



THE CITY OF SAN DIEGO

OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

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Analysis of the Updated Offer for the SDCCU Stadium Site in Mission Valley

OVERVIEW

On October 14, 2019, San Diego State University (SDSU) presented an initial offer for the Existing Stadium Site during the City Council meeting. This offer was presented following the public release of the appraisal of the site, and the offer contained an initial purchase price of \$68.2 million, as well as other proposed terms. Following that meeting, on October 28th, SDSU sent the Mayor a revised offer (Updated Offer) for the site that contained a new purchase price as well as other revisions to the terms of the offer. The revised price is \$86.2 million, plus price indexing based on the proportion of the site that is owned by the City's Water Utility Fund. The Updated Offer includes a purchase price that is much closer to the amount our Office recommended as being fair and equitable during the October 14th Council meeting, and contained in Report 19-24 REV.

The Updated Offer however contains numerous revised terms, including provisions requesting the City commit to expending up to \$10.0 million from the General Fund portion of the purchase price proceeds back into projects on or adjacent to the site, mainly the Fenton Parkway Bridge. During the Council meeting on November 18th, the Council has the opportunity to ask questions, request clarification, and provide input regarding any of the terms in the Updated Offer. Staff is requesting Council provide direction to the City's negotiating team regarding the Updated Offer before direction is given to draft the final Purchase and Sale Agreement (PSA). 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 among other things required the City to exclusively negotiate with SDSU on the

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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 to address needed public capital improvement projects in the City and reduce costs for water utility ratepayers.**

Measure G required its initiative language be incorporated into the Municipal Code. In keeping with this requirement, the City Council added Section 22.0908 into the Municipal Code in January 2019. With this action, the Council has codified and incorporated the terms of Measure G that were presented to the public and ultimately approved by City voters in November 2018.

From the passage of Measure G last November through this September, City staff and SDSU staff were meeting on a frequent basis (typically at least once per week) exchanging information and preliminarily negotiating various terms and conditions prior to the release of the appraisal and draft environmental impact report. In October, the City Council decided to make any go-forward discussions about the potential terms of sale public by docketing the item for discussion at the Council meeting on October 14th. Following the Council President's announcement of that decision, SDSU brought an offer (their initial offer) to the October 14th meeting for Council consideration.

Leading up to the October 14th Council meeting, our office released Report 19-24 "Analysis of the Existing Stadium Site Appraisal", which provided details on the negotiations, a brief description of how the appraisal was conducted, and a further discussion on what would constitute a fair and equitable price per the terms of Measure G. In summary, while the appraisal provided a price of \$68.2 million, our office determined that a more reasonable and justifiable price would be \$91.9 million, with a restoration of reductions made in the appraisal for the River Park as well as stadium demolition, and indexing the costs to the approximate close of the sale.

Following the City Council meeting on October 14th, an Updated Offer was sent to the Mayor on October 28th with new terms for the site. The Mayor on that same day sent a letter thanking SDSU for their revised offer and noting that the Updated Offer would be forwarded to the Council for review. This offer will be considered by the Council during the November 18th meeting, at which time the Council will be asked to provide direction to staff on the terms before staff begins the process of final negotiations needed to prepare the Purchase and Sale Agreement (PSA). The Updated Offer suggests that, once the Environmental Impact Report and PSA are completed, these documents will be presented to the California State University Board of Trustees on January 28, 2020, for their final approval of the PSA and certification of the EIR. After that meeting, the PSA will be presented to the City Council for their final approval, with the close of the transaction coming no later than March 2020.

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, and has continued to work with staff to understand and clarify various points in both the initial and revised offers. Our office appreciates City staff keeping us apprised of the negotiations as they moved forward over the last year.

FISCAL AND POLICY DISCUSSION

Purchase Price

The initial offer SDSU presented to the City Council on October 14th proposed purchasing the property for \$68.2 million, which was the value contained in the appraisal after deducting estimated costs for the River Park and stadium demolition, set at 2017 dollars. The Updated Offer made on October 28th contained a new purchase price, which is detailed in Table 1 below. In effect, the new price is \$86.2 million, which includes no value deductions for the River Park or the stadium demolition. Further, SDSU offered to index the price paid up to the date of close on the sale, but only for the portion of the sale that would accrue to the City’s Water Utility Fund. Indexing this portion of the Updated Offer price increases the overall price from \$86.2 million to a total of \$87.9 million, assuming the date of close contained in SDSU’s Updated Offer. The General Fund (or more accurately the Capital Outlay Fund) would receive \$54.3 million, and the Water Utility Fund would receive \$33.6 million. The only difference between this revised purchase price and the recommended \$91.9 million purchase price contained in our previous report, is that the indexing factor (adjusting the price to 2020 dollars) would only apply to the Water Utility Fund portion of the purchase price.

Table 1: Comparison of Revised Purchase Price Offer to Initial Offer (\$ in millions)

	General Fund Portion	Water Utility Fund Portion	Total
<i>Initial Offer</i>	\$43.0	\$25.2	\$68.2
<i>Updated Offer Increases:</i>			
Demolition/River Park	11.3	6.7	18.0
Indexing for Water Utility Fund ¹	0.0	1.7	1.7
Updated Offer	\$54.3	\$33.6	\$87.9

¹ Assumes a March 2020 closing date, and thus indexing of 2.149% over a period of 2.5 years

<i>Other Provisions in Updated Offer:</i>			
Fenton Parkway Bridge-City	\$(8.5)	\$0.0	\$(8.5)
Other Project Improvements-City	(1.5)	0.0	(1.5)
Net Increase of Updated Offer	\$1.3	\$8.4	\$9.7

One new aspect of the Updated Offer is that there are two provisions that would require the City to commit proceeds from the sale towards projects contained within or benefiting the site. The Updated Offer would require the City to contribute \$8.5 million towards the Fenton Parkway Bridge (described in more detail below). Additionally, the Updated Offer requests the City allocate \$1.5 million of the purchase price proceeds in a separate account jointly controlled by the City and SDSU to be held for other related project improvements. As you can see in Table 1, these provisions reduce the additional \$11.3 million that the General Fund would have received from the increased purchase price in the Updated Offer by \$10.0 million from \$11.3 million to \$1.3 million. Further, by agreeing to these deal points, the Council would be committing \$10 million of General Fund proceeds to public projects providing benefit to the contemplated SDSU development area as opposed to those proceeds being available for Council to discretionarily allocate to other priority capital needs within the City. **The Council may wish to seek additional clarity as to what the requested \$1.5 million for “other related project improvements” may**

go towards, as well as the necessity of spending \$8.5 million of the purchase price proceeds now for the Fenton Parkway Bridge that probably will not begin construction for several years.

Fenton Parkway Bridge

A major point contained within both offers is that SDSU is committing to build a new two-lane bridge over the San Diego River, connecting Fenton Parkway with Camino del Rio North on the other side. SDSU has committed to building the bridge once the City has completed the design and environmental review, and prior to the occupancy of more than 65% of the planned development of the site. However, while SDSU will pay for the construction of the bridge, they have determined that their fair share of the cost is approximately 25%, and they would seek to receive reimbursement for the remaining costs of the bridge beyond their 25% share.

SDSU is seeking to be reimbursed for the costs of the bridge through three sources. In the Updated Offer, SDSU has requested that the City contribute up to \$8.5 million of the purchase price proceeds towards the construction of the Bridge, which is shown in Table 1 above, as one of the reimbursement sources. The second source is a \$1.3 million prior developer contribution that remains as dedicated funding in a City account for construction of the bridge. For the final funding source, SDSU would negotiate a reimbursement agreement with the City to seek DIF credits for development on the property, subject to other terms negotiated surrounding the applicability of DIF payments (described in more detail below). The amount of the DIF credits would be capped at an amount equal to the amount that, when combined with the other two sources, equals 75% of the total costs of the bridge, or equal to the amount of DIF that the development project would otherwise pay. Further, DIF financing could also potentially be held to a total of 43% of the total costs of the bridge, which is the DIF basis contained in the draft Mission Valley Impact Fee Study, and is based on a traffic analysis.

Further, as mentioned, SDSU has committed to building the bridge, but only prior to the occupancy of more than 65% of the planned development of the site. Given the timelines contained in the offer, which commit SDSU to building the new stadium and River Park prior to any other vertical development, and provisions calling for both the stadium and River Park to be done within seven years, it could potentially be more than seven years before SDSU will be required to build the bridge. This could significantly increase the cost of the structure, which could impact the amount of resources that the City needs to dedicate to the reimbursement agreement.

Additional clarity should be sought on the reimbursement agreement that SDSU would be seeking with the City, including more information on the cost estimates for construction of the bridge, as well as an estimate of when SDSU anticipates building the bridge itself. **The Council should seek additional clarity on how the reimbursement agreement with SDSU for the Fenton Parkway Bridge would be structured.**

Possessory Interest Taxes

Possessory Interest Taxes are unsecured property taxes that are paid by private entities that own property and other business interests that are otherwise located on land that would be exempt from

property taxes, such as land owned by the state government. These taxes are assessed by the County and accrue to the various taxing entities that derive revenue from the property tax.

Regarding this project in particular, Measure G contained numerous provisions that directly referenced possessory interest taxes and how they were to apply to this project. Section 22.0908(c)(5) listed out various facilities and uses that were to be developed through this project, and in particular, listed commercial, technology, and office space, retail uses, hotel, faculty and staff housing, student housing, and community housing as all contributing possessory interest taxes, as applicable, to the City.

The Updated Offer presented by SDSU contains a provision regarding possessory interest taxes, which states that “SDSU’s non-state private development partners construction improvements in the Project solely for private use and not for the benefit of or in support of SDSU’s governmental mission will be required to pay sales tax, possessory interest tax, and/or transit occupancy tax, as required by applicable law. SDSU and other publicly developed property will be exempt from paying property or possessory interest taxes.”

What remains unclear in this offer point is what constitutes properties or development that is for the benefit of or in support of SDSU’s governmental mission? It is unclear what these uses could be, and if this deal point would exempt certain aspects of the project, such as student, faculty, and staff housing, from possessory interest taxes, and thus conflict with Measure G. **The Council should seek additional clarity on which types of properties would be exempt from possessory interest taxes under this provision, and if these exemptions would be in line with the provisions of Measure G.**

Development Impact Fees

One of the unique aspects of this project is that, since SDSU is a state entity, any development done on land that it owns is typically exempt from local taxation, including property taxes and development impact fees (DIF). However, Measure G contained explicit language regarding the applicability of these taxes to this project.

For DIF, Section 22.0908(l) states that “Such sale and ultimate development shall require development within the Existing Stadium Site to comply with the City’s development impact fee requirements, parkland dedication requirements and housing impact fees/affordable housing requirements.” In essence, Measure G envisioned that the development of the site would generate DIF revenue, despite the fact that development on state-owned property would be exempt.

The Updated Offer, as well as the initial offer, both contained language on DIF, which reads “SDSU’s non-state private development partners construction Non-SDSU Facilities will pay development impact fees (“DIF”), but SDSU and other publicly developed and occupied facilities will be exempt.” Further, the offer contains an additional exemption that, since the project as currently envisioned will build out more park space than what is called for in the community plan update, no developer will have to pay park DIF fees since the property would have more parks than are required in the community plan update.

This language regarding DIF contains the same ambiguities as the language regarding possessory interest taxes, as described above. Thus, without additional clarification on the exemptions, it is unclear as to whether or not the portion of the project that would not pay DIF would be in conflict with the terms of Measure G. **The Council should seek additional information on the types of properties that would be exempt from DIF, and if these exemptions would be in line with the provisions of Measure G.**

Indemnification Provisions

A critical consideration related to the potential sale of the Mission Valley stadium property is whether the City will be adequately indemnified for any potential liability arising on the property once the contemplated transaction has closed. This is a reasonable expectation as the City would no longer have control of the property and because the transaction is being structured as an "as is" sale. The Updated Offer specifically provides these indemnifications:

- "SDSU will purchase the Property "as is", with all faults. SDSU will defend and indemnify the City against all claims regarding Property's condition and waive all environmental claims against the City."
- "SDSU will defend and indemnify the City for all legal challenges with respect to approval of the FEIR, PSA, and campus Master Plan."

It is imperative that the proposed transaction explicitly provide the City with strongly-worded indemnification for all circumstances caused by or relating to this property post-close, recognizing that SDSU may not be able to indemnify the City against losses caused by the City's wrongdoing or sole negligence. It is not clear whether the Updated Offer adequately indemnifies the City for all property related liability. For example, will the City be fully indemnified for potential future flooding on the property related to Murphy Canyon Creek or any other appurtenant water sources? Will the City be indemnified for any potential future contaminated soil related litigation? Will the City be indemnified for any capital failures or other potential liabilities that may occur at the current stadium site given that football games and potentially other activities are anticipated to continue for at least another two years? **We recommend the Council request that the proposed transaction explicitly provide the City with strongly-worded indemnification protections for any and all circumstances related to this property.**

Challenges Associated with Achieving the Current Target Closing Date

The Updated Offer indicates the closing "will occur shortly after the parties enter into the PSA with a target closing date of no later than March 27, 2020." The proposed transaction can fairly be characterized as being complex and multi-faceted. The Council will have its first opportunity to review and comment on the Updated Offer on November 18th, and may request additional clarification and/or propose to amend certain terms. The City's negotiating team is hoping the City Council will provide them with as much detail and specificity about the desired transaction before directing them to prepare and negotiate the final PSA. Our Office understands that negotiating/developing final PSAs for transactions of this nature can take several months and even years in some instances. It should also be noted that we are entering the upcoming holiday season where key staff may be away or otherwise unavailable. Finally, we understand that final documents

may need to be submitted to the California State University Board of Trustees weeks before the targeted January 28th meeting.

While it is certainly possible that a final PSA could be negotiated and drafted in time to make the identified CSU Board of Trustees meeting in January and the following targeted close deadline of March 27th, it is our understanding that it will be very challenging as there will be many transaction details that need to be thoughtfully vetted and negotiated by the parties. If those details are not adequately vetted and documented in the final PSA, the City could incur additional financial and legal risks in the transaction. It is our belief that the City, SDSU, and public are best served by an expeditious close once a final PSA has been developed and approved. **We recommend the Council ask SDSU and the City's negotiating team about potential challenges associated with quickly developing a final PSA and the likelihood of being able to achieve the targeted close deadline of March 27th.**

Concerns about the Proposed Property Lease Should There Be a Delay in Closing

The Updated Offer states that if the closing date does not occur by June 30, 2020, through no fault (including unreasonable delays) of either party, (a) the City will lease the Property to SDSU for \$1 per month; (b) SDSU will assume all ongoing costs of maintaining and operating the Property, including the stadium; and (c) unless the delay is the City's fault, the purchase price will increase on a prorated basis, applying an index factor of 2.149% from July 1, 2020 until the Closing Date. This provision raises a few questions and concerns for our Office including but not limited to:

- There is no outside closing date which means there is no contractual urgency for SDSU to do everything in their power to close the transaction prior to June 30, 2020 as planned/targeted in the Updated Offer. Given SDSU has publicly expressed interest in an expeditious close, it seems very reasonable and potentially useful for Council to request the transaction stipulate a close no later than December 31, 2020.
- SDSU's original offer to the City stated that "the economics of SDSU's offer are greatly impacted if the above scheduling milestones are not achieved." The referenced milestones included closing the transaction in February 2020. The Updated Offer now includes a provision that would allow for an open-ended delay in closing. This provision creates some question about the economic viability of the project were there to be a significant delay in the close.
- If a significant delay in the close results in the City leasing the Property to SDSU for \$1 per month, SDSU agrees to assume all ongoing costs of maintaining and operating the Property including the Stadium. However, it is our understanding that the City as the Lessor would, or could, be responsible for capital repairs and be liable for adverse circumstances related to capital failures. **We recommend the Council request SDSU to accept complete responsibility for the Property and fully indemnify the City for any liability related to the Property or operations thereon while it is under their control as Lessee.**
- The Updated Offer says that the annual index factor will be applied to the purchase price beginning July 1, 2020 "unless the delay is the City's fault." How will "fault" be defined

and what will determine if something is the fault of the City, SDSU, or be attributed to some other factor?

- This provision takes effect if the close does not occur by June 30, 2020, through no fault (including unreasonable delays) of either party. Our Office wonders what effect, if any, this provision would have if one party alleges the other party is at fault for the delayed close? How would this allegation be resolved? Would the \$1 per month lease be effectuated if fault on the part of either party is alleged?

Ideally, the transaction will close prior to June 30, 2020 as planned thereby eliminating the need for a "Potential Delay in Closing" provision. A delay in the close beyond June 30, 2020 creates concern for all involved parties including the public. It raises questions about the Project's economic viability, the timeliness of assets promised to the voters, public liability, deal term disputes, etc. **The IBA recommends the Council ask SDSU for complete Property indemnification and a worst case outside close date of no later than December 31, 2020 to provide contractual incentive to effectuate an expeditious close.**

CONCLUSION

During the Council meeting on November 18th, the Council will hear from City staff and SDSU on the Updated Offer for the existing stadium site. This meeting represents an opportunity for Council to ask questions, request clarification, and provide input regarding any of the terms in the Updated Offer. Staff is requesting Council provide direction to the City's negotiating team regarding the Updated Offer before direction is given to draft the final Purchase and Sale Agreement (PSA). Our Office thinks that the Council may wish to seek clarity or provide input on several deal terms which are currently too vague for formal consideration. In particular, our Office recommends the Council:

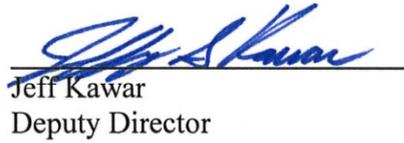
- seek additional clarity as to what the requested \$1.5 million for "other related project improvements" may go towards, as well as the necessity of spending \$8.5 million of the purchase price proceeds now for the Fenton Parkway Bridge;
- seek additional clarity as to how the reimbursement agreement with SDSU for the Fenton Parkway Bridge would be structured;
- seek additional clarity as to which types of properties would be exempt from possessory interest taxes under this provision, and if these exemptions would be in line with the provisions of Measure G;
- seek additional clarity as to the types of properties that would be exempt from DIF, and if these exemptions would be in line with the provisions of Measure G;
- request that the proposed transaction explicitly provide the City with strongly-worded indemnification protections for any and all circumstances related to this property;

- ask SDSU and the City's negotiating team about potential challenges associated with quickly developing a final PSA and the likelihood of being able to achieve the targeted close deadline of March 27th;
- request SDSU to accept complete responsibility for the Property and fully indemnify the City for any liability related to the Property or operations thereon while it is under their control as Lessee; and
- ask SDSU for complete Property indemnification and a worst case outside close date of no later than December 31, 2020 to provide contractual incentive to effectuate an expeditious close.

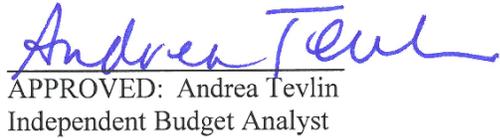
Ultimately, it will be up to the City Council to determine whether the final terms are fair and equitable and in the public interest, as well as consistent with Measure G and campaign promises, once the City and SDSU have finalized their negotiations on a purchase and sale agreement.



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