CITY OF MENLO PARK

THE FOLLOWING IS A LINK TO THE EARLY RELEASE OF THE STAFF REPORT FOR THE APRIL 6, 2010 CITY COUNCIL MEETING REGARDING THE MENLO GATEWAY PROJECT:

http://service.govdelivery.com/docs/CAMENLO/CAMENLO_97/CAMENLO_97_20100406_en .pdf

CITY OF MENLO PARK

# COMMUNITY DEVELOPMENT DEPARTMENT

The staff report is being released early on March 25, 2010.

**Council Meeting Date: April 6, 2010**
**Staff Report #: 10-044**

**Agenda Item #: F-1**

**REGULAR BUSINESS: Consideration of the proposed Term Sheet for the Menlo Gateway (Bohannon Hotel & Office) Development Agreement**

***(Please note: There will be a special Council presentation on the Final Environmental Impact Report (EIR) and Fiscal Impact Analysis (FIA) from 5:30 p.m. to 6:45 p.m. preceding the regular Council meeting).***

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## RECOMMENDATION

Staff recommends that the City Council consider the proposed Term Sheet for the Menlo Gateway (Bohannon Hotel & Office) Development Agreement (Attachment A) and proceed with the review process based on the Term Sheet, according to the previously established schedule as follows:

- April 7: Housing Commission recommendation on the BMR (Below Market Rate) Housing In Lieu Fee Agreement;
- April 19: Planning Commission public hearing on all aspects of the project;
- May 3: Planning Commission recommendation on all aspects of the project;
- May 25: City Council public hearing on all aspects of the project;
- June 15: City Council first step of actions on the entire project; and
- June 22: City Council second (and final) step of actions on the entire project.

The policy decision to approve a project of the proposed size at this location, balancing the benefits and impacts, is a Council decision. The Planning Commission will be asked to make a recommendation on this policy decision at its meeting on May 3. The City Council would then need to consider all inputs, including comments from the community, in making the policy decision, which is currently scheduled for June 15, 2010.

## BACKGROUND

### Project Description

The Bohannon Development Company has submitted a proposal for a mixed-use office, research and development (R&D), hotel, and health club development on nine properties addressed 100 to 190 Independence Drive (Independence Site) and 101 to

155 Constitution Drive (Constitution Site). An area plan showing the project in context of its surroundings is included as Attachment B. The proposal is currently branded as the Menlo Gateway project, although it has also been referred to informally as the Bohannon hotel and office project. The proposed project would require the following actions:

1. **General Plan Amendment** to create a new Mixed-Use Commercial Business Park land use designation, which would allow research and development (R&D) facilities, offices, hotels/motels, health/fitness centers, cafes and restaurants, and related commercial uses. The maximum floor area ratio (FAR) would be set at 100% for offices, R&D, and related commercial facilities, 12.5% for health/fitness centers, cafes and restaurants, day care facilities, and related retail/community facilities, and 25% for hotels/motels (total maximum FAR of 137.5%);
2. **General Plan Amendment** to change the land use designation of the properties from Limited Industry to Mixed-Use Commercial Business Park;
3. **Zoning Ordinance Amendment** to create a new M-3 (Mixed-Use Commercial Business Park) zoning district, consistent with the General Plan Amendment described above, and undertake associated modifications to other sections of the Zoning Ordinance, in particular the creation of specific parking requirements for the M-3 district;
4. **Rezoning** the properties from M-2 (General Industrial) to M-3 (Mixed-Use Commercial Business Park);
5. **Development Agreement** to create vested rights in project approvals, address implementation of the proposal, and specify benefits to the City;
6. **Architectural Control** approval of specific project plans for the construction of new buildings with a maximum of 955,170 square feet of gross floor area (137.5 percent FAR) and a maximum building height of 140 feet;
   - The Constitution Drive site would include two eight-story office buildings totaling 494,669 square feet; potential neighborhood-serving convenience retail and community facility space; and two multi-story parking structures;
   - The Independence Drive site would include a 200,000-square-foot, eight-story office building; a 171,563-square foot, eleven-story, 230-room hotel; a 68,519-square-foot health and fitness center; a 4,245-square-foot restaurant; potential neighborhood-serving convenience retail and community facility space; and a shared multi-story parking structure;
7. **Tentative Parcel Maps** (one on the Independence site and one on the Constitution site) to merge lots, adjust lot lines, and establish easements.
8. **Heritage Tree Removal Permits** to remove 36 heritage trees on the Independence site, 31 heritage trees on the Constitution site, seven off-site trees along Chrysler Drive, one off-site tree along Independence Drive, and two off-site trees along Marsh Road;
9. **BMR Agreement** for the payment of in-lieu fees associated with the City's Below Market Rate Housing Program; and
10. **Environmental Impact Report (EIR)** to analyze the potential environmental impacts of the proposal. In addition to analyzing the proposed project, the EIR considers an

optional approach to the proposed General Plan Amendment and Zoning Ordinance Amendment that would involve the "X" Conditional Development overlay zoning district and an associated Conditional Development Permit.

The following table summarizes some of the key features of the proposal as represented on the most recent set of project plans, dated March 10, 2010:

| Land Use | Constitution Site (Closest to SR 84) | Independence Site (Closest to US 101) | Total |
|---|---|---|---|
| Office/R&D | 494,470 s.f | 200,000 s.f. | 694,470 s.f. |
| Hotel | n/a | 173,436 s.f./ 230 rooms | 171,436 s.f./ 230 rooms |
| Health Club | n/a | 68,705 s.f. | 68,705 s.f. |
| Café/Restaurant | n/a | 4,285 s.f. | 4,285 s.f. |
| **Total** | **494,470 s.f.** | **446,426 s.f.** | **940,896 s.f.** |
| Parking Structures | | | |
| Number | 2 | 1 | 3 |
| Spaces | 1,504 | 1,017 | 2,521 |
| Size | 446,232 s.f. | 313,220 s.f. | 759,452 s.f. |

**Review Process**

The applicant submitted an initial proposal in 2004, and submitted a revised proposal in 2007 to incorporate the features and needs of a specific full-service hotel, namely Marriott Renaissance ClubSport. A comprehensive listing of past public meetings and milestones associated with the each proposal to date is included as Attachment C. The staff report and the presentations from previous meetings are available for review on the City's website or in the City offices.

On November 17, 2009, the City Council provided direction to enter into good faith negotiations on the Development Agreement with the applicant. The direction was accompanied with a number of caveats of what individual Council members felt was important for the City's negotiating team to consider a project of the proposed size. The minutes from the meeting, including a summary of each Council Member's caveats, is included as Attachment D.

On February 23, 2010, the Menlo Gateway Council Subcommittee, comprised of Council Members Cohen and Fergusson, submitted a report that included an updated public outreach and project review schedule. An excerpt of the schedule, as reviewed at that meeting, is included as Attachment E. On March 25, 2010, the Final Environmental Impact Report (EIR) and Fiscal Impact Analysis (FIA) were released and are available for review on the City's website and the City offices. These documents provide necessary context for the Council and the community to consider the proposed Term Sheet. As such, there will be a special Council presentation on the Final EIR and FIA from 5:30 p.m. to 6:45 p.m. on April 6 preceding the regular Council meeting on this item. In addition, the Planning Commission meeting scheduled for April 19, 2010 is critical for obtaining timely public comment on all aspects of the proposal.

**ANALYSIS**

**Development Agreement Term Sheet Negotiations**

A Development Agreement is a contract between the City of Menlo Park and a project sponsor that delineates the terms and conditions of a proposed development project. A Development Agreement allows a project sponsor to secure vested rights, and it allows the City to secure certain benefits. The City Council is not obligated to approve a Development Agreement, but if the City Council does want to approve a Development Agreement, the terms of the Development Agreement need to be acceptable to both parties; one party cannot impose terms on the other party.

The Council Subcommittee played an integral role throughout the process, including the provision of oversight and advisory services during the Development Agreement negotiation. The City's negotiating team, comprised of the City Manager, the City Attorney, Deputy City Manager and Development Services Manager met multiple times a week over the past 18 weeks. The negotiating team met internally to discuss strategy and specifics, held negotiating sessions with the applicant team, and consulted with the Subcommittee on a variety of topics. Subcommittee Reports were issued monthly at City Council meetings to give the rest of the Council and the community updates on how negotiations were progressing.

As described above, the City Council provided direction to the negotiating team on November 17, 2009 in the form of caveats. One of the first tasks that the staff negotiating team performed was distilling the caveats into a set of parameters, which were reviewed by the Council Subcommittee. The parameters can be summarized as follows:

Highest Priority Items

- Timely guaranteed revenue
- Substantial vehicle trip reduction
- Substantial reduction in greenhouse gas emissions
- Limits on transferability without City approval
- Reasonable limits on the time for construction - Hotel in 1st phase
- Improvement to the footprint & aesthetics of the parking structures
- Priority hiring program for Menlo Park residents
- Commitment to pursue LEED gold for office and silver for hotel

Other Priority Items

- Improving bike and pedestrian connection to and from the Belle Haven neighborhood and in the Marsh Roar corridor
- Land for housing

- Increased revenue beyond FIA projections
- Undergrounding of transmission lines
- Developing a vision for the Menlo Park waterfront area
- Enhancing Bayfront Park
- Providing retail services or child care on-site or nearby
- Additional public benefits such as bus shelters and youth programs

The negotiating team provided the parameters to the applicant to establish expectations and a framework for conducting the negotiations.

## Development Agreement Term Sheet

The proposed term sheet is included as Attachment A, along with a cover letter from the applicant. The term sheet covers 12 topics. These topics would get fleshed out into specific legal language into a much more extensive Development Agreement. Some of the topics crossover into mitigation measures from the EIR and potential conditions of approval. When considering the terms of the Development Agreement, it is important to remember that it reflects a negotiated package and any one aspect cannot be viewed in isolation. Staff believes that a majority of the parameters have been achieved in the proposed Term Sheet as summarized below.

### *Term #1: Quality Hotel*

The applicant has agreed to construct a four star quality, full-service hotel either before or concurrent with any office construction. The basic rationale and justification for the City to consider a proposal for zoning changes to increase the maximum allowed density for office uses is tied to the provision of a quality hotel that generates substantial revenue to the City through transient occupancy tax (TOT). The main benefit that the Menlo Gateway proposal offers to the City is the potential revenue and amenities of a quality hotel. Hotel quality affects room rates, which affects transient occupancy tax. Therefore, it is important from the City perspective to ensure that a quality hotel will be built, and that it will be built first.

### *Term #2: Revenue Guarantee*

Using the projections in the City's FIA as a guide, the applicant has agreed to guarantee revenue to the City to the extent that actual revenue from TOT and sales tax does not meet projections, up to $225,000 per year for a maximum of 20 years. The guarantee, based on the revenue schedule referred to as Exhibit A of the Term Sheet (Attachment A-6), would commence three years after the hotel opens. For context, Attachment F provides summary information from the City's FIA for revenue and expenditure projections for the low, medium and high scenarios. The summary table shows that the projected property taxes alone would cover the City's expenses related to the project. The revenue target established in the term sheet combines the low TOT projection and the medium sales tax projection, to establish the base year 2008 revenue target of $1.2

million, comprised of $1,050,783 of TOT and $150,504 of sales tax, which would escalate at two percent per year. Since the revenue target includes sales tax, it creates an incentive for the applicant to lease to tenants that have the potential to generate sales tax. The guarantee also helps protect the City against the poor performance of the hotel. The negotiating team and the applicant explored an number of options related to revenue guarantees, including the possibility of structuring the revenue guarantee as a percentage of gross office rents. Although appreciating the elegance of the concept, it proved unworkable for the applicant, especially with respect to being able to finance the project or separating ownership of the hotel from the office portion of the project in the future.

***Term #3: Term for Retaining Development Rights***

The initial term of the Development Agreement would be 5 years. By the fifth year of the agreement, the applicant either would have to make a complete building permit submittal, which would likely cost hundreds of thousands of dollars to prepare the necessary documents or pay a fee to the City in the amount of $300,000 for a two year extension, with the ability to get a third year if a complete building permit submittal is made by the end of the second year, i.e. year seven. If submittal for building permits was made by the fifth year, then there would be an automatic three year extension of the Development Agreement. To keep the Development Agreement active, the applicant would have to obtain a building permit and start construction by the end of the eighth year. Once construction starts on the Independence (Hotel) phase, then the applicant would have until the 15$^{th}$ year to start construction on the first office building on the Constitution phase. Upon starting construction on the first Constitution office building, the applicant would have an additional five years to start construction of the second Constitution office building. The overall timeframe reflects current market conditions and overall timeframes for preparing necessary permit documents, permit reviews, construction, and market absorption. The incentives are aligned to encourage the applicant to commence construction of the hotel, and the office development cannot proceed in advance of hotel construction.

***Term #4: Public Benefits***

The term sheet includes three separate types of public benefit. The first type involves $1 million worth of capital improvement projects allocated to (1) the Belle Haven neighborhood and (2) Bedwell Bayfront Park or other City-wide recreational improvements, which would be funded, designed and implemented by the applicant. These specific projects would be based on City-conducted outreach and ultimately be at the discretion of the City Council. The money would be indexed for inflation starting in 2010 and the work would need to be completed prior to the completion of the first office building on the Constitution phase. This approach allows at least half, potentially more, of the benefits to be focused on areas near the project, and give the City Council decision-making authority on how money is spent.

The second type of public benefit would be a voluntary imposition of an additional one percent TOT on the hotel for a total TOT of 11 percent for the life of the hotel, provided the City TOT remains at the current rate of 10 percent; the additional 1 percent would terminate if the City raises its TOT to 11 percent or above. This concept is one of the supplemental revenue ideas from the City's FIA. This public benefit provides funds, approximately $105,278 on the low end and $146, 986 on the high end (both in 2008 dollars) with the first phase of development and does not have any restrictions associated on how future City Councils would decide on how to spend the money. The applicant does provide a couple of suggestions that the money could be spent for further trip reduction or greenhouse gas reduction efforts in the City.

The third public benefit item is a commitment to a priority hiring program with JobTrain for Menlo Park residents.

The negotiating team and the applicant did explore the potential to achieve some of the other parameters, which could be categorized as public benefit items, such as the provision of land for housing, undergrounding the electrical transmission lines along the Constitution site, developing a vision for the Menlo Park waterfront, and providing retail services or child care on-site or nearby. The applicant determined that these items were not financially feasible and the negotiating team determined that these were not as high of a priority compared to other parameters. The City Council could consider funding these or other items once the City starts receiving the projected TOT if the project is approved and built.

***Term #5: LEED Building Standards***

The applicant is committed to designing the office buildings to achieve LEED (Leadership in Energy and Environmental Design) gold and for the hotel and health club to achieve LEED silver based on the registrations that occurred in the Spring of 2009. The applicant is required to make a good-faith effort to obtain certification for the applicable levels.

***Term #6: Vehicle Trip Reduction***

The applicant has agreed to reduce the projected net new average daily trips from 11,113 to 9,242, which reflects a 17% reduction in trips. The applicant has agreed to annual monitoring to verify trip counts after occupancy of the second Constitution office building. If the project is not in compliance with the trip limits, then the project would be subject to a fee of $100 (indexed to inflation) per daily trip in excess of the trip limit with funds to be used by the City for trip reduction programs. Much of the work to come up with the trip limit came from efforts to reduce the project's greenhouse gas emissions. Even though the greenhouse gas analysis shows that trips could increase and still meet the Bay Area Air Quality Management District (BAAQMD) draft thresholds for emissions, the applicant agreed to a permanent trip limit to address the Council caveat regarding trip reduction. By agreeing to this trip limit and penalty structure, this requirement was able to be applied to the EIR to eliminate three significant and unavoidable transportation impacts, one air quality impact, and one noise impact. The trip limit would remain in place beyond the life of the Development Agreement for the life of the project.

***Term #7: Greenhouse Gas Reduction***

The applicant spent time refining project features to reduce greenhouse gas emissions in order to satisfy requirements of the EIR. Through the Development Agreement negotiations, the applicant has agreed to go a step further to reduce greenhouse gas emissions associated with the energy consumption of the buildings by participating in a program such as PG&E's Climate Smart or comparable offset program so that the buildings energy consumption/use will be carbon neutral. This requirement would be beyond the life of the Development Agreement for the life of the project.

***Term #8: Permit Processing***

The term sheet calls for the City to expeditiously process permits and future approvals for the project. In addition, the term sheet would allow the City Manager to extend performance times called for in the Development Agreement up to a maximum of 180 days if the applicant is proceeding expeditiously. These items demonstrate the City's commitment to making the project a success and allows the project to move forward with some flexibility in the schedule if unforeseen delays are encountered.

***Term #9: Land Use Vesting Rights***

The term sheet calls for the applicant to have the vested right to build the project consistent with the various project approvals generally based on the laws in affect at the time of approval. This provision gives the applicant certainty during the term of the Development Agreement. This is a standard term of Development Agreements to minimize risks to property owners and investors.

***Term #10: City Fees***

The term sheet calls for the City fees to be capped at the current levels at the time of approval of the Development Agreement, except for fees that are subject to indexing or the imposition of new Citywide fees. Two of the City's highest fees are the Below Market Rate (BMR) housing in lieu fee and the traffic impact fee, both of which are indexed. The Utility Users Tax (UUT) is not fixed, and the project will pay the same rates as other comparable Menlo Park properties. The project would be subject to any new fees and taxes that are applicable Citywide.

***Term #11: Project Modifications***

The applicant has already prepared options that incorporate the use of landscape reserve parking and modify the footprints of the three parking structures, which are analyzed in the Final EIR. The applicant is committed to making further improvements to the exterior of the parking structures, regardless of the garage footprints, subject to City staff review and approval. In addition, the term sheet calls for other project modifications to be approved by City staff if the changes are substantially consistent with original project approvals.

***Term #12: Transferability***

Transfer or sale of the property prior to completion of the hotel would be limited and subject to City Manager approval. Transfer after completion of the hotel would be allowed subject to certain conditions without City approval. All obligations of the Development Agreement, such as environmental mitigations, public benefit payments, revenue guarantees, and conditions of approval, would be assumed by any new owner or transferee of any portion of the property. The applicant has a long-term stake in the community that involves buying and holding property, not selling property.

**Financial Analysis**

The City retained the services of two experts, Suzanne Mellen of HVS Consulting & Valuation and Rob Perrino of Cushman & Wakefield, to provide guidance regarding the financial feasibility of the hotel and office aspects of the project. The funds for these services were provided to the City by the applicant and the City in turn contracted directly with the respective firms. The firms were tasked with performing market studies, financial projections and valuations of portions of the project as well as an overall project pro-forma to determine the overall feasibility of the project and the value of entitlements. The financial consultants from HVS and Cushman & Wakefield will be in attendance at the April 6, 2010 meeting and will be available to answer Council questions.

***Hotel Analysis***

The executive summary of the Hotel Analysis is included as Attachment G. A full copy of the HVS Report has been made available to Council Members and is available for review by the public at the Community Development Department at City Hall and is available on the City's website. The following is a summary of the HVS analysis and findings.

HVS determined that the proposed Marriott Renaissance ClubSport project is feasible from a market demand perspective, assuming that the approximately 700,000 square feet of office space is developed adjacent to the hotel. While the Renaissance ClubSport is projected to operate profitably, HVS concludes that the development costs of the project coupled with the challenge of getting a hospitality product of this magnitude financed, leads it to conclude that the hotel project can only be rendered feasible if it is developed in conjunction with the more economically viable office product.

The subject site, while providing excellent access and visibility from U.S. 101, is relatively isolated, in that it is removed from demand generators at the current time. With the simultaneous development of the ClubSport and the office space, the hotel will offer an environment attractive to not only the adjacent office users, but also transient guests from other sub-markets as well. The hotel/club/office mixed-use development is very synergistic – each component enhances the revenue potential of the other by providing amenities that generate demand and a rental rate premium.

HVS undertook a complete market analysis for the proposed hotel. They anticipate that the hotel will compete with nine hotels totaling approximately 2,000 hotel rooms in the Menlo Park and Palo Alto area. While the local hotel market is depressed at the current time, having experienced a 21% decline in room revenue in 2009, they anticipate that the market will gradually recover to pre-recession occupancy levels by 2013. As occupancy recovers, they anticipate a rebound in average room rates reaching 2007 levels by 2013 (unadjusted for inflation). They have projected the hotel to achieve a stabilized occupancy of 74% and an average rate of $243 in 2017, its fourth year of operation.

According to HVS, the market for athletic facilities has fared better during this economic downturn - local athletic clubs have, for the most part, sustained their membership levels and initiation fees and monthly dues have not seen a significant decline. The eleven athletic facilities in the subject's market area were evaluated, however only the Pacific Athletic Club was considered by HVS to be truly competitive with the subject ClubSport. They project the club to ramp up to a stabilized level of 4,600 members by the end of 2017.

HVS made the following assumptions in its analysis:

1. That the Renaissance ClubSport will be complete and operational by January 1, 2014;
2. That the hotel market, which is depressed at the current time, will have fully recovered, from a demand perspective, as of the date of opening;
3. That average room rates will rebound once lodging demand recovers;
4. That the ClubSport will begin pre-selling memberships prior to the health club's opening and that 40% of the memberships will be pre-sold, creating positive cash flow to the operation at day one.
5. That the Renaissance Hotel will attain operating ratios and a profit level typical for a first-class, full-service hotel of this nature. HVS' projections are based on a database of comparable operating statements and its hotel forecasting model, adjusted for the specifics of the property and its market;
6. That the ClubSport will generate operating ratios and a profit level typical for an athletic club of this nature. HVS' projections are based on comparable athletic

club statements provided by Leisure Sports and its forecasting model, adjusted for the specifics of the property and its market.

7. The combined hotel and club operating forecast was compared with the operating performance of the Renaissance ClubSport in Walnut Creek for reasonableness.

The proposed project was valued as of the date of opening, January 1, 2014, to evaluate what the developer could sell the project for once it is completed. The valuation was based on a discounted cash flow analysis based on market rates of return. The discounted cash flow analysis was based on the annual cash flow (net income available for debt service and return on owner's equity) to be generated by the property over a ten year period, plus the reversionary sales proceeds from an assumed sale of the project at that time, i.e. as of December 31, 2023. The annual cash flow and reversion were discounted at a rate of 12.5%, which reflects a blended cost of debt and equity capital. The concluded value, as of January 1, 2014, was calculated to be $107,400,000, including membership pre-sale revenue.

The cost to develop the property must be taken into consideration to determine whether the project is feasible. In addition, in order to determine the value of the land intended for the Renaissance ClubSport, HVS performed a residual analysis whereby the value of the land was estimated by determining the value of the hotel as of the date of opening, and deducting the cost to develop the property. The remainder is what a developer could afford to pay for the land. In this particular case HVS did not deduct a typical entrepreneurial incentive as a cost of development, as would normally be the case. If HVS had deducted what it stated is a typical entrepreneurial incentive of 15% of development costs, there would be no residual value to the land, reflecting the marginally feasible nature of the hotel portion of the overall project, i.e. the developer must earn its profit from the office component. HVS based its land residual analysis upon the following assumptions:

1. The hotel's budgeted development cost, provided to HVS by the developer based on its contractor's estimate, equates to $89,138,965 ($359.46 per square foot x 248,672 square feet). This cost, which is exclusive of land cost, was compared to the development cost of the recently constructed Renaissance ClubSport in Aliso Viejo, California for reasonableness and was found to reasonable.
2. To the budgeted development cost HVS added 50% of the pre-development monies spent to date ($4,000,000) – assuming that this cost is shared with the adjacent office building.
3. In addition, a developer's fee to cover overhead during the pre-development phase was estimated at $3,000,000, based on HVS' database of detailed hotel development budgets.
4. A worst case scenario for this analysis was included, which was based on the assumption of a $10 lower average room rate, two percentage point lower

occupancy, $10 less membership dues per month and a $90 lower club initiation fee.

HVS concludes that the residual value of the Renaissance ClubSport site is estimated to be $11,300,000 as of the date of the project's completion (January 1, 2014) and $9,300,000 as of January 1, 2010, assuming an annual discount rate of 5%. Note that no developer's incentive has been included in HVS' analysis, i.e. HVS concluded that if a developer paid $9,300,000 for the land today (valued at $11,300,000 in 2014) and developed the Renaissance ClubSport for a total of $96,100,000, that they would be able to sell the project for $107,400,000, or an amount just equal to their total investment, without any imputed profit. According to HVS, real estate developers require some incentive to undertake the enormous risk of developing projects, particularly ones of this nature, which require a substantial investment for many years before any positive cash flow is generated. HVS concluded that the developer of the Renaissance Clubsport will have to wait until the office buildings are sold or refinanced to earn any profit on the development of the Renaissance ClubSport component of this project.

***Office Analysis***

The executive summary of the Office Analysis is included as Attachment H. A full copy of the Cushman & Wakefield Report has been made available to Council Members and is available for review by the public at the Community Development Department at City Hall and is available on the City's website. The following is a summary of the Cushman & Wakefield analysis and findings.

Cushman & Wakefield prepared a valuation consulting assignment of the office and retail portion of the Menlo Gateway Project performing the following work:

- Subject property inspection to the extent necessary to adequately identify the real estate
- Research relevant market data, in terms of quantity, quality, and geographic comparability, to the extent necessary to produce credible valuation consulting results
- Review of architectural renderings
- Review relevant studies prepared by other consultants
- Interview the developer
- Review and analyze developer's development cost estimates and pro-forma
- Interview Menlo Park Planning Personnel assigned to the Menlo Gateway Project

- Develop a market value estimate of the fee simple interest, as of January 1, 2010, for the subject land based on current zoning assuming a maximum Floor Area Ratio (FAR) of 45%
- Develop a market value estimate of the fee simple interest, as of January 1, 2010, for the subject land based on the proposed office and retail development
- Determine the general overall feasibility of the office/retail component of the project by utilizing the discounted cash-flow (DCF) methodology.

Cushman & Wakefield made the following market/economic observations in performing its analysis:

- Job creation for Bay Area employment will improve the project's probability of success
- An increase in initial round venture capital funding will lead to job creation and office space demand (leasing)
- Office space leasing at the project creates demand for Renaissance ClubSport
- Current office rent levels are flat
- Current class A office vacancy rates remain high with landlord concessions (free rent, generous tenant improvement allowances)
- Demand analysis indicates there is 3.89 years of oversupply of office space in the Silicon Valley and San Francisco Peninsula
- Current market conditions do not make the project feasible, today
- Overall improvement in real estate fundamentals (leasing, rents, financing) is needed

Cushman & Wakefield made the following assumptions about the office/retail portion of the project in performing its analysis:

- Approximately $4 million in entitlements to be spent by the developer is needed to coordinate, plan, and get approvals for office/retail portion
- Construction costs estimated at $250 million (excluding land, entitlements, and leasing commissions)
- Construction commencement in 2012 (estimated) with final completion in 2015 (estimated)
- Pre-leasing campaign of office space will be beneficial to the overall success of the project
- Absorption period for the office space is forecasted at 35 months (January 2014 thru December 2016)

Cushman & Wakefield reached the following conclusions:

- Land value of the office/retail portion of the project based on the proposed entitlements discounted back to 2010, best case is $51.2 million and worst case $15.8 million
- Financial projections indicate that the office/retail portion of the project would sell for approximately $341,250,000 in 2014 based on discounted cash flows assuming construction commenced in 2012 and no changes to construction schedule
- Project is economically feasible over the long-term, but the calculated Internal Rate of Return of approximately 12.68% is below an industry target return of 15%, and relies on sale of the project to achieve that return

***Combined Financial Findings for Entire Project***

Cushman & Wakefield prepared a Land Residual Analysis for the full project, which is included as Attachment I. This analysis shows the land residual analysis for both the office/retail portion of the project, as well as the hotel portion of the project. It also includes a residual land value for the property under its present zoning. This analysis concludes that the property currently has a value of $36.7 million under the "best case" and current value of $18.7 million under the "worst case" assumptions. The total residual land value of the combined project is estimated to be $60.5 million under the "best case" assumptions and $15.8 million under the "worst case" assumptions. This results in a value of the entitlements, i.e. increase in the residual land value of the fully entitled project, of $23.8 million under best case assumptions and no increase in value under the "worst case", i.e. the project would not be financially feasible and therefore the entitlements would add no value to the property.

Cushman & Wakefield also prepared a proposed construction pro-forma for the combined office and hotel project, included as Attachment J, based on assumed commencement of construction in 2012 showing cash invested in the project and cash flows from leasing/operations. This pro-forma projected net cumulative cash flow is potentially not positive until 2023 indicating a required long-term holding period for the developer and considerable risk, according to Cushman & Wakefield. Total capital investment over the first seven years, including real estate commissions, future tenant improvements, and contingency (but excluding the value of the land) is projected to be as much as $430 million over the estimated 11 year holding period (2024).

**Conclusion**

Given (1) the conclusions of the FIA and the financial analysis prepared by independent experts, (2) the requirement that the hotel be built first with potential for significant long-tern revenue with guarantees, (3) the extensive measures to minimize environmental impacts, and (4) other Development Agreement terms, such as public benefit funding, staff recommends that the City Council consider the proposed Term Sheet for the Menlo Gateway (Bohannon Hotel & Office) Development Agreement (Attachment A) and proceed with the review process according to the previously established schedule (Attachment E).

## IMPACT ON CITY RESOURCES

The applicant is required to pay planning permit fees, based on the Master Fee Schedule, to fully cover the cost of staff time spent on the review of the project. The applicant is also required to bear the cost of the associated reviews by consultant. For the consultant review, the applicant deposits money with the City and the City pays the consultants.

The FIA itself provides projections of the potential changes in fiscal revenues and service costs directly associated with development of the proposed project, for both the City and associated special districts. The Draft FIA was released on July 23, 2009 for an extended public comment period that ended on October 19, 2009. The Final FIA, prepared in response to comments on the Draft FIA, was released on March 25, 2010 for a 26-day review period. Comments on the Final FIA are due on or before the Planning Commission public hearing scheduled for April 19, 2010. A presentation highlighting the findings of the Final FIA will be provided before the start of the regularly scheduled City Council meeting in the Council Chambers starting at 5:30 p.m. On April 6, 2010, handouts of the presentation will be posted on the City's website after the meeting.

## POLICY ISSUES

The proposed project will ultimately require the Council to consider a policy decision whether to change the General Plan land use designation and the zoning classification for the property. The implications associated with this decision will be analyzed through the project review process.

Staff is not making a recommendation on the policy decision to approve a project of the proposed size at this location given the benefits and impacts, as this is a Council decision. The Planning Commission will be asked to make a recommendation on this policy decision at its meeting on May 3, 2010. The City Council would then need to consider all inputs, including comments from the community, in making the policy decision, which is currently scheduled for June 15. At each of those meetings, staff will ask the Commission and Council, respectively, to first focus on the larger policy issue before weighing in on the details of the specific proposal.

For the meeting of April 6, 2010, the Council should decide whether it is generally comfortable with the term sheet as proposed. If the Council is generally comfortable, then there may be some specific items that the Council would like refined further concurrently with public review process. Staff could then attempt to negotiate with the applicant on modifications or revisions to the term sheet. If the Council is not generally comfortable with the term sheet as proposed, then the Council could stop the process and ask staff to go back to the table or the Council could direct staff to finish processing the project based on the proposed term sheet with the intention of denying the project.

**ENVIRONMENTAL REVIEW**

The Draft Environmental Impact Report was released on July 23, 2009 for an extended 60-day public comment period that ended on September 21, 2009. The Final EIR, prepared with response to comments on the Draft EIR, was released on March 25, 2010 for an extended 26-day review period. Comments on the Final EIR are due on or before the Planning Commission public hearing scheduled for April 19, 2010. A presentation highlighting the findings of the Final EIR will be provided before the start of the regularly scheduled City Council meeting in the Council Chambers starting at 5:30 p.m. On April 6, 2010, handouts of the presentation will be posted on the City's website after the meeting.

Justin Murphy
Development Services Manager

William L. McClure (JM)
William L. McClure
City Attorney

Kent Steffens
Kent Steffens
Deputy City Manager

Glen Rojas
City Manager

**PUBLIC NOTICE**

Public notification was achieved by posting the agenda, at least 72 hours prior to the meeting, with this agenda item being listed. In addition, the City sent an email update to subscribers to the project page for the proposal, which is available at the following address: http://www.menlopark.org/projects/comdev_iac.htm A postcard mailed Citywide announcing the future meeting dates is scheduled to be mailed on April 8, 2010.

**ATTACHMENTS**

A. Letter from David D. Bohannon II, dated March 24, 2010 with proposed Development Agreement Term Sheet
B. Menlo Gateway Area Plan
C. Project Meetings and Milestones
D. Approved City Council Minutes for the Meeting of November 17, 2009

E. Excerpt of Public Outreach and Development Agreement Negotiation Process, dated February 23, 2010
F. Summary of City Revenue and Expenditures from Fiscal Impact Analysis (FIA)
G. HVS Executive Summary
H. Cushman & Wakefield Executive Summary
I. Land Residual Analysis
J. Construction Pro-Forma for Office and Hotel

**REPORTS AVAILABLE FOR REVIEW ON CITY WEBSITE AND IN CITY OFFICES**

A. Final Environmental Impact Report (EIR), dated March 2010, distributed separately
B. Final Fiscal Impact Analysis (FIA), dated March 2010, distributed separately
C. Hotel Financial Analysis, dated March 2010, distributed separately
D. Office Financial Analysis, dated March 2010, distributed separately

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# BOHANNON
DEVELOPMENT COMPANY

March 24, 2010

The Honorable Richard Cline
Mayor of the City of Menlo Park
And Members of the City Council
City of Menlo Park
701 Laurel Street
Menlo Park, CA 94025

**RE: Menlo Gateway Project—Development Agreement Term Sheet**

Dear Mayor Cline and Members of the City Council:

On behalf of the Bohannon Development Company (BDC), we are extremely pleased to present the Menlo Gateway Term Sheet, which sets forth the terms negotiated between BDC and the City of Menlo Park (City) for the Development Agreement (DA).

As you may be aware, BDC and the City's negotiating team spent literally hundreds of hours working to fashion financially feasible terms that address the expectations outlined by the City Council at its November 17, 2009 hearing. BDC has made every effort to respond to the Council's parameters while retaining a readily viable project for the City.

We recognize that Menlo Gateway is a large scale project by Menlo Park's standards, but we have intentionally designed a "self-mitigating" project that seeks to offset most negative impacts to the City, its neighborhoods, and the environment. Menlo Gateway also is uniquely positioned to significantly improve Bohannon Park and its environs by redeveloping underutilized, industrial land and by providing much-needed commercial amenities to the east side of Menlo Park. Moreover, BDC set out to create a project that is truly sustainable—balancing the conflicting demands of economic, environmental, and social sustainability.

With respect to economic sustainability, the Bohannon family is uniquely situated to deliver the unprecedented commitments set forth in the Term Sheet for the City Council's consideration because of our long-term investment in the Menlo Park community. For example, BDC has asked for no public funding, financing or subsidies as are being offered to similar projects throughout the Peninsula and the Bay Area. Moreover, we have agreed to guarantee the downside risk of the City's anticipated hotel revenue stream for a period of twenty years.

Moreover, the City now is poised to be a beneficiary of the Bohannon family's unique investment philosophy by way of our ability to provide substantial financial commitments. In particular, the City will benefit from roughly $1.4 million in new TOT and sales tax revenue. The City also will benefit from BDC's funding of $1 million in capital improvement projects for the Belle Haven neighborhood and Bayfront Park, as determined by the City Council. The City also will receive supplemental revenue from a voluntary 1% increase to the TOT tax on the hotel to be

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A1

utilized by the City for such programs as vehicle trip reduction, GHG emissions reductions, or other public purposes.

With respect to environmental sustainability, Menlo Gateway delivers a robust and state of the art project that commits to significant vehicle trip reduction, GHG emission offsets, and gold and silver LEED certification—all of which set new benchmarks for development in Menlo Park, in addition to the Bay Area as a whole. These commitments go above and beyond the design features already incorporated into the project to make Menlo Gateway a true leader in sustainable development.

Lastly, with respect to social sustainability, the Menlo Gateway project meaningfully contributes to the City's social fabric by entering into a Priority Hiring Program with JobTrain that will give Menlo Park residents priority for Menlo Gateway jobs. In addition to this preference program, the project will bring approximately 2,300 jobs the area, while also creating 1,900 shorter-term construction jobs.

While BDC expects the Menlo Gateway project to be very successful in the long-term because of its unique balance of uses, the near term economic projections are extremely marginal, especially as a consequence of the cost of sustainability features, project amenities, design treatments, mitigations, and impact fees. As a result, the project can only carry a certain amount of additional "public benefits" (beyond those contained in the project itself) and remain feasible, which necessitated our re-prioritization of certain DA parameters that simply could not be sustained. BDC has, however, done its best, in conjunction with the City's negotiating team, to accommodate the Council's expectations in the face of unavoidable financial realities. The work of the City's hotel and office consultants (HVS and Cushman & Wakefield, respectively) recognizes the financial challenges of this project. This work further supports the Renaissance ClubSport perspective that the synergy of uses between the hotel and office components of the project are critical to Menlo Gateway's overall success.

We therefore ask the Council to recognize that the Bohannon family is uniquely positioned to deliver such a robust project with such unprecedented commitments to the City of Menlo Park during this economic time. We know this market, we have a successful track record in the community, and we are prepared to remain with this project for the "long haul."

We thank you for your consideration of this matter. We welcome your questions and further dialogue and look forward to our upcoming public hearing on April 6, 2010.

Sincerely,

David D. Bohannon II
Senior Vice President

Enclosure

# MENLO GATEWAY

## DEVELOPMENT AGREEMENT TERM SHEET

1. **Hotel**

- Bohannon intends to construct a Marriott Renaissance ClubSport hotel facility on the Independence property.

- In the event a Marriott Renaissance ClubSport hotel facility is not feasible, Bohannon shall construct a full-service hotel affiliated with a national hotel brand (e.g. Hilton, Westin, Marriott, Intercontinental, etc.), which is of a quality and offers services consistent with the requirements of a AAA "four star" rating or higher, that is projected to produce TOT revenue within the range as described in the BAE Fiscal Impact Analysis.

- Bohannon shall construct the hotel portion of the Independence Phase first or concurrent with any office building(s).

2. **Guarantee**

- To the extent that the annual TOT (at 10%) and sales tax revenue from the Project falls below the table in Exhibit A ("BAE Low Estimate"), Bohannon shall pay the shortfall in an amount not to exceed $225,000 annually.

- Guarantee payments shall commence three years after the hotel opens and shall continue for twenty years.

- Guarantee extinguishes if Bohannon terminates its right to construct or the right to construct expires by the terms of the Development Agreement, without commencing construction of building on the Constitution Site.

3. **Term**

- The initial term of the Development Agreement shall be five years (Initial Term).

- The term shall automatically be extended for three years upon submittal of a substantially complete building permit application for the hotel portion of the Independence Phase prior to expiration of the Initial Term.

- Prior to expiration of Initial Term, Bohannon may extend the term for two years by making a payment in the amount of $300,000. Bohannon shall submit a substantially complete building permit application for the hotel portion of the Independence Phase by the end of the seventh year for an additional one year extension.

- Bohannon shall obtain a building permit for the hotel and commence construction by the end of the eighth year.

- Bohannon shall obtain the building permit for and commence construction of the first office building on Constitution within 15 years of the Development Agreement's effective date. Bohannon then shall have five additional years to obtain the building permit and commence construction for the second office building on Constitution.

4. **Public Benefits**

- Bohannon shall implement capital improvements with a cost not to exceed $1 million (indexed for inflation from 2010), the specifics of which shall be determined after public outreach by the City. Such amount shall be allocated between the Belle Haven neighborhood and Bayfront Park/other City-wide recreational improvements at the discretion of the City Council.

  --The City's outreach shall commence upon Bohannon's submittal for the first Constitution building permit.

  --Bohannon shall complete the work prior to the City's final building inspection.

- Bohannon shall voluntarily raise the hotel's TOT rate to 11% for the life of the project with the additional 1% to be used by the City for such programs as vehicle trip reduction, GHG emission reductions, or for other purposes as determined by the City Council. The additional 1% TOT shall extinguish if the City raises the City-wide TOT to 11% or more.

- Bohannon shall provide a Priority Hiring Program with JobTrain for Menlo Park residents.

5. **Leadership in Energy and Environmental Design (LEED)**

- Bohannon shall show compliance with LEED standards in effect at the time of LEED registration. Upon completion of construction, Bohannon shall submit a request for Gold certification for the office buildings and Silver certification for the hotel to the U.S. Green Building Council. Bohannon shall use good faith efforts to obtain such certifications.

6. **Vehicle Trip Reduction**

- The net new trips from the project shall be reduced from 11,113 to 9,242 trips per day.

- Based upon annual traffic counts after completion and occupancy of the project, the applicant shall be subject to a $100 penalty (indexed for inflation from 2010) per excess average daily trip if such reduction is not achieved.

7. **Greenhouse Gas (GHG) Emissions Reduction**

- The buildings' GHG emissions associated with energy consumption shall be fully offset through participation in PG&E's ClimateSmart program or a comparable program subject to the City Manager's reasonable approval.

8. **Permit Processing**

- City shall expeditiously process permits and approvals required for development, use, and occupancy of the project.
- Provided the applicant is proceeding with due diligence, the City Manager or his/her designee(s) may extend the time for issuance of a permit or for other performance hereunder for a reasonable period of time not to exceed 180 days.

9. **Vesting**

- The applicant shall have the vested right to build the project consistent with the various project approvals and subject to the terms and conditions of the Development Agreement. Generally, the applicable City laws applicable to the project shall be those in force and effect on the effective date of the Development Agreement.

10. **Fees**

- Generally, there will be a fixed cap at current rates on the effective date of the Development Agreement for city fees and exactions, except for fees scheduled to rise by way of indexing and/or the imposition of new City-wide fees/taxes.

11. **Project Modifications**

- Bohannon will pursue a design process with City staff to improve the aesthetics of the parking structures.
- Project modifications that are substantially consistent with the initial project approvals may be approved by the City Manager or his/her designee.

12. **Transferability**

- Prior to completion of the Independence Phase, City may limit transfer or assignment to an experienced developer with the appropriate financial resources, subject to approval by the City Manager.
- After completion of the Independence Phase, Bohannon's rights may be transferred subject to the terms and conditions of the DA.
- DA shall be transferable to any lender or subsequent purchaser, without restriction, in the case of foreclosure.

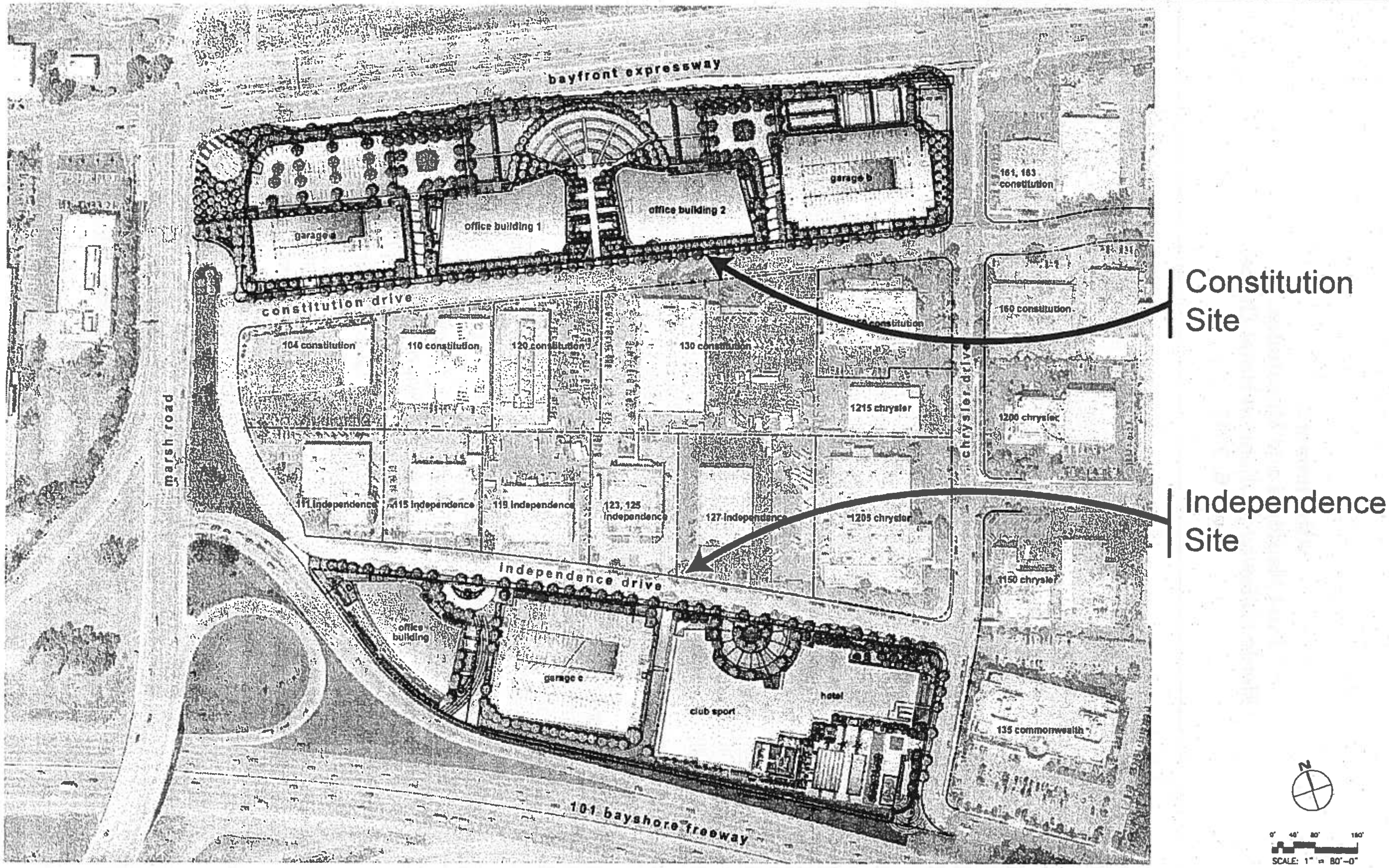
Menlo Gateway Revenue Guarantee
Target Revenue Amounts by Year

Exhibit A

| Year | Revenue Target (1) |
|---|---|
| 2010 | $1,251,900 |
| 2011 | $1,276,938 |
| 2012 | $1,302,477 |
| 2013 | $1,328,526 |
| 2014 | $1,355,097 |
| 2015 | $1,382,199 |
| 2016 | $1,409,843 |
| 2017 | $1,438,039 |
| 2018 | $1,466,800 |
| 2019 | $1,496,136 |
| 2020 | $1,526,059 |
| 2021 | $1,556,580 |
| 2022 | $1,587,712 |
| 2023 | $1,619,466 |
| 2024 | $1,651,855 |
| 2025 | $1,684,892 |
| 2026 | $1,718,590 |
| 2027 | $1,752,962 |
| 2028 | $1,788,021 |
| 2029 | $1,823,782 |
| 2030 | $1,860,257 |
| 2031 | $1,897,462 |
| 2032 | $1,935,412 |
| 2033 | $1,974,120 |
| 2034 | $2,013,602 |
| 2035 | $2,053,874 |
| 2036 | $2,094,952 |
| 2037 | $2,136,851 |
| 2038 | $2,179,588 |
| 2039 | $2,223,180 |
| 2040 | $2,267,643 |
| 2041 | $2,312,996 |
| 2042 | $2,359,256 |
| 2043 | $2,406,441 |
| 2044 | $2,454,570 |

Footnotes:

(1) Target revenue is the total estimated sales tax and TOT revenue (assuming 10% TOT) to the City based on the Fiscal Impact Analysis dated July 1, 2009 ($1,203,287) and escalated 2% per year for inflation starting in 2008.




B

MENLO GATEWAY

BOHANNON DEVELOPMENT COMPANY

100-190 INDEPENDENCE DRIVE AND 101-155 CONSTITUTION DRIVE, MENLO PARK, CA

Project Number: 9586.01

AREA PLAN

09/27/2007 05/15/2009
12/21/2007 07/07/2009
04/02/2009 03/10/2010

G2

COMMUNITY DESIGN + ARCHITECTURE

DES

**Attachment C**
**Past Meetings and Milestones**
**Menlo Gateway (Bohannon Hotel-Office)**
**April 6, 2010**

| Date | Body | Topic |
|---|---|---|
| *04/23/2004* | *Milestone* | *Original Proposal Submitted* |
| 07/14/2005 | Community Meeting | EIR Scoping Session |
| 10/04/2005 | City Council | Study Session |
| *03/09/2006* | *Milestone* | *Original Proposal Put on Hold* |
| *01/16/2007* | *Milestone* | *Revised Proposal Submitted* |
| 03/20/2007 | City Council | Presentation |
| 06/04/2007 | Planning Commission | EIR Scoping Session |
| 06/19/2007 | City Council | EIR Scoping Session |
| 07/10/2007 | City Council | EIR Scoping Session |
| 07/31/2007 | City Council | FIA Procedure Review |
| 08/27/2007 | Planning Commission | Study Session |
| 10/23/2007 | City Council | Study Session and Regular Business |
| 01/15/2008 | City Council | FIA Request for Proposals (RFP) Review |
| 04/22/2008 | City Council | FIA Proposal Approval |
| 07/30/2008 | Community Meeting | FIA Workshop |
| 09/09/2008 | City Council | Initial Subcommittee Appointment |
| 04/14/2009 | City Council | Review of Public Outreach and Development Agreement Negotiation Process |
| 06/16/2009 | City Council | Finalization of Public Outreach and Development Agreement Negotiation Process (Information Item) |
| *07/23/2009* | *Milestone* | *Release of Draft EIR and FIA* |
| 07/23/2009<br>07/29/2009 | Community Meetings (3 total) | General Review of Proposal, Draft EIR and FIA, and Public Benefits |
| 08/05/2009 | Housing Commission | Review of Draft EIR Summary and Population and Housing Chapter and Individual Comments |
| 08/05/2009 | Transportation Commission | Review of Draft EIR Summary and Traffic and Transportation Chapter and Individual Comments |
| 08/19/2009 | General Commission Meeting | General Review of Proposal, Draft EIR and FIA, and Public Benefits (*Targeted at the Bicycle, Environmental Quality, Library, and Parks and Recreation Commissions*) |
| 09/02/2009 | Belle Haven Homeowners Association | Staff Presentation of Summary of Draft EIR Conclusions at the Request of the Homeowners Association |
| 09/08/2009 | Atherton Transportation Committee | Staff Presentation of Summary of Traffic and Transportation Chapter of the Draft EIR at the Request of the Town of Atherton |
| 09/14/2009 | Planning Commission | Public Hearing on Draft EIR |
| *09/21/2009* | *Milestone* | *Close of Draft EIR Comment Period* |
| 10/05/2009 | Planning Commission | Study Session on Development Program, FIA, and Public Benefit |
| 10/19/2009 | Planning Commission | Continuation of Study Session |

| Date | Body | Topic |
|---|---|---|
| 11/3/2009 | City Council | Study Session |
| 11/9/2009 | Planning Commission | Recommendation on direction on Development Agreement Negotiations |
| 11/17/2009 | City Council | Direction on Development Agreement Negotiations |
| 12/15/2009 | City Council | Subcommittee Report |
| 1/12/2010 | City Council | Subcommittee Report |
| 2/23/2010 | City Council | Subcommittee Report |
| *3/25/2010* | *Milestone* | *Release of Term Sheet, Final EIR and FIA* |

# CITY COUNCIL
# COMMUNITY DEVELOPMENT AGENCY
# REGULAR MEETING MINUTES

**Tuesday, November 17, 2009 at 7:00 p.m.**
**701 Laurel Street, Menlo Park, CA 94025**
**City Council Chambers**

CITY OF MENLO PARK

The Council convened at 7:00 p.m. with Council Members Cohen and Fergusson absent and all other members present.

**PLEDGE OF ALLEGIANCE** – Led by Mayor Robinson

**ANNOUNCEMENTS**

- City is accepting applications for the Housing Commission and the Finance & Audit Committee – Deadline December 4th

**A. COMMISSION/COMMITTEE VACANCIES, APPOINTMENTS AND REPORTS** – None

**B. PRESENTATIONS AND PROCLAMATIONS**

1. Proclamation and presentation on the 2010 Census initiatives (*Attachment*)

The proclamation was received by Margot Grant, Census Coordinator with the County of San Mateo. She also gave a PowerPoint presentation.

Council Member Fergusson arrived at 7:09 p.m.

**C. PUBLIC COMMENT #1**

- Marilu Serrano – spoke about the Belle Haven School / Ravenswood School District

**D. CONSENT CALENDAR**

1. Adopted **Resolution No. 5895** approving the Memorandum of Understanding (MOU) between the City of Menlo Park and agencies within the San Mateo and San Francisco Counties for records data sharing within the West Bay Information Sharing System (WBISS); and authorizing the City Manager and Chief of Police to sign on behalf of the City of Menlo Park, the MOU allowing the Menlo Park Police Department to become of member of West Bay Information Sharing System (WBISS) (*Staff report #09-156*)

**Action:** Motion and second (Boyle/Fergusson) which passed unanimously approving the Consent Calendar.

**E. PUBLIC HEARINGS**

1. Adoption of a Resolution accepting the Fiscal Year 2009-10 State Supplemental Local Law Enforcement Grant (COPS Frontline) in the amount of $100,000; and approval of a request to use the funds in support of specific technology initiatives (*Staff report #09-155*)

Staff presentation by Management Analyst, Susan Tsai

D1

Mayor Robinson opened the Public Hearing

**Action:** Motion and second (Boyle/Cline) which passed unanimously to close the Public Hearing.

**Action:** Motion and second (Robinson/Cline) which passed unanimously to adopt **Resolution No. 5896** accepting Fiscal Year 2009-10 State Supplemental Local Law Enforcement Grant (COPS Frontline) in the amount of $100,000; and approving use of the funds in support of specific technology initiatives

**F. REGULAR BUSINESS**

1. Provide comments on the Menlo Gateway (Bohannon Hotel & Office) proposal located at 101 to 155 Constitution Drive and 100 to 190 Independence Drive in order to guide negotiations of the proposed Development Agreement and adopt a Resolution authorizing the City Manager to execute amendments to the contract with Bay Area Economics (BAE) for potential additional fiscal and economic consulting services with funding provided by the project applicant (*Staff report #09-163*)

Public comments:

- Henry Riggs on behalf of the Planning Commission – Gave a summary of the Planning Commission's concerns, comments and suggestions on the project
- Mr. Bohannon, project applicant – Spoke to the carbon neutrality issues
- William Nack – Building Construction Workers spoke in favor of the project
- Victor Torreano – Spoke on behalf of the sheet metal workers union in favor of the project
- Angie Simon – Western Allied Mechanical spoke in favor of the project
- Mike Swanson – Plumber Steam Fitters Union spoke in favor of the project
- Richard Stamper – Resident of Belle Haven for 52 years spoke in favor of the project
- Mark Leach – Electrical Workers of San Mateo County spoke in favor of the project
- Laurita Wheeler – spoke in support of the project
- Nancy Cash – spoke in support of the project
- David Howard – spoke in support of the project
- Fay Hintzen – Mt. Olive Church spoke in favor of the project
- Vincent Bressler – cut the parking in half, have an outside witness to the negotiations and have it recorded and made public
- Steve Kennedy – spoke to photo voltaic lighting
- Ev Gonzalez – spoke to photo voltaic lighting
- Patti Fry – not a great project but it could be and the M-2 needs a plan first
- Gail Slocum – go into negotiations, have report backs and a clear process and a two member subcommittee of the Planning Commission
- Katie Ferrick – spoke to the carbon footprint issues, parking garages and the opportunity for growth this project has for Menlo Park

The Council took a break from 9:23 to 9:33 p.m.

**Action:** By consensus of the Council, direction was given for the city to enter into good faith negotiations with the developer with caveats. A summary of the Council member's caveats is included in a separate attachment.

**Action:** Motion and second (Fergusson/Robinson) which passed unanimously approving **Resolution No. 5897** authorizing the City Manager to execute amendments to the contract with

Bay Area Economics (BAE) for potential additional fiscal and economic consulting services with funding provided by the project applicant.

2. Consideration of state and federal legislative items, including decisions to support or oppose any such legislation, and items listed under Written Communication or Information Item – None

**G. CITY MANAGER'S REPORT** – None

**H. WRITTEN COMMUNICATION** – None

**I. INFORMATIONAL ITEMS** – None

**J. COUNCILMEMBER REPORTS**

1. Report from the City Council Subcommittee on High Speed Rail

**K. PUBLIC COMMENT #2** – None

**L. ADJOURNMENT** – 11:56 p.m.

Margaret S. Roberts, MMC
City Clerk

The minutes were accepted at the Council meeting of December 15, 2009

**Menlo Gateway Development Agreement**
**Summary of City Council Caveats for Entering into Good-Faith Negotiations**
**11/17/09**

## Scale/Traffic/Greenhouse Gases

Boyle

- Not necessarily interested in reducing parking, but interested in improving the aesthetics of the parking structures by improving the design.
- Concerned about whether the traffic and greenhouse gas emission goals are achievable; what would the framework be for the negotiating team and the developer?
- In order to reduce trips further, pursue increases in shuttle use by enhancing overall shuttle service and connections to other systems (e.g., Stanford's Margueritte).
- Explore new exit off 101 Northbound.
- Consider a bike bridge that crosses the railroad tracks from the Onetta Harris Center to Chilco Street as a potential benefit.

Cline

- Would like some flexibility in the future in case there is not a need for the amount of office that has been proposed (700,000 square feet).
- Apply some creativity and vision to the parking structures; think about Zipcars, hybrids, carpools, etc.
- Likes the 50% trip reduction goal (should set a high bar for staff to try its best) and should include a high standard of "clawbacks".
- Fine with the term "approach" for carbon neutrality.
- Wants flexibility to deal with a potential future problem of US 101 and surrounding streets turning into a parking lot.
- Would like to focus traffic mitigations on the Middlefield Road corridor.

Robinson

- Agrees with Cline's comments and appreciates Boyle's comments.
- Craft a goal that pushes the envelope of what is doable.
- TDM would usually result in a 5-10% reduction maximum, so a 50% reduction is a great goal for reducing greenhouse gases, but reluctant about drawing a line in the sand.
- Building housing would reduce trips; alternatively could strive to reduce vehicle miles traveled (VMT) of current re-directed trips.
- Parking structures should be as aesthetically pleasing as possible.
- Concerned about traffic on feeder roads and Marsh Road/US 101 interchange.
- Observes consensus for being aggressive in terms of reduction of trips and greenhouse gas emissions, but not on how specific the reductions should be.
- OK with non-local offsets of greenhouse gas emissions given the bang for the buck associated with preserving carbon sinks elsewhere.

Fergusson

- Reduce traffic and traffic-related impacts so that they are at or below the impacts associated with Alternative 3.
- The 38% trip reduction (or 6,906 net new trips) could result from TDM and/or from a reduction in project size.
- Echo previous comments about the parking structures. Don't build them all; reduce size; phase implementation so that only the minimum number of spaces that are absolutely necessary are built.
- Has serious issues with the site layout on Constitution; would like to see the parking structures "behind" the buildings, especially if the transmission lines go underground.
- OK with the term "approaching" carbon neutrality, but would prefer that the project "be" carbon neutral; the project should definitely mitigate to a less than significant level.
- Thinks reduction targets (i.e., a specific number) should be provided.

*Cohen (as communicated by Council member Fergusson)*

- Reduce traffic by 50%.

## Housing

Fergusson

- Planning Commission recommendation is spot on – locating housing near jobs reduces carbon footprint.

Robinson

- A great way to reduce trips would be to have 50% of the employees live on-site.

Boyle

- Likes the idea of housing (or sports fields), but not a "Big 3" issue, which are revenue, traffic and climate change.

Cline

- Would like to start with land and figure out use later – maybe not housing.

*Cohen (as communicated by Council member Fergusson)*

- Provide housing, at least land for housing

## Timeline

Fergusson

- Include milestones for reasonable progress.
- Include a phasing plan so that the City gets benefits sooner rather than later.
- Develop project in as rapid a manner as economically feasible.

- Encourage R&D/lab uses to reduce trips, even though water resources may be required. R&D/lab is a reasonable use for water resources.

Boyle

- Timely, guaranteed revenue with two sub-points:
    - City to maintain transfer rights;
    - Ensure that hotel is built in the first phase.
- Include a mechanism to receive revenues within a few years (e.g., in year 3 or 4) or similar timeframe like the Sun Microsystems Development Agreement.
- Consider a 5-year term with options to renew.
- Sales tax in lieu or a percentage of gross rents may be worth exploring, but it is complicated.

Cline

- Concurs with Boyle.
- Guaranteed revenue should be for the life of the project, not just a term.
- There should be "clawbacks" as disincentives for doing nothing.
- Assess whether traffic metrics can be improved.
- Discuss the types of potential offices uses in order to find a way to encourage a percentage of sales oriented uses.

Robinson

- Likes what he has heard from others.
- Certain aspects of the agreement should tie the hands of future Councils and should be set in stone.
- Incentivize revenue producing office uses and discuss revenue in lieu of sales tax.

*Cohen (as communicated by Council member Fergusson)*

- Provide guaranteed income stream besides the hotel.
- Complete in 5 years, start in 1 year, and build the hotel first.

**<u>Context</u>**

Fergusson

- Would like to see this area as a destination; therefore, needs to connect to the Haven Area.
- Corner of Marsh Road and Bayfront Expressway, with its adjacency to Bayfront Park and Bay views is a gateway / landmark / "signature" / defining location; one element of the project with the potential as a gateway feature befitting the importance of the location is the hotel.
- In order to achieve the vision, the transmission lines must be placed underground. What happens to the transimission lines here sets a precedent for all future Bayfront development.

- Retail services reduce trips.
- Explore pedestrian overpass of Bayfront Expressway.

Cline
- Look into Belle Haven needs, such as bike paths and access routes.
- Look into retail services in the project area or elsewhere.
- Look into a library for Belle Haven.
- Provide better connections to bay trails and parks.
- Consider opening the tunnel to the Sun Microsystems campus at Willow Road.

Boyle
- Fergusson's and Cline's comments are all things to try for, but the "Big 3" are revenue, traffic, and climate change; housing is at the next level.

Robinson
- Concur with previous comments.
- Would like to put the power lines underground whenever possible.
- Explore on-site retail services.
- Increase shuttle use as part of TDM for the area.
- Explore enhanced bus service for commuters from the East Bay crossing the Dumbarton Bridge.
- Consider upgrades to Bayfront Park, such as pathway improvements, as an extension of the health club.

**Benefits**

Cline
- Refer to comments from previous meeting.
- Likes the idea for a local library.
- Mitigations and benefits are two different things.

Robinson
- Pursue benefits that have a nexus to the project.

Boyle
- Invest in Dumbarton corridor transit, such as express buses across the bridge.

Fergusson
- Child care can reduce trips.
- Increase connectivity to the Bay Trail; local Menlo Park improvements should complement/tie into the East Palo Alto Waterfront Access Plan's system of open space, trails, public access, and restoration.
- Pursue more native species at Bayfront Park to create an upland habitat to complement the Don Edward National Wildlife Refuge.

- Additional recreation fields would be good.
- Willing to consider a larger conference component to the hotel.
- Incorporate the ability to utilitize recycled water for irrigation and inside the building in the future.

E

# Attachment E

## Excerpt of Public Outreach and Development Agreement Negotiation Process

## Menlo Gateway (Bohannon Hotel-Office Mixed-Use) Proposal

| | | | | |
|---|---|---|---|---|
| **MILESTONE: Publish Final EIR and FIA for public review on or before March 25, 2010 and advertise through press release, public notice in newspaper, and email bulletin** | | | | |
| 14. | **City Council** regular item to review business terms of development agreement | Early release of staff report on 3/25/10 | Council agenda published<br>Web site project page updated & email bulletin sent | 4/6/10 |
| **MILESTONE: Mail Citywide notice advertising future meeting dates.** | | | | |
| 15. | **Housing Commission** review and recommendation for approval of draft BMR Housing agreement | 1 day after Council review of the business terms of the Development Agreement | Housing Commission agenda posted<br>Web site project page updated & email bulletin sent | 4/7/10 |
| 16. | **Planning Commission Public Hearing** – Recommendation on final EIR, final FIA, General Plan Amendment (map and text), Zoning Ordinance Amendment, Zoning Map Amendment, Development Agreement, Architectural Control, Tentative parcel Maps, and BMR Housing Agreement | 2 weeks after Council review of the business terms of the Development Agreement. Public comment on the final EIR and Final FIA should be submitted either before or at this meeting in order for the comments to be considered prior to the Commission's recommendation. | Planning Commission agenda published<br>Public Hearing Notice published and mailed to project distribution area<br>Web site project page updated & email bulletin sent | 4/19/10 |
| 17. | **Planning Commission** recommendation on the entire proposal | 2 weeks after Planning Commission public hearing | Planning Commission agenda published<br>Web site project page updated & email bulletin sent | 5/3/10 |



As reviewed on 2/23/10

# Attachment E

## Excerpt of Public Outreach and Development Agreement Negotiation Process

## Menlo Gateway (Bohannon Hotel-Office Mixed-Use) Proposal

| | | | | |
|---|---|---|---|---|
| 18. | **City Council Public Hearing** –Final EIR, Final FIA, General Plan Amendment (map and text), Zoning Ordinance Amendment, Rezoning Property, Development Agreement, Architectural Control, Tentative Parcel Maps, and BMR Housing Agreement | 3 weeks after Planning Commission recommendation | Council agenda published<br>Public Hearing Notice published and mailed to project distribution area<br>Web site project page updated & email bulletin sent | 5/25/10 |
| 19. | **City Council** – Certification of Final EIR, Acceptance of Final FIA, Approval of General Plan Amendment (map and text) resolution, Introduction of an Ordinance Amending the Zoning Ordinance, Introduction of an Ordinance Rezoning Property, Introduction of an Ordinance Approving the Development Agreement, Architectural Control, Tentative Parcel Maps, and BMR Housing Agreement | 3 weeks after City Council public hearing | Council agenda published<br>Web site project page updated & email bulletin sent | 6/15/10 |
| 20. | **City Council** – Adoption of the Ordinances for Amending the Zoning Ordinance, Rezoning Property, and Approving the Development Agreement (consent item) | Next available Council meeting after first reading | Council agenda published<br>Web site project page updated & email bulletin sent | 6/22/10 |

*Note: all dates tentative and subject to revision.*

**Attachment F**

**Summary of City Revenue and Expenditures from Fiscal Impact Analysis (FIA) for the Menlo Gateway Project**

| **City Revenue Estimates (TOT and Sales Tax Only)** | **Low Range** | **Development Agreement Revenue Target** | **Middle Range** | **High Range** |
|---|---|---|---|---|
| Transient Occupancy Tax (TOT) | $1,052,783 | $1,052,783 | $1,289,116 | $1,469,863 |
| Sales Tax Revenue | | | | |
| Business-to-Business | $29,902 | $74,655 | $74,655 | $388,591 |
| Retail | $46,086 | $46,086 | $46,086 | $46,086 |
| Employee Spending | $29,763 | $29,763 | $29,763 | $29,763 |
| Subtotal Sales Tax Revenue | $105,751 | $150,504 | $150,504 | $464,440 |
| **Total TOT and Sales Tax Revenue** | **$1,158,534** | **$1,203,287** | **$1,439,620** | **$1,934,303** |

F

| **Net City Fiscal Impact (not including TOT and Sales Tax)** | **Low Range** | | **Middle Range** | **High Range** |
|---|---|---|---|---|
| Property Tax (City of Menlo Park share) | $491,000 | **Not Applicable** | $491,000 | $491,000 |
| Utility User Tax | $36,000 | | $36,000 | $36,000 |
| Business License | $114,500 | | $114,500 | $114,500 |
| Other Revenue | $70,381 | | $70,381 | $70,381 |
| Subtotal Revenue | $711,881 | | $711,881 | $711,881 |
| Total Expenditures | $484,542 | | $484,542 | $484,542 |
| **Net Surplus (Deficit)** | **$227,339** | | **$227,339** | **$227,339** |

*Source: Fiscal Impact Analysis prepared by Bay Area Economics for the City of Menlo Park*

HVS

# Executive Summary

HVS has performed a market study, financial projections and valuation of the Proposed Renaissance ClubSport in Menlo Park. Based on our research we have determined that the project is feasible from a market demand perspective, assuming that the proposed roundly 700,000 square feet of office space is developed adjacent to the property. While the Renaissance ClubSport is projected to operate profitably, the development costs of the project coupled with the challenge of getting a hospitality product of this magnitude financed, leads us to conclude that the project can only be rendered feasible if it is developed in conjunction with the more economically viable office product.

The subject site, while providing excellent access and visibility from U.S. 101, is relatively isolated, in that it is removed from demand generators at the current time. With the simultaneous development of the ClubSport and the office space, the hotel will offer an environment attractive to not only the adjacent office users, but also transient guests from other sub-markets as well. The hotel/club/office mixed-use development is very synergistic – each component enhances the revenue potential of the other by providing amenities that generate demand and a rental rate premium.

HVS has undertaken a complete market analysis for the proposed hotel. We anticipate that the hotel will compete with nine hotels totaling roundly 2,000 hotel rooms in the Menlo Park and Palo Alto area. While the local hotel market is depressed at the current time, having experienced a 21% decline in rooms revenue in 2009, we anticipate that the market will gradually recover to pre-recession occupancy levels by 2013. As occupancy recovers we anticipate a rebound in average room rates reaching 2007 levels by 2013 (unadjusted for inflation). We have projected the hotel to achieve a stabilized occupancy of 74% and an average rate of $243 in 2017, its fourth year of operation.

The market for athletic facilities has fared better during this downturn - local athletic clubs have, for the most part, sustained their membership levels and initiation fees and monthly dues have not seen a significant decline. The eleven athletic facilities in the subject's market area were evaluated, however only the Pacific Athletic Club would be considered truly competitive with the subject ClubSport. We project the club to ramp up to a stabilized level of 4,600 members by the end of 2017.

We have made the following assumptions in our analysis:

HVS

1. That the Renaissance ClubSport will be complete and operational by January 1, 2014;
2. That the hotel market, which is depressed at the current time, will have fully recovered, from a demand perspective, as of the date of opening;
3. That average room rates will rebound once lodging demand recovers;
4. That the ClubSport will begin pre-selling memberships prior to the health club's opening and that 40% of the memberships will be pre-sold, creating positive cash flow to the operation at day one.
5. That the Renaissance Hotel will attain operating ratios and a profit level typical for a first-class, full-service hotel of this nature. Our projections are based on a database of comparable operating statements and our hotel forecasting model, adjusted for the specifics of the property and its market;
6. That the ClubSport will generate operating ratios and a profit level typical for an athletic club of this nature. Our projections are based on comparable athletic club statements provided by Leisure Sports and our forecasting model, adjusted for the specifics of the property and its market.
7. The combined hotel and club operating forecast was compared with the operating performance of the Renaissance ClubSport in Walnut Creek for reasonableness.

The proposed project was valued as of the date of opening, January 1, 2014, to evaluate what the developer could sell the project for once it is completed. The valuation was based on a discounted cash flow analysis based on market rates of return. The discounted cash flow analysis was based on the annual cash flow (net income available for debt service and return on owner's equity) to be generated by the property over a ten year period, plus the reversionary sales proceeds from an assumed sale of the project at that time, i.e. as of December 31, 2023. The annual cash flow and reversion were discounted at a rate of 12.5%, which reflects a blended cost of debt and equity capital. The concluded value, as of January 1, 2014, was concluded to be $107,400,000, including membership pre-sale revenue.

The cost to develop the property must be taken into consideration to determine whether the project is feasible. In addition, in order to determine the value of the land intended for the Renaissance ClubSport we have performed a residual analysis whereby the value of the land is estimated by determining the value of the hotel as of the date of opening, and deducting the cost to develop the property. The remainder is what a developer could afford to pay for the land. In this particular case we have not deducted a typical entrepreneurial incentive as a cost of development, as would normally be the case. If we were to deduct a typical entrepreneurial incentive of 15% of development costs there would be no residual value to the land, reflecting the marginally feasible nature of this component of

HVS

the project, i.e. the developer must earn his profit from the office component. We have based our land residual analysis upon the following assumptions:

1. The hotel's budgeted development cost, provided to HVS by the developer, equates to roundly $89,138,965 ($359.46 per square foot x 248,672 square feet). This cost, which is exclusive of land cost, was compared to the development cost of the recently constructed Renaissance ClubSport in Aliso Viejo, California for reasonableness.
2. To the budgeted development cost we added 50% of the pre-development monies spent thus far or $4,000,000 – assuming that this cost is shared with the adjacent office building.
3. In addition, a developer's fee to cover overhead during the pre-development phase, was estimated at $3,000,000, based on our database of detailed hotel development budgets.
4. We were requested to perform a worst case scenario for this analysis, which we have based on the assumption of a $10 lower average rate, two point lower occupancy, $10 less membership dues per month and a $90 lower club initiation fee.

The following chart sets forth the land residual analysis under a best and worst case scenario.

**Land Residual Analysis**

| | | Best Case | Worst Case (1) |
|---|---|---|---|
| Estimated Value of Renaissance ClubSport as of Date of Opening - January 1, 2014 | | $107,400,000 | $93,100,000 |
| Less: | | | |
| Pre-development costs | 4,000,000 | | |
| Development Cost at $359.46 x 248,672 square feet (2) | 89,138,965 | | |
| Developer's Fee | 3,000,000 | | |
| Total | | 96,100,000 | 96,100,000 |
| Residual Value to the Land as of January 1, 2014 | | $11,300,000 | $0 |
| Land Value discounted back to January 1, 2010 @ 5% per year | | 9,300,000 | 0 |

*(1) Worst case scenario assumes $10 lower ADR, 2 point lower occupancy, $10 less membership dues per month and $90 lower initiation fee*
*(2) Construction costs are taken from the developer's proforma and includes 50% of Garage C*

Based on our analysis, the residual value to the Renaissance ClubSport site is estimated to be $11,300,000 as of the date of the project's completion (January 1, 2014) and $9,300,000 as of January 1, 2010, assuming an annual discount rate of 5%. Note that no developer's incentive has been included in our analysis, i.e. we are concluding that if a developer paid $9,300,000 for the land today (valued at $11,300,000 in 2017) and developed the Renaissance ClubSport for a total of $96,100,000, that they would be able to sell the project for $107,400,000, or an amount just equal to their total investment, without any imputed profit. Real estate developers require some incentive to undertake the enormous risk of developing projects, particularly ones of this nature, which require a substantial investment for many years before any positive cash flow is generated. The developer of the Renaissance Clubsport will have to wait until the office buildings are sold or refinanced to earn any profit on the development of the Renaissance ClubSport component of this project.

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# EXECUTIVE SUMMARY
# Menlo Gateway – Office/Retail Portion

Cushman & Wakefield has prepared a valuation consulting assignment of the office and retail portion of the Menlo Gateway Project. The scope of our assignment was as follows:

- Subject property inspection to the extent necessary to adequately identify the real estate
- Research relevant market data, in terms of quantity, quality, and geographic comparability, to the extent necessary to produce credible valuation consulting results
- Review of architectural renderings
- Review relevant studies prepared by other consultants
- Interview the developer
- Review and analyze developer's development cost estimates and pro-forma
- Interview Menlo Park Planning Personnel assigned to the Menlo Gateway Project
- Develop a market value estimate of the fee simple interest, as of January 1, 2010, for the subject land based on current zoning assuming a maximum Floor Area Ratio (FAR) of 45%
- Develop a market value estimate of the fee simple interest, as of January 1, 2010, for the subject land based on the proposed overall FAR of 137.5% (100% office/retail FAR)
- Determine the general overall feasibility of the office/retail component of the project by utilizing the discounted cash-flow (DCF) methodology. (Important to note: Feasibility is not just about optimal financial outcomes. Intangible community and institutional values may be just as important)

**Project Overview**

The property is situated at the northeast quadrant of the U.S. Highway 101 and Marsh Road interchange in the City of Menlo Park. The 11.59 acre site will be improved with a speculative development to comprise of two, Class A, office/retail buildings and one, Class A, office building collectively containing 694,670 square feet. Additionally, there will be three, five-story, parking garages.

The project will have excellent exposure, access, and identity from U.S. Highway 101. The property will have a desirable Menlo Park address. Its location is central between San Francisco and San Jose. The buildings will offer bay views. Nearby amenity will include a to be built Renaissance ClubSport.

Based on our analysis we have determined the project to be economically feasible, however, with significant capital required. Projected net cumulative cash flow is potentially not positive until 2023 indicating a required long-term holding period for the developer and considerable risk.

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## Market/Economic Observations

- Job creation for Bay Area employment will improve the projects probability of success
- An increase in initial round venture capital funding will lead to job creation and office space demand (leasing)
- Office space leasing at the project creates demand for Renaissance ClubSport
- Current office rent levels are flat
- Current class A office vacancy rates remain high with landlord concessions (free rent, generous tenant improvement allowances)
- Demand analysis indicates there is 3.89 years of oversupply of office space in the Silicon Valley and San Francisco Peninsula
- Current market conditions do not make the project feasible, today
- Overall improvement in real estate fundamentals (leasing, rents, financing) is needed

## Project

- Approximately $4 million in entitlements to be spent by the developer is needed to coordinate, plan, and get approvals for office/retail portion
- Construction costs estimated at $250 million (excluding land, entitlements, and leasing commissions)
- Construction commencement in 2012 (estimated) with final completion in 2015 (estimated)
- Pre-leasing campaign of office space will be beneficial to the overall success of the project
- Absorption period for the office space is forecasted at 35 months (January 2014 thru December 2016)

## Valuation

- Land value based on the proposed entitlements, best case is $51.2 million and worst case $15.8 million
- Our projections indicate that the project would sell for approximately $341,250,000 in 2014 based on discounted cash flows, assuming construction commenced in 2012 and no changes to construction schedule
- Project is economically feasible over the long-term, but the calculated Internal Rate of Return of approximately 12.68% is below an industry target return of 15%

# Menlo Gateway-Office/Retail/Renaissance ClubSport Land Residual Analysis

The Land Residual method is based on the principle of balance and the related concept of contribution, which are concerned with equilibrium among the agents of production (i.e. labor, capital, coordination, and land). In this method, we estimated the value of the subject land based on the current zoning assuming a maximum Floor Area Ratio (FAR) of 45% and based on a FAR of 137.5% for the proposed Office/Retail development. Our valuation method involved calculating the subject's stabilized net operating income from market rental rates and operating expenses and capitalizing the net operating income. From this value we deducted the costs associated with constructing the improvements. The difference between the Value and the Costs equates to the value attributable to the land.

| Land Residual – Value Summary, *As of January 1, 2010* | | |
|---|---|---|
| **Valuation Scenario** | **Best Case** | **Worst Case** |
| **"As Proposed" – (Office/Retail Portion)** | $51,200,000 | $15,800,000 |
| **"As Proposed" – (Renaissance ClubSport Portion)** | $9,300,000 | $0 |
| **Total "As Proposed" 137.5% FAR** | $60,500,000 | $15,800,000 |
| **Less: Current Zoning – Assuming 45% FAR** | ($36,700,000) | ($18,700,000) |
| **Value of Entitlements** | $23,800,000 | $0 |



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## LAND RESIDUAL ANALYSIS - *As Proposed (Office and Retail Portion)*

| | | Best Case | | Worst Case |
|---|---|---|---|---|
| Average Annual Rent per SF (Office and Retail Components) | | $65.73 | | $60.00 |
| Potential Annual Rental Income (Office and Retail Components) | | $65.73 | | $60.00 |
| Less: Vacancy and Collection Loss at | 7.0% | (4.60) | | (4.20) |
| Effective Gross Income (EGI) | | $61.13 | | $55.80 |
| Less: Expenses (Full-Service) | $18.00 Per Square Foot | (18.00) | | (18.00) |
| Net Operating Income (Office and Retail Components) | | $43.13 | | $37.80 |
| Overall Capitalization Rate (Office and Retail Components) | | 8.5% | | 8.5% |
| **Estimated Property Value/SF (Office and Retail Components)** | | **$507.40** | | **$444.71** |
| Estimated Construction Costs (1) | | ($357.46) | | ($357.46) |
| Entrepreneurial Incentive | 15.0% | ($53.62) | | ($53.62) |
| 50% of Pre-paid $8 million Entitlement costs | | ($5.76) | | ($5.76) |
| Total: Estimated Construction Costs, Profit, & 50% of Pre-paid Entitlement Costs | | ($416.83) | | ($416.83) |
| **Estimated Land Value per Buildable Foot** | | **$90.56** | | **$27.87** |
| Maximum Coverage Ratio | | 137.5% | | 137.5% |
| Total Gross Land Area (acres) to Office-Retail Portion (2) | | 11.59 | | 11.59 |
| Total Net Rentable Area of New Office-Retail Development (square feet) | | 694,183 | | 694,183 |
| Estimated Land Value | | $62,868,280 | | $19,347,927 |
| Less: Cost of Sales | 1.0% | ($628,683) | | ($193,479) |
| Estimated Land Value | | $62,239,597 | | $19,154,448 |
| Less: Discount Factor at 5.0% Discount Rate for 48-Month Holding Period | | 0.822702 | | 0.822702 |
| Estimated Land Value | | $51,204,641 | | $15,758,403 |
| **Final Estimated Land Value, Rounded** | | **$51,200,000** | | **$15,800,000** |
| **Estimated Land Value per Gross SF** | | **$101.41** | *Avg.* $ 66.36 | **$31.30** |

*(1) Construction costs are taken from the developer's proforma and includes 50% of Garage C*
*(2) APNs: 55-234-240, 250, 260, 270 and 55-235-040, 050, & 080*

## LAND RESIDUAL ANALYSIS - *As Proposed (Renaissance Hotel Clubsport Portion)*

| | | Best Case | Worst Case (1) |
|---|---|---|---|
| Estimated Value of Renaissance ClubSport as of Date of Opening - January 1, 2014 | | $107,400,000 | $93,100,000 |
| Less: | | | |
| Pre-development costs | 4,000,000 | | |
| Development Cost at $359.46 x 248,672 square feet (2) | 89,138,965 | | |
| Developer's Fee | 3,000,000 | | |
| Total | | 96,100,000 | 96,100,000 |
| Residual Value to the Land as of January 1, 2014 | | $11,300,000 | $0 |
| Land Value discounted back to January 1, 2010 @ 5% per year | | 9,300,000 | 0 |

*(1) Worst case scenario assumes $10 lower ADR, 2 point lower occupancy, $10 less membership dues per month and $90 lower initiation fee*
*(2) Construction costs are taken from the developer's proforma and includes 50% of Garage C*

## LAND RESIDUAL ANALYSIS - *Current Zoning Assuming Maximum Allowable FAR of 45%*

| | | Best Case | | Worst Case |
|---|---|---|---|---|
| Average Annual Rent per SF NNN | | $21.00 | | $15.00 |
| Potential Annual Rental Income | | $21.00 | | $15.00 |
| Less: Vacancy and Collection Loss at | 10% | (2.10) | | (1.50) |
| Effective Gross Income (EGI) | | $18.90 | | $13.50 |
| Less: Expenses (Triple Net) | 3.0% of EGI | (0.57) | | (0.41) |
| Net Operating Income | | $18.33 | | $13.10 |
| Overall Capitalization Rate | | 9.0% | | 9.0% |
| **Estimated Property Value/SF** | | **$203.70** | | **$145.50** |
| Estimated Construction Costs[1] | | ($73.97) | | ($73.97) |
| Entrepreneurial Incentive | 15.0% | ($11.10) | | ($11.10) |
| **Total: Estimated Construction Costs & Profit** | | **($85.06)** | | **($85.06)** |
| **Estimated Land Value per Buildable Foot** | | **$118.64** | | **$60.44** |
| Maximum Coverage Ratio | | 45% | | 45% |
| Total Gross Land Area (acres) [2] | | 15.94 | | 15.94 |
| Total Potential Net Rentable Area (square feet) | | 312,456 | | 312,456 |
| Estimated Land Value | | $37,068,708 | | $18,883,776 |
| Less: Cost of Sales | 1.0% | ($370,687) | | ($188,838) |
| Estimated Land Value | | $36,698,021 | | $18,694,938 |
| **Final Estimated Land Value, Rounded** | | **$36,700,000** | | **$18,700,000** |
| **Estimated Land Value per Gross SF** | | **$52.86** | *Avg.* *$ 39.89* | **$26.93** |

*(1) Construction costs are taken from Marshall & Swift and developers in the marketplace.*
*(2) APNs: 55-234-240, 250, 260, 270 and 55-235-040, 050, 080, 100, & 110*

## ;ed Construction Pro-Forma for Office and Hotel

| 4 | 5 | 6 | 7 | 8 | 9 | 10 | 11 | 12 | 13 | 14 | 15 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| 2013 | 12/2014 | 12/2015 | 12/2016 | 12/2017 | 12/2018 | 12/2019 | 12/2020 | 12/2021 | 12/2022 | 12/2023 | 12/2024 |
| $0 | $6,153,000 | $9,069,000 | $10,378,000 | $11,009,000 | $11,483,000 | $11,841,000 | $12,209,000 | $12,589,000 | $12,980,000 | $13,383,000 | $0 |
| $0 | $2,520,915 | $13,626,031 | $28,881,365 | $37,891,142 | $39,265,466 | $40,681,020 | $42,139,043 | $43,534,219 | $42,355,323 | $43,419,168 | $46,982,611 |
| $0 | $8,673,915 | $22,695,031 | $39,259,365 | $48,900,142 | $50,748,466 | $52,522,020 | $54,348,043 | $56,123,219 | $55,335,323 | $56,802,168 | $46,982,611 |
| | | | | | | | | | | | |
| $0 | $0 | $0 | $0 | $0 | $0 | $0 | $0 | $0 | $0 | $ 175,809,647 | $0 |
| $0 | $0 | $0 | $0 | $0 | $0 | $0 | $0 | $0 | $0 | $0 | $529,291,151 |
| $0 | $0 | $0 | $0 | $0 | $0 | $0 | $0 | $0 | $0 | $232,611,815 | $576,273,762 |
| | | | | | | | | | | | |
| $0 | $0 | $0 | $0 | $0 | $0 | $0 | $0 | $0 | $0 | $0 | $0 |
| $0 | $0 | $0 | $0 | $0 | $0 | $0 | $0 | $0 | $0 | $0 | $0 |
| 019 | $0 | $0 | $0 | $0 | $0 | $0 | $0 | $0 | $0 | $0 | $0 |
| $0 | $0 | $0 | $0 | $0 | $0 | $0 | $0 | $0 | $0 | $0 | $0 |
| $0 | $64,210,900 | $64,210,899 | $0 | $0 | $0 | $0 | $0 | $0 | $0 | $0 | $0 |
| 763 | $0 | $0 | $0 | $0 | $0 | $0 | $0 | $0 | $0 | $0 | $0 |
| 172 | $3,721,831 | $3,895,502 | $0 | $0 | $0 | $0 | $0 | $0 | $0 | $0 | $0 |
| $0 | $0 | $0 | $0 | $0 | $0 | $0 | $0 | $823,401 | $3,817,153 | $4,195,324 | $2,774,940 |
| $0 | $7,504,045 | $7,815,778 | $8,274,198 | $0 | $0 | $0 | $0 | $1,393,532 | $6,422,169 | $7,007,444 | $4,634,976 |
| 389 | $5,316,901 | $5,565,002 | $0 | $0 | $0 | $0 | $0 | $0 | $0 | $0 | $0 |
| $0 | | | | | | | | | | | |
| 343 | $80,753,677 | $81,487,181 | $8,274,198 | $0 | $0 | $0 | $0 | $2,216,933 | $10,239,322 | $11,202,768 | $7,409,916 |
| 343) | ($72,079,762) | ($58,792,150) | $30,985,167 | $48,900,142 | $50,748,466 | $52,522,020 | $54,348,043 | $53,906,286 | $45,096,001 | $221,409,047 | $568,863,846 |
| 833) | ($327,279,595) | ($386,071,745) | ($355,086,578) | ($306,186,436) | ($255,437,970) | ($202,915,950) | ($148,567,907) | ($94,661,621) | ($49,565,620) | $171,843,427 | $740,707,273 |