DEVELOPING A BUSINESS PLAN
FOR
MILWAUKEE MUTUAL INSURANCE COMPANY
-
EXISTING AND FUTURE
REAL ESTATE INVESTMENT AND DEVELOPMENT ACTIVITY

by

John Charles Wolter

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SUBMITTED IN PARTIAL FULFILLMENT

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ABSTRACT

In a review of the past and present real estate investments of Milwaukee Insurance, the major activity is identified as speculative land investments. Most of the real estate land investments are joint venture partnerships with investor/developers in Atlanta and Phoenix.

An analysis was made of the high level of risk associated with investing in undeveloped land and the appropriateness of this type of investment considering Milwaukee Insurance's investment requirements and management capabilities. The company is financially able to invest a limited percentage of its assets is real estate and the joint venture partnership is an effective form of ownership. The real estate operation is dissimiliar to the insurance business. The President of the insurance company serves the critical role of buffering the two business activities. The President is considering retirement within the next several years, raising the issue of providing an alternative organizational structure to replace the key function he plays as the linkage between the two businesses.

In addressing the investment risks and the succession issue, several recommendations are made concerning the profitable continuation of the real estate activities. One of the most important is the restructuring of the real estate operation as a wholly owned subsidiary holding company to own and manage the real estate investments. This new company would have a seperate identity and an internal source of investment funds from its retained earnings. Other recommendations are made concerning the management of the various investment risks.

Thesis Supervisor: James McKellar

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INTRODUCTION

Milwaukee Mutual Insurance Company (Milwaukee Insurance) has been actively investing and developing real estate since the 1970s. These real estate investments have included apartments, townhomes, and land. Land investment and development has been the main activity of the Company for the past several years.

The process of developing a business plan for the real estate investments of Milwaukee Insurance requires taking a fresh look at its real estate activities and formulating realistic goals that are consistant with its investment needs and management capabilities. The emphasis in this paper is on the strategic and operating planning issues. Project planning for the individual investment properties has been previously completed. The results of this business planning process are strategies and programs for a three-year time period aimed at achieving the goals established in this plan.

The business plan presented in this paper involves the restructuring of a wholly owned real estate subsidiary - Milwaukee Realty - as a holding company to own and manage the investment properties of its parent company, Milwaukee Insurance. Milwaukee Realty will also undertake additional real estate investment and development projects with the goal of maximizing before-tax income.

In this paper, Milwaukee Insurance will sometimes be identified as the "parent company", and its real estate operations, past and present, will be referred to as Milwaukee Realty, "Milwaukee", or simply "the company".

An entrepreneurial, opportunity-oriented real estate operation such as Milwaukee's has to compete with sophisticated organizations for investment opportunities, capital, and customers, in an environment of increasingly complex governmental regulations and constantly changing markets. The impending reduction in tax incentives for real estate currently being proposed in Congress will put additional pressures on real estate profits, and add to the need for efficiency and organization in this competitive business.

It is evident that the real estate industry will continue to offer investment opportunities for corporations and institutions that have the financial resources and the skills required to assume the risks involved in owning and improving real estate. Changes in the national and local economies and in the demographics of various growth markets will also give rise to opportunities for the corporate investor.

The process of developing this business plan begins in Chapter One with a review of the background and current status of Milwaukee Insurance and its real estate activities. Chapter Two, Current Projects, describes the past and present activities of Milwaukee Realty and presents each property's program and action plans. The third chapter identifies issues that are critical to the continued operation and success of Milwaukee Realty. These critical issues are used in formulating appropriate goals for the three year planning period presented in Chapter Four, Goals and Strategies, which also addresses guidelines for obtaining these goals. Chapter Five, Summary and Action Plans, summarizes the findings of the business plan and describes the specific actions that will be required over the three-year implementation period of this plan. Chapter Six contains the conclusions.

CHAPTER I

COMPANY BACKGROUND AND CURRENT STATUS

Milwaukee Insurance is a state chartered mutual insurance company which, through its wholly owned subsidiaries, develops, underwrites, and services auto, property/casualty, and life insurance products in six midwestern states: Wisconsin, Minnesota, Iowa, Illinois, Indiana, and Ohio. As of June 30, 1986, Milwaukee Insurance reported total assets of $157 million and a net worth of $35.1 million.

Milwaukee Insurance and its subsidiaries maintain their principal offices at 803 West Michigan Street, Milwaukee, Wisconsin 53201.

Milwaukee Insurance actively invests its assets in a portfolio of bonds, stocks, and real estate. Its real estate activities have included investing in and developing real estate since 1980, with one earlier apartment development project started in 1972 and sold in 1978. Real estate investments have comprised a small percentage of the assets and revenues of the Company, but have achieved higher than average returns. The primary investment strategy of the Company has been to acquire and hold real estate for appreciation and/or development of raw properties in order to create additional value. These assets are usually held for a two-to-four year period and then sold.

Milwaukee has undertaken real estate investments and developments on its own and in partnership with other investment and development partners. Major projects have included the development of two apartment complexes, a townhome subdivision, raw land assemblies and investments, and a mixed-use land development.

The real estate investments have achieved an annual return on its average total equity investment in real estate of 31% for the period between 6/31/80 and 6/31/85, during which period the average total book value of its real estate portfolio was $3,111,956 per year.[1] This five-year-period begins with the early start-up of the Company's real estate activity and ends with a series of sales of property primarily acquired or developed during that period. Exhibit One charts the total book value of the real estate investments for that period. Since 6/31/85 the company has acquired two additional properties and has one major parcel under contract for sale, scheduled to close in November 1986.

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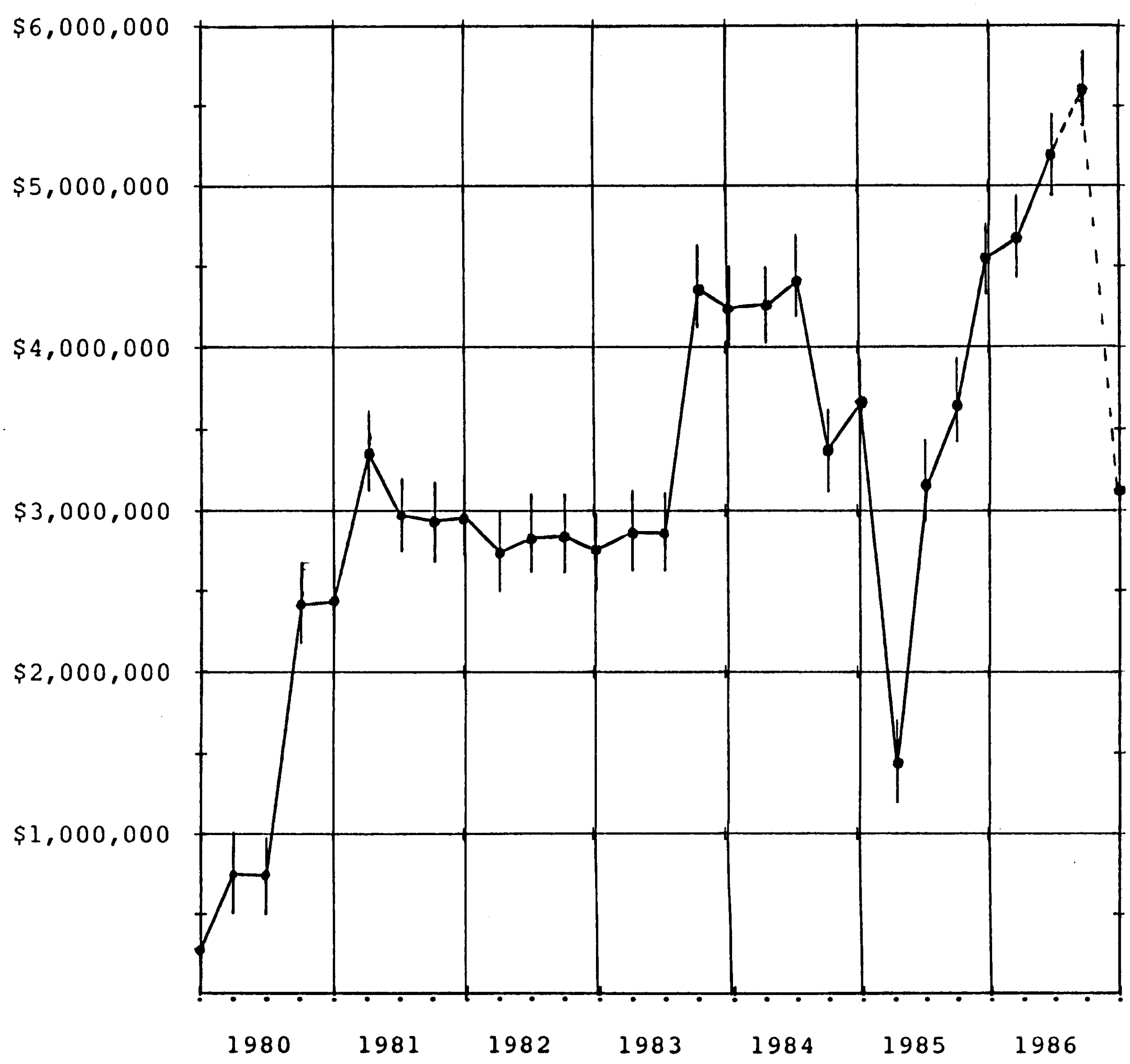
[1] This estimate of the return on equity is based on the liquidated value of the Company's real estate portfolio as of 6/31/85 ($9,020,468), less the outstanding mortgage indebtedness ($3,615,978), plus the profits earned on nine sales of real estate in late 1984 and early 1985 ($6,996,044), which result in a total value of the Company's real estate holdings and profits as of 6/31/85 of $12,400,534. This assumes that the liquidation value of the two properties held by the Company as of 6/31/80 was $1,482,049, over twice the $734,449 book value at that time. Liquidation value is defined as a realistic market sales price for a property, as is, assuming a sale within a one-year period.

EXHIBIT ONE

INVESTMENT ACTIVITY AND
REPORTED BOOK VALUE OF REAL ESTATE INVESTMENTS
(12-31-79 through 6-30-86 and 12-31-86 projected)



Milwaukee Insurance only began formally managing and diversifying its real estate portfolio in late 1982, when a full time employee was hired, as Vice President - Real Estate, specifically to run the real estate investments. The President of Milwaukee Insurance had previously managed the real estate portfolio in addition to his other primary responsibilities for the insurance operations.

Real Estate Investments

As of June 30, 1986, Milwaukee Insurance owned real estate investments, not including its home office building, totaling $13,493,983 ($5,197,569 of book value and $8,296,414 of mortgage indebtedness). Of these total real estate investments, $2,772,011 ($611,011 book value and $2,161,000 mortgage indebtedness) was in improved properties; $1,437,963 ($859,963 book value and $578,000 mortgage indebtedness) was in land development in progress; and $9,284,008 ($3,726,595 book value and $5,557,413 mortgage indebtedness) was in raw undeveloped land scheduled for future development (68% of total investment cost). These real estate investments are diversified geographically and by property type as presented in Exhibits Two and Three.

In summary, Milwaukee Insurance is a mutual insurance company with a total asset portfolio of approximately $130 million. The real estate investments of the Company represent a small percentage of the total investment portfolio (4%), but have produced average annual returns in excess of 30% over the period 1980-1985. In 1982, the Company created a new position, Vice President, Real Estate, to manage these investments.

EXHIBIT TWO

Analysis by State and Project
(values as of 6/30/86)

State: Property	Net Book Value	%	Debt	%	Liquidated Market Value	%
Wisconsin:						
Brookfield	$1,359,964	26	$ 678,000	8	$4,000,000	17
	1,359,964	26	678,000	8	4,000,000	17
Arizona:						
Walden Place	110,710	2	0	0	120,000	1
Paiute Inv.	0	0	2,061,000	25	2,656,114	12
92 T-Bird	92,571	2	82,286	1	497,828	2
94 Greenway	575,491	11	718,823	9	2,818,125	12
	778,772	15	2,862,109	35	6,092,067	27
Georgia:						
Shiloh II	2,299,607	44	2,915,028	35	9,183,814	40
Shiloh III	366,648	7	1,250,000	15	2,316,250	10
Shiloh IV	392,578	8	591,277	7	1,350,000	6
	3,058,833	59	4,756,305	57	12,850,064	56
Total:	$5,197,569	100	$8,296,414	100	$22,942,131	100

Total Liquidated Market Value		$ 22,942,131
Less:	Debt	< 8,296,414 >
	7.5% Sales Expense	< 1,720,660 >
Total Net Liquidated Asset Value		12,925,057
Less:	Net Book Value	< 5,197,569 >
Unrealized Gain from Current Real Estate Investments		$ 7,727,488

EXHIBIT THREE

Analysis by Property Type
(values as of 6/30/86)

	Book Value	%	Debt	%	Liquidated Market Value	%
Improved Properties:						
Residential:						
Apartments . . $	0	0	$2,061,000	25	$2,656,144	11
Other	110,710	2	0	0	120,000	1
Commercial Land (1)	500,301	10	100,000	1	1,200,000	5
	-------	--	---------	--	---------	--
	611.011	12	2,161,000	26	3,976,114	17
Land Development in Progress: (intended use)						
Residential (2) . .	143,327	3	113,000	1	375,000	2
Office (3)	573,309	11	465,000	6	2,000,000	9
Ind./Commercial (4)	143,327	3	0	0	425,000	2
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	859,963	17	578,000	7	2,800,000	13
Raw Land (intended use)						
Residential (5)	1,427,990	27	1,893,105	23	6,004,738	26
Office (6)	689,882	13	874,508	10	2,755,144	12
Ind/Commercial (7)	1,608,723	31	2,789,800	34	7,405,985	32
	---------	--	---------	--	---------	--
	3,726,595	71	5,557,413	67	16,165,867	70
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Total	$5,197,569	100	$8,296,414	100	$22,942,131	100
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Notes

1. Brookfield Parcels 3, 6, and 8
2. Brookfield Parcel 2 (5 A.)
3. Brookfield Parcels 1,2,10, and 11 (20 A.)
4. Brookfield Parcel 9 (5 A.)
5. 94 Greenway, Shiloh II (45 A. 20%), Shiloh IV
6. Shiloh II (68 A. 30%)
7. 92 T-Bird, Shiloh II (114 A. 50%), Shiloh III

CHAPTER II

CURRENT PROJECTS

This Chapter describes each of the current real estate properties in which Milwaukee Insurance is involved, in order to establish the current status of its business. The properties are classified by type: Improved Properties; Land Development in Progress; and Undeveloped Land.

Improved Properties

Investments in improved properties include a general partnership interest in an apartment complex, a single-family townhome, and two fully developed commercial building sites.

The general partnership interest in the apartment complex is a 57.25% interest in a syndication, Paiute Investors Limited Partnership, owning a 45% interest as a general partner of Paiute Properties. Paiute Properties owns the 232-unit Shadow Ridge garden apartment complex in Scottsdale, Arizona. The undeveloped apartment land was originally acquired in 1982 in partnership with two other investors who are active in the development and management of apartment projects. Shadow Ridge was completed in 1984 and reached pro forma occupancy by year's end.

A similar apartment project in Scottsdale, the Indian Bend Apartments, was constructed in 1972 in a joint venture with these same partners. This partnership interest was sold in 1978.

In 1984, after experiencing sizable losses from its insurance operations, Milwaukee sought to minimize the tax losses that were being generated by the Shadow Ridge project. Feeling confident in the long-term profitability of the investment, in February, 1985, Milwaukee syndicated its 45% interest and 42.75% of it was sold to limited partners along with 99% of the losses. As a result, Milwaukee retained an effective 25.76% (45% X 57.25%) ownership interest without its parent company having to book the project's tax losses. During the period of ownership, the tax losses reduced the project's original $205,369 book value to zero.

The Shadow Ridge apartment project has recently been experiencing vacancy in the range of 12% to 15%, and it has been unable to realize the projected rent increases, resulting in a slight negative cash flow. The Scottsdale rental market has softened over the last year, and interviews indicate that many of the renters are leaving to buy homes in the area. Overall success of this property is dependent on the success of the property management team in maintaining occupancy and rents and in the mid- to long-term appreciation of apartment properties.

The only other building currently held as an investment is an 1800-square-foot townhome in the Walden Place subdivision in Scottsdale. This property was one of four original Walden Place units acquired in 1980 for rental income and appreciation. This unit had previously been sold in December 1984 for $124,000, with a $100,000 seller carry-back mortgage. The buyer defaulted on the note, and the property was reacquired in May 1986. This property is expected to be resold within the next several months for $120,000.

The improved commercial land, located in Brookfield, Wisconsin, consists of two fully improved building parcels, of four acres and three acres, both zoned for regional (commercial) business. These parcels are adjacent to a recently completed 200,000 square-foot fashion-oriented shopping center and a 25,000 square-foot bank building currently under construction. These two parcels are part of a larger land development Milwaukee is completing, of which 20.3 acres were sold for the shopping center in April 1985 and two acres for the bank building in June 1985. The balance of the acreage is under development and in the process of being rezoned.

Land Development in Progress

As of 6/30/86 Milwaukee had an investment of $859,963 in land and improvements-in-progress totaling 45-acres in

Brookfield, called Westfield. Westfield is the second phase of the larger 86-acre project. The mixed-use land development plan for Westfield is for five acres of mid-density residential, 20 acres of office, and five acres of light industrial, with the remaining 15 acres to be developed as a natural area with a small lake.

The Brookfield property, including the two improved commercial building sites previously discussed and the Westfield project, accounts for $1,359,964 (26%) of the total book value invested in real estate.

Milwaukee Insurance began assembling the Brookfield property with small acquisitions in 1970, 1972, and 1973 as the possible future building site of its home office. In the late 1970's, Milwaukee Insurance chose instead to expand its downtown Milwaukee office building rather than move to the 20-acre site it had assembled. Additional purchases of land in Brookfield were subsequently made in 1980 and 1981, enlarging the site to 42.75 acres, and in 1983, a mixed-use land development plan was prepared and engineering work on the site was started to develop building sites for sale. Two additional land assemblies in 1984 and 1985 resulted in the final assemblage of a contiguous 86-acre parcel, which was improved with sewer, water, and roadways in 1984 and 1985.

The improvements remaining to be made include the construction of a 15-acre natural area requiring the excavation of a multi acre lake and the planting of native woodland, prairie, and wetland vegetation. This natural area has been designed to enhance the aesthetic character of the surrounding development; to create a high quality wildlife habitat and integrate it with an adjacent wildlife corridor. This area will maintain and/or increase the water-retention capacity of the existing flood plain and treat runoff originating from paved surfaces and buildings before it enters the lower watershed.

Westfield, the final development phase of the Brookfield property, requires rezoning of 30 acres for a mixed use of residential, office, and light industrial parcels. The rezoning request for Westfield has received some opposition from local residents owing to their concerns about traffic congestion in the area. Milwaukee has assumed a cooperative position and is assisting in the City of Brookfield's efforts to obtain roadway improvement funds from the State of Wisconsin. It is anticipated that final zoning approval will be obtained within the next six months and construction of the final improvements will begin this winter. Sale of building sites will begin upon obtaining the rezoning approval.

Undeveloped Land

Milwaukee's interests in undeveloped land, held for appreciation and/or future development, include two joint-venture partnerships owning land in Scottsdale, Arizona, and three partnerships owning parcels of undeveloped land in Georgia. The intended future land uses for these properties includes residential, office, and industrial/commercial.

As of 6/30/86, the total book value of its interests in undeveloped land was $3,726,595. These investments include two properties in north Scottsdale, Arizona, and three in suburban northwest Atlanta, Georgia.

The two Scottsdale properties, with a 6/30/86 book value of $668,062, include a 50% ownership in 41.75 acres zoned for medium density residential (94 Greenway Venture), and a 1/7 ownership in 10 acres zoned for commercial (92 T-Bird Venture). Both of these properties are in one of the fastest growing areas of Scottsdale, and they are in the Pima/C.A.P Improvement District, which has planned and will begin construction of the roadways and utilities in the district, possibly as soon as 1987. The partnership is master planning the 94 Greenway property and will sell all or a portion of the land within the next six months. The 92 T-Bird partnership plans to continue holding the commercial property for at least another year.

The remaining three interests in undeveloped land - Shiloh II, III, and IV, all in suburban Atlanta - have a current book value of $3,059,833, representing 59% of total equity invested in real estate. Milwaukee's land investments in Georgia have all been joint ventures with a local Atlanta partner.

The Shiloh II partnership assembled a 227-acre parcel, in June 1985, fronting on Interstate 75 at the intersection of Georgia State Highway 92. As of 6/30/86 Milwaukee had invested $2,299,607 in Shiloh II, which represents 44% of the total real estate invested assets. The property is presently under contract for sale for $10,896,000, scheduled to close on November 3, 1986. The Shiloh II partnership agreement provides Milwaukee with a preferred precentage return on its equity in the partnership upon sale and a proportional distribution between the partners of the remaining sales proceeds. If the sale closes as scheduled, Milwaukee's total book value of its real estate investments will be reduced by $2.3 million, dropping its total investment in real estate to $3.3 million.

The Shiloh III partnership acquired a 109-acre parcel of land in June 1985, in which Milwaukee has a 50% interest and as of 6/30/86 a total equity investment of $366,648. This parcel is zoned for commercial and multi-family, but sewer is not available to the site at the present time.

Limited sewer treatment capacity in the area could restrict the ability to develop this site for the next several years. This property was recently refinanced at a floating rate 1.5 points above prime, interest only for three years, substantially reducing the carrying costs from the original mortgage.

As of June 30, 1986, Milwaukee's investment in the Shiloh IV joint venture was $392,578 for a 50% interest in 180 acres of land acquired in June 1986. This property is zoned for single-family residential, and sewer will be available by the end of 1987.

To summarize, the real estate investments of Milwaukee Insurance are located in three markets: Milwaukee; Phoenix; and Atlanta. These investments are not only diversified geographically, but also by product type and deal structure. Approximately 71% of the real estate portfolio is in undeveloped land, 12% in existing properties, and 17% in a 45 acre development in progress.

CHAPTER III

CRITICAL ISSUES

This Chapter will address the nature of land speculation, the primary real estate activity in which Milwaukee Insurance Company is involved. The financial, and management strengths of the Company will also be described as well as its major weaknesses. These weaknesses include, the pending retirement of Milwaukee's chief executive, and the concentration of its investment activities in the high-risk land speculation business.

Land Speculation

Exhibit Three reveals that 98% of the book value in real estate for Milwaukee Insurance is invested in land, either in improved commercial building sites (10%), land under development(17%), or raw land(71%). The raw land in the portfolio was not acquired with the intention of development, but to be sold for profit resulting from appreciating land values.

Land speculation strategies underlie the majority of the properties in which the Company's assets are invested. Land speculation is the primary investment strategy for five of the Company's current investments: 92 T-Bird; 94 Greenway; and Shiloh II, III, and IV. Therefore, an understanding of the economic and social issues related to this business will aid in developing appropriate goals.

Although some economists agree that speculation performs an important function in stabilizing volatile markets, the term is frequently used pejoratively.(1) The popular perception is that the risk of loss to which the speculator is exposed to is not sufficient to justify the profits being made.(2)

Economists as far back as Adam Smith and David Ricardo have recognized the residual nature of land prices: "Rent is paid because corn is high."[3] Economists have defined rent as the returns to a factor of production that is in limited or inelastic supply.[4] Because the demand for residential land depends on the demand for housing, economists consider the former to be a derived demand. Generally, factors of production that are subject to derived demand will tend to be inelastic.[5] In short, in the case of a new house, "Land prices are determined by house prices rather than the other way around."[6]

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[1] See, for example, Michael Dennis and Susan Fish, Programs in Search of a Policy, Toronto, Hakkert, 1972, pp. 325-328.

[2] Gary Sands, Land-Office Business, Lexington, Mass., Lexington Books, 1982, p. 8.

[3] Stanley W. Hamilton, Public Land Banking: Real or Illusionary Benefits?, Toronto, Urban Development Institute of Ontario, 1974, p. 5

[4] See Wallace Smith, Housing:The Social and Economic Elements, Berkeley, Calif., University of California Press, 1971, pp. 18-21.

[5] Paul A. Samuelson, Economics: An Introductory Analysis, 3rd ed., New York, McGraw Hill, 1955, pp. 500-502.

[6] Hamilton, Public Land Banking: Real or Illusionary Benefits?, p. 5.

Land speculation has many colorful and contrasting definitions. For example, Fred Harrison, in his book The Power in Land,[1] cites Prof. Botha's definition of land speculation as 'an investment over a relatively short period of time in an asset yielding an unrealistically high rate of return accompanied by a relatively low degree of risk'.[2] Harrison also cites Henry George as stating that land speculation was not only the cause of depressions; but that it was "the great initiatory cause".[3] George concludes that land speculation was to blame for cyclical recessions by increasing land rents, forcing prices up, thus creating unemployment and bankrupting some firms that would otherwise be profitable and competitive.[4]

In addition, Peter Wolf, in his book Land in America, cites Professor John Henry Denton, head of the real estate studies at the University of Arizona, who also had a disdain for land speculation:

> "Unlike speculation in commodity futures or common stocks, land speculation does not support a market or provide a stimulus to production. In fact, it has just the opposite effect. It destroys the marketability of large areas of land by pricing them out of reach of immediate users. It deprives our communities of many facilities

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[1] Fred Harrison, The Power in Land, p. 21.

[2] D.J.J. Botha, Urban Taxation and Land Use, Report of a one-man Commission appointed by the City Council of Port Elizabeth, South Africa, 1970, p.23.

[3] H. George, Progress and Poverty, centenary edn. 1979, New York: Robert Schalkanbach Foundation, p. 264.

[4] Progress and Poverty, op. cit., p.264

> needed for good living (such as parks and playgrounds) by driving the price of land beyond what communities can afford. It limits competition by holding a large part of the land supply off the current market. It channels capital funds away from productive investment into sterile adventures and may be responsible for the present-day dearth of private risk capital."[1]

Wolf counters this argument by comparing real estate land speculation and commodity futures and common stocks. Wolf states that after the initial sale of a commodity future, sold by a farmer or producer to hedge against major price changes, and the initial sale of a stock issue by a corporation to raise working capital, most transactions which follow are generally speculative exchanges. Buyers and sellers hope to profit on the change in value of the commodity contract or on the rise in the price of the stock issue.[2]

Continuing, Wolf presents several positive contributions made through a market for land based on speculation. "The speculative purchaser enables a market to exist. Demand for land enables a seller to dispose of real property, and thereby to stop paying taxes on it and to convert the land into liquid funds. Just as in the commodities business or the securities market, without the

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[1] Peter Wolf, Land in America, New York, Pantheon Books, 1981, p. 380.

[2] Ibid., p.380

speculative purchaser very often there would be no buyer at all." Nevertheless, Wolf points out that land holdings are illiquid and have high holding costs. By contrast, most stock issues pay an annual share of profits to the stockholders and there is a central securities market where the stock investor can generally find a ready buyer for his securities.[1]

Land speculation is regarded by many as a risky, and somewhat controversial investment. Wolf cautions that the high real costs of holding vacant land will further increase the risks. Moreover, he warns that there will continue to be increasing public regulation over the conversion of raw land into developed property. Wolf cautions that a shortage of credit alone presents a force that can diminish the value of land rather than permit it to rise in accordance with or even at rates greater than the annual rate of inflation. "When buyers cannot finance construction to build profitably, their thirst for raw land dries up. When people cannot afford interest costs to finance new homes, land developers disappear from the market."[2]

The Company's strategy for investing in land has been to acquire land, located in the path of development, that is expected to undergo development within three to five years

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[1] Wolf, _op._ _cit._, p. 381.
[2] Wolf, _op._ _cit._, p. 4

from acquisition. As a result of this three to five year lead time, selected properties can be purchased for substantially less than their future developed value. Moreover, the properties probable future use and the availability of essential utilities can often be projected over that time period. Whereas the primary investment strategy is to sell the property before it is developed, usually after a two to four year holding period. The Company will undertake various predevelopment improvements to add additional value to the land during the holding period.

For example, upon assembling seven contigious parcels of land in June 1985 for the 227-acre Shiloh II property, the partnership prepared topographic maps of the site, a land use master plan, and preliminary road, sewer and water plans. This basic information established the site's potential use and its costs to develop. The property was marketed for sale before any physical improvements were made. In June 1986 the 227-acre parcel was put under contract for sale with the contingency that the seller complete the rezoning and obtain the approvals for sewer per the previously prepared master plan and sewer plan. Equally important, if a sale is not concluded, the partnership could undertake the actual construction of the property's infrastructure.

In summary, for the Shiloh II project, the primary strategy was to acquire the land as a speculator. During the holding period various predevelopment steps were taken to add value to the site and to shorten the lead time required when the actual development began. Secondarily, if the property was not sold and the market for developed land is strong, the partnership can assume the role of developer, and make the physical improvements to the property.

Acknowledging the controversial nature and the many risks involved, the Company's current real estate activities are primarily in land held for speculation. The Company's recent profits from this activity and its current land holdings, support its decision to continue, for the present, in the land speculation business. At the same time it will also continue with its land development and income property activities. Critical issues associated with the risks of land speculation, and their implications for future investments, will be discussed later in this chapter.

Strengths and Weaknesses

Milwaukee Insurance Company's strengths include: its financial ability to invest $5 to $7 million in real estate and its willingness to assume mortgage indebtedness; the real estate experience and corporate authority of the insurance company's President, and the established partnership relationships in Atlanta and Phoenix. The past performance of its existing real estate investments, which have appreciated and are readily marketable (i.e. Shiloh II, 94 Greenway, and the Brookfield commercial building sites) also represent a strength for the organization.

The Company's weakesses include: the ensuing retirement of the President and the lack of depth and back-up support in the real estate management; the high-risk speculative nature of the unimproved real estate, which constitutes a major percentage of the investment portfolio.

Strength - Financial Ability

The financial capacity of the parent Company to invest a portion of its assets in speculative real estate is a function of: its investment income needs and capabilities; the need to diversify its investment protfolio; and the insurance regulations and other requirements with which it must conform.

Most of the Milwaukee Insurance's assets are invested in bonds and stocks ($103 million and $13.5 million as of 6/30/86) because of their relatively low risk and high liquidity. Real estate provides a greater return-on-investment and diversification. Milwaukee has earned an average of 31% annually on an average equity investment of a little over $3 million over the period 6/31/80 to 6/31/85. Equally important as past experience, Milwaukee has invested in three additional properties within the last year, one of which is presently under contract for sale for over twice its cost. Consequently, owing to its past earnings and the recently acquired investments, Milwaukee Insurance has increased its total equity investment in real estate to its present $5.2 million.

Investing in real estate requires Milwaukee Insurance to draw funds out of its other invested assets to acquire the property and to pay debt service and development expenses. This reduces the amount of assets invested in bonds and stocks. This also reduces the reportable income earned on total invested assets for the periods when no is income received from its real estate investments. This reduction in reportable investment income is the opportunity cost, the effective internal cost of capital, for the equity invested in real estate. Until the property generates income from rents or upon sale, the insurance company's total income reported on invested assets is reduced.

Determining a formula for the optimal amount of equity to have invested in real estate involves quantifying: the risks; the timing of the returns; the opportunity cost of the invested equity; and the capabilities of management to realize the returns projected for the properties. Generally, if investing in real estate offers a greater rate of return than the average rate earned by the bonds and stocks, at a level of risk acceptable to the Company, investing a portion of its assets in real estate will increase the overall long-term yield on its total investments.

To a large degree, Milwaukee Insurance's financial strength comes from having deep pockets - the ability to afford the holding costs and to survive financially in the event the anticipated returns on the investments are not realized. The insurance operations receives over $140 million annually in insurance premium revenues. Of this amount, several million are retained in cash reserves for the payment of claims and operating expenses. Similarly, larger amounts are invested in short-term treasury notes which are readily available for large expenses. As a result of the Parent Company's large cash flow and reserves, the funds for the payment of the real estate's carrying costs and development expenses are readily available.

As a result of a willingness to assume the liability of mortgages on real estate investments, Milwaukee has benefited from financial leverage as property values have increased. The mortgage indebtedness on the total real estate portfolio is $8.3 million. Although most of this indebtedness is non-recourse, Milwaukee Insurance's Board has previously authorized the assumption of recourse debt of $8 million on the construction loan for the Shadow Ridge apartments in 1984. In addition, the Board recently approved the refinancing of the Shiloh III partnership debt involving a total recourse debt to the partnership of $2.5 million. The use of leverage could likewise work in reverse if the property values are stable or decline because of the large debt service.

Another issue affecting Milwaukee Insurance's financial ability to invest in real estate are the benefits of diversification of its assets, both within its total investment portfolio between type of investments (such as stocks, bonds, and real estate), and within the real estate portfolio by product type and geographic location.

Diversification benefits exist if the returns, or changes in values, on different assets do not change identically. Goldman Sachs Real Estate Research, in their April 1986 Real Estate Report, comparing equally weighted regional office portfolio returns from 1978 to 1985, conclude:

> "Portfolio diversification tends to provide a higher return in relation to its volatility (as measured by its standard deviation)."

In the same report, when comparing regional diversification of an all-office property portfolio to isolate the effects on region as opposed to structure types, they conclude:

> "The low and even negative corrolation between the real estate and the stock and bond returns highlight the potential benefits of including real estate in a broader portfolio."

If this data for office building returns is representative of general real estate returns, then geographic diversification tends to soften the swings ("volatility") in real estate portfolio returns, and the diversification of a general portfolio of bonds and stocks.

As a property/casualty insurance company, Milwaukee Insurance is under the regulatory control of the Insurance Commissions of the various states in which it sells its insurance products. The State of Wisconsin has enacted statutes establishing classes of investments and percentages of total assets or dollar limits on the investments that property/casualty insurance companies operating in the state must follow. Most states' Insurance Commissioners have the discretion to give special rulings for specific variations from the statutes' guidelines, although it is generally considered prudent to follow the insurance commission's guidelines.

Real estate, unlike bonds and stocks, is not an actively traded investment that can be readily sold in a market. Because of this illiquidity of real estate, the states only allow a small percentage of an insurance company's total assets (5% in Wisconsin) to be real estate for investment purposes. The concern of the states is that insured consumers have reliable insurance funds available for claims under the terms of their insurance policies. If the claim is for an event that is covered by the insured's policy, the insuring company must be able to pay the claim from cash reserves, or if necessary, by converting its invested assets into cash. Of the Company's present $157 million in total assets, just over $5.3 million is invested in real estate investments, or around 3% of total assets.

Strength - President

A major strength of Milwaukee Realty is the people that are associated with the Company's real estate investment activities. The task of meeting the goals and objectives in this business plan is the responsibility of a team of people. This team includes management, its investment partners, and outside professionals.

Milwaukee's original involvement and success in real estate is due to the talents of the President of Milwaukee Insurance. The President has over 20 years of real estate experience, primarily investing in and developing apartments in the Phoenix area for his own account. His real estate experience, his active interest in the company's real estate, and his years of business experience as President, make him a key person in the success of Milwaukee's real estate investments.

As President of Milwaukee Insurance, he has an excellent working relationship with the Board of Directors. His extensive personal and corporate experience in real estate investment and development, and the rapport he has established with the Board, have been vital in obtaining the resources and in providing the autonomy that Milwaukee Realty has required.[1] The ability for the real estate activities to operate independently of the bureaucracy and culture of the insurance company is a function of the power of the President.[2]

A high degree of autonomy has been necessary because of the very different styles of operation of an insurance company and a real estate business. The President provides the necessary authority and autonomy for the real estate activities to operate with few restrictions. Without his direct or implied support, it would be difficult for the real estate operations to effectively function within the corporate structure and culture of the insurance business.

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[1] Richard M. Emerson, "Power-Dependence Relations.", American Sociological Review 27", 1962, pp. 31-41.

[2] Richard E. Simmons, Managing Behaviorial Processes: Applications of Theory and Research, Arlington Heights, Ill., AHM Publishing Corporation, 1978.

Because people are the key ingredient in the operation of any business, the personal aspirations of the people associated with Milwaukee's real estate activities are important issues to consider. The President has been president of the insurance company for over 30 years, succeeding his father, who had been one of the founders of the Company in 1917. For the President, the opportunity to add substantially to the net worth of the company is largely a matter of pride. Though it is a mutual insurance company, owned by its policy holders, a number of the President's family members are actively involved in the management and the company will eventually be passed on to the next generation of his family.

Strength - Joint Venture Partnerships

Murry Seldin, professor of real estate at American University, is quoted in Land in America as advising that because of risk, because so much information is needed, "It's best to do your own investing in your own back-yard." For this purpose, six of the Milwaukee's out of town real estate investments are owned in partnership with two experienced real estate investors and developers in Atlanta and Phoenix.

The three investments with the Atlanta partner (Shiloh II, III, and IV) are all speculative land investments. As a result of this partnership, Milwaukee has a local professional representing its interests in the Atlanta real estate market. For instance, the Atlanta partner regularly meets with brokers to investigate potential investment opportunities, often being able to select likely properties before they are actively marketed. In this instance, brokers know that the Atlanta partner represents a larger investor having the ability to acquire attractive properties. Therefore the brokers present properties to Atlanta partner before making them available to others. Furthermore, the Atlanta partner can represent the existing investment properties for sale to brokers and prospective buyers.

The Phoenix partner (92 T-Bird, 94 Greenway, and Shadow Ridge apartments) is less active on a day-to-day basis. Nevertheless, his many years of experience in the Phoenix market and his specific knowledge of apartment development, have proven profitable for the Company.

The personal relationships and business associations with our investment partners, and the outside professionals hired for specific tasks, are very important factors to the success of Milwaukee's investments. Establishing and maintaining these relationships is a requirement for the success of a thinly-staffed real estate operation.

Strength - Existing Investments

The third major strength is the value of its present real estate investments. Several of these properties, at their current market values, have substantial unrealized gains over their book value. Three properties; Shiloh II, 94 Greenway, and the Brookfield commercial building sites, are in strong local markets and are readily marketable at prices that would generate substantial gains over their book value. In addition to these three properties that should be sold for sizeable profits within the next year, four additional properties; Shiloh III, Shiloh IV, 92 T-Bird, and the land under development in Brookfield, have the potential to also provide attractive returns within the next two years. The small Walden Place townhome will be sold at close to its book value within several months. The Shadow Ridge project will require several years for the rents to increase before its sale and the Westfield project will require from three to five years to sell out the building sites.

The most readily marketable of the existing projects is the 227-acre Shiloh II parcel is presently under contract for sale, and scheduled to close in November, 1986. If for some reason, the sale is not completed, the property will continue to have distinct advantages over other comparable property in the area. The site has interstate and state highway frontage and it is wooded with a gently rolling topography. It is anticipated that the zoning will be completed and sewer capacity allocated by the end of 1986. A state and county funded vocational school will begin construction in 1987 on property immediately adjacent to the site. The main access to the school will be via a frontage road that will be built through the Shiloh II parcel. This frontage road will connect two major roads, both with interchanges onto I-75.

While the carrying costs for this property are low in relation to the property's market value, the sale is important because it would free up $2.3 million, or 44% of the book value of Milwaukee's assets invested in real estate. In addition to allowing Milwaukee Insurance to report a sizable gain to net worth, this sale will make funds available for reinvesting in one of several other investments in Arizona presently being analyzed by the company. As of 6/30/86, 59% - or over $3 million, invested in real estate were in undeveloped land in Georgia. The sale of the Shiloh II property will allow a more even distribution of real estate assets between markets to be established.

A second property with a good likelyhood of being sold within one year is The 94 Greenway property, 41 acres in north Scottsdale, is in an area of high growth and is one to two years away from development. The property is in a master planned improvement district and all roads and utilities are anticipated to be installed during 1987. Discussions with Scottsdale's planning staff indicate that in exchange for dedicating approximately three acres of the site for road right-of-way, the City would consider increasing the residential density on a portion of the site. This will require master planning the site and obtaining zoning approval. A sale subject to this rezoning is feasible within the next several months.

The two improved commercial building sites in Brookfield are also likely to sell within a year's time. They are in one of the fastest growing commercial corridors in Wisconsin. The sites are adjacent to a new shopping center and a new bank building currently under construction. The City of Brookfield has just lifted a six- month building and rezoning moratorium that it had placed on this area because to the increased traffic congestion. A major land use and traffic study is being completed that will assist the City in controlling and accommodating the new development occuring in the area. Both of these building sites are zoned and fully serviced and their sale is anticipated within the next year.

In addition to the above three properties that could be sold in a one year period, the four properties described below are projected to be sold within a two year period.

The 10-acre 92 T-Bird property in north Scottsdale is adjacent to a new residential community. It is one of the only commercially zoned areas in the CAP improvement district. The property's sale is anticipated in 1987 to coincide with the improvement district's roadway and utilitity construction.

The 109-acre Shiloh III property in northwest suburban Atlanta is zoned for 20 acres of commercial and the balance for multifamily. The commercially zoned land fronts on a county roadway. A fully-developed commercial corner, approximately 1,000 feet from the site, is at an interchange of a state highway and Interstate I-75. The development of Shiloh II is dependent on the resolution of the the adjacent City of Ackworth's sewer capacity problems. Although the property is outside the City's boundaries, it is currently within a sewer district that is designated to be served by the City. A new county sewerage treatment plant is under construction less than one mile from the site and the State of Georgia and Cobb County are negotiating with the City to resolve the City's sewer problems. It is anticipated that this property will be developed in late 1987 or 1988 when the sewer jurisdiction issue is resolved.

The recently acquired Shiloh IV property, 180 acres of residential land in suburban Atlanta, has near term development potential. New sewer lines will be available to this site in late 1987, although there is a strong demand for large single family building sites in the area which could be serviced by septic systems.

The Westfield land under development in Brookfield will be developed as office, light industrial, and medium density residential. The rezoning is anticipated to be approved in 1986, with the final site improvements to be completed during 1987. Sales of these building sites will begin in 1987 and continue for three to five years.

Strengths - Summary

The strengths offered by Milwaukee's existing real estate investments are based on expectations that these properties will generate profits from their sales over the next two years. The first three properties, Shiloh II, 94 Greenway, and the commercial building sites in Brookfield, offer the least risks and the shortest holding periods in order to realize their appreciated market values upon sale.

The risks involved are primarily from the future demands for developed land in Atlanta, Scottsdale, and Brookfield, and the availability of zoning and infrastructure improvements for several of the projects. These are substantial risks but all of the properties are located in areas that are presently experiencing growth and development.

In Summary, Milwaukee's strengths are: the financial ability of its parent company to assume the risks involved in its real estate investment activities; the experience and authority of the President and his active involvement in the real estate investments, along with established partnership relationships in Atlanta and Phoenix; and finally, the potential profits that are available from its existing real estate investments.

Critical Issues - Weaknesses

There are two primary weaknesses of Milwaukee's real estate operations. The first is its reliance on the President of the parent company for the authority and access to resources that are critical to the real estate operations, especially as the President is anticipating retirement in the next several years. The second is the high-risk speculative nature of the Milwaukee's investments in undeveloped land.

Weakness - Dependence on President

The dependence of real estate activities on the support of the President is a major weakness in terms of the longevity of Milwaukee Realty. This is primarily due to the President's retirement, possibly within the three-year time frame of this plan. There are three major areas of dependence that are critical to the current successful operation of Milwaukee's real estate operation: access to resources; authority to assume risks for the parent company; and the authority for Milwaukee to function independently from the parent company.

The first dependency is the ability to obtain resources to invest in real estate.[1] The President is in a

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[1] Jeffrey Pfeffer, Organizational Design, Arlington Heights, Ill., Harlan Davidson, 1978, p. 63.

position within Milwaukee Insurance to allocate the large amounts of money needed for the real estate investments.

For instance, the President is the head of the Investment Committee and advises the outside financial management group who manage the insurance company's bond and stock portfolios. The President is the central figure in monitoring and coordinating the insurance operations and the investment results. This makes the President the most knowledgable person concerning the financial status of Milwaukee Insurance.

The second dependency is the authority to assume risks. Most of Milwaukee's real estate investments involve substantial elements of uncertainty resulting from unplanned variations. In such rapidly changing environments, an organic, nonbureaucratic authority structure is required.[1]

Real estate investments, especially speculative investments, involve higher risk because of the constantly changing economic environment. Formal rules and procedures could not effectively deal with the normal level of uncertainty or risk typically associated with speculative investments. The President has the authority to quickly respond both to the investment opportunities and problems and constraints.

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[1] Raymond E. Miles, Theories of Management: Implications for Organizational Behavior and Development, New York, McGraw-Hill, 1975

The third area of dependence is the authority for Milwaukee's real estate operations to function independently from the insurance company's operation. The effective location of Milwaukee Realty within the parent company's organizational structure, reporting directly to the President, has a major effect on the problem definition and criteria for decision making required in the real estate activities.[1] These differ substantially from those definitions and criteria generally involved with the insurance company's activities.

Also, the economic and business factors, the risks, the proformance criteria, and the operating styles required in a small real estate operation differ from those associated with operating an insurance company.

In summary, the continued successful operation and the longevity of Milwaukee's real estate operation is dependent on the support and authority currently provided by the President of Milwaukee Insurance. In planning for the President's approaching retirement, alternative sources will be required to provide access to resources, the authority to assume risks, and the autonomy to function independently from the other subunits within the parent organization.

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[1] D.C. Dearborn, and H.A. Simon, "Selective Perception: A Note on the Departmental Identification of Executives.", Sociometry 21, 1958, pp. 140-44.

Weakness - Risks Associated with Land Speculation

Milwaukee's second major weakness is the high risk speculative nature of its investments in undeveloped land. The large majority of Milwaukee's invested real estate assets are in undeveloped land, and although they are located in communities that are presently experiencing demand for land, there are many factors that could affect this demand, and thus the value of the undeveloped real estate.

There are risk factors that are associated with land investments in general, and there are risk factors that are specific to each individual property. Wolf discusses a number of misconceptions that are widely held today concerning the value of land and the risks associated with its ownership.[1] The first misconception is that the land, like improved real estate, has innate value. This assumption can be especially dangerous if a buyer equates the value of raw land with that of a house or an office building. Raw land has little innate value, and it usually requires substantial additional investment for roads and utilities before it has productive value. In addition, the holding costs for raw land can be very high. For these reasons, financial institutions are reluctant to lend money for land purchases, which accounts for the common practice

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[1] Peter Wolf, Land in America, pp. 18-26.

of seller financing of land sales.

The value of undeveloped real estate is much more difficult to establish than developed property. Developed property can usually be reliably appraised. Land values are difficult to determine because the sales values of comparable land is often distorted by speculative expectations. Buying and selling land in a speculative market can be compared to playing "musical chairs". When the music stops, the person left standing is the person who most recently bought property at the highest inflated price. Consequently, the potential for unrealistically inflated land values makes it especially important to buy at a low price, before the speculative interest in the land appears. The timing of the acquisition and sale within this speculative cycle is very difficult to determine.

Another risk factor is that unlike the future value of developed real estate, the future value of raw land is almost totally dependent on social, political, and environmental trends in the community where the land is located. These external factors offer both risk and speculative potential, and it is the risks that are most important factors affecting the potential future values of Milwaukee's existing real estate investments.

Furthermore, there are fewer buyers for undeveloped land than there are for developed properties.

Often the buyers for undeveloped land are speculators and will only be interested in buying as long as the land values are increasing.

Finally, the growth rate of the American population is slowing down which translates into a decreasing demand for new development, and thus, for land.

The business plan for Milwaukee Realty will have to address two major areas of constraint: an organizational structure which is dependent upon its President for obtaining funds for investment and the authority to operate independently; and the many risks inherent in investment in land.

In this Chapter the major strengths and weaknesses of Milwaukee Insurance and Milwaukee Realty have been represented. The analysis was intended to inform the goals and strategies set forth in the following Chapter.

CHAPTER IV

GOALS AND STRATEGIES

In the first section of this chapter, three major goals for Milwaukee Realty are established. In the second section the specific strategies for achieving these goals are described.

There are three goals that should guide the business activities of Milwaukee Realty: increased net worth of Milwaukee Insurance; insured longevity of the real estate operation; and improved management of the risks.

Increasing Net Worth

The goal of Milwaukee's investing in real estate, especially high-risk land speculation, is to generate the maximum amount of reportable income to add to the net worth of the parent company, Milwaukee Insurance. Milwaukee Insurance has the financial ability to invest a portion of its assets in speculative investments, however, this amount is limited. The total equity invested in real estate should not exceed 5% of total assets, which is the current guideline established by the Wisconsin Insurance Commission. This 5% limit should include a reserve adequate to service the mortgage debt on the real estate investments for a period of one year. This reserve will reduce the chance that the total book value, which includes the capitalized debt service, will exceed the 5% limit in the event of a slowing of the real estate markets.

The effective management of Milwaukee's current real estate investments and the careful selection of new acquisitions should enable Milwaukee to continue to realize medium-term (two to four years) average annual returns on equity that are substantially higher than that of the bond and stock portfolio. The goal of adding to net worth is accomplished by increases in the value of its real estate investments and the sale of these appreciated assets for a profit. The sale of these appreciated assets will result in generating reportable income and adding to net worth.

This appreciation of value can be measured annually by having an independent appraisal made to determine the fair market value of the total real estate portfolio. The increase in appraised value of the portfolio over the previous year, plus the income earned from real estate during that year, will determine the effective increase in wealth from the assets invested in real estate. These returns should be in the range of 20% to 30% per year on the average total equity invested during that period.

Longevity

The second goal is the longevity of Milwaukee's real estate operations. Survival and growth are basic goals of most organizations. For Milwaukee Realty, its survival and growth as a subunit of Milwaukee Insurance requires that the organizational structure be modified in anticipation of the President's retirement.

Milwaukee Realty will continue to need the autonomy and the access to resources that it has available to it currently via the support of the President. Milwaukee's dependence on the President will need to be replaced by other forms of legitimacy and authority within the parent company. A flexible operating structure, as opposed to a well defined, mechanistic structure is required in order to deal with the high level of uncertainty involved in the real estate business.[1]

Establishing a staff of at least two professionals with a separate operating identity and the authority to obtain its funds for development and reinvestment from retained earnings will provide a more appropriate and flexible operating structure. This goal should be accomplished within one year.

Improved Management of Risks

The third goal is greater management of the risks associated with the real estate activities.

Uncertainty refers to events that the organization can not forecast. Real estate investments involve a high

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[1] Tom Burns, and G.M. Stalker, The Management of Innovation, London, Tavistock, 1961.

degree of uncertainty, particularly the land speculation business, and it is this uncertainty that results in both the investment risks and the opportunities for profit.

The majority of Milwaukee Realty's current investment portfolio consists of properties whose values are dependent on factors that can not be easily predicted. The level of the overall risk in the real estate portfolio should be coordinated with the financial objectives of the parent company. At this time the parent company is financially stable and very motivated to agressively add to its net worth, hence, the current highly speculative real estate portfolio. On the other hand, its financial status could change and the risk exposure of Milwaukee Realty's investment portfolio should be adjusted accordingly.

Risk in the land speculation business can also be managed by product and geographic diversification and through deal structure.

In summary, the business plan for Milwaukee Realty will contain three goals: achieving an increase in net worth through careful acquisition and sale of properties; reorganizing the management structure to ensure Milwaukee Realty as an on-going concern; achieving an optimal risk/return ratio with respect to the overall financial status of the parent Company, Milwaukee Insurance.

Strategies

Four strategies have been developed to achieve the aforementioned goals. The first is the formal restructuring of Milwaukee Realty as a wholly owned subsidiary of Milwaukee Insurance. The second strategy is the improvement of risk management through careful analysis of acquisition and use of forecasting techniques to monitor and predict those factors which effect property values. The third strategy is to further diversify the real estate portfolio both geographically and by product type (e.g. improved vs unimproved property). The fourth strategy entails the hiring of an additional professional to assist in general management, market research, project development, and sales activities.

Strategy # 1
Restructuring Milwaukee Realty

Establishing Milwaukee Realty as a separate holding company for Milwaukee Insurance's real estate investment is the first step in formalizing the Company's real estate activities. For Milwaukee Realty to function effectively, the authority and autonomy that the President has supplied will have to be replaced as he approaches retirement. A clearly defined corporate identity, properly positioned in the organizational structure, will provide some of these requirements. The holding company structure brings all of the real estate investments together so that their revenues and expenses can be effectively monitored.

The initial capitalization of Milwaukee Realty by Milwaukee Insurance will provide the funds to set up its operations and carry the cash flow requirements of the existing investments through June 30, 1987. Additional funds required would be obtained from a line of credit issued by the parent company with Milwaukee Realty paying an adjusted rate tied to yields of the parent company's other income producing assets.

This structure provides an internally generated source of revenue and at the same time places the burden of the risks and carrying costs directly on the real estate group.

Currently the Company's real estate assets are owned by the parent company and are carried on its books in various accounts that serve the statutory insurance accounting and reporting needs of the Company, but which have little use in managing and accounting for them as real estate investments. The reporting needs of the parent insurance company and the management needs of the real estate operation, therefore, are very different. However, as an as affiliated company, Milwaukee Realty would hold and account for the real estate investments and their consolidated balances will be reported to the parent company. Therefore, much of the perfunctory reporting requirements could be eliminated.

Strategy # 2

Risk Management Through Forecasting

This strategy deals primarily with property acquisition and sale. Accurate forecasting and investment analysis can provide the technical advantage of being able to avoid poor investments and properly price and time the acquisition and sale of potential and existing investments.A systematic approach to analyzing regions and metropolitian areas can offer an understanding of the type and timing of demand for specific products.

Adequate forecasting provides useful information which could prevent investments in property with below average rental or capital growth prospects. An understanding of historical and projected macroeconomic forces and their effects on the property markets is useful in selecting investments. Properties whose prices have been driven beyond their economic value by speculation can be identified and avoided. Accurate market information generally is expensive to obtain. In the case of a speculative land investment portfolio, the high cost of this information is justified because of the high risks associated with speculation.

Strategy # 3

Risk Management Through Diversification

Milwaukee's current business activity involves assuming large risks in order to realize the large profits it is seeking. Whereas the past several years have not included a major economic recession, and the markets Milwaukee has invested in have experienced rapid growth, the returns on investment have been very good. A risk management strategy to minimize the major down side risks could involve accepting a somewhat lower, but more certain rate of return. A better balanced investment portfolio, with a variety of property types, offers a more stable, long-term investment strategy for wealth accumulation.

During periods when Milwaukee Insurance is strong financially and in a position to invest in high risk investments, Milwaukee Realty's current speculative portfolio is appropriate. However, due to the length of time required to change the composition of a real estate portfolio, any sudden changes in economic conditions could leave these investments very exposed, with the substantial carrying costs coupled with reduced property values. Therefore, a greater diversification of properties is desirable.

As financial ability and economic conditions allow, a portion of the portfolio can be invested in speculative land. The present geographic diversification via partnerships with local investors is very effective. In addition, other large equity partners should be brought in to share the costs and the risks of the larger speculative investments. Other geographic areas could be considered depending on the investment opportunities and the qualifications of the local development partner.

A second level of diversification involves developing a portion of the portfolio's land, as was done with the Brookfield property. Development trades off the costs of the increased investment required for development against the benefits of greater revenues and the increased liquidity of the developed property. Another benefit is the opportunity to take an active, rather that a passive, role in creating value.

Building or acquiring income producing properties for a portion of the real estate portfolio offers a third level of diversification. These properties produce cash flow from rents and are often more liquid than land because there are more interested buyers. The value of income producing properties can usually be accurately appraised. An additional benefit of income producing property over land is that improved property offers a hedge against inflation in the form of increased rents and higher costs for new, competing structures. By contrast, land can be negatively impacted by inflation because as the costs of construction increase, demand for land usually decreases.

However, income producing properties have some characteristics that do not fit that well with Milwaukee's goal of producing reportable income. Income properties generally offer more stable, but lower rates of return. Another problem is that depreciation of the structure offsets the income, reducing the net reportable income. Finally, income producing properties involve property management. This results in additional operating costs, further reducing the property's reportable income, or the need for additional staff to enable Milwaukee to manage the property.

Strategy # 4
Addition of Professional Staff

Milwaukee presently operates with the Vice President of Real Estate, and an administrative assistant as staff. To accomplish the goals and to efficiently maximize the values of its existing investments an additional professional person will be required. This person will have general responsibilities in researching investment opportunities, preparing development plans, and taking an active role in marketing and sales.

The four strategies designed to achieve the planning goals of Milwaukee Realty include: a formal restructuring of the management for real estate activities; using forecasting techniques to inform investment decisions; achieving portfolio diversification to manage risk; and increasing the professional real estate staff for more effective management of real estate investment activities.

CHAPTER V

SUMMARY AND ACTION PLANS

Summary of Business Plan

Milwaukee Realty's business is currently in land speculation. Its mission is to generate the maximum amount of reportable income to add to the net worth of its parent company, Milwaukee Insurance. To accomplish this during the planning period will require the realization of the appreciated values of a number of its current speculative land holdings.

Its second goal is for Milwaukee Realty to become an ongoing subsidiary of Milwaukee Insurance in preparation for the retirement of its President, who has been responsible for providing the resources and autonomy that Milwaukee Realty has required to successfully operate. This involves restructuring Milwaukee Realty as a seperate holding company, owning and managing the properties in the real estate portfilio, and also seeking additional investment opportunities.

The third goal of is to improve the management of the risks associated with its real estate activities. Forecasting trends and analizing prospective investments will guide the future selection of acquisitions. Future investment decisions will also be made in consideration of the benefits of further diversifying the real estate investments among several geographic areas and by type of investment. The diversification decisions will be based on the parent company's financial ability to assume risk in return for reportable income.

Action Plans

In this final chapter, the investment activity planned for the real estate holdings of Milwaukee Realty will be presented. An action plan for the current portfolio is designed to conform with the goals and strategies outlined in the foregoing chapter. These include portfolio diversification and profit maximization. Project specific programs were included in the projects discriptions in Chapter Two.

The following are the suggested actions, organized by year, that Milwaukee should take towards achieving its goals. The timing of these events is largely dependent on sales of property. With only one transaction presently under contract, planning based on the presumption of such uncertain events is tentative at best. The schedule as outlined has been established by the Milwaukee management and its partners as a most likely scenario. The likelyhood of the sale of a specific property depends to a large degree on its pricing in relation to other similar properties. A buyer for a property can usually be found if the price is reduced enough. During periods when there are few buyers bidding on properties, the liquidation price could be well below the originally anticipated price. The properties scheduled for sale within the first planning year are either in a very active market where Milwaukee, as seller, is pricing these properties at or slightly below what is considered a "fair asking price" to induce the sale.

1986

* Restructure Milwaukee Realty
* Obtain necessary approvals and complete Shiloh II sale.
* Rezone Westfield project, begin construction of natural area, and market improved commercial building sites.
* Master plan, rezone, and sell 94 Greenway.
* Sell Walden Place townhouse.
* Preliminary forecast modeling and acquisition analysis of north Scottsdale area.

1987

* Develop forecasting model for the Atlanta and Phoenix markets.
* Hire additional professional.
* Complete construction of Westfield natural area, begin sales of Brookfield mixed use sites.
* Sell 92 T-Bird property.
* Sell Shiloh II property.
* Investigate selling or developing Shiloh IV property.

1988

* Continue sale of Brookfield building sites.
* Complete sale or development of Shiloh IV property,

<u>1989</u>

* Continue sale of Brookfield building sites.

CHAPTER VI

CONCLUSIONS

The main function of Milwaukee Insurance´s real estate operation has been to maximize the return on the company´s invested assets. To achieve this, the Company has primarily made speculative investments in undeveloped land. The management structure of the real estate operation involves one professional, the Vice President - Real Estate, reporting directly to the President.

Seeking opportunities in growth markets, the Company has invested in Atlanta, Phoenix, and Milwaukee. Joint venture partnerships are utilized in the Atlanta and Phoenix properties to capitalize on the skills and local knowledge of the joint venture partners. Several of these properties have the potential of substantial profits upon sale. Thus, the most immediate strategy for generating profits is to sell these highly appreciated properties. Moreover, the many risks associated with speculative land investment encourage consolidating any increased property values whenever possible to reduce the Company´s overall risk exposure.

These investment risks require careful attention to assess the Company´s ability and willingness to assume these risks. There are several risk management strategies that can be adopted: diversification - geographic and property type; demographic and market analysis; and the continued use of knowledgeable joint venture partners. Improving the management of these risks will involve investing additional resources to obtain data to analyze the various factors that affect the value of property.

Underlying the successful operation of the Company's real estate activities is the authority and active support of the President. With the President retiring in the next several years, and if the Company chooses to continue to invest in real estate, alternative sources of authority for making decisions and allocating resources will be required. Without the corporate legitimacy and authority supplied by the President, the smaller entrepreneurial real estate operation will be smothered by the larger bureaucratic insurance operation and its culture.

In summary, there are three critical actions required for the continued successful operation of Milwaukee Insurance's real estate investments. The first is realizing the profit from its current investment properties. The second is understanding and managing the risks associated with owning real estate, especially land. And finally, providing alternative forms of authority to enable the real estate operation to survive the retirement of the President.