Appendix VI: Bolan Smart Associates report

BOLAN SMART ASSOCIATES, INC.
1150 K STREET NW, SUITE 1211, WASHINGTON, DC 20005 • (202) 371-1333

Appendices to MNCPPC Planning Board Report
Bethesda Purple Line Station Financial Analysis
September 20, 2013

Background

Bolan Smart Associates (BSA) was asked to assist MNCPPC in the financial analysis aspects of its evaluation of two Bethesda Purple Line (PL) Station options involving what is known as the Apex Building. The approach and findings outlined in this report are based on best available sources of information, with noted limitations. While the ownership of the Apex property was contacted, the ownership representatives declined to provide any specifics regarding building and occupant details. Due to the myriad of design, engineering and other factors impacting cost considerations, the findings need to be viewed as representative of a range of estimates.

Summary

Notwithstanding the inexact nature of the subject financial analysis, the conclusions are clear:

1. Increasing the zoning capacity to the maximum currently permitted under County Code is not likely to create the economic conditions sufficient to justify the near term demolition of the Apex Building. Other assistance, perhaps valued upwards of $5M to $10M, may be needed to help close the financial gap.
2. While increased potential density conveys value, the variety of costs incurred to (a) relocate the existing tenants, and (b) construct the new building structural systems needed to support the PL Station, act as value “deducts” (up to $25M+/-) that may exceed the near term benefit of using extra density. This means that keeping the existing building may be the better economic choice.
3. Given the type of public cost commitments represented by the two station options, there are no station related “cost savings” to be realized that could hypothetically be directed to help in redeveloping the Apex property. A suggested $10M savings in moving the new Red Line Station southern entrance off of Elm Street and onto the Apex property is more than offset by the added cost of either of two tunnel options that would restore the Capital Crescent Trail access under Wisconsin Avenue (as proposed to be part of the demolition approach and included only as a pedestrian walkway if the current right-of-way is retained).
4. There are two types of possible solutions to helping close the likely economic gap, which could be either sufficient in themselves, or could work in tandem. One is the prospect of gaining economic efficiencies by consolidating the Apex property with the adjoining properties for purposes of redevelopment (with or without merged ownership). The other approach is to employ public investment tools otherwise used for public purpose by Montgomery County and the State of Maryland, including what might be appropriately considered part of the Purple Line construction budget.

Scenarios – (see MNCPPC report for site illustrations)

KEEP Existing Apex Building

- Purple Line project funds station improvements inside current tunnel right-of-way.
- New Red Line Station southern entrance elevator shafts come up through Elm Street.
- Montgomery County pays for new Red Line southern entrance ($80M).
- Possible building redevelopment longer-term constructed around existing PL Station.

DEMOLITION / New Development (2016)

- Property ownership provides newly constructed right-of-way shell-ready for PL Station.
- Purple Line project funds station improvements inside new shell right-of-way.
- New Red Line Station southern entrance elevator shafts moved south off Elm Street.
- Montgomery County pays for new Red Line southern entrance ($70M).
- Montgomery County pays for replacement Capital Crescent Trail tunnel ($15M to $30M).

Public Cost Differentials

<u>Purple Line Project (street access, platform improvements and tracking)</u> – As currently contemplated, the proposed Purple Line Station related costs in Bethesda are budgeted to be funded from a combination of public improvements (assuming a station-ready shell) and private sources (in such case as a new station-ready shell needs to be provided). The prevailing Purple Line project construction budget includes:

- Purple Line Station track and interior
- Purple Line ventilation stack (40 ft by 20 ft shaft extending 90 feet above grade)

The Maryland Transit Administration (MTA), the agency coordinating the planning of the Purple Line, estimates that there is no material cost difference between equipping the existing KEEP tunnel and a newly constructing equivalent shell under DEMO. The assumption is that the Bethesda Station would be built within an Apex property provided “box” or “shell”, either in the exiting tunnel, or a new equivalent. This means under the DEMO scenario, the property owner would be responsible for paying for a replacement PL Station shell, obviously per agreed upon engineering and design.

Under the KEEP option, MTA’s needed date of beneficial occupancy (ready to start PL Station improvement) could be later than 2015, but under DEMO, the current building would have to come down by late 2015 or early 2016 in order for the new construction to provide MTA with a new station-ready shell in time to add the Purple Line related improvements before the targeted 2020 opening. Any PL Station operational cost differentials associated with the KEEP vs. DEMO scenarios are expected to be minimal.

<u>Montgomery County</u> – At an earlier point, Montgomery County committed to funding the construction of a new southern entrance to the existing Bethesda Metro Red Line Station. The budgeted cost for this Red Line Station improvement ranges between $80M (KEEP) and $70M (DEMO). Under MTA estimates, the $10M+ construction cost savings under the DEMO option is attributed mostly to not needing to relocate major utility infrastructure under Elm Street, which would be needed under the KEEP option.

Montgomery County is also considering funding the replacement of the Capital Crescent Trail under the DEMO option, with at an estimated cost of $15M to construct a new tunnel solely under Wisconsin, or $30M to fund the Wisconsin tunnel plus a tunnel connection extending further east under Elm Street. Operational cost differentials for Montgomery County and for the Red Line Station are assumed as a wash under either station scenario. The contemplated Montgomery County capital costs include:

Red Line South Entrance	$70M to $80M
CCT Option 1 (Wisconsin tunnel to Elm Street portal)	$15M
CCT Option 2 (Wisconsin tunnel to Elm Street Park portal)	$30M
CCT Through New Bldg Interior Finishes	$300K

Economic Impact – There are a variety of non-direct public related economic cost and benefit implications regarding the respective Apex property scenarios:

KEEP Existing Apex Building

- Elm Street west of Wisconsin closure (partial two+ years).
- Spin-off effects on neighborhood of added Purple Line Station.

DEMOLITION / New Development

- Wisconsin Avenue closure (partial one year), and maybe Elm Street east of Wisconsin.
- Temporary loss of existing Apex related business activity.
- Accelerated economic returns from much larger Apex redevelopment than current.
- Premium neighborhood spin-off effects of superior Purple Line Station.

Of first order, the respective required partial street closures will cause disruption to both traffic and area businesses, patrons and residents. Without estimating specifics, the expectation is that based simply on the magnitude of traffic levels, a partial closing of Wisconsin Avenue (DEMO) for up to one year for tunnel construction, would result in a least twice the economic disruption compared with a partial closure of Elm Street west of Wisconsin for two or more years to allow for the Red Line elevator shaft construction.

Additional potential economic impact on Montgomery County and the Bethesda community consequent from the near-term demolition of the Apex building relates to the relocation options and decisions for the existing users, including:

- American Society of Health-System Pharmacists (ASHP - building owners)
- Morgan Stanley Smith Barney
- Various financial, real estate and other office type users
- Regal 10 Cinemas, Food and Wine Company, and other smaller first floor retail oriented tenants

With one exception, the assumption is that most existing tenants in the Apex Building could readily relocate within downtown Bethesda. The exception is the 10 theater Regal Cinemas, an older format movie house (opened in 1992), but still a contributing business to the surrounding neighborhood. With an estimated 350,000+ annual ticket sales, generating some $300,000+ in annual Montgomery County amusement tax revenue, there is no question that the theaters represent a unique economic presence. The question is how important is the movie operation to the rest of downtown Bethesda, and to some degree, the rest of Montgomery County?

Given the breadth of other economic activity in downtown Bethesda, the temporary, or even permanent absence of the Regal 10 Cinemas, is not expected to be a fundamental deciding factor in the vast majority of peoples' decisions to frequent downtown Bethesda. Moreover, the tax revenue impact on Montgomery County would be expected to be mitigated by offsetting movie house patronage elsewhere in the County, with a limited amount of leakage spreading into other jurisdictions.

Private Sector Considerations – Apex KEEP vs. DEMOLITION valuations

The Apex ownership's voluntary decision to facilitate tearing down the existing building is predicated on the value of demolishing the existing building, and starting afresh, matching or exceeding the forgone value of keeping the building. Whether or not the Apex ownership is an active real estate developer, the decision to proceed with building anew is driven primarily by deciding that the income value of the building "as is" is less than the land value of the property as if it were made available for new development (representing the "contributory value" of the land towards new development):

KEEP Valuation Components

- Income value of existing 170,000 sf bldg. circa 1992 (1.54 FAR, assessed @ $44M for 2013*).
- Present value of unused buildable area (future redevelopment) if available or achievable.
- Deduct for construction cost premiums for future redevelopment to build around PL Station.

DEMOLITION Valuation Components (land without current building)

- Present value of potential building area (FAR).
- Deducts associated with possible costs of relocating the tenants in the current building.
- Deducts for costs for replacing the PL Station "shell".

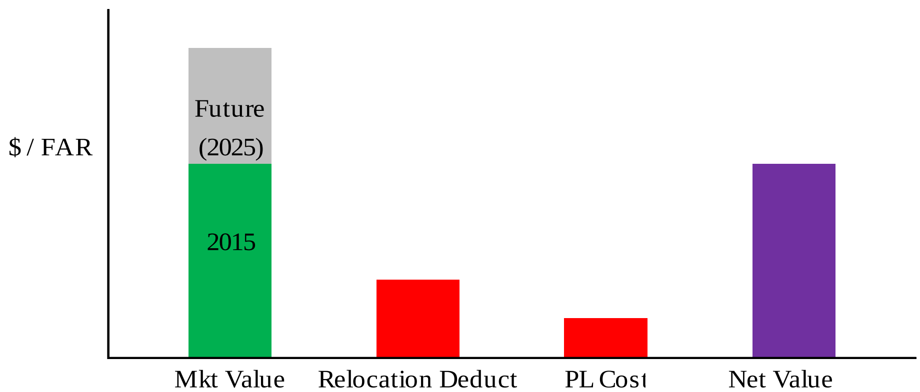
<u>Land Value Variables</u> – There are many variables that factor into the determination of the actual land value for a given site. For the Apex property, these include:

1. The amount of buildable square footage permitted under zoning (floor-area ratio, or FAR).
2. The near-term and projected longer-term market demand (and timing) for new construction.
3. The price for immediately marketable building area (FAR).
4. The hold price, or discounted value, of future to-be-built FAR.
5. Building footprint / massing factors (how much FAR can be optimally used on-site).
6. Private sector costs of accommodating the Purple Line.
7. Possible value enhancements associated with having a better Purple Line Station.

***** 2013 real estate assessed value of the current Apex property is $43.86M. This value, calculated by the State of Maryland, was last reset in 2011, and reportedly included consideration of building net income in determining value. Following a three year cycle of updates, the next assessment is in 2014. For real estate taxation purposes, the building has a 32.4% tax exemption attributed to the non-profit status of the health related major user (ASHP).

Net Land Value per FAR

(market value – tenant relocation costs – PL Station costs = net value)



Note: Relocation deduct applies only to DEMO scenario, as future redevelopment of existing Apex Building would be planned ahead.

Zoning – Based on discussion with MNCPPC, there are three zoning scenarios that could be applied to the PL Station options:

- existing zoning = up to 550,000 square feet (5.0 FAR)
- hypothetical (uncertain) future zoning = up to 880,000 sf (8.0 FAR) (330,000 sf over 5.0 FAR)
- actual future zoning = up to 880,000 square feet (8.0 FAR) (330,000 sf over 5.0 FAR)

The existing zoning is assumed to apply equally under either the KEEP or DEMO scenarios. The hypothetical future zoning and actual future zoning categories are premised on the current potentially allowable density applicable in downtown Bethesda, based on the Montgomery County zoning code, but that is not presently available at the subject location. With the pending 2014+ review and possible update of the downtown-wide Bethesda Sector Plan, one scenario might be that the Apex property may become eligible for an increase in permitted FAR regardless of any accelerated or other near term public action associated with accommodating the Purple Line Station. Seeing however, as the outcome of the future Bethesda Sector Plan review remains an uncertainty as of today, the assumption for valuation purposes under the KEEP option is that the future prospects of being granted an 8.0 FAR needs to be considered as hypothetical, with the implication being that the property owner must heavily discount the possible future value of this uncertain zoning, if even to assign it any value at all. For the purposes of this analysis, the assumed zoning treatment under the DEMO scenario is not limited by a zoning uncertainty, and is assigned the full surety of an actual future 8.0 FAR zoning.

Current (2015) Land Value – In the case of the existing Apex building, while it is currently only a little over 20 years old, three economic considerations are at work accelerating its possibly being razed and redeveloped within the next 10 to 20 years regardless of the Purple Line Station construction scenario. Since the building's initial opening there has been: (a) a profound rise in the overall level of economic activity in downtown Bethesda (especially in the blocks immediately adjacent to the Apex property); (b) there is now the presumed arrival of the combined Purple Line and Red Line South Entrance at this location; and (c) there has been a dramatic increase in land value, both in terms of per FAR values, and the amount of existing or hypothetical future unbuilt FAR available compared with the existing building. All of these factors translate into the situation where the underlying value of the land, if made available for new development, may exceed the income value of the property as currently improved.

Based on recent land sale comparables and discussions with real industry practioners, a current unencumbered land value for near term development in downtown Bethesda is estimated to be in the range of $100 per buildable / allowable square feet of development. This would be for a centrally located mixed use development undifferentiated between commercial or residential uses, and is assumed to be the market based benchmark for determining the current value of buildable area under the KEEP option. In the case of the DEMO scenario, a slight 5% value premium is added ($105 per FAR) to the immediately developable FAR, an addition attributable to: (a) being able to build additional parking below grade (see deduct discussion below); and (b) the superior user environment that would be assumed to result from building a totally new Purple Line Station vs. fitting one into the existing rail tunnel easement.

<u>Development Phasing and Land Value Discounts</u> – Since the end user market / tenant demand in Bethesda is finite, it is not as if an unlimited amount of additional potential FAR is all valued the same per FAR in present day (i.e. 2015) terms. Above a certain level (say 550,000 SF) for a commercial / residential mixed use project, at even the best of locations, the ability to market more space for near term use starts to diminish. For valuation purposes, this means that above a certain (admittedly imprecise) point, the current value of extra unused FAR on a specific property begins to decline relative to the initially marketable building area. The economic impact of this is to dilute the current value of the extra buildable area, to be held for a period of time, and only to be realized sometime in the future when the unbuilt FAR actually becomes economic to develop. The development community deals with this phenomenon by discounting the future value of currently unmarketable FAR by some factor, assumed in this analysis at a 10.0% per year discount rate (or 20% discount in case of hypothetical zoning) after applying an annual assumed value appreciation of 2.0%.

- present value of FAR = current buildable FAR value + discounted value of future unbuilt FAR

For the purposes of this study, it is assumed that under DEMO 550,000 square feet of FAR (existing zoning @ 5.0 FAR) could be built near term, and that any additional potential FAR would need to be held off the market for up to ten years (2025), until such time as the background market is ready to absorb the development of the additional square footage. In the meantime, the cost of the unbuilt FAR would be carried by the property owner:

KEEP FAR Land Valuation (2015)

current buildable square foot value (170,000 sf)	$100 per FAR (incl. in existing bldg value)
discounted value of future unbuilt area (380,000 sf)	$48 per FAR (10% annual disc. from 2025)
disc. value of hypothetical unbuilt area (330,000 sf)	$20 per FAR (20% annual disc. from 2025)

Notes: Future unbuilt area reflects actual zoning (i.e. 5.0 FAR); hypothetical unbuilt area reflects potential but uncertain future zoning (i.e. difference between actual 5.0 FAR and possible 8.0 FAR).

Analysis assumes that current unbuilt FAR could not be transferred for immediate redevelopment to an alternate site.

DEMOLITION FAR Land Valuation (2015)

current buildable square foot value (550K)	$105 per FAR
discounted value of future unbuilt area (330K)	$50 per FAR (10% annual disc. from 2025)
discounted value of hypothetical unbuilt area	not applicable for actual 8.0 FAR zoning

Land Value Deducts *(unencumbered land value minus value deducts = net land value)* – As introduced above, the starting point for determining net land value of the to-be-built FAR is other land values / sales that are not otherwise unencumbered by PL Station development related implications. From this base, any value deducts need to be applied. In the case of the subject property, these possible value deducts associated with redevelopment include the following:

Redevelopment Value Deducts

	KEEP	DEMOLITION
Construction Start / Phasing	2025+	2016+
Foundations	> 35% challenged	new
Parking	< 60% footprint	95% footprint
Existing Users Relocation	not applicable	major expense
Other Existing Ownership Costs	not applicable	not considered
Removal of Existing Building	similar	similar
PL Station Exterior / Shell	existing	needs replacement
PL Emergency Ventilation Stack	no impact / off-site	to be added inside bldg
Red Line Surface Ventilation	existing	needs replacement
CCT Through Building	not planned / existing walkway	to be added inside bldg
New Bldg Extra Construction Costs	substantial	minor

Future Apex Building Redevelopment (KEEP) – The current Apex site area from Elm Street to the southern edge of the current tunnel under the KEEP scenario, in other words a major portion of the below-grade footprint of the existing Apex building, would be basically unusable to the Apex owners under future redevelopment. In addition, under the KEEP scenario, the existing concrete pilings in the area of the existing tunnel supporting what would be the PL Station and the current building are not considered sufficient to support a much taller building than at present. What this means is that in addition to the general construction staging challenges of redeveloping the Apex property around an operating PL Station at some future date under KEEP, the ability to effectively re-engineer the foundations may be seriously compromised. This is not a 100% encumbrance, however, since the station area under KEEP, including some modest setback from the existing tunnel structure, and extending north to the Elm Street property line, encompasses only 35% of the overall Apex site.

Though no specific design or engineering analysis has been conducted on the part of MNCPPC, the view is that the challenge of constructing a new 550,000 sf project of 20+ story buildings around and over an existing PL Station is likely to require a combination of special engineering and construction compromises. Were these extra expenses to cost, or to result in a devaluation totaling on the order of $15 to $20 / sf of building area compared to if there was no PL Station, the total additional expense could top $10M under the KEEP scenario, or on the order of 5% of a new development costing upwards of $200M.

<u>Near-Term Redevelopment (DEMOLITION)</u> – As outlined above, there are major differences in terms of implied private sector costs between the KEEP and DEMO scenarios. While under DEMO there are some distinct design and engineering advantages associated with being able to build an entirely new PL Station and building complex, there are also extraordinary one-time costs that a KEEP scenario does not have to replicate. The biggest additional expense under DEMO is likely to be relocating all the current users, involving early termination of leases, moving and re-fitting costs at new locations, plus possible ongoing business related disruptions. The other primary extra cost is the assumption under the proposed DEMO scenario that the private property owner needs to provide suitable replacement space (and larger than under KEEP) in which to locate the PL Station and associated other public components. This means that the private developer needs to allocate built area and deliver an enclosed "shell" space comprising floors, walls and ceilings for each of the direct PL Station components spanning both the concourse and street levels, incorporate a new CCT platform traversing the concourse level, and accommodate a 40 ft by 20 ft emergency ventilation shaft extending to the roof level of any new building.

As with the KEEP scenario, detailed analysis of each potential cost deduct item has not been conducted on the part of MNCPPC. The expectation is that the extra expenses under DEMO could readily cost $25M or more ($150 / sf if computed against the current 170,000 sf Apex building or $45 / sf for a new 550,000 sf building) compared to where there was no required tenant relocation or PL Station shell replacement construction needed. These substantial and unique total cost deducts mean that from a net land valuation standpoint, the first $25M of additional FAR value that may be assigned to the DEMO option provides no net financial benefit to the Apex ownership.

Quantitative Summary – Apex ownership perspective

Illustrative Net Valuations

KEEP FAR Valuation (current building + unused FAR @ 5.0 total FAR per existing zoning)

current building value (2014)	$45M (170,000 sf) (2013 assessed value $44M)
unused FAR @ 5.0 FAR	$20M (380,000 FAR built in 2025)
PL Station cost deducts	<u>($10M)</u>+/-
Total	***$55M +/-***

KEEP Valuation (current building + unused FAR @ 8.0 total hypothetical FAR)

current building value (2014)	$45M (170,000 sf built)
unused FAR @ 5.0 FAR	$20M (380,000 FAR built in 2025)
hypothetical additional 3.0 FAR	$5M (330,000 FAR built in 2025)
PL Station cost deducts	<u>($10M)</u>+/-
Total	***$60M +/-***

DEMO Valuation @ 5.0 FAR

FAR @ 5.0 FAR	$60M (550,000 FAR built in 2016+)
PL Station cost deducts	($25M)+/-
Total	***$35M +/-***

DEMO Valuation @ 8.0 FAR

FAR @ 5.0 FAR	$60M (550,000 FAR built in 2016+)
unused FAR @ 3.0 FAR	$15M (330,000 FAR built in 2025)
PL Station cost deducts	($25M)+/-
Total	***$50M +/-***

KEEP vs. DEMOLITION Comparisons

DEMO Valuation @ 5.0 FAR

DEMO @ 5.0 FAR	$35M+/-
KEEP @ Current Bldg	$45M+/-
Difference / Gap	***($10M)+/-***

DEMO Valuation @ 8.0 FAR

DEMO @ 8.0 FAR	$50M+/-
KEEP @ Current Bldg	$45M+/-
Difference / Gap	***$5M +/-***

DEMO @ 8.0 FAR	$50M+/-
KEEP @ 5.0 FAR	$55M+/-
Difference / Gap	***($5M)+/-***

DEMO @ 8.0 FAR	$50M+/-
KEEP @ Hypothetical 8.0 FAR	$60M+/-
Difference / Gap	***($10M)+/-***

Economic Gap Considerations

Current Apex Ownership – Despite the challenges of navigating an accelerated repositioning of its current property and taking on a major move, there are a number of prospects driving the potential for the current Apex ownership to consider embracing a DEMOLITION scenario:

1. Under near-term redevelopment, possibility of obtaining more FAR and avoiding the future uncertainties regarding achievable building area.
2. Accelerated opportunity to realize future redevelopment value, enhanced by optimum design and construction.
3. Expedited resolve of possible future internal decision making requirements regarding future redevelopment of the existing building.
4. Moment-in-time opportunity to benefit from active collaboration with the public sector.
5. Avoidance of inconvenience of living through a PL Station construction project.
6. Updating of their (ASHP) occupied space (not in 25 year old building).
7. Possible public interest appeal of helping make for a better long-term urban transit environment.

<u>Consolidated Block Planning and Development</u> – With or without merging ownerships, both the Apex property interest and the adjoining 7200 Wisconsin / Woodmont parcels could gain significant cost savings / added value through coordinated block-wide planning, construction and operations. The whole block shares in dealing with the impacts of the existing former rail right-of-way the split up the parcels. They have in common some non-rectangular property boundaries and shared street frontages, and could have aligning interests in improving the overall through site access, including how the treatment of the Purple Line Station impacts the wider block. In short, a jointly conceived, block-wide development plan could help achieve a higher market profile for the respective properties, which when coupled with design and construction cost efficiencies, could be projected to convey millions of dollars of added value to each subcomponent.

<u>Other Public Financed or Benefited Offsets</u> – There is no question that the accelerated redevelopment of the Apex site, combined with a more optimally designed Purple Line Station, will translate into some degree of additional economic activity and tax revenue for Montgomery County and the State of Maryland. Without adjusting for whether a bigger, more prominent building complex, and the positive spin-off effect that will occur surrounding the new station, is 100% new, or primarily redistributive of what would otherwise occur, two increments of net economic gain are likely to be true:

- First is the probability that a DEMO scenario will realize more quickly a much bigger new building than would occur were the current Apex building to stay. Near-term, the additional real estate revenues alone generated by a new building could easily exceed $2.0M per year more than is currently the case.
- Second, other economic multipliers, including an incremental halo effect of having a superior permanent Purple Line, would add to the overall positive economic impact of witnessing a DEMOLITION scenario compared with KEEP scenario.

Granted, these positives need to be tempered by the probability that over time some of these development upticks will occur anyway, and the possibility (considered unlikely) of the migration of the owner / user (ASHP) to another jurisdiction. Nonetheless, the prospect of pushing forth with a DEMOLITION equation provides an economic impact foundation to help make it happen by applying any number of public investment tools otherwise used for public purpose by Montgomery County and the State of Maryland.

Study Limitations

- No cost premiums added for making DEMO scenario happen by 2015.
- Non-real estate related costs of current Apex ownership not considered.
- Process and costs of obtaining needed replacement easements not considered.
- Assume no near term APF / traffic constraints affecting redevelopment.

Public Benefits – See MNCPPC report