



COMMUNITY DEVELOPMENT DEPARTMENT

Council Meeting Date: May 11, 2010

Staff Report #: 10-064

Agenda Item #: F-1

REGULAR BUSINESS: Update and Possible Direction on Terms of the Menlo Gateway (Bohannon Hotel & Office) Development Agreement

RECOMMENDATION

Staff recommends that the City Council consider the updates related to the terms for the Menlo Gateway (Bohannon Hotel & Office) Development Agreement and provide direction as necessary.

BACKGROUND

On April 6, 2010, the City Council reviewed the proposed Development Agreement Term Sheet for the Menlo Gateway project. The term sheet covered 12 topics as follows: (1) Quality Hotel; (2) Revenue Guarantee; (3) Term for Retaining Development Rights; (4) Public Benefits; (5) LEED Building Standards; (6) Vehicle Trip Reduction; (7) Greenhouse Gas Reduction; (8) Permit Processing; (9) Land Use Vesting Rights; (10) City Fees; (11) Project Modifications; and (12) Transferability. The 12 topics of the three-page term sheet have been transformed into a 40-plus-page draft Development Agreement, including the Ordinance to approve the agreement. Some of the topics crossover into mitigation measures from the EIR and potential conditions of approval contained in the draft Conditional Development Permit.

In addition to reviewing the term sheet on April 6, 2010, the Council authorized the continued review of the project according to the following schedule:

- 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 11: Development Agreement Term Sheet check in with Council;
- 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, if applicable.

On April 7, 2010, the Housing Commission voted unanimously to recommend approval of the BMR Housing Agreement. On April 19, 2010, the Planning Commission held a public hearing on the project. On May 3, 2010, the Planning Commission made its recommendation after considering all of the public comments and documents, including the draft Development Agreement and draft Conditional Development Permit. Since the April 6, 2010 Council meeting, the City has received 26 pieces of correspondence regarding the Menlo Gateway project. All of the correspondence was presented to the Planning Commission. (Copies of the eight pieces of correspondence related to the Development Agreement have been submitted to the Council under separate cover). The Commission voted 4-3 (with Commissioners Bressler, Kadvany and Pagee opposed) to recommend approval of the project with the following additional items:

1. Accept the alternate parking structure design;
2. Modify the hotel consistent with the rendering presented at the meeting if acceptable to applicant;
3. Re-examine the amount of the penalty for non-compliance of the trip limitation;
4. Tighten the definition of minor and major modifications and what would come back to the Planning Commission for review;
5. Encourage the applicant to identify five to 10 acres of land for housing in the City;
6. In the negotiations, consider a sales tax in lieu fee to be applied to office square footage as completed in a range of approximately \$1.40 per square foot per year.

ANALYSIS

The Development Agreement is a contract between the City of Menlo Park and the applicant that delineates the terms and conditions of a proposed development project. A Development Agreement allows an applicant 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. 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. The remainder of the analysis section provides updates regarding the terms of the Development Agreement since the April 6, 2010 Council meeting. When considering the following information, it is important to remember that the Development Agreement was not yet drafted when the Council was considering the Term Sheet on April 6, 2010. The updates are grouped into three subsections as follows: (A) requests for additional information, (B) potential changes to the Development Agreement, and (C) Planning Commission recommended items. To supplement this staff report, staff will provide a detailed presentation at the May 11, 2010 Council meeting.

Requests for Additional Information

A1. Provide more details regarding the priority hiring program.

Section 5.4 of the draft Development Agreement regarding the Priority Hiring Program states the following:

Owner shall create a priority-hiring program that will use JobTrain, or a comparable program selected by Owner if JobTrain is not able to operate such program, as the first source for referral of qualified applicants for entry-level job openings related to both the Hotel and office uses, as well as construction positions. This program shall offer first priority job postings to Menlo Park residents and graduates of applicable JobTrain training programs. Owner and JobTrain shall coordinate and provide periodic reports to the City as to the program's progress.

A2. How does the draft DA compare to other Development Agreements such as Sun Microsystems, University Circle, and the Stanford Hospitals?

Staff has collected information regarding the Development Agreements for Sun Microsystems in Menlo Park, University Circle/Four Seasons in East Palo Alto, and the proposed Stanford Hospitals project in Palo Alto. Staff will present summary comparisons at the Council meeting on May 11, 2010.

A3. What does the City intend to do in terms of planning for the adjacent Haven Area?

Once the processing of land use entitlements for the Menlo Gateway projects conclude, staff resources can be re-allocated to other Council priorities related to land use and business development. Staff is initially going to focus on issues related to the permitting process in the M-2 zoning district and the three sites that comprise the Willow Business Area (AMB's Willow Park, Menlo Business Park, and the GM site). After better understanding the scope of work associated with the M-2 permitting and Willow Business Area efforts, staff would then be able to turn its attention to the Haven Area if the Council concurs with the sequencing of these priorities. The Redevelopment Implementation Plan adopted in the Fall of 2009 includes potential funding to study the Haven Area, which is located within the redevelopment project area. At this point in time, staff would recommend a two phase approach for the study – phase one visioning and phase two planning. Visioning would involve the current property owners, businesses and other stakeholders to determine a long term vision for the area. A design charrette might be a productive exercise to explore all possibilities for the area. Once the vision is established, then the planning would begin to achieve the vision. Planning efforts could range from minor amendments to the Zoning Ordinance, General Plan Amendments or a Specific Plan, with an emphasis on infrastructure upgrades, including the evaluation of placing the electrical transmission lines underground.

Allocations of staff resources and funding for consultant services could occur as part of the fiscal year 2011-12 budget process.

A4. Re-examine the financial analysis by probing the assumptions deeper and running various sensitivity analyses.

The applicant agreed to pay for the cost to have Cushman & Wakefield (“CW”) perform additional analysis by adjusting assumptions/variables in the construction pro-forma related to the “cap” rate, existing land value, and projected office rents. A Memorandum from Robby Perrino of CW providing the additional analysis is included as Attachment A. The additional analysis includes the following:

- Data regarding historical cap rates and historical comparable sales back to 2000/2001, along with a discussion of the “band of investment technique” in deriving overall cap rates based on debt and equity and mortgage interest rates, showing cap rates from the various different methodologies ranging from an average of 5.94% on the low end, 12.35% on the high end with an average of 8.70% (original analysis used cap rate of 8.5%)
- Discounted cash flow (“DCF”) analysis with a 6.0% going in cap rate, 6.5% terminal cap rate, showing a 2014 value of between \$398 million and \$435 million (average of \$416 million compared to original DCF valuation of \$341 million)
- Construction pro-forma at 6.0% going in cap rate with land included in cost, resulting in an internal rate of return (“IRR”) of 14.37%; and without land included, resulting in an IRR of 15.90% (compared to original IRR of 12.68%)
- Discounted cash flow analysis with a 7.5% going in cap rate, 8.0% terminal cap rate, showing a 2014 value of between \$349 million and \$382 million (average of \$366 million compared to original DCF valuation of \$341 million)
- Construction pro-forma at 7.5% going in cap rate with land included in cost, resulting in an IRR of 13.26%; and without land included, resulting in an IRR of 14.76% (compared to original IRR of 12.68%)
- Construction pro-forma at 8.5% going in cap rate without land included, resulting in an IRR of 14.16% (compared to original IRR of 12.68% with land included)
- Discounted cash flow analysis with a 9.5% going in cap rate, 10.0% terminal cap rate, showing a 2014 value of between \$308 million and \$335 million (average of \$322 million compared to original DCF valuation of \$341 million)

- Construction pro-forma at 9.5% going in cap rate with land included in cost, resulting in an IRR of 12.19%; and without land included, resulting in an IRR of 13.65% (compared to original IRR of 12.68%)
- Discounted cash flow analysis assuming market rent for office space is \$6.50 per square foot per month fully serviced (with annual increases) with all other variables constant from original analysis, resulting in a value of between \$412 million and \$449 million (average of \$430 million compared to original DCF valuation of \$341 million)

While it should be pointed out that in CW's professional opinion, it is not a likely scenario under any circumstances, based on the above analysis the potential increase in the residual land value could be as much as \$74 million (the difference between \$430 million and \$341 million discounted from 2014 to 2010 at 5%)—resulting in a total increase in residual value based on the granting of land use entitlements of up to \$101 million. Utilizing what CW projects is a more likely scenario, the increase in residual land value would be closer to its original projections, assuming the economy recovers to the point that this project is economically viable.

A5. How does the greenhouse gas emissions reduction in the Term Sheet compare to the terminology used in the EIR?

In describing greenhouse gas emissions related to the energy consumption from the buildings and parking structures, the EIR uses the terms “direct” and “indirect” emissions. The direct emissions are related to on-site natural gas consumption and indirect is related to the generation of electricity off-site. Section 5.7 of the draft Development Agreement regarding Greenhouse Gas Emissions Reductions states the following:

5.7 GHG Emissions Reductions. Owner shall cause the GHG emissions associated with electrical and natural gas energy consumption for any and all buildings included in the Project to be fully offset through Owner's participation in PG&E's ClimateSmart program. In the event such ClimateSmart program is discontinued or becomes financially burdensome on the Project, Owner may propose substitution of a comparable GHG offset program selected by Owner, subject to the City Manager's reasonable approval for the Project. All parcels/buildings within the Project shall be enrolled in the same GHG offset program. The terms provisions of this Section 5.7 shall survive the expiration or termination of the Development Agreement and shall be incorporated into the Conditional Development Permit. Owner shall provide City with an annual report and documentation demonstrating compliance with this Section 5.7.

Using the gross direct and indirect emission estimates from the EIR, the greenhouse gas emissions would be reduced by 3,070 metric tons annually through participation in the ClimateSmart program. Since this commitment is for the life of the project, the

requirement from the Development Agreement needs to be incorporated into the Conditional Development Permit and will be as part of the staff report for the May 25, 2010 Council meeting. In addition, the Conditional Development Permit includes the following provision to ensure that the building shells are designed consistently with the assumptions in the Draft EIR as follows:

8.22 Concurrent with building permit submittals for the shell of each structure, the applicant shall submit documentation using approved computer modeling programs with the applicable version of the California Energy Code that is in effect at the time of submittal demonstrating that the structure has been designed in a manner such that the applicable phase of the project (i.e., Independence Site and Constitution Site), approximates the kilowatt hours for electricity and therms for natural gas consumption per year as shown on the table below subject to review and approval of the Building and Planning Divisions prior to issuance of each building permit. The total kilowatt hours for the site shall not exceed 8,254,343 and the therms for the site shall not exceed 170,295, unless the applicant can provide documentation demonstrating that the studied carbon dioxide emissions are not exceeded.

Target Campus Annual Energy Consumption by Project Phase

	Electricity (kWh/yr)	Natural Gas (Therms)	Total Energy (kBtu/yr)
Hotel/Health Club/Garage C	2,008,744	89,122	15,766,034
Independence Office and Retail	1,811,600	21,545	8,335,679
Constitution Office 1/Garage A	2,203,595	29,814	10,500,067
Constitution Office 2/Garage B	2,230,404	29,814	10,591,539
Total	8,254,343	170,295	45,193,318

Potential Changes to the Development Agreement

B1. Could a certain percentage of the public benefit projects be allocated specifically for Bedwell Bayfront Park instead of general recreational purposes?

Section 5.2.1 of the draft DA regarding Public Benefit – Capital Improvements states the following:

The capital improvements to be paid for and caused to be constructed by Owner, and the areas of the City to which such capital improvements are to be made, shall be determined by the City Council following the City’s conduct of a public outreach process; provided, however, that such capital improvements shall be allocated between the Belle Haven neighborhood (approximately 50%) and Bedwell Bayfront Park or other city-wide recreational improvements

(approximately 50%), at the reasonable discretion of the City Council. The City shall commence such public outreach process upon Owner's submission of an application for a building permit for the first office building in the Constitution Phase, and the City shall complete such public outreach process and identify for Owner in writing the specific capital improvements to be made by Owner within six months of receipt of such building permit application.

Since the April 6, 2010 City Council meeting, the Friends of Bedwell Bayfront Park have submitted a letter requesting that a minimum of 35 percent of the \$1,000,000 funding be dedicated to Bedwell Bayfront Park. The applicant is willing to accept this limitation, but staff does not support the change because it could limit the Council's flexibility in determining the best use of the funds approximately 15 or more years from now. If the Council would like to earmark a certain percentage of funds specifically to Bedwell Bayfront Park, the Council should provide direction to staff. On a related note, both the applicant and staff support the inclusion of language in the Development Agreement that would restrict the use of the funds to preclude active recreation, such as golf activities or sports fields.

B2. Explore options for collaborative solutions to underground the transmission lines on the Constitution Site.

The applicant is willing to incorporate the following language into the term sheet.

Utility Undergrounding. Owner agrees to work collaboratively with and support City efforts to underground existing electric transmission lines located on the Constitution Site. The City intends to pursue future land use planning studies in the Haven Avenue area, which may include utility undergrounding. If the Constitution Site were included as part of a future undergrounding plan, the owner would work with the City to explore ways of enhancing the site layout for the proposed project as long as there is no loss of square footage or delay of project construction. Owner agrees to support the undergrounding of utility lines from its property as long as costs for undergrounding are borne by others. Nothing in this agreement creates any obligation for the City to provide funding for utility undergrounding.

B.3. Should some items within the City Manager's authority be changed to the City Council?

The draft Development Agreement terms would allow discretion for the City Manager to approve:

- changes in the hotel product within pre-established criteria;
- transfers in ownership of the project within pre-established criteria;
- changes to the project that are "substantially consistent with approved plans and Project Approvals"; and

- time extensions up to 180 days.

The specific citations in the Development Agreement related to the City Manager are as follows:

- 1.36 Substantially Consistent Modifications
- 4.5 Easements; Improvements
- 5.1.2 Guarantee Payments
- 5.2.3 Capital Improvements
- 5.7 GHG Emissions Reductions
- 8.2 Additional Extensions
- 15. Estoppel Certificate
- 17.1 Owner's Right to Assign
- 17.2 Procedure
- 17.5.3 Release Upon Transfer of Property
- 19.3.3 Amendment Exemptions

The applicant is not willing to accept the change from the City Manager to the City Council given the types of items and potential for increased uncertainty. As a standard practice, the City Manager would use his or her discretion to advise the City Council of any decision.

B.4 Re-examine the inflationary factor associated with the revenue target.

The revenue target increases two percent per year from the 2008 base year amount of \$1.2 million, begins three years after hotel opening, and continues for 20 years. The two percent factor was a negotiated item and the applicant is unwilling to make a change.

B.5 Develop a way to re-evaluate the trip limit if the hotel product changes or some offices are not built.

The applicant has agreed to the following additional provisions under Section 5.6 Vehicle Trip Reduction of the Development Agreement that would require adjustment in the trip limit if the hotel product is changed or the office buildings are reduced:

- 5.6.1 If the proposed hotel as defined in Section 1.17 is replaced with a different hotel product, resulting in reduced square footage of the hotel and/or sports club, the vehicle trip limitation shall be adjusted downward commensurate with the reduction in uses. The new vehicle trip limitation shall be determined by the City's Transportation Manager based on the most recent ITE Standards and may be appealed by the owner to the City Manager, whose decision shall be final. The adjusted trip limitation, if implemented, shall become the basis for assessing penalties in accordance with the EIR Mitigation Monitoring Plan.

5.6.2 If land-use entitlements for one or both office buildings in the Constitution Phase expire or are terminated by Owner, the vehicle trip limitation shall be adjusted downward commensurate with the reduction in uses. The new vehicle trip limitation shall be determined by the City's Transportation Manager based on the most recent ITE Standards and may be appealed by the owner to the City Manager, whose decision shall be final. The adjusted trip limitation, if implemented, shall become the basis for assessing penalties in accordance with the EIR Mitigation Monitoring Plan.

B6. Consider beginning the trip monitoring program with the Independent Phase.

The applicant has agreed to start trip monitoring upon completion of the hotel. The change will be reflected in Conditional Development Permit condition 8.68.

B.7 Re-evaluate the annual \$100 per average daily trip penalty.

The applicant has agreed to increase the penalty, which would be incorporated into Conditional Development Permit condition 8.68, as follows:

- Up to 500 trips above 9,242 = \$100 per trip
- 500 to 1,500 trips above 9,242 = \$150 per trip
- 1,500 trips or more above 9,242 = \$200 per trip

B8. Consider incentives to have the developer start construction sooner.

Staff did explore this question with the applicant, but he indicated that that City could not offer any realistic incentives to start construction sooner. The decision to proceed with construction will depend on economic conditions beyond the City's influence.

B9. Collaborate further with Fire District without over-burdening the project.

Staff has met with Fire District staff to discuss collaborative options. The Fire District did provide a number of options to consider that are being reviewed as an attempt to compromise. The applicant has agreed to offer the following two items to the Fire District: (1) up to \$100,000 in addition to any Fire Code compliance requirements to install emergency vehicle priority devices on traffic signals between 300 Middlefield Road and the project site, and (2) payment of a Fire Impact Fee if the Fire District conducts the required nexus study and the City Council adopts a fee prior to issuance of each applicable building permit. As of the printing of this staff report, the Fire District has not had an opportunity to respond to this offer, but staff will continue discussions with the Fire District.

B10. Evaluate ways to work cooperatively to reorganize elementary school district boundaries in the vicinity of the project.

The applicant has agreed to include the following language in the Development Agreement:

School District Boundaries. In an effort to reorganize school district boundaries so that the project site is transferred from the Redwood City Elementary School District to the Ravenswood School District, Owner agrees to cooperate with future efforts by City or others, but Owner shall not be required to fund such an effort.

B11. Evaluate alternatives to 11% TOT level if TOT is increased by the City.

The Fiscal Impact Analysis included items for additional revenue. One idea was related to construction sales tax. The applicant has agreed to include the following language in the Development Agreement regardless of whether or not the City raised citywide TOT:

Construction Sales Taxes. For all construction work covered by this Agreement, Owner agrees to make diligent and good faith efforts to include a condition of all construction contracts with all qualifying contractors, subcontractors and material suppliers, a requirement to obtain a seller's sub-permit from the California State Board of Equalization to record construction purchases as Menlo Park sales. Upon the request of the City Manager, the Owner shall show copies of such construction contracts documenting these requirements.

Planning Commission Recommended Items

C.1 Project should use revised parking structure designs presented by applicant

The applicant has agreed to pursue the landscape reserve (reduced footprint) parking option as reflected in Conditional Development Permit 8.18. In addition, the applicant has agreed to pursue the revised exterior elevations to the parking structures as presented to the Planning Commission on April 19, 2010.

C2. Project should use revised hotel architectural designs presented by applicant

The applicant is willing to pursue changes to the revised footprint and exterior elevations to the hotel as presented to the Planning Commission on May 3, 2101. This commitment will be reflected in the Conditional Development Permit.

C3. Re-examine the annual \$100 per average daily trip penalty

The applicant has agreed to modifications per item B7 above.

C4. Bring future architectural changes to the Planning Commission for input

The applicant has agreed to present the final architecture for review and comment by the Planning Commission prior to each building permit issuance. This allows the applicant to share the designs with the public and get input from the Planning Commission if any changes are substantially consistent with the approved plans. The specific language associated with this concept would be presented in the May 25, 2010 staff report.

C5. Applicant to help identify future housing sites in Menlo Park

The applicant has agreed to actively participate in a citizen advisory committee to assist the City in identifying future housing sites when it updates the Housing Element of the General Plan if the City decides to create such a committee. The specific language associated with this concept would be presented in the May 25, 2010 staff report.

C6. Consider a sales tax in lieu fee for the office portion of the project

The applicant does not agree to the imposition of a sales tax in lieu fee. One could view the hotel component of the project as serving a comparable function of generating revenue to the City in relationship to the office. With projected revenue from TOT and sales tax of \$1,251,900 (2010 dollars), the 694,669 square feet of office is effectively responsible for an in lieu fee of \$1.80 per square foot of office floor area.

Conclusion

The applicant has agreed to a number of changes related to the Development Agreement. All statements regarding applicant agreement should be viewed as a package. If one particular item were to be modified, it may affect agreement to other items. Unless the Council directs otherwise, staff will continue working with the applicant to refine specific language as described in this report to present to the Council on May 25, 2010.

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 Draft Fiscal Impact Analysis (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 that ended on April 19, 2010. The City Council does not need to take any actions related to the FIA. The FIA 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.

POLICY ISSUES

The proposed project will require the Council to consider a policy decision whether to create a new General Plan land use designation and new zoning district, and then change the General Plan land use designation and the zoning classification for the property. The project review process has been structured in a way to provide the Council with a broad spectrum of inputs to make an informed decision on the policy matter. The City Council is scheduled to consider policy decision on May 25, 2010 and take action on June 15 and June 22, 2010.

ENVIRONMENTAL REVIEW

The Draft Environmental Impact Report (EIR) 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 that ended on April 19, 2010. The City Council is scheduled to consider certification of the EIR on June 15, 2010.

Justin Murphy
Development Services Manager

William L. McClure
City Attorney

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_jac.htm On April 9, 2010, the City mailed a postcard to all postal customers and property owners in Menlo Park announcing the future meeting dates, including the May 11, 2010 Council meeting.

ATTACHMENTS

- A. [Cushman & Wakefield Sensitivity Analysis, dated May 6, 2010](#)