TO:       HONORABLE CITY COUNCIL
FROM:     CITY MANAGER       DEPARTMENT: ADMINISTRATIVE SERVICES
DATE:     JULY 24, 2006      CMR: 276:06
SUBJECT:  AMENDED AND RESTATED GROUND LEASE BETWEEN STANFORD UNIVERSITY AND CITY OF PALO ALTO FOR THE QUARRY ROAD SUBSTATION SITE, 281 QUARRY ROAD.

RECOMMENDATION
This report recommends that Council: 1) adopt the attached Mitigated Negative Declaration and Mitigation Monitoring Program; and 2) approve the attached Amended and Restated Ground Lease between the Board of Trustees of the Leland Stanford Junior University (Stanford) as Lessor and the City of Palo Alto (City) as Lessee for the Quarry Road substation site (Lease Agreement).

BACKGROUND
On July 1, 1968, the City entered into a 39-year ground lease with Stanford for the Quarry Road substation site. On July 22, 2002, Council approved the selection of Eden Housing, Inc. (Eden) as the developer for an affordable rental housing project on a site to be selected. The Alma Street substation site was included in the Housing Sites Inventory adopted by the City Council on December 22, 2002 as part of the Housing Element of the Palo Alto Comprehensive Plan. In December 2003, Council approved the South of Forest Area Coordinated Area Plan, which rezoned the Alma substation site from PF (Public Facility) to RT 50, a multi-family residential zone. On June 1, 2004, Council approved an amendment to the Fiscal Year 04/05 Capital Improvement Plan (CIP) budget to allocate $500,000 for initial engineering studies to provide for the relocation of the Alma substation. On September 27, 2004, Council held an Affordable Housing Study Session focusing on preliminary work completed by Eden Housing regarding development options for the Alma substation site. On June 5, 2006, Council approved a Request for Bid Proposals (RFBP) for the sale of the City-owned property located at 2460 High Street and directed staff to solicit proposals for sale of the site with the understanding that the net sales proceeds from the sale could be deposited in the Residential Housing Fund, to be used to offset the costs of the proposed development of the Alma Street substation.
DISCUSSION

The current 39-year lease for the Quarry Road Substation will expire on June 30, 2007. The attached proposed Lease Agreement will amend and restate the current lease to extend the term for 51 years and provide for the relocation of the Alma Street substation facility to Quarry Road substation site. The relocation of facilities to one site will provide the same service now provided by two sites and will free up the Alma substation site for development of affordable housing, subject to Council approval. Located at 841 Alma Street, the Alma Street substation site is a 15,681 square feet parcel which, according to the 2002 Housing Sites Inventory, would accommodate a minimum of 10 residential units.

The attached Lease Agreement (summarized in Attachment B) is based on the form of lease agreed to between Stanford and the City for the Mayfield playing fields, modified as appropriate to reflect the terms of this transaction and the different use of the property. Major differences between the proposed Lease Agreement and the current lease include the term (51 years versus 39 years) and the rent provision. The current lease provides for a nominal rent consisting of the City paying all taxes, fees and assessments of any kind levied on the property. The proposed Lease Agreement provides for a basic rent of $1 per year, and additional rent consisting of two components: first, the City shall pay all taxes, fees and assessments levied on the property, as is required in the current lease; and second, the City is to credit Stanford for 94,846 gross square feet to be applied towards the in-lieu housing impact fee payable pursuant to Chapter 16.47 of the Palo Alto Municipal Code (Approval of Projects with Impacts on Housing). Chapter 16.47 requires developers of large commercial and industrial projects to contribute to programs increasing the City’s low and moderate income housing stock by providing either a number of low and moderate income housing units determined by a formula or providing an in-lieu fee. The housing in-lieu fee is currently $16.01 per square foot of proposed development (to be increased by approximately 3 to 3.5% to $16.50 in 2007 when the Lease Agreement commences). Stanford may apply all or a portion of its 94,586 square foot Housing Impact Credit (HIC) to any future Stanford project or projects in Palo Alto. If Stanford uses its full HIC, the monetary rent for the lease remains the basic rent. If however, the HIC cannot be used either because the City cannot grant the credit or Stanford is not permitted to apply the credit, and the City and Stanford are unable to agree upon an alternate City fee to which the credit may apply, the basic rent will increase to the full basic rent multiplied by a fraction, the numerator of which is the unused HIC relinquished by Stanford and the denominator of which is 94,586. Full basic rent is $118,800 for the first lease year and increased in succeeding years by 1.5%. (For an example of the full basic rent calculation, refer to the attached lease summary.) Additional terms of the lease include the requirements that the City is responsible for all utilities, maintenance and repairs and that any replacement improvements costing more than $30,000 shall require Stanford’s prior approval.

Because the Quarry Road substation now serves Stanford electric customers only, the existing lease provides for a nominal rent. The relocation of the Alma substation to combine with the Quarry Road substation will result in the site serving users other than Stanford customers, and therefore, the attached Lease Agreement provides for a market value rent. The full basic rent was determined by a professional appraisal which concluded the value of the 0.396-acre property, considering the unimproved property could be developed under Medium Density Multiple Family Residence District (RM-30), to be $1,485,000. At an 8% return, the rent would be $118,800 per year. The 94,586 square feet of HIC, valued at its approximate 2007 value of
$16.50 per square foot, is equivalent to the estimated development potential if the substation site were not utilized for electrical purposes.

It should be noted that due to the significant investment on the part of the City in relocating its substation, estimated to be $2,435,000, staff would have preferred an easement rather than a lease; however, an easement would have required an eminent domain action.

**RESOURCE IMPACT**
The annual basic rent for the entire lease term ($51.00) is due upon commencement of the Lease. This and any future monetary cost due to application of the full basic rent will be budgeted as part of the Utilities Department budget. As a result of the HIC, the City’s Housing Fund would not receive the $1.56 million from commercial in-lieu fees that would be generated by the 94,586 square feet of commercial development.

**POLICY IMPLICATIONS**
The proposed lease does not represent any change to existing City policy. The lease makes possible the relocation of the Alma substation facilities and the reuse of the site for affordable housing, which is in compliance with Comprehensive Plan policies which designates the Alma substation site as suitable for affordable housing and includes the site on the housing sites inventory of the Housing Element.

**TIMELINE**
Following Council approval of the Lease Agreement, staff will return to Council for approval of the contract.

**ENVIRONMENTAL REVIEW**
In accordance with the California Environmental Quality Act (CEQA), staff has prepared the attached draft Mitigated Negative Declaration and Mitigation Monitoring Plan for the lease agreement and bid package for the engineering redesign and rebuild of the Quarry Road substation. The engineering redesign and rebuild will include increasing the capacity of the Quarry Road substation by adding an additional 60kV/12kV switchgear lineup and transformers and four new 69kV circuit breakers to the existing utility equipment on site. New foundations will be constructed to support the new equipment that is to be located within the existing fenced area surrounding the Quarry Road substation. This equipment will be relocated from the existing Alma Street substation and use of the Alma Street site as a substation will be discontinued. New 12kV underground electrical feeders along with new duct lines are to be constructed from new equipment along Quarry Road towards Downtown Palo Alto. The existing 60kV overhead power lines located in the alley behind the Alma Street substation will be relocated when the use of the Alma Street substation is discontinued. The draft Mitigated Negative Declaration was circulated on May 26, 2006 with a 20-day review period in accordance with state law that ended on June 15, 2006. The Final Mitigated Negative Declaration and the Mitigation Monitor Plan are included as Attachment C.
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ATTACHMENTS
Attachment A:  Lease Agreement  
Attachment B:  Summary of Lease Agreement  
Attachment C:  Final Mitigated Negative Declaration and Mitigation Monitoring Plan

cc: Stanford