REPORT TO OVERSIGHT BOARD **NO: RSA-OB-16-003**

Oversight Board Meeting: June 20, 2016

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

BACKGROUND

The Successor Agency to the Former Redevelopment Agency of the City of Sunnyvale (Successor Agency) is expected to consider modifications to the Amended Disposition and Development and Owner Participation Agreement for the Sunnyvale Town Center ("2010 ADDOPA") on June 28th. The Amendments will require the approval of the Oversight Board. The Oversight Board held a meeting on May 11th at which Successor Agency staff presented background information on the 2010 ADDOPA in preparation for the Oversight Board meeting to consider approval of amendments to the 2010 ADDOPA. At the May 11th meeting the Oversight Board raised questions regarding the environmental remediation provisions of the 2010 ADDOPA. The questions related to the ongoing liability of the Successor Agency to pay for remediation and monitoring costs associated with Successor Agency owned property as required by the 2010 ADDOPA. Members of the Oversight Board expressed concern that the standards for approval of the amendments to the 2010 ADDOPA under the Redevelopment Dissolution Law could not be met if the Successor Agency's liability for environmental remediation and monitoring was not reduced.

DISCUSSION

The questions raised by the Oversight Board are addressed below. This staff report also addresses the standards for the Oversight Board to approve the amendments to the 2010 ADDOPA.

Dissolution Law Requirements for Approval of 2010 ADDOPA Amendments

The Dissolution Law (AB1x 26 as amended by AB 1484 and as further amended by SB 107) sets certain standards for Oversight Board actions. Health and Safety Code (HSC) Section 34179(i) provides that oversight boards have a fiduciary responsibility to holders of enforceable obligations and the taxing entities that benefit from distributions of property tax and other revenues. HSC Section 34180 specifies certain actions of the Successor Agency that require the approval of the Oversight Board. These actions include establishment of new payment terms for loans, issuance of bonds, continued acceptance of federal or state grants that require matching funds, sale of property to the sponsoring city pursuant to a compensation agreement, establishment of the ROPS, a request by a successor agency to enter or reenter into an agreement with the sponsoring city, and a request by the successor agency to pledge property tax revenue. The amendments to the 2010 ADDOPA are not expected to include any of the above

provisions that would trigger the required Oversight Board approval in HSC Section 34180.

HSC Section 34181 specifies certain actions that the Oversight Board can direct the Successor Agency to do. These include the disposition of all assets of the former redevelopment agency, ceasing performance and terminating all existing agreements that are not enforceable obligations, transferring housing assets, terminating certain agreements between the dissolved redevelopment agency and a public entity related to the operations of public improvements, and determining whether agreements between the dissolved redevelopment agency and private parties should be terminated or renegotiated to reduce liabilities and increase net revenues to the taxing entities. The modifications to the 2010 ADDOPA most closely fits within the final category of actions (renegotiating agreements to reduce liabilities and increase net revenues to the taxing entities) requiring the Oversight Board's approval. HSC Section 34181(e) provides that the Oversight Board may approve any amendments or termination of these types of agreements if its finds that the amendments or early termination would be in the best interest of the taxing entities. This is the standard that should guide the Oversight Board in considering the amendments to the 2010 ADDOPA.

Environmental Remediation.

Section 4.04 of the 2010 ADDOPA addresses payment of environmental remediation costs for the Town Center site. Under the terms of the 2010 ADDOPA, the former Redevelopment Agency and the Developer agreed to split the Environmental Cost, as defined in the2010 ADDOPA, equally. The 2010 ADDOPA represents a reduction in the former Redevelopment Agency's liability for environmental costs from the 2007 ARDDOPA which required the former Redevelopment Agency to pay 85% of the Environmental Costs. For purposes of the 2010 ADDOPA, the Environmental Costs include:

- All oversight fees charged by the Regional Water Quality Control Board
- All hazardous waste generator fees.
- Hazardous waste transportation fees.
- Fees for environmental consultants and attorneys related to potential contributors to the hazardous materials.
- Cost to install, operate and maintain soil, soil vapor and groundwater remedial systems, vapor barriers, passive or active venting systems, indoor air monitoring systems and groundwater treatment systems.
- Costs associated with abandonment, closure and removal of groundwater monitoring wells and remedial facilities.
- Costs associated with third party claims against the Developer, the City and the Agency.

The current Environmental Costs are primarily related to monitoring fees associated with the monitoring wells installed on the contaminated sites and have been the range

of approximately $280,000 per year since the dissolution of the Redevelopment Agency. The Successor Agency is responsible for 50% of this cost each year.

The sharing of the Environmental Costs is advantageous to the Successor Agency since the hazardous materials sites are all located on property owned by the Successor Agency. No Further Actions letters have been issued by the Regional Water Quality Control Board for Blocks 1, 2, 3, 4 and parcel 209-35-015 of Block 5 (Building T parcel). There are three areas of known contamination within the project site. All three areas of known contamination emanate from former dry cleaners that were located on property owned by the Successor Agency. The former Redevelopment Agency acquired the properties in 1968 pursuant to eminent domain actions. Two of the former dry cleaner sites are located on Lot 1 of Block 6 and one is located on Block 5, near where the Penney's Structure is located. The Developer is not in the chain of title for these properties and thus would not ordinarily have liability for the environmental remediation required to remove contaminants from the soil and groundwater.

The Oversight Board requested additional information on the remediation including whether insurance would be available to cover the Successor Agency's obligations under the 2010 ADDOPA and whether there are any responsible third parties that could be pursued for the remediation costs. The Successor Agency has explored the option to obtain insurance and has consulted with AON Insurance Services West, Inc. AON has informed the Successor Agency that cost cap insurance is generally not available. AON underwriters are still reviewing the environmental reports related to the property in order to determine if a pollution liability policy would be available and to provide a premium quote. The Successor Agency does not expect to receive confirmation on the availability of pollution liability insurance until sometime after the Oversight Board meeting.

Oversight Board members also requested information on whether there was any possibility of pursuing third parties to recover remediation costs. The history of the hazardous contamination of the site dates back to prior to 1979 and most likely before that. The hazardous contamination most likely emanates from three dry cleaners that were previously located on Murphy Avenue starting in the 1940's and continuing until the construction of the Town Center Mall in 1978. At the time that the dry cleaners were operating it was common for dry cleaning solvents to be disposed of in the sewer system. Additional contamination may have occurred as a result of sewer backups and leaks from sewer pipes.

In 2007 the then developer of the Sunnyvale Town Center, RREEF, commissioned an investigation into the ownership of the dry cleaners located on Murphy Avenue. The report prepared by Navigant Consulting reviewed property records, business license records, phone directories, chamber of commerce records and other public documents in an attempt to ascertain the owners of the dry cleaning establishments. The investigation traced the ownership of the parcels where the dry cleaners were located as well as the business owners of the dry cleaner establishments but was not

successful in finding any parties still living that could be considered responsible parties and pursued through the filing of cost recovery lawsuits.

In addition to attempting to track down the former owners and dry cleaning operators of the contaminated property, the former Redevelopment Agency also pursued litigation against the manufacturers of the chemicals found on the site. In 2008, the former Redevelopment Agency and the City brought suit against three chemical manufacturers and later added the manufacturer of the dry cleaning equipment discovered to have been used at one of the dry cleaning sites. The lawsuit against the chemical companies hinged on a novel testing method designed to determine the manufacturer of the chemicals used on the site. However, as a result of numerous factors, the expert testimony relied upon to make the Agency and City's case was deemed not to meet the standards of admissibility. The former Redevelopment Agency and the City agreed to settle the litigation against the chemical companies for $10,000 which did not fully cover the costs of litigation. The suit against the manufacturer of the dry cleaning equipment was also settled for a nominal amount of $50,000 after it was discovered that through a series of mergers and acquisitions the liability for these types of actions rested with an insolvent party. The settlement amounts received from these lawsuits were used to pay costs of litigation incurred by the City and the former Redevelopment Agency.

The City and the former Redevelopment Agency also filed claims with the issuers of various insurance policies covering the property. All of the insurance policies excluded claims for pollutants unless the discharge was sudden and accidental. The City argued that sewer backups that most likely caused some of the soil and groundwater contamination were a sudden and accidental discharge covered by the policies. The City, as the named insured on the policies, mediated the claims with three insurers without having to file suit and reached a settlement for $1,165,000. The fourth insurance company was more recalcitrant but ultimately the City received a settlement of $1,040,000 after the City brought suit.

The City through aggressive and novel legal actions was able to recover in total $2,205,000 from insurers and manufacturers. Costs associated with that recovery, including attorney's fees and related litigation costs were approximately $800,000. This does not take into account the extensive amount of time and resources expended by City staff. As the City was the named insured for all the above policies, it was entitled to use the remainder of the recovery to pay for remediation costs that had been incurred by the City.

Elimination of TIF Payment.

As was discussed at the Oversight Board's meeting of May 11th one of the proposed amendments to the 2010 ADDOPA is the elimination of the tax increment payment to be made to the Developer upon completion of certain improvements within the project. In order to provide the Oversight Board with the information necessary to make the finding

that the amendments are in the best interest of the taxing entities, it is important to understand the tax increment payment currently in the 2010 ADDOPA.

The 2010 ADDOPA requires that the former Redevelopment Agency pay to the Developer the tax increment generated from the Town Center Project from fiscal year 2003/04 through fiscal year 2025/26. The tax increment payment obligation does not commence until the occurrence of the "Minimum Project TIF Date." The Minimum Project TIF Date is defined as the date on which completion of no less than 150,000 square feet of the retail portion of the project is complete including evidence of leases with retail tenants for the 150,000 square feet and completion of the improvements to Redwood Square. Section 8.02(a) of the 2010 ADDOPA requires that the first Annual Payment of the Project Tax Increment is also to include the "Interim Project Tax Increment". The Interim Project Tax Increment is defined as the project tax increment generated between fiscal year 2003/04 and the first Annual Payment. Thus, in addition to all tax increment generated from the Minimum Project TIF Date through fiscal year 2025/26, the 2010 ADDOPA requires that all of the tax increment previously generated since fiscal year 2003/04 be paid to the Developer.

The 2010 ADDOPA also provides for the payment of the Interim Project Tax Increment prior to the occurrence of the Minimum Project TIF Date upon the occurrence of the "Interim TIF Payment Date". The Interim TIF Payment Date is defined as the date upon which the construction of Building D exterior walls are completed and the theater in Building T is completed. Section 8.01 of the 2010 ADDOPA specifically states that the completion date of the theater which is a trigger for the Interim TIF Payment Date "may be extended pursuant to this Agreement."

The 2010 ADDOPA caps the annual payments made to the Developer at $4,500,000, plus 50% of the amount that the annual Project Tax Increment exceeds $4,500,000, except to the extent necessary to make the Interim Project Tax Increment payments. The 2010 ADDOPA also specifies the method to calculate the Annual Payment owed to the Developer and the Interim Project Tax Increment. Based on the calculation method set forth in the 2010 ADDOPA and conservative projections of the increase in assessed valuation associated with the Town Center Project, the Successor Agency estimates that the amount owed to the Developer if the trigger for payment of the Interim Tax Increment is achieved would be approximately $21 million and if the Minimum Project TIF Date occurred the total payment of tax increment to the developer could be in the range of $50 to $65 million.

The Oversight Board raised questions about whether the Developer is still entitled to the tax increment payments due to the delays in the project. The 2010 ADDOPA includes a schedule for completion of the Minimum Project as well as pre-conditions to the Developer commencement of the Minimum Project. The retail development that is required to meet the condition for the occurrence of the Minimum Project TIF Date requires the completion of construction of some combination of the retail portions of Buildings D, E, F, N,H, I, J, L and T. Section 5.02 and Exhibit H of the 2010 ADDOPA

provide that the condition to commencement of the construction of any of these retail buildings is executed leases for 75% of the retail square footage and acceptable financing. Neither of these conditions have been met.

The trigger for the payment of the Interim Project Tax Increment is the construction of the Interim Project Improvements and the completion of the theater. The Interim Project Improvements are the exterior walls of the Building D excluding the first floor retail area. The Interim Project Improvements have been completed. The commencement of construction of the theater in Section 5.02 and Exhibit H is conditioned upon execution of a theater lease and acceptable construction financing. Neither of these conditions has occurred.

Section 12.04 of the 2010 ADDOPA excuses any parties' performance under the 2010 ADDOPA if the cause of the default or delay is the result of conditions that are outside the control of the party delayed. Section 12.04 lists standard conditions for an excused delay such as war, riots, strikes, etc. Litigation is also specifically listed as a condition that allows a party to delay performance.

Based on the provisions of the 2010 ADDOPA regarding the conditions necessary to commencement of construction of the improvements required to commence the payment of the Project Tax Increment or the payment of the Interim Project Tax Increment, which have not occurred, as well as the provisions of Section 12.04 regarding delay, the Developer can make a credible argument that their failure to complete construction of the improvements for the Interim TIF Payment Date or the Minimum TIF Payment Date would be excused as a result of a delay resulting from litigation. Any litigation that might occur as a result of the Developer's argument would lead to further delays in the development of the project and in the taxing entities ability to receive increased property tax revenues as discussed below. Shortly after the 2010 ADDOPA was entered into by the former Redevelopment Agency, the former developer was sued by one of the members of the previous development entity. The lawsuit alleged that the foreclosure of the development entity was not appropriate and that the previous development entity retained an ownership interest in the property. This lawsuit was not resolved until August 2015 when the California Supreme Court rejected the previous development entities' petition for hearing. The protracted history of this litigation would serve to bolster a delay argument under Section 12.04. Additionally, the 2010 ADDOPA conditions the Developer's performance on certain actions occurring, including obtaining financing for the required improvements. Since the preconditions required for the Developer's performance did not occur, the time periods for completion of the improvements would likely be extended once those conditions are met.

Although there is ambiguity in the 2010 ADDOPA that could lead to a different conclusion regarding the tax increment payments, the ambiguity itself is a potential liability. If the modifications to the 2010 ADDOPA are not approved the Developer may assert a claim for the tax increment payments. Any such claim would almost certainly lead to litigation which would require the Successor Agency to incur litigation costs. The

2010 ADDOPA does not contain an attorneys' fees clause so regardless of whether the Successor Agency was successful in any litigation, the legal costs associated with such litigation would have to be paid from RPTTF. The Modifications to the 2010 ADDOPA will eliminate this potential liability as well, thus allowing for the renewed development of the project, after being stalled for almost 6 years, leading to the taxing entities ability to receive the increased property tax revenues discussed below and providing a benefit to the taxing entities.

The completion of the minimum project envisioned under the amendments to the 2010 ADDOPA would conservatively result in an increase in property tax revenues to the taxing entities through property tax year 2028-29 of over $30 million. This includes increased revenues to Sunnyvale Unified of over $7 million and to Fremont High School of over $6 million. It is likely that the actual revenues to the taxing entities will be greater and certainly will continue beyond property tax year 2028/29.

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 2010 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:

June/July – Successor Agency Board considers amendments to the 2010 ADDOPA and related documents.

June/July – Oversight Board considers amendments to the 2010 ADDOPA and related documents.