COUNCIL AGENDA: 12/14/10
ITEM: 4.2

CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: HONORABLE MAYOR AND CITY COUNCIL

FROM: Kim Walesh

SUBJECT: See Below

DATE: November 30, 2010

Approved

Date 11/30/10

COUNCIL DISTRICT: 3

SUBJECT

AMENDMENT OF BUSINESS TERMS FOR THE OPTION, PURCHASE, AND SALE OF THE AIRPORT WEST PROPERTY FOR DEVELOPMENT AND FOR DEVELOPMENT OF A MAJOR LEAGUE SOCCER STADIUM

RECOMMENDATION

Adopt a resolution to:

1. Approve Amendments to Two Amended and Restated Option Agreements and related Purchase Agreements with Coleman Airport Partners LLC for the property located at 1125 Coleman Avenue.

2. Approve Amendments to an Amended and Restated Option Agreement and related Purchase Agreement with FWSH Partners LLC related to the 14 acres for the Soccer Stadium site located at 1125 Coleman Avenue.

OUTCOME

The Developers of the project, Coleman Airport Partners LLC and FWSH Partners LLC (Developer), have advised City staff that they wish to move forward with development of the site, but cannot proceed under the current terms of their respective agreements with the City due to the downturn in the economy and lack of liquidity in the marketplace. Current economic conditions continue to significantly impact the demand for new construction in Silicon Valley and pose a particular challenge in maintaining the ability for the Developer to continue their real property interest in the site. Approval of the proposed recommendations will allow the development of the Airport West site to move forward despite these difficult economic conditions, while minimizing negative impacts to the General Fund and providing counter-cyclical investment. The development proposal for the Airport West property continues to include 1.5 million square feet of office/R&D space, 95,000 square feet of retail space, 300 hotel rooms development, and a 14 acre parcel reserved for a 15,000 seat soccer stadium. The property once developed will generate substantial property tax, sales and use tax for the City.

Retaining a highly successful developer in the current economic climate will allow the City to move development forward as the economy recovers.

The adoption of the resolution would reduce non-refundable option payments by $2 million to $5 million as well as extend the option period from 2013 to 2015. If Developer closes on the property earlier, a reduction of $4 million in non-refundable option payments will occur. While Developer's intent is to proceed with the soccer stadium prior to the development of the other portions of the site, in the event that the economic climate continues to preclude the implementation of the stadium the option includes provisions for the City to consider allowing retail on the stadium site.

BACKGROUND

In 2005, the City of San Jose purchased the 74.8 acre property located at 1125 Coleman Avenue from FMC. The property is now known as the Airport West property. The City's intent was to purchase only 52 acres of the property to support the Airport expansion program. FMC was unwilling to sell the City a portion of the site. In order to assist the Airport, the City acquired the additional 23.23 acres. The Airport required significant land for construction lay down, interim parking and, at the time, off-Airport rental car operations. The intention and vision for the property was to assist the Airport with the construction of the new terminal as well as develop the site for economic development purposes to support job and revenue generation.

In May 2008, the City Council approved a Memorandum of Understanding (MOU) between the City and Coleman Airport Partners LLC that outlined the price, option period and uses on the property. Approved uses included the development of a proposed Earthquakes Major League Soccer Stadium on roughly 14 acres of the site. The balance of the site would include 1.5 million square feet of office, R&D, 300 hotel rooms and 95,000 square feet of retail space. On May 5, 2009 the City Council approved an amendment to the approved option terms for the property in recognition of the global economic crisis. The amendment reduced the purchase price and the amount for option payments. Restated Business Terms included:

- Coleman Airport Partners LLC and FWSH Partners LLC controlling 64.5 acres for a purchase price of $89,010,000.
- Revised option payments of $1 million to be paid June 30, 2010; $2.5 million to be paid June 30, 2011; and $3.5 million to be paid June 30, 2012 for the 50.5 acres.
- Option payments are not be applicable to the purchase price and are non-refundable
- FWSH Partners controls 14 acres for a purchase price $7 million for the stadium. The stadium site has no development entitlement rights.

A 9.3 acre portion of the Airport West property had been previously discussed as a Bay Area Rapid Transit (BART) maintenance facility. In 2009, the City was informed that BART no longer was in need or desired a portion of the Airport West site. Subsequently, staff has been working on a proposal to develop a regional soccer facility to serve residents of San Jose and the region.

In May, 2010 Coleman Airport Partners indicated to staff that economic conditions related to new construction remain poor and requested a 90-Day extension of the Option Agreement to allow Developer and the City to renegotiate the current terms of the Amended and Restated Option Agreement for the Development site and the Commercial site. On June 22, 2010, and subsequently on September 21, 2010, the Council approved two 90-day extensions to the Option Agreement for the Development site and the Commercial site. Staff has continued to work with the Developer throughout this period to outline appropriate amendments to the Option Agreements and the Developer continues to make substantial investment in planning, design, and preconstruction work for development of the site.

ANALYSIS

Proposed Amendment

The Airport West property remains one of the most important development sites in San Jose. Maintaining the viability of sites like this is critical to supporting the City's long term economic growth by providing suitable locations for the significant employment growth and regional amenities being considered in the Envision 2040 General Plan Update. The proposed amendment to the option agreement focuses on three key areas requiring modification:

- The timing and amount of option payments
- An incentive for near term purchase of the stadium parcel contingent upon the remaining demolition of buildings
- Provisions for alternate uses should the stadium prove infeasible.

Option Timing and Amounts

While the Developer remains confident in the long-term viability of the site, the near-term economic environment remains adverse to new development, especially of a speculative nature. Land values continue to be disproportionally impacted by the economic decline and Developer has requested that their respective option agreements be renegotiated to reflect current market conditions. The current agreements provide the following payment schedule:

December 21, 2010 to June 30, 2011	$1,000,000
July 1, 2011 to June 30, 2012	$2,500,000
July 1, 2012 to June 30, 2013	$3,500,000

These payments reflect a total of $7,000,000 to be received by the City through June 30, 2013. To maintain a financially viable interest in this property, the Developer is requesting that the schedule be revised to provide a higher initial payment to the City with a reduced total amount over a longer horizon. The revised non-refundable payment schedule would be:

December 21, 2010 to December 21, 2013	$2,000,000*
December 22, 2013 to December 21, 2014	$1,000,000
December 22, 2014 to December 31, 2015	$2,000,000

*If Developer purchases the 14-acre soccer stadium parcel by June 2012, a credit equivalent to the first $2 million option payment will be given, reducing the total option payments for that parcel from $7 million to $5 million.

This revised agreement would result in a maximum of $5,000,000 in option payments being paid to the City through December 31, 2015, down from $7 million in the current agreement which is a decrease of $2 million in option payments. The option payments will be nonrefundable and will not be applied to the Purchase Price of the Development Site or the Commercial Site but may be applied to the Stadium Site as discussed below. The proposed reduction in option payments are a direct result of the downturn in the local economy combined with tight financial markets. Currently in the San Jose MSA, new commercial/industrial construction has stalled as tenants are seeking more favorable lease terms given the amount of existing vacant space. The Developer remains committed to the project as demonstrated by their investing over $6 million in option payments, construction design and entitlement work. Developers anticipate the build to suit market will return after 2013 and therefore are looking to extend the option period.

Conclusion

The national and world economy has changed dramatically since the City entered into a negotiations agreement with the Developer in June 2007 and since the Council approved the original agreement in May 2008. The Developer's proposed restructuring reflects this changed reality and the reduction in the site's value over the last two years. Property and Portfolio Research (PPR) a leading provider of commercial real estate statistics has forecasted office/R&D values in San Jose returning to FY 2006-2007 levels by early 2015. In addition, the Santa Clara County Assessor has commented that the value of industrial and commercial property will continue to drop for the next two to three years at a minimum.

The Developer's independent financial capacity, proven track record for delivering projects, and desire to continue with the project based on the strength of the site still represent an important opportunity during this recession. The ability to maintain the financial viability of new development on this key opportunity site will be critical to maintain the City's financial interest in the property and support long term economic development goals. The revised proposal creates incentive for the Earthquakes Stadium to move ahead of the office and commercial development providing much needed counter-cyclical investment and job creation in San Jose.

Near Term Purchase

The City's Economic Development Strategy calls for a distinctive set of sports, arts, and entertainment offerings, and specifically aims to enable construction of the San Jose Earthquakes/Major League Soccer Stadium on the Airport West property. To ensure that this best-in-class professional sports venue remains the high priority in developing the property, the proposal incents the Developers to purchase the 14 acre stadium parcel earlier than the proposed 2013 end of the option agreement. Under the current terms of the option agreement, the Developer has until June 30, 2013 to complete the purchase of the 14-acre stadium parcel, priced at $7,000,000. The proposed amendment provides an incentive to the Developer of the Stadium to complete this transaction within 18 months of making the first additional option payment to the City. If Developer closes on this portion of the property within 18 months (June 2012), the option payment of $2,000,000 to be received by December 21, 2010 will be applied to the $7,000,000 purchase price. In the event that the Developer does not purchase the stadium parcel within 18 months of the making the first option payment they will pay a total of $5,000,000 in option payments.

In addition, the proposed amendment provides that the Developer will demolish all existing buildings on the stadium parcel within six months of purchase to encourage ready development at the site. The value associated with this demolition is estimated to be $3 million and the City will be obtaining a performance bond in that amount to make certain that the demolition occurs. The bond will be returned to the Developer when the demolition is completed.

Alternate Development on Stadium Site

The near-term development of this key property is important to the fiscal viability of the City's investment in the site and to promote new development and economic vitality in the immediate area. There remains a possibility that a stadium may be financially infeasible at the location. The Developer requests that in addition to the financial amendments to the agreement that the City will allow the sale of the Stadium Site for an alternative retail development at this location for $7,000,000. The Developer's proposal is to allocate 200,000 feet worth of traffic capacity from the current office/R&D entitlements on the economic development portion of the property to the Stadium portion. It should be noted that any commercial development would be required to adhere to all relevant City policies. In the event that the stadium is developed, this traffic capacity would be released back to the economic development parcel for office/research and development uses.

Outstanding Debt

In 2005, the City purchased approximately 52 acres with lease revenue bonds through the City's Financing Authority (the "Authority"). The City obtained a HUD loan for the remaining 23.23 acres. The lease revenue bonds issued in 2005 refunded in 2008 with the Authority's Series 2008F Bonds ("Series 2008F Bonds") as a result of the bond market disruption. The Series 2008F Bonds are secured by lease revenues from the sublease of the 52 acres of the Airport West property between the City and the Authority. The HUD loan is secured by 23.23 acres of the Airport West property in addition to CDBG funds and additional City property.

Additionally, the Airport issued $9,467,000 in commercial paper notes, secured by a subordinate pledge of Airport revenues, to make lease payments to the Authority for the use of 52 acres portion of the Airport West property for construction lay down and contractor parking at the Airport West property. The Airport's use of the Airport West property terminated as of June 30, 2010.

The Series 2008F Bonds and the HUD Loan must be repaid in order to complete a sale of the property. The commercial paper notes are not secured by the property, and will be paid by the Airport through other sources.

Outstanding Secured Debt Related to Acquisition and Use of Airport West Property (As of November, 2010)

Debt Instrument	Outstanding Principal
Lease Revenue Bonds	$67,195,000
HUD Section 108 Loan	$21,877,000
Total Debt	*$89,072,000*

General Fund Impact
The proposal maintains the purchase price at $89,010,000 less the $5 million credit for the 50.5 acre economic development parcel and the 14 acre stadium parcel, while reducing the amount received for option payments and extending the term of the option agreement.

The balance of revenues to the City that would be received from the remaining 9.3 acre parcel previously identified for use by VTA for BART in the near term. Staff is exploring options for the use of the property as a regional soccer facility by the Parks, Recreation and Neighborhood Services Department. In the instance that the City retains the regional soccer facility use the City will need to support continuing debt service associated with the remaining debt on the property.

Since 2008-2009, the City has incurred debt service costs of $10.6 million. Through the proposed option payment, an additional $23 million in debt service costs would be incurred through 2014. This debt service obligation was factored into the 2011-2015 General Fund Five-Year Forecast issued in February 2010. A portion of this debt service cost would be reimbursed from the proposed option payments.

EVALUATION AND FOLLOW-UP

Staff will continue to work with the Developer to move the stadium site forward and to market the office project to appropriate tenants.

POLICY ALTERNATIVES

Alternative: The City Council could direct staff to maintain the current options with Developer

Pros: The City would maintain the shortened option period as well as the existing option payment schedule.
Con: At the present time, the current option payment is about to expire and given the structure of the existing agreement, the Developer has informed the City they would have to make the difficult decision to walk away from the project.

Alternative: The City Council could direct staff to conduct a Request for Proposal (RFP) process for the Airport West Property

Pros: The City could receive a higher price for the Airport West Property.
Cons: In the current economic climate, particularly in light of the difficulty obtaining real estate financing, it is not likely a greater price for the Airport West property could be obtained.
Reason for not recommending: The proposal being considered offers the City counter cyclical investment in a $50 million dollar stadium and related construction jobs, possibly securing a professional Major League Soccer team, and continues the partnership with Developer, retaining their proven experience and access to capital to quickly move forward with full development of the project when economic conditions improve.

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.

This memorandum will be posted on the City's web site and discussed at the December 14th City Council meeting.

COORDINATION

This memorandum was coordinated with the City Attorney's Office, Budget Office, Parks, Recreation and Neighborhood Services and the Finance Department.

FISCAL/POLICY ALIGNMENT

The project aligns with the City's Economic Development Strategy #12, "Develop a Distinctive Set of Sports, Arts, and Entertainment Offerings Aligned with San Jose's Diverse and Growing Population."

COST SUMMARY/IMPLICATIONS

As noted earlier, the City's current outstanding principal associated with the property is:

Debt Instrument	**Outstanding Principal**
Lease Revenue Bonds	$67,195,000
HUD Section 108 Loan	$21,877,000
Total Debt	*$89,072,000*

As described below, the Developer's desire to move forward with the project at a reduced purchase price of $84 million for 64.5 acres of land and reduced option payments in the amount of $7 million over a four year period. The debt service costs (principal and interest) required through FY 2013-14 are anticipated to be approximately $23 million. Staff has indicated that the application of the $7 million in the Developer's option payments plus the application of the sale proceeds from both the 14 acre soccer parcel and rent payments from the proposed regional soccer facility could eliminate any impact to the General Fund in the short term to cover debt service prior to the sale of the 50.5 acre development parcel. There is potential risk to the General Fund in that purchase of the soccer parcel and the 9.3 acre parcel could be delayed and the amount obtained for the 9.3 acre parcel could be insufficient to cover debt service, causing the General Fund additional expense. In this scenario the General Fund would pay for outstanding debt service payments until such time as the remaining 50.5 acres are sold. The Budget Office has already assumed debt service costs associated with the property in its current budget forecast.

General Fund Portion of Principal for 74.8 acres	$89,072,000
Application of a Purchaser Credit	$5,000,000
Developer's Purchase Price	84,000,000
Budget Surplus/Deficit	*$72,000*

It should be noted that the CSFA 2008F bonds are backed by a letter of credit (LOC) which will be up for renewal in June 2011. It is unclear whether any penalties would be assessed related to the letter of credit should Developer buy the property before the City's LOC expires.

Sale of the Property

As discussed above, the City has existing secured debt of $89 million dollars for the 74.8 acre Airport West property. Developer's proposed revised purchase price for the 64.5 acres of the property is $89 million. $5 million of the $6 million previously paid by the Developer will be applicable to the purchase price at closing, so the total amount of revenue paid by the Developers for the property, if the property closed escrow prior to 2011 would be $84 million.

The best case scenario for sale of the property would entail Developer purchasing the property as early as possible, limiting the City's carry costs on the property. Under the worst case scenario, the City could sell the soccer parcel and 9.3 acre parcel, applying the proceeds of those sales to debt service payments without subsequent sale of the property to the Developer. In this instance, diminished parcel size against the remaining debt for the full 74.8 acre parcel would represent the greatest risk of future indebtedness associated with the remaining 50.5 acre parcel. It is important to note, however, that the smaller 50.5 acres retains all of the development entitlement that is currently spread across the 74.8 acres as previously approved by City Council.

As discussed above, the option to RFP the property in this economic climate represents an even greater risk to the City. The current developers are motivated to protect the investment they have already made in the site. In addition they have adjacent land holdings and stand to benefit from control over larger land holdings in a premier location near downtown San Jose and the Airport. Staff believes that an RFP has a high potential to yield a developer who will offer a similar option arrangement at a significantly reduced price than that currently being offered by the current Developer. Option payments are also likely to be further reduced and the General Fund will be obligated to shoulder debt service payments during the RFP and negotiation period for the 74.8 acre property.

<u>CEQA</u>

EIR Resolution No. 71716, File No: PP08-093 and File No: PDC09-004.

/s/
KIM WALESH
Chief Strategist/Acting Director
Economic Development

For questions please contact Nanci Klein, Division Manager, at (408) 535-8181.