Iowa Department of Administrative Services
Director's Office

Chester J. Culver, Governor
Patty Judge, Lt. Governor

Mollie K. Anderson, Director

Iowa Legislative Council's Fiscal Committee
Mercy Capitol Acquisition Issues
June 14, 2007

1. Section 4.3 of the proposed sales contract states that a Phase I Environmental Report has been completed by the Seller. Has that report been reviewed and can we get a copy of the report? Section 4.3 also allows the state to prepare an update to the Environmental Report. Is this being considered?

   The seller has not completed a Phase I Environmental Report. In December of 2001, the state contracted for a Phase I Environmental assessment when it was considering the purchase of the property. The report has been reviewed and provided to the Dept. of Management. An update of the assessment is planned.

   This issue of asbestos has been discussed previously with Mercy officials. An analysis was previously completed in 1993 and it was deemed to not be an issue and that it was appropriately contained. The facility continues to be an active licensed hospital and the issue of asbestos is not an issue related to the existing operations of the facility. A further evaluation of this issue will be completed prior to closing.

2. When was the hospital facility constructed and last renovated?

   The hospital facility was constructed in phases between 1954 and 1981, and according to the recently completed appraisal "is in good condition". The most recent renovation work was completed by Mercy and occurred after Mercy took possession in 2002.

   Mercy purchased the property for approximately $6 million and expended an additional amount of approximately $6 million for renovation purposes, as well.

3. The Department includes an estimated cost of $2.0 million for demolition of the Annex Building and for converting the facility to usable office space for state employees. How was this figure arrived at and is it adequate to satisfactorily complete the work? A concern is that $2.0 million (less the demolition cost) will not be enough to adequately complete the renovation of the facility. Inflationary costs for construction should be factored into any estimates associated with the renovation, as the work will not commence until 2009 or 2010.

   Originally, DAS estimated that the costs associated with making the hospital facility ready for occupation at $1 million in mid-2006 for discussion purposes. This figure was increased to $2 million as discussions progressed. DAS recently concluded a more precise evaluation of the necessary changes and has provided that analysis on attachment "A". We currently estimate that these costs will total $1,993,750 in current dollars, which includes a 25% contingency factor totaling $398,750. At this time, we believe this is a sufficient amount to complete the work.

   This amount does not include funding for demolition of the annex building. While we originally intended to include the cost of demolition in line item, the demolition will need to

be completed at the start of the project. We requested language during this past session which will permit the expenditure of funds for demolition from previously appropriated moneys. We are also directed by the legislation to evaluate whether any amounts spent for this purpose can be included in the amount we plan to finance. The "Cost/Benefit" document will be updated to reflect this.

4. The Department estimates the Asset Value of the property and buildings at $8.07 million. How was the estimate calculated?

   This original evaluation was our best estimate prior to obtaining any an appraisal related specifically to the property. We are currently updating this figure.

5. The proposed purchase agreement includes the exchange of parking lots between the State and Mercy Capitol. The parking lot that the State would receive from Mercy Medical would be used for construction of a parking structure for occupants of the new office building that will be constructed north of Des Moines Street. The Department would like to have the property exchange completed as soon as possible in order for the construction of the parking structure to commence. Can the parking lot trade be deferred until December, giving the Legislative Council more time to gather information and analyze the feasibility of the project?

   <u>The trade of parking lots could be deferred; however, doing so will expose the state to additional risk.</u> Under the current proposed timeline, construction on the parking lot site to be received in the exchange will likely begin in the spring of 2008. Prior to commencing construction, DAS must have access to the sit for survey work, geotechnical work and for other purposes with respect to planning and design work. Given that preconstruction planning and design costs typically equal approximately 10% of the total project cost, it would not be prudent to incur any portion of these costs until such time as the exchange is finalized. Delaying the start of the design work will also delay the start of construction and likely increase the total cost of the project.

6. The draft purchase agreement requires the state to pave state parking lot before the transfer of the parking lot can occur. Where in the purchase agreement does the state take back ownership of the state lot once the overall property purchase it completed.

   The traded parking lot would become part of the real estate that we purchase from Mercy; however, as a result of continuing questions regarding this issues we are submitting language to Mercy's attorney which would clarify that the parking lot would be included in the sale.

7. The cash flow related to the repayment of the loan and the timing of relocating the state employees into the facility needs further examination. The funds that are pledged to repay the loan are appropriated funds that are currently being used as rent. We are concerned that funds will need to be appropriated to cash flow the loan repayment while the facility is being renovated.

   The Mercy Capitol facility contains both storage and office space that could be immediately occupied and utilized upon vacation by Mercy. Also, we intend to discuss with Mercy the opportunity to have access to and occupy the facility for a period of time before the transaction closes and the state legally takes possession of the site for purposes of completing any necessary conversion work. Accordingly, since loan payments are made on a quarterly basis, sufficient revenue should be generated during this transition period to satisfy the loan requirements before the first payment is due. SEE ATTACHEMENT "B"

8. Will DAS complete a Return on Investment analysis or a Total Cost Analysis before proceeding with any decision to purchase the Mercy Property?

A "Return on Investment" analysis has not been completed and is not anticipated. We have completed a "Total Cost" analysis and calculated a potential savings in comparison to existing lease costs. SEE ATTACHMENT "B"

It should also be noted that DAS continually reviews issues related to property acquisition opportunities related to the Capitol Complex and that current trends indicate that acquisition costs will increase over time and that the greatest "return on investment" on an appropriate acquisition will likely be realized by completing that transaction earlier rather than later.

9. Sections 11.1 and 11.2 refer to damages of $200,000 prior to the closing date. Is this standard language, how was this amount arrived at?

   Mercy placed this language in the document. A follow-up phone call with Mercy counsel indicates flexibility on the $200,000 number. The figure represents a triggering amount that will allow either party to "walk away" from the deal. For example, if the State wants to buy the property, even if it burns down (in which case the State would get insurance proceeds) and the land in exchange for the sale price, Mercy is likely agreeable to it if the state is agreeable. The State could also decide in this situation to "walk away" from the transaction. The parking lot exchange would stand.

   If the State does not terminate the agreement, we would be assigned by Mercy all interests in any insurance policies in place to cover the damages incurred. There would be no reduction in the purchase price, except for the amount of any deductible called for in the insurance policies.

Mercy Capitol Acquisition Cost/Benefit Summary
Working Draft

Estimated Asset Value:

Land

9.71 acres X $_____/acre (per recent Capitol Complex land appraisal) = $_____

Buildings

3 primary buildings (main hospital, pharmacy, maintenance building) = $_____

Total Asset Value = $_____

Terms and Conditions of Financing:

Annual Payment

$8,000,000 loan (includes $6.0m acquisition cost and $2.0m Conversion costs) @ 5.34% for 20 years = $ 654,894

Quarterly Payment

$654,894/4 quarters = $ 163,724

Life of the Loan

$5,097,878 Interest + $8,000,000 Principal = $ 13,097,878

Cash Flow to Repay Loan:

180,000 sq ft of office space currently leased yearly at $15.00/square foot = $2,700,000

Number of Quarters/Year = 4

Leased Space Cost/Quarter = $ 675,000

Assumption: Total Quarterly Sq Footage = 45,000

Less: Quarterly loan repayment (from above) =	$163,724
Quarterly utility cost @ $1.25/square foot =	$ 56,250
Quarterly custodial @ $3.10/square foot =	$139,500
Quarterly routine maintenance @ $1.00/square foot =	$ 45,000
Quarterly major maintenance @ $1.00/square foot =	$ 45,000
Total:	$449,474
Difference = Quarterly Net Cash Flow:	$ 225,526
Number of Quarters/Year:	4
Annual Net Cash Flow:	$ 902,104
20 Year Loan Period Savings	$18,042,080

Basis for Potential for Lease Reduction:

$902,104 Annual Net Cash Flow/180,000 square feet = savings = $5.01/square foot

New Lease Rate = Satisfies All Loan Payment Requirements and Operating Costs:

$15.00/square foot current price minus $5.01/square foot savings = $9.99/square foot

Benefits:

- The state will acquire an asset valued at approximately $____. This provides an opportunity for future Capitol Complex growth. The acquisition would be the largest expansion since 1913.
- This will permit the state to reduce the size of the new office building from 350,000 square feet to 300,000 square feet. The state will benefit by saving over $8,500,000 in construction cost.
- This will provide annual lease savings of over $900k and approximately $18.0m during the life of the loan.
- All of the acquisition and conversion costs can be repaid with lease payments.
- This will solve a variety of current and future Capitol Complex parking and expansion problems.