. This leaves us with anywhere between zero and $65,000 in reserves to draw upon for unexpected emergencies and MCC will face serious challenges in trying to replenish that reserve.

By comparison, MCC recently incurred an expense of $ 24,000 when Hypatia's boiler broke down.

Furthermore, we should not expect the interest rate for any rebuilding loan to remain the same. The way loans are structured nowadays, loans agreements, while structured for 25-30 years have payments worked out for only five years, with a “balloon payment” of the remainder due after five years. Usually at that time, the loan can be refinanced for another five years. For most of the last decade, interest rates have been at historic lows and there is no guarantee that interest rates will remain that low. If they go higher, then rent--which, for the length of the loan will be at least $12 higher than it originally was—will then push even higher, thereby further raising rents and depleting resources needed to maintain MCC's houses.

It should be noted that in 2009 MCC borrowed $300,000 to meet an unexpected influx of maintenance expenses—some of them coming from code requirements by the City of Madison. Borrowing should only used for investments in capital that can yield new money, and the fact that MCC so recently found it necessary to borrow money for ongoing expenses is a concern. **Clearly, MCC needs to bolster its reserves if we expect the organization to respond to emergencies.**

<u>Final thoughts</u>

It should be noted that the selling of 244 W. Lakelawn Pl. does not mean the end to Lothlorien Co-op. Ofek Shalom opted to move to a smaller house when its original site on Butler Street burned to the ground in 2001, and Ofek Shalom continues to exist and thrive today. However, the same courtesy offered by Ofek has not been extended to MCC by representatives of Lothlorien Co-op.

On one level, it is understandable—for many people, Lothlorien as it has existed at 244 W. Lakelawn Pl. has been an icon on the lake and many people have fond memories of the location. However, MCC exists to provide low income housing, not to provide historic preservation. Furthermore, all eleven of MCC's co-ops have unique cultures that are special and have contributed to the development of Madison's unique housing co-op movement—no one single house is more important to the co-op movement than the other houses.

Here's a question to ask: is it fair for one house to appropriate so much of MCC's resources if it jeopardizes MCC's ability to adequately maintain and protect the other ten houses? This is something that MCC members are being asked to decide.

All members of MCC love and have attachments in varying degrees to the houses in which they live or used to live. **The question before MCC members is whether keeping one of the buildings is worth going into debt a half-million dollars when selling the building and replacing the 31 units with 31 other units at other houses will result in a much-needed half-million surplus. Is it worth the $20.24 increase for each MCC member?**

Please choose wisely.

Haven McClure

coordinatingofficer@madisoncommunity.coop