State Center – Transit-oriented Development Briefing

Department of Legislative Services
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Background

Current State Center Complex

State Center refers to an approximate 20+-acre campus comprised of four State office buildings and surface parking lots in mid-town Baltimore City, generally bordering Preston Street. In addition, the site contains a 650-space parking structure, a chiller plant, and the 5th Regiment Armory building. The complex contains the largest concentration of State government offices with close proximity to the State Center Metro stop and the Cultural Center light rail station. The current inventory includes approximately one million square feet of State office space for roughly 3,500 State employees working in many different State agencies. The site also contains approximately 1,000 parking spaces in both above ground surface lots and a below ground parking structure. The Department of General Services (DGS) is the custodial agent for most of the property; however, the Department of Labor, Licensing, and Regulation is the custodial agent for the 1100 Eutaw Street office building, and the 5th Regiment Armory is under the jurisdiction of the Military Department. The complex includes:

- 201 West Preston Street – completed in the early 1970s, includes 435,600 gross square feet (gsf), including 202,320 gsf of State office space, 82,080 gsf of lab space, and 151,200 gsf of parking garage space;

- 300 West Preston Street – completed in the late 1950s includes 118,907 gsf of State office space;

- 301 West Preston Street – completed in the late 1950s includes 334,183 gsf of State office space;

- 1100 Eutaw Street – completed in 1956 and includes 220,000 gsf of State office space; and

- Maryland 5th Regiment Armory.

Aging and Inefficient Facilities

According to DGS commissioned studies, the accelerated deterioration of the State Center facilities has reached the point where the State should consider strategic reinvestment options for its current and future office space needs at State Center. The 300 and 301 West Preston Street buildings, which combined comprise over half of the total gsf of State office space at the State Center Complex, are considered to be at or near the end of their useful life and continue to suffer from a backlog of deferred maintenance and asbestos abatement needs which have contributed to the accelerated deterioration and need for replacement of the facilities. Overall, DGS has determined that the deferred maintenance and asbestos abatement situation in these buildings is considered severe enough that a renovation is not considered economical or fiscally prudent.

In addition, studies suggest that excessive operating costs and inefficiencies further heighten the need to address future replacement of the State Center facilities. It is noteworthy that the excess costs are in many respects, attributed to the lack of adequate deferred maintenance of the facility. Overall, these studies conclude that the State's cost of occupancy would be lower if the State were to pay rent in privately developed, fully renovated space at State Center than it would if the State were to choose to extend the useful life of the current facilities and maintain State ownership and operation of the buildings.

Transit-oriented Development

The Administration has chosen to pursue a public-private partnership (P3) which would replace the current State Center property with a mixed-use transit-oriented development (TOD), consisting of office space, retail, housing, and parking. Some of the factors that helped shape this consideration include access to transit (Metro and light rail), the opportunity to implement a broader economic revitalization effort to reconnect neighborhoods in Baltimore City, State debt and fiscal limits making exclusive State funding unlikely, and the availability of equity from private sector partners.

Development Timeline

The TOD concept has been under consideration by the State at least since 2004. The following outlines the evolution of the project to date:

- **Selection of Master Developer:** A request for a master developer was issued in fall of 2005, with selection of Struever Brothers, Eccles, and Rouse with other partnering entities, referred to as State Center, LLC, made in the spring of 2006.

- **Memorandum of Understanding:** A memorandum of understanding was signed in June 2007 between the Board of Public Works (BPW) and State Center, LLC to set up exclusive negotiating rights.

- **Interim Development Agreement:** DGS and State Center, LLC agreed to an Interim Development Agreement in December 2007 for one year, plus two 30-day extensions.

- **Letter of Intent:** In December 2007, DGS was delegated authority to issue a letter of intent (LOI) to State Center, LLC, establishing basic parameters of the proposed redevelopment, including the location of State offices and employees and the preferred ownership structure of the redeveloped property. In September 2008, DGS issued the LOI forming the basis for negotiating the Master Development Agreement (MDA).

- **Preliminary Development Plan:** A Preliminary Development Plan was submitted in April 2008, outlining the proposed build-out and project development phases, an analysis of the anticipated development costs and funding mechanisms, and an assessment of the project's economic impact. DGS confirmed the Preliminary Development Plan in September 2008.

- **Master Development Agreement:** The MDA is a legal framework for development of State Center which:

  - grants exclusive development rights for 15 years;

  - provides for a phased development process, including:

    - a 50-year ground lease with two 20-year options; and

    - State space leases; and

  - makes provision for financial formulas that address:

    - ground lease rents; and

    - space lease rents.

DGS originally planned to request BPW approval of the MDA in early January 2009; however, the budget committees requested that the MDA approval be deferred until a hearing could be held on the project.

Developer Owner Option

After assessing various options for development of the State Center property, the Administration believes that a developer ownership model should be pursued. Under this approach, the developer would build the entire mixed-use development program, which includes the State office space, on land currently owned by the State. The State sells or leases the land to the developer and becomes a tenant, paying rent for office space. At the end of the long-term office space lease, the developer retains ownership of the building and land until the expiration of any ground lease.

Elements of the project would include a mix of new buildings, as well as re-skinning existing office buildings on the site. Re-skinning entails stripping the buildings to their structural components and rebuilding all systems (plumbing; electrical; and heating, ventilation, and air conditioning) and installing new facades. The total project would be completed in phases over an approximate 10-year period.

- **Office Space:** 1.35 million square feet in commercial space (including an undetermined amount of new or renovated State employee office space to replace the existing 950,000 square feet);

- **Retail Space*:*** 100,000 to 250,000 square feet of new ground level retail space;

- **Housing:** 700 to 1,400 new housing units (including a mix of market rate and workforce/affordable housing); and

- **Parking:** over 4,000 parking spaces including spaces for State employees.

Project Benefits

The Administration identifies the following benefits that it believes accrue from the development of this project as a TOD:

- **Economic Stimulus:** 12,000 new construction jobs would be created during construction, which is phased over multiple years, as well as an estimated 10,000 new non-state jobs upon completion.

- **New Taxes:** The property would be subject to property taxes, which benefits Baltimore City. Assumptions are made regarding additional direct and indirect sales and income taxes. Direct taxes are estimated at $35 million per-year to the State and $40 million per-year to Baltimore City at full build out. Indirect taxes are estimated at $24 million to the State and $20 million to Baltimore City. These benefits would not fully accrue until the debt on the tax investment financing is repaid.

- **Urban Redevelopment:** The restoration of the street grid would reconnect neighborhoods.

- **Green Buildings:** Implementation of Leadership in Energy and Environmental Design (LEED) Silver-rated buildings would reduce utility usage by up to 40%.

- **New Housing:** This includes roughly 1,400 houses, including 30% targeted as low-income units.

- **Transit Ridership:** Additional transit ridership would involve users of Metro, bus, and light rail options.

- **Efficiency:** A more efficient State office complex would result from development. State employees would be housed in new office space that is functionally efficient and environmentally friendly.

- **Debt and Operating Budget Mitigation:** Efforts were made to limit the impact on State debt affordability limits and the general fund.

- **Direct Benefits to the State:** The State would pay market-based rent, save the direct operating costs associated with DGS security and maintenance, receive a base ground rent of $2,000 per acre; and receive a share of net operating income.

Financing Plan

State Center is currently envisioned as a $1.6 billion project involving a combination of loans, private equity from the developer and institutional investors, a variety of tax credit programs, and debt issued by the State or State entities. **Exhibit 1** details the sources and uses for the proposed project. Specifically, this entails:

- $888 million in loans, consisting of a $741 million senior loan secured by income on the property and a $147 million loan on the condominium property;

- $338 million in debt issued by the State, consisting of a $314 million Tax Increment Financing issuance by the Maryland Economic Development Corporation (MEDCO) and a potential $23 million parking bond issued by the State;

- $234 million in various State and federal tax credit programs; and

- $145 million in equity from the developer and institutional investors.

Exhibit 1
State Center Transit-oriented Development Conceptual Financing Plan

Source	Amount	Assumptions
Senior Loan on Income Property	$ 741,300,646	6.75%-I 30yr-AM 1.2 DCR
NMTC on Income Prop Debt	$ 65,953,047	41.34% Enhancement
Construction Loan on Condo Property	$ 147,293,804	6.75%-I 30yr-AM 1.2 DCR
Federal Tax Credit Equity	$ 36,442,493	20%, $1.15 pricing
State Tax Credit Equity	$ 6,000,000	20%, $0.80 pricing
Low Income Housing Tax Credit Equity	$ 102,939,140	9% credits, $0.85 pricing
Equity - Master Developer	$ 28,900,585	20% of total equity
Equity - Institutional Investor	$ 115,602,342	19% IRR, 80% of total equity, 8% cash on cash
Max NMTC Enhancement on Equity	$ 23,017,205	41.34% enhancement
TIF Financing on Public Infrastructure	$ 314,254,055	See Chart Below
Parking Revenue Bonds on State Parking	$ 23,943,205	for 1 per 1,000 for state office
GAP	$ (6,396,258)	
Total Sources	$ 1,599,250,263	

Uses	Amount	Assumptions
Acquisition	$ -	
Site Development		
Public	$ 89,439,987	Assumes adequate utilities
Private	$ 17,217,933	Assumes adequate utilities
Hard Costs – Base Bldg		
Office - Reuse	$ 94,726,318	$210 /Square Foot*
Office - New	$ 308,669,076	$180 /Square Foot*
Retail - Reuse	$ 6,836,381	$210 /Square Foot*
Retail - New	$ 42,450,483	$170 /Square Foot*
Condo - Market	$ 92,143,156	$200 /Square Foot*
Condo - Affordable	$ 39,489,924	$200 /Square Foot*
Parking	$ 113,859,794	$20,000 /Square Foot*
Armory / Civic	$ 65,830,627	$160 /Square Foot*
Apartment	$ 250,369,392	$160 /Square Foot*
Hard Costs – TI		
Office	$ 97,465,766	$45 /Square Foot*
Retail	$ 22,581,034	$80 /Square Foot*
Soft Costs		
A&E	4%	% of construct
Leasing & Marketing	2%	% of construct
Organization & Profesional	2%	% of construct
Carry Costs	9%	% of construct
Financing & Settlement	4%	% of construct
Development Fees Market	4%	% of construct + SC
Development Fees - Mixed Income Apts.	10%	% of construct + SC
Total	$ 251,200,035	
Contingency	$ 106,970,359	
		*2008 Dollars
Total Uses	$ 1,599,250,263	

Note:
ALL NUMBERS ARE FOR DIALOGUE PURPOSES ONLY AND HAVE BEEN FORMED BASED ON CONCEPT DRAWINGS AND BROAD BASED INDUSTRY ASSUMPTIONS

Source: Master Development Agreement

Master Development Agreement

The Administration's current plan is to take the MDA to BPW for approval following a hearing by the legislature. This agreement is a legally binding document which outlines the parameters of the development predicated on three alternatives. Under the MDA, the State has three options, illustrated in **Exhibit 2**. This entails implementing the full phasing of the TOD as envisioned, rejecting the full development and permitting the developer to construct retail and housing on portions of the site, or rejecting both the concept plan and the alternative ground lease options and buying out the developers rights.

Approved Concept Plan

Upon BPW approval, the developer would submit a lease proposal for State review within one year. A draft of the phase ground lease plan would be submitted to the State within three years. The State and the developer would have six months to agree on the first phase ground lease and occupancy lease to be submitted for BPW approval. Each subsequent phase would follow these procedures until project completion. The term of the ground lease would be for 50 years, followed by two 20-year renewal options.

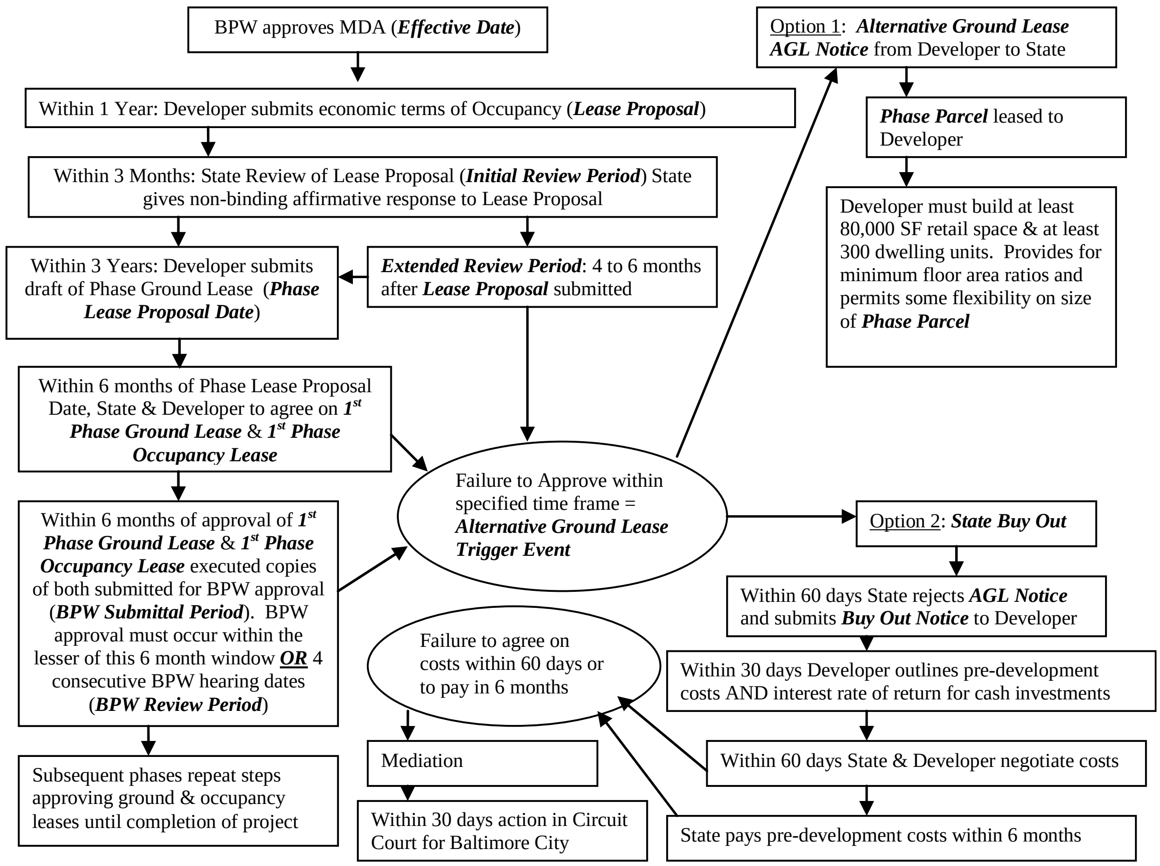
Alternative Ground Lease

An Alternative Ground Lease Trigger Event occurs if the State does not meet the review schedule and approval deadlines in the MDA or chooses to not move forward with the Approved Concept Plan. Under an Alternative Ground Lease, the developer may still choose to develop a TOD around the existing State office buildings under certain minimum density standards and the State would retain the right to renovate its buildings and maintain its presence within the existing building footprints.

State Buy-out Right

If the State opts to reject the Approved Concept Plan and the Alternative Ground Lease options, a buy-out notice would be sent to the developer. The developer determines the pre-development costs plus interest, and submits them to the State for negotiation. The State will have six months to pay those costs; however, if the State and the developer cannot agree on the amount within 60 days, it will result in mediation or ultimately court action in the circuit court for Baltimore City.

Exhibit 2
Master Development Agreement Flow Chart



BPW: Board of Public Works
MDA: Master Development Agreement

Source: Master Development Agreement

Policy Issues

There are numerous policy issues associated with this project. This includes a major shift from State-owned buildings to State tenancy, the viability of the financing plan, the true cost to the State, other options for redevelopment of the State Center complex, inadequate funding for the maintenance of State-owned buildings, and a virtually non-existent oversight role of the legislature for P3.

A Shift from State Ownership

State agency operations are housed in a mix of State-owned buildings and leased space. State Center represents a major shift from State-owned space to a model where the State would cede control of the site to a private developer for an extended term while paying market based rent. The underlying premise is that the State does not allocate sufficient operating or capital resources to the construction or maintenance of its office buildings, and thus must enter into an agreement with the private sector in order to develop and maintain administrative space. **The decision to shift from State ownership is a major one that should include the legislature, particularly since the costs to the State could be significant.**

Viability of the Financial Plan

Access to Capital

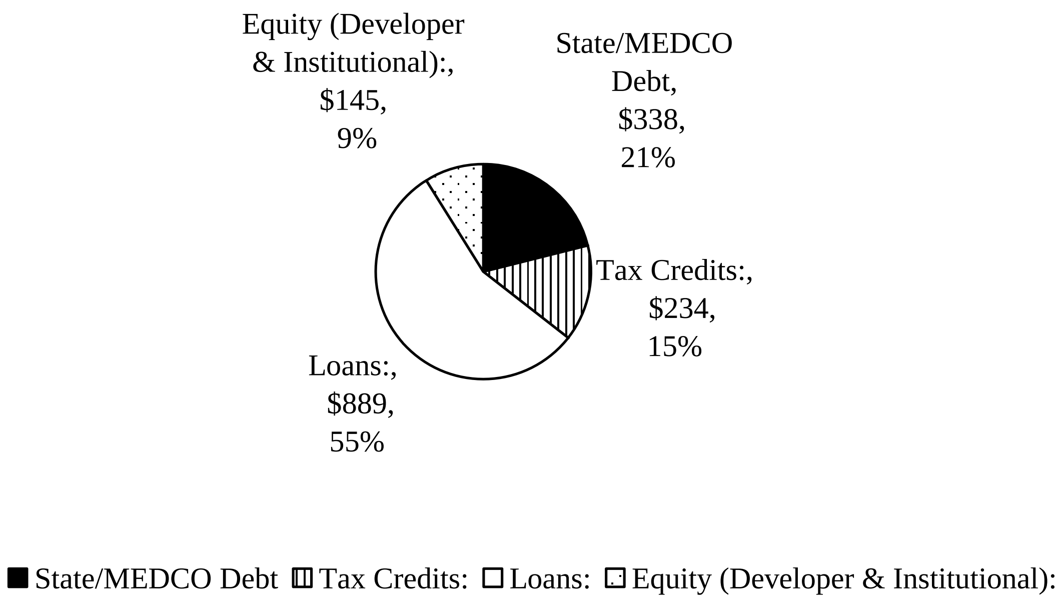
The collapse of the U.S. housing market and resulting surge in mortgage loan defaults is impacting financial institution lending policies. As currently configured, the project financing plan assumes over $1 billion in loans and use of private equity from the developer and institutional investors. Access to capital is more difficult as banks have tightened lending policies. The cost of this capital could be greater then anticipated, or alternatively may not be available at the levels contemplated.

In December 2008, the Florida Department of Transportation announced that a public-private partnership to construct the $1.2 billion Miami Access Tunnel had fallen through in part because of the issues related to the provision of private equity and the current uncertainty in the financial markets.

Availability of Tax Credits

The financing plan assumes that both federal and State historic tax credits would be used. The eligibility of these tax credits is questionable. The funding plan also entails the use of the federal Low-income Tax Credit. Typically the State receives approximately $100 million of Low-income Housing Tax Credit program authority annually from the federal government which is administered under federal guidelines as a competitive allocation. The State Center TOD would command a large share of the entire allocation in the year in which the tax credits would be used. Another consideration is the marketing of the credit. The proposed financing plan indicates $0.85 pricing, which in the current tax credit market would be considered high. Should the pricing be less than anticipated, the amount of credits applied for would need to increase accordingly.

Exhibit 3
State Center Financing Plan
($ in Millions)



MEDCO: Maryland Economic Development Corporation

Source: Master Development Agreement

Costs to the State

The State Center TOD project can be expected to have significant capital and operating costs to the State. One of the difficulties with analyzing this proposal is that many large elements have, and continue to be, under development. The Administration plans to complete the project in four phases over a multi-year period. Operating leases for each phase are expected to be completed as each phase is developed. The true impact on the State budget may never be known.

However, the State is an equity partner in the project as it relates to anticipated cash flows and future rent payments. As such, the State should be able to clearly understand its financial position and obligation prior to executing the MDA and any future ground and operating leases. The State should be provided with a clear and concise financial pro-forma that assesses the economic impacts of the various development proposals through returns analysis to both the State and proposing developer based on current development costs and values, including the value of the State Center assets.

Capital Issues

- **Assessed Value of the State Center Property:** DGS has been procuring assessments of the properties at State Center but has not publicly announced the range of value. Under the TOD proposal, the State would receive $2,000 per acre under a ground lease, as well as a share of potential net income. However, it is not apparent that the State will receive fair value or future value under this arrangement. Moreover, the receipt of appraisals is not enough in this instance to be able to make informed decisions about the value of the asset that the State is bringing to the table in the proposed development. Instead, the Maryland Department of Planning should be providing the State with this evaluation under its clearinghouse responsibilities prior to any disposition of the property.

- **Site Development Costs:** Site development costs are estimated at $106.7 million – with 84% allocated to the cost of the State office portion of the project. It is not clear why such a large allocation of these costs is made to the State office portion of the project, which effectively drives up the rents required from the State.

- **Project Counts Toward Debt Affordability Limits:** Although the Administration has attempted to establish a financing plan which permits construction of a $1.6 billion project outside of State debt affordability limits, it is apparent that the project would fall within the definitions of a capital lease. The proposal indicates that long-term State ownership is expected, suggesting that the State will occupy the facilities for the majority of their useful life. Additionally, the ownership of the property again reverts to the State at the end of the lease term (which could be as short as 50 years or as long as 90 years if both 20 year extensions are exercised). What effect a project of this magnitude will have on the State's debt criteria will need to be evaluated.

Operating Issues

Issues Related to Rent

Under the proposal, the State would be required to pay market based rent. Documents prepared at various times suggest that this amount would be in the range of $26-$28 per square foot, or higher. The Administration asserts that the State will pay less in rent than it pays now, when factoring in assumptions for asbestos removal and costs to extend the life of the facilities for 10 years. However, based on how the State budgets for capital projects (which are not a component of operating rent) the Department of Legislative Services (DLS) believes that agency rents will increase significantly in the operating budget. Issues pertaining to rent include:

- **Unequal Comparisons Relative to Operating Budget Impact:** The Administration is making an unlike comparison of capital costs, which would not appear in agency budgets, with the actual rents that would appear in the operating budget. Asbestos abatement costs and any costs for extending the life of the buildings would likely be funded from the general obligation (GO) budget. Amortizing these capital costs over 10 years and including them in rent calculations inflates the cost of rent.

- **What Is Market Rent?** As shown in **Exhibit 4**, the rent includes a number of components including the costs of debt service, taxes, building fit-up, utilities, security, plus any extras that the State would want to add to monitor water and electricity savings.

- **Effects of Rent Escalation and State Options to Move:** The developer is relying on the State to be a long-term tenant in order to retire the large amounts of debt associated with the project. Data from the developer suggests that 3% rent escalations can be expected annually, potentially increasing rents above $40 per square foot in the out-years. The State is likely to not have much choice about paying its rent regardless of how high it goes, nor to be able to move to less expensive space.

Exhibit 4
State Center Redevelopment Rent Calculation

Rent Components	Items Covered by Each Component
Base Building Rent	Debt service, cash-on-cash return divided by net leasable space with annual escalation
Tenant Improvement Rent	Improvements to base building to prepare space for occupancy Amortized over term of occupancy lease as square foot cost
Pass Through Rent	State share of operating expenses -utilities, maintenance, security, housekeeping, etc. -taxes With annual escalation
Direct Add-ons	Electricity smart meters Use of renewable energy sources or offsets Installation of water meters Utilities billed directly to the State Added housekeeping

Source: Master Development Agreement; Standard State of Maryland lease form with green provisions

Issues Related to the Private Sector Return on Investment

- **Costs for Payments to Developer and for Use of Private Equity:** The development plan calls for an approximate $50+ million development fee paid to the development team. In addition, the MDA would provide a rate of return of 19% to the equity investors, which may be considered excessive and above industry standard.

Issues Related to Expected Benefits

- **Effect of Higher Rents on New Taxes to the State:** As shown in Exhibit 4 , the State payment includes components based on debt service and taxes. The additional taxes to Baltimore City and the State will apparently be derived in part from the higher State rents, albeit passed through to each level of government after making payment to the developer;

- **Effect of Substitution on New Jobs:** In addition to construction jobs created as the project is developed, the proposal assumes the creation of new jobs both through new retail and office space. It is not known to what extent the jobs counted are based on the movement of State agencies from other sites (either in Baltimore City or one of the counties). To the extent that this substitution is not accounted for, the number of jobs created may be overstated.

- **Net Operating Income Likely to Be Minimal:** As negotiated and contemplated in the MDA, the base annual rent payment to the State is $2,000 per acre. The subordinated equity participation is structured such that to the extent available net operating income payments would be paid in the following priority order: (1) debt service; (2) reserves; (3) preferred developer return; (4) developer pre-development costs; (4) 80% to the State until all reimbursement rent is paid and 20% to the developer; (5) once all reimbursement rent is paid, that State would then receive 10% as profit-sharing rent and 90% would go to the developer.

Other Operating Issues

- **Utility Cost Savings:** The buildings would be built as LEED Silver-rated buildings which should result in an energy reduction factor. The Administration assumes almost a 40% reduction from current energy costs. Can such a savings materialize?

- **Security and Administrative/Maintenance Cost Savings:** Under the developer built model, the occupancy cost comparison assumes building security costs would be cut by more than half. The assumption is that security could be privatized and that under this service delivery model costs could be reduced – presumably there would be a reduction in DGS security and police budget requirements. Savings would only accrue, however, if DGS abolished the personnel and operating costs for security at the State Center site. In practice, agencies have not followed through with personnel savings as promised, asking instead to reallocate resources to other needs. This was the case with the Maryland Department of the Environment, for example, when it implemented a new environmental permitting information technology system.

- **Cost to Relocate State Agencies:** The cost of moving State agencies during the project is estimated at between $8.0 million and $12.0 million according to the Maryland Department of Transportation (MDOT) and DGS, which is an additional cost to the State associated with the proposed projects. These relocation costs appear understated. The Maryland Department of Planning was proposed to move from State Center to Prince George's County. Funding of $1.74 million was included in the fiscal 2007 budget. Relocation costs would have to be added to each agency budget.

Facility Renewal and Maintenance

The reported accelerated deterioration of the State Center facilities underscores the need for the State to adequately account for and fund facility renewal and is likely to serve as the impetus for the urgent pursuit of future P3 projects. This issue has been raised by DLS in recent years as the State's facility renewal project backlog for just those facilities managed by DGS exceeds $100 million.

Consistent with maintenance best practices in other states, legislation should be considered which:

- **establishes a rent surcharge for critical maintenance, applied to all State agencies. Funds could be credited to dedicated special fund from which DGS could fund personnel and maintenance expenses. The benefits of this proposal is that it would leverage special and federal funds and would only require a nominal increase per sf; and**

- **applies a surcharge on all State-owned capital construction projects when authorized for construction funding, to be credited to a special fund for capital facility renewal. The surcharge would need to be calibrated to raise approximately $20 million per year for this purpose.**

Lack of Legislative Oversight

Public-private Partnerships

The development of the State Center project began in 2004 and has progressed through a number of significant agreements. A master developer was selected, and the State is currently on the cusp of entering into a legally binding Master Development Agreement – all with almost no oversight or involvement by the legislature. The pre-development stages for the proposed State

Center TOD including the selection of the developer took place without any requirement to notify and/or seek approval from the legislature – the entire approval process is at the discretion of the Board of Public Works.

Budget bill language was adopted at the 2006 session, committee narrative at the 2007 session, and additional restrictive budget language at the 2008 session, requesting complete reports on the project and its costs. The amount of information in each year's report was limited, owing largely to the way in which the project is being developed over time. Had language not been adopted it is not clear how and when any information on the project would have been presented to the legislature.

Any project involving a multi-year commitment of State resources, particularly one costing $1.6 billion, should have formally involved the legislature from the beginning. This project highlights the need for a statutory framework for legislative involvement and oversight of P3 proposals.

Under current law, legislative oversight of public private partnerships is limited to certain revenue producing transportation projects through the Maryland Transportation Authority, with a 45 day review and comment. This includes submission of a cost/benefit analysis, the scope of toll setting authority, contract oversight, and the scope of payments.

Legislation should be considered which prohibits the Administration from entering into any phase of a public private partnership without the review and comment of the budget committees of at least the following minimum project elements:

- **A full description of the project, including the need and justification for it;**
- **A Pro Forma financing plan which examines:**
  - **the impact and cost on the State operating and capital budgets;**
  - **the planned involvement of any State debt, including debt issued by quasi-State agencies such as MEDCO;**
  - **the assessed value of the State's assets that are involved; and**
  - **projected rates of return for developers and use of private equity.**

Pre-development Costs

Any amount spent by the State on pre-development costs of State Center is unknown, and has not been specifically identified in either MDOT or DGS budgets. If the State were to enter into the MDA but then exercise the buy-out option, the cost exposure to the State is also not known until the developer ascertains its costs (plus interest). At a time when the State is cutting spending by hundreds of millions for various programs it should not be subjected to unknown pre-development costs. The quandary is if the State does not approve the MDA then the developer will be out potentially millions of dollars without recompense. This also raises the issue of selecting a sole master developer with whom the State negotiated development rights**. It may be advisable for the State to create a funding pool for pre-development costs from which multiple developers could draw equal shares of funding in order to submit competing proposals. The State Center project also highlights a need for agencies to identify pre-development costs for public private partnerships.**

State Options

The buildings at State Center are in need of a combination of rehabilitation or replacement. The budget committees have been presented with only one option, to replace and rehabilitate the site as a $1.6 billion transit oriented development. All options should be considered, with or without private sector involvement. This could include:

- **Purchase of Office Buildings in Baltimore City and Sale of the State Center Property:** This could allow for private development of the State Center site and potentially allow the State to acquire newer office space that may be for sale.

- **Rehabilitation of State Center:** The State could implement a multi-year phased renewal of the State Center buildings without the additional office, retail, housing, and parking envisioned in the TOD plan. If the buildings are renovated as green buildings, the same potential utility savings offered by the TOD option could be achieved by the State.

- **New Buildings at State Center:** The State could also consider a phased multi-year redevelopment of the site by building a new office building on one of the parking lot parcels and demolishing the older structures.

- Any of the above combinations developed in combination with a private sector partner to implement elements of the TOD concept.

Costs to the State

Under any scenario, State financing of the State Center complex is always going to be less expensive than the private sector due to the cost of 15-year AAA rated tax exempt GO bonds. The TOD project financing proposal contains elements which will cost the State significantly more than self financing, such as:

- construction loans of nearly $900 million in taxable debt;

- tax increment financing sold by MEDCO;

- a payment of $50+ million for developer fees; and

- an estimated $145 million in private equity with an annual rate of return of 19%.

DLS believes that the TOD concept for State Center also would count toward State debt affordability limits. The State does, however, have more debt capacity than it had at this point last year due to the Capital Debt Affordability Committee's recent change to the debt outstanding to personal income affordability limit.

Unknown Project Elements

As noted, the State Center TOD is a work in progress and the total cost exposure to the State may never be known. Many elements of the project have been refined over the past year; however, there are significant portions that remain uncompleted. Examples include:

- **Total State Square Footage:** The State currently uses roughly 1.0 million square feet of space at State Center. The State Center TOD is targeting the same amount of space, but the actual amount rented could range as high as 1.5 million square feet.

- **Which Agencies Would Be Sited at State Center:** State Center plans identify a number of potential agencies which could be moved to State Center. Some are presently in State-owned space. It is not known which agencies would move or what would become of current State-owned assets.

- **Impact by Fund Type:** Efforts have been made to identify agencies based on the goal of minimizing the impact on the general fund. However agencies with significant special or federal funds will have less funding for service delivery and in the case of special funds may be required to raise fees. It is also not known if it makes sense to move agencies to State Center based on their funding source, when such a move may impact services to the populations and constituencies that they serve.

- **Parking:** Limited information exists on if the State will be required to sell debt for additional parking infrastructure and/or if there will be a parking surcharge assessed to the employees sited at the State Center.

- **5th Regiment Armory and Power Plant Transition Plan:** The project does not include financing and funding for the 5th Regiment Armory, nor does the MDA fully articulate how this project would be structured or financed.

- **Impact of Delayed Construction of a New Public Health Lab:** Phase II development is predicated upon the 201 West Preston Street building being vacated by the State as early as 2011 or 2012. While recent developments suggest that the State will pursue a P3 for the construction of the new lab, which could speed the delivery of the facility, it is questionable whether even this delivery method will be quick enough to meet the State Center proposed development timeline.

Conclusions and Recommendations

The proposed State Center public private partnership is a $1.6 billion undertaking which offers the opportunity to redevelop a major State asset that is nearing the end of its useful life. There are benefits and costs to the State and Baltimore City. A number of significant issues are raised in this analysis, which question the higher costs, the financial viability of the project, and whether alternative redevelopment options were adequately considered.

At this point in the project's development the budget committees need to consider the following:

- **Status of the MDA:** The budget committees need to make a decision on whether or not the State should enter the legally binding Master Development Agreement**. There are a number of uncertainties associated with the State Center proposal, but it appears that significant impacts can be expected for the operating budget based on significant rent increases. It is also not clear that the proposed benefits will materialize. Finally, the State could finance a more austere capital program with tax exempt GO debt, phased over multiple years. This would have to become a priority in the State's capital program, but if included could yield similar benefits such as green building construction, at a lower cost. For these reasons DLS recommends that the committees recommend to BPW that the State not sign the MDA.**

- **Additional legislation: The legislature should also consider the lessons that arise from this project pertaining to the need for legislation to address:**

  - **Legislative Oversight of public private partnerships, including ways to identify and fund pre-development costs for agencies and potential private sector partners.**

  - **Establishment of a dedicated source of funds for operating and capital maintenance. Absent a dedicated funding mechanism, deferred maintenance costs will only cost the State more money in the future and increase pressure on the State to enter costly into public private partnerships.**