

TO: HONORABLE CITY COUNCIL

FROM: CITY MANAGER DEPARTMENT:ADMINISTRATIVE SERVICES

DATE: MAY 10, 2004 CMR: 253:04

SUBJECT: LEASE OF OFFICE/RETAIL SPACE IN THE NON-PARKING AREA ON THE LOT S/L SITE, 445 BRYANT STREET

This is an informational report and no Council action is required.

BACKGROUND

On March 19, 2001, Council approved a new University Avenue Off-Street Parking Assessment District to provide funding to design and build two new parking structures on Lots R (High/Alma South Garage) and S/L (Bryant/Florence Garage). In addition to building a parking structure on the Lot S/L site, Council approved construction of a non-parking area that would be an extension of the parking garage. Costs for building the extension were to be paid from the City's General Fund. Initial plans for this area were for a downtown teen center, with the remaining space to be used for rental and other commercial purposes. Rent from commercial users was to be used to offset the City's debt service costs for constructing the non-parking area.

On May 14, 2001, as a result of a Youth Master Plan study and a student survey indicating teens would prefer having more programs, activities and special events rather than a new downtown teen center, Council approved a staff proposal endorsed by the Youth Council to allocate 75 percent of net revenues derived from renting the entire non-parking area to funding youth and teen activities. On December 10 and December 17, 2001, Council reviewed and approved the financing for construction of the non-parking area on the Lot S/L site. Construction of the Lot S/L garage, including the non-parking area, was completed in February 2004.

DISCUSSION

Staff is currently advertising the non-parking area for lease. The building area is 7,410 square feet, consisting of two 3,705 foot floors of open bare space ready for a tenant to build to suit. The space is divisible to 1,500 square feet, and the zoning allows for ground floor retail and second floor office or retail. During the design process, Council specified

the uses that would be permitted under the Ground Floor Combining District (GF) as: 1) eating and drinking; 2) personal services; 3) retail services; and 4) travel agencies. Financial service providers are not allowed nor are any conditional uses. The space includes a common area required for access to the second floor that would prohibit a restaurant use larger than 1,700 square feet from occupying the first floor. The City will be responsible for maintaining the outside of the building, the roof and heating and air-conditioning system (HVAC). The tenant will be responsible for all other maintenance, taxes and insurance. Tenant improvements are estimated to cost \$80-\$100 per square foot.

The non-parking area of the Lot S/L garage was constructed for less than the budgeted cost, leaving \$1 million remaining in bond proceeds. Staff plans to use some of these remaining funds to pay for shell improvements, such as the HVAC, in order to assure the equipment is installed that is easiest for the City to maintain. The City's cost would be approximately \$40 to \$50 per square foot (\$296,400 to \$370,500) of the total tenant improvements of \$80-\$100 per square foot (\$592,800 - \$741,000).

In its December 10, 2001 report to Council regarding the financing of the construction of non-parking space on Lot S/L (CMR:444:01), staff estimated rental revenues would be \$462,000, assuming a \$4.50 per square foot rent for second floor office space and \$5.00 per square foot rent for first floor retail space. This amount would have covered the projected annual debt service payment on the taxable Certificates of Participation (COPS) of around \$331,000, leaving net revenue of \$131,000 to partially offset the Barker Hotel assessment; for youth and teen services; and for General Fund revenue. However, since the 2001 staff estimates, the current market for office/retail space has weakened, and the leasable square footage is actually less than originally thought. Staff has begun advertising the space for lease and has received several offers. The highest per square foot rental proposed so far is \$3.00. If the entire site is leased for \$3.00 per square foot, the annual rent would be \$266,760, far less than the 2001 projected rent of \$462,000. Although the actual annual debt service payment for the S/L lease space COPS is \$320,000 (less than the \$331,000 projected in the 2001 staff report), it would require a rent of at least \$3.70 per square foot to cover the annual debt service payment.

To better market the property and get the best rent and longest lease, the City may have to pay a real estate agent commission. A commission would be based on a maximum \$1.50 per square foot up to a maximum of \$10 per square foot (\$75,000). Paying for tenant improvements out of the COP proceeds is authorized; however, real estate commissions are not. Therefore, funds for the commission would need to come from the rental proceeds.

It should be noted that while the initial rent for the lease of the S/L space is less than the \$3.70 per square foot needed to cover the annual debt service payment, the S/L rent will

increase each year over the term of the lease. The annual COP lease payment remains constant for its 20-year term, so it is likely the revenue from the leased space will grow to cover the payment. As an example, if the entire space were to lease for \$3.00 per square foot and each year the rate was increased by a percentage equal to the increase in the consumer price index (assuming 2 percent), it would take 7 years to reach the break-even point of \$3.70 per square foot.

RESOURCE IMPACT

The City portion of the tenant improvement cost will be a maximum of \$296,400 to \$370,500, to be paid out of \$1 million surplus in bond proceeds. The maximum cost to the General Fund for the real estate commission will be \$75,000. Staff anticipates using remaining project surplus funds to retire bonds or offset annual debt service. Once a lease has been negotiated, staff will return to Council for approval of the lease.

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