

August 14, 2018

To: The Historical Resources Management Commission
From: Lawrence Shepard and Chuck Cunningham, Co-owners
3820 Chiles Road Project
Re: Adaptive Reuse of the Pacific Standard Life Building

Commissioners:

This document, based on the more voluminous Project Application, describes seven separate initiatives to evaluate, implement, or otherwise further adaptive reuse of the Pacific Standard Life Building. The first of these was mounted by UC Davis when it weighed exercising its option to purchase the building and site. The other six were supported over a three-year period by Lawrence Shepard as he searched for a means to achieve his goal in buying the property, preservation of the existing structure.

Adaptive Reuse of the Pacific Standard Life Building

Origins of the Building

Built in 1965 for Intercoastal Life Insurance Company, predecessor to Pacific Standard Life Insurance Company, the 53,000 square foot building occupies the western half of a 7.4 acre (400'x800') parcel. The second story housed corporate offices while the first floor stored the voluminous insurance contracts, records and securities of the company in the pre-digital era. The first floor was built as a vault with one entrance, no windows and partially subterranean. In 1989 the building's ownership passed to the California Commissioner of Insurance as receiver in the July 1989 bankruptcy of Pacific Standard's successor, Southmark Corporation, a high-flying Texas-based financial services company that used junk bonds to buy up smaller companies.

Development Team

The building was purchased by an investor group that included Lawrence Shepard in 1996 and was leased to the University of California under a 20-year lease. In August 2014 the University announced to the ownership group that it would not extend its occupancy of 3820 Chiles Road or exercise its option to purchase the property. Fond of the existing building, he was attracted to the challenge of adaptively reusing it as he had preserved other properties including:

- the 1874 Hunt Boyer Mansion, Davis, a National Register property that was under threat of demolition when he bought and restored it in 1978
- his primary residence at 66 College Park built in 1926 that, when acquired in 1980, served as a boarding house for 11 students
- three flats in the Francesca Apartments, 850 Powell Street, San Francisco dating from 1924
- two 75-year-old cabins in Bucks Lake, Plumas County
- 15 early and mid-Century homes in Davis and Sacramento, California
- approximately 30 less remarkable postwar tract homes and condominiums abandoned and boarded up during the Great Recession.

Identifying as a (now retired) professor rather than a developer, Shepard finds fulfillment in breathing new life into old structures. The process most often involves interdependent issues of physically and financially stabilizing properties while rehabilitating and repurposing them. These are tasks corporate developers find time-consuming, risky and complex.

Chuck Cunningham, well known civil engineer in Davis, joined Shepard as co-owner and co-manager of the project.

Adaptive Reuse of the Existing Building

The table and text that follow describe seven separate initiatives to evaluate, implement, or otherwise further adaptive reuse of the Pacific Standard Life Building. The first of these was mounted by UC Davis when it weighed exercising its option to purchase the building and site. The other six were supported over a three-year period by Lawrence Shepard as he searched for more than two years for a means to achieve his goal in buying the property, preservation of the existing structure. After studying purchase of the building in some depth UC Davis decided not to exercise its option to purchase the building. In declining to buy the property the UC Davis Executive Director of Real Estate Services cited seismic issues discovered by consulting engineers and its poor location. Remedying the seismic issues would have added considerable but unknown costs to a much-needed rehab of the building. The locational issue was not distance from campus (UC occupies a great deal of space across I-80 equidistant from campus) but isolation: 3820 Chiles Road is not adjacent to other offices and providers of support services.

It is noteworthy that after extensive due diligence, the largest office and R&D tenant in the region--one possessed of a burgeoning appetite for space, one for which the specified purchase price was not a significant sum, and one which had occupied and operated the building for 20 years--concluded that in light of the building's structural and locational limitations, it was not worth rehabilitating.

2015 Study Team. After taking possession of the property in 2015 with the intention of restoring the building, the owner assembled a study team to assess the practicality of developing the site with the existing structure as the centerpiece of an office/R&D park. The team was composed of a contractor, an architect, an engineer, two commercial real estate brokers, and the owner. Notwithstanding the owner's predilection, the team concluded saving the building was impractical due to a combination of structural and design issues. Paramount among these were seismic deficiencies identified by engineers retained by UC Davis. Other major impediments identified by the study team included its isolated location, gross deficiencies with respect to Title 24 and ADA requirements, obsolete design and layout, and the vault-like basement.

The study team concluded that at best rehabbing the building would cost what a new building would cost without meeting modern design standards for commercial buildings and could cost considerably more because of unknowns. Far from representing an asset for economic development, this conspicuous site and obsolete building could stand brown and dark for many years so it should be demolished in favor of uses for which there is current demand.

After confronting the impracticality of restoring the obsolete building, the study team analyzed the feasibility of demolishing the building and developing a new office/R&D park on the site, without the burden of the existing building. Multiple plot plans and pro formas were considered. The challenge here was three-fold:

Initiatives Intended to Support the Preservation of the Pacific Standard Life Building (2013 - 2017)
3820 Chiles Road

Initiatives	Type	Proposed Land Use	Focused on Adaptive Reuse of Existing Building?	Time Line
UC Davis Due Diligence including Seismic Review in anticipation of exercising favorable purchase option	Feasibility Study	Office R&D	Yes: UCD declined to exercise option to purchase after detailed assessment	
Ongoing marketing efforts to lease or rebuild-to-suit using multiple commercial real estate brokers	Marketing Campaign	Office R&D	Yes: attracted no prospective buyers or tenants in 3 years	
2015 Study Team developed detailed cost analysis & layout for R&D Park with existing bldg. as centerpiece	Feasibility Study	Office R&D	Yes: determined adaptive reuse to be infeasible and the site to be infeasible	
PSL Lofts Condominium Project	Alternative Use Study	Residential	Yes: experienced development partners declined to participate because of risk	
2015 - 2016 City of Davis & Greater Sacramento Economic Development Campaign	Marketing Campaign	Office R&D	Yes: attracted no prospective buyers or tenants in 2 years	
MarketONE Builders/Cushman & Wakefield Economic Feasibility Analysis	Feasibility Study	Office R&D	Yes: determined site to be infeasible for Office R&D due to size and location	
2017 Economic & Planning Systems, Inc. Independent Evaluation of Land Use Alternatives	Feasibility Study	Office R&D	Yes: concluded office R&D and retail uses infeasible with or without existing building	
Current Project - EIR	Alternative Use Study	Residential	No	
				2013 2014 2015 2016 2017 2018

1. Commercial real estate brokers on the team argued that R&D and office tenants prefer to co-locate with similar uses and with service providers in a “campus” environment. This resonated with UCD’s second reason for leaving the site, its isolation. To overcome this, the team proposed using some of the already small site to open space amenities for employees and visitors. On this site in this market, they also argued that there should be 5 parking spaces per 1000 square foot of building rather than the required 4 spaces. These provisions materially reduce the buildable square footage. Finally, the brokers estimated a minimum five to seven-year build-out of any office/R&D park built on this site. In addition to tying up millions of dollars in infrastructure, this exacerbates risk by making the project vulnerable to any new, larger research park approved in the interim like Mace Ranch Innovation Center.
2. While design and development of corporate facilities in urban centers are influenced by corporate image and marketing, office/R&D space in suburban markets like Davis is built for local enterprises and start-ups making it cost-driven. Such space represents a commodity and its development is subject to huge economies of scale. As a result, projects like the Interland Research Park (originally about 50 acres), the original Mace Ranch Research Park across I-80 (more than 100 acres) and the proposed Mace Ranch Innovation Center (102 acres) enjoy much lower development costs than sites as small as 3820 Chiles Road (7.4 acres).
3. There is an abundant inventory of land already zoned for and better located for business park. Just in the immediate vicinity of the site, south of I-80 adjacent to the freeway between the Mace Blvd. and Richards Blvd. exits there are more than 20 acres of vacant office/R&D land. This land alone, when considered next to the vacant standing inventory of office space, represents more than a decade’s absorption in the Davis market.

The factors caused the study team to conclude it is impractical to establish a commercial business park on the 7.4 acre site.

2015-2016 City and Regional Economic Development Efforts. Aware of the University’s decision to vacate the existing building and acting under the impetus of the city’s critical need for new revenue, the city’s deputy chief innovation officer contacted the owner in August 2015 expressing interest in using the building to stimulate economic development in Davis. She and senior city staff toured the building in December and were provided the 2014 seismic study as well as summary statements of the contractor and real estate brokers who participated in the 2015 Study. The city remained interested in the possibility that the building could be used to attract a major technology firm from the Bay Area. An informal arrangement was agreed upon under which the City of Davis economic development team and Greater Sacramento CEO Barry Broome would draw the property to the attention of a specific internationally known tech giant and other firms expressing interest in the region. The owner could pursue alternative uses but was asked to support the economic development effort by having a rendering of the building drawn for use by economic development officers of the City of Davis and Greater Sacramento. Wanting to unreservedly support the city’s aspiration to bring a tech giant to Davis, the owner went the extra step of developing a printed brochure and a two-minute animated rendering at

a cost of \$8,000. After the passage of a full year, local officials indicate that they had not been able to identify a single prospective tenant to show the materials requested.

The applicants believe that city staff responsible for economic development now concur with the 2015 Study Team that the 52-year-old building does not have the potential to attract a user.

2016 MarketOne Builders and Cushman & Wakefield Analysis of the Viability of Building a New Building. A concern remained that by rezoning the site from commercial to residential uses the City Council might be tying the hands of future councils by reducing the supply of commercially zoned land (albeit highway commercial land). In the summer of 2016 the owner asked Cushman and Wakefield, an international commercial real estate brokerage firm, to assess the viability of creating a new office building on the site. At their request, James Fitzgerald of MarketOne Builders did a cost study of constructing a *new* office building that met modern design, seismic and energy efficiency standards. His site-specific numbers were very close to numbers produced a year before by Steve Harrison and his group of subcontractors. Cushman and Wakefield Managing Director Ron Thomas and his Davis colleague Jim Gray analyzed Fitzgerald's cost figures against market rents in Davis. Their conclusion is that if a developer were to build such a structure today *putting in the land at zero cost*, the developer

“ . . . would lose \$111,000 per year, at 90% occupancy, and would take construction risk. This deal would never get underwritten for a loan . . . Average rents in Davis (are) \$1.86 MG (per month gross). Until rents rise – to \$2.75 or \$3.00 per foot it is unlikely that any spec office building will get built.”

In the long run, office and commercial rents in our region rise by little more than the rate of inflation, two to three percent annually, so a fifty percent increase in rents would require more than a decade and, of course, the land has more than zero cost.

This analysis provides confirmation of the findings of the 2015 Study Team: it would be many years—likely decades-- before this parcel becomes viable for such office/R&D uses.

Continued Efforts to Market the Property (Q4 2014 to the present). Starting soon after he contracted to buy out his partners in Fall 2014, the owner alerted prominent members of the commercial brokerage community that he intended to rehab the building so it and the unbuilt half of the site would be available for lease and/or build-to-suit. As was noted above, this marketing effort was supplemented by the work of economic development officers from the city and Sacramento region in their efforts to bring companies to the area. This 28-month effort has produced nothing: these sources have identified only three prospects with any possible interest but none of them were interested enough to tour the property. Two of these were fitness/recreational center users and one was office and light manufacturing, a far cry from the high-tech R&D user sought for broader civic benefit.

The applicants' inability to attract even one potential buyer or tenant to tour the building or site confirm the conclusions of the 2015 Study Team and the City of Davis/Greater Sacramento

marketing effort on behalf of the region: firms that want to locate in Davis—especially firms capable of being game changers in the local economy—require land and build-to-suit opportunities in research parks large enough to provide three things: economies of scale in development; co-location with service providers; and expansion opportunities.

2017 Economic & Planning Systems, Inc. (EPS) Study. This study, conducted by an independent consulting firm often used by the City of Davis and other jurisdictions, analyzes the viability of developing the site under four land use scenarios with options 2 through 4 requiring demolition of the existing structure:

1. Adaptive reuse of the existing building for office/R&D use
2. Construction of a new office/R&D building
3. Construction of mid-sized retail
4. Construction of for-sale and rental housing as contemplated in our original application (later modified to all rental)

EPS determined that it is not economically feasible to develop the site for office/R&D purposes either by adaptively reusing the old building or by starting with new construction. Adaptive reuse would require one time and on-going losses having an estimated total present value of \$6.6 million even when zero cost is attached to the land. Under this scenario, the 52-year-old building would retain locational and functional limitations enumerated in the report.

New construction of an office/R&D building would yield a more functional building without remedying locational limitations but it was still estimated to lose \$4.1 million without allowance for land costs. In its detailed analysis, EPS identified as the source of this conclusion low commercial rents prevailing in the Davis and regional markets. For an office/R&D project to make sense to an investor and lender, monthly lease rates would have to rise by about 50 percent \$2.90 per gross leasable square foot, a phenomenon that would likely require decades.

The conclusion of EPS that office/R&D is infeasible on this site corroborates:

1. the decision of UC Davis not to purchase and renovate the building following its 2014 due diligence;
2. the findings of the 2015 Study Team and the 2016 MarketOne Builders and Cushman & Wakefield analysis; and
3. the fruitless marketing efforts of the owner, his brokers and city and regional economic development authorities since early 2015.