



Memorandum

TO: HONORABLE MAYOR AND
CITY COUNCIL

FROM: Paul Krutko

SUBJECT: See below

DATE: March 15, 2004

Approved

Date

Council District: City-Wide

SUBJECT: APPROVAL OF AGREEMENTS RELATED TO THE EXPANSION OF LOGITECH ICE

RECOMMENDATION

Adoption of a resolution authorizing the City Manager to negotiate and execute:

- (a) an Expansion Agreement with San Jose Arena Management LLC, a California limited company regarding the construction and financing of the second expansion to the Ice Centre of San Jose (Logitech Ice), and
- (b) the Amended and Restated Lease and Management Agreement with San Jose Arena Management LLC for the operation and management of the Ice Centre of San Jose.

These actions further the vision of San Jose as the world's most livable city, with diverse and distinctive qualities of life contained in the Economic Development Strategy by "Encouraging Sports Teams, Events, Facilities, Professional as well as Amateur" (Initiative 12).

BACKGROUND

At its meeting of June 29, 1999, the City Council approved an Expansion Agreement with San Jose Arena Management LLC (SJAM) for the construction and financing of the renovation and expansion of the Ice Centre. Concurrently, the Council also approved a twenty-five year Lease and Management Agreement ("Lease Agreement") with SJAM for the Ice Centre. Under that Expansion Agreement, SJAM renovated the existing facility and constructed approximately 58,000 square feet of new improvements including a third sheet of ice and training facilities for the National Hockey League San Jose Sharks.

Demand by the public for both organized and recreational use of the facility has grown steadily since this first expansion. Approximately 700,000 users participated in programs and special events in the facility in 2003, an increase of 17% from 600,000 users in 2001. The array of ice-related programming is extensive, ranging from hockey (youth for boys and girls, adult, travel and high school), figure skating (lessons, freestyle, dance and public), speed skating, curling, community programs and a number of hockey tournaments and figure skating competitions. For example, the adult in-house hockey program is the second largest in the country with 82 teams and 1,500 participants. Logitech Ice offers the largest amount of private ice time for aspiring figure skaters in California. 1010 skating lessons are given on a weekly basis. Public skating sessions are offered daily and in most cases twice daily. In 2003, 7700 children participated in the Free Use program, which is equivalent to \$79,000 in donation. Exhibit A is a detailed report on the level of activities occurring at the Ice Centre.

The demand for, and heavy use of, the existing three ice rinks has caused SJAM to identify the need for a second expansion, which would include the construction of a new fourth rink with ancillary dressing rooms and restrooms strategically sited adjacent to Rinks 1 and 2. These existing two rinks and the new rink would be linked by a remodeled existing mezzanine that would add a restaurant and banquet facility.

The proposed expanded Ice Centre would make Logitech Ice the largest ice facility in the Western United States. This will drive significant business to downtown hotels. Currently, participants at various events at the Ice Centre book 4000 room nights at the Wyndham and Crowne Plaza hotels.

In order to identify all costs that would be necessary to construct the expansion, SJAM has met with all of the City's Development Services partners to identify issues and requirements and presented an application for a site development permit. On September 19, 2003, a Site Development Permit (File No. H03-035) was approved to construct an approximately 33,034 square foot addition to an existing ice rink on a 19.34 acre site.

ANALYSIS

A City "one voice" staff team (Finance, General Services, Public Works, Planning Building and Code Enforcement, Transportation, Economic Development and the City Attorney's Office) have been engaged in a review of the proposed expansion and have negotiated a comprehensive Second Expansion Agreement (the "Expansion Agreement") covering the expansion of the facility and the financing of the new improvements. Additionally, an Amended and Restated Lease Agreement with SJAM (the "Amended Lease Agreement") has been negotiated to provide for continued operation and maintenance of the Ice Centre covering the expanded facility. The following paragraphs describe the terms of the Second Expansion Agreement and the Amended and Restated Lease Agreement.

Second Expansion Agreement

The Expansion Agreement establishes how the new improvements and renovations at the Ice Centre will be accomplished and financed. SJAM anticipates breaking ground on the project in April and completing the expansion work this Fall. The City has already approved a site development permit for the expansion. Key provisions of this agreement include:

- **Facility Improvements** -- The expansion project will consist of the construction of a new fourth rink with ancillary dressing rooms and restrooms and the remodeling of the existing mezzanine to add a restaurant facility.
- **Construction** -- The new facility construction will be completed by SJAM under the supervision of the Department of Public Works. The City's Planning, Building & Code Enforcement Department has approved permits for the new construction and renovation including the Site Development Permit. The work will be publicly bid and all contractors will be required to provide a payment and performance bond. It is estimated that the cost of construction will not exceed \$8 million, including all hard and soft costs, furniture, fixtures, equipment and contingencies. SJAM is responsible for all construction costs including design, engineering, permits, city fees, financing costs, parking improvements and public art and assumes the risk of all construction cost overruns. SJAM is also responsible for procuring all furniture, fixtures and equipment. Prevailing wages will be paid for all construction work..
- **Construction Financing** -- The City of San Jose Financing Authority will finance the construction of the new improvements through the issuance of taxable municipal debt. SJAM will provide the City with an irrevocable direct pay letter of credit in an amount sufficient to pay two years of Base Rental and Additional Rental payments due to the City under the Amended Lease Agreement. This will provide the City with access to funds for debt service and other expenses in the event of default by SJAM. SJAM intends to start construction prior to issuance of bonds at their own risk..

Amended and Restated Lease Agreement

The Amended Lease Agreement sets forth the terms and conditions under which SJAM will lease, operate and maintain the Ice Centre of San Jose.

- **Rent** – Base Rental payments by SJAM to the City are calculated to cover (i) debt service on the existing bonded indebtedness and new debt issued to fund the costs of the expansion and renovations, assuming a 5.90% all-in rate on the variable rate taxable bonds and (ii) projected capital replacement and repair needs in the public areas of the Ice Centre. In addition, the City will receive Additional Rent payments to cover insurance and costs of the City payable to the Arena Authority for its oversight and review of the facility. The Arena Authority fee has been negotiated at \$35,000 per year adjusted by CPI.

- **Term** -- The term of the Amended Lease Agreement shall be from December 13, 2000, and shall continue to December 13, 2024. If in the City's sole discretion, it determines to continue the use of the Ice Centre as a community ice sports facility, the City shall notify SJAM of this determination at least one year prior to the expiration of the Term. The parties shall, for a period of not less than six months, exclusively negotiate in good faith to agree upon a new Lease and Management Agreement.
- **Guaranty** -- The current lease requires SJAM to provide an irrevocable letter of credit payable to the City in an amount sufficient to pay two years of maximum annual debt service on the bonds issued in 2000 for the existing facility and a Guaranty. The language in the Amended Lease Agreement is proposed to be changed to reflect a Letter of Credit equal to two years of Base Rental and Additional Rental payments due to the City. This change more accurately reflects the risk of loss of revenue to the City. The Amended Lease Agreement also deletes the requirement that the owners of SJAM provide a separate guaranty of the payment of debt service while they are operators but requires this guaranty of any assignee of SJAM. A guaranty from SJAM that will guarantee lease payments from any assignee of SJAM. In other words, if SJAM assigns the lease to another operator, SJAM will guarantee the next payments in an amount calculated to the costs of debt service on the bonds.
- **Competing Facilities** -- Under the terms of the current lease, SJAM has the right of exclusive negotiation and first refusal if the City, or the City with a third party, proposes to develop or finance the development of another permanent multirink recreational ice center. SJAM can either submit a competing proposal or make a determination that a proposal is not feasible. If SJAM determines that a competing proposal is not feasible and the City proceeds with an agreement with a third party, SJAM has the right to require the lease to be renegotiated based on decline in attendance at the Ice Centre.

The Amended Lease Agreement modifies this clause to require SJAM to prove to the satisfaction of the City that a competing facility has caused a decline in the financial performance of the Ice Center and to allow renegotiation of the annual Base Rental Payments to reflect that impact. In addition, SJAM expressly waives its right of first refusal in the event of the development of a single rink facility equivalent to the defunct rink at the Eastridge Mall in an area east of Interstate 880 and U.S. 101.

- **Manager Duties and Responsibilities** -- SJAM has the sole responsibility and right to operate, manage and maintain the facility for the term of the agreement, and at its sole cost and expense to provide all management expenses, labor and materials appropriate to carry out its duties.
- **Naming and Advertising** -- SJAM has the right to sell naming rights of the facility subject to City approval. SJAM will use reasonable efforts to include "San Jose" in any new name. The City has approval rights over the location, design, size and appearance

of the graphic statement to portray the name or logo on the exterior of the facility. SJAM may sell advertising and sponsorships within the existing facility with a general prohibition of companies that market or distribute alcohol or tobacco products. The exception is in the third rink provided that the advertising does not promote consumption of such products. Council had granted this exception to reflect the fact that the third rink is the Sharks practice rink and has a higher media profile in the facility.

- **Mezzanine Restaurant** -- SJAM is responsible for operating and granting concession privileges for the vending and sale of food and beverages within the Ice Centre. Beer and wine may be sold in the proposed Mezzanine Restaurant only. SJAM may display logos of beer and wine for sale in the Mezzanine Restaurant inside the restaurant facility.
- **Parking** -- After construction of the fourth sheet of ice, the Lease Agreement expands the associated Ice Centre parking area from 200 to 285 parking spaces for the exclusive use of Ice Centre patrons, including 35 private parking spaces for players and coaches. An additional two hundred spaces, located in the municipal parking lot adjacent to the Ice Centre and the Municipal Stadium, may be available as overflow parking subject to the rights of the City, the San Jose Giants, and San Jose State University to use these spaces. SJAM will pay for the restriping of the spaces in the Ice Centre parking lot and the municipal parking lot in accordance with a site plan approved by the City's Department of Transportation as a part of the expansion project.
- **Prevailing Wage** -- Subject to any collective bargaining agreement that includes the Ice Centre, SJAM is obligated to pay not less than the General Prevailing Wage as determined by the City's Office of Equality Assurance for operating employees in applicable and appropriate classifications.
- **Living Wage** -- The current lease agreement approved by City Council on June 29, 1999 explicitly exempts the Ice Centre from the San Jose Living Wage Policy. The Amended Lease Agreement continues that exemption.
- **Consultation on Prices** -- SJAM shall consult with the City and the Arena Authority on the rates and charges for public skating programs.
- **Impositions** -- SJAM is obligated to pay any and all taxes, including possessory interest taxes, if any, and other governmental charges on it or the facility except for any assessments that may be levied by the City on the property.
- **Use of Premises** -- SJAM shall have the right to occupy and use the public areas of the Ice Centre for the operation of a community recreation facility, which includes ice skating, ice hockey league play, ice sports classes, practice and training facilities related to ice sports, ice sports tournaments, ice skate rental, facility rentals, locker area, pro-shop, vending, arcade, sports medicine facility, food service, and any other activities related to ice sports or other recreation programs. SJAM shall have the right to the

private areas of the facility to be used by the Sharks as its exclusive training and practice facility.

- **Community Access** -- The public will be able to skate at convenient prime times and at other available times. SJAM is obligated to operate the Ice Centre in a manner that encourages public use, and to provide a variety of youth-oriented programs and activities, including free general admission, skate rental, and group instruction to participants in an at-risk youth program it establishes. The City will continue to receive up to 50 hours of free use of the facility annually. The Arena Authority provides oversight of the use of this time.
- **Management Oversight** -- An annual report of SJAM's performance in operating the Ice Centre shall be prepared by the Arena Authority. The Arena Authority's oversight responsibilities are as follows: (i) preventative maintenance oversight; (ii) capital improvement program administration; (iii) community use programming and outreach; and (iv) providing services as the City liaison to SJAM.
- **Repair and Maintenance** -- SJAM is responsible for the ordinary repairs and maintenance of the Ice Centre. The City is responsible for capital repairs and replacement of specified improvements, equipment and systems in the public areas of the facility, with the work supervised by SJAM and paid for by the City.
- **Capital Repair and Replacement Reserve** -- This is a segregated fund established to receive and account for Base Rental Payments reserved for the City's capital repair and replacement expenditures.
- **Default** -- SJAM would default in the event of bankruptcy, receivership, unauthorized assignment or change in ownership, or failure to pay amounts required under the Amended Lease Agreement. The City would default if it failed to disburse construction funds under the Second Expansion Agreement.
- **Assignment** -- SJAM may not assign the Amended Lease Agreement prior to July 31, 2018 except as approved in writing by the City, which approval is subject to the City's sole discretion. After July 31, 2018, the Amended Lease Agreement may be assigned, subject to the City's reasonable approval of a successor who meets specified criteria. The July 31, 2018 date coincides with the termination of the Sharks' lease of the HP Pavilion.

Plan of Finance

Consistent with the plan of finance for the first expansion to the Ice Centre, the Finance Department in coordination with the Office of Economic Development, City Attorney's Office, SJAM and our financial advisor, Public Resources Advisory Group, has been developing a financing strategy which includes the issuance of additional taxable variable rate bonds to finance the fourth ice rink at

Logitech Ice. The estimated amount of the bond issue is \$9.0 million, which would be used to fund the total cost of construction of the ice rink at approximately \$8.0 million, with the balance of the bond proceeds paying cost of issuance for the bonds, funding a debt service reserve fund and funding interest payments (capitalized interest) to the bondholders during the construction period.

Given the historically low interest rate environment and the significant balance that has accumulated in the Capital Repair and Replacement Reserve (approximately \$3.5 million), staff is recommending a restructuring of SJAM's current base rental payment of \$2.2 million per year. The Restructured Base Rental payments are projected to be sufficient to pay debt service and expenses on the bonds at an assumed all-in borrowing rate of 5.90%, and to fully fund the Capital Repair and Replacement Reserve.

In addition to Base Rental, SJAM will make Additional Rent payments of \$35,000 per year (adjusted to CPI) for City costs associated with Arena Authority oversight, plus an amount adjusted annually to reflect the City's actual costs for property insurance.

The current financing schedule is presented below. Please note that distribution of the preliminary official statement and subsequent activities will not occur until the construction contract has been awarded.

March 23	Council approval of Amended and Restated Lease Agreement and Expansion Agreement
May 18	Council/Financing Authority Board approval of bond issue and related financing documents, including the Official Statement
May 19	Mailing of Preliminary Official Statement
May 26	Pricing of Bonds
May 27	Bond Closing; funds available

PUBLIC OUTREACH

San Jose Arena Management LLC has had intensive discussions with the users of the current Logitech facility as well as the San Jose Sports Authority and the San Jose Arena Authority on their needs and the demand for an expanded Ice Centre. The Office of Economic Development also has reviewed the project with representatives of San Jose State University and the San Jose Giants.

COST IMPLICATIONS

Costs associated with the issuance of the bonds for the second expansion of the Ice Centre of San Jose will be paid for from the bond proceeds. All of the financing team participants work on a contingency basis and are only paid upon the successful sale and close of the bonds.

HONORABLE MAYOR AND CITY COUNCIL

March 15, 2004

Subject: Approval of Agreements Related to Expansion of Logitech Ice

Page 8 of 8

COORDINATION

This report has been coordinated with the Department of Finance, Transportation and Public Works, and the City Attorney's Office.

CEQA

CEQA: Negative Declaration, File No. H-93-06-038 and add addenda thereto, File No. HO3-035.

PAUL KRUTKO
Director, Office of Economic Development