


MEMORANDUM

DATE: MAY 19, 2009

TO: HONORABLE COUNCILMEMBER CARL DEMAIO –
COUNCIL DISTRICT 5

FROM: JEFF W. GRAHAM, VICE PRESIDENT-REDEVELOPMENT 

SUBJECT: ADDITIONAL CONCERNS REGARDING NEW CITY HALL PROJECT

Centre City Development Corporation (CCDC) is in receipt of your memorandum requesting a review and response to a letter from Irving Hughes addressed to the Mayor dated May 12, 2009 concerning the Civic Center Complex financial analysis. Jones Lang LaSalle (JLL) has been the lead consultant in preparing the financial analysis on this project and thus we have requested their professional opinion on the issues raised in the Irving Hughes letter. I have attached JLL's response for your consideration.

You have requested that CCDC direct JLL to compare the Gerding Edlen development alternatives with a "Hold Steady" scenario that assumes a hypothetical identical proposal from a similar developer for a new City Hall to be delivered 10 years from now. I refer you to my previous response dated May 4, 2009 (a copy of which is attached for your reference) which describes the reasons why CCDC staff and JLL believe such a comparison is infeasible. Relying on an unidentified developer to submit and commit to a theoretical proposal 10 years from now with terms identical to that submitted by Gerding Edlen places the City at risk. It contradicts our commitment to uphold analysis integrity by not including financial assumptions which are purely hypothetical in nature and not supported by market or economic data, a developer proposal, lease documents, landlord lease renewal proposals, or the professional opinion of outside consultants. Similar speculative assumptions were also excluded from all of the Gerding Edlen and other non-development alternatives.

You have also requested a full accounting of CCDC expenses to date on the professional analysis and services related to the Civic Center Complex project. The following is an itemization of certain costs incurred through May 8, 2009.

Honorable Councilmember Carl DeMaio

May 19, 2009

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Services Performed / Consultant	Expenditures as of May 8, 2009	Encumbrances as of May 8, 2009	Contractual Credits Pending (Peer Review)	Total Net Costs
Financial / Economic Analysis				
Jones Lang LaSalle (lead financial consultant)	\$612,109	\$13,152	(\$100,000)	\$525,261
DMJM H&N AECOM (facilities condition assessment)	107,234	0	0	107,234
David F. Davis Real Estate (surplus land valuation)	4,400	0	0	4,400
Economics Research Assoc. (fiscal/economic impacts)	30,000	0	0	30,000
Public Private Dev't Solutions (municipal finance)	1,000	0	0	1,000
Sustainability Review and Assessment				
Paladino and Associates	4,970	0	0	4,970
Financial Peer Review				
Ernst and Young	77,094	39,606	0	116,700
Facilities Needs Assessment				
Gensler Architects	412,180	39,191	0	451,371
Public Outreach and Engagement / RFQ(P)	294,075	66,190	0	360,264
Legal	23,700	0	0	23,700
Other Consultants	14,894	3,646	0	18,540
Total Expenses	\$1,581,656	\$161,785	(\$100,000)	\$1,643,440

Should you have additional concerns or questions, please do not hesitate to contact me.

cc: Honorable Mayor Sanders
Honorable City Councilmembers
City Attorney
Andrea Tevlin, Independent Budget Analyst
CCDC Board of Directors
Frank Alessi, Senior Vice President & Chief Financial Officer

Attachments: Memo from Councilmember Carl DeMaio dated May 12, 2009
Response Letter from JLL dated May 19, 2009
Memo to Councilmember Carl DeMaio dated May 4, 2009



COUNCILMEMBER CARL DEMAIO

FIFTH DISTRICT
CITY OF SAN DIEGO

MEMORANDUM

DATE: May 12, 2009

TO: Honorable Mayor

CC: City Councilmembers
City Attorney
CCDC Board of Directors

FROM: Councilmember Carl DeMaio *Carl DeMaio*

RE: Additional Concerns Regarding New City Hall Project

Since the proposal of building a new City Hall first surfaced, I have raised concerns about the financial representations being made by project backers. Already the initial financial representations on this project have had to be revised by the Ernst and Young (E & Y) peer review report.

Based solely on the revised numbers from the E & Y review, I have maintained that the City should abandon this project in its current form to focus on getting its own fiscal house in order and making progress on neighborhood infrastructure problems.

Now comes word of even more potential problems with the financial projections for this project.

- **Project Comparisons Overstate Lease Rates:** Two of the City's own commercial lease advisors today delivered a letter to the City Council stating "we unequivocally conclude that the proposed project will cost significantly more than is being portrayed." (See Attachment A)

The letter outlines evidence that the City is using inflated rates for leases in the "Hold Steady" proposal, which makes the redevelopment proposal appear more advantageous. When adjusting just two of the lease rates used in the model to correspond with market conditions, these experts conclude that the claimed

savings were inflated by more than \$40 million over the first 15 years. Please keep in mind that this figure only pertains to two of the leases – this number is likely to climb as other lease proposals are similarly scrutinized.

Action Item Requested: I request that the City's Real Estate Assets Department (READ) publicly release all lease data so further independent market analysis can be performed. Additionally, I request that CCDC review and respond to the Irving-Hughes analysis.

- **Project Comparisons Use Different City Hall Developments:** In reviewing CCDC's revised financial forecasts on the project, my office discovered an "apples-to-oranges" comparison between the City Halls built in the Hold Steady scenario and the redevelopment proposal – that unjustifiably benefits the redevelopment proposal by tens of millions of dollars. (See Attachment B) In response, CCDC confirmed the variation in City Hall model used, but refuses to augment their financial forecast accordingly. (See Attachment C)

Action Item Requested: I request that CCDC be instructed to use an "apples-to-apples" comparison between similar City Hall models – including a master lease structure of two identically-sized buildings – in their comparisons between the redevelopment proposal and the Hold Steady scenario.

- **Accounting of Taxpayer Funds Spent To-Date:** During the May 7th Budget Committee Hearing, I confirmed that CCDC has spent northwards of \$2 million to date on the proposed City Hall. This likely includes monies for an advocacy campaign by a local public relations firm – as well as staff time expended for media interviews and endorsement meetings.

Action Item Requested: I request that CCDC fulfill my request made at the May 7th Budget Committee Hearing for a full accounting of their expenses to date on this project. Furthermore, I respectfully request that the Mayor's Office instruct CCDC to discontinue any activities that constitute, or may provide the appearance of, lobbying or advocacy on this project at taxpayers' expense.

- **Details on Proposed Exclusive Negotiating Agreement (ENA):** CCDC and project proponents are clamoring for the City to enter into an ENA with the Portland, OR developer behind this project. They claim such a move would come at "no risk" to taxpayers.

Unfortunately, my office has learned that the developer would likely seek a clause providing for taxpayer reimbursement of their expenses incurred to date for this

project in the event that the City decides not to proceed. Additionally, the City may be required to reimburse the developer for any further changes to design of the facility – despite the promotion of an ENA to “iron out” any design issues.

Action Item Requested: I request that the City Attorney’s Office review models for ENAs and be prepared to brief the City Council on a vehicle that would provide no financial exposure to taxpayers in the event the City enters into an ENA.

In addition to responding to the financial questions above, I ask the Mayor’s Office to begin work on the implementation details for the “Hold Steady” option. Such a plan would mix aggressive negotiations with a variety of commercial landlords for short-term space with the development of management models for redistributing the City workforce in the most economical and efficient manner.

While I am not endorsing the concept at this time, such a plan may include consideration of shuttering the City Administration Building early, along with the Civic Concourse. Given the list of possible capital expenditures for those two facilities, there may be less expensive options particularly given the short-term nature of our need. I believe this issue warrants further study and examination.

Finally, I do support ongoing discussions with the State, County, Port, and other government entities on more integrated solutions to government office space and would hope the Mayor’s Office would take a leadership role in facilitating those discussions.

While I oppose construction of a new City Hall until our financial problems and neighborhood infrastructure issues can be addressed, I continue to insist that decision-makers be provided with reliable financial modeling, so that a public policy decision based on accurate data and assumptions can be made. I look forward to working with your office in this regard in the coming months.



Jones Lang LaSalle Americas, Inc.
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May 19, 2009

Honorable Mayor Sanders
City of San Diego
202 C Street, 11th Floor
San Diego, California 92101

Re: Irving Hughes Letter to Mayor Sanders – Civic Center Redevelopment
Analysis

Dear Mayor Sanders:

This is in response to the inaccurate assertions and unsubstantiated claims made in a letter dated May 12, 2009 that was authored by Irving Hughes and addressed to Mayor Jerry Sanders and City Councilmembers (IH Letter), which critiques certain assumptions made in Jones Lang LaSalle's ("JLL") April 2009 updated financial comparison of the Gerding Edlen Development ("GED") proposal and the "Hold Steady" non-development alternative.

The IH Letter's assertion that JLL's findings in the updated financial analysis "provide an incredibly misleading conclusion of 'cost savings' from building the proposed City Hall" is in itself misleading. Furthermore, the IH Letter **inaccurately describes fundamental elements of the "Hold Steady" scenario and incorrectly represents the lease cost assumptions contained in the current JLL financial analysis.**

Throughout the Civic Center analysis process, our client has attempted to rely on data supported by valid market data, actual lease proposals, and submitted developer proposals. The IH Letter promotes the use of lease assumptions without providing any such substantive support.

First and foremost, the IH Letter's attempt at a comparative analysis is based on the initial JLL analysis prepared in early 2008 which has since been replaced by an updated analysis dated April 2009. It is obvious that the global and local economies and markets have changed significantly between those two points in time. Thus the impetus for the update to the original analysis.

The IH claim that the current JLL analysis overstates the cost savings in the redevelopment alternatives appears to entirely hinge on the argument that on a 10-year comparative basis (between 2013 and 2022) the lease cost assumptions are overstated and do not reflect costs that could be achieved in today's market. An attempt to illustrate this argument is through a table on page 3 of the IH Letter, which is attached for reference. However, the combined use of a 10-year time period and inaccurate

rental rate assumptions in this table leads to an overall wrong conclusion. Please note the following errors:

1. Incorrect representation of the rental rate assumptions in the updated financial analysis of April, 2009.

Rather than referring to the lease assumptions in the JLL report dated April 2009 that reflect changes in market conditions, the IH Letter analysis applies rental rate estimates contained in JLL's previous analysis for which assumptions were formulated in early 2008 and before the City received lease renewal proposals from its three landlords. The IH Letter states that the rents in the "90%" column are based upon a JLL renewal assumption of \$2.74 - \$2.75 per square foot ("PSF"), full service gross, with 3% annual rent escalations. In fact, the current April 2009 JLL analysis assumes an average renewal rate of \$2.17 PSF, full service gross (considering Civic Center Plaza, Executive Complex and 600 'B' Street, with 3.0% - 4.0% annual escalations during the 2013/2014 renewal date through 2017 (based on landlord responses), until the new City Hall is delivered in 2018. These lease renewal rates were based on the three landlord proposals for a 10-year renewal term and reduced by 5% (as agreed to by CCDC staff and the peer review selection panel), and further adjusted to provide for no tenant improvement allowance.

The IH Letter further states JLL's rent escalations contain a 20% rate reset every 10 years, when in fact JLL assumed a rate reset of 15% to occur every 10 years to capture occupancy expenses (FSG rent, plus expense escalations), with a base year reset. Applying this assumption results in total rent increase of approximately 2% every 10th year, not 4.5% on an annual basis as claimed by IH. This renewal factor applies only to those non-development alternatives which assumed full renovation of the City-owned facilities. It does not apply to the "Hold Steady" alternative since that option assumes a new City Hall in 2018.

The IH Letter states that negotiated rental rates should reflect approximately \$1.25 for Executive Complex (\$2,044,815 / 136,321 SF) and \$1.375 for 600 B Street (\$2,528,873 / 153,265 SF), yet provides absolutely no data, comparable executed lease information or other support for this extremely aggressive assertion. This is particularly concerning considering the City's total space requirement is in excess of 500,000 SF, with limited options in the market.

2. Analysis uses a 10-year basis for comparing the costs between the JLL lease assumptions rather than a 5-year comparison basis (the assumed renewal term of the three leases under the "Hold Steady" alternative). DMJM | AECOM, Ernst and Young (EY) and JLL all concur that the

“Hold Steady” option is only viable for up to 10 years until the City-owned buildings will require replacement.

After adjusting the IH Letter analysis to reflect the correct lease assumptions and the correct time line for comparison, the claim of overstated savings “of at least \$40 million” would be significantly reduced and would not materially change the current 10, 15 and 50 year cost comparison between the “Hold Steady” alternative and the GED alternatives. Further, the IH Letter provides no factual support, such as independently verifiable lease comparables, to defend their claim that lowest rate they use in their analysis is market supported. Although it may be possible to achieve savings below the current JLL estimates, JLL does not believe the lowest rates used in the IH Letter analysis is market supported.

The IH Letter contains several other inaccuracies and unsubstantiated statements. One such statement alludes to the potential of risks to the City by proceeding with an Exclusive Negotiation Agreement (ENA) with GED. However, the IH Letter provides absolutely no basis to support this speculation and it is doubtful the City would proceed with an ENA in a manner that exposed it to any significant risk. One of the main goals of the ENA process is to find mutually acceptable terms to contractually mitigate risk, not increase it.

The analysis of the Civic Center alternatives is highly complex and contains many factors, of which lease rates is but one. Consequently, it is imperative that any debate about the veracity of the data contained in the financial analysis start with a clear understanding of the baseline assumptions being used and how they are modeled in each alternative. This clearly is not the case with the IH Letter analysis. The citizens of San Diego should have confidence in the high level of integrity and intense scrutiny applied to this revised analysis by both EY and JLL, two of the largest and most qualified real estate advisory firms in the world. Moreover, all of the updated assumptions in the current financial model have been thoroughly vetted and agreed to by CCDC staff and the peer review selection panel which was comprised of Carl DeMaio, Councilmember District 5, Mary Lewis, Chief Financial Officer for the City of San Diego, Kim Kilkenny, CCDC Board member, and Greg Stein, San Diego County Taxpayers Association Board member.

The decision about the correct course for the City to take for the Civic Center is of critical importance to the citizens of San Diego and has significant financial and functional implications for the City in both the short and long term. In light of this, continued scrutiny of the analysis performed on alternatives influencing such an important decision is healthy and warranted. However, this scrutiny should be based on an understanding of the framework of the financial analysis and the actual facts behind the data it contains. Furthermore, any claims about data being incorrect should

Mayor Sanders
May 19, 2009
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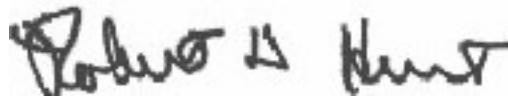
only be made when new data is provided that can be substantiated and independently verified.

We appreciate the opportunity to continue working with CCDC and the City on this important project. Please let us know if any additional information would be useful at this time.

Sincerely,



Tandra Martinez
Executive Vice President



Bob Hunt
Senior Vice President

Attachment

IRVING HUGHES

Life is a lease. Negotiate well.

May 12, 2009

The Honorable Jerry Sanders
202 C St., 11th Floor
San Diego, CA 92101

Re: Civic Center Redevelopment Proposal

Dear Mayor Sanders and City Councilmembers:

We write to voice our significant concerns over the current proposal to redevelop the downtown Civic Center. From both a professional standpoint as well as that of the taxpayers, we must warn decision-makers that the financial modeling and corresponding advocacy efforts from proponents provide an incredibly misleading conclusion of “cost savings” from building the proposed City Hall.

For the reasons we outline below, it is vital that decision-makers understand that the savings implied by the financial models overstate the costs of the status quo option by at least \$17 million over the first 10 years, and at least \$40 million over the first 15 years. Furthermore, there is likely a proportionate overstatement of lease costs relative to market levels for the Civic Center Plaza. As a result, the costs of the status quo option are likely distorted even further, by millions more dollars over the 10-and 15-year timelines.

As you may know, we each have in excess of 20 years of experience in negotiating leases for a variety of clients in downtown San Diego. We have consistently represented a majority of the downtown tenants in their lease transactions, including having the past representation of the City of San Diego in its leases at 600 B Street, 1010 Second Avenue and 1200 Third Avenue. Recently we were hired by CCDC to represent the agency in their lease negotiations – which ultimately led to its move to 401 B Street. Currently our firm represents more than 40 active tenants in downtown for more than 500,000 square feet of office space.

The assumptions being used in the modeling as they relate to the cost of renewing the City’s downtown leases are simply out of touch with the current state of the downtown rental market. The City is in a tremendously favorable bargaining position, and should use the current market downturn to obtain lease rates that benefit the City and taxpayers, not that seemingly serve to justify constructing a new City Hall. We are also troubled that this disconnect between market conditions and assumptions has allowed proponents to advocate that their project saves the City (and taxpayers) money while attempting to drum up stakeholder support for the project.

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With only limited access to the data and assumptions being used to justify these claims, **we unequivocally conclude that the proposed project will cost significantly more than is being portrayed.** The following points underscore this conclusion:

Landlord Proposals are Not in Line with the Market

In the April 22nd Jones Lang LaSalle (JLL) presentation, figures are provided that show the aggregate variance between the April 2008 JLL estimates and the 2009 landlord proposals. A variance of \$5.5 million (2.9%) for Total Base Rent is provided, while a variance of \$3.3 million (1.9%) is provided for As-Is Rent.

For the Civic Center Plaza, where the City occupies 243,176 square feet, JLL assumes that rental rates increase from \$1.83 to \$2.74 per square foot. In the Executive Complex, where the City occupies 136,321 square feet of space, the model anticipates the costs will escalate from \$2.15 to \$2.74 per square foot.

The fact that proposals received only vary by 2% - 3% from this modeling (not surprising given that any prudent landlord would review the JLL analysis prior to issuing a proposal), and that the updated analysis of the proposal assumes that leases can be negotiated down by another 10%, still does not coincide with current market conditions. These assumptions clearly distort the analysis in favor of proceeding with the project. We strongly urge decision-makers to note the significant amount of savings that can be attributable to the "Hold Steady" scenario below.

Rental Rates Assumed at 90% of Landlord Proposals

According to the JLL "Updated Financial Evaluation Briefing," the rental costs in the baseline Hold Steady scenario reflect "90% of proposed rents provided by landlords" from March of 2009. This assumption significantly overestimates costs in the current market, and inappropriately provides justification for moving forward with the project.

Given current market conditions for downtown San Diego, and using available data on two of the March 2009 proposals, a more appropriate estimate for the Hold Steady option should reflect 50% of the proposed rental rates. As shown below, the difference in cost for the Hold Steady option is significant, and only reflects two of the lease proposals due to data availability. In other words, the savings will likely be significantly higher when the same market conditions are applied to the remaining leases of the City. (Note that tenant improvement allowances have been left out of the table below for simplicity.)

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	Year	Rents @ 90%		Rents @ 75%		Rents @ 50%	
		Exec Complex	600 B	Exec Complex	600 B	Exec Complex	600 B
10 Year	2008						
	2009						
	2010						
	2011						
	2012						
	2013		\$4,551,971		\$3,413,978		\$2,528,873
	2014	\$3,680,667	\$4,688,529	\$3,067,223	\$3,516,397	\$2,044,815	\$2,604,739
	2015	\$3,827,894	\$4,829,186	\$3,189,911	\$3,621,889	\$2,126,608	\$2,682,881
	2016	\$3,981,010	\$4,974,062	\$3,317,508	\$3,730,546	\$2,211,672	\$2,763,368
	2017	\$4,140,250	\$5,123,283	\$3,450,209	\$3,842,462	\$2,300,139	\$2,846,269
15 Year	2018	\$4,305,860	\$5,276,982	\$3,588,217	\$3,957,736	\$2,392,145	\$2,931,657
	2019	\$4,478,094	\$5,435,291	\$3,731,745	\$4,076,468	\$2,487,830	\$3,019,606
	2020	\$4,657,218	\$5,598,349	\$3,881,015	\$4,198,762	\$2,587,344	\$3,110,194
	2021	\$4,843,507	\$5,766,300	\$4,036,256	\$4,324,725	\$2,690,837	\$3,203,500
	2022	\$5,037,247	\$5,939,289	\$4,197,706	\$4,454,467	\$2,798,471	\$3,299,605
Total		\$38,951,746	\$52,183,241	\$32,459,789	\$39,137,431	\$21,639,859	\$28,990,690
10 Year Total		\$15,629,820	\$24,167,030	\$13,024,850	\$18,125,273	\$8,683,234	\$13,426,128
15 Year Total		\$38,951,746	\$52,183,241	\$32,459,789	\$39,137,431	\$21,639,859	\$28,990,690
		10 Year Difference		\$8,646,728		\$17,687,489	
		15 Year Difference		\$19,537,768		\$40,504,439	

*Important Note: The “Year” labels above come directly from the JLL analysis (2008 = Year 1). Data from the lease proposals, however, begins in 2013 and 2014, respectively. It is unclear from the two separate sources (lease proposal data and JLL spreadsheet presentations) how the lease data was merged into the JLL spreadsheet. As a result, we have combined the data in accordance with the years as they are listed in the documents we have reviewed. However, as a result of the difficulty in matching these years appropriately because the lease data is not itemized in the JLL presentation, we have merged the lease data in accordance to the years provided. In short, this means that we are likely **underestimating** the 10 and 15 year differences by a significant amount. However, the spreadsheet above represents our desire to remain conservative, given the available data.*

According to the Jones Lang LaSalle analysis, the 600 B lease of 153,265 square feet is scheduled to expire in 2013. The estimated renewal rates increase to \$2.75 per square foot (PSF)

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beginning in 2013, with approximately 3% annual increases until 2022. This is completely misaligned with current market rates for similar space.

The table above shows how applying realistic market conditions significantly alters the validity of savings claims by proponents over the first 10 and 15 years of the project timeline. Before taking any similar difference from remaining City lease locations (i.e. the Civic Center Plaza, for which actual lease proposal data is unavailable to us), the 15-year savings to the Hold Steady scenario compared to the proposal to build a new City Hall **exceed \$40 million over the first 15 years of the JLL analysis.**

Furthermore, the initial JLL analysis of the Civic Center Plaza lease rates anticipates that in 2014, the rates will jump from \$1.83 to \$2.74. The current market rate for such space should be around \$1.50, indicating that even more significant savings are available to the City if it renews its leases at market-appropriate levels.

Rent Escalations

In the assumptions section of the JLL report, market leases are estimated to increase 2.50% annually, with a 20%, 10-year “Rate Reset” for FSG Leases. This equates to rental increases of 4.5% annually – for 30+ years! This is completely inconsistent with reality, especially since we’ve seen the rental market decrease by 40% just over the last 12 months!

The City Faces Risks by Entering into an Exclusive Negotiating Agreement

The opposition to moving forward with this project has been based on the City’s current financial difficulties. To respond to this opposition, proponents have reinforced their efforts to assert that the proposal will save the City money.

Despite the increased efforts of proponents to indicate otherwise, the proposal to redevelop the Civic Center will not save the City money relative to pursuing other alternatives. Our rough estimates indicate that costs associated with the Hold Steady scenario are inflated by well over \$40 million.

Furthermore, it is possible that the developer would seek at least partial reimbursement for the cost of its efforts thus far in the event that an agreement to undertake the project is not reached. It is also our understanding that any further changes to the project, such as design, that may be required to fit the City’s needs will have to be paid by the City. These particular points would be conditions set out in an Exclusive Negotiating Agreement (ENA), but are in stark contrast to the notion that there is “no risk” to the City in entering into such an agreement.

We urge the Mayor and Council to consider these concerns before proceeding with an ENA. It is imperative that the Mayor and City Council scrutinize the cost savings being touted by

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proponents. City decision-makers must approach the decision to move forward with such an agreement with appropriate and accurate background information. For the reasons laid out above, we do not believe that an accurate comparison of the City's options has been made available to date. Please do not hesitate to contact us to discuss this matter further.

Sincerely,



Craig Irving
Principal




Jason Hughes
Principal

MEMORANDUM

DATE: MAY 4, 2009

TO: COUNCILMEMBER CARL DEMAIO – COUNCIL DISTRICT 5
TOM AARON, COUNCIL REPRESENTATIVE/BUDGET ANALYST-
DISTRICT 5

FROM: JEFF W. GRAHAM, VICE PRESIDENT-REDEVELOPMENT 

SUBJECT: UPDATED CIVIC CENTER COMPLEX FINANCIAL PROJECTIONS

I am in receipt of your memorandum dated April 23, 2009 regarding the updated Civic Center Complex financial projections prepared by Jones Lang LaSalle (JLL). In your correspondence, you request a clarification of certain financial assumptions used in the projections and possible additional sensitivity analyses performed. Specifically, you address the following two issues:

1. Differing Assumptions for New City Hall Development Program:

As you correctly identify, differing development program assumptions were assumed in the JLL financial projections for the Gerding Edlen Development (GED) alternatives versus the Non-development Alternative 5 - "Hold Steady" alternative. Throughout the extensive analysis performed on the City's occupancy alternatives, both Centre City Development Corporation (CCDC) staff and JLL have strived, to the greatest extent possible, to base the financial projections on one or more of the following: supporting market and economic data, information retrieved directly from the developer proposal or lease documents and landlord renewal proposals. Both CCDC staff and JLL have avoided including speculative or hypothetical development, sales, other assumptions not supported by a proposal or other data in the analysis. For instance, in the GED Phase One Only alternatives (GED C and D), no assumption was made about the City's ability to sell or lease the two excess blocks (Parkade and COB) to another developer for additional revenue, nor was any revenue included in the analysis.

Applying the above approach led to the following development program assumptions for the GED and "Hold Steady" alternatives.

Gerding Edlen Alternatives A – D

The GED proposal provides the City with a full public-private partnership delivery approach with benefits and risks shared between the developer and the City. Based on GED Alternatives A through D, which are variations of the GED proposal, the City is responsible for lease payments over 30 years on the entire 853,000 SF building in order to receive favorable financing terms. Upon retirement of the debt, ownership of the entire building transfers to the City. During the 30-year lease term, GED is proposing to offset the City's cost of carrying the obligation on the entire building by assuming the risk and cost of master leasing the space not occupied by the City.

Based on the Gensler Facilities Needs Assessment, the City is estimated to require approximately 660,000 USF of space upon initial occupancy. Therefore, the GED master lease is assumed to cover 193,000 USF of office space, the balance not needed by the City. As staffing and space requirements increase over the 30-year debt service period, the City's net lease obligation increases in proportion to the additional space occupied, while the master lease income decreases.

In other words, the master lease income received by City from GED is not a net revenue generating source but rather a mere dollar-for-dollar offset of the City's costs for the additional, but unneeded space. It is a mitigation of the City's lease costs on the entire building until needed by the City.

In addition, the GED proposal also provided options that consider the City's financial obligation only on its occupied space (GED Alternatives E-G), in which a vertical parcel map creates two separate ownership blocks within the building and GED is directly responsible for the portion not occupied by the City, thus resulting in no master lease revenue.

Non-development Alternative 5 - "Hold Steady"

As your memorandum correctly states, the new City Hall modeled in Alternative 5 - "Hold Steady" assumes the facility will be developed using a delivery method similar to a "build-to-suit" rather than a public-private partnership absent an actual development proposal at this time for delivery in 10 years.

Consistent with all other non-development alternatives: Using a "build-to-suit" delivery method in Alternative 5 is consistent with the modeling approach used in each of the other non-development alternatives from the date the initial non-development analyses were prepared in May 2008. The approach taken in the "Hold Steady" scenario is the proposed delivery of a building in 2018 sufficient in size to accommodate the City's occupancy requirements for 15 years (through 2032). This results in approximately 40,000 USF of excess space for the first five years of occupancy; the City migrates into the balance of the building's space thereafter. The assumption was made that 80% of

the excess space (32,000 USF) would be leased to other tenants directly by the City during the five-year period (not a master lease with a developer). Again, absent a proposal at this time from a developer to assume the financial obligations and risk of master leasing the vacant space for a building not proposed for another 10 years, a "build-to-suit" is a more typical delivery method and consistent with avoiding speculative assumptions.

No net change in results: However, it is important to note that even if Alternative 5 were modeled similarly to the GED alternatives with a developer assuming the master lease obligations for the unneeded space, the master lease revenues received by the City would merely be a direct offset of increased costs to construct the additional space. In other words, it would result in no net change to the annual cost projections of Alternative 5.

2. Minimum and Maximum Capital Expenditures Analysis

Your memorandum questions the minimum amount of \$0 assumed for capital expenditures over the next 5 years in the GED alternatives versus the \$13.2 million minimum assumed in Alternative 5 - "Hold Steady" over the next 10 years.

The estimated cost of necessary capital expenditures required in the City-owned buildings over the next 10 years is a value with a considerable degree of variance. The cost estimates used in the JLL cost projections were based on the very extensive Condition Assessment Report prepared by DM&JM | AECOM. That report, however, was prepared to determine the extent of renovations required to extend the useful life of the buildings for the longest period possible (30 years), not as a short term solution pending building replacement within 5 to 10 years.

Absent a more focused condition assessment and cost estimate based on the next 5 to 10 years, JLL believed it was reasonable, albeit optimistic, to assume foregoing any fire sprinkler installation and major capital improvements and repairs for the next 5 years pending the imminent delivery of a new City Hall in 2014. To address your concern that zero capital improvement costs were assumed, JLL also performed a sensitivity analysis at the upper end of the potential cost range of \$23.3 million over the next 5 years.

The request recently received by CCDC from Mayor Sanders and Councilmember Faulconer to commission a more focused condition and cost assessment over the next 5 and 10 year period will, I believe, address our concerns. CCDC will direct DMJM | AECOM to perform the short term focused study and those results will be substituted for the range of costs currently assumed in the GED and "Hold Steady" alternatives. We believe the revised condition assessment can be completed within 10 business days. Once the financial analysis is revised, all public presentation material shall be immediately updated to reflect the revised analysis results.

Councilmember Carl DeMaio

Mr. Tom Aaron

May 4, 2009

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Please let me know if I have misunderstood or not addressed any of your concerns. Thank you for your continued efforts in reviewing the JLL analysis to ensure that it meets all tests of objectivity and accuracy.

cc: Honorable Mayor Jerry Sanders
Honorable City Councilmembers
Andrea Tevlin, Independent Budget Analyst
Fred Maas