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Civic Center Redevelopment: City of San Diego entering into an ENA with Gerding Edlen

Board Action: SUPPORT the City entering into an Exclusive Negotiating Agreement with Gerding-Edlen that poses minimal financial risk to the City.

Background on the Civic Center Redevelopment

San Diego's Civic Center Complex is four square-blocks comprising approximately 6.1 acres and housing five public structures: CAB (the City Administration Building), San Diego Civic Theatre, Convention and Performing Arts Center, Evan Jones Parkade, and COB (the City Operations Building/Development Services Center).

In December 2007, a committee selected two developers for the proposed redevelopment of the Civic Center Complex. Out of the eight responses to the city's RFP, Gerding Edlen and Hines were selected as finalists. In August of 2008, Hines withdrew their proposal and Gerding Edlen became the remaining redevelopment candidate.

In April 2008, CCDC (Centre City Development Corporation) released a Facilities Needs Assessment Report and a Facilities Conditions Assessment Report citing the need to redevelop the Civic Center Complex.[1] The study concluded that there needs to be an estimated $125 million in renovations—which include retrofitting and removal of hazardous materials, including asbestos.[2] An additional reason noted for the redevelopment of the Civic Center Complex is that current leases that house 2/3 of the city's workforce expire in 2013 and 2014.[3]

The City and CCDC have opted to study seven non-development alternatives and seven development alternatives for the Civic Center Complex. These will be outlined in Tables 1 and 2 on the following pages. The city hired financial consultant Jones Lang LaSalle (JLL) to perform a cost analysis regarding these alternatives. JLL concluded that the least costly alternative was to have the land redeveloped by a private developer. JLL's initial study was released in May of 2008.

CCDC hired Ernst & Young (EY) to conduct a peer review (third party analysis) of JLL's study. They found that current market evidence does not support rental rates or construction growth rates used within the study. As a result, there may be significantly different gaps among development and non-development alternatives. In addition, EY recommended changing the fifth alternative to a 10-year hold-steady, since a new City Hall would be needed if major renovation were not conducted. This report was released in March of 2009.

[1] Gensler was the consultant for the Facilities Needs Assessment Report and DMJM was the consultant for the Facilities Condition Assessment Report and its supplemental study.
[2] The Facilities Condition Assessment Report notes that there are deficiencies totaling $93.6 million. $125 million is from JLL's interpretation in their May 2009 Updated Financial Evaluation Briefing.
[3] These leases currently cost the city $13 million annually.

In response EY's report, JLL released an updated financial analysis on April 23, 2009. To respond to various concerns and changes in market conditions, JLL released an additional report on May 20, 2009.[4]

When the city issued RFPs, it had the following development objectives:

- Lowest cost alternative
- Minimum LEED Silver certification
- "Smart Growth" principles: Livable and walkable streets; "sense of place"; mixed-use (if residential, affordable units must represent a minimum of 20%)
- Anchorage to C street and the Core District
- Optimization to city services and civic engagement
- Potential job growth that occurs with private development
- Efficient and cost-effective city operations; productive and healthy work environment

[4] Irving Hughes, the current leasing agent for the city's leased buildings, released a report in May 2009 that raised the implication that rates used in JLL studies were inflated. JLL acknowledged at the San Diego City Council Rules Committee meeting on May 27, 2009 that this was true, and they adjusted their assumptions accordingly. This updated May report included updated financial assumptions, changes due to professional opinions, updated lease renewal proposals, included buildings' residual value, updated Parkade cost data, and provided representation of gross and net City Financial obligations.

Gerding Edlen has divided its project into three phases, which are:

- Phase I (completed 2013): a 34-story City Hall, a Council Chambers and Customer Service Center adjacent to City Hall, ground floor retail, public plaza, and the reopening of B Street.

- Phase II (completed 2016): renovation of the theatre, mixed-use on Block 13 and Block 15, demolition of the parkade, and additional underground parking.

- Phase III (completed 2018): demolition of the City Operations Building, fire station move, additional underground parking, and mixed use on Block 1.

Table 1: Gerding Edlen Development Alternatives. Note: the proposals being considered most frequently are A, B, and D (highlighted below).

Alternative	**Description**	**10-Year Nominal Costs**	**15-Year Nominal Costs**	**50-Year Net Present Value**[5]
Alt. A	Provides for full development of Phases 1, 2, and 3. Land is sold to developer. City receives Phase I Parking Revenue.	$179.3 million	$338.5 million	$600.8 million
Alt. B	Provides for full development of Phases 1, 2, and 3. Land is leased to developer. City receives Phase I Parking Revenue.	$222.2 million	$355.0 million	$554.2 million
Alt. C	Provides for full development of Phase 1 only. City retains excess land. Assumes Parkade occupancy at 50%. City receives Phase I Parking Revenue.	$231.4 million	$384.2 million	$626.0 million
Alt. D	Provides for full development of Phase 1 only. City retains excess land. Assumes Parkade occupancy at 80%. City receives Phase I Parking Revenue.	$226.5 million	$372.9 million	$592.4 million

[5] Net Present Value is the total present value of something over time—given a respective discount rate. JLL uses 2013 dollars for this.

Alt. E	Provides for full development of Phases 1, 2, and 3. Land is sold to developer. City does not receive Phase I Parking Revenue.	$185.4 million	$357.0 million	$721.9 million
Alt. F	Provides for full development of Phases 1, 2, and 3. Land is leased to developer. City does not receive Phase I Parking Revenue.	$231.2 million	$373.7 million	$672.2 million
Alt. G	Provides for full development of Phases 1, 2, and 3. Land is sold to developer. City does not receive Phase I Parking Revenue.	$207.2 million	$399.6 million	$867.5 million

Source: Jones Lang LaSalle. "Updated Financial Evaluation Briefing: San Diego Civic Center Complex." 23 April 2009.

Table 2: Non-development Alternatives. Note: the proposal being considered most frequently is the "Hold Steady" (highlighted below).

Alternative	**Description**	**10-Year Nominal Costs**	**15-Year Nominal Costs**	**50-Year Net Present Value**
Alt. 1	Renovate existing city-owned buildings and continue to lease building space.	$254.6 million	$426.3 million	$998.1 million
Alt. 2	Renovate existing city-owned buildings, acquire Civic Center Plaza, convert workspaces to efficient standards, and lease reduced space.	$238.4 million	$373.5 million	$844.1 million
Alt. 3	Renovate existing city-owned buildings, continue to lease Civic Center Plaza, convert workspaces to efficient standards, and lease reduced space.	$238.8 million	$372.9 million	$871.7 million
Alt. 4	Renovate existing city-owned buildings, convert workspaces to efficient standards, convert Concourse into office space, and lease reduced space.	$225.6 million	$335.8 million	$784.7 million

Alt. 5: "Hold Steady"	Renews existing leases for five years with no improvements. Performs only necessary improvements to preserve safety and functionality. In five years the city seeks a new development partner for a targeted date for City Hall completion in 2018.	$216.8 million	$416.3 million	$789.8 million
Alt. 6	Renovate existing city-owned buildings, convert workspaces to efficient standards, convert Concourse into office space, and lease reduced space in suburban locations.	$229.3 million	$344.9 million	$809.6 million
Alt. 7	Renovate existing city-owned buildings, convert workspaces to efficient standards, and lease reduced space in suburban locations.	$242 million	$388.2 million	$910.3 million

Source: Jones Lang LaSalle. "Updated Financial Evaluation Briefing: San Diego Civic Center Complex." 20 May 2009.

In addition to these alternatives, another option has been presented: landowners in a strategic downtown location have offered a low rate with a 40-year lease with option to buy. This deal will lease 580,000 square feet to the city for 40 years at a rate lower than what the city is currently paying. At the end of the lease, the city has the opportunity to purchase the space for $1.

In May 2009, DMJM/AECOM was asked to release a supplemental analysis in light of changes in current conditions. The report concluded the following:

> "These buildings all have substantial need for individual deficiency repairs as well as system-wide capital renewal replacements. These buildings are approaching 50 years of a life cycle, and many of the existing systems have reached or exceeded their serviceable life."[6]

The analysis operated under the assumption that critical repairs and replacements in each building would be conducted within five years for Gerding Edlen's proposal and within ten years for the hold-steady scenario. Under the Gerding Edlen scenario, over five

[6] AECOM. "Facilities Condition Assessment Supplement." *San Diego Civic Center Complex*. Page 3.

years, there will be an estimated $19,465,765 in minimum expenditures; under the hold-steady scenario, that figure would be doubled to $40,092,407 in ten years.[7]

Policy Implications and Questions

1. The Ernst & Young report has noted that Scenario 5 ("Hold Steady") is not a feasible alternative. On page 56 of their report, they state that "continuing to renovate these buildings on an emergency basis is not an appropriate management plan for a City. This scenario has the most significant risk potential.."

2. JLL uses a fifty year timeline, which may be too long of a horizon to look at the Net Present Value of redevelopment over time—especially given the costs and need for maintenance and renovation.

3. JLL compares the "Hold Steady" scenario to each of the development alternatives, but in that scenario, it uses a smaller City Hall. This skews the data since it is not comparing two similarly sized buildings.

4. According to Gerding's representatives, once the city enters into an Exclusive Negotiating Agreement (ENA) with Gerding, the city would bear all expenses if any redesigns, plan changes, or feasibility studies are done. It is also unclear what the guidelines for these are.

5. If properties are sold instead of being leased, the city has the potential to lose out on a large amount of money ($66 million made if it is sold compared to $330 million made if it is leased). In addition, if the city leases land for a private development, it has to go to the vote of the people, but when the land is sold for a private benefit, it does not.

6. If the state propositions fail, the state government has already warned local governments that they will see reductions in their budgets. The City of San Diego stands to lose approximately $36 million.

7. LEED Silver certification is a minimum standard of the RFP. It should be noted that having a sustainable building does not require LEED-certification, and obtaining that certification could amount to additional millions that will ultimately be borne by taxpayers.

[7] The analysis notes that "a minimum expenditure approach to maintaining these buildings over a five-year period, and especially a ten-year period will render these buildings in a condition that will face them to be demolished at the end of the pro forma period." DMJM/AECOM. "Facilities Condition Assessment Supplemental: San Diego Civic Center Complex." Available from http://media.ccdc.com/resources/resource_files/projects/civiccenter/Attachment%20EE%20-%20DMJM%20Supplemental%20Analysis.pdf. May 2009, Page 3.