



Date: August 1, 2022

To: Wanda S. Page, City Manager
Through: Bertha T. Johnson, 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

In the Fall of 2017, the City of Durham began exploring options for the future use of the property located at 505 W. Chapel Hill Street (Parcel ID# 114577) given the City no longer had a municipal use for the site. After a period of community engagement, the City launched a two-phase solicitation process, which occurred from Fall 2018 to Spring 2019. As an outcome of this competitive solicitation process, in November 2019, the Durham City Council authorized the City Manager to enter into negotiations with The Fallon Company (“TFC”), a private development company, for the purchase and redevelopment of the property. In October 2020, negotiations resulted in the Durham City Council authorizing the City Manager to execute a Purchase and Sale Agreement, Master Development Agreement, and other necessary documents related to redevelopment of the property, based upon an approved development program submitted by TFC.

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).

In Spring 2021, TFC proposed revisions to the approved development program and deal points to restore project feasibility. Proposed revisions included: (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 onsite office space 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 North Carolina Brownfields Program. In April 2021, Durham City Council voted to reject TFC’s revised offer and directed the General Services Department to re-start the solicitation process.

In Fall 2021, the City re-opened the solicitation process, releasing a Request for Qualifications (RFQ) followed by a Request for Proposals (RFP). The City received two complete RFP responses. Both responses were reviewed by an evaluation panel composed of staff from across

City departments (Community Development, Finance, General Services, Planning, and Transportation). Both development teams were then interviewed in-person by the evaluation panel on June 10, 2022.

Based on the two proposals and after conducting interviews, the General Services Department proposes that City Council reject both offers and re-start the process.

Motion

To receive a presentation on the disposition and redevelopment of 505 W. Chapel Hill Street; and

To reject all proposals received in response to the Request for Proposals issued February 2, 2022, for the purchase and redevelopment of 505 W. Chapel Hill Street.

Background

Following the initial solicitation process, negotiations, and termination of the PSA with The Fallon Company, the City of Durham re-started the solicitation process. During the RFQ, individual development firms were invited to submit their qualifications as lead developer, affordable residential developer, and/or commercial developer. Pre-qualified firms were then invited to form a complete development team, defined as a lead developer, an affordable residential developer, and a commercial developer (where one firm could fulfill more than one role), and respond to the RFP.

Development teams were asked to respond to five defined City priorities for the site:

1. Provide 80 units of onsite housing affordable to residents at 60% AMI in perpetuity;
2. Generate significant revenue to the City from the sale of land and future local tax revenues from onsite development;
3. Deliver a mixed-use project, including a significant component of commercial space, with a preference for a minimum of 250,000 gross square footage;
4. Preserve the existing Milton Small Building as part of the development program; and
5. Deliver signature design and an activated street-level experience, to support Downtown's identity and vibrancy.

Issues and Analysis

Five firms were qualified as both lead developer and commercial developers; three firms were qualified as affordable residential developers; one firm was qualified as a lead developer only; and one firm was qualified as a commercial developer only. From this pool of pre-qualified firms, two complete teams were formed who submitted RFP responses: Akridge (lead and commercial developer) teamed with DHIC, Inc. (affordable residential developer); and Ancora (lead and commercial developer) teamed with WinnCompanies (affordable residential developer).

The two proposals were evaluated by the City's evaluation panel according to criteria laid out in the RFP. These criteria reflect the articulated priorities for site redevelopment:

Evaluation Criteria	Total Points
Approach to Affordable Housing Units	30
Generation of Financial Return to City – Offered land price, including delivery schedule & financing plan	18
Generation of Financial Return to City – Tax revenues	6
Generation of Financial Return – Deal structure and approach to financing affordable units	6
Approach to Delivery of Mixed-Use Development	10
Rehabilitation of Existing Building	10
Approach to Activated Ground-Floor and Overall Urban Design	10
Approach to Community Benefits – Engagement, programming, minority ownership	10
Total Points Possible	100

Both teams submitted development programs aligned with priorities laid out in the RFP, including meeting required minimum of 80 units of permanently affordable housing. The Akridge proposal contained a larger residential program, while the Ancora proposal put forth a larger component of lab and office space. There is also major variance in the financial offers submitted by each team. The table below provides an overview of how each team performed against the criteria included in the RFP:

	Akridge	Ancora
Approach to Affordable Housing Units	<ul style="list-style-type: none"> Meets minimum of 80 units permanently affordable at 60% AMI 400+ units split in two buildings : mid-rise w/ affordable units along Jackson St., high-rise, 100% market tower along Chapel Hill St. 	<ul style="list-style-type: none"> Meets minimum of 80 units permanently affordable at 60% AMI 293 units total in a single mid-rise building
Generation of Financial Return to City	<ul style="list-style-type: none"> Nominal offer for the land, paid up front 	<ul style="list-style-type: none"> Offer for the land contingent upon City subsidy
Approach to Delivery of Mixed-Use Development	<ul style="list-style-type: none"> Does not meet City's preference for 250,000 SF commercial space Retail included in both new lab and existing building 	<ul style="list-style-type: none"> Does meet City's preference for 250,000 SF commercial space Small component of retail & community space in existing building
Rehabilitation of Existing Building	<ul style="list-style-type: none"> Use of historic tax credits Ground floor retail & public art gallery Office space for tenants who value proximity to life science users 	<ul style="list-style-type: none"> Use of historic tax credits Ground floor café and childcare center Office and lab space to support diverse tenant mix
Approach to Activated Ground-Floor and Overall Urban Design	<ul style="list-style-type: none"> Open space anchored by "Central Green", accessible from all bounding streets Public art gallery in existing building Ground floor retail in residential and commercial buildings, provide conduit into public courtyard 	<ul style="list-style-type: none"> Highly visible, ~ 1 acre open space w/ frontage along Chapel Hill St. Public art that re-purposes staircase from original building Space for cafes and retail to activate ground floor

<p>Approach to Community Benefits – Engagement, programming, minority ownership</p>	<ul style="list-style-type: none"> • Onsite programming to engage youth; partnership with NCCU • Commitment to marketing equity ownership opportunities to minority investors 	<ul style="list-style-type: none"> • Onsite programming, including seed fund for minority life science entrepreneurs & workforce training • Community space for Blackspace • Commitment to marketing equity ownership opportunities to minority investors
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Both of the teams put forth low offers to purchase the site. In addition to the one-time purchase price, the generation of financial return to the City also included an evaluation of the future tax revenue streams associated with onsite development. The Durham County Assessor produced real estate property tax revenue and business personal property tax estimates over a ten-year period, based on each of the proposed development programs. The two programs are similar in terms of estimated total tax revenue generated. These estimates do not take into account the tax credits and exemptions that both development teams intend to pursue, including participation in the North Carolina Brownfield Program, which provides a reduced real estate property tax burden over a ten-year period. As such, actual tax receipts collected by the City of Durham would be lower than these estimates.

Treatment of the Milton Small Building

The preservation of the Milton Small building, one of five stated priorities for redevelopment, has a significant financial impact on the site’s land value.

- **Historic context of building:** The existing building was designed by George Milton Small Jr., one of the leading Miesian modernist architects in North Carolina. During the 1950s and 1960s he designed some of the most forward-looking projects in the Triangle region, including the Home Security Life Building at 505 W. Chapel Hill St. Dating to 1957, the structure is regarded as the state’s first Miesian tall office building. Many of Small’s buildings have been demolished in recent decades, and the structure at 505 W. Chapel Hill Street is one of the last remaining landmarks of Small’s mid-century modernism.¹
- **Impact on land value:** The building has been in disuse since 2018 and would require extensive rehabilitation to be put back into active use. This is not uncommon for buildings built in this era. Additionally, the transition from its original purpose, a commercial office building, to municipal police station resulted in site changes not necessarily conducive to a modern, 21st century commercial or residential use. Both development teams confirmed they would need to completely gut the building, which carries a high cost. The Akridge team’s financial offer is predicated on the Milton Small building having a residual land value of -\$7 million, while the Ancora team assumes rehabilitation of the Milton Small building nets a residual land value of \$890,000. This difference stems primarily from assumed rents and Ancora’s assumptions around City subsidies. Through high-level analysis, using development team assumptions, HR&A estimates the impact of the Milton Small rehabilitation on land value to be between -\$6.1 million to -\$4.5 million.

Alternatives

HR&A Advisors, the consultant firm engaged to assist the General Services Department throughout this process, provided City staff with context on macroeconomic trends that impact land value in order to help inform some of the decision points before Council:

¹ Black, David. “[Small, G. Milton, Jr.](#)” NC State University Libraries – Architects and Builders. 2021.

- **Rising construction costs:** The ongoing pandemic continues to impact construction costs, with significant price increases that impact project feasibility. In the Triangle, structural steel prices increased by 30% in the first quarter of 2021, and the price of construction materials overall are at a 35-year high.² As an illustration of this increase in prices, Akridge, one of the current finalists, also participated in the original solicitation process. Their construction cost budget in 2019 was \$113.5 million, while their construction cost budget in 2022 was \$253.6 million. The development programs are different (the original construction budget of \$113.5 million did not include preservation of the existing building), but the more than doubling of the budget highlights the large increases in cost. Nationally, construction materials experienced a 21% increase in cost from February 2021 to February 2022, and “many factors contributing to the destabilized prices remain unresolved and new issues are emerging,” suggesting that prices will be volatile through at least the end of the year and into 2023.³ It is unlikely construction costs will shift dramatically downward in the future. This high cost of construction impacts the amount a developer will be willing to pay to purchase the site—because rents have not grown at the same rate as costs, developers cannot fully offset construction costs, which in turn influences overall project feasibility and value.
- **Overall uncertainty in the market:** Rising construction costs are one factor contributing to overall uncertainty in the market. The Downtown Durham office market is facing high vacancy (Q1 2022 overall vacancy was 17.7%, 18.9% for Class A)⁴, compared to extremely low vacancy pre-pandemic, highlighting the ongoing uncertainty in the office market. Combined with supply chain issues, labor shortages, and rising inflation, developers are facing higher risk regarding new construction, and this higher risk in turn impacts the amount a developer will be willing to pay to purchase the site. As the volatility associated with the pandemic continues, it is unlikely that this perceived risk will decrease in the near-term, which will negatively impact the land value of the site in the short to intermediate time.

Within this economic context, there are several paths forward the City can consider, each with its own trade-offs and opportunity costs. As a first step, Council should confirm which policy goals are still a priority for site redevelopment. Once goals are confirmed, this will inform the appropriate mechanism and timeline for disposition. Depending upon next steps desired by Council, coordination with the City Attorney’s Office regarding a path forward will be necessary. Paths forward, and their ability to advance stated priorities are presented below:

- **Secure Affordable Housing:** If the City wishes to advance its priority around development of onsite affordable units, as a next step Council can explore subdivision of the site, enabling construction of a new mixed-income residential building to proceed, while retaining ownership of the remainder of the site for future disposition once market conditions stabilize. This would require a new solicitation process to enter into an agreement with an affordable residential developer.
- **Preservation of Existing Building:** A key first decision point is around the preservation of the existing building. The previous and current solicitation processes both required preservation of the existing building, given its architectural significance, which is discussed earlier in this memo. Confirming a position on the building—whether it must be preserved

² Wells, Erika. “[A perfect storm: Triangle contractors hurt by soaring construction costs.](#)” Triangle Business Journal. 13 April 2021.

³ Volz, Andrew. “[Construction Outlook – H1 2022.](#)” JLL Research.

⁴ [Raleigh-Durham Office Market Report.](#) Q1 2022. Avison Young.

and rehabilitated or whether the City is open to future development that demolishes the building—is a key next decision point for Council. Given the high costs associated with rehabilitation, the City could pursue a path whereby the City takes an active role in advancing rehabilitation of the building (i.e. acting as the developer itself in many ways), creating a new community asset. The City could also pursue a local landmark designation for the building, which allows for a 50% property tax deferral for as long as the property's historic features are maintained. This would improve the financial outlook for a private development partner, but would also have fiscal impacts for the City in terms of reduced tax revenue in perpetuity.

- **Negotiate with Existing Parties:** If the City is willing to accept a lower financial return in exchange for its other priorities—including affordable housing units, public open space, preservation of the building, and jobs-supporting commercial development—Council can choose to commence negotiations with Akridge and/or Ancora to secure a development agreement that advances the City's priorities.
- **Re-Start Process:** A fourth scenario is that Council decides to hold the entire site and go back to the market once conditions stabilize, in an effort to determine if a greater cumulative benefit to the City is attainable, now or in the near future. In thinking through a new process, the City will need to decide:
 - **Priorities for site redevelopment:** The current Durham City Council should articulate its priorities for site development.
 - **Mechanism for disposition:** Durham City Council can decide whether or not to proceed with a two-stage RFQ and RFP process intended to lead to a fee-simple disposition, which is the approach the City has taken in the last two solicitations. It can also decide if the City would be open to a ground-lease structure, whereby the City retains ownership and foregoes a larger upfront financial return from a one-time sale in favor of a long-term revenue sharing partnership with a private development partner. Lastly, if Durham City Council decides that generation of financial return is the ultimate goal, Council could decide to pursue an upset bid and sell the site with no restrictions (save for existing zoning and covenants associated with the site) to the highest responsible bidder.

Financial Impact

In advance of the RFP process, in July 2021, the City of Durham engaged a third-party appraisal firm to conduct a full appraisal of the site. The appraiser produced estimates of the site's land value under two scenarios: the market value of the site assuming a fee simple transaction with no restrictions, and the value of the site assuming a fee simple transaction with the City's priority restrictions in place (as laid out in the RFP, including preservation of the Milton Small Building and inclusion of 80 units of permanently affordable housing). Based on appraiser's analysis, the market value of the site in July 2021 was \$14.98 million, and the value with restrictions was \$8.39 million.

The financial offers to purchase the site submitted by both development teams were lower than anticipated and not in alignment with the third-party appraisal of the site. Given the disparity between the proposed offers and the appraised value, the City's Evaluation Panel concluded that neither proposal merited the low sales offers. The General Services Department therefore recommends that Durham City Council reject both proposals and receive direction from Council on how best to proceed.

Equal Business Opportunity Summary

The Equal Business Opportunity Program (EBOP) form was not utilized in the Request for Proposals process.

Contractor Workforce Diversity & Hiring Practices

Akridge

According to the contractor's responses to the "Contractor Workforce Diversity Questionnaire," the contractor is a large employer consisting of a mix of professional/skilled and unskilled workers. The contractor believes it has a diverse workforce because within the office component of the company, about half are female or minority. The contractor did list a few examples of efforts it makes to have a more diverse workforce. The contractor's response is attached to this memorandum.

DHIC

According to the contractor's responses to the "Contractor Workforce Diversity Questionnaire," the contractor is a small employer (less than 50 employees) consisting of mostly professional/skilled workers. The contractor believes it has a diverse workforce because 100% of the senior leadership is female while 59% of the total staff is female; of DHIC's professional and manager positions, 68% are held by females and/or minorities. The contractor did list a few examples of efforts it makes to have a more diverse workforce. The contractor's response is attached to this memorandum.

Ancora

According to the contractor's responses to the "Contractor Workforce Diversity Questionnaire," the contractor is a small employer (less than 50 employees) consisting of mostly professional/skilled workers. The contractor believes it has a diverse workforce because they have worked explicitly to recruit, hire, and retain minorities with specific focus on providing a career onramp and growth potential to non-traditional candidates. The contractor did list a few examples of efforts it makes to have a more diverse workforce. The contractor's response is attached to this memorandum.

Winn

According to the contractor's responses to the "Contractor Workforce Diversity Questionnaire," the contractor is a large employer consisting of a mix of professional/skilled and unskilled workers. The contractor believes it has a diverse workforce because they are more than 61 percent of its 3,770 team members are non-white and almost half are women; minority team members hold 60% of all managerial and supervisory positions. The contractor did list a few examples of efforts it makes to have a more diverse workforce. The contractor's response is attached to this memorandum.

Attachments

Exhibit A: Presentation

Exhibit B: Contractor Workforce Diversity Questionnaire - Akridge

Exhibit C: Contractor Workforce Diversity Questionnaire - DHIC

Exhibit D: Contractor Workforce Diversity Questionnaire - Ancora

Exhibit E: Contractor Workforce Diversity Questionnaire - Winn