



Date: April 22, 2021

To: Wanda S. Page, City Manager
Through: W. Bowman Ferguson, Deputy City Manager
From: Jina B. Propst, Director, General Services Department
Subject: Update on Disposition and Redevelopment of the Property Located at 505 W. Chapel Hill Street

Executive Summary

On October 5, 2020, the Durham City Council authorized the City Manager to execute a Purchase and Sale Agreement, Master Development Agreement, and other necessary documents related to redevelopment of the property located at 505 W. Chapel Hill Street – Parcel ID 114577 (Exhibit A), based upon an approved development program submitted by The Fallon Company (“TFC,” also dba West Chapel Hill Development, LLC).

The City entered into a Purchase and Sale Agreement (the “PSA”) on October 28, 2020. The PSA provided TFC a due diligence period during which the developer was permitted to conduct any and all additional evaluation of the property necessary to ensure project feasibility prior to closing. Feasibility analysis conducted by TFC during subsequent due diligence identified site conditions TFC cited as being inconsistent with project feasibility as contemplated in the Master Development Agreement (MDA).

While articulating its continued enthusiasm in the project, on Friday, March 19, 2021, DLA Piper LLP, counsel to TFC, sent a Purchaser’s Termination notice to the City of Durham under Section 5 of the PSA for the property located at 505 W. Chapel Hill Street.

Accompanying the termination notice was a memorandum from TFC entitled “Requested Changes regarding 505 W. Chapel Hill Street” (Exhibit B). The memorandum illuminated proposed revisions to the approved development program and deal points which TFC believed could restore project feasibility. Revisions proposed by TFC include: (a) A purchase price reduction from \$9.25 million to \$7.0 million in nominal dollars, (b) Residential conversion of the existing Milton Small building (in lieu of commercial conversion), (c) Reduction in minimum required square feet (SF) of office space onsite from 300,000 to 250,000 SF, (d) satisfactory resolution to an onsite traffic improvement mandate asserted by the North Carolina Department of Transportation (NCDOT), and (e) allocation to TFC of the entire residential building tax exclusion available through the State’s Brownfields Program.

This agenda item provides City Council with an update presentation on the termination notice and alternative proposal memo received from TFC.

Recommendation

General Services Department recommends that the City Council receive a presentation on the disposition and redevelopment of 505 W. Chapel Hill Street.

Background

In April 2019, the City of Durham issued a RFP that invited pre-qualified development teams to submit a proposal to purchase 505 W. Chapel Hill Street and deliver a transformative mixed-use program that fulfills the City's objectives for the property.

On June 15, 2020, City Council affirmatively approved restrictive covenants and a rezoning for the 505 W. Chapel Hill Street property from Downtown Design District – Support 1 (DD-S1) to Downtown Design District – Core with a development plan (DD-C(D)) Z2000006. The restrictive covenants were placed on the property as a means to legally enforce the City's affordable housing mandate for the project, regardless of property owner.

On October 5, 2020, the Durham City Council voted 6-0 to approve six related motions supporting the proposed disposition of the City-owned property located at 505 W. Chapel Hill Street. Motions approved by City Council included authorization for the City Manager to execute and/or record a Purchase and Sale Agreement, Master Development Agreement, and other necessary documents to effectuate the conveyance and development of property consistent with an approved development program proffered by TFC.

The City signed the PSA on October 28, 2020. The PSA provided TFC with a 45-day due diligence period (through December 14, 2020) during which the developer was permitted to conduct any/all additional evaluation of the property necessary to ensure project feasibility prior to closing. Feasibility analysis conducted by TFC during the initial 45-day due diligence period resulted in the following subsequent negotiations between the parties:

- First Due Diligence Period Extension: through January 19, 2021
- Second Due Diligence Period Extension: through March 19, 2021
- Optional Third Due Diligence Extension: through April 23, 2021

Under the terms of the extended due diligence period, the developer was required to either proceed to closing, further extend the due diligence period by providing a nonrefundable deposit, or to terminate the PSA. On Friday, March 19, 2021, TFC notified City staff that due diligence evaluations and feasibility analysis conducted to date resulted in a determination that it is financially infeasible for TFC to proceed with redevelopment of the property as required under the MDA.

The General Services Department, anticipating this termination notice and in an effort to understand the current position of TFC, requested TFC to submit details outlining alternatives for potential consideration by the City. TFC subsequently provided a memorandum (Exhibit B) outlining alternative proposal(s) for redevelopment of the property. Changes to the approved development program (Alternatives A and B) proposed by TFC are summarized in the following table:

| | CITY COUNCIL OBJECTIVE | PROPOSED TFC ALTERNATIVES (A/B) |
|--|---|--|
| AFFORDABLE HOUSING | Provide 80 units of onsite housing affordable to residents at 60% AMI in perpetuity | – Optional +11 units available at 80% AMI for 5-7 years; would require an additional ±\$800K City subsidy |
| REVENUE GENERATION | Generate significant revenue to the City from the sale of land and future local tax revenues | – Purchase Price decrease from \$9.25M to \$7M <i>Nominal</i> – Estimated future property tax revenue decrease from ~\$2.37M <i>NPV</i> to ~\$1.54M <i>NPV</i> |
| MIXED-USE DEVELOPMENT | Deliver a mixed-use project, including a significant office space component ideally ≥150,000 gross square feet (SF) | – Residential unit count increase of 52 units – Minimum office space decrease from 300,000 SF to 250,000 SF |
| HISTORIC PRESERVATION | Preserve the existing Milton Small building | No Change |
| SIGNATURE DESIGN/ STREET-LEVEL ACTIVATION | Deliver signature design and an activated street-level experience to support Downtown’s identity and vibrancy | – Additional Design Limitations; No floating ground floor treatment opening Milton Small onto the greenspace – Less Activated Site; No street-level extension bringing Milton Small forward to Chapel Hill Street |

Substantive changes to the approved development program proposed by TFC would have the effective of reducing the net present value (NPV) of anticipated revenue to the City over time, ranging from approximately \$3,000,000 to \$3,800,000 as compared to the approved MDA.

As described in the TFC alternatives memorandum, the majority of the change in anticipated revenue to the City is predicated upon two key factors identified by TFC: (a) a greater cost to renovate the Milton Small building than estimated by TFC in its RFP response, and (b) current market uncertainty caused by the COVID-19 pandemic.

The proposed shift in the use of the Milton Small building from office/retail to residential/retail has the anticipated fiscal impact of eroding revenue generation for the City in several ways. Future property tax proceeds would be impacted not only by TFC’s proposal to leverage a greater percentage of the previously negotiated brownfields tax exclusion, but additionally by TFC’s proposed leveraging of state and federal historic tax credits, a local historic landmark tax deferral, as well as by the Milton Small portion of the project achieving a lower estimated future property tax valuation based upon the change in use from office to residential.

TFC's proposed use of historic tax credits/deferrals would have the anticipated design impact of preserving the Milton Small building in a manner consistent with its historic character; however, maintenance of the historic character would depart from design improvements anticipated under the approved MDA intended to increase street-level activation and vibrancy, including opening the ground-level of the building onto the greenspace and constructing an addition designed to bring the existing building closer to Chapel Hill Street.

TFC's proposed Alternative B could increase the total affordable unit count above the baseline of 80 units at 60% AMI, providing the option of 11 additional units at 80% AMI, but at a premium of approximately \$800,000 to the City, with long term affordability criteria to be determined based upon proposed conversion of the units to for sale condominiums after 5-7 years.

TFC's memorandum additionally notes an outstanding ruling by NCDOT requesting a turn lane on South Gregson Street, representing an additional potential impediment to project advancement that could ultimately result in an additional request by the developer for monetary concessions from the City of up to an estimated \$450,000.

Issues and Analysis

Section 86 of the City's charter authorizes City Council to publicly or privately sell, lease, rent, exchange or otherwise convey, or cause to be publicly or privately sold, leased, rented, exchanged or otherwise conveyed, any property, real or personal or any interest in such property, belonging to the City, upon the affirmative vote of four Council members, and in compliance with the State law.

As a result of TFC's termination of the approved PSA, the City is currently not contractually obligated to convey the City-owned property located at 505 W. Chapel Hill Street to any party. The City may elect any future course of action that City Council may desire that is permissible under the City's Charter and in compliance with State law.

Alternatives

Based upon the City's charter authority and State law, immediate next steps for the City with regard to the property could include:

- (a) the City could recommence negotiations with TFC;
- (b) the City could explore subdivision of the site, enabling the City to proceed with construction of a new mixed-income residential building, while retaining ownership of the remainder of the site for future disposition once market conditions stabilize, all of which would involve a new solicitation process; or
- (c) the City could restart the solicitation process by issuing of a new Request for Proposals in an effort to determine if a greater cumulative benefit to the City is attainable in the marketplace, now or in the near future.

Depending upon next steps desired by Council, coordination with the City Attorney's Office regarding a path forward will be necessary.

Financial Impact

TFC's termination of the Purchase and Sale Agreement will result in the City not receiving the bulk of the anticipated sales revenue of \$9,250,000 from TFC d/b/a West Chapel Hill Development LLC in fiscal year 2021.

The proposed alternatives, if City Council elect to consider them, could reduce the estimated NPV of total revenue to the City over ten years post-closing by \$3,000,000 to \$3,800,000 below revenue estimates supported by the approved MDA. The majority of the difference in estimated total revenue to the City is attributable to TFC's proposed reduction in the sales price from \$9,250,000 to \$7,000,000.

Equal Business Opportunity Summary

This item does not require review by the Equity & Inclusion Department for compliance with the Ordinance to Promote Equal Business Opportunities in City Contracting.

Attachments

Exhibit A – TFC Purchaser's Termination Notice

Exhibit B – TFC Memorandum re: Requested Changes Regarding 505 W. Chapel Hill Street

Exhibit C – Redevelopment of 505 W. Chapel Hill Street City Council Update Presentation