MEMORANDUM
DEPARTMENT OF FACILITY SERVICES
COUNTY OF PLACER

TO: Honorable Board of Supervisors **DATE:** March 11, 2014

FROM: MD Mary Dietrich, Facility Services Director
By: Laurie Morse, Property Manager

SUBJECT: Placer County Government Center – Costco Wholesale Corporation and Conkey Real Estate Development, LLC Negotiations

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ACTION REQUESTED:

1. Approve the proposed key business and financial terms for the Option to Ground Lease and Ground Lease between the County of Placer and Costco Wholesale Corporation, a Washington Corporation;
2. Authorize the Director of Facility Services or designee to execute the Real Estate Lease Services and Property Development Agreement between the County of Placer and Conkey Real Estate Development, LLC; at a cost not to exceed $937,500 in net County cost;
3. Authorize the Director of Facility Services or designee to execute the Site Access and Negotiating Agreement between the County and Costco Wholesale Corporation, a Washington Corporation.

BACKGROUND:

Over its 70 year history, the Dewitt Center (now referred to as the Placer County Government Center) (PCGC) has served Federal, State and County needs and has functioned as an economic driver for government, employment and local businesses. The DeWitt Center was originally constructed in 1943 during World War II to receive medical casualties from overseas and to provide treatment to patients from military bases in the region. The complex was built in a little less than 1 year and originally comprised more than 750,000 square feet of buildings on 220 acres. This chapter was short lived as the Hospital was declared surplus by the War Assets Administration and officially closed in December 1945.

Thereafter, the Dewitt Center was purchased by the State of California in June 1946 for use as a mental institution. During its 26 years of operation, this institution was the economic anchor for the Auburn community as the area's largest industry and employer. The State's announcement of the pending closure of the facility in 1971 triggered a campaign to save the Center as well as the County's evaluation of opportunities to re-utilize the complex. Through this evaluation, the County determined that the Center held great opportunity for the furtherance of its own facility needs; however it was evident that to operate and maintain the large complex, at the least cost to taxpayers, a plan for use of the surplus buildings by both public and private users was necessary. In 1972, the County accepted the deed which contained a limitation on use of the property for public purpose, but immediately began pursing legislation to eliminate that restriction. The County was successful in that effort, and in 1978 Assembly Bill 1943 was approved by the Governor which removed the restriction in exchange for a quitclaim deed back to the State of 18 acres of land which were subsequently sold for private development.

Over its 40 years of ownership, the County has maintained its leasing program taking into consideration opportunities to provide space for private, public, and non-profit organizations and even leasing for no rent when the use was considered beneficial to the community and when there were no other opportunities for a higher and better use. Revenue from these leases has contributed significantly to the on-going maintenance, operations and improvements of roads, parking lots, buildings, and common areas. However, staff believes that these leased facilities have exceeded their useful life since the cost to upgrade these obsolete buildings to meet current codes and regulations (building, plumbing, fire, electrical, lead/asbestos abatement, and Americans with Disabilities Act) far exceeds the potential return from leasing.

In December 2003, your Board certified the DeWitt Government Center Facility Plan Environmental Impact Report (EIR) which led to the construction of the Community Development Resource Building, the Auburn Justice Center, and two shelter facilities. As one of the stated objectives of the project was to remove aged, outdated and potentially hazardous building inventory from the complex, the EIR also provided for the demolition of the original 1943 vintage buildings. To date, more than 325,000 square feet of buildings have been demolished to make way for new construction and opportunities to redevelop the PCGC. In the meantime, the County also secured Home Depot as a ground lease tenant at the PCGC. The Home Depot Ground Lease was entered into October 2006 and since opening in 2009, it has generated significant revenue for the County and provided good jobs to the community, all at minimal cost for property management, maintenance and utility expenses as compared to managing and maintaining the existing leased building inventory.

To begin the process to consider further options for the PCGC, in July 2011, staff presented to your Board a report on the County's Comprehensive Facilities Master Plan which was originally prepared in 1993. This presentation outlined efforts to project County space needs into the future and identified the holding capacity of County owned properties. As a result of this analysis, staff identified that the PCGC had sufficient development capacity through at least 2035 for County operations. This evaluation also identified additional capacity for private commercial development in the vicinity of Willow Creek Drive and First Street near Home Depot.

COSTCO DEVELOPMENT OPPORTUNITY:

In November 2011, staff reported to your Board that the County had received an unsolicited request from Conkey Real Estate Development LLC (Conkey) to develop a Costco Warehouse store on approximately 16 acres of PCGC property (Commercial Development Area – See Exhibit A). Costco has a good reputation of being highly profitable, well capitalized, credit worthy, and a leader in retail sales. Notwithstanding, revenues from rents, sales tax and in-lieu property taxes, Costco brings additional economic benefits from the 165-170 estimated new jobs to the local economy. Costco is recognized for its commitment to providing a living wage with health benefits. In recognition of these benefits, your Board agreed to pursue the feasibility of this opportunity. Consequently, your Board authorized staff to enter into an Exclusive Right to Negotiate Agreement (ERNA) with Conkey to allow time for Conkey to perform investigations, determine project feasibility, and negotiate terms for the lease of the PCGC property.

In December 2012, staff provided your Board with a progress report on the ERNA. Staff indicated that it had numerous meetings with Conkey to discuss infrastructure capacity, site development constraints, potential impacts to the PCGC, and the basic framework for transactional documents. Staff also reported that Conkey had requested approval to proceed at his own risk to initiate entitlement applications to the Community Development Resource Agency (CDRA) in advance of your Board's approval of material terms. Subsequently on June 25, 2013, Conkey submitted a Predevelopment Application to CDRA. This submittal revised the original site plan by shifting from the land south of Willow Creek to a site encompassing more land on the west side of First Street (Proposed Costco Project Area – See Exhibit B). On October 7, 2013, Conkey submitted an Initial Project Application and Environmental Questionnaire on behalf of Costco to initiate the environmental review process and negotiated a three party agreement for preparation of an EIR.

To date, Conkey and Costco have performed feasibility analyses, met with various staff and entities to determine costs and constraints to locating a Costco Warehouse store at the PCGC. Conkey has actively negotiated key financial terms with Costco for an Option to Ground Lease (Option) and Ground Lease (Ground Lease) with Costco. Today, staff is seeking your Board's approval of the following key financial terms and direction to proceed with negotiations of material terms for an Option and Ground Lease.

FINANCIAL TERMS:

Option and Ground Lease Key Business and Financial Terms:
The following terms being recommended are consistent with your Board's direction and policy to negotiate an Option and Ground Lease which is market based and consistent with private sector leasing practices. The terms also provide consideration to the County for other impacts and issues from the proposed Costco project.

1. **Option Term:** 30 months with two 6 month options to extend.

2. **Lease Term:** 20 years with three 10 year options to extend.

3. **Base Rent:** Costco to pay $325,000 annually with 10% rent escalations every 10 years.

   A May 2012 appraisal of the PCGC property indicated a fee value of $4,880,000 for unentitled land. To convert this to an annual rental rate, the appraiser applied a 9% rate of return yielding an annual rent of $440,000. While the appraisal provided a good starting point, typical private sector transactions take into consideration other factors before establishing the agreed-upon rent. The type and quality of the tenant (including creditworthiness/financial capability, anchor tenant creating demand and increased land values for surrounding properties, value of improvements being constructed, current interest rate, other considerations such as escalations, off-site improvements, and other lease terms) merit adjustments in the ultimate rate of return. It was also noted that ground leases are highly uncommon making it difficult to identify comparable deals. Staff has substantiated that a lower rate of return is appropriate for this particular transaction. As a result, the negotiated rental rate is $325,000 annually yielding a rate of return on the property value at 6.7%.

4. **Rent Commencement:** Rent shall commence the earlier of one year after the Effective Date of the Lease or when Costco opens for business. After such date, the full Base Rent in effect at the time shall be due and payable.

5. **Extraordinary Costs Rental Credit:** Costco to receive a $1,000,000 credit applied in $100,000 annual increments over the first ten years of the lease.

   Similar to the Home Depot Ground Lease where the rent was adjusted by approximately $1.4 million based upon extraordinary costs for retaining walls, grading, and off-site improvements, Costco would receive this credit for above-and-beyond development costs (e.g., remove and relocate internal PCGC utilities including the main water loop, construct infrastructure due to inadequate water pressure to meet fire flow requirements, encase canal, construct retaining walls due to grade differentials, and construct roadway improvements). Several of these improvements will provide later benefits to the County as it develops surrounding lands for government and commercial purposes.

6. **Demolition and Hazardous Materials Remediation Costs Rent Credit:** Costco to receive a rent credit equal to Costco's actual costs to demolish buildings and remediate any hazardous materials on behalf of the County. The County reserves its rights to perform a portion or all of the demolition and environmental remediation during the Option Term if deemed advantageous by the County.

7. **Additional Rent Due to County Operations Impacts:** On Ground Lease commencement, Costco to pay $650,000 as additional rent as compensation for the value of existing improvements being impacted by the Costco project.

   While the cost to relocate these operations will be higher, it is an opportunity for the County to move impacted operations from deficient buildings and to address programmatic requirements. Staff is working with affected departments to program, plan for their move and address future growth and program needs.

8. **Senior Center Contribution:** As consideration for the Option to Ground Lease, no later than upon execution of the Option to Ground Lease, Costco shall pay consideration for an approximate 8,000 square foot building for relocation of the Multi-Purpose Senior Center, Inc. The parties shall collectively identify a suitable location for this facility and assist in negotiating the terms for a lease. Costco shall pay the consideration for a minimum period of five (5) years and provide a tenant improvement allowance in an amount not to exceed $200,000. County estimates these total contribution costs not to exceed $530,000 total. If Costco fails to enter into its Option to Ground Lease or is unable to exercise the Ground Lease, then the County shall reimburse Costco for the consideration and tenant improvements allowance.

CONKEY - REAL ESTATE LEASE SERVICES AND DEVELOPMENT AGREEMENT:
Key to continuing negotiations with Costco is your Board's approval of the proposed Real Estate Lease Services and Development Agreement (Development Agreement) with Conkey. This Development Agreement is needed to end Conkey's intermediary role in the negotiations and ground lease arrangement. This structural change in the negotiations will eliminate any delay due to third party negotiations and potential inconsistencies in lease terms.

When the County entered into the ERNA with Conkey, it was anticipated that Conkey would enter into an Option to Ground Lease and Ground Lease with the County and perform the environmental and entitlement processes for a Costco Warehouse store. Conkey would lease the bare ground from the County at its unentitled value and sublease its leasehold interest to Costco at an entitled value. Originally, it was believed that this would attract Costco to locate a store in Auburn by avoiding its initial investment of time and money to secure the environmental clearances and entitlements. As the project has progressed, Costco has expressed its need to play an active role in the environmental and entitlement process in order to manage timelines, expenses and potential project impacts and mitigations. Therefore, Conkey and the County have agreed that it would be most beneficial to the project if Conkey's intermediary role in the negotiations and the future Ground Lease was eliminated.

Staff believes that Conkey contributed significant value to the County as a result of his role to date and is due compensation for facilitating the Costco transaction. At Conkey's own risk and expense, Conkey:

- Secured Costco's commitment to pursue development at PCGC by taking a leadership role to market and foster a relationship with key Costco representatives;
- Paid the County consideration for the Exclusive Right to Negotiate;
- Performed critical due diligence activities that verified the suitability of the site for a Costco Warehouse Club store;

- Addressed critical development issues including water pressure, building demolition and relocation;
- Negotiated a cost-effective environmental review process with the environmental consultant and the Community Development and Resource Agency;
- Negotiated business points for the Option and Ground Lease presented to your Board today;
- Provided valuable assistance by addressing industry and development related questions as needed and requested by County.

Upon your Board's approval of the Development Agreement, Conkey will be compensated $150,000 for his efforts to date including facilitating the approval of the proposed Site Access and Negotiating Rights Agreement (SANA) between the County and Costco (discussed below). The SANA provides assurances and a specific timeline wherein both County and Costco will negotiate on an exclusive basis. Costco also commits that it will not negotiate with any other party for property within a 5-mile radius of the proposed site at the PCGC.

Additional payments to Conkey are conditioned upon specific performance milestones (e.g., execution of an Option and Ground Lease, receipt of entitlements, project approvals and building permits, Ground Lease execution, and store opening). This approach acknowledges that accomplishment of each milestone brings the County greater certainty towards the ultimate Costco store opening. It also recognizes the increase in land value as a result of environmental approval and entitlements. Should Costco not exercise its Ground Lease after receipt of project entitlements and building permits, the County could market and lease the land at an entitled value which brings a significant premium particularly to a like retailer. The economic returns to the County (rents, taxes, jobs, fees paid) are acknowledged within the milestone and compensation structure. Exhibit C provides the key performance milestones, compensation and anticipated timing for payment. If any of the milestones are not achieved, Conkey will not receive payment for that milestone or any successive milestones. County Counsel and Risk Management have reviewed the proposed Agreement and find it acceptable. Conkey has approved and executed this Agreement. Staff therefore recommends your Board's approval of the proposed Development Agreement.

COSTCO - SITE ACCESS AND NEGOTIATING AGREEMENT:
As mentioned above, the initial payment to Conkey is contingent upon the execution of a Site Access and Negotiating Agreement (SANA) with Costco. The term of the SANA is 4 months with one 4 month option to extend. Your Board's approval of the proposed SANA is necessary to memorialize the relationship between the Costco and the County, the assurance that neither party is negotiating with another party within a 5 mile radius of the PCGC, and each party's commitment to negotiate the Option and Ground Lease. The SANA can be terminated by either party; however, in such event Costco must provide the County with copies of reports or studies related to the physical condition of the PCGC site. These studies will have value to the County as it considers other opportunities for development at the PCGC. The SANA has been reviewed and approved as to terms by County Counsel and Risk Management and staff recommends your approval of this Agreement. Costco has approved and executed the SANA.

OTHER CONSIDERATIONS:
The proposed Costco project will impact 10 private tenants. In June 2013, Property Management notified the private tenants of the status of the Costco project and informed them that their occupancy could not continue beyond December 2014. In recognition that the need to relocate will not commence until after the Option and Ground Lease are negotiated, staff intends to notify tenants of the timelines which may provide additional time to tenants that need to secure alternative facilities. Some tenants intend to move as early as this summer due to operational reasons. All current leases are set to expire by February 2015 or are on month-to-month status. Staff recognizes the difficulty and challenges associated with finding alternative locations and will continue to support these tenants by making suggestions and introductions to local brokers. Some of the tenants have already initiated efforts to find alternative locations. Staff has also outreached to non-profits that receive free

community storage and one has already moved, and the other two are prepared to move when they receive a more definitive timeline. Should tenants desire to relocate earlier than their lease provides, Property Management will allow leases to terminate early and will waive last month's rent to help offset moving costs.

CONCLUSION:

Upon your Board's approval of the Agreements described in this Memorandum, staff will continue negotiations with Costco for an Option to Ground Lease and Ground Lease for your approval. These documents will contain all of the terms of the transaction including provisions such as failure to construct, open or operate, exclusivity, etc. As with the Home Depot agreement, Costco will have the obligation to maintain the lease premises, pay all utility costs and pay all real property, possessory taxes, and personal property taxes. Staff anticipates returning to your Board with the complete Option to Ground Lease and Ground Lease prior to expiration of the SANA.

ENVIRONMENTAL CLEARANCE:

The action to approve the Development Agreement is not a Project as defined in the California Environmental Quality Act (CEQA) Guidelines Section 15378 (a) and therefore is not subject to CEQA. The action to approve the SANA is Categorically Exempt from CEQA pursuant to Section 15306 - Information Collection which exempts basic data collection, research, and resource evaluation activities leading to an action which a public agency has not yet approved. The proposed Costco Project will undergo an independent environmental review pursuant to CEQA and CDRA's processes.

FISCAL IMPACT:

The total proposed Development Agreement fee is $937,500, with $150,000 payable immediately upon execution by the County of the SANA and the Development Agreement. This first milestone payment is available in the Capital Projects Fund Project No. 4910 – Development Projects. The remaining amounts will be budgeted to coincide with the timing of subsequent milestone payments.

Revenues from the Costco project are projected to exceed $20.5 million over the initial 20-year lease term. These revenues include rents, sales tax, and in-lieu property taxes, and are net of the costs associated with replacement of impacted County facilities, rent from existing PCGC private tenants, fees paid pursuant to the Developer Agreement, and the Costco rent credits. Revenues are expected to exceed $87 million over the 50-year term should all options be exercised by Costco.

Attachments: Exhibit A –Commercial Development Area
Exhibit B – Proposed Costco Project Area
Exhibit C - Performance Milestones and Payment Real Estate Lease Services and Property Development Agreement

Cc: County Executive

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EXHIBIT A

COMMERCIAL DEVELOPMENT AREA

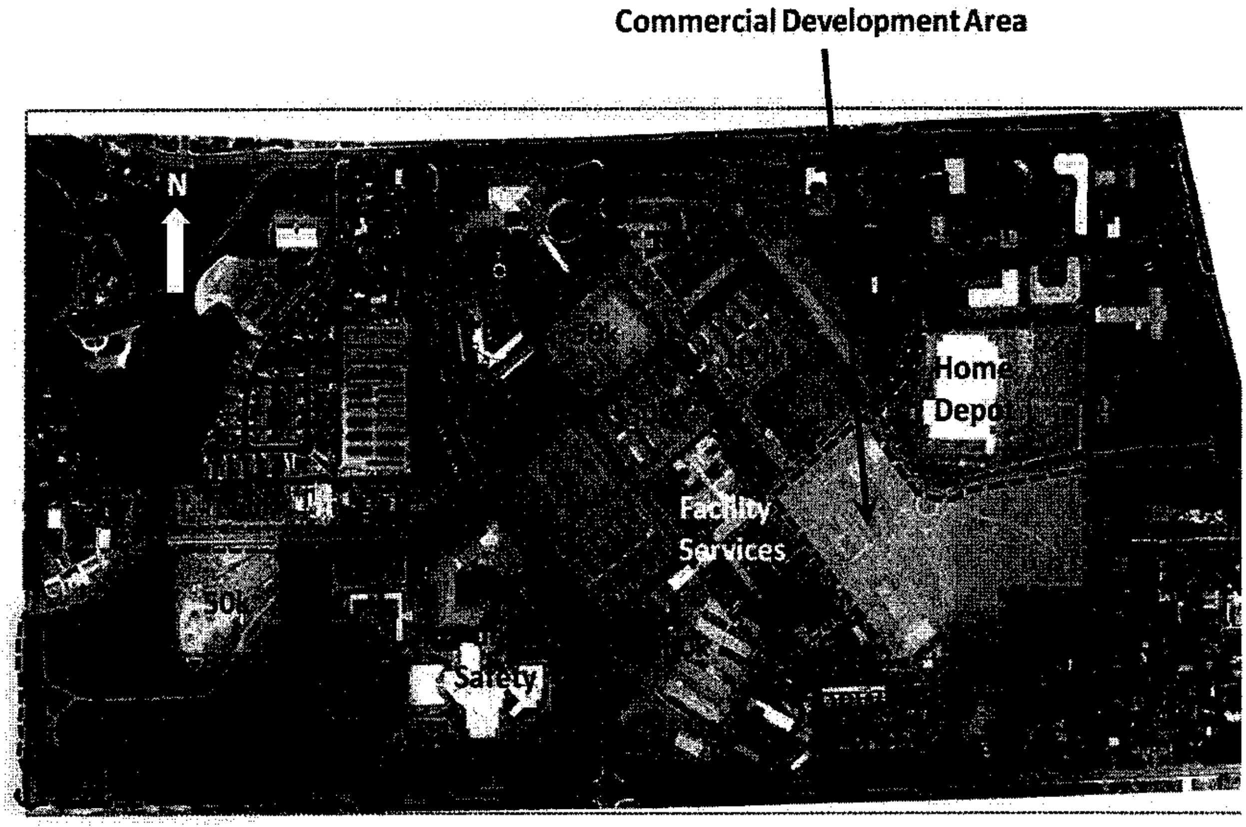
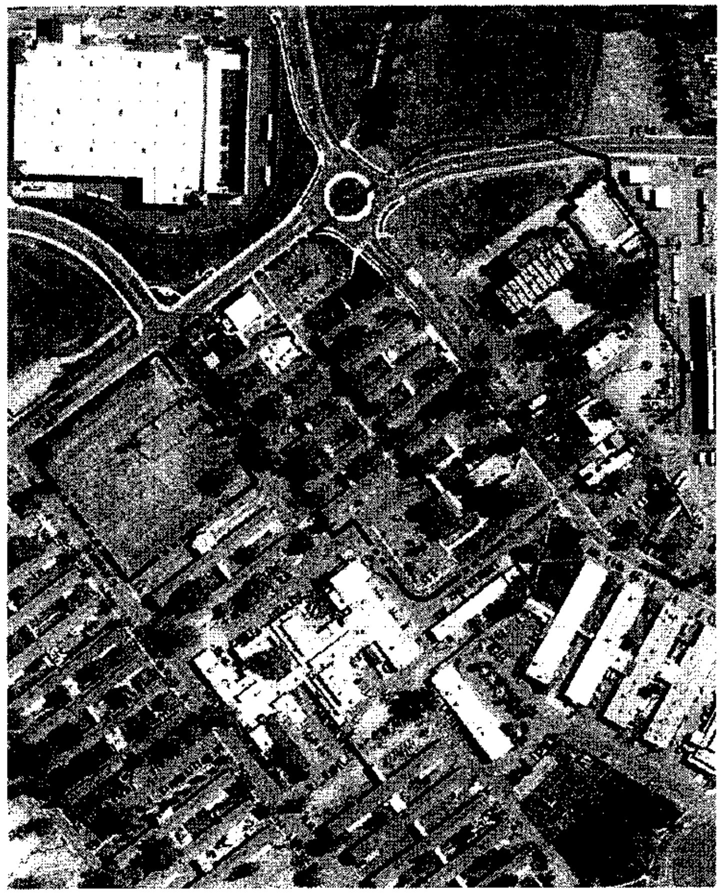


EXHIBIT B

PROPOSED COSTCO PROJECT AREA



Auburn Concept Site Plan 5.4 Bound

EXHIBIT C

Performance Milestones and Payment
Real Estate Lease Services and Property Development Agreement
between the County of Placer and Conkey Real Estate Development, LLC

PERFORMANCE MILESTONE		AMOUNT OF PAYMENT	EXPECTED PAYMENT TIMELINE
1	Execution of the Development Agreement and Site Access and Negotiating Agreement.	$150,000	February 2014
2	Execution of Option to Ground Lease with the County.	$225,000	Fall 2014
3	Approval of entitlements and environmental review for the Costco Warehouse Store and all litigation and appeal periods has passed.	$250,000	Fall 2015 – Spring 2016 12-18 months from execution of option
4	Issuance of a Building Permit for the project and exercise by Costco of the Ground Lease.	$237,500	Fall 2016. 2 years from execution of option
5	Costco Warehouse Store opening.	$75,000	Spring/Summer 2017 6 months to one year from exercise of Ground Lease
	TOTAL	$937,500	