

PUBLIC ROUNDTABLE ON
“THE SOUTH CAPITOL STREET DEVELOPMENT
DISPOSITION APPROVAL RESOLUTION OF 2006”

Before the
Committee on Economic Development
Council of the District of Columbia

The Honorable Sharon Ambrose, Chairman

July 6, 2006, 10:00 a.m.
Room 412, John A. Wilson Building



Testimony of
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Good morning, Chairman Ambrose and members of the Committee on Economic Development. My name is Natwar M. Gandhi, Chief Financial Officer for the District of Columbia. I am here to testify on the South Capitol Street Development Disposition Approval Resolution of 2006.

Approval Resolution

The resolution transfers real property interests within the ballpark site from the District to WDC Baseball Partners, LLC, to construct a development that will include 925 spaces of stadium parking; team retail; 660 residential units, with some portion of those affordable; a 180-room hotel; 25,000 square feet of retail; and approximately 680 private parking spaces. This transfer will include obligations on the part of the developer to complete the stadium parking by opening day in 2008 and to pay market value for the development rights, subject to deductions for non-standard development costs that may be imposed by the District.

Recent Developments in the Stadium Project

Since we last met, I'm pleased to report that the sale of the ballpark bonds went quite well. We achieved triple-A ratings through the purchase of bond insurance, which was attainable only because the underlying ratings on the bonds were found to be of investment grade quality by all three rating agencies. We received more than \$535 million in bond proceeds for baseball spending. This money to build the new ballpark is in the bank, and it is earning interest. Further, the Sports Commission has broken ground for the new stadium. The shovels are in the ground, and the landscape of the area is changing.

As construction proceeds, costs of specific line items within the construction budget have and will continue to fluctuate, reflecting the actual experience of each stage of the stadium project. We will continue to track the budget and spending throughout the project. Table 1 shows ballpark obligations and expenditures as of July 5, 2006.

Table 1
Summary of Ballpark Obligations and Expenditures to Date *(in millions)*

Activity	A	B	C	D	E = B-D
	Budget Estimate	Revised Budget Estimate	Committed to-date	Spent to Date	Remaining Amount
RFK Renovation	24.0	24.0	23.3	23.3	0.7
Ballpark Hard Costs	320.0	320.0	203.4	2.0	318.0
Ballpark Soft Costs	175.2	169.3	111.7	45.7	123.6
<i>Project Contingency</i>	19.3	20.8	12.2	2.8	18.0
Land/Environmental/Relocation/Demolition	111.6	117.5	105.8	97.8	19.7
<i>Land Acquisition</i>	97.7	97.7	95.6	95.7	2.0
<i>Tenant Relocation</i>	4.0	4.0	1.4	0.9	3.1
<i>Demolition</i>	1.5	1.5	1.3	0.4	1.1
<i>Environmental Remediation</i>	8.5	14.4	7.4	0.8	13.6
TOTAL	\$630.8	\$630.8	\$444.2	\$168.8	\$462.0

Contingency

The increase in the contingency fund is a major change. It increased substantially as a consequence of upfront costs associated with the issuance of bonds that were \$16 million lower than expected. These contingency funds have been used to provide coverage for cost increases in other parts of the budget. We have, thereby, preserved all of the original contingency monies allocated in the budget.

Environmental Remediation

Another important change is the increase in environmental remediation costs to \$14.4 million. An initial increase to \$11.4 million was due to the discovery of 20 underground fuel tanks under the former asphalt plant. These tanks are quite old, and several of the tanks are leaking.

Since the end of May, additional inspections have uncovered more fuel tanks and asbestos in the building formerly owned by the Architect of the Capitol. Although the structure was built to be asbestos-free, refrigeration units were brought in and asbestos was found in the insulation. The removal of this additional oil and asbestos will cost approximately \$3 million, which increased environmental remediation costs further to approximately \$14.4 million. These higher costs will be paid from the project contingency fund.

This level of environmental cost was not projected either as part of the Phase I Environmental Study performed last year for my office or by a second study completed by the Office of Property Management (OPM) to determine the land value for purchase offers on the site. At the time the Phase I Environmental Study was conducted, the District did not yet control the site and, therefore, invasive environmental testing could not be done. The Phase I Environmental Site Assessment was performed in accordance with American Society of Testing and Materials (ASTM) standards. The analysis identified current and past uses of the property as well as “recognized environmental conditions” observed at the site. The study was conducted through a review of records, site reconnaissance, and interviews. The Phase I study estimated total environmental remediation costs to be \$8 million.

Subsequent to the Phase I study, OPM completed another environmental study in preparation for their purchase offers to owners of the parcels on the baseball site. The OPM study estimated environmental costs to be approximately \$6.3 million, about \$1.7 million less than the Phase I study. Again, neither study identified the additional costs that have subsequently been identified as part of the actual demolition and excavation.

Parking at the New Stadium

Today's discussion will focus on parking at the new stadium. While parking is a critical issue, it must be viewed within the context of building the overall baseball stadium project on time and on budget. We must assess carefully whether any parking proposal adds significant risks of delays and/or risks of not completing the project within the hard and soft caps that the Council set.

The costs of not completing the stadium on time must be considered. If the Sports Commission and the District use reasonable best efforts to complete the stadium by opening day 2008, and it is not completed until after the 2008 baseball season, the additional costs to the District include rent reductions at RFK, higher construction costs, lost stadium taxes, and additional costs of running RFK. The sum of these items could be as much as \$30 million if an entire season is lost, depending upon negotiation, arbitration, and the extent of actual damages.

If the team contends that this failure was the result of a lack of reasonable best efforts on the part of the District or the Sports Commission, the team may argue for compensation for its financial losses. Under such circumstances, if the team's argument were determined to be valid, our current estimates suggest that the District's hypothetical exposure could increase further by more than \$50 million.

If the delay in the use of the new stadium is for less than a full season, or if the stadium can be used but the full program is not finished, the District would not have met its obligations under the Baseball Stadium Agreement and could be liable for damages. The amount of the damages cannot be estimated at this time because they would be a matter of negotiation between the team and the District.

It is our understanding that if engineering designs are not underway by August 1, so that construction can begin by Labor Day, the WDC Baseball Partners' parking proposal will not be completed by March 1, 2008, as stated in the resolution.

Financial Analysis of the Proposal

WDC Baseball Partners plans a \$281 million private development project, to be funded with equity from WDC Baseball Partners and California Urban Investment Partners and private debt. Although California Urban Investment Partners has signaled its interest in the project, they have not yet provided a commitment letter. No lender has yet been selected. Our analysis suggests that the project, as we understand it, would cost 40-50 percent more than WDC Baseball Partners currently estimate.

In order for debt to be issued, a customary commercial loan of the size contemplated by this transaction will require title insurance. While the District currently has possession of the baseball site and is able to build, the District does not hold clear indefeasible title to the land.

In particular, issues relating to the District's power of eminent domain will not have been finally resolved (including time for appeals) prior to Labor Day. At least one major title insurance company has expressed a preliminary willingness to provide title insurance under these circumstances, on customary terms with the exception of requiring AWC to cover defense litigation costs. This carrier's point of view may not necessarily be reflective of the entire industry, and the size of the commercial debt contemplated may still require resolution of issues relating to title insurance.

In addition to resolving issues raised by the lender relating to title insurance, to be under construction by Labor Day, a number of legal steps must be taken. I will discuss these later in this testimony.

The WDC Baseball Partners proposal offers approximately \$61 million for the development rights on the north side of the stadium. Of the \$61 million, \$34.7 million will be used to create affordable housing on the site, and \$2.9 million will be spent on community benefits such as LSDBE mentoring programs. That will leave about \$23.5 million for parking. However, about \$41.4 million will be needed to build stadium parking, construct the team store and box office, and cover costs of coordination with Clark Construction, as they are building the adjacent stadium. This leaves a gap of \$17.9 million.

Funds from the Sports Commission stadium parking budget may be used to pay a portion of the parking costs – that amount has not yet been negotiated. For purposes of providing an estimate, we are assuming that at least \$14 million will be needed for the south parking and, therefore, at most \$7 million – the balance of the \$21 million budget – could be available to the developers. Additionally, \$2.1 million could also be available from the construction budget for a total of \$9.1 million. There would still be a budget shortfall of \$8.8 million. All of these figures are still subject to negotiation. The funding for this parking proposal, as we currently understand it, is shown in Table 2 below.

Table 2
Parking Proposal -- June 30, 2006 *(in millions)*

Development Rights Value	
Original Land Value	\$61.1
Affordable Housing Deduction (20%)	(34.7)
Community Benefits	(2.9)
Value After Deductions	\$23.5
Parking Garage	(31.6)
Team Retail	(5.3)
Clark Coordination	(4.5)
Total Parking and Team Retail Costs	(\$41.4)
Required District Payment to Developer for Parking	
Portion of Parking Budget (after cost of south parking)	7.0
Portion of Construction Budget	2.1
Total available for Developer	\$9.1
Financing Gap	(\$8.8)

Based on our analysis, the proposed funding sources for the private development and the stadium parking will not be sufficient to build 20 percent of the residential units as affordable, 925 parking spaces on the north side of the stadium, and 300 parking spaces on the south side of the stadium within the budget. Given the identified sources and uses of funds, the budget gap would be approximately \$8.8 million.

The exact square footage of development rights to be transferred may change. If the square footage is reduced for any reason, the results could vary: (1) the agreement with the developer may be terminated, (2) the number of parking spaces to be provided by the developer could decline, or (3) the amount of money paid by the developer could be reduced (thus increasing the budget gap).

A key issue is set-back requirements from the stadium. In particular, the Construction Administration Agreement states that any development on the baseball site must be set-back at least 50 feet from the stadium, but the developer's

proposal does not comply with that requirement. As a result, the square footage of development rights available could change if, for example, the development must be on a smaller footprint that complies with the set-back requirements.

Uses of Funds

There are various ways to manage a budget shortfall, including reducing the percentage of affordable housing, but these solutions have not yet been negotiated and will require some time to put in place.

Moreover, the cost cap legislation states that:

- Any revenue derived from development rights on the ballpark site may be used for any overruns on the land acquisition and remediation costs that are documented; and
- Any excess revenues derived from development rights that are not used for costs overruns for land acquisition and environmental remediation must be deposited into the Community Benefit Fund.

As currently proposed, no funds from the sale of development rights will be available to pay for land and environmental cost overruns or to be deposited in the Community Benefit Fund. Our understanding is that the Office of the Attorney General has determined that the resolution is legally sufficient and, accordingly, consistent with the cost cap legislation. I leave it to the Council to satisfy itself that the transaction contemplated by the resolution is consistent with the cost cap legislation. Again, the issue of time becomes very important, as these matters would need to be resolved in time for construction on the WDC Baseball Partners' proposal to start by Labor Day.

The WDC Baseball Partners proposal assumes the market value of the development rights purchased is \$61 million. We believe the \$61 million figure is reasonable based on current market conditions in the area. This number includes the reduction in value due to the allocation for the stadium parking.

Legal Issues with the Current Parking Proposal

I want to take a few minutes to emphasize in detail all of the legal actions that must be resolved in order for the proposal submitted by WDC Baseball Partners to move forward. As I mentioned before, I want to emphasize that in order for the District to have the best chance to avoid contractual penalties under the District's agreements with baseball, all of these steps must be completed by August 1, to begin design and engineering so that construction may begin by Labor Day.

Initially, the Council must not only approve this legislation, but also approve certain aspects of the definitive agreements with WDC Baseball Partners. In addition, there are a number of legal and/or contractual issues that will need to be resolved in order for this proposal to move forward, including:

Financing

Will WDC Baseball Partners be able to complete negotiations in time for construction to start by Labor Day, relating to private debt financing in the amounts contemplated, if issues arise relating to the lender being comfortable with the terms of any title insurance secured for the property?

Will WDC Baseball Partners be able to complete negotiations on the equity financing as contemplated in its proposal in time for construction to start on or before Labor Day?

Inconsistencies with the Construction Administration Agreement

The Construction Administration Agreement contains specific provisions relating to the design specifications for the development contemplated by WDC Baseball Partners' proposal, including with respect to:

- Distance from the baseball stadium,
- Distance between building structures located near the baseball stadium,
- A requirement for parking for buses near the baseball stadium, and
- Restrictions on street access for retail establishments located near the baseball stadium.

To the extent there are currently inconsistencies between the specifications outlined in the Construction Administration Agreement and the design plans for the project as currently proposed by the WDC Baseball Partners, the team, the District and WDC Baseball Partners will need to agree on how such inconsistencies will be reconciled. Further, under the Contract Administration Agreement, in addition to the above mentioned design concerns, the team has a more general consent right over the overall design of the project proposed by WDC Baseball Partners.

Indemnification

Will WDC Baseball Partners provide indemnification for any liability the District may have to the team if the parking is not completed on time for reasons outside the control of WDC Baseball Partners?

It is our understanding that KUD, the construction company that the developer would use, plans to indemnify WDC Baseball Partners for cost overruns or late delivery, but those will not include damages that the District would experience due

to delays. Further, the agreements to indemnify WDC Baseball Partners will not be executed until November 2006, according to KUD.

Coordination

Agreements are necessary to outline the coordination responsibilities between the two builders, the Sports Commission and WDC Baseball Partners. Once these two projects are underway, coordination between the Clark/Hunt/Smoot team building the stadium and KUD building the proposed parking/multi-use complex will be critical. There will be two developers working side by side in a very small space. Priority of work will have to be agreed upon and enforced.

In summary, and at the risk of being redundant, will the relevant parties be able to complete negotiations by Labor Day on a range of documents and legal actions involving at least the following 11 items:

1. Submission of any additional documents requested by the Zoning Commission to secure zoning approval;
2. Approval by the Council of the resolution that is the subject of today's discussion, including confirmation that the resolution is consistent with the cost cap legislation;
3. Obtaining from the team any necessary consents, approvals and amendments under the District's earlier agreements, including resolution of any design concerns of the team relating to this project;
4. Negotiation of an agreement between WDC Baseball Partners and the stadium construction manager with respect to coordination of construction priorities;
5. Negotiation (and approval by the Council, if required) of the definitive agreement between the District and WDC Baseball Partners;

6. Negotiation of an agreement relating to the north parking facility contemplated by the Exclusive Rights Agreement, including the scope of WDC Baseball Partners' indemnity obligations to the District;
7. Completion by WDC Baseball Partners of its equity financing to the satisfaction of the District;
8. Identification of a lender and completion of the debt financing portion of WDC Baseball Partners' proposal to the satisfaction of the District;
9. Identification of an appropriate WDC Baseball Partners' affiliate to act as a guarantor as contemplated by the Exclusive Rights Agreement, and the completion of negotiations relating to such guaranty;
10. Identification of a bank to issue the letter of credit contemplated by the Exclusive Rights Agreement and completion of the negotiations of such a letter of credit on terms satisfactory to the District; and
11. Completion of actions required to transfer property to WDC Baseball Partners.

Other Parking Options

As I have stated, it is critical to complete parking construction by opening day 2008. If the WDC Baseball Partners proposal is not accepted, we believe there are four alternative options that could be completed in time for opening day 2008. (See attached maps.)

Under Option A, the District can complete a 925-space above ground structured parking garage on the north side and a 300-space below grade garage on the south side, as originally planned. The total parking budget would be approximately \$33 million. This is an increase of \$12 million from the original budget. A portion of this is due to increased construction costs. In addition, the Zoning Commission

has indicated that if this proposal were approved, the parking on the south side would need to be covered with a park or plaza, and the exterior of the parking on the north side would have to “wrapped” with an aesthetic covering. The main idea is that the cars would not be visible from the street, and the streetscape is improved. These new aesthetic costs result in more than half of the increase.

Under Option B, the District can move forward with an interim surface parking solution. This option would include approximately 640 surface parking spaces on the ballpark site and 585 surface parking spaces across the street outside of the baseball stadium site. The offsite parking would be on the WASA site across 1st Street, and the District would need to lease space from WASA to accommodate these offsite spaces. This option does not conform to the Baseball Stadium Agreement, which states that all 1,225 spaces must be on the baseball stadium site. As a result, the team owners would have to approve this option. This option could be completed within the current \$21 million budget.

Under Option C, the District could build the proposed 300 below grade spaces on the south side and a 925-space reinforced above ground parking garage on the north side that could support future development with retail at the ground level and residential or commercial development above. The District could recoup a portion of the added costs of this option at a later time through the sale of development rights to a developer such as WDC Baseball Partners. The legal and timing issues associated with committing to a sale of development rights now could be addressed at a later date. This option would cost an estimated \$41 million.

Under Option D, to enhance the development potential of the reinforced structure parking, the District could build additional underground parking spaces that may

be necessary for future development, resulting in a total of 1,500-1,700 parking spaces on the north side (including the parking spaces for the future development). This option would cost approximately \$83 million. Given the existing \$21 million budget for parking and \$2 million for team retail, the District would need an additional \$60 million for this option.

Table 3

Alternative Parking Options

	Description	Cost (in millions)	Completion	Implications
A. Above Ground	300 spaces on the south side 925 spaces on the north side in above ground garage	\$33	12-15 months	None, if Zoning Commission approves
B. Interim Surface Parking	300 spaces on the south side 340 spaces on the north side 585 spaces off site	\$21	less than 12 months	Need Team Approval and Access to WASA site
C. Reinforced Above Ground Parking	300 spaces on the south side 925 on the the north side in above ground garage	\$41	13-16 months	None, if Zoning Commission approves
D. Support Future Development	300 spaces on the south side 1500-1700 spaces on the north side (925 for Stadium)	\$83	18 months	Additional cost to be offset by sale of future development rights

The Gates Group has recently submitted a proposal to finance parking. In its current form, this proposal would require a Sports Commission or District government guarantee of the debt service payments, and the District would be charged an interest rate of 10 percent – which is approximately double what we currently pay for our general obligation borrowing. It may be possible to negotiate with the Gates Group to remove these two impediments. As the proposal currently stands, however, we could not recommend it as a means to finance stadium parking.

Finally, as you know, the Zoning Commission is meeting this evening to consider both the WDC Baseball Partners proposal and the above ground parking proposal. Whatever is decided tonight will certainly impact all that we are discussing here today.

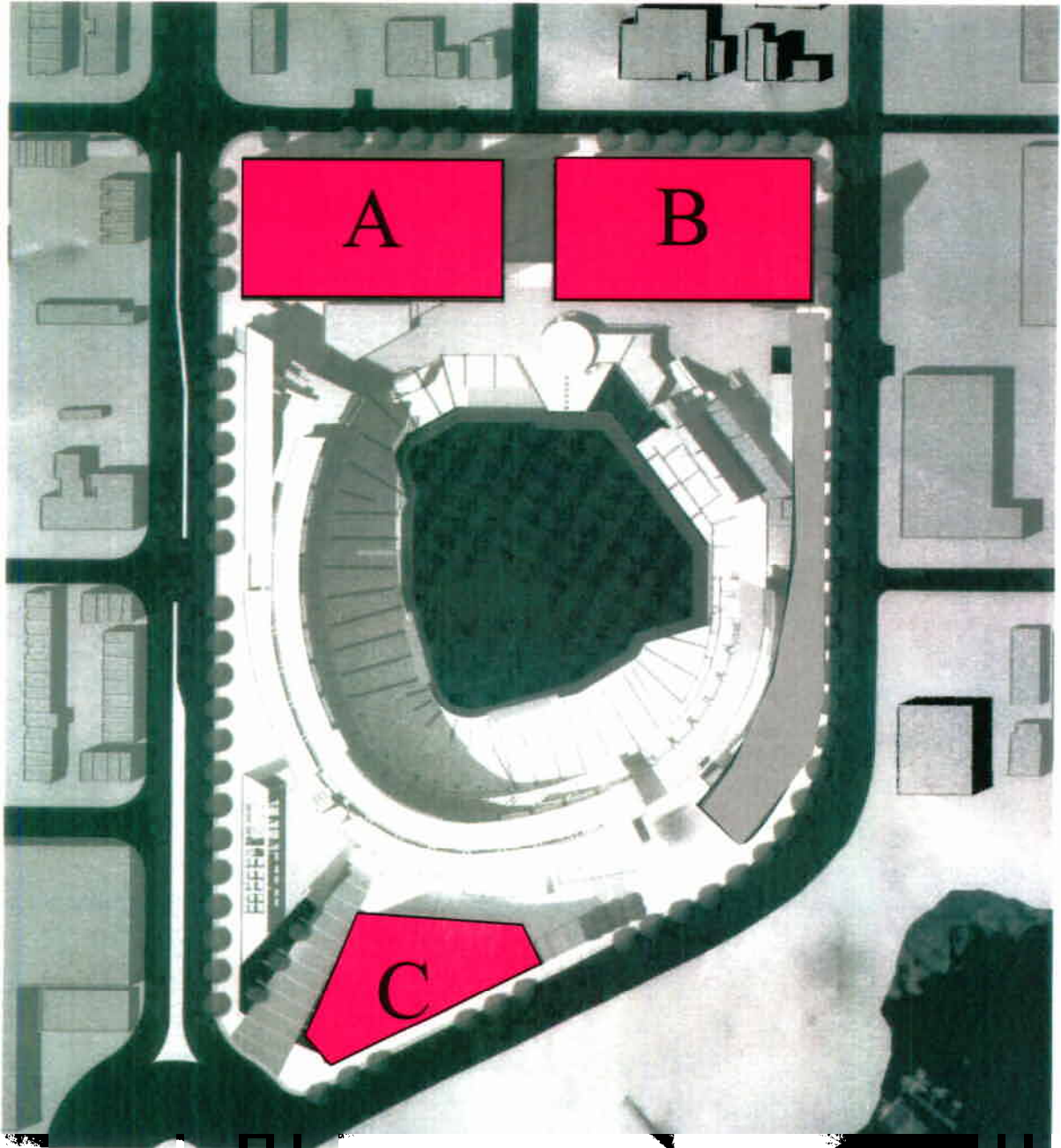
Conclusion

If the necessary agreements are negotiated (including financing for the full project cost) and Council actions are passed in a timely manner, the WDC Baseball Partners project could be completed for the 2008 season. However, as I have noted in my testimony today, in addition to the customary give and take of negotiations in any set of commercial arrangements of the type contemplated by the WDC Baseball Partners' proposal, there are a number of threshold issues relating to getting a lender comfortable with the state of title for the stadium site and obtaining necessary consents from the team on design that could significantly delay the start of construction. Accordingly, we believe the proposal substantially increases the risk that the stadium will not be completed on time and on budget. We also find that there may be other, less risky ways to provide the parking required in the Baseball Stadium Agreement, as described in the four options presented above. The cost of delays is substantial.

The District is committed to build a new 42,000 seat baseball stadium on time and on budget. It has made that commitment to the new owners of the baseball team, the financial markets and the purchasers of our bonds, and to the residents of our city. A great deal is at stake. Concrete actions must be taken. We stand ready to help in any way that we can.

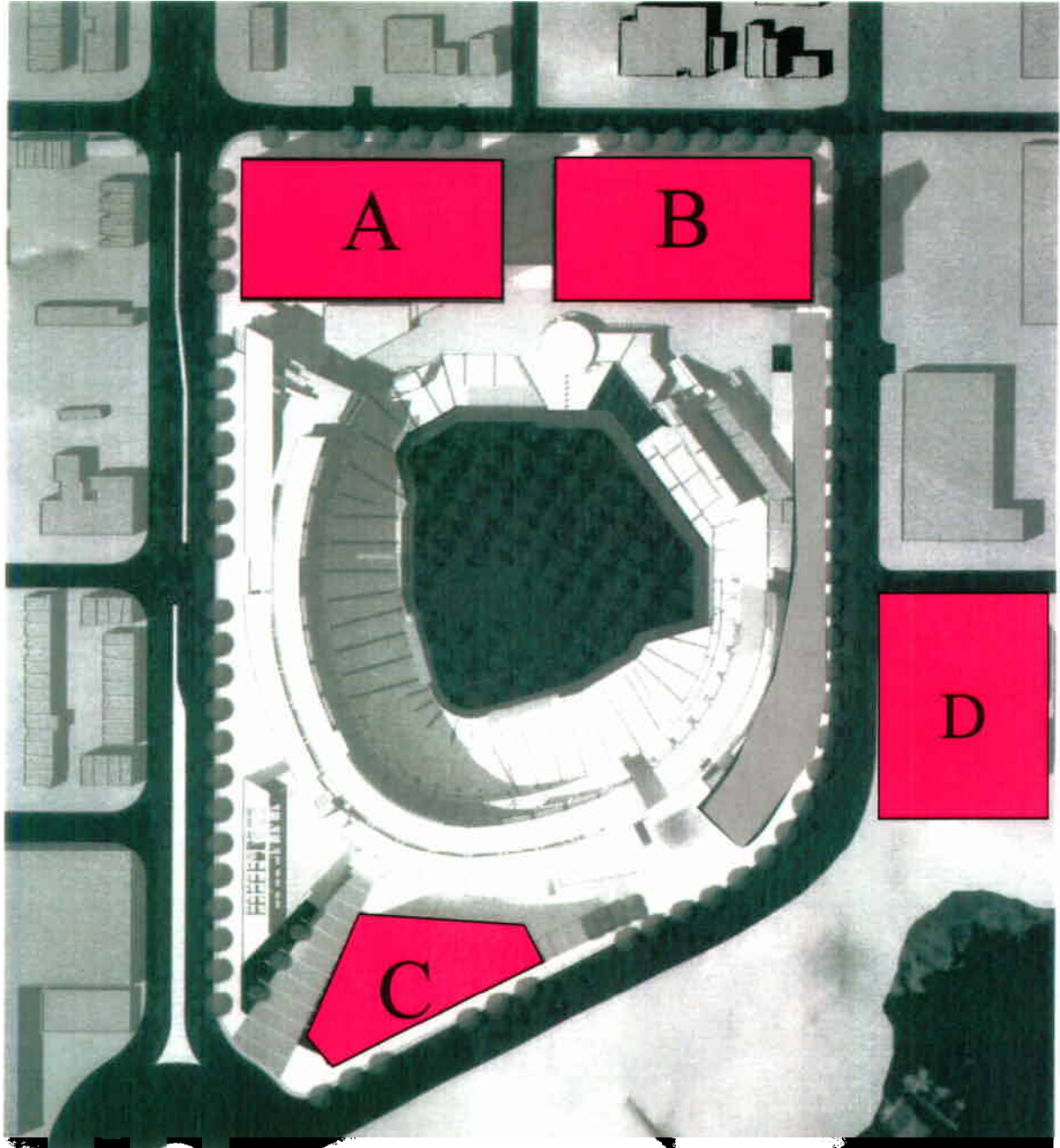
Thank you for the opportunity to testify. This concludes my testimony, and I am happy to answer any questions you have at this time.

Option A: Above Ground



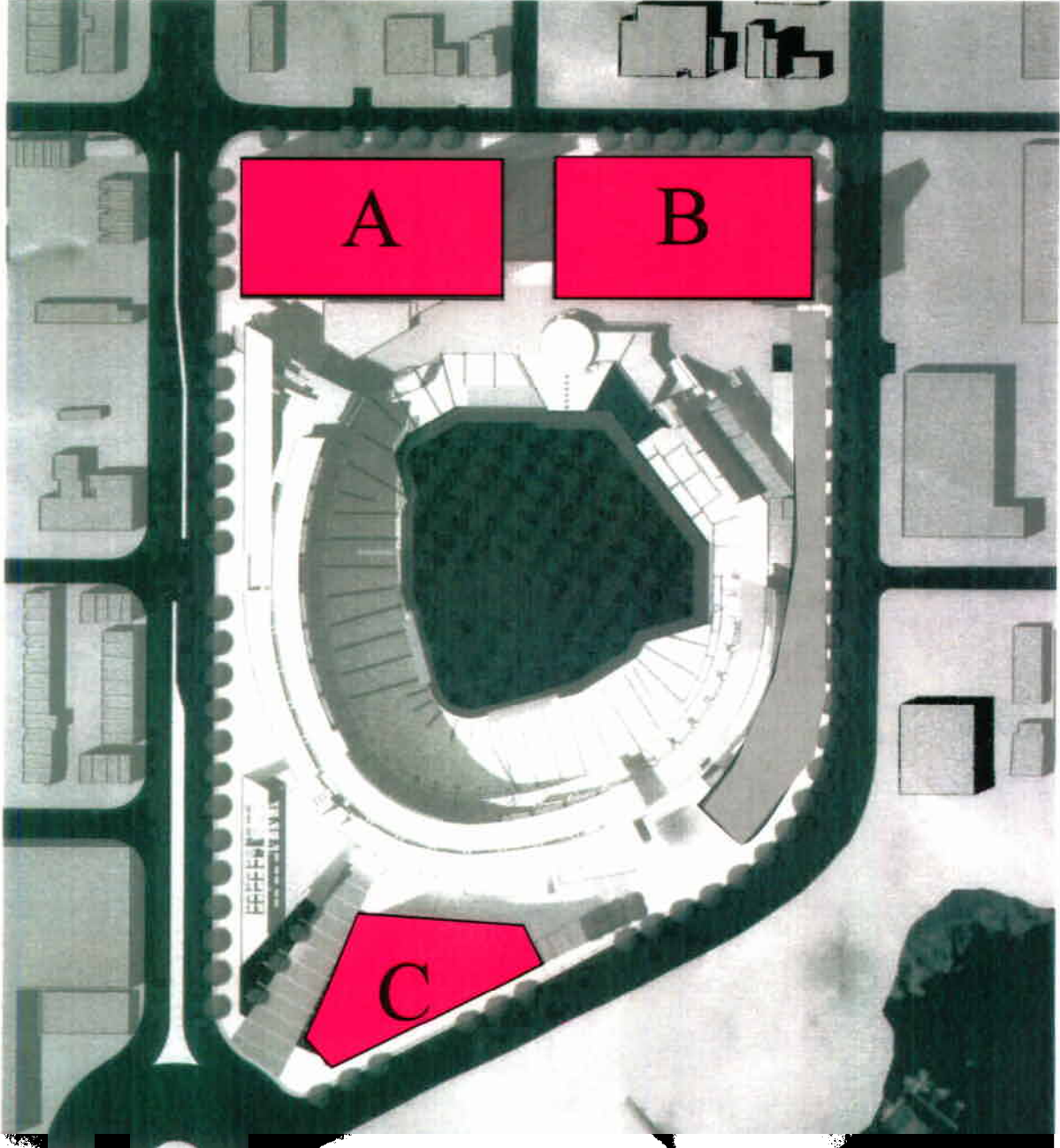
Description		Cost (Millions)	Completion	Implications
Parcels A & B	925 spaces in above ground garages	\$33	12-15 months	None, if Zoning Commission approves
Parcel C	300 spaces			

Option B: Interim Surface Parking



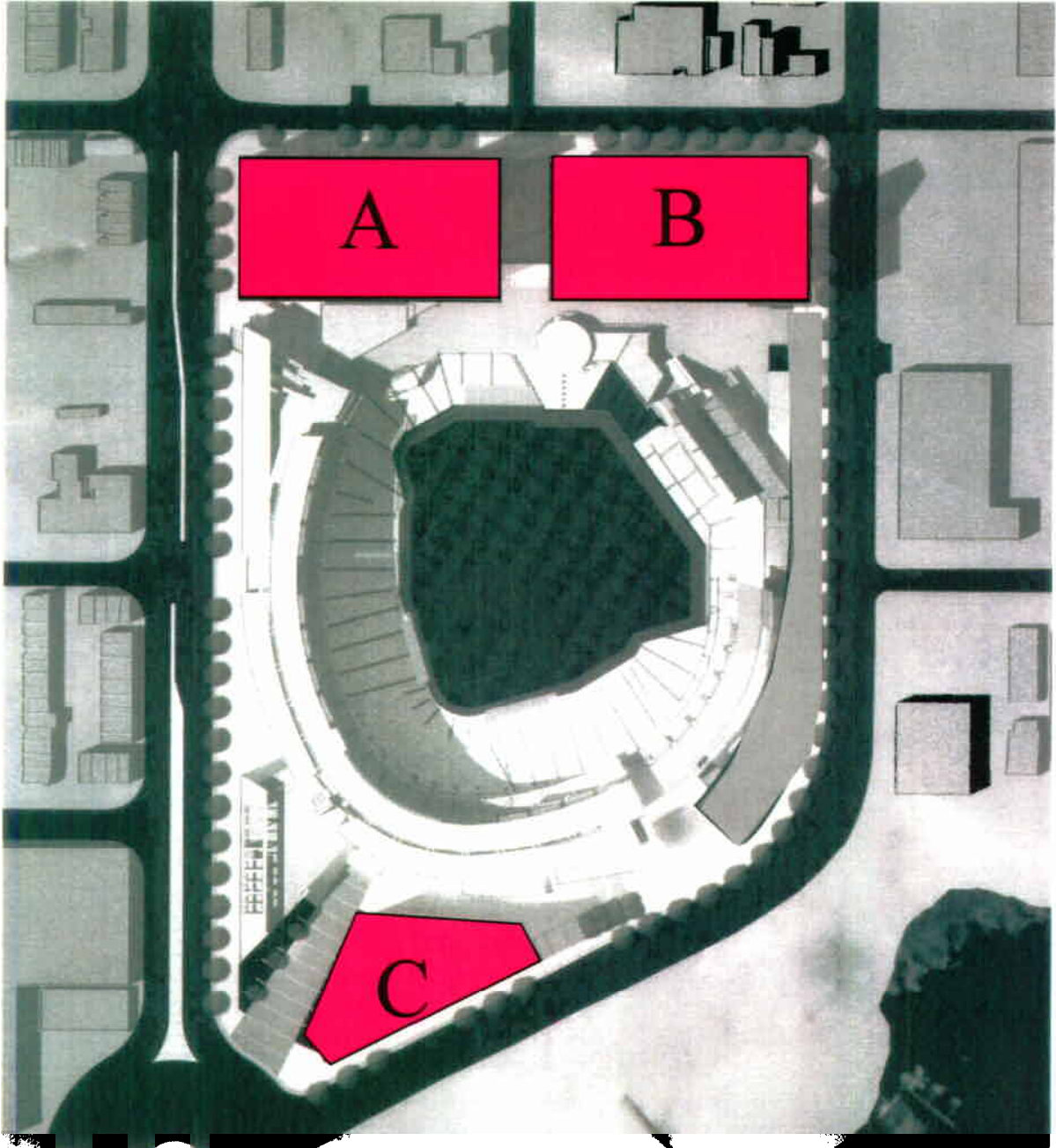
Description		Cost (Millions)	Completion	Implications
Parcels A & B	340 spaces	\$21	Less than 12 months	Need Team approval and access to WASA site
Parcel C	300 spaces			
Parcel D	585 spaces on WASA site			

Option C: Reinforced Above Ground Parking



Description		Cost (Millions)	Completion	Implications
Parcels A & B	925 spaces in above ground garages	\$41	13-16 months	None, if Zoning Commission approves
Parcel C	300 spaces			

Option D: Support Future Development



Description		Cost (Millions)	Completion	Implications
Parcels A & B	1500-1700 spaces (925 for Stadium)	\$83	18 months	Additional cost to be offset by sale of future development rights
Parcel C	300 spaces			