

Request for Committee Action

To: Community Development & Regulatory Services
Date: 8/25/2015
From: Community Planning & Economic Development
Prepared by: CPED, Finance and City Attorney staff
Presented by: Bob Lind, CPED, x5068
File type: Action
Subcategory: Staff Direction

Subject:

Awarding Negotiating Rights for 800 South Washington Avenue (Guthrie Liner Parcel)

Description:

Recommendation:

1. Award exclusive negotiating rights to M.A. Mortenson for the purchase and development of the City-owned property at 800 South Washington Avenue (Guthrie Liner Parcel) for a period of six months, or alternatively, to Sherman Associates for six months as described herein; and
2. Authorize City staff to negotiate redevelopment contract terms and, upon successful negotiations, return for further City Council review and approvals.

Previous Actions:

- October 22, 2010, City Council approved the sale of a portion of 800 Washington Avenue South to the American Academy of Neurology (AAN).
 - July 2, 2010, City Council authorized staff to negotiate redevelopment contract terms with the AAN and granted exclusive development rights to Artspace Projects Inc. for a two-year term for the Washington Avenue frontage.
 - November 22, 2002, City Council authorized execution of a purchase agreement between the City and Hennepin County Regional Rail Authority to acquire the Parcel E property as part of the implementation of the Guthrie Theatre development. The City acquired the property in May 2003.
-

Ward/Neighborhood/Address:

Ward 3
Downtown East
800 Washington Ave S

Background/Analysis:

On March 18, 2015, the City issued a Request for Proposals (“RFP”) seeking development proposals for a vacant parcel of land at 800 South Washington Avenue, commonly referred to as the “Guthrie Liner Parcel”. Notification of the RFP was e-mailed to CPED’s 840-person distribution list in the development community, both local and national. On March 26, 2015, CPED staff held a pre-proposal meeting to address questions about the RFP; twenty-six people participated in the meeting.

In response to the RFP, the City on May 20, 2015 received three development proposals from

Saturday Properties, M.A. Mortenson Development and Sherman Associates Development. CPED staff worked with the proposers to refine and clarify their proposals and gave each the opportunity to provide additional information or modifications to their proposals.

Summary of Responses:

- Saturday Properties: Six story mixed use building
Restaurant and retail: Approximately 10,500 sq. ft. on ground level
Hotel: 166-room Element by Westin hotel on floors 1-6 (98,900 sq. ft.)
Office: None
Valet Parking: For hotel and restaurant – a minimum of 140 stalls would be needed in the Riverfront Ramp at market rates
Purchase Price: \$2,850,000 (\$117 psf)
Total Development Cost: \$31.0 million
- Sherman Associates: Nine story mixed use building – floor 9 (rooftop) is only partially enclosed
Restaurant/Recreation: Pinstripes, with approximately 25,800 sq. ft. Ground floor includes a 1,200 sq. ft. patio, Floor 2 includes enclosed patio seating for 100 plus 10 bowling lanes and some bocce courts, Floor 9 contains 3,000 sq. ft. of roof deck space plus some bocce courts
Other Retail: None
Hotel: 140-room Kimpton boutique hotel on floors 1 and 3-7 (78,960 sq. ft.) Approximately 6,700 sq. ft. for restaurant and bar on floor 9
Office: Approximately 15,800 on floor 8, would be leased to Sherman Associates for corporate headquarters, or other interested office tenant such as American Academy of Neurology
Public Parking: Available in the Riverfront Ramp; a pedestrian connection to the ramp is proposed underground
Valet Parking: None
Purchase Price: Initially at \$2 million, later revised to \$3.5 million (\$143 psf)
Total Development Cost: \$47.8 million
- M.A. Mortenson: Nine story mixed use building
Restaurant and Bar: Approximately 5,300 sq. ft. bar on ground floor at the Chicago Avenue corner
Other Retail: Approximately 2,500 sq. ft. of neighborhood oriented retail on ground floor at the 9th Avenue corner
Hotel: 188-room Hyatt Centric hotel on floors 1-8 (106,669 sq. ft.)
Office: Approximately 14,000 sq. ft. on floor 9 (plus 1,000 sq. ft. terrace) Would be sold or leased to the American Academy of Neurology (AAN) A 10th floor for AAN expansion might be built in the future
Public Parking: Available in the Riverfront Ramp; a pedestrian connection to the ramp is proposed at ground level
Valet Parking: For hotel and restaurant – up to 140 stalls would be needed in the Riverfront Ramp at market rates
Purchase Price: \$3,784,945 (\$155 psf)
Total Development Cost: \$49.4 million

A review team consisting of staff from CPED Economic Development and Planning, City Finance, City Attorney's office, and City Council staff from Wards 3 and 7 reviewed and met on the three proposals throughout the month of June 2015. It was determined that the Saturday Properties proposal should be eliminated from consideration since the other two proposals were superior in terms of project size and density and public benefits. The remainder of this report will be dedicated to comparing the Sherman and Mortenson proposals.

The Sherman and Mortenson proposed developments showed similarities in a number of areas, including maximizing the property's potential; building mass and height (9 stories); mix of uses (hotel, restaurant and office); total development costs (\$47-49 million); construction timeline; and connections to the adjacent Riverfront Ramp and AAN building. Additionally, both developers demonstrated that they have assembled solid development teams and have the development experience, financial strength, and organizational capacity necessary to undertake and complete their proposed projects.

However, there are a number of significant areas in which the Mortenson and Sherman proposals are different. These differences are discussed below.

Hotel:

The hotel is the largest component of both the Mortenson and Sherman proposals. The proposed Mortenson hotel is a 188-room Hyatt Centric hotel, considered a full service lifestyle hotel, with valet parking, which is 48 rooms (34%) larger than the 140-room Kimpton boutique hotel proposed by Sherman (no valet parking). A review of the hotel operating pro formas showed similar occupancy rates, average daily room rates and net operating income. The City Assessor's Office would value these two hotels almost identically on a per room basis, however, since the Hyatt Centric hotel has 34% more rooms, the projected City taxes from the Hyatt Centric hotel would be significantly higher than the Kimpton hotel.

In the hotel category staff favors the Mortenson proposal.

Restaurant/Retail/Entertainment:

One of the three City development goals from the RFP was "Maximizing retail space on the ground floor. Proposals should, at a minimum, include retail at both corners fronting along Washington Avenue."

The Mortenson proposal satisfies this requirement, while the Sherman proposal does not. The Kimpton hotel lobby at the corner of Washington Avenue and 9th Avenue does not qualify as a "retail" use, and therefore the Sherman proposal is technically non-compliant with the RFP. However, the Sherman proposal does include Pinstripes as the tenant for most of the 1st floor, all of the 2nd floor and a portion of the 9th floor.

Mortenson proposes a full-service bar and restaurant at the corner of Washington Avenue and Chicago Avenue, and a neighborhood oriented retail (coffee shop or other retail) at the corner of Washington Avenue and 9th Avenue. Both of these would provide the kind of active uses the City is seeking on the site. There is a proven market in the Mill District for small scale restaurants (Spoon River, KinDee Thai, Sanctuary, Zen Box) and some retail (Dunn Brothers, Ticket King), so if the initial tenants would fail in the future, these spaces should be able to be re-leased successfully.

Sherman proposes that Pinstripes be the tenant for most of the 1st floor along Washington Avenue, all of the 2nd floor and a portion of the 9th floor. Several members of the review team have been to the Pinstripes in Edina and agree that this establishment provides a casual and active atmosphere to its patrons. However, the review team did have several concerns and questions.

The first concern is that there is no proven long-term market in this area for a business like Pinstripes. If the business would fail in the future, Sherman Associates has indicated that the majority of the 2nd floor would be converted to hotel rooms or other hotel uses, and the 1st floor would be converted to restaurant space operated by the hotel, the hotel lobby would be expanded, and any remainder would be marketed to commercial uses. The 9th Avenue corner would remain the hotel lobby and would continue to be relatively inactive.

The second concern is whether this is the best location for Pinstripes. The review team does not have enough input or feedback from the Guthrie, Mill City Museum, local business owners and area residents to draw any conclusions here. The review team believes that the opening of a Pinstripes somewhere in downtown Minneapolis would be a great asset.

In the restaurant/retail category staff favors the Mortenson project.

Letters of Interest, Support and Intent:

The Mortenson proposal includes a strong “letter of support” from the American Academy of Neurology for the office space, and a “letter of interest” from Hyatt Hotels Corporation for the hotel space. No letters were provided for the restaurant or neighborhood retail space.

The Sherman proposal provided a “letter of intent” from Pinstripes, Inc. for the restaurant/retail/entertainment space, and a “letter of intent” from Sherman Associates for the office space. No letter was provided from Kimpton for the hotel space.

Not surprisingly, neither proposer has received a “commitment letter” nor a “franchise rights letter” from the hotel tenant. As soon as one proposer is granted exclusive negotiating rights to the property, a franchise application for rights to a hotel should be submitted immediately.

The support of the American Academy of Neurology was not a requirement for any proposed development on the site, and their support was not one of the main factors in comparing and evaluating the two proposals. However, AAN’s explicit support for the Mortenson proposal is noteworthy. In particular, we understand that AAN has a preference for the Hyatt Centric hotel brand for their visiting doctors and professionals, and in addition to owning or leasing the 9th floor of the project, they wish to expand their operations into a 10th floor that could be constructed economically sometime in the future.

In the letters of interest, support and intent category staff favors the Mortenson proposal.

Exterior Design:

Although the two buildings look noticeably different in many respects, the exterior design of both buildings appear to be of high quality, with creative and innovative features and elements, unique use of spaces, and a very contemporary look. Both designs use a variety of materials to provide contrast and color to the exterior surfaces of the building.

In the exterior design category staff ranked both proposals equal.

Purchase Price:

M.A. Mortenson is willing to purchase the site for \$3,784,945 (\$155 psf).

Sherman Associates originally offered \$2 million for the site. However, the review team discovered errors in Sherman's hotel operating pro forma, and once a corrected hotel operating pro forma was submitted, Sherman revised its purchase price to \$3.5 million (\$143 psf).

All proceeds from the sale of the site (net of sales expenses) must be used to retire outstanding tax-exempt general obligation bonds that the City issued to acquire the entire block and construct the adjacent Riverfront Parking Ramp. A larger purchase price means that more bonds would be paid off, which would benefit the City's parking fund and parking system in future years.

In the purchase price category staff favors the Mortenson proposal.

Riverfront Ramp Utilization:

Both proposals are showing a pedestrian connection either at grade (Mortenson) or underground (Sherman) to the Riverfront Ramp. The Hyatt Centric hotel would offer valet parking in the Riverfront Ramp and the Kimpton hotel would not. Since the Hyatt Centric hotel is 40 rooms larger and would offer valet parking, it is logical to assume that the Hyatt Centric hotel would utilize the Riverfront Ramp to a greater degree than the Kimpton hotel. Assuming that AAN purchases or leases one floor in either proposed development, their utilization of the ramp would be identical.

Ramp utilization for the restaurant/retail/entertainment components of each project is far more difficult to predict. Under the Sherman proposal, Pinstripes is occupying a significantly larger amount of space (25,800 sq. ft.) than the combined restaurant and retail space under the Mortenson proposal (7,800 sq. ft.) Therefore, even though some of Pinstripes space would be for low density recreational use (bowling lanes and bocce courts), it is logical to assume that Pinstripes patrons would utilize the Riverfront Ramp to a greater degree than Mortenson's restaurant and retail space.

However, there are two unknown variables in this category that could change ramp utilization significantly. The first variable is the percentage of restaurant and retail patrons that would actually use the Riverfront Ramp versus use of other nearby parking options. When the Guthrie was constructed it was assumed that the vast majority of Guthrie patrons would utilize the Riverfront Ramp directly across the street. This level of use never materialized since many Guthrie patrons do not like to park in large ramps or are willing to walk to smaller ramps or other less expensive alternatives. The second variable is whether any validated parking will be provided to restaurant and retail patrons. There was not enough information provided in either proposal for staff to quantify the potential impact of these variables.

In the riverfront ramp utilization category staff ranked both proposals equal.

Public Benefits:

Because of the various similarities in both proposals, we would expect the number of construction jobs created to be roughly the same. Mortenson estimated 120+ permanent jobs, with 75 of them being full-time hotel staff jobs, but provided no detail about the remaining 45

jobs. Sherman estimated 110 full and part-time jobs for Pinstripes and an additional 70 full-time hotel staff jobs. Sherman also stated that if they occupy the 8th floor as their corporate headquarters, then there would be an additional 100 jobs. However, these would be relocated jobs and it seems more reasonable to assume that AAN would lease that space anyway.

Both proposals provided estimates of annual property taxes and sales and use taxes from their respective development. However, in order to assure that consistent assumptions and methodologies were used in developing these figures, City Finance Department staff generated the following projections:

	<u>Mortenson</u>	<u>Sherman</u>	<u>Difference</u>
Annual City Property Taxes	\$246,847	\$223,839	\$ 23,008
Annual City Lodging Taxes	247,711	189,295	58,416
Annual City Entertainment Taxes On Lodging	283,099	216,337	66,762
Annual City Sales Taxes on Lodging	<u>47,183</u>	<u>36,056</u>	<u>11,127</u>
TOTAL	\$824,840	\$665,727	\$159,313

In addition to the above taxes, both projects would also generate non-lodging entertainment taxes, downtown restaurant taxes, downtown liquor taxes, and non-lodging sales taxes. There was not enough information provided in either proposal to make estimates of these taxes. These additional taxes would narrow the difference between the Mortenson and Sherman proposal. It is assumed that Pinstripes would generate more of these other non-lodging taxes than the restaurant and retail space in the Mortenson project, and thus provide an offset to the \$159,313 difference listed above.

In the public benefit category staff favors the Mortenson proposal.

Recommendation:

The review team found that both the M.A. Mortenson and Sherman Associates proposed developments would be excellent projects for the site. However, based on the differences noted above, the review team’s recommendation was Mortenson.

It is therefore recommended that M.A. Mortenson be granted exclusive negotiating rights to the 800 South Washington Avenue property for a period not to exceed six months. City staff and representatives from M.A. Mortenson would negotiate the terms and conditions of the sale and development of the property, and City staff would return with a term sheet for City Council consideration within this six month period, unless the City Council approves an extension of the exclusive negotiating rights period.

If the exclusive negotiating rights period with Mortenson expires without a City Council approved term sheet, then staff is directed to meet with representatives of Sherman Associates to discuss their interest in the property at that time. If Sherman Associates is still interested, and their proposed project has not changed significantly as determined by the CPED Director, then Sherman Associates would be granted exclusive negotiating rights to the property for a period not to exceed six months. City staff and representatives from Sherman Associates would negotiate the terms and conditions of the sale and development of the property, and City staff would return with a term sheet for City Council consideration within this six month period, unless the City Council approves an extension of the exclusive negotiating rights period.

Next Steps:

Subject to the City Council's award of exclusive negotiating rights to Mortenson for the purchase and development of 800 South Washington Avenue, staff will begin negotiations with Mortenson as soon as possible. During the six month exclusive rights period, City staff will measure the progress of the negotiations via established benchmarks such as progress in securing a hotel commitment and agreement on Riverfront Ramp parking arrangements. Once an agreement between staff and Mortenson is reached, staff will return to the City Council (probably in early 2016) for approval of a term sheet and authorization to enter into a redevelopment contract with Mortenson.

Financial Review:

Select financial statement.

- Future budget impact anticipated.**
- Approved by the Permanent Review Committee. – Not Applicable**
- Meets Small and Underutilized Business Program goals. – Not Applicable**