

**REPORT TO THE OVERSIGHT BOARD OF THE MERCED DESIGNATED LOCAL
AUTHORITY,
AS SUCCESSOR AGENCY TO THE REDEVELOPMENT AGENCY
OF THE CITY OF MERCED**

TO: OVERSIGHT BOARD MEMBERS

FROM: JOHN MCCLENDON, SUCCESSOR AGENCY COUNSEL

DATE: AUGUST 1, 2013

**SUBJECT: EXTENSION OF COSTCO PARKING LOT LEASE – CORNER OF “R”
AND WEST 15TH STREETS**

BACKGROUND

The Merced Designated Local Authority, as Successor Agency to the Redevelopment Agency of the City of Merced (“DLA”), was established by statute to take actions to wind down the affairs of the former Merced Redevelopment Agency in accordance with the California Health and Safety Code.

In 1992, the former Redevelopment Agency of the City of Merced (“RDA”) entered into a Disposition and Development Agreement with Costco Wholesale Corporation (as amended, the “DDA”) pursuant to which the RDA sold certain real property to Costco and Costco agreed to develop a Costco retail store and make other improvements to the site and surrounding areas. A portion of the site was determined to be contaminated, and, in 1993, the Agency and Costco entered into that certain Lease Agreement With Option to Purchase (the “Lease”), pursuant to which the parking lot was leased to Costco instead of sold to Costco as originally contemplated by the DDA.

In 2003, the Lease was extended for ten years. The DLA and Costco previously entered into that certain First Amendment to Lease Agreement with Option to Purchase dated May 24, 2013 (“May Amendment”), which was not approved by the California Department of Finance (“DOF”) in accordance with Assembly Bill 1x 26, as amended by AB 1484. The proposed Amendment shall supersede and replace the May Amendment.

DOF stated in its letter of July 15, 2013 (attached) that the DLA did not establish the need for a 24 month lease. Counsel believes that a 24 month lease is needed because (i) the option period for Costco’s purchase of the property is 365 days, and since the option could not be exercised in July 2013, exercise of the option would necessarily extend the lease beyond 12 months, (ii) exercise of the option is predicated upon completion of remediation of the property, and though the remediation may be complete in less than 12 months, once the option is exercised the combined time frame would exceed 12 months, and (iii) because the DLA has been unable to find an accountant to

perform its due diligence reviews (“DDR’s”), the DDRs have not been started, and the DDRs are a prerequisite to the issuance of a finding of completion. The property cannot be disposed of except in connection with approval of a long range property management plan (“LRPMP”), which is due 6 months after a finding of completion is issued. Given preparation, review and approval time frames, though the DLA anticipates that the LRPMP would be complete in 12 months, it appears unlikely that disposal of the property in accordance with any LRPMP would occur in less than 12 month.

Nonetheless, counsel recommends entering into a lease extension for 12 months as requested by DOF. A copy of the proposed Lease Extension is attached as Exhibit A to Resolution M-2013-05A. The Lease Extension will expire in July of 2014 with a year to year renewal and contains with no other material changes to the terms and conditions of the existing Lease.

DISCUSSION

The purpose of this Staff Report is to obtain authorization to finalize and enter into the Costco Lease Extension.

Material Terms of the Existing Lease

The following is a brief summary of the material terms of the Existing Lease. The summary is not intended to be all-inclusive, and the Lease and Extension should be consulted prior to taking any action on the Lease Extension.

Property: A portion of the Costco parking lot located between the Costco store and R Street. The portion of the parking lot closest to the store (including the Costco gas station) is already owned by Costco.

Lease Payments: Lease payments are currently \$5,091.67 per month. Upon the initial extension of the Lease in 2003, lease payments were adjusted to fair market rent. Section 7 contains a number of provisions applicable to the determination of fair market rent.

Term: The Lease expired on July 12, 2013.

Remediation: Section 11 of the Lease states that the RDA will perform all remediation at no cost to Costco.

Option to Purchase: Costco is granted an option to purchase the parking lot property during the term of the lease in Section 13. The option is exercisable after written notification by the RDA to Costco that all remediation of the property is complete and requires completion of a Phase II environmental report to demonstrate such completion. Section 13 also sets forth a methodology for calculation of the option price.

Status of Remediation

Section 11 of the Lease states that the RDA will perform all remediation at no cost to Costco. The Costco parking lot clean-up is related to the remediation of the R Street

properties. The Costco parking lot itself is not contaminated, instead the groundwater under the site is contaminated with gasoline from the 1415 R Street (former Exxon) and 1455 R Street (Pacific Pride Car Lot) sites.

Staff and Counsel have had a number of discussions with the State Regional Water Quality Control Board, Provost & Pritchard, and the former RDA's environmental consultant (who is now a City employee) for the clean-up of the R Street properties. The clean-up had progressed over a number of years to the monitoring stage, but monitoring was stopped as a result of the dissolution of the RDA. Dave Norman of Provost & Pritchard indicated that it may be possible to pursue final action with respect to the Costco parking lot prior to and apart from the R Street properties.

Lease Extension

Staff and counsel believe that it would be appropriate to enter into the lease extension for one year (with a possible two year extension) and, as soon as possible, to commence remediation and other activities necessary to prepare the property for sale to Costco. The extension will expire in July of 2014 with no other material changes to the terms and conditions of the existing lease. Due to the Successor Agency's limited legal budget and an assessment that the lease amount is reasonable, neither staff nor counsel believe that further negotiation is required.

Kosmont Companies prepared a Broker Opinion of Value dated December 6, 2012, which concluded that the current rent of \$5,091.67 per month (\$61,100.04 per year) is within the range of fair market value for the rental of the property.

RECOMMENDATION

1. Approve Resolution M-2013-05A, authorizing Michael Amabile, or his designee, to finalize and execute the Lease Extension in substantially the form attached to the Resolution, and authorizing Michael Amabile, or his designee, to take such other actions as he deems necessary or appropriate with respect to the Lease Extension.