

By Electronic Mail

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August 19, 2021

Hon. Mayor Erica Pezold
Hon. Mayor Pro Tempore Donald Sedgwick
Hon. Councilmember Jeanine Heft
Hon. Councilmember Bill Hunt
Hon. Councilmember Donald Wheeler
Interim City Manager Kenneth Rosenfeld

Re: Merlone Geier Partners' ("MGP") Responses to Councilmember Wheeler Slideshow Comments of June 29, 2021 Concerning the Village at Laguna Hills Project ("VLH" or "Project")

Dear Mayor Pezold, Mayor Pro Tempore Sedgwick, Councilmember Heft, Councilmember Hunt, Councilmember Wheeler, an Interim City Manager Rosenfeld:

The purpose of this letter is to respond to certain comments that Councilmember Wheeler made during the Council's hearing of June 29, 2021, as part of his slideshow presentation. This presentation, which the Councilmember delivered with the apparent purpose of undermining the work of the City's staff and consultants, is replete with errors, mischaracterizations, and unsubstantiated allegations. There is no aspect of the presentation or the Councilmember's comments during the hearing that serves as evidence to justify denial of any of the project applications. We trust these responses will help to avoid distraction from legitimate consideration of MGP's applications by the Council.

1. Summary of Comment: MGP bought the mall in 2013 and was "supposed to be finished in 2018."

Response: This statement reflects a fundamental misunderstanding of land use entitlements. Obtaining land use entitlements, such as those MGP obtained in 2016 for Five Lagunas, does not mean anything is "supposed" to be constructed by a particular date, or ever. Although a developer does not invest the very significant time and expense necessary to obtain land use entitlements without expecting to build its project, the developer is not "supposed" to build anything upon obtaining those entitlements, much less a project that the developer concludes the market will no longer support.

If a city wants a commitment from a developer to build within a certain period of time, and if the developer is interested in entering into a development agreement, then the city can bargain for such a commitment as a term of the development agreement. Here, the City did exactly that,

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specifically because the City hopes to see development, including retail and park development, on the Mall site sooner rather than later. Of course such a commitment by a developer is itself a community benefit, entails substantial financial risk, and reduces the developer's ability to make other commitments.

As noted elsewhere, the Lake Forest Development Agreement cited by the Council does not require the developer ever to build anything during that agreement's 20-year term; this is a crucial difference between that development agreement and the one the City negotiated with MGP.

Finally, if the reference to the year 2018 comes from the 2016 Five Lagunas Addendum, the comment also misunderstands that Addendum. The 2016 Addendum clearly stated that the year 2018 was assumed as a buildout date strictly because that was the earliest the Five Lagunas project could possibly be completed, and therefore ensured that the Addendum's air quality analysis was properly conservative. In other words, by assuming the Five Lagunas project could be completed by 2018, the Addendum assumed the construction equipment and truck fleet for the years 2016-2018, which were more polluting than later fleets would be. Similarly, the Village at Laguna Hills Addendum assumes a 2024 buildout date, for the same reason: a conservative analysis that ensures air quality impacts from construction are not understated. In neither case were these projections identified as any type of deadline for project completion.

2. Summary of Comment: Simon Properties sold the Mall to MGP in 2013 for \$104 million. Over the past Two years Simon Properties' stock has been doing great. This shows malls are not dead.

Response: First, the stock price of one publicly traded mall owner is not a valid proxy for the health of the entire mall industry. Nonetheless, one simply needs to read the press to know closure of lesser quality malls is rampant. Simon, along with many other mall owners, has been selling, closing, or repurposing these "B" and "C" malls for many years. Despite its vast size, Simon Property Group recognizes, as MGP does, that it is "not bigger than the market," and has met challenges by realistically assessing opportunities and threats in the market as it exists. In Simon's case, this assessment included the recognition in 2013 that the Laguna Hills Mall would never again be viable at 1,000,000 square feet of retail in the anachronistic enclosed mall format. That assessment led to Simon's decision to sell the mall.

Nor has Simon Property Group's stock price been immune to the global decline in large shopping malls. Simon Property Group's highest stock price was \$227.60 in August 2016 and has been below \$150 since mid-December 2019. Councilmember Wheeler asserted that Simon's stock has been "doing great" over the past two years, which may be true considering

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the headwinds the company faced, but in fact its stock price declined from \$159.76 on June 28, 2019 to the \$127.56 shown on Councilmember Wheeler's slide.

3. Summary: Ever since MGP acquired the Mall in 2013, tax revenues from the Mall have been on a "straight trip down," which suggests mismanagement because other retail and other revenue sources have all gone up.

Response: The loss of sales tax revenues from malls is a national trend, not specific to Laguna Hills. Much of the loss is due to closure of department stores. Approximately 40% of department stores in the United States have closed since 2016 and about half of the remaining 1,600 mall-based department store locations are expected to shutter in the next four years. Laguna Hills Mall is no exception.

As shown in the April 27, 2021 Staff Report, tax revenues from the Mall have in fact been on a "straight trip down" since at least 2006/2007, with one minor blip in 2010/2011. To the extent tax revenues from other retail sites such as strip malls have increased, that is consistent with the evidence that department-store-dependent large-scale malls in most cities have been the most severely affected by the retail changes of the last 15-plus years. In addition, contrary to the assertion that MGP "mismanagement" is responsible for the City's "loss" of \$2 million in tax revenues from the Mall, the City's tax revenues from the Mall had already slid to about \$1.5 million (in 2020 dollars) when MGP acquired it, and the food court had already closed due to the Mall's decline.

4. Summary: Under the Development Agreement, the City would get only \$3 million in addition to \$23 million in Quimby fees, which would be due anyway.

Response: This statement ignores the fact that \$15 million of this \$26 million total are guaranteed and nonrefundable in the first 7 years even if no residential units are ever built, and that in the absence of this Development Agreement term, Quimby fees would be due only if and when individual dwelling units were actually constructed. In addition, MGP would pay more than \$4.6 million of these nonrefundable payments in the first 15 months, long before any part of the Project could be completed and occupied even on the most optimistic schedule. And finally, as noted above, this argument also ignores the substantial community benefit the City bargained for by obtaining MGP's commitment actually to construct key elements of the Project, several of them within the first seven years.

5. Summary of Comment: Lake Forest put in 4,500 residences on vacant land and got \$300 million, so Laguna Hills should get at least \$100 million.

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Response: No evidence is cited for this statement and we have found none. Lake Forest's 2020 Housing Element Progress Report shows a total of 3,650 building permits issued from 2014 through 2020.

6. Summary of Comment: MGP will receive a windfall of rents: 1,500 x \$2,500 = \$3.75 million per month vs. only \$12,000 per month (based on \$3,000,000 that's additional to Quimby fees) for the City. This is not fair.

Response: This statement confuses gross revenues with profits and reflects a misunderstanding of how real estate development works. . Any income from rents can only be realized after investment of meaningful capital to construct the buildings, in this case many hundreds of millions of dollars. Further, the statement ignores the most important benefits the City negotiated in the Development Agreement, and ignores the vital tax revenues and economic benefits the Project would provide.

7. Summary of Comment: The Kosmont Study's net fiscal benefit reflects a math error. The fourth column of the [third] slide shows the project's actual "fair share." This project will house 15% of the City's population and the slide shows that the rest of the city will be subsidizing this 15%, who will get a "free ride." The old Mall made \$1.5 million per year with 1 million sf; the new retail structure will be ¼ the size. The hotel will not provide much revenue; the on-site sales and use tax revenue will not in fact be \$846,000; and the other sales and use tax figure represents double counting.

Response: Kosmont was hired by the City and prepared the study at the direction of the City's leadership and staff. Kosmont has no relationship with MGP.

Councilmember Wheeler presented three slides purporting to show that the Project would result in an annual fiscal detriment to the City of \$1,226,032 rather than the annual fiscal benefit of \$1,306,700 shown by the Kosmont report. These slides contain many clear errors and unsupported assertions, as opposed to the evidence-based determinations made in Kosmont report.

- First slide, first table:
 - First column incorrectly identifies Off-Site/Indirect Sales & Use Tax as "On-Site/Indirect Sales & Use Tax."
 - Second column incorrectly asserts, without explanation, that Indirect sales and use tax revenues are "Double Counted Sales Tax." Page 13 of the Kosmont

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report explains off-site sales and use taxes and the adjustments made to ensure a conservative allocation of sales taxes between the on-site direct and the off-site indirect categories.

- Fourth column excludes **all** sales tax from Project revenues to the City. The exclusion of all sales tax revenues is the reason the slide shows annual Project revenues of \$1,836,000 vs. the \$2,992,000 shown by the Kosmont report.
- First slide, second table: Excludes **all** categories of City General Fund Expenditures attributable to the Project other than Public Safety. The only explanation provided is that “Non-Departmental” should be “included in Gen. Gov.,” but page 16 of the Kosmont report explains the difference between these two categories. There is no reason to exclude any of the categories excluded from this table; the exclusions are the reason the slide shows annual Project-related General Fund expenditures of only \$1,501,100 while the Kosmont study shows **higher** City expenditures of \$1,685,300.
- Second slide, first table, “Sales & Use Tax (On-Site/Direct)”: This table appears to be a new iteration of the first table on the first slide, adding back \$390,768 of the sales and use tax revenues that were entirely excluded from the first slide. The premise of this number is that if a 1,000,000-sf mall generated about \$1.5 million in sales tax revenue in 2013 (when MGP acquired the Mall property), then the Project’s 250,000 square feet of retail cannot possibly generate the \$846,000 projected in the Kosmont report. Pages 12-13 of the Kosmont report explain the current data used for the \$846,000 projection. Nothing in Councilmember Wheeler’s presentation addresses this explanation.
- Instead, Councilmember Wheeler takes 25% of \$1.5 million (\$375,000), adds \$15,768 for reasons that are unclear, and arrives at \$390,768 as the total annual on-site /direct sales and use tax for the Project. This number is based on the premise that 250,000 square feet of modern retail/restaurant/cinema uses, specifically selected and designed for the 21st century, cannot possibly generate more than \$1.50 per square foot in sales and use taxes (\$1.5 million divided by 1 million square feet) - the amount generated in 2013 (in constant 2020 dollars) by a declining and underutilized 1970s-era mall.

No evidence supports this conclusion, and one small example demonstrates why it is so far off the mark. Today, the three restaurants on the Project site, which total 23,000 sf, **alone** generate \$211,600 in sales and use tax to the City per year, or \$9.20 per square foot. See Kosmont report pages 12-13. This \$211,600 that the City receives

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today is more than half the \$390,768 Councilmember Wheeler asserts the entire Project site will generate in on-site sales and use taxes at full buildout. Subtracting \$211,600 from \$390,768, Councilmember Wheeler assumes the remaining 227,000 square feet (91%) of the Project's retail and theater uses, as well as its hotel, will generate a grand total of \$179,168 in annual sales and use taxes. This number is not credible and again, no evidence has been provided to dispute the conservative Kosmont estimate of future sales and use taxes from the Project.

- Second slide, first table, "Sales & Use Tax (On(sic)-Site/Indirect": The slide asserts: "The indirect is offset by the city expenditures for them as additional pseudo-residents." This is incorrect for several reasons. First, as noted above, the table erroneously refers to the "indirect" category as on-site when in fact it is off-site. As the Kosmont report states at page 13, "Off-site / indirect sales tax revenue projections are estimated based on the taxable sales generated by the spending of Project residents and employees, off-site, within the City." There is no "double counting." Second, no evidence is provided that "city expenditures for ... additional pseudo-residents [employees?]" offset the sales and use tax revenues they will generate.
- Third slide: The premise of this slide and Councilmember Wheeler's statements is that the Project needs to do more than offset its impacts to the City's operating budget, and if the Project does not generate revenue for the City that is proportionate to its share of the City's total population, the Project will get a "free ride."
- First, this approach is unsound. Many existing households in the City contribute much more or much less to City revenues than a "fair share" calculation per residents of each household would indicate. Existing households that contribute less - whether because of family size exceeding the citywide average, lack of recent property tax reassessment, or other reasons - are not and should not be labeled "free riders."
- Second, the argument is based on the fallacious assumption that on average three new residents would occupy each Project dwelling unit. As noted in our letter of June 29, there is no evidence in the record to support such a high estimate for the Project, whose units will average 842 square feet. Nor is there evidence contradicting the estimate the City adopted in 2015 for its Quimby Act Resolution and in 2016 for Five Lagunas: 1.42 residents per high-density multifamily unit.

Using 1.42 residents per unit, the Project would generate revenue for the City that would far exceed its "fair share" under Councilmember Wheeler's suggested approach. Adding 2,130 residents to the City's 2021 population of 31,073 yields a total of 33,203

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residents. The Project would account for 6.4% of City residents by this measure. The City's 2020/2021 budget was \$23,148,238 (<https://www.ci.laguna-hills.ca.us/DocumentCenter/View/4663/2019-21-Biennial-Budget>). Adding the Kosmont estimate of a \$1,685,300 annual Project impact to City expenditures, the City's 2020/2021 budget would be \$24,833,538 if the Project were built out today. The Project would generate \$2,992,000 in General Fund revenues to the City in 2020 dollars. These revenues far exceed 6.4% of \$24,833,538, which is \$1,589,346. Thus even under Councilmember Wheeler's approach, the Project would provide far more than its "fair share" to the City's General Fund even before Development Agreement proceeds are taken into account.

8. UVSP Arguments

Response: These arguments have been addressed elsewhere, are incorrect factually, are irrelevant legally, and directly conflict with numerous prior determinations and actions taken by the City Council within the UVSP.

9. Summary of Comment: Traffic going north to jobs will be bad and the El Toro exit will be terrible; neighboring cities will also be developing.

Response: This argument is based on the premise that the Project will house 4,500 residents, which as noted above is unsupported. The professionally prepared traffic impact study, following the City's and Orange County's traffic impact analysis guidance, shows that the Project would not cause the approaches to the I-5 or the I-5 mainlines to exceed their capacity. By contrast, the slide's contrary conclusion depends on a cascade of assertions that are not credible: that the Project would house 3,600 adults; that each of these adults would need or want to drive to the I-5 during the same 60 minutes each morning; and that each of these adults would need or want to drive from the I-5 to the Project site during the same 60 minutes each afternoon. The assertion that the Project, by itself and assuming no other vehicles on the road, would cause a 200-vehicle "overflow" on the roadways between the Project site and the I-5 is utterly unsupported.

10. Summary of Comment: The City's parking regulations are outdated and inadequate; every high-rise in the City has parking overflows.

Response: No evidence is presented that parking per the City's code, which would provide 1.875 parking spaces per unit – with most units being studios or one-bedrooms and the average for all units standing at 842 square feet – would lead to parking overflow. To the extent Oakbrook Village is considered a negative example, as we have noted, VLH's wrapped parking places residential parking on the same level as the residences, which increases the

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convenience of parking in assigned parking spaces compared to Oakbrook Village, which does not have this feature and also has a larger average unit size.

Councilmember Wheeler cites his experience on the Traffic Commission for his conclusion that “every high-rise in the City has parking overflows.” We have reviewed the Traffic Commission agendas for 2017-2019 and see no evidence that that was the case. The majority of issues addressed during this time focused on traffic speed reviews, sight distance analyses, street sweeping issues, and road maintenance, but not overflow parking. On January 17, 2018, the Traffic Commission addressed parking issues raised by residents of two neighborhoods, but neither of those neighborhoods appears to be near any “high-rise” building. And as of that date, the level of concern in those neighborhoods had not risen to a level that the residents supported adoption of a residential parking permit program under Municipal Code chapter 11-24.

11. Summary of Comment: The Development Agreement gives away all our rights.

Response: The Development Agreement does not give away any City rights; instead, it provides the City with benefits the City could not otherwise obtain, in return for an extended vesting period.

12. Summary of Comment: High density housing leads to degradation, crime, and “Harlem.”

Response: Despite the fact that high density housing [30 dwelling units per acre minimum] is expressly required by both the UVSP and the General Plan, Councilmember Wheeler expressed concerns about high density housing in this area. The problem, he indicated, is that if high density housing were approved for the project site, the area would degrade to a “less than desirable neighborhood” such as “Harlem,” where “you know the rest of the story.”

It would obviously be unlawful for the City to deny a project based on racial animus. Government Code section 65008 provides that “any action pursuant to this title by any city, county, city and county, or other local governmental agency in this state is null and void if it denies to any individual or group of individuals the enjoyment of residence, landownership, tenancy, or any other land use in this state because of [factors enumerated in Government Code section 12955].” Those factors include race, color, religion, sex, gender, gender identity, gender expression, sexual orientation, marital status, national origin, ancestry, familial status, source of income, disability, veteran or military status, or genetic information.

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13. Miscellaneous slides: losing shopping, overflow of 306 schoolchildren, liquefaction, groundwater, chemicals.

Response: These issues have been addressed. No shopping would be lost; empty and underutilized Mall buildings would be replaced with 227,000 additional square feet of new retail, restaurants and cinema. School impacts, which the School District has conservatively estimated, would be addressed through payment of statutory fees. Construction of mid-rise buildings using methods that avoid impacts from liquefaction-prone soils and corrosive groundwater is common in the area and would be carefully monitored by both the applicant's consultants and the City, per Conditions of Approval.

14. Summary of Comment: Development Agreement was negotiated only by the Applicant and the former City Manager, none of whom lived in Laguna Hills. The public, including FLAG, were ignored; the public uniformly said they didn't want the mall turned into a housing development.

Response: The Development Agreement was negotiated between MGP and the City Manager, City staff and City consultant Kosmont. Merlone Geier had no role in determining who would negotiate the Development Agreement on the City's behalf. Merlone Geier engaged in extensive community outreach, which resulted in changes from its original concept for VLH, including reduction in proposed residential units from 2,100 units to 1,500 units; increase in retail from 233,000 to 250,000 square feet; and reduction in proposed office space from 822,000 square feet to 465,000 square feet. To the extent Councilmember Wheeler's comments suggest that through the Development Agreement process, the City's negotiators should have prevented the Laguna Hills Mall from being "turned into a housing development," it is not the function of a development agreement to fundamentally change a proposed project. The suggestion that the City should have done this provides a textbook example of the reasons the Legislature has repeatedly had to strengthen the Housing Accountability Act and has enacted the Housing Crisis Act of 2019.

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You are welcome to contact Stephen Logan of MGP at (858) 259-9909 should you wish to discuss these matters further.

Regards,



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