Request for City Council Committee Action from the Department of Community Planning and Economic Development

Date: October 31, 2013

To: Council Member Lilligren, Chair, Committee of the Whole

Subject: Target Center: Arena Renovation Project

Recommendation:

1. Approve the attached Arena Renovation Project Term Sheet.
2. Authorize execution of a renovation agreement among the City of Minneapolis, the Minnesota Timberwolves Basketball Limited Partnership and AEG Management TWN, LLC, and related future amendments to the operating and playing agreements, consistent with the term sheet, in connection with the renovation project.
3. Authorize execution of a rent amendment to the playing agreement, as further described in the term sheet, irrespective of the renovation project.
4. Appoint Jeff Johnson (Minneapolis Convention Center Executive Director), Chris Larson (Minneapolis Convention Center Facilities Operations), and Steve Mattson (AEG's Target Center General Manager) to the "Design Group" for the renovation project.
5. Designate the Minneapolis Convention Center Executive Director to serve as the City's project manager for the renovation project.

Previous Directives: On February 22, 2013 the City Council authorized execution of an extension of the Health Club Lease. On December 4, 2009, the City Council authorized issuance of up to $60,000,000 of taxable bonds to refund prior bonds, currently outstanding in the principal amount of $50,385,000. On June 16, 2009, the City Council adopted a resolution authorizing the transfer of Target Center property and agreements from the Minneapolis Community Development Agency to the City and appointed the Minneapolis Convention Center Executive Director as the contract administrator. On April 13, 2007, the City Council selected an affiliate of AEG Facilities, Inc. (AEG) as the operator, authorized execution of an Amended and Restated Arena Lease, Operating, Management, Use and Assurances Agreement, consented to the assignment by Midwest Entertainment Group LLC and assumption by AEG of Target Center Arena agreements, and authorized the Finance Officer to transfer funds and adjust 2007 appropriations as necessary. On March 10, 1995, the City Council and Board of Commissioners approved the terms and authorized the execution of the Target Center Purchase Agreement, related lease and financing documents, and the issuance of tax exempt bonds.

Department Information

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Approved by:	Jeremy Hanson Willis, Kevin Carpenter and Susan Segal
Presenters in Committee:	Jeremy Hanson Willis

Reviews

- Permanent Review Committee (PRC): Approval ___ Date ________________
- Civil Rights Approval Approval ___ Date ________________
- Policy Review Group (PRG): Approval ___ Date ________________

Financial Impact

- Other financial impacts are described within this report under the Renovation Agreement Terms.
- As part of the Mayor's recommended budget for 2014, capitalized interest has been identified to pay debt service in 2014 on any new renovation debt that may be issued and due in 2014. Any revision to this will be reflected in a final bond resolution. Beginning in 2015, local sales tax revenue would be used to pay the City's portion of the debt service.
- The Renovation Agreement does not impact the existing Target Center Finance Plan relating to the current operations and debt. Revenue sources for the current and proposed debt are separate.
- When the design, budget and construction schedule have been finalized and staff returns to the City Council with a request for a "go ahead" decision for the project, including the authorization to issue debt, an updated Target Center Finance Plan will be presented to the Council.

Community Impact

- Neighborhood Notification
- City Goals
- Comprehensive Plan
- Zoning Code
- Other

Supporting Information

The Target Center was constructed in 1990 and consists of two components—a health club and an arena. Each component is leased to private parties. Earlier this year, the City Council approved an extension of the Health Club Lease as an inducement for the tenant, LTF Real Estate Company, Inc. (Lifetime), to make substantial improvements to the health club premises. The City has been negotiating with the arena tenants, Minnesota Timberwolves Basketball Limited Partnership (the "Team") and AEG Management TWN, LLC ("AEG"), for the past several months on a plan to renovate the arena as well.

<u>Renovation Agreement Terms</u>

The attached term sheet outlines the material terms of the proposed renovation agreement, including:

- City to issue taxable general obligation sales tax revenue bonds for the entire project costs of $97 million, plus financing costs;
- Team will be responsible for making payments to cover 44.3% of debt service, secured by a one-year, replenishable letter-of-credit or escrow deposit;
- AEG's 5.7% share will be paid from the pledge of specific, new revenues to be generated as a result of the renovation;
- City will pledge local sales tax revenues to pay its 50% share of debt service;
- Team will extend its agreement to play in the arena by seven years through the end of the 2032 basketball playing season;

- AEG will extend the term of the operating agreement, and related parent company guaranty, through 2032 to coincide with the seven year extension of the Team's playing agreement;
- Team and AEG will agree to a long-term arrangement for the Lynx to continue to play in the arena through 2032 (the current agreement expires in 2014);
- City agrees to undertake, over the remaining term of the playing and operating agreements, at least $50 million in capital improvements to the arena: $25 million for "Building Improvements" and $25 million for "Multi-Use and Basketball Improvements";
- AEG and City agree to restructure their options to terminate the operating agreement as follows:
    - Extend the option from 2019 to 2025, and
    - Increase the threshold to be met to incur the termination option to include both a cumulative operating loss for the three-year period 2022-2024 and an annual loss in at least two of the three years;
- City agrees to accelerate an approximately $1.75 million capital amortization repayment to AEG to 2014/2015, rather than spread annually through 2025;
- City agrees to revise the annual maximum operator reimbursement to AEG – rather than declining at an annual rate of 2%, the amount will be fixed at $1.5 million annually for the duration of the operating agreement;
- The profit sharing formula with AEG, that is a potential offset to the annual maximum operator reimbursement, will not change, with the expectation that the renovation will ultimately improve the profitability of the arena;
- Team agrees to a "clawback" provision providing for reimbursement to the City for a share of the City's investment in the renovation project if the Team is sold within the first four years after execution of the Renovation Agreement on a scale starting at 20% and declining in increments of five percent each year.

<u>Special Legislation—Property Tax Exemption and Construction Manager at Risk</u>

The 2013 legislature authorized two special laws to facilitate the renovation project. Laws 2013, chapter 143, article 4, section 42 authorizes property tax exemption of the arena ("Section 42"). Laws 2013, chapter 143, article 4, section 43 authorizes use of construction manager at risk as the project delivery system ("Section 43"). Both special laws require local approval to become effective. The City's IGR staff will be presenting Sections 42 and 43 to the City Council for approval in the next council cycle.

The term sheet contemplates that, subject to City Council approval of Section 42, whether or not the renovation project proceeds, the City and Team will execute an amendment to the playing agreement that replaces the Team's current personal property tax obligation with an annual rent payment of $1.35 million, escalating at 2% per year, but with a 2-year waiver of the escalation amount. The parties intend to execute this amendment prior to council approval of the special laws. Upon approval of the special laws, staff will forward the requisite resolutions to the Secretary of State and the City Assessor in order to make the changes effective for taxes payable 2014.

The term sheet also contemplates that, subject to City Council approval of Section 43, the City will procure a construction manager at risk early in the design process rather than waiting for completion of full plans and specifications before bidding out the construction contract. This approach is intended to provide faster project delivery and better value engineering opportunities.

Appointment of Design Group; Next Steps

The term sheet provides for creation of a Design Group to oversee consultant selection, design and pre-development activities. The City and the Team will each have three seats on the Design Group. The proposed City representatives are Jeff Johnson, the Minneapolis Convention Center Executive Director, Chris Larson, in Minneapolis Convention Center Facilities Operations and Steve Mattson, AEG's Target Center General Manager. The Minneapolis Convention Center Executive Director will also serve as project manager and the City intends to engage an experienced Owner's Representative to assist with project management.

It is anticipated that the City will release RFP's for an architect and a construction manager by the end of the year. Staff will return to the City Council with the Design Group recommendations for selection early next year.

The Design Group will work to finalize the design, budget and schedule as soon as reasonably practicable. When the design, budget and schedule have been finalized, staff will return to the City Council for a "go ahead" decision and related actions, including authorization to issue bonds and execution of a guaranteed maximum price contract with the construction manager. If the parties decide not to proceed with construction for any reason, the Team will reimburse its percentage share of the design and pre-development costs incurred by the City.

Construction of the project is expected to start in mid-2014 and take approximately 18-24 months to complete. If the Team decides to vacate its administrative office space in Target Center during the pendency of the renovation project and the parties agree to a reuse plan for the vacated space, staff will return to the City Council for authorization to adjust the project budget and agreements to incorporate the vacated space into the renovation project as further described in the term sheet.

Decision to Proceed; Additional Agreements

If the City Council decides to proceed with the renovation project, prior to issuance of the bonds, the parties will execute one or more agreements that more fully address the project financing and security, together with the contemplated amendments to the operating, playing and use agreements between the City, Team and AEG to provide for the extensions, specified revenues, and other items outlined in the term sheet.

The amendments will also make significant changes in the capital improvements process going forward. The City agrees to expend at least $50 million through 2032, allocated evenly between building improvements and multi-use/basketball improvements.
The Design Group will help coordinate Team and AEG input into the short- and long-term capital improvements program for the arena. The City also agrees to periodically conduct a third party facility needs assessment for the arena. The City's Convention Center Executive Director will serve as the City's "Contract Administrator" to oversee arena capital improvements.