TO: Mayor and Council

FROM: Steven D. Powers, City Administrator

CC: Tom Crawford, CFO
Mary Joan Fales, Senior Assistant City Attorney
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SUBJECT: 2/18 Council Agenda Item DS-6 - Resolution to Approve Exercise of Right of First Refusal

DATE: 2/18/14

Terms of the Right of First Refusal

In accordance with the terms of the Industrial Facilities Exemption Certificate Agreement Between the City of Ann Arbor and Edwards Brothers, Inc. and the Term Sheet regarding the purchase of the property, dated November 22, 2013, between Edwards Brothers Malloy, Inc. and Edwards Property Management, LLC and the University of Michigan, the City has until February 26, 2014 to exercise its Right of First Refusal. If the City exercises its Right of First Refusal then the City must close on the purchase by February 28, 2014.

The purchase price for the 16.2 acre site is $12,800,000. The Term Sheet requires that the seller execute a lease at closing in which the seller will pay the purchaser monthly rent of $250,000 along with all property taxes and expenses. The lease term is March 1, 2014 to December 31, 2014, with a total value of $2,500,000. (The City has requested the lease but it has not been provided to-date so we have not confirmed all of the lease terms.)

Environmental remediation may also impact the total cost of purchasing the land. The Term Sheet requires that the purchaser of the land is responsible for the first $200,000 in environmental remediation costs. The seller of the land is responsible for the next $300,000 in projected environmental remediation costs, with any remaining costs being the responsibility of the purchaser.

Due Diligence

On January 6, 2014, City Council directed the City Administrator and the City Attorney to gather appropriate information to be used by the City Council to evaluate whether to exercise the City's Right of First Refusal. Consistent with the City standard procedures for evaluating the acquisition of real property, the City Attorney's office ordered and reviewed title documents and a survey of the property to ensure that Edwards Brothers could convey good and marketable title. The title documents did not disclose any issues and the survey confirmed there are no deviations from the apparent boundaries. A review of existing cell tower leases was completed. Also, an Environmental Site Assessment of the property and physical inspection of the building and related asbestos survey were conducted. Post Closing, if the Right of First Refusal is exercised, a Baseline Environmental Assessment establishing that the City has completed all appropriate environmental inquiries and a Due Care Plan will be completed which will address asbestos disposal as part of any demolition of the existing building, and any required remediation activities on the site.

At or before Closing, if the Right of First Refusal is exercised, lease terms for Edwards Brothers occupation of the building for the period of March 1, 2014 through December 31, 2014 and any required assignments for the existing Cell Tower Leases will be finalized.

Analysis of City's Options Regarding Purchase

A team of City staff have been reviewing the City's options regarding purchase of the property. The team has discussed and analyzed all of the City's available options given the City's Right of First Refusal. We understand that one of the main goals in purchasing the property would be to protect the City's tax base.

<u>Financial Analysis</u>

The following financial analysis details potential financial impacts of the purchase on the City's General Fund, the overall impact on the City, as well as impacts on all taxing jurisdictions combined.

Several key assumptions have been made for the purpose of this analysis:

1. The specific terms of Edwards Brother's leaseback for ten months do not include an early termination provision.

2. The net present value over 25 years was utilized for each scenario.

3. The effect of the property being removed from tax rolls:
   - Present value of the General Fund's lost Real Property taxes is approximately $510,000.
   - Present value of all taxing jurisdiction's lost Real & Personal Property taxes is approximately $6.2 million.

4. If the City exercises its Right of First Refusal, the General Fund is likely liable for 100% of any losses.

5. Since Edwards Brothers has already negotiated an agreement with the University of Michigan, staff considers all costs and lost taxes a sunk cost at this point in time. Council may decide to try to gain some of the lost taxes back by exercising the Right of First Refusal.

6. Where a range of potential proceeds from the sale of the site are possible, staff based their assumption on the appraised values and not what the University has offered to pay. Given interest in the property, staff is assuming a low likelihood of selling below appraised values.

7. Sale of the property by the City assumes a $7.9 million sales price in year two (equal to the value of the collateral) with a $25 million project developed including a $1.5 million Brownfield. This is equal to the lower end of the range below, and we recognize that the sales price may differ, along with the value of development on the property.

Millage Rate Scenario	City Purchases and Holds (Mils.)	City Purchases but is unable to Sell (Mils.)	City Purchases and Sells (Mils.)
	Net Present Value		
8 mills – City General Fund Impact	$ (10.0)	$ (4.0)	$(2.4) - $1.9
16 mills - Total City Impact	$ (10.0)	$ (4.0)	$(1.2) - $3.1
59 mills - All Jurisdictions	$ (10.0)	$ (4.0)	$5.3 - $9.6

The analysis shows that there is a possible negative impact in every scenario, except where the benefit of the taxes to all taxing jurisdictions is taken into account. Also, we note that if the City is unable to recoup the $4.5 million of General Fund balance that is assumed will be used to finance the acquisition of the site, the General Fund balance would fall to the 9% to 10% of expenditure range from the existing 14% to 15% range.[1]

Possible Scenarios Regarding the Purchase

We understand that there may be other goals regarding purchase of the property in addition to the goal of protecting the City's tax base. The following analysis builds on the financial analysis provided above, with consideration of the achievement of various goals, along with the possibility of risk. We considered the most likely scenarios regarding the purchase of the property given all information that we have acquired to-date, including our due diligence on the property as well as discussions with developers who have expressed interest in acquiring the property from the City if the City purchases the property.

The most likely scenarios along with their descriptions are:

1. **Decline to exercise the Right of First Refusal**: Inform Edwards Brothers that the City will not exercise its Right of First Refusal.

[1] The City has received informal inquiries regarding other City-owned land, and if any of these come to fruition, the proceeds of sale could have a positive impact on the General Fund.

2. **Purchase the property and negotiate with the University**: Purchase the property, and then negotiate with the University of Michigan to find a mutually agreeable solution for the use of the land.

3. **Purchase the property and enter an agreement to sell the property to a sole developer**: Purchase the property, and then select one of the developers who have approached the City and negotiate a Purchase Agreement/Option Contract with that developer exclusively.

4. **Purchase and sell the property to a developer chosen by RFP or after listing the property for sale**: Purchase the land, and prepare the land for sale, including rezoning, if necessary. Offer the land for sale as part of an RFP or by listing the property for sale with a broker and receiving bids (such as with the sale of the former YMCA lot).

Along with the information below regarding the likely scenarios, we have also provided the attached chart that addresses whether the scenarios would likely meet various goals, as well as what risks and uncertainties are possible with each scenario.

<u>Scenario 1</u>
Scenario 1, Decline to exercise the Right of First Refusal, has the least financial risk for the City, as no general fund dollars, or other funds will be used for purchase of the property. This scenario may reinforce good relations with the University of Michigan, and would immediately lead to City resources that are being used for this effort being able to be redeployed to other City business.

<u>Scenario 2</u>
Scenario 2, Purchase the property and negotiate with the University, ultimately may allow for the City to retain a portion of the parcel on the City tax rolls or receive some compensation for lost tax revenues. This scenario also provides an opportunity for reaching a collaborative community solution for all parties that takes into account the land needs of the University, as well as the City's economic health. Of course, such a process may not ultimately lead to a mutually agreeable solution.

Regardless of ownership of the parcel, City Council should request that the University of Michigan participate in discussions with the City about the University's future development plans, potential land acquisitions, and the City's master plans.

<u>Scenario 3</u>
Scenario 3, Purchase the property and enter an agreement to sell the property to a sole developer, would keep the property on the tax rolls, as well as increase the tax base for all taxing jurisdictions. An appropriately scaled development could also become a catalyst for additional development along the State Street corridor. Of course, as shown in the financial analysis, this scenario would not necessarily lead to a net increase of general fund or tax dollars given the City's initial investment. Other possible negative impacts include the impact of the initial purchase price and carrying cost on the General

Fund balance, the opportunity cost for the use of City resources, as well as the possibility that the property may require more density than the community desires in order for the City to be able to recoup most or all of its investment in the property.

Consistent with this scenario, we have had several discussions with developers who are interested in purchasing the property from the City. Generally, these meetings have been productive, with several who have expressed interest in working with the City exclusively regarding potential development of the property related to the City's purchase.

An example of the specific terms being offered by one such developer, include the following:

- Project: Student Housing
- Purchase price: $12,800,000
- Earnest money: $150,000, with balance of purchase price paid at closing
- After 90 days from execution of the Purchase Agreement and payment of earnest money, the developer may terminate the Purchase Agreement for any reason (including a determination that the project is not feasible).
- For the next 210 days, purchaser secures government approvals, which would include, but not be limited to, rezoning and site plan approval, and possibly Brownfield approval (which the City does not have final approval authority) and other approvals for the site. Earnest money would not be refundable to the developer during this period, unless the developer does not receive necessary governmental approvals during this time.

Although discussions with developers are ongoing, and there have been many inquiries about the property, the types of terms being offered do not provide the City with guaranteed funds to support the purchase of the property.

Also, the general terms do not specify the required zoning or other specific government approvals required to build the project. In fact, most developers have not provided, or been able to provide, specifics as to the exact zoning and density that would make such a project economically feasible. Other developers have indicated a purchase would be conditional on the City rezoning the property to C3, allowing dense commercial uses. As such, the eventual result of a project under this scenario may be one that exceeds the density desired by the community or what is specified in the City's Master Plan. Some developers have suggested that they would require a significant retail component or all retail, where the City's Master Plan specifically calls for residential, office, or mixed use if the site is rezoned, but does not specifically identify commercial as a preferred use of the site.

The recently adopted <u>South State Street Corridor Plan</u> provides future land use recommendations for portions of the corridor. The recommendation for the Edwards Brothers site is Site 1-E in the Site Specific Recommendations section (page 28):

Site 1-E– This 16.7 acre site is located on the west side of South State Street and is surrounded on three sides by land owned by the University of Michigan. The site currently is being used as a book manufacturing facility. This use and similar light industrial uses, in addition to office uses, are consistent with the existing M1 (Limited Industrial) zoning and should be allowed to continue. If this parcel is redeveloped in the future, residential and a mixture of office and residential uses would be appropriate for this site. Office uses would be consistent with existing office uses along South State Street just north of the site. Residential uses would support the intensification of the University of Michigan's South Athletic Campus as well as provide housing opportunities for students and employees working at nearby office uses. The O (Office) zoning designation would be the most appropriate zoning designation to support these future land uses.

The Master Plan does support commercial uses in the corridor through the following recommendations:

CM-11: Preserve economic development potential by creating opportunities for high quality, attractive development and redevelopment. (Page 11)

2. Provide opportunities for more local services, such as restaurants, pharmacies, salons, etc. to accommodate the daily needs of visitors, employees and future residents in the area.

LU-11: Promote mixed land uses (residential and office or residential and ancillary retail) along the corridor. (Page 13)

Other recommendations which could be relevant to the site include:

CE-1: Evaluate the feasibility of using vacant or underutilized parcels for alternative energy generation. (Page 9)

CM-3: As housing is integrated into the corridor, encourage expansion of affordable housing options. (Page 10)

4. Location of Connector Transit Station – The location of a transit station north of East Eisenhower will be determined in the second phase of the Connector study, which should be completed in 2013. (Page 34)

Scenario 4

Scenario 4, Purchase and sell the property to a developer chosen by RFP or after listing the property for sale, offers many of the same benefits as Scenario 3, but would also allow the City to have a more deliberative process regarding the eventual sale and development of the property. The City could take additional time for planning, and could proactively rezone the property in order to reach a desired result. This scenario may also include a better selection process to identify an appropriate developer, and the increased competition among potential developers may lead to a more favorable sales price to repay the City for its purchase of the property. This scenario also provides the City with additional time to engage the University in long-term planning discussions to see if there is a mutually beneficial solution in regards to the property, such as dividing the property for use by a private developer and the University. The City could also require that a developer provide specific public benefits in such a scenario, such as providing a location for a connector transit station, as mentioned in the recommendations of the Master Plan quoted above.

During the initial period in which the City holds the property, the Term Sheet indicates that the City would receive rent from Edwards Brothers. The City could also perform environmental remediation and use the property for other purposes during this time.

Possible negative impacts of this scenario include that the City's initial purchase may keep the property off the tax rolls during the period that development is being considered. Also, as with Scenario 3, there is the impact of the initial outlay of the purchase price to the General Fund balance, as well as carrying costs which could extend for some time. There is also the possibility, although somewhat remote, that the City could end up holding the property for a prolonged period of time.