COUNCIL AGENDA: 06-19-07
ITEM: 2.4

CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: HONORABLE MAYOR AND CITY COUNCIL

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

SUBJECT: **SEE BELOW**

DATE: May 29, 2007

Approved Kay Winer   Date 6/4/07

Council District: City-Wide

SUBJECT: ADOPTION OF A RESOLUTION ESTABLISHING A LONG TERM GROUND LEASING POLICY FOR MINETA SAN JOSE INTERNATIONAL AIRPORT

RECOMMENDATION

Adoption of a resolution establishing a long term ground leasing policy for Mineta San Jose International Airport ("Airport") that sets forth standard business terms and conditions for the lease of undeveloped ground at the Airport.

CEQA: Resolutions No. 67380 and 71451, PP 07-077.

OUTCOME

Approval of the resolution will establish standard terms and conditions for all aviation and non-aviation long term ground leases at the Airport. This publicly available policy will enable interested parties to familiarize themselves with the basic business terms and conditions of long term ground leases, provide standard terms for any future request for proposal for the lease and development of Airport property, and minimize time spent in negotiating basic business terms and conditions of such ground leases.

BACKGROUND

Ground rental rates at the Airport are currently set pursuant to Resolution 72250. Under that Resolution, the rental rate for undeveloped land was established and increases by the Consumer Price Index (CPI) every July 1. The Resolution also gives the Director of Aviation the authority to have Airport property appraised and to set the annual ground rental rate at 10% of the appraised value per square foot. However, no lease terms or conditions other than ground rent have been established as standard terms. As a result, each ground lease is negotiated individually, resulting in a more time consuming process and potential inconsistencies between each agreement.

ANALYSIS

The proposed resolution establishes a long term ground leasing policy for the lease of undeveloped ground at the Airport. This policy would apply to all future ground leases with a term of over 7 years. While all such leases would require Council approval, any lease terms and conditions that do not fall within the policy would be highlighted and need to be specifically approved by Council.

The long term leasing policy incorporates the following terms and conditions:

Use

- Intended use of the property for aviation related uses must be consistent with the City's Airport Master Plan. Aviation related development requiring airside access will receive the highest priority for ground leasing opportunities. Other uses in order of priority shall be: aviation related development not requiring airside access; aviation operation and maintenance support facilities; aviation business and service related facilities; and non-aviation related business and service related facilities not requiring airside access.
- The leased premises shall be delivered "as is" with no warranties as to habitability or use.
- FAA approval will be required for all non-aviation uses.
- The City shall not be responsible for the payment of brokerage fees for the leasing or development of Airport property.

Term

- Applies to ground leases with terms over 7 years (typical minimum term for amortization of any investment); maximum lease term is 30 years for aviation related uses and 40 years for non-aviation related uses.
- The length of term will be determined by the amount of the investment in the property and guided by the attached Investment Term Schedule. The Investment Term Schedule investment amounts will increase annually on July 1 pursuant to the CPI.

Rent

- Rental rates for Airport property or Airport controlled property should be established at fair market value as legally permissible.
- Initial ground rent is market rate and established in accordance with the City's then-current policy for setting Airport ground rent.
- Ground rent will increase annually pursuant to the CPI. The premises will be reappraised every 5 years and the rent will be adjusted accordingly. As an alternative to reappraisal,

the City can use the value of similar property to establish the rent adjustment. In no event will the rent ever decrease below the then current rent.

- Tenant shall pay a reduced "construction" rent of one-half the lease rate for up to 12 months (may be less, depending on project scope) or upon receipt of certificate of occupancy, whichever occurs earlier.
- Upon expiration of the original lease term, in the event that the City agrees to re-lease the property to the tenant, the tenant will pay market value rent to the City for both the leased premises and the improvements, should the tenant wish to continue leasing the premises.
- A security deposit equal to two months' rent in the form of cash or a letter of credit shall be required.

Improvements

- Construction of the proposed improvements must commence within 12 months from the execution date of the ground lease. Failure to commence construction within this time frame will result in liquidated damages and/or termination of the ground lease.
- Tenant shall be responsible for the cost of bringing any utilities required for its operations to the leased premises.
- Ownership of improvements, except for tenant's personal property and trade fixtures, reverts to the City upon lease expiration, or the City may require demolition and restoration of the site to its original condition.
- The tenant may use and store hazardous materials on the leased premises only to the extent necessary to conduct its operations at the Airport and subject to all applicable laws and permit requirements. The tenant shall be responsible to remediate any releases of hazardous materials caused by the tenant on the leased premises during the term of the lease.
- Any request to mortgage, pledge or otherwise encumber the tenant's interest in the lease or the improvements shall be subject to the City's consent, which shall not be unreasonably withheld. Reasonable grounds for denying consent shall include, but are not limited to, the following:
  - The tenant proposes to mortgage, pledge or otherwise encumber more than seventy-five (75%) of the value of the tenant improvements.
  - The terms of any proposed mortgage or encumbrance will materially and adversely affect the City's interest in the premises or the tenant improvements.

Sublease/Assignment

- The City reserves the right to terminate the lease and recapture the premises in the event the tenant requests approval of a sublease of all or any portion of the premises or assignment of the lease to any third party that is not an affiliate of the tenant. For the purpose of this provision, "affiliate" shall mean any entity that controls, is controlled by, or is under common control with the tenant. "Control" in this context shall mean the direct or indirect ownership of more than fifty percent (50%) of the voting securities of an entity or possession of the right to vote more than fifty percent (50%) of the voting interest in the ordinary direction of the entity's affairs.

- If the City decides not to terminate the lease upon receipt of a request for assignment or sublease to any third party that is not an affiliate of the tenant, the City will not unreasonably withhold its consent to the proposed assignment or sublease. Reasonable grounds for denying consent shall include, but are not limited to, any of the following:
    - The proposed transferee's intended use of the premises is not for an aviation-related purpose or will materially and adversely affect the City's interests at the Airport.
    - The proposed transferee's financial condition is or may be inadequate to support its obligations under the lease.
    - The proposed transferee has failed to meet any legal or contractual obligations to the City or is adverse to the City in any pending litigation.
- Should the City approve a sublease or assignment to any third party that is not an affiliate of the tenant, the City shall receive fifty percent (50%) of any profits the tenant derives from subletting or assigning its interest in the premises.
- Any request by the tenant for approval of a sublease, assignment, mortgage, pledge or other encumbrance to any third party that is not an affiliate of the tenant shall be subject to a $1,000 administrative fee for costs incurred by such request.

Insurance

- The tenant's minimum insurance requirements shall be determined by the City's Risk Manager.

POLICY ALTERNATIVES

As an alternative to the new Resolution, the City has the option of continuing to negotiate Airport ground leases on a case-by-case basis. This alternative, however, perpetuates the less efficient processing time and administrative burden for routine decisions, leases, licenses, permits and agreements, with this burden impacting not only staff, but Council as well.

PUBLIC OUTREACH/INTEREST

☐ **Criteria 1**: Requires Council action on the use of public funds equal to $1 million or greater. **(Required: Website Posting)**

☐ **Criteria 2:** Adoption of a new or revised policy that may have implications for public health, safety, quality of life, or financial/economic vitality of the City. **(Required: E-mail and Website Posting)**

☐ **Criteria 3:** Consideration of proposed changes to service delivery, programs, staffing that may have impacts to community services and have been identified by staff, Council or a Community group that requires special outreach). **(Required: E-mail, Website Posting, Community Meetings, Notice in appropriate newspapers)**

This item does not meet the above criteria requiring additional notification; however, it will presented to the Airport Commission on June 5, 2007 and posted on the City's Council Agenda Website for the June 19, 2007 Council Meeting.

COORDINATION

This proposed resolution has been coordinated with the Budget Office, the Office of Economic Development and the City Attorney's Office.

FISCAL/POLICY ALIGNMENT

The Agreement is consistent with the Economic Development Strategy adopted by Council in November 2003 and aligns most significantly with Strategic Initiative #1: Build a World-Class Airport and Air Services.

CEQA

CEQA: Resolutions No. 67380 and 71451, PP 07-077.

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

For questions, please contact William Sherry, Director of Aviation, at (408) 501-7669.

INVESTMENT TERM SCHEDULE

Aviation Related

Dollars Invested			Term
$1,000,000	-	$3,000,000	8 to 10 years
$3,000,000	-	$8,000,000	10 to 15 years
$8,000,000	-	$13,000,000	15 to 20 years
$13,000,000	-	$18,000,000	20 to 25 years
$18,000,000	-	$23,000,000	25 to 30 years
Greater than		$23,000,000	Negotiable

Non-Aviation Related

Dollars Invested			Term
$8,000,000	-	$13,000,000	15 to 20 years
$13,000,000	-	$18,000,000	20 to 25 years
$18,000,000	-	$23,000,000	25 to 30 years
$23,000,000	-	$28,000,000	30 to 35 years
$28,000,000	-	$33,000,000	35 to 40 years
Greater than		$33,000,000	Negotiable