
OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

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**City Council Meeting and
Redevelopment Agency Date:** October 12, 2009

Item Numbers: 200 & 1

Civic Center Complex Exclusive Negotiation Agreement (ENA)

OVERVIEW

On Monday, October 12, 2009 the City Council is being asked to approve necessary actions to authorize the execution of an Exclusive Negotiation Agreement (ENA) with Gerding Edlen Development Corporation (GED) for the development of the Civic Center Complex including a new City Hall. In addition, the City Council is being asked to consider the option of creating a Citizens' Oversight Committee to provide input during or at the conclusion of the negotiation process. On a separate action item, the Redevelopment Agency is being asked to authorize the expenditure of up to \$705,000 for costs associated with the City's obligations associated with the ENA including negotiation and drafting of a Development Agreement.

On May 27, 2009 the Rules, Open Government, and Intergovernmental Relations Committee (Rules Committee) heard an initial overview from the Centre City Development Corporation (CCDC) on the Civic Center Complex proposal. On June 10, 2009 the Rules Committee heard additional presentations on the proposal from CCDC and more detailed and separate presentations from the consultants hired by CCDC, Gerding Edlen, and the Independent Budget Analyst (IBA). At the June 10, 2009 Rules Committee meeting, the committee members voted 4-0, with Council President Hueso absent, to direct the Mayor to develop an ENA and present it to the Council for review and approval. The Committee members also directed the Mayor to include thirteen conditions to be included in the proposed ENA (See Attachment A).

Prior to the June 10, 2009 Rules Committee meeting, the IBA released report 09-48 Civic Center Complex that reviewed the information on non-redevelopment and redevelopment options provided by the consultants; and provided additional information to augment what had already been provided to the Rules Committee and City Council members. Our analysis relied on the numbers presented by CCDC's financial consultant Jones Lang LaSalle (JLL) and peer reviewed by Ernst & Young. In our report we noted

that we believed the process used by both firms were thorough but we also recognize that the final numbers could change based on the scope of the project and future market conditions. Our report also included a number of recommendations for Rules Committee consideration. We concluded our report by recommending that the Rules Committee, followed by the City Council, begin discussions with the City's negotiating team on parameters to be included in a successful ENA.

The purpose of this report is to review our initial recommendations and observations; provide additional analysis of new developments since the issuance of IBA report 09-48; and review and provide recommendations on the draft ENA.

FISCAL/POLICY DISCUSSION

Prior IBA Recommendations

In IBA report 09-48 on the Civic Center Complex, we provided numerous recommendations for the Rules Committee, and ultimately the City Council's consideration. The following summarizes the recommendations and the actions taken on those recommendations since June 10, 2009.

- ***That the proposed financial mechanism and alternative methods be carefully evaluated and compared by the City's Debt Management Department, with consideration given to concerns that were identified in IBA report 09-48 (Pages 7-8).***

Status: To date this item has not been completed. Staff has stated the information provided by the financial consultants is sufficient and they will not be providing additional analysis on the financing mechanisms at this time.

- ***The City's Real Estate Assets Department provide a third party review of Irving Hughes concerns and Jones Lang LaSalle' (JLL) response and render an opinion regarding the two alternative positions (Report 09-48 page 11).***

Status: In a September 2, 2009 Memorandum to the IBA (See Attachment A), James Barwick, the City's Real Estate Assets Director, provided an analysis of the disparity between Irving Hughes and JLL's rent assumptions. In his conclusion, Mr. Barwick states "While it is extremely difficult to predict rent levels five years into the future, it is my opinion that the rent projection methodology used by JLL is professionally sound and provides the more accurate prediction of the City's rent in 2014."

- ***That the Mayor’s financial staff complete an analysis of the fiscal impacts of the Civic Center proposals to the City’s operating budget and Five-Year Financial Outlook (Report 09-48 Page 12).***

Status: On October 1, 2009 the Mayor released his 2011-2015 Five-Year Financial Outlook. The Five-Year Financial Outlook discusses two scenarios related to the construction of a new Civic Center Plaza and two related to the continued occupancy of the existing facilities for at least five years. Each scenario focuses on the expenses associated with addressing deficiencies with the existing Civic Center Plaza outlined in DMJM’s May 2009 Facilities Condition Assessment Supplement. The two scenarios related to the construction of a new Civic Center assume delivery of the facility in FY 2014 with little or no additional costs incurred to the operating budget. This assumption is based on projected savings related to the decrease in rent payments with the consolidation of City employees into one facility and efficiencies related to the new facility. It should be noted that costs associated with the relocation of the Emergency Operations Center once the new Civic Center is completed are not included in the Outlook. This is discussed in more detail later in this report.

- ***That regardless of the legal perspective, consideration is given to submitting this project to a public vote to gauge public support and involve the community in this monumental project. It is of the utmost importance that the financial viability of this project holds up to public scrutiny ensuring a transparent process. This is similar to the process used to develop PETCO park (Report 09-48 Page 11)***

Status: In our initial report, we noted that GED’s three phase redevelopment proposal may require a vote of the people under City Charter Section 90.3. City Charter Section 90.3 states:

(a)The City may not enter into the agreements necessary for financing, development, and construction of a major public project that confers a significant private benefit, unless that project is submitted to a vote at a municipal election and a majority of those voting in that election approve the project.

(b) For purposes of this section 90.3

(1) The term “major public project” means any capital improvement for which the expenditure of City funds is proposed, other than capital improvements for water, sewer or

other public infrastructure, and for which the City's total cost is in excess of an amount equal to ten percent (10%) of the City's General Fund budget for the fiscal year in which the project is proposed to be approved by the electorate;

On June 9, 2009, the City Attorney's Office released an opinion on the applicability of San Diego Charter Section 90.3 and whether it is appropriate or necessary to include a public vote requirement in the ENA with GED for the development of the Civic Center Complex. The City Attorney's Office stated that the public vote requirement for San Diego Charter Section 90.3 does not apply to an ENA. The reason given is that an ENA does not bind the parties to the disposition and development of any parcels.

On September 2, 2009 the City Attorney's Office released a Memorandum of Law that addresses the question of whether the Civic Center Complex requires a vote of the electorate. In their Memorandum, the City Attorney's staff states that the combination of a new City Hall and mixed use development qualifies as a capital improvement pursuant to Charter Section 90.3. However, until the scope of the project is finalized and a financing option is chosen by the City, the determination whether the Civic Center project requires a public vote cannot be completed.

It is important to note that the Mayor and Councilmembers Faulconer and DeMaio have suggested that a public vote, regardless of the legal requirements, should be considered.

Previously Identified Items to Consider

In addition to the recommendations provided in IBA report 09-48, we also detailed additional items for the Rules Committee and City Council consideration.

City's Emergency Operations Center

In report 09-48 we discussed that the GED redevelopment proposal does not assume that the City's Emergency Operations Center (EOC), currently located in the City Operations building, will be located in the current location or in the redevelopment footprint. In addition, it is unclear if the City would be able to continue to operate the EOC in its current location even if COB underwent a renovation. To date, the future of the City's EOC has not been discussed with the City Council. ***The IBA recommends that the City discuss the long-term future of the Emergency Operations Center concurrently with the ENA negotiations if the Civic Center project moves forward.***

Fire Station #1

In addition to the EOC, we also noted that Fire Station #1 is located in COB and regardless of the final decision of the Civic Center redevelopment, the station will need to be relocated. The City and CCDC have been actively working on solutions for the station. CCDC has included the total cost of site acquisition (\$8.8 million) and construction (\$36 million) of a new station in their long-term budget. GED's proposal includes a new fire station in the redevelopment of the current COB site (Phase III). Under this scenario the \$8.8 million for site acquisition would not be necessary. Depending on the impact of the State of California's take of Redevelopment funding, this \$8.8 million in savings could provide vital capital to other projects that might be delayed or canceled due to the State's actions.

Main Library

At the June 10, 2009 Rules Committee meeting, direction was given to the Mayor to present additional analysis on costs associated with including a library in the project and potential revenue sources for analysis and design changes. CCDC's September 16, 2009 Report to the City Council discusses three possible options for including the new main library into the Civic Center redevelopment site. Each of these options would require additional analysis on the feasibility of including the project in the redevelopment footprint. CCDC has estimated that it would cost \$200,000 to complete this analysis. It is important to note that recently the City has made substantial progress on moving forward with building a new main library in the East Village and co-locating the facility in the Civic Center Plaza redevelopment site could significantly impact that project.

On July 7, 2009, the City Council authorized a letter of intent with the San Diego Unified School District for a forty-year lease of two floors of the proposed nine-story New Main Library. Following that action, the City submitted an application change related to the \$20 million State grant to request the inclusion of a charter school and an extension of time for the grant agreement.

In its request to the State, the City outlined its planned schedule for project progress. In approving the changes, the State has relied on the City's schedule and requires that milestones be met, including the update of all plans and specifications for the project and City Council approval to release bids of the major trades by November 15, and City Council approval of a construction contract and the begin of construction by August 1, 2010.

Failure to meet these milestones may jeopardize the City's receipt of the State grant funding. To date, the City has spent approximately \$17 million on the Main Library, including costs related to site acquisition and building design. Work is now underway to secure Council authorization to update plan specifications which will allow for the bidding process to begin.

As currently envisioned, the proposed design of the Civic Center does not easily allow for the incorporation of the Main Library project, due to several incompatible design and access requirements. These include the varying size of floor plans, structural factors to accommodate the weight of books, and desired street-level location for public access for both uses.

Requesting these two significant projects be combined may result in the loss of the State funding, and the inability to execute the lease arrangement with the San Diego Unified School District, and the City may be required to forfeit these sources of funding. In addition, the costs related to completed design work on the Main Library would be lost.

New Items for Consideration

Impact of Future City Personnel Reductions

In CCDC's September 16, 2009 report to the City Council, they point out the Facilities Needs Assessment for the City's downtown operations was done in 2008 and does not capture personnel budget reductions taken after the report was completed. As CCDC notes, the reduction of personnel already taken and the likelihood of future reductions could significantly impact the space needs required by the City in the future. CCDC states that "during any potential negotiations with GED, this data should be re-evaluated to update the forecast of future space needs."

On August 18, 2009 Councilmember DeMaio released a memorandum requesting an updated financial model based on the possibility that the space needs for a new City Hall could be reduced. In a September 9, 2009 response to Councilmember DeMaio's memorandum, CCDC states that:

"If the outcome of the updated needs assessment is a reduction in current and projected City Staff, as is expected, then a corresponding reduction in the amount of required space upon occupancy and in the future may be appropriate. The City and GED will then need to discuss the benefits and risks of maintaining the same building size as originally proposed, even though the City may never require all of the space, or reducing the size of the proposed City Hall building."

The IBA agrees that the City's office space needs will be less in the future than originally projected in 2008. The City's fiscal condition has worsened considerably due to the recession requiring further budget/position reductions. A long recovery is anticipated in the Mayor's Five-Year Financial Outlook with no growth projected in personnel during the outlook period. Based on City space requirements the size of the new City Hall could be reduced.

However, it is unclear how the City Council would participate in this decision prior to completion of negotiations. *The IBA recommends that if the size of the new City Hall*

were to change during this process, then the new scope and financial impacts be discussed with the City Council prior to the conclusion of negotiations and the drafting of a Developer Agreement.

Build America Bonds

In addition to IRS Ruling 63-20 and conventional financing options, CCDC staff has provided information regarding Build America Bonds (BABs) as a possible means of financing a new City Hall. As mentioned in the staff report, BABs are authorized under the American Investment and Recovery Act (Act). The Act allows state and local governments to issue taxable bonds in 2009 and 2010 to finance any capital expenditures for which they could otherwise issue tax-exempt governmental bonds. Government issuers of taxable BABs receive reimbursement from the federal government equal to 35 percent of the interest payments on the bonds.

The staff report provides that local governments typically experience lower net borrowing costs (estimated in the report to range from 42 to 121 basis points). The IBA generally concurs about the savings potential, noting that actual interest rates could change significantly before bonds are issued. The report further indicates that each 25 basis point change in the net effective interest rate impacts the City's total 33-year financing costs by an estimated \$47 million. As a public vote on financing a new City Hall is contemplated for November 2010, it is important to recognize that BABs are only authorized through the end of calendar 2010 which makes timing a significant consideration. ***The IBA recommends that the BAB financing option be further evaluated in conjunction with the City's Debt Management staff during potential negotiations.***

IBA Comments and Recommendations on the Draft ENA

At the June 10, 2009 Rules Committee, the Committee members directed the Mayor to develop an ENA and present it to the Council with the inclusion of thirteen conditions. The IBA has compared the draft ENA proposed by CCDC to the conditions approved by the Rules Committee. Each of the conditions has either been incorporated into the draft ENA or addressed in CCDC's September 16, 2009 report.

After reviewing the draft ENA, the IBA has the following questions or recommendations for City Council consideration:

- It is unclear in the draft ENA or CCDC's September 16, 2009 report who will be the lead negotiator for the City. Will the lead negotiator be a City employee or a consultant? If the lead negotiator is a consultant, who will be the City's lead staff person? ***The IBA recommends that the members of the negotiating team***

be clearly identified via memorandum to the City Council prior to commencing negotiations on the development agreement.

- If the City Council chooses to move forward with a Citizens' Oversight Committee, the makeup and the scope of the Committee's charge is unclear. Would the committee provide feedback during negotiations on the Development Agreement or after an agreement has been reached? Would the Committee continue through the construction phases?

CCDC notes in their September 16, 2009 report that the formation of such a committee could be a discussion "now or at a future date if and when a final agreement is negotiated between the City and GED." *The IBA recommends that if the City Council elects to move forward with a Citizens' Oversight Committee that the makeup, purpose, and term (or duration) of the Committee be decided prior to commencing negotiations on a development agreement.*

- Under the "Exclusive Right to Negotiate Section" of the draft ENA, the term of agreement is for twelve months with an extension of two additional six month periods if necessary. The extension may be granted at the discretion of the Mayor or his designee and the developer. With the proposed language in the draft ENA, it is unclear how the City Council will be informed if an extension is granted or if the Council will be consulted prior to the granting of an extension.

In addition, the draft ENA does not provide a timeline with milestones that could be used by the City Council to gauge how negotiations are proceeding. *The IBA recommends that the City Council clearly define a process where prior to an extension to negotiations being granted, the City Council is consulted and given an opportunity to provide feedback. In addition, the IBA also recommends that CCDC provide a timeline for negotiations that includes milestones. Similar to labor negotiations, the City's Civic Center negotiating team should update the City Council at least monthly on the progress of negotiations and any significant changes to the scope of the project.*

Funding of the ENA

The Centre City Development Corporation estimates that the cost of entering into an ENA will be approximately \$705,000, including costs for negotiation, site condition analysis, environmental and legal reviews, financial analysis, design changes, and drafting of a development agreement. On June 10, 2009, the Rules Committee directed that the Civic Center project, including negotiations, have no negative impact on the City's General Fund. As such, it is requested that the Redevelopment Agency authorize the expenditure of up to \$705,000 from the FY 2010 Centre City Project budget, to be funded from land disposition proceeds. These funds are currently available within the remaining budget for the Civic Center project, so no other project impacts are anticipated

as long as costs remain within this estimate. We recommend that the negotiating team include the status of actual negotiating costs when providing updates to the City Council.

CONCLUSION

In our June 10, 2009 Report to the Rules Committee on the Civic Center Complex Proposal, we recommended that the Rules Committee, followed by the City Council, begin discussion on parameters to be included in a successful ENA. Many of those parameters have been included in the draft ENA. The purpose of this report was to review our recommendations and observations that were provided in our initial report on the Civic Center Complex Proposal. This report also provides additional analysis of new developments since the issuance of IBA report 09-48 along with recommendations on the draft ENA for City Council consideration.

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