
ARCH ISSUES COMMITTEE
RE: ISSUES BULLETIN 2004-1

Full Q&A with RA President Rick Beyer and Treasurer John Higgins

ARCH Issues Committee (AIC) representatives met with Reston Association (RA) President Rick Beyer and RA Treasurer John Higgins on Dec. 5 to discuss the RA Headquarters Referendum (the HQRef). In advance of that meeting, the AIC conducted independent research on the HQRef: it monitored RA drafting sessions, attended several local meetings at which the referendum was discussed, and solicited various viewpoints on the referendum's merits (including meeting with several residents who had expressed concern and/or opposition). By Dec. 5, the AIC had created a set of questions that reflected, in its judgment, the most important issues surrounding the HQRef, most of which had not yet been fully clarified in the ongoing public debate. These questions were typed (set forth in full below) and were presented to the RA President and Treasurer at the Dec. 5 meeting. At that meeting, Mr. Beyer and Mr. Higgins provided answers orally. The AIC then transcribed/typed those answers and provided them to the RA President and Treasurer for confirmation. The confirmed answers, in full, are produced below in *blue italics* with the indication "*RA Officers' Response.*" This material served as the basis for Issues Bulletin 2004-1, and is being made available on the ARCH Web site for those wishing additional detail on this important issue for the RA membership.

Buy/Build vs. Lease

The AIC has identified four significant benefits to owning vs. leasing RA office space: (a) by fixing annual costs for space in the near term through a mortgage or construction loan, RA's members would be protected against lease rate increases (possibly substantial over the term of a mortgage/loan given Reston's current real estate market); (b) by accumulating equity in its own building, the RA would enjoy advantages down the road derived from the building's sale or loan value (*RA Officers' Response: ought not exaggerate it, but better to have it than not*); (c) according to RA's calculations, owning would be less expensive than leasing equivalent space; and (d) RA would not be vulnerable to a landlord who chooses to do something else with the property.

1. Are there additional, material benefits to the buy/build option? *RA Officers' Response: The number one reason is to be able to control your own destiny and not be at the mercy of the landlord. A fifth reason also: there will be build-out costs if RA leases that may not be relevant in a build/buy option.*
2. The principal concerns we have heard expressed on the buy option (inapplicable to a decision to build) is that RA may be forced to buy space larger than it requires, meaning RA may become: (a) a landlord for its unused space (a role for which RA was not intended and has no expertise); or (b) a partial owner in a building (via joint venture or as owner in a commercial condominium) which

could create complications (e.g., if other “condo” owners in the building default). These concerns are arguably premature, since how a buy option would be executed is necessarily for the future. Nonetheless, how do you respond to these concerns? *RA Officers’ Response: Several thoughts: 1) RA won’t be in a position to buy a huge space given the \$ cap in the referendum; 2) in all events RA is looking for a utilitarian space; RCC has amenities and RA, therefore, is looking for a more utilitarian building with maybe a conference room or two; 3) there is “zero support” on the current board for getting into a larger building than is needed and getting into the rental business (interesting note: RA could lease a 30,000 sq ft building tomorrow and rent out space with no referendum); 4) yes, we could face having to be a condo owner in a larger building, but that is not preferred and there is no interest on the RA Board of reviewing a condo style facility.*

3. There have been some questions raised about the possibility that RA may refinance in the future if it owns, and to what extent that might increase the total cost of this effort. Local media reported recently that you believe a referendum would be required “to borrow on an equity loan.” Is that so, or are there other assurances you could provide on this topic? *RA Officers’ Response: No, the RA Board could do an equity loan w/o a referendum; however, note that there has been no board that has borrowed. Indeed, RA has equity now and has never even discussed borrowing (and worth noting that would have been an option for the Nature House and the RA Board didn’t even think about it, and instead went out and raised \$). We would never borrow to pay operating expenses since it doesn’t make sense, but if the board ever did that it would be accountable to the membership at election. Control point is the budgeting process itself.*
4. Notwithstanding the apparently strong reasons for buying or building, are there any scenarios where leasing would be a preferable course? *RA Officers’ Response: Yes. A suitable building to buy or land to build on may not be available; and if we buy and have only a condo option available, that may not be suitable or acceptable. We will look seriously at the build option, not just buy. Only site we know that is now available is the central services site and that has challenges. Would then have to look at interest rates and other financial factors at the time. So, yes, leasing may still be where we end up; many factors to be weighted to determine what is in best interests of the membership at the time we make a decision.*
5. The HQRef provides authorization to buy/build in “Reston.” Does this mean RA property only, Small Tax District 5, or something else? *RA Officers’ Response: It means RA property plus the Town Center (or all of Small Tax District 5). We want the building to have a Reston, and not a Herndon or other, address.*

Understanding the \$5 Million Base Line

We understand that the original \$4.8 million cost number (\$5 million in the final version of the HQRef) was produced by multiplying 20,000 sq. ft. (which we understand RA's Board has said is "comparable" to what RA now leases) times \$240, RA's estimate of the current cost per sq. ft. to buy office space in Reston. Our research revealed several questions about this calculation that did not appear to be answered in the draft HQRef explanatory material AIC saw, and your clarifications here could be very helpful:

1. How many square feet does RA currently lease? *RA Officers' Response: +/- 19,000 sq ft. We think the same number in a newer building will get us slightly more utilization because the layout of the current building is not very efficient. We might be able to squeeze in a conference room or two in addition to what we now have, but that is it. This will be a utilitarian space.* If 20,000 square feet is more or less than that number, how/why was the 20,000 square foot number chosen? *RA Officers' Response: See previous answer.*
2. Some concern has been raised that \$240 may be substantially below the average cost of commercial real estate in Reston. How/why was the \$240 figure chosen? *RA Officers' Response: We're talking about Class B space; no way we could afford Class A. The \$240 number was obtained by talking to local commercial realtors who advised that \$240 was at the low end of Class B space. This is not a high-end concept. That, by the way, may well make it harder for us to find an acceptable solution, but we are not coming to the membership asking for a high end option.*
3. With no high-level expectations or building plan defined in advance of the HQRef, some are concerned that a realistic price per square foot cannot be estimated. Does RA currently envision a purely utilitarian building that provides the necessary office space at the lowest possible cost, or one that provides community space and other amenities for the membership? In short, what is the vision for the new headquarters, and/or how will that vision be defined? *RA Officers' Response: See above answers; this is a utilitarian concept only.*
4. Will furnishing or maintaining the building add to the cost (and how are utilities and maintenance currently treated under the lease)? *RA Officers' Response: RA's current lease is triple net – RA pays for everything, including utilities and maintenance. So no matter what decision is taken, there should be no change or addition here. It is worth emphasizing, however, that RA will need a new HQ no matter what. Even if we lease, there will be some one-time costs because there will be build-out costs of anywhere between \$15-20/sq ft.*

The Escalation Clause

The escalator is defined as "the percent change in the average market price per square foot for commercial office space sold in Reston, Virginia from September 2004 through the date of purchase of the property." The principal concerns the AIC has heard expressed are that: (a) there is no index that tracks the "average market price for

commercial office space in Reston,” since location within Reston and quality of the space are variables that do not allow for a single “average market price”; and (b) there is no sunset provision on the escalator (or the general authorization).

1. Is there an identifiable, industry-standard index RA will be using to calculate any increase in the purchase price? *RA Officers’ Response: No; however, it will be based on comparable sales for Class B space, and we agree that we will first look to see if there are sufficient comps for the geographic region in Reston where we will be buying or building. Worth also noting that if the Class B average goes to \$440/sq ft, then RA will almost certainly be leasing. Point: the escalation clause is not a one-way street. Also note that RA might be forced to lease a facility that was built at \$440 per sq ft. Rental rates have no ceiling.*
2. If not, could you provide a concrete example or description of how you understand RA would attempt to determine the “average market price for commercial office space in Reston”? It might be helpful for voters to at least understand how RA would determine what that average is today. *RA Officers’ Response: See above.*
3. Our sense is there is some concern that the escalator as written, coupled with the fact that there is no limitation on the size of the building RA might buy or build, could be used to significantly increase the cost of the project (and size of the building). For example, as has been suggested to us, assume the Dulles Metro Extension (as increasingly seems possible) and the significant increases to commercial real estate values along or near the corridor that extension would surely bring. If RA had not yet bought or built its headquarters by then (there is no sunset), RA might well build or buy outside the corridor but corridor real estate averages could help inflate the cost of the RA project. What does RA say to these concerns? See answer above. *RA Officers’ Response: Limited to Class B comps and will limit to the specific area of the buy/build if there are sufficient comps for that area.*
4. Even among some we have talked to who strongly support the referendum in concept, the lack of a sunset provision has generated some unease. Some time limitation may help ensure that, while addressing a looming contingency (termination of the existing lease), a buy or build would take place under circumstances not much changed from those obtaining today, at a time when financial projections originating now would probably still be largely valid. Are there reasons why a sunset provision was not included here, including any constraints on RA in this area about which those having this concern should be aware? *RA Officers’ Response: A sunset was not added because we didn’t want to handcuff the board on things that might not allow us to get a deal or might handicap our negotiating position. HOWEVER, we want to be clear: this referendum is intended only for this RA move and nothing else, and we will say so publicly.*

The Required Equity Investment

Building or buying would require some amount of equity investment. Our research suggests three possible sources: (a) a special assessment (approx. \$50/unit for a 20% down payment on \$5 million, approx. \$70/unit for 20% on \$7 million, based on approx. 20,000 RA units); (b) RA's capital/replacement reserve (some believe that use of these reserves for a source of buy/build equity investment is beyond the stated or intended purpose for which reserve contributions were made and is thus inappropriate, that investing reserves in real estate is impermissible, and/or that the reserves are already underfunded and, if tapped, would have to be replenished in short order, probably through a special assessment); and (c) an equity loan secured by RA's current property assets (and whether the terms that could be secured would make that a favorably alternative, and whether it makes sense to encumber any of RA's existing property, would obviously require study). We recognize that these issues are arguably premature. Nonetheless, in the interests of full disclosure to voters:

1. Are you aware of any other possible sources of equity funding? *RA Officers' Response: Yes. There are two additional possibilities. The first is a "zero down" loan. While this may affect the interest rate on the loan, we are a settled member of the community so the affect may be limited. The second possibility is managing our working capital to fund any initial equity investment that may be required. This could mean delaying certain payments on liabilities to provide initial cash. RA expects to end the current fiscal year (December) with about \$2.5 million that exceeds our working capital needs. It is a cumulative sum, built up over a number of years, that are unallocated funds in our General Fund. Whether we could/should do a zero down deal, or use working capital to fund an initial equity investment, will come down to the Fiscal Committee balancing how much we can/want to put down and how that affects the interest rate. It will be about getting the best deal possible for the membership. The Fiscal Committee will make this recommendation.*
2. Do you view the capital reserve as a legitimate source of possible equity funding? *RA Officers' Response: NO - Our auditors have not issued a negative opinion so arguably the Repair and Replacement Reserve (RRR) reserve is currently adequately funded. A new reserve study will be released shortly, and almost certainly it will say we need to be putting more into the community to repair its aging infrastructure. While we could borrow from the RRR, we do not view borrowing from the RRR as a realistic or preferred option. We likewise don't think borrowing on the service center equity is the preferred approach.*
3. Do you have any insights on the question of cash requirements that would be helpful for voters, including how if at all the equity investment could (if it should) be minimized? *RA Officers' Response: Our instinct is that it is preferable here to do a no-cash (zero down) deal or manage our working capital to meet whatever initial cash investment may be required. Those are our clear*

preferences. 20% down on a \$5 million mortgage would represent \$1 million. Again there is \$2.5 million in excess working capital, plus almost \$3 million in our Repair and Replacement Reserve. Using our working capital to fund a mortgage would also lower our monthly payments. The fiscal committee will make the recommendation to the board regarding the optimal use of our working capital. Under no circumstances would we use the RRR. It is not necessary.

Implementation

If the HQRef is approved, the significant decision of choosing between build vs. buy, and assessing the various options associated with each, would remain. It has been suggested the RA membership might benefit if the RA Board were to appoint an ad-hoc or ‘blue ribbon’ advisory panel (comprised in part of RA members with relevant expertise) that would work with the RA Board in determining, evaluating, and implementing the various choices.

1. Would you look favorably on such a concept, and if not why? *RA Officers’ Response: Yes. In fact, I (Rick Beyer) intend to appoint just such an ad hoc or blue ribbon committee, having it report to the Fiscal Committee. My approach is to build consensus by widening participation; and the Board is the last line in the decision-making process. We need to look to others to help us in this process. I intend to identify individuals in our community who can offer expertise and other assistance, in helping us identify the options available to us, evaluating those options, and assisting in implementation. I believe I have authority under RA’s bylaws to make those appointments without need of RA Board approval, so this is something I will do if the referendum is approved. The Fiscal Committee will review anything this ad hoc group does, so by the time the issues get to the RA Board they will have been vetted by the ad hoc panel, then the Fiscal Committee, and finally the RA Board. So I expect beginning in January, 2005 there will be an expanded volunteer group that will work with the fiscal committee to study facility options.*
2. If not, how generally do you understand RA would execute against this new authority? *RA Officers’ Response: See above.*

RA Officers’ Response: Several miscellaneous issues:

1. *Process: The ballot question will be mailed on Dec. 10. A 10% turnout is required, and a majority of that turnout will control. Ballots must be returned by Jan. 7.*
2. *Reston as a Town: The building referendum does not impact Reston becoming a town. Assets and liabilities would be transferred into the town. RA cannot wait while this debate goes on, since RA’s lease is expiring. RA must move. However, RAs membership will have to consent in some way to becoming a town, and presumably that consent will not be given unless/until RA’s assets*

are properly accounted for (here, by a transfer of ownership of whatever building may be bought/built to the town, or assignment of the lease).

3. *Impact on the Governing Documents: None. This deal is totally independent of the governing document changes, including the cap. We will not, and we will not allow others, to argue the cap must be changed to finance the new HQ. Unrelated. If the cap is to be changed, it will be based on arguments that address RA's operating needs independent of the HQ.*

4. *Timing: The referendum timing is appropriate versus the work that needs to be completed. We can not negotiate facility alternatives with developers or builders and then go to the voters. No developer will take a property off the market and wait for a referendum to pass (which will take about 5 months). Real estate opportunities will come and go. We need to have the pre-approval so that our fiscal committee can begin the process of developing alternatives.*

-end-

ARCH issues Homepage: <http://www.restonarch.org/committees/communitywide.htm>

ARCH Bulletins Homepage: <http://www.restonarch.org/bulletins>

ARCH Homepage: <http://www.restonarch.org/>