



THE CITY OF SAN DIEGO

OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

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Item Number: S500

101 Ash Street Building Decisions on Bid Award

OVERVIEW

On June 18, 2018, the City Council received its first comprehensive update from staff on the status of the 101 Ash Street project and approved additional CIP appropriations that were necessary given the changes made to the project scope, schedule and increased costs. Four potential scenarios were presented to the Council on how to move forward; the Infrastructure Committee on May 23, 2018 had agreed with staff's recommendation of Scenario 3 and Scenario 4:

- 1) Move City staff into the building as-is; or
- 2) Make improvements to only the first floor so that it could serve as a 'one-stop shop' for the Development Services Department; or
- 3) Make tenant improvements to the bottom two and top three floors of the building, as was originally contemplated when the City took possession of the building; or
- 4) Make tenant improvements to the entire building to maximize the number of personnel that could be moved into the building.

At the June 18 meeting, Council concurred with the Infrastructure Committee to have staff issue a new RFP for tenant improvements at 101 Ash, that does not include a 24/7 work schedule and that requests bids on two potential scopes of work – a base scope of work with improvements to five floors of the building (Scenario 3), and an alternate scope of work that includes improvements to all 19 floors (Scenario 4). Given that project costs for both Scenario 3 and Scenario 4 were expected to require at least \$18.0 million, our Office recommended approving the proposed \$13.2 million CIP appropriation adjustment to be added together with the original tenant allowance of \$5.0 million that was already appropriated.

Since that time, responses to the RFP have been received and bids have been evaluated to identify the lowest responsive bidder. On August 7, 2018, Council will be asked to determine which scope of work to award given the bid results: the base scope with improvements to five floors or the alternate scope for all 19 floors. A third option is also provided to cancel the bid and begin moving employees into the building as soon as possible.

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This report includes a discussion of the three potential options for going forward that are included in the staff report. In addition, we review the proposed financing plan for the Development Services Department’s portion of tenant improvement costs and any implications to the not-to-exceed Development Services User Fee rates increases that were approved in June 2018.

FISCAL AND POLICY DISCUSSION

Updated Project Costs

Following the May 23, 2018 Infrastructure Committee meeting, staff released a new Request for Proposals which required both a base bid for improvements to five floors and an alternate bid for all 19 floors. Three responses were received and the respondent with the lowest responsive bid, as determined by the Public Works Department, was West Coast General Company. The bids for construction received from the winning respondent included \$12.4 million to improve five floors and \$17.1 million for improvements to all 19 floors. When including costs for design, information technology, furniture, project contingency and other costs estimated by the Public Works Department, total capital costs are projected to be \$19.5 million and \$25.9 million for the five floor and 19 floor options, respectively. These costs are detailed in Table 1 below and are compared against the projected capital costs from February 2018 that totaled \$31.4 million, and were based on a 24/7 work schedule for improvements to all 19 floors.

The updated capital costs estimate, including the winning construction bid received under the new RFP, represents a reduction of \$5.5 million from the February RFP results when comparing a like-for-like scope of work (19 floors). When including estimates for financing costs for DSD’s portion of improvements and moving expenses, the projected total all-in total costs for improving all 19 floors is approximately \$7.9 million less than the February 2018 estimate.

Table 1 – 101 Ash Project Improvement Costs

	FEBRUARY 2018		AUGUST 2018	
	19 Floors		5 Floors	19 Floors
CAPITAL COSTS				
Construction	\$ 22,179,500	\$ 12,372,696	\$ 17,080,261	
Design	664,650	867,888	832,888	
IT Costs	275,304	993,254	993,254	
Furniture	2,567,870	1,609,614	2,567,870	
Soft Costs	2,012,136	1,256,870	1,508,790	
Asbestos Monitoring & Mitigation	708,453	111,776	256,428	
Other Costs	114,128	537,154	288,154	
Project Contingency (10%)	2,852,204	1,774,925	2,352,765	
Total Capital Costs	\$ 31,374,245	\$ 19,524,178	\$ 25,880,410	
OPERATING COSTS				
Financing Costs	3,582,641	2,503,210	2,730,774	
Moving Expenses ⁽¹⁾	3,021,920	1,510,960	1,510,960	
TOTAL COSTS	\$ 37,978,806	\$ 23,538,348	\$ 30,122,144	

(1) February 2018 estimate for moving expenses assumed \$10/square foot; August 2018 estimate assumes \$5/square foot.

Options for City Council Consideration

In addition to the two alternative scopes of work discussed above – the base scope with improvements to five floors or the alternate scope for all 19 floors – a third option is also provided to cancel the bid and begin moving employees into the building as soon as possible. The options as identified in the staff report and the associated capital costs are as follows:

- 1) Option A: Move City staff into the building as-is - *\$2.8 million*; or
- 2) Option B: Make tenant improvements to the bottom two and top three floors of the building (previously presented as Scenario 3) - *\$19.5 million*; or
- 3) Option C: Make tenant improvements to the entire building (previously presented as Scenario 4) - *\$25.9 million*.

The capital costs associated with Option A total \$2.8 million and, according to staff, represent the bare minimum cost necessary to move a maximum capacity of 801 employees into the building immediately. This primarily consists of \$1.3 million in existing contracts and other costs that have been incurred to date. The balance is mainly attributed to building access control updates and IT improvements that would be required under all three options. We note that this cost would be more than fully funded by the original \$5 million allowance for tenant improvements that was included in the 2016 lease. However, if this option is chosen, one of the primary objectives of having this building include a one-stop location for DSD permitting would not be realized and additional space for 493 employees would need to be found elsewhere.

The difference in total capital costs to improve all 19 floors under Option C is approximately \$6.4 million more compared to Option B. If this Option is chosen, it is assumed that 202 more employees will be able to occupy the building (955 employees for Option B and 1,157 employees for Option C).

The staff report notes that over 20 years, Option B would be expected to save \$1.1 million over not occupying 101 Ash and instead incurring the cost of using entirely leased outside space over the future 20 year period; Option C would be expected to save \$43.0 million, a difference of \$41.9 million. This analysis (attachment 3 to the staff report) is based on staff's assumption that outside lease rates will start at \$3.00 per sq ft per month, which is significantly higher than the \$1.70 per sq ft per month rate at 101 Ash. Including staff's expenditure projections for operating expenditures at 101 Ash adds \$0.80 per sq ft per month which increases the effective costs under the lease-to-own agreement to \$2.50 per sq ft per month.

The same analysis was conducted by staff for the June 18, 2018 meeting which estimated the difference between the 5 floor and 19 floor scenarios to be \$34.3 million. This improvement when using staff's analysis comparing the benefits of each option is a direct result from the bid for Option B coming in \$1.9 million more than projected, and Option C coming in \$3.6 million less than projected. While our Office did not fully agree with all the assumptions utilized by staff for this analysis (as we discussed in our June 14, 2018 report), we believe the results of the bids strengthens the case for Option C.

However, we would like to note that the General Fund bears the largest portion of the additional capital costs under Option C, approximately \$4.4 million. The primary reason for this is that DSD’s costs, as the other most significant occupant of the building, do not vary greatly between the two options.

Additional Funding Required for Option B and Option C

As a result of the actions taken on June 18, 2018, there is currently \$18.2 million appropriated in the 101 Ash Project CIP: \$5.0 million from the original tenant allowance, \$9.5 million in capital outlay funds, \$2.1 million in previously budgeted General Fund moving costs, and small fund balances from several departments that are expected to occupy the building.

Given that the updated capital cost estimates of \$19.5 million for Option B and \$25.9 million for Option C both exceed the current appropriation level, additional funding is required, should Option B or Option C be chosen. As illustrated in Table 2 below, after accounting for various appropriations adjustments based on space planning and project cost changes for several funds that are contributing to the CIP¹, either an additional \$2.3 million or \$7.9 million would be required depending on which option is chosen.

This additional required funding is proposed to be sourced by reallocating Tobacco Settlement Revenue Bond proceeds from the Fire-Rescue Air Operations Facility CIP to the 101 Ash Project CIP, as previously suggested by our Office. A corresponding increase to the current \$80.5 million General Fund Commercial Paper Program not-to-exceed authorization is included within this action, up to either \$83.0 million or \$88.8 million depending on the option selected by Council, in order to reallocate funding to the Fire-Rescue Air Operations Facility CIP when needed.

Table 2 – Additional Funding Need and Tobacco Bonds Reallocation

	Option B <i>(5 Floors)</i>	Option C <i>(19 Floors)</i>
Total Capital Cost	\$ 19,524,178	\$ 25,880,410
Current Appropriation	18,186,165	18,186,165
Correction from June 18 Action	(180,781)	(180,781)
Appropriation Adjustments ⁽¹⁾	(789,568)	1,554
Funding Need/Tobacco Bonds Reallocation	\$ 2,308,362	\$ 7,873,472

(1) For Option B, the appropriation adjustments include deappropriations from the IT Fund (\$217,551), Public Works Contracting (\$388,529) and Arts and Culture (\$183,488), based on space planning and cost adjustments for each department's share of improvements. For Option C, the adjustment is the net difference from an increase in funding from the IT Fund (\$149,780) and a decrease from Public Works Contracting (-\$148,226).

Financing Plan for DSD’s Portion of Improvements

Assuming either Option B or Option C is chosen, DSD will occupy the most significant amount of the 101 Ash Building after General Fund departments, including the one-stop permit center to be located on the first floor which involves the most significant amount of improvements. Given that the improvements to the first floor are to occur under either option, the Department’s costs under the reduced scope of Option B are not significantly different from Option C: DSD’s share of capital costs are \$10.8 million under Option B and \$11.5 million under Option C. After the

¹ An adjustment is also being made to correct an error in the appropriations made during the June 18, 2018 action.

Department’s \$2.0 million share of the original \$5 million allocation for tenant improvements provided under the lease, DSD’s net funding gap is \$8.8 million under Option B and \$9.6 million under Option C.

Staff is proposing an interfund loan from the Capital Outlay Fund to finance the additional amount necessary to fund DSD’s share of costs. An authorization to execute the interfund loan is included in the actions associated with this item should either Option B or Option C be chosen, which stipulates that the interest rate and the repayment term will be fixed at the time of loan execution, expected upon completion of construction. The staff report notes that the repayment term of the loan will not exceed 15 years and that the interest rate will be set such that it is equivalent to the General Fund’s current borrowing rate for the applicable borrowing term. Our office does not have concerns with these parameters. Assuming the term is set at 15 years, the corresponding interest rate would be 3.04%.

Table 3 – DSD’s Capital and Assumed Financing Costs

	Option B <i>(5 Floors)</i>	Option C <i>(19 Floors)</i>
DSD's Share of Capital Cost	\$ 10,766,375	\$ 11,576,301
DSD's Share of \$5M TI Allocation	(2,005,463)	(2,005,463)
DSD's Net Funding Gap / Financed Amount	\$ 8,760,912	\$ 9,570,838
<i>Debt Service: FY 2020</i>	376,774	411,026
<i>FY 2021-2034</i>	753,547	822,052
<i>FY 2035</i>	376,774	411,026
Total	\$ 11,303,210	\$ 12,330,774

As shown in Table 3 above, the difference in annual debt service costs between Option B and Option C is nominal when financed over 15 years, with both resulting in repayments of approximately \$400,000 in FY 2020 and \$800,000 thereafter.

DSD User Fees

On July 18, 2018, the City Council approved adjustments to DSD User Fees in part to recover costs related to the Department’s share of 101 Ash tenant improvements which were not yet known at the time Council considered the user fee increases. As such, Council approved not-to-exceed fee increases of 6% in FY 2019², up to 4.5% in FY 2020, and up to 3.5% in 2021. Given that the Department’s budget projections for their 101 Ash tenant improvements match the projected debt service discussed above (approximately \$400,000 in FY 2020 and \$800,000 thereafter) there is no change to the current assumption that the full increase will be required for both FY 2020 and FY 2021. With that said, it should be noted that other factors will play a significant role in determining these rates, which most notably includes the level of building permit/development activity. The actual rate increases will be determined as a part of the budget development process for these fiscal years.

² The full 6% increase is anticipated to go into effect in September 2018.

CONCLUSION AND RECOMENDATIONS

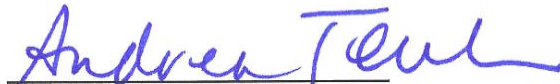
Staff is presenting three potential options moving forward: canceling the bid altogether and moving employees into 101 Ash as-is (Option A), or completing tenant improvements to either five floors (Option B) or all nineteen floors (Option C). Based on the bid results received following the June 18, 2018 City Council meeting, capital costs are estimated to be \$19.5 million for Option B and \$25.9 million for Option C. **Of the three options presented, our Office recommends Option C to move forward with improvements to all 19 floors.** As we discuss in the report, we believe the results of the bids strengthen the case for Option C. In addition, improving the entire building all at once maximizes use of space in this City owned building. It also allows the City to consolidate more employees into one building, which positively affects operational efficiencies, and provides increased budgetary certainty by reducing the need to rely on the office space rental market and being subject to lease rate fluctuations over time.

With respect to interfund loans, this would likely be the first occasion under which a City governmental fund has loaned funds to another City enterprise fund, as far as our Office is aware. While this may be a cost-effective practice, prior to any future loans we recommend consideration be given to the development of a council policy regarding interfund loans. Such policy could include guidelines on repayment terms, interest rates, and limits to both lending and borrowing amounts.

As discussed in our June 14, 2018 report, we also recommend that the Mayor's staff provide at a minimum quarterly updates to the City Council on the status of this important project.



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