



PROSPER
PORTLAND
Building an Equitable Economy

DATE: January 16, 2019
TO: Board of Commissioners
FROM: Kimberly Branam, Executive Director
SUBJECT: Report Number 19-02

Authorizing an Amendment to the Pre-Development Services Contract with Mortenson Construction for Design of the 100 Multnomah Office Building in the Oregon Convention Center Urban Renewal Area

BOARD ACTION REQUESTED AND BRIEF DESCRIPTION

Adopt Resolution No. 7299

This action by the Prosper Portland Board of Commissioners (Board) will authorize an amendment to the Pre-Development Services Contract (Contract) with Mortenson Construction and increase Prosper Portland's investment in the 100 Multnomah Office Building (Office Building) at the southwest corner of NE Multnomah Street and NE 2nd Avenue in the Oregon Convention Center Urban Renewal Area (URA); see a Project Summary in Attachment A.

The Office Building is proposed to be located adjacent to and on top of the Prosper Portland-owned Convention Center Garage (Garage) that is currently under construction. Staff is requesting Prosper Portland Board approval since this increased investment exceeds the amount previously authorized for this project; if approved, the agency's commitment to the Office Building will increase from \$477,593 to \$1,602,052 and will enable Prosper Portland to complete the design work necessary to achieve approval by the Portland Design Commission.

STRATEGIC PLAN ALIGNMENT AND OUTCOMES

The effort to design and construct the Office Building on top of the Garage aligns with Prosper Portland goals by: (1) creating healthy, complete neighborhoods by contributing to the continued growth and tenanting of the Lloyd District and the Convention Center area as a mixed-use, transit-oriented employment center; and (2) supporting the agency's financial sustainability, since this will maximize the development of the property's air rights and provide an opportunity for Prosper Portland to generate income to continue invest in public goals.

Amending the Contract will enable Prosper Portland to advance the Office Building through schematic design and 50 percent design development and prepare the associated cost estimates, including participating in a Design Advice Request and Design Review Hearing with the Portland Design Commission. Combined with continued tenanting and financing efforts, this enable the agency to further examine overall financial feasibility of the Office Building.

If the Office Building is determined to be feasible upon completion of this work, staff will likely seek future Prosper Portland Board approvals for the following phases of work, or the pursuit of a development partner who could assume these costs:

- Approving a Design-Build Contract with Mortenson Construction, including approximately \$1,500,000 to complete design development and construction documents and specifications;
- Approving the Contract Price for the Office Building; and
- Approving a \$12,000,000 to \$20,000,000 equity investment for construction of the Office Building.

On February 14, 2018, through Resolution No. 7263 the Prosper Portland Board, acting as the agency's Local Contract Review Board (LCRB), authorized exempting the Contract from low bid solicitation. Should Prosper Portland be the contracting entity for certain scopes of work, subsequent contracts with Mortenson Construction would also require LCRB exemption from low-bid solicitation.

BACKGROUND AND CONTEXT

The Oregon Convention Center Urban Renewal Plan was adopted in 1989 with the primary goal of establishing "at least one headquarters hotel in the immediate vicinity of the Oregon Convention Center to capitalize on the convention center's capacity." Between 2004 and 2012, Prosper Portland partnered with Metro – the owner and operator of the Oregon Convention Center – to accomplish this goal. In May 2012, Metro issued a competitive Request for Proposals for a development team to build, own, and operate a private convention center hotel; Metro Council ultimately selected the Mortenson Development, Inc. team, which includes Mortenson Construction as the general contractor. The Prosper Portland Board supported this selection on April 30, 2012 through Resolution No. 6942. Metro subsequently entered into a binding Development and Financing Agreement with Mortenson Development for the construction of the 600-room Hyatt Regency Portland at the Oregon Convention Center (Hotel), which is currently under construction and anticipated to open in fall 2019.

Through the Hotel design and development process, Prosper Portland, Metro, Mortenson Development, and Hyatt determined that the Hotel's parking needs would best be met through construction of a stand-alone parking structure on the adjacent 0.88 acre Prosper Portland property known as Block 49. Through Resolutions No. 7165 (February 10, 2016) and No. 7222 (December 14, 2016), the Prosper Portland Board authorized entering into a Parking Structure Development Agreement with Mortenson Development to construct a 442-stall, seven-story parking garage (Garage) on Block 49 for an amount not to exceed \$32,200,000 to support the development and operation of the adjacent Hotel. Resolution No. 7222 and the related not-to-exceed cost included the foundation and superstructure within the Garage to support future development of an office tower above. The Garage is currently under construction and is anticipated to be operational in summer 2019.

During the Garage design and development process, the site was determined to have additional development and entitlement capacity beyond the Garage. Consequently, Prosper Portland directed Mortenson Development to prepare a preliminary plan to develop an approximately 100,000 square foot Office Building served by two additional levels of parking on top of the Garage. Mortenson Development completed this work and incorporated into the Garage design the systems and foundation superstructure necessary to support a potential Office Building.

On February 14, 2018, the Prosper Portland Board approved Resolution No. 7263, which authorized entering into a Pre-Development Services Contract (Contract) with Mortenson Construction for \$477,593 to complete conceptual design and associated cost estimate for the Office Building. Prosper Portland and Mortenson Construction subsequently entered into the Contract on July 12, 2018, with that work completed between July and December 2018. Concurrent with this design effort, Prosper Portland hired an office broker, Capacity Commercial Group, to evaluate market conditions and pursue tenancing opportunities, and a development advisor, Bruce Wood, to evaluate the development

feasibility and financing opportunities for the Office Building. The results of this work are summarized below:

Conceptual Design, Cost Estimate, and Schedule

Mortenson Construction prepared a conceptual design for the Office Building that includes the following programmatic elements (see Conceptual Design Building Perspectives in Attachment B):

- Ten stories including 139,940 gross square feet (117,810 rentable square feet);
- Enhanced corner lobby with reconfigured elevator core;
- One and a half floors of parking (101 parking spaces) serving the office use;
- Second floor amenity space that could include bathroom and showers and gym/workout space or large conference room with approximately 100-person seating capacity;
- The lower floors (three through five), which are adjacent to and abutting the Garage, consist of approximately 7,000 square feet with 15-foot clear ceiling height that provide a unique full floor presence for smaller tenants;
- The upper five floors that are above the Garage consist of approximately 20,000 square feet which is an efficient floor plate for individual tenants or a multi-tenant scenario; and
- Top floor lounge and amenity space with views overlooking the Willamette River, downtown Portland, and the West Hills.

Mortenson Construction estimates the total construction cost for the conceptual design to be \$56,785,163. This cost estimate includes \$6,700,000 in design, estimating, and construction contingencies and assumes compliance with prevailing wage and Prosper Portland Green Building and Business and Workforce Equity requirements.

The current schedule anticipates the following major milestones for the scope of work included in the proposed contract amendment:

- Completion of schematic design by February 2019; and
- Completion of 50 percent design development by May 2019.

Through future phases of work subject to future approvals, the current schedule anticipates the following major milestones:

- Completion of 100 percent design development by August 2019;
- Completion of 75 percent construction documents and submission of a building permit package by November 2019;
- Construction to begin by June 2020; and
- Construction to be completed by May 2022.

Market Analysis

Prosper Portland staff has consulted with brokerage advisor Capacity Commercial Group on the current state of the office market. Overall, the Portland office market has been strong this economic cycle. Staff used several key statistics to evaluate the Class A office market including vacancy rate, lease rates, deliveries (new office space that becomes available), and net absorption (change in occupied office space). From this data (see Table 1 below), staff has concluded that the Lloyd sub-market continues to outperform the overall Central City market and that furthering design and development of the office building is timely and prudent.

Table 1

	Central City Combined	Lloyd Sub-Market
Vacancy Rate	11.6 percent	2.2 percent
Rental Rates	\$22.21	\$33.64
Deliveries (in square feet)	148,702	0
Net Absorption (in square feet)	88,936	(14,794)

Additionally, staff evaluated the pipeline of new construction in pre-development, under construction, and recently built. The Office Building will compete primarily against other new buildings that deliver in late 2021 and early 2022, although there may be additional competition from existing inventory and other unleased or partially leased buildings that are recently built. Overall, 1,340,839 square feet of new space has been delivered in the past year, 817,795 square feet is under construction, and 1,032,140 square feet is in pre-development. In reviewing the specifics of where the vacancy in this pipeline is concentrated, it seems to be mostly focused in less desirable locations for office space. By contrast, the well-located, amenity-rich office space is leasing well before and during construction. For a detailed 2018 office market summary, see Attachment C.

Tenancing Strategy

Prosper Portland is evaluating leasing space in the Office Building to both public sector and private tenants. For private sector tenancing, Capacity Commercial Group is marketing the Office Building through conventional market methods. Marketing began on October 24, 2018 and includes direct outreach to the brokerage community and suitable tenants, industry standard venues such as CoStar and Vertical Email, and through Capacity Commercial Group’s proprietary database. For public sector tenancing, Prosper Portland staff has been conducting direct outreach to public partners to discuss potential tenancing scenarios. Staff has had several meetings to date with possible public tenants that have expressed interest in the project and discussions are ongoing. Staff anticipates most leasing activity will occur after the Office Building has been approved by the Portland Design Commission.

Development Feasibility and Financing Opportunities

Prosper Portland staff has prepared a development proforma to evaluate total project costs (in addition to the total construction cost estimated by Mortenson Construction), financing scenarios, cash flows, and development metrics including internal rate of return and return on cost. As part of this effort, staff has contacted the City of Portland Debt Manager and private financing sources to provide insight into the availability of and terms for financing the Office Building, as there are insufficient Oregon Convention Center URA resources to fund full construction. Assumptions incorporated into this analysis include:

- Prosper Portland as the long-term owner and operator of the building (not intending to sell within two to three years after completion);
- Includes \$2,000,000 owner contingency. Together with the \$1,300,000 carried by Mortenson as construction contingency, this totals \$3,300,000 which equals 5.6 percent of total construction cost;

- Approximately \$900,000 in Regional Arts and Cultural Council funds for public art and \$900,000 in green energy technology costs for a total of \$1,800,000;
- Construction financing is likely to be available at rates ranging from 5.25 percent to 6.75 percent with 25-year amortization;
- Approximately 50 percent of the Office Building must be tenanted with reasonably high-quality tenants to secure financing;
- Lease rate of \$35 per square foot based on input from brokers;
- The higher the tenanting percentage and the higher the tenant quality, the lower the interest rate and equity requirements. Equity requirements could be as low as zero for a building fully tenanted with public agencies; and
- Financing terms are fluid and subject to negotiation. For example, leasing 50 percent or more of the building to a high-quality public or private tenant could significantly improve financing terms.

Staff evaluated several development scenarios and determined the following:

- Total project cost of the conceptual design, including all soft costs and financing costs, is approximately \$77,000,000;
- Prosper Portland development equity requirements range from \$12,500,000 to \$20,000,000; and
- Internal rate of return exceeds six percent, which is consistent with the agency's Financial Sustainability Plan.

In the event Prosper Portland decides to not pursue full development of the Office Building as developer and owner, investing in the incremental cost associated with the current proposed scope of work and subsequent work to complete the design through construction documents and permitting has merits. The result of that effort would be a fully permitted building (in accordance with the current International Building Code, which is subject to change effective December 31, 2019), which would be a marketable asset. If Prosper Portland were to pursue that approach, it could undertake issuing a solicitation for a development partner concurrent with the subsequent construction document phase or after receipt of building permits.

EQUITY IMPACT

Prosper Portland has a compelling interest to ensure that the agency's owned and sponsored projects provide opportunities for State of Oregon Certified firms (Minority-Owned, Women-Owned, Disadvantaged, and Emerging Small Businesses, or M/W/D/ESBs). Prosper Portland has established a 20 percent utilization goal for professional services costs and a 20 percent utilization goal for hard construction costs. For the \$477,593 in professional services awarded to Mortenson Construction in the Pre-Development Services Contract, Prosper Portland anticipates they will award 20.4 percent to M/W/D/ESB certified firms. For the \$1,130,000 phase of work included in this next phase, Prosper Portland anticipates Mortenson Construction will award 24 percent to M/W/D/ESBs.

Although the contract to construct the Office Building is not included as part of this work phase and will be awarded later subject to approval by the Prosper Portland Board, in terms of past and ongoing performance on Prosper Portland construction projects, Mortenson Construction has achieved:

- 24.1 percent M/W/D/ESB utilization on construction of the AC Marriott Hotel; and
- 21 percent M/W/D/ESB utilization on construction of the Garage to date.

Based on Mortenson Construction's results regarding both professional services and hard construction costs, Prosper Portland intends for Mortenson Construction to perform at a comparable or better level

during construction and to continue to take all reasonable and necessary steps to optimize opportunities for certified firms and achieve Prosper Portland’s equity goals.

COMMUNITY PARTICIPATION AND FEEDBACK

Prosper Portland staff recently presented the conceptual design of the Office Building and intent to proceed with the continued design and feasibility of the Office Building to the Go Lloyd Board. In general, feedback has been supportive of making the Garage a mixed-use project and maximizing development adjacent to the MAX light rail, and of the building contributing to a vibrant Lloyd neighborhood with elements that reflect the Lloyd EcoDistrict concept. The Portland Design Commission also publicly discussed the Office Building as part of the consideration of the Hotel and Garage design. Public comments during those discussions expressed support for maximizing development on the site and pursuing a mixed-use project above the Garage. During this next phase of work, staff will seek approval by the Portland Design Commission and will continue to coordinate with and seek input from the Go Lloyd Board.

BUDGET AND FINANCIAL INFORMATION

The fiscal year (FY) 2018/19 Oregon Convention Center URA Revised Budget includes \$650,000 for Project Development for the Office Building in FY 2019/20 and \$2,500,000 forecast for FY 2019/20 (see Attachment D). The amount allocated specifically to this project in the current fiscal year is not sufficient to fund the additional scope; therefore, staff will seek Prosper Portland Board approval of a spring 2019 budget amendment incorporating a reallocation of these funds between fiscal years.

RISK ASSESSMENT

Investing in design and development of the Office Building as an owner includes the following inherent risks:

- Project cost increases due to design changes and construction inflation;
- Tenanting;
- Lease rates;
- Market trends; and
- Availability of and terms for construction and permanent loans.

For any one or a combination of these risks, the Office Building may be determined to be financially infeasible. To mitigate these risks, Prosper Portland has:

- Completed conceptual design and an associated cost estimate including design, cost escalation, and construction/owner contingencies;
- Hired a commercial office broker to assess market conditions, trends, and office lease rates, and to pursue a tenanting strategy;
- Contacted public agency partners that may be interested in tenanting the building;
- Contacted public and private financing sources to determine the availability and terms for securing construction and permanent loans; and
- Evaluated total project costs and financing strategies.

This work has indicated that while risks remain, there are no “red flags” cautioning that the project is infeasible. These conditions will continue to be monitored and evaluated as staff proceeds through the next design phase. In the event costs and/or financing and tenanting prospects were to change significantly, Prosper Portland can terminate the Contract at any point.

In the event Prosper Portland were to determine at some future date that the project is infeasible to develop on its own (for example due to inability to secure sufficient lease commitments or inability to commit the required equity to the project), Prosper Portland would still own a permitted, shovel-ready office building as a marketable asset that could be bundled with the air rights and potentially sold in whole or in part to a development partner. It is highly likely that through such a development partnership, Prosper Portland would be able to recoup the incremental costs associated with advancing design of the Office Building through Design Review approval, construction documents, and permitting.

Not approving this action will result in schedule delays and inability to apply for permits under the current International Building Code, which the City of Portland anticipates amending effective December 31, 2019.

ATTACHMENTS

- A. Project Summary
- B. Conceptual Design Building Perspectives
- C. City of Portland 2018 Office Market Summary
- D. Oregon Convention Center URA Financial Summary