COUNCIL AGENDA: 5-02-06
ITEM: G.2

CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: HONORABLE MAYOR AND CITY COUNCIL

FROM: William F. Sherry, A.A.E.

DATE: 4-12-06

SUBJECT: FUEL FARM LEASE AND OPERATING AGREEMENT BETWEEN THE CITY OF SAN JOSE AND SJC FUEL COMPANY, LLC

Approved

Date 4/18/06

Council District: Citywide

RECOMMENDATION

a) Approval of a new Fuel Farm Ground Lease and Operating Agreement with SJC Fuel Company, LLC for the development of a jet fuel storage facility for a term of 30 years, with an approximate annual rent to the City in the first year of approximately $368,134.
b) Adoption of a resolution authorizing the Director of Aviation to negotiate and execute any amendments to the Fuel Farm Ground Lease and Operating Agreement with SJC Fuel Company, LLC to reduce the size of the leasehold premises at no change in the rent per square foot, as necessary to reflect changes in the plans and specifications for the fuel storage facility, as such changes may be approved by the Director of Aviation.

OUTCOMES

Approval of the Fuel Farm Lease and Operating Agreement will allow the development and operation of a new fuel storage facility allowing the closure of the existing fuel farm and construction of the new terminal roadway system.

BACKGROUND

The construction and operation of a new airline fuel storage and dispensing facility is one of the critical improvements recommended in the Airport Master Plan, adopted June 1997. The airlines serving Mineta San José International Airport have agreed to form a Consortium as a separate entity to fund and oversee the construction and operation of the facility. This method is common

in the airport industry, such as with Orange County, Portland, Phoenix, Burbank, Sacramento, Seattle, San Francisco and Los Angeles.

On June 27, 2000, Council adopted Resolution Number 69712 authorizing the City Manager to negotiate and execute a new Fuel Farm Ground Lease, Operating Agreement, and any other documents necessary to effect the transaction with San José Fuel Company, LLC, for the development of a jet fuel storage facility for a term of 30 years. The agreement was never completed as a result of the economic impact of September 11, 2001 and the airlines' inability to commit to the cost of the project. However, the airlines have come together again with the firm intention of funding, building and maintaining a fuel facility. A fully executed Fuel Farm Ground Lease Agreement must be in place in order for the Consortium to secure financing for the construction.

Pursuant to the Airport Master Plan, the project will provide up to four (4) million gallons of storage capacity, although development is expected to be implemented in phases as demand warrants. Design of the new facility would consist of installation of fuel storage tanks located on vacant Airport property on the north side of Hwy 101; fuel dispensing racks located on the airfield ramp north of Terminal A; and a pipeline under Hwy 101 connecting the storage and dispensing sites. Environmental mitigation measures identified in the Airport Master Plan EIR would be incorporated into the project plans. The Consortium would be required to obtain development permits from the City and other entities. The total project cost is approximately $30,000,000 (thirty million) dollars.

ANALYSIS

The airline Consortium will be made up of all scheduled carriers and cargo operators. The Fixed Base Operators, Into-Plane fueling agents, Itinerant (non-scheduled) and other Non-Contracting Users shall have access to the Fuel System, subject to reasonable and non-discriminatory rules, regulations and fees established by the Consortium and approved by the Director of Aviation. The Consortium will enter into an Agreement with a third party to operate and maintain the fuel farm. The contracting airlines will also formally agree among themselves as to their obligations for the use, operation and improvement of the Fuel System, and the allocation of costs and revenues of the Fuel System. The specific cost for fuel accessed from the fuel farm by airline carriers will be stipulated in an Interline Agreement between the Consortium members as a formula based on recovery charges for the actual fuel and recapture costs and capital improvements and operations. Airport staff has reviewed the terms of the Interline Agreement and the agreement between the Consortium members, with the objective of insuring that new entrants to the Airport are treated fairly regarding access to the cost of fuel and to membership in the Consortium.

The rental rate for the ground lease is $1.52 per square foot per year in accordance with Resolution #72250, which is the rate resolution that establishes rental fees for use, in part, of unimproved land. The rent will increase by 1% per year and be readjusted every five years

based on an appraisal of the property. The project is expected to encompass approximately 242,193.6 square feet of space. The rent for the first year would be approximately $368,134.

The Consortium's goal is to complete construction and begin operation within thirty (30) months from date of execution. The lease also includes a provision for rent credit to the Consortium in the amount of $500 dollars per day upon early completion.

Upon construction and operation of the new fuel storage/dispensing facility, the existing Chevron fuel facility will be permanently closed. The existing facility consists of the active Chevron fuel farm and the immediately adjacent inactive City fuel farm facility. The regulators have granted a waiver to the Airport for permanent closure of the inactive City fuel farm due to its close proximity to the active Chevron fueling facility, as removal activities could possibly damage the active Chevron facility. This waiver expires in May 2008. Upon closure of the active fuel facility, staff plans to work with Chevron to take appropriate remediation measures to address contamination issues at the their site. Closure and removal of both the active and inactive fuel facilities within this timeframe is necessary, because they are in the path of roadway improvements required under the roadway master plan construction that begins in early 2008.

It is a mutual goal of both the Airport and the Airlines to provide access to an efficient Fuel Farm Facility at the lowest rate possible. As discussed above, the Fuel Farm Ground Lease Agreement defines the Leased Premises and construction provisions for the development of a fuel receipt, storage and delivery system. However, the Consortium's project design phase, subsequent to execution of the ground lease, may support an alternative system that is superior to the current proposal under the ground lease. Specifically, the Consortium is presently studying the feasibility and cost of an alternative system that would utilize substantial existing off-airport storage capability, rather than building all new tanks on Airport property. This off-airport storage would then be connected via pipeline to a smaller new tank on Airport property on the north side of Hwy 101 to provide some on-airport storage. In the event that the Director approves the alternative system, the Consortium would require a smaller leasehold space than currently planned. Therefore, the Director requests that Council delegate the authority to enter into any required amendments to the Fuel Farm Ground Lease necessary to reduce the size of the leasehold premises in the event that the Director approves the alternative system.

The Fuel Farm Lease between the City and the Consortium includes standard language, which requires the Consortium to indemnify the City from all consequences of the Consortium's use of the leased premises, including the release of hazardous materials.

ALTERNATIVES

Airport staff evaluated alternative methods for the construction and operation of an Airport fuel system, including a system financed, owned and operated by the Airport, as well as an oil or

pipeline company financed, owned and operated fuel system. These alternatives were not pursued since the cost of fuel is lowest with a system owned and operated by the Consortium.

MASTER PLAN CONSISTENCY

The San José Municipal Code requires that capital projects at the Airport be consistent with the adopted Airport Master Plan. As the proposed lease and operating agreement is for the fuel storage facility explicitly identified in the Master Plan as Project "S-1," the proposed action is consistent with the Airport Master Plan pursuant to Municipal Code Section 25.04.210 (B)(2).

PUBLIC OUTREACH

Not applicable.

COORDINATION

This memo has been coordinated with the City Attorney's Office, Public Works Department and Risk Management.

COST IMPLICATIONS

There are no City costs associated with this agreement or the proposed amendment.

CEQA

Resolutions No. 67380 and 71451, PP 06-029.

WILLIAM F. SHERRY, A. A. E.
Director of Aviation
Airport Department

For questions, please contact Bill Sherry at (408) 501-7669.