CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: HONORABLE MAYOR AND CITY COUNCIL AND CITY OF SAN JOSE FINANCING AUTHORITY BOARD

**FROM: Paul Krutko
Ralph Tonseth
Larry Lisenbee**

SUBJECT: Acquisition of the FMC Property

DATE: August 12, 2004

Approved [signature] Date 8-13-04

Council District: Citywide

RECOMMENDATION

Adoption of a resolution by the City Council

(a) Approving a Purchase Agreement with FMC Corporation for the purchase of no less than 51.54 acres of property located at 1125 Coleman Avenue at a price of twenty-five dollars ($25.00) per square foot or $56,242,500.
(b) Approving the terms of a loan of Airport funds not to exceed $3,735,000 for annual debt service payments on the Section 108 loan, for a term from January 1, 2005 to June 30, 2018, with interest payable by the City to Airport funds accruing on a monthly basis at the City's rate of return on its invested pool of funds.

2 Authorizing the City Manager to:

(a) Exercise authority on behalf of the City to complete the acquisition of up to 23.23 additional acres of the property pursuant to the Purchase Agreement, for up to two years following the close of escrow, for a total additional price not to exceed $25,297,475; and
(b) Execute Covenants, Conditions and Restrictions (CC&Rs) for the property located at 1125 Coleman Avenue at the close of escrow for the purchase of the property; and
(c) Negotiate and execute a Right of Entry Agreement and Easement for all portions of the property located at 1125 Coleman Avenue acquired by the City pursuant to this Purchase Agreement for purpose of permitting continued access by FMC to perform environmental remediation; and
(d) Execute all documents and agreements necessary to secure a Section 108 loan for the purchase of the additional 23.23 acres of the property, including a Note and Contract with the Secretary of the United States Department of Housing and Urban Development.

(e) Negotiate and execute all other documents and agreements necessary to complete this transaction.

3. Directing staff to proceed with the development of the bond financing documents for the issuance of lease revenue bonds to finance the acquisition of the Property.

4. Adoption of the following 2004-2005 appropriation ordinance amendments in the General Fund:
   (a) Establish a City-Wide appropriation to the Office of the City Manager in the amount of $563,000 for the FMC Property Deposit.
   (b) Reduce General Fund Contingency Reserve by $563,000

5. Adoption of a resolution of the City of San Jose Financing Authority stating its intent to issue debt to finance the acquisition of 51.54 acres of land located at 1125 Coleman Avenue.

The project is aligned with the recommendations of Economic Development Strategy No. 2, "Build a World-Class Airport Facility and Air Services."

BACKGROUND

On May 18, 2004 the City Council approved a Term Sheet and authorized staff to negotiate an agreement with FMC Corporation for the purchase of 74.87 acres of property located at 1125 Coleman Avenue at a price of $81,539,960. Council also authorized staff to submit a Section 108 Housing and Urban Development (HUD) loan to support the purchase of 23.23 acres of the 74.87 acres of the FMC property and directed staff to pursue a Brown Fields Economic Development Initiative (BEDI) Grant to support the development of the FMC property. Purchase of the FMC property allows the City to fulfill multiple critical goals. In the short-term control of the property could substantially facilitate the progress of the construction of the North Concourse Building and related projects at the Airport. In the long-term the City would have the ability to substantially enhance City revenues through the build out of the three million square feet of office/research and development uses allowed on the property.

The City is proposing to purchase the property in two phases. In the first phase the City would complete the acquisition of approximately 52 acres of the property ("the Phase I Property"). In Phase II the City would complete the acquisition of the remaining 23 acres of property, (the "Phase II Property"). The Phase II property requires additional environmental clearances before the City would be willing to purchase the land. FMC anticipates obtaining all requisite clearances within two years of closing escrow on the Phase I Property. The Phase I Property will be used for interim Airport uses such as interim construction staging/lay down, rental car parking/servicing and other Airport parking-related facilities as needed subject to future Council approval of a lease agreement between the Financing Authority and the City and an associated amendment to the Airport Master Plan, both of which are tentatively scheduled for consideration by Council in November of 2004. The Phase II Property would be available for use by the City for short-term economic development purposes including: rental agency used car sales, recreational vehicle sales, and courier and delivery services.

Financing for the project will come from two sources: lease revenue bonds and a HUD Section 108 loan. Purchase of the Phase I Property would occur through the issuance of lease revenue bonds by the City of San Jose Financing Authority (the "Authority"). The Authority would use bond proceeds to acquire the Phase I Property, which would then be leased 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 in an amount sufficient to pay debt service and other financing costs of the Authority's bonds. The source of the City lease payment would be Airport funds. Purchase of the Phase II property will be financed through a Section 108 loan. On July 15, 2004 staff submitted to HUD a Section 108 loan application and an application for a BEDI Grant to support the FMC project. HUD will provide notification of award status for both the loan and grant by the beginning of November 2004. Purchase of the FMC property is contingent upon both the issuance of the lease revenue bonds and obtaining the HUD Section 108 loan with at least a two year commitment of time in which the City can access the funds for the loan.

The remainder of this memorandum presents items negotiated since the Term Sheet was approved by City Council on May 18, 2004 to be incorporated within the Purchase Agreement as well as additional information on items required for City Council action on this item.

ANALYSIS

Working together FMC representatives and City staff have prepared a Purchase Agreement and supporting documents for the acquisition of the FMC property in accordance with the Term Sheet previously approved by City Council. In finalizing the Purchase Agreement, a limited number of terms have been added or modified from those in the Term Sheet document.

Indemnity Provisions

The approved Term Sheet stated that "FMC shall continue to have the obligation to perform remedial work required by the DTSC (Department of Toxic Substance Control) or an environmental agency with respect to the contamination on the property attributable to FMC". This language was interpreted by City staff to mean perpetual responsibility on the part of FMC for such clean up and by FMC staff to mean limited responsibility. The Purchase agreement contains compromise language that would have FMC responsible for such clean up for ten years after the final No Further Action determination (NFA) issued for the site. FMC does not expect to receive a final No Further Action determination on Phase I for approximately ten years and on Phase II for approximately 20 years. The Purchase Agreement would therefore be expected to provide indemnity described in the above paragraph for approximately 20-30 years. After these indemnification provisions expire the City would reacquire its rights to all statutory and common law remedies for governmentally-ordered clean up that the current proposed indemnity covers.

Limitations on Use, Particularly in the Event of City Breach of Contract Related to Phase II Property

The Term Sheet stated that "at the Phase I Close of Escrow, the City and FMC shall enter into a declaration of Covenants, Conditions and Restrictions in a form to be attached to the Purchase Agreement, that will restrict the property adjacent to the remaining FMC owned property to the uses currently permissible under the PD Zoning for an additional period of time."

FMC wanted to protect the marketability of any property that might be retained by FMC. FMC may retain property in the event that FMC cannot obtain the necessary environmental clearances required to convey the entire 23.23 acre parcel to the City or because of a breach of contract by the City after the Phase II property has been offered to the City.

The parties have negotiated a Covenants Conditions and Restrictions for the project that contemplate a 50' buffer if FMC is not successful in conveying all or a portion of the Phase II property to the City at the end of the two year period following the Phase I Close of Escrow. This buffer zone will require certain types of City development in the buffer zone to be landscaped to minimize the visual impact of City development on the remainder property. Additionally, the City will not be permitted to put a concrete batch plant within 250 feet of the remainder property. Under this scenario, the stipulated buffer zones and use restrictions would apply to both FMC and the City.

If the City breaches the contract and does not purchase the Phase II property from FMC as specified within the Purchase Agreement than the buffer zone on the City Property adjoining the remaining FMC property will be 250' and the conditions will be more restrictive. Rental car facilities, new vehicle sales and parking lot oriented uses would only be permissible provided that the buildings for such facilities located within or against the buffer zone would be with the parking lots oriented away from the buffer zone. Landscaping and berms would be required to screen uses from the adjacent property.

In the event that the City defaults, the City would construct the public street serving both properties as shown in the Planned Development Zoning at the property line, if otherwise permitted by applicable planning and governmental authorities. The street would act as part of the buffer between the properties. If the City breaches its contract with FMC the CC&R's also require that the City demolish the existing buildings that do not conform with the permitted uses within the buffer zone within one year of the City's breach.

After careful review and discussion, staff recommends acceptance of the buffer zone and use restrictions outlined. Certain of the City uses could potentially impact FMC's ability to market adjacent property. These provisions protect the parties in the unlikely instance of a City breach as well as in the instance that FMC is not able to obtain the required environmental clearance on the Phase II property and as a result retains ownership of all or part of the Phase II property.

Phase 2 Liquidated Damages and FMC Right to Recover Damages and Attorney's Fees

The Term Sheet did not contemplate a provision for FMC to obtain liquidated damages if the City breaches the contract on its obligation to purchase the Phase II property.

FMC believes that the overall price that it can obtain for a smaller piece of property sandwiched between the adjacent property owned by Arcadia and the City could be less than the price negotiated with the City. After some discussion related to an appropriate liquidated damage provision, the negotiators for FMC and the City determined that a better approach to this issue would be to let the parties pursue a remedy in Court in the unlikely event of City breach. It was determined that in such an event, if FMC were to prevail, it would not be made whole if it were required to pay for its attorneys' fees expended in bringing such an action. Thus, despite the fact that standard City contracts generally do not contain attorneys' fee provisions, this agreement permits the recovery of a prevailing party's attorneys' fees, provided that the payment of those fees is capped at $500,000.

Given that FMC will have to prevail in court regarding the nature of a potential breach by the City and the minimal likelihood that the City will not fulfill its contractual obligations, staff does not oppose FMC's request.

Right of Entry Agreement – Attorney's Fees

After the City purchases the property from FMC, FMC will be required to complete remedial work and monitor treatment systems. FMC's right to enter the property is governed by the Right of Entry Agreement. This agreement includes a provision for either party to recover attorney's fees in the event of a lawsuit over remediation efforts on the site, provided the attorney's fees are capped at $500,000.

Staff believes that the City would not undertake legal action under the Right of Entry Agreement unless it was certain FMC would have violated the terms of the Agreement. As such the provision would more likely provide additional protection to the City and is therefore an acceptable exception to the general policy prohibiting contractual provisions allowing an award of attorney's fees to either party.

Additional Updates

The following information provides updates on elements of the proposed transaction.

Section 108 Schedule and Related Issues

As mentioned above, staff submitted both a Section 108 loan application for $26 million and a BEDI grant application for $2 million, the maximum allowed, to HUD on July 15, 2004. The HUD funds will support the City's purchase of the Phase II property. The application was completed in accordance with HUD guidelines and the City has sufficient capacity remaining in the Section 108 loan program. The agreement with FMC specifies a Section 108 funding by December 15, 2004 the close of escrow on the Phase I property. If the City cannot obtain the funding, with a two year window in which to purchase the Phase II Property, by December 15, 2004 the contract will become null and void and FMC will have no further obligation to sell, and the City will have no further obligation to purchase the Property. The terms of the Purchase Agreement allow the parties to extend the agreement, with a written amendment, should both parties agree to a delay. Under the Agreement, the City Manager is authorized to extend escrow on behalf of the City.

Airport Loan

City staff developed a set of conservative assumptions underlying the proforma for the purchase of the Phase II 23 acre parcel. Based on those assumptions it is conceivable that additional funds will be required, in the early years of the purchase, to support debt service on the property. In the long-term the City is estimated to earn approximately $25 million in income over the 20 year amortization period for the HUD loan.

In order to protect the City's CDBG allocation and the General Fund, staff is requesting Council approval of a loan of Airport funds to be utilized by the City for debt service payments on the Section 108 loan, if required. The amount of the loan is not to exceed $3,735,000. Federal law requires all airport owners that receive Federal assistance, such as the City, to use airport revenues for the capital or operating costs of the Airport. As a general rule, any use of airport revenues by an airport owner for costs that cannot properly be considered airport capital or operating costs is considered to be improper "revenue diversion." However, so long as the City pays any borrowed funds back to the Airport fund over a set term of years with interest at the prevailing rate, the proposed loan of Airport funds would not constitute revenue diversion.

In order to comply with the federal law regarding revenue diversion, any Airport funds borrowed for debt service on the Section 108 loan are proposed to be paid back over a set term of 13.5 years with interest. The amount of the loan per year shall be determined by the City Manager's Budget Office, in coordination with the Airport Department and the Office of Economic Development. Interest shall accrue on a monthly basis at the City's rate of return on its invested pool of funds. The City may borrow Airport funds for debt service payments on the Section 108 loan only after Airport revenues have been applied to all other uses required under the airline leases and the Master Trust Agreement for the issuance of Airport bonds.

Staff projects that Airport funds will be available for debt service on the Section 108 loan if needed. However, in the event that Airport funds are not available after Airport revenues have been applied to all other uses required under the airline leases and the Master Trust Agreement for the issuance of Airport bonds, the City will be obligated to pay debt service on the Section 108 loan either from the City's CDBG allocation or from the General Fund.

City's Lease Revenue Bonds

The current plan contemplates that the Authority will issue tax-exempt lease revenue bonds to fund the purchase of the Phase I Property. As the proposed uses of the Property are refined during the development of the financing plan, it may be determined a portion or all of the bonds will need to be issued on a taxable basis. Title in the Phase I Property will vest in the Authority and the Authority will lease the property to the City. The annual lease payments will be in an amount equal to the debt service on the bonds.

As the Airport Department will be using the Property, the City will make the lease payments from Airport revenues. If the Airport no longer has use of the Property, then payments will be made from the General Fund. The bond documents will contain provisions to give the City flexibility with the long term use of the Property, such as an option for the City to purchase the Property with Airport revenues.

The closing of the bonds and the close of escrow on the purchase of the Property will occur simultaneously. The closing is anticipated to occur on December 15, 2004.

Repayment of the Phase I Property Deposit

If approved by City Council, the City Manager's Budget Office will authorize the payment of the $563,000 Phase I deposit from the General Fund. The deposit amount will be repaid to the General Fund in December or at such time that lease-revenue bonds are sold to support the purchase of the Phase I Property.

Resolution of Intent for the City's Lease Revenue Bonds

Federal tax regulations allow issuers of tax-exempt bonds to use bond proceeds for reimbursement of certain project costs paid prior to the issuance of the bonds. However, such reimbursement can only occur if the issuer has adopted a Resolution of Intent declaring its intent to reimburse the expenditure with bond proceeds. This Resolution applies to expenditures paid no more than 60 days prior to the adoption of the Resolution, and in general, reimbursement must be made no later than three years after the expenditure is originally paid. The Resolution of Intent must describe the project and state the maximum principal amount of obligations expected to be issued for the project. At the time it adopts the Resolution, the issuer must have a reasonable expectation that it will issue debt for the project.

As described above, the purchase of the Phase I Property is intended to be funded with tax-exempt bonds to the extent that the City's use of the Property is eligible for tax-exempt financing. The par amount of the bonds is anticipated to be approximately $80 million, which includes funding for improvements to the Property that will be debt financed. It is anticipated that bond documents will be brought forward for City Council consideration by the end of November 2004. The HUD Section 108 loan has similar provisions and allows for reimbursement of certain costs previously expended on the project to be financed.

PUBLIC OUTREACH

Not Applicable

COORDINATION

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

CEQA

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

BUDGET REFERENCE

Fund #	Appn #	Appn. Name	Total Appn.	2004-2005 Proposed Operating Budget Page	Last Budget Action (Date, Ord. No.)
001	7901	General Fund Contingency Reserve	$24,473,675	III-4	6/22/04, Ord. 27196

PAUL KRUTKO, Director
Office of Economic Development

RALPH TONSETH, Director
Norman Y Mineta, San Jose
International Airport

Assistant Budget Director

LARRY LISENBEE
Budget Director