



City of Arts & Innovation

City Council Memorandum

TO: HONORABLE MAYOR AND CITY COUNCIL **DATE: JUNE 23, 2015**

FROM: PUBLIC UTILITIES **WARD: 1**

SUBJECT: PROPOSED PURCHASE AND SALE AGREEMENT WITH NNN MISSION SQUARE, LLC FOR THE ACQUISITION OF THE MISSION SQUARE OFFICE BUILDING LOCATED AT 3750 UNIVERSITY AVENUE FOR \$37,995,000 – SUPPLEMENTAL APPROPRIATION

ISSUE:

The issue for City Council consideration is approval of a purchase and sale agreement with NNN Mission Square, LLC for the purchase of the Mission Square Office Building located at 3750 University Avenue for \$37,995,000.

RECOMMENDATIONS:

That the City Council:

1. Approve the expenditure of \$37,995,000 inclusive of the purchase price, due diligence, title and escrow fees and related miscellaneous closing costs;
2. Approve a supplemental appropriation in the amount of \$37,950,000 from the unappropriated Electric Fund balance (Fund 510) to the Building and Improvements Account No. 6000010- 462050;
3. Approve a supplemental appropriation in the amount of \$1,200,000 from the unappropriated Electric Fund balance to the Building Maintenance Account No. 6000010-424130, representing the net cost between the first year operating expenses and the amount already budgeted for Mission Square lease costs included in the proposed Fiscal Year (FY) 2015/16 Operating Budget;
4. Approve an increase in estimated revenues for the proposed FY 2015/16 budget in the amount of \$2,200,000 to the Electric Fund Land and Building Rental Account No. 0000510-373100 to reflect tenant income from commercial operation of the building;
5. Adopt the appropriate reimbursement resolution to provide the future option of using bond funds instead of operating funds for the capital financing requirements;
6. Approve the purchase and sale agreement with NNN Mission Square, LLC for the purchase of the Mission Square Office Building and parking structure; and

7. Authorize the City Manager or his designee to execute the Agreement, including making minor non-substantive changes and to sign all documents and instruments necessary to complete the transaction.

BOARD RECOMMENDATION:

The Board of Public Utilities (Board) considered this item at their regularly scheduled meeting on June 19, 2015. Staff will provide an oral update regarding the Board's recommendation during the City Council presentation.

BACKGROUND:

The Mission Square Building consists of approximately 127,533 square feet of rentable office space in a six-story building plus a basement level and a 489 parking stall garage situated on approximately 2.5 acres of land (Property). The Property was originally constructed in 1984. Riverside Public Utilities (RPU) staff currently occupies floors 3, 4 and 5, which represents about 58% of the total building space. The lease expires on September 30, 2022 and the remaining lease obligation is slightly over \$20 million.

Staff previously received City Council approval during closed session on October 21, 2014 and April 7, 2015 to negotiate the acquisition of the Mission Square Building located at 3750 University Avenue. City staff and the Seller have reached mutually agreeable terms and a negotiated purchase price of \$37,950,000 for the Property. A purchase and sale agreement (Attachment 1) for the Property is attached that has been executed by the Seller. The City procured an appraisal from R.P. Laurain & Associates with a date of value of April 10, 2015 that supports the purchase price. The following is a summary of the key deal points contained within the Agreement:

- Deposit of \$750,000 due within 30 days from full execution of agreement and is refundable during the due diligence period;
- The City has until August 1, 2015 to complete all due diligence items such as title review, physical inspections, environmental studies, obtain an appraisal, lease and financial document review;
- The City will procure a third party independent appraisal to confirm the value of the Property (this has been completed);
- City Council to approve the purchase and sale agreement prior to August 1, 2015;
- Deposit becomes non-refundable after August 1, 2015, but applied toward the purchase price at the close of escrow;
- Escrow to close on October 12, 2015;
- Seller to credit City in the amount of \$141,240 toward the purchase price for future Morgan Stanley tenant improvements;
- Seller to have escrow holdback of \$405,960 in funds for future Gresham Savage tenant improvements; if funds are not used prior to expiration of the lease on March 31, 2019 then escrow will return the unused funds to Seller; and
- Seller agrees to indemnify City up to \$350,000 within twelve months from the close of escrow should City identify any soil condition that requires environmental remediation.

In order to meet the schedule set by the seller, staff was able to have several property inspections performed as part of the City's due diligence process. A summary of the due diligence and property inspections is described below:

Structural

The City hired Knapp & Associates to perform a structural inspection of the property. The building was constructed in the early 1980's and does not meet current seismic codes. The building is grandfathered

in as far as its continued use, as long as no additions are made to the building's size, and no alterations are made that would weaken the existing lateral systems of the building. The consultant suggests that if the City wanted to strengthen the building, it could carbon fiber wrap the existing concrete beams and columns which would be the most cost effective and structurally beneficial approach. The development of a cost estimate for such an improvement was not included in the consultant's scope of work. A high level estimate of the cost places it on the order of \$3,000,000; however, disruption of the building occupancy would likely push the cost considerably higher. There is no urgency to conduct a seismic retrofit.

Mechanical, Electrical & Plumbing

The City hired Tmad Taylor & Gaines Engineers who prepared a mechanical, electrical and plumbing equipment and systems (MEP) inspection report on March 9, 2015. The report concluded that the building MEP systems and major equipment were found to be generally in fair to good condition. All equipment was operational and in serviceable condition. Most of the equipment appears to be well maintained and some of the original heating and cooling equipment components have been replaced over the years. However, much of the major equipment is at or near the end of its expected service life. The report also noted that the existing MEP systems do not meet current Energy Codes or Title 24 Energy standards. The report recommended that in the short term the City should plan for unexpected equipment failures and additional component replacements. Staff estimates the cost for long-term MEP equipment replacement is approximately \$2,500,000.

Elevators

The City had Executive Elevator, Inc. perform an elevator inspection on April 10, 2015. The report concluded that all four elevators were running properly at the time of inspection but noted that the elevators have exceeded their 25-30 year life expectancy by about 2-7 years. Staff estimates the cost to replace the elevators is approximately \$2,500,000.

Roof

The City had the Garland Company, Inc. prepare a roof inspection report dated April 22, 2015. Only the upper roof section was inspected since the lower patio roof section was inaccessible at the time of inspection. The report concluded that the upper roof is in overall fair condition and some areas of the protective white coating need to be repaired along with a clean-out of drainage pipes and some minor re-sealing. Staff estimates the approximate cost to make these minor repairs at \$10,000.

Asbestos

The City procured a limited asbestos survey report from Converse Consultants dated April 22, 2015 which sampled suspect building materials located within common areas such as corridors, plenums above suspended ceilings, stairwells, electrical and mechanical rooms. The survey did not detect asbestos in the building materials sampled. However, the report recommended that further asbestos testing be performed prior to any renovation of tenant occupied space.

Phase I Environmental Assessment

The City hired SCS Engineers who performed a Phase I Environmental Assessment report in May 2015. The report did not identify the presence of any hazardous materials present on site. However, the report did identify that three former gas stations formerly occupied the site from 1930 until at least 1969. There were no historical records found to determine if these former gasoline stations and/or automotive service operations have resulted in subsurface impacts to the Property. Therefore, the report concluded that the presence of these former gas stations and automotive service operations at the Property is indicative of releases or threatened releases of hazardous substances that are considered a recognized environmental condition (REC). Staff believes that if there were any former underground storage tanks on the Property, it is highly likely that they would have been removed as a result of construction of the

office building in the 1980's since excavation for the foundation and basement would most certainly have required their removal if these underground tanks were present. As such, staff believes the risk for any potential REC is very low. The Seller has agreed to indemnify the City up to \$350,000 for 12 months from the close of escrow should the City determine that there are any REC's that require clean-up.

Americans with Disabilities Act

The City hired Brian H. Lee, Architect, who is a Certified Access Specialist to inspect the Property for any potential Americans with Disability Act (ADA) issues. As of the writing of this report, receipt of this inspection report is pending. No major issues were found during the inspection. Minor adjustments to certain areas of the parking garage may be indicated in the inspection report. Staff will provide a briefing of the inspection report result in oral comments.

Financial Modeling

Staff has constructed a financial model to evaluate the proposed acquisition versus a long-term leasing arrangement. Assumptions in the model were based on current tenant revenues and on-going operating expenses. Costs identified in the inspection reports (with the exception of the seismic retrofit) were included in the model. The model assumes continuing the majority of the leases to private tenants as they term out. Staff anticipates RPU would occupy an additional 8,000 – 10,000 square feet over the financial modeling period as that space becomes available and vacant. Future revenues and costs have been escalated in the model to reflect inflation. Standard commercial terms for commissions and leasing costs, including tenant improvement allowances have been incorporated. All of the assumptions in the financial model have been vetted with the City's professional financial advisor, commercial broker and internal General Services Department staff.

Staff recommends creation of separate sinking fund and operating reserves for the building. The sinking fund reserve balance would be funded through tenant revenue and would grow to \$12,600,000 based on 25% of the projected future value of the building. An operating reserve equal to 100% of gross operating revenues is recommended to smooth cash flow related to commercial operation of the building.

The results of the financial modeling indicate a 30-year nominal dollar value of \$32,600,000 for ownership versus the cost of leasing. The net present value of those nominal dollars is \$18,500,000. These values include the proposed reserves that would grow to \$16,700,000 by the end of the 30-year modeling period.

FISCAL IMPACT:

The cost to acquire the Property will be \$37,950,000 plus approximately \$45,000 in due diligence, title, escrow and related closing costs for a total amount not to exceed \$37,995,000 million. The supplemental appropriation for the purchase of the building will be transferred from the Electric Fund balance to the Building and Improvements Account No. 6000010-462050. Included in the FY 2015/16 proposed operating budget are \$2,500,000 in Mission Square lease expenses which will be used to offset the first year operating expenses for the facility. The supplemental appropriation for the remaining costs of \$1,200,000 will be transferred from the Electric Fund balance to the Building Maintenance Account No. 6000010-424130. The first year costs of operation will be offset by tenant income of approximately \$2,200,000.

Prepared by: Girish Balachandran, Public Utilities General Manager
Certified as to
availability of funds: Brent A. Mason, Finance Director/Treasurer
Approved by: John A. Russo, City Manager
Approved as to form: Gary G. Geuss, City Attorney

Attachments:

1. Purchase and Sale Agreement – 3750 University Avenue
2. Reimbursement Resolution