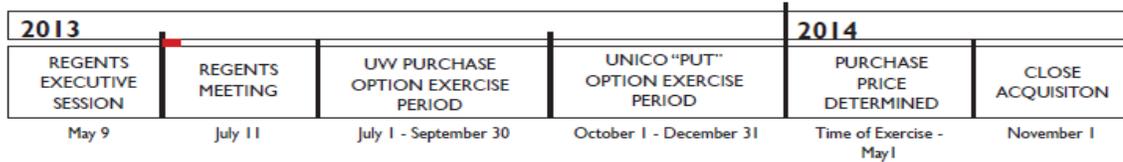


VII. STANDING COMMITTEES

B. Finance, Audit and Facilities Committee

Cobb Building – Approve Exercise of Purchase Option and Financing Plan



RECOMMENDED ACTION

It is the recommendation of the administration and the Finance, Audit and Facilities Committee that the Board of Regents:

1. Delegate to the president or his designee the authority to exercise the purchase option for the leasehold interest in the downtown Cobb Building. Final settlement price will be determined by May 1, 2014 and the closing date will be November 1, 2014; and
2. Approve the financing plan for the purchase at a borrowing amount not to exceed \$36 million to include closing and financing costs.

RATIONALE

1. Regain property control with the rest of the Metropolitan Tract
2. Re-capture underlying land value
3. Capture discount on purchase price driven by current market conditions

BACKGROUND

The Cobb Building is an 11 story 90,000 square foot building located on the corner of University and Fourth Avenue in downtown Seattle within the University’s Metropolitan Tract. It was built in 1910 and was one of the first medical office buildings on the west coast. In 1955, the Cobb Building was included in the master lease that the University signed with Unico Properties (“Unico Master Lease”). It was operated and managed by Unico as a medical office building until 2004.

In July of 2004, the University amended the Unico Master Lease to remove the Cobb Building. At the same time, the University entered into a new 45-year lease with Unico to implement a significant re-development and conversion of obsolete medical office space to 91 high-end rental apartment units. In accordance with the lease agreement, the University contributed approximately \$7.9 million to the \$38.5 million development. The University receives \$154,000 per year in rent but has no additional obligation or liability for development costs or on-going operating expenses.

VII. STANDING COMMITTEES

B. Finance, Audit and Facilities Committee

Cobb Building – Approve Exercise of Purchase Option and Financing Plan (continued p. 2)

The lease provides the University with three purchase opportunities in October 2014, October 2024 and October 2034. The University has a window in which it can exercise the 2014 purchase option: July 1st through September 30th 2013. If the option has not been exercised by that date, Unico has 90 days to “put” the property back to UW. If no action is taken by December 31, 2013, there will not be another purchase opportunity until 2024.

The University’s most recent analysis of the market value of the property indicates the following estimated purchase price for the leasehold:

Appraised Value of Property:	\$50 million
<Less: Land Value>	<\$2.2 million>
<Less: Excess Return to UW>	<\$13 million>
Equals: Purchase Price	\$34.8 million

The final appraised value will be determined by a process set forth in the lease that requires the appointment of MAI appraisers by both the University and Unico. A final value must be decided on by May 1, 2014.

The land value is fixed at \$2.2 million per the lease agreement.

The Excess Return is determined by a formula set forth in the lease and is based primarily on the property’s market appreciation from 2004 to 2014. Unico is guaranteed an annual internal rate of return and any excess return is shared with the University in the form of a purchase discount. If the final appraised value exceeds \$50 million, the University’s discount will increase by \$0.75 for every \$1 of higher value.

PURPOSE AND BENEFIT

The University plans to exercise its purchase option to gain control of the property and to realize the current discount (excess return).

Buying the remaining leasehold interest in the Cobb Building will consolidate the University’s ownership of all of the properties leased to Unico since 1955. With control, the University will have the flexibility to either manage the building for its annual operating income of \$2.3 million or ground lease the property to earn higher rent based on the increased underlying land value.

The University’s analysis and recommendation related to the purchase of the leasehold interest in the property have been reviewed with the Advisory Committee on Real Estate (ACRE).

VII. STANDING COMMITTEES

B. Finance, Audit and Facilities Committee

Cobb Building – Approve Exercise of Purchase Option and Financing Plan (continued p. 3)

PROPERTY PROFILE

- Agreement: Long term ground lease to Unico Properties
- Lease Expiration: 3/23/50 (40 years remaining on 45 year term)
- Size: 90,000 Square feet ; 11 stories; 91 Units
- Occupancy: 98%
- 2012 Operating Income: \$2.3 million
- Ground Rent: \$154,000/year
- Capital Expenditures: Unico funds all tenant improvement and capital costs

PURCHASE TERMS

The Purchase and Sale Agreement for the leasehold interest will be finalized before November 1, 2014 and is planned to contain the following general terms:

- Seller: Cobb Building LLC (owned by Unico Properties)
- Purchase Price: Estimated to be no higher than \$40 million (final price subject to appraisal conducted by May 1, 2014)
- Closing Date: November 1, 2014
- Due Diligence Prior to Exercise of Option: University inspection of title, property conditions, leases and contracts
- Contingencies: None

FINANCING PLAN

Sources and Uses of Funds (\$000):

Sources of Funds

Taxable General Revenue Bonds	35,600
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Uses of Funds

Estimated Lease Buyout	35,000
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Estimated Closing Costs	250
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Estimated Financing Costs	350
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Total Uses of Funds	35,600
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Estimated Annual Debt Service (30 years, 5%)

Metropolitan Tract Revenues	2,319
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VII. STANDING COMMITTEES

B. Finance, Audit and Facilities Committee

Cobb Building – Approve Exercise of Purchase Option and Financing Plan (continued p. 4)

Metropolitan Tract revenues are considered appropriated local funds; therefore this loan is excluded from the Internal Lending Program. Additionally, due to the commercial use of the property, tax exempt funds are not available. The interest rate on the loan will be a pass-through of the actual taxable interest rate that the University is able to obtain when bonds are issued.

Treasury Office, in conjunction with UW Real Estate, has performed due diligence on this purchase and is comfortable that the projected net operating income is sufficient to service \$36 million in debt at 1.0 times coverage for the first full year of operations in calendar 2015, increasing to 1.1 times coverage by the 4th year of University ownership. As a conservative measure, the assumed interest rate is 5%, roughly 50 basis points higher than today. This is a newly renovated asset in a prime downtown location that commands premium rents and will continue to do so in the coming years. The ten year proforma in Attachment A shows the revenues and expenses from this project.

There are some risks to this transaction. By exercising the option, the University is locked into buying out the lease and is subject to market risk and interest rate risk until the closing date of November 1, 2014. If real estate values climb substantially in the next sixteen months, UWRE will fund any difference between the maximum loan amount and the purchase price with Metropolitan Tract reserves. Unrestricted reserves as of June 1, 2013 were \$15.5 million. A 50 basis point interest rate cushion has been built into the proforma and the project is affordable at that level. If rates increase more than 50 basis points, UWRE will fund the shortfall from other Tract revenues or reserves.

A sensitivity analysis was performed on the impact of interest rate changes on the amount that is required from UWRE reserves and revenues. With each 25 basis point increase in rates, UWRE will be required to fund about \$1 million from reserves or pay an additional \$70k in annual debt service.

OPERATING PLAN

The University will retain the current third party residential management firm to conduct the day-to-day activities of the property. Operating and maintenance costs will be paid from Cobb revenues before debt service. Future capital maintenance and improvements will be paid from net cash flows.

The property will be managed along with the other Metropolitan Tract properties in the University's downtown portfolio.

VII. STANDING COMMITTEES

B. Finance, Audit and Facilities Committee

Cobb Building – Approve Exercise of Purchase Option and Financing Plan
(continued p. 5)

REVIEW AND APPROVAL

The purchase of the Cobb Building leasehold interest and the financing plan have been reviewed and recommended for approval by the Senior Vice President and the Chief Real Estate Officer.

Attachment
Financial Proforma

<u>Cobb Building</u> (\$000)	<u>CY 2013</u> Projected Unico	<u>CY 2014</u> Projected Unico (10 mos)	<u>CY 2014</u> Projected UW (2 mos)	<u>CY 2015</u> Projected UW	<u>CY 2016</u> Projected UW	<u>CY 2017</u> Projected UW	<u>CY 2018</u> Projected UW	<u>CY 2019</u> Projected UW	<u>CY 2020</u> Projected UW	<u>CY 2021</u> Projected UW	<u>CY 2022</u> Projected UW
Total Operating Revenue	3,180	2,729	546	3,373	3,474	3,579	3,686	3,797	3,911	4,028	4,138
Total Operating Expenses	970	832	166	1,029	1,060	1,092	1,124	1,158	1,193	1,228	1,265
Net Operating Income	2,210	1,897	379	2,344	2,415	2,487	2,562	2,639	2,718	2,799	2,873
Debt Service (DS) ¹	1,277	1,064	387	2,319	2,319	2,319	2,319	2,319	2,319	2,319	2,319
Debt Service Coverage	1.7	1.8	1.0	1.0	1.0	1.1	1.1	1.1	1.2	1.2	1.2
Non-Operating Income	-	-	-	-	-	-	-	-	-	-	-
Ground Rent Payment to UW	174	145	-	-	-	-	-	-	-	-	-
Net Income (After DS & Grd Rent)	759	688	(7)	25	96	168	243	320	399	480	554
Beginning Balance			-	(7)	18	114	282	525	844	1,243	1,723
Ending Balance			(7)	18	114	282	525	844	1,243	1,723	2,277

Notes:

¹UW debt service includes principal and interest and is calculated on borrowing amount of \$36M @5.0% over 30 years