The City of San Diego

Staff Report

DATE ISSUED:	June 21, 2022	
TO:	City Council	
FROM:	Office of the Chief Operating Officer	
SUBJECT:	Proposed Settlement Agreement Involving Acquisition of the 101 Ash Street and Civic Center Plaza Properties	
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Council District(s):	3	

OVERVIEW:
Presented for City Council consideration is a proposed settlement agreement negotiated among the following parties: (a) the City of San Diego; (b) Cisterra Partners, LLC (Cisterra) and its affiliates, as the owner of the 101 Ash Street and Civic Center Plaza (CCP) properties (collectively, Properties); and (c) CGA Capital (CGA) and its affiliates, as the lender for Cisterra's earlier acquisition of the Properties. The settlement proposal stems from extensive mediation sessions managed by retired Magistrate Judge Jan Adler and is memorialized in a proposed Settlement Agreement and Mutual Release (Agreement) (**Attachment 1**) and explained in the City Attorney's accompanying report.

PROPOSED ACTIONS:
Adopt a set of resolutions to:

(1) Approve the Agreement and authorizing the Mayor or designee to sign the Agreement and take all actions and sign all additional documents reasonably necessary to effectuate the Agreement, including the termination of the existing lease-to-own agreements between the City (as tenant) and Cisterra's affiliates (as landlord) for the Properties and the City's acquisition of fee title ownership of the Properties;

(2) Make a finding that the City's actions to resolve the pending disputes with Cisterra and CGA and to acquire fee title ownership of the Properties, including the payment of funds under the Agreement, will achieve numerous public purposes and benefits (see **Attachment 2** for facts in support of this finding);

(3) Authorize the Chief Financial Officer to encumber and expend a total amount not to exceed $132,363,953 from a combination of funding sources, as further described in this report, to consummate the transactions under the Agreement for the City to acquire fee title ownership of the Properties, which total amount includes: (a) the purchase price for the 101 Ash Street property, in an estimated amount of $85,719,063, assuming the closing occurs by the target date of July 11, 2022; (b) the purchase price for the CCP property, in an estimated amount of $46,071,829, comprised of outstanding CCP Loan balance of $46,064,890 and late fees and penalties of $6,939*, assuming the closing occurs by July 11, 2022; (c) a contingent amount of $500,000 for a potential increase in the purchase price for the Properties, as calculated under the Agreement, in the event the closing occurs after July 11, 2022; and (d) title and escrow fees payable by the City to Chicago Title Company in an amount not to exceed $80,000; and

(4) Authorize the Chief Financial Officer to amend the Fiscal Year 2022 Budget to reimburse non-general funds for rent payments and operating costs for 101 Ash in the amount of $11,763,983 from abated rent payments as detailed in the attached resolution.
(5) Authorize the Chief Financial Officer to amend the General Fund Fiscal Year 2023 Budget by $17,407,649, and the Debt Funded General Fund Equipment Fund by $46,064,890 and the Fiscal Year 2023 Capital Improvements Program (CIP) budget appropriations by $73,491,414 as detailed in the attached resolution.

* Late fees and penalties of $6,939 are expected to be funded with existing General Fund appropriations as these costs are not eligible for tax-exempt financing.

DISCUSSION OF ITEM:

Background – CCP

Prior to its attempt to acquire the building, the City was the primary tenant at 1200 Third Avenue (known as Civic Center Plaza and referred to as CCP) for nearly 25 years. The City assumed the rights of the then primary tenant, Bank of America, in 1991. CCP is 265,986 square feet (sf) and provides office space for approximately 850 City employees.

According to staff report #14-073 revised, issued January 20, 2015 (**Attachment A**) the then City management began negotiations to purchase CCP in late 2013; however, this was far too late to fully execute an agreement and secure financing before the lease would expire seven months later. Through many twists and turns, including a change in the recognized ownership control of CCP, and the City recognizing it was unable to issue bonds within the seller's required escrow timeframe due to litigation, negotiations languished.

By the end of 2014, the City's "volunteer broker," Jason Hughes, introduced City officials to Cisterra Partners, LLC, which had created a new entity, CCP 1200, LLC, to serve as a buyer ready to purchase CCP from the current owners and immediately, via a lease purchase agreement, lease it back to the City. This arrangement was the lease-to-own agreement presented to the City Council via report #14-073, dated January 20, 2015 (**Attachment A, previously referenced**), and subsequently executed by the City on March 13, 2015 (**Attachment B**). The City's lease-to-own price of $44 million was based primarily on the sales price between the new entity, CCP 1200, LLC, and the recognized owners of CCP (Chase bank as trustee) and was to be paid over a lease-to-own term of 20 years via a rent payment of $270,000/month or approximately $1.00/sf/month with an annual increase of 2.5%. The lease-to-own agreement with the City included the adjacent property at 201 A Street known as the King-Chavez Community High School (KCCHS). The City has since maintained primary occupancy of the office building and oversight of the sublease to KCCHS (**Attachment C**).

Background – 101 Ash

In fiscal year 2015, during the backdrop of the CCP deal, the City began a review of its downtown office space leases. Through this review, staff identified that almost 49 percent of the City's current leases were scheduled to expire within the next five years. During this time, the City was expanding both Engineering and Capital Projects (formerly known as Public Works) and the Development Services (DSD) Departments and needed more office space. Additionally, the lease at Executive Complex was expiring in 2019 (**Attachment D**). The Executive Complex was undergoing a significant renovation with lease rates expecting to drastically increase upon renewal. It was also accepted at the time that lease rates were increasing steeply in general. In addition to increased space needs, the City Operations Building (COB) which housed DSD needed significant repairs with an estimated capital and maintenance backlog need of $128.9 million, according to a fiscal year 2015 condition assessment (**Attachment E**). Facing increasing lease rates and increasing office space needs, the City looked to reduce its reliance on third party leases and the vulnerability to changing market conditions.

The table below is a snapshot of the City's downtown office space portfolio in 2016.

	Owned		**Lease-to-Own**	**Leased**	
	COB	**CAB**	**CCP**	**525 B St.**	**Executive Complex**
FTEs – Approx.	355.00	426.00	805.00	514.00	459.00
SF – Occupied	143,000	130,000	265,986	116,180	141,889

By moving DSD out of COB, creating a new one-stop customer service permitting center, and relocating City staff out of Executive Complex, a need for approximately 300,000 sf was established. In addition to housing DSD, COB was also the location for the City's Emergency Operations Center (EOC) and Fire Station #1. City staff also began looking for a suitable location for the EOC. Per a May 17, 2018 staff report regarding 101 Ash Street Building Lease and Proposed Tenant Improvements (**Attachment F**), initially there were no office buildings marketed for sale adjacent to the existing Civic Core; however, a 2016 staff report to Council presenting the 101 Ash lease (**Attachment G**) states that in 2015 the owners of 101 Ash approached the City to purchase or enter into a lease-to-own at a price range of approximately $100 million. No agreements were reached.

101 Ash is a 315,456 sf office building, which served as the former headquarters of Sempra Energy and had been primarily vacant since mid-2015, when Sempra Energy moved out. With no other properties for sale adjacent to the Civic Core, and no agreements reached on 101 Ash, City staff began negotiations for a lease at 110 Plaza, commonly referred to as Executive Complex; however, those negotiations fell through as well.

In early 2016, Cisterra, again through Jason Hughes, emerged as the buyer of 101 Ash, and proclaimed to be "under contract" or would be "under contract" pending the City's commitment via a letter of intent (LOI). In July 2016 a non-binding LOI for 101 Ash, with Cisterra (**Attachment H**) was received and signed by Cybele Thompson, the former Real Estate Assets Department Director. The LOI outlined three occupancy options the City could pursue:

1. The City could take an assignment of the Purchase and Sale Agreement (PSA) from Cisterra,
2. The City could enter into a 20-year lease-to-own with Cisterra, or,
3. The City could terminate the LOI and compensate Cisterra for documented and verified unrecovered expenses.

For various reasons, the City chose to pursue option #2. A lease-to-own agreement was negotiated for 101 Ash between 101 Ash, LLC (a Cisterra affiliate) and the Faulconer administration, which was presented to City Council via report #16-070 and adopted by City Council via Ordinance #20745 on November 17, 2016 (**Attachment G, previously referenced**). The lease was fully executed soon thereafter at a purchase price of $72.5 million with an additional $5 million added for tenant improvements (TI). With an effective date of January 3, 2017, the lease-to-own terms called for a fixed monthly rental payment of $534,726.50 or approximately $1.70/sf per month for 20 years.

Based upon the seller's commissioned valuation and various reports regarding the property's condition, primarily suitable only for financing, the condition of 101 Ash was conveyed to City Council as "good and with evidence of on-going maintenance." The $5 million TI allowance was to be used to renovate all floors of the building accommodating approximately 1,100 employees with an anticipated move-in date of July 2017, as stated in the staff report presenting the 101 Ash lease to City Council (**Attachment G, previously referenced**). By April 2017, however, City staff found themselves still developing the project scope and the move-in date was pushed back to 2019. By August 2017, the scope was defined, and plans were submitted to DSD for review. The plans were now much more in depth than originally envisioned and included modifications to plumbing, electrical and HVAC systems, among others. The plans were approved by DSD in October 2017, and by January 2018 the 101 Ash TI Project Request for Proposals (RFP) was posted for bids.

During the Fall of 2017, and while the 101 Ash TI Project RFP was being finalized for bids, the renovation project at the Executive Complex was in full swing. This resulted in deteriorating conditions at Executive Complex where the City had nearly 450 employees working. As a result of these deteriorating conditions the City decided to expedite the work at 101 Ash by requesting a 24/7 work schedule in the RFP. The solicitation closed in February 2018 with two bidders, the lowest responsive bidder at $21.7 million, considerably higher than the $5.0 million allotted.

Following the May 2018 update, staff revised the RFP removing the expedited 24/7 schedule. Bids were received and reviewed in July and presented to City Council in August (**Attachment J**) with the City accepting the lowest responsive bidder to renovate all 19 floors for $17.1 million. The total budget for the 101 Ash TI Project was increased from $5.0 million to $25.9 million and included the renovations to accommodate 1,157 employees as well as "staff time, modular office spaces and other related project costs."

According to the May 2018 update, of the planned improvements of the 19 floors, DSD staff was expected to occupy approximately 40.9 percent of the building with 516 of the 1,157 planned workspaces. As such, about 42.3 percent of the total cost of the tenant improvements were expected to be paid by the enterprise fund, primarily due to the one-stop customer service facility planned for the first floor. As part of the financing plan, the Capital Outlay Fund was used to front approximately $9.5 million in enterprise related costs. The DSD enterprise fund was anticipated to begin repayment of the interfund loan once the tenant improvements were completed, final costs were determined and DSD employees moved into the building.

Additionally, DSD and other special revenue funds paid operating costs and rent to the General Fund based on the expected square footage to be occupied by each department once the tenant improvements were completed. Rent and operating cost payments began after the lease was executed in fall of 2016 and continued through the end of fiscal year 2022. In addition to the authority requested related to this settlement agreement, this action requests authority to appropriate funds and reimburse the DSD enterprise fund and other non-general funds for certain rent and operating costs as described in the fiscal considerations section of this report.

Following City Council approval in August via Resolution No. 311956 (**Attachment K**); in September 2018, the project was awarded to the lowest responsive bidder, West Coast General. Permits were stamped in October and construction began in November 2018 with an expected move-in date of September 2019. As the project progressed, the amount of work identified increased and the move-in date was delayed again, and the first move-ins occurred in December 2019. Within one month, by mid-January 2020, all of the staff that were moved into 101 Ash over the previous four weeks were abruptly moved out when asbestos containing debris was discovered in an occupied conference room.

By March 2020, it became clear to City management that occupancy of 101 Ash would be postponed indefinitely. The City commissioned a "Forensic Review" to determine what occurred. One of the most significant findings was that proper due diligence did not occur prior to acquisition of the building, resulting in failure by the City to fully appreciate the condition and age of the various systems supporting the operations of the building. As a result of these findings, the City commissioned an in-depth Building Condition Assessment (BCA). The publicly-released Forensic Review: Preliminary Report on 101 Ash, prepared by James Parker of the Hugo Parker Law Firm (**Attachment L**), as well as the 101 Ash Building Condition Assessment, prepared by Kitchell (**Attachment M**), were presented to City Council in August 2020. The BCA concluded that most of the buildings systems were many years past their useful life and needed replacement. The BCA also concluded that $26.2 million would be needed to remediate and resolve the asbestos issues. In total, the BCA estimated that $115.0 million in various repairs, full system replacements and asbestos abatement was needed. It is important to note that these estimated costs have likely increased substantially, due to supply chain challenges and inflation resulting from the COVID-19 global pandemic.

101 Ash remains vacant today, and before it could be occupied for regular use, repair or replacement of deficient building systems and remediation of asbestos would need to occur.

Litigation on CCP and 1010 Ash

Beginning on September 1, 2020, and to the present, at the direction of the then Mayor, the City's Chief Financial Officer has withheld the scheduled lease payments due under the lease of the 101 Ash property. Following the withholding of the September lease payment, the mortgage holder on the 101 Ash property, pursuant to an assignment of rights by the lessor, submitted their first Government Code claim to the City for rent ($534,726.50) and related damages. Monthly claims for rent due have been made since September 1, 2020, including monthly notices of default. With authorization from the City Council, the City engaged outside legal counsel, Schwartz Semerdjian Cauley & Evans LLP, and initiated litigation against both the lessor (Cisterra) and lienholder (CGA) to abate rent during the time period the building could not be occupied for its intended purpose.

The City withheld lease payments because it could not occupy the property for its intended purpose. The City Council authorized segregating lease payments in a dedicated, interest-bearing account pending a court-ordered or negotiated resolution.

The Proposed Settlement

The proposed settlement has several components to it and does not include any section 1090 claims or other claims the City or any other entity has or may have against Jason Hughes, his affiliated entities, or yet-to-be-discovered wrongdoers. The proposed settlement also does not include any claims the City has or may have against any contractors who performed work at the 101 Ash building. The parties to this settlement would only be Cisterra and its affiliates, CGA and its affiliates, and the City.

A. Cisterra Repayment of Profit on 101 Ash

Attachment P is a document prepared by Cisterra which reflects an estimation of the closing costs associated with the original 101 Ash lease-to-own transaction. Excluding the proceeds that were paid to Jason Hughes, Cisterra's two principals in the transaction (Steve Black and Jason Wood), profited $7.4525 million from the 101 Ash transaction. As part of the settlement proposal, Cisterra agrees to return this amount to the City, and the City will pay $12.3 million in back rent and $0.96 million in late fees owed under the 101 Ash lease. As further explained below and in **Attachment 2**, this would bring the purchase price for 101 Ash to approximately $65 million, below the $67 million appraisal (**Attachment Q**), received by the City before closing costs and remodeling expenses included in the original transaction. This repayment will occur in two separate installments: the first payment of $2,626,250 will be deposited in escrow and applied for the City's benefit upon the closing for the City's acquisition of the Properties under the Agreement, and the second payment of $4,826,250 will be made directly to the City no later than June 30, 2023.

B. Termination of Existing Lease Agreements and Transfer of Title to City

Upon the closing as envisioned under the Agreement, Cisterra and the City will terminate the existing lease-to-own agreements for the Properties, Cisterra will transfer fee title ownership of the Properties to CGA, CGA will transfer fee title ownership of the Properties to the City, and CGA will acknowledge full repayment of the outstanding loans originally issued in connection with Cisterra's acquisition of the Properties. As part of the settlement, the City will agree to indemnify Cisterra and CGA in all litigation except as described in Section 11.2 of the Agreement. This includes the asbestos lawsuits/claims and related employment whistle-blower claim related to the tenant improvement work at 101 Ash as well as the Gordon case. The City may have insurance coverage for part of the asbestos claims (subject to any applicable insurance coverage limits). The City has retained the Hugo Parker law firm to handle the City's defense of asbestos-related claims.

C. CGA (Lending Group) Concession

1) Waiver of "Yield Maintenance" Fee (Prepayment Penalties)

Under the terms of current lease-to-own agreements, should the City decide to refinance either of the loans in order to reduce the lease payments or to take out Cisterra and/or CGA, there is a provision that requires the City to pay a Yield Maintenance Fee to CGA equivalent to the present value of the lost payment revenue that was otherwise due (essentially a prepayment penalty). This provision makes it uneconomical for the City to ever choose to pay the leases off in their entirety or to refinance them. Based upon a calculation prepared by the City's independent Municipal Advisor, KNN, this would have amounted to a cost to the City of approximately $7.488 million on 101 Ash and $4.219 million on CCP (**Attachment R**). Under the proposed Agreement, CGA has agreed to waive these fees, providing a present value saving to the City of $11.707 million, removing the costly barrier to prepayment.

D. Financing of the City's Acquisition of CCP and 101 Ash

Assuming a closing date for the City's acquisition of the Properties on July 11, 2022, the purchase price amounts for 101 Ash and CCP are estimated at $85.7 million and $46.1 million, respectively. Generally, the purchase price for each Property is equal to the outstanding loan amount owed to CGA under the original transactions, plus certain late fees for delayed or abated rent payments owed under the lease-to-own agreements. The 101 Ash purchase price includes payment of abated rent payments totaling $12.3 million and accrued late payment fees of $0.96 million.

During the course of mediation, the City obtained a restricted appraisal for each Property, as further described in **Attachment 2**. The appraisal for 101 Ash (**Attachment W**) contemplated two scenarios. The first was that the building in its current condition has no value, but indicated that the land has a value of $36-42 million. The second scenario presumes abatement or remediation occur, making the building occupiable, with a value of $82.2-92.8 million**.** The appraisal for CCP (**Attachment X**) identified the land value, if vacant, has a value of $10-15 million and if the building were renovated and stabilized that it would have a value of $87 million. The CCP appraisal ultimately concluded that in its current condition, if the building was owned and occupied by the City that the value is $26-41.6 million. It is important to note that both appraisals were performed under a limited scope and their intended use is restricted only to aiding the City in its mediation.

The funding sources for the City's payment of the purchase price for each property will consist of a combination of: (i) Cisterra's profits from 101 Ash of $7,452,500; (ii) current commercial paper notes (Notes)/ lease revenue bond (Bond) proceeds; (iii) General Fund cash currently unencumbered in the Fiscal Year 2022 Capital Improvements Program (CIP); (iv) General Fund cash recommended for allocation to the CIP in the Fiscal Year 2023 Proposed Budget; and, (v) a portion of the General Fund amounts for the budgeted lease payments for 101 Ash and CCP in the Fiscal Year 2023 Proposed Budget. All General Fund cash recommended to be repurposed from the CIP will be backfilled using current or future Bond and Note proceeds and there will be no impacts to implementation timelines for the projects from which the General Fund cash will be repurposed. Below is a breakdown of the sources of funds for the acquisition of each building.

<u>Funding Sources for $85.7 Million Payment for 101 Ash</u>

After discussions with the City's bond and tax counsel, it has been determined that any use of new or existing Bond proceeds to acquire 101 Ash would have to be done on a taxable basis. This is primarily due to the fact that today, the City cannot reasonably represent that it has the intention of occupying the building for office space for City employees. As such, by using cash from several sources to acquire the building and switching from cash to bond proceeds to fund eligible capital improvements, the City will realize the greatest economic savings. The sources of funds and payoff amounts to acquire 101 Ash are as follows:

Cash Resources Available for Purchase of 101 Ash		
FY 2023 General Fund Budgeted Lease Payments for 101 Ash and CCP*	$	9,955,149
CIP Cash to be converted to Note/Bond Proceeds:	$	68,311,414
Return of Cisterra Profit to be received in FY 2023:	$	7,452,500
Total Cash Resources:	**$**	**85,719,063**
Payoff Amounts for Purchase of 101 Ash Assuming July 11, 2022 Closing		
Principal Outstanding (Excluding Abated Rent Payments):	$	72,456,654
Abated Rent Payments:	$	12,298,710
Accrued Late Payment Fees:	$	963,699
Total Payoff of 101 Ash:	**$**	**85,719,063**
Balance for Acquisition of 101 Ash:	**$**	**-**

* The FY 2023 budget includes a total of $10,276,094 for lease payments for 101 Ash and CCP. This amount of $9,955,149 assumes the July 2022 lease payment for CCP of $320,945 is made on July 1, 2022 and the remaining budget for FY 2023 is available for reallocation to the purchase of 101 Ash.

As described above, the original purchase price for 101 Ash was $72.4 million. Added to the amount financed, was $5 million at the request of the City for renovation work, approximately $2.8 million in closing costs, $7.5 million in profits paid to Cisterra (being returned as part of this settlement), and $4.4 million paid to Jason Hughes (which is not part of this settlement and still subject to recovery by the City). This brought the total amount to be financed to approximately $91.8 million. Had the City continued to make its monthly lease payments for 101 Ash, the outstanding principal balance would have been $72.4 million. The actual amount required as noted above is $85.7 million which includes $12.3 million in back rent owed under the lease as well as associated late fees of approximately $0.96 million.

Attachment S provides a list of CIP annual allocations that will now be funded with tax-exempt Bond/Note proceeds. The projects within the annual allocations recommended for repurposing from cash to tax-exempt Bond/Note proceeds have been carefully reviewed and it has been determined there will be no impact to implementation or construction timelines for these projects.

Funding Sources for $46.1 Million Payment for CCP

Because CCP is already primarily used for a qualified public purpose, CCP can be financed primarily on a tax-exempt basis. In order to expedite the closing process and minimize the costs associated with a new Bond transaction, it is recommended that the City use Notes or Bond proceeds to fund at least 90% or $41.5 million, but up to 100% or $46.1 million of the amount of the CCP acquisition costs. Staff requests contingency authority to fund up to 10% or $4.6 million of the purchase price of CCP with unencumbered cash from the CIP program to fund the King Chavez portion of CCP. The City's commercial paper note counsel is currently conducting analysis on eligibility to fund the King Chavez portion of the CCP purchase with tax-exempt debt. If the analysis determines that the King Chavez portion of the purchase does not qualify for tax-exempt debt, the City will cash fund that portion of the purchase of CCP. Repurposed cash from the CIP will be backfilled using current Bond and Note proceeds and there will be no impacts to implementation timelines for the projects from which the General Fund cash will be repurposed.

The City will then issue Bonds in the 3rd quarter of Fiscal Year 2023 to fully refund the outstanding Notes and reset the General Fund Commercial Paper Program to its authorized $88.5 million capacity. The following table displays the estimated amount of Note/Bond proceeds available for the acquisition of CCP, the full payoff amount for CCP (excluding accrued late fees of $6,939.22 which will be cash funded) and the balance of Note/Bond proceeds remaining for existing projects and equipment.

Note/Bond Proceeds Available for Civic Center Plaza (CCP)		
Estimated Note/Bond Proceeds Available for CIP in July 2022:	$	107,728,000
Total Note/Bond Resources Available:	**$**	**107,728,000**
Payoff Amount for Purchase of CCP Assuming July 11, 2022 Closing		
Principal Outstanding:*,**	$	46,064,890
Total Payoff of CCP:	**$**	**46,064,890**
Balance of Note/Bond Proceeds Remaining for Existing Projects/Equipment:	**$**	**61,663,110**

* In addition to the principal outstanding for CCP of $46,064,889.97, there are accrued late payment fees of $6,939.22 as a result of late payments for the months of July and August 2021 which brings the total payoff amount for CCP to $46,071,829.19. The accrued late payment fees will be cash funded and will not impact the balance of note/bond proceeds remaining for existing projects/equipment.

** Up to 10% or $4.6 million of the outstanding principal may be funded with unencumbered cash from the CIP program related to the King Chavez portion of CCP.

A comparative financial analysis is included in **Attachment T**, which summarizes the impacts of three possible scenarios: 1) Do nothing – leave existing loans in place; 2) Private placement of standalone refinancing with CGA,; or 3) Proposed cash purchase with funding swap and City Bond/Notes Program (with 30-year and 14-year Bond alternatives). Repayment of the outstanding loans using available cash released from CIP and the CP Note funds for 101 Ash, and CCP, respectively, delivers the most optimal results. Please note that if the cash-funded CIP is back-filled with a 30-year Bond issuance, while this option provides for lower annual debt service and more budgetary affordability, the overall amortization costs will be higher compared to issuing a Bond series with a 14-year repayment term.

Strategic use of Bonds and Notes and the ability to directly tap the capital markets for low-cost financing based on the City's ready access and strong credit rating to provide funding for the settlement proposal is both achievable and fiscally sound. Working with the City's Chief Financial Officer, Debt Management, Department of Finance and Engineering and Capital Projects staff have concluded that the CIP funding swaps **will not impact** either the timely funding or the completion of existing or proposed capital improvement projects.

The additional funding required for the settlement payments will, however, accelerate the need for the next general fund backed Bond issuance from current projections. See **Attachments S** and **U** for the cash funded projects and the projects for which the City Council has previously authorized up to $293 million in Bonds and Notes, respectively. Also see **Attachment V** for a breakdown of the projected spend-down of available bond and note proceeds and the projected timing of new Bonds to cover the projects listed in **Attachments S** and **U** and fulfilling settlement payments. In summary, to accommodate the proposed funding plan for the two properties as well fulfill the ongoing needs of the City's existing CIP funding commitments, the next anticipated Bond offering is necessary to occur in the 3rd Quarter of Fiscal Year 2023.

E. Jason Hughes

It is important to note that Jason Hughes is ***not*** a part of the proposed settlement. The City and any other entity still have full rights to pursue any and all civil and/or criminal action against Hughes and his firm Hughes Marino. The $9.484 million he received on both transactions as the City's "volunteer broker" may still be recovered by the City in the civil litigation and the District Attorney can pursue criminal charges.

BENEFITS OF APPROVING THIS PROPOSED SETTLEMENT

To substantiate that the City is receiving adequate consideration under the Agreement, the City Council will be asked to make a finding in the accompanying resolution that the City's actions to resolve the pending disputes with Cisterra and CGA and to acquire fee title ownership of the Properties, including the payment of funds under the Agreement, will achieve numerous public purposes and benefits. Factual support for this finding is set forth below and in **Attachment 2**, previously referenced.

Council will need to decide whether to approve the proposed Agreement settling the dispute with Cisterra and CGA or continue down the path of litigation. Continuing to pursue litigation brings uncertainty and could take years to be resolved; whereas approving this settlement agreement will put an end to a substantial portion of litigation that has been an ugly chapter in the City's history and provide the City with the certainty to focus on other big projects and needs we are facing.

Even if the City were to litigate and win in court, there are potential negative operational and financial consequences to the City. Should the leases be invalidated under the City's section 1090 litigation, the City would seek the repayment ("claw-back") from the lienholder/lessor of all lease payments made by the City pursuant to the void leases. There is no guarantee how much the City would recover, if anything, especially for CCP which the City has occupied during the entire time of the lease to own agreement. Also, should the City win its case, the operational and financial implications differ for each building.

CCP

City staff currently occupies the building and has done so for over 30 years. If the City prevails on its section 1090 case and the lease is void, several scenarios could unfold, which we believe could include, but are not limited to:

1. **City Staff Being Evicted:** Cisterra and/or CGA could decide they no longer wish to do business with the City and refuse to lease or sell CCP to the City. This would require nearly 800 employees and related equipment to relocate into other City owned or leased office space.

2. **New Lease & New Terms:** The City and Cisterra or CGA could enter into a new lease where the City is a tenant with no intention on purchasing the building. Under this scenario, the City and Cisterra or CGA would have to come to terms regarding an agreeable rent, which could result in a substantial increase to the then market rate. If reasonable terms cannot be reached, the City would have to relocate staff into other City owned or leased office space.

3. **New Lease/Purchase & New Terms:** The City and Cisterra or CGA could enter into a new lease/purchase at the then "current" market value, which could result in a substantial increase. While case law suggests claw-back is allowed, at least to the point the City knew of Hughes getting paid, there is still a question as to how much the City might claw-back since the City has had full use of the building during the time of the invalidated lease. The issue of claw-back regarding any of the other scenarios would also remain in question given the City's use of the building.

4. **New Lease with Original Terms:** The City and Cisterra or CGA[1] could enter into a new valid lease/purchase agreement at the original purchase price with all past payments being appropriately applied towards principal and interest. This is an extremely unlikely outcome following years of costly litigation between the parties.

Again, under any of these scenarios, there is a question as to whether or not the City would be entitled to recover any portion of its lease payments since the City has had full use of the building since the inception of the lease and throughout the litigation.

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[1] CGA, as the primary security interest holder, could foreclose upon Cisterra for its own default or the City's default on CCP or 101 Ash.

101 Ash
The scenarios for 101 Ash are different than CCP, with their own implications. These could include, but are not limited to:

1. **Walk Away with Liability Expenses:** The City could walk away from the transaction and return the building to Cisterra. If this is the City's decision, it is likely that the City will still have a level of financial responsibility to remediate the building, which could range from $15 million to $115 million, and the City would have nothing to show for this expenditure. The cost estimates were provided in August of 2020 and the summer of 2021 and are likely to have increased substantially, primarily due to the COVID-19 global pandemic which has created significant challenges to the supply chain and inflation. The bullets below lay out questions related to the range in remediation costs of $15 to $115 million:
    a. *Is there any contamination to any of the mechanical equipment/airducts caused by the asbestos?* While the systems may have outlived their useful life, the courts may have to determine if the system(s) are contaminated and if the City would be responsible for replacing them. A cost estimate to fully remediate the building, including removing the asbestos and replacing all of the major systems is between $85 million and $115 million.
    b. *Does the City only have to encapsulate the asbestos, or does it have to remove it altogether?* This is estimated to cost between $15 to $25 million for the respective options.
    c. *How much insurance or third-party recovery, if any, is there to help offset these costs?* Estimates are as high as $20 to $30 million; however, unless an insurance company agrees to pay the maximum amount of coverage, the final amount may need to be litigated.

2. **New Lease with Original Terms & Liability Expenses:** The City and Cisterra or CGA could enter into a new valid lease/purchase agreement at the original purchase price with all past payments being appropriately applied towards principal. The City would still have an uncertain level of financial obligation to remediate, either to occupy, to lease to a third party, sell, or to scrape and rebuild to redevelop on the land.

3. **Claw-Back with Liability Expenses:** The City could attempt to claw-back all previous lease/purchase payments, which total $23,527,966 as of December 31, 2021. A City victory in the section 1090 case does not automatically mean the City would be entitled to all or some of the lease payments made as the payments were made to CGA and not to Cisterra. Under this scenario, the City still has questions regarding the level of financial commitment for remediation that would be required to occupy, lease to a third party, sell, or to scrape and rebuild/redevelop.

While the City is in a much better position should it win its lawsuit, it is not without some level of operational and financial exposure to the City and, in the end, the City would not own either asset. Additionally, the litigation will be very costly and take several years to resolve. This prevents the City from having certainty over the future and restricts the City from determining the best use of its owned buildings, how to optimize its leased spaces, and inhibits the City to meaningfully consider options for redevelopment of its assets in this area and to create positive transformational change. With the State having plans to redevelop adjacent blocks and SANDAG pursuing potential locations for the development of a downtown mobility hub, the City is uniquely positioned to influence and participate in the redevelopment of our downtown core. Not having certainty for many years to come on the potential use and ownership of two of the City's largest buildings, would sideline the City from being a part of these opportunities and the opportunity to contribute to creating additional affordable housing for San Diegans. The current Civic Core properties (CAB, CCP, the Parkade, the Concourse, etc.) are not a positive reflection of the eighth largest city in the country. In addition, the City cannot wait another eight to ten years to decide what to do with COB (as previously discussed) and CAB, which serves as our City Hall. CAB has mechanical and plumbing problems that may become irreparable and, according to a 2015 condition assessment (**Attachment O**), the capital and maintenance backlog need was estimated to be

$69.7 million with this number only having increased in the last seven years. Further, redevelopment occurring all around these assets will likely only increase future rental values; consequently, if the City does have to renegotiate its lease rates, or secure other downtown office leases, it will likely be at a much higher rate.

POTENTIAL NEXT STEPS

If Council approves the proposed settlement, it preserves options for the City as to what to do with the Civic Core as we would have ownership of CCP and the adjacent 101 Ash parcel, which may include:

1. **Tear down the Ash building and redevelop the property.** The City would have some remediation options that would need to be determined prior to demolition. It could opt to demolish 101 Ash and redevelop the parcel or sell the then vacant parcel for redevelopment.

2. **Redevelop the properties as part of a larger plan.** This would still require some level of remediation prior to demolition. A large-scale redevelopment project for the area could be contemplated for the Civic Core, which includes CAB, CCP, the Concourse, the Evan B. Jones Parkade, Civic Theatre, Downtown Johnny Brown's and could also include the adjacent COB and 101 Ash parcels to allow for better phasing of a large development project. This could be done in conjunction or in partnership with other redevelopment projects that the State and SANDAG are contemplating in the area. This also creates the opportunity for the City to increase the amount of affordable housing being developed for San Diegans as this would be a programmatic requirement of a large mixed-use development project.

3. **Sell the building in as-is condition.** Given the known asbestos and remediation requirements, the value of the 101 Ash building is virtually zero; however, the land does have value, especially with other agencies contemplating redevelopment projects in the area.

4. **Remediate the building to the full extent and lease-out or sell.** This option would include removing all of the asbestos and replacing all systems, making it into a quality facility for the City to lease or sell to a third party to occupy.

5. **Remediate the building to the full extent and occupy it.** This option would include removing all of the asbestos and replacing all systems, making it into a quality facility for City staff to occupy.

The opportunity to control the assets in and around the Civic Core for redevelopment purposes provides the City with opportunities to reimagine the area that is long overdue. There are many options for the City to pursue. Upon approval and execution of the Agreement, City leadership will work with the Office of the Independent Budget Analyst and will return to the City Council within one year with an update and information on which options the City may wish to pursue.

CONCLUSION

Through the proposed settlement, the City will recover $7.4525 million from Cisterra and save approximately $11.707 million in Yield Maintenance fees being waived by CGA. In addition, the City still preserves the opportunity to pursue legal claims against Jason Hughes and possibly recover an additional $9.484 million, as well as legal claims against contractors who performed work at 101 Ash. Therefore, City staff is recommending approval of the proposed Agreement in order to save the City years of costly litigation, with an uncertain future. By settling the litigation with Cisterra and CGA now, the City will gain control of two downtown sites and will be able to determine how to optimize them and consider redevelopment opportunities for the Civic Core that results in positive transformational change for our City and its residents.

<u>City of San Diego Strategic Plan:</u>

This item relates to the City's Strategic Plan Operating Principles of Trust & Transparency by providing information and data to the City Council to make better informed decisions and build trust with the public.

Fiscal Considerations:
While the lease-to-own agreements are being terminated as part of the proposed Agreement, the proposed settlement can be viewed from a purely financial standpoint as a refinancing of the existing lease-to-own obligations for both CCP and 101 Ash by primarily issuing lease revenue bonds. While 101 Ash is being cash purchased, financing the cash-funded CIPs with lease revenue bonds to allow for the purchase of 101 Ash, replaces one debt obligation with another. Given recent volatility in interest rates and based on the eventual timing and structure of the bond issuances, debt service saving targets as recommended per the City's Debt Policy may not be met; however, as discussed above, there are other benefits that justify the refinancing (see **Attachment T**). The settlement will avoid significant prepayment penalties built into both lease-to-own agreements if City was to try to refinance as-is under those agreements. For reference, an estimate completed in January 2022, projected the prepayment penalty avoided would be $4.2 million for CCP and $7.5 million for 101 Ash. Additionally, upon completion of the proposed settlement the City will own both properties outright and will be released from covenants dictating use and occupancy terms within the existing leases. Continuing operations and maintenance obligations will be at the sole discretion of the City. The proposed settlement would also result in General Fund budgetary savings in Fiscal Year 2023, as there are currently capital lease payments of $9.955 million, for CCP and 101 Ash, included in the Fiscal Year 2023 Proposed Budget which is anticipated to be used as a funding source for the 101 Ash acquisition.

CCP Purchase:
The impact of the CCP purchase by using Commercial Paper proceeds will be to accelerate the need to issue lease revenue bonds sooner than previously anticipated and as depicted in **Attachment V**. As mentioned above this is not expected to impact the availability of funding for, or the completion of the City's other ongoing CIP needs. Assuming CCP is fully funded with tax exempt Bond and Note proceeds, the current estimated annual debt service payment related to the CCP purchase is $4.4 million and would be structured as level payments to mature the same year (2035) as the existing lease. Based on further discussion with tax counsel and City's future cashflow needs, the restructuring could provide the City flexibility to extend the term thus lowering the annual payments. However, keeping like maturities (no extension) is staff's recommended approach. Because the CCP lease is currently structured to increase by 2.5% each year (as opposed to level debt service) it is helpful to compare total debt service (principal and interest) of the take-out bonds with the total remaining lease payments, which based on current rates are $59 million and $57.7 million, respectively. Also of note, the use of CP Notes, as bridge financing to the bonds, would incur interest costs. For example, assuming 'take-out' bonds are issued in January 2023 to cover the CCP purchase, an estimated $325,000 in CP interest payments would be incurred in the interim 6 months from settlement closing.

101 Ash Purchase:
The 101 Ash settlement anticipates financing certain CIP-projects, that are currently cash-funded to allow for the cash purchase of 101 Ash of $68.3 million. Assuming these CIP projects are ultimately funded with 30-year tax exempt bonds, as would be customary for CIP financing, the average annual debt service would be approximately $4.1 million versus annual lease payments of $6.4 million. This is based on interest rate assumptions as of June 2022 and represents annual budgetary savings of approximately $2.3 million per year during the remaining term of the lease. However, the total debt service over the life of the CIP bonds is estimated to be $123 million versus total remaining lease payments of $92.5 million.

General Fund Cash from Capital Improvement Program (CIP) for 101 Ash and CCP Purchase:

The maximum amount of General Fund cash to be converted to Note/Bond is $73.5 million for the purposes of (i) funding a portion of the 101 Ash Street Purchase, (ii) up to 10% of the CCP purchase price related to the King Chavez school, (iii) contingency for a closing date on the purchases after July 11, 2022, and (iv) title and escrow fees. The following table provides detail on each of these amounts.

Maximum General Fund Cash in CIP to be Converted to Note/Bond Proceeds		
101 Ash Purchase:*	$	68,311,414
CCP Purchase:**	$	4,600,000
Contingency for Closing Date After July 11, 2022:***	$	500,000
Title and Escrow Fees:	$	80,000
Total Cash Resources:	**$**	**73,491,414**

* The remainder of the $85.7 million purchase of 101 Ash will be funded with a combination of FY 2023 budget lease payments for 101 Ash and CCP and returned profits from Cisterra related to 101 Ash.

** Up to 10% or $4.6 million of the outstanding principal may be funded with unencumbered cash from the CIP program related to the King Chavez portion of CCP.

*** The purchase prices for both 101 Ash and CCP assume a closing date of July 11, 2022. If the closing date extends beyond July 11, 2022, the City will pay a per diem fee of $7,050.43 for 101 Ash and $4,350.57 for CCP.

Attachment S provides a list of CIP annual allocations that will now be funded with tax-exempt Bond/Note proceeds. The projects within the annual allocations recommended for repurposing from cash to tax-exempt Bond/Note proceeds have been carefully reviewed and it has been determined there will be no impact to implementation or construction timelines for these projects.

Reimbursement of 101 Ash Rent and Operating Costs:

Since inception of the 101 Ash lease-to-own agreement, DSD and other non-general funds have contributed towards rent and operating costs based on the anticipated square footage each department would occupy upon move-in. Rent and operating cost payments began after the lease was executed in fall of 2016 and continued through the end of Fiscal Year 2022. Similar to how a business is required to pay rent while it prepares office space for use prior to move-in, these funds contributed towards the monthly lease payments of 101 Ash while tenant improvements were underway. However, since these departments were not able to occupy the building and all construction work has halted, staff recommends that rent and operating costs paid after the move-out date of January 17, 2020 be reimbursed. The table below reflects the total payments made after the move-out date by DSD and other non-general funds on January 17, 2020 and occupancy of 101 Ash was postponed indefinitely.

Non-General Fund Payments After Move-Out of 101 Ash Street			
Fund	**Fund Name**	**Total Jan. 17, 2020 to June 30, 2022**	
200001	Facilities Financing Fund	$	375,517
200205	Transient Occupancy fund	$	268,562
200217	Underground Surcharge Fund	$	436,282
200224	Energy Conservation Program Fund	$	1,024,376
200226	Local Enforcement Agency Fund	$	132,277
200308	Information Technology Fund	$	1,189,788
700036	Development Services Fund	$	10,269,373
720057	Engineering & Capital Projects Fund	$	171,014
	Total:	**$**	**13,867,189**

This action is requesting authority to appropriate the entire $11.8 million of the abated rent payments set-aside in a separate fund as of June 30, 2022 and to return $2.1 million of rent payments made by DSD and other non-general funds during FY 2022 for a total reimbursement of rent payments and operating costs of $13.9 million that occurred between January 17, 2020 and June 30, 2022. The following table reflects the resources available to reimburse non-general funds.

Sources Available for Non-General Fund Lease Payements and Operating Expenses		
Abated Rent Payments Set Aside Available on June 30, 2022:	$	11,763,983
Reimbursement of Rent and Operating Costs received by the General Fund in FY 2022	$	2,103,206
Total Sources:	**$**	**13,867,189**
Non-General Lease Payments and Operating Expenses		
Non-General Fund Payments after move out of 101 Ash (Jan. 17, 2020 to June 30, 2022)	$	13,867,189
Total Expenses:	**$**	**13,867,189**
Balance of Non-General Fund Lease Payments and Operating Expenses:	**$**	**-**

Charter Section 225 Disclosure of Business Interests:
Disclosure information provided by Cisterra: Three Cisterra entities are included among the parties to the Agreement. With respect to two of those entities, CCP 1200, LLC and 101 Ash, LLC, the beneficial equity ownership is held 82 percent by Steven L. Black and 18 percent by Jason Wood. With respect to the third entity, Cisterra Partners, LLC, the beneficial equity ownership is held 100 percent by Steven L. Black. Neither the Cisterra entities nor any of their principals will be entitled to any payment or distribution of City funds under the Agreement.

Disclosure information provided by CGA/Wilmington Trust: CGA Capital, LLC ("CGA") is a limited liability company that acts as the servicer of the loans issued to Cisterra for Cisterra's initial acquisition of the Properties ("Loans"). To establish a lender entity for the Loans, CGA formed trusts ("Lender Trusts"), all of which are held by entities (not by individuals) which are "Qualified Purchasers" or "Qualified Institutional Buyers" as defined under federal securities laws and regulations. The trustee of the Lender Trusts is Wilmington Trust, National Association, which is a national banking association and a subsidiary of M&T Bank Corporation, a publicly traded company listed on the New York Stock Exchange under the ticker MTB. (Note that Charter section 225 does not apply to a publicly traded company listed on a stock exchange.) The Loans are principally secured by first lien deeds of trust on the Properties and priority first lien absolute assignments of all leases and rents associated with the Properties. CGA is not an indirect or direct owner of the Properties. Neither CGA nor any affiliate, owner, officer, or employee of CGA will receive more than 10 percent of the purchase price proceeds from the sale of either of the Properties, directly or indirectly. In addition, to the best of CGA's knowledge, no individual who is an officer, director, employee of, or otherwise affiliated with the Lender Trusts or with any institution holding an interest in the Lender Trusts will receive greater than 10 percent of the purchase price proceeds from the sale of either of the Properties. Instead, the purchase price proceeds will be used to prepay the outstanding balance of the Loans.

Environmental Impact:
This activity, the approval of a proposed settlement, is not a project pursuant to CEQA Guidelines Section 15378(b)(5), as it is an organizational or administrative activity of government that will not result in direct or indirect physical changes in the environment. The settlement agreement would result in the City's acquisition of two downtown properties already improved with buildings, but would not result in any physical changes to the properties or any related improvements without further additional City actions in the future that are neither known nor reasonably foreseeable at this time. As such, this activity is not subject to CEQA pursuant to CEQA Guidelines Section 15060(c)(3). Pursuant to CEQA Guidelines Section 15352(a), approval of this proposed settlement does not constitute approval of any future projects. Any future projects on the subject properties would be subject to environmental review in accordance with the City's Land Development Code and CEQA.

Climate Action Plan Implementation:
N/A – Does not have a connection to the CAP.

Equal Opportunity Contracting Information (if applicable):
N/A

Previous Council and/or Committee Actions:
Previous Council and/or Committee Actions were referenced in the Discussion and staff reports attached as listed below.

Planning Commission Action:
N/A

Key Stakeholders and Community Outreach Efforts:
N/A

Attachments

Attachment 1:	Proposed Settlement Agreement and Mutual Release
Attachment 2:	Public Purposes and Benefits of Settlement Agreement
Attachment A:	CCP Staff Report #14-073 Revised, issued January 20, 2015
Attachment B:	CCP Lease (executed March 13, 2015)
Attachment C:	Sublease with King -Chavez Community High School
Attachment D:	Executive Complex Lease
Attachment E:	2015 COB Condition Assessment
Attachment F:	May 17, 2018 staff report regarding 101 Ash Street Building Lease and Proposed Tenant Improvements
Attachment G:	2016 Staff Report and Lease for 101 Ash
Attachment H:	LOI for 101 Ash, dated July 2016
Attachment I:	[intentionally omitted]
Attachment J:	2018 Staff Report – 101 Ash TI Project Selection, dated July 31, 2018
Attachment K:	Resolution No. 311956, dated August 2018
Attachment L:	Forensic Review: Preliminary Report on 101 Ash (prepared by Hugo Parker Law Firm)
Attachment M:	101 Ash Building Condition Assessment (prepared by Kitchell)
Attachment N:	Jason Hughes Letter, dated Nov. 19, 2014
Attachment O:	CAB 2015 Condition Assessment
Attachment P:	Cisterra's estimated "closing statement"
Attachment Q:	2016 Appraisal of 101 Ash
Attachment R:	Calculation of Value of Yield Maintenance Fee Waiver and Potential Refinancing Saving
Attachment S:	FY 2022 and FY 2023 Capital Improvement Program (CIP) Recommended Funding Source Adjustments
Attachment T:	Comparative Financial Analysis of 101 Ash-CCP Purchases
Attachment U:	$293 Million Appropriation Authorization Project List
Attachment V:	Projected Uses for Existing Bond Proceeds and Commercial Paper Notes
Attachment W:	2022 Restricted Appraisal of 101 Ash
Attachment X:	2022 Restricted Appraisal of CCP

Penny Mauser

Penny Maus, Director, Real Estate and Airport Management

Jay M. Goldstone

Jay Goldstone, Chief Operating Officer