REPORT TO CRA/LA BOARD OF COMMISSIONERS

ON

Vine Street Office Towers
(1601 & 1605 North Vine Street)

JANUARY 20, 2011

PURPOSE

To provide the CRA/LA Board of Commissioners with an updated overview of the Vine Street Office Towers' project history and respond to public concerns that have been raised related to: (1) appraisal process in connection with CRA/LA's acquisition of the site in 2006; (2) disposition price in conveying the site to Pacific Ventures ("Developer); (3) due diligence during the initial underwriting of the Developer's capacity and more recent business operating capabilities, and (4) project benefits to the City; and to address questions raised by Councilmembers at the November 17, 2010 meeting of the Housing and Economic Development Committee about the current market demand for office space in relation to current vacancy rates, including the feasibility of the project $4.50 per square foot lease rates.

REPORT

Project Background

The pursuit of projects such as the Vine Street Office Towers was an effort to address a blighting condition identified in the Hollywood Redevelopment Project Area Plan. At the time of the adoption of the Plan, the area was found to contain the following conditions:

> "Economic stagnation characterized by a shortage of available industrial space for entertainment related uses, a decline in residential investment, shifting commercial uses and a ***shortage of first-class office space***."(emphasis added)

In early 2006, the Hollywood Project Area staff actively sought to identify sites that could accommodate the development of new Class-A entertainment commercial office space. Staff recognized that no new Class-A office buildings had been built in Hollywood in more than 25 years. The lack of new, modern and sizeable contiguous space placed Hollywood at a competitive disadvantage with large entertainment firms who wanted to remain or locate in Hollywood. At the time, there was also concern about creating a better jobs/housing balance with nearly 4,600 housing units either under construction or in the entitlement process. The property located at 1601 North Vine Street is one of the properties identified as a prime site which was underutilized as a private parking lot that included a florist and hamburger stand. It was also brought to the staff's attention that the property owner at the time was interested in divesting of some of his real estate assets and might be interested in selling the site.

CRA/LA was interested in acquiring this key site so that CRA/LA could have control over the future development through the anticipated execution of a Development and Disposition Agreement. Due to previously expressed disinterest by the owner in selling property to CRA/LA, it was determined that a direct acquisition would not be possible. At the time, staff was working with a former Paramount Studios executive (Earl Lestz), who was interested in promoting the development of office space for entertainment firms in Hollywood. A number of stakeholders in the Hollywood business community, including the Hollywood Chamber of Commerce, were also very interested in the CRA/LA's involvement in such development. Mr. Lestz was made aware of CRA/LA's interest in the site for development of entertainment office space. Mr. Lestz was aware of the work done by Pacifica Ventures with the repositioning of the

Culver City Studios and the firm's potential interest in developing in Hollywood. He was able to negotiate a deal between the 1601 North Vine Street property owner, Ullman and Pacifica Ventures to acquire the property.

During the time that Pacifica Ventures was in discussions with the owner, CRA/LA was also having discussions with Pacifica Ventures about the type of project that would be suitable for the site. Prior to starting the development of a formal Exclusive Negotiating Agreement, on July 14, 2006, CRA/LA submitted correspondence to Ullman Investments, LTD, apprising them of Rules Concerning Participation and Preference by Owners that allow for property owners to submit redevelopment proposals. The letter referenced CRA/LA's knowledge of a March 23, 2006 Letter of Intent between Pacifica Ventures and Ullman Investments and requested Ullman's approval to negotiate with the buyer regarding the Subject Property. Mr. Ullman signed the letter confirming that it was acceptable for the Agency to negotiate with the Buyers. On July 26, 2006, Pacifica Ventures submitted a proposal to CRA/LA proposing a mid-rise Class-A commercial office building. The CRA/LA Board approved acquisition of the site from Pacifica Ventures by the CRA/LA and the Exclusive Negotiation Agreement on September 7, 2006.

Appraisal & Acquisition

Attachment A is a re-creation of the timeline of key dates and processes related to the acquisition of the property by the CRA/LA based on available documents and staff discussions with available former employees involved in the transaction. As reported to the Housing, Community and Economic Development Committee, none of the staff directly involved in the initial acquisition are currently employed at the CRA/LA. Further, some of the key documentation is missing from CRA/LA's files. Therefore, some of the history is based on assumptions and the recollections of staff directly and indirectly involved.

CRA/LA's acquisition of the site took place at the height of a very fast-paced, dynamic and rising real estate market. CRA/LA commissioned an appraisal for the site by Pacific Real Estate that concluded the value of the property as $4,070,000 on May 23, 2006. According to the developer, in conjunction with securing a private loan for the acquisition of the property by the developer, the developer independently contracted for an appraisal by CB Richard Ellis that provided a value of $5,450,000 in order to meet the lender's customary practice of requiring appraisals to substantiate the requested loan. This appraisal was dated May 25, 2006 which was provided to CRA/LA staff.

At the time the transaction took place, CRA/LA had in place written administrative procedures to determine value, reconcile differences with the seller's value and/or asking price and obtain board approval to make acquisitions beyond the allowed variance. The key procedures related to this transaction are discussed below:

1. *Negotiate an acquisition price up to 20% greater than the CRA/LA appraised value.*

   The written procedures allowed staff to make an offer that was up to 20% above the appraised value. Using this option would have enabled CRA/LA to acquire the site for $4,884,000 based on the Pacific Real Estate appraisal commissioned by the CRA/LA.

2. *Secure approval from the CRA/LA Board of Commissioners to acquire properties for more than 20% above the CRA/LA-commissioned value.*

   The administrative procedures allowed the CRA/LA to pay more than 20% above the appraised value if approved by the Board of Commissioners. The Board Memo requesting approval of the acquisition stated that the property was being acquired at its appraised value.

3. *Obtain either an internal or external peer review of outside appraisals.*

   Based on CRA/LA records, it appears that the former Senior Real Estate Officer requested the former Appraisal Manager to conduct a peer review of the Developer's CB Richard Ellis appraisal prepare for the Developer's lender. However, staff has not been able to locate a Review Report and cannot conclude as to whether or not a formal or informal review took place. The CB Richard Ellis appraisal appears to be the appraisal referred to in the Board Memo dated September 7, 2006 in which the Board was asked to approve the acquisition of the property. The Board Memo would have been more informative if it had included an explanation about the outcome of the analysis of the difference in appraised value between the Pacific Real Estate and CB Richard Ellis appraisals. The written Board Memo simply says "The Agency will acquire the Vine Street Property for its fair market value, supported by a certified independent appraiser using universal standards of professional appraisal standards ("USAP")" (presumably referring to the CB Richard Ellis appraisal).

During the last several months, staff has attempted to understand better the differences in the appraisals. In that regard, CRA/LA retained the services of an appraisal professional to conduct a review of the Pacific Real Estate and CB Richard Ellis appraisals. The consultant concluded that the Pacific Real Estate Appraisal was more accurate of the value at the time. It should be noted, however, that the Developer has also retained the services of a Member of the Appraisal Institute (M.A.T.) appraiser to review the two 2006 appraisals. That appraiser concluded that the CB Richard Ellis appraisal was more accurate. These continued differences speak to the range of opinions and values that can be provided by appraisers for the same property, that even today are still difficult to reconcile.

CRA/LA's practices no longer allow for CRA/LA to acquire a property based on an appraisal not commissioned by CRA/LA but reviewed by CRA/LA. This practice was changed approximate 18 months ago, and recently documents in the Administrative Procedures as if in place today call for CRA's Appraisal Unit to either utilize qualified in-house staff or select an appraiser from

a pre-qualified pool of firms. The appraisal prepared either in-house or contracted by and prepared for CRA/LA is used as the basis for the property valuations.
Staff review has uncovered no evidence that the appraisal prepared by CB Richard Ellis was prepared for any reason other than meeting the requirements of the acquisition lender at the time.

The price paid by the CRA/LA was equal to the price negotiated at arm's length between the Developer and the seller of the property, which terms were agreed to 3 months before the Board took action approving the acquisition by the CRA/LA. Pacifica Ventures entered into a Purchase and Sale Agreement with Ullman Investments and Joseph E. Simon dated May 15, 2006 with closing deadline of September 12, 2006 which is the date on which escrow closed. The Agreement included a contingency period until July 14, 2006 to allow for they buyers approval of and/or satisfaction with the physical condition of the property, all applicable government ordinances, rules and regulations, all private restrictions, all licenses, permits and other governmental approvals and/or authorizations relating to the Property, and any and all matters concerning the current and future use and development of the property. The Agreement did not specifically cite the approval of CRA/LA financing as a contingency that would allow Pacifica Ventures to terminate the agreement. The Board approved the acquisition from Pacifica Ventures on September 7, 2006, and escrow between Developer and CRA/LA closed on November 7, 2006.

Disposition Price

Concerns have been expressed about the Disposition and Development Agreement ("DDA") which calls for conveying the land to the developer for $825,000.

The $825,000 for which the land will be conveyed to the developer is based on a re-use analysis that determines the land value based the requirements of the CRA/LA as specified in the DDA. The table below illustrates the value of the land based on CRA's requirements.

Stabilized Net Operating Project	$4,795,000
Threshold Return	8.33% [1]
Supportable Investment Value	$57,553,000
(Less) Total Development Costs	($56,728,000)
Residual Land Value/Reuse Value	$825,000

[1] As of the date of the 33433 report, the independent analyst concluded that market conditions required a minimum return of 9.00%; however, the developer was willing to accept a lower threshold.

It should be noted that, in the re-use analysis, the $825,000 Reuse Value for the project prescribed by CRA/LA would be the same regardless of whether $5,450,000 or $4,070,000 was paid for the property. Sale of property at fair reuse value is a long established practice and specifically authorized in Section 33445 of the Health and Safety Code.

Developer Capacity

During the initial underwriting of the project, CRA/LA staff identified Pacifica Ventures as a team of entertainment industry real estate veterans, including professionals from Culver Studios and Paramount Studios. When discussions with Pacifica Ventures began, the firm had recently been successful in the acquisition and repositioning of Culver Studios which entailed increasing its occupancy and expanding its operations. In addition to improving the operations of Culver Studios, the firm had experience in developing entertainment-related buildings, including a 50,000 square foot office building in Culver City and the Sony Animation Building. Pacifica Ventures was also in the process of developing a new film and television production facility in Albuquerque, New Mexico that included 200,000 square feet of entertainment office and support space. The experience of the firm and its key executives, Hal Katersky and Dana Arnold, indicated that it had the capacity to undertake and completed the development of Vine Street Office Towers.

In recent months, concerns have been raised about the Developer's challenges with its other projects and properties. The Developer reports that the lawsuits, have all been settled. It should also be noted that Albuquerque Studios, which was developed and owned by a Pacifica Ventures partnership, has been in bankruptcy court and in the process of reorganization for approximately one year.

The developer does not have a commitment of construction financing at this time. This is not unusual given the state of the lending industry, The developer initially had a 90-day commitment, however, due to lengthy project approval delays it has expired. It is assumed that there will be a pre-leasing condition as part of any financing commitment obtained by the developer and that this pre-leasing requirement will be approximately 50%. Transfer of the property by the CRA/LA to the Developer will not occur until a firm financing commitment is in place and all conditions of that commitment have been met.

Staff has discussed the project with Workers Realty Trust (WRT) II, LP, the Developer's equity source and the owner of 96% of the development entity. To date WRT has invested $3.9 million in the predevelopment phase of the project. WRT indicated its strong commitment to staying in the project and providing the remaining equity funds necessary to complete construction. WRT is also the lender in the Albuquerque Studios project.

Cost/Benefit Analysis – Project Importance

As described in the Project Background section, the Vine Street Office Towers project was seen as a significant project necessary to retain and attract major entertainment firms in the Hollywood area by bringing to the market the first new Class-A office space in 25 years. In addition to providing 108,000 square feet of space, the project also includes 194 parking spaces for public use which will contribute greatly to what key stakeholders have identified as an impediment for the area.

Vine Street Office Towers is a project that will contribute significantly to the local economy and the agency's tax increment resources. In the 33433 Summary Report, CRA/LA's costs are projected to be $7,862,693. Upon completion of the development, it is projected that the project will generate $13 million in tax increment revenues that CRA/LA will be able to use to invest in affordable housing and other economic and community development projects.

The immediate economic benefits of the project will be the 347 construction jobs and 483 permanent jobs. The nonprofit organization, Construction Industry Research Board has developed models and formulas for calculating the multiplier impact of construction jobs. It is estimated that the $56.7 million development will create have a multiplier of 19.659 jobs across all industries which translates to approximately 1,100 new indirect employment opportunities. In addition, minimally, the 415 annual average of these jobs will generate an additional $2,150,800 ($415x10x52) each year in sales for local businesses through these new employees' expenditures on lunch and other goods and services. Other economic impact factors calculated through the year 2037 includes $20.3 million in additional property tax revenue (includes the $13 million discussed above that will flow to CRA/LA), $24.6 million in gross business revenue receipts of which the City will receive 1%, and $1.2 million in utility user tax revenue.

<u>Marketability, Demand and Vacancy Rates</u>

Entertainment companies that wish to relocate or expand to Hollywood cannot find a suitable location due to the lack of ***contiguous*** Class A office space. There has not been a leasable new office building built in Hollywood for the past 25 years. The supply of Class A contiguous office space has not been able to meet the demand of entertainment companies, who have subsequently moved to cities like Burbank and Culver City. Currently, there are only 3 buildings, which are all 25 years and older, that have 30,000 square feet or more of contiguous space. This is not enough to meet the demand of prominent entertainment companies that will bring employment and commerce to the Hollywood Redevelopment Project Area.

At the last HCED meeting, CRA/LA staff presented an analysis of the current office market in Hollywood. Currently, Hollywood has 2.2 million square feet of Class A office space with a 17% vacancy rate. Although these buildings are classified as Class A, staff learned that most major institutional buyers classify these properties as Class B given their age. The most surprising data is that, of the available office space, only 3 buildings, comprising 150,177 contiguous square feet, are available for lease for buildings offering 30,000 contiguous square feet or more. These three buildings are the comparable properties for the 1601 Vine Street Office Project. This illustrates the need for more Class A property in Hollywood in order to bring entertainment jobs back to Hollywood and stimulate the local economy.

With regard to the marketing and demand for office property, the Developer retained Ramsey-Shilling approximately 14 months ago. They have indicated that the interest level is strong, however no company will risk their planning time and costs until the Project is fully entitled.

Ramsey-Shilling has had a long and successful track record of leasing high end office space in Hollywood as evidenced by the 100% lease up of buildings such at the El Capitan Office and Theater Building, 1800 North Highland, 6725 Sunset and LA Center Studios. In each of these cases, Ramsey-Shilling was retained to lease 100% vacant, but recently renovated office buildings, all of significant size ranging from 40,000 square feet to 240,000 square feet. In each of these cases 100% lease up was completed in a relatively short time.

Income Projection Feasibility

The Developer has estimated average lease rates of $4.50 per square foot for Vine Street Towers. The market rate for what is considered Class A office space in Hollywood is approximately $3.00 per square foot. However, these properties are all 25 years and older. Although some have been renovated, they will not have all the amenities or quality of the 1601 Vine Street project. The broker retained for the project estimates rates will be higher due to this fact. In an economic analysis prepared by Keyser Marston Associates in September 2009 it was reported that the current average for the prime Class A office space, was in premier office location, the range of $4.50 to $5.00 per square feet.

While the current low and uncertain economy and real estate market naturally raise questions about the potential to command the projected rents, there are several factors which protect the interests of CRA/LA from proceeding with the transaction should the lease rates not be achievable. CRA will not convey the property until the Developer has obtained construction financing for the project, at which time the lender must be satisfied, the project is economically viable. The schedule of performance in the DDA establishes outside dates for achieving financing.

CONCLUSION

Files currently available to staff suggest that CRALA's appraisal procedures may not have been followed. However, we have uncovered no evidence that the developer was involved in this process or benefited financially from the process used. Today, the CRA/LA owns the site and has negotiated an appropriate transaction for its development. The DDA contains protections that ensure that the property will not be conveyed unless and until all financing is in place and construction can commence and be completed. The project remains important for retention and attraction of the office operations of entertainment industry related businesses and the corresponding job creation in Hollywood.

Christine Essel
Chief Executive Officer

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Calvin E. Hollis
Chief Operating Officer

ATTACHMENT

Attachment A – Chronology of 1601 North Vine Street