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City of Alexandria, Virginia

MEMORANDUM

DATE: JUNE 29, 2021
TO: THE HONORABLE MAYOR AND MEMBERS OF CITY COUNCIL
FROM: MARK B. JINKS, CITY MANAGER /s/

DOCKET TITLE:
Consideration of Funding for Purchase of 1703 North Beauregard for Public School Purposes at the Request of the Alexandria City Public Schools. **(This is not a public hearing item)**

ISSUE: Should the City provide \$17.9 million to ACPS to acquire an office building at 1703 North Beauregard with renovation costs to be requested at a later date?

RECOMMENDATION: That City Council:

1. Endorse the purchase by the Alexandria City Public Schools (ACPS) of an office building located at 1703 North Beauregard at a cost to be funded by the City of \$17,920,000 contingent upon ACPS agreeing to transmit to the City the building's rental payments to be paid to ACPS by private sector tenants to be used to offset a portion of the City's debt service costs incurred to fund this acquisition; and

2. Direct the City Manager to bring forward for Council action an appropriation ordinance in September, 2021 increasing the capital projects appropriation for School purposes by \$17.9 million in order to fund this proposed acquisition.

BACKGROUND: ACPS has proposed that the City fund its proposed acquisition of 1703 Beauregard (“1703”) which is an office building adjacent to the Ferdinand T. Day Elementary School. This office building is four stories and totals some 75,000 square feet of office space plus basement space. The facility was constructed in 1998 and is 23 years old. This office building shares a parking structure with the Ferdinand T. Day School. This 1703 Beauregard property is on the market for \$18.3 million and is owned by the Association for Supervision and Curriculum Development (ASCD). ACPS has executed a letter of intent with ASCD at a proposed purchase price of \$17.9 million. This does not include any future renovation costs that in one analysis ACPS staff estimated at \$15.0 million and for which funding has not been requested by ACPS at this time, but would likely be expected to be requested by ACPS in the upcoming FY 2023 to FY 2032 Capital Improvement Program.

Determining the market value of office buildings in this volatile commercial real estate market is difficult, as values paid for office buildings sales widely vary. Unlike home values where there are many sales in a neighborhood of similar houses, commercial office buildings are sold less frequently and often have different commercial circumstance that impact value. For example, the City real estate assessment of 1703 in 2021 was \$12.0 million, which has fallen steadily since a peak assessed value of \$23.5 million in 2013. This major drop in assessment value reflected the substantial declining market for suburban office buildings in Northern Virginia such as those at the Mark Center. However, the City 2021 assessment may reflect the bottom of a market and not yet reflect the demand that Landmark Mall’s/Inova redevelopment and other economic circumstances may create for office space in the City’s West End. There is apparently a competing purchase offer for 1703. The proposed purchase price is less than it would cost to replace this building at today’s construction costs. The building appears to be in good condition, which will be subject to verification during the due diligence period.

This 1703 North Beauregard office building is encumbered with three leases totaling 23,801 square feet in leases that run until 2027 and 2032, with the longest lease of 12,488 square feet for the first-floor tenant running until 2034. While these leases produce about \$0.7 million per year in income, the leases also block use of that space by ACPS unless the leases were bought out. The cost of that buyout will not be known until negotiations between ACPS and the tenants occur. ACPS believes that it can buy out at a reasonable cost the shorter-term leases making three of the four floors available for ACPS use in the short-term. The first floor would likely remain rented for some period of time.

If Council concurs with my recommendation, the building purchase will need to be considered by the Planning Commission’s 9.06 process as well as an appropriation be made by Council in September, and the City’s 2021 borrowing plans increased by \$17.9 million.

Proposed Uses

Since the start of discussions in April about this potential purchase there have been a number of potential uses considered by ACPS: ACPS has settled in on a firmer proposed plan. In the short-term, vacant space in 1703 would house some ACPS administrative functions, then serving as swing space for schools to allow the rebuilding of the George Mason Elementary School and then the Cora Kelly Elementary School, and finally a new 600 student elementary or secondary school which the ACPS projects the need for in about 10 years. The Schools CIP did not have any swing space facility budgeted in their CIP request for the George Mason of Cora Kelly projects. If enrollment falls short of projections, and a new school is not needed, this space can be used for ACPS administrative offices that are now in leased space.

Net Present Value Analysis

ACPS also provided a Net Present Value Analysis during the purchase discussions with the City that asserts that purchasing 1703 Beauregard would represent a financial gain over building a new 600 student school in 10 years. The prior ACPS analysis makes assumptions about leases that are not consistent with the latest ACPS plans. The assumed discount rate in the analysis is too high, the cost of financing is also not factored in, and the analysis assumes that in 10 years a 33-year old building has the same remaining lifecycle costs as a new building. In addition, no swing space alternative costs are factored in. As a result, there are so many unknowns that were not able to be calculated, that it is best to set-aside this analysis and consider the two options similar in economic value.

FISCAL IMPACT: The acquisition cost of the 1703 building of \$17.9 million and the subsequent renovation costs of \$15 million are not included in the adopted ACPS, nor the City CIP in FY 2022. If 1703 replaces the new 600-student school in the latter years of the CIP, then the construction budget for a new school can be eliminated. The fiscal impact is less a matter of the reallocation of these funds, and more on the short-term and mid-term impact of this purchase and renovation on the City’s debt service budget. Debt service on the \$17.2 million would be about \$1.6 million in the first full year of principal and interest repayment, and then start a gradual decline until fully repaid in year 20.

It should be noted that because of the private users of this building that tax-exempt bonds may not be able to be used to fund debt service because of IRS private use regulations that restrict the use of tax-exempt bonds when private parties are tenants. Therefore, some of the bonds issued may need to be taxable bonds with higher borrowing costs. This may add annually some \$0.1 million to \$0.2 million more the debt service numbers, raising the debt service cost to between \$1.7 and \$1.8 million for the first full year of principal repayment. The application of the \$0.7 million in rent would lower the annual budget impact to between \$1.0 million and \$1.1 million.

While not an unsurmountable budget number by itself, that addition of debt service (along with the debt service resulting from the recent approval of \$12.5 million in new aquatic facility funding by ACPS and City Council) will exacerbate an already very challenging debt service budget picture for the next few fiscal years. While City staff is working to temper this rate of increase, a steep climb of debt service and significant tax rate increase pressure will be present in FY 2023, FY 2024 and FY 2025.

FY 2022 - 2026 General Fund Debt Service



