



Memorandum

TO: HONORABLE MAYOR
AND CITY COUNCIL

FROM: Paul Krutko

SUBJECT: See Below

DATE: March 2, 2009

Approved

Date

3/9/09

COUNCIL DISTRICT: #3
SNI AREA: NA

SUBJECT

**AMENDMENT OF THE OPTION AGREEMENTS FOR THE AIRPORT WEST
PROPERTY LOCATED AT 1125 COLEMAN AVENUE**

RECOMMENDATION

Approve an Amendment of the Option Agreements for the Airport West property located at 1125 Coleman Avenue to eliminate the requirement of the developers to provide a letter of credit under the agreements.

OUTCOME

The Developers of the project, Coleman Airport Partners LLC and FWSH Partners LLC, have advised City staff that they wish to move forward with development of the Airport West site, both to construct an approximately 15,000 seat soccer stadium and for development of 1.5 million square feet of office, R&D development, 95,000 square feet of retail and 300 hotel rooms. Due to the severe downturn in the economy, the Developers are seeking to restructure the current terms of the agreements. Specifically, the Developers have indicated that they would likely terminate the Option Agreements prior to March 31, 2009 in order to avoid having the \$3 million Letter of Credit (LOC) called by the City if the agreements are terminated after March 31, 2009 under the terms of the Option Agreements. The LOC was intended to assist the City in covering debt service payments if the Developers terminated the transaction after the initial 90 day period, of any option period, allowing the City to pay some of the debt service while it conducts a Request for Proposals (RFP) process for disposition of the property. In addition, such

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a termination would also cause the Developers to lose \$6 million in option payments already paid to the City.

The Developers continue to have confidence in the long term viability of the Airport West site. The purpose of the action proposed in this memorandum is to approve an amendment to the Option agreements, eliminating the required Letter of Credit and allowing City staff time to negotiate a restructure of the current agreement that takes into account current market conditions. Staff and the Developer have made significant progress in initial negotiations and anticipate returning to City Council with revised business terms for the Option and Purchase and Sale Agreements for action no later than the April 28, 2009 Council meeting.

BACKGROUND

In 2005, the City of San Jose purchased the 74.8 acre former FMC property located at 1125 Coleman Avenue, now known as the Airport West property. In June, 2007 the City Council authorized staff to enter into an Exclusive Negotiations Agreement (ENA) to develop approximately 66 acres for economic development purposes including a soccer stadium. The City's Municipal Code allows the private sale of property for economic development purposes. In May of 2008, a Memorandum of Understanding (MOU) between the City, Coleman Airport Partners, FWSH Partners, and Earthquakes Soccer was approved by the City Council. On July 24, 2009 the City entered into two Option Agreements with Coleman Airport Partners LP for the acquisition of the 74.8 acres of the former FMC property.

In the intervening period, the global credit crisis and national recession has stalled or eliminated significant numbers of residential, office and retail projects throughout Silicon Valley. The Developers want to proceed with the project expressing confidence in the long-term viability of the site from an economic development perspective. The Developers also see the Airport West property as the best site possible for a future soccer stadium and home of the Major League San Jose Earthquakes professional soccer team. In order to proceed the Developers have advised the staff that they need to restructure the terms of the agreement because the economic development project will generate insufficient returns to justify the current purchase price of \$132 M.

The Developers agreed to provide a Letter of Credit (LOC) in the amount of \$3 million under the terms of the current Option Agreements. The LOC was intended to assist the City in covering debt service payments if the Developers terminated the transaction after the initial 90 day period, of any option period, allowing the City to pay some of the debt service while it conduct a Request for Proposals (RFP) process for disposition of the property. The option periods are January 1 to June 30 and July 1 to December 31 annually. The Developers must give notice to the City prior to March 31, 2009 that they are not proceeding or the City can draw upon the LOC.

ANALYSIS

To date the Developers have paid \$6 million in required option payments and have provided the required Letter of Credit. The \$6 million in option payments paid by the Developer satisfies the

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City's debt service requirements on the Airport West property through June, 2009. The Developers have made substantial investment in planning, design, and preconstruction work for development of the site. Over the last year, the Finance Department has strategically responded to market conditions and refinanced the outstanding debt on the property. Debt service payments for the property are financed with variable rate debt and are currently less than the Developer's option payments. The Budget Office subsequently reserved an amount of \$2.3 million from option payments, in the event that future option payments would not be paid.

Worldwide economic conditions have negatively impacted pricing structures and liquidity throughout Silicon Valley. Due to the global recession and credit crisis, construction of new office, R&D, and residential development is frozen across the nation. Land values across Silicon Valley have diminished precipitously, leasing activity has decreased significantly, and construction of most new projects has been placed on hold. Many players in the economy are conserving cash until such time that there is more liquidity in the market place and evidence of stabilization in major economic indicators.

Coleman Airport Partners and FWSH believe in the site and their proposed project and think that this is still an appropriate time to make cash investment to proceed with the contemplated project despite the current economic conditions. However, for that to eventuality to occur the City and developers must come to agreement on possible modifications to the existing agreements to allow the Airport West developments to continue. The Developers and City staff are working to renegotiate the terms of the agreement, reflective of current market conditions that will allow development of the site to proceed. The Developers are highly experienced, have an extensive track record for successful development, and have the financial resources to proceed with a restructured agreement.

It is important that the City staff and Developers recommend a restructuring for City Council consideration in the next thirty days. If that is not possible, the staff would recommend to the City Council that the City proceed with an RFP for the Airport West property.

STAFF RECOMMENDATION

Staff recommends the Amendment of the current Option Agreement to eliminate the LOC requirement. Failure to amend the Agreement as requested will cause the developers to terminate the contract and may forestall the opportunity for the Council to consider a restructured Agreement. Staff is working closely with the Developers to bring forward a revised Agreement for consideration by the City Council on April 28.

EVALUATION AND FOLLOW-UP

As stated above, staff intends to bring a recommendation on restructuring the current Agreement forward for City Council consideration by April 28, 2009.

POLICY ALTERNATIVES

Alternative: *The City Council could direct staff to terminate the agreement with the current applicants and further direct staff to conduct a Request for Proposals (RFP) process for the Airport West Property.*

Pros: The City Council could seek new development partners that could yield benefits not provided in the current agreement.

Cons: In the current economic climate, particularly in light of the difficulty obtaining real estate financing it is not likely another development team will have the investment capacity and interest in the Airport West site at this time.

Reason for not recommending: The proposed amendment allows the City an opportunity to explore whether a restructured agreement to continue with the current development plan envisioned for the site is possible. Such a restructure agreement would generate a counter cyclical investment in a soccer stadium and related construction jobs, securing a professional Major League Soccer team, and continue the public-private partnership with Developers who have proven experience and access to capitol to move forward with full development of the project when economic conditions improve. In addition, the current Developers include the owner of the Earthquakes Major League Soccer franchise that holds the rights to that franchise for northern California.

PUBLIC OUTREACH/INTEREST

- Criterion 1:** Requires Council action on the use of public funds equal to \$1 million or greater.
(Required: Website Posting)
- Criterion 2:** Adoption of a new or revised policy that may have implications for public health, safety, quality of life, or financial/economic vitality of the City. **(Required: E-mail and Website Posting)**
- Criterion 3:** Consideration of proposed changes to service delivery, programs, staffing that may have impacts to community services and have been identified by staff, Council or a Community group that requires special outreach. **(Required: E-mail, Website Posting, Community Meetings, Notice in appropriate newspapers)**

This memorandum will be posted on the City's web site and the Office of Economic Development's website (www.sjeconomy.com).

COORDINATION

This memorandum was coordinated with the City Attorney's Office, the Airport, and the Finance Department,

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FISCAL/POLICY ALIGNMENT

The project aligns with the City's Economic Development Strategy #11 "Revise Key Land Use and Transportation Policies to Reflect the new Realities for the San Jose Economy", and Strategy #12, "Encourage Sporting Teams, Events, and Facilities, Professional as well as Amateur"

COST SUMMARY/IMPLICATIONS

The impacts of any new development proposal will be analyzed and included for City Council consideration at the April 28, 2009 meeting.

CEQA

Not a project. Appropriate environmental review as required by CEQA would be conducted as a condition of the any new development proposal if the new development proposal alters the development already approved for the site.



PAUL KRUTKO
Chief Development Officer

For questions please contact Paul Krutko, Chief Development Officer, at (408) 535-8181.