

STATE BOARD OF LAND COMMISSIONERS
February 16, 2016
Regular Agenda

SUBJECT

Commercial Real Estate Business Plans

BACKGROUND

At its September 2015 meeting, the Land Board approved a contract with CenturyPacific, LLLP as the Commercial Real Estate Advisor to the Land Board. Under the terms of the contract, CenturyPacific would complete business plans and provide recommendations regarding management and prudent disposition of the commercial properties. Pursuant to their existing contract, CenturyPacific would revise the plans annually upon request and be available for ongoing consultation on the implementation of the business plans for additional fees.

DISCUSSION

CenturyPacific has completed draft business plans for nineteen commercial properties. The Land Board's Investment Subcommittee met on January 5, 2016, to review the business plans. The Investment Subcommittee found that the analysis was sound and that the plans met the requirements of the scope of work. The Land Board was briefed in executive session at its January 2016 meeting.

The plans recommend disposal of twelve of the properties during 2016 and four parking lots during 2017, and that the Land Board retain the Capitol Park Plaza building and adjacent parking lot, and the Hoff parking lot. A summary of the CenturyPacific analysis and recommendations is included as Attachment 1.

Part of the basis for the recommended disposal timeline is the current strength of the commercial real estate market. To maximize the value of the assets, every effort should be made to rapidly proceed with the disposal process.

The Department has evaluated the use of existing staff and continued use of the Land Board's Commercial Real Estate Advisor (Advisor) under the existing contract to manage the disposal process.

Use of existing staff to manage the disposal process would increase their workload and would impact the commercial property disposal process and/or the cottage site auction process. Without additional resources, the Department would not expect to be able to prepare twelve properties for auction this year. As a result, there is risk of missing the current strong real estate market. Using existing staff, the Department expects that 2-4 properties could be prepared for auction this year.

Alternatively, use of the Advisor would allow a third party expert to manage preparation of the properties for disposal. The Advisor would work cooperatively with Department staff and an assigned Deputy Attorney General on tasks described in Attachment 2. The demand on

existing staff would be reduced and the impacts on the commercial property disposal process and cottage sites auction process would be decreased. With the Advisor, the Department could strive to prepare twelve properties for auction in 2016. As a result, there is a better chance of capitalizing on the strong real estate market. The Advisor would coordinate the selection of service providers such as appraisers, title companies, environmental review services, surveyors, brokers, auctioneers, and others.

The Department recommends continued use of the Advisor to facilitate the commercial real estate disposal process. The Advisor will represent the Land Board and the Department in facilitating the disposal process. The Advisor has limited conflicts of interest and will act as a liaison between the Land Board and the Office of the Attorney General, the investment sales broker(s), property/parking management, and the selected service providers. In addition, the Advisor will act as a fiduciary and will work with the Department and the Office of the Attorney General to establish sale policies for buyer underwriting, pre-auction feasibility and post-auction closing periods as well as buyer qualification requirements.

Pursuant to CenturyPacific's recommendation, separate and apart from the Advisor role to avoid potential conflicts of interest, the Department recommends hiring a qualified investment sales broker(s) with significant experience in the relevant geographic markets and a firm grasp of the unique characteristics of the various property types.

RECOMMENDATION

The Department recommends approval of the following items related to the Land Board's commercial real estate portfolio:

1. Acceptance of the final commercial real estate business plans as developed by the Commercial Real Estate Advisor.
2. Disposal of the twelve commercial properties and four parking lots as specified in the business plans using a process consistent with the Idaho Constitution and Idaho Code.
3. Retention of the Capitol Park Plaza building, the adjacent parking lot, and the Hoff parking lot.
4. The Department will use the Land Board's Commercial Real Estate Advisor to manage the disposal process and provide continued assistance and expertise.
5. The Department and/or the Commercial Real Estate Advisor will procure other real estate service providers, including broker(s), needed to complete the disposal process.
6. The business plans and the disposal strategy will be reviewed annually or when changing real estate market conditions may dictate.
7. The Department will update the Land Board on the status of the disposals prior to the first auction and at other significant times during the process.

BOARD ACTION

ATTACHMENTS

1. Commercial Portfolio Executive Summary
2. Commercial Real Estate Advisor Tasks
3. Broker Scope of Work

COMMERCIAL REAL ESTATE PORTFOLIO
PORTFOLIO BUSINESS PLAN

EXECUTIVE SUMMARY

The State of Idaho Board of Land Commissioners' ("Land Board") commercial real estate portfolio is comprised of nineteen properties (including five parking lots) in Boise (15), Idaho Falls (3) and Heyburn (1). Property types include commercial office, specialty retail, self-storage, industrial, parking lots and an active equestrian training facility and with a single-family residence. The properties were acquired between 1993 (Garro Building, parking lots) and 2012 (Battelle Building) and current estimated asset values range from \$137,500 to \$5.5MM. The portfolio includes eight commercial buildings (and a variety of other structures, including a project with 33 self-storage buildings) and seven parking lots totaling 243,979 built square feet (SF) on 26 separate parcels (103.4 acres). In general, the properties are well-located, well-leased (83.7% as of December 31, 2015) at market rates, have high historical occupancies, and (with few exceptions) appear to be in good repair. With the exception of vacant and underutilized properties (Lincoln Road, Home Federal, Pleasant Valley), the properties are in service at their highest and best use.

The Land Board's original investment in the portfolio of properties is \$24,102,707. The current, estimated fair market value of the portfolio is \$31,502,435 - representing a nominal 30.7% value increase. If held by the Land Board, the estimated present value of future portfolio net cash flow is approximately \$27,288,778. Based on CenturyPacific's financial analysis, the current market value of the portfolio is worth 15% more to an investor than if held by the Land Board. Estimated 2016 portfolio net cash flow is \$1,394,017 (4.4% implied yield).

CenturyPacific strongly recommends the disposition of sixteen (84.2%) of the portfolio properties for two primary reasons: i) the current favorable real estate sales environment, and ii) management and operational issues related to the non-core nature of commercial properties in the context of the larger IDL-managed portfolio. At present, the investment market is robust and active for well-leased, well-located properties. Investors are purchasing assets at values implying aggressive direct capitalization rates not seen since the peak of the last market cycle. General economic fundamentals (employment growth, consumption) combined with investment sales inventory constraints, low-cost and highly-accessible debt financing and a low interest rate (and financial return) environment are fueling investor appetite and supporting the current "sellers" market. Should fundamentals change and capitalization rates rise, asset values and liquidity will move sharply downward. Secondly, IDL appears to have organizational structures and processes that, while likely very well-suited for the management of resource lands, create challenges for the efficient ownership and operation of commercial real estate. Based on CenturyPacific's review of provided information, IDL does not appear to have systems or personnel in-place to adequately monitor property or third-party contractor performance, cannot efficiently operate commercial real estate (capital projects, leasing, contracting) due to organizational requirements, is not following CRE best-practices as evident in property lease

documentation and reporting, and is burdened by liquidity and exit value constraints due to the auction/sale process.

CenturyPacific recommends retaining three strategic assets: Capitol Park Plaza, the adjacent CPP Lot and the Hoff Lot. These assets should be retained to accommodate for the long-term office needs (and occupancy cost management) of State of Idaho entities as well as to satisfy current leasehold encumbrances across the parking lot portfolio that could be consolidated on the Hoff Lot (the CPP lot is already 116% encumbered by lease commitments). If Capitol Park Plaza, the CPP Lot and the Hoff Lot are retained, the anticipated divestiture value of the portfolio is \$25,031,011 and combined 2018 (post divestiture) net cash flow is estimated at \$425,141.

Portfolio properties should be prepared for marketing (documents in order, operations optimized, appropriate professionals retained, asset opportunities/deficiencies addressed) and should be divested of in an orderly, prudent manner. Properties for divestiture should be aggressively marketed and sold pursuant to a sale process that is consistent with the Idaho constitution, tailored to commercial real estate. Portfolio properties should attract good local and regional interest from a variety of investors and command fair, risk-adjusted values upon sale.

Recommendation:

**Retain Capitol Park Plaza, the CPP Lot and the Hoff Lot
Divest all other properties**

Timeframe:

Early 2016-TBD 2017

Estimated FMV:

\$30,000,000-\$32,000,000

Estimated "If-Held" Value:

\$26,000,000-\$28,000,000

EXHIBITS

A: Portfolio Property Matrix

Portfolio Summary:

19 distinct properties in three cities: Boise (15), Idaho Falls (3), Heyburn (1)

Parcel Count and Areas:

Parcel Count: 26

Land Area: 103.37 acres

Built Area: 243,979 SF

Parking Stalls: 268 (on 2.08 acres of the 103.4 total acres)

Land Board Investment Type:

Income Producing

Property Types: 5

Commercial Office (6)

Retail (1)

Self-Storage (1)

Parking Lots (7)

Industrial/Commercial, including land (4)

Lease Status:

On average, the portfolio is 83.7% leased (excluding parking lots).

Parking stalls are 39.2% encumbered by current lease commitments (105 of 268 stalls).

Ownership Percentage, Acquisition Date and Initial Investment:

100% fee ownership. The properties were acquired between 1993 and 2010 for an estimated total of \$24.1MM. See Exhibit A for property-specific information.

Commercial Real Estate Advisor Tasks

The Advisor shall represent the Land Board and the Department to facilitate the management and prudent disposal process. The Advisor shall act as a liaison between the Land Board and the Office of the Attorney General, the investment sales broker, property/parking management and the selected real estate service providers. The Advisor shall work with the Department and the Office of the Attorney General to establish sale policies for buyer underwriting, pre-auction feasibility and post-auction closing periods as well as buyer qualification requirements.

Expected duties include, but are not limited to:

- 1) Preparation of properties for auction in cooperation with Idaho Department of Lands (IDL) staff, assigned Deputy Attorney General (DAG), and service providers to:
 - A. Negotiate and work to complete lease amendments as needed to improve the marketability and value of the assets.
 - B. Work to remove and/or resolve encumbrances, whether or not of record, to improve marketability.
 - C. Create documents including but not limited to estoppel certificates, assignments, non-collusion affidavits, purchase and sale agreements, deeds, and certificates of compliance with the constitutional limit on land sales contained in Article IX, Section 8 of the Idaho Constitution.
 - D. Develop an auction administration agreement along with any related documents or application forms.
 - E. Establish appropriate application fees and/or earnest money amounts.
 - F. Develop and populate publicly accessible document portal for prospective bidders.
 - G. Provide continued expertise regarding the transaction(s) through sale closing, recording and funding.
 - H. Perform any other due diligence deemed necessary and approved in advance by IDL.

- 2) Hire and manage subcontractors necessary to facilitate and complete the disposal process, including but not limited to:
 - A. Title companies.
 - B. Appraisers.
 - C. Environmental assessment contractors.
 - D. Broker(s) (to be recommended by the Investment Subcommittee and approved by the Land Board).
 - E. Auctioneer(s)/Transaction Professionals

- 3) With IDL and the assigned DAG, oversee the broker(s) to ensure the sales process is in compliance with Idaho Constitution Article IX, Section 8; Idaho Code §§ 58-313, 58-314, and 58-314A, and such other applicable laws or policies as may exist from time to time, except that installment sales are not authorized by the Land Board.

The Advisor will not provide legal services or advice, which remain the responsibility of the assigned DAG.

Investment Sales Broker Scope of Work

The Investment Sales Broker or Brokers (Broker) shall possess significant experience in the relevant geographic markets and a firm grasp of the unique characteristics of the various property types. The Broker shall provide all services required to effectively market and sell commercial real estate at competitive auctions.

Expected duties include, but are not limited to:

- 1) Develop robust, tailored marketing and outreach plans appropriate for the various property types.
 - A. Work with the Commercial Real Estate Advisor and the Department to position the property in the marketplace so as to maximize net sales proceeds to the Land Board, including working with other members of the divestiture team (appraisers, environmental contractors, DAG's office, title companies, Commercial Real Estate Advisor, etc.).
 - B. Provide a Broker Price Opinion for each property.
 - C. Market the properties to potential applicants for purchase.
 - D. Market the properties after an application is received to increase potential participation in the auction.
 - E. Produce and distribute marketing materials.
 - I. Electronic/web-based.
 - II. Printed.
 - III. Signage.
 - IV. Advertisements in industry publications.
 - F. Conduct tours of the properties for prospective applicants/bidders.
- 2) Maintain industry standard documentation for each property.
- 3) Sell the properties using an auction process tailored to commercial real estate while remaining compliant with the Idaho Constitution and Idaho Code as they pertain to the sale of endowment lands.
 - A. Identify the proposed location, physical set up, and logistics for the auction.
 - B. Furnish all equipment, materials and qualified personnel required to register and pre-qualify auction participants, to conduct the auction and to collect and secure funds during and after the auction.
 - C. Complete all actions necessary to close escrow for each auction.
- 4) Negotiation and transaction-related post closing activities.

This scope of work is preliminary and shall be refined by the Department, DAG, and the Commercial Real Estate Advisor prior to advertisement. Auction services may not be included in the scope of work for the Broker.