CITY OF OAKLAND/ REDEVELOPMENT AGENCY

AGENDA REPORT

OFFICE OF THE CITY CLERK

2006 NOV 16 PM 4:28

TO: Office of the City/Agency Administrator
ATTN: Deborah Edgerly
FROM: Community and Economic Development Agency and Office of the City Attorney
DATE: November 28, 2006

RE: **A City Resolution Adopting A General Policy To Lease, Rather than Sell, City Property; and**

An Agency Resolution Adopting a General Policy To Lease, Rather than Sell, Property for Redevelopment Purposes.

SUMMARY

The Redevelopment Agency typically conveys properties it acquires to third parties for redevelopment purposes. The City sometimes conveys properties it owns for a number of reasons, including sales of surplus property to other agencies or third parties.

With few exceptions, the Agency historically conveyed properties to developers by outright sales. The only recent transaction in which the Agency ground leased a large development site is to Forest City for the Uptown Project in downtown Oakland. The City typically does not convey property for large development projects.

CEDA staff and the City Attorney jointly wish to apprise the Agency and the Council that: (1) a number of other cities and redevelopment agencies have adopted a general policy of leasing rather than selling their properties; (2) Council can achieve the same goals in many instances by ground leasing as it can by selling property; and (3) the Council/Agency has the option of adopting a similar policy. This report provides the basic pros and cons of cities/agencies using ground leases versus selling property. This report will also describe the circumstances and factors cities and agencies typically consider in deciding whether to convey property by sale or lease.

FISCAL IMPACT

There is no current fiscal impact because the adoption of a general policy on leases and sales of properties, in and of itself will have little or no fiscal impact. Each lease/sale transaction that subsequently comes before the Council/Agency would be analyzed individually for fiscal impact.

BACKGROUND

The City/Agency owns more than 1,000 properties. The table below lists categories of properties by the City/Agency custodianship (see Table 1). These properties fall into a wide variety of categories, including:

- Land that has been deliberately acquired for a specific facility or purpose (e.g., site for a fire station, park, corporation yard, etc.);
- Properties acquired for future development;
- "Remnant" parcels, which are irregular parcels left over from road construction or other capital projects;
- Bequests and donations of property;
- Property that was previously developed for a city facility;
- Parcels that are jointly administered with other government agencies.

The vast majority of the City's properties are dedicated for a civic purpose, so only a very small fraction of these properties will ever be considered for possible sale or lease. On the other hand, the Agency probably will transfer most of its properties for redevelopment by private developers.

Table 1: Ownership of City/Agency Properties

Responsible City/Agency Department	Number of Parcels	Typical Uses of Parcels
Life Enrichment Agency	511	Parks, open space, museums, libraries, etc.
Public Works Agency	342	Maintenance facilities, street remnants, etc.
Redevelopment Agency	76	Redevelopment
CEDA	47	Various
Fire Department	24	Fire Stations
Police Department	1	Police Station
Other	12	Oakland/Alameda County Coliseum; Oakland Joint Powers Financing Authority; Oakland City Center LLC; etc.
Total	*1,013*	

In the coming year, the Redevelopment Agency is poised to transfer a number of properties to developers, including property on Martin Luther King Way for a condominium project, and at the former Oakland Army Base, Oak Knoll and other development sites. It is unclear at this time how many properties the City will convey in the near future, but it typically sells or leases a number of properties each year.

Redevelopment agencies generally choose to convey property by ground lease or sale depending on the specific circumstances of the proposed development and the agency's needs. Cities typically use their redevelopment agencies to develop large projects. Accordingly, when cities convey property it is usually for reasons other than redevelopment (e.g., to generate revenue, reduce potential liabilities of owning property). Although this report primarily discusses policies and practices of redevelopment agencies, the same principles may apply to transfers of land by cities.

Based on an informal survey of Bay Area redevelopment agency and city staff and counsel, and on our own experience, this report provides the basic pros and cons of using ground leases versus selling redevelopment property, and the circumstances under which agencies typically use each form of conveyance.

Some redevelopment agencies, including those of San Francisco, Pinole, and Pittsburg, have policies that discourage selling property in favor of ground leasing where possible, to retain real estate as a long term public asset. In those jurisdictions, with a few exceptions, redevelopment agencies almost always usually ground lease rather than sell redevelopment property. Other agencies have no strict conveyance policy. Still other agencies typically sell redevelopment property outright rather than ground leasing the property.

A. Ground Leasing

Redevelopment agencies (and cities) commonly use ground leases: (1) if the agency or the public may need or desire to have the flexibility to use the property in the future or for other purposes; (2) if the ground lease will provide some longer term economic benefit, including a rental revenue stream and/or appreciation; (3) if the agency wants to easily exert more control over a development; or (4) as a matter of policy to ensure that public property remains public property even though privately developed.

1. Potential Advantages

a. Agency's Future Use

By ground leasing a property, an agency remains the owner of the property, and the private developer is the ground lease tenant. Unless the agency gives the tenant an option to purchase and the tenant ultimately buys the property, the land will revert back to the agency at some point. The agency could develop the property for some other use if and when it reverts back to the Agency.

b. Flexibility in Creating a Revenue Stream

Ground leases allow the agency to structure payments to meet its financial needs. Ground leases can include a one-time upfront payment of rent, or it can provide for an annual or other periodic income stream. Though the agency can participate in the profits of the project in both a ground lease and a sale, profit participations are easier to monitor and enforce under a ground lease because the agency has a direct relationship with the tenant.

A tenant's ground lease rental payments could give an agency a consistent, predictable revenue stream, based on the agency's unique needs. The Agency retains the flexibility of structuring the revenue stream in a myriad of ways. If, for instance, the Agency wants the entire property value up front (similar to getting the full purchase price in an outright sale), it could require the tenant to pay a large up front rental payment, with nominal payments in future years. Conversely, the agency could require the tenant to make periodic rent payments based on the amount and timing determined by the agency's needs.

Moreover, the agency might reap the benefit of future property appreciation by using rent escalation lease provisions. For example, it may be very difficult to determine a retail property's value because there may be few comparable parcels of a similar size, use and location. These transactions could allow for a revaluation of the property after several years, and the agency could increase the rent if the initial valuation was too low.

c. Exerting More Control Over Project Development

An agency generally retains more control over a development by ground leasing rather than selling a property to a developer. The agency retains the ownership interest under a ground lease. If an agency sells property outright, it relinquishes its ownership interest and can only enforce its rights against a defaulting developer by, for instance, suing to invoke a "right to repurchase" under the disposition and development agreement (DDA) between the parties. Generally speaking, if a developer defaults or does not operate the property as the agency expects, it is much easier for the agency to terminate a lease than for the agency to file a lawsuit to take back the property the agency has sold to the developer pursuant to a repurchase right.

A redevelopment agency can often use a ground lease to balance the control it needs, while giving the developer adequate flexibility to administer its development. For example, if the project is risky, the agency can ground lease the property, giving the developer an option to purchase after several years of operation, once the developer shows that the project has been successful.

d. Retaining Public Property As A Matter Of Policy

Some agencies have observed other jurisdictions that have conveyed a significant portion of their public property to private developers, and have instead adopted the general policy that public property should remain public property, even if it is privately developed. . Ground leasing allows an agency to convey property for private development, yet keep the property for future public use and potential property appreciation.

2. Potential Ground Lease Disadvantages

a. If an agency ground leases a property, as the property owner, it retains potential liability for activities on the property or environmental defects, even if it requires the tenant to indemnify the agency in the lease. Claimants see an agency on the title and may look for the "deep pocket" to sue. However, this risk can be addressed in many cases by making sure that the tenant (or a guarantor) is financially strong and capable of backing up its obligation to indemnify the agency. Also, environmental laws impose potential liability on an agency for certain environmental matters whether or not it has sold the property outright or ground leased it to a developer.

b. Some developers argue that projects are more difficult to finance with a ground lease, loans are more expensive, and loan documents are more complex. Additionally, some developers have never ground leased property before and are not familiar with the concept. Based both on the experience of attorneys in the City Attorney's Office and on the views of the attorneys we have surveyed, we believe most lenders have become more comfortable with making ground-leased based loans. Loan documents indeed can be more complicated and include more mortgagee protection provisions. However, most major lenders have frequently financed ground lease transactions and ground lease financing is commercially and customarily available in the financial market.

c. In some cases, an agency may be compelled to pay for more of the infrastructure and upgrade costs if it ground leases property. Since the agency may ultimately end up with the property, the developer will argue that the agency should cover the long-term costs attributable to the property. The City of Pinole, for instance, has a strict ground leasing preference that has resulted in the city covering more upgrade and infrastructure costs than it would have otherwise.

d. Depending on the type of development that is likely to take place on the site, leasing may generate 25% to 30% less revenue (in terms of the "present value") than a sale of the property. This is because, under a long-term ground lease, the tenant does not enjoy the appreciation of land value and, and at the end of the lease term, may face greater uncertainty as to the long-term accommodation of its business. However, this is not a universal rule, and each transaction should be analyzed for its economic impact, along with a consideration of the other non-economic factors favoring leases.

e. Finally, sales may be preferable for particular transactions such as for affordable ownership (as opposed to rental) housing projects based on the unique needs and considerations of those types of projects. However, the general policy would not preclude such sales.

B. Transfer by Sale

A sale may be preferable if the agency's need for money outweighs the need to keep a long term asset, and the agency has determined that it will have no use for the property in the future.

However, as noted above, even in that case, the agency could structure a ground lease so that the developer makes a large up front rental payment in an amount comparable to the purchase price in an outright sale.

A developer may complete a project more quickly if the agency sells it the property. Unless the purchase is made at a deep discount, a developer who purchases the property usually has a financial incentive to complete the project quickly and start recouping the cost of purchase. Again, however, if the developer has to make a large upfront ground lease payment, it has the same incentive to complete the project just as quickly.

An agency may also choose to transfer the property by sale where the agency only owns a portion of the project area or small, irregular parcels. For example, in the San Francisco's Bloomingdales project, the developer already owned most of the land but needed the City to vacate some rights of way. The City sold the property to the developer because the City only owned small pieces of land in the project area, and leasing the parcels would have been impractical.

Conversely, transferring property by sale has many disadvantages. Conveying fee title to a developer allows the developer to maximize their profit from publicly-owned property. Additionally, it is more complicated to structure a sale transaction to accommodate an agency's desire for a long-term income stream. And while an agency can participate in the profits of the project in both a ground lease and a sale transaction, profit participations are easier to enforce under a ground lease because of the direct relationship between the agency/landlord and the developer/tenant.

KEY ISSUES AND IMPACTS

A. Ground Leasing Agency Property

PROS:

1. **Retaining the Property as a Public Asset.** Ground leases allow an agency to retain the property as a long-term public asset.

2. **Controlling the Use of the Property**. Ground leasing gives an agency more control over the developer's operation or use of the property than through an outright sale Generally speaking, it is easier to terminate a lease than it is to get property back once the agency has sold it. Also, the developer is more likely to cure a "default" or maintain the project because it knows the agency can more easily terminate a lease than file a lawsuit to enforce a "repurchase right."

3. **More Flexibility.** Ground leases can help an agency retain control, while giving the developer adequate flexibility to operate its project. For example, if the project is risky, the

agency can use a ground lease with an option to purchase the property after several years of operation, once the developer demonstrates that the project has been successful.

4. **Retaining Public Property.** Ground leasing allows the agency as a policy matter to keep public property truly public.

5. **Meeting the Agency's Financial Goals.** Ground leases allow the agency to structure payments to meet its financial needs. Ground leases can include a one-time large payment of rent, or it can provide for an annual or other periodic income stream. Moreover, profit participations are easier to monitor and enforce under a ground lease.

6. **Projects Subject to the Tidelands Trust.** Many development projects at the Port, or on the water, are subject to the public trust. A trust overlay often prohibits the sale of property, and in such a case ground leasing is the only option.

CONS:

1. **Ongoing Liability.** The agency/landlord may retain some liability for activities on the property or environmental defects, even with strong indemnification and hold harmless provisions in the lease.

2. **Financing Problems.** Some developers argue that projects are more difficult to finance with a ground lease, loans are more expensive, and loan documents are more complex.

3. **Cost of Upgrades and Infrastructure.** Some agencies pay more infrastructure and upgrade costs because the agency will ultimately end up with the property.

4. **Slower Development.** Developers have incentives to complete projects quickly, if they purchase the property or make a large one-time payment at the commencement of the project.

A. Sale of Agency Property

PROS:

1. **Meeting the Agency's Financial Goals.** A sale is preferable where the agency's need for money outweighs the need to keep a long term asset, and if the agency has determined that it will have no use for the property in the future.

2. **Faster Development.** Unless the purchase is made at a deep discount, a developer who purchases the property usually has a financial incentive to complete the project quickly and start recouping the cost of purchase.

3. **Agency Only Owns a Portion of Project Area.** The agency may choose to sell the property to the developer where the agency only owns a small portion of the project area or irregular parcels.

CONS:

1. **Possible Windfall to Private Developer.** Transferring fee title to a developer allows the developer to maximize their profit from publicly-owned property.

2. **Less Flexibility in Meeting the Agency's Financial Goals.** It is more complicated to structure a sale transaction to accommodate an agency's need for a flexible income stream. And while the agency can participate in the profits of the project in both a ground lease and a sale, profit participations are easier under a ground lease because the agency has a direct relationship with the lessee.

3. **Less Enforcement Rights.** In an outright sale, the agency does not have the same level of control or leverage to enforce the developer's obligations or monitor the project's operation.

SUSTAINABLE OPPORTUNITIES

Economic: Adopting a general policy of leasing rather than selling does not by itself have specific economic impact. Each potential sale or lease transaction would be analyzed for its economic impact on the agency/city.

Environmental: Environmental impacts would be analyzed based on each individual transaction.

Social Equity: Social equity might be enhanced if the city/agency adopted a general policy of retaining agency/city property for the benefit of the public.

DISABILITY AND SENIOR CITIZEN ACCESS

Adopting a general policy of leasing public property would not affect disability or senior access, except to the extent that the agency/city, as owner of the property, would likely have greater power to ensure such access. Each particular sale or lease transaction would be analyzed for disability and senior access.

RECOMMENDATION(S) AND RATIONALE

Based on the discussion above, the City Attorney's Office and CEDA staff recommend that the Council and the Agency consider the relative advantages and disadvantages of selling versus ground leasing its properties.

Adopting a general policy of leasing would not preclude the agency or city from deciding to sell in the appropriate situation. In instances where staff determines it preferable to sell, staff would include in its report to Council/Agency the rationale for selling rather than leasing. So, for example, guided by a general policy preferring leases, CEDA Real Estate would analyze each parcel for its Highest & Best Use and determine whether it would recommend an exception to the policy based on the current financial position of the City/Agency, and the factors favoring sales over leases as described above. CEDA Real Estate would then determine if it is an option to sell the parcel and, if so, what legal or practical constraints would restrict the sale. The Council/Agency could then decide whether to accept staff's recommendation to adopt an exception to the general policy for that particular transaction.[1]

ACTION REQUESTED OF THE AGENCY

CEDA staff recommends that the Council and Agency consider adopting a general policy of leasing, rather than selling, its properties. The City Attorney's Office has reviewed the recommendations and advises that the proposed policy is consistent with policies other cities have adopted and that such a policy does not raise any legal issues.

Respectfully submitted,

John A. Russo
City Attorney

Daniel Vanderpriem
Director of Redevelopment, Economic Development and Housing and Community Development

APPROVED AND FORWARDED TO THE COMMUNITY AND ECONOMIC DEVELOPMENT COMMITTEE:

Office of the City Administrator

Prepared by:
Dianne Millner
Alix Rosenthal
Deputy City Attorney

[1] The Real Estate Services Division is the designated office that coordinates all property issues (including the purchase, leasing, sale, and exchange of property) for the City and Redevelopment Agency (Agency). If a parcel is being considered for possible exchange, sale or for use as a leased asset, CEDA Real Estate must follow strict procedures for analyzing the property. These procedures are governed by several local, state, and Federal laws including:

- Surplus Land Act (California Government Code 54220 et seq.);
- Oakland City Charter (specifically Sections 219 and 2702);
- Oakland City Policies for the Sale and Lease of Property (specifically Ordinances 10142 C.M.S., 11602 C.M.S., 11603 C.M.S., and 11722 C.M.S.);
- California Redevelopment Law (California Health & Safety Code 33000 et seq.);
- California Department of Transportation Right of Way Manual (esp. Chapter 16 – "Excess Lands"); and
- Any relevant Federal laws or regulations.

APPROVED AS TO FORM AND LEGALITY:

Office of the City Attorney

OAKLAND CITY COUNCIL

RESOLUTION NO. ____________ C.M.S.

RESOLUTION ADOPTING A GENERAL POLICY TO LEASE, RATHER THAN SELL, CITY PROPERTY

WHEREAS, the City sometimes sells City-owned real property to third parties for a variety of reasons, including transfers after the City determines that the land is not needed for City purposes; and

WHEREAS, the City has determined that it is in the City's best interest to retain as much City-owned property as feasible for the benefit of the public; and

WHEREAS, the City will continue to comply with all legal requirements that may apply to transfers of City-owned property; and

WHEREAS, adoption of this resolution has no current fiscal impact because the adoption of a general policy in and of itself has no fiscal impact now, therefore, be it

RESOLVED: That the City hereby finds and determines that when the City determines it advisable or necessary to transfer City-owned property, it shall be the general policy of the City to lease rather than sell the property; and be it

FURTHER RESOLVED: That the City retains the power to make exceptions to this policy for a particular transaction; and be it

FURTHER RESOLVED: That if staff recommends the sale of City property, it will provide the *rationale for the recommendation; and be it*

FURTHER RESOLVED: That the City shall continue to comply with all legal requirements that may apply to transfers of City-owned land.

IN COUNCIL, OAKLAND, CALIFORNIA,____________________, 2006

PASSED BY THE FOLLOWING VOTE:

AYES- BROOKS , BRUNNER, CHANG, KERNIGHAN, NADEL, QUAN, REID AND PRESIDENT DE LA FUENTE,

NOES-

ABSENT-

ABSTENTION-

ATTEST:______________________________

LATONDA SIMMONS
City Clerk and Clerk of the Council
of the City of Oakland, California

FILED
OFFICE OF THE CITY CLERK
OAKLAND

2006 NOV 16 PM 4:28

APPROVED AS TO FORM AND LEGALITY:

D. Miller

Agency Counsel

REDEVELOPMENT AGENCY OF THE CITY OF OAKLAND

RESOLUTION NO. ____________ C.M.S.

AGENCY RESOLUTION ADOPTING A GENERAL POLICY TO LEASE, RATHER THAN SELL, PROPERTY FOR REDEVELOPMENT PURPOSES

WHEREAS, the Agency often acquires and sells Agency-owned real property to third parties for the purposes of redevelopment and the elimination of blight in accordance with California Redevelopment Law; and

WHEREAS, the Agency has determined that it is in the Agency's best interest to retain as much Agency-owned property as feasible for the benefit of the public; and

WHEREAS, the Agency will continue to comply with all legal requirements that may apply to transfers of Agency-owned property; and

WHEREAS, adoption of this resolution has no current fiscal impact because the adoption of a general policy in and of itself has no fiscal impact; now, therefore, be it

RESOLVED: That the Agency hereby finds and determines that it shall be the general policy of the Agency to lease rather than sell its property; and be it

FURTHER RESOLVED: That the Agency retains the power to make exceptions to this policy for a particular transaction; and be it

FURTHER RESOLVED: That if staff recommends selling Agency property, it will provide the rationale for its recommendation; and be it

FURTHER RESOLVED: That the Agency shall continue to comply with all legal requirements that may apply to transfers of Agency-owned land.

IN AGENCY, OAKLAND, CALIFORNIA,____________________, 2006

PASSED BY THE FOLLOWING VOTE:

AYES- BROOKS, BRUNNER, CHANG, KERNIGHAN, NADEL, QUAN, REID AND CHAIRPERSON DE LA FUENTE

NOES-

ABSENT-

ABSTENTION-

ATTEST:______________________________
LATONDA SIMMONS
Secretary of the Redevelopment Agency
of the City of Oakland