COUNCIL REPORT

CITY OF MOUNTAIN VIEW

DATE: May 3, 2016

CATEGORY: Unfinished Business

DEPT.: Community Development/Finance and Administrative Services/City Attorney's Office

TITLE: **Business Terms for Disposition and Development Agreement and Ground Lease for Hope Street Lots 4 and 8**

RECOMMENDATION

1. Approve negotiated business terms by and between the City and the developer, the Robert Green Company (RGC), for the development of the Hope Street Lots 4 and 8.

2. Authorize the City Manager to execute the Disposition and Development Agreement and Ground Lease with the RGC for the development of Hope Street Lots 4 and 8 consistent with the business terms negotiated during the Exclusive Right to Negotiate Period.

BACKGROUND

At the January 20, 2015 Study Session, staff presented property information on four downtown surface parking lots (4, 8, 11, and 12). At this meeting, Council expressed support for a mixed-use development on Lots 4 and 8 as the first site to develop (Attachment 1).

On March 31, 2015, Council directed staff to focus initially on development of the Hope Street Lots (4 and 8) and market the long-term ground lease opportunity through a Request for Qualifications (RFQ) and a Request for Proposals (RFP) that would include a hotel and net increase in parking (Attachment 2).

On October 6, 2015, Council directed staff to continue discussions with the RGC focused on exploring mixed-use development options on Lot 8, including some type of residential use, and developing a revised project financing strategy (Attachment 3).

On January 12, 2016, Council approved the RGC as the best-qualified developer to develop the Hope Street Lots and directed staff to proceed with entering into an

Exclusive Right to Negotiate (ERN) Agreement and commence the negotiation process for development of a mixed-use hotel/office development with a unique hotel of at least three-diamond quality, an increase in the number of public parking spaces from 149 to a minimum of 225, revenue generation, and an agreement by the hotel operator to allow enhanced access to hotel employees for labor organizing activities and expedited union voting process. (Attachment 4).

Since then, staff and the RGC have been negotiating in good faith on key business terms that will lay the foundation for the Disposition and Development Agreement (DDA) and Ground Lease. The City Council discussed the price and terms of the lease payment with its real property negotiators in a Closed Session on April 19, 2016 and directed staff to bring this item to the Council on May 3, 2016.

ANALYSIS

Any action on this item is in Council's role as property owner, not as the land use authority; if the recommended actions are taken, the Council will consider the entitlement of the project at a later date.

Key Business Terms

Staff and the RGC have established a constructive and professional working relationship with each party negotiating effectively and in good faith. The proposed project and business terms are as follows:

Scope of Development:

- Hotel on Lot 4—A 180-room Joie De Vivre (JDV) full-service lifestyle hotel featuring at least a three-diamond quality rating per AAA's scale and 5,000 square feet of meeting space, 7,000 square feet of food and beverage service, and a rooftop hospitality deck. The proposed hotel is five stories and 55′ in height. The hotel will meet LEED Silver® Certification Standards.

- Office on Lot 8—A Class A commercial building of 52,725 square feet designed for a corporate headquarters office. Approximately 2,725 square feet is slated for ground-floor retail, café, and/or office lobby space. The proposed office is four stories tall. The office will meet LEED® Certification Standards (Silver or higher).

- Parking—The project as proposed includes a total of 385 parking spaces located in three levels below grade of Lots 4 and 8. There will be at least 225 dedicated public parking spaces available at all times. Currently, 149 public parking spaces are located on Lots 4 and 8. The result is 76 net new public parking spaces. Additional public parking spaces, over and above the 225 dedicated public parking spaces, are likely to be available during evenings and weekends when office employees are not working and during hotel guest nonpeak hours.

- Floor Area Ratio (FAR)—The hotel FAR is 3.24 and the office FAR is 1.85.

- The entire project generally conforms to the land use regulations of the Downtown Precise Plan, though an exception will have to be made because, although it conforms with the 55′ height limit, the five-story hotel exceeds the four-story height limit.

DDA: This agreement governs the development and construction of the project and will cover both the hotel and office building.

Term of Lease: Separate leases will be executed for the hotel and office building along with the DDA. The lease term will commence upon approval of the construction loan and the closure of the two existing surface parking lots. The term of the lease is 55 years after lease commencement. The lessee will have an option of four 10-year extensions for a total of 95 years.

Labor Considerations: The RGC has agreed to allow enhanced access to hotel employees for labor-organizing activities and an expedited union voting process as directed by Council and required by the RFP.

Compensation for Hotel Employees: The RGC has agreed to include a provision in the DDA requiring the hotel operator to provide compensation commensurate with the RFP for employees working at the hotel. The hotel operator will be required to comply with the City's Minimum Wage Ordinance so compensation for hotel employees will meet or exceed the City's minimum wage.

Development Fees: The RGC will pay all normal and customary fees.

Financial Return to the City: The City will receive a financial return from various revenue sources over the term of the lease as follows:

<u>Base Ground Rent</u>

Hotel: Base rent for the hotel on Lot 4 will commence upon issuance of a Certificate of Occupancy (COO). Base rent for the hotel will be $450,000 per year (Year 3 of stabilization) with annual Consumer Price Index (CPI) adjustments.

Office: Base rent for the office building will commence upon closing of the construction loan and termination of public parking on the site. Rent during the first year of construction will be $240,000, payable in equal monthly installments of $20,000. Rent during the second year of construction will escalate to $360,000 per year, payable in equal monthly installments of $30,000 per month. Construction is estimated to be completed in approximately 18 months. The rent will escalate to $400,000 per year with annual CPI adjustments thereafter.

The base rent serves as a floor or guaranteed rent and will be adjusted every sixth year based on the higher of either the minimum base rent as inflated by CPI annually or 75.0 percent of the cumulative average of percentage rent for the preceding five years. Minimum base rent will not decrease. Base rent is established to cover the estimated debt service related to the Certificates of Participation issued by the City to fund the construction of the parking. The debt service is estimated at $870,000 annually, and the minimum base rent commences at $750,000 when the office and hotel open with annual increases. Other revenues and funds (e.g., hotel surcharge, possessory interest tax, sales tax, etc.) can be used to cover the debt service for the initial years.

Percentage Rent

Percentage rent is based on the annual gross revenues of the hotel and office as follows:

Hotel: Percentage rent of 3.0 percent on annual gross hotel revenues with an increase to 3.5 percent in Year 21 and increase to 4.0 percent in Year 31 of operations.

Office: Percentage rent of 10.0 percent on annual gross office revenues with an increase to 10.5 percent in Year 21 and increase to 11.0 percent in Year 31 of operations.

Hotel Surcharge

The project will include a hotel surcharge of 3.0 percent for hotel guests to be levied by the operator, 2.0 percent to be received by the City and 1.0 percent to be retained by the RGC. The City's 2.0 percent surcharge will continue for the life of the lease, unless the City's TOT rate is increased by at least 2.0 percent, at which time the surcharge would be discontinued. City's hotel surcharge for Year 1 of operations is projected at $211,000. The RGC's 1.0 percent hotel surcharge will expire upon reaching a Net Present Value (NPV) of $944,000 (projected to be Year 10 of operations), at which point the 1.0 percent surcharge would be discontinued.

Bonus Rent

The City will receive bonus rent of 5.0 percent of annual revenues in excess of $1.0 million above the amounts established in the pro forma. This could provide additional rent to the City if the project performs better than projected by the RGC in its pro forma and provides some protection to the City to ensure the accuracy of the projections in the pro forma. However, no bonus rent will be provided during the first 10 years if the cumulative gross revenues projected in the pro forma are not received.

Participation Rent

In the event the RGC were to sell or refinance its interest in either the hotel or office building with positive equity, the City would receive additional revenues based on a percentage of gross proceeds for each sale and refinance.

In the case of a sale, the City would receive 1.0 percent of the first sale and 2.0 percent thereafter of gross sales proceeds if a threshold of final project costs adjusted annually by the CPI is met. In the case of a refinance, the City would not participate in the first refinance, but would receive 2.0 percent thereafter of the net refinancing proceeds (i.e., the difference between the new loan and the outstanding balance of the existing loan being refinanced), so long as the appraised value accepted in the transaction by the incoming lender meets the threshold of final project costs inflated by CPI annually. The initial refinancing from the construction loan would be excluded from the participation rent provision.

The final project costs will be determined based on the total of all project costs at the conclusion of construction. The final project costs will be defined for the hotel and office individually. Currently, the project budget is $108.3 million combined; therefore, if the project sells for more than construction cost (adjusted for inflation), the City will receive 1.0 percent on the first sale and 2.0 percent for each subsequent sale. This could generate over $1.0 million at 1.0 percent and over $2.0 million at 2.0 percent on future sales.

Public Parking

The RGC will operate and maintain both parking structures, with 225 spaces dedicated to public parking. The public parking Operations and Maintenance (O&M) allocation is $240,000, again borne by the RGC, which represents a cost avoidance (savings) to the City.

The RGC proposes to provide two hours of free public parking Monday through Friday during business hours. After two hours, public parking will be paid. On nights and weekends, there will be three hours of free public parking. During the initial six months of parking operations, the RGC (with the parking management company) and staff will meet monthly to discuss the status of parking operations. Meetings will occur thereafter as necessary. If there are issues related to the parking, the developer will be obligated to respond to and resolve parking-related issues. Resolution of parking issues related to management and pricing will be in consultation with the City.

If at some future date the Council establishes paid public parking in the downtown, the RGC proposes a new category of public parking revenue would be tracked separately and the RGC would pay the City 50 percent of the gross public parking revenues.

Other Revenues

In addition, the City would receive property taxes (possessory interest) and sales tax generated by the project, estimated at $180,000 in Year 1 of operations.

City Participation: A financial participation of $25.5 million (down from the originally requested $26.4 million) by the City is proposed to offset the project costs associated with the public parking component and the prevailing wage requirement. No out of pocket General Operating Fund dollars will be spent on the project. Staff and the RGC explored various financing strategies and recommend financial participation provisions as follows:

- Parking In-Lieu Fee (PILF) Fund—The City has $5.7 million of PILF for the purpose of increasing parking capacity in the downtown area. Staff proposes utilizing the entire $5.7 million for this transaction, which nets 76 new public parking spaces with the potential for additional public parking on evenings and weekends.

  The City's $5.7 million of PILF funds would be increased if additional PILF funds are received (any increase in PILF would be offset towards reducing the COPs or TOT Rebate). The PILF payment would be paid upon both: (1) closing of construction loan; and (2) developer's evidence of expenditure of its first $5.7 million in equity.

- Certificates of Participation (COPs)—Staff recommends issuing $12.0 million in COPs for the project. The projected annual debt service of the COPs is $870,000 and is proposed to be offset by minimum annual base rent and other project revenues (hotel surcharge, sales tax, possessory interest tax, etc.).

- Transient Occupancy Tax (TOT) Rebate to the RGC—TOT rebate time frame of 10 years:

  – 100.0 percent TOT rebate for Years 1 through 5

  – 90.0 percent TOT rebate for Years 6 through 10

The TOT rebate will expire upon reaching an NPV of approximately $7.8 million or after Year 10 of operations, whichever occurs first, at which point the City will receive the full TOT generated.

A summary comparison of the business terms presented in January 2016 for Council authorization to enter into the ERN and current are outlined as follows:

	Original/January 2016 Proposal	**April 2016 Proposal**
City Contribution	$26.4 million	$25.5 million
Base Ground Rent	$750 Year 1 $825 Year 2 $862 Year 3 3.0% increases annually	Same—plus office rent prior to opening: $420,000 Increases to 75.0% of the 5-year average percentage rent
Percentage Rent—Hotel	3.0%	3.0% Years 1-20 3.5% Years 21-30 4.0% Years 31 on
Percentage Rent—Office	10.0%	10.0% Years 1-20 10.5% Years 21-30 11.0% Years 31 on
Bonus Rent	5.0% revenues > $1.0 million above Pro Forma	Same
Participation Rent	None	1.0% on first and 2.0% thereafter of gross proceeds on sale or refinancing

Required Development Timeline: In its capacity as the land use authority, Council will seek community input and provide direction on site plan, design features, and environmental sustainability, among other development factors. The deal has enumerated performance milestones, including the following:

- The RGC will submit a formal development application in Quarter 3 of 2016.
- An initial Study Session will take place by the end of calendar year 2016.
- Anticipated consideration of development application by the City Council in Quarter 2 of 2017.
- Upon the RGC's construction loan closing, rent will commence and the City will close Lots 4 and 8 for public parking use.

Staff is currently developing temporary public parking solutions in anticipation of closing Lots 4 and 8 for future construction, including options such as valet parking, shared parking agreements, and restriping and paving of Lot 11.

Construction Delay

One of the deal points involves addressing the potential that funding for a hotel project may not be available for a period of time due to a downturn in the economy, particularly for a project of this quality and complexity due to the underground parking. In the event the RGC possesses all of its entitlements but cannot obtain the necessary construction financing to build the project, a reasonable period of delay of up to a maximum of 42 months (3.5 years) is allowed for the market to recover sufficiently for financing to become available. If the financing does not become available within that time frame, the City would have the ability to terminate the DDA and ground leases.

FISCAL IMPACT

The financial terms provide for return to the City as follows:

- Minimum base rent.
- Percentage rent of gross revenues, with increases in outer years.
- Hotel surcharge.

- Bonus rent.
- Participation rent on the sale or refinance of the hotel or office.
- A percentage of paid public parking revenues if applicable in the future.

In addition, the City will receive property taxes (possessory interest), sales tax (estimated at $180,000 initially), and could potentially also receive bonus and participation rent from the project. The bonus rent is difficult to estimate as it is unknown how much or if the project will perform better than the pro forma. The participation rent could generate over $1.0 million on the first sale and could generate over $2.0 million at 2.0 percent for future sales.

The City is projected to receive <u>net annual revenues</u> as follows:

Year 1	$335,000
Year 6	$864,000 (City commences to receive 10 percent of TOT)
Year 11	$2.8 million (City commences to receive 100 percent of TOT)
Year 21	$4.2 million (increase in percentage rent)
Year 31	$6.8 million (COPs paid off and additional increase in percentage rent)

The cumulative cash flow projected is as follows:

15-Year Cash Flow	$17.2 million
30-Year Cash Flow	$84.3 million
55-Year Cash Flow	$311.8 million

The City currently has $5.7 million in PILF to fund additional parking spaces downtown and this would be the City's only out-of-pocket contribution towards the project. The project generates the remaining funding needed for the City's participation in the development of this project, as outlined earlier.

CONCLUSION

Staff believes the RGC is a highly qualified developer and this project will achieve longstanding benefits to the City that enhance the economic vitality of our downtown, including adding a new full-service hotel with meeting space, office for business headquarters, increased public parking, and significant ongoing revenues for City services.

Staff recommends that Council authorize the City Manager to execute a DDA and Ground Lease based upon the business terms outlined in this report.

ALTERNATIVES

1. Do not accept the business terms as outlined.

2. Direct staff to negotiate additional or different business terms.

3. Provide other direction.

PUBLIC NOTICING

Development of the Hope Street Lots may impact residents and businesses downtown during construction. Staff has begun outreach and communication efforts regarding the development project. A page on the City website is dedicated to the project at http://goo.gl/B90onr. Interested individuals can receive notifications and updates about the project via *myMV* (http://mountainview.gov/mymv/). Staff has sent electronic notices and/or postcards to downtown property owners and business owners, and to the Chamber of Commerce, Central Business Association, and Old Mountain View Neighborhood Association. Social media will be used to communicate key steps in this process as well. The meeting agenda and Council report have been posted on the City's website and announced on Channel 26 cable television.

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Attachments:
1. January 20, 2015 Study Session
2. March 31, 2015 Council Report—Hope Street Lots
3. October 6, 2015 Council Report—Hope Street Lots Development
4. January 12, 2016 Council Report—Hope Street Lots-ERN