Oakland Oversight Board Memorandum

TO: Oakland Oversight Board

FROM: Mark Sawicki

SUBJECT: Fox Theater Loan Assignment

DATE: October 23, 2017
ITEM: #4

RECOMMENDATION

Staff recommends that the Oakland Oversight Board adopt a resolution approving the assignment to the City of Oakland of approximately $47.5 million in loans receivable which were made to Fox Oakland Theater, Inc., for renovation of the Fox Theater, contingent on the City agreeing to pay 30% of the loan repayments to the Oakland Redevelopment Successor Agency ("ORSA").

EXECUTIVE SUMMARY

The former Oakland Redevelopment Agency made several loans currently totaling $47.5 million in principal to Fox Oakland Theater, Inc. ("FOT"), a nonprofit affiliate of the City, for the 2006-08 renovation of the theater. The Fox Theater property will be transferred to the City by ORSA (the successor to the assets of the Redevelopment Agency, including the loans) pursuant to the approved Long Range Property Management Plan. The purpose of the loan assignment proposed here is to transfer the remaining duties and functions associated with the Fox Theater, including responsibilities over staffing the administration of the loans, from ORSA to the City, in order to complete an unwind of any remaining long-term redevelopment activities of ORSA related to the Fox Theater. The assignment of the loans receivable is contingent on the City entering into a compensation agreement with ORSA to transfer 30% of the loan repayments it receives back to ORSA for the remaining terms of the loans (which extend to 2036). This represents a return on the portion of investment that came from unrestricted funds such as tax increment revenue, versus from redevelopment bond funds.

OUTCOME

The redevelopment dissolution statutes, in particular Health and Safety Code Section 34181, direct the Oversight Board through the Successor Agency to:

> Determine whether any contracts, agreements, or other arrangements between the dissolved redevelopment agency and any private parties should be terminated or renegotiated to reduce liabilities and increase net revenues to the taxing entities, and present proposed termination or amendment agreements to the oversight board for its approval. The board may approve any amendments to or early termination of those

agreements if it finds that amendments or early termination would be in the best interests of the taxing entities.

The assignment of the FOT loans receivable is part of the transfer of the project to the City of Oakland to terminate ongoing activities of ORSA. This action will reduce the liabilities of ORSA by reducing the staffing costs now incurred by ORSA (currently a 49-year liability to manage the lease and a 19-year liability to manage the loans) by approximately $440,000 per year. Now that FOT will be able to make some debt payments, the loan structure will also generate revenue for ORSA of approximately $1,100,000 per year for 19 years, which is the remaining term of the loan. As part of the assignment, the City will pledge to pay ORSA the unrestricted proportional share of the loan repayments, which is 30% of the total, or approximately $330,000 per year. Without the transfer of the property and loans to the City, ORSA will need to exist as an entity through the remaining term of the lease, which is approximately 25 years longer than any other long term obligations of ORSA, such as bond debt.

BACKGROUND/LEGISLATIVE HISTORY

2005-06 Approval and Agreement

On July 19, 2005, the Redevelopment Agency Board and City Council approved resolutions authorizing a Disposition and Development Agreement ("DDA") between the Redevelopment Agency and Oakland Renaissance NMTC, Inc. ("ORNMTC"), a non-profit corporation, for the renovation of the Fox Theater (Agency Resolution No. 2006-0046 C.M.S. and City Resolution No 79382 C.M.S).

On July 18, 2006, the Redevelopment Agency and City approved resolutions authorizing an Amended and Restated DDA between the Redevelopment Agency and ORNMTC, which was later assigned to FOT, a newly-created single-purpose non-profit corporation. FOT was established by the City of Oakland and the Redevelopment Agency of the City of Oakland to manage the Fox Theater Project and to own and manage the other financial entities created to generate equity from Historic and New Markets Tax Credits (Agency Resolution No. 2006-0057 C.M.S. and City Resolution No. 80057 C.M.S). The Redevelopment Agency ground leased the property to FOT for 60 years pursuant to the DDA on September 20, 2006.

2008 Amendment

On July 15, 2008, the Redevelopment Agency approved resolutions authorizing the Agency Administrator to: (1) amend the DDA to provide for an additional loan to FOT for $7,450,000 to pay for increased project costs; (2) enter into a Tenant Improvement Grant Agreement with GASS Entertainment Inc., the selected theater operator, for $2,000,000 to pay for theater tenant improvements; (3) enter into a loan agreement with Fox Theater Master Tenant, LLC ("FTMT"), which is controlled by FOT via the ground lease and DDA, for $2,700,000 to pay for additional theater tenant improvements and restaurant tenant improvements; (4) enter into a loan agreement with Oakland School for the Arts for $2,300,000 to fund the school's tenant improvements (Resolution Nos. 2008-0075 C.M.S. through 2008-0080 C.M.S.).

2009 Amendment

On May 19, 2009, the Redevelopment Agency approved a resolution authorizing an amendment to Resolution No. 2008-0077 C.M.S. to divide the $2.7 million loan to FTMT into two loans: (1) a $1.4 million loan to FTMT for restaurant tenant improvements, and (2) a $1.3 million loan to Friends of the Oakland Fox ("FOOF") (Redevelopment Agency Resolution No. 2009-0061 C.M.S.)

2010 Amendment

On January 5, 2010, the Redevelopment Agency approved a resolution authorizing the Agency Administrator to amend the DDA to provide for an additional loan to FOT for $2,000,000 to pay for increased project costs. (Agency Resolution No. 2009-0061 C.M.S.)

Dissolution of Redevelopment Agency

On February 1, 2012, the Redevelopment Agency was dissolved by operation of law. On July 17, 2012, the City Council approved a resolution establishing the Oakland Redevelopment Successor Agency ("ORSA") as the successor to the Redevelopment Agency. Under the dissolution law, ORSA became the owner of all the assets and liabilities of the Redevelopment Agency, including the Redevelopment Agency's interest in the property and the loans made by the Redevelopment Agency to the project.

Long Range Property Management Plan

In 2013, pursuant to the dissolution law, a Long Range Property Management Plan ("LRPMP") for the disposition of former Redevelopment Agency property was approved. The Fox Theater property is listed in the LRPMP as a property held by ORSA to fulfill existing obligations. At the time, the enforceable obligations included various contingent commitments to the tax credit investors such as buyouts, guaranties, and indemnities. The LRPMP provides that, once the enforceable obligations are satisfied and/or the terms of the various contingent obligations run out, the property will be transferred to the City and be retained by the City for future development.

2016 Loan Assignment

On October 4, 2016, the ORSA Board approved a resolution authorizing the assignment of the $1.4 million FTMT loan to FOT to eliminate the tax credit structure that had been required to finance the renovation of the Fox Theater, ORSA Resolution No. 2016-008 C.M.S.

ANALYSIS

REVIEW OF EXISTING FINANCIAL STRUCTURE AND NEED TO MODIFY LOANS AND DEBT

The intent at project inception was that the loans would all be invested in the Fox Theater as long-term subsidies; the Fox Theater would still be owned by the Redevelopment Agency, and the Redevelopment Agency would get the benefit of the improvements at the end of the lease term. The loans were an additional layer of Redevelopment Agency control when the property was leased to FOT, but were not expected to be fully repaid unless Theater revenues were dramatically greater than projected. The primary issue now before the Oversight Board concerns management of the financial obligations related to the Fox Theater. Following the dissolution of the Redevelopment Agency and the wind-down of the tax credit syndication structure that financed the theater renovation, the City is expected to assume ownership and direct control of the Fox Theater. Once the various contingent commitments to the tax credit investors run out by late 2018, including the compliance period and the IRS review period for NMTC transactions, the LRPMP will permit the City to acquire the property, subject to the ground lease. However, the loans made to the project by the Redevelopment Agency are now ORSA assets, and should also be assigned to the City along with the property, in order to fully wind down ORSA's continuing involvement in the Fox Theater Project.

The renovation of the Fox Theater required large subsidies by the Redevelopment Agency to make the project financially feasible. The Redevelopment Agency used FOT to create the tax credit structure and leverage its subsidies, in the form of loans, to bring additional equity to the project. The syndication of tax credits generated over $26 million towards the renovation of the Fox Theater that would have otherwise needed to be funded by the Redevelopment Agency.

The Redevelopment Agency initially loaned FOT $32 million for the project in two loans issued in 2006. Four additional loans totaling $14.4 million were made to FOT or assigned to FOT over the following nine years. These were mostly soft loans with no required debt service payments, although the $1,400,000 tenant improvement loan to FTMT which was assigned to FOT and has approximately $1,250,000 in outstanding principal is being repaid to ORSA.

With the elimination of the tax credit structure and the anticipated property transfer, there is a substantial amount of debt owed to ORSA from the Fox Theater that needs to be addressed, including $47,534,470 in principal and approximately $27,420,975 in accrued interest. Without any payments, these loans are expected to total approximately $129,144,741 by September 20, 2036 when the loans become due and payable.

Rather than wait until the end of the loan terms, staff proposes to transfer to the City the loans made by the Redevelopment Agency for the project, along with the transfer of the property and all other responsibilities for managing the project. The proposed transaction will eliminate substantial staffing costs now being paid by ORSA and increase payments to ORSA over the next 19 years, which will result in additional funds distributed to the taxing entities from the Redevelopment Property Tax Trust Fund ("RPTTF").

Transferring the Fox Theater loans from ORSA to the City, along with the property transfer, will substantially reduce ORSA's staffing costs for the project. Approximately 2 FTEs or $444,000 in staffing costs for the Fox Theater were included in the FY 2017-18 ROPS. The staffing tasks include: (1) managing the ground lease and DDA; (2) managing the various entities -- a non-profit corporation, a for-profit corporation and two limited liability companies -- established as part of the Fox Theater syndication, which requires staff to oversee two boards, two annual audits, four sets of annual tax returns, four tax credit investments, five bank accounts, and manage several legal, accounting and property management contracts; (3) overseeing maintenance, improvements and other tenant issues; and (4) making sure the Fox Theater entities comply with the various compliance and reporting requirements to insure there are no claims on the tax credit guaranties by ORSA.

Most of the Fox Theater debt, approximately 70%, is bond funded, and, under the Bond Expenditure Agreement and bond covenants, any revenue from loan payments on bond-funded debt must be transferred to the City to be used for bond-eligible purposes. These loans have terms of 30 years or less. In 2036, when the loans are due, FOT will still have 30 years on the lease for the Fox Theater, but not any other significant assets. Even if FOT makes $1.1 million per year in interest payments for the next 19 years, the outstanding ORSA debt will grow to approximately $108,244,741. Most of the ORSA loans will therefore need to be written off at some point, and in recognition of this fact, most of this debt is listed as 'Doubtful Accounts' in ORSA's Listing of Notes and Loans Receivable. By 2036, the Fox Theater will likely need substantial capital improvements, which will require FOT to borrow new funds to finance capital projects such as a new roof, exterior painting and repair, mechanical, electrical and plumbing upgrades and replacement and other major improvements. This new financing would need to be secured in front of the existing loans, so even if the terms of the ORSA loans are extended, there might not be significant revenue at the end of the term to repay the loans.

In the interest of unwinding ORSA from its remaining long-term redevelopment activities, staff proposes to: (1) transfer the $46,286,831 in project-related loans receivable from ORSA to the City; (2) enter into a compensation agreement between the City and ORSA in connection with the assignment of the loans, under which the City will be obligated to compensate ORSA for 30% of loan repayments received by the City over the terms of the loans (representing the share of tax increment revenue invested in the project); and (3) eliminate the Fox Theater from future ROPS, reducing annual staffing costs to ORSA by $444,000 compared to the FY 2017-18 ROPS. Termination of the tax credit structure and completion of debt payments on the conventional loan will allow FOT to accelerate the repayment of the ORSA loans. It is estimated that FOT should be able to pay $1.1 million per year in debt service repayments on the ORSA loans. Of this, 30% of the total debt service is attributable to the unrestricted (non-bond-funded) portion of the loans. In other words, this is the amount attributable to tax increment revenue invested, which therefore should be repaid to ORSA, increasing the funds to be distributed to the taxing entities.

These actions will reduce ORSA's obligations, increase ORSA's revenue, and thus benefit the taxing entities. The savings in staffing for transferring the property and the associated loans will reduce staffing costs by over **$10,780,000** through 2066 (based on reduced staffing of $220,000 per year for 49 years). In addition, 30% of the debt service repayments will be paid to ORSA; approximately **$6,270,000** in revenue for the benefit of the taxing entities through 2036 (0.30 *

$1.1 million per year * 19 years). The reduction in costs and increase in revenue will result in **$17,050,000** in additional funds being distributed to the taxing entities from RPTTF. FOT should also be able to reimburse the City for its $220,000 per year in staff costs from the savings in administrative costs and fees from the elimination of the tax credit structure used to finance the project.

POLICY ALTERNATIVES

Retention of the loans by ORSA is an alternative not recommended. There is no conceivable way that FOT will be able to fully repay all the ORSA loans. If ORSA does not assign the loans to the City, at some time ORSA will need to write off the debt. While FOT invested all the ORSA loan funds in the Fox Theater - as well as tax credit equity, grants and other funds – the Fox Theater value, based on an income approach, is not worth the cost of the renovations. The projected future rent from the Fox Theater is not enough to make full interest payments on the ORSA loans, let alone repay the principal, and FOT's liabilities are growing. The Fox Theater is the only asset that FOT has. There are no other sources of funds to repay FOT's loans from ORSA. This situation will not significantly change over the course of the lease. Even if the Fox Theater were to become more lucrative through more intense use or by charging higher rents, the total revenue would not be enough to cover the annual interest payment.

COST SUMMARY/IMPLICATIONS

The reduction in staffing costs on the ROPS and increase in debt service payments to ORSA will reduce the need for RPTTF by ORSA, increasing the payments of residual RPTTF made to the taxing entities, or result in direct payments from the City to the taxing entities per the required compensation agreement. The increased distributions from RPTTF or payments from the City to the taxing entities from these changes to the Fox Theater Project will be approximately $550,000 per year for 19 years, or $10,450,000, and $220,000 per year for the following 30 years, or another $6,600,000.

For questions regarding this report, please contact Patrick Lane in Public/Private Development at 238-7362.

Respectfully submitted,

/s/

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