



Memorandum

TO: HONORABLE MAYOR
AND CITY COUNCIL

FROM: Kim Walesh
Joseph Horwedel

SUBJECT: Zero Waste Energy Development
Company Lease

DATE: June 7, 2011

Approved

Date

6/8/11

COUNCIL DISTRICT: 4
SNI AREA: N/A

RECOMMENDATION

- a. Adoption of a resolution to adopt the Mitigated Negative Declaration prepared for the Dry-Fermentation Anaerobic Digestion Facility Project, File No. SP09-057, as having been completed in compliance with the California Environmental Quality Act and reflecting the City's independent judgment and analysis, and to adopt a related mitigation monitoring and reporting program. Council District: 4 (Planning, Building and Code Enforcement)
- b. Adopt a resolution to authorize the City Manager to execute a ground lease in the form proposed, with Zero Waste Energy Development Company (ZWED) for the construction and operation of a dry anaerobic digestion facility on Water Pollution Control Plant land, for a 30 year term, with an annual base rent equivalent to \$850,000 on Phase I, and potential additional rent payments of \$4.35 per organic ton processed in Phases II and III, subject to annual adjustment directly tied to Consumer Price Index increases.

OUTCOME

Approval of this ground lease will allow Zero Waste Energy Development Company, LLC (ZWED) to construct a three-phase dry fermentation Anaerobic Digestion facility that will process organic material from San Jose and other municipal solid waste streams and convert it into electricity.

BACKGROUND

Staff was approached by ZWED in 2008 regarding the possible use of Plant buffer lands for the development and operation of a dry anaerobic digestion facility to process organic waste. On June 16, 2009, the City Council approved a Memorandum of Understanding with ZWED

June 7, 2011

Subject: Zero Waste Energy Development Company Lease

Page 2

directing staff to develop lease terms for the proposed development following their expressed interest in the property. The City based its selection of ZWED on the common ownership of the proposed facility with the adjacent properties.

The Site was acquired in 1982 as part of the buffer lands of the Plant. The City of San Jose and the City of Santa Clara are joint owners of Plant lands under the terms of the 1959 San Jose Santa Clara Joint Powers Authority Agreement. The treatment plant serves the homes of 1.4 million residents and about 17,000 main commercial/industrial sewer connections across the cities of San José, Santa Clara, Milpitas, Cupertino, Campbell, Los Gatos, Monte Sereno, and Saratoga. The cities and sanitation districts that contribute to the Plant share in any land use revenues. The site operated as a private landfill from approximately 1938 to 1969. The original landfill operation encompassed 166 acres which included the still operating Zanker Road Landfill property; the Zanker Resource Management Company purchased its 70-acre portion from the City in 1982. Since the cessation of disposal activities at Nine Par, the site has remained mostly undeveloped with only a recycled water filling station fronting the site and intermittent soil management and cover maintenance activities occurring as needed. More than half of the site's 96 acres are designated as wetlands leaving an approximate developable area of 40 acres.

Older landfills, such as Nine Par, present potential threats to groundwater from contaminants leaching from waste, landfill gas hazards as a result of decomposing waste, and structural concerns due to differential settlement of the site over time. Consequently, development of the site will require review under California Title 27 Regulations as a Post Closure End Use activity. Under these regulations, the City of San José is the Local Enforcement Agency (LEA) for the non-operating inactive Nine Par landfill site, and must approve an amendment to the Solid Waste Facility Permit and Closure Plan. A Solid Waste Facilities Permit (SWFP) will need to be obtained from the LEA, and concurred by the CalRecycle Permit Program, to cover proposed activities on the site. Development and activities on the site have also been extensively coordinated with the San Francisco Bay Regional Water Quality Control Board.

The Anaerobic Digestion Facility will be owned, managed and operated by Zero Waste Energy Development Company, LLC (ZWED). ZWED is a partnership between Zanker Road Resource Management, Ltd. and GreenWaste Recovery, Inc. Each company is separate and distinct and, while they share some common ownership, the companies and their facilities are operated independently and have separate and distinct functions. The two facilities adjacent to the Nine Par site, Zanker Road Resource Recovery Operation and Landfill (ZRRROL) and Zanker Material Processing Facility (ZPMF), are owned in their entirety by Zanker Road Resource Management, Ltd.

ANALYSIS

The subject 40 acre site is currently vacant and consists of a portion of the former Nine Par Landfill, a tidal marsh area, and the Plant's inactive recycled water filling station. The Nine Par Site is adjacent to the Zanker Road Resource Recovery Operation and Landfill and the Zanker Material Processing Facility.

June 7, 2011

Subject: Zero Waste Energy Development Company Lease

Page 3

Development

ZWED proposes to develop the project in three phases, with each phase being capable of handling 75,000 tons of incoming organic waste material per year plus 15,000 tons of bulking material and compost amendments, for an eventual total of 225,000 tons of organic feedstock and 45,000 tons of bulking agent to be used in the anaerobic digestion process per year. The 15,000 tons of bulking material added at each phase will be transferred from the adjacent ZRRROL facility.

The proposed project will include three approximately 60,000 square foot enclosed buildings. Each building will include an enclosed receiving area for organic waste delivery and storage, sixteen digesters for the extraction of biogas, an engine room, compost curing tunnels, and a biogas storage area. The enclosed buildings will be equipped with an air circulation control system that will regulate air within the structure, and exhaust air through biofilters in a manner that controls any odors and emissions. The facility will also include a maintenance shop, administrative office, and washroom facilities for employees.

Business Terms

Valuation

The nature and previous use of the site present significant challenges to any future use. In addition to the added regulatory processing associated with the former landfill use, the site is currently not served by utilities, is surrounded by undesirable uses and requires significant investment in the design of any development due to the geotechnical challenges associated with construction on top of waste. In considering whether the site is suitable for this or any development these considerations have needed to be analyzed, especially in the context of determining an appropriate valuation.

Through analysis and evaluation of comparable light industrial properties in the immediate area, staff has determined the fair market value of the Phase 1 portion of the site for the duration of the lease to have a net present value equivalent to the site improvement costs of \$11.8 million. As ZWED shall perform all pre-development work associated with site preparation, staff has worked closely with ZWED to determine the costs associated with bringing the complete site to a developable condition. Under the terms of the proposed lease agreement, ZWED will be credited up to \$850,000 per year towards the Phase 1 base rent to offset the total amount to be expended on site improvement amortized over 30 years at a rate of 6%.

Term

The City and ZWED will enter into a ground lease with an Initial Term of seven years from the date of execution for all three leaseholds comprising approximately 40.7 acres of leasable area. ZWED shall have an automatic irrevocable right to continue the leasehold for the Phase 1 portion of the site for an additional 23 years following the initial term. In the event that ZWED has started implementation of Phase 2 of the development by submitting a complete building

June 7, 2011

Subject: Zero Waste Energy Development Company Lease

Page 4

permit package within the initial seven year term, it shall have the right to continue the Phase 2 leasehold for the remainder of the 30 years, and continue the Phase 3 leasehold for an additional five years. ZWED will have to begin implementation of Phase 3 within this 5 year renewal period in order to maintain the Phase 3 leasehold.

In the event that ZWED has not commenced the implementation of either Phase 2 or Phase 3 as specified, the lease provides for three options to extend the Initial Term for the Phase 2 & Phase 3 leaseholds by one year, exercisable upon notice and payment of \$100,000 for each year and each option. Exercising these options will not extend the 30-year term of the lease. The lease provides the right to exercise one additional ten-year option on continuous renewal of the full lease based on an appraised market value less 10%.

Rent

The base rent for Phase 1 shall be payable as a proportional credit against the expenditure of site development costs or as a payment of \$850,000 per year. Rent for Phases 2 and 3 shall be collected on the number of organic tons collected at the facility. Every ton above the anticipated 75,000 tons of organic waste anticipated in Phase 1 shall be subject to a \$4.35 per ton of organic waste. To ensure that the City maintains payment equivalent to fair market value for Phases 2 and 3, a minimum payment equivalent to 60% of all anticipated tonnage has been included in the lease. Per City Council's direction though the approved Memorandum of Understanding, the per ton payments will be periodically adjusted by a factor equal to one plus the Annual Percentage Change in the CPI-U index. Staff has also negotiated a one-time 10% increase in the per ton rate due at the time of the first ton entering Phase 2 of the project. Assuming a 3% per year increase to represent CPI-U, and 18 months construction time for Phase 2 development, staff anticipates rent to begin as payment of \$297,470 in year nine of the lease. This is projected to increase to a payment of \$689,699 in year 14 of the lease as Phase 3 become active. Over the 30 year life of the lease, staff is anticipating minimum payments of over \$16.5 million. Incoming revenues will be distributed between the City of San Jose, City of Santa Clara and tributary agencies as predetermined by the master agreements with these agencies.

Assignment

Assignment or sublease is subject to the approval of the City and all use of the property will further the intent and/or goals of the City's Green Vision. In the event that ZWED meets the conditions in order to lease either Phase II or Phase III and does not construct the corresponding phases of the anaerobic digestion facility, but intends to use the property for another purpose or assign or sublease the property to a separate entity, both parties agree to negotiate on the appropriate equivalent to the per ton payment provided by the anaerobic digestion facility.

Liabilities/Indemnification

Under the provisions of the lease, the City retains liability for the physical and environmental condition of the property, including any hazardous materials present, previously landfilled materials, soils and groundwater conditions in existence prior to July 1, 2011. The City is also responsible for compliance with any applicable laws relating to the conditions. However, ZWED

June 7, 2011

Subject: Zero Waste Energy Development Company Lease

Page 5

will be responsible for the cost of improving the site which will include any predetermined remediation relating to pre-existing conditions as a result of development. The City is indemnified against any costs or actions actually incurred or sustained as a result of the introduction of hazardous materials to the property or the exacerbation of any existing or unknown contamination caused by ZWED. ZWED has also agreed to perform the following maintenance activities:

- Mowing and Weed Abatement
- Erosion Control and Repair
- Maintenance and Replacement of Landscape/Vegetation
- Irrigation and Maintenance for Frontage Plantings along Los Esteros Road
- Maintenance and Repair of Landfill Cap and Site Drainage Infrastructure
- Maintenance and Repair of Site Fencing
- Ongoing Vector, Fire and Litter control
- ISO Settlement Mapping and reporting every 5 years.

Process

Staff has been working with ZWED since approval of the Memorandum of Understanding in 2009 to understand the full extent of the challenges posed by potential development of the site and to work through a lease structure that supports this innovative use of the property. The substantial details of the lease, including the responsibilities for maintenance of the site and any monitoring associated with the former landfill, have been negotiated and attached in draft format. Staff has continued to work expeditiously with ZWED to meet their timeline which is tied to the City's commercial organic waste processing service. The timeline is also linked to a Section 1603 grant program as part of the American Recovery and Reinvestment Act of 2009 which provides cash grant incentives for renewable energy projects but requires a portion of construction be completed by the end of the calendar year.

Because the City of Santa Clara owns the plant lands jointly with the City of San Jose, the Santa Clara City Council will also need to approve the lease. TPAC recommendation is also required for the consideration of a lease or other agreement between the two joint owners. In addition, the Milpitas City Council and the boards of the tributary agency sanitation districts need to approve amendments to their respective Tributary Agency Agreements. Staff has coordinated with TPAC and the City of Santa Clara throughout the negotiation of the proposed lease and following Council's action on the resolution authorizing the City Manager to negotiate and execute the ground lease, staff will coordinate with City of Santa Clara staff to bring the item before Santa Clara City Council.

Conclusion

The ability to leverage private investment in City property, provide an immediate resolution to a potential burden to City resources and to create a future revenue stream applicable to the General Fund represents a significant benefit to the City. Due to the unique disposition of property and the potential for future requirements to remediate, maintain and monitor this complex site even in the event that no project occurs, the facilitation of complementary development to the

June 7, 2011

Subject: Zero Waste Energy Development Company Lease

Page 6

surrounding uses represents the best alternative for use of the property. The proposed use is consistent with the preferred Land Use Alternative for the Plant Master Plan and provides benefit to the City's long-term sustainability goals by diverting waste from landfills through conversion it into a renewable energy source. The lease is also consistent with the Council's adopted guiding principle for City ownership of real estate: supporting the cost-effective delivery of core City services to the community. Future revenue from the lease will support City services, while the site is currently generating no revenue and is not supporting any City services.

PUBLIC OUTREACH/INTEREST

- Criterion 1:** Requires Council action on the use of public funds equal to \$1 million or greater. **(Required: Website Posting)**
- Criterion 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)**
- Criterion 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 action does not meet any of the above listed criteria; however it will be posted on the City's website for the June 21, 2011, Council agenda.

COORDINATION

This memorandum has been coordinated with the City Attorney's Office, Environmental Services Department, and Planning Building and Code Enforcement. This item is scheduled to be reported at the June 16, 2011 Treatment Plant Advisory Committee.

COST SUMMARY/IMPLICATIONS

Zanker Road Biogas, LLC, will be responsible for all one time and ongoing costs related to the development and operation of this facility, including site preparation, permitting, project design, construction, operations, maintenance, and on-going closed landfill mitigation monitoring on the Nine Par parcel related to this project.

This project will likely produce lease revenue for the City, City of Santa Clara and tributary agencies. As a joint owner of the Plant lands, Santa Clara is entitled to receive a share of any income derived from the lease of Plant lands during the term of the JPA. The Master Agreements governing the relationships for the City of Milpitas and the Cupertino Sanitary, West Valley Sanitation, Burbank, and Sunol sanitary districts provide the agencies with

June 7, 2011

Subject: Zero Waste Energy Development Company Lease

Page 7

"participation rights" in the Plant lands through 2031. The Master Agreements state that, if San Jose and Santa Clara sell or otherwise dispose of any of the lands no longer needed for Plant purposes, the agencies have the right to share in any revenue derived. The Master Agreements further provide that Santa Clara and the tributary agencies are not entitled to receive revenue from the disposition of land until they have fully paid their allocable share of land costs. It should be noted that San Jose is scheduled to annex the entire Sunol District over the next few years, and as a result, San Jose will assume all of Sunol's rights in the Plant lands.

CEQA

The Director of Planning recommends that the City Council adopt a resolution adopting the Mitigated Negative Declaration (MND) prepared for the Zero Waste Development Company Dry-Fermentation Anaerobic Digestion project (File No. SP09-057) as having been completed in compliance with CEQA reflecting the City's independent judgment and analysis, and the adoption of a mitigation monitoring and reporting program.

On April 8, 2011, the Director of Planning, Building and Code Enforcement circulated an Initial Study/Draft Mitigated Negative Declaration for a 30-day public review through the State Clearinghouse in conformance with the requirements of the California Environmental Quality Act (CEQA). The project is for the Zero Waste Energy Development Company to construct a 270,000 ton per year dry fermentation anaerobic digestion (AD) facility to process the organic portion of solid waste. The facility includes three 60,000 square foot buildings, incidental office space, biofilters, outdoor space for aerated curing piles, screening and stockpiling finished materials, six power generators and three emergency generators on an approximately 41 gross acre site.

The project is consistent with the existing zoning for the site, which is LI Light Industrial, and allows recycling processing facilities and co-generation facilities with a Special Use Permit. The project is also consistent with the General Plan Land Use designation of Public/Quasi-public for the site in that the use is a part of the City's Zero Waste Strategy by diverting the City's commercial food waste away from landfills and converting it to compost and biogas.

The Initial Study and MND for the AD facility was prepared and processed in compliance with the requirements of CEQA (see: <http://www.sanjoseca.gov/planning/eir/MND.asp>). The Director of Planning, pursuant to the requirements of Title 21 of the San Jose Municipal Code, reported that there is no substantial evidence in the public record received to date that the project will have a significant effect on the environment with the identified mitigation measures included in the project. The MND has been prepared and processed in a manner that reflects the City's independent judgment and analysis as Lead Agency.

The City has identified potential significant impacts as a result of the project to Air Quality, Biological Resources, Geology and Soils, Hazards and Hazardous Materials, Hydrology and Water Quality, and Noise. All of the significant impacts identified can be reduced to a less than significant level with mitigation. The mitigation measures are identified in the Initial Study, the Mitigated Negative Declaration, and the Mitigation Monitoring and Reporting Program for the project.

HONORABLE MAYOR AND CITY COUNCIL

June 7, 2011

Subject: Zero Waste Energy Development Company Lease

Page 8

As part of the Council's consideration of the Mitigated Negative Declaration (MND), the Mitigation Monitoring and Reporting Program is also attached. If Council adopts the MND, the Council will also be adopting the Mitigation Monitoring and Reporting Program to ensure the mitigation measures relating to the project are implemented.

The Planning Division has received comment letters on the Initial Study/Mitigated Negative Declaration from local government agencies and from local non-profit organizations. Staff is currently responding to those comments and will forward the comments and responses in a supplemental memo.



KIM WALES
Director of Economic Development
Chief Strategist



FOR JOSEPH HORWEDEL, DIRECTOR
Planning, Building and Code Enforcement

For questions please contact Chris Burton, Senior Executive Analyst, at (408) 535-8114