

County of Santa Clara Office of the County Executive



CE04 082906

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DATE: August 29, 2006

TO: Board of Supervisors

FROM: 
Peter Kutras Jr.
County Executive

SUBJECT: Recommendations on the Fairgrounds Theater Development

RECOMMENDED ACTION

Consider recommendations relating to the financing and development of the Fairgrounds Theater.

Possible action:

- a. Authorize the transfer of \$15 million in funding from the County General Fund to the Silicon Valley Theater Financing Corporation (Corporation) to partially offset the increase in development costs caused by the delay resulting from the City of San Jose lawsuit.
- b.

Authorize the County Executive to set aside such funds from the General Fund for the contribution to the Corporation, to be reflected in the mid-year FY07 budget and the recommended FY08 budget, and to advance such funds, if such action is determined necessary for purposes of the Theater financial pro forma and bond marketing, to be repaid from General Fund reimbursements following receipt of the settlement funds from the City on July 1 of the respective fiscal year of each payment, or upon receipt of proceeds from the development of the Tully Road parking lot.

And upon approval of actions a. and b.

- c. Adopt the Resolution approving a financing for a theater at the County Fairgrounds, approving the form of and delegating authority to the County Executive to complete, execute and deliver a Ground Lease for the theater site and other Agreements related to the financing, development and operation of the project; making necessary findings; and authorizing the taking of all necessary related actions. (Roll Call Vote)
- d. Accept the Financial Pro Forma Analysis prepared by the theater project and County's underwriter, Citigroup Global Markets, Inc., and the Feasibility Analysis prepared by the County's independent financial feasibility consultant, Economics Research Associates. These analyses demonstrate that the Theater project remains financially feasible under the assumption of the recommended transfer of funding.
- e. Authorize the County Executive to approve necessary revisions to the plans and specifications of the Fairgrounds Infrastructure Project that were approved by the Board in 2004 and are on file with the Clerk of the Board. Authorize the County Executive to approve necessary revisions and re-issue the plans and specifications for bidding, accept bids and subsequently recommend award of the contract to the Board for their approval.
- f. Approve Sixth Amendment to Professional Services Agreement with MacKay & Soms, civil engineers for the Fairgrounds Revitalization Project, for specific services related to the Fairgrounds Infrastructure Project, increasing the compensation from \$1,273,000 to \$1,510,757, and extending the time for completion of services from December 31, 2006 to December 31, 2008.
- g. Approve delegation of authority to the County Executive, or designee, to negotiate, approve, execute, amend and terminate, if necessary, documents related to the Fairgrounds Revitalization Project and Fairgrounds Infrastructure Project, including all necessary public utility construction agreements with PG&E, San Jose Water Company, SBC, the City of San Jose, or other public utilities, agencies or entities, for the direct performance of infrastructure work by such entities, such as joint trench work for the undergrounding of utilities, the installation and connection of public utilities, necessary street and related improvements, and all such work related to the Infrastructure Project. Such delegation of authority shall also include, as may be necessary, any escrow instructions, parcel maps, public street dedications required by the City of San Jose, grants of easements for utilities and access, ground leases, memoranda of lease, consents, estoppel certificates, subordination agreements, subdivision maps, lot line adjustments, quit claims, reciprocal easement agreements, rights of entry, licenses, related documents, and to grant any related approvals, consents or extensions to the time periods in any

agreements related to the Revitalization Project or Infrastructure Project, for a three-year period ending September 1, 2009, following approval by County Counsel as to form and legality.

FISCAL IMPLICATIONS

The development of the Fairgrounds Theater will be financed from the proceeds of bonds issued through the Silicon Valley Theater Financing Corporation, using the County Financing Authority as the bond-issuing conduit. A Resolution of the County Financing Authority to accomplish that is recommended under a separate agenda item today for the Authority. Upon completion and operation of the Theater, all debt service and other costs of operating the Theater will be paid from Theater operating revenues. The County General Fund is not the guarantor of this bond issue and the County is not in any way obligated for debt service or any other operating costs of the Theater. The Ground Lease between the County and the Corporation, and the Development Agreement between the Corporation and the Developer (Garfield Traub Development), and a Side Letter agreement between the County and the Design-Builder (Turner Construction Company) include provisions that the County would be financially responsible for some mitigation or costs only under certain extraordinary conditions such as the discovery of significant underground hazardous material on the Theater site, the failure to allow the Developer to access the property, or the failure of the County to perform the site grading work of its Infrastructure Project in advance of the Theater development. No such extraordinary conditions are anticipated.

The Financial Pro Forma analysis (Attachment 3), prepared by Citigroup Global Markets, Inc., includes a series of financial schedules and other information regarding the sources and uses of funds, the bond structure and rates, bond yields, the project fund, capitalized interest fund, information on debt service, and a detailed financial model that shows all expenses, revenues, flows of funds, coverages and cumulative balances for the term of the debt service. The pro forma also displays the residual proceeds that would flow to the County under the operating assumptions of the theater. The County receives residual proceeds when the Surplus Fund builds up to and maintains a level of \$10 million. Assuming that the theater performs in accordance with the projections, the County would begin receiving proceeds in the seventh year of operations, starting at about \$1.8 million in that year, increasing to about \$25 million in year 30, for a total release of funds to the County of about \$217 million over the 30-year term of the bonds.

Although the County would make a \$15 million General Fund contribution to the Corporation under the recommended actions, these funds could be reimbursed from one or more sources of revenue. The County will receive offsetting funds from the City of San Jose in the amount of \$22.5 million related to the Theater lawsuit settlement. Three payments of \$7.5 million each will be received on July 1, 2007, July 1, 2008 and July 1, 2009. The terms of the City lawsuit settlement specify that the \$22.5 million in damages be applied to public projects that benefit the residents of the City and the County, such as the new Crime Lab and seismic upgrades to County hospital buildings. The \$15 million recommended under this action is commensurate with two of the annual payments from the City.

An alternative source of funding to repay the General Fund for this \$15 million contribution would be the proceeds from the development of the Tully Road parking lot, which could be realized in FY08. The Fairgrounds Revitalization Project, originally approved in 2000, designated the Tully road parking lot for mixed-use or commercial development, depending on the rezoning decisions and entitlement processes that would be initiated by the County and adopted by the City of San Jose. The parking lot is a separate, 14-acre parcel across the street from the Fairgrounds proper. The value of the land, depending on its intended use, is in the range of \$14 million to \$28 million. If the Board approves proceeding with the Fairgrounds Infrastructure Project, the parking improvements built under that project would replace the Tully Road parking. In 2002, the Administration began the General Plan amendment process with the City for the

Tully Lot, but that effort was suspended when the Revitalization Project was delayed. That process would be resumed upon resumption of the Theater development and the Infrastructure Project.

The approval of the full \$15 million is necessary at this time for the purposes of the Corporation's bond issue. The bond issue Official Statement will include the fact that the County has approved the \$15 million, thereby lessening the amount of bonds that must be sold to finance the project. As described in the Background section below, the total development cost for the theater has increased from \$66 million to \$96 million in the two-plus years since the pre-lawsuit guaranteed maximum price. The transfer of \$15 million to the Corporation will partially offset the increase in development costs to a level that can be sustained by the operating revenues. The financial pro forma would not be viable without this transfer of funds.

Funding for the Infrastructure Project has been rolled forward from 2004 and is currently budgeted in the Special Programs budget in the amount of approximately \$9 million. Phase I of the Infrastructure Project (onsite infrastructure) was previously bid in June 2004, and favorable bid results were received, all within the estimate for that phase of the work. The project was not awarded at that time, however, because of the pending lawsuits from the San Jose Downtown Association and the City of San Jose. The two-year delay will most likely result in increases in cost for that phase of the work. The amount of any such project cost increase will be unknown until the bids are received. Also, in FY06 the Board approved an emergency transfer of funds to the Fairgrounds Management Corporation (FMC) in the amount of \$750,000 from this infrastructure budget, thereby reducing the amount available for the Infrastructure Project. The County Executive will report back to the Board after the bidding regarding the adequacy of the project budget and the potential requirement for additional funds to reimburse the project budget for the contribution to the FMC or for increased bids on the Infrastructure Project.

The re-bid Infrastructure Project will also include Phase II of the work – offsite infrastructure. The third and final phase of the work is the public utility work on Umbarger and Monterey Roads. This work will be accomplished directly by the public utility companies under contracts with the County, and funded by the Infrastructure Project budget. The recommended contract amendment of \$237,757 for the project's design engineering firm will also be paid from the Infrastructure Project budget.

REASONS FOR RECOMMENDATION

Upon settlement of the lawsuits with the San Jose Downtown Association and the City of San Jose, and upon re-evaluation of the project feasibility, the Board has requested the Administration to provide recommendations about whether to proceed with the theater development. The revised project feasibility study has been completed by Economics Research Associates, and a new set of financial pro formas has been prepared by Citigroup Global Markets. The new financial documents incorporate the increased development costs that have been provided by Turner Construction Company (Attachment 5). After many weeks of intensive evaluation, the conclusion is that with the infusion of \$15 million as described in the Recommended Actions, the development of the Theater remains financially feasible. The project will not be viable without the infusion of the funds due to the significant cost increase that was caused by the litigation

Adopting the Resolution is necessary to approve the financing and the Ground Lease, confirming the Board's May 18, 2004 approval of the Ground Lease between the County and Corporation, setting forth the terms and conditions under which the Corporation would finance, develop and operate the Theater on the Fairgrounds land defined under the Lease.

With respect to the Fairgrounds Infrastructure Project, new approval is needed to modify the 2004 plans, authorize re-bidding of the project, and amend the design engineer's contract to enable the project to move forward. The County's Infrastructure Project is a separate project from the Corporation's theater development, consisting of parking, road and utility improvements that will support the Theater as well as the Fairgrounds Revitalization Project and the ongoing operations of the Fairgrounds.

The engineering contract amendment for additional funding authorization and time of completion is necessary to update, amend and enhance the plans and to provide for construction support during the combined periods of the infrastructure and theater construction. The amended services will include incorporating into the plans the three addenda issued during the initial public bidding of the infrastructure project in June 2004, and to incorporate off-site improvement plans for Monterey and Umbarger Roads. The work also includes review of the plans and specifications to identify any amendments required by changes to codes, construction standards, governmental regulations or ordinances that took effect since June 2004. Combining the on-site and off-site improvement plans into one bid package will increase the efficiency of performing the work and will result in bid savings to the County. Incorporating the previous addenda will make it easier for contractors to bid the project. Construction support by the engineer under this amendment will provide the County with the necessary expertise for coordination of the contractors and will ensure that the plans are executed in accordance with the design intent.

BACKGROUND

Previous Board Actions

The Board of Supervisors previously approved the Fairgrounds Theater development on May 18, 2004, adopting a resolution and approving the Ground Lease whereby the Corporation would finance, develop and operate the Theater. The Corporation added its approval of the same actions on July 7, 2004. The County Financing Authority approved the project financing, adopting a resolution and approving bond documents, on August 3, 2004.

Attachments 8 through 11 are Board transmittals and a resolution from 2004 that include detailed information and background about the project and the previous approvals by the Board, the Financing Corporation, and the County Financing Authority.

Status of Lawsuits

In 2005 the Santa Clara County Superior Court granted a judgment in the County's favor on all plaintiffs claims in the San Jose Downtown Association lawsuit, ending that litigation. On February 16, 2006, the San Mateo County Superior Court ruled in favor of the County on our Motion for Summary Judgment in the City of San Jose lawsuit, throwing out all of the City's claims and upholding the County's position. In March 2006, the County and the City agreed to settle the litigation without proceeding to trial. The settlement agreement terms include \$22.5 million in damages related to the theater delay to be paid by the City to the County, as described above.

Construction Cost Inflation

Since the summer of 2004, when the last formal construction project cost estimate was completed, there has been significant inflation in the construction industry and changes in the construction bidding market. The project cost escalation and bond sizing, as compared to 2004, is summarized as follows:

(Millions)	<u>July 2004</u>	<u>Current</u>
Project Cost	\$66.0	95.9
Net of \$15 Million Contribution & Interest earnings		76.8
Capitalized Interest, Reserves and Financing Costs	<u>21.0</u>	<u>31.5</u>
Total Bond Issue Size	\$87.0	\$108.3

(Total bonding authority will be \$115 million to provide the Financing Authority and the underwriter with the maximum flexibility to issue one or more series of bonds as Senior Bonds or Subordinate Bonds, or a combination of such bonds.)

The total project cost includes the direct construction costs for approximately 40 subcontractors representing all elements of the work, the design–builder fee, the cost of equipment, and a conservative project contingency. The project cost estimates are provided by Turner Construction Company and are summarized in Attachment 5. The category of capitalized interest, reserves and financing costs includes the following: capitalized interest (i.e., interest during construction), the required debt service reserve fund, underwriter's fee, and costs of issuance. Those estimates were provided by the project bond underwriter, Citigroup.

Financial Pro Forma and Bond Marketability

Citigroup has been asked to reevaluate the project financial feasibility and update the financial pro forma based upon the increased bond sizing. That work has been completed and is attached as Attachment 3.

The financial pro forma is structured such that the residual proceeds accrue to the County after the payment of debt service, all other costs, and the maintenance of a supplemental reserve fund. Citigroup has evaluated the effect of the increased bond sizing on the amount and timing of residual revenues that would be realized by the County. The increased cost of the project obviously results in increased financing costs and a larger total bond issue, with correspondingly higher annual debt service payments. The aggregate amount of the increased debt service payments, then, takes away revenues that would otherwise apply to the County in the form of residual proceeds. However, this negative effect is offset by the fact that the interest rates anticipated to be paid on the bonds are now lower than the rates modeled in the 2004 pro forma. Also, the rate of interest to be received on the invested reserve fund and capitalized interest fund has increased since 2004. The new pro forma therefore indicates that the County would still begin receiving residual proceeds in the seventh year, which is the same year projected in the original pro forma.

CONSEQUENCES OF NEGATIVE ACTION

Without the recommended actions the Theater project cannot move forward and the Fairgrounds Revitalization Project would not be implemented as previously approved by the Board. If the Revitalization Project were to be abandoned, the Administration would have to develop a new master plan for the Fairgrounds and present such a plan for Board consideration some time in 2007. To the extent that any new proposed plan for the Fairgrounds involved non–public uses, such as commercial or residential development, the County would not have land use authority over those developments. Currently, the County has land use authority for the Theater (approved in 2000 and 2004) and the other

public purposes of the Fairgrounds Revitalization Project approved in 2000, as well as an approved Final Environmental Impact Report. Any new development proposal would require the County to start over with a new environmental review process under the California Environmental Quality Act (CEQA), including traffic mitigation and other significant requirements.

STEPS FOLLOWING APPROVAL

Upon approval of the recommended actions, Citigroup will begin the bond marketing process, with an anticipated bond closing date of October 5, 2006. Upon funding, the Corporation will create the project fund and authorize the development of the theater to begin. The County Executive will transfer the sum of \$15 million to the Corporation Fund, finalize and execute the Ground Lease, and perform other delegated actions under this approval. The plans for the infrastructure project will be revised to permit re-bidding and subsequent award in time for the infrastructure improvements to be coordinated with the theater construction.

ATTACHMENTS

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- Attachment 1: Resolution Approving a Financing for a Theater at the County Fairgrounds
- Attachment 2: Form of Ground Lease between the County & the Silicon Valley Theater Financing Corporation
- Attachment 3: Financial Pro Forma Analysis–Scenario 7/26/06–Citigroup Global Markets, Inc.
- Attachment 4: Feasibility Analysis – August 2006 – Economics Research Associates, Inc.
- Attachment 5: Theater Development Cost – August 2006 – Turner Construction Company, Inc.
- Attachment 6: Sixth Amendment to Santa Clara County Agreement for Services with MacKay & Soms Civil Engineers, Inc.
- Attachment 7: Revised Notice to Bidders for Fairgrounds Infrastructure Project

- Attachment 8: Board Transmittal CE04 101805 – Status Report on the Fairgrounds Theater Project
- Attachment 9: Board Transmittal CE04 050404 – Approval of Form of Ground Lease and Adoption of Resolution
- Attachment 10: Board resolution approving a Financing for a Theater at the County Fairgrounds and approving delegation of authorities
- Attachment 11: Board Transmittal CE07 040604 – Board Workshop on Fairgrounds Theater Development
- Supp Info Information 1 – Revised transmittal
- Supp Info 2–Memorandum from County Executive