REPORT OF THE
CHIEF LEGISLATIVE ANALYST

DATE: February 28, 2014

TO: Honorable Members of the Budget and Finance Committee

FROM: Gerry F. Miller, Chief Legislative Analyst

Council File No: 11-1980
Assignment No: 14-02-0147

SUBJECT: The Village at Westfield Topanga Subvention Agreement

SUMMARY

In December 2012, the City Council approved a Memorandum of Understanding (MOU) (CF# 11-1980-S5) outlining the terms of a subvention to assist the development of The Village at Westfield Topanga (Project), to be developed by Westfield, LLC. Westfield, LLC has proposed to develop the Project under the legal entities 21919 Erwin Street LLC and West Valley Owners LLC (collectively the Developer). The proposed Project is comprised of the construction of a new 549,394 square foot, first class mixed-use development that will include a relocated Costco Wholesale store as the anchor retail tenant occupying approximately 165,759 square feet with an ancillary member-only fueling station. The Project will also include upscale retail, boutique specialty shops, personal services, restaurants, a community center, associated common spaces, parking, landscaping and other uses typically found in a first class regional shopping center. Due to current market conditions, the Developer has opted not to include a hotel component in this initial phase of the development but reserves the right to pursue construction of a hotel in the future. The proposed development will be located on the southeast corner of Victory and Topanga Canyon Boulevards in the Warner Center Region of the City of Los Angeles.

In June 2013, the City Council instructed the Chief Legislative Analyst (CLA) to negotiate a final Subvention Agreement to implement those terms outlined in the MOU. In accordance with the approved MOU, negotiations have resulted in a proposed Subvention Agreement which would provide approximately $20.9 to $25 million net present value (NPV) over a 25-year term (Agreement) (Attachment A) to support development of the Project. The Developer will guarantee that the City continue to receive current City public revenues generated at the project site of approximately $116,141 annually. The Developer will also implement a community benefits package that includes a contribution of $3.325 million to establish The Village at Westfield Topanga Public Benefits Trust Fund.

RECOMMENDATIONS

That the Council, subject to the approval of the Mayor:

1. FIND under the California Public Resources Code Section 21166 and the California Environmental Quality Act Guidelines Section 15162, on the basis of substantial evidence contained in the whole record, that since certification of the Environmental Impact Report (EIR) No. ENV-2007-3393-EIR (SCH 2007101117), on November 14, 2012, there have been no changes to the Project, no changes with respect to the circumstances under which the Project is being undertaken, or no new information of substantial importance concerning the Project, which cause new significant environmental effects or substantial increase in the severity of previously identified significant effects, and therefore no additional environmental review is required for the Project;

2. APPROVE the Subvention Agreement by and between the City of Los Angeles (the City), 21919 Erwin Street LLC (Erwin), and West Valley Owner LLC (West Valley), (Erwin and West Valley are

collectively referred to as the Developer), substantially in the form attached as Attachment A concerning The Village at Westfield Topanga (Project), and authorize the Mayor to execute said agreement;

3. AUTHORIZE the City Administrative Officer (CAO), with consent of the CLA and the City Attorney, to negotiate and execute additional non-material changes to the Subvention Agreement as necessary;

4. REQUEST the City Attorney to prepare and present an ordinance to establish The Village at Westfield Topanga Public Benefits Trust Fund for the receipt and disbursement of three million three hundred twenty five thousand dollars ($3,325,000) to fund community benefits; and

5. REQUEST the City Attorney to prepare and present an ordinance to establish The Village at Westfield Topanga Trust Fund for the receipt and disbursement of subvention payment pursuant to the Subvention Agreement and to provide for the reporting requirements set forth in California Government Code Section 53083.

FISCAL IMPACT STATEMENT
The Village at Westfield Topanga is estimated to generate net new public revenues of approximately $41.9 million net present value (NPV) in various General Fund revenues over 25 years. City policy allows up to fifty percent of net new General Fund revenues to be used for the purpose of a subvention. As proposed, The Village at Westfield Topanga would retain up to $20.9 to $25 million NPV in net new revenues in various General Fund revenues, for up to 25 years. In no event will the Developer receive more than fifty percent of the net new revenues generated by the Project.

ENVIRONMENTAL REVIEW
Since certification of the Environmental Impact Report (EIR) No. ENV-2007-3393-EIR (SCH 2007101117), on November 14, 2012, there have been no changes to the Project, no changes with respect to the circumstances under which the Project is being undertaken, or no new information of substantial importance concerning the Project, which cause new significant environmental effects or substantial increase in the severity of previously identified significant effects, and therefore no additional environmental review is required for the Project.

BACKGROUND
The Village at Westfield Topanga is a major development that is proposed to construct a new 549,394 square foot first class mixed-use development in the Warner Center Region of the City of Los Angeles. The Project's anchor retail tenant will include the relocation of a Costco Wholesale store currently located at 21300 Roscoe Boulevard in Canoga Park into approximately 165,759 square feet of the Project site with an ancillary member-only fueling station. The Project would also include approximately 281,238 square feet of shopping center retail, 71,147 square feet of restaurant space, 17,000 square feet of grocery store/food hall/mini anchor space, and 14,250 square feet of community/cultural area.

On May 9, 2012, the City Council approved Motion (Zine/Wesson) instructing the CLA to evaluate The Village at Westfield Topanga project for possible forms of economic development incentives to assist in development of the Project. The Developer indicated that without financial assistance from the City in a form similar to that provided to the Wilshire Grand and the Olympic North Hotels, development of the Project would not be feasible.

On December 12, 2012, the City Council adopted a CLA report that authorized the CLA to execute a Memorandum of Understanding to negotiate the terms and conditions necessary to provide financial assistance to the Developer. The actions also authorized the selection of a consultant to conduct the analyses necessary to evaluate the economic impacts of the proposed Project. As a result, the CLA conducted a competitive bidding process for qualified consultants and selected the combination of Rosenow Spevacek Group, Inc. (RSG) and PKF Consulting USA (PKF) to conduct the financial analysis for the retail and hotel components of the Project. In May 2013, RSG and PKF provided a comprehensive financial and economic assessment of the Project that concluded the development had a feasibility gap of $48.8 million and would generate approximately $140.1 million in gross value or $61 million NPV over 25 years.

On June 28, 2013, the City Council authorized the CLA and City Attorney to negotiate a subvention agreement and other related documents that are in conformance with the previously approved MOU and includes a community benefits package that maximizes the City's benefit. During ongoing discussions and negotiations of the subvention agreement, the Developer indicated a change in the Project's scope of development, specifically removing the hotel component from the initial phase of development, increased development costs, added a parking fee program, and made some changes to the proposed tenant mix. As per the Developer, current market conditions do not support development of the hotel at this time. As a result, City staff instructed RSG to review the entirety of the development's program changes including the development feasibility, fiscal impact and economic impact determinations in comparison to the previous 2013 report.

RSG provided the attached revised report dated February 25, 2014 (Attachment B) that summarizes the key differences between the 2013 report and the revised tenant information and development program. The RSG report indicates the total cost of development to be approximately $335.6 million of which $300 million is supportable investment and $35.6 million results in a feasibility gap. The report further indicates the revised Project would generate approximately $95.4 million in gross value or $41.9 million NPV over 25 years in net new public revenues. City policy allows projects such as this to receive a subvention of no more than 50 percent of net new revenues generated by the project. As per RSG's analysis and City policy, the Developer would have the opportunity to receive approximately $20.9 million NPV over 25 years to support development of the Project.

The Subvention Agreement indicates a subvention amount of $20.9 million if the Project is built as proposed and meets RSG's sales revenue forecasts. In consideration of the $35.6 million feasibility gap and revised development program focused on constructing a first class upscale shopping center that looks to exceed sales forecasts, the proposed Subvention Agreement would allow the Developer the opportunity to continue receiving subvention assistance within City policy up to $25 million NPV within the 25 year term.

Subvention Agreement

The attached Subvention Agreement is the result of the negotiations directed by the City Council to provide support to The Village at Westfield Topanga Project. The terms in the Subvention Agreement conform to the Council-approved MOU, as summarized below:

1. Determination of Funding Gap: A pro-forma analysis using the direct capitalization method identified a $35.6 million feasibility gap. The direct capitalization method was used because it requires fewer assumptions and relies on projected revenues as soon as the Project reaches stabilization. RSG used the income of the retail component at year 2017 as the basis for the direct capitalization of the property as all the project components would be operational by that date and a going-in capitalization rate of 7.1 percent on the retail and 6.6 percent on ground leases.

2. Subvention Amount: A cumulative amount of annual subvention payments received by the Developer currently estimated by the City to be $20.9 million (NPV in 2013 dollars) using a discount rate of six percent over a 25-year term. The Developer will be entitled to continue receiving annual subvention payments up to $25 million (NPV in 2013 dollars) using a six percent discount rate within the 25 year term contingent upon the project construction cost reconciliation process warranting that amount as described in the Subvention Agreement and net new tax revenues exceeding revenue projections. The subvention payments will be comprised of up to 50 percent of the City's share of the sources of net new General Fund revenues collected from the Project. As per the City's legal counsel, establishing a Community Taxing District is not required to serve as the mechanism to process the subvention. No later than one hundred eighty (180) days after the Completion Date, the Developer and City Administrative

Officer will commence to establish the final maximum Subvention Amount which will be established by conducting a final review and audit of the Total Project Construction Costs and the Project Financing.

3. Existing City Revenue Protections: For purposes of calculating the annual net new public revenues to process the subvention payments, the City will exclude the actual tax revenues, including property taxes, received by the City during the full year prior to the Completion Date from: 1) the existing Canoga Park Costco Wholesale store operating at 21300 Roscoe Boulevard which is proposed to be relocated to the Project site, 2) the proposed Costco gas station, 3) any net lost City revenues attributable to the closing of the existing Costco Wholesale store which is not replaced by an existing business on the Costco Site (such net amount shall be excluded from Net New Tax Revenues and shall not form the basis of any subvention payment) and 4) any other tax revenues from Excluded Retailers to be measured only within the first three years after the Completion Date. Excluded Retailers include but are not limited to 1) commercial retail stores exceeding 2,000 square feet, 2) eating and drinking establishments exceeding 2,000 square feet, and 3) stores selling convenience goods (i.e. grocery store or pharmacy) located within each categories "Trade Area" as further defined in the Agreement.

4. Subvention Term: Beginning on the Completion Date which is the date the City first issues certificates of occupancy or temporary certificates of occupancy for not less than 428,115 square feet of completed improvements and ending on the first to occur of (i) the 25^{th} anniversary of the Completion Date, (ii) the date on which the Developer has received the Subvention Amount, or (iii) the termination of the Subvention Agreement for any reason pursuant to the terms of the Agreement.

5. Developer Guarantee: The Developer shall guarantee that the City continue to receive current public revenues generated by the Project site, estimated at $116,141 annually, until the subvention ends or the full guarantee amount has been paid. The Developer Guarantor shall execute an unconditional corporate guarantee substantially in the form attached as Exhibit G in the Subvention Agreement.

6. Transfer of Hotel and Property: Not applicable.

7. Hotel Operator: Not applicable.

8. Hotel Standards: Not applicable.

9. Construction Sales Tax: The Developer will cause the City to be designated as the "point of sale" for all construction related purchases (including purchases made by any subcontractors of the Developer's general contractor) for the Project. It would be the sole responsibility of the Developer to ensure that all contractors on qualified construction contracts obtain the necessary permits from the State to self-report sales tax, and credit would only be given for Construction Sales Tax that the City actually receives.

10. Community Benefits Package: A community benefits package has been negotiated with the Developer and will be implemented in association with development of the Project including the implementation of a Local Hiring/First Source/Minority Business Recruitment program, the use of guidelines established by U.S. Green Building Council for Leadership in Energy and Environmental Design (LEED) Rating System for new construction, payment into The Village at Westfield Topanga Public Benefits Trust Fund in the amount of $3.325 million within 90 days of the Effective Date of the Agreement, establishing a location within the Project for the San Fernando Valley's annual "Walk of Hearts" event, digital signs within the Project for displaying public service announcements and community messages, and public art and programming in the Project's outdoor plaza. As indicated in the recommendations in the report, the City Attorney is requested to prepare and present a City ordinance to establish The Village at Westfield Topanga Public Benefits Trust Fund.

11. Preconstruction Activities: The Project site has been cleared of any improvements and graded in preparation to commence construction.

12. Construction Commencement: The Developer is committed to commence construction of the Project within 180 days of the approval by the City Council of the Subvention Agreement (see Attachment A, Exhibit I, Schedule of Performance).

Gross Value versus Net Present Value (NPV)

Throughout this report, gross value and NPV are expressed for the feasibility gap calculations as well as projected net new tax revenues. The key number on which to focus is the NPV. It represents the amount of money the developer must generate up-front to finance the construction of the project and, so that the comparisons are valid, the amount of net new tax revenues projected form the project in today's dollars.

A common NPV situation with which many people are familiar is a home mortgage. If someone buys a house for \$300,000 and puts \$100,000 down, the buyer must get a loan for the remaining \$200,000. If that buyer obtains a 30-year fixed rate loan with monthly payments of \$1,500, the buyer would be paying \$18,000 per year in principal and interest (\$1,500 x 12). Over the 30 year period, the buyer would be paying \$540,000 in principal and interest on the mortgage (\$18,000 x 30). Therefore, the buyer would be paying a total of \$640,000 for the house over a 30-year period (\$540,000 + \$100,000). However, it would not be accurate to say that the buyer is purchasing a \$640,000 house. The buyer is purchasing a \$300,000 house, with \$100,000 down and a \$200,000 loan. The \$200,000 is the NPV of the payments the buyer makes over the 30 year period of the loan.

At the core of all site specific tax revenue (SSTR) transactions is whether there is sufficient funding available from future revenues to enable the developer to raise the capital today necessary to build the project. The City uses independent consultants, paid for by the developer, to conduct this analysis.

The first step is calculating the cost of building the project. These costs include land acquisition if applicable, hard construction costs and soft costs such as design, construction and project management, permit fees, etc.

The second step is to calculate the expected annual Net Operating Income (NOI) once the project is completed and operational. The NOI is projected annually over 20 to 25 years, depending on the proposed term of the SSTR agreement. This includes rent revenues and any other revenues generated by the project less operating costs such as labor, maintenance, utilities, security and taxes. If the NPV of the projected NOI is not sufficient to generate sufficient funding to construct the project, a "feasibility gap" exists which, if not closed, would make building the project infeasible.

The third step is to calculate the net new tax revenue generated by the project. According to City Council policy dating back to the late 1990's, if a feasibility gap exists, the City will consider reinvesting up to 50% of net new revenues generated by the project and the City would keep the remainder. The reinvestment of up to half of the net new revenues increases the NOI with the goal of achieving a NOI sufficient to fund the construction of the project. The best numbers to focus on with regards to the net new revenues is also the NPV so that the expected additional revenue to the City is compared in today's dollars to the amount of construction funding that the developer can generate today with the additional cash flow.

In the case of the proposed The Village at Westfield Topanga project, the feasibility gap is \$35.6 million NPV. The NPV of all of the net new revenues expected to be generated by the development is \$41.9 million (gross dollars of \$95.4 million). Half of the NPV of the new revenues is \$20.9 million, leaving a remaining gap of \$14.7 million which the Developer will have to cover from other sources. The proposal before you also includes a provision that, if and only if the project generates more net new tax revenue than projected, the Developer can receive up to an additional \$4.1 million NPV to help cover more of the gap. In this event, the City will also receive an additional \$4.1 million NPV. The gross dollar amount of this portion cannot be calculated today because it will depend on when the additional net new revenue is generated.

Assembly Bill 562 Compliance

In accordance with California State Assembly Bill 562 (AB 562) and Government Code Section 53083(a), on and after January 1, 2014, each local agency shall, before approving any economic development subsidy within its jurisdiction, provide all of the following information in written form available to the public, and through its Internet Web site, if applicable:

1) The name and address of all corporations or any other business entities, except for sole proprietorships, that are beneficiary of the economic development subsidy, if applicable.

    WEST VALLEY OWNER, LLC
    c/o Westfield, LLC
    Attention: Peter Schwartz, General Counsel
    2049 Century Park East, 41st Floor
    Los Angeles, CA 90067

2) The start and end dates and schedule, if applicable, for the economic development subsidy.

    Beginning on the Completion Date which is the date the City first issues certificates of occupancy or temporary certificates of occupancy for not less than 428,115 square feet of completed improvements and ending on the first to occur of (i) the 25th anniversary of the Completion Date, (ii) the date on which the Developer has received the Subvention Amount, or (iii) the termination of the Subvention Agreement for any reason pursuant to the terms of the Agreement.

3) The description of the economic development subsidy, including the estimated total amount of the expenditure of public fund by, or revenue lost to, the local agency as a result of the economic development subsidy.

    A cumulative amount of annual subvention payments received by the Developer currently estimated by the City to be \$20.9 million (NPV in 2013 dollars) using a discount rate of six percent over a 25-year term. The Developer will be entitled to continue receiving annual subvention payments up to \$25 million (NPV in 2013 dollars) using a six percent discount rate within the 25 year term contingent upon the project construction cost reconciliation process warranting that amount as described in the Subvention Agreement and net new tax revenues exceeding revenue projections. The subvention payments will be comprised of up to 50 percent of the City's share of the sources of net new General Fund revenues collected from the Project. As per the City's legal counsel, establishing a Community Taxing District is not required to serve as the mechanism to process the subvention.

4) A statement of the public purposes for the economic development subsidy.

    Pursuant to the MOU, the Developer requested certain financial assistance from the City to ensure the feasibility of the Project and help offset project costs. The City has determined that the project is not financially feasible without the City's assistance and that the development of this Project is of public benefit and contributes to the general welfare of its citizens because it will be constructed on a site long vacant in the community, eliminating a source of economic and physical blight, will create temporary and permanent jobs, as well as increasing the City's tax base to better fund vital municipal facilities and services, and providing other public benefits, such as local hiring, living wage protections, sustainable design and construction of new open and community spaces.

5) Projected tax revenue to the local agency as a result of the economic development subsidy.

The Project is projected to provide a significant positive impact to the northwest San Fernando Valley area, the City and the Los Angeles County regional economy. During the construction period, the economic impact of the Project is expected to generate thousands of direct and indirect jobs and approximately 2,205 jobs upon completion. The Project is also anticipated to generate approximately $95,400,000 in total new City revenues and approximately $458,000,000 in overall economic impact to the regional economy over the 25 years following the Completion Date.

6) The estimated number of jobs created by the economic development subsidy, broken down by full-time, part-time, and temporary positions.

FULL and PART TIME EMPLOYMENT

	Temporary (Construction) Jobs		Permanent (Operations) Jobs	
	Part Time	Full Time	Part Time	Full Time
Jobs				
Direct	190	912	500	1,177
Indirect	186	227	87	107
Induced	238	290	150	184
Total	614	1,429	737	1,468

Sources: Fiscal Feasibility Analysis, United States Bureau of Labor Statistics, and MIG, Inc.
Note: Analysis is based on full time equivalents.

Oscar O. Ixco
Analyst

Attachment A: Subvention Agreement
Attachment B: The Village at Westfield Topanga Revised Feasibility Study