



**Date:** June 5, 2023

**To:** Wanda S. Page, City Manager  
**Through:** Bertha T. Johnson, Deputy City Manager  
**From:** Jina B. Propst, Director, General Services Department  
**Subject:** Request for Qualifications for Redevelopment of 505 W. Chapel Hill Street

### **Executive Summary**

The City owns the four-acre parcel located at 505 W. Chapel Hill Street (parcel ID 114577), containing an existing building originally designed by Milton Small, built for the Home Security and Life Insurance Company in the 1950's, and its supportive surface parking lots. The building has been vacant since early 2019. The City is in discussions to enter into a 12-month lease for the site exterior with WeaverCooke Construction for vehicle parking and material laydown area during the construction of the senior affordable housing project Ashton Place.

The General Services Department recommends that City Council authorize beginning a competitive, two-step property redevelopment process for 505 W. Chapel Hill Street to produce the type of development that will reflect the six public interest goals of the City Council for the site, including affordable housing units. The first step in this process is authorizing staff to issue the proposed Request for Qualifications to solicit interest from qualified development partners.

### **Motion**

To authorize the City Manager to issue the Request for Qualifications to solicit interest from qualified development partners; and

To authorize the City Manager to make modifications to the Request for Qualifications in the best interest of the city to achieve the six public interest goals.

### **Background**

In the Fall of 2022, City Council authorized the City Manager to hire HR&A Advisors, Inc., to manage a two-stage site disposition process with a Request for Qualifications (RFQ) and Request for Proposals (RFP) to solicit a development partner who will deliver on the City's priorities for site redevelopment at 505 W. Chapel Hill Street.

In Fall and Winter 2022, HR&A Advisors conducted analysis of downtown, citywide, and regional market dynamics across office, lab, residential, and retail uses and briefed Council with findings from this analysis to shape three key decision points for Council: (1) on-site development priorities; (2) the role the City wishes to play in site redevelopment; and (3) the City's preferred mechanism for disposition. In December, City staff and HR&A facilitated a discussion with City Council around onsite development priorities and reached consensus on a defined set of priorities that will serve as the foundation for the proposed property disposition process.

In December 2022, the General Services Department and HR&A Advisors presented City Council with an update on 505 W. Chapel Hill Street and facilitated a discussion on Council priorities. As an outcome of that discussion, Council affirmed initial priorities for site redevelopment, as follows:

#### Council Priorities for Site Redevelopment

1. Provide onsite affordable housing with a minimum of 80 units delivered at 60% AMI
2. Preserve the existing Milton Small Building, with potential funding support from the City (subject to legal constraints)
3. Deliver a mix of uses so that development serves as an economic driver for Durham, such as inclusion of commercial space that creates permanent jobs
4. Deliver signature design and creation of an iconic gateway that is welcoming to all Durham residents
5. Include significant space for a museum or other significant placemaking element to commemorate the West End history and Hayti legacy
6. Generate financial return to the City over the long term

After receiving Council direction on development priorities, HR&A worked with City staff to prepare a draft RFQ. Provided Council authorizes the City Manager to issue the RFQ, City staff will work with HR&A to finalize and distribute it to prominent local, regional, and national real estate developers.

#### **Issues and Analysis**

The six priority goals defined by City Council each present tradeoffs that impact the financial return the City will receive and are detailed below.

#### Onsite Affordable Housing (80 units at 60% AMI)

Affordable housing is the Council's highest priority associated with this site. Its inclusion in the final development program will negatively impact land value and the financial return the City could derive from the site were it to pursue a fully market-rate residential program. This tradeoff includes (1) the negative land value associated with the development of each affordable housing unit and (2) the opportunity cost of not realizing positive land value from the delivery of market-rate units. Therefore, for each unit of affordable housing developed:

- Negative land value for one housing unit at 60% AMI: **-\$70,000 to -\$91,000<sup>1</sup>**;
- Positive land value for one market-rate housing unit: **\$19,000-\$26,000; and**
- Total tradeoff per unit between market-rate and affordable units at 60% AMI: **\$89,000-\$117,000**. Should the City pursue greater affordability (delivering units at lower % AMI), that would increase the negative land value impact per housing unit. Subsidy available to developers, such as the 4% and 9% Low-Income Housing Tax Credits (LIHTC), help to address these financial impacts and render development feasible.

#### Milton Small Building Preservation

Should the City require preservation of the Milton Small building, any costs the developer bears to rehabilitate the structure, return it to viable use, and prepare it for commercial or residential tenants will negatively impact land value. MBP, a construction engineering firm, conducted a cost estimate analysis for the rehabilitation of the Milton Small Building, which concluded that it would

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<sup>1</sup> Estimates derived from 2022 developer proposals (Akridge & Ancora) from the second solicitation process for 505 W. Chapel Hill St.

require approximately **\$17 million**<sup>2</sup> to return the building to a viable shell condition. Should the building be positioned for commercial use, HR&A analysis indicates that a developer would need to spend an additional **\$5.4 million-\$6.3 million** for tenant improvements prior to occupancy.<sup>3</sup> Therefore, the total estimated cost to rehabilitate the Milton Small Building is approximately **\$22 million-\$23 million**, carrying significantly negative impacts on the site's land value.<sup>4</sup> Any proposed direct public subsidy for rehabilitation of the Milton Small Building would be subject to qualifying public purpose/public use requirements.

#### Approach to Onsite Mixed-Use Development

The City is interested in advancing mixed-use development onsite, including a commercial component that creates jobs and drives economic development in downtown. Given the changing economic conditions as a result of the COVID-19 pandemic, along with the rise of hybrid/remote work and increasing construction costs, commercial job-centric uses are not as accretive as they once were. Meanwhile, with average multi-family residential rents increasing within Downtown Durham, market-rate residential uses are comparably more accretive than commercial uses. Each use presents different considerations regarding its impact on land value:

- **Office:** Given increasing predominance of remote and hybrid work opportunities, office is less likely to drive value on the site. Based on the offers from the previous disposition process, HR&A estimates that office drove a negative land value between **-\$195 per square foot (PSF) to -\$62 PSF**.<sup>5</sup>
- **Lab:** Lab space may be a more accretive commercial use given the Triangle's history as a hub for life sciences and the nature of lab work, especially in the future when in-person use of specialized equipment returns to historic norms. However, some feasibility questions still exist given lab space is typically more expensive to build, and construction and materials costs are at all-time highs. Based on the offers from the previous disposition process, HR&A estimates that lab drove a positive land value between **\$1 PSF to \$47 PSF**.
- **Market-rate residential:** Durham's multifamily market is rapidly expanding, and if Council were to sell the site with no conditions, it would likely result in a mostly residential mid to high-rise community with some ground floor retail as required by ordinance, due to the highly accretive nature of market-rate residential development. Based on the offers from the previous disposition process, HR&A estimates that market-rate residential drove a positive land value between **\$24 PSF to \$93 PSF**.
- **Affordable residential:** Increased rents paired with growing demand for housing translates to a greater need for affordable housing, particularly to prevent displacement and to support existing lower income residents. As mentioned above, affordable units carry a negative land value tied to the level of affordability and the number of units delivered.
- **Retail:** Curated, distinct, local retail characterizes Downtown Durham, and much of the new, planned development includes ground-floor retail that both activates the ground

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<sup>2</sup> Estimates derived from cost estimation study conducted by MBP, October 3, 2022.

<sup>3</sup> Estimates derived from 2022 developer proposals (Akridge & Ancora) from the second solicitation process for 505 W. Chapel Hill St.

<sup>4</sup> Estimates derived from 2022 developer proposals (Akridge & Ancora) from the second solicitation process for 505 W. Chapel Hill St.

<sup>5</sup> All use estimates discussed in this section are derived from developer proposals (Akridge & Ancora) from the second solicitation process for 505 W. Chapel Hill St.

plane and serves as an amenity for residents onsite and throughout the neighborhood. Often, ground-floor retail operates at a loss and is subsidized by the commercial and/or residential components above as a critical placemaking element that increased the attractiveness of the development.

### Signature Design

With a higher standard for design of any real estate, open space, or cultural assets onsite, this will likely require additional construction costs for premium materials and architectural complexity. While construction costs are already at historic highs as a result of broader economic challenges brought on by the pandemic, these signature design elements contribute to an enhanced site plan and public realm which will create incremental value.

### Historic Marker/Museum for West End History and Hayti Legacy

The extent to which the cultural memorial element paying homage to West End history and the Hayti community occupying space within the broader development will reflect the impacts that this element will have on overall land value. If this takes the form of a marker such as a plaque or statue within the open space element of the project, the impact on land value would likely be negligible. However, if this element were to be something that occupied significant space within the development (such as a museum), especially if that element takes away space from other accretive commercial uses, it can have a negative impact on land value.

In the prior disposition round, Akridge proposed an art gallery on the ground floor of the Milton Small building. While Akridge anticipated that it could collect **\$38 PSF** for commercial uses in the building, it expected to collect **\$12 PSF** for the art gallery space. This lower rent translates into a lower land value for the Milton Small building than if it had been rehabilitated fully into space for a more accretive use like market-rate office. This lower land value translates to a lower financial return for the City.

Should the City actively occupy space in service of a cultural/historical venue, the City's committed tenancy would improve land value considerations. The City serving as an anchor tenant for the space could improve how the developer markets the site to potential tenants and how it attracts capital investment from private partners. This also connotes that the City is making a long-term financial commitment to occupy the space, investing in the site and its future success.

### Long-Term Financial Return to the City

The previous two solicitations were for a fee-simple disposition, where a private developer would pay the City a one-time payment to purchase the site. This structure aligned with the then-priority to generate a substantial financial return. Under revised priorities, Council is now open to options that could provide the City with revenue over a longer term, as opposed to a single, upfront payment. This could include a range of solicitation structures, including a ground lease, whereby the City owns the land and leases it to a developer over a term that can extend as long as 99 years. The City would receive payment for its continued ownership of the land and can structure the agreement with the developer to ensure that it can participate in the development's financial upside should it outperform expectations. A ground lease ensures that the City retains more control over site redevelopment and is able to achieve its goals. In approaching this solicitation

process, allowing developers to propose a range of transaction and partnership structures will help ensure the City can secure the best deal to meet its goals.

**Alternatives**

The City Council could choose to sell the property outright to a developer and deploy those funds to the affordable housing fund. This path is not recommended as the two previous solicitation processes did not produce a viable project with this pathway and without restrictions, the private market is unlikely to create affordable housing.

**Financial Impact**

There is no financial impact to the City at the RFQ stage beyond the existing consultant contract with HR&A Advisors, Inc.

**Equal Business Opportunity Summary**

The agreement was reviewed by the Underutilized Business Compliance Division in the Finance Department with the Ordinance to Promote Equal Business Opportunities in City Contracting. In the absence of subcontracting opportunities, no M/WUBE goals were assigned. Goals will be considered and applied in the Request for Proposals and Contracting Phases of this development.

**Contractor Workforce Diversity and Hiring Practices**

Due to the nature of this agenda item, obtaining Contractor Workforce Diversity & Hiring Practices information is not applicable.

**Attachment**

RFQ - 505 W. Chapel Hill Street Redevelopment