



Office of the City Manager

INFORMATION ITEM

July 19, 2005

To: Honorable Mayor and
Members of the City Council

From: Phil Kamlarz, City Manager *Phil Kamlarz*

Subject: Oxford Parking Lot Development Update

SUMMARY

As the development of the Oxford Parking Lot continues to move forward, the developers have made significant progress with the entitlement process, financing options and working with staff to draft the Disposition and Development Agreement (DDA). However, there are a number of unresolved issues that are discussed in this report. In particular, there are significant financial risks to the City and increasing construction costs have resulted in a substantial financing gap. The available ways to fill the gap are likely to add significantly to the City's costs and may further increase the risks.

CURRENT SITUATION AND ITS EFFECTS

The City has been working on a complex transaction by which the City-owned Oxford parking lot would be transferred to a private joint venture between the David Brower Center (named after the first Sierra Club Executive Director and founder of Friends of the Earth and Earth Island Institute) whose board is composed of representatives from environmental organizations who intend to develop a David Brower Center building and a non-profit housing developer, Resources for Community Development ("RCD").

The configuration of the project is described in detail in the accompanying report recommending a general plan amendment to accommodate the project, and thus is only briefly described here. The Oxford lot would be subdivided into four parcels. As consideration for the transfer of the lot, on one parcel, the joint venture would build an underground parking garage extending across the entire area of the lot containing 105 parking spaces to replace the 130 currently on the lot. At the ground level one side of the lot will be occupied by the Brower Center, which would house an auditorium, gallery, restaurant and office space for environmental organizations such as Center for Eco-Literacy, Earth Island Institute and Rainforest Action Network. On the other side of the lot, linked by a courtyard, the "Oxford Plaza" would be constructed on two horizontally configured parcels, one above the other. The first, at ground level, would be made up of parking behind retail space. The second, above the first, would be made up of 96 units of low-income work force family housing.

The construction cost of the parking structure was intended to be equal to or in excess of the market value of the Oxford lot. The lot was valued in 2004 at \$5.7 million at its highest and best use, and \$4.2 million with the approved development program. Construction costs of the parking structure improvements were estimated at \$4.8 million and their cost is now estimated at \$6.5 million. The joint venture would grant a lease to the City of the parking parcel and structure for 99 years. The City would receive an option to repurchase the parking parcel for \$1 after the period of time necessary to render the project eligible for the tax credits that constitute a key component of project financing.

When the project was presented to Council on May 18, 2004, the only City subsidy envisioned in 2004 was a \$2.5 million reservation from the Housing Trust Fund, and a loss of revenue from the existing lot, for a two-year construction period. Based on current parking rates, that loss is about \$300,000 per year for a total of about \$600,000.

Estimated construction costs for the project have now increased from a total of \$52.2 million to \$63.5 million. As a result, the Housing, Retail and Parking components of the project currently have a funding gap that may be as high as \$8.5 million, assuming that the Brower Center, which plans to raise \$9 million from private sources will successfully raise the additional \$4 million dollars they need now that they have started their fund-raising campaign.

Staff had been working on a Disposition and Development Agreement (DDA) to implement the project with the development team based on the 2004 financial assumptions. During the course of the last year, several issues including ownership of the parking, financing plans for the various components, obligations of both the city and the developers, have been discussed. While many items have been resolved, significant issues remain outstanding. The major source of the difficulty is that because the construction cost estimates for the project have increased, the financing plans must change in order to cover the increased costs. Changes in financing can require changes in ownership structure or loan obligations among the parties that must be reflected in the DDA. Consequently the draft DDA has not been finalized.

Staff will be working closely with the developer over the summer to attempt to resolve the outstanding issues and close the financing gap. At this point it is likely that either the City's role in the project will need to be altered substantially in order to make the project feasible, or some components of the project will need to be significantly revised. Either of these possibilities will require careful Council review and approval. A further update will be provided to the Council in September.

BACKGROUND

1. Council Legislative History 2000-2004

In December 2000, the City Council requested that the Planning Commission establish a process and that the City Manager assign appropriate staff to work with the Commission in the development of a Request for Qualifications (RFQ) and a feasibility study on possible

underground parking on the Oxford Parking Lot, space for the arts, and affordable housing. Following the City Council's action in December, the Council further recommended that the Oxford site become the home of the David Brower Environmental Center.

A Request for Qualifications (RFQ) for the development of the Oxford Lot was sent to more than 100 interested parties in June 2002. A 12-member selection held interviews of the five development teams that had responded to a RFQ and the selection committee made a unanimous decision to select the team of Resources for Community Development and Equity Community Builders (RCD/ECB). On December 10, 2002 the City Council approved the development team of RCD/ECB and authorized the City Manager to enter into an Exclusive Negotiating Agreement ("ENRA") between the City and the Developer. The term of the ENRA does not expire until December 2005.

Since 2002, the development team has made several presentations to the City Council on the progress and the issues surrounding the development of the Oxford Lot. The developers have made substantial progress in identifying financing and funding sources, preparing cost estimates, processing entitlement applications for design, and environmental review.

The project as proposed offers both benefits and costs to the City and involves some significant risks. Here we briefly review the benefits and costs that are currently known and also provide a summary of the foreseen risks and potential future costs of the proposed development.

Due to the highly complex nature of the project, the interconnectedness of the three projects, and the need for specialized expertise to appropriately advise the City on this transaction, outside counsel was retained and has been advising staff at all junctures.

2. Policy Reason for Project

The benefits from the project are clear. It would replace a parking lot with 96 units of badly needed, permanently affordable, workforce family housing to the downtown, a location rich in employment opportunities and centrally located for transit. It would bring a major center for environmental organizations to Berkeley's downtown, creating both employment in an area of critical importance and a center for creative exchange and public outreach on topics of great interest to the citizens of Berkeley. It would also strengthen the retail base of downtown with street-level retail while maintaining over 100 spaces of parking to replace the current 130 surface spaces, and potentially providing additional parking to meet the needs of the Magnes Museum being created across the street.

3. Prior Known Project Costs

The known costs of the project as of 2004, when the Council last was briefed on this project, are the opportunity cost for use of the lot, the loss of annual parking revenue of \$300,000 during the construction period (2006-2008) totaling about \$600,000, and the subsidy for the housing from the City's Housing Trust Fund of \$2.5 Million.

Council also agreed, in approving the Exclusive Negotiating Agreement with the developers, that the City wishes to exchange its current situation, ownership of the parking lot and its air rights, for ownership of a parking structure with a similar number of spaces, with the land ownership and air rights over the parking transferred to allow the development of affordable housing and the Brower environmental center. The premise of this exchange was that the market value of the lot would be offset by the cost of constructing a new parking structure.

3. CURRENT ISSUES

As the development has evolved, a number of significant obstacles have been encountered. The most important of these are a large gap in project financing, rapidly escalating construction costs, uncertainties related to tax credits and exemptions and other regulatory, contractual and practical problems. These are discussed in turn below.

A. Gap in Project Financing of \$8.5 Million

Currently the project construction costs total \$63,500,000. This constitutes a twenty-two per cent increase over the 2004 project estimate of \$52,245,000. As a result, the funding gap has increased from \$2.5 million to \$8.5 million. Even if the current gap were closed, over time increased construction costs could create additional gaps in financing. The feasibility of any final project and the advisability of a City commitment to it can only be assessed once these factors have been sufficiently clarified.

The breakdown of the total construction costs for the project is approximately as follows:

	2005	2004
Housing	\$31,000,000	\$25,287,000
David Brower Center	\$20,500,000	\$18,958,000
Parking Structure	\$6,500,000	\$4,800,000
Retail & Surface Parking	\$5,500,000	\$3,200,000
Total Project Cost	\$63,500,000	\$52,245,000

Currently Seifel Consulting Inc., financial consultants for the City, is reviewing the latest project costs as part of their feasibility review of the project’s financing. All areas of the development have increased in cost, and the construction costs for the residential component are particularly high due to the site configuration and the complexity of construction. Residential unit construction cost currently averages \$323,000 per unit. Underground parking structure costs exceed \$60,000 per parking space, which is a cost burden to the development.

B. Potential Strategies to Close the Gap

Following approval by Council on June 14, 2005 the developer and the city submitted an application to the Department of Housing and Urban Development (HUD) for a Brownfield Economic Development Incentive grant (BEDI) in the amount of \$2,000,000. In September staff and the developer will need to submit an application to HUD for a Section 108 Program loan, since BEDI grants are made only to organizations that use the HUD 108 loan program. If we are successful in obtaining the BEDI grant, the use of the 108 Program loan must be carefully evaluated to see what financial commitments and risk such a loan may entail since it is secured by the City's future CDBG allocations. Mitigation of the risk involved could partially offset the value of any BEDI grant.

The developer is exploring a variety of other funding sources and strategies to close the financial gap including the following:

- Reduction in construction costs by obtaining additional cost estimates and interviewing for a new builder.
- Increasing New Market Tax Credits.
- Increasing Low Income Housing Tax Credits.
- Reducing potential assessment of property or possessory interest taxes on the public parking parcel.
- Borrowing against projected revenue from the retail portion of the project.
- Seeking additional funding from the City's Housing Trust Fund.
- Seeking further subsidies from the City in the form of a share of the annual parking revenues in order to service additional private debt.

The developer argues that the cost of construction of the underground parking is now higher than the value of the land and that the City should subsidize this additional amount. Staff has commissioned an update of the appraisal to review current land value. In addition, City staff believes that the way the costs are allocated between RCD and the David Brower Center also requires close examination and further review. The correct allocation is not a clear-cut matter given the complexity of the sources of financing for the project, so this will be a matter requiring further discussion with the developer.

C. Use of New Market Tax Credits

The New Markets Tax Credit (NMTC) Program permits taxpayers to receive a credit against Federal income taxes for making qualified equity investments in designated Community Development Entities (CDE's). Substantially all of the qualified equity investment must in turn be used by the CDE to provide investments in low-income communities. The credit provided to the investor totals 39% of the cost of the investment and is claimed over a seven-year credit allowance period. Investors may not redeem their investments in CDE's prior to the conclusion of the seven-year period.

NMTC's are allocated annually to CDE's under a competitive application process. These CDE's then offer the credits to taxable investors in exchange for stock or a capital interest in the CDE's. To qualify as a CDE, an entity must be a domestic corporation or partnership that: 1) has a mission of serving, or providing investment capital for, low-income communities or low-income persons; 2) maintains accountability to residents of low-income communities through their representation on a governing board of or advisory board to the entity; and 3) has been certified as a CDE.

The Oxford Lot developers intend to use NMTC's to finance all parts of the project except the housing. There are several restrictions and requirements with the NMTC's and staff is not sure at this point how all other proposed financing sources will synchronize with the NMTC's. A consortium of CDEs will probably assist the project. A critical issue is how much of the development financing will be passed through the CDE, and how the organizational and legal structure can be designed to leverage the maximum amount of NMTC.

D. Project Ownership Structure

The overall ownership structure of the proposed development is extremely complicated, partly due to the need to provide for the different interests involved; the City, the Brower Center, Resources for Community Development; and partly because of the requirements of some of the proposed sources of financing and subsidy. As mentioned above, the current plan is to have four condominium parcels: the public parking structure, the Brower Center, the Oxford Plaza Apartments; and the Retail along with the surface parking beneath the apartments. These parcels would be linked by a reciprocal easement agreement (REA) that governed the relationships and mutual responsibilities of the owners.

Separating the parcels can allow liens related to the project financing on those parcels in particular without putting the other parcels at risk. Some of the financing alternatives proposed by the developer would allow liens on the parking parcel that could put the City's control of the parking at risk if the developers default, and as a result, staff has refused to agree to such alternatives.

As initially proposed, the parking structure would be leased to the City for a nominal payment such as \$1 annually for a term of ninety-nine years, and after the time required for the developer to take advantage of tax credits which is currently estimated to be ten years, the City could purchase the structure for a similar nominal payment, retaining it as public parking.

The exact structure of the ownership depends on the requirements of the financing and this is not yet fully worked out. As was mentioned previously, the \$300,000 annual revenue from the public parking was to be retained by the City. New financing options may require the use of the revenue for debt service, and may require a different ownership structure and a different payment structure to the City.

E. Construction security

With the project already having difficulty coming up with sufficient financing, further cost increases would put the entire project at risk. Should cost increases in excess of budgeted contingencies show up during the construction period, this could force the City to cover the increase or lose its already substantial investment in the project.

The developer's proposed security for the construction of the parking structure is a completion bond, accompanied by a "Completion Guarantee Agreement", which is a personal guarantee. While a completion bond covers failure of the contractor to properly carry out the work, if there are reasons why costs increase that are not the fault of the contractor, such as the discovery of subsurface conditions that require redesign of the parking structure, then without an effective Completion Guarantee Agreement, unless more funding can be found from other sources the City becomes the last available financing source for covering the additional cost overruns.

The value of the Completion Guarantee Agreement rests with the resources of the party providing the guarantee. The developer has proposed that this would be provided by the non-profit entities doing the development, however these organizations do not, by themselves, have sufficient resources to provide an effective guarantee. The City normally accepts this additional risk for affordable housing development, and has stepped in with additional funding, for example in the University Neighborhood Apartments project when previously undiscovered subsurface water flows resulted in increased foundation costs. The City may not wish to accept such a risk where construction of the parking is concerned, since the replacement parking is the basic minimum requirement the City has set for allowing development of this project. In addition, failure to complete the David Brower Center could result in loss of the 40% of the land allocated to that project. Therefore, the City has continued to insist on guarantees that the project will be completed without additional cost to the City.

Outside counsel has also advised that the entire project as presently configured would be exempt from competitive bidding based on the integrated and interconnected nature of the project components and construction process. Any change in the integrated nature of the project would

have to be reevaluated and could result in the parking structure having to go through the City competitive bidding process.

F. Amount of Public Parking

The developer has expressed willingness to build a two-level parking structure as a means to accommodate additional parking in the downtown, if that is desired by the City and financing made available, but stated that such a decision would need to be made by December 2005 in order to allow modification of construction plans. The Judah Magnes Museum has expressed tentative interest in providing funding in return for an allocation of parking that would meet their parking obligation for development of the Museum across the street, but no details are currently available about how such an agreement would be structured. The Mitigated Negative Declaration has evaluated the environmental impact of both one and two levels of parking, however the applicant would need to modify its application for Use Permits since the current application specifies only one level of parking. If, prior to the end of the year, the organizations interested in additional parking, such as the Magnes Museum and the Downtown Berkeley Association, have found the means to finance the additional nearly \$6,000,000 needed to build the second level, the City could consider this option.

G. Public Parking Construction Warranty

Normally, a ten-year builders' warrantee will accompany the construction of the parking. This is a complex development, in which the underground parking is near the water table and must be developed using watertight building methods and in which the parking structure also serves as the foundation for major buildings above it. This poses certain risks that defects in construction may or may not show up within the ten years. Furthermore, if the parking structure is expanded to two levels, such an expansion would significantly increase the risk to the City of cost overruns due to both the size of the project and going substantially beneath the water table, as well as the risk of construction defects and costly future maintenance problems.

H. Guaranteeing Environmental Uses of the David Brower Center (DBC)

The original proposal states that "the Brower Center will be a green home for the 21st century environmental movement; a cultural commons for the people of Berkeley; a bustling town square for global citizens; a think-tank of creative practices, models and strategies, for what Brower referred to as "CPR": conservation, preservation and restoration of the Earth." "Under one roof, a diverse mix of environmental organizations will have a permanent address."

The David Brower Center space includes a 200-seat auditorium, four meeting rooms and a gallery for a total of 7,400 square feet. This conference space, as well as the green building features, make the construction costs of the building much more expensive than a typical office building. This could be a deterrent to attracting other lenders to fund these additional costs, particularly if the NMTC were not obtained. In addition to the office lease revenues for the 33,700 square feet of office space, the first year's cash flow for the David Brower Center include approximately \$335,000 in annual revenue from the use of the conference facilities. The staff also believes that it might be difficult to obtain this level of revenue from the use of this space or operating expenses from this space might be higher than anticipated, thereby affecting the ability of the Center to achieve positive cash flow.

Since there is a risk that the DBC will not be able to rent all or part of its office space to the originally proposed environmental groups at rents that allow repayment of its loans, the DBC would risk foreclosure (and might not be able to obtain financing at all) unless it retains the option to rent the vacant commercial space to anyone including both for-profit businesses and tax-exempt large institutions like the University of California. In addition, if the City undertakes loan obligations that it must repay with project revenue from the DBC, such as could happen with a HUD 108 Program loan, then the City would also have an interest in renting unused space to the highest available bidder. While such uses should be temporary until financing was sufficiently paid off that the DBC could afford to lower the rents to a level affordable by the non-profit environmental groups that are its primary concern, this might require a substantial period of time such as ten or twenty years.

The most effective long-term control over use of the property would be provided by a permanent deed restriction, which could allow flexibility for short-term financial need after review by the City. The developers have been unwilling to agree to deed restrictions and requirements in the DDA to commit to the use of the space for the stated purpose of the DBC, citing their inability to secure favorable financing if such restrictions applied. While staff has not insisted on such restrictions beyond requiring their good faith efforts, the Council should be aware of the significant risk that the City may end up with uses of the Brower Center which are unrelated to the purpose for which the City agreed to this complex transaction in the first place.

The only long-term guarantee of the uses of the DBC is the composition of the Board of Directors, which is currently made up of representatives of the Center for Eco-Literacy, the Rainforest Action Network, and the Earth Island Institute, along with a member of the Brower family. This could change over time, however.

I. Project Timeline:

In 2004, staff and counsel begin preparing the draft DDA for submission to the City Council. During initial review, it was determined that the developer must successfully complete all environmental and historic project review prior to the execution of the DDA. For the past year, the developer has been preparing plans, studies and analyses for Planning in order to proceed

with the entitlement process. The General Plan Amendment and environmental review are before Council this evening. The developer hopes to resolve the issues and bring the use permit for the project to the Zoning Adjustments Board in September.

Staff will be working closely with the developer over the summer to attempt to resolve the outstanding issues and close the financing gap. A further update will be provided to the Council in September, along with a revised timeline for the project.

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Attachments