11/30/09 Draft

Overview of Financing the Potomac Yard Metrorail Station:

This Implementation Plan is provided for discussion and planning purposes in connection with anticipated proffers for the proposed rezoning of Landbay F at Potomac Yard, and in connection with anticipated development activities for other landbays at Potomac Yard where developer contributions to construct a Metrorail station have long been contemplated. The proposed rezoning of Landbay F increases the development on that landbay from 600,000 square feet of "big box" retail to 6,395,000 square feet of residential or office, an additional 245,000 square feet of retail, and 170,000 square feet of hotel. Indisputably, according to traffic studies already provided, the transportation network in this area of the City of Alexandria will not support this development, and thus the rezoning cannot be approved, in the absence of the construction of a new Metrorail station.

In contemplating this and developing this implementation plan, the following fundamental principles should guide the City of Alexandria, its political decision makers, and staff:

- The City is supportive of the type of long-term, quality mixed-use development contemplated at Potomac Yards, and plans to provide the bond financing of the Metro Station, but the financial risk to the City must be carefully structured and managed.
- The City plans to enact a special tax district that will help pay for a portion of the cost of the Metrorail Station, and to issue general obligation bonds for such construction, most likely backed by the full faith and credit of the City of Alexandria.
- However, the "gap" between the anticipated tax revenues from the special tax district, plus additional incremental net revenues generated by the project, will need to be "bridged" in the early years of the bond financing by developer contributions from the owners of Landbays F, G, H, I, J and K, so that if the projections are met, there will be no negative cash impact on the City's General Fund.
- Any financing plan proposed pursuant to this plan must receive approval from the New York bond rating agencies so as not impairing the City's AAA/Aaa credit ratings, and be able to be underwritten as a high quality bond issuance.
- The final financing plan when approved by City must be based on final plans approved by the Washington Metropolitan Area Transit Authority and the City, and a guaranteed maximum or other fixed price construction contract for construction approved by Metro must be in place for the station to be constructed and must be structured to minimize the possibility of cost overruns.
- Even with a combination of special tax district, proffered contributions, other contributions, and increased taxes, it is possible that if projections are not met, the City will have to pay any shortfalls, and this risk and the impact on the City's

ability to do other projects must be factored in to all proffer negotiations to result in a conservative, sound financing structure with shared risk.

DISCUSSION

A plan of finance and agreement with the owner of North Potomac Yard (Landbay F) in regard to funding the $240 million (assumes the midpoint of a $210 million to $270 million construction range which is the B2 option with a 2015 construction midpoint) Metrorail station to serve Potomac Yard and adjacent neighborhoods is a necessary precedent to any rezoning of Landbay F. Since the additional 8.3 million square feet of additional density of all types contemplated for Landbay F can only occur if the necessary transportation infrastructure (including a new Metrorail station) is provided, it must be certain that the Station can be financed, constructed and put into operation.

Financing a $240 million project is an exceedingly difficult challenge given the enormity of this cost. In perspective, $240 million is about two and one-half times the cost of the new T.C.Williams High School recently constructed in the City. Proof of the difficulty of this is that there has been only one Metrorail station (New York Avenue) constructed and added to the existing entire 103-mile Metrorail system that serves the Washington, D.C. area since the system was constructed starting in the 1970’s. This is in large part due to the cost of such station additions, as well as the lack of significant federal and state funding opportunities for adding stations to existing subway systems. Also since individual stations largely benefit individual localities, the Washington Metropolitan Transit Authority (WMATA) does not spend its limited capital dollars on adding Metrorail stations to its system. In Virginia, where State transportation capital funding assistance to localities has collapsed, as the State’s transportation tax revenues have fallen sharply, there are also is no current significant new funding for mass transit capital projects such as a new Metrorail station. The absence of state and federal funding opportunities, leads to the conclusion that any Metrorail station to serve Potomac Yard must be planned to be locally funded and financed.

Modeling of Financial Feasibility:

In order to determine the financial feasibility of funding a Metrorail station, the City retained the transportation consulting firm of PB Consulting to undertake calculation of tax revenues potentially generated by the development of Potomac Yard, as well as modeling how City-issued general obligation bonds could raise the funds necessary to fund the construction of the station. These bonds would be serviced and repaid by a combination of developer contributions, net new taxes, as well as special tax district revenues.

The PB modeling made the following key revenue assumptions:

1. Tax rates assumed at 2009 levels and policies,
2. Special Tax District at 20-cents per $100 of valuation,

3. As contemplated by the original Potomac Yard CDD approval, all of Potomac Yard (except the most southern Landbay L) including Potomac, Greens and Old Town Greens would be included in the Special Tax District and all net new tax revenues from those landbays (including already zoned Landbays G and H) counted as available revenues,
4. No current tax revenues generated by any Potomac Yard landbays would be counted as available for a Metrorail Station financing,
5. Real Estate unit values (i.e., per unit or per square foot values) at 2009 values,
6. 10% value increase assumed for properties within ¼ mile of the Metrorail station entrance, with two entrances to the Metro Station provided,
7. 6.5% (hotel) to 59.8% (residential) of new tax revenues (not including the $.20 per $100 special tax district revenues) would be assumed to be used to finance City and School services and capital costs to serve Potomac Yard and thus would not be available to assist in the Metrorail station financing.
8. 25-year straight-line build out of planned development starting in 2017, and
9. No federal or state aid.

At the City's direction, PB consulting used the following key bond financing assumptions:

1. 30-year amortization of the bonds, commencing in 2014;
2. Use of AAA/Aaa rated general obligation bonds issued by the City,
3. Capitalized construction period interest, during the first three years;
4. A $275 million bond issuance ($240 million for construction, $30 million for capitalized interest during construction, and $5 million in related bond issuance costs);
5. Interest only repayment in years four, five and six; and
6. Gradual build-up of principal repayment in years seven through seventeen, and then level principal and interest through year thirty.

The results of the PB analysis shows that while there are sufficient net new tax revenues after 2024 to cover the debt service obligation of the Metrorail station bond financing, there is an up front gap of more than $32 million from 2014 to 2024 (years 1 to eleven). This is because the net new tax revenues generated from development are projected not to grow sufficiently in the first eleven years after the bonds are issued (in part because the buildout of this order of magnitude of new development will be phased over the long term because of the limitations of market absorption). These projections are subject to many variables (actual station construction costs, land valuations, buildout timetable, interest costs, etc) and would need to be rerun and any financing plan adjusted accordingly to the realities of the time in which the decisions of going forward or not going forward with a Metrorail station would need to be made. For this reason, the final underwriting and construction contracting decisions must be based on final approved plans, a not to exceed construction contract price acceptable to the City and its advisors, s well as a sound and predictable financing plan.

Developer Contributions:

In order to finance a portion of the Metrorail station ($____ in total debt service over the 30-year period including $275 million in bonds and $_____ in interest), it will be necessary for the developers to proffer to pay for a significant portion of the Metro Station development that will benefit them by increasing the value of their property as well as accelerating when the market will facilitate the development of the property. Without such proffers, including a written agreement about such proffers and other related matters executed with the City by each of the three sets of owners (PYD, RREEF's institutional client, and MRP) their successors, no Metrorail Station can or will be built at Potomac Yard. In addition, the proposed density increase in North Potomac Yard/Landbay F of some 8.3 million square feet would not be able to be constructed, as the Metrorail station is precedent for any new development density in Landbay F as it is the only way that such density can receive adequate transportation capacity to function.

Any developer agreements with the City need to recognize the different land use status of the various Landbays at Potomac Yard. For already developed property (Potomac Greens, Old Town Greens, Slaters Lane retail and the Station at Potomac Yard) there would be no developer proffer expected as development has already taken place. Those properties would be subject, however, to (as was originally contemplated in the original Potomac Yard CDD approved by the City in 1999) the special tax district levy (20-cents per $100 of valuation is currently contemplated).

For the properties within a quarter of a mile of the entrance to the proposed Metrorail station and where the allowed density is already in place (Landbays G and H) but there has not been development, there would be a proposed $10 per square foot contribution (to be adjusted annually for inflation and paid at the time of each building's issuance of a certificate of occupancy) to assist paying for a Metrorail station. There 2.2 million square feet of development within a quarter mile of the Metrorail station in Landbays G and H. This $10 per square foot would raise about $22 million (in 2009 dollars) which is about the cost of adding the second southern entrance to the proposed Metrorail station.

This $10 per square foot contribution can be justified as reasonable in that research has shown that the value of buildings within ¼ mile of a Metrorail station increase in value (i.e., in rents achieved) in comparison with similar properties not that close to a Metrorail station. If a property increases by 10% in long term value or about $40 per square foot, due to the presence of a Metrorail station within a quarter mile, it would be reasonable for the developers to pay $10 of that towards the costs of the Metrorail station. As of the time of the issuance of this draft Plan (11/30/09), the owners of Landbays G and H have not agreed to the concept or specific structure of such a contribution.

For the owner of Landbay F, where any upzoning does not currently exist, and would only be approved as Metrorail station dependent, the proffer should be significantly more than $10 per square foot, as the contemplated possible increase in approved overall density is upwards of 8.3 million square feet. As indicated earlier in this Implementation section of this North Potomac Yard Plan, the potential public increment of value through a rezoning alone (i.e, not including any long term value added from actual construction of higher density improvements) may be as much as $100 million to over $200 million. Given today's unsettled commercial real estate markets, the determination of the value of a rezoning is challenging. A large portion of this public creation of private value should be allocated and proffered towards the new Metrorail station upon which any rezoning would be dependent.

The timing of a proffer payment would need to be negotiated and structured to fit the financing needs of the Metrorail station, and would have to be able to be financed by the developer in the commercial lending marketplace. Some of these funds should be paid upfront and be sufficient to cover the estimated current minimum $32 million gap between projected revenues and projected debt service costs, and some of the funds paid at the time of the development. While paying upfront for infrastructure puts a burden on the development project to be financed, it is a common real estate development practice. For example, PYD paid for $40 million upfront in anticipation of future development to construct the new Monroe Avenue Bridge, as well as tens of millions for other infrastructure which will serve their future project.

It would not be unreasonable for the developer of North Potomac Yard/Landbay F to also proffer a significant upfront contribution for the transportation infrastructure – in this case a portion of the costs of the Metrorail station. As of the time of the issuance of this draft Plan (11/30/09), the owners of North Potomac Yard/Landbay F have not agreed to an upfront proffer in an amount that would be sufficient to close the $32 million funding gap, nor have they agreed to a significantly larger rezoning related proffer than the $10 per square foot. Negotiations with the City are active and ongoing.

In addition to the cash proffers, there will have to be negotiations of the allocation of risk, and contingency plans and protections structured to cover circumstances that could arise prior to, during and after the Metrorail Station is constructed. Without such an executed agreement between the City and the owner of North Potomac Yard/Landbay F, on funding and related conditions, no new density authorization can be legally assumed to have been granted by the City through the development and approval of this North Potomac Yard Plan, and therefore no new development could be initiated in Landbay F without a formal executed agreement and an actual rezoning (which is a distinct and separate action from an adoption of a North Potomac Yard Plan.

City Risks and Debt Policy Implications:

While the financial model's projections and potential future agreements with developers in regard to their contributions could result in a plan of finance for the Metrorail station that is self-financing from developer contributions and net new tax revenues generated by that development, such projections are just projections and reality may be very different. Also City issuance of $275 million in bonds would represent a major, significant change in City debt policies and practices.

First, in regard to the model's projections and eventual reality, it is very difficult to predict real estate development. While real estate development is cyclical in nature, predicting the cycles is difficult. While many real estate pro forma projections proved out correct, many real estate pro forma projections have been materially incorrect. The current commercial real estate market place contains many examples of highly inaccurate projections and failed real estate ventures (such as development related local government issued "dirt bonds" that are now in default). While the use of a general obligation financing would avoid a default situation, there is the real possibility that once the station was constructed that it would take far more time than the model projects for net new tax revenues to cover bond debt service obligations. This means that there is a risk that a deficit would occur and need to have a funding source. While some of this down side risk to the City and its General Fund may be able to be shared with the developer of Landbay F, in the end of the day it will be the City that is standing behind any bonds issued and would be the City's responsibility as the final backstop and ultimate obligator to pay debt service as it becomes due. Failure to repay the bonds is not a realistic, pragmatic option as it would result in a downgrading of the City's top AAA/Aaa bond ratings and the raising of future borrowing costs (if not an actual inability to access the bond markets to raise capital for City needs some time period).

A second set of major issues for the City are the debt policy implications of the City issuing $275 million in new bonds to finance this new Metrorail station. For several decades the City has had in place very conservative debt policy guidelines with specific numerical targets and limits. This has resulted in the City's debt being considered low in comparison with other jurisdictions by the New York bond rating agencies. If the City issued $275 million in additional bonds it would increase the City's debt burdens in year 2015 and beyond by about 64% (from a projected $433 million in 2015 to $708 million). This would raise the City's primary measure of debt capacity (debt as a percent of property value) from a projected 1.18% in 2015 to 1.93%. In comparison with other AAA/Aaa rated localities in Virginia and Maryland this would shift the City's debt burdens from being on the low end when compared to those localities to the high end when compared to these peer localities.

While this represents a significant, material increase, according to the City's independent financial advisors, it would not in and of itself jeopardize the City's top AAA/Aaa bond ratings. In particular, the rating agencies recognize that the investment in heavy or light rail transit systems is an investment with multi-generational benefit if coupled with new transit-oriented development. This view and bond rating agency acceptance is highly likely to hold in the future, but cannot be guaranteed to not change in the future.

The issuance of $275 million in new debt will have the implication of potentially limiting future major public projects that the City may want to consider funding. For example, if federal, state or other funds are not substantially available to upgrade the planned Potomac Yard high capacity transit from a Bus Rapid Transit (BRT) to a street car system, then that upgrade may have to be delayed until such time as a large portion of the Metrorail station bonds have been repaid.