

MEMORANDUM

January 13, 2015

TO: Planning, Housing, and Economic Development Committee
Government Operations and Fiscal Policy Committee

FROM: Jacob Sesker, Senior Legislative Analyst *JSS*

SUBJECT: **Property Disposition—Material Terms—Portion of the Conference Center Parcel**

Expected for this session:

- Ramona Bell-Pearson, Assistant Chief Administrative Officer
- Tina Benjamin, Chief of Special Projects, DED
- Dee Metz, White Flint Development Coordinator

On December 5, 2014, the Executive transmitted material terms related to a proposed disposition of a 3.1-acre portion of the Conference Center property (5701 Marinelli Road in North Bethesda). This discussion will be limited to a discussion of the material terms because the Executive has not yet issued a Declaration of No Further Need (DNFN). Since the clock starts ticking with transmittal of the DNFN, the Committees do not need to make any specific decisions today. However, this briefing provides an opportunity for Committee members to ask questions that relate to the material terms of the proposed disposition.

SUMMARY OF THE PROPOSED DISPOSITION—MATERIAL TERMS

A letter from Director of Economic Development Silverman to Council President Leventhal explains the material terms of the proposed disposition. See © 1. This disposition is unusual insofar as the interest to be disposed is the lifting of a use restriction on land that it is already subject to a long-term (up to 99 years) ground lease. The existing ground lease was executed prior to the Council's approval of the White Flint Sector Plan, which established a more dense and urban vision for White Flint. The use restriction, which limits development on the entire 4.7-acre Hotel Parcel by allowing only development of a first class hotel, in effect limits the ability of both the County/landlord and the Sublessee (North Bethesda Hotel LLC, an entity formed and controlled by JBG) to take advantage of increased zoning capacity and flexibility on the subject site.

To understand the transaction, some details regarding the property are necessary. First, the entire property is approximately 11.92 acres. That property includes both the Conference Center Parcel and

the Hotel Parcel. The current Hotel Parcel (approximately 4.7 acres) can be generally described as the land on which the hotel sits, as well as the surface parking lot to the east of the site (between the hotel itself and Rockville Pike). The sublease allows only hotel development on the entire Hotel Parcel. JBG expanded the hotel from 225 guest rooms to 450 guest rooms in 2008, meaning that additional hotel development is highly unlikely, and under the use restriction non-hotel development is not allowed.

The proposed disposition of property would split the Hotel Parcel into two distinct pieces by creating a new 3.1-acre "East Parcel." The use restriction (as well as some cross easements and operating agreements) would no longer apply to the East Parcel. A new ground lease would be created for the East Parcel under which the County would be entitled to receive market value rent as a lease payment from the sublessee or any successor. The ground rent will be derived from the value of the floor area achieved at certified site plan.

The new proposed sublease does not modify several terms of the existing sublease which affect ground rent. For example, the proposed sublease continues the current terms, under which there is no rent due during the first two years after construction commences, with only 39% of the rent due during years 3 through 5, and includes market reset and circuit breaker provisions that are intended to keep the ground rent under the lease in line with market conditions.

WHITE FLINT SECTOR PLAN

The White Flint Sector Plan was approved in 2010. The entire 430-acre Sector Plan lies within ¾ mile of the White Flint Metro Station. The vision for the Sector Plan was to transform an auto-oriented suburban development pattern into a vibrant and sustainable urban center that includes residences and businesses. The Conference Center is in the 54-acre "Metro West District," which included most of the existing public uses/assets in the plan area—Wall Local Park, Montgomery County Aquatic Center, and the Bethesda North Conference Center and Hotel. The plan called for realignment of Executive Boulevard and the creation of two new local streets within Metro West—Market Street and Woodglen (Extended). All of those changes to the road network in the district affect the Conference Center, Hotel, or both. The plan also identified Metro West as the location of the future civic green.

The East Parcel (subject of this disposition) fronts on Rockville Pike and is located immediately across the Pike from White Flint Metro Station. As such, the property was rezoned to have a height limit of 300' and a floor area ratio (FAR) of 4.0. This zoning makes this surface parking lot site one of the most valuable pieces of real property in the Sector Plan area.

COUNCIL COMMENTS & EXECUTIVE RESPONSES

The Council provided the Executive with comments and requests for additional information in response to the material terms. Below are the Council comments, along with the accompanying Executive responses in italics.

1. Question:
The material terms state that the ground rent will be derived from the property's fair market value based on the FAR in a final site plan approval. How will fair market value be determined? Once fair market value is determined, how will the ground rent be derived?

Answer:

Fair market value was determined by a recent appraisal. The County will use the fair market value determined through the appraisal to set the ground rent by coordinating the FAR established in the development site plan with the type of development planned for the Project. For example: Ground rent will be based on the actual FAR achieved for commercial (\$60/FAR SF) residential (\$50 FAR SF) and retail (\$50 FAR SF) as those uses are denoted in the final and non-appealable site plan approval.

2. Question:

The material terms state that the sublease will automatically terminate 10 years after lease commencement date if construction has not been initiated. Does termination of the sublease mean that all rights held by the lessee with respect to the east parcel would revert to the County?

Answer:

If the sublease is terminated after 10 years, because construction has not commenced, then all development rights authorized by the sublease will terminate and certain property rights revert back to the County. Any rights not covered by this sublease but that are contained within the original sublease will remain in effect unless that original sublease is breached or terminated. In addition the County has, and will continue to lease this property in accordance with the existing Master Lease Agreement between Montgomery County and the Montgomery County Revenue Authority.

3. Question:

The material terms indicate that all of the surface parking spaces (approximately 267) currently on the site will be replaced in a structured parking facility built by the developer within the East Parcel development. Will all replacement parking be open and available to the public? What portion of the public parking will be short-term versus long-term parking?

Answer:

The displaced surface parking spaces that result from construction authorized by this sublease that are currently for the use of the Hotel, will be replaced by parking that is either incorporated into the mixed use development constructed by JBG on the East Parcel, or through agreement with the County, will be incorporated into the structured parking constructed on the North Parcel as part of the Conference Center garage. The displaced surface parking spaces from the East Parcel are primarily for the use of the Hotel and to meet the mixed use development parking obligations. The North Parcel structured parking is intended to replace the surface spaces displaced by the Executive Boulevard and Market Street redesign and development and will be for use by the Conference Center for parking. There is currently a practice that allows for public parking at the Conference Center surface lot when spaces are not in use by the Conference Center. That practice will continue and spaces in the Conference Center structured garage will be open to the public when available.

4. Question:

Does the sublease grant the lessee additional development rights on portions of the East Parcel that may need to be acquired by the County for transportation improvements?

Answer:

No, all right-of-way needed for master planned infrastructure such as the BRT or other Rockville Pike expansion has been addressed and reserved. However, the lessee will be required to

construct a private road (Woodglen Drive) through the East Parcel development that is the responsibility of the private development for which the County has no obligations.

FAIR MARKET VALUE

Under the County's property disposition law, County Code §11B-45, the County Executive may not dispose of real property owned or controlled by the County for less than fair market value (FMV) unless the Council waives the FMV requirement. In the case of a sale of real property, it is necessary to provide appraisal of the property (within the last 12 months) as evidence of FMV. However, in the case of other dispositions, a recent appraisal of the specific property in question is not required.

In this instance, the Executive has provided Council Staff with two appraisals that are both recent and very relevant, but which are not appraisals of the specific property interest the County intends to dispose of here. If Committee members would like to have an opportunity to discuss those appraisals, that discussion should occur in closed session because the disposition is the subject of ongoing negotiations.

COUNCIL STAFF COMMENTS

In this case, issues related to uses allowed, height, and density were discussed during the Master Plan process and the Council's deliberations on the CR zone. As such, there may be no need for a public hearing. However, given that the DNFN has not yet been posted or transmitted to the Council, there is no need to make a decision now regarding waiver of the public hearing.

Similarly, while the material terms state that the ground rent will be derived from the land's fair market value, and while the County Executive has provided two recent and relevant appraisals from which FMV can be derived, there is no need to make a decision now regarding waiver of FMV. As stated above, because disposition is the subject of ongoing negotiations, that discussion should occur in closed session.

Finally, the memorandum on the material terms describes the relationship between the Revenue Authority (MCRA) and the County as it relates to ownership of the land in question. According to the memorandum, "MCRA will remain the owner of the land until all of the debt is paid off on both the land and the Conference Center construction bonds." Staff recommends requesting additional information about when the land and construction debt will be paid off in order to better understand the various property interests in the Conference Center and Hotel Parcels.

Attachments:

- © 1 Letter from Mr. Silverman to Mr. Leventhal –Material Terms
- © 6 Map
- © 7 Letter from Ms. Bell-Pearson to Mr. Leventhal – Responses to Council Comments



DEPARTMENT OF ECONOMIC DEVELOPMENT

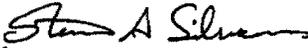
Isiah Leggett
County Executive

Steven A. Silverman
Director

MEMORANDUM

December 5, 2014

TO: George Leventhal, President
Montgomery County Council

FROM: Steven A. Silverman, Director 
Department of Economic Development

SUBJECT: Material Terms Related to New Sub-Lease on a Portion of the Conference Center Parcel

While the proposed new sublease to allow for development on the East Parcel constitutes a release of interest related to County real property, it is the opinion of the County Executive that this does not constitute a disposition as that term is defined in Section 11B-45 of the County Code. This is not a disposition because the land subject to this proposed new sublease is currently under an existing sublease that gives restricted control of the property to JBG pursuant to a 99-year ground lease. The material terms of this proposed new sublease are being presented for County Council notice and comment because the new sublease further entitles the Sublessee to a broader use of the Conference Center property than is currently entitled under the existing sublease.

The proposed sublease involves a transaction whereby the County will enter into a new agreement with the JBG LLC that has been established for the development of this property related to approximately 3.1 acres of land located within the Bethesda North Conference Center land, found at 5701 Marinelli Road in North Bethesda.¹¹ The current long term sublease between the County and North Bethesda Hotel LLC (an entity formed and controlled by JBG) limits the Sublessee's ability to develop the property only as hotel facilities. JBG has requested the County lift that restriction so that they will be able to develop the property consistent with the newer

¹ This is the same JBG organization that is a Party to the existing sublease. For their legal purposes a different limited liability corporation (LLC) was established to contract for the new terms and conditions contained in this proposed sublease.



Commercial Residential Mixed Use Zone (CR Zone) and take advantage of the close proximity to the White Flint Metro station, making it a true Transit Oriented Development (TOD). Under the current long term Sublease, we are limited to the original ground rent and any built-in escalations, and although it allows for additional development on the site, that is restricted to hotel development. The addition of mixed use transit oriented development on this site adjacent to Metro would be both consistent with the Sector Plan and add tremendously to the real estate tax base as well as the White Flint Transportation District tax base.

This new sublease would lift the hotel restriction, and allow the County to dramatically increase the ground rent for the area of the parcel being developed as a mixed use project, using new ground rental rates based upon office, retail and residential FAR values in line with recent appraisals commissioned by the County. The rents would be applied to the number and types of square footage of retail, office, and residential approved and built by the developer. Additionally, the new sublease separates the East Parcel from the current Hotel Parcel, which allows the County to separate all of the complex cross easements and operating agreements that exist between the Hotel and the Conference Center that would not pertain to the property east of the new Woodglen Drive, which is the road added in the Sector Plan that will eventually bi-sect the Conference Center property. The new sublease will be coterminous with the existing sublease for the hotel, with both expiring at the same time.

The attached existing sublease agreement, along with the assignment and assumption documents, will give further background to the existing relationship the County has with JBG through the North Bethesda Hotel LLC entity, as well as the terms of the existing agreement. The material terms discussed below are in addition to the existing sublease terms contained in the attached agreements. The new sublease changes three major components of the existing sublease:

- 1) The boundaries of the existing Hotel sublease will be amended so that the existing operational and management relationship between the Conference Center and the Hotel remains intact.
- 2) A new ground lease is created related to the East parcel that entitles the County to receive market value rent as lease payment from JBG or any successor. This new ground lease will run coterminous with the lease related to the Hotel Parcel.
- 3) The restriction requiring all future development to be limited to development of a first class hotel is removed relative to the East Parcel.

History

In 1999, the Montgomery County Revenue Authority (MCRA) issued debt for the purchase of an 11.92 acre parcel then owned by the Washington Metropolitan Area Transit Authority for the purpose of constructing an executive level conference center and hotel. MCRA subsequently entered into a master lease with Montgomery County for 100% of the

conference center parcel, with annual ground rent due to MCRA equal to the annual debt service on the land. MCRA will remain the owner of the land until all of the debt is paid off on both the land and the Conference Center construction bonds.

Although the property is subdivided as a single Lot, it is split into two tracts, the Conference Center Tract and the Hotel Tract. The Conference Center Tract consists of approximately 7 acres (roughly 60% of the site) and is described generally as the land upon which the conference center sits plus the surface parking lot to the north of the conference center. The Hotel Tract consists of approximately 4.7 acres (roughly 40% of the site) and is generally described as the land upon which the hotel sits, plus the surface parking lot to the east of the hotel (closest to Rockville Pike). (Please see attached exhibit.)

In January, 2003, Montgomery County executed a sublease for the Hotel Tract with the original developers/owners of the hotel adjacent to the conference center, Quadrangle Development Corporation (QDC), for 99 years. QDC sold their interest in the hotel and the underlying ground to JBG Properties in 2006, which expanded the hotel from 225 to 450 guest rooms in 2008. The sublease contained a covenant restricting the use of the Hotel Tract to exclusively a first-class hotel.

With the passage of the White Flint Sector Plan and the hallmark nature of the conference center parcel – which is located directly across from the White Flint Metro entrance and at a key intersection in the Plan – there is a unique opportunity to stimulate additional development opportunities that will help fulfill the objectives of the Sector Plan. As such, the County and JBG have identified the need to lift the exclusive hotel use restriction and allow for mixed use development on the portion of the subleased parcel located to the east of the hotel currently being used as a surface parking lot.

Proposed New Sublease

In an effort to identify the best vehicle in which to retain the existing relationship between the conference center and the hotel (and the covenants and easements that govern the operations of this jointly-managed complex) and to provide for new development opportunities on the under-utilized subleased portion of the land, it became apparent that splitting the existing sublease into two separate subleases would be required. Accordingly, the County and JBG are proposing to: 1) amend the boundaries and definition of the “Land” in the current sublease to only be the land associated with the hotel operations (denoted as “Hotel Parcel” on the attachment); and 2) create a new sublease for the eastern portion of the privately-controlled parcel (denoted as “East Parcel”) to allow for the mixed-use development envisioned in the Sector Plan. This East Parcel is currently under the exclusive control and management of JBG Properties under the original 99 year sublease. The County has no authority over the East Parcel except for those available to the County as the Landlord related to the 99 year ground lease.

Many of the terms and principles found in the East Parcel sublease mirror the terms and principles agreed to by the County and the hotel owner in the original sublease executed in 2003. The material terms of the new East Parcel sublease are as follows:

1. The Initial Term of the East Parcel sublease will coincide with the Hotel Parcel sublease, and will expire on the last day of the Initial Term for the Hotel Parcel. In addition, the East Parcel initial lease term can be extended for two additional twenty-five year terms and a final twenty-four year term, as is the case with the Hotel Parcel sublease.
2. The ground rent will be derived from the land's fair market value based on the actual FAR achieved upon final and non-appealable site plan approval. In an effort to document the formula that will be used to determine the ground rent, it is estimated that the development on the East Parcel will be 592,556SF. This is based on a site plan approval for 350,000± SF of office, 210-220 residential units within 210,000± SF of FAR, and 30,000± SF of retail.
3. As with the original ground lease on the property, no rent shall be payable for the first two years following the construction commencement date, while 39% of the rent shall be payable for the third, fourth, and fifth years following the commencement of construction.
4. This sublease will automatically terminate 10 years after the lease commencement date if construction has not been initiated.
5. A market reset adjustment shall occur in years 30, 50, 70 and 90 of the ground lease, which shall be based on a three appraisal process that will be capped at a decrease or increase of no more than 15% of the rent from the immediately prior year.
6. In the event that the tenant sells or transfers a controlling interest in the property to a non-affiliated entity prior to construction, 60% of the net profits generated from any sale shall accrue to the County.
7. All of the surface parking spaces (estimated to be 267 spaces) displaced by the development of the East Parcel will be replaced in a structured parking facility built by the developer within the East Parcel development.

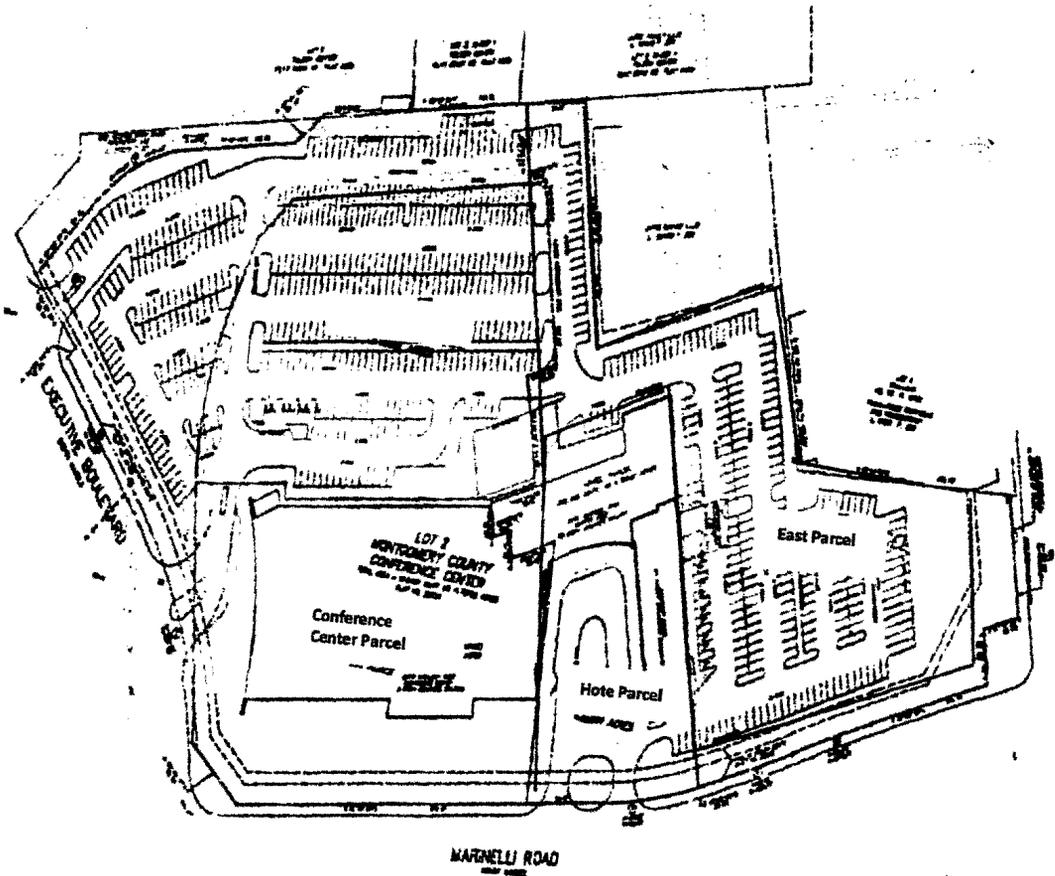
It should be noted that JBG (and all subsequent owners of the hotel adjacent to the conference center) shall continue to pay ground rent on the Hotel Parcel in accordance with the terms of the original sublease for the remainder of the 99-year sublease.

We look forward to receiving your comments regarding this proposed sublease. We are also in the process of scheduling a briefing related to updates on County planned

development for the White Flint area surrounding and including the roads, the Conference Center/Hotel grounds and the Conference Center garage.

If you require any additional information please contact me at x72005 or Tina Benjamin at x72006.

Attachments





OFFICES OF THE COUNTY EXECUTIVE

Isiah Leggett
County Executive

Timothy L. Firestine
Chief Administrative Officer

January 8, 2015

To: George Leventhal
Council President

From: Ramona Bell-Pearson *Ramona Bell-Pearson*
Assistant Chief Administrative Officer

Subject: North Bethesda Conference Center Sublease

This memorandum is in response to the County Council questions submitted to the County Executive on the material terms related to the Sublease Agreement between Montgomery County and the North Bethesda Hotel Lessee, LLC. Mr. Leggett has asked me to respond to the questions which I have attempted to do through the responses listed below. I will also be available along with Dee Metz, the White Flint Implementation Coordinator at the joint work session of the Government Operations and Fiscal Policy and Planning, Housing, and Economic Development Committees that is currently scheduled for January 15, 2015. Please find the questions and answers below submitted for your consideration.

1. Question:

The material terms state that the ground rent will be derived from the property's fair market value based on the FAR in a final site plan approval. How will fair market value be determined? Once fair market value is determined, how will the ground rent be derived?

Answer:

Fair market value was determined by a recent appraisal. The County will use the fair market value determined through the appraisal to set the ground rent by coordinating the FAR established in the development site plan with the type of development planned for the Project. For example:

Ground rent will be based on the actual FAR achieved for commercial (\$60/FAR SF) residential (\$50 FAR SF) and retail (\$50 FAR SF) as those uses are denoted in the final and non-appealable site plan approval.

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2. Question:

The material terms state that the sublease will automatically terminate 10 years after lease commencement date if construction has not been initiated. Does termination of the sublease mean that all rights held by the lessee with respect to the east parcel would revert to the County?

Answer:

If the sublease is terminated after 10 years, because construction has not commenced, then all development rights authorized by the sublease will terminate and certain property rights revert back to the County. Any rights not covered by this sublease but that are contained within the original sublease will remain in effect unless that original sublease is breached or terminated. In addition the County has, and will continue to lease this property in accordance with the existing Master Lease Agreement between Montgomery County and the Montgomery County Revenue Authority.

3. Question:

The material terms indicate that all of the surface parking spaces (~267) currently on the site will be replaced in a structured parking facility built by the developer within the East Parcel development. Will all replacement parking be open and available to the public? What portion of the public parking will be short-term versus long-term parking?

Answer:

The displaced surface parking spaces that result from construction authorized by this sublease that are currently for the use of the Hotel, will be replaced by parking that is either incorporated into the mixed use development constructed by JBG on the East Parcel, or through agreement with the County, will be incorporated into the structured parking constructed on the North Parcel as part of the Conference Center garage. The displaced surface parking spaces from the East Parcel are primarily for the use of the Hotel and to meet the mixed use development parking obligations. The North Parcel structured parking is intended to replace the surface spaces displaced by the Executive Boulevard and Market Street redesign and development and will be for use by the Conference Center for parking. There is currently a practice that allows for public parking at the Conference Center surface lot when spaces are not in use by the Conference Center. That practice will continue and spaces in the Conference Center structured garage will be open to the public when available.

4. Question:

Does the sublease grant the lessee additional development rights on portions of the East Parcel that may need to be acquired by the County for transportation improvements?

Does the sublease grant the lessee additional development rights on portions of the East Parcel that may need to be acquired by the County for transportation improvements?

Answer:

No, all right-of-way needed for master planned infrastructure such as the BRT or other Rockville Pike expansion has been addressed and reserved. However, the lessee will be required to construct a private road (Woodglen Drive) through the East Parcel development that is the responsibility of the private development for which the County has no obligations.

cc: Dee Metz, Implementation Coordinator White Flint
Tina Benjamin, Chief Special Projects DED