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HIGHLIGHTS

Public-private partnerships to develop real estate in and around transit facilities present a noteworthy opportunity for urban developers. In this article, Robert Pearman provides an introduction to these "joint development" projects and the agency-developer agreements that govern them, discussing such factors as transit agency public contracting laws, transit operational requirements, and schedule and design issues.

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FEATURED ARTICLES

Joint Development of Transit Properties

Robert C. Pearman, Jr.

Introduction

Joint development programs and policies related to transit facilities have come into vogue in the past decade, primarily as reflected in statutory changes and the development of internal policies by public transit agencies, such as the Bay Area Rapid Transit District (BART) and the Los Angeles County Metropolitan Transportation Authority (MTA). The practical implementation of such programs, however, has lagged the publicity. Nevertheless, as the concept matures and as mass transit, especially rail, expands in California, joint development around transit facilities is becoming a significant opportunity for private developers. (For purposes of this article, the term "joint development" refers to public-private partnerships that leverage resources and create value from the synergy between development projects and their proximity to transit facilities.)

This article is addressed to practitioners who may be familiar with real property purchase and sale agreements and construction documents, but are unfamiliar with transactions in the context of transit facilities and operations. The article outlines key elements of typical agreements, using a hypothetical to illustrate the disposition of transit agency real property and the concomitant development of public-private facilities.

Hypothetical Project Description

Suppose a transit agency (Agency) is considering the disposition and joint development of surplus Agency real property near an intermodal transit station (rail and bus) which bisects a rail right-of-way (ROW); the Agency owns additional land adjacent to the station and ROW, initially acquired for either parking for transit users or some other undetermined purpose. Available real property interests also include airspace over the rail ROW or excess widths along the ROW.

A private entity proposes, on and around the station site, to:

- Construct retail/commercial improvements (private development);
- Develop a joint parking structure for use by both transit riders and its private development tenants; and,
- Obtain airspace rights over the rail ROW to beneficially assist the developer in the entitlements process with the local jurisdiction.

In consideration of such a proposal, the Agency may broadly require:

- Sufficient parking for its immediate and long-term ridership (rail system users) and transit users (including users of buses and other modes of transport) of the station;
- Access to the station and parking for transit users over and through the joint development site;
- Access by the Agency to its rail facilities for maintenance and operational purposes;
- Sufficient operational safety clearance between the trains and rail ROW, and the development; and
- A fair return on its original real estate investment.

Overview of Key Issues

Real Property Conveyances

Preliminary issues, primarily from the Agency's perspective, include:

- The Agency's statutory charter must allow it to undertake joint development of this type. Fortunately, over the last two decades newly created transit agencies invariably have been given such authority, and the legislative empowerments of older agencies have often been amended expressly to allow joint development. See, *e.g.*, Pub Util C §§30634 (former Southern California Rapid Transit District, now MTA), 99420 (transit operators), 100130.5 (Santa Clara Valley Transportation Authority), 132410(a) (Blue Line Authority).
- If the ROW and Agency Site was acquired in whole or in part with funds from tax-exempt bonds (*e.g.*, state Props 108 and 116, county sales tax revenue bonds), then Internal Revenue Service and applicable state and local requirements must be satisfied to allow what might otherwise be deemed a shift to an impermissible "private use or activity." See IRC §141.
- Does the Agency have fee title to the subject property? Agency acquisitions from railroads, for example, with the initial objective solely to operate a public transit line, might only include an easement to operate rail, not full fee ownership.
- Safety and operational constraints may limit the real property interests that can be conveyed by the Agency or the permissible uses and activities adjacent to the transit facilities. For example, land within a certain distance from the track centerline may be off-limits to construction activities, and the need for overhead clearances will restrict use of airspace above the

tracks. See, *e.g.*, Cal Pub Util Comm'n Gen Order Nos. 26-D, 95, 143-B.

- Easements need to be reserved for (1) the benefit of the transit riders, to utilize the parking structure and to access the transit facilities through the private development if necessary; and (2) access for the Agency's maintenance of its ROW and transit facilities.

Effect of Public Contracting Laws

There are various ways that the construction of the parking structure's transit user space can be "financed." For example, the Agency can simply pay the developer an agreed amount to construct its necessary spaces. In that case, the Agency would pay based on construction draw requests, and the agreement will contain language typical of public works construction funding agreements.

Alternatively, the consideration for providing the public parking could be factored into the overall sale price when the Agency's real property interests are transferred to the developer. In that case, there would be no Agency disbursements per se, although there still may be a need for Agency approvals as stages of construction proceed. A direct disbursement by the Agency would entail the application of various public contracting laws (*e.g.*, prevailing wages under Lab C §1720), resulting in higher costs and additional time for construction.

Certain land subdivision scenarios could also involve the application of public works laws. For example: (1) the development of the private facilities and public parking could be situated on one legal parcel and constructed under one construction contract; (2) there could be two separate legal parcels, with the garage on one and the private development on the other, with two separate construction contracts; (3) the private and parking developments could be on one legal parcel, but there could be a separate construction contract issued for the joint-use parking structure and a separate one for the private development. It may be possible in the latter two cases, assuming no direct Agency funding of the garage, that only the parking structure need comply with the numerous public construction law requirements, insulating the separate private development and its separate construction contract from those requirements. (But see Stats 2003, ch 804, affecting Lab C §§1726, 1781, which makes it riskier for public agencies to participate in a transaction that is not clearly exempt from prevailing wages.)

By law (*e.g.*, Lab C §1735) and internal administrative code, the Agency will require certain nondiscriminatory employment practices with respect to its buyers and developers. The Agency also may have affirmative requirements with respect to promotion of opportunities for small, minority- and women-owned businesses. See Pub Cont C §2000; but see Prop 209 (Cal Const art 1, §31); see also California Construction Contracts and Disputes §4.19 (3d ed Cal CEB 1999). The use of two separate construction contracts may lessen the impact of those laws and policies on the private development, but a would-be developer needs to carefully examine the effect of each agency's policies on (1) development on land that the agency conveys, and (2) any project with which the Agency has a contractual relationship.

In addition, governmental accounting and auditing requirements may apply. In part, this analysis may involve "tracing the dollars." For example, if federal or state grants or bonds were used to acquire a part of the site, then those funding agreements may have certain accounting and auditing policies (see, *e.g.*, Govt C §8546.7) attach to the funds even though a private developer is the ultimate contractor or owner of the affected facilities.

Finally, Agency rules, conflict-of-interest laws, and the Political Reform Act of 1974 (Govt C §§81000–91015) may restrict the private developer's contacts with the Agency and contributions to members of its governing board. For example, MTA board members are subject to specific statutory restrictions regarding gifts (Pub Util C §130051.17) and lobbying (Pub Util C §130051.18).

Allocation of Responsibilities on Design Issues

The Agency's desired input and authority with respect to construction of the parking structure and any related facilities and rights (access rights, etc.) benefiting transit users will undoubtedly be more extensive than its role with respect to the private development.

Some of the issues relevant to the project's relation to transit operations and facilities include: (1) if there is a consistent design theme in the Agency's parking facilities, integration of that design into the new parking structure; (2) preservation of allocated transit spaces, and restriction of their use to transit users, through physical (*e.g.*, separate parking areas with restricted access) or mechanical (*e.g.*, keycard identification) design elements; (3) convenient access to the rail station and other intermodal facilities (bus, shuttle) at the site; (4) construction timetable (is there a need to have the garage completed by a date certain, *e.g.*, for the opening of the rail station?); and, (5) design approval and construction controls, as appropriate, if the garage construction or location affects rail operations.

Design Approvals

The Agency may have uniform design and aesthetic standards for its system's parking structures; thus, although this project entails joint use, the Agency may desire conformity to its other structures. Private developers, on the other hand, perhaps scarred by bureaucratic delays in working with other public entity "partners," will be

leery of excessive Agency review and approval powers that may adversely affect its private development. One way to handle the design review and approval in a manner that precludes the Agency's micromanagement of the developer's construction activities is for the parties to first agree on an initial level of design documentation, *e.g.*, conceptual plans. Thereafter, the Agency's approval rights would be solely limited to aspects inconsistent with the original approved plans or changes that may directly affect transit operations.

Even if Agency authority over the design and construction of the private development is less intrusive, there are still potential areas of conflict:

- The need to ensure coordination of the project with the rail line and its safety and operational imperatives;
- Encouragement of retail or commercial uses that attract or enhance the convenience of transit riders, or, at the least, discouragement of uses that may be controversial or may deter ridership; and
- To the extent the private development's construction or location may affect rail operations, limited design approval rights of the Agency.

A more detailed level of review and approval by the Agency may be unpalatable to the private developer, particularly when the Agency is not funding any part of the private development.

In the real world, undoubtedly there will be contentious negotiations on these points, as developers will want to minimize the Agency's ability to delay work or increase costs through any review and approval rights and remedies. Developers tend to want to limit the time period for any Agency review, preferring, for example, a "deemed approval" process in which, if Agency comments aren't delivered within a certain number of days, the developer can treat that stage of plans as deemed approved. Depending on the scope of the overall project, to ensure that deadlines are met, the Agency may designate a specific staff person with authority to approve design elements of the project.

The parties must also decide whether Agency comments will be merely advisory or whether the developer will be compelled to redesign if the Agency disapproves any aspect of the project. They must further decide how construction disputes will be resolved if the Agency deems that the work in progress needs correction. In the case of disagreements that could lead to substantial delays in the project schedule, a solution may be to refer disputes to a rapid mediation/arbitration process to obtain speedy decisions and prevent litigation.

The role of the Agency, in spite of its proprietary capacity as landowner, may be restricted as a result of negotiations with the developer. Typically, however, an agency will state that its governmental role—*i.e.*, any statutory legal authority to approve and permit certain work on and around its transit ROW—is not abrogated by the agreement.

Hazardous Substances

From the Agency's standpoint, one of the incentives to participate in public-private ventures is to minimize open-ended environmental liability on its holdings of contaminated properties. (For example, lands near a former freight rail ROW, a frequent locale of public rail routes, are likely to have some history of hazardous substances.) Thus, in the disposition agreement, the Agency may seek to place hazardous substances cleanup responsibility on the developer by making the transfer as-is, but giving the developer a sufficient pre-closing due diligence period to determine whether the risks are acceptable. It is also possible that, in the event the target property is contaminated, the seller (*e.g.*, the railroad referred to above) may be liable to the buying agency for its share of cleanup costs for the period of railroad ownership, and any such obligation may be applied to the benefit of the developer. In practice, the Agency, especially if it has held title to the property for some time, is likely to have to share in cleanup costs. Certainly, the Agency will seek indemnification for any claims or liabilities that might arise due to uses occurring after its title transfer.

Project Schedule

The project schedule will be partly determined by the associated rail line. For example, parking will be crucially important to the commencement of rail service, and if construction involves activity in and around the transit ROW after rail service begins, certain work may have to be deferred to the early morning hours of no (or less frequent) train service. The schedule also will be very important in establishing the basis for certain remedies, such as liquidated damages for delay.

Default and Remedies

Particularly when the joint development facility has an impact on the transit operations, *e.g.*, by providing necessary station site parking, the Agency may propose a range of powers and remedies that could lead to contentious negotiations. The proposed powers and remedies could include:

- Work not conforming to the plans and specifications (as determined by whom?) will be considered defective and shall be corrected at the developer's sole cost and expense;
- Agency has the ability to stop work in progress if the work is found to be materially defective or nonconforming;

- Developer is required to furnish at its own expense any redesign and revisions to the construction documents necessary to correct any errors, omissions, failures, or deficiencies in such documents;
- If, in the opinion of the Agency, a defect or deficiency in the work requires immediate correction, or if the defect or deficiency does not require immediate correction but the developer fails to undertake corrective work within a stated period, the Agency may perform such repairs or other corrective work and can charge the developer for the costs;
- On the occurrence of an uncured event of default, the nondefaulting party shall have the right, but not the obligation, to provide the performance or compliance in question on behalf of the defaulting party.

Some of these rather draconian "self-help remedies" may be unpalatable to developers, especially when the parking structure is one that will not be used solely by the Agency's ridership, but also by tenants of the private developer.

In addition, the Agency faces a liability risk that a third party decision-maker (such as a judge or arbitrator) may later determine that the Agency, in its objections to the work or its attempts to stop work, was wrongful or mistaken. Furthermore, Agency "self-help" could lead to delays in the project, as the Agency arranges to carry out the disputed portion of the work. A wrongful decision by the Agency in this regard may expose it to damage claims by the developer.

Generally, there will be a notice and cure period before the Agency can declare a default. There may be certain key dates, though, that have to be met and that serve as a warning to the developer or a trigger for the Agency. For example, because the rail line's revenue operation date depends on completion of the parking structure, the Agency may, on a certain date, be forced to declare a default and move to exercise its remedies to ensure opening of the structure in a timely manner. The prospect of this type of event may also be a prime rationale for a liquidated damages clause (see CC §§1671, 3275, 3369; Govt C §53069.85), providing that for every day's delay past a certain date, the developer must pay a certain amount in daily liquidated damages. Liquidated damages could be calculated on the basis of the cost of interim parking, or lost projected transit user revenues, on the assumption that ridership will be reduced by the lack of onsite parking.

Liens and Lenders

The Agency will want to make sure that any liens and encumbrances on the joint-use parking structure cannot easily take precedence over its reserved parking easement and thus eliminate the transit user parking. The developer's lenders (helping to finance the construction) will be asked by the Agency to agree to maintain the primacy of the reserved transit parking easements in case of foreclosure. Negotiations will almost certainly ensue among the Agency, the developer, and its lender to determine how the lender's remedies, in case of a loan default, are to be balanced with the Agency's similar competing rights in case of a project default.

Operations

The project's key operational concerns include: the long-term maintenance of the parking structure; requirements to rebuild in case of damage and destruction; the parking rates; hours of operation; security for the parking structure; parking structure management contracts; advertising content and revenues; and, the implementation of controls to ensure the availability to transit users of their allocated spaces.

Generally, revenues from parking are allocated as follows: If the private developer is responsible for maintaining the joint-use parking structure, it will retain the revenues from the transit users' parking; the rates, however, may be subject to the Agency's concurrence. There may be an inherent conflict between the developer's desire to maximize revenue and the Agency's desire to minimize transit user parking fees so as to make commuting cost-effective.

Several of the requirements during the construction phase may apply post-acceptance as well. For example, the Agency may have an insurable interest in the parking structure and will seek to be named as an additional insured in various casualty and liability policies. Thus, provisions for the use of insurance and condemnation proceeds to go toward restoring any transit parking spaces taken or damaged would be essential. In case of a wholesale destruction of the parking structure and its reconstruction, most transit agencies will require—as in the initial project development—certain review rights regarding design and construction.

Insurance

Insurance requirements may include: commercial general liability insurance (due to the location of the development, any standard exclusions for work within a certain distance of railroad operations must be addressed through endorsements or removed); state workers' compensation and employers' liability insurance; design professionals' liability coverage; if available, an owner's protective policy to supplement coverage under architects' or engineers' policies that benefit both the developer and the Agency; builder's risk insurance providing coverage for physical damage or destruction of the work through completion; and, upon acceptance, an all-risk policy of insurance covering the project and the Agency's interest in it. At this time, earthquake insurance coverage is generally deemed commercially unavailable. The Agency will want a clause

stating that insurance proceeds (and condemnation proceeds, if any) go first toward restoring full operational use of the parking structure.

Dispute Resolution

Fast-track arbitration would be an appropriate dispute resolution process to include in the project agreements. Timetables would be shortened and formalities reduced, with the goal of reaching a decision within the schedule. Depending on the Agency's role in funding the work, certain disputes and claims of $375,000 or less may be subject to resolution under the Local Agency Public Construction Act. Pub Cont C §20104. The developer should pass on to and incorporate in construction subcontracts their agreement to participate in any arbitration or dispute resolution process as needed when disputes arise between the developer and the Agency.

Conclusion

Although they may resemble disposition and development agreements of other public agencies, joint development agreements involving transit properties often reflect both the distinct legal constraints imposed on transit agencies and the operational constraints and requirements of the system itself. Accordingly, the lawyer who negotiates and documents these types of joint development agreements must understand these unique features.