

MEMORANDUM OF LAW

DATE: September 29, 1994

TO: Michael R. Steffen, Deputy Director, Real Estate
Assets Department, Acquisition & Valuation Division

FROM: City Attorney

SUBJECT: Ground Lease at Miramar Naval Air Station --
General Municipal Obligation Should Obviate
Concern for Surety Bonding Requirements

During recent negotiations with the United States Navy and Marine Corps (the "Government") for a ground lease of property at the Miramar Naval Air Station, the subject of performance surety bonds was raised. Section 10(c)(4) of the draft lease contains a provision allowing that upon demand of the Government, the City would have to provide the Government with surety bonds to secure certain obligations under the lease. These specific obligations are: (a) the duty to lawfully remove or dissipate any hazardous wastes which may come upon the leased property; and (b) the duty of restoration, i.e., to remove works, improvements, and structures at the conclusion of the lease term and to leave the property clean, level, and compacted. The hazardous waste bond could be demanded at any time; the restoration bond could be demanded at any time during the last five years of the lease. The Government has included these security provisions in the lease because the specific performances they will ensure appear to be presently unfunded by the City.

As you know, we have contended that the surety bonding provisions are unnecessary and asked that they be omitted from the lease. However, the Government, perhaps understandably, retains a concern that no source of funding presently exists to which the City could resort in order to meet its future obligations. To assist its decision on whether to later exercise its right to demand bonds, the Government has asked for clarification of the City's view of its obligations. Specifically, the Government has requested some assurance that the City's obligations under the lease would indeed be its general -- as opposed to special -- obligations.

The Government's concern primarily stems from the proposed uses of the leased property, which generally are solid waste landfill operations and sludge processing operations. These operations have their own distinct sources of "enterprise" or use-based funding (the Sewer Revenue Fund in the case of sludge processing, and landfill tip fees,

for the most part, in the case of landfill operations). The Government has questioned the City as to whether it believes that its obligations are limited to these special funds, or whether its general fund will ultimately be responsible for fulfilling the lease obligations.

This office was asked for an opinion on this question, which follows:

It is true that the Sewer Revenue Fund (San Diego Municipal Code section 64.0403) and the Refuse Disposal Fees (San Diego Municipal Code section 66.01125) will be primary sources of funding the lease. These funds have origin as special revenue from rate or fee payments, or alternatively, from the issuance of revenue bonds. In the instance of bond revenue, only Sewer Revenue Bonds are presently at issue (Series 1993 Bonds). The indentures for these bonds do not establish any special sinking fund for purposes of meeting the proposed lease obligations. The Sewer Revenue Fund will be funding a portion of the lease obligations for purposes of asset acquisition, operation, and maintenance without regard to the special lease provisions covering hazardous waste and restoration obligations. The same is true of the Refuse Disposal Fees. Thus, the security sought by the Government does not exist in the form of any bond covenant or special provision concerning the enterprise funds, so we return to the principal question, i.e., whether it is the special funds or the City's general fund which will ultimately be responsible for the lease.

The terms of the lease itself are dispositive of this question. It is the City of San Diego, and not any of its particular governmental departments, that is defined as Lessee. Nowhere in the lease is it provided that the Lessee's obligations shall be limited to the special revenues derived by the Metropolitan Wastewater Department or the Environmental Services Department. Rather, this lease is being entered by the City as a general obligation in fulfillment of a variety of municipal obligations.

The City possesses the authority to enter leases of general obligation under Section 1 of its Charter, which provides:

SECTION 1. INCORPORATION AND CORPORATE POWERS.

The municipal corporation now existing and known as "The City of San Diego" shall continue to be a municipal corporation under the same name, with the boundaries as now established or as may hereafter be legally established. Such municipal corporation shall have perpetual succession; may use a corporate seal; may sue and defend in all courts and places, and in all matters and proceedings whatever; may own and acquire property within or without its boundaries for

either governmental or proprietary, or any municipal purpose, either by succession, annexation, purchase, devise, lease, gift or condemnation and may sell, lease, convey, exchange, manage and dispose of the same as the interests of said City may require; receive bequests, donations and gifts of all kinds of property within and without The City of San Diego in fee simple or in trust for charitable or other purposes, and do all acts necessary to carry out the purposes of such gifts, bequests and donations; may own and operate public utility systems, including the joint or sole operation and ownership of utilities for the purchase, development and supply of water and electrical power for the use of the City and its inhabitants and others; and generally shall have all municipal powers, functions, rights, privileges and immunities of every name and nature whatsoever now or hereafter authorized to be granted to municipal corporations by the Constitution and laws of the State of California. emphasis added.

California Constitution, Article XI, Sections 3 and 5, allow cities like San Diego to adopt charters to provide for government of their own municipal affairs. The charters must be consistent with other constitutional limitations, and one such limitation important to this analysis concerns limitation of local debt. California Constitution, Article XVI, Section 18 provides for a limitation of local indebtedness. In material part it states that "no county, city, town . . . shall incur any indebtedness or liability in any manner or for any purpose exceeding in any year the income or revenue provided for such year, without the assent of two thirds of the qualified electors"

This limitation is observed and embodied in San Diego's Charter, section 99, which contains nearly identical language. In compliance with this limitation, at the time this lease will be entered the City will be in a position to certify availability of funding to cover all rental payments for the term of the lease. The City's general obligation to the lease will therefore be within the debt limitation provisions, so far as rental payments are concerned.

The lease provisions regarding hazardous waste and restoration of the leased property upon the expiration of the lease should next be considered. Although these potential or eventual liabilities will be general obligations of the City, we do not view these obligations as being actual or present for purposes of the debt limitation provisions.

In regard to the hazardous waste provisions, all of the obligations are entirely conditional upon the contamination of the property by some hazardous waste. Since no hazardous waste (other than that to be received by the Household Hazardous Waste Transfer Facility) is intended to be introduced to the site, and since the lease in fact forbids such introduction, we cannot say for certain that there is presently or will ever be any actual duty to remove or dissipate hazardous waste. This duty would become actual only upon some event occurring that is truly not intended by the parties. It is a purely conditional liability, and for this reason is of no significance with respect to present debt limitations.

The restoration obligations are subject to similar conditions and intentions. The lease provides in effect that landfills are to be operated, maintained, closed, and monitored in strict accordance with federal, state, and local law. If this intent is fulfilled as it ought to be, "restoration" of the landfill parcels should be an ongoing facet of the City's operations, and theoretically could be complete upon expiration of the lease, leaving no additional obligation to be fulfilled. This highlights the real problem with considering the restoration obligation to be a present one, for it is unknown at this point in time what "restoration" will involve, what it will cost, or whether it will occur in due course of operation. Clearly this is why the draft lease provides that the Government may not demand a bond until the last five years of the term, since no set sum could reasonably be established today. As such, the restoration obligation is not a present one for purposes of debt limitation.

To conclude, we believe that the obligations under this lease, including the hazardous waste and restoration obligations, will be the general obligations of the City of San Diego and will be backed by its full faith and credit. This, however, has no immediate bearing on the intention to fund these obligations from sewer and refuse disposal revenues. Only in the event that the obligations become actual and present, and if the enterprise funds should prove deficient, would the City's general credit be called upon. To avoid this situation, and a possible demand by the Government to supply bonds, a sinking fund could be established either now or at some later time during the term of the lease for purposes of meeting these obligations, to the extent they can then be identified and estimated.

Hopefully this explanation will suffice in meeting your concerns, as well as those of the Government.

JOHN W. WITT, City Attorney

By

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Deputy City Attorney

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