Oversight Board Meeting: May 11, 2016

**SUBJECT: Study Session on Amendments to the 2010 Amended Disposition and Development and Owner Participation Agreement for the Sunnyvale Town Center.**

## REPORT IN BRIEF

The Successor Agency to the Sunnyvale Redevelopment Agency is expected to consider amendments to the Amended Disposition and Development and Owner Participation Agreement for the Sunnyvale Town Center ("ADDOPA") in June 2016, including the assignment of the Agreement to a new development entity (STC Venture, LLC). The amendments will require the approval of the Oversight Board. Successor Agency staff are still negotiating the amendments but prior to presenting the amendments to the Oversight Board, the Successor Agency staff is holding a Study Session with the Oversight Board to provide background on the existing ADDOPA in order to assist the Oversight Board in considering the amendments when they are presented to the Oversight Board for approval. No action is being requested of the Oversight Board at this time.

## BACKGROUND

The Sunnyvale Town Center Project was the central focus of the Sunnyvale Redevelopment Agency's ("RDA") activities from the adoption of the Central Core Redevelopment Project Redevelopment plan in 1975. The RDA's initial redevelopment effort involved the construction of a parking structure to support the Town Center Mall that included Macy's, Montgomery Wards and later J.C. Penney. The RDA financed its participation in the development of the mall through the issuance of tax increment bonds and lease revenues bonds. The tax increment bonds remain an obligation of the Successor Agency and are expected to be fully repaid in 2022.

The Town Center Mall opened in 1979 and successfully operated through 2002. Prior to closure of the mall in 2002 the RDA entered into an agreement with the mall owner to provide for expansion and reconfiguration of the mall. The expansion plans included land swaps between the RDA and the mall owner that resulted in the RDA owning 4.07 acres of property on Sunnyvale Avenue (a portion of what is now designated as Block 5), where the mall owner constructed a public parking structure that is currently closed.

After closure of the mall and a determination that the RDA owned parking structure on Mathilda was unsafe the RDA sought a proposal for redevelopment of the site from the property owners. In 2004 the RDA entered into a Disposition, Development and Owner Participation Agreement ("DDOPA") with Fourth Quarter that included plans for the redevelopment of the Town Center mall with residential, retail and office improvements as well related infrastructure and parking improvements.

Shortly after completion of the DDOPA, Fourth Quarter defaulted on the DDOPA and as an alternative to litigation to resolve the default issue, Fourth Quarter proposed transferring the project and project agreements to RREEF, a large real estate investment trust, which would develop the property in joint venture with Sand Hill Property Company.

In 2007 the RDA entered into the Amended and Restated Disposition, Development and Owner Participation Agreement ("ARDDOPA") with Downtown Sunnyvale Mixed Use LLC, (the single purpose entity formed by RREEF and Sand Hill Property Company).

Downtown Sunnyvale Mixed Use commenced work under the ARDDOPA in March 2007 and between March 2007 and February 2009 completed the required property transfers, demolition and excavation, the construction of steel framing on Block 3 for retail buildings and the commencement of construction on retail, residential and office buildings. However, in late 2008 with the world-wide economic meltdown, completion of construction of the project became impossible. In 2009 the RDA and the developer agreed to an amendment to the ARDDOPA to extend the deadlines for performance. Despite the extensions, the Developer was unable to make required loan payments in 2009 and in late 2009 foreclosure proceedings were commenced by Wachovia Bank. In late 2009, the Superior Court appointed a receiver for the project and authorized the receiver to act as the developer and to make all decisions related to the ARDDOPA and related documents. Under the direction of the receiver and in conjunction with the RDA, the Target store was completed and opened.

In 2010 the Receiver requested amendments to the ARDDOPA in order to move the project forward and create an opportunity to attract a qualified developer to recommence the project. The RDA initially entered into a modification agreement with the Receiver and then subsequently the terms of the modification agreement were incorporated into an Amended Disposition, Development and Owner Participation Agreement ("ADDOPA") entered into between the RDA and the Receiver in August 2010.

<u>Sunnyvale Town Center Agreements</u>:

The former RDA was party to a variety of agreements related to the Town Center Project including:

- **<u>The "ADDOPA" (2010)</u>**. The former developer entered into an owner participation agreement with the RDA in 2007, which was replaced in 2010 with an agreement entitled the "2010 Amended Disposition and Development and Owner Participation Agreement" (ADDOPA). The ADDOPA is further described below.

- **<u>Operation and Reciprocal Easement Agreement ("OREA") (2008).</u>** The OREA is an agreement between the RDA, the former developer, and the owners of Macy's and Target. It sets forth obligations of the parties with respect to providing mutual access for vehicles, pedestrians, parking, landscaping, utilities, construction, maintenance, and telecommunications facilities.

- **Public Parking Ground Lease (2007, amended 2010).** This is a 75-year lease between the former developer and the RDA which allows the developer and its successors to use RDA-owned parking structures for public parking.

- **Operation and Maintenance Agreement ("Penney's Structure Agreement") (2000, amended 2007).** The Penney's Structure Agreement outlines the operation and maintenance responsibilities with regard to an RDA-owned parking structure.

- **Public Street and Utility Maintenance Agreement (2007, amended 2010).** This Agreement obligates the developer and its successors to maintain certain public streets and utility facilities.

- **Easement Agreement (Public Access and Parking) (2007)**. The RDA granted the City an easement over the parking parcels to ensure that the parking was available to the public.

ADDOPA

The ADDOPA is the primary document governing the former RDA's relationship with the developer for the Town Center Project. Essential terms of the ADDOPA are as follows:

- The ARDDOPA provided for a series of land swaps between the developer the RDA that resulted in the RDA owning the land where the public parking structures are located on Blocks 1 and 2 (excepting that area of the parking structures over which private residential units are developed), the portion of Block 6 to be developed with a parking structure and all of the land under the new street grid. The RDA retained the property within Block 5 containing the Penney's Structure it acquired as part of the land swaps completed pursuant to the DDOPA. The RDA subsequently transferred the street grid to the City.

- Upon approval of the City Council of a Special Development Permit, the developer was to build, lease and operate a mixed-use, open-air development consisting of approximately 931,000 sq. ft. of retail (including a multiplex movie theater complex, the existing Macy's and new Target store), 315,000 sq. ft. of office; and up to 292 for-sale housing units.

- The developer was to build, maintain, repair and replace all parking structures. A minimum of 5,471 parking spaces were be provided. A significant portion of the parking has been constructed but the planned parking structure on Block 6 has not commenced.

- The developer was to build, maintain, repair and replace all public streets in the project area. The developer was also to construct all sidewalks within the area and along the adjacent streets which bound the area.

- The developer was to construct and maintain a “Redwood Plaza” of at least 33,000 square feet around the six heritage redwood trees, and make it available at no cost to the City for public events up to 15 times per year. The square is intended to remain open to the public at all times.

- The developer was to establish a private security force to provide security and traffic control for the project, such that the City’s Department of Public Safety would not be required to provide routine patrols.

- In consideration for the above and, in particular, for replacing the RDA’s Mathilda Avenue parking deck, for placing a substantial amount of the new parking underground, and for constructing, repairing and replacing public streets and other public amenities, the ARDDOPA provided for the developer to receive annual payments from the project tax increment. The annual payments were to be made for each year between the base year of FY 2003/2004 until FY 2025/2026; however, no funds were payable to the developer until the first year after completion of the portion of the project required for tax increment receipt. To protect against an unanticipated windfall to the developer in the event the assessed value rose more rapidly than projected, the tax increment payments were limited to $4.5 million per year, plus an amount equal to 50% of any tax increment in excess of this limit. The 2010 ADDOPA retained the requirement to make annual tax increment payments to the Developer with the payments tied to completion and retail leasing of 150,000 square feet of new retail. Interim tax increment consisting of the tax increment generated by the Project between 2003-04 and the date of completion of the minimum project required for tax increment payments was payable to the developer at time of completion of theatre if the construction schedule for the theatre was met, to provide incentive for accelerated theatre completion.

- The ADDOPA extended the Project completion dates from those set forth in the ARDDOPA and the required project improvements necessary to be complete for the developer to receive the tax increment payments were revised. Developer performance related to project completion was tied to the Developer obtaining financing and retail lease commitments.

- The ADDOPA required that once construction recommenced, buildings had to be completed by the end of the construction timetable for each building. Failure to complete construction of a building once recommenced would result in the developer being obligated to pay liquidated damages to the City in the amount of $5 million dollars to compensate the City for lost sales tax revenue.

- Project development beyond the Minimum Project is at the discretion of the Developer.

- The ADDOPA permitted transfer of the Project due to foreclosure of loans, or to transferee developer meeting experience, financial and business reputation standards. The RDA may object using commercially reasonable discretion.

- The ADDOPA waived defaults that existed at the time the Modification Agreement was signed.

- RDA remedies for default under the ADDOPA include an option to purchase the property at fair market value and the option to terminate the ADDOPA if the Minimum Project is not complete by December 31, 2015, provided, however, if the failure to complete the Minimum Project by December 31, 2015 is due to financial market conditions beyond the control of the Developer, then the RDA and the Developer are required to negotiate in good faith to seek to reach agreement on an extension of the termination date to 2020.

- Environmental remediation costs from date of the Receiver's appointment are allocated 50-50 between RDA and Developer (the ARDDOPA allocated environmental remediation costs 85% to the RDA and 15% to the developer) and RDA provided certain indemnifications to the Developer related to environmental remediation.

**DISCUSSION**

Since the execution of the ADDOPA in 2010, little development has occurred in the Town Center. This is primarily the result of two factors. First the economic recovery from the recession has been slower than predicted and the climate for finding retail and/or residential developers willing to step into the project has not been favorable. Secondly, Sand Hill Property Development sued the receiver and Wells Fargo Bank, the successor to the Receiver, related to the foreclosure. The lawsuit was finally resolved when the California Supreme Court rejected Sand Hill's petition for review of the Court of Appeal decision in favor of Wells Fargo Bank. Since the execution of the ADDOPA in 2010 the partially complete portions of the Project have sat fallow, including the residential structures on Block 1 and 2 and the steel framing for future retail buildings located between Macys and Target. Macy's and Target have continued to operate and the office buildings along Mathilda have been fully leased. The Penney's parking structure at Sunnyvale Avenue and Iowa has remained closed, and Block 6 which is slated for development with a parking structure, a hotel and retail uses has remained a surface parking lot. The parking structures on Block 1 and 2 are available for office parking and public parking. The partially complete structures are a blight on the project and have hampered further development of the downtown area.

In August, 2015, Wells Fargo Bank (REDUS SVTC, LLC) solicited proposals for the sale or transfer of the parcels it owns in the Town Center, consisting of approximately 20 acres. The parcels owned by Wells Fargo include: Blocks 1 and 2 containing the two complete office buildings on Mathilda (Apple and Nokia are the tenants) and the partially completed residential structures (the parcel containing the parking structures on Blocks 1 and 2 are owned by the Successor Agency); Block 3 except for the parcel containing the Macy's store; Block 4 except for the parcel containing the Target Store; Block 5 except for the parcel containing the Penney's Parking Structure; and portions of Block 6 slated for retail and hotel development. On November 15, 2015, Wells Fargo submitted a "Notice of Intent to Transfer" to sell its interest in the Town Center property to a to-be-formed joint venture comprised of affiliates of (a) Sares Regis Group of Northern California; (b) Hunter Properties, Inc., and (c) an institutional investor advised by J.P. Morgan Asset Management ("Transferee"). In March 2016, the three parties formed a joint venture called STC Venture, LLC.

Under Article 6 of the ADDOPA, the Successor Agency is able to review specified criteria related to a proposed transferee's business qualifications to assess the transferee's business capabilities prior to the transfer occurring. Certain transfers are exempt from Successor Agency review, including transfers of properties that have received a certificate of completion. The two offices buildings on Mathilda were issued certificates of completion under the ADDOPA and thus transfer of those buildings did not require Successor Agency review and consideration.

Article 6 of the ADDOPA list four criteria for review of a proposed transferee:

1. Has experience in and has completed major mixed-use commercial, retail, and residential projects of similar size, scope and nature involving a mix of national, regional and local tenants;

2. Has adequate financial capacity, including the references of at least two lending institutions with substantial lending experience in California mixed use real estate, to timely commence and complete the construction thereof;

3. Possesses a good business character and reputation; and

4. Has prior development projects and an operating presence in California.

In late November and early December of 2015 the Successor Agency engaged the services of two consultants to complete review of the Wells Fargo's proposed Transferee in accordance with the criteria set forth in the ADDOPA and completed an extensive review process of the proposed Transferee. On December 10, 2015, the Successor Agency considered all of the information provided by Wells Fargo, the Transferee, City staff and the Successor Agency's consultants in order to evaluate whether the proposed Transferee met the criteria set forth in the ADDOPA. After a lengthy discussion by the Successor Agency (the City Council, acting as the Successor Agency Board) determined that the Transferee met the criteria set forth in the ADDOPA. Copies of the Staff Report and consultant reports considered by the Successor Agency Board are available for review at the following website.
http://sunnyvale.ca.gov/HotTopics/DowntownDevelopment.aspx .

Amendments to the ADDOPA

Subsequent to the Successor Agency review and approval of the transferee, Wells Fargo transferred the two completed offices buildings for a value of approximately $270 million. Wells Fargo and the Transferee have been negotiating the terms of the transfer of the remaining portion of the project. The transfer of the project to the Transferee is conditioned on amendments to the ADDOPA, including an extension of the schedule for completion of the Minimum Project to 2020. Successor Agency staff and the Transferee have been meeting regularly to negotiate the terms of an amendment to the ADDOPA. Although those negotiations are continuing and final terms have not been agreed upon, the parties expect to reach agreement and present the terms of an amendment to the ADDOPA to the Successor Agency by the end of the June 2016. The most significant change to the ADDOPA from the Successor Agency's position is that the Transferee has agreed to forego the tax increment payments in exchange for other amendments to the ADDOPA including the extension of time periods for performance, clarification that residential units may be rental or for sale, and changes to the developer conditions to commencing construction of the retail improvements. The Amended ADDOPA is expected to continue to require the Successor Agency to pay 50% of the environmental remediation costs associated with the property, as well as provide certain indemnifications to the Developer. The Successor Agency will continue to own the properties containing the parking structures, including the J.C. Penney's structure which is expected to be reopened after certain improvements are made by the developer. The developer will continue to be responsible for the repair and maintenance costs of the parking structures. The Successor Agency expects that the parking structures located on Blocks 1 and 2 will be transferred to the City at a future date as public use properties. The Penney's structure may not be transferred to the City until the repayment in full of the certificates of participation (COPs) that refinanced the original lease revenues bond, since the COPs are secured by the property at Sunnyvale and Iowa. The COPS are expected to be repaid in 2022.

In addition to the amendments to the ADDOPA, the Successor Agency also expects to consider amendments to the OREA to address reciprocal easements over the parking structures to provide access to the residential parking, and amendments to the Penney's Structure Agreement to clarify that developer's rights to use the parking for the theatre and retail development to be constructed on Block 5.

The Successor Agency expects that the amendments to the ADDOPA will result in transfer of the Wells Fargo owned portions of the property to STC Venture, LLC. Assuming the amended ADDOPA is approved by July 2016, the submittal of revised building and improvement plans for the project is scheduled in fall 2016 with recommencement of construction beginning in spring 2017. The transfer of the property and the completion of the development will result in significant increased property taxes to the taxing entities and thus is in the best interest of the taxing entities. The expected amendments will also reduce the Successor Agency's obligations to the developer by eliminating the potential tax increment payment. The amendments to the ADDOPA are required for the transfer of the project to STC Venture, LLC and the recommencement of construction of the project.

## PUBLIC CONTACT

Public contact was made by posting the Oversight Board agenda on the City's official-notice bulletin board outside City Hall, at the Sunnyvale Senior Center, Community Center and Department of Public Safety; and by making the agenda and report available at the Sunnyvale Public Library, the Office of the City Clerk and on the City's Web site.

## RECOMMENDATION

Next Steps

In order to proceed with the transfer of the project to STC Venture, LLC and the amendments to the ADDOPA there are various actions that are required by the City, the Successor Agency and the Oversight Board. The propose schedule of actions is as follow:

May 23 – Sunnyvale Planning Commission considers amendments to Special Development Permit.

June 28 – Successor Agency Board considers amendments to the ADDOPA and related documents.

June/July – Oversight Board considers amendments to the ADDOPA and related documents.

Submitted by:
Brice McQueen, Successor Agency Manager

**Attachments**

1. 2010 Amended Disposition and Development and Owner Participation Agreement
2. Exhibit A – Map Showing Sunnyvale Town Center Property
3. Exhibit B – Project Description