

# THE REDEVELOPMENT AGENCY OF THE CITY OF SAN JOSE

## MEMORANDUM

TO: REDEVELOPMENT AGENCY BOARD	FROM: HARRY S. MAVROGENES EXECUTIVE DIRECTOR
SUBJECT: SEE BELOW	DATE: MAY 12, 2009

### INFORMATION

SUBJECT: FOURTH AMENDMENT TO THE DDA WITH 360 RESIDENCES LLC

On June 21, 2005, the Redevelopment Agency entered into a Disposition and Development Agreement (DDA) with 360 Residences LLC (the successor in interest to Mesa SoFA Partners, LLC), the Developer for the development of Agency-owned land at 351-369 South First Street/360-396 South Market Street (Site). The DDA provided that the Developer would purchase the Site from the Agency for \$10,000,000 and build approximately 11,000 square feet of retail space and 213 condominiums in a high-rise tower (Project).

One lease of Agency property and three amendments to the DDA have been approved by the Board for this Project as outlined below:

Lease Approved for an Off-site Sales Office (May 2006) -The Developer leased from the Agency ~7,000 square feet of ground floor retail space in the Fairmont Annex for use as the Project's temporary sales office.

First Amendment (June 2006) -The Developer received approval to allow earlier transfer of Agency property in order for the Project to qualify under the then current High Rise Incentive Program.

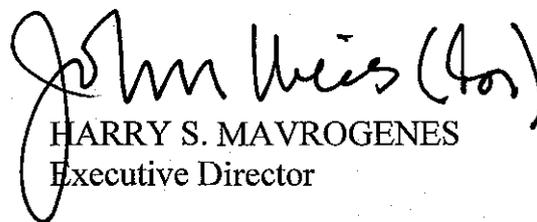
Second Amendment (January 2007) -After value engineering the design in order to maintain project quality, the Board approved deferring payment of \$2 million of the \$10 million sales price to the sale of the first residential unit.

Third Amendment (May 2008) - In accordance with proposed regulations of the City to encourage the creation of a pool of funds for large scale art projects, the developer's public art contribution was changed from building the art work into the project to making a contribution of \$597,000. Subsequent to the Third Amendment being approved, the for-sale residential market continued to deteriorate as part of the nationwide recession. In response to the Developer's request for assistance, Agency staff is preparing to bring a proposed Fourth Amendment to the DDA to the Agency Board for its consideration on June 9, 2009.

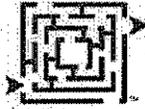
The proposed Fourth Amendment would amend the Agency's Promissory Note (Note) to provide that the outstanding debt would no longer be payable upon sale of the first residential unit, but would be payable to the extent the Project generates a profit after payment of all other debt and equity in the Project. A financial analysis prepared by Keyser Marston analyzing the financial impacts of the Fourth Amendment is attached. Additionally, the outstanding rent for the sales office would be deferred and added to the Note, 50% of the payment of Public Art Fees would be deferred, and unforeseen street improvements would be funded by the Agency, in an amount up to \$106,000.

As consideration for the changes under the proposed Fourth Amendment, the DDA will include covenants and restrictions affecting the retail spaces of the Project for a period of 20 years that will prohibit certain uses and set first class standards for operations and maintenance of the retail spaces.

Consistent with City and Redevelopment Sunshine policy practices, a more detailed staff report on the recommendation will be released for public review 14 days in advance of the scheduled Agency Board meeting. Also as required by Redevelopment Law the proposed Fourth Amendment and the attached Supplemental Summary Report will be on public display for the same 14 day period. A notice of the availability of those documents for public review will be published in the San Jose Mercury News.

  
HARRY S. MAVROGENES  
Executive Director

Attachment



**KEYSER MARSTON ASSOCIATES**  
ADVISORS IN PUBLIC/PRIVATE REAL ESTATE DEVELOPMENT

**MEMORANDUM**

ADVISORS IN:  
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REDEVELOPMENT  
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**To:** John Weis  
San Jose Redevelopment Agency

**From:** Keyser Marston Associates, Inc.

**Date:** April 29, 2009

**Subject:** Supplemental Summary Report  
Fourth Amendment to DDA with 360 Residences LLC

This is a supplemental memorandum to a Section 33443 Summary Report entitled "Summary Report Pursuant to Section 33433 of the California Community Redevelopment Law on a Disposition and Development Agreement (DDA) by and between the Redevelopment Agency of the City of San Jose (Agency) and 360 Residences LLC (formerly Developer SoFA Partners, LLC) (Developer), a Delaware limited liability company, dated June 21, 2005. The Summary Report summarizes the key financial terms of the DDA between the Agency and the Developer.

The purpose of this analysis is to summarize the revised key business terms with the fourth amendment to the DDA and the resulting revised costs and revenues to the Agency.

**I. BACKGROUND**

**Disposition and Development Agreement (DDA)**

On June 21, 2005, the Redevelopment Agency entered into a DDA with Developer for the development of Agency-owned land at 351-369 South First Street/360-396 South Market Street (Site), known as the former Dimensions Site. The DDA provided that Developer would purchase the Site from the Agency for \$10,000,000 and build approximately 11,000 square feet of retail and 203 condominiums in a high-rise tower (Project).

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### **First Amendment to DDA – Facilitate approval of Final Parcel Map**

In June of 2006 Developer sought and received Agency Board approval to change the DDA so that the Agency could record a parcel map for the proposed Project prior to transfer of the Property in order for the Project to qualify under the then current High Rise Incentive Program of the City's Inclusionary Housing Policy, which was a key requirement for the Developer to move forward with the Project. The recording of the final parcel map was a requirement for obtaining a foundation permit prior to the expiration of the Agency's High Rise Incentive Program on June 30, 2006. Failure to obtain a foundation or building permit for the Project prior to the expiration date of the High Rise Program would have obligated the Project to provide 20% of units to Moderate Income Households at Moderate Income prices.

### **Second Amendment to DDA – Promissory Note on Land Payment**

By July 2006, Developer reported to the Agency that its current construction cost estimates exceeded the projected construction budget. Developer sought to maintain both the high quality of design and finishes and the original purchase price of the property offered to the Agency and move forward with the Project. This necessitated a value engineering analysis to reduce project costs. Developer revised the Project plans to cut costs by eliminating the below-grade basement and parking area and including an additional floor of saleable units (ten additional units). However, by December 2006, after obtaining the necessary permits for the revised project, estimated project costs continued to be in excess of the Developer's budget and already-approved bank financing. Rather than request a price reduction, the Developer requested that the timing of the \$10,000,000 payment to the Agency be modified.

On January 30, 2007, Agency Board approved the second amendment to the DDA with Developer. The Second Amendment modified the timing of the payment of the purchase price of the Site by providing for payment of \$8,000,000 at the close of escrow and the execution of a \$2,000,000 Promissory Note due and payable upon the sale of the first residential unit in the Project and modified the Schedule of Performance. The Note was signed by Developer, Mesa Development LLC and David K. Hill Trust, to provide additional security for the Agency. With approval of the Second Amendment, the Agency transferred its land to the Developer in February 2007 after the payment of \$8,000,000 for the Site from the Developer.

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### **Third Amendment to DDA – Revising the Public Art Provision**

In May 2008, the Redevelopment Agency Board approved the third amendment to the DDA with Developer to assist the Project in the deteriorating residential real estate market by revising the public art provision of the DDA. The third amendment provided a 40% reduction in the Developer's total public art obligation to \$597,000 with a \$57,500 payment to the Office of Cultural Affairs (OCA) upon execution of the third amendment and the planned final payment of \$539,500 upon the sale of the first residential unit in the Project. These funds will be allocated to the City of San Jose's pooled Downtown Public Art Trust Fund. The OCA will use the pooled fund to develop works of art throughout downtown San Jose in accordance with the San Jose Public Art Master Plan and the Downtown Public Art Focus Plan.

### **Proposed Fourth Amendment to DDA**

Since the third amendment, the San Jose and greater Bay Area for-sale housing markets have continued to decline during the nationwide recession. Overall the nation's credit market and particularly the home loan market have remained tight even with substantial measures enacted by the Federal Government to stimulate a recovery. To help mitigate the growing projected losses of the Project caused by rising costs and declining sales prices and absorption, the Developer approached the Agency in October 2008 to gain additional time to sell the residential units and to restructure the Promissory Note.

#### **A. *Proposed Fourth Amendment – First Amendment to Promissory Note***

Modifies the terms of the \$2,000,000 Promissory Note: (1) to increase the principal balance of the Note to reflect the deferred rent owed by the Developer to the Agency for the sales office in the Fairmont Hotel Annex Lease; and (2) to change the Developer's repayment of the Note to a formula based on available net profits generated from the Project.

Under the proposed Amendment, the Agency's outstanding debt will no longer be payable when the first residential unit is sold but rather will be payable when and to the extent the Project generates a profit after payment of funds owing to the construction lender and the mezzanine lender and the return of equity invested by the Developer.

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**B. Proposed Fourth Amendment – Payment of Public Art Funds**

Revises the public art provision to defer 50% of outstanding obligation due to the Office of Cultural Affairs until 12/31/2010,

The balance of \$539,500 was due upon the sale of the first residential unit in the Project, which is anticipated to occur in the summer of 2009. Under the proposed Amendment, the payment shall be converted to two equal payments, with the first payment due upon close of escrow of the first residential condominium unit to a non-affiliated party of the Developer and the remaining payment due on 12/31/2010. The funds will be placed in the Downtown Public Art Fund to be used by OCA to develop new works of art within downtown redevelopment areas. Expenditure of pool funds will be guided by the recently developed Downtown Public Art Focus Plan and the subsequent bi-annual project plans developed by the Public Art Program in consultation with the Redevelopment Agency.

**C. Proposed Fourth Amendment – Street Improvements to Market Street**

Modifies the DDA's Method of Financing to enable the Agency to reimburse Developer up to \$106,000 for unforeseen street improvements to Market Street required by the City of San Jose.

Building and Public Works final approval of the off-site improvement plans on Market Street in the fall of 2007 reflected a larger area of street and sidewalk replacement for utilities connections than had been indicated in earlier submitted public improvement plans, resulting in \$106,000 in unfunded work in the Developer's lender approved budget. Under the proposed Amendment the Agency will reimburse the Developer for the estimated unfunded amount out of the 08/09 capital budget Miscellaneous Public Improvements budget line.

**D. Proposed Fourth Amendment – Fairmont Hotel Annex Lease**

Amends the lease between Agency and Mesa SoFA Partners, LLC for ground floor retail space at 170 S. Market Street to change the term of the lease to end on June 30, 2009 and to reflect that rents payments due during last six months of the lease will be added to the promissory note and paid accordingly, and update requirements for verification of insurance coverage.

In May 2006, the Developer leased 7,030 square feet of ground floor retail space located in the Fairmont Hotel Annex building from the Agency for its sales office for a period of

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32 months with an option to extend the term for additional 12 months upon adjustment of the base rent.

Under the terms of the proposed amendment to the sales office lease, Developer's monthly base rent payment obligations will be added to principal balance of the new proposed Promissory Note between the Developer and the Agency. Throughout the term of the proposed amended lease, the base rent will remain unchanged at \$14,060 per month and Developer will continue to pay its share of the common area maintenance charges to the Agency. The Developer has also agreed to the one time installation of Agency approved graphics related to marketing the project in the former sales office store-front windows within 30 days of Developer vacating the sales office space.

**E. Proposed Fourth Amendment - Retail Covenant**

As consideration for the Agency obligations under the Fourth Amendment, the DDA will be modified to include Covenants, Conditions and Restrictions (CCR) related to the leasing and maintenance of the retail spaces of the Project.

The proposed Amendment will require the Developer to execute and record CC&R's against the Retail Spaces. The term of the CC&R's will be for a period of 20 years. The CC&R's will prohibit certain uses and require the Developer and subsequent Owners of the retail space in the Project to maintain the retail space in a first class manner, to the benefit of the Downtown area.

**II. ANALYSIS OF AGENCY COST AND REVENUES**

**A. Estimated Cost to the Agency**

For this agreement, the cost to the Agency is estimated to be:

Land Payment	Amendment to Promissory Note	\$2,000,000
Fairmont Hotel Annex Rent	6 months rent: Jan thru June '09 Added to Promissory Note	\$84,360
Fairmont Hotel Annex Rent	Up to additional 2 months rent To be added to Promissory Note	\$28,120
Market Street Improvements	Reimbursement to Developer	<u>\$106,000</u>
		\$2,218,480

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The land payment and the Fairmont Annex Rent are foregone revenues and therefore considered a cost to the Agency. The Market Street improvement reimbursement is also a cost.

**B. Estimated Repayment from Amended Note to the Agency**

The revenue to the Agency will be based on the financial performance of the Project and the funds remaining after payment of the construction loan, mezzanine loan, and cash equity invested by the Developer. The estimated financing on May 1, 2009 is \$157 million.

**Est. Financing as of 5/1/09**

*(Source: Mesa)*

	<u>Estimated</u>
Construction Lender	\$99,158,472
Mezzanine Lender	55,081,381
Mesa Cash Equity	<u>2,846,561</u>
<b>Est. through May 1, 2009</b>	<b>\$157,086,414</b>

The following table illustrates that, if the sales prices average \$750,000 per unit, there would be sufficient funds to the repay the current financing (debt and equity but not the repayment of the Agency Note).

**Project Revenues**

**Necessary to repay financing**

Condo Sales	213 units	\$750,000 average per unit	\$159,750,000
Retail Condo Sale	11,050 SF		<u>4,000,000</u>
			163,750,000
(Less) Commissions/ Closing Costs			<u>(6,550,000)</u>
		<b>Available to repay financing</b>	<b>\$157,200,000</b>

In fact, prior to the close out of sales, which will not be before 2010, there will be carrying costs and marketing costs that need to be financed. As a result, the final financing will be higher than the current amount stated above. It is not possible to project with accuracy what the additional costs might be. However, it is expected that the sales price might need to average approximately \$800,000 per unit to repay the financing (debt and equity). This level of average price per unit cannot be predicted today. Therefore, the repayment of the Agency Note is dependent on future pricing at a level that might not be achieved and consequently it is not likely that there will be sufficient funds to repay the Note.

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**C. Net Cost to Agency**

The net cost to the Agency is \$2.2 million.

Previously, the Agency received a land payment of \$8 million. After completion of condominium sales, the Agency will receive approximately \$1 million per year in property tax increments. Overall, the Project produces a net revenue to the Agency.

**III. CONCLUSION**

In summary, the Agency is considering this Amendment as part of an effort to bring this Project to completion. When completed, the Project will be a significant asset in the downtown bringing new residents to the area.

With respect to the Note, the Developer intended to fund the payment of the Note through cash flow from the Project. Under the amended Note, the cash flow from sales will now be used to fund carrying costs and marketing costs through the completion of sales and to repay financing as described in the amended Note. At this time, under the terms of the amended Note, there are no funds projected from the Project going to the Agency. The Agency's revenues from the Project would then be the \$8 million paid for the land and the property tax increments received annually.