

bae urban economics

MEMORANDUM

To: Bruce Knopf, County of Santa Clara

From: David Shiver, Principal, and Jessica Hitchcock, Senior Associate

Re: Peer Review of Master Development Agreement for Santa Clara County Civic Center

Date: April 29, 2016

Purpose

This memorandum summarizes the results of a peer review of the Master Development (“MDA”) Agreement negotiated by Santa Clara County (“County”) and Lowe Enterprises (“Developer”) for the master planning and development of new consolidated County facilities at the County’s Civic Center. BAE Urban Economics, Inc. (“BAE”) was engaged by the County to undertake a peer review of the proposed MDA, and provide an independent assessment of the reasonableness of the proposed business terms and whether these terms protect the County’s interests by mitigating cost and other risk exposures and assuring performance of the Developer.

Summary of Findings

The County and Developer have negotiated the MDA for a series of projects that are yet to be fully determined as part of the master planning process; the County is in the process of determining its space needs and financing mechanisms. Hence, there is a degree of uncertainty related to the scope and timing of the overall project. The parties have had to negotiate a MDA that reflects these potential uncertainties, resulting with a MDA with a complex structure.

At the Board’s request, the MDA contains multiple provisions that give the Board of Supervisors oversight and approval responsibilities. For example, prior to the commencement of each discrete development phase, the Board must issue an authorization to proceed. In addition, the Board has requested the flexibility to terminate the agreement at various junctures; hence, there are negotiated payment provisions if the County terminates for convenience. Moreover, changes to the Guaranteed Maximum Price in excess of the Board approved Project Budget Contingency (“owner’s contingency”) require Board approval

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in the manner prescribed by the County's financial and budgeting policies (Board Policy 4.14.2(B)(2)(a)).

Based upon the foregoing analysis, BAE believes that overall, the April 21, 2016 execution version MDA is fair and reasonable and contains a number of negotiated provisions to protect the County's interests while at the same time providing flexibility to the County to respond to changing needs, priorities, or circumstances.

Background

In 2013, the County selected the Developer through a competitive process to master plan and facilitate the construction of a new civic campus. The County currently occupies a 55-acre site centrally located between north and central San Jose in the Silicon Valley. The County evaluated the long-term costs associated with maintaining its buildings and determined that a new campus would permit the County to better integrate its services to meet the needs of the 21st century. Moreover, the existing buildings are arranged in a suburban style campus, and consolidating facilities would not only make for more efficient county facilities but also free-up valuable land for private development. Given the strong real estate market, proceeds generated from these excess parcels can be used to generate long-term income for the County.

In 2014, the County and Lowe entered into preliminary discussions and executed a Predevelopment Facilities Agreement ("PFA"), which laid out a series of Guiding Principles and authorized the County to exclusively negotiate a MDA with the Developer. The Guiding Principles and the Executive Summary of the MDA highlight the following goals:

- **Capacity:** formulate a modernization and consolidation plan for County facilities while working with an experienced developer;
- **Finance:** prepare a financially responsible plan that caps the County's cost exposure and create an ongoing revenue stream from surplus assets;
- **Flexibility:** create a flexible framework with discrete phases for long-term implementation, and allow the County to exit the deal if financing is not available or if the Board of Supervisors decides not to pursue additional work;
- **Competitive private sector participation:** provide other competitive opportunities for other private sector entities to have a role in construction; and
- **Jobs:** Promote economic growth and high value jobs.

Methodology

Determining Consistency with Best Practices

BAE interviewed public entities with experience working in private public partnerships (P3s), specifically agencies with a strong track record utilizing different P3 arrangements, including design-build contracts and design-build-finance-operate-maintain (DBFOM) models. While

some public entities, like a city, will negotiate a transaction for a single project like a city hall or police station, BAE broadened its search to identify agencies with strong P3 backgrounds. Interviews were conducted with the Virginia Office of Public-Private Partnerships and the University of California, Office of the President, Department of Real Estate Services and Strategies, both of which have entered into multiple agreements with private developers to construct and/or operate public buildings and infrastructure. BAE also reviewed the master development agreement for a similar project undertaken by the County of San Diego and drew upon its own experience in the recently approved civic center complex partnership in the City of Long Beach.

Review and Comments on Initial February 5th Draft MDA

BAE reviewed the draft Master Development Agreement dated February 5, 2016, and held a series of discussions with County staff to better understand the intent of the negotiated business terms. These terms were compared to the County's Guiding Principles and best practices on P3 arrangements. After its review of the February 5th draft MDA, BAE prepared a comprehensive set of comments and suggested areas where language in the draft MDA could be changed to clarify the intent of the parties and to strengthen protections for the County.

Review of April 21 Execution Version MDA

As this analysis was underway, the County negotiated a number of changes to the developer fee (Article VIII), change process (Article IX), savings (Section 15.22), and termination clauses (Article XII), which were incorporated into the final April 21 execution version MDA. In addition, the County incorporated into its final MDA a number of the changes suggested by our review of the February 5th Draft MDA. BAE reviewed these changes and updated its analysis accordingly.

It should be noted that BAE's review of the negotiated business terms does not constitute an opinion of legal sufficiency; our review was performed as a business review only based upon our experience as a real estate consultancy with a practice area in public-private partnerships. BAE understands that County counsel will perform a legal review independent of this analysis. This memorandum summarizes our review of the deal structure and negotiated terms as presented in the April 21, 2016 execution version MDA.

Summary of Deal Structure

Developer Role and Responsibilities

Under the MDA, the Developer serves as a master developer responsible for preparing the Master Plan, facilitating development, and managing construction. The County sought outside master planning and development expertise since it does not have the capacity nor expertise to facilitate the creation of a Master Plan, design documents, or manage phasing and construction of a large-scale Civic Center. The County will pay the Developer a fee for its expertise and services.

In the first stage, the Developer is responsible for developing a master plan in collaboration with the County. Development is expected to be phased because it is unlikely that the County will be able to finance the entire Civic Center at once. For each site, the Developer will facilitate the development process, commissioning design, and managing construction. The County would be responsible for arranging financing for its buildings. During construction, the Developer is responsible for completing the approved project within the approved Guaranteed Maximum Price (“GMP”). The developer essentially is a construction manager “at risk” since the developer would be responsible for any costs in excess of the County-approved GMP (see Section 9.05, “Limitation on Changes”). Upon completion, the Developer will hand over each building for the County to operate and maintain.

County Role and Responsibilities

The County will be actively involved in the master planning process (Phase A) and will take the lead on the CEQA environmental review (Phase B). During design (Phases C and D), while the Developer will take the Lead in managing Third Party consultants, the County will provide input, review, and approval of work products. The County will develop a Financing Plan and pay for all costs during predevelopment and construction in amounts approved by the Board of Supervisors. During construction (Phase E), the Developer is responsible for construction management, although the County will have discretionary approval rights regarding scope changes and change orders (see the section on *Cost Controls* below). Overall, the developer is responsible for completing the approved construction within the approved GMP.

Table 1: Developer and County Roles

	Description	Developer Role	County Role
Phase A	Master Plan	Developer will prepare the Civic Center Master Plan for the 55-acre site, including managing consultants, completing due diligence, and coordinating with the County and its subconsultants.	County will coordinate between the Developer and County's subconsultant, ABA, who will work with departments on programmatic needs. In addition, the County will pay predevelopment costs, review, and approve Developer work products.
Phase B	Entitlements (CEQA/EIR and Other Approvals)	Developer will have a limited role in Phase B and will mostly support and advise County staff during the CEQA/EIR process. The Developer is expected to prepare a preliminary budget estimate for development on the Richey site.	County will take the lead on the CEQA/EIR process, which includes managing CEQA consultants and taking action on the Final EIR and Master Plan. The County will also pay for predevelopment costs.
Phase C	Preliminary Design & Engineering	Developer will coordinate preliminary design and engineering, manage third-party consultants, and prepare an estimated budget for the Cost of Work.	County will determine the final scope of the initial phase, review and approve Developer work products, prepare a preliminary financing plan, and pay all predevelopment and third-party costs.
Phase D	Financing and Completion of Design Documents	Developer will coordinate the final design documents with third-party consultants, competitively solicit bids from general contractors, and prepare an updated budget which will provide the basis for the Guaranteed Maximum Price in Phase E	County will review and approval final construction drawings and the final budget, including the Guaranteed Maximum Price for Phase E, pay all predevelopment and third-party costs, and implement the County's Financing Plan.
Phase E	Construction	Developer will manage all aspects of construction, coordinate with contractors, and relocate County departments.	County will finance construction and pay all third-party costs, approve change orders, and provide input.

Phasing

The above table summarizes the tasks associated with each phase, and each party's responsibilities. It should be noted that the work under Phase A and Phase B is expected to be completed for the entire 55-acre site. The County then has the option of prioritizing design and construction for individual parcels. Each phase will consist of separate Phases C through E, which includes design through construction. The County (i.e. the Board) must approve the budget and scope of each Phase C, D, and E before issuing a notice to proceed for progressing onto the next phase.

Assessment of Key Business Terms

The following sections highlight key business terms set forth in the MDA. For each theme, there is a summary description of the major terms, an assessment of risks, and finding regarding the overall reasonableness of the MDA provisions.

Developer Fee Schedule

In exchange for its services, the Developer is eligible to earn a fee in each phase:¹

- Phase A – fixed fee of \$756,000
- Phase B – fixed fee of \$262,500
- Phases C and D – fixed fees for managing the design and development (“Development Management Fee”) as shown in Table 2, not to exceed two percent of the audited Direct and Offsite Costs
- Phase E – fixed fees for managing construction (“Construction Management Fee”) as shown in Table 3, not to exceed three percent of the Cost of Work, excluding the developer management fee and other Excluded Costs as defined in the MDA

¹ The fees are based on Exhibit L of the *Master Development Agreement*.

Table 2: Development Management Fee for Initial and Subsequent NCF Phases*

PROJECT	Total DMF over combined schedule of Phases C & D**	
1. Office Building Project, including associated TI's FF&E, on-site alterations, parking alterations, and off- sites	Option A 150,000 - 250,000 sf	\$ 1,680,000
	Option B 300,000 to 400,000s.f.	\$ 2,390,000
2. Alternate: Parking Structure	550,000 sf accommodating approximately 1,600 spaces	\$ 580,000
3. Alternate: Central Plant	1 Lump Sum	\$ 250,000
4. Alternate: Specialty Building Space (e.g. Board Chambers, amenity space -cafeteria, etc.)	15,000 - 25,000 sf	\$ 320,000

Notes:

* The Development Management Fee shall be escalated annually on January 1st beginning 1/1/2020 for any Subsequent NCF Predevelopment Phase C or D. The adjustment shall be based on the annual rate of increase for the preceding twelve months as published in the Engineering News Record's (ENR) Building Cost Index (BCI) for San Francisco, or other equivalent index if the ENR no longer is available.

** Reconciliation Provision: the Development Management Fee shall be reconciled and shall not exceed two percent of the audited final costs of Direct Costs and Offsite Costs for the relevant phase of New County Facilities.

Table 3: Construction Management Fee for Initial and Subsequent NCF Phases*

PROJECT	Construction Management Fee **	
1. Office Building Project, including associated TI's FF&E, on-site alterations, parking alterations, and off- sites	Option A 150,000 - 250,000 sf	\$ 2,900,000
	Option B 300,000 to 400,000s.f.	\$ 4,120,000
2. Alternate: Parking Structure	550,000 sf accommodating approximately 1,600 spaces	\$ 1,000,000
3. Alternate: Central Plant	1 Lump Sum	\$ 430,000
4. Alternate: Specialty Building Space (e.g. Board Chambers, amenity space -cafeteria, etc.)	15,000 - 25,000 sf	\$ 550,000

Notes:

* The Construction Management Fee shall be escalated annually on January 1st beginning 1/1/2020 for any Subsequent NCF Phase E. The adjustment shall be based on the annual rate of increase for the preceding twelve months as published in the Engineering News Record's (ENR) Building Cost Index (BCI) for San Francisco, or other equivalent index if the ENR no longer is available.

** Reconciliation Provision: the Construction Management Fee shall be reconciled and shall not exceed three percent of the audited final Cost of Work, excluding the Development Management Fee, for the relevant phase of New County Facilities.

During Phases A and B, the fixed fees are related to the Developer's actual staffing needed to facilitate the Master Plan in Phase A and to assist the County during the CEQA process in Phase B. Because these fees generally reflect direct staffing costs, they appear reasonable based on the services proposed. The fees for the Initial Phases A and B have already been negotiated and will be applicable if the County approves the MDA. In addition, the County has included a provision in the MDA such that if a Notice to Proceed for the Initial NCF Phase is issued for Phase C earlier than anticipated, then the County only owes the portion of the Phase B Developer Fee earned to date. This builds in an incentive for the County to complete the CEQA/EIR process in Phase B in a timely manner, and allows the County to achieve cost savings if Phase B is completed earlier than expected.

In Phases C, D, and E, the County has the option of choosing from a menu of different development options, based on available financing and types and building sizes (see Table 2 above). The fees were calculated by applying two percent and three percent, respectively, to relevant costs to estimate the Development Management Fee and Construction Management Fee. Based on BAE's experience reviewing transactions, incentive management fees typically range from two to six percent, with larger projects associated with lower fees. In this case, the Developer will be eligible to earn up to five percent on Direct and Off-site Costs, and two to three percent on Indirect Costs, which is within the range of the fees earned for this type of development.

In addition, County staff has negotiated a claw back provision for the Development Management Fee and Construction Management Fee, and the fees paid are capped at two percent and three percent, respectively. If this calculated cap is less than the fixed fee paid to the Developer, the Developer will refund the difference to the County upon construction completion. Overall, the provisions related to the Development Management Fee and Construction Management Fee appear to be fair and reasonable.

Cost Controls

The executive summary of the MDA states that one of the goals of the agreement is to cap the County's cost exposure. Based on best practices of other agencies, it is important to craft the agreement to build in protections and clearly assign responsibilities in the event of delays or unforeseen cost increases and provide a clear process for reviewing and approving any necessary changes. The MDA has several provisions designed to control costs and give the County a high degree of control during the planning, design, and construction of its facilities.

Negotiated Phase A and B Costs

For Phases A and B, the County has negotiated a maximum cost of the Developer's due diligence, master planning, and entitlement activities in the amounts of \$2,971,000 for Phase A and \$627,000 for Phase B. The MDA contains provisions that would reduce these costs to the extent Phases B and A overlap or Phases C and B overlap.

Phases C, D, & E Costs

Under the MDA, the costs of Phases C, D, and E generally will be determined at future date in the course of the master planning, due diligence, and entitlement work undertaken in Phases A and B. Phase C, D, and E costs will be subject to the approval of the Board of Supervisors.

Guaranteed Maximum Price

The principal mechanism to control costs during Phases D and E is the Guaranteed Maximum Price (“GMP”) concept and the change process set forth in the MDA in Section 4.04 and Article IX, respectively. A GMP is a key component to many agreements with public entities as a safeguard against construction cost overruns. In general, public entities have finite resources and are only able to dedicate a limited amount of funding to projects, so this mechanism encourages developers to properly conduct due diligence and accurately estimate reasonable costs.

One risk, however, that is associated with a GMP provision is that it often leads to developers and contractors overestimating costs in order to build in an extra cushion. This risk can be mitigated by the County by breaking the GMP into several pieces by both phase and major work component and by validating costs through the services of an independent cost estimator. In addition, the MDA requires that the developer obtain at least three competitive bids from contractors for construction work (see Section 5.01(B) of the MDA). BAE further understands that the County intends to undertake such an independent validation as part of its GMP approval process.

Cost Savings

The MDA includes a provisional Savings clause subject to a obtaining a favorable FPPC Opinion regarding inclusion of the Distribution of Savings clause. Such a provision would provide the Developer an incentive to control costs through a shared savings provision in Section 15.22. Under this term, if the actual, audited cost of construction is less than the GMP, the Developer would receive additional compensation in the amount of 35 percent of the savings subject to a cap of 35 percent of the Developer’s Construction Management Fee. It should be noted that any unexpended developer contingency is excluded from the distribution of savings.

Change Process

Under Article IX in the MDA, there are three well-defined categories of change process that may result in change orders as well as a process for filing and resolving any claims. Two would have an impact on the GMP, and one would not. A Change Order is defined in Section 9.02 of the MDA as a change in the scope of the work of Developer initiated either by the County or the Developer that would be the basis for an increase or decrease in the GMP. The MDA sets forth a process for review and approval of Change Orders by the County.

A second category of change orders is A Work Change Directive set forth in Section 9.03 of the MDA that permits the County at its sole discretion to initiate a change in the scope of work to be completed in a phase. This protects the County by allowing it to modify a project as circumstances warrant, subject to mutually acceptable price and terms negotiation. The third category change order is a Minor Change in Section 9.04 of the MDA that permits the Developer to propose a minor change in the design or some other aspect of the Developer's work but does not result in a change to the GMP. This provision is also subject to County review and approval.

Section 9.05 of the MDA limits the changes to GMP to those that have been approved by the County in its sole discretion or a County Work Directive as well as for changes that occur because of an unanticipated change in regulatory requirements, certain Hazardous Materials conditions, or a Force Majeure or Excused Delay. Sections 9.08 through 9.09 set forth a claims process in the event a dispute arises related to a requested Change Order or Directed Work Change. These provisions place a set of reasonable time limits on the Developer and County for the filing, review, and disposition of a claim.

In addition, before a change to the GMP can be proposed, funding for a proposed change would first come from unexpended amounts in the contractor's contingency, developer's contingency, or any savings as indicated in Section 9.02(A)(2).

Overall, the change process provisions collectively permit flexibility to both the County and the Developer in the performance of Developer's planning, design, and construction activities but at the same time these provisions give the County a high degree of control over the process with discretionary approval rights and set time limits and a disposition process for any claims that may arise.

Force Majeure and Excusable Delays

Section 7.02 the MDA provides for a change to the GMP that may arise from a Force Majeure event but only in an instance when the Force Majeure event causes a delay in the completion of the Developer's work or other milestone activity. In the event of such a Force Majeure event, the Developer would follow the process set forth in Article IX (Change Process). Since a Force Majeure delay is by nature unpredictable, the only way the County can limit its cost exposure is by narrowing what would be considered by the County for a change in GMP; Section 7.02 does this by setting forth the conditions under which the County would consider a change to GMP for a Force Majeure event.

The MDA also provides in Section 9.05 for an adjustment to the GMP for what are called Excusable Delays. In Section 1.02(HH) of the February 5, 2016 draft MDA, Excusable Delays were broadly defined to include "any act or omission" of the County, and per Section 7.02(E) in that earlier draft the Developer could seek an adjustment of the GMP for that delay. In Section 1.02(JJ) of the April 21, 2016 MDA, the Excusable Delay concept has been narrowed considerably to be as a result of a "grossly negligent or wrongful act or omission of County in

its proprietary capacity under this Agreement and which may have a direct impact on the performance of Developer's obligations hereunder....” In addition, this revised MDA excludes any action of the County arising from its regulatory capacity or its enforcement of the MDA. Overall, both the Force Majeure and Excusable Delay provisions of the MDA are fair and reasonable.

Environmental/Hazardous Materials Risks

To reduce risks associated with the costs of pre-existing unknown hazardous materials or third party claims of bodily injury or property damage related to hazardous materials, under Section 4.03(F)(8) of the MDA, the County will procure a pollution legal liability policy and name the Developer as a named insured and the Developer will procure at its cost contractor pollution legal liability policy to cover any releases of hazardous materials by the Developer and/or its contractors and name the County as a named insured. Because the County already has a Pollution Legal Liability (PLL) policy, it can simply add the Developer to its existing policy. While no agreement or insurance policy can ever fully mitigate the County's risk exposure, BAE understands that the County will set policy coverage, limits, deductibles and other terms in the final MDA in a manner to protect the County's interests. Overall, the MDA provides a framework for mitigating environmental and hazardous materials risk.

Project Quality Control

The Guiding Principles indicate that the County seeks a facility that will realize operational and consolidation cost savings and to achieve these savings the Developer must deliver a project that meets its design and performance specifications. The following is BAE's findings regarding several key provisions related to project delivery and quality.

Specifications

Public agencies interviewed by BAE strongly recommended providing a detailed list of specifications establishing minimum standards prior to the commencement of schematic design (i.e. beginning of Phase C). According to interviews, in a design build arrangement, the architect may be instructed to cut costs or specify cheaper systems in a turnkey project that the Owner would not otherwise specify.

The MDA mitigates against this risk by having the County and Developer agree to a Basis of Design, defined in Section 1.02(B) of the MDA. The County has already hired a qualified consultant to assist the County in internal space planning that identifies the County's service and operational requirements. Section 4.03(C) of the MDA sets forth the process in Phase A for the Developer to prepare a Basis of Design and cost estimates subject to County approval. These provisions additionally include submittal of cost estimates and value engineering proposals that satisfy the general design criteria set forth in the Basis of Design but offer options to save costs or time. Overall, these provisions provide the County with adequate controls since it has to approve the design and cost estimates. Any subsequent changes also must be approved by the County (see discussion of *Cost Controls* above).

Owner's Representative

Although the Developer is responsible for coordinating consultants to develop design documents and manage construction, there are key moments during the process where the County is required to review and approve. BAE understands that the County will hire a third-party owner's representative during the design process as a third-party to protect its interests. For example, after the Developer completes the schematic designs but before the construction set begins, the County is required to review and approve the design. The same review and approval occurs before a 90 percent construction document set is issued, and prior to competitive bidding by contractors. If the plans do not represent the County's wishes, or if there are technical gaps, the County has the expertise to respond with recommended changes. This also lowers the risk that the County will have to issue Work Directives to change the design late in the process, which can cause cost overruns, work delays, and changes in the GMP.

Warranty

Warranties protect the County from construction defects. BAE recommended negotiating extended warranties to encourage better construction methods. The rationale is that if a Developer or Contractor is held to a longer warranty period, there is a built-in incentive to deliver a building free of defects because the Developer or Contractor must absorb the costs of fixing errors. Moreover, strong warranty provisions that incent better construction methods can also reduce long-term operating costs.

Article 10 of the MDA stipulates that the Developer will provide a warranty for up to one year for materials, equipment or workmanship that was not designed, manufactured, or installed as required by the Project Documents. If a defect is identified and the problem is corrected, an additional one-year warranty will apply ("Warranty Fix It Period").

In addition to the baseline one-year warranty, County staff subsequently negotiated provisions in the April 21 execution version MDA that require the Developer to use reasonable good faith efforts to include a minimum one-year contractor warranty period in the Construction Contract and applicable Subcontracts, and extended warranties for the following systems:

- Two-year warranty for building systems (electrical, plumbing, heating, air conditioning, and other major systems);
- Six-year warranty for structural components (subject to limitations); and
- 20-year warranty for the roof

In addition, the MDA requires the General Contractor to assume for a period of three (3) years all responsibility for each warranty and guaranty that may be required concerning installation, operation or performance of equipment, materials, and systems as provided by a

distributor, manufacturer, Contractor or subcontractor for the full period of such warranty and/or guaranty (Section 10.02(E)).

These extended warranties represent a significant improvement over the original baseline one-year warranty period, and offers the County an added protection by ensuring performance of key systems, which is pertinent for office structures. In fact, the County's warranty period is stronger compared to terms observed in other projects, such as the San Diego County Civic Center. Overall, the MDA contains adequate provisions for the County to ensure that the Developer delivers the project as designed and specified, and includes added protections for key systems by requiring the Developer to negotiate extended warranties from the Contractor.

Overall, the MDA contains adequate provisions for the County to ensure that the Developer delivers the project as designed and specified. After completion, project would be covered by a one-year warranty, and certain project elements may be covered by extended warranties. After expiration of such warranties, the County could file a claim against the Developer as may be permitted by law.

Termination Payments

One of the County's Guiding Principles for the MDA is to create a flexible framework for proceeding with a new consolidated civic center. The County and Developer negotiated provisions in the MDA that give the County the right to terminate the MDA prior to completion of the project. BAE reviews these provisions in this section of the peer review.

Deferred and Delay Compensation Fee

Article 12 describes penalties the County is liable for in the event the County suspends, delays, or interrupts the performance of all or a portion of the Work. Based on discussions with County staff, the Developer asked for the inclusion of this section because it has to dedicate resources to the project, and if the County decides to terminate for any reason unrelated to the Developer's performance, the Developer will be paid a termination fee associated with the risk and opportunity costs associated with pursuing the County's project compared to what it would have gained by pursuing other projects.

In addition, the Board has requested the flexibility to be able to terminate the project at various junctures. Financing has not yet been secured, and the County does not know how much it can bond against, and whether there are sufficient assets to pledge for collateral. In addition, the decision to initiate design on the Richey site and subsequent phases is subject to approval by the Board. Their decision will hinge on factors such as funding availability and economic cycles, which are unpredictable. The Deferred and Delay Compensation Fee provide an option in the event the Board decides that the County should not proceed with subsequent phases. For these reasons, it is important to assess the reasonableness of the termination payments.

There are two instances in which termination penalties can apply: terminating without cause and for temporarily delaying the project without issuing a Notice to Proceed for Phase E. In the first case, the Deferred Compensation Fee is equivalent to four times the monthly development fee applicable at the time of termination. The table below shows an estimated schedule assuming a smaller office building, with penalties ranging from \$150,000 in Phase B to \$580,000 in Phase E. The MDA also limits the exposure at \$1 million, capping the penalty if the County pursues a larger scale development. These provisions for payments appear consistent with the project uncertainties, with higher costs applied during construction compared to predevelopment. This arrangement also reflects an improvement over the original negotiated terms because it prohibits the Developer from collecting across phases if a Notice to Proceed has been issued for concurrent phases.

Table 4: Deferred Compensation Fee Schedule

<u>Initial Phases</u>	<u>Developer Fee</u>	<u>Phase Period (Months) (a)</u>	<u>Monthly Developer Fee</u>	<u>Estimated Termination Payment (b)</u>
Phase A	\$ 756,000	12	\$ 63,000	\$ 252,000
Phase B	\$ 262,500	7	\$ 37,500	\$ 150,000
Phase C (c)	\$ 1,008,000	12	\$ 84,000	\$ 336,000
Phase D (c)	\$ 672,000	8	\$ 84,000	\$ 336,000
Phase E	\$ 2,900,000	20	\$ 145,000	\$ 580,000

Notes:

(a) The estimated time to complete Phases A and B is based on *Exhibit C, Initial NCF Phase Fee Development Phase Business Plan* prepared by Lowe. BAE estimated the length of time to complete Phases C, D, and E.

(b) The termination payment that applies is based on when termination occurs, and is not cumulative across phases. In no event shall the maximum deferred compensation fee exceed \$1 million.

(c) The Development Management Fee reflects the fee for a small office building, and will be paid in Phases D and E.

Sources: Draft Master Development Agreement by and between County of Santa Clara and Lowe Enterprises Real Estate Group; BAE, 2016.

A Delay Compensation Fee also applies if within 12 months after Lowe has completed the Initial Phase C, the County does not terminate the MDA but does not issue a Notice to Proceed for Phase D, which is possible if the County is unable to secure financing. The Delay Compensation Fee will also apply if the County fails to proceed with Phase E within four years following the approval of the Master Plan. A payment equivalent to four times the monthly Development Management is owed at that point. If the County subsequently moves forward with the project, the Delay Compensation Fee offsets the payment owed for Construction Management. If the County terminates the Agreement, the Delay Compensation Fee is credited against the Deferred Compensation Fee owed. Overall, the termination provision has been negotiated to recognize the needs of both parties: the need for the County to have

flexibility in determining the size and scope of its project and the need for the Developer to profitably invest its resources.

Minimum Developer County Buildings

In addition to granting the Developer the exclusive right to assist the County to plan, design, and construct buildings for a seven-year period, the MDA also guarantees a minimum contract floor of \$150 million. The Developer initially asked for a minimum contractual square footage, but County staff did not want to be held to this term, knowing that financing was uncertain. Instead, a minimum contract floor was established, which stipulates that the developer has contractual rights to the development of the first \$150 million in value of new County buildings. Under earlier versions of the MDA, the County would have paid a penalty proportional to the amount of its spending below this minimum floor. Under the April 21, 2016 MDA, these penalty provisions were deleted. Therefore, the County would have no payment obligation under such circumstance.

County staff has indicated to BAE that it is in the process of working with the Finance Department to determine how much funding might reasonably be available for the Richey site, given the proposed timeline. BAE believes that this provision is clearly stated and formula is straightforward.

Developer and/or Contractor Non-performance and Default

The MDA provides three common mechanisms to protect the County in the event of the Developer's non-performance and default: termination for default, progress payment retentions, and performance bonds. Section 12.03 sets forth the County's right to terminate the MDA in the event that the Developer or a Contractor becomes insolvent or fails to perform with no obligation to pay to the Developer a termination fee. The County can step into the Developers role to complete the project. The MDA also provides in Section 8.07(D)(2) for a 10 percent retainage from progress payments (200 percent for punch list items) that would be released once the County determines that the Developer's work has been satisfactorily completed. Finally The MDA requires the Developer in Section 13.03 to obtain performance and payment bonds and name the County as a dual obligee for all construction contracts in Phase E. While many agreements of this type include per-diem monetary penalties in the event that the developer or its contractors fail to perform, the three provisions in the MDA effectively provide a potentially significant monetary incentive for the Developer (and its Contractors) to perform its obligations under the MDA, particularly during the construction Phase E.