A RISK MANAGEMENT STRATEGY FOR PUBLIC-PRIVATE PARTNERSHIPS: SAN FRANCISCO'S YERBA BUENA GARDENS

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ABSTRACT

This thesis analyzes the public-sector's business strategy in the public-private partnership formed to develop the proposed 23-acre, $1.5-billion Yerba Buena Gardens (YBG) project in downtown San Francisco. Formalized in 1984, the partnership aims to use the development value of this land, which the San Francisco Redevelopment Agency (SFRA) owns, to fund public amenities including magnificent gardens and cultural facilities.

In partnership with the private master developer, Yerba Buena Gardens Associates (YBGA), the SFRA would share risk for the life of the project. Therefore, as a response to the project's historical legacy and financial scale, the public sector officials crafted a strategy that would provide a framework to define and control how project risks were shared. Two elements were key: (1) aligning the interests of each party and, (2) ensuring the necessary flow of funds to construct and operate the public facilities.

This thesis analyzes the partnership agreement throughout the evolution of the project to gain an understanding of how the strategy developed and survived as the project was racked by programmatic, economic, and political change. The negotiating posture and actions of the SFRA are interpreted as evidence of the Agency's entrepreneurial behavior in actively sharing risk with its private development partner. Finally, the strategy is evaluated as a risk management tool for the SFRA and as a model for public risk-sharing more generally.

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We would also like to extend our deep appreciation to Lynne Sagalyn for her commitment and support, not only throughout the thesis process, but over our past year of study. Her overwhelming knowledge of, and passion for, this thesis topic added tremendous value to its content and our educational experience.

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CHAPTER FIVE

List of Exhibits

INTRODUCTION

In downtown San Francisco on October 17, 1989, a grand-opening party was taking place on the top floor of the new Marriott Hotel. After more than 30 years of controversy, the opening of the Marriott symbolized the first tangible accomplishment of the City's $1.5-billion, 23-acre public-private joint venture, Yerba Buena Gardens (YBG). As developers, public officials, and interested citizens joyously celebrated the realization of the first phase of the city's most ambitious redevelopment project, a devastating earthquake measuring 7.1 on the Richter scale shook northern California, adding one more jolt to a development agenda already bedeviled by a shaky history.

The Marriott hotel and all the construction activity on nearby blocks represent a milestone in the City's redevelopment of downtown. Named "Yerba Buena" after the first San Francisco settlement, YBG is a city initiative orchestrated by the San Francisco Redevelopment Agency (SFRA) in concert with its private-sector partner, Olympia & York (O&Y), a Toronto-based concern and one of the world's largest real estate development companies.

The project is interesting to study for several reasons. First, it is arguably one of the largest and most complex redevelopment plans in the U.S. today. Second, the City's strategy -- which aims to create a public-amenities package dependent on mixed-use private development for both construction and operations funding -- is different from most public-private partnership projects taken on by city redevelopment agencies. For instance, development of downtown festival marketplaces creates a single public-oriented use, with adjacent complimentary uses springing up through subsequent private development initiatives. In contrast, the plan for YBG is an enormous mixed-use project including hotel, office, retail, residential, cultural, recreation, and entertainment uses all being developed -- in scheduled sequence -- by the Agency in partnership with a single master developer.

Third, the existing underground City-run Moscone Convention Center, located within the project boundaries, is being expanded beneath the planned public gardens and recreation areas. In addition, the new home of the San Francisco Museum of Modern Art (SFMOMA), to be constructed and financed by a museum-related entity, is also within the YBG boundary. Although developed independently of the partnership, these uses have become symbolic of the entire project: they represent both the economic revival and cultural policy objectives that have propelled the city initiative for so many years. They also promise to create a critical mass of attractions likely to insure the ultimate success of the project.

Fourth, the SFRA is actively playing the role of an entrepreneurial deal-maker in San Francisco's distinctly restrictive development climate. Improvements planned for construction in the YBG area are not subject to the city's standard design review process; they may exceed the city's zoning height restrictions; and they are not generally subject to the Proposition M growth restraint which limits annual office space construction to 475,000 square feet per year. In addition, while there is a citizen review process for the makeup of the public-amenity package and program, the SFRA retains control over the final decisions. Thus, the SFRA's business negotiations and policy decisions will have a profound impact on both the physical and programmatic integrity of the downtown area.

Finally, the drawn-out history and extended negotiation processes involving several levels of City government, diverse citizen coalition groups, and business organizations, have created substantial pressure on the SFRA to produce the sought-after public amenities. There is so much pressure, in fact, that the SFRA is plowing ahead with its plan to construct the public amenities, despite soft market conditions that are causing O&Y to delay purchase of the land and construction of the private improvements. Since the SFRA's goal is to fund the construction of the public amenities with proceeds from the sale of land on which the private improvements will be constructed, this becomes a true test of the SFRA's initial business strategy which was first formalized in the 1984 Disposition and Development Agreement (DDA) and subsequent amendments with the private developer.

A detailed study of this unique and complex public-private partnership should reveal a process by which a public agency translates its public policy objectives into sound business terms for risk-sharing. An analysis of the Agency's behavior, throughout the protracted life of the project, will shed some light on what it means for a public deal-maker to take on risk.

Plans, Icons, and Images

Yerba Buena Center (YBC) is an ambitious 87.3-acre mixed-use redevelopment site, located in the South of Market (SOMA) district directly adjacent to the office and retail districts of downtown San Francisco (See Exhibit 0.1). YBG is a 23-acre portion of the YBC area consisting of the three "Central Blocks" (CB-1, CB-2, and CB-3) bounded by Market, Folsom, Third, and Fourth Streets, and one adjacent "East Block" (EB-2) bounded by Third, Second, Mission and Howard Streets (See Exhibits 0.2 and 0.3).

The distinctive 40-story Marriott tower, set slightly away from the heart of downtown, is now one of the more noticeable elements in San Francisco's beautiful skyline. It is less than affectionately known by residents and visitors alike as the "jukebox," for its distinctive ornamental black glass windows in the shape of a jukebox located in a random pattern near the top of the pink concrete box-like structure. Its hulking shape rises above the neighborhood like a misplaced mountain.

The hotel is located on Market Street, near the corner of Fourth Street and occupies approximately 25% of one block of the four-block YBG redevelopment area. Behind the hotel to the south is a huge construction site. On the adjacent block, thick concrete and steel beams form a roof for Marriott's underground meeting rooms and a base for proposed above-grade development. On the south end of the adjacent block, steel columns and beams jut out of the ground across the street from the above-grade entrance to the underground Moscone Convention Center. Construction trailers and cars sit behind the Convention Center entrance on a fenced gravel parking area. Razed land and free-standing buildings that were once part of a city block are visible on the blocks to the east. Around the site are newly constructed residential, retail, and office buildings awaiting completion of the project.

Though the site is pretty bleak today, the SFRA envisions an active, vibrant urban park teeming with San Francisco residents, workers, tourists and other visitors. It imagines the YBG project as a symbol of the cultural diversity of the city, a high quality urban mecca that will have its own distinct sense of place. It hopes the place will become a destination for the diverse groups that both inhabit and visit the city.

The program currently planned for the YBG site includes the 300,000-square-foot underground Moscone Convention Center with its equally large underground expansion, and the recently completed 1500-room Marriott Hotel. It also anticipates three major office buildings to contain 1.5-million square feet of space, retail shops including a cinema and other entertainment facilities, a cultural center, a 750-seat theater, 10 acres of elegantly landscaped public gardens and open spaces, a child care center, a carousel, a children's museum, and the new home of the San Francisco Museum of Modern Art. Construction on the public amenities has started, while anticipated dates for construction and completion of the private improvements are still in negotiation.

Thesis Intent and Organization

Over the past twenty years, city governments have become increasingly involved in partnerships with private development companies in order to maximize the value and utility of publicly owned developable land. They have sought partnerships as a means of benefitting from the expertise of private developers in constructing, operating, and maintaining structures of public significance. From a financial perspective, the city's goals have often been to manage the public risk and responsibilities for the end product, while simultaneously providing public amenities designed to further public policy objectives.

This thesis examines the key elements of the business strategy employed by the SFRA in its partnership with O&Y to construct, operate, and maintain the YBG development.

Throughout the extensive negotiations, three issues were of particular significance: (1) whether the SFRA should sell or lease the land, (2) how responsibilities for providing various amenities and public facilities would be divided between public and private parties, and (3) how the money paid to the SFRA for the private development rights would be spent to achieve public objectives.[1] After years of intense negotiations, these issues were resolved by creating a conditional phasing plan which would transfer the development rights to the private developer over time, in concert with funding needs of the SFRA for construction and maintenance of the public amenities.

The central theme of this thesis is that the city's business strategy represents a form of entrepreneurial risk-taking. The conceptual strategy implemented by the SFRA in its selection of and negotiation with the developer was formulated to insure completion of the public amenities, the Yerba Buena Gardens (YBG), while simultaneously managing the risks and responsibilities assumed by the public sector. How this strategy was translated into business terms in order to establish mutual objectives for both the public and private side, how it has evolved throughout the process, and how it has been an effective risk-management tool for the SFRA are the central issues explored in this thesis. The generalizable question is how the strategy might be applied to other public-private partnerships.

Chapter One describes the long history of the project and analyzes its impact on the current public pressures faced by the SFRA to produce the YBG public amenities. These pressures have resulted in a definite conceptual business strategy to manage public risk and responsibility while maintaining flexibility and control over the assets.

Chapter Two describes this business strategy, which we have termed the "phasing and bucket strategy," and explains how the SFRA used the strategy to prioritize the construction, operation, and maintenance of the public amenities and insure that the objectives of the program are met.

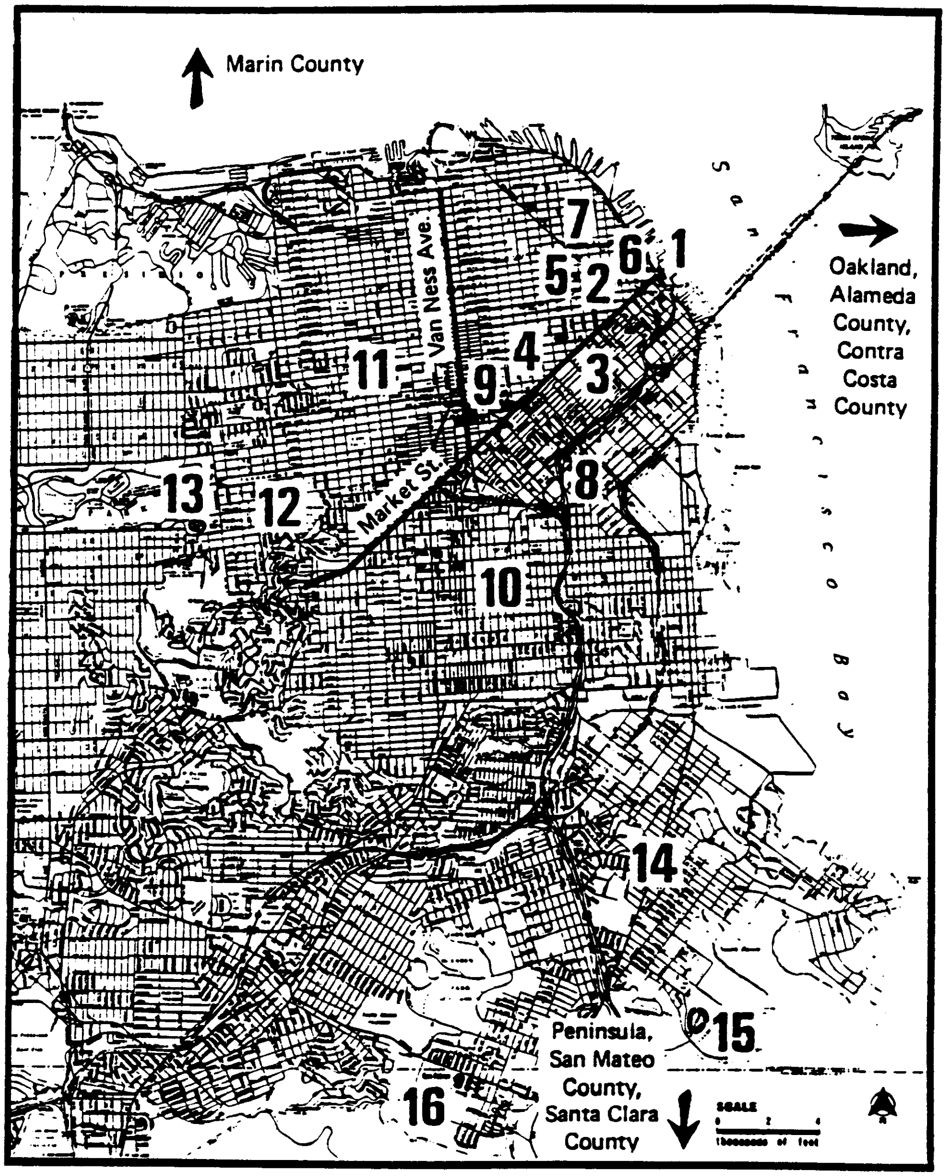
Chapter Three analyzes how the strategy has weathered time and evaluates its effectiveness in maintaining the goals embodied in the original 1984 Disposition and Development Agreement with the private developer.

Chapter Four interprets the SFRA's actions as a means of public risk-taking. What does it mean for a public entity to take risks? What behavior of a public entity indicates that it is taking risks? This chapter evaluates the effectiveness of the SFRA's strategy in managing the project's risks -- development, financial, operating, political, and economic. It also works toward developing an analytic framework to address these questions.

Chapter Five applies the analytic framework to the SFRA's business strategy for the YBG development. How viable is this strategy for managing public risk-taking? What has the SFRA learned from implementing YBG? In what ways can the characteristics of this concept be applied to other public-private joint ventures?

EXHIBIT 0.1

Plan of the City of San Francisco



Legend:

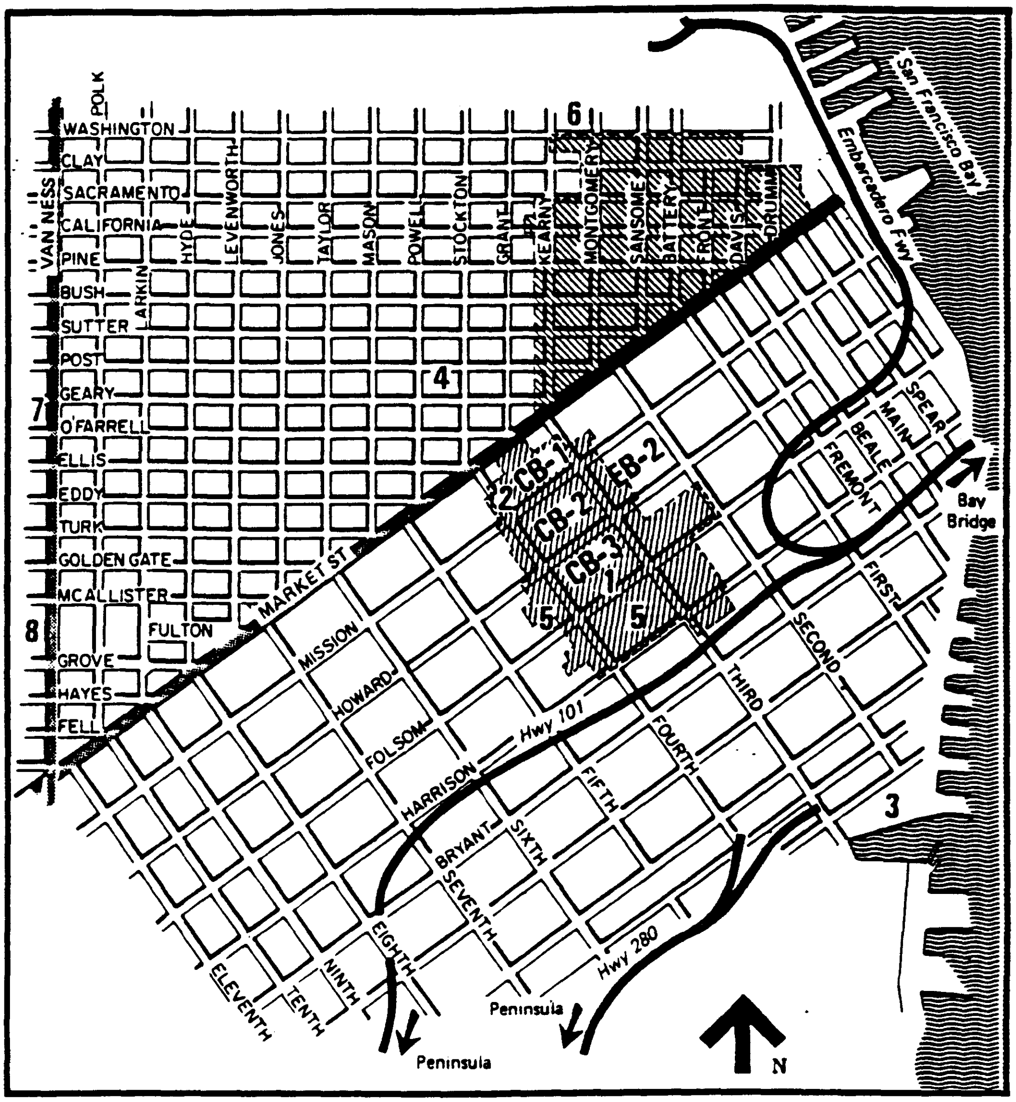
1. Market Street
2. Financial district
3. Yerba Buena Center (South of Market)
4. Tenderloin
5. Chinatown
6. Golden Gateway Project
7. North Beach
8. Mission Bay (SP Project)
9. Civic Center/City Hall
10. Mission district
11. Western Addition
12. Haight-Ashbury
13. Golden Gate Park
14. Bayview/Hunters Point
15. Candlestick Park
16. Cow Palace

City and County of San Francisco

City and County of San Francisco (courtesy of San Francisco Department of City Planning).

EXHIBIT 0.2

Plan of Downtown San Francisco and YBC·



Legend:

1. Moscone Convention Center
2. GSA site (49 Fourth St.), site of proposed Marriott Hotel
3. Proposed site for new domed stadium
4. Union Square
5. TODCO housing
6. International Hotel
7. Goodman Building
8. City Hall

CB-1 Central Block 1
CB-2 Central Block 2
CB-3 Central Block 3
EB-2 East Block 2

Yerba Buena Center project

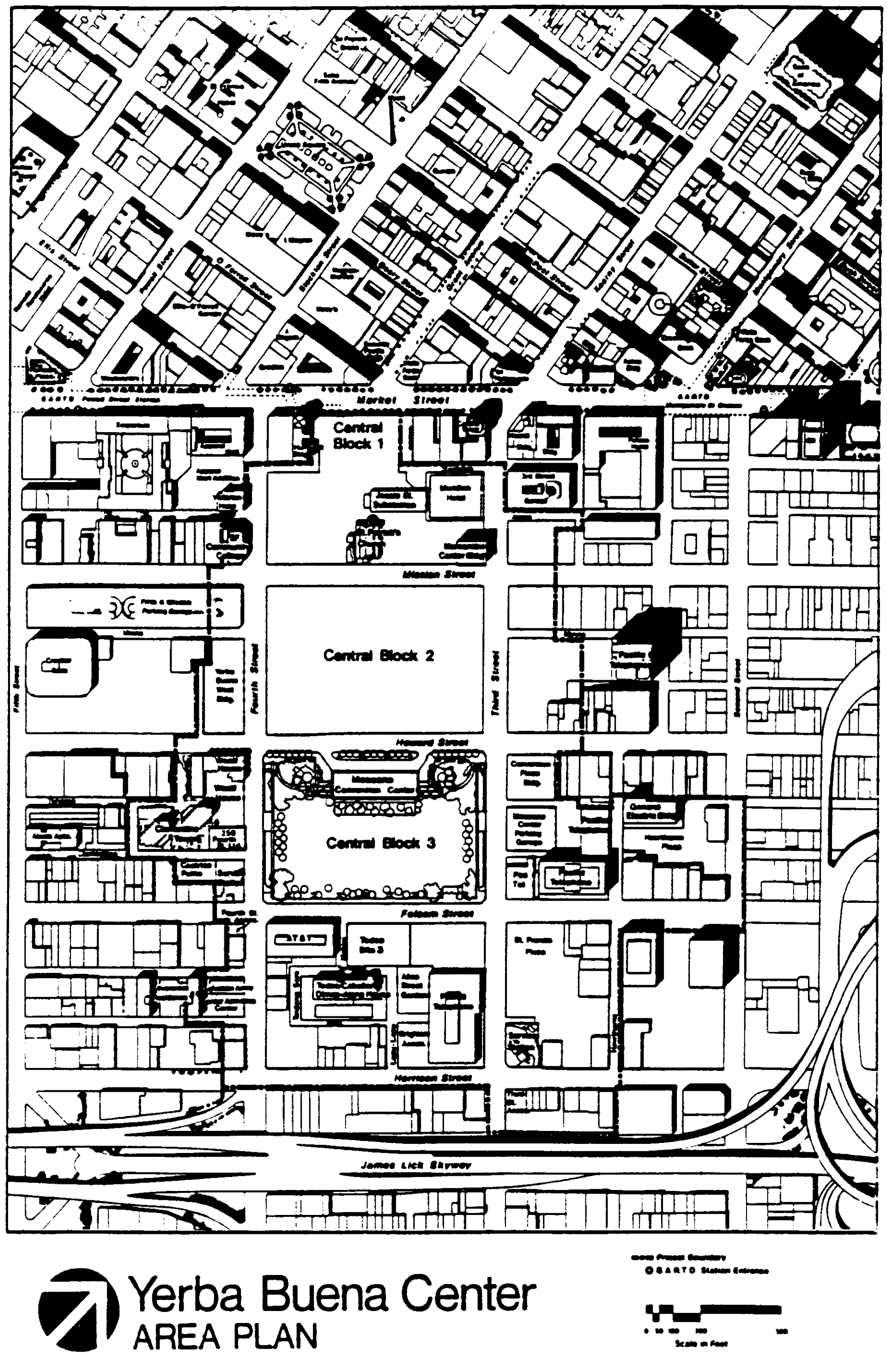
Financial district

Downtown San Francisco

Downtown San Francisco (courtesy of San Francisco Department of City Planning).

EXHIBIT 0.3

Area Plan of YBC and YBG



Source: San Francisco Redevelopment Agency

CHAPTER ONE

CONTROVERSY LEADS TO PUBLIC POLICY CHOICES

No analysis of YBG would be complete without some understanding of the complicated 30-year long struggle which shaped the city's public-private deal. In fact, the legacy of the SFRA's efforts to realize the redevelopment project was perhaps the strongest motivation in creating a strategy that could cope with myriad risks -- financial, political, construction, and operations -- entailed in a project of this scope.

Three Decades of Effort

To fully understand the impacts of the YBG history on the current deal, there are three important items to note. (The details of the complicated history are presented in Appendix B.) First, the current public amenity program represents a concept in constant evolution, from 1953 to 1991, and now includes a significant cultural element encompassing permanent art displays, a performing arts center, and the San Francisco Museum of Modern Art. Second, almost all of the housing sites have been eliminated from the plan for the Central Blocks. Third, the SFRA has shown its willingness to take on financial risks relating to the private improvements.

The long struggle to realize some public benefits from the downtown site began in 1953. Interested citizens and government officials have proposed a number of different programs for the development. Early planners, citing the goal of downtown economic revival, proposed large-scale business-oriented developments. These invariably included office buildings, a hotel, a convention center, a sports arena, and parking. Of course, this type of plan did not sit well with the citizen groups who fought to replace the low-cost housing that was razed in the YBG area under the guise of the federal urban renewal program.

The conflicts resulted in numerous legal battles during the late 1960s and 1970s. These were fought to determine both the fate of the displaced residents and a programmatic mix that would provide important public benefits, without subjecting the public to excessive cost. Citizen groups were eventually successful in requiring the SFRA to replace the housing that was lost, but they were not successful in securing a low-rent housing component within the YBG program.

Other lawsuits challenged the propriety of the Agency's various financing plans and underlying political power struggles added additional spice to the efforts to protect the diverse public interests in the site. The first plans to finance the large-scale public amenity package (including the convention center, sports arena, and recreation and park spaces) proposed a $219 capital expenditure to be funded by a $225-million SFRA bond issue[2] (Exhibit 1.1).

The revenues to pay off the bonds would be generated from land rents from leases with private developers for sites in the YBG area, income from the public facilities, a hotel tax allocation, and a property tax increment.[3] This plan did not survive the legal challenge intact and resulted in the elimination of the sports arena from the program.[4] Whether or not the public arguments were correct, that there would be insufficient revenues to support the public amenities, the fact remained that the public goals were dependent, by design, on private large-scale development.

The delays from the legal challenges and the City's strong desire to build a convention center facility led to the City's take over responsibility for construction of the convention center. As soon as the last legal hurdle was cleared, the City issued $97 million in bonds to construct the convention center.

The Developer Selection Process

With the convention center component of the project underway, the SFRA issued a Request for Qualifications (RFQ) Program Agreement in April 1980 to local, national, and international developers interested in bidding for development rights on the remainder of the three Central Blocks and the one East Block (hereafter referred to as the Central Blocks). The RFQ set out the SFRA's objectives for the area:

> The Agency desires to develop a complex set of uses of a uniquely San Franciscan character that will be an asset to the City and downtown, complement and create a generally supportive setting for the George R. Moscone Convention Center, provide an

> environment attractive to our City's working population -- be a place where people will come to enjoy lunch, where families will spend an afternoon, where our citizens will meet and browse through markets and shops, as well as being a focal point for our many visitors -- a place to stay, to shop, dine, and be entertained. A city of great physical charm with significant cultural assets and creative talents, San Francisco provides an opportunity for the developer to take advantage of these attractions and create a unique environment for our City.[5]

Despite the recommendation in 1976 of a Mayor's committee of interested citizens that the program contain a significant housing component,[6] the SFRA did not envision a low-rent housing component as part of the public amenity package. The desired development program for YBG set out in the RFQ included:

- •An 800-room to 1500-room hotel;
- •A minimum of 260,000 square feet of retail/ entertainment/amusement use;
- •A minimum of 50,000 square feet of cultural use;
- •Up to 500,000 square feet of office space;
- •Up to 500 units of residential use on CB-1;
- •Developer discretion as to residential units on the other blocks, additional cultural use, recreational use, and parking.[7]

In addition to the cultural facilities, the public amenities included 10 acres of park-like open space described as an "urban garden" available for fairs, special exhibits and performances.[8]

After reviewing the qualifications of the ten developers who responded to the RFQ, the SFRA narrowed the field to two finalists: Cadillac-Fairview and the team of O&Y/Marriott/Beverly Willis.[9] From the Agency's perspective, the strengths of Cadillac-Fairview were its extensive experience in large mixed-use development projects and its design team's expertise in creating people-oriented active spaces.[10] The strengths of the O&Y/Marriott/Willis team were its ability to complete projects in tight time frames, its reputation for honoring commitments, and its willingness to be flexible.

O&Y gets the Brass Ring

In November 1980, the team of O&Y/Marriott/Willis (hereafter O&Y/Marriott, since Willis as a limited partner has no day-to-day decision-making power) was selected for exclusive negotiating rights for the YBC Central Blocks.[11] The SFRA noted that both finalists had the necessary financial capacity to build large and complex projects, the experience with public-private partnerships, a design team with the ability to create large people-oriented mixed-use projects, and the skills to implement a special project such as YBG. The Agency chose O&Y/Marriott, however, for several additional reasons:

- A demonstrated sensitivity to the projects needs and ability to respond positively to the Agency's concerns;
- A team with exceptional creativity in community arts and recreation program;
- A qualified project executive;
- A design team with experience in cultural, entertainment, amusement and recreational uses;
- A team that can work successfully with the large diversity of groups in San Francisco.[12]

The initial negotiations between the SFRA and the selected team began in December 1980 and lasted 3 years. In

April 1984, the negotiators announced an agreement of basic financial terms including construction costs, lease revenues, and tax increments. After the agreement was announced, numerous presentations were then made to citizen groups on the proposed business terms of the Disposition and Development Agreement (DDA) and the programmatic plan for Yerba Buena Gardens, as well as the public amenities.[13] The agreement was signed on December 19, 1984, by Mayor Dianne Feinstein .[14] Since 1984, both the program and the financial structure of the DDA have been renegotiated several times. Details of the 1984 business negotiations and subsequent deal changes are further discussed and analyzed in Chapters Two and Three.

The 1984 YBG Program

The 1984 proposed YBG program, estimated to cost $104.5 million (Exhibit 1.1), resulted from the match of public desires and private development deemed necessary to generate the revenues necessary to provide the desired public amenities. The major proposed uses were purposely interlocked -- both physically and financially -- in order to help the SFRA manage the risk that O&Y might not fulfill its obligations for the public amenities. From the perspectives of the developer, business community, citizen groups, and public officials, the cultural facilities became the key to the project's success, the symbol assuring all that the project would reflect San Francisco's unique character.[15] The proposed program (Exhibit 1.2) included:

- •10 acres of plazas and gardens;
- •100,000 square feet of cultural facilities;
- •340 to 540 units of residential units;
- •160,000 to 200,000 square feet of retail;
- •Two office towers containing 1,250,000 square feet of office space
- •1,500 hotel rooms;
- •170,000 square feet of Amusement/Recreation/ Entertainment (ARE);
- •2,300 parking spaces.[16]

As presented in an axonometric site plan by the SFRA (Exhibit 1.3), the magnitude of the public amenity component has a much stronger visual impact than the height and mass of the hotel and office towers. This was probably done purposefully to show that the SFRA was working toward tangible public objectives in order muster public support for the YBG project. It also leads to the interpretation that public opinion concerning the development had had a strong impact on the SFRA's behavior and would probably continue to do so.

The Historical Legacy

To evaluate the public objectives for this redevelopment, it is first necessary to identify the "public." In San Francisco, this question is particularly relevant since traditionally strong population diversity has been a defining element of public debate, creating an almost extreme tension between the forces of rapid change and continuation of tradition.

It is clear from the long embroiled history of the YBG development[17] that these forces have been at work since the project was first proposed in 1953. On the one extreme are those who sought retribution for the seemingly senseless destruction of a residential neighborhood. On the other extreme are those whose interests in the rapid completion of the convention, hotel, and office facilities represented the desire for enhancement of San Francisco's business climate and attraction as a place for private investment. It has been the City's job, through its own actions and the activities of the SFRA, to represent these diverse interests by using its publicly owned land to produce benefits that serve the interests of the public as a whole while minimizing the financial risks to the resident taxpayers. This has been a difficult balancing act indeed.

Over the three decades of planning, the interests and political power of groups within the business community, citizen coalitions, and public offices have shifted dramatically. This, in turn, caused the public objectives and policy goals to be pushed and pulled, twisted and shaped like taffy. At various points in time, economic revival of the downtown, low-cost housing for residents, and cultural and arts emphasis have each taken precedence as the driving policy force behind the progress (or lack of progress) in achieving a redevelopment plan for YBG.

Economic Revival versus Low-cost Housing

These public policy objectives for YBG are revealed in the variety of issues surrounding the struggle to realize the development. But no issue has been more intense than the initial fight over slum clearance and housing reuse. The City's economic objectives were first expressed in the 1950s by the original planners in their zeal to raze the "skid row" neighborhood and replace it with a convention center for tourist and visitor needs, a large stadium, offices, hotel, retail stores, and 7,000-car parking garage. Because local business interests wielded considerable power over the elected and appointed officials at the time, these arguments were politically palatable.[18]

Other public amenities sought by the SFRA in the early evolution of the development program included parks, pedestrian open spaces, and a 2,200-seat theater. While these amenities represent important public objectives, the SFRA's arguably premature actions of demolition and sluggish response to the goals of providing quality low-rent relocation housing for the YBC residents indicates some insensitivity to this important public objective. It also emphasizes the choice of the SFRA and City favoring economic and architectural revitalization over housing. Despite the large housing component recommended by the Mayor's committee in 1976, the SFRA continued its efforts to implement a large-scale commercial development plan void of any sizable affordable housing component.

The economic policy justification became easier and easier for the SFRA to support, in part because of the power wielded by local business interests particularly after the area was razed. As time passed and the housing obligations of the SFRA to the former inhabitants were being met in other areas of the city, even citizen coalitions who had fought so hard to stop the project had a strong interest in realizing some public amenity and policy benefits from the long-vacant site.

It is easy to imagine the business pressures on both the City and the SFRA to revitalize what was an unsightly, predominantly industrial area "in the path of downtown business expansion."[19] In designing a program for the redevelopment project and in stating its objectives in the 1980 RFQ, the SFRA expressed a clear vision of the public benefits it sought.

The Public Motivation for Tangible Results

The image of a festive urban garden filled with resident families and visitors enjoying entertainment, shopping, restaurants, and cultural activities has been the clear overriding public objective. Whether or not these public benefits justify the displacement of the former residents of the razed neighborhood, they have now become the key motivation and result sought. The SFRA devised the YBG deal strategy to insure that the cultural and public amenities will be realized and to assure themselves that the project will finally be judged by San Francisco residents (particularly those who fought so hard to prevent the YBG development) as a success.

Timely completion of the YBG cultural amenities has become the SFRA's primary impetus in its continuing negotiations of the Disposition and Development Agreement with O&Y.[20] Once the housing issue was settled in the late 1970s and it became clear that the planning for the project would proceed, citizen groups that had been opposed to the development for so many years as well as local SOMA community groups began to participate in the planning process with the SFRA to insure that they would benefit from the development.

In fact, the citizen participation has been so active that one self-proclaimed community activist is the current president of the Redevelopment Agency Commission,[21] the group responsible for approving SFRA decisions. Due to this level of community participation, the SFRA's policy goals began to focus upon both economic revival of the YBG area and demonstrating a strong support of cultural and arts policy.

Cultural Policy Drives Today's Deal

The new politically acceptable goal became a recognition of the cultural vitality of San Francisco, now embodied in the proposed Yerba Buena Gardens Cultural Center (YBGCC). Clearly, this image would also enhance the value of the private development rights. The reasoning was simple: the project will be more successful if the area takes on the day-time activity of the downtown and a vibrant weekend and night life, making it a more desirable place to spend time for shoppers, tourists, residents, office workers, and conventioneers.

In San Francisco, the trend toward increasing city support of cultural and artistic endeavors has recently been formalized in the May 1991 Proposed Arts Policy, developed through a community planning process begun in 1988. The goal is to have the arts policy adopted as part of the City Master Plan.[22]

Several of the goals expressed in the Proposed Arts Policy relate directly to efforts made by the SFRA to construct the YBGCC and to operate cultural and arts programs. One of the main goals of the community participants is to enhance, develop, and protect the physical environment of the arts in San Francisco.

> A more directed program of facility maintenance, creative use of non-arts city facilities and public and private facilities partnerships will yield not only a more stable arts community but a more economically sound and artistically rich environment....New outdoor spaces should also be encouraged through private and public developments....[Another policy goal is to] develop and maintain a mid-sized downtown performing arts facility available to community-based, culturally diverse arts groups easily accessible to visitors....Agencies that have major construction programs,such as the Port of San Francisco, the Redevelopment Agency and the Airport, participate in the public percent for art program but do not necessarily have policies relative to the use of their facilities for arts purposes. The

Redevelopment Agency's project, Yerba Buena Gardens, is a notable exception.[23]

Clearly, the SFRA's arts policy for YBG has been effectively communicated and supported by the community. Because of this long-standing citizen interest and involvement in YBG, the SFRA is under additional pressure to produce the desired facilities in a manner that effectuates the politically desired program.

In summary, the historical legacy of delays and obstacles in the YBG plan have put intense public pressure on the SFRA to produce tangible results for its many years of effort and expense. In addition, the cultural facilities have evolved into the symbol of community participation in the planning process and support for the project. In turn, these forces have pressed the SFRA to implement a business strategy directed at realizing the public amenities as soon as feasibly possible, while protecting the public's financial interests in the agreement and continuing negotiations with O&Y/Marriott.

EXHIBIT 1.1

Comparative Projected Sources and Uses of YBG Construction Funds

(Estimates in millions)

	1972 Plan	1984 Plan[3]	1991 Plan
Uses			
Convention Center	$219[1]	Constructed by City	Constructed by City
Sports Arena		N/A	N/A
Other Public Amenities		$104.5[4]	$97.0[9]
Pay off HUD Loans		$28.0[5]	$16.0[10]
Total Uses	$219	$132.5	$113.0
Sources			
Bond Issue - Convention Center	$225[1]		
Bond Issue - Other		$28.0[5]	$16.0[10]
Land Sale Proceeds -			
CB-1		$38.5[6]	$37.8
EB-2		?[7]	$37.6[11]
Other YBC Land Sales		$29.0	
Tax Increment Bonds		$15.0	
Hotel Tax Allocation Bonds		$13.0	
Marriott Lease Renegotiation			$10.0
Other Sources		$9[8]	$11.6[12]
Total Sources	$225	$132.5	$113.0
Net Balance	$6[2]	$0	$0

Source: Benson & Flaster, A Risk Management Strategy for...YBG
MIT/CRED Thesis, 1991

Exhibit 1.1 (continued)

Notes

1 - In 1974, a legal settlement reduced the maximum bond issue to $210 million. The sports arena was eliminated to reduce the cost of the convention center and other public amenities to $162.5 million. The low bid received on the construction of the remaining public amenities. In 1978, the convention center was extracted from the SFRA responsibilities. The City issued its own bonds in the amount of $97 million to construct the convention center.

2 - Information is not available to determine whether this $6 million difference between the bond issue amount and the projected costs is attributable to fees or an interest reserve.

3 - Keyser Marston Associates, YBG Public Sector Feasibility Report, October 1984.

4 - Total program hard construction and soft costs were projected to be $109 million, this included the housing fund contribution of $5 million is subtracted to make 1984 projected costs substantially comparable to 1991 projected costs. Keyser Marston Associates, YBG Public Sector Feasibility Report, October 1984.

5 - To pay off HUD loans, in 1983 bonds in the amount of $28 were issued for a seven-year term, secured by a letter of credit. Payments were to be made from a combination of tax increment receipts and revenues from the sales of property outside the YBG area.

6 - Proceeds from the sale of CB-1 included both the office parcel and the residential units that would be sold several years in the future. The base price of $32.5 million for the office parcel represented the escalated figure. Keyser Marston, Feasibility Report.

7 - The sale price for the EB-2 parcels was not yet determined in 1984. Estimated sale proceeds were to be used to complete the gardens on CB-2, if necessary, and to complete public amenities on CB-3. Any remaining balance could be placed into a housing fund.

8 - Includes lease revenues and interest.

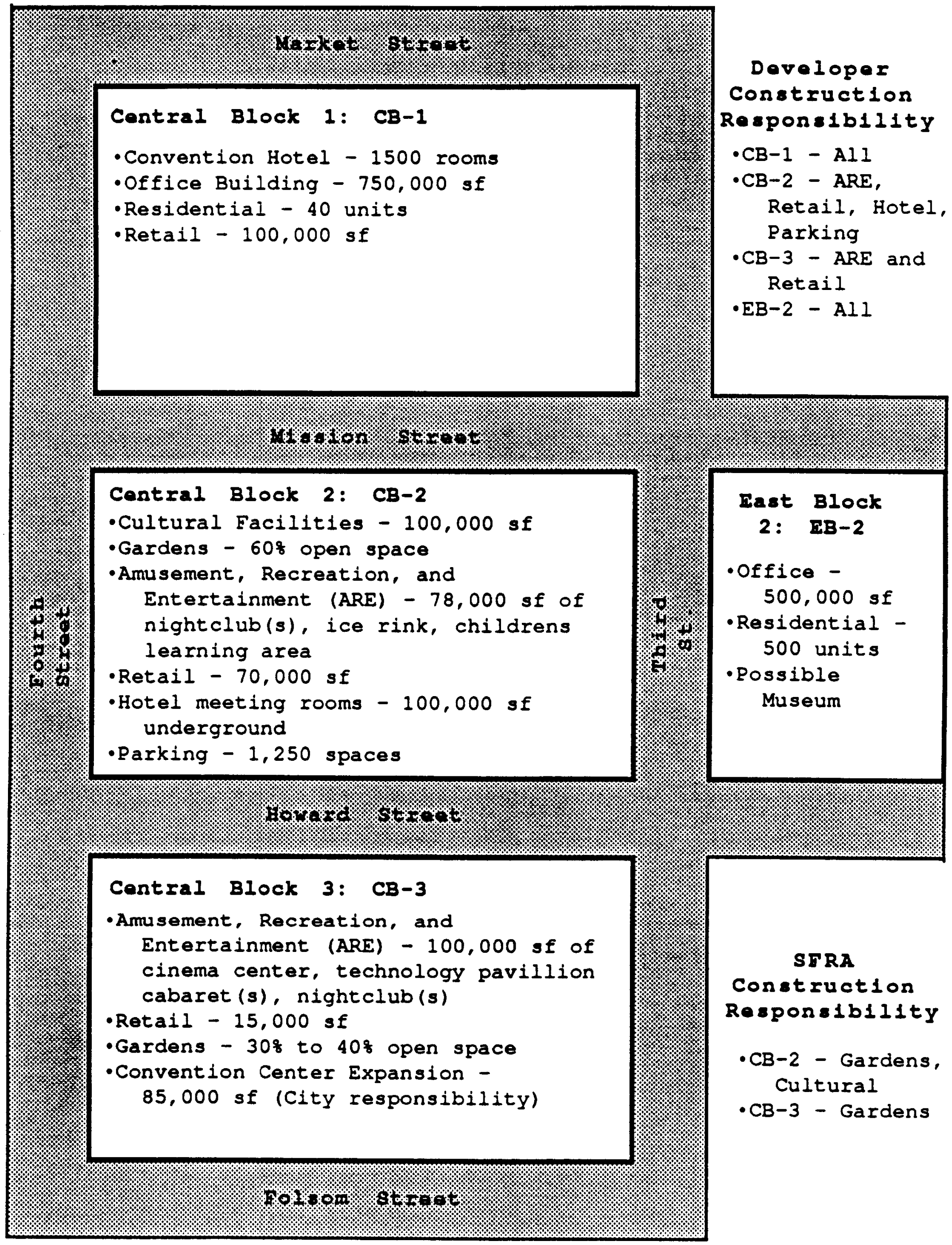
9 - Includes additional responsibility for construction of CB-3 public amenities. CB-2 public construction is projected to total $62 million, leaving $35 million for construction of CB-3 amenities. The $97 million includes all hard construction and soft costs for the public amenities, but does not include construction of the CB-2 west-edge gardens or the pedestrian bridges. The projected total cost with the additional amenities is $111.8 million.

10 - Bonds to pay off HUD loans were refinanced in 1990. The current SFRA obligation is $16 million. (See Note 2 above). Bonds will be paid off or refinanced in 3 years. The SFRA intends to use sale proceeds from the sale of an EB-1 office site to retire the bonds.

11 - Sale prices were fixed in 1991 at $20.5 million for EB-2a and $10.5 million for EB-2c. These prices escalate with the San Francisco construction cost index, and are projected to be sold in early 1993 for $24.6 million and $13 million, respectively.

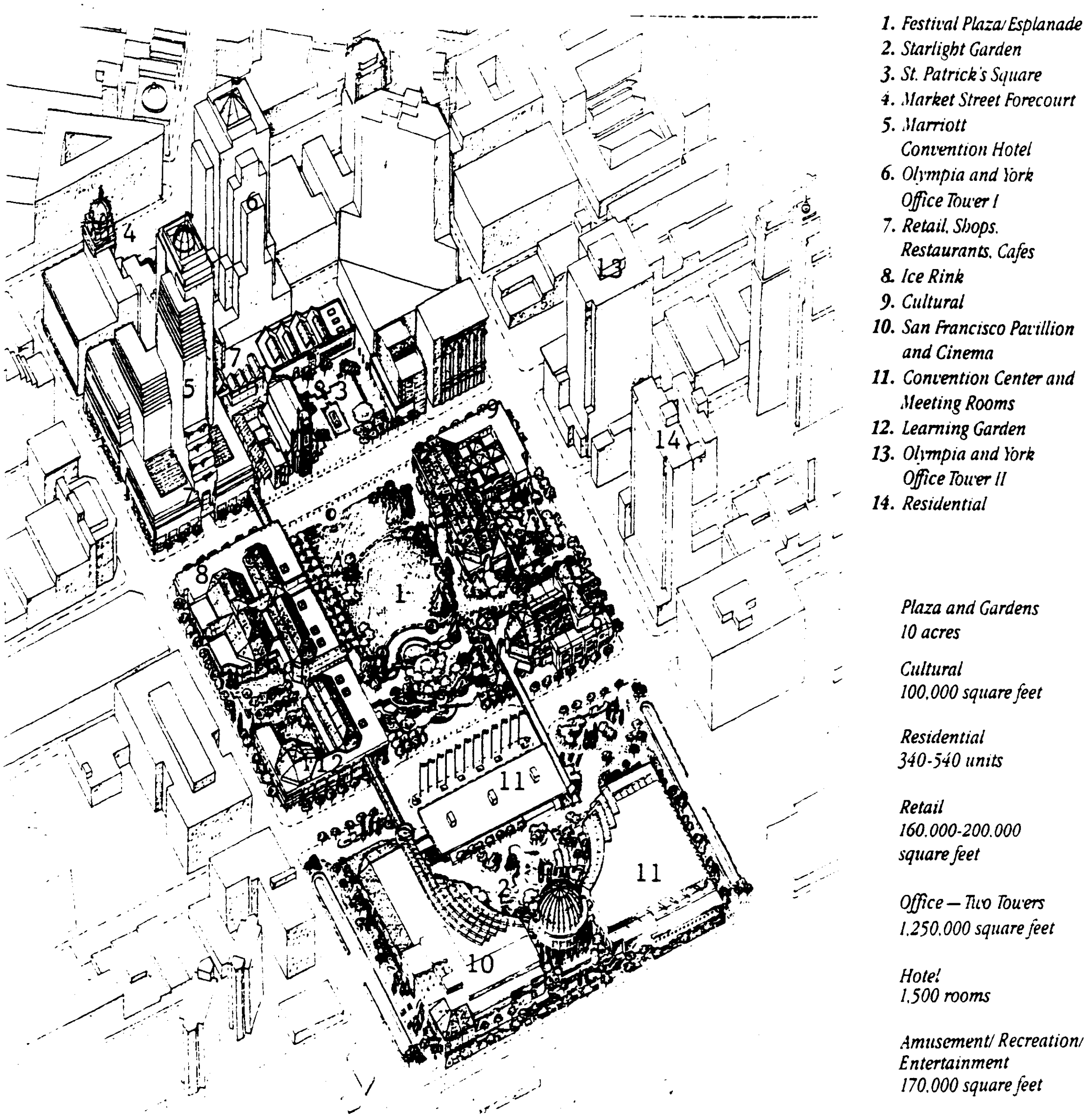
12 - Other projected sources of funds include $6.9 million of interest earnings, a $3 million payment from a Moscone Convention Center refinancing, and a tax increment receipt of $1.7 million. These revenues are dependent on interest rates and timing of payments. The projections are based on construction through 1994.

EXHIBIT 1.2
YERBA BUENA GARDENS
1984 Program and Construction Responsibility



Source: Benson & Flaster, A Risk Management Strategy for...YBG
MIT/CRED Thesis, 1991

EXHIBIT 1.3
Axonometric of 1984 Program



Yerba Buena Gardens
Source: San Francisco Redevelopment Agency

CHAPTER TWO

THE "PHASING/BUCKETS" STRUCTURE AS A BUSINESS STRATEGY

In negotiating and implementing the 1984 agreement with YBGA, the SFRA was trading the value of publicly owned land in exchange for YBGA's expertise in developing the public amenities. What the SFRA clearly wanted was an exciting, inviting and usable public center, and it chose the O&Y/Marriott team based, in part, on its "exceptional creativity and excellence".[24] In taking on such a large mixed-use project, the SFRA needed to devise a strategy that prioritized the staging and development of the public amenities to insure that the City's objectives would be met.

This chapter will explain how that framework, developed through the three-year negotiation process and formalized in the 1984 deal, was designed to give the SFRA some security that the public amenities would be constructed, maintained, and operated in the public's best interest. This was achieved through a business strategy that combined a phased selling of development rights with a financial plan we call the "buckets" concept.

Picture a series of buckets: After water has filled up the first bucket, it spills or flows into the next bucket. As that one fills up, the water flows into the third bucket. And so on. And so on. The buckets represent the control mechanisms in the deal, and the water represents construction funding for the public amenities and the revenue stream generated from the private development to fund the operation and maintenance of the public amenities.

The buckets strategy evolved from a central premise: Link the development rights with the developer's obligations in such a way as to insure construction of the public amenities package. The sale of land and associated development rights would be tied to the public objectives, with receipt of sale proceeds timed to coincide with the SFRA's funding needs for constructing the public amenities. This was the way for the SFRA to manage the risk that the developer would walk away from the deal before the public amenities were completed because the firm had gotten what it wanted early in the process. The revenue stream from the leased parcels and SFRA participation in the returns of the private development were also dedicated and their use prioritized so that maintenance of the public amenities would be assured.

Translating Policy Goals Into Business Terms

The 1984 agreement between the SFRA and YBGA, as detailed in the Disposition And Development Agreement (DDA), was the product of an arduous negotiation process. It was shaped by the need for the SFRA to create sufficient incentives for private development, yet still secure the following public interests: Fair land values given the proposed uses and level of risk; quality design, construction, and operation; and the completion of obligations by the developer.

The purpose of the DDA and the volumes of other legal and supporting documents were to define the series of events and responsibilities of each party in order for the public-private partnership to realize the completion and successful operation of the YBG development. The various documents describe in great detail the methods by which land values were determined, the terms and procedure for disposition of land, the control and standards for design and construction, and the general rights and obligations of each party. This section will draw from these materials to present and discuss three overriding business-policy principles which guided and shaped the 1984 DDA.

The first principle was balancing density and dollars. Since the purpose of this partnership is to leverage the development value of the private uses, concentrated on CB-1, to fund the public amenities, it was necessary to establish the scale of private development that would correspond to the anticipated economics of the desired public amenities. While no "real financials" were used to determine this needed development intensity,[25] there was a clear attempt to maximize the value and development potential of the private hotel and office parcels.[26] As-of-right building height limits were increased from 80 feet to as much as 400 feet, and under-utilized development rights were transferred from the adjacent sites and less dense private and public improvements.[27] This served to offer YBGA more of the development use which they perceived to be desirable, in order to entice them to develop and operate the less desirable retail and ARE uses, the key objective of the SFRA.

The second objective of the SFRA, as will be illustrated by a review of the negotiations later in this chapter, was to control the development of the public improvements, which though funded through private sources, would be delivered through the public agency. It was important that the Agency, and not a private developer, be viewed as managing the construction, operation and maintenance of the public amenities. YBGA would be responsible for the construction, operation, and maintenance of the commercial improvements to the parcels which it purchased or leased.

Phasing of development was the third overriding principle. It was employed to schedule the construction of the project's multiple components and to mitigate the major financial risks faced by both the public and private side. The details of this principle will be analyzed in the following section.

A Risk-Mitigating Structure

The mechanisms laced throughout the 1984 agreement served to ensure, as much as possible, that each party's interests would be met. The rights and obligations are linked in such a way that the development cannot get ahead of itself, and that the objectives of each party are kept in sync. Checks are in place to insure that the original objectives, or particular obligations of each phase, must be satisfied before continuing forward. Each phase would include interlocking and simultaneous obligations to perform in ways that meet the objectives of each party. The team created a series of options to activate each successive phase. Through phasing, a framework has been established which attempts to squeeze the development value from the SFRA's property to fund its public improvements, while maintaining a long-term interest in the property to insure the operation and maintenance of these improvements. This framework dictates (1) the development opportunity for the private side as a partner with the SFRA, (2) the flow of funds from the disposition of parcels to private developers to fund the public benefits, and (3) the flow of funds from the revenue stream of commercial components to operate and maintain these benefits for the life of the project.

Linking Objectives Through Parcelization: The organization of phases, and options to those phases, was facilitated by parcelization of the 23-acre site. By breaking up the large site into several development parcels, clusters of parcels and related obligations could be linked together, all the while protecting the economic value of parcels in subsequent phases. This resulted in a series of three phases with associated options to build-out specific amounts of commercial development. With an initial option payment of $4,000,000, YBGA received the right to exercise all of the three options provided certain obligations were met. The option for each phase, unless otherwise approved by the SFRA, could be exercised only if the option to the preceding phase had been exercised. The options consisted of the rights to the lease and/or purchase of specific portions of the site by YBGA from the SFRA.[28] Exhibit 2.1 describes the terms of the 1984 agreement. The significant construction and operating obligations are as follows:

Phase 1 of the development consisted of the hotel facilities at ground level on CB-1 and underground CB-2. The terms of the initial 60-year lease would provide the SFRA with annual land rent to be used for the continued operation of the public improvements. YBGA would build, operate and maintain the hotel facilities.

Phase 2 & Phase 2R (residential) represented a complex variety of private and public uses. YBGA would purchase the office parcel on CB-1 and the residential parcel on CB-1. These proceeds would be used to fund the construction of the public amenities on CB-2. YBGA would also lease the parcels proposed for retail, ARE uses, and parking on the remainder of CB-1, CB-2 and CB-3. These revenues, along with participation in the office and residential buildings, would help to fund the operation of the public improvements on CB-2 and CB-3. The Developer would be responsible for building, operating and maintaining the above private uses in Phase 2. The Cultural Facilities and Gardens on CB-2 (and CB-3 if funding became available from the sale of EB-2 or other sources) would be completed with Phase 2, and the SFRA would be responsible for building, operating and maintaining these facilities with the funds described above. The City would be responsible for building, operating and maintaining the Convention Center addition on CB-2 (underground).

Phase 3 would consist of the sale of the office parcel on EB-2 and the residential parcel on EB-2. Each parcel would be sold separately either to YBGA or another entity, with YBGA having a right of first refusal in each case. The purchaser of each EB-2 parcel would be responsible for the construction, operations and maintenance of the property in conformance with the agreement. The DDA included a contingency for a museum on EB-2. YBGA, upon the Agency's selection, would negotiate in good faith with a museum entity to occupy a portion of the site, but would have no financial obligation with respect to the museum facility or entity.[29]

It had been anticipated that Phase 1 and 2 would proceed as soon as possible. Prior to the signing of the DDA, however, O&Y canceled the planned 1984 ground-breaking for the CB-1 office tower, citing that the rental market was too soft to justify construction. The 1984 DDA called for the construction schedule as shown in Exhibit 2.2.

The CB-1 hotel and office parcels, located on Market Street closest to the existing financial center, were clearly the focus of YBGA's primary development objectives and the key source of its long-term returns. Because these parcels would fund the public improvements, it was also logical to build and complete them first. The SFRA, therefore, tied their own objectives to the private development rights of the CB-1 parcels. Joseph Coomes, the attorney representing the SFRA throughout the negotiation process, described the SFRA's scheduling interest using a train analogy: "[CB-1] was the locomotive and the garden and cultural were the caboose, and [the SFRA] wanted the caboose to leave the station with the locomotive."[30]

At YBGA's request, the Marriott Hotel would be the first phase of the development. With the combination of a weak rental market for office space and the completion of the City's Convention Center, the hotel seemed to present the least risk. The SFRA also granted YBGA's request to next proceed with the office building ahead of the retail and ARE, provided that they be linked. Several controls were included in the 1984 DDA to insure that the gardens, retail, and ARE were done with the office building on CB-1, the essence of what would be Phase 2. Further, the Agency would reserve a right of reverter when they conveyed the office parcel(s).[31] In order to make the reverter meaningful, the developer's initial financing of the land cost, as well as the construction cost, would be limited to a maximum mortgage of 80% and a minimum of 20% equity.[32]

YBGA would be required to meet several conditions for Phase 2 in advance of purchase the CB-1 office building site, including: Completion of the design and commitment to the timely construction of the retail on CB-1, CB-2, and CB-3, the ARE on CB-2 and CB-3, and the parking on CB-2. The conditions for obtaining a certificate of completion to occupy the CB-1 office building required that YBGA at the same time complete the shell for the retail and ARE uses, or otherwise post security to assure completion.[33] Upon meeting the obligations of these phases, YBGA would next have the option of proceeding, through the right of first refusal for the EB-2 parcels, Phase 3.

With the deal structured as a series of options, the option for a particular phase of development could not be exercised until the obligations of the preceding phase were met. For example, if YBGA did not proceed with Phase 1, the hotel, it would lose the balance of the project, plus $1,000,000 of its $4,000,000 option deposit. If they proceeded with Phase 1 but not Phase 2, they would lose $4,000,000 plus the plans and specifications for the CB-1 office building (estimated to be $10 million at the scheduled conveyance date) and their rights to the balance of the project. If they proceeded with Phase 1 and 2, but failed to proceed with Phase 3, they would forfeit 50% of the option deposit, $2,000,000.[34] Through the series of linkages and option-sequence requirements such as these, the SFRA created incentives and mechanisms that would commit YBGA to a schedule geared toward satisfying the interests of both public and private parties.

Creating a Flow of Funds: This phasing of private development and the sale of parcels was designed to provide the SFRA with funds to meet the needs for its capital improvements. The commercial improvements, through lease and participation revenue, would then provide a continuous flow of funds for the operation and maintenance of the public improvements. The flow of funds can be compared to a series of **buckets**; The funds in one bucket must be full before money can go on to the next bucket.[35] This concept can clearly be seen in the flow of funds from each of two special accounts presented in Exhibits 2.3 and 2.4.

The proceeds from the sale of the office parcel and the residential parcel on CB-1 would be placed into a special Capital Account. The SFRA would then draw money from this account for the following public improvements as illustrated in order of priority in the Capital Flow Of Funds, Exhibit 2.3. The first three of these to receive funds, the two gardens and the cultural facility, were deemed essential by the developer as the core of the public improvements that were needed to proceed with the project.[36] The anticipated (but not guaranteed) proceeds from the sale of EB-2, other SFRA funds (including tax increments), and the City's contribution to CB-3 from a refinancing of the Moscone Convention Center bonds would also be placed into the Capital Account. These proceeds would then be used to complete the CB-2 gardens (if necessary), the CB-3 Gardens and the

Cultural Buildings, with any remainder contributed to a housing fund.[37]

Participation in the profits from the office building(s) and all rental income from the leased parcels on CB-1, CB-2 and CB-3 would be placed into a special account to finance annual expenditures for the security, operations and maintenance of the Gardens and Cultural facilities (GSOM and CSOM). The developer also agreed to pay 20% of the annual budget of GSOM. The funds from this account were committed in order of priority as illustrated in the Operating Flow of Funds, Exhibit 2.4.

A Fit, Finally, For Both Sides

To fully understand the implications and the reasoning behind the structure of this agreement, it is important to unravel the business negotiations between the SFRA and YBGA.[38] The business terms were not developed in isolation from the negotiations over the design and scope of the project. The SFRA's plan was to capture the private development value of CB-1, through sale proceeds and lease revenue, and use it to fund the public improvements on CB-2 and CB-3. Therefore, it was important that the scale of the private development relate to the anticipated economics of the desired public amenities.

There were two major issues which would determine the role of the SFRA in the construction and the continued operation of the project: development control and long-term land ownership. First, to what extent would the SFRA construct, operate and maintain the public improvements? Originally, the developers offered to build, operate and maintain the entire project. For a number of reasons, not the least of which was the concern that the SFRA might be perceived as giving the land away, the Agency rejected this initial offer. This led to the logical separation of public and private uses and their respective responsibilities. The SFRA would build, operate and maintain the public improvements, while YBGA would build, operate and maintain the private uses and portions of the common area and circulation.

The second major point concerned land ownership and the flow of funds relating to each use -- would the parcels be sold or leased, and how much value was there in these development sites? If the SFRA chose to sell all of the land which was intended for private development, it believed it would be giving up future opportunities for the public. On the other hand, they needed to sell some parcels in order to generate the necessary up-front capital for the construction of the public amenities on a pay-as-you-go (versus bonding) basis. The solution was to divide the property into deeded and leased parcels. (As a developer of major office buildings, O&Y had an interest in owning the office parcels in order to maintain a significant long-term presence in the San Francisco market.) The disposition price was determined by a combination of the allowable building area and comparable rents and prices in San Francisco. The profit-sharing participation which the SFRA negotiated for the office building would provide the public with future benefits from the property even though the land would be sold.

The solution to sell certain parcels and lease others was a natural match, structurally, with the SFRA's cash flow needs for its stated responsibilities. The sale proceeds would be placed into the Capital Account for construction of the public benefits and the annual revenues from leases and participation would be placed into the special account for GSOM and CSOM.

This solution not only dictated the way in which land was to be conveyed and transferred, but it had other important implications for the private developer. YBGA felt that the gardens, if properly designed, constructed and maintained, would be a crucial element in making the project work as a destination center, which is why they initially proposed to build, operate and maintain them. Further, YBGA wanted to do all that it could to protect itself from the very real possibility that San Francisco might change its view on development objectives -- specifically -- what the City might do with future project revenues. With the "buckets" solution, the funds that the developer pays into both the capital and operating accounts are contractually committed and prioritized for the garden and cultural elements. Additionally, the 20% contribution that YBGA makes to the annual budget of GSOM brings them a certain degree of influence over the the construction, operations and maintenance of the gardens. These spending valves, integral to the bucket strategy, work to meet the developer's objectives that the gardens get built, and that they get built according to plans and standards that will protect or enhance their private investment.

In hindsight, this solution and its elements may seem conceptually simple, but its logic and structure, not immediately apparent at the start of negotiations, crystalized the flow of funds strategy and gave direction to resolving other matters. Joseph Coomes reflected on this solution. "This technique, the concept of the buckets and the special [accounts], was a major solution that led the way to a resolution of a lot of the other economic issues between us."

Balancing Control & Flexibility

The matter of control versus flexibility, an intense issue of negotiation, can perhaps be described best with a generalization: Each party wanted flexibility with respect to their own responsibilities while exercising control over the responsibilities of the party seated across the table.

The SFRA's desire for control and certainty -- with respect to the construction and operation of the private improvements -- often came in direct conflict with the developer's quest for design, financing, and operational flexibility. The mixed-use nature of the program called for uses with which YBGA had little experience -- retail and ARE, in particular. Due to their speculative nature, specifically, the ARE, YBGA wanted the flexibility to bring in the appropriate expertise and methods of financing as needed. They consistently took the position that they would not stay in the project forever, and that it was in the best interest of the project to bring in new entities (equity/participant lenders, anchor tenants, or master operators) at any stage of the process, but especially during the financing stage. Pamela Duffy, Attorney for YBGA recalls that it became a key element during negotiations. "The [SFRA's] continued refrain was, 'you are the master developer who made the bid,' and the developers continued refrain was, 'if you don't think we know what we are doing then why did you pick us? If you think you can do this, do it yourself. We know what we are doing, we have international reputations, you don't [have to] worry; we are not three airline pilots building a tasty-freeze.'"[39]

The Agency's interests are illustrated by a letter written to the YBGA team during the master developer selection process. It suggested that because of the uniqueness of the retail uses, an experienced entity should be identified to manage and operate such uses.[40] (By 1984, the Rouse Company, known for its urban retail centers, (Faneuil Hall in Boston and Harbor Place in Baltimore) had joined the development team.[41]) The Agency encouraged the developer's use of experts to ensure the projects success, but it wanted YBGA to have the ultimate responsibility for constructing the private uses.

After much negotiation on this issue, a compromise was reached which allowed YBGA to transfer rights to related entities, provided control was exercised through O&Y. As part of that deal, a capped guarantee was required from O&Y's parent, O&Y N.Y. Corp., for 25% of construction cost to further back up construction obligations. Further, assignment was restricted during construction, to anchor tenants, master operators, and institutional lenders, though it would be allowed more freely during the operations phase of the project.

Design control was another critical negotiation issue. Each party wanted some degree of control over the other party's improvements as their decisions would directly affect the image of the entire project. The SFRA viewed this as perhaps the most critical aspect of their public-interest responsibilities. Because of its inherent visibility, permanence, and international exposure, the design would be the most likely subject of public criticism for the life of the project -- and thus, a statement of the SFRA's competence and skill in managing the project. The casual visitor or tourist would view the success of the project by its physical characteristics or sense of place, one of the SFRA's key objectives, rather than by the financial returns to either private or public entities.

These public interests yielded an agreement which gave the SFRA substantial design control. All architects would be subject to their approval, and the SFRA staff and Commission had approval power over the design of all improvements, limited to the exterior in the case of the privately built structures. Detailed design concept drawings that illustrated the massing, scale, materials, and general project image were approved with the signing of the DDA. Any subsequent evolution of the designs following these initial concepts required approval by the SFRA.

The issue of control was, of course, reversed over the terms of the design for the public improvements. As stated earlier, in exchange for their 20% contribution to the GSOM budget, YBGA was granted a certain degree of influence over the construction, operation, and maintenance of the public improvements, as they would directly affect the image of the retail and ARE.

Each party wanted and received equal measures of control and flexibility with respect to potential marketplace failures. The Cultural Center, on the public side, and the ARE, on the private side, were untried uses and as such presented each side with a high degree of risk. To offset some of this risk, each party had the right to convert the use if it failed, after first offering the other party the right to step in and operate those uses.

Making Ends Meet

Because the public entities and private firms have inherently different objectives, priorities, and perceptions of development value, public-private partnerships can create opportunity and reduce risk for both sides. The private side, for example, often trades portions of its future operating revenues in exchange for reduced predevelopment risk with respect to land acquisition and government approvals. This was the case with YBG.

As a public agency in control of the land, the predevelopment risk to the SFRA was not as significant because it was more controllable, and was apparently worth accepting in return for a lower subsequent risk in operating the public amenities. A more specific example of interlocking interests is the priority of the construction and maintenance of the central Esplanade Garden on CB-2. This garden is the focus of the public amenities package, yet it is also crucial to the success of YBGA's retail and ARE uses on EB-2. The fact that the Esplanade Garden would be the first amenity to receive capital funds, as well as operating funds, illustrates how the interests of each side were often interlocked to the benefit of each party.

The structure of this agreement clearly seems to meet, in concurrent fashions, the public and private needs of the partnership. As the attorneys representing each side describe below, the neat fit was not always so clear:

According to Pamela Duffy, attorney for YBGA:

> It might have been better if at the outset, [we had] a better understanding of the degree to which either party had to have flexibility on certain issues and control on others...We spent four months captive to accountants and economists and appraisers...The solution, the participation solution, could have been reached very quickly.

Joseph Coomes, attorney for the SFRA, commented:

> [There were] numerous times when principals would argue for hours and, finally, the other side would understand the real reason for the request, and say: 'Oh that's your problem, lets work to solve it'...There were a lot of communication gaps. Misunderstanding and ignorance is worse than candor in these situations.

Duffy concluded:

> There is a certain level of mutual suspicion, sometimes, when the public agency and private developer meet across the table, [suspicion] that does not exist in a private deal. Quickly eliminating the one-upsmanship can be very productive.

The business principles which guided the City's negotiations with its private development partner ultimately yielded a workable plan of action. The result of a three-year negotiation process, the 1984 DDA embodied resolution of both the control and flexibility issues and a mechanism for sharing the financial risks of the project. It reflected the SFRA's public-interest objectives, while at the same time it met the private developer's objectives so necessary for funding those public goals. The flow of funds "bucket" concept was crafted to meet the needs for the public improvements through construction and operation. The parcelization of the property into phases allowed the SFRA to tailor the flow of development opportunity into a series of options which would provide the needed funds. These options provided the desired level of control, for the SFRA, and flexibility, for YBGA. The phasing allows the SFRA to tie their objectives to YBGA's development rights, yet YBGA has no obligation to go forward with a given phase/option until the design approvals, financing, and master operators are in place. YBGA's real return for sharing their future private revenues, which they will pay fair market value to achieve, is flexibility and a decreased level of predevelopment risk because that risk is shared with the public.

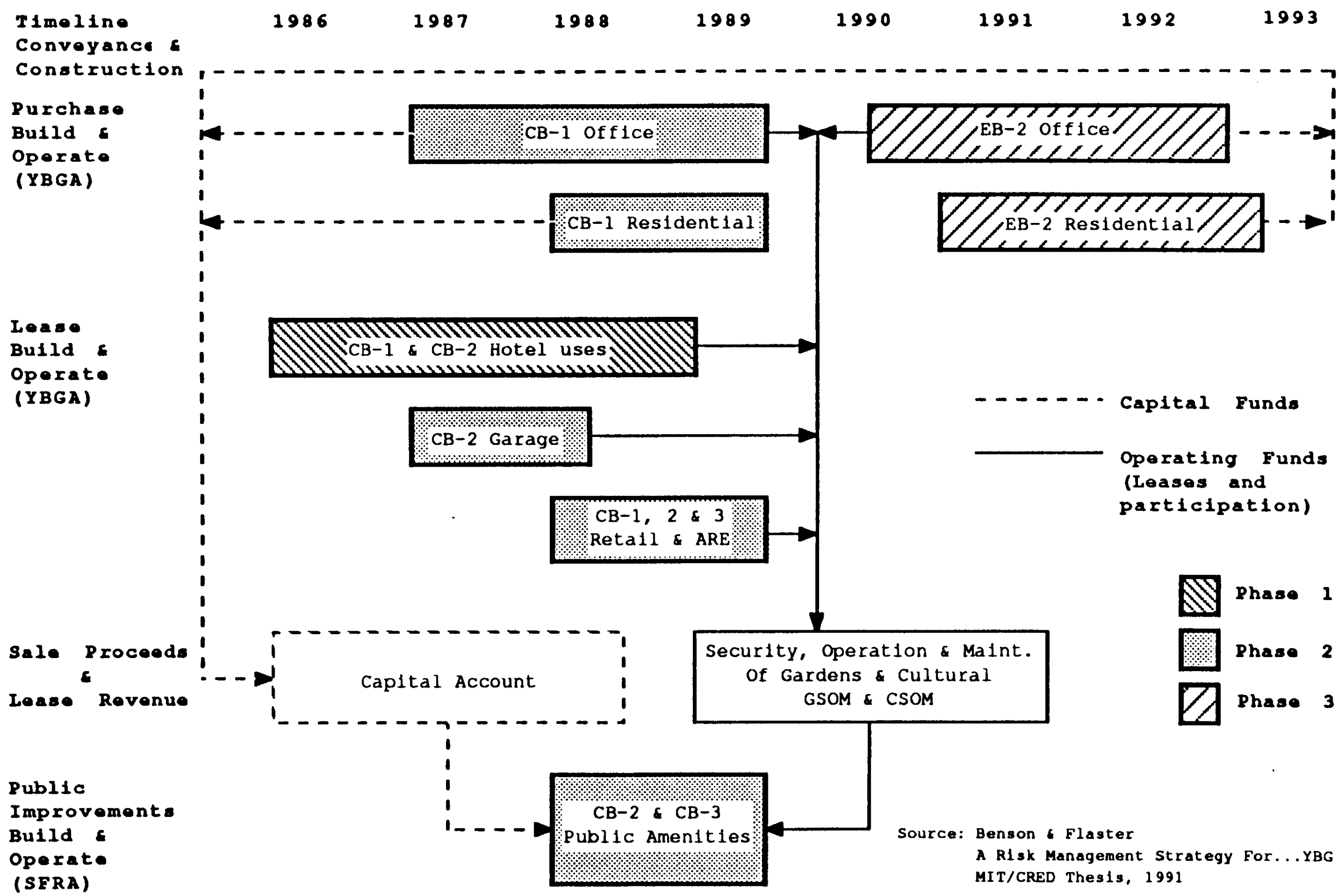
The DDA was approved by the SFRA Commission on October 30, 1984, and by the City Board of Supervisors on December 10, 1984. One week later, the Mayor signed the agreement triggering a potential construction start for the hotel in 1986 and the office building in 1988. With total costs of the public improvements estimated at $104.5 and construction scheduled to begin in 1988, the partnership and their relationship still had a long way to go. Would the "buckets" framework act as the glue to hold the deal together and sustain the inevitable political, physical, and economic changes, or would it fall victim to the process and become outdated?

EXHIBIT 2.1
DEVELOPMENT PHASING
AS INTERPRETED FROM THE 1984 DISPOSITION AND DEVELOPMENT AGREEMENT

	PHASE 1	PHASE 2	PHASE 3
SALE OF PARCELS & USES YBGA to: Purchase, build, and operate		CB-1 Office CB-1 Residential (To be sold as condominiums)	EB-2 Office EB-2 Residential (these parcels to be sold separately, YBGA has right of first refusal)
SALE & PARTICIPATION TERMS		CB-1 Office Price - $32,497,500 (to be adjusted annually to S.F. construction index); 8% participation payment to SFRA after 15% preferred return to YBGA. CB-1 Res. Price - $1,476,000 (to be adjusted annually to S.F. construction index). Profit sharing equal to 30% of YBGA's net profit from unit sales.	EB-2 Office Price - Fair Market Value at the time. 8% participation payment to SFRA after 15% preferred return to YBGA. EB-2 Res. Price - Fair Market Value at the time. Profit sharing equal to 30% of YBGA's net profit from unit sales.
LEASE OF PARCELS & USES YBGA to: lease, build and operate,	CB-1 Hotel and Meeting facilities underground CB-2	CB-1, CB-2, & CB-3 Retail A.R.E. and Parking	
LEASE & PARTICIPATION TERMS	Holding Rent - $325,000 ($500,000 after opening) Min. Rent - $1,050,000 ($1,500,000 after 8 years) Percentage rent - 4% gross room sales and 2% of other sales	Retail base rent of $1 per sq. ft. and escalating rent after 20% preferred return A.R.E. same as retail but no base rent. Parking rent equal to 50% of net cash flow	
PUBLIC USES SFRA to: build, and operate.		CB-2 & CB-3 Gardens and Cultural facilities	

Source: Benson & Flaster, A Risk Management Strategy For...YBG
MIT/CRED Thesis, 1991

EXHIBIT 2.2
Capital Structure & Construction Schedule Of YBG
As Per The 1984 DDA



Source: Benson & Flaster
A Risk Management Strategy For...YBG
MIT/CRED Thesis, 1991

EXHIBIT 2.3

CAPITAL FLOW OF FUNDS

Source: Benson & Flaster

A Risk Management Strategy For...YGB

MIT/CRED Thesis, 1991

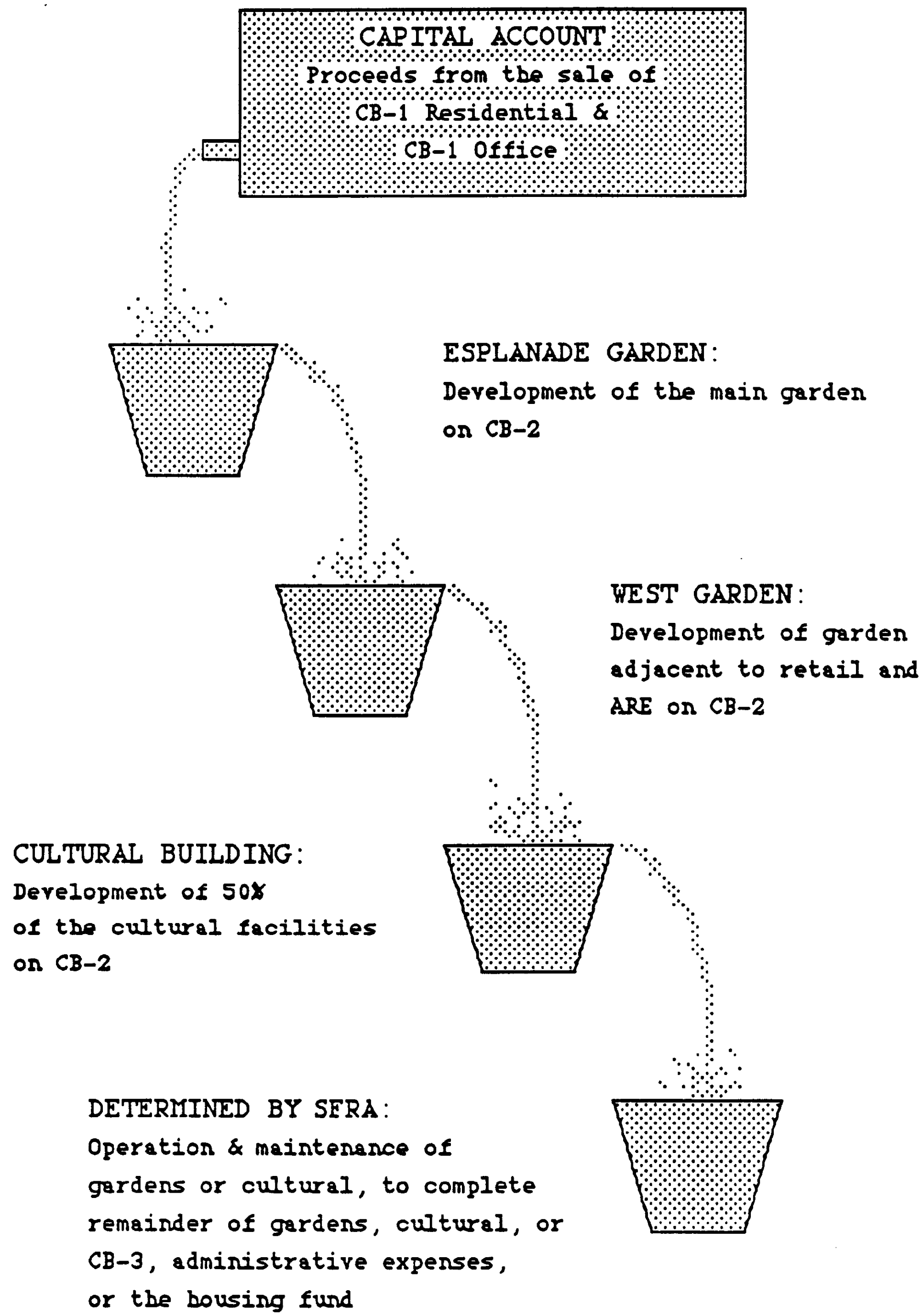


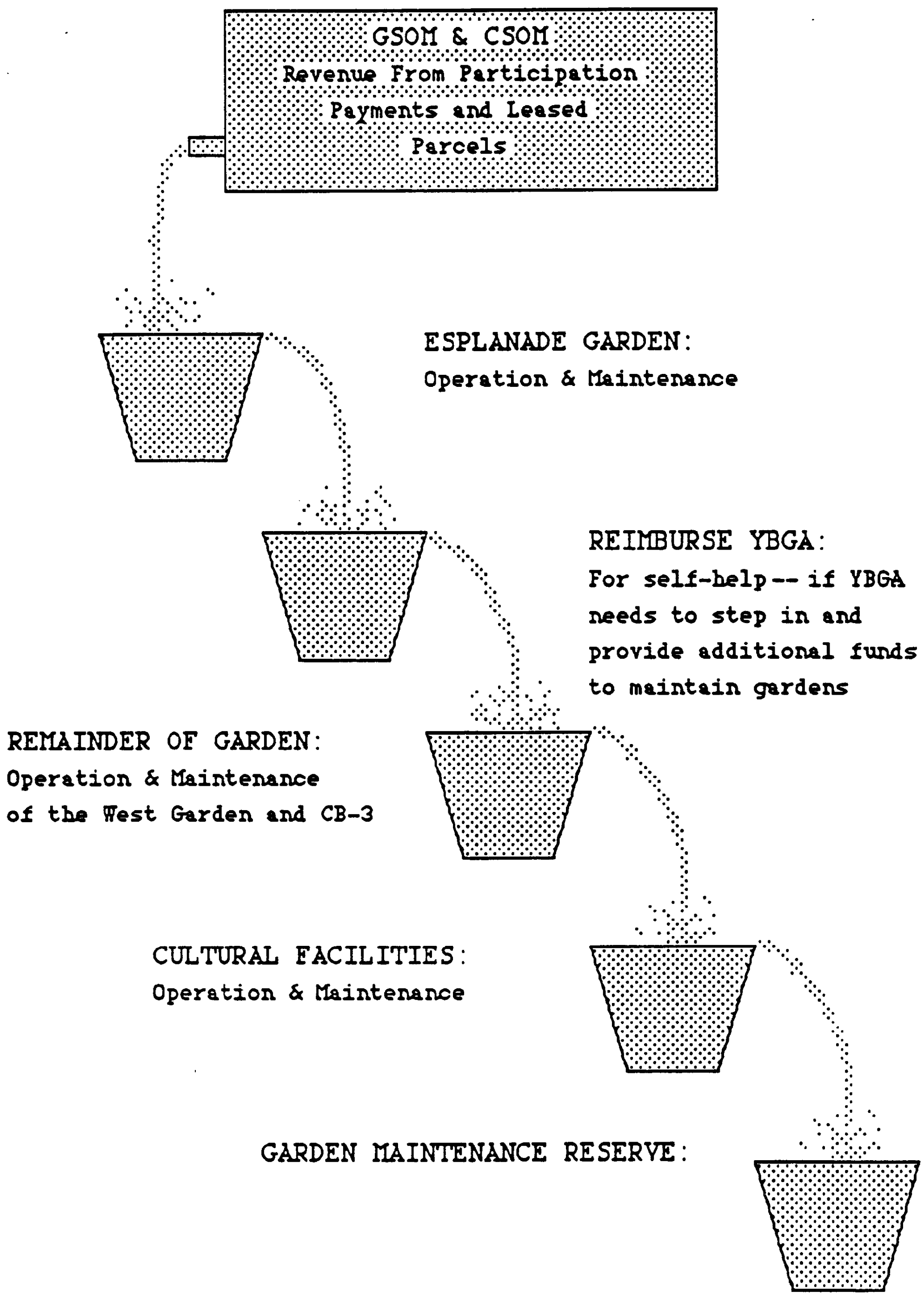
EXHIBIT 2.4

OPERATING FLOW OF FUNDS

Source: Benson & Flaster

A Risk Management Strategy For...YBG

MIT/CRID Thesis, 1991



CHAPTER THREE

HOW HAS THE STRATEGY WEATHERED TIME?

Today, more than six years after the signing of the original DDA, the SFRA and O&Y are renegotiating the financial terms for the sale and development of the office parcels on CB-1 and EB-2. The deadlines for the construction of the office, retail, and ARE, have repeatedly come and gone with no tangible results. And while these sites are currently as dormant as the national real estate industry, those sites (on CB-2) targeted for the public improvements are bursting with activity as preconstruction work begins for the Performing Arts Center, the Visual Arts Center, and YBG's centerpiece -- the 5-acre Esplanade Garden. How has the SFRA managed to begin its public amenity improvements in advance of the private development? Has the SFRA assumed greater risk by doing this? Does the buckets strategy still exist, and if so, how has it evolved over the course of negotiating the public-private deal?

To answer these questions, this Chapter first analyzes the current renegotiations between the SFRA and O&Y. Then it looks back over the past six years in an attempt to understand how the 1984 agreement and buckets strategy have evolved. This discussion, preparation for a more detailed study of public risk-taking in Chapter Four, should reveal how risks are shared between public and private partners as political, design, and financial changes continue to shape the YBG development.

Since the signing of the 1984 DDA, ten amendments have been passed to redefine specific rights and obligations of each party. A chronological list of significant changes and events can be found in Appendix C, while the more influential changes will be reviewed and discussed throughout this chapter.

Public Development in a Recession

On May 2, 1991, Mayor Art Agnos accepted an $11.1-million[42] check from O&Y which would insure the construction of the public improvements on CB-2. He hailed it as the realization of planning that began in the 1960s. "This check assures that a decades-old dream will finally come true with the magnificence envisioned by the Friends of the Yerba Buena Gardens. Our generation will point to this project and say, this is what we got done for San Francisco. It is the kind of urban renewal we will be able to point to with pride."[43] Shortly afterwards, the SFRA made commitments to the cultural buildings and the Esplanade Garden on CB-2 by awarding steel contracts of $2.5 and $3 million, respectively, for the Visual Arts Center and the Performing Arts Center. (See Exhibits 3.1 - 3.4 for current plans and program information.) The West Garden will be built at a later date as its design is integral with the planned retail on CB-2. These CB-2 public amenities (the Esplanade Garden and cultural facilities) are now expected to cost $62 million, while the set value of the CB-1 office parcel is $37.8 million.[44]

Before jumping into a detailed discussion of the current renegotiations, it is important to understand the two fundamental problems which have brought the parties back to the bargaining table: (1) The construction of the project has been delayed, and (2) in order to adequately fund the CB-2 public improvements, the SFRA needs net proceeds from the sale of the CB-1 office parcel greater than the price as set by the 1984 DDA.

While construction of the Marriott Hotel (Phase 1) began on schedule in August 1986, the other portions of the project (Phase 2 and 3) have been delayed for a number of reasons. In February 1986, announcement that the George R. Moscone Convention Center would be expanded under CB-2, immediately delayed construction of the cultural facilities and gardens on CB-2 until the summer of 1991. By 1987, in light of the weak market for commercial office space delayed the sale and development of the CB-1 office (Appendix C). The details of these significant changes will be discussed in another section. This section and the following section will describe what steps have been taken, and may yet be taken, to provide the SFRA with the necessary funds to complete these improvements.

The commencement of public amenity construction on CB-2, the first step toward the tangible realization of public development, was the result of an agreement embodied in the Eighth Amendment to the original DDA, and approved by the SFRA, on January 30, 1991, just months before the Mayor's statements. As in previous amendments, this one included an extension of the date for conveying the CB-1 office parcel, however, it differed distinctly with respect to construction and financing priorities. Recognizing the difficulties in current capital and real estate markets, yet aware of public pressures to commence construction of the public amenities, this DDA amendment scheduled construction of the public improvements on CB-2 to begin before conveyance of the office parcels and related obligations by YBGA. As the schedule below shows, the developer agreed to make a series of "deposits" totaling $35 million whose structure corresponded to the SFRA's anticipated needs for funding of the public improvements.

Deposit Schedule:[45]

Payment 1	Feb. 7, 1991	$3.6 million
Payment 2	Apr. 1, 1991	$3.1 million
Payment 3	May. 1, 1991	$9.9 million
Payment 4	Oct. 1, 1991	$9.8 million
Payment 5	Jan. 2, 1992	$8.6 million

The SFRA would retain a prior deposit of $2.8 million to bring the total purchase price to $37.8 million. The reader should note that this $2.8 million would later become a point of confusion and disagreement between the two parties when contemplating an alternate solution using public-bond financing. YBGA would also be required to put up a $4.6-million letter of credit in April 1991.[46] With the May 1 payment, (payment plus interest and premium) the remaining payments would be guaranteed -- if YBGA were to default after this payment, the SFRA could keep all of the deposits, or tender the property and force YBGA to pay the full purchase price.

... deposit solution, the parties had been ... empt bond-financing arrangement, ... made it infeasible. Tax-exempt ... ause it could potentially provide ... proceeds than the cash payments, ... of the developers' payment stream ... being less than the $37.8-million ... pu ... posit approach, designed to be ... acceptable financing arrangement, ... necessary cash flow for the public ... rificing the bond-financing option ... amount of funds available to the ... ave the SFRA the security of having ... not just a promise of financing, ... d with ordering materials and meet their construction ... ule.

The public-private partnership is now approaching a fork in the road as illustrated in Exhibit 3.5. As prescribed by the amendment, prior to October 1, 1991, the SFRA and YBGA would continue to work together to structure a tax-exempt bond issue that would provide the Agency with $48 million in net proceeds to substantially fund the construction of its improvements. This financing would subject the CB-1 office parcel to a special property tax-increment (a Mello-Roos bond to be described in the next section) which the SFRA would use to pay off the bonds over time. The deposit solution essentially gave YBGA the option of finding alternative financing while continuing its deposits. If bond-financing is arranged before October 1, 1991, then the deposits will be returned to the Developer. It is important to note, however, that while the original DDA called for YBGA to finance the purchase of the CB-1 office parcel with a minimum of 20% equity, the Agency is now helping the developer to finance the purchase with 100% public bond-financing. This increased risk exposure for the SFRA, should YBGA default, will be discussed in Chapter Four.

Because land sale proceeds will also be required to develop the public amenities on CB-3 at a later, undetermined date, YBGA and the Agency will continue to negotiate the terms for conveying the EB-2 office parcels. YBGA's right to purchase these parcels, however, is now dependent on the SFRA receiving net proceeds from the sale of CB-1 of no less than $48 million,[47] either from a bond issue or by cash payments by YBGA before October 1, 1991 (Exhibit 3.5). YBGA would also be required to make a series of construction cost premiums and interest payments to compensate for the delays in conveyance and construction.[48]

The Relationship Intact...So Far

In the current negotiations, one of the SFRA's key objectives is to obtain a premium, or "bump", on the sale of the CB-1 office parcel. The Agency needs these additional funds to meet its construction commitments for the CB-2 public improvements. To once again interlock the parties interests, the SFRA has tied YBGA's rights to develop EB-2 to the realization of a bump by October 1, 1991. This section will discuss the SFRA's attempts to provide public financing for the conveyance of CB-1 to YBGA, and, should these attempts fail, their plan to substantially finance the public amenities with the deposit payments and tax-increment financing, without O&Y.

Both parties first attempted to achieve this bump by using a Mello-Roos bond issue (see Appendix D). This is a tax-exempt financing method by which municipal agencies in California can issue tax-exempt bonds secured by a property tax lien to finance public facilities.[49] A specific area is designated as a Mello-Roos district and a special district-wide tax is assessed annually in an amount necessary to pay debt service on the bonds. This special tax becomes a lien on the property. The plan for YBG was to issue a senior piece of debt for up to $40 million and a subordinate piece of debt, to be purchased by O&Y, for up to $12 million.[50] After subtracting $4 million to cover the costs of bond issuance, the SFRA anticipated net receipts of approximately

$48 million. The "Mello-Roos" tax assessment on CB-1, paid by YBGA, would pay off the bonds.

This plan, however, ran into problems. While the SFRA agreed to accept a bump of $8.2 million, given the current conditions of the capital markets, YBGA could only produce a bump of $5.4 million, without paying more than the negotiated price for the land. The difference in these figures, $2.8 million, turned out to be the prior deposit that was noted in the last section. If this seems confusing, it was. The SFRA was assuming that the $5.4 million would be in addition to the $2.8 million, but O&Y thought otherwise.[51] Once the parties understood each other's position, there was no deal.[52]

The SFRA Commission, a varied group of seven professionals and community activists appointed by the Mayor, would not accept the Mello-Roos financing plan for two reasons. First, it felt the YBGA offer was not sufficient to compensate the Agency for its exposure to greater financial risk. Second, it was unwilling to risk rising interest rates for the two months between signing the agreement and marketing the bonds. The commission was unwilling to approve the plan because it was concerned that, if YBGA defaulted, the SFRA would have been responsible for payment of $3.3 million of Mello-Roos taxes per year.[53] By June 1991, the opportunity to issue Mello-Roos bonds, in time to meet the City Assessor's annual deadline for establishing tax-assessment districts, had passed.[54]

As a result, the deal was in limbo, stuck between the unworkable previous arrangement and an uncertain future. Currently, two alternate forms of public financing are being considered. First, in anticipation that the Mello-Roos approach might not be successful, in early 1991 the Agency obtained approval to issue $20 million of tax-increment bonds. The SFRA would use these in addition to the deposits if the deadline was not met (O&Y would continue deposits and lose office rights to EB-2). The proceeds from this issue were intended to bridge the gap between the capital funding needs and the later sale of EB-2.

Second, in yet another attempt to work with O&Y to finance its purchase of the CB-1 office site, the SFRA applied to the Commission for approval of a General Obligation Bond which would have provided the Agency with net proceeds of approximately $48 million. Robert T. Gamble, Deputy Executive Director of Finance for the SFRA, saw this as a possible way for the SFRA to get its bump and for YBGA to meet its October 1 deadline (Exhibit 3.5). "A SFRA General Obligation Bond would be supported by cash, a letter of credit, or bond insurance [provided by YBGA]. The SFRA would essentially be acting as a bank. Since we would not allow the Mello-Roos [bond issue] to default, we might as well put our own credit on the line. If the issue could be insured, we could get a AAA rating and increase the spread to create a higher bump -- maybe $11.35-million."[55]

It was generally understood that this General Obligation bond would have presented no greater financial risk than a Mello-Roos Bond because the SFRA would not have permitted default on either bond. However, because the General Obligation bonds would be a direct obligation of the Agency, the perception of greater risk doomed the proposal.[56] The General Obligation bond proposal appeared to present the Agency with the desired funds along with acceptable financial risk. By turning it down, however, the Agency is clearly attempting to manage the perceived risk viewed by the public. The issue remains unsettled, with the parties still at work on an acceptable General Obligation Bond agreement.

As illustrated in Exhibit 3.5, if they do not reach agreement on a bond financing by October 1 1991, YBGA will complete its series of deposits for $35 million, but lose its right to purchase the EB-2 parcels for office use. In that event, Gamble believes the SFRA would then likely issue a tax-increment bond for up to $20 million to aid its funding for capital improvements: "In a sense we're creating our own bridge financing". The public improvements on CB-2 are expected to cost approximately $62 million[57] and would be funded from the following sources:[58]

Sale of CB-1 office parcel[59]	$35.0 million
Renegotiated Marriott lease[60]	$10.0 million
Tax Increment Bond Proceeds	$16.6 million
Total	$61.6 million

The relationship between the SFRA and YBGA appears to be at yet another fork in the road, but the SFRA is finally moving toward realization of its public development objectives -- despite the uncertain timing of private commercial development. On May 2, 1991, if O&Y had elected not to make the deposit payment which guaranteed the purchase of CB-1, YBG and its public amenities would have suffered yet another setback, perhaps delaying construction for several more years. And, the SFRA stepped forward and accepted much of the risk from which it had spent the better part of a decade actively attempting to shelter itself.

While it appears that they will raise the still-needed funds through one of the public financing sources described above, have they protected their risks? Or have they gotten just enough money to get themselves into "trouble"? While it is likely that the public amenities on CB-2 will be completed and stand as a cultural success and urban landmark for generations to come, there appears to be little protection for the public exposure to financial risk.

With the October 1 deadline drawing nearer, each side seems to feel that this could be the final fork in the road. Although deadlines have repeatedly been extended in the past, this one appears to be more concrete, for both financial and political reasons. First, the SFRA has set the construction of the public amenities into motion and will soon need the bump, either from O&Y or its own public-financing (tax-increment) play. Second, and perhaps more important, Mayor Art Agnos is up for re-election in November. Without a tangible resolution of this issue, he would have a difficult time explaining to the voters why O&Y was granted an extension and why the city and the SFRA could not stand firm on their positions. Before evaluating these uncertainties, it is important to understand the other changes that have taken place since the original DDA.

Programmatic Changes -- Or Policy Changes?

The YBG development has undergone a variety of changes since the 1984 DDA (Exhibits 3.1 - 3.4). These changes, both internal and external, have shaped the evolution of the agreement to date. A chronological list of significant events can be found in Appendix C, while the more influential changes will also be reviewed in this section.

The most significant programmatic change, ironically, will have very little visual impact on the completed project: The City of San Francisco, in need of more space for the Moscone Convention Center, reached an agreement in 1986 to expand underground and beneath the cultural buildings and the gardens on CB-2.[61] (The 330,000-square-foot expansion will have an above-ground lobby at Howard Street and connect with the existing Convention Center under Howard Street.) As a result, construction of the public amenities had to be delayed until the summer of 1991. Also, the change displaced the planned 1,250 parking spaces YBGA was obligated to build,[62] likely a great financial relief for the developer. To partially compensate for the loss of parking spaces, the City parking authority will include an additional 850 spaces in its planned expansion of the Fifth and Mission parking garage. Despite these changes in responsibility, there is no legal agreement or exchange of funds between the YBGA Partnership and the Parking Authority.

A second set of changes involved the uses for EB-2, now divided into three parcels: EB-2a, EB-2b, and EB-2c. EB-2a is still targeted as the site of a 500,000-square-foot office building. In July 1988, after considerable negotiations with the SFRA and O&Y, the San Francisco Museum of Modern Art (SFMOMA) announced its plans to build a 200,000-square-foot "world-class museum" on EB-2b. The parcel will be purchased from the SFRA for a nominal sum of $1, while the construction and operation of the museum will be funded entirely by private donations.

As of September 1990, in the single largest capital campaign for an American museum, SFMOMA had raised funds in excess of the $60-million construction cost. (Most of the pledges have come from the SFMOMA's Board of Trustees.[63]) Construction is scheduled to begin in early 1992 with a grand opening planned for early 1995.[64] Flanked by the proposed office towers on either side and directly across from the two recently redesigned cultural buildings, the SFMOMA will anchor a new, and architecturally rich, cultural and business corridor in San Francisco. These five buildings have been designed by a variety of internationally acclaimed architects. Mayor Agnos, commenting on the museum and cultural center, compared it to Lincoln Center in New York.[65]

From the perspective of the SFRA-YBGA partnership, the presence of the Museum will create a synergy between the cultural facilities on CB-2 and the EB-2 block, thereby increasing the value of the EB-2a and EB-2c sites. It will also solidify the image of YBG as a significant multi-cultural complex.

While these efforts and images are very impressive, whether they properly represent the City's original intent to create a cultural center for, and representing, San Francisco's diverse ethnic and social population is arguable. Many special interest groups feel that the new complex will cater to a select few of elite citizens and tourists. The recent change in the focus of the Yerba Buena Gardens Cultural Center (YBGCC), a nonprofit organization formed to manage the facilities, illustrates this concern. The YBGCC role has changed from being a renter to a presenter.[66] This move was made in order to produce shows and exhibitions which would draw the crowds and revenues deemed necessary to meet the operating budget. But, this fundamental change in policy has spread concerns that City's initial mission, to provide a forum for San Francisco's multi-cultural artists and neighborhood theater groups, will not be realized.[67]

Residential uses also fell victim to changing economic conditions. The EB-2c parcel, previously designated for residential use, may now accommodate a 300,000-square-foot office building under the conditions of the Eighth Amendment. The SFRA originally guaranteed that this building, like the proposed office buildings on CB-1 and EB-2a, would be exempt from certain city guidelines. To squelch public criticism, O&Y agreed that this one would be included in the City's quota on annual office construction (475,000 square feet per year) as prescribed by the Downtown Master Plan, Proposition M. This office building would also be subject to the City's strict design guidelines and approval process.[68]

The only other proposed residential use in YBG has also been eliminated. In 1988, the Seventh Amendment included a provision to alter the use of what was originally the CB-1 residential parcel. Now, it may be leased to YBGA for the development of a 55,000-square-foot sports club, which is to be completed with the CB-1 office building.[69] These changes removing residential components from the program run contrary to the concerns of various special interest groups and the SFRA's original desire as reflected in its RFQ. They also conflict with the city's housing master plan which calls for reserving all possible new sites for residential use. In response to criticism from the Planning Commission, SFRA Executive Director Edward Helfeld said: "Offices are the engine that gets us the money."[70] It appears that the higher tax revenues as well as the higher lease and land sale proceeds associated with these commercial uses were too compelling for the City and the SFRA to ignore, fiscally pressed as they are to deliver the public amenities.

Phasing Shifts to Meet Changing Demand

The parcelization of the property structured in the 1984 DDA is still clearly evident. However, specific obligations (or "ties") with respect to options or phases have been added, altered, or are still being renegotiated. The Seventh Amendment called for the existing retail and ARE lease to be split into two separate leases. The first lease was for the retail on CB-1, and the second, for the retail and ARE on CB-2 and CB-3. Since that time, however, in the Memorandum Of Understanding of June 1990, YBGA relinquished all rights to develop retail and ARE on CB-3. This was done in anticipation of future public financing to construct these improvements. The SFRA is now responsible for constructing and soliciting operators for these facilities.

Although the Marriott hotel uses on CB-1 and CB-2, (Phase 1), have been completed and Marriott continues as operator of the hotel, the development relationship between the Marriott Corporation and O&Y was severed in the spring of 1991. This separation was anticipated and presents no significant changes to the DDA nor does it threaten the hotel bucket funding operations of the public amenities. In an attempt to market the hotel for a sale, the Marriott Corporation renegotiated its lease with the SFRA, adding clauses required by the mortgage lender, and in return for the potential economic benefit afforded by this renegotiation, Marriott agreed to pay $10 million to the

SFRA.[71] In the event of a sale of its leasehold rights, Marriott would likely continue to manage and operate the hotel.

O&Y is now obligated to purchase and lease the CB-1 parcels and on them to develop a sports club, retail facilities and an office building. The option to purchase the EB-2a and EB-2c office parcels depends on O&Y's decisions targeted at the October 1, 1991 deadline described previously; the right to build out the sites further depends on O&Y developing the retail and ARE uses on CB-2.

As has been true all along, the office buildings still drive the deal. Despite the current real estate slump and recession, O&Y still has a long-term interest in securing a significant cluster of commercial office buildings in San Francisco, and YBG still offers the best opportunity for achieving this goal.[72] The SFRA, by tieing its development objectives to O&Y's rights to the office parcels, is seeking its goal of leveraging the development value of CB-1 to fund the public amenities on CB-2. This method has resulted in O&Y paying at least $35 million -- perhaps several years in advance of construction -- for the CB-1 office parcel. It is possible that they may also decide to pay in advance for the EB-2 parcels. Today, the proposed construction dates are as follows:[73]

Parcel	Target Date	Outside Date
CB-1	Jul. 1993	Jul. 1995
EB-2a	Dec. 1994	Dec. 1998
EB-2c	Dec. 1996	Dec. 1999

The Buckets Survive

The bucket strategy, as described in Chapter 2, is still intact. The money has begun to flow into both the Capital Account (approximately $24 million) and the Special Accounts (GSOM & CSOM -- approximately $6 million) for the construction and continued operation of the public amenities on CB-2.

At one point it was anticipated that the SFRA would need to contribute $24 million of its own funds for capital improvements.[74] However, the advance payments, as set forth in the Eighth Amendment, guarantee that proceeds from the sale of CB-1 are being placed into the Capital Account. The SFRA maintains that the bump (with O&Y before October 1, 1991 deadline) or tax-increment bonds (without O&Y after the deadline) will provide additional and timely funding to complete the gardens and both cultural buildings, not just the gardens and 50% of cultural as anticipated in the original DDA in 1984. Since the tax-increment bonds would be secured by future land sales anticipated within the next few years, the capital funding bucket still appears intact.

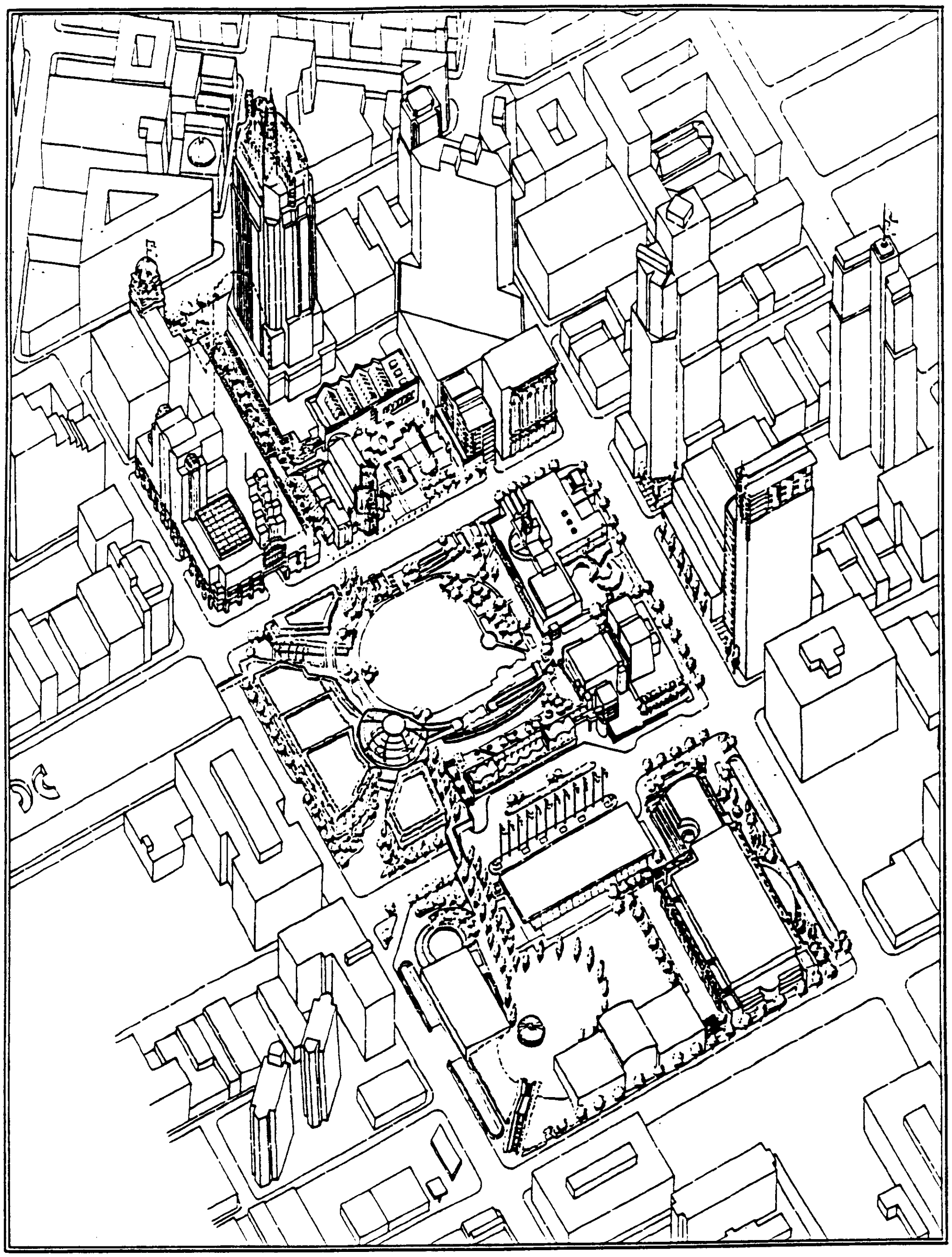
The current flow of funds from the CB-1 hotel lease (approximately $3 million), along with O&Y's 20% contribution to the GSOM, will, the SFRA believes, be sufficient to fund the GSOM and CSOM accounts as originally anticipated. While the representatives of the cultural facilities (YBGCC) have argued that they, and not the Gardens, should be the first bucket in the flow of operating funds, the bucket strategy and its list of priorities remains substantially[75] intact and unchanged (Exhibit 2.3 and 2.4). As the program and the needs of the various operators continue to become clearer, a change to the operating flow of funds, while conceivable, could only be achieved through an amendment to the original DDA. This is unlikely, though, since currently there are no other financial means to support the Gardens. The bucket strategy not only dictated the use of specific funds, it continues to provide a workable framework to channel (and reorganize if needed) the allocation of funds as the YBG project continues to evolve.

The Public Takes on More Risk

The terms of the public-private agreement formalized in the original DDA defined the risk exposure of each party in broad terms through site-specific obligations. As political, physical, and economic changes redefined the risks involved in the YBG development, the deal had to be renegotiated to mitigate risks that threatened to deep-six the project. Ever subject to events beyond its control, no matter how tightly crafted a DDA, the development of YBG has been caught in the midst of a historic glut of office space, a credit crunch, a national recession, and a private partner who feels the pinch of all of these. O&Y currently has its hands full with an even larger project, Canary Wharf in London, England, the first phase of which (9 buildings totaling 4.5-million square feet) is scheduled for occupancy in late 1991-92. (Upon completion, the 71-acre development will feature 24 buildings and 12-million square feet of space with an estimated price tag of $6.5 billion.[76])

To move the YBG project forward, the SFRA has reversed its construction priorities and commenced the construction of the public amenities -- taking additional risk in the process. Specifically, which risks have increased and which risks have been reduced? Are the public and private parties equally sharing the burden of current risks, or has the SFRA taken on a greater share? Chapter 4 analyzes these risks in greater detail and evaluates the risk-taking strategy of the SFRA as a public agency. An analysis of the risks involved in the 1984 DDA and the changes apparent in the current agreement reveals how the SFRA manages its risks as a public deal-maker.

EXHIBIT 3.1
YBG 1991 AXONOMETRIC



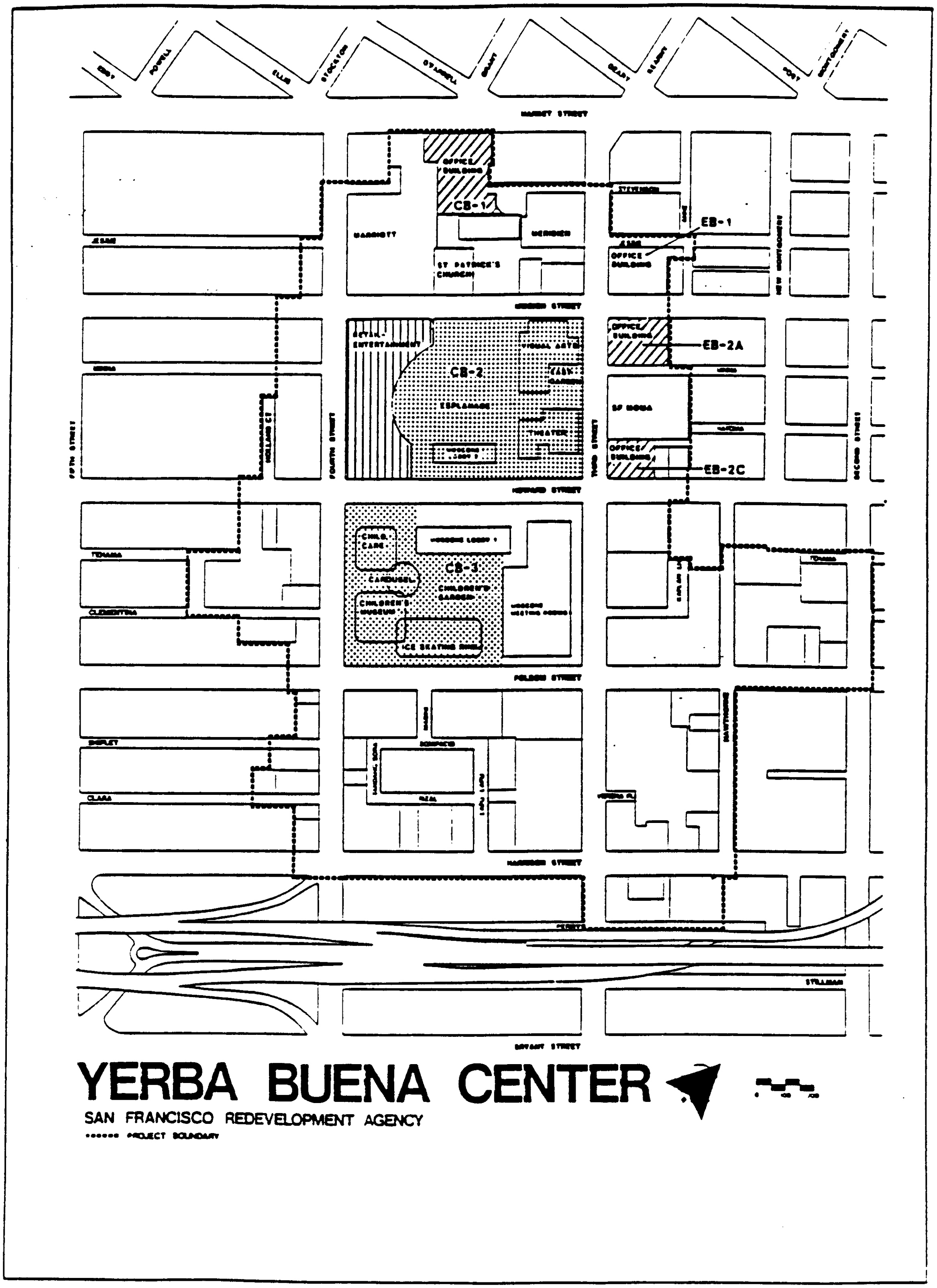
YERBA BUENA GARDENS

S A N   F R A N C I S C O ,   C A L I F O R N I A

OLYMPIA & YORK

Source: Olympia & York

EXHIBIT 3.2
YBG 1991 SITE PLAN



Source: San Francisco Redevelopment Agency

EXHIBIT 3.3
YBG 1991 Fact Sheet

Yerba-Buena-Gardens "Fact Sheet"

PROGRAM	RESPONSIBLE PARTY
CB-1: 750,000 sq. ft. office building	YBG Associates
1,500 room convention hotel	YBG Associates
Up to 100,000 sq. ft. retail located in:	
Hotel	
Office Building	
Retail Galleria	
55,000 sq. ft. to be determined	YBG Associates
(SFRA to maket site)	
550 underground parking spaces	YBG Associates
Rehabilitation of Jessie Street Substation	SF Museum of Modern Art
2 acres open space: Market Street Forecourt	YBG Associates
St. Patrick's Square	
CB-2: 30,000 sq. ft. retail on gardens	YBG Associates
45,000 sq. ft. Restaurant/Entertainment	YBG Associates
48,000 sq. ft. Cinemas	
75,000 sq. ft. Cultural Facilities:	SF Redevelopment Agency
Theater - 750 seats	
Visual Arts Center:	
gallery/exhibit space of 9,500 sq. ft.	
video/film facility - 100 seats	
forum/festival space 9,000 sq. ft.	
administration/box office - 6,000 sq. ft.	
general services (incl. bookstore and cafe) - 4,750 sq. ft.	
Hotel meeting rooms underground - 130,000 sq. ft.	YBG Associates
Moscone Convention Center Expansion - 330,000 sq.ft.	City
(underground exhibit space and meeting rooms)	
Pedestrian bridge from 5th and Mission Garage	SF Redevelopment Agency
200-300 parking spaces	YBG Associates
(subject to design constraints)	
6 acres open space	SF Redevelopment Agency
CB-3: 25,000 sq. ft. ice rink (w/food service)	SF Redevelopment Agency
20,000 sq. ft. Children's Museum	SF Redevelopment Agency
10,600 sq. ft. Carousel and Museum	SF Redevelopment
10,000 sq. ft. Child Care	SF Redevelopment Agency
Pedestrian bridge from CB-2	SF Redevelopment Agency
110,000 sq. ft. Moscone Convention Center meeting rooms	City
EB-2: 500,000 sq. ft. office building	YBG Associates
300,000 sq. ft. office building	YBG Associates
Incidental Retail - 10,000 sq. ft.	YBG Associates
200,000 sq. ft. Museum of Modern Art	SF Museum of Modern Art

05/91

Source: San Francisco Redevelopment Agency

EXHIBIT 3.4
YBG PROGRAM COMPARISON

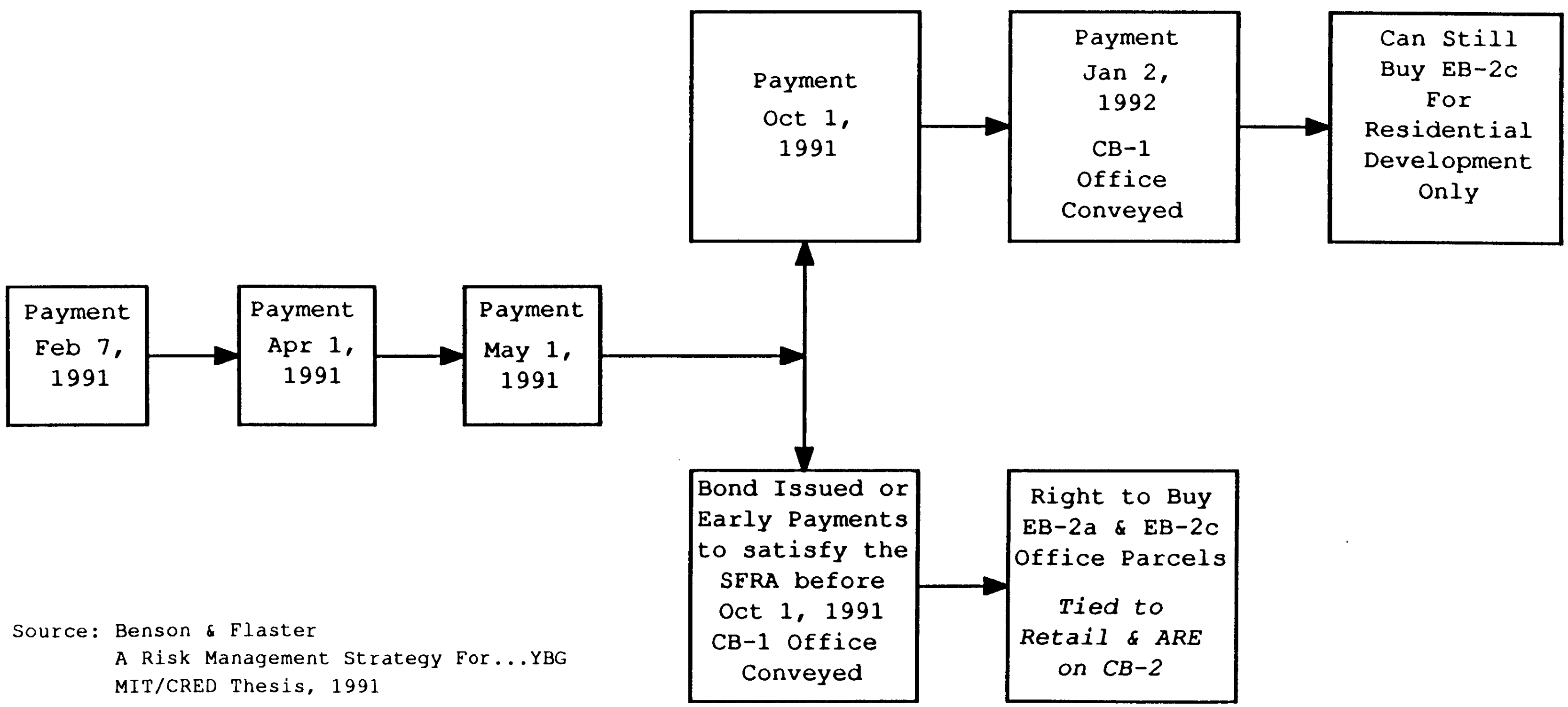
		1984 Program	1991 Program
I.	**OFFICE**		
	CB-1	750,000 sf	750,000 sf
	EB-2a	500,000 sf	500,000 sf
	EB-2c	0 sf	300,000 sf
	Sub Total	1,250,000 sf	1,550,000 sf
II.	**RESIDENTIAL**		
	CB-1	40 units	0 units
	EB-2c	300-500 units	0 units
	Sub Total	340-540 units	0 units
III.	**RETAIL** (1991)		
	CB-1 (w/ sports)	90,000 sf	155,000 sf
	CB-2 (w/ cinemas)	82,000 sf	123,000 sf
	CB-3	11,000 sf	0 sf
	EB-2 (incidental)	0 sf	10,000 sf
	Sub Total	183,000 sf	288,000 sf
IV.	**ARE**		
	CB-2		
	Ice Rink	30,000 sf	0 sf
	Child Museum	40,000 sf	0 sf
	Child Care	0 sf	0 sf
	CB-3		
	Ice Rink	0 sf	25,000 sf
	Child Museum	0 sf	30,600 sf
	Child Care	0 sf	10,000 sf
	Sub total	70,000 sf	75,000 sf
V.	**CULTURAL**		
	CB-2 YBGCC	100,000 sf	101,800 sf
	EB-2 SFMOMA	0 sf	200,000 sf
	Sub Total	100,000 sf	303,800 sf
VI.	**PARKING**		
	CB-1	450 spaces	550 spaces
	CB-2	1,250 spaces	200-300 spaces
	EB-2	400-600 spaces	700-900 spaces
	5th & Mission Gar	0 spaces	850 spaces
	Sub Total	2,100-2,300 spaces	2,300-2,700 spaces

Source: Benson & Flaster, A Risk Management Strategy For...YBG
MIT/CRED Thesis, 1991

EXHIBIT 3.5

THE FINAL FORK IN THE ROAD

O&Y PAYMENTS TO THE SFRA
AND FUTURE DEVELOPMENT RIGHTS - 1991



Source: Benson & Flaster
A Risk Management Strategy For...YBG
MIT/CRED Thesis, 1991

CHAPTER FOUR

THE SFRA AS AN ENTREPRENEUR

In a public-private joint venture as ambitious and complicated as YBG, the public agency acting on behalf of the city needs the power and the ability to act in the public's best interest in shaping -- and reshaping -- the deal with its private partner. This necessarily involves a behavioral flexibility not normally associated with the rigid bureaucratic patterns of public-sector behavior. It also requires that the public developer willingly assume real estate risks that are typically considered the responsibility of profit-oriented private developers. The SFRA will be judged successful if it can balance the new entrepreneurial behavior with its traditional responsibility for accountability to the public.

This chapter analyzes the risks associated with the project's development, partnership, and finance, and how these risks have been managed, assumed or reduced by the SFRA. In particular, it seeks to evaluate how elements of the phasing/buckets strategy have served as risk-management tools. The first section discusses the entrepreneurial behavior of the SFRA; the next four sections interpret the behavior of the SFRA and the results of extended negotiations with the developer which changed the SFRA's risk exposure. Finally, the strategy is examined from a more general perspective of risk management. This last section seeks to draw out principles that might be applicable to other public agencies implementing development projects in a public-private partnership environment.

The reader should refer to Exhibit 4.1 for a brief analysis of how the phasing/buckets strategy helped the SFRA manage real estate development risks as anticipated in the 1984 agreement. Exhibit 4.2 illustrates, within the framework of the strategy, how the SFRA managed, eliminated or assumed additional risk through the continuing negotiations.

Entrepreneurial Behavior Shapes the Strategy

Although the SFRA has retained the phasing and buckets strategy, both project-specific and external changes between the years of the initial agreement and the current deal have caused it to assume more risk in some areas while shedding risks in other areas. In implementing the strategy, the SFRA's goals have been to legally commit O&Y to fulfill its obligations toward YBG and to establish strong bargaining positions for details that would be negotiated at a later date. Built into the idea that the partnership would be a very long-term relationship, the SFRA also anticipated that inevitable changes would require strong and consistent bargaining power to protect its broader interests.

In negotiating the 1984 DDA, the Agency agreed to assume full development risk for construction of the public facilities and gardens in exchange for sales proceeds from the office sites to fund their construction. Long-term lease revenues received from the Marriott hotel, ARE and retail sites, and participations in the office revenues were intended to generate public operating funds. Assuming that the project is successful, the reversion after 60 years[77] of the leased land and improvements and the revenues earned from the leases and participations represent long-term benefits to future generations of San Francisco residents.

In the short run, the Agency has taken on the responsibility for organizing and managing the construction of the cultural facilities, as well as the public gardens on CB-2 and CB-3. In negotiations since 1984, the Agency also agreed to construct the ARE facilities on CB-3, partly in order to finance the construction of these improvements through a public-bond financing vehicle, if necessary. While public agencies typically take responsibility for construction of public amenities such as parks and recreation facilities and fund these amenities through publicly issued tax-exempt bond issues, the SFRA has undertaken the construction and funding of the YBG amenities in an atypical fashion: The public amenities are both directly physically and financially linked to private commercial development, an entrepreneurial and risky approach for a public developer.

The keystone of the phasing strategy was to time the availability of proceeds from the sale of land to match the SFRA's funding needs for constructing the public facilities. While the phasing strategy is still being used to tie O&Y to the deal, the flow and amount of the funds available to finance the SFRA's construction activities do not match the Agency's current economic needs.

The Agency recently decided to proceed with its intended 1991 construction start date, despite the reluctance of O&Y to proceed with construction of the private improvements. In doing so, it has bowed to the community pressures to see some tangible benefits and the City's desires to have the gardens and cultural facilities completed for the opening of the Moscone Convention Center expansion. By adjusting its construction priorities, but not abandoning its goal to finance the public amenity construction with the proceeds from land sales, the Agency is exposing itself to a short-term gap in construction funding. More importantly, it is also increasing its exposure to a long-term capital funding gap.

Its efforts to create bridge financing to fill the $16.6-million gap between its capital fund balance (after receipt of the CB-1 sale proceeds) and the CB-2 public amenity funding requirements[78] indicate the SFRA's recognition of this timing risk. Additionally, construction funding for the total projected $97-million public amenity cost[79] is dependent on both inflation adjustments to the EB-2 site prices and on interest earned on the Agency account.[80] By proceeding with its schedule, the SFRA is increasing the risk that the capital fund bucket will not be full enough to meet its construction needs.

From a longer term perspective, if construction costs for the total public amenity package (on CB-2 and CB-3) escalate above the actual proceeds from the sale of the office parcels (on CB-1 and EB-2) and any additional tax increment financing, the SFRA may be pressured to sell other available sites in the project area to cover the costs. Although the SFRA has always intended to use its land in the Yerba Buena Center district to fund the public amenities, and it believes that there is sufficient value in other parcels to cover any additional cost,[81] pressure to sell the sites might not result in a reasonable sale price. Additionally, a "fire sale" might not result in the most advantageous use mix, since some uses have higher economic value than others. This, in a sense, is the well-known attribute of illiquidity associated with real property ownership -- only viewed from a public-sector perspective.

Politically, the project is currently being supported by Mayor Agnos,[82] who is assisting the SFRA in obtaining tax increment financing to bridge the anticipated capital funding gap. Presumably, the City would also support the SFRA in creating bridge financing to fill any gap between future capital funding requirements and the timing of other YBC land sales, actions which would avoid the public perception that the Agency was giving away the land at too low a price. In the current climate, though, since the steel for the cultural facilities has already been ordered and cultural facility management issues are currently being discussed with citizen groups, the political implications of development risk seem to be moot: Once the ball gets rolling, it's hard to stop.

One serious political risk being faced by the SFRA, however, is the mayoral election in November 1991 in which Mayor Agnos faces some strong challengers. Alarmingly close to the October 1, 1991 deadline (which could either result in a live deal with delayed private improvement construction dates or a severance of additional ties with O&Y), the impending election and its results could have drastic implications for the SFRA's continued ability to behave entrepreneurially in the YBG deal. First, it makes the October 1 deadline a much more "real" deadline than previous deadlines since Mayor Agnos would get bad press if the City and SFRA did not stand firm in their position. Second, by already committing itself to the public-amenity construction, the SFRA may have reduced the its bargaining power with regard to the October deadline because of economic pressure to fill the capital funding bucket.

Betting on a Private Developer Partner

In any public-private joint venture, the public agency takes on risks associated with the particular party or parties with which it becomes a partner. In selecting the team of O&Y/Marriott as the single master developer for design and construction of the private improvements, the SFRA limited the number of parties with whom it would have to continue to negotiate. Yet, it also put all of its eggs in one basket.

While the Agency made its initial selection from among several highly qualified groups, the O&Y/Marriott team brought with them an international prominence, a reputation for financial stability, and a tentative agreement with the Rouse Company to manage the YBG retail operations. The team also demonstrated an understanding of the quality of the project and the willingness to be flexible in the long-term relationship. Since the SFRA has had an image of YBG as a world-class development from the start, the experience, reputation, sensitivity, and "deep pockets" combination of the O&Y/Marriott team was especially difficult to resist (or for the other competitors to beat).

The SFRA recognized that O&Y was the linchpin to the team and pursued a strategy aimed at tieing the developer, through financial incentives and commitments, to working with the SFRA for the long-term.[83] With this in mind, the Agency's negotiators built several mechanisms into the 1984 DDA to protect the SFRA from the risk that the selected team would default on its obligations, either because it had already gotten the prizes in the YBG deal or because its enormous financial commitments in other projects (such as Canary Wharf in London) might prevent it from fulfilling its YBG commitments in a timely manner.

Mechanisms to Mitigate Default Risk: First, the SFRA structured some land transactions as leases and some as sales with phased conveyances occurring over an initial 4-year schedule. In doing so, the Agency tried to match cash proceeds necessary to pay for construction of the public amenities and cash requirements for maintenance and operations. Since the developer's interest in entering into the public-private agreement in the first place was to establish a substantial long-term market position in the San Francisco office market, the SFRA recognized that the schedule might stretch over a longer period. By implementing the phasing structure, the Agency attempted to control the tension between its need for timely realization of land sales proceeds and O&Y's long-term commercial interest in the speculative development of the properties.

Second, perhaps the strongest motivation for O&Y to remain in the deal and to work with the SFRA to complete the project has been the SFRA's trump card -- the office parcels on EB-2 slated for future development. Primarily an office developer, O&Y has shown its colors by its reluctance to build and operate the retail on CB-2 and by its relief regarding the elimination of its responsibility to construct underground parking on the site of the Moscone expansion.[84] Further relief has come from the removal of its housing responsibility on CB-1.

Since O&Y is now substantially obligated to build only what it builds best, it surely must want all three office sites of YBG -- a concentrated locational presence in the severely constrained San Francisco office market. The 1.55-million square feet to be potentially added by O&Y at YBG represents 4.8% of the total Class "A" office space inventory in the city as of 1990,[85] and 10% of the total office space inventory in the South of Market district.[86] Its percentage of Class "A" space in the Yerba Buena area is significantly higher since the area is not now a Class "A" office location. Perhaps more notably, due to Proposition M construction restraints, the YBG office buildings represent 26% of the pipeline of potential new office space in the core office area until the year 2000.[87] This makes O&Y's speculative interest very valuable indeed.

If it completes the cash payments required by the Deposit Schedule, but does not provide the Agency's desired bump in cash proceeds from the financing of the CB-1 sale, O&Y preserves only an option to build a housing component on EB-2. Thus, it is clearly in O&Y's interest to continue to press for rights to develop the remaining two office parcels. While the SFRA seems rigid in its position that O&Y provide the bump by October 1, 1991 or forfeit such rights,[88] O&Y insists that it will not pay a sales price for the CB-1 office site higher than that agreed to in the 1984 agreement although it will work with the SFRA to create an attractive financing package that would provide additional funds.[89]

The third factor mitigating the risk that O&Y would default is the up-front funding of option payments, as well as the predevelopment costs, required of the developer in the early years of the partnership. Since the parcels are intended to become an integrated mixed-use project, design, legal and other expenses allocable to the later phases would necessarily be incurred during the first phase. After 11 years of effort, O&Y has spent approximately $25 million on such costs, exclusive of the required option payments.[90] This money would be down a sink hole if O&Y were to default on its obligations. On the other hand, from the developer's perspective, these predevelopment costs might be considered risk-mitigating option payments -- albeit costly -- which preserve its long-term rights without actually committing to the development.

A fourth measure mitigating the risk of default is the set of imposed guarantees and minimum equity investments the SFRA required of O&Y.[91] With these requirements, the Agency intended to insure that the developer would have sufficient cash available to fund its legal obligations, thereby mitigating the risk that internal pressures or other financial commitments of the development company would cause it to default on its YBG financial obligations. Interestingly, however, the Agency has considered eliminating this safety feature by allowing the developer to finance 100% of its cash advance payments for the CB-1 office site through the Mello-Roos financing plan. This would clearly mitigate the developer's risk, a highly unusual use for public funds.

Fifth, the SFRA restricted the ability of the developer to assign its interests in the YBG parcels until the improvements were completed and even then, assignment is only permitted after Agency approval. This anti-speculative covenant mitigates the risk that O&Y will be able to sell out its position and leave the SFRA with an unwanted partner. It is important because the Agency needs to protect the quality of construction, design, and operations, as well as assure itself of the financial ability of the developer partner to perform its long-term obligations.

Other Factors Protecting the Agency: Despite the financial and legal ramifications, it would not be in O&Y's long-term corporate interest to walk away from the possibility of developing all three office sites. Even though the YBG development, estimated to cost $1.5 billion, is smaller, in comparison, than the London Canary Wharf project, O&Y's only other on-going development project estimated to cost £4-billion (currently approximately $6.5 billion), the news of an O&Y default would cause irreparable damage to the parent company's reputation and shake lenders' confidence about the ability of O&Y to honor its other commitments. In addition, the founders of the Toronto-based, privately-held family company are known to be interested in passing the company to the second generation and would not want to pass on an unhealthy company.[92] While these internal pressures might create an incentive for O&Y to reduce its short-term development exposure, the company would be giving up a substantial future value.

The failure of the phasing/buckets strategy to fully protect the SFRA from default risk could come about if O&Y is unable to successfully work with the Agency, by October 1, 1991 on financing that would give the SFRA the bump it requires from the sale of the CB-1 office site. Then the question becomes whether or not the two parties have enough mutual interest to continue to work together. If not, and O&Y decides proceed only with its right to develop the CB-1 office, what negotiation terms would be acceptable for O&Y severing its right to construct housing on EB-2c?

Even though each side has a lot invested, both politically and financially, at this point it is difficult to predict the outcome. While the SFRA and O&Y have been described by a close participant in the process as "spiders in a jar,"[93] it would be a major setback to the SFRA if it had to begin negotiations anew with another developer. On the other hand, the SFRA believes that putting the EB-2 office sites up for bid might create an opportunity to realize higher values on those parcels since they should become more attractive when the San Francisco Museum of Modern Art and the public amenities are completed.[94] Realistically, however, continuation of the partnership is probably the least costly and most opportune solution for both parties.

Sharing the Private Market Risks

In joining with a private developer partner and making funding requirements for the public amenities dependent on the conveyance of the private parcels, the Agency clearly assumed the development risk of proprietary ownership. The crux of the deal is that the SFRA believes that the long-term value of property at YBG is significant because of its location and the quality of public amenities being built there.[95] Thus, the Agency's big-picture entrepreneurial strategy is to share this risk with the developer in order to realize higher value for the public land and create long-term public benefits.

While some elements of the phasing/buckets strategy were designed to mitigate some of the predevelopment and short-term risks, the SFRA designed other elements to shift to the private developer longer-term market risks that might effect the value received for the land.

Pricing Publicly Owned Property: Although publicly owned land utilized by a public-private partnership is typically sold at a discount to induce private developers to take risks, the SFRA has reduced substantial predevelopment risk to its private partner by conveying the phased parcels to the developer with all necessary approvals in place. In turn, in the 1984 DDA, the SFRA sought fair market values for its property, and it did so in a way that would preserve the parcel's fair market value by the time of construction.

It attempted to solve this problem by tieing the 1984 fair market value of CB-1 to a construction-cost index that would track inflation. By fixing the price in this manner, the SFRA tried to limit the down-side property market risk that the sale proceeds would not reflect fair market value for the predetermined use at the time of conveyance. If property values declined, but inflation persisted, the Agency clearly would become a winner. While this general inflation adjustment mitigated such down-side risk, it would not adjust upward if land values increased faster or greater over time than inflation.

Recognizing that the program of use and density of development might change through the predevelopment process, the parties left the price of the EB-2 sites undetermined in the 1984 DDA. They stipulated that when the price was negotiated, it would reflect fair market value at that time. While they discussed including a clause to adjust the price of CB-1 office site for any changes to the use intensity, the SFRA and O&Y agreed such a change would trigger a renegotiation of the base price at that later date.[96] Thus, the understanding between the two was a clear sharing of the risk associated with market conditions, with the Agency shifting the down-side risk associated with CB-1 onto the developer and retaining the down-side risk associated with EB-2.

Since 1984, movement in the inflation index has upped the price of CB-1 from $32.5 million to $37.8 million[97] in 1991. Due to soft market conditions, however, it is arguable whether the land fair market value has actually increased during this time. Although we do not have the data to assess comparable land prices in the YBG area, a comparative analysis of the YBG sale prices for the CB-1 and EB-2 sites can shed some light into the SFRA's success in protecting itself.

Per the 1984 DDA, the land price per square foot of gross buildable floor area on the CB-1 office site increased from $43 in 1984 to $50 in 1991. By comparison, the 1991 negotiated land price per square foot of gross floor area for the EB-2a office site is $41[98] and for the EB-2c office site is $35.[99] Since the fair market value per buildable gross square foot in the YBG area is lower today than it was in 1984, and the Agency is entitled to a much higher price for CB-1 today, the SFRA seems to have successfully shifted some of its down-side market risk to the developer on the CB-1 site.[100] From the developer's perspective, however, it shifted the down-side risk on the EB-2 sites onto the Agency by leaving the EB-2 prices unnegotiated in 1984.

Phasing and Use Mix to Maintain Economic Value: The SFRA also attempted to protect the economic value of the entire YBG redevelopment property through the development stage by parcelizing the private land uses. It did this in such a way that the first phase exists as independent set of developed properties with each subsequent phase, including those with the public amenities, integrating successfully with the existing improvements. The physical attributes of the project area guided this tactic. The hotel and CB-1 office sites, as the first phase and part of the second phase, are on Market Street, a location which allows each to operate without the synergy of the public amenities. In fact, the Marriott is currently operating successfully on its own, but this was made possible by the presence of the convention center.

Since 1984, the SFRA has take on more risk by adjusted the phasing strategy.[101] Since the SFRA believes that the cinema and restaurants will attract people to the site, integrating the retail and ARE from the opening day of the project with the CB-2 cultural facilities, gardens and open spaces has been important to the Agency. Because the obligation to build the CB-2 retail is now tied to the purchase of the EB-2 sites and O&Y's option to purchase these sites may expire on October 1, 1991, the SFRA may end up without a developer for the CB-2 retail and ARE. Even if O&Y stays in the deal, these private improvements will certainly open for business much later than the CB-2 public amenities. The SFRA perceives this as one of the biggest risks it faces.[102]

Living with Local Market Conditions: If O&Y does retain its rights to develop the EB-2 office sites, it may not make economic sense to build the retail or the offices in the time frame established by the SFRA, despite the fact that the SFRA is plowing ahead with construction on the cultural facilities. One reason that O&Y has delayed construction of the CB-1 office since 1984 has been the soft San Francisco market conditions,[103] where the vacancies for Class "A" office space currently stands at 10%.[104] In revising the phasing, the SFRA may have actually shifted additional market risk back onto itself.

While the 1984 agreement specified dates of purchase by O&Y and completion of the improvements on each parcel, the agreement also allowed room for the inevitability of having to negotiate changes. Originally, construction on the cultural facilities and public gardens on CB-2 was supposed to start in 1988 but was delayed until 1991 due to the City's decision to expand the Moscone Convention Center. Interestingly, this was probably both a political and lucky break for the SFRA. Because of poor office market conditions and bleak forecasts for near-term improvement, it would have been difficult to convince O&Y to go ahead with the purchase of the CB-1 office parcel. That would have left the SFRA with a construction funding problem. Now, with the completion of the Moscone expansion, the value of the other sites may have increased.

Along with the completion of the Moscone expansion and the Museum of Modern Art in the next few years, current forecasts by consultants and commercial brokers anticipate a window of opportunity in the San Francisco office market in 1995, based on a large turnover of leases and the cumulative effect of the office-space growth restraints.[105] Anticipation of these events is likely to induce O&Y to agree to construct the CB-1 office building within the next four years. Forecasts of a 4% to 6% vacancy rate in the financial core in the late 1990s would signal future increases in rent levels[106] and simultaneously create an opportunity for development of the EB-2 parcels. While the SFRA clearly shares the private market risk with its phasing strategy, and has even taken on more risk by revising the phases, it has probably gotten lucky as a result of the impact of the City's restrictive zoning policy on the timing of development opportunities in the San Francisco property market. In any event, the SFRA is at least aware that it needs to be sensitive to the local market conditions in its continuing negotiation strategy.

Coping with External Market Conditions: In 1984, it would have been difficult to anticipate the extent of the impacts of the softening real estate market, the Tax Reform Act of 1986, and the current banking crisis on real estate development. Poor market conditions in real estate and a national recession beginning in the late 1980s have seriously affected both the ability and desire of O&Y to proceed with the YBG development on the initial schedule. Since the SFRA's activities depended on the private development, the economic downturn has delayed the construction of the public amenities as well.

The phasing/buckets strategy could not deal specifically with those risks of government-imposed disincentives for real estate investment or of illiquidity in the capital markets.[107] While timing delays and capital improvement funding problems stemming from these macro-economic factors could easily have completely derailed the project, the strategy has been both stable and flexible enough to substantially withstand these significant external market-driven crises. The project is alive -- if not on schedule -- and the relationship between the Agency and O&Y is still generating options for solving the funding gap -- even though frustration and tension may be exacting a toll.

While the economic and capital liquidity conditions are still not conducive for successful large-scale office development, the SFRA has assumed more risk by beginning to construct the public amenities on its current schedule. O&Y is still reluctant to proceed with development of the private improvements despite the capital funding needs of the project. These external risks, more so than any of the anticipated risks, have caused a leak in the bucket strategy.

Fiscal Success or Failure: Will the Buckets Fill Up?

As a means of preserving the long-term value of the land and improvements through reversion to the SFRA at the end of the lease term, The Agency decided to lease rather than sell the hotel, retail, and ARE sites . Doing so would create a long-term revenue stream that would substantially cover the costs for for the maintaining and operating the cultural facilities and gardens. This too, however, meant that the project would be dependent upon the successful implementation of private development, beyond construction and into the operations phase of the project.

Dependence on Success of Component Uses: The annual revenue from the Marriott lease, approximately $3 million, was intended to sufficiently fund the GSOM and CSOM for approximately 10 years. As was anticipated in the 1984 DDA, the Cultural Center will be increasingly responsible for generating revenue to make up for the future shortfall in the CSOM account.

Of the annual revenues being generated by the Marriott, only one-third represents the current holding rent of $1,050,000.[108] This means that two thirds of the annual revenue comes from the Agency's share of gross room sales, that is, it is linked to general economic conditions relating to business and vacation travel and especially convention visits. With pervasive business efforts to cut travel costs in the face of nationwide economic difficulties, the SFRA' revenues from this source are directly exposed to external market risks.

Leases for the CB-1 office, CB-2 retail, and the CB-1 sports club are anticipated to generate $310,000 annual fixed revenue.[109] The ARE is not subject to a minimum fixed rent, but the terms of its agreement (percentage rent on both retail and ARE calculated after operating expenses, debt service and a developer return on equity of 20%) may generate additional annual revenues from these uses. Both O&Y and the SFRA expect the cinema portion of the ARE to lose money annually, and the short-term value of the percentage rent on the retail is questionable.[110] By the terms of the negotiated agreement, the SFRA has assumed the lease-up risk and risk of retail operating success in the retail lease revenue structure.

By retaining participations in the net cash flow of the privately developed office buildings, the SFRA is also assuming some office market risk. The availability of these funds depends in part on the development costs, the state of the office market and on the ability of the developer or future owner to lease and operate the buildings successfully. Although the SFRA considers these participations worth very little today,[111] they may very well be valuable for their future contributions to the operating fund bucket.

Assuming that the CB-1 and CB-2 private improvements are completed by 1994 to 1995, the annual revenues and projected operating expenses for a stabilized year are conservatively estimated by the authors as follows:[112]

<u>Revenues</u>	
Marriott Lease:	
Fixed Revenue	$1,050,000
Percentage Revenue	1,950,000
Retail Leases: Fixed Revenues (CB-1, CB-2, CB-1 sports club)	310,000
Developer Contribution to Gardens (20% of operating and maintenance expense - see below)	500,000
Interest on Operating Fund[113]	83,000
Total Revenues	$3,893,000
<u>Expenses</u>	
Gardens	$2,500,000
Cultural Facilities	2,400,000
Total Expenses	$4,900,000
Net Income/(Loss)	($1,007,000)

The amount of money in the operating fund account to support the cultural facilities and gardens depends on when the private improvements and public amenities are completed. The operating fund currently contains approximately $6 million, or two years of payments from the Marriott lease.[114] Thus, the fund should be able to cover any potential losses for the first several years. Beyond that time, the operating fund will become increasingly dependent on the success of the private uses.

If there are insufficient revenues available to pay operating expenses for both the gardens and cultural facilities, the buckets strategy prioritizes the spending of the funds. The gardens have the first priority on use of the funds and the cultural facilities have the second priority. The gardens operating expense budget is projected to rise over the first ten years from $2.5 million to $4.0 million, and the cultural facilities budget similarly from $2.4 million to $3.8 million. Unless the operating revenues increase dramatically, the cultural facilities will have to become increasingly independent to avoid calls on the SFRA or the City to fund the deficit.[115]

While the SFRA has diversified its operating risks through the leasing of different uses and the office revenue participations, it is still substantially dependent on the revenues from the Marriott lease, and is likely to become increasingly dependent over time on the project synergy in making each component financially successful.

A Critical Mass of Cultural Facilities: By selling the EB-2b site to the San Francisco Museum of Modern Art (SFMOMA) for $1, the SFRA clearly hopes that the presence of the museum on the site will help create a critical mass of cultural attractions to insure both the financial and political success of the YBG project. The presence of the SFMOMA has also become critical to the political viability of the YBG development as a whole, for without it the project starts to look like a large office complex surrounding a park.

This critical mass of cultural facilities is intended to support the hotel, retail shops, restaurants, and cinema. Despite the short-term probability that the retail and ARE on CB-2 will not open in sync with the CB-2 public amenities and Moscone expansion, the long-term prospects for success seem hopeful, provided the SFRA can afford to construct, operate and maintain the facilities with the standard of quality that it intends.

The recent change in the program for the performing arts center, from being a renter to a presenter, was promulgated to increase the likelihood that it will be able to become more financially independent toward the late 1990s. Citizens are concerned that this change will defeat the original purpose of the facility by inhibiting participation of local performing arts groups, and create an elitist cultural mecca. The change also entails additional operating and management risk to the SFRA. Although the original intention of the Cultural Center was independent operations, the SFRA might need to contribute additional funds to maintain the integrity of the facilities. In addition, there has been constant public pressure stemming from a debate among future users of CB-2 and CB-3 on the appropriateness of the operating fund priorities. Despite this political pressure, the bucket concept still exists,[116] leading to the conclusion that the strategy is effective as a political risk management tool.

Taking on the Role of a Banker

Perhaps one of the biggest risks the SFRA has considered taking on since the 1984 agreement is the financial risk for underwriting O&Y's land purchases. Neither the phasing or the buckets strategy anticipated this active decision of the SFRA, nor does either strategy help the SFRA to manage financial risk.

In working with O&Y to create the Mello-Roos bond financing plan, the SFRA was willing to adjust its requirement that O&Y have not less than 20% equity in the deal. The Mello-Roos plan effectively would have allowed O&Y to finance 100% of the land purchase price for CB-1 in exchange for the SFRA receiving a purchase price premium or "bump" for taking on the credit risk. From the SFRA's perspective, it was willing to take the credit risk on the financing because if O&Y defaulted on its obligations, the SFRA would have to foreclose on the land. The SFRA was hoping to flatten the vicissitude in the capital market by substituting public credit for private credit, essentially acting like a bank because it has confidence in its real estate collateral.[117]

Its willingness to assume this credit risk was tied directly to its needs for an increase in the proceeds for the sale of the CB-1 office parcel to fund the construction of the CB-2 public amenities. The SFRA staff decided that it would accept a bump of $8.2 million, but O&Y offered only

$5.4 million.[118] The Commission decided that the offer was not enough to compensate it for both the credit risk and the capital market risk.[119] Thus, the SFRA capped its financial risk by not accepting the Mello-Roos bond finance plan.

The SFRA is obviously cognizant of its financial risks and is willing to assume more to accomplish its construction goals. Both the Agency staff and the Commission, however, appear to understand that they have only a certain risk tolerance level, since there was a clear decision not to accept the Mello-Roos bond finance plan because the additional financial risk was undervalued. In addition, the SFRA anticipated potential problems with that plan and has been working on a different approach to generate additional construction funds through tax-increment financing, in effect creating bridge financing to fund the CB-2 construction costs until additional proceeds are received from the sale of the EB-2 parcels.

The Phasing/Buckets Strategy as a Risk Management Tool

The phasing and buckets strategy contained in the initial 1984 agreement effectively allowed the SFRA to manage most of the anticipated risks of being a development partner with a single master developer for a large and complicated mixed-use redevelopment project. The SFRA has clearly acted entrepreneurially by knowingly assuming specific risks and attempting to mitigate and shift other risks inherent in the YBG project.

The strategic risk management tools of the SFRA in its partnership with O&Y in the YBG redevelopment project can be summarized as follows:

<u>Phasing strategy elements</u>

- Parcelize to insure value of each phase and synergy of the property as a whole;
- Put the "prizes" desired by the developer in the last phase of the project;
- Do not explicitly assume financing responsibility for the private components of a project;
- Time the completion of the public amenities with the completion of the private improvements to create synergy;
- Actively manage the politics of programmatic changes with the City government and citizen groups;
- Restrict assignability of the development rights;
- Recognize property market and economic market conditions to protect the value of the development;
- Require that specific plans for each phase of the project be established up-front;
- Implement a combination of property sales and leases to meet needs for construction funds, operating funds, and long-term benefits to the city.

<u>Buckets Concept for Capital Improvements Funding</u>

- Fix prices for land sales with an escalation tied to an index simulating inflation;
- Choose developer with financial stability and a strong reputation;
- Require minimum equity and guarantees;
- Do not explicitly assume financing responsibility for the private components of a project;
- Restrict assignability of developer rights;

- Actively manage the politics of programmatic changes with the City government and citizen groups.

<u>Buckets Concept for Operations Funding</u>

- Diversify revenue sources;

- Require most significant revenue source to be completed early;

- Establish funding priorities;

- Recognize that construction delays can affect level and/or timing of the revenue stream;

- Recognize that structure of lease revenues and participations can significantly affect revenues generated;

- Recognize that regional and national economy may impact the success of use components;

- Reduce dependence on developer by tieing revenues to property performance if agency has control mechanisms to manage property to maintain and enhance performance;

- Require consent of agency for developer to sell or assign management contracts and leases;

- Establish the obligations of the agency to cover operating deficits;

- Actively manage the politics of operating priorities with the City government and citizen groups.

By implementing these elements of the phasing and buckets strategy and by maintaining the framework of the strategy throughout the negotiated evolution of the deal, the SFRA has managed its development, partnership, market, operating, and financial risks with ingenuity and sophistication. Over the long and complicated life of the project, however, the SFRA has also knowingly and purposefully assumed more risk in order to accomplish goals that are independent of the real estate market discipline under which the project must operate in the long term. The difficulties inherent in a public-private partnership in this type of setting are discussed in Chapter Five.

EXHIBIT 4.1
RISK MANAGEMENT STRATEGY IN THE 1984 DDA

RISKS ASSUMED/MITIGATED/ SHIFTED/ELIMINATED BY SFRA STRATEGY	DEVELOPMENT RIGHTS - LAND PURCHASE AND CONSTRUCTION PHASING STRATEGY	PUBLIC AMENITY CONSTRUCTION FUNDING - BUCKET STRATEGY	PUBLIC FACILITY OPERATION AND MAINTENANCE FUNDING - BUCKET STRATEGY
External Market Risks Interest Rates Inflation Capital Market Liquidity (Availability) Tax Policy Regional Economy	·Mitigated risk by flexibility on developer purchase and construction dates ·Shifted risk to private developer by not explicitly assuming any financing responsibility for developer land purchase	·Shifted down-side risk to privated developer by fixing land purchase price on CB-1 with inflation escalation ·Mitigated risk by minimum developer equity requirements (20%) ·Mitigated risk by choice of developer with "deep pockets" ·Assumed risk of interest rates on capital fund	·Assumed risk of interest rates on operating fund ·Assumed risk through structure of lease revenues and participations, revenues are subject to external risk of each use
Project Risks			
Development Risk			
Construction Cost	·Shifted risk to private developer by selling and leasing parcels to developer to construct the private improvements ·Mitigated risk by constructing public amenities over time in phases as funding became available from land sales	·Eliminated risk of construction cost increases of private improvements on sold and leased parcels ·Assumed risk of increases in the public amenity construction cost ·Assumed risk that YBG land sales proceeds may not be enough to cover the cost of the desired quality of the public amenities	·Assumed some risk of cost increases on private improvements (due to % returns on cash flow after debt service and developer returns)
Construction Timing	·Mitigated risk by establishing each phase with a workable synergy to attract people. ·Mitigated risk by timing completion of private improvements with public amenity construction priorities	·Assumed timing risk on the public amenities ·Assumed risk that developer would try to delay land purchase beyond desired dates of public amenity construction	·Assumed risk of construction delays on private improvements since revenues can only be generated after the private improvements are completed
Political	·Assumed risk of program changes through potential of additional public amenity construction cost and delays, and from developer purchase and construction delays due to market conditions	·Assumed risk of additional political pressure if developer delays its purchase of CB-1 office site and construction of the private improvements beyond scheduled construction of public amenities	·Mitigated risk by legally establishing funding priorities for gardens cultural facilities ·Assumed risk that community would disagree with funding priorities as established by the buckets.

Source: Benson & Flaster, A Risk Management Strategy for...YBG
MIT/CRED Thesis, 1991

Operating Risks	**DEVELOPMENT RIGHTS - LAND PURCHASE AND CONSTRUCTION PHASING STRATEGY**	**PUBLIC AMENITY CONSTRUCTION FUNDING - BUCKET STRATEGY**	**PUBLIC FACILITY OPERATION AND MAINTENANCE FUNDING - BUCKET STRATEGY**
Property Markets	·Mitigated risk by flexibility of sale and construction dates for private sites to minimize the risk of opening the private improvements when the property market is in a recession. ·Protected the SFRA property values	·Assumed risk that O&Y will want to delay the payments for the land in order to time the entry of new construction to the market. ·Mitigated the risk of not receiving the proceeds by establishing deadlines for land purchase	·Assumed risk by tieing flow of funds into public amenity operating account to the property performance.
Operating Variability of Cash Flows and Project Vacancy	·Assumed risk that project will not be successful until all phases are complete ·Mitigated risk by establishing each phase with a workable synergy to attract people.	N/A	·Assumed risk of the funding available for the SFRA to maintain and operate the public facilities over time
Financial Risks			
Terms of Debt and Fees	·Mitigated risk by breaking the project into phases, eliminating the need to for developer to finance the entire project at once	·Mitigated financial risk for construction of public amenities by selling land to developer and by requiring developer to finance land purchase on its own	·Mitigated risk of having to funding public amenities by diversity of lease revenue and participations ·Assumed risk that the cultural facilities would become self sufficient over time
Restrictive Covenants	·Mitigated risk by restricting assignability or transfer of development rights by developer until after completion of private improvement construction	·Mitigated risk by restricting assignability or transfer of development rights by developer until after completion of private improvement construction	·Mitigated risk by requiring consent of SFRA for assignment of leases and operating contracts after private improvements are completed
Partner Risks			
Operating Risks	·Mitigated risk by phasing developer funding commitments over time ·Assumed risk that O&Y would try to get out of its obligation to build retail on CB-2 because it doesn't have retail expertise	·Assumed risk that O&Y would be unable to meet its commitments because of its portfolio of other properties	·Mitigated risk by substantially generating funds from properties ·Mitigated risk by having O&Y responsible for contributing only 20% directly to the GSOM
Default	·Mitigated risk by tieing development rights on prize parcels to the SFRA's timely receipt of land sale proceeds and construction of private improvements integrating with public amenities ·Shifted risk through up-front cash spent by O&Y for option payments, negotiations and design of the entire project (over $25 million to date)	·Mitigated risk by requiring minimum capitalization guarantees by the O&Y parent company ·Mitigated risk by minimum developer equity requirements (20%) ·Mitigated risk by selecting partner that places value on its reputation	·Assumed risk if public amenities were constructed before private improvements since operating fund is dependent on private property revenues.

EXHIBIT 4.2
CHANGES IN PUBLIC RISK EXPOSURE SINCE 1984

RISKS ASSUMED/MITIGATED/ SHIFTED/ELIMINATED BY SFRA STRATEGY	DEVELOPMENT RIGHTS - LAND PURCHASE AND CONSTRUCTION PHASING STRATEGY	PUBLIC AMENITY CONSTRUCTION FUNDING - BUCKET STRATEGY	PUBLIC FACILITY OPERATION AND MAINTENANCE FUNDING - BUCKET STRATEGY
External Market Risks Interest Rates Inflation Capital Market Liquidity (Availability) Tax Policy Regional Economy	·Reduced risk by establishing prices on EB-2 office parcels ·Increased risk of unanticipated externalities making market conditions worse - Tax Reform Act of 1986, 1990 credit crunch	·Increased risk by willingness and necessity of assuming financing risk ·Increased risk by practically eliminating minimum developer equity requirements ·Reduced risk by converting use on EB-2c from housing to office use and increasing economic value	·No changes
Project Risks			
Development Risk			
Construction Cost	·No Change	·Increased risk by taking on construction responsibility for CB-3 public amenities	No Change
Construction Timing	·Increased risk that project will not be completed in synergistic phases by changing phasing options ·Reduced risk of additional delay in construction of private improvements by proceeding with construction of public amenities (when public amenities are complete, developer should have more incentive to build the private uses	·Reduced risk of receiving CB-1 proceeds on time for economic needs by securing developer obligation to pay cash ·Increased risk of receiving EB-2 proceeds in time to pay for public amenity construction. Results in need to create bridge financing and take on financing risks	Increased risk due to delay in completion of private improvements, although Marriott currently provides sufficient operating funds
Political	·Reduced risk by getting mayor's support with receipt of cash payments for CB-1 ·Increased risk by delaying decision point for developer purchase of EB-2 until right before mayoral election	·Reduced risk by getting mayor's support with receipt of cash payments for CB-1 ·Increased risk by delaying decision point for developer purchase of EB-2 until right before mayoral election	No change

Source: Benson & Flaster, A Risk Management Strategy for...YBG MIT/CRED Thesis, 1991

Operating Risks	**DEVELOPMENT RIGHTS - LAND PURCHASE AND CONSTRUCTION PHASING STRATEGY**	**PUBLIC AMENITY CONSTRUCTION FUNDING - BUCKET STRATEGY**	**PUBLIC FACILITY OPERATION AND MAINTENANCE FUNDING - BUCKET STRATEGY**
Property Markets	·Increased risk by establishing new private improvement construction dates and taking a stronger stand on the deadlines	·Reduced risk by fixing floor prices for EB-2 parcels ·Reduce risk by constructing public amenities in advance since this will create a higher value for the private sites	·Increased risk short term risk that uses will be successful due to phasing changes and completion of the public amenities before private improvements ·Reduced risk due to attraction of expanded Moscone Convention Center
Operating Variability of Cash Flows and Project Vacancy	·Increased risk by adjusting phases so that CB-2 retail may not be completed with the CB-2 public amenities	·No Change	·Increased risk through change in cultural facility from renter to presenter ·Reduced risk due to attraction of expanded Moscone Convention Center
Financial Risks			
Terms of Debt and Fees	·No change	·Increased risk by constructing public amenities in advance of private improvements - creates need for bridge financing ·Increased risk through willingness to finance developer's land purchase and willingness to assume credit risk	·Increased risk that it may have to fund cultural facilities due to change from renter to presenter
Restrictive Covenants	·No change	Increased risk by willingness to reduce developer equity requirements	·No Change
Partner Risks			
Operating Risks	·No change	·No change	·No change
Default	·No change	Increased risk through willingness to finance almost 100% of the purchase of CB-1 in order to get premium on the price	·No change

CHAPTER FIVE

DOES THE YBG STRATEGY SINK OR SWIM?

The saga of YBG and the public-private partnership formed to facilitate the public objectives, will continue far beyond the scope and the time constraints of this thesis. Still, much can be learned from this complicated and sometimes adversarial partnership.

A Decade Later: Strategy Intact

It can be argued that each party has already passed a point of no return, and that if they were presented the current deal anew with nothing yet at stake, each party would turn it down citing that the returns simply did not justify the risks. Through the negotiation process, the parties established a momentum and mutual commitment to continue to work together until they, or market and economic forces beyond their control, presented a solution or termination to their objectives. Their respective interests have been interwoven to a point, and so much effort, time and money have been invested, that each party has been willing to work through the short-term obstacles in order to achieve their long-term objectives.

This relationship, however, could not have been held together throughout this turbulent process without a successful strategy or framework, one that created mutually binding interests. The phasing/bucket strategy has continued to keep each party's interests in lock-step with those of the other. It has also served as a framework to adjust and fine-tune the specifics of the agreement as various conditions changed, all the while protecting the initial public objectives sought through commercial development. The SFRA's primary objective in seeking a private partner was that the private development would fund the public amenities. Even though the construction of the private and public improvements are no longer in sync due to market conditions, the funding source -- from the private side to the public side -- is still very much intact, if not stretched by the likelihood of public financing.

The questions of whether the SFRA has used the phasing/bucket strategy to effectively manage their risk, or whether they have exposed the public to too much risk are rather subjective. As embodied in the original deal, the strategy was certainly an effective tool to control and share risk. Guided by its initial construction and operating objectives, the SFRA secured its interests against certain private rights and obligations. When the SFRA abandoned the original construction priority and commenced construction of the public improvements in the face of a real estate depression, these actions may have seemed reckless. Though what must not be overlooked, is the fact that the structure and mechanisms of the 1984 deal allowed the SFRA to offset this risk, in part, with what it achieved through O&Y's commitment to an escalated price for the CB-1 office parcel.

This, remember, comes through at a time when most commercial real estate has fallen in value and buyers are few and far between.

This strategy, as any business strategy, falls short of telling its user what its priorities should be, or how much risk is too much. The SFRA has knowingly taken on risk to develop these public benefits for the current citizens and future generations of San Francisco. If the SFRA encounters significant construction cost over-runs or operating difficulties, ultimately its financial cushion will be the taxpayers of San Francisco. The question, is how much has been gained by the public-private strategy as opposed to an outright public development of the Gardens, independent of private investment and commercial activity in this area?

In developing a risk-management strategy for a public agency in partnership with a private developer, each side must possess skills or resources that the other party desires. Since these commodities have different values to each party, value can be created by reallocating them among the partnership. To discover exactly what these commodities and values should be, in light of the often conflicting public and private objectives, a framework is needed to tie these interests together so that the partnership can work together towards a common goal. This can be illustrated by the current negotiations: The SFRA wants a "bump" on the sale of the CB-1 office parcel, while O&Y desires the right to purchase and develop the EB-2 office parcels. By linking these two very different objectives, the public and private sides are now focusing their efforts to resolve a difficult financial dilemma.

The phasing/buckets strategy has provided an effective framework, one able to control the specific timing of rights and obligations as well as the flow of funds for these rights with respect to construction and operation. This has allowed each party to protect their interests while it has defined the risk-sharing agreement. Though the planning for the YBG project has been racked by unstable political, physical, and economic factors, the structure of the agreement has remained very much intact. Perhaps the parties have made an attempt to preserve the structure because it has been the one stable element throughout the process, the bulwark of an otherwise turbulent environment without which there would have been much more flailing and groping maneuvers to stay afloat.

Questions of Accountability

It is obviously difficult to negotiate and deal in any partnership when the basis for existence of the partner entities and the motives for entering into the partnership are often at odds. Is the public risk being taken on for public benefits or private benefits? Is it appropriate for a public agency to take on the same level of entrepreneurial risk as a private entity that does not have either a fiduciary responsibility to act in the best interest of the public or a high level of political accountability? How does a public developer formulate an effective strategy for managing risk with a private partner whose purpose, responsibilities, and motivations are in many ways foreign to the public officials?

In a private entity, even one that is publicly held, owners knowingly make a financial commitment to support the decisions of the management. They can choose to stay as owners or, if they disagree with decisions, they can choose to sell their position. While companies do have a fiduciary responsibility to their owners, they don't have the same mandate for political accountability, nor do their decisions effect the basic needs and daily existence of the owners. Choosing a place to reside and being subject to the financial commitments of the local government should not subject a citizen to the same level of business risk as buying a share of stock.

The public agency has a clear responsibility to provide public benefits. In doing so, there are business risks that are necessarily taken in order to achieve the public goals. In the case of YBG, however, the SFRA has assumed risks not typically associated with the traditional construction of public improvements. The Agency is betting on the strength of the private development and operations to help it realize a more ambitious project than it would otherwise be able to achieve through traditional methods of public finance. As one observer put it, the SFRA is trying to build a Cadillac, when a Honda would suffice.[120]

When the public developer takes on risks that are clearly tied to the private risks and benefits, the line between public and private becomes blurred. Therein lies the conflict, and the difficulty of both finding a public risk-management strategy and making it work throughout the long and constantly challenging life of a real estate project developed by a public-private partnership.

The Return on Public Investment

Central to the conflict is the measurement of return. A private development company measures its return on investment primarily in monetary terms, although it clearly has some interest in providing public benefits if only to promote the self-interested financial success of its investment. The public agency is less concerned with financial measurements of return than with the publicly expressed satisfactions of citizens and political constituencies, notwithstanding the fact that it has some interest in financial returns because they help secure the citizens' satisfaction with the outcome of public risk-taking. The difference between these priorities can make common goals very tough to perceive, and it can intensify the potential for mistrust between the public and private parties.

Do the benefits of public-private development justify the business risks that a public agency might impose on the city residents? In our society, this really depends upon whether the citizenry consents. If so, then the answer must be yes, especially in these times of fiscal constraints. But it must be reasoned and calculated risk-taking, supported by agency accountability, both political and financial. Public agencies entering into these kinds of complex obligations need to be actively responsible for strategically managing the risks undertaken and capable of understanding the ramifications of assuming the special risks of real estate development. Crafting and using a concept like the phasing and buckets strategy provides a guide for internal and external evaluation of the deal, in light of the agency's goals and risk tolerances.

As part of this assessment framework, the agency becomes constantly accountable to the public in a variety of ways. In the case of the YBG development, the public has actively participated in the decision-making processes, even prior to the SFRA's partnership with O&Y. Through the community participation, the public has had an opportunity to choose its benefits. Through the support of the YBG Cultural Center and the SFMOMA, it has chosen the symbol of arts and culture as its return for the public risk-taking.

The phasing/bucket strategy provides an understandable framework that the SFRA can use to publicly communicate the complicated deal. Certainly the public is aware of the framework and conceives of the risks within the structure. This is evidenced in at least one instance by the citizen discussion of the funding priorities for operation and maintenance of the public amenities. It is also evidenced in a broader sense by the citizen participation in the SFRA Commission's decision not to accept what it considered unreasonable financial risks in the recent CB-1 financing proposals.

The public benefits chosen through this process are very difficult to measure in a traditional manner of cost-benefit analysis because they are qualitative benefits, and not necessarily quantitative in every sense. How do you measure the benefits of health care, police protection, or even a park, playground, or museum? Certainly, these policy goals can be measured only subjectively since they benefit the public as a whole. When a public developer, however, takes on private financial risk to achieve these policy benefits, perhaps the return should be measured by both the project-specific public benefits, on the basis of qualitative criteria, as well as by the additional financial return available to fund other public benefits. After all, the private developer would expect a higher return for higher risk, so why shouldn't the public developer?

What lessons has the SFRA learned?

In contemplating developing another project as complex as YBG, one lesson the SFRA has learned was expressed by Robert Gamble, the SFRA's Deputy Executive Director of Finance:

> We might not put all our eggs in one basket with a single large developer. There's a fundamental problem with a single developer in a project like

> YBG....The DDA becomes a giant monolithic document that no one understands. The Agency is subject to negotiating with a hardball developer. Competition would be good.[121]

Arguably though, while the competition of a multi-developer deal would have a positive impact on the bargaining power of the SFRA, the deal might have similar problems with the complexity of the documents and may even be more difficult to administer and coordinate.

Another important lesson is that the public sector cannot ignore market fundamentals. While office use has typically been the economically viable use that subsidized other less profitable uses such as housing, it too is subject to external economic risk. When a mixed-use project becomes dependent on office use as the economic justification of the deal, it is in serious danger of losing its mixed-use identity and becoming an oversized office park. This would in many ways defeat the public policy objectives.

With the luxury of hindsight into the extreme economic difficulties faced by the office market today, a third very important lesson is that the public developer cannot rely on the office component to drive the deal according to schedule. In fact, it came dangerously close to stalling the YBG deal. The original agreement was structured in a relatively strong office market that has grown progressively worse since 1984. This is not to suggest that other uses would have faired better or that the deal was not financially justified. Rather, it leads to the realization that the SFRA was actively participating in real estate development and making calculated decisions with respect to product and risk.

The Agency and YBG, along with the private sector, have suffered some unexpected setbacks in recent years. Still, the Agency's original strategy, along with some unique and sophisticated public financing solutions, has managed to keep the project from sinking. While it is true that the office development is still driving the deal financially, the public amenities are now steering the way.

Conclusion

If economic conditions had not changed so dramatically after the DDA was signed, the YBG project would have probably proceeded with much less deviation from the schedule and funding requirements. Public agencies that develop projects dependent on private development must try to create stable strategies to anticipate such inevitable changes. That is the bottom line of public management for this type of risk-taking: It forces the public developer to prudently evaluate the public benefits in terms of the agency's financial risk tolerance and allows it to be politically accountable.

The phasing/buckets strategy implemented by the SFRA in developing YBG did help protect it from anticipated risks, but the SFRA's own purposeful deviation from the strategy has led it into uncharted waters. While the benefits of Yerba

Buena Gardens to the City of San Francisco will soon be realized, the ultimate costs and returns are still unknown.

APPENDIX A: LIST OF ACRONYMS

ARE	Arts, Recreation, & Entertainment
CB	Central Block
CSOM	Cultural Security, Operation, & Maintenance
DDA	Disposition and Development Agreement
EB	East Block
GMCC	George R. Moscone Convention Center
GMCCX	George R. Moscone Convention Center Expansion
GSOM	Garden Security, Operation, & Maintenance
MIT CRED	Massachusetts Institute of Technology, Center for Real Estate Development
O&Y	Olympia & York
RFQ	Request For Qualifications
SFMOMA	San Francisco Museum of Modern Art
SFRA	San Francisco Redevelopment Agency
YBC	Yerba Buena Center
YBG	Yerba Buena Gardens
YBGA	Yerba Buena Gardens Associates (Olympia & York and The Marriott Corporation)
YBGCC	Yerba Buena Gardens Cultural Center

APPENDIX B: HISTORY OF YBG - 1953 TO 1980

Yerba Buena Center is located in an area that was designated in 1953 as Redevelopment Area "D" (See Exhibit 0.3), a possible redevelopment project under the federal urban renewal program for the purpose of removing residential uses from the area of mixed industrial and commercial uses because of substandard and blighted living conditions.[122] At that time, the neighborhood contained a mix of factories, warehouses, machine shops, laundries, boiler works, and residential hotels and boarding houses sheltering working class residents. The area was described by planners, newspapers and city officials as "skid row", inhabited by bums, drifters and transients.[123]

The original planners of YBC presented their project as a two-fold public service: economic revival through construction jobs and increased tourist and convention business, and assistance to the city in clearing out an "undesirable element".[124] In response to lobbying by the business community, the initial redevelopment proposal was for a large-scale development with office buildings, hotel, retail shops, a baseball and football stadium, a convention center with exhibition halls to meet city tourist and visitor needs, and parking for 7,000 cars. This plan would have resulted in total clearance of the 23 blocks, but was opposed by the City Planning Director who found little evidence of blight as required under the federal urban renewal program.[125]

In 1961, after redefining the boundaries of Area "D", the SFRA applied for a federal urban renewal survey and planning grant which was accepted (in the amount of $600,000) in October 1962. While no specific plan had been developed, the application outlined the SFRA's proposed treatment of the SOMA area:

- Total removal of the residential buildings;
- Removal of the business structures blighted beyond conversion or conservation;
- Renovation of salvageable commercial and industrial buildings by existing owners;
- Creation of public areas which contribute to a wholesome working environment, with provision for needed public facilities;
- Replotting of parcels to allow better use of land and encourage new investment;

- Development of all vacant or open land by existing owners.[126]

Despite the anticipated comprehensive rehabilitation of the YBC area and wholesale harsh removal of residents, the SFRA application included public amenities and a sports arena. This idea carried through to the 1963 General Plan Proposals published by the Department of City Planning[127] and to it was added a park and convention center convention center. In early 1964, the SFRA completed a preliminary conceptual and design plan for YBC that provided for open pedestrian space in the central blocks between Third and Fourth Streets, leading to a convention and exhibit hall between Howard and Folsom Streets, and hotels, offices, and retail spaces on either side.[128] It is worth noting that this plan is not significantly different than the 1991 site plan.

In 1966, the SFRA entered into a loan-and-capital-grant contract with the Department of Housing and Urban Development (HUD) through which $19.6-million of federal funds were made available for property acquisition, relocation, demolition, and site preparation.[129] In 1967, designers were retained to produce a plan for a 350,000-square-foot exhibition hall, a 14,000-seat sports arena, an 800-room hotel, a 2,200-seat theater, 4,000 parking spaces, office buildings, retail shops, and pedestrian malls and plazas. This plan was approved by the SFRA as meeting its criteria in integrating large-scale public uses with economically productive private development, emphasizing pedestrian movement and environment.[130]

The Legal Battles Begin

In preparation for implementing the YBC plan, the SFRA began displacing residents and demolishing buildings.[131] In response, the first of numerous legal battles by citizen action groups began in 1968. Acting on resident complaints of poor quality relocation offerings and maltreatment by SFRA relocation workers, attorneys from the San Francisco Neighborhood Legal Assistance Foundation (SFNLAF) petitioned HUD for an administrative hearing on the YBC relocation plan.[132]

After HUD denied the SFNLAF petitions, the YBC residents formed the Tenants and Owners in Opposition to Redevelopment (TOOR) and filed a complaint in federal court against both HUD and the SFRA, arguing that the SFRA had not located safe, decent and sanitary housing for displacees according to rights contained in the 1949 Housing Act. The suit was settled by the SFRA agreeing to provide 1,500 units of low-cost housing.

When TOOR discovered that the SFRA planned to fulfill its obligation by counting public housing already scheduled to be built, and that this would be taking the low-cost housing away from other needy residents, TOOR again filed suit for injunctive relief in 1970. Two weeks later, Judge Stanley A. Weigel granted the injunction, and halted all demolition and relocation until the YBC relocation plan was revised.[133]

When settlement discussions failed, Judge Weigel drafted a consent decree that required the SFRA to guarantee production within 3 years (by November 1973) of 1,500 to 1,800 units of new low-rent housing anywhere in the city and to house relocatees in decent, safe, and sanitary housing within their means. The decree also required that four residential hotels within the project area, but outside the Central Blocks, be refurbished at SFRA cost until the replacement units were constructed. This agreement allowed the SFRA to continue relocation and demolition in the YBC project area[134].

Problems with the First Financing Plan

Meanwhile, the SFRA was actively soliciting development proposals for the Central Blocks. In 1970, the development team of Schlessinger-Arcon/Pacific was selected to develop both the public and private facilities on the Central Blocks.[135] By mid 1971, partly in response to the Agency's sluggish attitude toward the statutorily and judicially imposed obligations for replacement housing and partly in response to intense pressure to break ground for the convention center complex, the City's Chief Administrative Officer, Thomas Mellon, began to question the SFRA's handling of the YBC project.[136]

The financing plan devised by then Director of the SFRA, Justin Herman, and Albert Schlessinger of the development team was a result of both political and economic considerations. The goal was to put together a scheme, though not necessarily the least costly, which would provide the most rapid, flexible, and politically acceptable method of raising funds and exercising control over their use for construction of the public facilities. The plan called for tax-exempt bonds backed by the city's hotel tax, to be issued by non-profit corporations established by Schlessinger and his partners. Schlessinger-Arcon/Pacific would then receive substantial developer's fees (over $5-million) for building the public facilities and would negotiate a fee with a general contractor, rather than submit the project to competitive bid.[137]

Mellon announced the existence of possible illegalities and conflicts of interest in the public facilities financing plan proposed by the SFRA [probably due to the participation of Schlessinger in both the development entity and the non-profit corporation, leading to a question of the 'public purpose' of the bond financing], plus serious design defects for the YBC exhibition hall. This led to the City's decision to develop the convention center facilities directly,[138] although the basic design for an underground facility was retained to prevent additional delays.[139]

Mellon was critical of the plan partly as a result of his recent experience with construction cost over-runs on Candlestick Park,[140] and partly because of a private political power struggle between himself and Herman. He suggested that construction responsibility for the YBC public and private facilities be split, with the public facilities built by the City and funded through a City offering of a general obligation bond issue to be submitted to the voters.[141] While the mayor, Joseph Alioto, was primarily concerned with getting the YBC facilities built, he also recognized that a vote on the general obligation bonds would be unlikely to succeed.

When the dust cleared, the City had responsibility for construction of the public facilities, Schlessinger/Arcon-Pacific was reimbursed for its expenses in what has been described as a probable "buy-off", and Mellon had the task of devising a new financing plan. Shortly after this internal political squabble, Herman died, reducing further the role of the SFRA in the YBC development project.[142]

Between 1971 and 1978, YBC suffered further financing difficulties, legal setbacks, and significant design changes. Until 1972, the project was able to proceed using federal grants and loans, totalling over $40-million by that time. The 1972 financing plan proposed a $219-million capital expenditure (hard construction costs were estimated to be $142-million) to be funded by a $225-million SFRA bond issue. Under this arrangement, the public facilities would be leased by the Agency to the City for an estimated $14.5-million annually, enough to amortize the bonds and to cover any additional expenses that might be incurred by the SFRA. The lease term was 35 years, at which time title to the facilities would be transferred to the City. The rent would be payable whether or not the facility revenues covered the debt.[143]

The bonds were projected to be sold at a 6% interest rate, although a memo from the City's Budget Analyst suggested that a 7 to 7 1/2% rate would be more likely. The plan's revenue projections were itemized from the following sources:

- Land rents from leases with a private developer for sites in the Central Blocks;
- Income from the public facilities;
- Hotel tax allocation (36% of the then 5.5% city wide hotel tax);
- Property tax increment over the amount of property taxes received in 1965.[144]

The plan was approved unanimously by the City's Board of Supervisors after perfunctory hearings at which the Supervisors did not question the validity of the inherent cost and revenue assumptions.[145] Immediately after the approval, two taxpayers' law suits were filed in state court, challenging the financing plan as an unconstitutional attempt to encumber San Francisco residents with massive long-term debt obligations without seeking voter approval. They claimed that since the City was obligated to make the "rent" payments to the SFRA even if revenues were not sufficient to cover the debt, then the bonds were actually general obligation bonds requiring voter approval.

Settlements and Renegotiations

At about the same time, six conservation groups filed suit in federal court, claiming that YBC violated the National Environmental Policy Act of 1969 (NEPA). As a result of plaintiffs' agreement not to appeal the adverse decisions, HUD agreed to produce an Environmental Impact Statement. Appeal of the suits would have delayed the YBC project indefinitely. Also, at about the same time in 1972, the TOOR settlement was being renegotiated since the SFRA had been sluggish in fulfilling its affordable housing obligations.[146] (Although later than anyone would have anticipated, the SFRA finally did provide low-rent units in excess of the number required under the settlement agreement.)

In 1974, after two years of the City not answering the legal complaints in the financing suits, a tentative settlement was reached. Because the taxpayers were concerned the revenues available to fund the annual bond payments, the agreement reduced the maximum bond issue from $225 to $210-million to finance all of the public amenities, including the convention center. It also required deletion of the sports arena from the public facilities portion of the bond issue.[147] In 1975, the City received a low construction bid of $162.8-million for the remaining facilities, but continual litigation, escalating construction costs, and deletion of the sports arena from the program caused the contractor to withdraw the bid.[148] (See Exhibit 1.1).

In 1976, Mayor George R. Moscone appointed a committee of sixteen interested citizens, including both proponents and opponents of a convention center, to submit a recommendation for the development of YBC. Following public meetings, review, and comments, the committee recommended an alternative plan that retained the convention center and provided for 3-million square feet of office space, 300,000 square feet of retail uses, 602 units of elderly housing, 300 units of subsidized-family housing, 650 units of market-rate housing, a commercial recreation/entertainment park (Tivoli style), and 350,000 square feet of light industrial uses for the 11 acres of the three Central Blocks.[149]

The underground convention center was to be constructed with a 4% hotel tax (instead of the property tax increment fund) that would collateralize the lease revenue bonds issued by the SFRA. The general terms of the financing plan were approved by the voters in November 1976. In 1977, the Board of Supervisors approved the recommendation of the Mayor's committee and permitted the City to retain a construction manager and an architect. Shortly thereafter, the voters approved all the necessary long-term City leases needed to support the convention center revenue bonds.[150]

In 1978, the SFRA filed a validation suit[151] on the specific details of the new YBC financing plan. As a result, interested parties challenged the financing plan, again for the reason that the plan violated the voters' right to approve the details of the long-term financing commitment by the City. The financing plan was upheld by the courts, and within days of the the last legal decision, with all legal barriers being removed, the SFRA sold its $97-million YBC bond issue to finance the convention center. Post-excavation work began in 1979, and the 300,000-square-foot Moscone Convention Center (so named because of the tragic murder of Mayor Moscone in November 1978) opened in 1981.[152]

APPENDIX C: CHRONOLOGY OF EVENTS SINCE 1980

•April 1980-	The SFRA issued a Request for Qualifications (RFQ) to local, national, and international developers.
•November 1980-	The SFRA selected the team of Olympia & York/Marriott Corporation/Beverly Willis Associates for exclusive negotiating rights to the YBC Central Blocks.
•December 1980-	The SFRA and O&Y/Marriott/Willis began to negotiate the terms of the Disposition and Development Agreement (DDA).
•April 1984-	The SFRA and O&Y/Marriott/Willis announced an agreement as to basic terms of the DDA.
•December 19, 1984-	The Mayor signed the Disposition and Development Agreement with construction to start in 1988. Cost of public improvements estimated at $52.5-million with construction to start in 1988.
•February 12, 1986-	A meeting was called in Mayor Dianne Feinstein's office to alert the SFRA and the Developer of the possible expansion of George R. Moscone Convention Center (GMCCX) and initiate studies to evaluate the proposed expansion.
•July 7, 1986-	A plan prepared by architects Mitchell-Giurgola, James Stewart Polshek, and Fumihiko Maki was adopted by the SFRA Commission. This plan demonstrated how the GMCCX could be accommodated underneath the Cultural buildings, the gardens, and a second Convention Center Lobby on CB-2. This plan would displace YBGA's planned 1,250 parking spaces.
•August 26, 1986-	Construction began on Phase 1, the 1,500-room Marriott Hotel on CB-1.
•November 2, 1986-	The voters approved Proposition B, which calls for the expansion of the Moscone Convention Center underground Central Block 2, conditioned on the Agency's determination that the gardens could be developed.

- •November 1986- The SFRA began negotiations with YBGA to delete the parking parcel from the DDA to permit the Convention Center Expansion.

- •August 19, 1986- The SFRA and YBGA agreed on a Fourth Amendment which 1) makes additional modifications to the schedule of performance in the DDA, 2) adds provisions relating to the proposed Convention Center Expansion Program, and 3) provides certain rights and easements in connection with the Marriott Hotel.

- •March 17, 1987- The SFRA and YBGA agreed on a Fifth Amendment which sets forth the terms and conditions for the Developer to proceed with construction of the improvements of the CB-2 Hotel parcel (underground) in accordance with a revised plan and easements which accommodate the GMCCX through CB-2. It also provided for extension for the Gardens start from 1988 to late 1990 or early 1991.

- •November 24, 1987- The SFRA and YBGA agreed on a Sixth Amendment which 1) provided for the removal of the CB-2 parking parcel from the DDA and the quitclaiming of the Developer's interest therein to the SFRA, 2) elimination of the option to purchase and its replacement by Developer's commitment to purchase the CB-1 office site on or before July 1, 1990, and 3) construction of the CB-1 office building to commence on or before July 1, 1995.

- •March 1, 1988- The SFRA approved the schematic plans for the GMCC expansion estimated at $102-million.

- •March 8, 1988- The preliminary cost estimates for gardens with the features necessary to mitigate impact of the GMCCX and to allow for inflation due to delays reviewed at SFRA meeting. Gardens cost refined and estimate of $95-million presented.

- •June 13, 1989- O&Y proposed plan to complete central blocks of YBG by 1992.

- •July 2, 1990- O&Y announced plans to construct three office buildings as a part of the $1-billion YBG development and handed over a $4.4-million check to SFRA as "good faith" payment, cementing an innovative financing agreement which allows the project to go forward and relieves city of having to utilize $24-million in tax increment funding.

•June 19, 1990- Reached a memorandum of understanding hours before a deadline for O&Y to commit to the project or lose its role in the project. This tentatively defined terms including the sale of the CB-1 office parcel to O&Y by July 2, 1990.

•February 7, 1991- Meyer Frucher, of O&Y, made the first installment payment,$3.6-million of $39. This new arrangement (Eighth Amendment) was necessary because a bond financing that had been contemplated was no longer feasible in the current economic climate. The deposit approach was selected because it provides the agency with advances of necessary cash flow for its public improvements, while preserving the options of bond financing at a later date to potentially increase the amount the agency will have available for public improvements.

•May 2, 1991- Mayor Art Agnos accepted an $11.1-million check that insures the construction of a 24-acre garden, cultural complex and tribute to Martin Luther King. Construction will begin by mid-summer on CB-2. The SFRA awarded a steel contract for the Performing Arts Center and the Visual Arts Forum. Construction of the centerpiece five-acre esplanade and fountain is scheduled to begin in October.

•June 1991- The SFRA and YBGA failed to reach agreement and lost the opportunity to finance the sale of the CB-1 office parcel through a Mello-Roos Bond issue.

•September 30, 1991-Deadline for CB-1 financing plan giving SFRA a premium on the CB-1 sale proceeds. If deadline is met, O&Y preserves the right to purchase EB-2 office sites. If deadline is missed, O&Y must continue cash payments, but loses the EB-2 office development rights, preserving only the right to develop EB-2c as residential.

APPENDIX D: GLOSSARY OF CALIFORNIA PUBLIC BOND FINANCE MECHANISMS

Tax Increment Bond

Tax-exempt bonds issued by a public agency for a public purpose. The annual payments to bond holders are secured by and paid from the incremental property taxes over a selected base year on land in a designated district.

Tax Allocation Bond

Tax-exempt bonds issued by a public agency for a public purpose. The annual payments to bond holders are secured by and paid from a designated portion of a city tax. For example, if a city's hotel tax is 10%, the city could designate 30% of the tax collected to pay off the bonds.

Mello-Roos Bond

Tax-exempt bonds issued by a public agency for a public purpose. The annual payments to bond holders are secured by and paid from a Mello-Roos property tax collected by the city on a designated district. The annual bond liability becomes a tax lien on the property.

NOTES

1 San Francisco Planning and Urban Research Association (SPUR), *Yerba Buena Gardens : Culture is the Key to Success, September 1984*, p. 1.

2 Chester W.Hartman, The Transformation of San Francisco (Rowman & Allanheld: 1984), pp. 107 - 108.

3 Hartman, Transformation of San Francisco, p. 108.

4 Hartman, Transformation of San Francisco, p. 118.

5 San Francisco Redevelopment Agency (SFRA), *Request for Qualifications, Mixed-Use Development, Yerba Buena Center, Downtown San Francisco*, April 1980, p. 5.

6 The committee recommended 602 units of elderly housing, 300 units of subsidized-family housing, and 650 units of market-rate housing.

San Francisco Redevelopment Agency (SFRA), *The Commissioners Indepth Briefing Agenda: Yerba Buena Center, Concise chronological Summary of Important Yerba Buena Center Events*, January 31, 1989.

7 SFRA, *Briefing Agenda.*, p. 19.

8 SFRA, *Briefing Agenda.*, p. 18.

9 The choices were first narrowed from ten developers to six. The six team were:

1. Cadillac Fairview Corporation of California;
2. Campeau Corporation California/Rouse Development Company of California;
3. Equity/Marriott Corporation/Beverly Willis;
4. Portman Properties;
5. Trammel Crow Partnership;
6. YBC Associates (Williams Realty Corporation/Herbert McLaughlin/Charles H. Shaw Company).

By then narrowing the choice down to two finalists, the Agency allowed the developers to strengthen their applications in preparation for a public presentation. Wilbur W. Hamilton, *Memorandum to Commissioners*, October 3, 1980, pp. 1 - 4.

10 Ben Thompson & Associates, a member of the design team, had designed such successful festival marketplaces as Boston's Faneuil Hall and Baltimore's Inner Harbor Market place. Hamilton, Memorandum, October 3, 1980, p. 4.

11 SFRA, *Briefing Agenda.*

12 Wilbur W. Hamilton, *Memorandum to Agency Commissioners,* November 19, 1980, pp. 3 - 4.

13 SFRA, *Briefing Agenda.*

14 SFRA, *Briefing Agenda.*

15 SPUR, *Yerba Buena Gardens: Culture is the Key,* p.3.

16 San Francisco Redevelopment Agency (SFRA), *Yerba Buena Gardens, A Summary Overview Of The Proposed Terms,* April 12,1984, pp. 3-5.

17 See Hartman, Transformation of San Francisco; and Chester W. Hartman., Yerba Buena: Land Grab and Community Resistance in San Francisco (Berkeley: National Housing and Economic Development Law Project, Earl Warren Legal Institute, University of California, 1974).

18 Hartman, Transformation of San Francisco

19 SFRA, *Request for Qualifications,* p. 7.

20 An immediate timing pressure is the upcoming opening date of the expanded Moscone Convention Center since the City desires the public amenities to be completed for the opening.

21 Buck Bagot, President of the SFRA Commission, interview with authors, June 5, 1991.

22 San Francisco Arts Commission's (SFAC) State-Local Partnership Program and the Department of City Planning, *Proposed Arts Policy for the City and County of San Francisco, Proposal for Adoption,* May 1991, p. iii.

23 SFAC, *Proposed Arts Policy,* pp. 27 - 30.

24 Wilbur W. Hamilton, San Francisco Redevelopment Agency (SFRA), *Press Release on Yerba Buena Gardens Agreement,* April 1984, p. 4.

25 Alan H. Loving, Senior Planner, San Francisco Redevelopment Agency, telephone conversation with authors, July 2, 1991.

26 The SFRA has the authority to supersede the standards of the City and County of San Francisco. The negotiated development intensities are reflected in the DDA. An Amendment to the Yerba Buena Project Redevelopment area is currently being drafted to approve these intensities regardless of who eventually develops the YBG parcels

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27 San Francisco Redevelopment Agency, *Draft Amendment to the Yerba Buena Project Area,* June 1991, pp. 5-16.

28 The Summary of the DDA explicitly states that except as expressly provided, or prior to Agency approval: (1) The Developer is prohibited from selling, assigning or transferring its interests under the agreement, (2) there shall be no significant change in the ownership of the Developer or its respective parents and partners, prior to recordation of a Certificate of Completion, and (3) the Developer is not to transfer its interest in the Deeded Developer Parcels or improvements on them before a Certificate of Completion and Right of Occupy is issued.

29 Keyser Marston Associates Inc., *Economic Report of Proposed Business Terms of Yerba Buena Gardens,* October 1984, p. 9.

30 *Surviving Downtown Development Negotiations,* recorded material from Semi-annual Members Meeting of the Massachusetts Institute of Technology Center For Real Estate Development (MIT CRED), Washington, D.C., December 4 and 5, 1985.

31 In event of developer default on its agreement, title to the land would revert to the SFRA.

Downtown Development Negotiations, recorded material.

32 Keyser Marston, *Proposed Business Terms,* p. 7.

33 Keyser Marston, *Proposed Business Terms.*

34 SFRA, *Yerba Buena Gardens, Proposed Terms,* pp. 11-12.

35 *Downtown Development Negotiations,* recorded material.

36 *Downtown Development Negotiations,* recorded material.

37 The SFRA has a moral, not legal, obligation to contribute excess proceeds from land sales to a fund to create low-rent housing.

38 The remainder of Chapter Two continually relies on the following sources of information:

i) *Surviving Downtown Development Negotiations,* recorded material from MIT CRED.

ii) Disposition and Development Agreement for between the San Francisco Redevelopment Agency and Yerba Buena Gardens Associates, December 1984.

39 *Downtown Development Negotiations,* recorded material.

[40] William W. Hamilton, Executive Director, San Francisco Redevelopment Agency, Letter to the YBGA team, October 20, 1980, p.2.

[41] Although the Rouse Company initially contemplated purchasing an equity position, it made no legal commitment to the partnership. In 1986, Rouse decided to drop out of the development team, citing that the size of the retail component was not significant enough to make the deal financially attractive.

[42] This $11.1 million check represents the scheduled May 1, 1991 deposit payment of $9.9 million plus interest and a construction premium. This is prescribed by the Eighth Amendment as described later in this section.

[43] Office of the Mayor of San Francisco, Press Release, May 2, 1991.

[44] The fair market value is $37.8 million (in 1991 dollars) as prescribed by the original price and escalation in the 1984 DDA.

[45] Agenda Item No. 7(f) to the San Francisco Redevelopment Agency Commissioners regarding the Eighth Amendment to the Disposition and Development Agreement, Yerba Buena Gardens, January 30, 1991.

[46] San Francisco Redevelopment Agency, Yerba Buena Center's Capital Improvements Program Tax Increment Bond Scenario, Run Date May 2, 1991, p. 1.

[47] The SFRA desires net proceeds of $48 million, as stated in the Eighth Amendment. As the negotiations developed, however, it became apparent that the Agency may accept less than this amount.

[48] Agenda Item No. 7(f) to the SFRA regarding Eighth Amendment.

[49] Authorization of Mello-Roos designation requires property owner (O&Y) election by a two-thirds vote.

Virginia L. Horler, Guide to Public Debt Financing in California (Packard Press: 1987), p. 88.

[50] Robert T. Gamble, Deputy Executive Director - Finance, San Francisco Redevelopment Agency, interview with authors, May 30, 1991.

[51] When the YBGA offered a bump of $5.4 million, the SFRA assumed that this was in addition to the $2.8 million. 5.4 + 2.8 = $8.4 million. YBGA, however, specified that it was to include the 2.8, not in addition to.

[52] Al Williams, General Manager, Olympia & York Companies (U.S.A.), San Francisco CA, interview with authors, July 11, 1991.

[53] Gamble interview, May 30, 1991.

[54] The team is still considering a Mello-Roos hybrid in which the Mello-Roos district would not be designated by the City Assessor until the summer of 1992, but YBGA would pay as if it were being taxed until that time.

Williams interview, July 11, 1991.

[55] If a General Obligation Bond, issued by the SFRA, were insured and had a AAA rating, the SFRA would receive a higher net proceed. This is because investors of the bonds would receive a lower rate of return due to the lower perceived risk. Since the Agency would be required to maintain a reserve equal to two years of interest payments, and the interest would be lower, the net proceeds would be higher.

[56] Al Williams, General Manager, Olympia & York Companies (U.S.A.), San Francisco CA, telephone conversation with authors, July 17, 1991.

[57] The projected cost of $62 million covers both the hard and soft costs for all the CB-2 public improvements except the West Garden. The remainder of the $97 million total projected cost will pay for the CB-3 public improvements and the CB-2 West Garden. The West Garden is being delayed due to the delay of the CB-2 retail and ARE on the west side of the block.

[58] Robert T. Gamble, Deputy Executive Director-Finance, San Francisco Redevelopment Agency, telephone conversation with authors, July 2, 1991.

[59] Of the $37.8 million sale price, the $2.8 million prior Marriott deposit has already been spent.

[60] The renegotiation of the Marriott lease will be discussed in a later section. Essentially, in exchange for changes to the lease in order to prepare for a sale of the leasehold interest, the Marriott Corporation agreed to compensate the SFRA in the amount of $10 million. Marriott would continue to operate the hotel.

[61] There was little opposition to the Convention Center expansion. While the Convention Center will be a loss leader for the City, it promises benefits to the City and the YBG development. The benefits created will include an estimated $22 per visitor per day in taxes to the City, and a greater use of the hotel, retail, ARE, and public amenities of YBG and nearby development.

Peter W. Miller, Financial Officer - Special Projects, City & County of San Francisco, interview with authors, June 5, 1991.

62 O&Y might still construct 200-300 parking spaces on CB-2 depending on design constraints.

63 Most of the pledges for the SFMOMA have ranged from $1 million to $10 million.

64 San Francisco Museum of Modern Art (SFMOMA), Press Release, September 11, 1990.

65 SFMOMA, Press Release, September 11, 1990.

66 As a renter, the YBGCC would be providing a forum for neighborhood theater groups and multi-cultural artists to be exposed to larger audiences. The revenues from such performances and exhibitions, however, would likely be very small and not cover operating costs. As a presenter, the YBGCC will continually organize, import, or create programs which are deemed likely to attract larger crowds and revenues. The YBGCC still plans to offer some rental space, in addition to its new role as presenter and producer.

67 Several representatives of multi-cultural artist groups expressed outrage concerning the change from a renter to a presenter. They saw this as a symbol that the facilities would cater programs to a select group of customers, rather than providing rental space for relatively unknown artists and performers.

Arts Democratic Club, Meeting to discuss the viability of the Yerba Buena Gardens Cultural Center and whose interests were being met, Potrero Hill Neighborhood Center, San Francisco, May 28, 1991.

68 San Francisco Planning and Urban Research Association (SPUR), *Yerba Buena Gardens: To be, or not to be?*, August, 1989, p. 2.

69 The terms of the sports club lease will include a base rent of $170,000 in 1990, to be increased every 5 years based upon the Consumer Price Index at a rate not less than 20% and not greater then 40%. There is still some discussion of using this site for residential.

70 "Yerba Buena Impasse Broken", San Francisco Examiner, June 20, 1990.

71 The Marriott Corporation paid the SFRA $6.5 million in May 1991. The remainder will be paid in three installments through 1995.

72 Williams telephone conversation, July 2, 1991.

73 *Memorandum of Understanding*, San Francisco Redevelopment Agency, June 20, 1990, p.6.

74 "Yerba Buena Project Agreement," San Francisco Chronicle, June 20, 1990.

75 The West Garden, as shown in Exhibit 2.3, is not currently being constructed and therefore needs no funding at this time.

76 Olympia & York Companies (U.S.A.), Press Release.

77 The Marriott lease would be for a term of 60 years with two 15-year renewal options. The CB-2 retail, ARE, and parking leases would run for 60 years. The CB-3 retail and ARE leases would run for 50 years. San Francisco Redevelopment Agency, *Yerba Buena Gardens, A Summary Overview Of The Proposed Terms*, April 12,1984, pp.19 - 20.

78 There will be a gap whether or not O&Y's cash payment obligation is completed or financing is arranged to provide the bump desired by the SFRA. The CB-2 amenities are projected to cost $61.6 million. After sale of CB-1, the fund will contain $35 million of CB-1 proceeds, plus a recently received $10 million from a Marriott lease negotiation. The amount of any bump received will not close the gap between the $45 million and the $61.6 million required. Tax-increment bond receipts of $16.6 may temporarily close the gap. Any bridge financing bonds issued are intended to be taken out by the sale of the EB-2 parcels. Gamble telephone conversation, July 2, 1991.

79 While construction revenues from land sales are adjusted for inflation by the 1984 agreement, construction costs are not despite the potential for a 3-to-5 year schedule for construction of the all the public amenities on CB-2 and CB-3.

80 See Exhibit 1.1 - Sources/Uses

81 The estimated value of the Agency's land holdings in the YBC district is $110-million to $120-million, including the Central Blocks. Gamble telephone conversation, July 19,1991.

82 Gamble interview, May 30, 1991.

83 Since Marriott has recently dropped out of the YBGA partnership and the Rouse Company (in 1986) decided not to pursue the retail management contract, the SFRA was correct in its initial assessment.

84 Gamble telephone conversation, July 2, 1991.

85 Total Class "A" office space in the city as of September 1990 was estimated at 32,385,084 square feet. Grubb & Ellis, *San Francisco Third Quarter Market Report*, October 31, 1990.

86 Total office inventory in the South of Market Area in the Third quarter of 1990 was estimated at 14,974,856 square feet. Cushman & Wakefield, *San Francisco Office Market Report*, Third Quarter 1990, p. 3.

87 Recht Hausrath & Associates, *Long Term Analysis for CB-1 Office Development, Draft Report*, December 10, 1990, p. 7.

88 Gamble interview, May 30, 1991.

89 Williams telephone conversation, July 2, 1991.

90 Williams telephone conversation, July 17, 1991.

91 The legal entity in the partnership with the SFRA was Olympia & York California Equities Corporation, a wholly owned subsidiary of Olympia & York Equity Corporation of New York, which in turn is a wholly owned subsidiary of Olympia & York Ltd. of Toronto. SFRA, *Proposed Terms*, p. 2.

The construction obligations of the developer were guaranteed by O&Y Equity Corporation in New York. For Phase 1, the cap on the guarantee was 20% of total development costs less developer equity contributed to phase 1. For Phases 2 and 3, the cap was 25% total development costs. In addition, on phases 2 and 3, the developer must maintain 20% equity. SFRA, *Proposed Terms*, pp. 20 - 21..

92 Miller interview, June 5, 1991.

93 Robert Wetmore, Keyser Marston Associates, San Francisco, California, interview with authors, May 31, 1991.

This is particularly interesting since one of the factors that can be inferred from the reasons given for the selection of O&Y over Cadillac-Fairview was the ability of the team members to work well with the SFRA team. It is worth noting that the project director on the original O&Y team is not the current project negotiator.

94 Gamble telephone conversation, July 2, 1991.

95 Gamble telephone conversation, July 2, 1991.

96 Williams telephone conversation, July 17, 1991.

97 Price in 1991 of $37.8-million consists of $2.8-million credit for a payment made by Marriott toward the CB-1 purchase and $35-million to be paid by O&Y by October 1, 1991.

98 $20.5 million for 500,000 gross buildable square feet.

[99] $10.5 million for 300,000 gross buildable square feet

[100] Despite the proposed location of the Museum of Modern Art between EB-2a and EB-2c, there is a strong argument that CB-1 should always be worth more than the EB-2 sites because of its location on Market Street. If this is true, then there is also an argument that the SFRA has protected its property value as long as the 1991 price received for the CB-1 office site is higher the 1991 prices of EB-2a and EB-2c. A comparison reveals that this is true, but since we do not know how much value can be attributed to the locational difference or how much comparable property values have changed, this argument is not a strong one.

[101] The SFRA originally timed its construction of the CB-2 cultural facilities to coincide with the construction of the CB-2 retail and ARE in order to complete the entire CB-2 block at the same time. In initially attaching the CB-2 retail and ARE construction and operation obligation to the right to develop the CB-1 office building, the SFRA attempted to insure that O&Y would not back out on its promise to build the retail at the same time as the CB-2 public amenities were being constructed.

As the agreement evolved, O&Y was able to extract the obligation to build the CB-2 retail from its option to purchase the CB-1 office site. In exchange, O&Y obligated itself to purchase the CB-1 office parcel outright and tied the obligation to build the CB-2 retail to the exercise of the EB-2 office site options. From the SFRA's perspective, this guaranteed the timely receipt of the sale proceeds when it needed the money to begin construction of the public facilities on CB-2.

[102] Gamble telephone conversation, July 2, 1991.

[103] Recht Hausrath, *Analysis for CB-1 Office Development,* December 10, 1990, p. 3.

[104] Grubb & Ellis, *San Francisco Third Quarter Market Report,* October 31, 1990.

[105] Gamble telephone conversation, July 2, 1991.

[106] Recht Hausrath, *Analysis for CB-1 Office Development*, p.8.

[107] The illiquidity in the capital market was caused in part from falling real estate values and the resulting effects on bank portfolio capital requirements.

[108] The holding rent increases to $1,500,000 after 8 years.

109 San Francisco Redevelopment Agency (SFRA), Projected Operating Costs and Revenues of Yerba Buena Gardens, Run Date: February 19, 1991.

The retail leases are subject to an annual minimum rent of $1 per gross square foot of floor area for up to 90,000 square feet on CB-1 and 50,000 square feet on CB-2, or $90,000 and $50,000. The sports club is expected to generate a minimum rent of $170,000 annually.

110 Because the percentage rent is calculated after debt service and developer return, the allocation of a share of the additional construction cost of the roof structure of the underground Marriott meeting rooms to the retail and ARE uses on CB-2 reduces the value of this revenue stream. Gamble telephone conversation, July 2, 1991.

111 Gamble interview, May 30, 1991.

112 These stabilized year projections are derived by the authors from: SFRA, Operating Costs and Revenues.

113 This source is dependent on the balance in the fund, currently estimated at $6 million. Since however, the fund will likely be depleted by operating deficits, annual stabilized interest is calculated as follows: 5% interest rate on a fund containing Marriott revenues ($3 million) plus retail lease revenues ($310,000) held for an average of one-half of a year -- 5% x $3,310,000 x 1/2 = $82,750 per year.

114 Gamble telephone conversation, July 19, 1991.

115 Gamble telephone conversation, July 2, 1991.

116 Williams telephone conversation, July 2, 1991.

117 Gamble telephone conversation, July 2, 1991.

118 O&Y had offered a bump of $8.2 million, but included a $2.8 million prior payment from Marriott as part of the bump. From O&Y's view, this left $5.4 million of premium to be created by the financing plan. The misunderstanding was cleared up after the Commission rejected the offer, but the offer still was not accepted.

119 Gamble telephone conversation, July 2, 1991.

120 Buck Bagot interview, June 5, 1991.

121 Gamble telephone conversation, July 2, 1991.

122 San Francisco Redevelopment Agency (SFRA), *The Commissioners Indepth Briefing Agenda: Yerba Buena Center, Concise chronological Summary of Important Yerba Buena Center Events*, January 31, 1989.

123 Hartman, Yerba Buena, pp. 93 - 98.

124 Hartman, Yerba Buena, pp. 97 - 98.

125 Hartman, Yerba Buena, p. 23.

126 Hartman, Yerba Buena, pp. 75 - 76.

127 SFRA, *Briefing Agenda*.

128 SFRA, *Briefing Agenda*.

129 SFRA, *Briefing Agenda*.

130 SFRA, *Briefing Agenda*.

131 Hartman, Yerba Buena, p. 24.

132 Hartman, Yerba Buena, p. 24.

133 Hartman, Yerba Buena, pp. 127 - 128.

134 Hartman, Yerba Buena, pp. 133 - 134.

135 SFRA, *Briefing Agenda*.

136 Hartman, Yerba Buena, pp. 186 - 187.

137 Hartman, Yerba Buena, p. 187.

138 Interestingly, a question of the "public purpose" of the bond financing was later used to explain the SFRA's taking of additional construction responsibility in 1990.

139 Hartman, Yerba Buena, pp. 185 - 187.

140 Candlestick Park is a professional football (San Francisco 49ers) and baseball (San Francisco Giants) stadium located on the southern fringe of the City.

141 Hartman, Yerba Buena, pp. 188 - 189.

142 Hartman, Transformation of San Francisco, pp. 104 - 105.

143 Hartman, Transformation of San Francisco, pp. 107 - 108.

144 Hartman, Transformation of San Francisco, p. 108.

145 Hartman, Transformation of San Francisco, p. 108.

146 Hartman, Transformation of San Francisco, pp. 115 - 116.

147 Hartman, Transformation of San Francisco, p. 118.

148 SFRA, *Briefing Agenda*.

149 SFRA, *Briefing Agenda*.

150 SFRA, *Briefing Agenda*.

151 A validation suit is a request for the court's opinion as to the legality of a proposed event.

152 Hartman, Transformation of San Francisco, pp. 152- 156.