To: George Lahanas  
Subject: Background on University Place Project and review of Columbia Sussex offer to purchase the land currently subject to a ground lease between the City and University Place Condominium Association  
Meeting: City Council Discussion Only - 18 Feb 2020  
Department: Planning, Building, and Development  
Staff Contact: Thomas Fehrenbach, Director of Planning, Building and Development

BACKGROUND INFORMATION:

University Place/ Council Discussion-Only Meeting 2-18-20  
In 1985, the City entered into a development agreement for the development of a downtown hotel and retail office complex and parking garage. The project was split via a condominium association into three units:

- Unit 1 – Parking Garage  
  Owned and operated by the City
- Unit 2 – Hotel  
  Owned by Columbia Sussex (CS), operators of the Marriott Hotel
- Unit 3 – Office Building  
  Owned/ managed by CS

The City maintains ownership of the land, which is leased to the condo association. When the lease ends for each unit, ownership of that unit will become the property of the City. The initial term of the lease was for $10 per year for 40 years, which ends in March 2026. There are 4 additional 10-year terms available to the individual units. The lease rate as of March 2026 was established by the original agreements between the City and the condominium association at 12% per year of the fair market value. That amount has been established by a Land Value Determination Agreement between the City and the association. Based on an assumed inflation rate of between zero and two percent, the annual lease payments are estimated at between $515,000 and $580,000 per year, beginning in 2026.

The condominium association is managed by CS and they handle the financials and operations. The City contributes approximately $30,000 to the Association’s annual budget via the Parking Fund for maintenance of the areas that the City has some responsibility for, as established by the master deed and bylaws.

In January 2020, CS delivered a non-binding expression of interest letter to staff proposing to purchase the land directly from the City for $3,500,000 in lieu of paying the rent established by the
original agreement and the subsequent land value determination. A sale of the land would have to be approved by the voters pursuant to the City’s Charter. Their analysis of the purchase price included a discount rate of 8.75% and indicated a net present value (NPV) of the property at between $3,800,000 and $4,400,000 based on the expected lease payments beginning in 2026. They indicated that the lower price is justified due to the office project not being economically feasible in its current situation.

The recent appraisal, however, performed by the City, valued the land at $4,110,000. The third party appraisal valued the land at $4,500,000. Further, the City’s initial analysis of the NPV based on a discount rate of 3-5%, which is closer to the mid-range between staff’s initial estimates based on conversations with professionals knowledgeable about our market and a more realistic rate of return for City investments, indicate a NPV of between $4,800,000 and $5,800,000. This NPV is for the land value only. It does not account for the present agreement which has the potential of having either the office building or the hotel building or both transferring to the City if the lease term ends for either of the buildings.

It has to be taken into consideration, however, that approximately $160,000 per year in tax increment revenues are currently being captured on the property to service debt issued in relation to improvements to the parking structure. Any portion of the property that becomes controlled by the City would become tax exempt, which would eliminate any tax increment available for capture and create a reduction in revenue for the City’s Parking Fund. Any option considered by Council should include an analysis of the revenue reduction created by the elimination of tax increment.

Some policy questions for Council consideration are:

1. Should the Council consider asking the voters to approve a sale of the property at either the price proposed or at a fair market price?
2. Does the Council desire to have staff explore a renegotiation of the ground lease on terms that are more palatable to CS while still acceptable to the City?
3. Should staff explore other options regarding potential arrangements including renegotiating the lease terms (e.g., City control of office tower, new lease with Hotel only, etc)

Staff continues to analyze the options for Council consideration and looks forward to discussing this item at your discussion-only meeting on February 18, 2020.

ATTACHMENTS:
Columbia Sussex- Proposal Letter for University Place
January 9, 2020

Thomas J. Fehrenbach
Community & Economic Development Administrator
City of East Lansing
410 Abbot Rd.
East Lansing, MI 48823

Dear Tom,

Proposal to purchase the land subject to the Amended & Restated Ground Lease dated August 3, 1987 ("Ground Lease") between the City of East Lansing ("City") as Lessor and University Place Associates ("University Place") as Lessee.

As you are aware Columbia Sussex Corporation owns and controls both the Hotel condo and the Office condo within the University Place condominium.

The Ground Lease expires on March 9, 2026 and has four 10 year renewal options.

By means of the Land Value Determination Agreement dated September 20, 2019 and three independent appraisals, the City and University Place have determined the Assessed Value for purposes of Section 3.C. of the Ground Lease, which is $4,300,000 to be adjusted by CPI between January 1, 2020 and March 10, 2026.

The annual rent for the first renewal term per section 3.C. of the Ground Lease is 12% of the Assessed Value, which is $516,000 subject to adjustment by the rate of inflation. The following CPIs will produce the following annual rents for the initial 10 year renewal term:

1.0% - $547,740
1.5% - $564,228
2.0% - $581,112

Given the 60:40 rent split between the Hotel and the Office condo, the rent payable by the Office condo, based on the 3 inflation rates will be in the range of $219,000 to $232,000.

As you are aware the Office condo in particular has struggled historically, making little or no money before payment of rent, to the point that the prior owner was unwilling to renew the lease under the existing terms and would have most likely caused the development to be returned to the City at the end of the initial lease term.
Columbia Sussex purchased the Office condo in 2018 to eliminate the 3rd party to the negotiations with the City, but this did nothing to resolve the underlying uneconomic nature of the Office condo and its inability to pay its share of the rent, if the Ground Lease is renewed in 2026.

A re-negotiation of the ground rent is therefore going to be a necessity prior to any renewal of the Ground Lease.

As an alternative to renegotiating the terms of the Ground Lease, Columbia Sussex proposes to acquire the land that is the subject of the Ground Lease, either directly or through University Place for a purchase price of $3,500,000.

Discounting the existing rent stream that results from the Land Value Determination Agreement at an 8.75% discount rate at the three inflation rates would produce the following values for the land subject to the Ground Lease:

1.0% - $3,847,300  
1.5% - $4,107,600  
2.0% - $4,393,000

However, as mentioned above the rent per the Ground Lease has to be re-negotiated and lowered significantly in order for the development to be viable. Therefore a significant discount is required to reflect the lowered rent stream - hence our offer to acquire the land for $3,500,000.

Other terms of the proposed acquisition are as follows:

Closing Conditions:

1. Confirmation of no title or survey matter that negatively affects the marketability, financing or use of the Property or constitutes a monetary lien.  
2. Execution of a Purchase and Sale Agreement, which includes agreed amendments to the Master Deed and Bylaws of the University Place Condo Association.

Closing: Five (5) business days after the execution of the Purchase Agreement.

The full purchase price will be paid in cash at closing and no financing will be required.

Closing Costs: Seller to pay transfer taxes. Purchaser will pay for title insurance. All other costs to be allocated based on local custom.

This is a non-binding expression of interest and is subject to the terms of any final written agreement.

Yours Sincerely,

Christopher J. Ballad  
Chief Financial Officer