Appendix H - Working Paper on Cubberley Site

Why This Document?
Throughout the life of the Commission, Cubberley has stood out as the “elephant in the room.” Until very recently, we have been ambivalent about whether to expend any time and energy on a very complex and politically charged issue, other than gathering infrastructure needs related to the site. We were also unsure whether the Council even wanted any advice from us on the matter.

However, recent events have changed that dynamic. On June 27, the Council indicated its intent to explore selling the City’s 8 acres at Cubberley to the Foothill-DeAnza Community College District, and later reversed that decision when the Palo Alto Unified School District (PAUSD) board formally indicated its intent to reuse the site for a school. At the Commission’s July 18 workshop with the City Council, several Council Members asked questions directly related to Cubberley.

Since the Council and the PAUSD are unlikely to come to any decisions on Cubberley prior to our final report, and since decisions related to Cubberley could have a significant impact on infrastructure plans and financing, a number of us felt it was too important to address in a limited manner. Mark Harris, Jim Olstad, and Ray Bacchetti agreed to put together an issue paper covering the key elements of the Cubberley situation as a means to facilitate a discussion by the Commission regarding Cubberley. Even if the Commission ultimately decides not to make any recommendations regarding Cubberley, at least 17 city residents will be well versed on the Cubberley situation and could individually provide input to the Council at the appropriate time as he or she desired.

Background and Context of the Cubberley Situation
Substantial budget pressures were being experienced by the PAUSD due to a variety of circumstances starting in the late 1970s and early 80s, including

- passage of Proposition 13 in 1978.
- declining PAUSD enrollment and revenue during the post–Baby Boom era.

In response to that stressed financial situation, the PAUSD closed several schools and sold some existing school sites in order to help sustain its educational programs at the level the community expected. This included the closure of Cubberley in 1979 and the City’s acquisition of Terman in 1981, among the sale and/or closure of other sites.

The City realized that the PAUSD was one of the City’s major assets and its decline would have severely negative impacts on the City as a whole, not the least of which would have been a decrease in general property values. The City and the PAUSD also recognized that sites once sold would never again be available for school use should the trends reverse in the future.
In 1987, the City put Measure B on the ballot with the intent to create a 5 percent utility users tax (UUT) that would be used primarily to fund lease payments by the City to the PAUSD for unused school sites (Cubberley being the premier site) of about $4.0 million annually, with $2.7 million applicable to Cubberley. In 1989, the City and PAUSD entered into what is known as the Lease and Covenant Not to Develop Agreement (Cubberley Lease), which covers a variety of complex clauses including lease arrangements at Cubberley and other sites.

At the time the original lease negotiations were taking place, the City was in a relatively good position in terms of financial capacity as compared to the PAUSD’s circumstances. The Lease and Covenant Not to Develop arrangement had the benefit of providing a major injection of operating budget money to the school district, while providing corollary benefits to the City such as preserving open space and playing fields, providing childcare sites and protection from liability for new infrastructure requirements (how ironic!) had these sites then been sold and developed.

Flash forward nearly 25 years and the respective financial situations and site needs have changed dramatically.

Here are a few of the key developments that make the situation very different today:

- The PAUSD is now a Basic Aid District, which essentially means that local property tax revenue far exceeds the amount of revenue the State is required to provide the district in excess of “basic aid” – a very small amount per student. Although property tax revenue has been somewhat affected by the recent financial crisis, PAUSD has not seen the reductions that many other California school districts have encountered and is likely poised to see property tax increases in excess of inflation for the foreseeable future. Property taxes are budgeted to provide about 73 percent of the PAUSD’s general fund revenue in 2011–12, or about $114 million out of a $159 million budget. The remainder is accounted for as follows:
  - Federal funds: 3 percent
  - Local income: 5 percent
  - Lease revenue: 6 percent
  - Parcel tax: 7 percent
  - State income: 6 percent

- The district has received approval from the voters for more than $500 million (Measure B in 1995 and Measure A in 2008) and a $600 parcel tax (Measure A in 2010) generating about $11–12 million annually, or about 7 percent of its annual operating budget. In addition, parents provide gifts in excess of $2 million annually through the foundation Palo Alto Partners in Education (PiE).
Enrollment has recovered dramatically since its low in about 1990, to the point that the district is now reopening sites: most recently, Garland is slated to reopen in several years, and the Board recently expressed an intent to reuse the Cubberley site in the near future for a secondary school (which halted the Council’s efforts to negotiate an offer to sell the City-owned 8 acres at Cubberley to Foothill-DeAnza College).

Thus, the current respective financial and enrollment conditions related to the Cubberley Lease are substantially different than they were 22 years ago when the City and the PAUSD entered into it. Financially, the City has been grappling annually with the issue of balancing the General Fund operating budget as well as meeting the ongoing capital assets/infrastructure needs of the community (pressures which were the impetus for the formation of our Commission).

The City’s current option on the Cubberley Lease expires by its stated terms at the end of 2014, and the City must notify the PAUSD by December 31, 2013, if it intends to renew the lease for another five years.

Now is the time for the Commission to provide input regarding the lease agreement as it relates to infrastructure.

Key Elements of the Cubberley Lease as They Relate to Infrastructure and Infrastructure Financing

Cubberley Lease Payment. In the current 2011–12 operating budget, the City is obligated to pay $4.60 million in lease payments for Cubberley (section 2.1 of the lease). Those payments are escalated each year at an agreed upon inflation factor currently estimated at 3 percent. This payment covers the 27 acres leased from the district, not the 8 acres the City now owns as a renegotiated consequence of the swap for the Terman site approved in 2002.

Childcare Sites. The Lease Agreement also includes City payments to the PAUSD for onsite childcare at 12 elementary school sites. In 2011–12, the City will pay $0.675 million for the combined 12 sites including utilities costs. The City contracts with Palo Alto Community Childcare (PACC), a nonprofit provider independent from the City, to operate the 12 sites. PACC pays the City approximately $100,000 in rental payments and utilities reimbursement. The childcare lease also runs concurrent with the lease term and will end if the lease is not extended by mutual consent of the City and the PAUSD in 2014. Without any information to the contrary, we assume that this arrangement will be renewed even if the current Lease Agreement is not. If this were not the case, the City would have an additional net slightly in excess of $0.5 million dollars annually to use for other purposes.

Covenant Not to Develop. An additional $1.78 million expense is budgeted for 2011–12 with a similar 3 percent inflation factor for succeeding years. In reading
the Cubberley Lease agreement, it is a section (2.2) that is separate from the Cubberley payments but clearly under the grand lease arrangement. The sites included in the original covenant are Ohlone, Jordan, Jane Lathrop Stanford, Garland, and Greendell. The Lease agreement allows for sites to reopen without reducing the covenant payment as long as new elementary schools are substituted, which has happened over the lease term as PAUSD reopened schools due to increased enrollment. Section 4.1 indicates that the purpose of the covenant is “to prevent further burden on the City’s infrastructure and in order to preserve a substantial amount of the City’s remaining open space.” If the lease is not renewed, the covenant payments expire as well.

This clause now appears to be obsolete given the district’s recently expressed intent to reopen existing sites. Further, there is no current plan for any sites to be sold for development, and the district has just recently purchased additional property at 525 San Antonio Road. Ironically, the $1.78 million annual covenant payment (from the City to the PAUSD) directly or indirectly puts a burden on the City’s infrastructure budgeting because these funds are not available to support infrastructure needs including Cubberley maintenance.

These “reversed financial circumstances” clearly need to be addressed during the Cubberley Lease option considerations/negotiations process.

**Key Elements Regarding Cubberley Not Embedded in the Lease**

**City Ownership of 8 Acres.** Through a separate but related agreement, in 2002 the City obtained title ownership of 8 acres of the Cubberley site in a swap exchange for the Terman site, which the City had previously acquired through a lease/purchase arrangement it created in 1981. These 8 acres were the focus of recent Council actions related to Foothill-DeAnza’s offer to purchase the site.

Although the City has the right to develop the 8 acres, as it deems appropriate, until September 1, 2022, the school district has the right-of-first-refusal on the sale by the City of these 8 acres to another party. After that the City has an unencumbered right to sell the 8 acres, if it decides to do so. Of course, the City and the district can renegotiate a sale back to the district at any time.

Given recent actions by both governing bodies, it is unclear as to what the next-or-ultimate disposition of the property will be. The City could retain it and develop it for its own purposes, or sell it at market value estimated at between $15 and $28 million. The recent purchase of the 2.6 acres at 525 San Antonio by the school district for $8.5 million would indicate a current market value of approximately $26 million.
Revenues and Expenses at Cubberley Outside the Lease Obligations. Current revenue at Cubberley is $2.54 million annually composed of the following elements:

- Foothill-DeAnza lease $0.93 million
- Property rental (artists, nonprofits, etc) 0.52
- Hourly rental (events, use of theater, etc.) 1.02
- City office rental 0.07

Annual expenses total $2.21 million including routine annual maintenance costs of about $330,000. Thus, the Cubberley complex is showing a net positive cash flow of about $300,000 (excluding the lease-and-covenant payments expense).

Tenants at Cubberley are being heavily subsidized in their rental payments. When considering the annual lease payments, the City is paying the school district approximately $4 per square foot for the building space it leases. However, it is generating less than $1 per square foot in rental income.

Planned CIP and Deferred Maintenance. As discovered through our Commission’s infrastructure investigations, this maintenance liability – not included in the above figures – cumulatively totals about $18.8 million through 2036, with $10.2 million scheduled between now and 2016. Public works indicates that optimal maintenance expenditures should be about $800,000 versus the $330,000 currently expended. This projected aggregate maintenance liability has several implications.

First, the revenue and expense statement as typically presented to the Council – most recently in the slide presentation at the June 27, 2011, meeting – is incomplete in that it does not include these ongoing maintenance expenses. These real maintenance costs should be acknowledged and represented in future reports. Secondly, the City should neither continue nor consider expending this level of maintenance money into the facility until the long-term use or disposition of Cubberley is resolved. The City should spend only what is needed to keep the facilities operational and safe.

Conclusions

The conditions that created the original need for the Cubberley Lease agreement have changed dramatically and are no longer in play today. With our City struggling to meet the financial requirements of the General Fund, let alone catching-up and keeping-up with the maintenance of the City’s overall infrastructure demands, now is the appropriate time for the school district to re-establish its management and financial responsibilities of and for the Cubberley site.

The Cubberley Lease agreement, with its associated amendments, has accomplished what it set out to achieve more than 20 years ago. It has preserved valuable public space and kept it maintained and available for public use and
enjoyment. In addition, it has provided the PAUSD with more than $125 million in operating cash to date, and will provide approximately $150 million in total cash infusion by the end of the current lease arrangement in 2014, if it is not terminated or amended prior to this date. Finally, it has preserved these sites for the district for its future use as and when necessary (which is apparently the case now).

As we indicated earlier, the PAUSD’s financial situation has improved dramatically over the past 20 years: with the passage of major bond issues for reconstruction and improvements to school facilities, generous community support through contributions to Palo Alto PiE, passage of a sizable parcel tax, and the attainment/surpassing of Basic Aid status. The district is in a strong financial position to finance its operations without all of the subsidies provided by the City through the Cubberley Lease Agreement.

The residents and businesses, through the City government, have contributed significantly to the restoration and financial strength of the district. With strong reserve balances and more than three years of payments left on the current lease option, the district should have sufficient time and financial resources to plan for a smooth transition to clear ownership.

Recommendations

The City should, at a minimum, decline to renew the Cubberley and non-development portions of the Lease and Covenant Not to Develop agreement in order to free $6.1 million (net of rental revenue) annually (in current dollars) and avoid a substantial portion of the upkeep expenditures of $18.8 million (in current dollars) through 2036. Indeed, it would be mutually beneficial for the City and the school district to begin discussions now on any potential new lease agreements related to childcare facilities or other noneducational uses, the transition of the 27 acres back to school district management, and clarification on the final disposition of the City’s 8 acres.

The $6.1 million operating expense savings represents potential annual cash availability to the City that could be reassigned to several infrastructure problem-solving applications. Example 1: If these funds were committed to a new issue of certificates of participation, it could finance a 30-year, $100 million debt obligation, sufficient to finance a new Public Safety Building and replace two fire houses. Example 2: If the funds were used to rebuild an Infrastructure Reserve, it could enable forward funding of new or renovated City assets, accommodating unexpected infrastructure costs without disturbing the ability of the City to keep up routine infrastructure maintenance needs, enable the raising of existing infrastructure quality (e.g., condition of streets, parks, and sidewalks), or any number of other real property redevelopment initiatives (including repurposing other existing infrastructure assets).

Regarding the 8 acres of Cubberley that the City owns, it is important to evaluate the best use of the parcel in relation to the future needs of the community. Historically,
there has been a secondary school campus on these 8 acres and the adjoining 27 acres owned by the school district. This may not be the same use going forward. Indeed, the school district should have considerable flexibility in the design of a middle school and/or high school campus on its 27 acres, together with the school district’s adjacent property at the former Greendell school site and the property recently purchased at 525 San Antonio.

Therefore, we encourage the City to evaluate potential alternatives for the highest and best use of its 8 acres on Middlefield Road, including the possibility of developing a variety of “community center” resources that could provide services to residents. In the event this process does not result in an approved plan for new City infrastructure on its 8 acres, then it may be preferable for the City to pursue sale of the land, either to the school district or to another purchaser. The City is presently bound by the school district’s right-of-first-refusal until September 1, 2022. In any event, the City should request a clear indication from the school district concerning its interest in the 8 acres.

Until the final disposition of the Cubberley site is determined, the City should spend only the minimum amount of funds necessary to keep the site safe and operational for the tenants occupying it. Major expenditures in facilities upgrades will be wasted if a major portion of the site is later razed to construct a new educational facility at Cubberley.

Respectfully submitted,
Mark Harris
Ray Bacchetti
Jim Olstad
November 30, 2011

References
1. Lease and Covenant Not to Develop Between the City of Palo Alto and Palo Alto Unified School District dated September 1, 1989
2. Amendment #1 to the Lease and Covenant Not to Develop dated July 21, 1999
3. Amendment #2 to the Lease and Covenant Not to Develop dated August 13, 2002
4. Background on the Utility Users Tax prepared by Lanie Wheeler dated May 2010
5. City Manager’s Report #1866 (Direction on the Submission of Letter of Interest to Foothill College Regarding new Educational Center at Cubberley Community Center) and associated Power Point Presentation prepared by Deputy City Manager Steve Emслиe for the Council Meeting of June 27, 2011
6. Various conversations and e-mail correspondence with City senior staff members Steve Emслиe, Lalo Perez, Phil Bobel, and Joe Saccio regarding the Lease and Covenant Not to Develop from July through October 2011
7. Accuracy of the working paper information verified by City senior staff members Steve Emслиe, Lalo Perez, and Phil Bobel

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