# City of Rialto

## Legislation Text

**File #:** 18-256, **Version:** 1

For City Council Meeting [April 24, 2018]

TO: Honorable Mayor and City Council

APPROVAL: Robb R. Steel, Interim City Administrator

Request City Council to Conduct a Public Hearing to Adopt **Resolution No. 7323** Approving (1) a Purchase and Sale Agreement and Joint Escrow Instructions and (2) a Construction Loan Agreement by and between the City of Rialto and Ayala@210LLC and Adopt Budget **Resolution No. 7324** Appropriating Funds for the maximum amount of $3,700,000.
**(ACTION)POWERPOINT**

**BACKGROUND:**
On March 14, 2017, the City Council approved an Option to Purchase and Develop Site Agreement ("Option Agreement") by and between the City of Rialto and Ayala@210LLC ("Developer") for a commercial development anchored by Cracker Barrel, Sonic, and a major chain hotel situated on an 8-acre site situated east of Ayala Avenue and north of Renaissance Parkway/Easton Avenue ("Site"). The site map is attached hereto as **Exhibit A**.

On March 28, 2017, the City Council approved a Purchase and Sale Agreement between the City and the County Flood Control District ("CFD") to purchase 4.4 acres of CFD parcels for $1,661,000. On September 1, 2017, the City closed escrow.

On March 28, 2017, the City Council approved a Purchase and Sale Agreement between the City of Rialto and the Rialto Successor Agency (RSA) to purchase 3.08 acres from the RSA for $1,342,000 (the "RSA Parcels"). On March 27, 2018, the City Council appropriated $1,342,000 to acquire the RSA Parcels in April 2018. On April 5, 2018, the City closed escrow on the RSA Parcels. The City of Rialto owns the Site.

The Option Agreement obligates the Developer (or in some cases, the purchaser/user) to complete the following tasks:

- **Secure Land Use Entitlements**. In December 2017, the Developer obtained the required entitlements to develop the Site and received Conditions of Approval for PPD # 2017-0066.

- **Prepare On-Site Improvement Plans and Obtain Bids**. The Developer prepared on-site improvement plans and received a proposal from Green Mountain Engineering to construct the on-site improvements. The City has not yet approved the on-site improvement plans.

- **Enter into Purchase and Sale Agreements**. The Developer entered into purchase and sale agreements with Cracker Barrel and Sonic for two of the six parcels and has also entered into a purchase and sale agreement with a hotel investor for a third parcel.

- **Prepare Plans and Bid Off-Site Improvements**. On January 23, 2018, the City Council approved Amendment #1 to the Construction Reimbursement Agreement by and between the City of Rialto and Ayala@210 LLC for a maximum reimbursement amount of $4,080,227 for off -site improvements to Renaissance Parkway. On April 2, 2018, the off-site construction commenced.

The project schedule is as follows:

| | |
|---|---|
| • April 2018 | Off-site construction commences. |
| • April 2018 | On-site construction commences. |
| • May 2018 | Cracker Barrel/Sonic construction commence. |
| • October 2018 | Cracker Barrel and Sonic open. |

**ANALYSIS/DISCUSSION**:

For various reasons, the proposed transaction structure changed. The original structure contemplated single parcel option takedowns when the Developer contracted with specifically approved users. This granted the City greater control over the ultimate users. However, the City conditioned the Developer to improve the larger Site with the first parcel acquisition, making it difficult to obtain construction financing when the City would not subordinate its remaining land to the construction lender.

Consequently, the City and Developer negotiated a revised transaction that conveys the land to Developer at no initial cost, with the ultimate purchase price secured by a first deed of trust and with the City providing construction financing for the horizontal site improvements. The City receives payment for the land purchase and a specified share of the construction loan upon each closing with an approved end user. Because the Developer receives public funding for construction, and because the City offers the land at less than fair market value, the Developer must pay prevailing wages for the horizontal construction and the City factored that incremental cost into the terms of sale. Users will acquire the pads for fair market value and the vertical construction shall not be subject to payment of prevailing wages.

Purchase and Sale Agreement

The original Option Agreement established a sales price of $3,805,000 for all six parcels. Staff proposes to reduce the base purchase price by the negotiated prevailing wage mark-up of $405,000 and additional $100,000 contingency, reducing the aggregate price to $3,300,000 (“Purchase Cost”). The table below illustrates the price for each proposed parcel under the original transaction and the revised transaction.

| Original Pricing | Parcel SF | Cost per SF | Total Purchase Amount |
|---|---|---|---|
| Parcel 1 (Cracker Barrel) | 99,785 | $ 12.00 | $ 1,197,420 |
| Parcel 2 (Sonic) | 38,215 | $ 14.25 | $ 544,564 |
| Parcel 3 (Multi-Tenant Building FRONT) | 41,949 | $ 12.00 | $ 503,388 |
| Parcel 4 (Multi-Tenant Building WEST) | 41,948 | $ 11.50 | $ 482,402 |
| Parcel 5 (Multi-Tenant Building EAST) | 30,147 | $ 11.50 | $ 346,691 |
| Parcel 6 (Hotel) | 81,216 | $ 9.00 | $ 730,944 |
| **TOTAL Current Pricing** | **333,260** | **$ 11.42** | **$ 3,805,408** |

| Revised Pricing | Parcel SF | Cost per SF | Total Purchase Amount |
|---|---|---|---|
| Parcel 1 (Cracker Barrel) | 99,785 | $ 10.41 | $ 1,038,000 |
| Parcel 2 (Sonic) | 38,215 | $ 12.36 | $ 472,000 |
| Parcel 3 (Multi-Tenant Building FRONT) | 41,949 | $ 10.41 | $ 437,000 |
| Parcel 4 (Multi-Tenant Building WEST) | 41,948 | $ 9.97 | $ 418,000 |
| Parcel 5 (Multi-Tenant Building EAST) | 30,147 | $ 9.97 | $ 301,000 |
| Parcel 6 (Hotel) | 81,216 | $ 7.81 | $ 634,000 |
| **TOTAL Revised Pricing** | **333,260** | **$ 7.81** | **$ 3,300,000** |
| | | | |
| **Variance between Original and Revised** | | | **$ (505,408)** |

On April 9, 2018, the County Recorder recorded the parcel map. Staff proposes to convey the six parcels (Parcels 1, 2, 3, 4, 5, and 6) to the Developer after the City records the parcel map but before on-site construction commences.

The City Attorney prepared a Purchase and Sales Agreement and Joint Escrow Instructions (**Exhibit B**). The Purchase and Sale Agreement replaces the Option Agreement in its entirety. The principal terms are:

- The City will carry back a purchase money note totaling $3,300,000 for Parcels 1 through 6 secured by a <u>First Deed of Trust</u> on the Site.

- The Loan will carry an interest rate of 4%, but the City will waive interest if the Developer completes the project in accordance with the terms of the Purchase and Sale Agreement.

- The promissory note matures on March 31, 2020. The Developer can extend the maturity for up to two years by depositing 1% of the total purchase amount for each year - total 2% (applicable to purchase price of remaining parcels on a pro-rata basis).

- The Developer does not make any payments until conveyance to an end user.

- The City shall grant partial releases upon payment of the land purchase price for each parcel.

- The Grant Deed contains covenants regarding specific uses for respective parcels (i.e. restaurants, etc.).

Construction Loan

The Developer procured an unsecured loan for pre-development expenses (“Unsecured Loan”). At present, the Developer identifies approximately $626,000 in project costs incurred. The City will examine all costs covered by the Unsecured Loan to ensure that the payments are consistent with the transaction terms.

The Developer obtained original a preliminary proposal for $2,430,000 from Green Mountain Engineering for the on-site improvements based upon prevailing wages (“Construction Cost”). The improvements include grading, walls, driveways, landscaping, and utilities in the common areas and some improvements in the Parcel 1 and 2 (Cracker Barrel and Sonic) pads to allow building construction. The prevailing wage increased the on-site construction cost by $405,000. On April 18, 2018, the contractor updated the Construction Cost to $2,555,000 due to landscape costs. The Developer and staff will work with the contractor to reduce the Construction Cost to $2,430,000.

When the City conveys the Site to Developer, the City will also concurrently fund the amount of $3,700,000 for the Construction Cost, signs, consultant services, City permits, and contingency (“Construction Loan”). The City will place the Construction Loan proceeds in an escrow or other suitable account for disbursement upon eligible expenditures. The City Attorney prepared the Construction Loan Agreement attached hereto as **Exhibit C**. The principal terms are:

- The City provides up to $3,700,000 in funding for on-site improvements, with a promissory note secured by a Second Deed of Trust subordinate only to the Purchase Money Promissory Note and First Deed of Trust. The City is the only secured lender for the Project.

- Disbursements from the Construction Loan escrow account shall conform to the approved on-site budget. Any disbursement requires both City and Developer approval.

- The Loan amount is 100% of the actual third party on-site improvement costs, incurred prospectively.

- The interest rate is 6% per annum compounded on outstanding balances.

- The Construction Loan matures on March 31, 2020. The Developer may extend the maturity for a total of two years until March 31, 2022 by depositing 1% of the total remaining purchase price for each year - total equal to 2% of remaining purchase price.

- The Developer will make payments to the City upon closing for each parcel and upon receipt of all reimbursements of other income related to the project.

- With each closing, the escrow shall equally distribute the Net Proceeds to pay the Developer's Unsecured Loan and the City's Construction Loan. After the Developer repays the Unsecured Loan in full, the City shall receive 100% of the Net Sale Proceeds until the City Construction Loan is repaid in full. Net Proceeds equals the total sales price to the end user, less any authorized expenditures including broker's fees, developer management fees, property taxes, and escrow costs.

- The City receives 100% of all reimbursement and fees paid by others for elements such as, but not limited to, on-site improvements and signs (monument and freeway). These revenues shall pay down the City Construction Loan.

- The Developer will receive $350,000 for general project management and overhead costs upon each closing as follows: Parcels 1 and 2 ($50,000 each); Parcel 6 ($50,000); Parcels 3, 4 and 5 ($75,000 each for the first two parcels sold and $50,000 for the last parcel sold).

- The City will advance all approved costs to complete construction in accordance with the Conditions of Approval. If the actual costs exceed the original approved budget, the Developer shall bear this risk with a reduced profit. If there are any savings, the Developer realizes the full benefit of the savings in greater profit. This term ensures that the City and Developer's goals align to contain costs, while ensuring a quality project outcome.

- The City and the Developer each receive 50% of first $200,000 of the project's profit. Thereafter, the City receives 30% and the Developer receives 70% of Net Profits as defined.

<u>Government Code Sections 52201 and 53083</u>
Pursuant to Sections 52201 and 53083 of the Government Code, the City must prepare a report ( **Exhibit D**) that provides information related to economic development activities on the RSA parcels and any subsidy using City funds. The City retained Keyser Marston Associates to prepare the required public information report. The City published notice in the San Bernardino Sun for the Section 52201 requirements on March 27, 2018 and April 3, 2018 and for the Section 53083 requirements on April 13, 2018.

<u>Risks</u>
The City is not normally a construction lender. Construction lending entails risk, and the potential loss of invested funds. That is why construction lenders receive significant fees for the provision of capital. In this transaction, the City will provide a substantial portion of the investment in the Project and accept risk related to the following events as examples:

- **Cost Overruns**. The construction costs may increase due to unforeseen conditions or change orders to the project scope. This may depress project economics and result in losses for both the City and Developer.

- **Downturn in the Economy**. If a recession were to occur before sale of all parcels, it may depress property values. Economic conditions may cause delayed or reduced repayment of the City Construction Loan based upon economic conditions.

- **Cracker Barrel and/or Sonic Terminate**. While unlikely, buyers occasionally terminate purchase and sale agreements near the finish line. If for some unforeseen reason, these users terminate their deals, the Developer will need to find another user. In the event of a recession, values may depress resulting in slower absorption and or reduced sales prices.

- **Hotel investor Terminates**. For the same reasons, the hotel development may be delayed causing the loan to remain outstanding for a longer duration or forcing a sale at a reduced sales price.

- **Developer is unable to build the entire site and/or repay the entire loan**. If the Developer is unable to develop the entire site after completing the on-site improvements, the City continues to own the site and can seek another developer to complete the project. A new developer may offer less for the land, resulting in a write-down.

The transaction structure attempts to mitigate for known risks, but the City bears risk for project performance.

**ENVIRONMENTAL IMPACT:**

On November 14, 2017, the City Council approved Resolution No. 7229 approving Environmental Assessment Review No. 2017-0055 ("EAR") for the proposed retail project known as Renaissance East. The EAR determined the proposed project will not result in any new significant impacts that are not analyzed in the RSP EIR, nor will the project cause a substantial increase in the severity of any previously identified environmental impact. The potential impacts for the proposed Project are the same or less than those described in the RSP EIR. In addition, there are no substantial changes to the proposed Project that would result in new or more severe environmental impacts than previously addressed in the RSP EIR, nor has any new information regarding the potential for new or more severe significant environmental impacts been identified. In December 2017, the City filed a Notice of Determination with the County of San Bernardino Clerk as required by the State CEQA Guidelines. The City has not received any protest.

**GENERAL PLAN CONSISTENCY:**

The proposed action fulfills the following General Plan Goals and Policies related to Economic Development:

**Goal 3-1: Strengthen and diversify the economic base and employment opportunities, and maintain a positive business climate.**

Policy 3-1.2: Encourage a variety of businesses to locate in Rialto, including retail, high technology, professional services, clean industries, logistics-based businesses, and restaurants/entertainment uses to promote the development of a diversified local economy.

Policy 3-1.4: Encourage the consolidation of smaller lots of industrial and commercial areas to attract larger industrial businesses or commercial projects.

Policy 3-1:6: Attract regional commercial uses along the SR-210 Freeway and I-10 Freeways, particularly at on- and off-ramps, by providing incentives such as fast track review of projects and fee credits.

The proposed project encourages retail, restaurant, and entertainment uses to locate in Rialto, while consolidating disjointed lots into a suitable development parcel, and attracting regional commercial uses to the 210 Freeway corridor.

**LEGAL REVIEW:**
The City Attorney prepared the Purchase and Sale Agreement and the Construction Loan Agreement (and related documents) and reviewed and approved the Budget Resolution and staff report.

**FINANCIAL IMPACT:**
Operating Budget Impact
Upon full build-out of the proposed uses, the City will realize approximately $150,000 per year in new general fund revenues from retail sales taxes, property taxes, utility taxes, and business license taxes. In addition, the City anticipates approximately $315,000 annually from transient occupancy taxes if the proposed 108-room hotel develops.

Capital Budget Impact
Staff proposes to utilize General Fund reserves of up to $3,700,000 for the Construction Loan. Staff recommends transferring $3,700,000 from the General Fund Reserve (Fund 010) and increase funding of $3,700,000 in Account Number 010-500-4255-3001. The City will then deposit $3,700,000 from Account Number 010-500-4255-3001 with an escrow company or banking institution in cooperation with the City Treasurer.

The City Council previously appropriated General Fund reserves of $3,003,000 to acquire the Site. Adding the Construction Loan increases the total General Fund reserve funding for the project to $6,703,000.

If the Developer utilizes the entire $3,700,000 Construction Loan, the City expects to receive approximately $7,147,354 from property sales and Construction Loan repayment as illustrated in the table below. The City expects to receive $3,300,000 for the land purchase price against costs of $3,003,000, producing a $297,000 return on investment. The City also expects to receive approximately $147,000 in construction loan interest for a total return on investment of $444,354. In addition, the City may receive project profit ranging from $135,000 to $250,000. These estimates are not guaranteed.

The table below illustrates the General Fund Cashflow. Staff anticipates receiving about $2,000,000 by June 30, 2018 from the Cracker Barrel and Sonic sales and $1,800,000 by December 31, 2018 from the hotel parcel sale. Staff further anticipates receiving about $1,600,000 by March 31, 2019 from a fourth parcel sale. The final parcel sale is projected in the fourth quarter of 2019.

| | Q2/18 | Q3/18 | Q4/18 | Q1/19 | Q2/19 | Q3/19 | Q4/19 | Totals* |
|---|---|---|---|---|---|---|---|---|
| **Land Transaction** | | | | | | | | |
| Parcel Number Sales | 1/2 | | 6 | 3 | | 4 | 5 | |
| Land Purchase Investment | $ (3,003,000) | | | | $ - | $ - | | $ (3,003,000) |
| Land Sales Proceeds | $ 1,510,000 | $ - | $ 634,000 | $ 437,000 | $ - | $ 418,000 | $ 301,000 | $ 3,300,000 |
| Net Land Cashflow | $ (1,493,000) | $ - | $ 634,000 | $ 437,000 | $ - | $ 418,000 | $ 301,000 | $ 297,000 |
| **Construction Loan** | | | | | | | | |
| Other Construction Expenditures | $ (1,796,000) | $ (1,874,000) | $ (30,000) | $ - | $ - | $ - | $ - | $ (3,700,000) |
| Construction Loan Repayment | $ 487,260 | $ 300,000 | $ 873,454 | $ 1,173,172 | $ - | $ 772,143 | $ 241,325 | $ 3,847,354 |
| Construction Loan Cashflow/Interest | $ (1,308,740) | $ (1,574,000) | $ 843,454 | $ 1,173,172 | $ - | $ 772,143 | $ 241,325 | $ 147,354 |
| | | | | | | | | $ - |
| Quarterly Cashflow | $ (2,801,740) | $ (1,574,000) | $ 1,477,454 | $ 1,610,172 | $ - | $ 1,190,143 | $ 542,325 | |
| Cumulative Cashflow | $ (2,801,740) | $ (4,375,740) | $ (2,898,286) | $ (1,288,114) | $ (1,288,114) | $ (97,971) | $ 444,354 | $ 444,354 |

| | |
|---|---|
| Revenue | |
| Land Sales Proceeds | $ 3,300,000 |
| Construction Loan Repayment | $ 3,847,354 |
| **Total Revenue** | **$ 7,147,354** |
| Expenses | |
| Land Purchase Investment | $ (3,003,000) |
| Construction Expenditures | $ (3,700,000) |
| **Total Expenses** | **$ (6,703,000)** |
| **Over/(Under)** | **$ 444,354** |

* Based on the developer utilizing the entire $3,700,000 Construction Loan

## RECOMMENDATION:

Staff recommends that the City Council:

1) Adopt Resolution (**Exhibit E**) approving a Purchase and Sale Agreement and Joint Escrow Instructions between the City of Rialto and Ayala@210LLC to convey City owned parcels for the development of a retail center at the northeast corner of Ayala Drive and Renaissance Parkway and Approving a Construction Loan Agreement for $3,700,000 between the City of Rialto and Ayala@210LLC to provide City funds for on-site improvements related to the development of a retail center at the northeast corner of Ayala Drive and Renaissance Parkway.

2) Adopt a City Budget Resolution (**Exhibit F**) appropriating reserves for the Construction Loan funding.

3) Authorize the City Attorney to make non-substantive technical changes to the Purchase and Sale Agreement and the Construction Loan Agreement.