TO: HONORABLE CITY COUNCIL

ATTENTION: FINANCE COMMITTEE

FROM: CITY MANAGER DEPARTMENT: ADMINISTRATIVE SERVICES

DATE: OCTOBER 17, 2006 CMR:373:06

SUBJECT: RECOMMENDATION REGARDING RENT CHARGED BY THE GENERAL FUND TO THE REFUSE FUND ON UNOPENED PORTIONS OF LANDFILL

RECOMMENDATIONS
Staff recommends that the Finance Committee recommend that Council establish a policy on rent charged by the General Fund to the Refuse Fund on closed portions of the landfill whereby the Refuse Fund should pay rent at less than full market value in consideration of the fact that the landfill area cannot be readily converted to the land’s highest and best use.

BACKGROUND
In the City Auditor’s review of the Environmental Services Center proposal, the City Auditor recommended that staff should determine whether the Refuse Fund should be responsible for paying rent on the closed, undeveloped areas of the landfill. The Finance Committee reviewed staff’s original recommendations on December 6, 2005 (CMR:441:05), and recommended that Council adopt a policy whereby the Refuse Fund pay rent on closed portions of the landfill that had not yet been developed into parkland. Staff was also directed to return with a proposed payment plan to recover unpaid rent for past periods and to provide funding for post-closure park development. Staff was also directed to examine the legal issues relating to the recovery of rent in past periods and to review the appraised value of the landfill area. This report provides a proposed rental amount and payment plan.

DISCUSSION
The City retained an independent appraiser to appraise the land, and that appraisal determined that the highest and best use of the land was Industrial-Research & Development. After review of the appraised value, staff considered the possibility that the landfill area cannot be readily developed into usable space in keeping with its highest and best use designation as Industrial-Research & Development. Accordingly, staff has referred this matter back to the Finance Committee to review this new consideration before submitting a proposed payment plan to the full City Council.

The proposed payment plan sets the rent at less than full market value (see Attachment A). The plan also accounts for the recovery of back rent on closed portions of the landfill since 2004-05,
which is consistent with the applicable two-year statute of limitation for collection of back payment. The statute of limitations applies from the date of the forthcoming written lease agreement which will be completed once Council considers the payment plan.

In her review of the Environmental Services Center proposal, the City Auditor noted several complicated land use issues with regard to locating a facility on the landfill site. The report states:

“The landfill site is dedicated parkland with flat, natural wetlands on three sides. Identification and discussion of all California Environmental Quality Act (CEQA) issues, regulatory agency permit and approval processes, and land use approval processes add complexities and costs to the proposed project. Use of dedicated parkland requires voter approval.”

Given the complexities of locating a facility on the landfill site, staff has considered that it may be difficult to readily convert the landfill area to the land’s highest and best use designation. Therefore, staff presents a payment plan whereby the rent charged on the closed portions of the landfill is based on a return on the land value of five percent, which is less than full market value, but which accounts for some possibility that the land could be converted to non-park use at a later time. As such, based on the square footage of the landfill, the amount charged would be $7,420,925, which is less than the full market rental return of ten percent as determined by the independent appraiser.

To avoid the need for customer rate increases due to increases in the amount of rent owed, the annual rental payments would follow the current payment schedule previously adopted by Council, which calls for annual payments of $4,288,747 through 2011-12, and payments of $2,094,332 in 2012-13 and $2,094,331 in 2013-14 (CMR:238:04). At the end of 2010-11, or when the landfill is scheduled to close and be developed as a park, the cumulative difference between the amount charged and the rent payments made would grow to $21,925,247. This plan would add $13,447,837 to the current payment schedule. Annual rent payments of $2,094,331 would continue from 2013-14 through 2019-20 with a final payment of $881,851 due in 2020-21 (see Attachment A).

**RESOURCE IMPACT**
The current Long Range Financial Plan reflects projected net operating deficits for the General Fund in 2014-15 and beyond, due in part to the elimination of rental payments according to the existing smoothing schedule. These projected net operating deficits could be reduced or eliminated entirely under the proposed payment plan. The plan could have an impact on Refuse Fund rates and charges to the ratepayers over the long term.

**POLICY IMPACT**
This change to the Refuse Fund rent responds to an audit recommendation and will not impact the rent charges of other utility funds. In addition, a policy question still needs to be addressed related to how much Refuse Fund rent shall be set aside for park development. Staff will return at a later time with a recommendation addressing this policy question.
ENVIRONMENTAL REVIEW
This matter is not a project for the purposes of the California Environmental Quality Act.

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ATTACHMENTS
Attachment A: Schedule of Landfill Rent
Attachment B: CMR:441:05 “Response to the Audit Recommendation Regarding Rent Charged by the General Fund to the Refuse Fund on Unopened Portions of Landfill”