

DJJ Building

Overview/ Update/ Status

Presented to Avondale Estates DDA
2/13/18

Key Parties

- AE Downtown Development Authority (“DDA”) – Landlord
- Dept. of Juvenile Justice (“DJJ”) – Tenant
- State Properties Commission (“SPC”) – Lease oversight and negotiations
- Savills Studley – Leasing broker for SPC

History/ Background

- AE DDA was created in 2001
- The DDA and the DJJ then executed a lease wherein a building would be constructed for the DJJ’s on-going use subject to the terms in the lease.
- The DDA then utilized their ability to float revenue bonds to finance the design and construction of the building. There were 2 bond issuances (2002 and 2003 for \$10 million and \$4.5 million, respectively).
 - All costs associated with the building’s development were financed into the bond issuance.
 - No direct public funds were used.

Building and Lease Details

Building Detail

- 4.47 acres of land
- ~98,250 Rentable Square Feet
- 4 Stories
- ~200 parking spaces (2/ 1,000 sf)



Current Lease Details

- Current Premises Rent = ~\$1,762,281 (~\$17.94/ sf NNN)(Increases 2.5% annually)
- Current Operating Expense Rent = \$441,990 (\$4.50/ sf) (Does not include utilities)(Does not increase)
- Current Capital Reserve Deposit = \$34,695 (\$0.35/ sf)
- The current lease structure = “Typical” state lease structure pre-2015 - Annual renewals (1-year lease terms)
 - The rules have recently changed, so the State can now sign true 10-year leases.
- **Currently waiting for DJJ’s notice of their intent to renew for the July 1, 2018 – June 30, 2019 lease year.**
 - DJJ has until May 15th to provide renewal notice.

Key Dates/ Deadlines

- Bonds are retired in May, 2018
- DJJ lease expires June 30, 2019 (assuming they stay until then)
- DJJ has 1 extension option which would extend the lease term 1 additional year from July 1, 2019 – June 30, 2020 (“Initial Extension Term”).
- If the DJJ exercises the Initial Extension Term, they have the right to extend the term by an additional 9 years in 1-year increments (“Final Extension Term”).
 - DJJ must give notice of their intent to extend by January 31, 2019.
- The rental rate for the Extension Terms will be an amount “mutually agreed upon pursuant to negotiations between Landlord and Tenant...”
- Generally speaking, this rental rate would reflect current “market rates” determined by a third party.
- The DJJ’s current rent (~\$18/ sf NNN), is above market.

Quick Real Estate Investment Lesson

- Location is important, but leases have most the power.
- Value is determined by the amount of risk associated with an asset.
 - For leased buildings, the most important factors in determining value are:
 - Credit rating of the tenant
 - Remaining term on the lease
 - Current and future rental rate of the lease
 - Location
 - Condition of building
- **Specific to the DJJ Building:**
 - Credit is as good as it gets ✓
 - Remaining term is VERY uncertain and getting worse ✗
 - Current rent is above market, so future rent is very uncertain ✗
 - Location is average ✓
 - Condition is good ✓

Quick Recap

1. Bonds are retiring soon
2. The DJJ hasn't exercised their right to renew the lease for the July, 2018 – June, 2019 lease year.
3. The lease completely expires in June, 2019
4. If the DJJ elects to extend their lease beyond June, 2019, the rental rate will be adjusted.
5. There is a value and stability creation opportunity in stabilizing the lease term and rental rate unknowns.

Path Forward #1

1. Attempt to “stabilize” the building

1. Amend the lease to a new 10-year lease (true 10-year lease) with the SPC
 1. Reset the rental rate to market
 2. Provide tenant improvement (“TI”) allowance (\$) per the tenant’s reasonable requests and leasing commission (“LC”) (\$) per market standards
2. Engage a third party for a rental rate/ TI/ LC comparable study – The study has been commissioned by one of the largest real estate companies in the world. A draft has been produced and the final report will be presented for review at our next meeting.

• Pros:

- Removes perceived risk from the asset (adds value)
- Allows the DDA to financially plan ahead

• Cons:

- Potentially long process with the SPC (this can be mitigated)
- Added costs associated with tenant improvements and leasing commissions (several options to pay for this)

Path Forward #2 (if #1 doesn't work)

1. Wait and see

1. Maintain the status quo

1. Wait for the DJJ and SPC to approach us with terms for an extended lease (assuming they will)
2. Hope we can agree on terms at a later date

Additional Misc Info

- Parking
 - Currently the DJJ leases additional parking from MARTA in the adjacent MARTA surface parking lot.
 - A developer has proposed a new affordable housing development on the MARTA parking lot.
 - If the development proceeds, the DJJ would want/ need that lost parking replaced.
- There are examples of similar situations getting sideways.

QUESTIONS?