COUNCIL AGENDA: 05-18-04
ITEM:

CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: HONORABLE MAYOR AND CITY COUNCIL

FROM: Paul Krutko Ralph Tonseth

SUBJECT: Acquisition of the FMC Property

DATE: May 13, 2004

Approved | Date

Council District: Citywide

RECOMMENDATION

Adoption of a resolution:

(a) Authorizing staff to negotiate an agreement with the FMC Corporation for the purchase of 74.87 acres of property located at 1125 Coleman Avenue at a price of $81,539,960 in accordance with a "Terms Sheet" that has been previously negotiated between City and FMC staff; and
(b) Directing staff to bring the finalized agreement back to the City Council for consideration; and
(c) Directing staff to pursue a Section 108 loan to support the purchase of 23.23 acres of the FMC property; and
(d) Directing staff to pursue a Brown Fields Economic Development Initiative Grant to support the development of the FMC property.

CEQA – Resolution No. 71716, File No PDC-12-104

BACKGROUND

The City is considering the acquisition of 74.87 acres of land owned by FMC located at 1125 Coleman Avenue directly adjacent to and west of the Norman Y. Mineta San José International Airport ("Property"). A small portion of the property, approximately 6 acres, is located in the City of Santa Clara with the balance of the property in San José. The land is part of the former FMC industrial facility, which was closed in 1996. The City approved a Planned Development Zoning Ordinance No. 26958 on September 2, 2003 for the Property and an adjacent 25-acre property owned by Arcadia Development Co. The PD zoning covers the portion of the Arcadia and FMC properties in San José andallows a maximum intensity of three million square feet of office/research and development uses, hotel, commercial and retail use. A private development agreement between Arcadia and FMC sets forth legal obligations between the owners of these properties related to development of infrastructure required to develop the properties in accordance with the PD zoning.

In furtherance of the potential acquisition of this Property, OED and FMC staff has put together a “Terms Sheet” with FMC, a copy of which is attached hereto as Exhibit “A”. It is recommended that the City Council direct staff to negotiate a purchase agreement for the Property by and between the Finance Authority of the City of San José and FMC in accordance with this “Terms Sheet” to be presented for consideration by the City Council later this year.

ANALYSIS

Economic Development Strategy and the Property

In November, 2003, the City Council unanimously adopted a Economic Development Strategy. As an international city for leading businesses and talent from around the world, developing a world class airport facility and air services was identified as a key strategic initiative. The strategic value of the Airport was singled out as an essential element for Silicon Valley by numerous corporate executives during the Mayor’s Getting Families Back to Work Study Sessions in August 2003.

The purchase of the FMC property supports the fulfillment of this vision in a number of ways. Most importantly, the proposed purchase will assist the Airport in moving forward on the construction of the new Central Terminal and related projects. It is proposed that Airport funds would be used to make lease payments for the northerly 52 acres for Airport uses such as interim construction lay down, rental car and other Airport related parking activities. The City has a critical need for land for facilities to support implementation of Airport Master Plan projects. Moreover, the FMC property also provides an opportunity to temporarily relocate all on-Airport rental car ready/return and servicing facilities until construction of the consolidated rental car garage/service area project near the future Central Terminal is completed. Such temporary relocation would allow the existing rental car parking lot, once vacated, to be used for temporary relocation of the Terminal C public parking lot when that lot is displaced by the anticipated short-term garage and roadway construction. Additionally, the availability of the FMC property provides flexibility to temporarily relocate some employee or public long-term parking if use on the current interim west side parking lot reaches capacity before new facilities are completed pursuant to the Master Plan.

In summary, due to the proximity of the FMC property to the Airport, it is anticipated that a City purchase of that property would significantly streamline Airport project construction during ongoing operational activities.

The other major economic development goal fostered through purchase of the FMC property is the ability to enhance City revenues. As mentioned above, the FMC property and the Arcadia property combined can accommodate three million square feet of office/research and development uses. The FMC property is directly adjacent to the planned terminus of the BART station. Eventual development of BART, in combination with the proximity of the land to the Airport is anticipated to make the location extremely desirable. Over the long-term, the City might decide to lease the property to developers seeking to construct office and R&D projects, which could generate significant ongoing income for the City. The City could realize significant revenues controlling a large land area poised for intensive development. City purchase of the property would also give the City control over the only remaining large parcel available adjacent to the land-locked Airport, giving the City the option of using Airport funds to purchase the property if Airport uses for the property became necessary in the future.

Anticipated Land Availability and Proposed Interim Uses

The City is proposing to purchase all 75 acres of the property in two phases. In the first phase ("Phase I"), the City would complete the acquisition of a 52 acre parcel, which is further shown on the attached exhibit "B" as the "Phase I Parcel". In "Phase II " the City would complete the acquisition of the remaining 23 acres of the property (the "Phase II Parcel"). FMC used the Property for heavy industrial purposes for approximately 50 years. These uses created extensive soil and ground water contamination that is the subject of remediation orders and deed restrictions imposed by the Department of Toxic Substance Control ("DTSC"). DTSC approved FMC's Corrective Measures Study for the Phase I Parcel, which recommended no further action for soil contamination. As a result, no further soil remediation on the Phase I parcel is currently required; however, FMC will continue to operate a groundwater remediation system on the Phase I Parcel. All of the Phase I property in the City of San José, however, is subject to a deed restriction that will prohibit its being used for housing, daycare, farming, hospitals, schools for persons under 18, and drilling for drinking water, oil or gas. The portion of the Property in Santa Clara subject to a separate restriction that prohibits drilling for and/or use of groundwater on that portion of the property. Additionally, the Phase I Parcel must be developed so that the ground is covered with buildings, paved parking, landscaping, etc. to minimize the spread of chemically impacted soil into the air. The owner of the Phase I parcel must also implement engineering controls such as wind erosion control and dust suppression during any construction on the Parcel also to minimize or eliminate potential exposure to chemically impacted soil.

The Phase II Parcel has yet to receive a "no further action" determination from the DTSC because site investigation has not been entirely completed. As a result, the Terms Sheet does not require that FMC transfer, and the City accept, title to the property until the DTSC makes a No Further Action determination. It is expected that the DTSC will make the No Further Action Determination for soil contamination on the Phase II Property within two years and that DTSC will impose deed restrictions on the property at least as restrictive as imposed on Phase I. If the DTSC does not make a no further action determination on the Phase II site within approximately two years of the close of escrow on Phase I, the City will not be compelled to purchase the property. The Terms Sheet does require that if DTSC makes a no further action determination on a portion of the Phase II Property, the City would purchase that portion, as long as the portion constituted a usable legal parcel.

The Terms Sheet also indicates that, if at the end of the two year period, FMC has not received a the No Further Action determination for all or a portion of the Phase II site, that the City-owned area immediately adjacent to the property remaining in FMC's ownership will be deed restricted to the uses currently permissible under the PD Zoning for an additional period of time.

As mentioned above, staff proposes to use Airport funds to lease the Phase I Parcel for Airport uses such as interim construction staging/laydown, rental car parking/servicing and other Airport parking-related facilities as needed. An amendment to the Airport Master Plan to allow these interim uses on the FMC property would be brought forward with consideration of the specific lease agreement. In the near future, the Phase II portion of the Property would be available for use by the City for short term economic development purposes including: rental agency used car sales, recreational vehicle sales, motorcycle sales and courier and delivery services

Property Acquisition

In 2001, when City staff was in discussions with FMC and John Sobrato for a portion of the property (in the Phase I area), the asking price was $46 per square foot. The price of land in the area has decreased significantly since then. In preparing for negotiations with FMC, the City asked Carneghi-Bautovich & Partners, Inc. to prepare an appraisal for the property. This appraisal indicated that the FMC property had a value of $20.56 per square feet with indemnification. FMC commissioned its own appraisal from Smith & Associates, Inc. The Smith appraisal valued the land at $27.22 per square foot with indemnification. After review of both appraisals and the market conditions currently existing, staff feels that the $25.00 per square foot represents fair market value for the property.

FMC has been clear that the company is interested in selling the total 74.87 acres in its entirety. FMC has held the property off the market for a period of time to allow for exclusive negotiations between the City and Agency.

Financing Structure

The financing required to purchase the FMC property is recommended to come from two sources: lease revenue bonds and a Section 108 HUD loan. It is proposed that the acquisition of the Phase I Property would occur through the issuance of lease revenue bonds by the City of San Jose Financing Authority (the "Authority") in which the Authority would acquire the Property and then lease the Property to the City for Airport use pursuant to an Operating Lease Agreement (the "Operating Lease"). Under the Operating Lease, the City would agree to make monthly lease payments for the use and occupancy of the Phase I Property in an amount sufficient to pay debt service and other financing costs of the Authority's bonds. The source of payment would be Airport funds as long as the Airport has beneficial use and occupancy of the Phase I Property. In the event the Airport was unable to make debt service payments the City's General Fund would be liable.

Section 108 Financing

It is proposed that the City make an application to the Section 108 loan program administered by the U.S. Department of Housing and Urban Development to provide funding to purchase the Phase II economic development parcel. It is important to note that Section 108 financing will not be drawn down by the project until the DTSC has made no further action determination on the Phase II Parcel. The Section 108 program is designed to facilitate economic development on the local level. The City of San José can borrow up to five times the City's Community Development Block Grant (CDBG) allocation. The City's annual allocation is approximately $12.9 million, consequently San Jose's total Section 108 capacity is $69.5 million. The City and Agency have three current obligations utilizing the Section 108 program:

- $18 million -- Tropicana
- $13 million -- CIM
- $ 5.6 million -- Security, Letiticia and Eu

The remaining balance of Section 108 funds is approximately $32.9 million. Purchase of the remaining 23 acres will require a Section 108 loan of approximately $25 million, leaving a balance of approximately $8 million in future borrowing capacity. The term of the Section 108 loan would be 20 years.

As all of the Section 108 loans begin amortizing, approximately $2 million in principal payments would be paid annually increasing to $4 million annually at the later portion of the anticipated amortization schedules. Principal payments, as they are made, restore the City's capacity for future Section 108 funded projects.

The Section 108 program guidelines specify that the local allocation of CDBG funds will be taken to support debt service if the municipality cannot make debt service payments. A local government would have the option of providing an additional source of funds to avoid diminishing the area's CDBG allocation. To eliminate the possibility of default on the Section 108 loan, the City would have the option of using Airport funds to provide a loan to the project to protect the City's CDBG funds. Any such loan of Airport funds would be required to be repaid with interest at the prevailing rate in effect at the time the loan is made, and the loan would need to be repaid over a fixed term of years. In the event that a loan of Airport funds for this purpose is necessary, Airport staff would recommend a repayment term of not more than 15 years. Based on the development of a conservative set of financial assumptions summarized below, the Phase II economic development parcel may require a loan of Airport funds in the early years of debt service payments.

<u>Financial Analysis of the Purchase of the Phase II Economic Development Parcel</u>

In order to determine if the purchase of the 23 acres would be financially feasible, staff built a set of financial assumptions for the proposed purchase. As mentioned above, the interim uses anticipated to occupy the site include rental agency used car sales, RV sales, motorcycle sales and or courier and delivery uses that pay a premium for proximity to the Airport. It is anticipated that these uses would pay 17 cents per square foot to lease space. Existing leases in the marketplace were reviewed to determine the likelihood of this scenario. The assumption is conservative and does not reflect any increase in lease revenues for an anticipated increase in land prices due to economic revival in the area. The analysis does assume a 3% increase in lease costs every 5 years, as part of a standard lease formula. The analysis also assumes that the City will re-lease only a quarter of the property in each of the first 4 years of the project. After consulting with brokers knowledgeable in the field, staff anticipates that an 85% occupancy rate will be achievable in four years.

The financial analysis focuses on uses as mentioned, such as rental agency used car sales that have an associated sales tax. After a review of sales tax revenue of existing similar uses within the City, it was assumed that these uses will conservatively generate an additional 9 cents per square foot in revenue. It is proposed that sales tax revenues generated through leasing activities on the project would be allocated to the project in order to assist in retiring debt service. The summary pro forma included below outlines the anticipated costs and revenues related to the purchase of the Phase II parcel.

Purchase of 74.87 Acres	$81,539,960
Purchase Price	$25.00
Ground Lease Income	$41,731,000
Sales Tax Income	$30,558,000
Total Income	$72,289,000
Section 108 Debt Service	$40,559,000
Development Cost	$3,500,000
Marketing Cost	$1,697,000
Total Costs	$45,756,000
Difference (+)	$26,553,000
Break Even Year	7th Year ($3.3 million)

The sample pro forma lists costs and revenues associated with the 20-year term of the Section 108 loan.

Environmental Indemnification

The Terms Sheet also contemplates that FMC shall provide indemnification and will continue, after the close of escrow, to be responsible for remediation required by the DTSC or any other environmental agency of contamination on the Property attributable to FMC, including claims by third-party property owners for costs of remedial work required by the DTSC or another environmental agency resulting from the migration of such contamination from the FMC property to such third-party owner's property. After the close of escrow, however, the City will be required to take on responsibility for damages caused by the contamination on the property, including personal injuries caused by exposure to toxics after the close of escrow and the devaluation of adjacent properties caused by migration of toxics onto those properties.

Arcadia Development Agreement

The property is also encumbered by a private development agreement with Arcadia, which owns approximately 25 acres adjacent to the FMC property. This agreement commits both parties to sharing in certain development related costs required to allow the property to be developed in accordance with the PD Zoning. It also allocates traffic capacity among the parcels that allows each party to utilize only that share of traffic capacity equal to the acreage of its property divided by the acreage of the entirety of the combined properties. As a result, this agreement allocates to the FMC parcel about 75% of total traffic capacity jointly allocated to Arcadia's and FMC's parcels under the PD Zoning.

CONCLUSION

The purchase of the FMC property is a unique opportunity to gain control of 75 strategically-sited acres that help to achieve the future viability of the Norman Y. Mineta San José International Airport. The purchase will also create significant economic development opportunities. Under the approved zoning for the project, the ultimate build-out of the project allows for up to three million square feet of office, research and development, hotel and commercial uses directly adjacent to the Airport and the BART terminus.

COORDINATION

This memorandum has been coordinated with the Airport, the City Attorney's Office, and the Department of Planning Building and Code Enforcement.

CEQA

Resolution No. 71716. File no PDC98-12-104

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