

# COMMITTEE MEMORANDUM

Item #2

## FOR INFORMATION

**COMMITTEE:** Committee of the Whole  
**FROM:** Alvin G. Coby, City Manager  
**DATE:** January 5, 2009  
**SUBJECT:** Abramson and Associates Evaluation of the Community Maritime Park Master Development Agreement and Sublease

Provided for the information of City Council is the initial evaluation by Abramson and Associates, Inc. of the draft Community Maritime Park Development Agreement and Sublease between Community Maritime Park Associates (CMPA) and Maritime Park Development Partners, LLC (MPDP). Supporting documents include copies of the November 26, 2008 draft Development Agreement and Sublease, the March 27, 2006 Master Development Agreement and the Master Lease between the City of Pensacola and Community Maritime Park Associates, and the December 6, 2005 Community Maritime Park Development Capacity/Productivity Analysis.

A City Council workshop has been scheduled for January 28, 2009, at 4:00 p.m. to discuss the Development Agreement in detail. Prior to the workshop, City staff will provide specific recommendations relative to the Agreement based upon internal review and the advice of consultants. Any changes in the Development Agreement that may occur in the interim as a result of discussions between CMPA and MPDP will be incorporated in the recommendations of staff.

Attachments

City of  
Pensacola



**MEMORANDUM**

**TO:** Thadeus Cohen  
Director, Community Development Department, City of Pensacola Gables

**FROM:** Barry Abramson

**SUBJECT:** Evaluation of Proposed Master Development Agreement between  
Community Maritime Park Associates, Inc. and Maritime Development  
Partners for Community Maritime Park, LLC

**DATE:** December 30, 2008

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**EXECUTIVE SUMMARY**

This memorandum presents our evaluation on behalf of the City of Pensacola of the proposed Master Development Agreement and Sub-Lease, dated November 26, 2008, between Community Maritime Park Associates, Inc. (CMPA) and Maritime Park Development Partners (MDP) for development of the Community Maritime Park project in Pensacola, FL and our assessment of the project's financial feasibility.

**Evaluation of Proposed Agreement**

In summary, while there are significant issues still to be resolved and concerns that may be considered to warrant refinements to improve the agreements, we consider MDP's proposed draft development agreement and sub-lease, subject to appropriate refinement, to present a reasonable framework for moving forward with the project. Conversations between MDP, CMPA's advisor, and us have indicated that MDP is aware of ongoing concerns (many of which were noted in CMPA's advisor's December 1<sup>st</sup> presentation to the CMPA board) and MDP has expressed some willingness to address them, though it remains to be seen whether these issues will be resolved to the satisfaction of the CMPA, the City, and MDP.

The proposed agreements generally conform to the terms and format of the master development agreement and master lease between the City and CMPA. However, as noted in the agreement between the City and CMPA, it was "the intent of those parties that the Project is being undertaken by CMPA in the public interest as a non-profit entity that is functioning

as the master developer to carry out a public purpose of benefit to the community” whereas MDP is a for-profit entity, a difference that implies that terms the City may have considered reasonable in the first set of agreements may not necessarily be so in the present agreements.

In summary, the major issues of concern that remain to be resolved or may be considered to warrant refinement are:

Development Fee amount and timing

- While the amount of the fee is considered to generally be in a reasonable range given the nature of the project, the potential overlap of staffing with that for general contractor, the need for additional CMPA/City owner representation, and the front-loading of the fee’s obligation and payment schedule should be reviewed.

MDP acting as general contractor for GMP contract for Site Improvement Project and Public Improvements and compensation for this role

- The compensation and other financial terms relating to the GMP general contractor need to be agreed upon and should be within a reasonable range of what could be achieved in the competitive construction marketplace, given the specific nature of the project and the various roles and responsibilities MDP is taking on. This is potentially a very significant financial issue. Developer’s preliminary proposals on this relative to the standards in the construction market indicate that this issue may present considerable financial implications.
- CMPA and City need to recognize that MDP playing both roles will require them to secure additional owner’s representation through the construction process to protect their interests.

MDP’s long term management of the public improvements and compensation for this role

- There are arguments pro and con for granting MDP a management contract and for the term to extend to what would likely be 15 years. MDP’s motivation to optimize

operation of the Public Improvements is a significant factor in favor of its involvement in management though a shorter term might be explored.

- The value of the management fee cannot at this point be adequately assessed due to a lack of reliable estimates for operating revenues, which would be a major determinant of the fee, nor can CMPA operating cash flow be estimated with confidence.
- This suggests that, whether or not the term of the agreement is shortened, a review of financial outcomes and renegotiation of compensation terms sooner than five years and/or provision for automatic adjustments (perhaps caps on total fees) could be explored in further negotiations. Some provision for limitation of management fee in the event of a negative cash flow might also be an appropriate avenue for exploration:

#### Sublease of Private Development Parcels

- We recommend that, as practical, the rents and other major terms be set within the agreements as opposed to left for later resolution.
- We have suggested and there has been conceptual agreement upon the broad outlines of a land valuation and lease structure that takes as a starting point the methodology and valuation in the valuation/lease rate evaluation performed for CMPA in 2005, and also accounts for evolving market conditions and the impact on value of various parcels of such factors as location, use, scale/density of development, structured parking, potential application of public funding/financing to support parking, site work, or the conference center.
- Other recommendations include:
  - Decrease time frames within which development must be started and set minimum amounts of development that must be developed in those time frames in order to avoid increased payments for land not already developed.
  - Set time frames and minimum amounts of development required for MDP to retain its lease rights to remaining undeveloped parcels.
  - Allow for limited time extensions for demonstrable conditions of market distress.

- Set substantial completion as a benchmark for the time frames.
- Explore the possibility of some lease payments for un-developed parcels.
- Lease on a parcel by parcel basis or otherwise provide for staged take-down.
- Confirm that the sub-lease(s) shall in no way be subordinated to any financing.

The above issues (along with various other issues) are discussed more fully later in this memorandum.

### **Prospects for Financial Feasibility**

#### Site Preparation and Public Improvements Program

The Public Improvements Budget attached as an exhibit to the Development Agreement indicates that approximately \$51.4 million is estimated to pay for the full scope of Site Preparation Project and Public Improvements. This would require additional public or private funding of \$13.4 million beyond the net \$38 million available from the CRA bond financing.

An Alternate Scenario assuming limited public funds presented in that exhibit would defer the conference center, resulting in a total budget of \$41 million, with a shortfall of \$2.95 million, which could be covered by the Developer loan (assuming agreement on acceptable terms) if not otherwise funded by additional public funding.

We note that the construction costs in these budgets include higher general contractor compensation than we would consider necessary and also that soft costs, particularly A/E costs, appear to be higher than we would anticipate as being necessary. Savings in these areas could possibly make up the shortfall in the Alternate Scenario. We also anticipate that the project would be contracted at a time of continued softness in the construction market, so cost escalation is not a significant concern as it was in the past.

Based on these factors, it appears that a reasonable baseline program of public improvements would be feasible, with restoration of the full program possible based on the level of

additional public funding that could be attracted to the project. It is also possible that the conference center might be restored to the program with less than full public financing if included in a hotel.

#### Operations of Public Improvements

A preliminary operating budget prepared by CMPA three years ago, supplemented by input from MDP on a limited number of operating components, and adjusted for the proposed fee structure, indicates that the Public Improvements would operate at a profit, though this profit would be marginal without the Pelican's profits, budgeted at \$250,000, based on the guaranteed annual commitment for the first five years. These estimates do not include any revenues from facilities rentals. MDP has not as yet provided requested refined analysis of the operating budget. Until such input is provided by MDP and reviewed, we consider the estimate of a positive operating cash flow for the public improvements after the five year guaranteed commitment to be provisional.

#### Private Development

The distressed condition of the real estate market which currently exists and can be anticipated to prevail for the near term will limit the potential for development over the next few years and what development can occur may require relatively low land pricing to attain feasibility. However, the market can be expected to gradually rebound and the advantageous location, natural amenity, and investment in public improvements should enable the project to return to a vibrant level of development and supportable land pricing somewhere in the range of that estimated prior to the market downturn.

The lease pricing structure will need to be crafted with care so as to encourage development in the lean years while undervaluing the land in out years when the market is expected to have recovered, as well as to incent a vibrant mix of uses and account for various factors that will impact supportable land pricing.

## **SCOPE OF EVALUATION**

The City engaged Abramson & Associates, Inc. effective Oct 24, 2008 to evaluate the proposed development agreement between CMPA and MDP and other documents and information in order to assess: the reasonableness of the agreement from the City's standpoint and the prospects for the project's financial feasibility and the realization by the City of the intended public improvements to be funded by the City's investment of public financing as well as the reasonableness of lease rates for the private development parcels. To do this, we:

- Reviewed relevant documents and information including the proposed master development and lease agreements between the City and CMPA, drafts of the agreement as it was being negotiated between CMPA and the MDP, and various other documents such as CMPA's master development RFP, MDP's proposal and related materials, development budgets and other financial analyses and exhibits provided by the MDP, and summaries prepared by CMPA's advisor;
- Consulted with CMPA's advisor, the City, MDP, and others to understand the context of and issues relating to provisions of various agreements;
- Discussed ongoing refinements of documents as they were being negotiated;
- Researched and analyzed relevant market and financial issues; and
- Shared findings with the City in a series of telephone conversations and in this memorandum.

## **BACKGROUND**

Background information is summarized below. This information has been selectively drawn from various agreements, the master development RFP, MDP's proposal, summaries prepared by CMPA's consultant, and other documents and input from project participants. The purpose of this summary is to provide readers of this memo with a broad outline of information considered particularly relevant to the evaluation; it is selective and should not be viewed as comprehensive. Readers are recommended to refer to the source documents.

### **CMPA Master Development Agreement and Master Lease**

Under the Master Development Agreement and Master Lease, both dated March 27, 2006, the City designated CMPA as the developer for the project and leased the project site to CMPA.

Key provisions of these agreements relevant to this evaluation include:

- CMPA will manage the Project and enter into the Maritime Museum Lease and Sub-Leases, subject to City approval, for design, construction, management, operation and use of the Public Improvements, the Private Improvements, and the Maritime Museum.
- It is the intent of the parties to this Agreement that the Project is being undertaken by CMPA in the public interest as a non-profit entity that is functioning as the master developer to carry out a public purpose of benefit to the community.
- CMPA shall construct the Site Preparation Project (those improvements necessary to prepare the Project Site for the Public Improvements), the Private Improvements (private mixed-use development), and the Public Improvements (the multi-use facility, conference center, and open park).
- The cost of the Site Preparation Project and Public Improvements are to be paid from Public Financing comprising \$40 million of City revenues bonds and such other public funding as the City may be able to obtain, and, if such funds are insufficient, public or private funds raised by CMPA.
- To the extent such funds are not sufficient, the Public Improvements program may be adjusted with the consent of CMPA.
- The City shall own the land and the Public Improvements.
- The term of the lease is 60 years at a rent of \$1.00 per year plus fair value rentals under sub-leases for Private Improvements.
- A condition precedent for the lease becoming effective is that an analysis of the Project by an independent consultant retained by the City indicates there is a market

for the proposed uses at a level sufficient for the successful economic viability of the Project.

- CMPA shall have the right to sub-lease parcels designated for private development as well as those parts of Public Improvements set aside for commercial enterprise.
- All revenues received for the Sub-Lease of parcels for Private Improvements shall be paid to the City which will deposit 10% into a renewal and replacement fund.
- The sub-lease payments to be paid by a Developer shall yield fair value to the City.
- Lessee shall have to justify to City that such lease payments constitute fair value to the City's satisfaction.
- Any sublease for private-development shall be subject to the City's approval in its sole discretion.
- All revenues from the Project Site, except sub-lease rental payments, are to be paid to CMPA, to be used for expenses, operating and capital reserves, with any remainder to be distributed to Pensacola charities.
- The Site Preparation Project design and component costs are subject to City Council review and approval.
- Project Professionals are defined as architects, engineers, consultants, planners, construction managers or any other persons, or combinations thereof, parties retained or employed by CMPA in connection with the planning, design, construction, and completion.
- Contracts and fee for the Project Professionals and Contractors are subject to review and approval by the City.
- All contracts between CMPA and the Project Professionals shall provide that they are assignable by CMPA to the City, including being automatically assigned to the City upon the termination of this agreement.
- CMPA will retain through competitive selection (utilizing the same procedure as the City would have used) the Project Professionals to prepare the Site Preparation Project Plans and Specifications.

- Site Preparation Project plans and specs shall be subject to City approval.
- To provide the coordination necessary for the successful and timely completion of the construction of the Project, the parties agree and acknowledge that there is a need for a project construction coordinator who shall be responsible for coordinating construction of the various parts of the Project. The City and CMPA agree CMPA shall be the Project Coordinator.
- CMPA shall select through competitive selection (utilizing the same procedure as the City would have used) Contractors to construct the Site Preparation Project and Public Improvements.
- The City shall review requests submitted by Lessee for payment from Construction Fund to determine their appropriateness to its satisfaction.

#### **Covenant with the Community**

In the Community Maritime Park Covenant, CMPA committed, among other things, to:

- Establishing a Contractor Academy to educate and assist local and minority contractors.
- All contractors will be sought to help ensure they are representative of the demographic diversity of the City with a particular focus on attracting minority-owned companies.
- Contracting for support services for the park from security to maintenance to accounting, legal, and advertising, will be done in a manner so that the result is that companies receiving the contracts will be representative of the demographic diversity of the community.

#### **Master Development and Design Criteria RFPs and Status**

In February, 2007, CMPA issued an RFQ for Master Developers and an RFP for a Design Criteria Team. Through the latter process, CMPA engaged a team led by Caldwell Associates, Inc. to assist it in: developing criteria to guide the planning, architectural and

landscaping design, and development of the Project; programs to define the CMPA Public Improvements; and plans, applications and supporting work to support CMPA's or the City's applications for permits required to develop, initially, the Site Improvements and subsequently, the Public and Private Improvements. The Design Criteria were completed and then approved by CMPA in November, 2007. As stated in the Developer RFP, CMPA expects that these Design Criteria will guide the design of every facet of the Project, they are generally guidelines and will be the basis for evaluating departures or deviation with the program specifications for the multi-use facility and conference center/classroom building being minimum requirements.

The Caldwell design team has been authorized to prepare plans and specifications and bid packages for and to secure permitting for major elements of the Site Improvement Project.

Following the Master Developer RFQ, CMPA short-listed four developers to receive an RFP. The RFP called for the master developer to perform all the tasks and discharge all of the responsibilities and obligations to oversee the development process that ultimately results in the construction of the Site Improvements and all Public Improvements (other than the Maritime Museum, Amphitheater/band shell, Maritime Research facility and Multi-Cultural Museum); cooperate its development obligations with the developer, if different, of the office building that will house the Studer Group; develop the private mixed-use development; operate and manage the private Improvements; provide operating and management support to CMPA in executing its management responsibilities for the Public Improvements; apply the Public Funding and secure additional funding to achieve the responsibilities.

In April, 2008, CMPA received proposals from two master developers and subsequently selected Land Capital Group with Maggi Development, proposing as Maritime Park Development Partners.

In October, MDP presented a proposed development agreement and this document has been the subject of negotiation between it and CMPA and a series of drafts, with our comment

upon these drafts, with the last of these drafts being the proposed agreement, dated November 26, 2008, and currently posted on the City's website.

## **EVALUATION OF PROPOSED AGREEMENT**

We were tasked with reviewing for reasonableness rather than negotiating the proposed agreement. In evaluating the proposed agreement, we recognize that it stems from a long chain of events, particularly the City contracting with CMPA to coordinate and realize the project, followed by CMPA's determination to implement its project responsibilities by means of partnering with a private master developer rather than directly managing the project through professional staff and/or consultants. This determination implied a trade in which CMPA was willing to give up a degree of hands-on control and incur potentially higher coordination costs in return for the benefits perceived to derive from engaging a developer

Generally, the proposed agreement confers upon MDP the role of Project coordinator, implementing the project under the oversight of CMPA. Specifically, MDP would:

- Coordinate various development and operational activities
- Construct the Site Preparation Project and the Public Improvements (except the portions to be constructed and managed by UWF – the Maritime Museum and Research Facility, Multi-Cultural Center and Amphitheater)
- Develop and manage the Private Development Parcels (possibly sub-sub-leasing parcels to other parties for development)
- Manage the Public Improvements

Key business terms of the proposed agreement and our assessment of these are summarized below:

### **Development Fee**

MDP would be paid, from the Public Financing, a development fee equal to 4.0% of the costs actually expended in the Public Improvements Budget with the exception of the cost of: (a)

Wetland Mitigation; (b) Impact Fees; (c) Developer fee; and (d) and unused contingencies plus office lease expenses. The fee would be based upon the eligible costs within the Project Budget that can be funded with public or Developer funding committed at that time, with subsequent adjustment as funding and allocation to eligible and ineligible cost components are actualized.

Development fees are often set at a percentage of either total development costs (with various adjustments) or hard costs. Generally, percentages typical in the industry for large scale projects are 3 – 5% (including developer overhead), with the low end tending to be more reflective of fees based on TDC and the high end reflective of fees based on hard cost. The fee can vary based upon such factors as project cost, complexity, effort, time, and risk. It is possible that at the present time of limited development opportunities, there may be some downward pressure on fees. The proposed 4.0% fee equates to approximately \$1.5 million for the Project Budget based on the public funding committed at present and approximately \$1,900,000 for the full Public Improvements program, in both cases equaling less than 4.5% of hard costs. MDP provided us with a staffing budget which appeared to account for a reasonable allocation of appropriate staff to the project and totaled along with overhead costs approximately the amount derived from the fee, assuming a Project Budget based on the public funding committed at present. Also, MDP, in its proposed Covenant with the Community Master Developer Commitment, which shall be the subject of a separate agreement with CMPA, has committed to providing \$250,000 in cash and in-kind services to assist in the Academy/Contractor's Advisory Council.

Based on the above factors, we feel the development fee to be in a reasonable range. We note that the general contracting arrangement proposed by MDP, discussed below, could be considered to impact the reasonableness of the development fee to the extent that: CMPA and/or the City would need to enlist construction owner's representation services beyond what might otherwise be satisfactorily provided on their behalf by the developer; and/or any significant overlap is considered to exist between the project management staff and the construction staff compensated from the general contractors overhead. We also note that

MDP's funding commitment is not referenced in the development or lease agreements and such reference could be considered appropriate.

#### **Payment of the Development Fee**

The proposed development agreement states that the development fee shall be deemed earned upon the Effective Date of the agreement, meaning it would be due in full if there were a termination not based upon Developer default, including in the event the Public Financing does not materialize and the Project does not proceed. The proposed agreement also states that CMPA shall pay the Developer one-quarter of the development fee at the closing of the Public Financing, one-quarter of the development fee at the Site Preparation Project Commencement Date, and the remainder in equal monthly amounts over the anticipated construction period for the initial construction phase of the Public Improvements; provided, however, that the monthly payment amounts would be adjusted as the Project progresses such that the total development fee finally paid is a percentage of actual costs rather than budgeted costs.

We consider the development fee being deemed earned upon the Effective Date to be an unusual provision, and especially onerous in the event the Public Financing does not materialize. Our understanding of the Developer's rationale for this position is that it will have invested considerable resources and brought significant value to the project by that point and that it wants to discourage unjustified termination. While we can appreciate these points, a less front-loaded obligation may be something that CMPA and the City may want to explore in further negotiations.

We feel the payment schedule is also somewhat front-loaded, though not as much so as the obligation referenced above. The Developer contends that this is a reasonable recognition of the considerable up-front and at-risk time, effort, and cost which MDP will already have invested at the time of these milestones. This is a judgment call which CMPA and the City will consider in further negotiations.

With regard to both of the above provisions, we note, there would be a disconnect between the obligation and source of payment if the Public Financing were not to be available at the Effective Date.

#### **Reimbursement of Project Professionals**

The proposed agreement calls for reimbursement of fees and expenses of Project Professionals from the Public Financing above and beyond the Development Fee. It is standard practice that costs for professional services beyond the scope of development management be outside the development fee. However, the list of Project Professionals attached as an exhibit to the agreement includes the Developer and a third party project manager. MDP has agreed in conversation that it is its intent that these be paid from the development fee and that this would be the case for any other third party professionals to the extent they were providing development/project management services. The language in the agreement should be modified to reflect that understanding. Some limitation on the amount of public financing that can be allocated to Project Professionals without CMPA approval may also be considered worth exploring.

#### **Developer as General Contractor and Compensation of GMP Contract**

The proposed development agreement states that: the developer shall establish a guaranteed maximum price for the construction of the Site Preparation Project and Public Improvements; the GMP shall provide for reimbursement of actual general conditions and reasonable allowances for overhead, profit, and construction contingencies; and the developer may act as general contractor. MDP has stated its intention to exercise its right to act as general contractor.

The developer taking on the role of general contractor is a major element of and decision point in the project.

If the developer were distinct from the general contractor, CMPA and the City would benefit from the developer's expertise, acting as an agent on their behalf, in selecting a general contractor, negotiating a general contract, and managing that contract, to provide the most

cost-effective delivery of the project, thereby maximizing the Public Improvements that could be provided in return for the investment of the Public Financing.

With developer playing the role of general contractor, the Developer's and CMPA's/City's financial interests are not aligned relative to the terms of the general contractor's compensation and its management of the GMP contract.

Specifically, their interests would diverge in that it would be in the developer/general contractor's financial interest to maximize the amounts and/or otherwise seek favorable terms with regard to its profit and overhead, general conditions, contingency, and treatment of any cost savings, and would be financially disincented to protect owner's (CMPA's/City's) interests in managing the contract in the event of conflicts over whether unanticipated costs would constitute change orders, warranting additional payment, versus being absorbed by the GMP general contract.

This recognition is not to say that an arrangement under which developer acts as general contractor is inappropriate or not in the best interests of CMPA and the City. Rather, it would put the onus on CMPA and City to feel comfortable that the Development Agreement sets the financial aspects that would apply to the general contractor in the GMP contract and are reasonable and that they have both the right and the qualified owner's representation to monitor and defend their interests in management of the project. It should also be noted that this issue relates to the general contractor compensation as opposed to the subcontracted work, as, whether or not MDP is general contractor, under a GMP contract, sub-contacting would be done through competitive bidding and ultimate costs of the subcontracted work would be "open book".

With regard to general contractor compensation, we note that prior drafts of the agreement called for levels of profit and overhead and contingency and a lack of cost savings pass-back or even sharing that we did not consider reasonable in the context of the competitive construction marketplace and the specifics of the project. Limitations on general conditions may also be appropriate. MDP has expressed a willingness to revise these terms but, to date,

the extent of such revisions that have been proposed verbally are still not considered to be in a range of reasonableness. The magnitude of the financial implications of this component of the agreement compel the City to ensure its satisfaction that these terms are reasonable.

MDP has stated that a GMP contract rather than a lump sum contract and MDP's acting as general contractor are both appropriate, in part, because it will allow MDP to best ensure contracting adheres to the intent of the Covenant with the Community and that the additional complexity and effort entailed in this warrants a higher compensation. MDP has also stated that the subcontracting will be open-book. While we see some basis for these contentions, we feel they are of a marginal rather than determinative nature.

We also note the possibility that some elements of the general contractor's staffing could overlap with the staffing presented by the developer to coordinate the project, which could imply a rationale for the contractor overhead or the development fee being lower than they would be if independently provided by unrelated parties. MDP has stated that there would not be any overlap. We have requested that MDP provide a description of general contractor staffing and a description of relative roles of this and developer's project management staff to support this contention but have not as yet received such information.

#### **Developer Advances to the Project**

The proposed agreement gives the developer the option, but not the obligation, to advance up to \$2,950,000 for the Public Improvements, subject to the approval of CMPA, at a mutually agreeable rate of interest, to be repaid upon the earlier of procurement of state and/or federal grants or as a credit or reduction in the Sub-Lease payments.

The developer had previously proposed an interest rate at its cost of equity capital, which, especially if compounded over a number of years, could dramatically impact sub-lease revenues. MDP has subsequently stated that it is preparing an alternate proposal on this. We feel that it would be advisable for the rate, or at least applicable parameters, be set within the agreement.

### **Site Preparation and Public Improvements Program and Funding**

The proposed development agreement states that if insufficient funds are available to pay the Site Preparation Project Costs and Public Improvements Costs, Developer shall revise the plans and specifications for the Site Preparation Project and Public Improvements and the Public Improvements Budget to reduce the costs to the amount of the Public Financing. Developer would have the right, for a period of up to two years, to raise public funds and/or private funds to complete the Project in accordance with the original plans and specifications.

The Public Improvements Budget attached as an exhibit to the Development Agreement indicates that approximately \$51.4 million is estimated to pay for the full scope of Site Preparation Project and Public Improvements. This would require additional public or private funding beyond the net \$38 million available from the CRA bond financing of \$13.4 million.

An Alternate Scenario assuming limited public funds presented in that exhibit would defer the conference center, resulting in a total budget of \$41 million, with a shortfall of \$2.95 million, which could be covered by the Developer loan (assuming agreement on acceptable terms) if not otherwise funded by additional public funding.

We note that this budget includes within the construction costs higher general contractor compensation than we would consider necessary and also that soft costs, particularly A/E costs, appear to be higher than we would anticipate as being necessary. Savings in these areas could possibly make up the shortfall in the Alternate Scenario. We also anticipate that the project would be contracted at a time of continued softness in the construction market, so cost escalation is not a significant concern as it was in the past.

Based on these factors, it appears that a reasonable baseline program of public improvements would be feasible, with restoration of the full program possible based on the level of additional public funding that could be attracted to the project.

### **Site Preparation and Public Improvements Plans and Specs**

The proposed development agreement states that:

- The final design of the Project shall be in general conformance with the Design Criteria approved by CMPA on November 28, 2007; provided, however, that from time to time the parties may agree to design changes deemed necessary in light of market and other financial conditions
- Plans and specifications for the Site Preparation Project and Public Improvements shall be coordinated among the Project Professionals, the Developer, and CMPA and shall be submitted by the Developer to CMPA for review and approval before the commencement of any work, with CMPA approval not be unreasonably withheld.
- All construction work on the Site Preparation Project and Public Improvements shall be done substantially in accordance with the Site Preparation Project plans and specifications.

The latitude these provisions provide Developer should be reviewed.

#### **Developer Management of Public Improvements**

The proposed agreement states that Developer shall act as CMPA's agent in managing the facilities and property controlled by CMPA (multi-use stadium, executive education center, the public park, and the conference center) for an initial term that shall be the shorter of 15 years or as long as it owns all or part of the Private Improvements; with termination within that period only in the event developer materially defaults in its performance of its Public Improvements management responsibilities. The parties may mutually agree to renew the term of the Developer's management responsibilities.

CMPA shall be responsible for all operating costs of the Public Improvements, including payment of the Management Fee. The source of funds for the CMPA operating budget shall be (i) \$175,000 per year from the Pelicans' use agreement; (ii) all of the Pelican's profits (including a guaranteed \$250,000 per year commitment for the first five years); (iii) all other net profits from the operations of the Public Improvements; and (iv) in the event of any shortfall, other revenue which may be derived from a consensual special assessment or other

fees or surcharges imposed upon or charged to Project users or tenants, and/or a portion of the tax increment actually generated by the Project and made available by the CRA.

All net cash flows from the operations of the Public Improvements shall be the property of CMPA, used to advance the Project.

Developer shall present written budgets to CMPA each year for approval or recommended changes.

Upon substantial completion of the Public Improvements, CMPA shall pay the Developer the property Management Fee equal to the following: (i) 4% of all office or other income from the Public Improvements (exclusive of the multi-use stadium); (ii) a fixed fee to be negotiated for the management of the park facilities including, but not limited to landscaping, capital improvements, security, and parking; (iii) 10% of gross revenues for event production, facilities rentals (excluding income derived from Pelican's lease), and sponsorship income (excluding stadium naming rights) administered by the Developer; and (iv) an annual facility management fee of \$250,000 for managing the multi-use stadium, adjusted annually by CPI. Management fees may be renegotiated every 5 years after commencement of operations of the multi-use stadium.

These management provisions raise a number of issues which could be of concern to the City stemming from its interest in the optimal management of the Public Improvements, its desire to see the Public Improvements operate on a sound footing, and its concern that potential operating shortfall would impact City or CRA revenues, either because special assessments against private development on sub-lease land could lower the value or delay the development on such land or, alternately, from allocation, at CRA's option, of a portion of TIF revenues.

It is noted that MDP does not have prior experience in operation of comparable facilities to the Public Improvements. Mitigating this concern is that, its role in development and ownership of the private improvements would give it a strong incentive to optimize the operation of the Public Improvements and it could be expected to engage appropriate

individuals to implement these responsibilities. Also, we believe that quality and care of management are more important than giving management to a lowest bidder.

We consider a 15 year term to be a longer commitment than we think would be typical for such a management contract. MDP contends that it needs this commitment to ensure satisfactory management of the Public Improvements to safeguard its long-term development and investment in the private development.

On the whole, we see some basis for MDP's arguments for being responsible for management and for this role to extend over a long time frame of development and ownership, though we do not feel these are necessarily essential elements for the developer. To the extent this is a concern to CMPA or the City, a somewhat shorter term might be explored.

With regard to compensation, those elements tying MDP's compensation to revenues aligns its interests with those of CMPA in maximizing these revenues. The fixed fee to be negotiated for the management of the park facilities is an improvement over prior drafts in which this component was to be based on a percentage of expenses managed by MDP; and, based on prior estimates, the amount in question would be anticipated to be relatively small. MDP has explained the fixed annual facility management fee of \$250,000 for managing the multi-use stadium as an amount that its research has indicated as typical for management contracts for comparable facilities and that it would likely be hiring such a third party manager or this component. MDP has not as yet provided requested validation for this research and no commitment exists in the agreement that a third party operator be engaged or that this element of the management fee be adjusted based on actual cost, which may be topics for further negotiation.

Particular concerns are that neither the CMPA operating cash flow nor the amount of the management fee can be estimated with any confidence at this point. A preliminary operating budget prepared by CMPA three years ago, supplemented by input from MDP on a limited number of operating components, and adjusted for the proposed fee structure, indicates that the Public Improvements would operate at a profit, though this profit would be marginal

without the Pelican's profits, budgeted at \$250,000, based on the guaranteed annual commitment for the first five years. These estimates do not include any revenues from facilities rentals. MDP has not as yet provided requested refined analysis of the operating budget.

The provision for renegotiation of the management fee every five years is an improvement over prior drafts. However, it is unclear what parameters would frame such renegotiation, i.e. if the parties could not agree would the agreement terminate or would there be some arbitration process? A review of financial outcomes and renegotiation of compensation terms sooner than five years and/or provision for automatic adjustments (perhaps caps on total fees) could be explored in further negotiations. Some provision for limitation of management fee in the event of a negative cash flow might also be an appropriate avenue for exploration.

Additional minor clarifications that could be explored in further negotiations could be that any management company or individual hired to manage the Public Improvements shall be compensated from the Management Fee and not as Project Professionals paid from Public Financing.

**Private Development Sub-Lease**

The proposed development agreement states that CMPA shall enter into a single Sub-Lease with MDP, in the form of an Exhibit to the agreement. The Sub-Lease refers at various points to the possibility of different parcels having different Commencement Dates

The Sub-Lease shall be for a term of 60 years and Developer shall negotiate with the City to extend the term for an effective term ending in 99 years.

The agreement sets out a process for determining the lease rate as follows. The rent for the land to be developed for the Private Improvements shall be at the fair value rent based upon the estimated fair value of the unimproved property as of the Effective Date of this Agreement, as determined by the City of Pensacola's real estate advisor within 90 days of the Effective Date. To determine the estimated value of the unimproved property, the City's real

estate advisor shall consider the methodology employed to produce the report, dated December 6, 2005, prepared on behalf of CMPA by Abramson & Associates, Inc. as well as such other factors considered relevant to a fair valuation of the land. The Developer would either agree to the updated estimation or retain another consultant and the parties would thereafter attempt to agree on the estimated value, or if they are unable to do so, either have the two consultants choose a third consultant to determine the value, or proceed to dispute resolution.

The Sub-Lease payments shall begin pro rata upon the completion of construction of each Private Improvement structure as defined by the City building department's issuance of a certificate of occupancy for final build-out. Sub-Lease payments shall be due only for the pro rata area of the Project on which vertical Private Improvements have been made, consistent with the following:

1. If material construction has commenced on any Private Improvements within the first 24 months of the effective date of the Sub-Lease, then the only Sub-Lease payments made for the next 36 months shall be pro rata for that portion of the Project Site that is developed once the certificate of occupancy is issued.
2. If, within 36 months of completion of any of the Private Improvements, the Developer commences material construction of any of the other Private Improvements, then the pro rata portion of Sub-Lease payments due shall be for those Private Improvements that have certificates of occupancy.
3. If, within 36 months of completion of any of the Private Improvements, the Developer does not commence material construction of any of the other Private Improvements, then either (i) Sub-Lease payments shall be due on the entire property available for construction of the Private Improvements, or (ii) the parties may amend the Sub-Lease to eliminate the Developer's exclusive right to develop those portions of the Project.

Based on conversations with MDP and CMPA's advisor, we anticipate and recommend a considerable evolution of the business terms of the private sub-lease.

First, we recommend that, as practical, the rents and other major terms be set within the agreements as opposed to left for later resolution.

We have suggested and there has been conceptual agreement upon the broad outlines of a land valuation and lease structure that takes as a starting point the methodology and valuation in the December 6, 2005 report, and also accounts for:

- The distressed condition of the real estate market which currently exists and can be anticipated to prevail for the near term.
- The expectation that the real estate market will ultimately return to a condition of health sufficient to support new development and land pricing in the range (on a real dollar basis) of that estimated in the 2006 report.
- The impact on value of various parcels of such factors as location, use, scale/density of development, the need for structured parking to support the development, the application of public funding/financing to support parking, site work, the conference center, if it is developed as part of a hotel or other private development.

We recommended that the approach also:

- Decrease the time frames within which development must be started and set minimum amounts of development that must be developed in those time frames in order to avoid increased payments for land not already developed.
- Set time frames and minimum amounts of development that must be developed in those time frames in order for MDP's to retain its lease rights to remaining undeveloped parcels.
- Allow for limited extensions to the above time frames for demonstrable conditions of market distress.
- Set substantial completion rather than commencement of construction as a benchmark for the time frames.

- Explore the possibility of some lease payments for un-developed parcels in addition to that paid for the developed parcels.
- Lease the private land on a parcel by parcel basis (as exact parcelization is determined) rather than as single sub-lease or, if a single lease, provide for staged take-down that would not unduly tie up remaining undeveloped parcels should MDP's rights be terminated. This could also allow for the extension of the lease term to 99 years applying only to parcels containing residential condominium components.
- Confirm that the sub-lease(s) (land and the lease payments) shall in no way be subordinated to any financing, i.e. any successor would be subject to Developer's obligations.

#### **Legal Issues**

There are a number of issues that lean more toward the legal. We understand that a review by an outside legal counsel will be conducted, which can provide input on issues such as those noted below as well as the agreements as a whole.

#### **Procurement Process**

MDP has contended that its acting as general contractor would provide efficiency in fulfilling CMPA obligations relative to City procurement processes for design and construction that would not be the case if it is not general contractor. This issue should be clarified.

#### **Assignment**

All contracts between the Developer and the Project Professionals and contractors shall provide that they are assignable by the Developer to CMPA, including being automatically assigned to CMPA upon the termination of the agreement.

#### **Default and Termination**

These provisions allow considerable opportunity for developer to cure defaults and delay termination.

**Payment & Performance Bonds**

The agreements do not require payment and performance bonds guaranteeing completion of the public improvements. We understand that this would be a requirement of the City and might be addressed in the agreements.

**Developer's Financial Capacity**

We recommend that an updated review of Developer's members' financial capacity and condition be performed by a qualified auditor.

## ASSUMPTIONS AND LIMITING CONDITIONS

- Information provided by others for use in this analysis is believed to be reliable, but in no sense is guaranteed. All information concerning physical, market or cost data is from sources deemed reliable. No warranty or representation is made regarding the accuracy thereof, and is subject to errors, omissions, changes in price, rental, or other conditions.
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