

VII. STANDING COMMITTEES

B. Finance and Audit Committee

In Joint Session With

C. Capital Assets Committee

South Lake Union Phase II Option - ApprovalRECOMMENDED ACTION:

The administration, the Finance and Audit and Capital Assets Committees recommend that the Board of Regents:

1. Delegate to the President or the President's authorized representative the authority to execute the contracts and other documents necessary to implement Phase II of the transaction that has been negotiated by representatives of City Investors LLC, City Investors XII LLC, Washington Biomedical Research Properties-II (WBRP-II), and the University of Washington for the development of new research and administrative office space in South Lake Union, including:
 - a. a consent to the assignment of the Phase II Option from the University and WBRP-I to WBRP-II;
 - b. a consent to the exercise of the Phase II Option by WBRP-II;
 - c. execution of a long-term occupancy lease or leases for the Phase II research and office buildings and approval of a project budget of \$169,605,000 which includes all project costs including service and consulting fees, and a projected cost of \$7,500,000 for furniture, fixtures and equipment to be financed either as part of the building project by WBRP-II or separately by the University; and
 - d. any other approvals, contracts or documents necessary to implement the transaction and to enable WBRP-II to exercise the Phase II Option not later than April 30, 2005, its expiration date.

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2. Delegate to the Executive Vice President or his designee the authority to:
 - a. execute an agreement to reimburse funds to be advanced by WBRP-II for continuing design services until such time as interim financing is in place to the extent that the cost of such services exceeds the amount already included in the Phase I project budget; provided, however, that the amount to be reimbursed shall not exceed \$500,000 and shall be repaid out of any interim financing and shall be part of the overall project costs outlined in 1(c) above;
 - b. approve an increase in the project budget, if needed to meet programmatic requirements, by up to \$7,500,000 for sales tax, additional tenant improvements, and furniture, fixtures, & equipment beyond the level established in the project budget.

BACKGROUND:

At the April 17, 2003 Regents meeting, the Board approved proceeding with development of new biomedical research space in South Lake Union, beginning with renovation of the Blue Flame Building as Phase I. The Board also approved a Phase II Option Agreement, held jointly by the University and Washington Biomedical Research Properties-I (WBRP-I), a Washington non-profit organization managed by the National Development Council (NDC), which would enable the University to expand into additional buildings to be constructed on the remainder of the block adjoining the Blue Flame Building, and a Phase III Option Agreement which provides for additional expansion on an adjoining block, if growth in demand and research funding warranted such expansions. The Phase II Option expires on April 30, 2005.

The Blue Flame Building was completed in December 2004, and is now occupied by School of Medicine research programs in biomedicine and related fields.

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There is demand for additional space supported by increased research funding. This demand cannot be met on campus and the facilities contemplated by the Phase II Option Agreement will be required to meet that demand. The Phase II Option will be assigned to WBRP-II, (another Washington non-profit organization managed by NDC).

Phase II will consist of approximately 300,000 gross square feet of new construction to provide space for office and laboratory uses and a below-grade facility to provide parking for the Phase II buildings as well as for the Blue Flame Building.

Lease and Financing Terms

In 2003 the state legislature granted the University authority to enter into long-term financing leases. The Blue Flame Building lease was undertaken pursuant to this grant of authority and the Phase II transaction mirrors the structure utilized in Phase I including long term occupancy leases for the buildings to be developed on the Phase II property. The transaction structure also includes a long-term ground lease between City Investors XII LLC, the land owner, and WBRP-II. The development will be undertaken by WBRP-II, utilizing a fee-based development services agreement with City Investors LLC, who will serve as development services manager. As with Phase I, a consultant will be hired by WBRP-II to independently monitor the construction schedule and budget.

The forms of the Phase II Ground Lease and the Development Services Agreement were agreed upon as part of the Phase I negotiations. The terms of these agreements are respectively summarized in the attached Exhibit 1. Exercise of the Phase II Option by WBRP-II will commit it to cause the development to be completed, to enter into the Ground Lease and the Development Services Agreement, which it will do only when the University has executed the Building lease(s).

Completion of the Phase II buildings is expected in December 2007. The overall project budget including the land is projected to be \$169,605,000 including all

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fees. Sources of capital funding are anticipated to include debt financing and up to \$23,000,000 in donor or other University funds, as summarized in the attached Exhibit 2.

Interim and permanent financing will be provided, as was the case for Phase I. Interim financing to WBRP-II will be by a lender to be competitively selected on the best available terms upon project commencement, and will remain in place until permanent “take out” financing is secured through tax-exempt bonds issued by a conduit such as the Washington Economic Development Finance Authority (WEDFA), which issued the bonds for Phase I, or another competitively selected conduit on behalf of WBRP-II. This conduit financing is necessary in order to obtain tax-exempt funds, thereby lowering the University’s lease costs. Bond issuance is expected to occur in late 2006 or early 2007.

The University will lease the buildings from WBRP-II through absolute net financing leases, the form of which were agreed to as part of the Phase I negotiations, with an initial term of 35 years, and a 10 year renewal option, that coincides with the underlying ground lease term. A summary of the building lease terms is attached as Exhibit 3.

Furniture, fixtures, equipment and other personal property for use by the University in the buildings will be acquired either directly by the University or by WBRP-II either through a tax-exempt financing lease mechanism or as part of the Building lease(s) for a term not to exceed 15 years. The lender to finance such property will be competitively selected based on lowest overall cost.

A summary of the anticipated Phase II occupancy costs, including associated personal property debt service, is attached as Exhibit 4.

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In order to secure the most cost effective bond rates, and as was the case for Phase 1, the lease will obligate the University to make payments from legally available, non-appropriated local funds that is a broader revenue pool than the School of Medicine revenues which are directly responsible for those payments.

Exercise of the Option for Phase II has been approved by the Vice President for Medical Affairs, the Executive Vice President and the Director of Real Estate. The financing and funding plans have been reviewed and approved by the Vice President for Medical Affairs and the Vice Provost for Planning & Budgeting. The University's financial adviser, real estate counsel and bond counsel reviewed and approved all transaction documents in form as part of the Phase I. project.

ENCLOSURES:

- Exhibit 1: Phase II Ground Lease and Development Services Agreement
- Exhibit 2: Phase II Summary of Projected Sources and Uses of Funds
- Exhibit 3: Phase II Building Occupancy Lease
- Exhibit 4: Phase II Summary of Projected Occupancy Costs (23M Equity)

EXHIBIT 1
Phase II Ground Lease and Development Services Agreement

Ground Lease

Ground Lessor City Investors XII LLC

Ground Lessee WBRP-II

Term Initial Term: 35 years plus time from rent commencement until issuance of the first Certificate of Occupancy (COO)
Commencement: Effective retroactive to January 1, 2005
Extension: Option to extend for additional 10 years

Land Value Agreed to be \$13,605,000

Rent

- 6% of land value (annual rate) from January 1, 2005 until issuance of first temporary certificate of occupancy (TCCO).
- 9% of land value (annual rate) upon issuance of the TCCO January 2004 through December 2009.
- On January 1, 2010 and every fifth year, rent is increased by greater of cumulative CPI or cumulative 3% annual increase
- Every tenth year there is an adjustment to market value/ground rent

EXHIBIT 1 cont.

Development Services Agreement

Development Service Contractor City Investors LLC

“Owner” WBRP-II

- Scope of Work
- Provide and/or manage all necessary services to secure permits and design and construct the improvements (including garage) and tenant improvements through completion of the Phase II project.
 - Engage architects, consultants and contractors on behalf of WBRP-II (direct contracts will be with WBRP-II)
 - Work with WBRP-II and UW in fiduciary capacity to assure timely and cost effective delivery of quality improvements consistent with the agreed plans and specifications .
 - Negotiate Guaranteed Maximum Price (GMP) contract with contractor for shell and core work (and possibly some or all of tenant improvement work).
- Compensation
- Market based fee only (3.25% of defined direct costs)
 - Vulcan is NOT a developer for profit in this transaction.
- Oversight
- Construction/Development Management oversight will be provided by an independent CM firm, as approved by WBRP-II
- Major Contracts (Probable)
- Design Services: MBT Architects
 - Construction: Turner Construction

EXHIBIT 2

Phase 1 Summary of Projected Sources and Uses of Funds

| Project Costs - Uses of Funds | | |
|-------------------------------|------------|----------------------|
| Total Development Cost | Notes 1, 9 | \$148,500,000 |
| FF&E | Note 2 | \$7,500,000 |
| Land | Note 3 | \$13,605,000 |
| Total | | \$169,605,000 |

| Sources of Funds | | |
|---------------------------------|--------|----------------------|
| Equity | Note 4 | \$23,000,000 |
| Long Term Tax Exempt Bond Debt | Note 5 | \$100,400,000 |
| Short Term Tax Exempt Bond Debt | Note 6 | \$25,100,000 |
| Personal Property Financing | Note 7 | \$7,500,000 |
| Land | Note 8 | \$13,605,000 |
| Total | | \$169,605,000 |

Notes

- 1 Includes ALL hard and soft,direct and indirect costs, including garage to serve both Phase I and Phase II
- 2 Furniture fixtures and equipment for tenant use
- 3 Land is not a true cost - but is a "value" in project - set by ground lease
- 4 Donations directly to 501c3 or UW or other UW funds
- 5 30 Year Term - For 80% of project costs
- 6 15 Year Term - For 20% of project costs
- 7 10 Year Term fully amortizing
- 8 Rent for land is via ground lease
- 9 Total includes fees of approx. \$16. 5M including design, finance, development services, construction management, asset management (WBRP-II), legal etc. of which \$950,000 (less a credit for retainer payments) is a contingent real estate and consulting fee to Washington Advisory Group negotiated as part of the original engagement. All fees will be paid by WBRP-II as part of project costs and will be funded through project debt.

EXHIBIT 4
Phase II Summary of Projected Occupancy Costs (23M Equity)
\$ in thousands except \$/sf costs

| <u>Annual Cost</u> | Note | Years 1-2 <u>2008-2009</u> | Years 3-7 <u>2010-2014</u> | Years 8-12 <u>2015-2019</u> | Years 13-17 <u>2020-2024</u> | Years 18-22 <u>2025-2029</u> | Years 23-27 <u>2030-2034</u> | Years 28-32 <u>2035-2039</u> | Years 33-35 <u>2040-2042</u> |
|-------------------------------------|------|-------------------------------|-------------------------------|--------------------------------|---------------------------------|---------------------------------|---------------------------------|---------------------------------|---------------------------------|
| Current Base Rent | 1 | \$11,188 | \$11,383 | \$11,609 | \$11,871 | \$9,505 | \$9,858 | \$7,348 | \$3,445 |
| Future TI Replacement | 2 | \$0 | \$0 | \$0 | \$0 | \$223 | \$223 | \$223 | \$223 |
| Net Charges | 3 | \$3,900 | \$4,524 | \$5,248 | \$6,087 | \$7,061 | \$8,191 | \$9,502 | \$11,022 |
| Personal Property Amortization | 4 | <u>\$1,043</u> | <u>\$1,043</u> | <u>\$782</u> | <u>\$782</u> | <u>\$782</u> | <u>\$782</u> | <u>\$782</u> | <u>\$782</u> |
| Total Annual Occupancy Costs | | \$16,131 | \$16,950 | \$17,639 | \$18,741 | \$17,573 | \$19,055 | \$17,856 | \$15,473 |
| \$/sq ft - all occupancy costs | | \$54 | \$57 | \$59 | \$62 | \$59 | \$64 | \$60 | \$52 |
| \$/sq ft - base rent only NNN | | \$37 | \$38 | \$39 | \$40 | \$32 | \$33 | \$24 | \$11 |

Notes:

- 1 Base rent decreases when initial debt is retired (2 tranches)
- 2 Assumes \$70/SF after 15 years
- 3 Net charges starting at \$13/SF
- 4 Assumes Replacement of 75% of initial FFE every 10 years