Metropolitan Transportation Authority
One Gateway Plaza
Los Angeles, CA 90012-2952
213.922.2000 Tel

Metro

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PLANNING AND PROGRAMMING COMMITTEE
October 18, 2006

SUBJECT: **ORANGE LINE/VICTORY AND BALBOA JOINT DEVELOPMENT**

ACTION: **AUTHORIZE THE NEGOTIATION AND EXECUTION OF A JOINT DEVELOPMENT AGREEMENT AND GROUND LEASE WITH REMETT, LLC.**

RECOMMENDATION

Authorize the Chief Executive Officer to execute and enter into the following development documents (The "**Development Documents**"):

A. Execute and enter into a joint development agreement (the "**JDA**") with Remett, LLC ("Developer"), providing for the development of approximately 1.9 acres of Los Angeles County Metropolitan Transportation Authority ("**Metro**") owned property located along Victory Boulevard, west of Balboa Boulevard, near the Metro Orange Line Balboa Station ("**Site**") for development of a low-rise office building and supporting parking as part of the existing, adjacent office park (the "**Development**");

B. Execute and enter into a ground lease (the "**Ground Lease**") covering the Site and providing for the construction and operation of the Development thereon; and

C. Execute and enter into such other agreements as may be necessary to implement the Ground Lease and/or the JDA, and provide for the construction and operation of the Development on the Site as contemplated in the JDA and the Ground Lease.

The key terms and conditions of the proposed transaction are set forth on Attachment A.

ISSUE

In January 2006, staff received an unsolicited proposal from Developer to construct and operate the Development on the Site. Staff considered Developer's proposal and has negotiated key terms and conditions that are acceptable to staff and Developer with respect to such Development. Such terms and conditions contemplate execution of the JDA and the Ground Lease. Execution of the JDA will obligate Metro to enter into the Ground Lease with the Developer upon satisfaction or waiver of certain conditions. It will also allow the

Developer time to complete pre-construction due diligence and gain all permits and entitlements (including a change in zoning) necessary to accommodate the proposed Development. The parties will also appraise the Site during the term of the JDA to determine the initial ground rent to be paid by the Developer under the Ground Lease. Upon satisfaction or waiver of the JDA conditions, the parties will execute the Ground Lease, which will allow the Developer to construct and operate the Development on the Site. Attachment A sets forth the key terms and conditions of the proposed transaction.

BACKGROUND

The Site is a narrow, roughly triangular parcel totaling approximately 1.9 acres in area. It is sandwiched between the Orange Line operating right-of-way and Victory Boulevard, bounded to the west by federal land and to the east by the Developer's existing office park at the southwest corner of Balboa and Victory. The Site is near the Orange Line's Balboa Station, but lies approximately half a block away, being separated therefrom by Balboa Boulevard and the Developer's existing office park. Birmingham High School lies across Victory to the north. The Site and the surrounding area are depicted on Attachment B.

The Site was acquired by Metro as part of the Los Angeles County Transportation Commission's purchase of certain railroad right-of-way from Southern Pacific along the Burbank Branch Line on March 13, 1991. During construction of the Orange Line, it was used as a construction staging area. The Site is no longer needed for Orange Line construction purposes, nor is it needed for Orange Line operations or for any other Metro purpose. As such, it is available for development.

The small, narrow shape of the Site, coupled with its mid block, sandwiched location between Victory Boulevard and the Orange Line operating right-of-way, presents considerable challenges to viable stand-alone development. The best development alternative is to include the Site as part of a new or existing adjacent development. The Developer is one of two adjoining property owners, the other being the federal government. The federal government's property is part of a federal reserve and is not suitable for development.

As currently envisaged, the proposed Development will consist of a two-story, approximately 31,000 square foot office building surrounded by approximately 150 surface parking spaces. The new building and parking will become part of the Developer's existing four-building, low-rise Encino Office Park at Balboa and Victory. The architecture of the new building will be consistent with that of the existing office development, and vehicular access to the new building, and its parking will be via the existing development's driveways on Victory and Balboa. The current conceptual site plan and a rendering of the proposed Development are included as Attachment C. The foregoing represents the current Development plan and is subject to change as the design process progresses.

The Site's current zoning, a mixture of Restricted Industrial and Public Facilities, does not allow commercial uses. To develop the proposed Development requires a zone change to commercial zoning, which the Developer has agreed to do at its sole cost during the term of the JDA. Staff anticipates that the zone change could take up to twenty-four (24) months to complete, and construction of the proposed Development could take another twenty four (24) months, subject to force majeure.

The proposed business terms for this transaction have been reviewed by The Maxima Group, one of Metro's outside economic advisors. Their review and analysis found that the proposed business terms represented a market transaction, and would generate revenue to Metro consistent with Metro's Joint Development Policy requiring a fair market return on the public investment.

The Developer's project team includes Remett, LLC (George E. Moss and Richard F. Moss).

POLICY IMPLICATIONS

The recommended actions are consistent with the goals of Metro's Joint Development Policy to:

- Promote and enhance transit ridership;
- Enhance and protect the transportation corridor and its environs;
- Enhance the land use and economic development goals of surrounding communities; and conform to local and regional development plans; and
- Generate value for Metro based on a fair market return on the public investment.

OPTIONS

The Board could choose not to authorize the Chief Executive Officer to execute the Development Documents, and, in connection therewith, recommend that staff solicit competitive proposals for development of the Site or cease all Site development activity at this time. Staff is not recommending these options for the following reasons:

- The Developer's proposed Development is a sound and viable plan, meeting the goals of Metro's Joint Development Policy, including providing a fair and reasonable financial return to Metro; and
- A competitive solicitation for development of the Site would not likely bear fruit, in that the Site's odd configuration and location present severe challenges to stand-alone development.

FINANCIAL IMPACT

Funding for this recommendation is included in Cost Center #2210, Project #610011. Since this is a multi-year project, the Cost Center Manager will be responsible for budgeting future year costs.

NEXT STEPS

Upon approval of the recommended actions, staff and its legal counsel will commence negotiation and documentation of the specific language of the JDA and the Ground Lease with Developer and Developer's legal counsel. Notwithstanding the forgoing, the JDA and the Ground Lease documents will contain the key terms set forth on Attachment A. Upon completion of the negotiation and documentation process, the Developer and the Chief Executive Officer will execute the JDA, and, upon satisfaction or waiver of conditions to close the JDA, as set forth in the JDA, will execute the Ground Lease.

ATTACHMENTS

Attachment A - Summary of Key Terms and Conditions of the Proposed Transaction
Attachment B - Depiction of the Site and the Surrounding Area
Attachment C - Conceptual Site Plan and Rendering for the Proposed Development

Prepared by: Greg S. Angelo, Manager of New Business Development

Roger Moliere
Executive Officer, Real Property Management & Development

Roger Snoble
Chief Executive Officer

ATTACHMENT A

Summary of Key Terms and Conditions

Orange Line - Balboa and Victory Site

GENERAL:

Developer/Ground Lessee:	Remett, LLC or another development entity owned and operated by George E. Moss and/or Richard Moss ("**Developer**").
Development Site/ Ground Leased Premises:	That approximately 1.9 acre parcel depicted on Attachment B (the "**Site**").
Proposed Development:	As currently envisaged, the proposed Development would consist of a two-story, approximately 31,000 square foot office building surrounded by approximately 150 surface parking spaces. The new building and parking would become part of the Developer's existing four-building, low-rise Encino Office Park at Balboa and Victory. The architecture of the new building will be consistent with that of the existing office development, and vehicular access to the new building, and its parking will be via the existing development's driveways on Victory and Balboa. The current conceptual site plan and a rendering of the proposed Development are included as Attachment C. The foregoing represents the current Development plan and is subject to change as the design process progresses.
Transfers, Assignment and Subletting:	Except as otherwise approved in writing by Metro in its sole and absolute discretion, Developer shall not transfer, assign or sublet (except for the typical subleasing of the leaseable office space within the Development) its rights or obligations under the JDA or the Ground Lease, or any portion thereof ("**Transfer**"), until Developer has completed the construction of the Development pursuant to the Ground Lease. Thereafter, Developer may Transfer its rights and obligations under the Ground Lease, or any portion thereof, subject to (i) satisfaction of reasonable transfer criteria (including criteria regarding the creditworthiness and experience of any proposed transferee) to be negotiated by Metro and Developer, and included in the Ground Lease, and (ii) Metro's reasonable written consent.

JDA:

JDA Purpose:	The JDA will obligate Metro to enter into the Ground Lease with the Developer upon satisfaction or waiver by the appropriate party of certain conditions. These conditions include, among others: (i) obtaining all necessary Development entitlements and permits, including processing the Zone Change (defined below); (ii) completing the Current Site Value Appraisal (described below in the "Appraisal – Current Site Value" section; (iii) obtaining construction financing commitments, and (iv) completing and receiving Metro and City approval of final plans and specifications for the Development.
JDA Term:	Twenty-four (24) months, with one (1) option, in favor of Developer, allowing extension of the initial twenty-four (24) month term for an additional six (6) months, but only as is necessary to complete the entitlement process for the Development. Developer can exercise the extension option ONLY IF (i) all conditions precedent to executing the Ground Lease and closing under the JDA have been satisfied or waived by the appropriate party (except for obtaining all entitlements necessary to construct and operate the Development), and (ii) Developer is not then in breach of or default under the JDA. The initial twenty-four (24) month term, as so extended, shall be known as the "**JDA Term.**"
JDA Closing:	Developer and Metro shall close the JDA and execute the Ground Lease once all conditions precedent to such closing and execution, as set forth in the JDA, have been satisfied or waived by the appropriate party (the "**JDA Closing**"); provided that such JDA Closing occurs prior to the expiration of the JDA Term.
JDA Consideration:	As consideration for the initial twenty-four (24) month term of the JDA, and in lieu of Metro's typical JDA option fee/holding rent, Developer has agreed to process the Zone Change (defined below) and all entitlements for the Development at its sole cost. If Developer exercises its option to extend the term of JDA, Developer shall pay an extension fee equal to the Construction Period rent that would have been due under the Ground Lease over such six (6) month period if the JDA Closing had occurred.

Zone Change:	The Site's current zoning is a mixture of Restricted Industrial and Public Facilities zones and does not allow commercial uses. Construction and development of the proposed Development requires changing the Site's zoning to a suitable commercial zone (the "**Zone Change**"). The Developer shall process such Zone Change and all related entitlements, at its sole cost, prior to expiration of the JDA Term. Staff and Developer anticipate that it could take Developer up to twenty-four (24) months to process and gain approval of the Zone Change and related entitlements.
Appraisal – Current Site Value:	Prior to JDA Closing, Metro and Developer shall have an independent, third party appraiser perform an appraisal of the fair market value of the Site's unencumbered fee interest, based on its highest and best use under current zoning. The opinion of value set forth in such appraisal shall be the "**Current Site Value.**" The date of value shall be as close to the JDA Closing as possible, pursuant to Metro and Developer agreement.
Design Review:	The design of the proposed Development will be advanced during the term of the JDA and will be a logical evolution of the Conceptual Site Plan and Rendering attached hereto as Attachment C. Metro approval of final construction documents for the Development will be a condition precedent to JDA Closing.
Financial Assurances:	Prior to JDA Closing, and, as a condition to said JDA Closing, Developer shall provide, for the benefit of Metro, acceptable financial assurances as to Developer's ability to design, construct and operate the Development. Such financial assurances will survive JDA Closing, will be included in the Ground Lease, and will ensure, among other things, the completion of construction of the Development in the event of a default by Developer. The determination of the form and amounts of such assurances will be in the sole discretion of Metro.

GROUND LEASE:

Unsubordinated Ground Lease Agreement:	At the JDA Closing, Developer, as tenant, and Metro, as lessor, shall enter into an *unsubordinated* ground lease, providing for the construction and operation of the Development on the Site (the "**Ground Lease**").

Ground Lease Commencement:	The term of the Ground Lease will commence upon execution of the Ground Lease by Metro and Developer on the date of the JDA Closing (the "**Commencement Date**").
Ground Lease Term:	The initial term of the Lease shall be sixty-five (65) years, which term may be extended as set forth in the following paragraph (such initial term as extended, the "**Ground Lease Term**").
Option to Extend Term:	The Developer shall have two (2) successive options to extend the term of the Ground Lease (each, an "**Option to Extend**"), each allowing extension of the Ground Lease Term for ten (10) years beyond the expiration of the then-current Ground Lease Term (each, an "**Option Period**"), subject to Developer being in compliance with all terms and conditions of the Ground Lease and all other Development-related agreements at the time a particular Option to Extend is to be exercised. Developer may exercise the 1st Option to Extend ONLY during the 54th year of the Ground Lease term, and may exercise the 2nd Option to Extend ONLY during the 4th year of the 1st Option Period. If an Option to Extend is not exercised pursuant to the terms and conditions of the Ground Lease, all subsequent Options to Extend shall be of no further force and effect.
Construction Period:	The "**Construction Period**" under the Ground Lease will commence on the Commencement Date and will extend to the earlier to occur of the following dates (the "**Constriction Period Expiration Date**"): (a) the date that the final Certificate of Occupancy is issued for the office building forming a portion of the Development; (b) the date that any portion of the Site is used for revenue producing purposes by Developer, and (c) the date occurring twenty-four (24) months after the Commencement Date.
Construction Rent:	During the Construction Period, Developer will pay "**Construction Rent**" to Metro in an amount equal to fifty percent (50%) of the Initial Base Rent (defined below). Construction Rent shall be paid in advance, in monthly installments equal to one-twelfth of the annual amount due.
Initial Base Rent:	"**Initial Base Rent**" shall be an annual amount equal to eight percent (8%) of the Current Site Value (as defined above), shall commence to accrue on the day following the Construction Period Expiration Date (the "**Initial Base Rent Commencement Date**") and shall continue for five (5) years

	thereafter. Initial Base Rent shall be paid in advance, in monthly installments equal to one-twelfth of the annual amount due.
Base Rent:	Subject to the CPI Adjustment and Market Rate Adjustment set forth below, "**Base Rent**" shall be an annual amount equal to eight percent (8%) of the Re-Zoned Site Value (as defined below). Base Rent shall commence to accrue on the fifth annual anniversary of the Initial Base rent Commencement Date (the "**Base Rent Commencement Date**") and shall continue until expiration or earlier termination of the Ground Lease. Base Rent shall be paid in advance, in monthly installments equal to one-twelfth of the annual amount due.
Appraisal – Re-Zoned Site Value:	Prior to the Base Rent Commencement Date, Metro and Developer shall have an independent, third-party appraiser perform an appraisal of the fair market value of the Site's unencumbered fee interest, based on its highest and best use under the Site's commercial zoning, after the Zone Change. The opinion of value set forth in such appraisal shall be the "**Re-zoned Site Value.**" The date of value shall be as close to the Base Rent Commencement Date as possible, pursuant to Metro and Developer agreement.
Base Rent Increases:	Base Rent shall be adjusted (each, a "**Base Rent Adjustment**") on the "**Adjustment Dates**" noted below in the manner noted below.

Adjustment Date	Type of Adjustment
5th Anniversary of the Base Rent Commencement Date	CPI Adjustment
10th Anniversary of the Base Rent Commencement Date	CPI Adjustment
15th Anniversary of the Base Rent Commencement Date	CPI Adjustment
20th Anniversary of the Base Rent Commencement Date	CPI Adjustment
25th Anniversary of the Base Rent Commencement Date	CPI Adjustment
30th Anniversary of the Base Rent Commencement Date	FM Rent Adjustment
35th Anniversary of the Base Rent Commencement Date	CPI Adjustment

Adjustment Date	Type of Adjustment
40^{th} Anniversary of the Base Rent Commencement Date	CPI Adjustment
45^{th} Anniversary of the Base Rent Commencement Date	CPI Adjustment
50^{th} Anniversary of the Base Rent Commencement Date	CPI Adjustment
55^{th} Anniversary of the Base Rent Commencement Date	CPI Adjustment
60^{th} Anniversary of the Base Rent Commencement Date	CPI Adjustment
Commencement of 1^{st} Option Period[1]	FM Rent Adjustment
Start of 6^{th} Year of 1^{st} Option Period[1]	CPI Adjustment
Commencement of 2^{nd} Option Period[2]	FM Rent Adjustment
Start of 6^{th} Year of 1^{st} Option Period[2]	CPI Adjustment

On each Adjustment Date that a CPI Adjustment is to occur as set forth above, Base Rent shall be adjusted, to equal the greater of (a) Base Rent on the day preceding that Adjustment Date multiplied by the cumulative increase in the Consumer Price Index over the period since the prior Base Rent Adjustment (or such increase over the period since the Base Rent Commencement Date, in the case of the Base Rent Adjustment due to occur on the 5^{th} Anniversary of the Base Rent Commencement Date), and (b) Base Rent on the day preceding that Adjustment Date multiplied by 1.104 (or multiplied by that amount equal to 1.02^{y}, where y equals the number of years, including fractional years, since the occurrence of the prior Base Rent Adjustment, in the case of the Base Rent Adjustment due to occur at the commencement of the 1^{st} Option Period). The Base Rent, as adjusted pursuant to this paragraph shall be the "**CPI Adjusted Base Rent**".

On each Adjustment Date that an FM Rent Adjustment is to occur, Base Rent shall be adjusted to the greater of (a) the CPI Adjusted Base Rent as of such Adjustment Date, and (b) an amount equal to eight percent (8%) of the fair market value of the Site's unencumbered fee interest, assuming that the Site is vacant and could only be used for the

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1 Assumes that Developer exercises the first Option to Extend.

2 Assumes that Developer exercises the second Option to Extend.

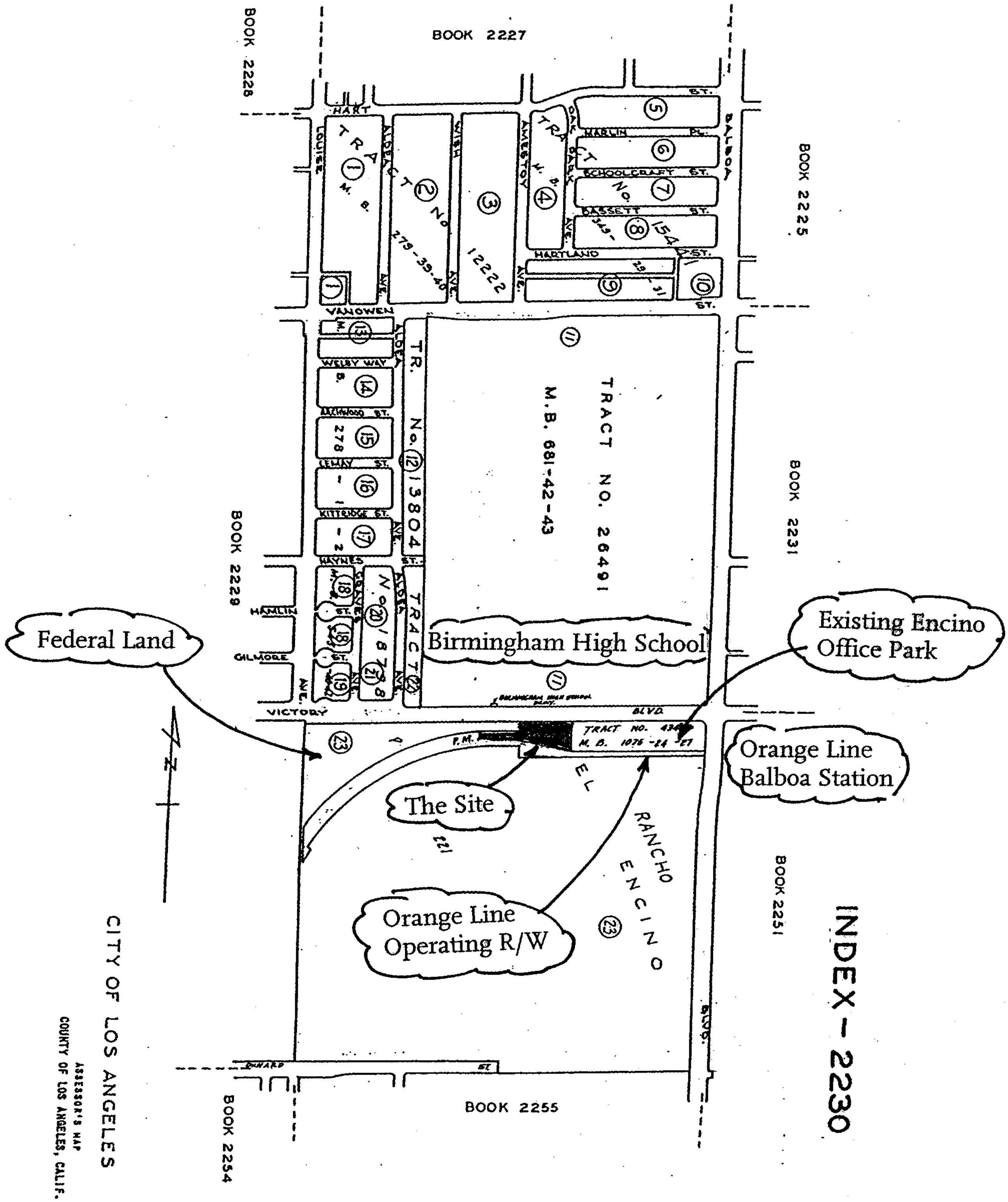
construction and operation of improvements of the type and size (and containing the same leasable area) as the improvements then existing on the Site.

Right of First Offer:	Metro will provide Developer with a first right to make a purchase offer for Metro's underlying interest in the Site if (a) such right of first offer would not violate or conflict with any present or then-current law, rule, regulation, or policy applicable to Metro or its activities, (b) Metro elects to offer its interest in the Site for sale at any time during the Ground Lease Term, (c) Developer is not in default under the JDA, the Ground Lease or any other agreement between the parties at the time Metro elects to offer its interest in the Site for sale, and (d) Developer complies with the provisions set forth in the Ground Lease (including those provisions pertaining to time limits and payment of monetary deposits). If Developer's offer is not accepted, Metro will have the right to sell its underlying interest in the Site to a third party without further rights of Developer for an agreed upon period of time to be set forth in the Ground Lease, so long as the sale price meets or exceeds ninety-five percent (95%) of the sale price previously offered by Developer.
Capital Improvement Reserve:	Developer shall fund and maintain a capital improvement reserve throughout the Ground Lease Term. Developer shall fund such reserve annually, in arrears, at an amount equal to two percent (2%) of the gross revenues generated from the Site and the Development over the preceding year. Capital improvement reserve funds can be expended only on permitted capital improvements, which will be specified in the Ground Lease, along with a procedure for the use and accounting of such funds.
Renovation Fund:	On the sixth (6th) anniversary of the Initial Base Rent Commencement Date, Developer shall establish, fund and maintain a renovation fund for the renovation and upgrade of the Development to physically reposition it and keep it in line with market standards. Developer shall fund the renovation fund annually, in arrears, through the forty-fourth (44th) year of the Ground Lease Term at an amount equal to one percent (1%) of the gross revenues generated from the Site and the Development over the preceding year. Funds in the renovation fund can be expended only on permitted renovations of the Development, which will be specified in the Ground Lease, along with a procedure for the use and accounting of such funds. All funds in the

renovation fund must be fully expended by Developer prior to the expiration of the forty-fifth (45th) year of the Ground Lease Term.

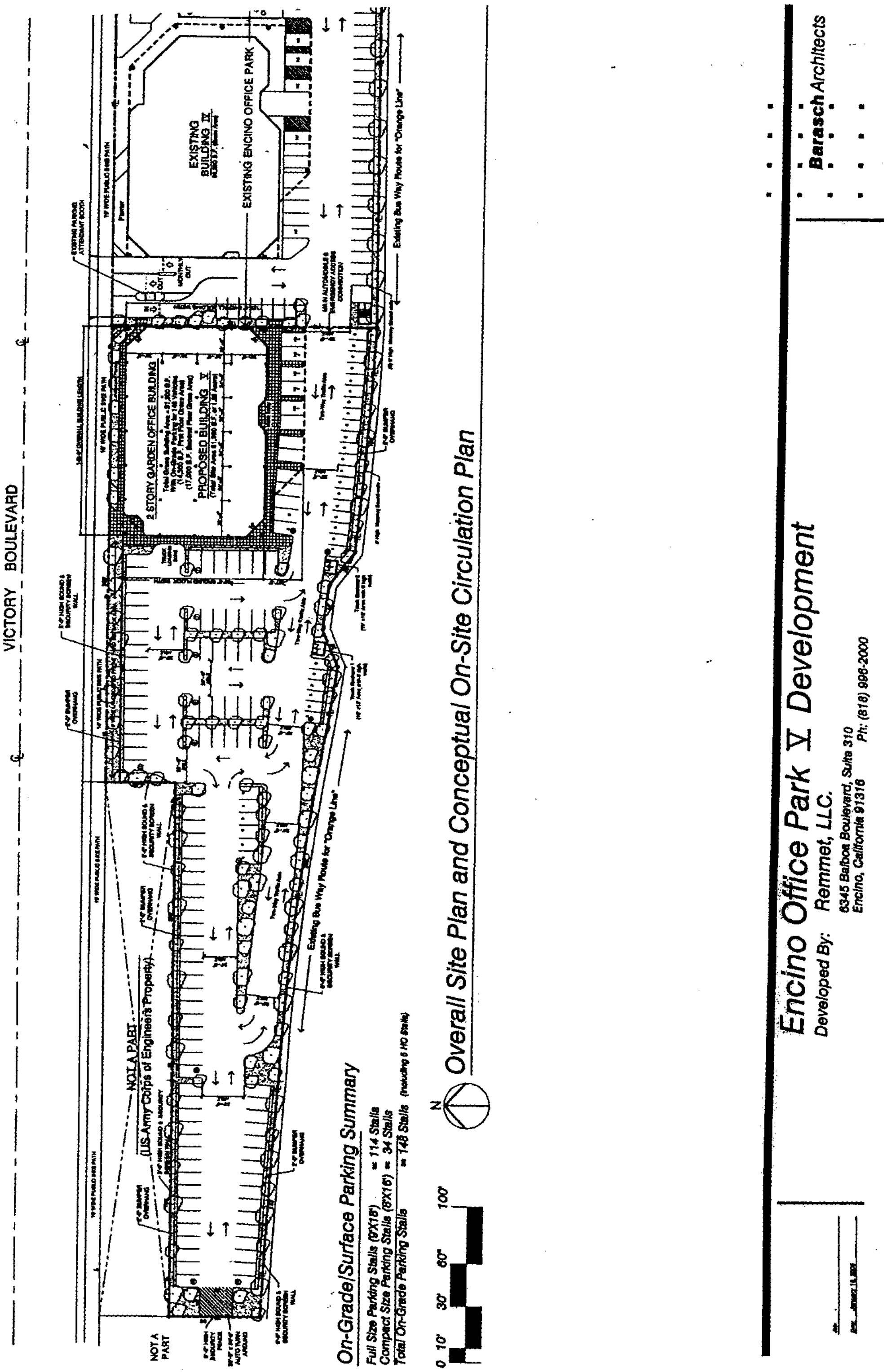
Reversion:	Eight (8) years prior to the expiration of the Ground Lease Term, Metro will indicate to the Developer whether or not it desires the Developer to, upon expiration of the Ground Lease Term: (i) demolish the Development and return the Site to Metro in the same condition it was in on the Commencement Date; or (ii) leave the Development in place for Metro's use. Developer shall comply with Metro's request. If Metro desires that the Development be demolished at expiration of the Ground Lease Term, Developer shall prepare an engineering study, demolition cost estimate and funding plan for such demolition, all to the satisfaction of Metro, which study, estimate and plan shall be agreed to by the parties seven (7) years prior to the expiration of the Ground Lease Term. Developer will ensure that the agreed upon funding for the demolition will be in place at least five (5) years prior to the expiration of the Ground Lease Term. Such funds shall not be useable by Developer, except for demolition of the Development and will only be useable upon Metro's written consent.
Capital Improvement Reserve:	Developer shall fund and maintain a capital improvement reserve throughout the Ground Lease Term. Developer shall fund such reserve annually, in arrears, at an amount equal to two percent (2%) of the gross revenues generated from the Site and the Development over the preceding year. Capital improvement reserve funds can be expended only on permitted capital improvements, which will be specified in the Ground Lease, along with a procedure for the use and accounting of such funds.
Encumbrances:	Subject to Metro's reasonable approval, Developer may encumber its leasehold estate with mortgages, deeds of trust or other financing instruments. The Ground Lease will include mutually acceptable mortgagee protection provisions. In no event will Metro's fee title or the rent payable to Metro, or any portion thereof, be subordinated or subject to Developer's financing or other claims or liens.
Other:	Other customary provisions contained in recent Metro ground leases will be included in the Ground Lease.

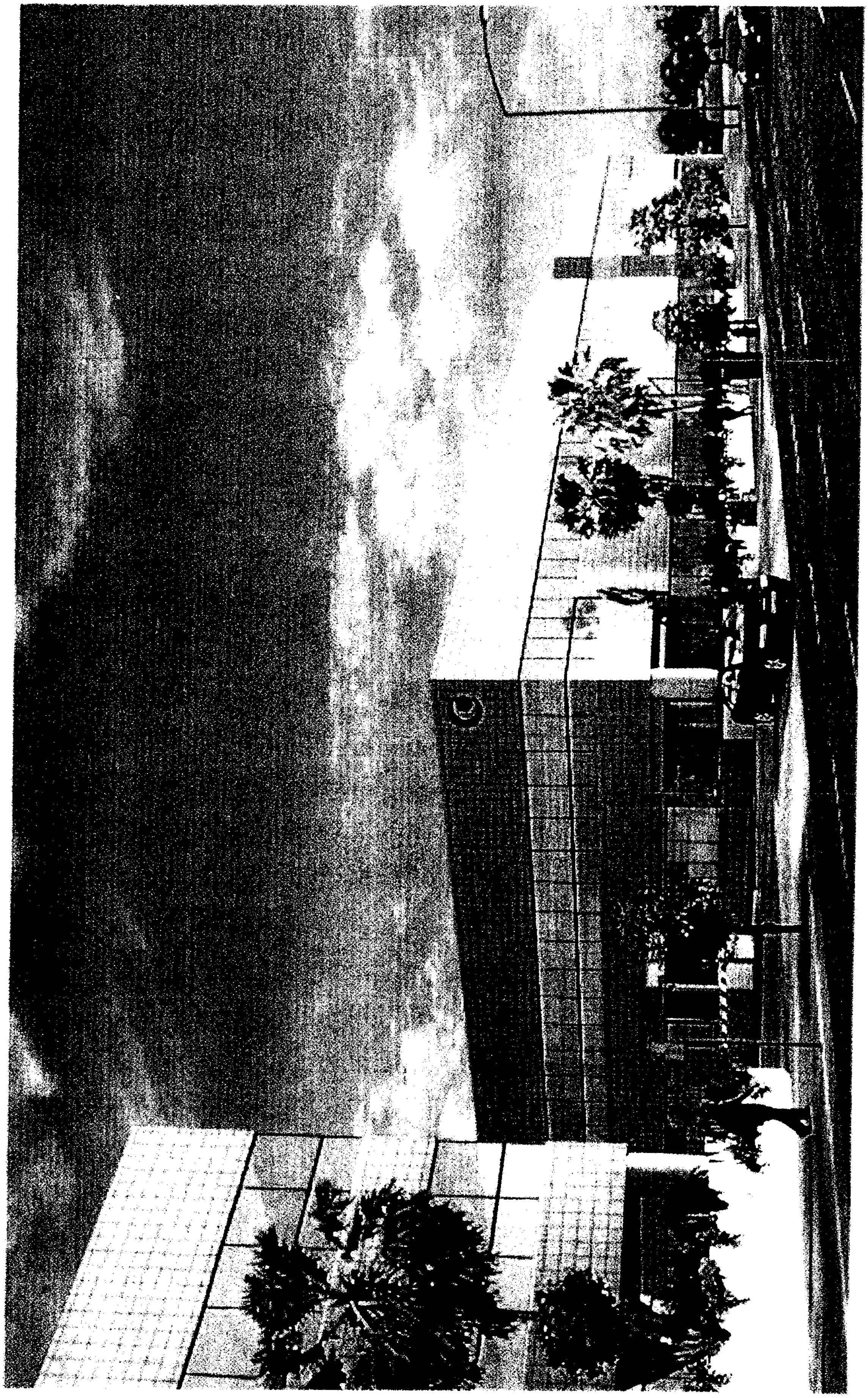
Depiction of Site and Surrounding Area



ATTACHMENT C

Conceptual Site Plan and Rendering for the Proposed Development





Encino Office Park V
Developed By: Remmet, LLC.