

Provided at the
Montana State Fund
meeting in March 2016.
Notes are by Pat.

Consideration of Acquiring the Parking Facility adjacent to the MSF Building March 11, 2016

Currently, MSF has an agreement with the city of Helena to lease 350 parking permits from the city in the adjacent parking garage. The agreement was effective upon the completion of the parking facility (June 2010) and is continuous for a period of 30 years or until approximately 2040. Among other criteria, the agreement states,

- The cost of the permits will be the monthly rate charged to other purchasers of permits for parking in other facilities within the Helena Parking Commission (HPC) parking district.
- MSF may continue to purchase at least 350 permits beyond the 30 year period as long as MSF elects to make the purchase and at the same rate as other purchasers of permits in other facilities operated by the HPC.
- If MSF does not anticipate using all 350 permits, MSF may notify the HPC of our intent not to use all the permits and allow the HPC to sell the permits not used by MSF and credit MSF for the cost of those permits.
- The parking facility is to be controlled access.
- Currently, MSF is paying \$71 per permit per month or \$298,200 per year. MSF receives approximately \$11,000 for the sale of permits not used.

MSF has been approached by the city of Helena about MSF's interest in taking ownership of the parking facility. MSF management expressed interest but qualified that analysis would be needed before MSF management was satisfied such a proposal could be presented to the Board of Directors. The analysis has included:

- A legal review to determine if MSF has the authority to acquire the parking facility. This review was completed by MSF General Counsel and concluded MSF and the Board has the legal authority to acquire the facility.
- As part of that discussion, MSF and the city of Helena agreed that an appraisal would be necessary. MSF created an appraisal bid document to request appraisal costs to determine the following values:
 - The MSF building without the parking facility included
 - The parking facility without consideration of the adjacent MSF building
 - The value of the combined properties

The bid appraisal was awarded to Elkhorn Appraisal Services, Gregory Thornquist of Helena, MT. The appraisal was completed December 8, 2015.

- A cost-benefits analysis to purchasing the parking facility.

The appraisal values provided by Elkhorn Appraisal provided the following:

1. The MSF building - \$28,000,000
2. The Parking facility - \$7,500,000
3. The combined building and parking facility - \$37,000,000

As noted, the combined value is \$1.5 million or 4.2% greater than the value of the individual properties. The appraisal report further assigns the \$1.5 million of additional value in the combined analysis as follows:

- MSF Building - $\$28,000,000 + \$1,183,099 = \$29,183,099$
- Parking Facility - $\$7,500,000 + \$316,901 = \$7,816,901$

MSF discussed the appraisal values with Ron Alles, Helena City Manager. Upon review of the appraisal values and discussion, Mr. Alles provided the City would be willing to sell the parking facility to MSF for \$7,700,000. Both parties agreed to discuss this value as the price of the facility with our respective governing authorities.

Using a purchase value of \$7.7 million, MSF analyzed the option of continuing to lease the facility as compared to purchasing the parking facility. The assumptions included in the analysis are in the following table.

Inputs:	
Purchase Price	\$7,700,000
Investment Rate of Return	3.75%
Maintenance:	
Year 1 Annual Maintenance	\$65,000
Maintenance Cost Increase	5.0%
Major Maintenance	\$500,000
Frequency (in years)	5
Rental Income:	
Rented Spaces	30
Initial Annual Rent Per Space	864
Rental Expense:	
Rental Rate Increase	3.0%
2016 Fee (Actual)	\$298,200
Appreciation:	
Garage Value Appreciation	1.0%
Garage Plus combined Initial	
Increased Value of \$1.5M	\$9,000,000

have seen increase of abt 5% / yr on lease / rental costs

We believe these assumptions are fairly representative of trends that are likely to occur and conservatively stated. The example is the appreciation assumption used in the analysis where we have conservatively used a 1% appreciation value per year. The summary of the results is in the next table, which depicts the comparison of continuing to lease the parking spaces as compared to a purchase option over the next 25 years until the parking agreement with the city ends. An explanation of the results is provided after the table.

Results at End of Lease Term				
Lease Option		Purchase Option		Difference
Lease Payments	(10,872,153)	Purchase Payment	(7,700,000)	
Investment Income	11,628,287	Maintenance	(5,602,261)	
		Rental Income	945,024	
		Cash Savings Accrual	8,263,266	
Cash Flow	756,134	Cash Flow	(4,093,972)	4,850,106
Residual Asset	7,700,000	Residual Asset	11,314,467	(3,614,467)
Net Value/(Cost)	8,456,134	Net Value/(Cost)	7,220,496	1,235,639

savings from not paying lease costs of about \$300,000/yr

in 2 yrs would see breakeven in 2 options

Lease Option

The lease option assumes MSF will continue to lease the parking facility.

- Lease payments are the annual payments over the 25 years assuming a 3% increase per year. Note that the last 2 years' lease rates have increased by 5% per year.
- Investment income is the amount earned on \$7.7M invested and earning 3.75% return. MSF is currently earning 3.15% on fixed security investments.
- The resulting cash flow is the difference between the investment income less the cost of the lease payments.
- The residual amount of \$7.7M is to reflect that if MSF did not purchase the parking structure, MSF would maintain the principal to be invested.
- The net value of \$8.5M reflects MSF would be ahead by this amount at the end of the term.

Purchase Option

The purchase option shows:

- The cash outlay to purchase the facility for \$7.7M
- The maintenance costs over the 25 year period assuming
 - Initial operating cost of \$65,000 per year increasing by 5% per year.
 - Major maintenance costs of \$500,000 every 5 years over the 25 year period.
- Rental income assumes MSF would lease 30 spaces to surrounding businesses starting at \$72 per month and increasing each year by 3%
- Cash savings accrual is the amount that would not be expended for the lease payments over time less the cost of maintenance. These savings would accumulate over time.
- The cash flow is the sum of the above parts.
- The residual asset assumes the value of the parking facility as an asset plus the value difference (\$1.5M) of the combined property and appreciation of 1% per year. This growth in the value of the property would not be reflected in the financial statements of MSF. Such value would not be realized unless MSF were to sell the building and parking facility.
- Again the net value of the purchase option is reflected at \$7.2M.

In reviewing the results of this analysis, one would conclude the better option is to continue leasing the facility as per the original agreement. Although the garage would appreciate in value, the appreciation would not be at a level to match the compounded growth of invested assets. However, it may be important to note that in the 25th year, the cost to lease the facility would be almost twice the amount as the cost of maintenance from owning the facility. In other words, the value of owning the facility greatly improves after the 25th year. In our analysis, the breakeven point for the purchase of the parking facility would occur in year 27. After that point, there is a positive benefit to MSF so that by the 45th year, the advantage of owning the parking facility exceeds \$9 million. As noted previously, if our assumptions were different, these outcomes would be different as well. For example, if the appreciation were 2% rather than 1%, the benefit of owning is accelerated.

Other areas to consider are listed as follows.

Pros of Purchase

- The combined building and parking under single ownership would have higher value long term than the building alone. There is no intent to sell the building. However, that is not to say it would not be considered at some time in the future and the opportunity to acquire the facility at this time may enhance the value in the future.
- Related to the item above, one could fairly easily argue that tenants and lenders are unwilling to lease or finance commercial properties with inadequate parking available.
- Currently, MSF is paying only about 50% of the cost in our lease rates to operate the garage. The lease costs can continually increase which are assumed in the analysis. However, the increases are tied to all parking facilities owned by the city. However, once the agreement between the city and MSF expires, the rate of increase could change. Note that there are currently city requirements similar to what is in the agreement as to hold the increases in rates the same for all facilities.
- If MSF owned the garage, MSF would be able to better enforce the low emission and car pool parking criteria established for the LEED certification.
- If MSF found a need for expansion in the future, MSF could use the parking property for expansion.
- If MSF decided not to purchase the facility, the city could decide to tear it down once the agreement has expired, leaving MSF with limited parking options. However, that would occur after 25 years.
- At some point, MSF could decide not to provide parking for employees and instead charge for the parking. The scenario is unlikely, but could be used as an incentive for employees to look for more environmentally friendly methods to commute to work.
- If MSF were to sell the building in the future without parking, the value could be less than in the combined scenario.
- MSF could put a roof on the top of the garage and install solar panels to generate electric power for the MSF building.

Cons of Purchase

- MSF has an agreement with the city to be able to have parking in the parking garage at the same monthly cost as other parking facilities the city owns. This agreement has about 25 years remaining. MSF will have parking under this agreement and MSF is not leveraged to purchase the garage.

- As noted, MSF will be able to invest the proposed \$7.7M purchase price and earn roughly the equivalent of the annual lease costs of the parking spaces.
 - If we purchase the garage, the outlay would not be earning investment income plus we would incur the additional management and maintenance costs on the facility.
- Maintenance costs of the facility would require either contracting the operations of the facility or possibly adding staff to maintain the structure. The city has indicated a willingness to provide management services to MSF should MSF purchase the parking facility.
- We don't know what the workplace of the future will look like. In the future, businesses will be doing more with remote work opportunities and less at a central location, therefore less parking would be required. As a result, there may be excess parking capacity.
- The Getchell parking garage is approximately 60% filled during the weekday. It was built in 2002 for approximately \$4.7M. This is an indication that there is not demand for the capacity of parking available in this area. According to the downtown development plans, that is not the case in other parts of the downtown area.
- Providing a parking supply discourages alternative modes of transportation such as bus, bike or walking.
- Possibility of political issues for obtaining the garage.

There are both legitimate Pros and Cons in the purchase consideration. One important factor for MSF or any business trying to attract and retain employees is in providing parking. The fact that MSF is able to provide covered parking for employees next to the building is a very-much-appreciated benefit of working for MSF. In addition, if MSF purchases the parking facility, the city could have the ability to use those resources to develop parking in other areas of downtown Helena where demand is greater. In other words, MSF would be assisting the city in the capacity for further downtown development.

Recommendations

With these considerations in mind, MSF management provides the following recommendations for Board consideration.

- Obtain outside legal review and interpretation on MSF's legal authority to purchase the parking facility.
- Request the Board approve MSF management to continue to pursue discussions and negotiations on terms for purchase of the parking facility.

MSF would then present the legal review and the terms and conditions of the purchase for approval at the next Board meeting.

The availability of parking for our employees was an important factor in the original plans to build the MSF building. There is now an opportunity to enhance the value of the building by adding the parking facility under the ownership of MSF.