THE CITY OF SAN DIEGO

OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

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Analysis of the Existing Stadium Site Appraisal

OVERVIEW

On October 8, 2019, an appraisal of the Existing Stadium Site was released by the Real Estate Assets Department. This appraisal, conducted based upon the joint instructions of both the City and San Diego State University (SDSU), arrived at a fair market value for the site of $68.2 million. However, this appraisal, per the terms of Measure G, is based on the assumption that the property would be sold to an independent third party in a market-based transaction (unrelated to SDSU or its proposed development project), and did not fully incorporate SDSU's development commitments under Measure G. One of the main conditions of Measure G is that the City will not incur the costs for the development of the River Park or the demolition of the current stadium. However, deductions for those costs are included in the current appraisal. Removing these deductions would bring the fair market value up to $86.2 million, prior to any potential indexing of costs to bring the appraisal from a 2017 value to a 2020 value when the transaction is expected to be executed. It is fair and consistent with the terms of Measure G for the City to consider various factors, including adjustments, deductions and equities, in arriving at a negotiated purchase price for the property that not only takes into account the appraised fair market value of the site, but also implements the provisions of Measure G. It will ultimately be up to the City Council to determine whether the transaction, including the purchase price, is fair and equitable and in the public interest.

BACKGROUND

Following the departure of the Chargers from what at that time was Qualcomm Stadium, there were competing initiatives that sought to secure development rights for the Existing Stadium Site, also known as SDCCU Stadium. In November 2018, local voters passed Measure G, a citizens' initiative, which required among other things for the City to exclusively negotiate with SDSU on the sale of the Existing Stadium Site. The final terms of the sale, per the measure, must be deemed by the City Council to be fair and equitable and in the public interest. Of the 135 acres within the appraised site, the City's General Fund owns 85 acres (63% of the land area) and the City's Water

Utility Fund owns 50 acres (37%). **It should be noted that all revenue derived from the sale of this property will be used for the benefit of public capital improvement projects and reduce costs for water utility ratepayers.**

Since the passage of that citizens' initiative, City staff and SDSU staff have been meeting on a frequent basis (typically at least once per week) exchanging information and working out various terms and conditions of the sale prior to the appraisal and the release of a draft environmental impact report. The City has not yet received a bona fide purchase offer from SDSU for the site.

In early negotiations, appraisal instructions were drafted for an independent appraiser to develop an initial Fair Market Value of the property. These instructions, which were mutually agreed upon by both City staff and SDSU staff, directed the appraiser to conduct an appraisal that reflects the residual value of a hypothetical third-party market-rate project. In particular, the appraisal assumed that a private buyer would be acquiring the property and developing it to its highest and best use. It is important to note that the appraisal does **not** consider the development as generally described in Measure G or as outlined in the SDSU Mission Valley draft environmental impact report. Further, per the measure, the appraisal was to consider the value of the property prior to the implementation of the initiative, which imposed a starting valuation date of September 30, 2017.

Finally, Measure G, as a citizens' initiative, directly expresses the will of the voters of the City of San Diego. This initiative was not placed on the ballot by the City or SDSU, but rather this initiative was drafted and placed on the ballot by independent proponents who desired to see certain objectives accomplished through the subsequent approval of the initiative by the voters. Appropriately, the City had no role in its development. The measure also required that, if approved by the voters, the language in the initiative would be incorporated into the Municipal Code. In keeping with this measure, the City Council amended Section 22.0908 into the Municipal Code in January 2019. As such, the City, by adhering to the terms of Measure G, is adhering to the terms that were publicly presented to and ultimately approved by the citizens of the City and which are now in the City's Municipal Code.

Our office has been receiving briefings from various members of the City's negotiating team, including both Mayoral staff and representatives from the City Attorney's office, on a biweekly basis since the beginning of the negotiations. Our office appreciates City staff keeping us appraised of the negotiations as they have moved forward over the last year.

FISCAL AND POLICY DISCUSSION

Appraisal Methodology

The appraisal report arrives at a September 2017 fair market value of the existing stadium site of $68.2 million. This estimate was arrived at using a discounted cash flow methodology, which begins by estimating the revenues that could be derived from the property once it is developed to its highest and best use. This methodology then deducts the costs that a developer would be required to incur to bring that property up to its highest and best use. Further, this methodology analyzes the revenues and expenses from the property over a specified amount of time (in this case, 14 years) and brings all costs back to a value as of September 30, 2017. All of these steps would typically be done in any commercial appraisal.

The appraisal deductions, totaling $256.2 million, include estimated costs to improve the property to its highest and best use. The largest deduction is for construction costs to build out the property, referred to as on-site costs, of $133.9 million. These costs include basic construction activities, such as utility improvements, site preparation, and general site improvements, and are based upon estimates provided by SDSU and the contractor, Clark Construction. All of these estimates would typically be included in a normal, market-based appraisal.

Other major deductions are for work outside of the typical construction required for such a site, and include the following:

- Foundation costs ($32.7 million): these costs are allowed for deep soil construction work that will be required due to the soils present on the site and their proximity to the river and other groundwater sources.
- Off-site improvement costs ($36.1 million): these are costs to improve the transportation network surrounding the Existing Stadium Site and are based upon a previous environmental impact report for a similar development on that site.
- Entitlement expenses ($8.0 million): these are the land use entitlement costs that will be borne by SDSU while they are preparing the site for development.
- Floodway elevation remediation ($6.0 million): these costs are included because a portion of the site will need to be raised out of the floodway. This, however, does not include any costs that might be borne for remediation of Murphy Canyon Creek.

Our understanding at this time is that the City's negotiating team will likely agree the four above-mentioned deductions are proper. However, with respect to the off-site improvement costs, the City has not yet received SDSU's purchase offer and therefore cannot determine, for example, if SDSU is providing off-site improvements of a total value that approximates what the appraiser assumed in formulating the $36.1 million deduction.

Table 1: Appraiser's Deductions in Arriving at Appraised Fair Market Value

Likely Agreed-Upon Deductions	**Initial Future Value**
On-Site Costs	$133,912,565
Allowance for Foundation Costs	32,746,385
Off-site Costs	36,111,082
Entitlement Costs	8,000,000
Remediate Floodway Elevation	6,018,479
Subtotal	*$216,788,511*
Other Deductions	**Initial Future Value**
River Park Construction	$25,947,330
Stadium Demolition	10,481,111
River Park Maintenance	3,026,931
Subtotal	*$39,455,372*
Total Deductions	**$256,243,883**

Stadium Demolition and River Park Costs

In arriving at the fair market value, the appraiser included deductions for the demolition of the current stadium as well as the construction and maintenance of the River Park. These deductions were made based on the approved methodology of the appraisal per Measure G, which was to consider the property as of September 2017 and value it as if the property would be bought and developed by a private third party. If the property were being developed by a third party, in order to achieve the revenue assumptions included in the appraisal, that developer would have to demolish the current stadium and develop the River Park as necessary conditions of developing the property. Thus, these deductions are typically included in a normal, market based appraisal.

The Voters' Expectations, as Prescribed in Measure G and the Municipal Code:

§22.0908(a): "Such sale shall be at such price and upon such terms and the Council shall deem to be fair and equitable and in the public interest; and the City may fairly consider various factors, including but not limited to: adjustments, deductions, and equities in arriving at a Fair Market Value."

§22.0908(i): "…River Park improvements shall be made at no cost to the City General Fund…"

§22.0908(n): "Such sale, upon completion, shall ensure that the City does not pay for any stadium rehabilitation costs, stadium demolition or removal costs, [or] stadium cost overruns…"

However, since this sale is being controlled by the terms of Measure G, this is not a normal, market-based sale. Measure G contains terms, which are now codified into the Municipal Code, which the City must consider, concerning the River Park and the stadium demolition. Municipal Code Section 22.0908(i) states "…River Park improvements shall be made at no cost to the City General Fund…", while Section 22.0908(n) states "Such sale, upon completion, shall ensure that the City does not pay for any stadium rehabilitation costs, stadium demolition or removal costs, [or] stadium cost overruns…".

Further, during a meeting of the City Council Environment Committee from March 14, SDSU stated that it intends to pay for the costs to both build and maintain the River Park, while also noting that maintenance of the park is still subject to negotiations. Under this condition, deducting the costs for maintenance of the River Park would also cause the City to incur those costs, similar to the park development and stadium demolition costs.

Based on the opinion of the appraiser, "if the City accepts the fair market value as the purchase price, [the City] will, in effect be paying for the demolition and River Park improvements as an off-set to the purchase price."[1] Thus, in order for the City to not incur the costs of the River Park development and the stadium demolition, and to avoid a conflict with the Municipal Code, the City Council should not accept the fair market value as presented in the appraisal, and should instead remove the River Park and stadium demolition cost deductions to arrive at an appropriate fair market value purchase price that implements the provisions of Measure G and related campaign promises.

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[1] From an email from Dave Davis to members of the negotiating team from October 8th, 2019.

In summary, based on the language contained in Measure G and the Municipal Code, as well as the statements and promises made by either SDSU or the proponents of Measure G, we believe it is the expectation of the voters that the City not incur the costs of these activities. However, the Municipal Code also states, in Section 22.0908(a), "Such sale shall be at such price and upon such terms as the Council shall deem to be fair and equitable and in the public interest; and the City may fairly consider various factors, including but not limited to: adjustments, deductions, and equities in arriving at a Fair Market Value." Thus, it is ultimately up to the City Council to determine what is a fair and equitable purchase price for the property.

In order to properly adjust the fair market value cited in the appraisal to conform to Measure G and this unique transaction with SDSU as the stipulated buyer, the aforementioned costs for the River Park and stadium demolition must be added back as shown in Table 2. It is important to note that because these costs will be incurred in the future they need to be discounted back to an appropriate 2017 value cost. In other words, while the actual cost of these three expenses is estimated to be $39.5 million in future dollars, the recommended add back for these expenses has a 2017 value of approximately $18.0 million as shown in the table below.

Table 2: 2017 Value of Potential Additions

	Sept. 2017 Value
Initial Fair Market Value (Rounded)	**$68,200,000**
Potential Additions to Value	
River Park Development	$12,291,655
Stadium Demolition	4,970,094
River Park Maintenance	784,902
Potential Additions Total	*$18,046,651*
Total	**$86,246,651**

Indexing the Costs

The City believes the appraisal should be reasonably adjusted by an appropriate factor to bring the 2017 valuation current to a 2020 value, or subsequent year value depending on the closing date. Per the terms of Measure G, the appraisal was to be set to a September 2017 date, as that was the date that the initiative petition was initially circulated for signature. Because of this provision, everything included in the appraisal is indexed to 2017 dollars and prices. Since the closing date of the transaction will be sometime in 2020 or thereafter, the City asked the appraiser for an indexing value that would bring the valuation of the property up to current dollars in 2020, or any subsequent year when the transaction might close. The appraiser advised that a factor of 2.149% could be reasonably used on an annual basis.[2] This could potentially bring the initial fair market value price up from $68.2 million to $72.7 million, assuming a September 2020 closing date, or the integrated price of $86.2 million up to $91.9 million, again assuming a September 2020 closing date.

[2] Our original report utilized an annual rate of 6.59% as calculated by the City's appraiser. However, after publication, our office was advised that the appraisal presented a cumulative three-year rate, rather than an annual rate as requested by the City Real Estate Assets Department. Our revised report reflects this change.

When considering an indexing factor, it is important to consider that approximately 37% of the property is owned by the Water Utility Fund, and thus by the ratepayers who pay for the City's water and sewer system. Selling or discounting this property at 2017 prices in 2020 or thereafter could expose the City to a legal challenge since this would potentially be limiting the value that should be obtained for the ratepayers. Whether or not such an index is included, as well as the closing date and process for the transaction, should be subject to the negotiations between the City and SDSU.

Table 3: Potential Impacts for Indexing Fair Market Value*

	Sept. 2017 Non-Indexed Value	Sept. 2020 Indexed Value
Initial Fair Market Value	$68,200,000	$72,692,019
Potential Fair Market Value	$86,246,651	$91,927,320

*Utilizing an index factor of 2.149% each year, and assuming a 2020 closing date.

Other Contingencies

The appraisal also did not include certain costs or considerations. For example, while the appraisal assumes that SDSU will purchase Murphy Canyon Creek, there is no deduction taken for any remediation that would need to be addressed in the creek itself; however, Measure G states that SDSU must mitigate drainage and hydrology impacts, such that allowing a deduction in SDSU's favor for those costs may be improper. Further, the appraisal did not consider the historical existence of environmental contamination at the site, nor did it consider any easements or impacts from future projects related to the City's Pure Water program that may take place on the site.

These considerations, as well as other considerations that could arise from the development, will continue to be subject to the ongoing negotiations between the City and SDSU. It is fair to assume that these considerations will also have a value placed on them, and as such, the above negotiable deductions should be considered in light of any other considerations given to the City by SDSU. It is premature to calculate the value of those considerations in the absence of an offer from SDSU.

CONCLUSION

The terms of the citizens' initiative and public commitments made by Measure G proponents prior to the election are the guiding terms for both the City and SDSU in their negotiations over the Existing Stadium Site. While the appraisal arrived at a fair market value for the property, this appraisal was based on a set of instructions which placed a value on a hypothetical, market-based transaction, and asked the appraiser to identify the deductions related to stadium demolition, the River Park, and other development costs for purposes of allowing the parties to negotiate a fair and equitable purchase price. Measure G is clear that the cost for these activities should not be incurred by the City, and as such, they should not necessarily be deducted from the purchase price of the Existing Stadium Site. **While the appraisal did state an initial fair market value of $68.2 million, given the terms of Measure G, which is the express intent of the voters through the citizens' initiative, it is justifiable that the actual fair market value for this unique transaction is $86.2 million. Additionally, the actual fair market value could reasonably be determined to be as high as $91.9 million, assuming a 2020 closing date with the appropriate indexing.**

Ultimately, it will be up to the City Council to determine whether the final terms are fair and equitable and in the public interest, as well as consistent with Measure G and campaign promises, once the City and SDSU have finalized their negotiations on a purchase and sale agreement.

Jordan More
Fiscal & Policy Analyst

Jeff Kawar
Deputy Director

APPROVED: Andrea Tevlin
Independent Budget Analyst