



THE CITY OF SAN DIEGO  
**REPORT TO THE CITY COUNCIL**

DATE ISSUED: June 10, 2010 REPORT NO: 10-086

ATTENTION: Natural Resources and Culture Committee  
Agenda of June 16, 2010

SUBJECT: Third Amendment to the Lease Agreement for the Environmental  
Services Operations Station

REFERENCE: FY2011 General Fund Budget adopted in December 2009, Report #09-  
167

REQUESTED ACTION:

1. Authorize Execution of the Third Amendment to the Lease Agreement (“Third Amendment”) for the Environmental Services Operations Station.

STAFF RECOMMENDATION:

Approve the requested action.

SUMMARY

In the late 1990s, the City determined that consolidating various refuse collection and recycling operations from four locations to one centrally located operations station would result in significant costs savings. A suitable site was identified and purchased with Refuse Disposal Enterprise funds. Since 2001, the General Fund has been reimbursing, with interest, the Refuse Disposal Enterprise Fund for its share of the purchase price and improvements of the Environmental Services Operations Station located at 8353 Miramar Place in accordance with the terms established under the 2002 Lease Agreement and two subsequent amendments. This requested Third Amendment extends the existing repayment schedule by an additional two years [through FY 2015]. This proposal was included in the FY 2011 General Fund Budget adopted by Council in December 2009 and incorporated in the Revised Fiscal Year 2011 Proposed Budget released in April 2010.

BACKGROUND:

In 1998, the City Council approved via resolution R-291076 the purchase of the 11.14 acre site located at 8353 Miramar Place and the 1.6 acre parking lot located just west thereof for the

purpose of centralizing the Environmental Services Department's [ESD] refuse, recycling and greenery collection programs. As explained in the accompanying City Manager's Report, the facility was purchased in full by ESD's Refuse Disposal Enterprise Fund [RDF] with the expectation that the General Fund would reimburse the RDF 55% of the costs associated with the purchase and improvements plus interest over a period of up to thirteen years. The allocation of costs was based on the anticipated use of the site for General Fund activities and RDF activities.

Resolution R-291076 directed the City Auditor and Comptroller, City Attorney, and City Manager to memorialize the repayment from the General Fund to the RDF. That initial agreement called for repayment from the General Fund equal to \$9,992,016 [55% of \$18,167,302] plus interest of \$3,715,229 for a total of \$13,707,245. ESD was required to make payments from the General Fund to the RDF by August 1<sup>st</sup> of each year in accordance with the following schedule:

**1<sup>st</sup> Schedule [Original Lease Agreement]**

<b>Fiscal Year</b>	<b>Annual Lease Payment</b>
July 1, 2001 – June 30, 2002	\$786,688
July 1, 2002 – June 30, 2003	\$960,124
July 1, 2003 – June 30, 2004	\$1,414,612
July 1, 2004 – June 30, 2005	\$1,803,156
July 1, 2005 – June 30, 2006	\$2,121,938
July 1, 2006 – June 30, 2007	\$2,834,097
July 1, 2007 – June 30, 2008	\$2,960,026
July 1, 2008 – June 30, 2009	\$826,604

Based upon a total General Fund project cost of \$13.7 million, the Financing Services Department developed a repayment schedule using operational savings designed not to increase the Collection Services Division's General Fund budget. That savings was a result of consolidation to the centralized facility and the ramping down of debt service payments associated with the purchase of the initial automated refuse container rollout following the City's conversion to automated collection. Each year's General Fund payment was specifically tailored to match the savings anticipated.

Payments were made in accordance with the schedule for the first two years. In FY 2004, due to General Fund financial constraints, the repayment was kept at the FY 2003 level of \$960,124 with the unpaid balance of \$454,488 deferred [with interest] until year eight of the agreement. At the time, the costs of additional improvements to the facility, funded from the RDF, were also incorporated into the schedule and the repayment term extended accordingly. This decision to modify the repayment required a new schedule and in June 2003 the following modifications were memorialized in the First Amendment to the Lease Agreement:

**2<sup>nd</sup> Schedule [First Amendment]**

<b>Fiscal Year</b>	<b>Annual Lease Payment</b>
July 1, 2001 – June 30, 2002	\$786,688
July 1, 2002 – June 30, 2003	\$960,124
July 1, 2003 – June 30, 2004	\$960,124

July 1, 2004 – June 30, 2005	\$2,243,570
July 1, 2005 – June 30, 2006	\$2,609,227
July 1, 2006 – June 30, 2007	\$3,321,386
July 1, 2007 – June 30, 2008	\$3,447,315
July 1, 2008 – June 30, 2009	\$1,881,276
July 1, 2009 – June 30, 2010	\$487,289
July 1, 2010 – June 30, 2011	\$487,289

Payments were made in accordance with the revised schedule for an additional year [FY 2004] and again, for financial reasons, the schedule was modified to its current repayment plan as reflected in the Second Amendment to the Lease Agreement:

**3<sup>rd</sup> Schedule [Second Amendment]**

<b>Fiscal Year</b>	<b>Annual Lease Payment</b>
July 1, 2001 – June 30, 2002	\$786,688
July 1, 2002 – June 30, 2003	\$960,124
July 1, 2003 – June 30, 2004	\$960,124
July 1, 2004 – June 30, 2005	\$960,124
July 1, 2005 – June 30, 2006	\$1,845,196
July 1, 2006 – June 30, 2007	\$1,845,196
July 1, 2007 – June 30, 2008	\$1,845,196
July 1, 2008 – June 30, 2009	\$1,845,196
July 1, 2009 – June 30, 2010	\$1,845,196
July 1, 2010 – June 30, 2011	\$1,845,196
July 1, 2011 – June 30, 2012	\$1,845,196
July 1, 2012 – June 30, 2013	\$1,845,196

**DISCUSSION:**

As a result of budget constraints in FY 2011, ESD proposed, and Council approved in December 2009, another modification of the Lease Agreement to provide at least \$900,000 in reduced General Fund annual obligation starting in FY 2011 for the remainder of the Agreement period. A correct amortization schedule and market interest rates have been applied to the revised Agreement. The schedule in the proposed Third Amendment reduces the annual General Fund payment from \$1,845,196 to approximately \$811,000 while extending the Agreement an additional two years through FY 2015. After the last payment in FY 2015, the General fund will have fully satisfied its current payment obligations for this facility.

As mentioned above, during the development of the First Amendment, additional principal of \$2,710,500 was added to the General Fund repayment schedule based on the assumption that capital improvements to the facility budgeted for FY 2003 through FY 2005 would be repaid by General Fund. These assumed improvements included the installation of photovoltaic panels and various upgrades to the Operations Station to meet storm water runoff requirements. However, the allocation of the associated costs failed to take into account the appropriate cost allocation based on the use and ownership of the building; that is, the General Fund and the RDF were considered co-owners of the facility on a 55% - 45% basis respectively. This oversight resulted

in rolling principal and interest for the entire amount of the improvements into the General Fund repayment plan established in the First Amendment [schedule 2] rather than having those improvement costs split proportionately between the two Funds.

In addition, while the General Fund was making the lease payments in accordance with the repayment schedule, the planned CIP expense for the facility did not conform to the payments received from the General Fund due to delays or postponement of the CIP projects. Due to the above stated ownership and CIP effects, the payment schedules established in the two amendments did not accurately amortize the principal owed and the corresponding interest resulting in the General Fund overpaying on a cumulative basis during FY 2006-2010 approximately \$1.1 million. This overpayment is being returned as a one-time year end adjustment to the General Fund in FY 2010.

In reviewing the past lease amendments, it was additionally understood that the interest rate charged to the General Fund was not recognizing the annual pay down of the principal in the amortization schedules. When the long term fixed rate was applied uniformly across the repayment term, the amortization of the principal portion on the short end was charged at the same rate as the principal portion on the long end of the amortization period. Due to this inflated rate application on some portion of the principal, the General Fund may have paid some extra interest. Due to the time lapse, there is no easy way to correct the past payment schedules to more accurately capture the cost of borrowing. However, the payment schedule will be corrected going forward in the Third Amendment for the period FY 2011-2015. See the sample schedule titled "Proposed Schedule" on Page 5.

The Refuse Disposal Enterprise Fund appropriated the approved amounts in its Capital Improvement Program Budget for the facility upgrades and those amounts were rolled into the repayment agreement. Approved project cost estimates totaled \$2,710,500 for improvements, while actual expenditures were only \$1,828,312. The General Fund was scheduled to reimburse the RDF for 100% of principal and interest on the total project cost estimated at \$2.7M. As noted previously, per the original intent, the General Fund should have been obligated to reimburse the RDF for 55% of the actual costs of \$1.8M plus interest. This resulted in an overpayment by the General Fund discovered after a review and analysis by ESD and Debt Management to determine the actual amounts owed. Subsequently, in FY 2010 the Refuse Disposal Fund will reimburse the General Fund for the overpayments in the amount of \$1,158,488. Overpaid principal will be credited back to the General Fund (a one-time payment in FY 2010) as a result of applying the proportionate split between the funds for improvements.

The City has determined this method of funding improvements entirely with RDF funds while the General Fund repays its portion over time will no longer occur. For future required improvements, the General Fund and Refuse Disposal Enterprise Fund will each fund their share up front through a CIP as approved by City Council.

Based on interest rates as of June 1, 2010, the proposed repayment schedule, including principal and interest, to be paid on August 1 annually, would be as follows:

**Proposed Schedule [Third Amendment]**

	Fiscal Year	Interest Rate <sup>(1)(2)</sup>	Principal	Interest	Total <sup>(3)</sup>
	2011	0.58%	\$ 780,678	\$ 30,214	\$ 810,892
	2012	1.07%	\$ 759,832	\$ 51,060	\$ 810,892
	2013	1.55%	\$ 769,863	\$ 41,029	\$ 810,892
	2014	2.08%	\$ 783,983	\$ 26,909	\$ 810,892
	2015	2.34%	\$ 801,514	\$ 9,378	\$ 810,892
Total of Payments			\$ 3,895,870	\$ 158,589	\$ 4,054,459

<sup>(1)</sup> Estimate as of 6/1/2010. To be fixed when the Third Amendment is executed

<sup>(2)</sup> Estimated average rate for FY 2011-2015 is 1.97%

<sup>(3)</sup> To be paid on August 1, commencing on August 1, 2010

FISCAL CONSIDERATIONS:

Approval of the Third Amendment results in annual savings to the General Fund of approximately \$1.03M in Fiscal Years 2011 through 2013 with additional General Fund payments required in Fiscal Years 2014 and 2015 in the amount of \$811,000 annually.

ENVIRONMENTAL STATEMENT:

This activity is not subject to CEQA pursuant to CEQA Guidelines section 15060(c)(2) because it will not result in any direct or reasonably foreseeable indirect physical change in the environment, and also because this activity is a government fiscal activity that does not involve commitment to any specific project and therefore is not a project pursuant to CEQA Guidelines section 15378 (b)(4).

PREVIOUS COUNCIL AND/OR COMMITTEE ACTION:

On December 7, 1998 Council approved R-291076 approving the initial purchase and improvements of the facility and the repayment plan. On December 2, 2009 Council approved this proposal as part of the FY 2011 General Fund Budget

COMMUNITY PARTICIPATION AND PUBLIC OUTREACH EFFORTS:

None.

KEY STAKEHOLDERS:

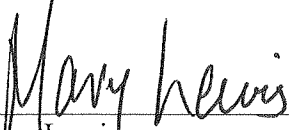
The citizens of San Diego, Environmental Services Department, Refuse Disposal Enterprise Fund, and the General Fund are key stakeholders.



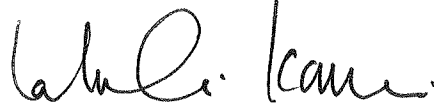
Chris Gonaver  
Environmental Services Director



David Jarrell  
Deputy Chief of Public Works



Mary Lewis  
Chief Financial Officer



Lakshmi Kommi  
Debt Management Director

CITY OF SAN DIEGO  
ENVIRONMENTAL SERVICES DEPARTMENT  
THIRD AMENDMENT TO LEASE AGREEMENT

This Third Amendment to Lease Agreement is entered into by and between the City of San Diego Environmental Services Department [ESD] and the Mayor's Office of the City of San Diego [Lessee].

**RECITALS**

WHEREAS, on February 28, 2002, ESD entered into a Lease Agreement [Lease] with Lessee for the lease of the improved real property located at 8353 Miramar Place, San Diego, California, as well as the employee parking lot located just west thereof [collectively the Property]; and

WHEREAS, on June 30, 2003, a first amendment to the Lease was executed by the parties to incorporate increased principal and interest for improvements to the facility and to revise the Lease term and payment schedule; and

WHEREAS, on June 7, 2004, a second amendment to the Lease was executed by the parties to revise the Lease term and payment schedule; and

WHEREAS, a third amendment to the Lease is necessary to correct inaccuracies in the principal and interest due under the Lease and to accommodate continuing financial constraints in the General Fund budget by further revising the Lease term and payment schedule;

NOW THEREFORE, ESD and Lessee, do hereby agree to amend the Lease as follows:

**AMENDMENT**

**Section 3. Lease Payments, subsection 3.1 Amount is amended as follows:**

From: Lessee agrees to take such action as may be necessary to include all lease payments due hereunder in the annual budget for the City of San Diego, make the necessary appropriation for all such lease payments, and make such lease payments to ESD in accordance with the following schedule:

<u>Fiscal Year</u>	<u>Annual Lease Payment</u>
July 1, 2001- June 30, 2002	\$ 786,688
July 1, 2002- June 30, 2003	\$ 960,124
July 1, 2003- June 30, 2004	\$ 960,124
July 1, 2004- June 30, 2005	\$ 960,124
July 1, 2005- June 30, 2006	\$1,845,196
July 1, 2006- June 30, 2007	\$1,845,196
July 1, 2007- June 30, 2008	\$1,845,196
July 1, 2008- June 30, 2009	\$1,845,196
July 1, 2009-June 30, 2010	\$1,845,196
July 1, 2010-June 30, 2011	\$1,845,196
July 1, 2011-June 30, 2012	\$1,845,196
July 1, 2012-June 30, 2013	\$1,845,196

To: Lessee agrees to take such action as may be necessary to include all lease payments due hereunder in the annual budget for the City of San Diego, make the necessary appropriation for all such lease payments, and make such lease payments to ESD in accordance with the following schedule:

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July 1, 2009-June 30, 2010	\$1,845,196
July 1, 2010-June 30, 2011	\$ 810,892
July 1, 2011-June 30, 2012	\$ 810,892
July 1, 2012-June 30, 2013	\$ 810,892
July 1, 2013-June 30, 2014	\$ 810,892
July 1, 2014-June 30, 2015	\$ 810,892

This Third Amendment to Lease Agreement shall affect only the terms and/or conditions referred to herein. All other terms and conditions shall remain in full force and effect.

IN WITNESS WHEREOF, ESD and Lessee each have caused their duly authorized representatives to execute this Third Amendment to Lease Agreement.

Date: \_\_\_\_\_

CITY OF SAN DIEGO  
ENVIRONMENTAL SERVICES DEPARTMENT

By: \_\_\_\_\_

Chris Gonaver  
Environmental Services Director

Date: \_\_\_\_\_

CITY OF SAN DIEGO  
MAYOR'S OFFICE

By: \_\_\_\_\_

Jay Goldstone  
Chief Operating Officer



I HEREBY APPROVE the form and legality of the foregoing Third Amendment to Lease Agreement this \_\_\_\_\_ day of \_\_\_\_\_, 2010.

Jan Goldsmith, City Attorney

By: \_\_\_\_\_  
Grace C. Lowenberg  
Deputy City Attorney