Government of the District of Columbia

Office of the City Administrator

Testimony of

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Public Hearing on Council Study of the Costs and Benefits of Bill 20-805, District of Columbia Soccer Stadium Development Act of 2014

Before the
Council of the District of Columbia
Committee on the Whole

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12:00 p.m.

Council Chamber
John A. Wilson Building
1350 Pennsylvania Avenue, NW
Washington, DC 20004

Good afternoon Chairman Mendelson and members of the Council. For the record, my name is Allen Y. Lew and I am the City Administrator for the District of Columbia. On behalf of Mayor Vincent C. Gray and myself, I am pleased to come before you today to present the many benefits of the proposed Soccer Stadium legislation and to discuss the findings from the Council's independent assessment of the transaction prepared by Convention Sports & Leisure International, The Robert Bobb Group and Integra Realty Resources.

With me today are members of the development team that have worked to assemble the proposed Soccer Stadium transaction. At the table are Scott Burrell who serves as the Senior Legal Counsel to the Office of the City Administrator and our transaction counsel, Tom Bridenbaugh from Leftwich & Ludaway.

To begin with, I would like to thank the Council and its consultants for all of the hard work and long hours that have gone into preparing the report. We welcome the transparency that it brings to the process and acknowledge the importance of the Council's oversight function.

The report, as you know, is lengthy—nearly 400 pages. We have reviewed the draft report and its key findings and conclusions; however, as you can well imagine, we have not yet had the opportunity to read it in detail and ask that we be given until the next Tuesday, November 11, 2014 to supplement our response.

Earlier this year, I presented testimony on the proposed transaction and the benefits that it will provide to the District of Columbia and its residents. In my testimony today, I would like to accomplish four things. **First,** I will discuss the economic benefits that the proposed transactions will bring to the District and its residents. **Second,** I will discuss the terms of the Development Agreement and the Groundlease—in essence, the public/private partnership that underlies the Soccer Stadium transaction. **Third,** I will discuss the land swap and valuation issues. **Lastly,** I will discuss the "risk factors" related to this transaction.

As you know Mr. Chairman, the Council has retained Convention, Sports and Leisure International, the Robert Bobb Group and Integra Realty Resources (the "CSL/Robert Bobb/IRR" team) to analyze the proposed transactions. To a significant extent, I believe the CSL/Robert

Bobb/IRR Team saw many of the same things that we see. There are, of course, differences in opinion and estimates as you would expect given a transaction of this size and complexity.

1. Economic Benefits

When the Mayor presented the Soccer Stadium legislation to the Council earlier this year, I presented the benefits that this transaction would bring to the District of Columbia. From our perspective, the key benefits of this transaction are nearly 2,500 new jobs, creating a new and vibrant neighborhood at Buzzards Point, $2.3 billion in new economic activity, $385 million in new fiscal benefits, and the construction of a world-class soccer stadium appropriate for the District's status as a world class, international city, but also as the Nation's Capital. As is appropriate, the CSL/Robert Bobb/IRR Group conducted an independent analysis of the transaction. Their analysis is not, as one would expect, identical to ours, but they have reached similar conclusions:

- They found the transaction will generate 1,683 new jobs.
- They found the transaction will generate $2.6 billion in new economic activity.

- They found the transaction will generate $365 million in new revenues.

- Lastly and most importantly, the new soccer stadium will accelerate the development of a vibrant, new neighborhood in Buzzard Point. The soccer stadium will leverage the other investments that the District of Columbia has made along the Anacostia River—namely Nationals Park, the South Capitol Street bridge and the Wharf Development.

Whether the Soccer Stadium transaction will generate $172 million in net new fiscal revenue to the District, as we estimate, or $109.4 million as the CSL/Robert Bobb/IRR team estimate, in either case, the transaction will result in net fiscal benefits and is good for the District and its residents. Perhaps more importantly, the transaction will significantly accelerate development in the Buzzard Point area or as the IRR, the Council's independent appraiser, concluded the proposed transaction had a "significant positive impact . . . and in particular on the marketability of sites located south and west of Nationals Park". [p.97] We agree with the assessment and as the consultant team noted, absent this transaction, development in Buzzard Point would be delayed by 5 to 8 years.

2. The DC United Transaction

The CSL/Robert Bobb/IRR Team compared the proposed structure and costs of the DC United transaction with the development of other MLS stadiums. On balance, I believe it is fair to say that they concluded the terms of the Development Agreement and Ground Lease are consistent with the terms of other MLS stadiums. Specifically, the consultants determined that the proposed structure is "reasonable relative to other MLS soccer-specific stadium developments". [p.18]. Moreover, while much has been said in the media about the proposed tax abatements, the CSL/Robert Bobb/IRR team concluded that without the abatements "it would become much more difficult for D.C. United to obtain any significant level of long-term stadium debt." [Exec. Summary .v]. The consultants have also confirmed that public subsidies were present in all but 3 of the 15 most recent MLS soccer stadium developments. [p.5]. The consultants observed that the average public investment is approximately 44%. [p.5]. Based on our current estimates, we estimate that the District will fund

47.8% of the total investment. If, however, the costs hit the contractual cap, the District will fund 50.4% of the total investment. In either case, the public investment in this facility will be consistent with the average public investment for such facilities.

3. Land Swap and Valuation Issues

As the conversation about the Soccer Stadium has unfolded over the last five months, I think it is safe to say that the most contentious issue has involved the proposed land swaps that will be used to fund this transaction. As we testified in June, these swaps are necessary in order to remain in compliance with the debt cap and they provide planning and financial certainty to the proposed transaction. By using the land swaps, the District can fund the proposed transaction with a relatively modest amount of cash. Moreover, we have entered into definitive and, assuming they are approved by the Council, legally binding Purchase and Sale Agreements for a substantial portion of the soccer stadium footprint.

Many have questioned the valuation of the land that underlies this transaction, the most contentious of which relates to the Reeves Center. The CSL/Robert Bobb/IRR team has conducted an independent review of the values. As I see it, their findings can be summarized as follows:

- They agreed with and, in fact, adopted the Fair Market Value for the Reeves Center that came from the three member land valuation panel;
- They agreed with and, in fact, adopted the Fair Market Value for Akridge's land at Buzzard Point;
- They agreed with and, in fact, adopted the Fair Market Value for the 1st and K Street parcel; and
- They agreed that the valuation of the Pepco land was not unreasonable.

There were, however, three areas where they disagreed with our land valuations. **First,** they felt that the Rollingwood and Supersalvage properties were over-valued. In this, they are not necessarily incorrect. In order to reach closure on the transaction and achieve financial and planning certainty, we agreed to pay a premium to acquire these parcels. DC United and Akridge helped defray some of this premium. While the purchase price for those parcels is higher than I or the Mayor would like, we feel the premium is appropriate in order to close these transactions. The CSL/Robert Bobb/IRR team recognized this. With respect to the overall land acquisition costs and even in light of their view of land values, stated that those values do <u>not</u> argue that "a decision to consummate the proposed transactions would be ill-advised as a matter of public policy, nor do our land value opinions suggest that a public assembly of the stadium site could be achieved at a cost equivalent to the sum of the values. The invocation of eminent domain by a condemning authority typically involves expenditures well in excess of market value in order to acquire title once legal and other professional costs are considered, to say nothing of the time and risk involved in the condemnation process." [p112]

Second, while the CSL/Robert Bobb/IRR team essentially agreed with the value of the Pepco land, they raised a question as to whether the cost of relocating Pepco's infrastructure should be netted from that number. The consultants, however, noted that were the District to take that land through eminent domain, the District would bear the cost of relocating these facilities. Given that, and given that the District is asking Pepco to relocate those facilities, the Mayor and I believe that the agreed upon cost is fair and reasonable.

Lastly, the CSL/Robert Bobb/IRR team believed that the District's 3-year leaseback of the Reeves Center should increase the buildings value by approximately $11 million. Although we have not had an opportunity to discuss this conclusion with the consultants, we do not believe they have properly analyzed this portion of the transaction. The leaseback in question is temporary in nature and as the consultants acknowledge will delay redevelopment of the site by 3 years. The rental rate is $18.23 per square foot and is far below market rents. Fundamentally, Akridge, or any other developer for that matter, is acquiring the site for redevelopment and it's difficult to imagine how a leaseback that delays redevelopment would add value to the site.

Equally important, we believe that their analysis failed to include the cost of capital—that is to say the mortgage payment on the $56 million acquisition cost of the Reeves parcel—that will be incurred by Akridge during the 3 year leaseback payment. If these costs are incorporated into their analysis, the $11 million difference essentially disappears as the carrying cost of $56 million at 5% to 6% is roughly $3 million a year or $9 to $10 million over a three year period.

Additionally, at the request of the community, the District and Akridge have agreed to certain modifications to the original agreement that would reduce the appraised value of the Reeves Center land, however Akridge has agreed to these changes without a reduction in the purchase price. The changes include:

- 100,000 to 150,000 sf of commercial space in the redevelopment of the Reeves Center
- 3,000 square feet of community space to be available for a weekly farmer's market;
- The building(s) will be constructed to at least a LEED Silver (or higher) certification;
- Community design open houses to ensure community input into the design;

- The District has early termination rights and extension options in their leaseback to afford the District maximum flexibility in their relocation from the Reeves Center.

Accordingly, as noted before, the District maintains that the Reeves Center is appropriately valued.

4. Risk Factors

Finally, Mr. Chairman, I would like to address the "risk factors" that are identified in the CSL/Robert Bobb/IRR report. At the outset, however, it is important to note that nothing in life is risk free. There is risk in everything that we do and it is impossible to structure a major transaction, or for that matter a walk across the street, without risk. To my way of thinking, the question is not whether there is risk, but rather is the level of risk appropriate for the transaction and has the risk been properly managed. In this regard, I believe the development team has done their job and done it well.

If we compare the risks in this transaction to those present in the Nationals Ballpark or the Convention Center deals, both of which are viewed in hindsight as highly successful endeavors, the risk in this transaction is far less than the risk in those situations. The major differences between this transaction and the other two models are as follows:

- We have virtually eliminated the land cost risk. There are only four parcels of land that we have to acquire in order to assemble the necessary footprint. We have negotiated and put in place binding purchase agreements with regard to 2 of the parcels and have letters of intent in place for the other 2. In contrast, when the Council approved the Nationals Ballpark and the Convention Center, we had not acquired all of the land and had significant acquisition exposures. In both cases, the final parcels of land had to be acquired through eminent domain.

- There was environmental risk in all three projects. In the case of the Soccer Stadium, the environmental risk is less as the design for the Soccer Stadium contemplates an essentially "at grade" structure. Thus, much less excavation and below grade work, which are the typical remediation cost drivers, will be required.

- Lastly, in both the Convention Center and the Ballpark, the District acted as both the horizontal and the vertical developer, which is to say that the District was responsible for the design and the construction of the structures. Here, that responsibility and the attendant risk, has been transferred to DC United. In addition, DC United has contractually agreed to assume responsibility for the District's share of the horizontal development costs should they exceed $150 million.

As a result of these differences, I believe the District's position has a much lower risk profile than it did in the other transactions.

There are, of course, risks associated with this transaction. In developing this deal, we have carefully considered those risks and structured the transaction in a method that minimizes the risk to the District. The CSL/Robert Bobb/IRR team identified seven risks, each of which I will address in turn.

1. **The Council of the District of Columbia, or a District Agency will materially alter the May 23, 2014 Land Exchange Agreement between the District and SWLH resulting in a renegotiation of the existing Agreement or potential termination of the Soccer Stadium Transaction as currently proposed.**

This is a major risk to the transaction. It, however, is completely within the District's control and this is precisely why the Mayor and I believe it is essential that the Council approve the Exchange Agreement "as is". If you do so, the District will have put in place more than one third of the required funding for this project and will have eliminated what I believe—and it appears the independent consultant agrees—to be the single largest risk to this transaction.

2. The Actual Costs of the District's Preconstruction Infrastructure Obligations Will Exceed its Stated $150 million Development Cap

The development agreements between the District and DC United expressly transfer this risk to DC United and require that DC United fund the overrun. The risk then is really one of non-performance by DC United of its contractual obligations. Risks 3, 4 and 5 that were identified by the consultant also involve non-performance by DC United. If DC United were not to perform its obligations under the development agreements, the cost to DC United is severe. Under the terms of the Non-Relocation Agreement, DC United is required to play all of its home games in the District of Columbia for the duration of the Groundlease (i.e. 30 years). The intent and the effect of the legal structure imposed by these two agreements is that DC United cannot move away from the District for 30 years. In essence, they would be trapped in the District without a new stadium and, in fact, do not even have a contractual right to play at RFK. Over the long run, this would drastically reduce and arguably eliminate the value of the franchise.

Alternately, the risks to the District are much less severe. Yes, the District would have assembled and made development-ready the land at Buzzard Point. The District, however, would remain the owner of that property and could sell or redevelop that land as and when it wished. Since all of the property other than the Ein and Super Salvage property are being bought at fair market value, in such an event, the District would wind up with an asset that would then be worth approximately what the District paid for it. To be fair, the District would in such a situation be out-of-pocket development fees associated with this effort, but those fees and expenses are on the order of $3 million, and are comparatively small.

Other than non-performance by DC United (i.e. Risks 2, 3, 4 and 5), the consultant identified two remaining risks. These are:

6. **Uncertainty surrounding the source of funding, design, development and occupancy schedule for the proposed New Government Center in Anacostia.**

We have carefully vetted this transaction and believe that it is financially viable. No later than next Tuesday, I will submit a letter that provides more detail on this point. Our confidence is based on the following. We envision that the transaction would be structured as a "build to suit" sale-leaseback. The term of the leaseback would be 20 years so the transaction should not qualify as debt. The developer would provide the necessary funding. Given the District's credit rating, financing should not be a problem.

From a land use perspective, the site was the subject of a Planned Unit Development application that was submitted by the District 8 years ago for the location of the Department of Transportation. That PUD was approved by the Zoning Commission. It, of course, would need to be renewed and revised, but that proposal sought to place more density on the site and we believe a smaller project like that being proposed is perfectly feasible.

The last risk identified by the consultant is as follows:

7. DC Stadium LLC will seek a permanent Property Tax Exemption or a significant Discounted Property Assessment

Value on the Stadium thereby eliminating or substantially reducing property taxes paid to the District.

This, of course, is a risk. It is, however, completely within the District's control whether to grant such an exemption or reduction.

Mr. Chairman and members of the Council, I ask that you quickly agendize and vote favorably for the soccer stadium legislation, particularly in light of the relatively close concurrence by your consultants with the District's estimates, planning and the transaction that was negotiated over a nearly year-long process.

That concludes my testimony and my team and I are available to answer your questions.

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