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JAIR LYNCH
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Memorandum

To:	Richard Reyes Gavilan
From:	Jair Lynch
Cc:	Jeff Bonvechio
Date:	December 1, 2014
Re:	Items to consider regarding an addition on floors 6-8

I. Valuation Overview (based on CBRE Appraisal – July 2014)
   a. The highest and best use for Floors 6, 7 and 8 would be office. CBRE valued the 115,000 SF of excess density at a gross market potential value of $27.75M. Residential was a close second in terms of value, approximately 10% less.
      i. Please note possible fluctuations in market conditions - As noted in the appraisal, the DC commercial office market is weak with a vacancy rate of over 11% and a significant amount of supply in the pipeline and thus could affect the competitive landscape and the ability to achieve the gross market potential value. The DC residential market is still strong today but (1) the economics are hinting at a potential slowdown of the residential market and (2) the likely public policy goals will lower the proceeds to fund affordable housing (see details below).

II. Valuation Constraints (items not factored or only partially factored in the CBRE Appraisal)
   a. Public Policy Goals - In the case of a residential use, the value derived from CBRE assumes zero affordable housing which is not consistent with the District's Inclusionary Zoning provisions of 8-10% set asides for affordable housing as well as not consistent with other District public private sales of land and/or air rights which have included 20 - 30% set asides for affordable housing. Please note, Councilmember McDuffie has introduced new legislation to mandate that all public private transactions have a 30% affordable housing component for households earning between 30 – 80% of the Area Median Income ("AMI"). The 2014 AMI in the DC metro for a family of 4 is approximately $107,000. These public policy goals will achieve a social good for the city but will be expensive housing to build and will

reduce the gross potential value significantly. For example: market rent for a two bedroom apartment at the City Center project located near the library rents for approximately $3,800 per month. Conversely, the maximum rent for a Low Income Tax Credit unit for someone earning $64,200 annually (at 60% AMI) would be $1,444/month[1]. The residential capitalization rate used by CBRE in its appraisal to determine gross market potential value is 4.5%. Applying this rate to the rent differential of $2,396 per month equates to an annualized loss of capitalized value of $630K per unit. Assuming the entire addition has 115 units with 29 units set aside for affordable housing (115 total units*25%) then $18M of value would likely be eliminated from the equation if the units were built to the same class A standard. Thus, an affordable housing requirement could reduce the CBRE gross market potential value by $15M to $20M depending on the actual affordable housing requirement math leaving the District with only $8M to $13M of potential proceeds before any other deductions.

b. Inadequate Parking – A private developer will likely require a significant parking requirement. For example, an office developer may require 77 parking spaces (based on a 1:1500 SF ratio) and a residential developer of condominiums may require 86 parking spaces (based on a 1:0.75 ratio). The current parking count is only 100 spaces, a reconfigured parking count could be 160 spaces and thus the appraisal assumed an automated mechanical system which could yield at least 60 parking spaces. However, even with this mechanical system less parking would be available for the library. The library program maintains current demand for parking including vehicles that serve branch libraries. Furthermore, the appraisal doesn't take into account the current program which contemplates consolidating loading and service currently on G Place to below grade, which would significantly reduce parking below 160 spaces. Therefore, the mechanical system doesn't really solve the problem. The appraisal deducted $7.25 MM for an automated system based on a 2012 conceptual estimate. Please note, we are aware that this automated system has only been installed in the District once. In addition, according to the Turner Construction Cost Index for urban projects, construction costs have risen approximately 7.7% over the last two years. Given that the earliest that construction could start is over two years from now, that could be an additional 7.7% or more of cost escalation. Thus the actual cost of the mechanical system could be $400K to $500K greater than the original estimate and may not meet the program need with multiple users. While not consistent with the program level A

[1] http://www.novoco.com/products/rentincome.php

could be partially converted to parking at great expense. Adding additional below grade floors of parking, would require significant underpinning of the existing structure and would also have to take into consideration the now existing metro tunnels which were built in the 1970s after the MLK opened in 1972.

c. Public Private Transaction - The CBRE valuation is based purely on market data points and doesn't factor in the discount that the private sector would apply to this type of transaction. The basis for a discount would include, but not be limited to, the complexity of a condominium structure over a public building as well as the extraordinary entitlements that a private site that consists of air-rights above a historic building would not be subject to. These limiting factors are further degraded by the nature of public private transactions including the fact that the District is rarely is a co-owner of a mixed use project (West End is the expectation not the rule). These constraints will likely result in a limited pool of local buyers versus a broader competitive set.

d. Time vs Money (District Capital Budget) – DCPL is currently dependent on the District Capital Budget for the majority of the funding for this project. To date, the District has budgeted $208 MM which will fully fund the project. Adding a private developer to an already complex and time consuming redevelopment will extend the current 5 years schedule (2014 – 2019) and could jeopardize the current funding. The design and construction of the entire redevelopment needs to move as one unit, including floors 6, 7 and 8. Feedback and analysis from the lead agency, the National Capital Planning Commission, suggests any addition will require specificity around programming and design and thus will require the District to select a private partner prior to initiating the full entitlement process. The time to procure a private partner via the Department of Planning and Economic Development could be 6 – 12 months, with an additional 6 – 12 months to finalize the appropriate agreements to warrant any significant investment of time and money from the developer to jointly seek the entitlements. For example, the Stevens School Process where the development program is a 50,000 historic building and new office building that will be next door ("side by side mixed use") will likely take over a decade to realize. The first solicitation was in 2008. No award. The second solicitation was in 2011, with an award in 2012, a DMPED approved land disposition agreement ("LDA") in 2014, but the council has yet to approve the LDA. The current projected completion date is 2019 or 2020.Once a private developer is on board DCPL would still need at least another two years to complete the current entitlement process as an additional layer of the Mayor's Agent would be added to the process because the addition would be a significant alteration of the historic structure . Please note, the Mayor's Agent process is a legal process and could be subject to an appeal which could further delay the project as the appeal would be heard at the District Court of Appeals.

III. Other Possible Constraints

a. Boutique Size - 115,000 SF of air rights over a public building is both a small amount of square footage and extremely complicated to be attractive to any seasoned owner/developer. A large, established Washington DC developer would likely only be interested in controlling the entire site which would include the existing library as well. However, even the opportunity to control the entire 9th and G Street block would be extremely challenging given that the library is a historic building and that community opposition to private redevelopment would be fierce.

b. Time is of the Essence – A private developer who only pays for the air rights at the commencement of construction (consistent with other public private partnerships) may not be aligned with the library's desire to commence construction to avoid further short term capital outlays in the current library including, but not limited to, window failures and existing hazard materials.

c. First vs. Life Cycle Costs – A private developer will often value lower first costs (initial cash outlay) in order to maximize returns at stabilization with 3 – 5 years while DCPL may value life cycle costs as the initial capital investment is intended to last 50 years.

IV. Program and Physical factors to consider

a. Condominium Structure - Like all mixed use projects, a shared condominium ownership structure would need to be established and maintained. This includes the creation, negotiation and review of several contractual arrangements between the parties including, but not limited to, condominium documents, reciprocal easement agreements, construction covenants and restrictions, and shared facilities agreements. These documents will govern the relationship between the parties during construction and operations including, but not limited to, loading dock management, trash removal, and snow removal. These agreements may also include policies on loitering and/or the definition of private vs public space which will impact all of DCPL's customers.

b. Dedicated Program Space - There would need to be dedicated spaces for the private use beyond the floors 6, 7, 8 including, but not limited to, a lobby on the ground floor as well as dedicated private access to the parking independent of library use. Library patrons would be prohibited from using these private spaces. The separate private lobby would cut into library program. Furthermore, there would need to be at least two emergency stairs going up to the office level which could create some complexities as they tie into the library emergency stairs (for example, security and pressurization).

c. Shared Program Spaces - There would need to be shared spaces with the private use beyond the floors 6, 7, 8 including, but not limited to, loading, deliveries, parking facilities, and roof access for mechanical or electrical equipment. DCPL will have to regulate these shared spaces with its staff, patrons, and maintenance personnel and contractors.
d. Separate Utilities - Separate metering of all utilities between public and private as well as the impact of the infrastructure and the risk of having these utilities above the library.
e. Functions – DCPL and the private developer will also have to negotiate as part of the condominium structure the policies and procedures for assembly functions. Issues of parking, security, cleanings, etc. will have to be memorialized.

V. Project execution factors to consider

a. A private developer would likely bring their own design team and suite of consultants, thus introducing another layer of professionals to manage. In order for both the library and the private developer to have the highest probability of success and be the most efficient each component of the project will need to be built at the same time. So the overall DCPL schedule would need to accommodate this private developer, which has a completely different set of needs and motivations from that of the DCPL.
b. Construction factors – In general, the existing structure of the library can support floors 6, 7 and 8. However, reinforcement would still be required, especially given the specifics of the point loads translated from the rectangular "Box" above to the larger footprint below. The structure of the library was intended to support additional floors of the same configuration, not the different configuration of floors 6, 7, and 8. Executing floors 6, 7 and 8 will necessitate structural reinforcement which means cost as well as possible esthetic and programming issues as the library would need to accommodate this supplemental bracing.
c. A private developer would likely have specific requests that may be incompatible with the overall library design, such as a spacious, prominent lobby fronting on G St. or 9th St.

VI. Liability and Legal items that would have to be considered and negotiated with a private partner

a. What happens if the private developer signs on to a deal and doesn't perform, effectively tying up the whole process? Will nonrefundable deposits satisfy the consequential damages that DCPL could suffer with a subsequent loss of funding? Time would be the greatest risk here.
b. DCPL exposure to litigation as a result of having a separate user above the library. This could take many forms.
c. Who controls major decisions? What if the private developer disagrees with the DCPL led process or ownership policy?
d. What happens if the private developer doesn't maintain its property well or builds a poor product?
e. What if the private developer decides to lease space to tenants that are a poor fit with the library?
f. What happens if the private developer has financial problems or sells to another owner that is a poor fit for the library?
g. What happens if the private developer is dissatisfied with DCPL facilities policies and demands changes?
h. What happens if the private developer's contractor damages the library or places a lien on the property?
i. What happens if the private developer fails to pay real estate taxes or shared expenses?
j. Real estate tax and insurance complications.
k. All of the risks above can be mitigated by a series of documents between two private parties. However to do so is a time consuming negotiation that will get priced into the deal. The more restrictions placed on the developer, the greater the price reduction.

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VII. Summary

a. **Library needs full building for program**. In 2012, the initial programming suggested the library could be less than 50% of an expanded building with an addition and thus several options were investigated from a financial, programmatic and ownership framework. In 2014, DCPL confirmed it needs 100% of the existing building and a small fifth floor addition totaling approximately 50,000 SF to become a 21st Century library of the future.
b. **Limited revenue**. The net positive financial benefits of selling the air rights for floors 6, 7, 8 would likely be less than 10-15% of the total costs to renovate the library based on size, location, entitlements with Federal Government, and the complexities of a local public private process that will include widely accepted and laudable public policy goals such as affordable housing.
c. **Limited additional foot traffic**. The net positive programmatic benefits of co locating a private use in an addition on floors 6, 7 and 8 are limited as office or residential uses likely will not significantly increase patronage and customer usage, which is a primary goal of a downtown central library. In addition, DCPL will have to consider the complexities of ownership in a mixed use building in which the public use will be more two thirds of the potential space.
d. **Major time delay**. An addition on floors 6, 7, and 8 results in a significant alteration of the existing historic structure as well as a time consuming procurement and negotiation with a private developer. This will add complexity to the existing review entitlements such as the Historic Preservation Review Board but will also add a legal proceeding with the Mayor's Agent to determine if the historic structure can be altered to accommodate an addition. Please, note the Mayor's Agent process would be subject to the appeal by any party to the District Court of Appeals.
e. **Budget risk**. The existing funding of $208 MM from the District Capital Budget will likely fund the main library but could be jeopardized with an extended process.
f. **Eliminates tax credit option**. Historic Tax Credits are a viable option and could raise 10 – 15% of total capital if the library elects to pursue a redevelopment approach that is more aligned with the preservation of the historic structure and thus does not propose an addition on floors 6, 7 and 8.
g. **Floors 6, 7, 8 not required for exciting program**. DCPL will emphasis first improving existing library services and expanding programmatic partnerships with non-profits and for profits organizations to increase patronage and enhance the customer experience. To that end, DCPL will design exciting space from the arrival at 9th and

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G Streets to the rooftop garden on the 5th floor that will allow the program come alive and make the MLK library a premier destination downtown.

h. **Legacy**. DCPL will respect and honor the historical significance of the building and the legacy of its namesake Martin Luther King Jr. by allowing the public components of the project to exist throughout the building.