State of Washington
Joint Legislative Audit and Review Committee (JLARC)

University of Washington

Metro Tract Report: 2005 Update

Report 05-8

March 2005

Upon request, this document is available in alternative formats for persons with disabilities.

JOINT LEGISLATIVE AUDIT AND REVIEW COMMITTEE
506 16th Avenue SE
PO Box 40910
Olympia, WA 98501-2323
(360) 786-5171
(360) 786-5180 Fax
http://jlarc.leg.wa.gov

The Joint Legislative Audit and Review Committee (JLARC) carries out oversight, review, and evaluation of state-funded programs and activities on behalf of the Legislature and the citizens of Washington State. This joint, bipartisan committee consists of eight senators and eight representatives, equally divided between the two major political parties. Its statutory authority is established in RCW 44.28.

JLARC staff, under the direction of the Committee and the Legislative Auditor, conduct performance audits, program evaluations, sunset reviews, and other policy and fiscal studies. These studies assess the efficiency and effectiveness of agency operations, impacts and outcomes of state programs, and levels of compliance with legislative direction and intent. The Committee makes recommendations to improve state government performance and to correct problems it identifies. The Committee also follows up on these recommendations to determine how they have been implemented. JLARC has, in recent years, received national recognition for a number of its major studies.

UNIVERSITY OF WASHINGTON METRO TRACT REPORT: 2005 UPDATE

REPORT 05-8

REPORT DIGEST

MARCH 2005

STATE OF WASHINGTON

JOINT LEGISLATIVE AUDIT AND REVIEW COMMITTEE

STUDY TEAM

Karen Barrett

LEGISLATIVE AUDITOR

Cindi Yates

Copies of Final reports and Digests are available on the JLARC website at:

http://jlarc.leg.wa.gov

or contact

Joint Legislative Audit & Review Committee
506 16th Avenue SE
Olympia, WA 98501-2323
(360) 786-5171
(360) 786-5180 FAX

Background

The State of Washington owns the Metropolitan Tract, a parcel of commercial office, retail, parking, and hotel properties, occupying approximately 11 acres, in downtown Seattle. The University of Washington (UW) has developed and managed the Tract, which generates income for the University—revenue that from time to time has been appropriated for debt service and construction of other capital projects at UW campuses. While Tract lands and improvements thereon may not be sold without statutory approval, 1999 legislation (RCW 28B.20.382) affirms the Board of Regents' full management control including the right to borrow funds, incur debt for improvements, and establish, renew, or extend leases for up to 80 years. That legislation directs the UW to report to the Joint Legislative Audit and Review Committee (JLARC) every two years on management of the Tract, current leaseholds, and related transactions. The UW's 2005 report follows. It responds to a set of questions framed by the JLARC Executive Committee (Appendix 1). The next UW report will be due in the 2007 Legislative Session.

Overview

This report on the UW's management of the Metropolitan Tract illustrates patterns of financial return from this public asset. The UW explains how oversight and control is exercised by the Board of Regents to ensure Tract properties are adequately maintained and remain competitive over time. The University responds to specific questions from JLARC concerning financial performance, factors, and outlook for the Tract, including notable leasehold changes and property improvements since the report filed in 2003.

Summary of 2005 Report

The UW's 2005 report responds to a biennial request to inform the Legislature about the University's current management practices, policies, financial performance and outlook for Metro Tract leasehold properties. JLARC comments, based on review of the UW's 2005 update, follow.

Metro Tract Value and Earnings

The UW estimates that its interest in the Metropolitan Tract is currently worth $265 million. The Tract generated nearly $14.8 million in income in FY 2004, with an estimated return on investment of 5.6 percent. The 2005 UW report indicates that the value of the Metropolitan Tract properties increased appreciably since its last report due to the continued recovery of rents in the commercial office market combined with building investment activity driven up by historically low interest rates.

Notable Leasehold Change

The UW negotiated a 45-year lease redevelopment agreement in 2004 that separates the Cobb Building from other Metropolitan Tract properties to improve the property's appreciable value in partnership with UNICO Properties, Inc. Effective this month, the Cobb Building is no longer governed by the master ground lease set to expire in 2014. Capital activity is set to begin this month converting the building's use from medical offices to luxury residential apartments.

Funds Available from Metro Tract for other UW Capital Projects

The UW's ten-year Tract financial plan suggests income sufficient to resume annual transfers of $8 million to the UW Building Account starting in 2008. The University's Board of Regents have instructed UW officers to manage the cash flow between now and 2008 to maintain annual fund transfers to the UW campus for Law School debt service and minor capital improvements. A line of credit will finance renewal of the 1910-era Cobb property in downtown Seattle. This $31 million project is described and briefly enumerated in the appended UW Metro Tract report (see page 3). Other reinvestment needs are being explored (see page 11) and for that reason, lawmakers might want to confirm expectations as it relates to income available from Metro Tract to support 2005 biennial and related six-year capital plans for the institution.

UNIVERSITY OF
WASHINGTON
Real Estate Office

RECEIVED
MAR - 3 2005
JLARC

February 25, 2005

Ms. Cindi Yates, Legislative Auditor
Joint Legislative Audit & Review Committee
506 – 16th Avenue SE
Olympia, WA 98501-2323

Re: 2005 Report on the Metropolitan Tract

Dear Ms. Yates:

On behalf of the Board of Regents of the University of Washington, I am pleased to provide the enclosed 2005 Report on the Metropolitan Tract pursuant to the January 28, 2005 letter from the Joint Legislative Audit and Review Committee and RCW 28B.20.382. The report is organized according to the questions posed in Attachment 1 to the letter.

As indicated in the report, a copy of the Financial Report for the Metropolitan Tract is also enclosed. In addition, the enclosed "Seattle Central Business District Office Report 2005" might be useful to the Committee by providing a current market overview and references to buildings on the Metropolitan Tract.

We look forward to answering any other questions the Committee may have. Please feel free to contact me at 206-616-3414.

Sincerely,

JL Henderson

Jeanette L. Henderson
Director of Real Estate

enclosures
cc: Weldon E. Ihrig, Executive Vice President

Box 359150 1326 Fifth Avenue, 400 Skinner Building Seattle, Washington 98101
206.616.3400 FAX 206.685.1547

2005 REPORT
ON THE
METROPOLITAN TRACT
SUBMITTED BY THE UNIVERSITY OF WASHINGTON

INTRODUCTION

This biennial report is provided pursuant to RCW 28B.20.382(2) as a summary of the financial performance of the Metropolitan Tract.

The Metropolitan Tract, located in downtown Seattle, is comprised of approximately 11 acres of developed property including office space, retail space, parking and a luxury hotel. This land was the original site of the University of Washington from 1861 until 1895 when the University moved to its present location on Lake Washington. Since the early 1900's, the Metropolitan Tract has been leased by the University to entities responsible for developing and operating the property. The majority of the Metropolitan Tract is leased to Unico Properties, Inc. and consists of office, retail and parking facilities. This lease began in 1953 and will expire in 2014. The Olympic Hotel property is now leased to LHCS Hotel Holdings (2002) LLC and operated as the Fairmont Olympic Hotel. This lease expires in 2040. In addition, the University directly controls approximately 345,000 square feet of office space under the Unico lease referred to as the Rainier Tower Sublease. At the expiration of the ground leases, the University will realize the full value of both the cash flows associated with the third party subtenants of Metropolitan Tract as well as the underlying asset value of the improvements.

The University's objective is to enhance the financial performance of the Metropolitan Tract through proactive asset management of the Unico Lease, the Fairmont Olympic Hotel Lease and the Rainier Tower Sublease, and to identify, define, evaluate and implement strategies to further improve the long term value and related cash flow of the University's interest in the Metropolitan Tract. Urbis Partners and Heitman Capital Management jointly provide third-party asset management services to the University for the Metropolitan Tract, for comprehensive oversight of the lessees and evaluation and implementation of strategic initiatives. The University's Real Estate Office provides institutional administrative representation through contract and audit oversight, preparation of financial statements, and accounting (accounts receivable and accounts payable) for the Metropolitan Tract. Direction and control of the Metropolitan Tract is under the authority of the Board of Regents of the University through its Capital Assets Committee.

The specific questions posed by the Joint Legislative Audit Review Committee are recited in this report, with answers following each question.

1. *Describe how the University exercises oversight to ensure that the Metropolitan Tract properties are adequately maintained, remain competitive, and summarize any notable changes occurring since the last report.*

The University has engaged professional real estate advisors to oversee and direct the tenancies on the Metropolitan Tract to ensure that the properties are adequately maintained and remain competitive in the market place.

Pursuant to the Unico lease and under the supervision of the University's real estate advisors, Unico prepares a rolling five-year capital improvement plan and corresponding budgets on an annual basis. The University's advisors then perform a physical inspection of the properties as well as a cost/benefit review of Unico's proposed capital improvement plan to determine which items should be undertaken during the budget cycle. The cost/benefit analysis assesses a number of factors such as whether the improvements will extend the useful life of the assets, address essential life/safety standards, maximize the probability of increasing rents in a property, or in the case of a declining market, those improvements that will support tenant retention and stabilize rents. A budget recommendation is then submitted for consideration, first to the Metropolitan Tract Committee, then to the Capital Assets Committee of the Board of Regents. Implementation of the capital expenditures plan is then monitored through physical inspections, review of architectural and engineering plans and thorough examination of billing records.

As a result of this capital improvement planning process, since 2000 approximately $54 million dollars have been invested in seismic repairs and improvements, elevator replacements, building security, building common area refurbishment, mechanical systems improvements, fire prevention, life/safety improvements, upgrades to comply with the Americans with Disabilities Act, exterior restoration and tenant improvements.

Under the Fairmont Olympic Hotel lease, the tenant is solely responsible for the planning, payment and implementation of physical improvements to the property. The lease requires re-investment of a certain percentage of gross revenue in capital projects each year and, although the lease does not provide for the University to have input on capital projects, operating standards that govern capital re-investment must be met. Following the Fairmont's 2003 acquisition of this lease, a number of major capital projects have been initiated at the hotel including renovation of the main lobby, refurbishment of the elevator systems, a major upgrade to the health club and the renovation of guest-room bathrooms. Because financial and operating risk are not assumed by the University under the Fairmont lease, there are fewer opportunities to influence the management or financial performance of the hotel. The site is fully developed and the historical significance of the building does lend itself to additional development.

The University also exercises oversight of the Metropolitan Tract properties through an annual compliance audit which tests certain key provisions to verify that the terms of each lease is being met. One significant provision that is audited in both major leases is an operating standard which the tenants are required to maintain. The tenants are also required to make specific annual investments in maintenance and repair of the buildings.

There are several notable changes to the Tract since the last JLARC report. First, the Cobb Building is under renovation to convert it from medical office into residential apartments. The University and Unico have entered into a separate 45 year lease for this particular building in order to implement the project. On the commencement date of the separate Cobb Building lease, the Cobb Building will be removed from the master Unico lease. The master lease will continue unchanged through its expiration in 2014 for the balance of the Tract office buildings. As the oldest building on the Tract, the 1910 Cobb Building had reached the end of its useful life as an office building. Working with Unico, residential experts, architects and contractors, a plan was developed to convert the office building into 90 units of rental apartments. The development will preserve the significant architecture of the building while providing seismic stability and new mechanical systems resulting in state of the art luxury residences. The Cobb Building lease is scheduled to commence in March 2005 with construction beginning immediately thereafter. The project is expected to be completed in the spring of 2006. The University will contribute approximately $7.7 million to the overall project budget of $31 million, the balance of which will be funded by Unico. During the term of this Cobb lease, the University will receive ground rent payments, and all of the improvements inure to the University at the end of the lease term. Unlike the master Unico lease, this lease provides buyout opportunities for the University every ten years during the lease term. We are excited about this project as it both preserves an historically significant building and enhances the mix of uses on the Tract with the introduction of a residential property.

Another change worth mentioning is the continuing progress of implementing the strategy for high-end, carriage trade retail along 5th Avenue. Brooks Brothers opened a flagship store on the corner at 5th & Union in September, in the former Eddie Bauer space, establishing a solid retail anchor at the north end of the Metropolitan Tract.

A $10.5 million voluntary seismic upgrade to Skinner Building was completed in 2004 furthering the University's commitment to maintaining the buildings on the Tract which are architecturally significant. The Skinner project received a NAIOP "Night of the Stars" award in the renovation and redevelopment category reflecting the notable achievement of a major life safety project undertaken while the building remained leased and occupied.

2. *Describe the financial performance of the Metropolitan Tract since the last report in 2003 specifically addressing the following items:*

a) *Provide a copy of the audited financial statements (balance sheets and income statements) for the last two fiscal years ending in 2003 and 2004.*

Copy enclosed.

b) *Provide updated information on financial performance including Return-On-Investment (ROI) for the past 10 years and information on the current value of the University's interest in the Tract.*

The current value of the University's interest in the Metropolitan Tract is made up of the cash flow associated with three separate and distinct leasehold interests and the residual value of the property at the time these leases expire. In the next report to JLARC, the Cobb Building will be included as a separate leasehold. The existing leases are as follows:

1) Unico Properties, Inc. ("Unico") has a ground lease which covers six office and retail buildings totaling approximately 1.5 million square feet of office space, 200,000 square feet of retail space and access to over 1,400 parking stalls. This ground lease commenced in 1953 and will expire in October 2014, at which time the "fee simple" interest in these real estate assets will revert to the University;

2) LHCS Hotel Holdings (2002) LLC ("Fairmont") leases the Olympic Hotel property, a 450-room luxury hotel operated by the Fairmont Hotels & Resorts, along with a parking garage of 610 stalls. This architecturally significant building underwent a total renovation beginning in 1980 before reopening in 1982. The Fairmont acquired this lease in August 2003 from Urban Four Seasons Hotel Joint Venture Limited Partnership. This lease will expire in 2040; and,

3) The University directly controls approximately 345,000 square feet of office space in Rainier Tower pursuant to a sublease with Unico. This sublease was the result of the University's acquisition of the leasehold of the original Rainier Bank Headquarters from Seafirst Bank in 1995 ("Rainier Tower Sublease"). This space is leased to third party subtenants. The Rainier Tower Sublease expires in 2017, three years after the expiration of the Unico lease.

To calculate the value of the University's interest in these three leaseholds, it is necessary to analyze each separately. For the ground lease with Unico, a discounted cash flow valuation methodology is used. Under this methodology, the estimated annual future cash flows that will be paid to the University under the ground lease plus the estimated residual value of the property upon reversion to the University at the end of the ground lease are discounted back to the present using an annual discount rate of 9.5%. This valuation methodology results in a present value of the University's current lessor interest and future reversion rights of approximately $217.55 million. This estimated value has increased from the 2002 report due to the continued recovery of the office market combined with an unprecedented interest in office building investment driven in large part by the historically low interest rates.

The value of the University's interest in the ground lease with the Fairmont for the Olympic Hotel has been estimated using a direct capitalization valuation methodology due to the relative stability of the cash flows and the long-term nature of this lease (35 years remaining). Under this methodology, the ground rent paid by the Fairmont to the University of approximately $2.9 million is capitalized at 8.00% to arrive at a value of $36.25 million, compared to the estimated $38.75 million value at the end of 2002. Actual 2002 ground rent earned by the University in 2002 was $3.1 million compared to $2.9 million in 2004. This ground lease revenue decrease is a direct result of the precipitous decline in the hospitality industry predicated by the general economic malaise as well as the aftermath of 9/11.

The value of the University's interest in the Rainier Tower Sublease space is calculated using a discounted cash flow valuation methodology. Under this methodology, the future estimated cash flows that will be paid to the University under its sublease arrangements with the third-party tenants (using market assumptions to calculate the cash flows beyond the current sublease terms) are discounted back to the present using an annual discount rate of 9.5%. The discounted cash flow analysis runs through 2014 (when the University gains control of the Unico managed properties), at which time the space is incorporated into the previously discussed Unico residual value analysis. Therefore, the value of the Rainier Tower Sublease is estimated to be $11.6 million. The value of this Sublease will move downward each year as the Unico ground lease expiration in 2014 approaches. It will be impacted less by market conditions, since much of the projected sublease revenue is based on long term lease contracts.

A summary of values is as follows:

Valuation Summary as of 12/31/04
(in millions $)

Component	*UW Ground Lessor Value**
Unico	$217.55
Fairmont Hotel	$36.25
Rainier Tower Sublease	$11.60
Total	$265.40

* The above values are based on estimates obtained by the University in consultation with its real estate advisors. These valuations are not based upon third-party appraisals.

The total value of the Metropolitan Tract increased by approximately $73.7 million from the levels stated in the 2003 report. This value change was driven by historically low interest rates and increased demand in real estate by investors creating an abundance of capital investing in the office market sector.

Return on Investment

Returns on real estate are often separated into two distinct categories: Income Return and Appreciation Return. Income Return is generally defined as the annual net cash flows generated from property operations divided by the current market value of the property. Appreciation Return is defined as the annual change in value of the property from one period to another resulting from changes in the market, net of capital expenditures and divided by the initial market value.

Because Income and Appreciation Return results are often used in measuring the performance of various types of real estate assets, these computations for the Metropolitan Tract ground leases are included herein. It is important to recognize that these results are most relevant for comparative purposes when analyzing current and anticipated trends for the Metropolitan Tract. Since a disproportionately high percentage of the value of the Metropolitan Tract holdings comes from the residual value of the underlying improvements (which revert to the University in 2014) and a lower percentage comes from the current cash flow return derived from the ongoing ground lease payments, it is generally expected that most of the future return will come from asset appreciation.

METROPOLITAN TRACT

Data on Financial Return to UW 1995 through 2004

	Metropolitan Tract Value and Return Summary									
	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
UW Value	152,556	162,415	179,604	198,763	211,743	244,100	216,250	191,750	209,550	265,400
UW Revenue less Op. Expenses	11,020	9,931	14,440	13,404	13,169	15,038	15,284	17,983	18,439	14,832
Capital Reinvestment	(6,554)	(2,515)	(4,077)	(3,419)	(5,217)	(7,300)	(6,600)	(12,300)	9,912	16,918
Transfers to Campus	9,000	9,000	5,950	8,000	8,000	8,000	8,000	8,000	8,000	8,000
Return on Investment										
UW Income Return	7.97%	7.36%	8.70%	7.96%	7.77%	6.20%	7.07%	9.38%	8.80%	5.59%
UW Appreciation Return	3.33%	5.56%	8.52%	9.14%	5.88%	15.30%	-11.92%	-11.33%	9.28%	26.65%

c) *Provide a summary describing the use of Metro Tract funds that were appropriated by Legislature for fiscal years ending in 2003, then in 2004:*

i. *What operating expenses of the University (if any) were paid from Metropolitan Tract income?*

None, other than operating expenses for the Metropolitan Tract consisting of insurance costs, professional services such as third party asset management, audit fees, and legal fees, and Real Estate Office expenses. No other operating costs of the University are paid from Metropolitan Tract income.

ii. *What amounts were deposited into the bond retirement account?*

Fund 387 FY 2003 July '02- June '03:	$8,324,984
Fund 387 FY 2004 July '03- June '04:	$8,331,502

This includes the transfer of $16 million from Metro Tract and interest earnings.

iii. *What were the University's actual debt service payments?*

Fund 387, FY 2003:	$4,649,050
Fund 387, FY 2004:	$2,950,071

iv. *What amounts in the Facilities Bond Retirement Account in excess of anticipated debt service needs were transferred to the UW Building Account?*

Fund 387, FY 2003:	$4,000,000
Fund 387, FY 2004:	$-0-

v. *What portion of the UW Building Account is funded by revenues from the Metro Tract and related to that, what kinds of projects were funded from the UW Building Account?*

The legislature appropriated $22,700,000 million from the UW Building Account (fund 064) in the 2003-05 biennium ($16,000,000 of which was Metro Tract revenue). This is approximately 65% of the estimated total revenue for the 03-05 biennium.

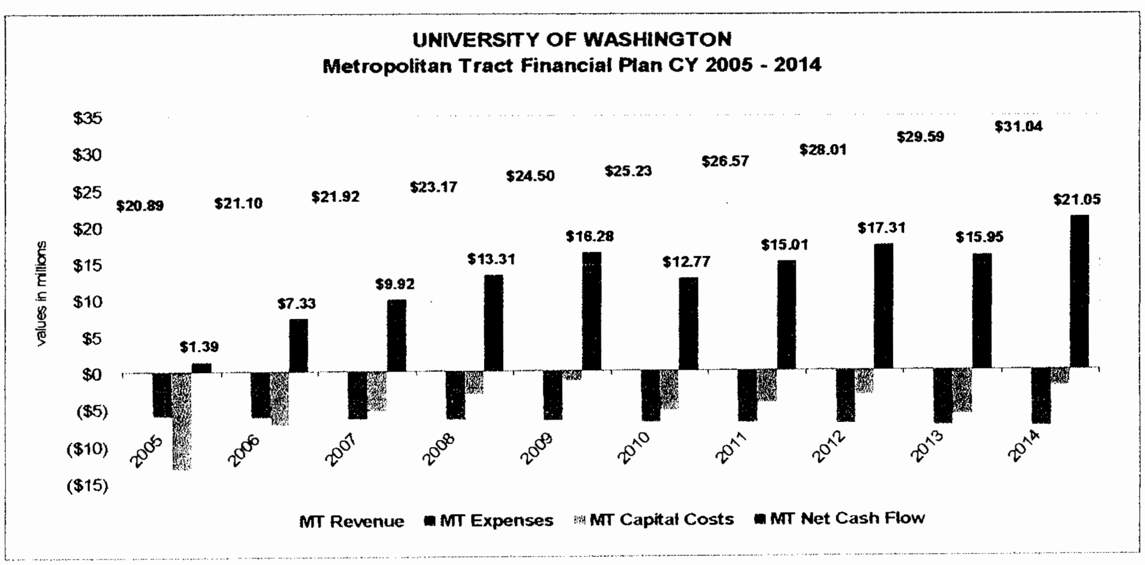
Projects funded in 2003-05 from the UW Building Account included: Johnson Hall, $15,552,000 (approximately 30% of the total project cost); Emergency Power, Phase II, $3,148,000 (approximately 47% of the project total); and Minor Works,$4,000,000 (approximately one third of the total amount of program renewal projects).

Minor Works, Building and Program Renewal projects include minor repairs and improvements to upgrade building systems and to meet changing program requirements. Each fiscal year, the capital budget for these projects is approved by the Board of Regents.

3. *Describe the expected performance of the Metropolitan Tract looking out ten years to 2015. Specifically,*

   a) *Provide financial projections and plans that illustrate revenues and expenditures for both operating and capital purposes, fund balance by fiscal year and any criteria used to determine appropriate reserve amounts. Please discuss major assumptions driving the University's current business plan for the Tract and this fiscal outlook.*

The following graph illustrates the anticipated revenues and expenses for the Metropolitan Tract for calendar years 2005 through the end of 2014, the expiration year of the Unico lease term. The financial projections below are estimates only and are based on current contractual rents and on assumptions on future market conditions as applied to the lease up of vacant space and tenant renewals as well as anticipated capital needs. The revenue is driven by anticipated market rental rates and projected growth over time. Capital expenditures are due in part to tenant improvements required to generate lease revenue as well as to maintenance of the physical plants and structures of the buildings. The accuracy of the model is highly dependent upon the accuracy of these assumptions.



The major assumptions driving the financial projections for the Metropolitan Tract are as follows:

- Average Annual Market Rental Rate Inflation
- Annual Contractual Rental Rate Increases
- Vacancy Rates and Projections
- Downtime Before New Leases Commence
- Renewal Probability Factors
- Tenant Improvement Expenditures for Leases

The Metro Tract Fund Balance as of 12/31/04 was $5.7 million. Reserves are determined by the Metropolitan Tract Committee based on estimated future capital needs and the timing of receipt of the rental income.

b) *Describe maintenance and improvement of buildings on the Tract in order to meet financial projections. Please include a description of Unico's responsibilities under its master lease, the current condition of buildings on the Tract, any plans under consideration for major improvements or development and how those will be financed, and any other efforts that will be undertaken in order to ensure that the buildings are properly maintained.*

As discussed in Question #1 above, the University is responsible for funding any capital improvements required on the Unico portion of the Metropolitan Tract under the Unico lease, and has implemented a process to ensure that the buildings are maintained at an acceptable level. This process has also afforded the University much greater influence in the overall direction of property management, including leasing activity which is the main driver for the University's financial returns from this lease. As the Unico lease expiration nears, the University has gained significant approval authority on lease rollover timing, new lease terms, tenant credit strength and tenant improvement investments. The buildings will be in good physical condition at the expiration of the Unico lease, with appropriate tenancies at market conditions.

It is important to note that Unico is responsible for the regular maintenance and repair of the properties. The lease requires that Unico invest at least 4% of its lease proceeds in maintenance and repair of the assets. Unico has exceeded this minimum expenditure in each of the past 10 years. In addition to the maintenance and repair of the buildings, Unico is also responsible for all operating costs including utilities, janitorial, property insurance and all other administrative costs related to the management of the buildings. Unico is also responsible for paying brokerage commissions related to the new and renewing tenants and the associated legal costs incurred in conjunction with lease negotiations.

Over the past several years, the University has undertaken in-depth exploration of additional development opportunities on the Tract. Three potential developments or redevelopments have been identified: the Cobb Building as discussed in Question #1; a retail "pad" site at the IBM Building Plaza; and a redevelopment of the Rainier Square site. The Cobb Building conversion to residential apartments is currently underway and will be completed in 2006. The IBM retail site project will occur once a retail tenant has been secured. Redevelopment of the underperforming Rainier Square site will be analyzed for viability of office, retail and parking. Residential and hotel projects will also be considered for this site.

The relatively small size of the IBM Retail project (approximately $4m) would likely result in the University financing it from cash flow of the Tract. This project will not commence until a tenant is secured providing revenue which will support the development costs. As discussed above, the Cobb Building is being financed primarily by a third party developer (Unico). Any Rainier Square project would also rely significantly on private third party financing. The University has obtained a private bank line of credit to finance fluctuations in the funding needs of the Tract required by these projects and for projected capital expenditures, and in order to ensure that the University consistently receives annual transfers to into the bond retirement account.

The Olympic Hotel site is fully developed, and any major improvements are the responsibility of the Fairmont.

c) *For the benefit of the legislative audience, please describe alternatives for management of the Tract following the Unico lease termination in 2014.*

Given that the Unico lease will not be renewed in its current form, there are three primary alternatives with respect to future management of the Metropolitan Tract:

- Ground Lease. The University could enter into a new ground lease with a third-party manager/developer (may or may not be Unico) on terms that would be significantly different from the terms of the existing ground lease with Unico.

- Contract Management. The University could hire third-party asset managers and property managers to manage the assets, or manage the assets directly.

- Hybrid Structure. The University could manage some of the buildings and enter into ground lease arrangements for others.

The terms of the existing ground lease with Unico reflect a 1950's business arrangement that was designed to compensate it for taking on the management responsibilities and the risks associated with development of the Metropolitan Tract buildings during the 1954-1977 time period. Because the Metropolitan Tract is now a mature asset with limited additional development sites, the business arrangement going forward (whatever alternative is chosen) will need to reflect current circumstances and risk criteria then established by the University.

Generally, a ground lease minimizes risk and provides some level of guaranteed return. A management structure, on the other hand, would likely generate the highest rate of return, but at the highest risk level. The advantages and disadvantages of each alternative will be fully considered before a decision is made.

APPENDIX 1 – 2005 METROPOLITAN TRACT QUESTIONS

1. Describe how the University exercises oversight to ensure that the Metropolitan Tract properties are adequately maintained, remain competitive, and summarize any notable changes occurring since the last report.

2. Describe the financial performance of the Metropolitan Tract since the last report in 2003 specifically addressing the following items:

    a. Provide a copy of the audited financial statements (balance sheets and income statements) for the last two fiscal years ending in 2003 and in 2004.

    b. Provide updated information on financial performance including Return-On-Investment (ROI) for the past 10 years and information on the current value of the University's interest in the Tract.

    c. Provide a summary describing use of Metro Tract funds that were appropriated by the Legislature. For fiscal years ending in 2003, then in 2004:
        i. What operating expenses of the University (if any) were paid from Metropolitan Tract income?
        ii. What amounts were deposited into the bond retirement account?
        iii. What were the University's actual debt service payments?
        iv. What amounts in Facilities Bond Retirement Account in excess of anticipated debt service need were transferred to the UW Building Account?
        v. What portion of the UW Building Account is funded by revenues from the Metro Tract and related to that, what kinds of projects were funded from the UW Building Account?

3. Describe the expected performance of the Metropolitan Tract looking out ten years to 2015. Specifically,

    a. Provide financial projections and plans that illustrate revenues and expenditures for both operating and capital purposes, fund balance by fiscal year and any criteria used to determine appropriate reserve amounts. Please discuss major assumptions driving the University's current business plan for the Tract and this fiscal outlook.

    b. Describe maintenance and improvement of buildings on the Tract in order to meet financial projections. Please include a description of UNICO's responsibilities under its master lease, the current condition of buildings on the Tract, any plans under consideration for major improvements or development and how those will be financed, and any other efforts that will be undertaken to ensure that the buildings are properly maintained.

c. For the benefit of the legislative audience, please describe management alternatives subsequent to the UNICO lease termination in 2014.