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Memorandum

Date: December 2, 2012

To: Senator Phil Berger
President Pro-Tempore
North Carolina Senate

From: Mark Trogdon, Director
Fiscal Research Division

John Turcotte, Director
Program Evaluation Division

Mark Bondo, Fiscal Analyst
Fiscal Research Division

Re: Governor's Proposed Lease of the Dorothea Dix Property

Per your request, we have conducted a fiscal analysis of the Governor's proposal to lease the Dorothea Dix Campus (Dix Campus) property to the City of Raleigh. Specifically, you have asked us to estimate if the aggregate value of the proposed lease compares equitably to the recent appraised fair market value estimates for the Dix Campus property. Our information base for the proposed lease used in our analysis relies upon limited terms and information from page 31 of the submitted Council of State Agenda released on November 30 by the Department of Administration.

Based upon our analysis, which we will describe below, it appears that the aggregate value of proposed lease payments over time, when adjusted to their net present value, are below recent appraisals by the Department of Administration of the Dix Campus property's fair market value.

Under the terms of the proposed lease, as specified on page 31 of the proposed Council of State agenda, the City of Raleigh would pay the State \$500,000 annually plus an annual increase of 1.5% for 75 years with an additional 24 year renewal option. The Department of Health and Human Services (DHHS) is allowed to maintain usage of the property for up to 15 years. However, any usage by DHHS will result in decreased lease payments and the provision of

maintenance of land that the City is not using. The City is required to develop and implement a master plan for the Dix Campus, and the State may review and approve any improvements, as per Statute.

On May of 2011, the State of North Carolina, through the Department of Administration, obtained property appraisals of the Dix Campus. Depending on the date of sale and the area to be sold, the appraisals ranged from \$58 million to \$86 million.¹ The State's appraisal did not assume that the area would be used for a park or public use. Furthermore, in news articles, the City of Raleigh reportedly used a \$35 million dollar valuation for the property.

Table 1 below presents our analysis of the proposed lease proposal over the 75 year time frame. The payments do not take into account any reduction related to DHHS maintaining a presence on Dix Campus or the provision of services for the Dix Campus required by any as yet seen lease agreement. Thus, for all scenarios, figures below may somewhat overstate the benefits to the State. As money received in the future is worth less than money today, we have calculated the net present value of the aggregate future lease payments back to the present. Our assumed discount rate for this analysis is at a rate of 3% per year which is an approximation of current long-term US Treasury rates.

Assuming the \$500,000 annual lease payment being proposed, and the annual 1.5% increase in that payment, the total nominal value of the lease payments over a 75 year period is \$68.5 million. If you conduct a net present value analysis of the stream of proposed lease payments, at a 3% discount rate, the discounted aggregate value of those payments in current terms is \$22.6 million. Thus, it would appear that the aggregate lease value of the property, over such an extended lease period, is not close in value to recent appraisals for the property by the Department of Administration.

As a what-if scenario, to approximate a stream of lease payments closer in value to the recent property appraisals, we have averaged the high and low Department of Administration appraisals from 2011 to come up with an average of \$72 million property valuation to use in a net present value scenario. Assuming the same discount rate, the annual required lease payments, and assuming a 1.5% annual increase in those payments, is an estimated beginning annual payment of \$1.6 million per year as compared to \$500,000. Please understand this calculation is for illustrative purposes only and does not purport to be the true value of the Dix Campus property; particularly in light of the newly proposed use which we understand was not contemplated in the most recent appraisals.

Table 1

Lease Option	Nominal Value	Net Present Value (3% Discount Rate)
Proposed \$500,000 per year lease payment plus 1.5% annual increase	\$68,486,390	\$22,574,170
\$1,600,000 per year "what-if" scenario lease payment plus 1.5% annual increase	\$219,156,449	\$72,237,345

There are a couple of areas of concern regarding this analysis and proposal as well:

- Our analysis is incomplete as staff has very limited information from the Department of Administration on this proposal
- The decision to lease the land to the City of Raleigh may not reflect the highest and best use of the Dix Campus
- Forecasting real estate value for a 325 acre tract, within the City of Raleigh over a 75 year (potentially 99 year) period is highly uncertain. It is unknown what the value of the Dix Campus is over such a time horizon given real estate trends in the Greater Raleigh Area
- Our analysis does not take into account the opportunity cost of doing something else with the property (future State use, sale to the private sector, or a combination of alternatives). There have been previous studies contemplating the area continue to be used in some capacity for mental health services; a consolidated DHHS Administrative Campus; a mixed use development; and, a park.

¹ Two scenarios assumed that the land was marketed and sold immediately and two scenarios assumed a two to three year delay in the sale of the property. The delayed sale resulted in a higher sale price.