- **Board of Directors**
  Asset and Recreation Committee

September 12, 2006 Board Meeting

7-1

Subject

Authorize entering into a farm lease (RL 2480) with HayDay Farms, Inc., a California corporation: Approximately 7,000 gross acres (6,598 water toll acres) designated as portions of MWD Parcel Nos. PVID-1-110 and PVID-1-130 in Riverside and Imperial Counties, California

Description

Authorization is requested to enter into a lease agreement for approximately 7,000 acres of agricultural farmland owned by The Metropolitan Water District of Southern California (Metropolitan) and located in the Palo Verde Valley (see **Attachment 1**). Metropolitan would enter into Farm Lease RL 2480 with HayDay Farms, Inc. at a rental rate of approximately $957,000 per year for five years.

HayDay Farms, Inc. (current tenant, formerly known as Tohshin Trading, Inc.) has requested a new lease agreement to continue farming Metropolitan-owned 7,000 gross acres which consist of 6,598 water toll acres (irrigated acres) as designated by the Palo Verde Irrigation District (PVID) (see **Attachment 2**). The current lease was in effect when Metropolitan purchased this property from San Diego Gas and Electric Company in 2001. It will terminate on December 31, 2007. The new lease agreement includes fallowing provisions that would conserve Colorado River water through the current PVID/Metropolitan Forbearance and Fallowing Program (Fallowing Program). The term of the new lease would be for five years commencing November 1, 2006. Metropolitan would have the right to terminate the lease with a one-year notice consistent with current leasing policies approved by the Board. The early termination clause includes an agreed-upon compensation of $200 per acre for each remaining year of an alfalfa crop based on a four-year cycle from planting. In addition, Metropolitan could immediately terminate the lease for cause, i.e., breach of contract, without compensating the tenant for crops.

The negotiated rental rate would be $145 per irrigated acre, consistent with area market value as determined by independent agricultural appraiser, Schenberger, Taylor, McCormick and Jecker, Inc. (see **Attachment 3**). There are no new Metropolitan or tenant improvements anticipated as part of the lease. However, optional improvements requested by the tenant, at the tenant's expense, would be subject to review and prior written consent by Metropolitan. The lease would also be subject to Metropolitan's use of the property in connection with the Fallowing Program and the acreage to be fallowed each year would be set by Metropolitan. While the tenant would not receive any of Metropolitan's sign-up or annual fallowing payments, Metropolitan would reimburse the tenant for rent and water tolls pre-paid by the tenant for the fallowed acreage, and for tenant's overhead and maintenance costs of $175 per fallowed acre per year as agreed to by the tenant and Metropolitan. All reimbursements to the tenant resulting from tenant's fallowing would be drawn from Metropolitan's Water Transfer Fund.

The proposed lease is consistent with the Board's objectives to maximize Metropolitan's investments by leasing real property at fair market rates to defray a portion of Metropolitan's ownership costs, and in this case, consistent with participation in the Fallowing Program. The land is subject to annual property taxes ($214,000) and PVID assessments ($32,000), both paid by Metropolitan. In accordance with the State of California's Board of Equalization Property Tax Rule 29b, no possessory interest tax will be levied on the tenant. **Attachment 4** presents answers to questions asked during past board discussions regarding the subject lease.

Policy

Metropolitan Water District Administrative Code Section 8230: Grants of Real Property Interests

California Environmental Quality Act (CEQA)

CEQA determination for Option #1:

The proposed action is categorically exempt under the provisions of CEQA and the State CEQA Guidelines. In particular, the proposed action consists of the leasing, licensing, maintenance, and operating of existing equipment and facilities with negligible or no expansion of use beyond that existing at the time of the lead agency's determination. In addition, it will not have a significant effect on the environment. Accordingly, this proposed action qualifies as a Class 1 Categorical Exemption (Section 15301 of the State CEQA Guidelines).

The CEQA determination is: Determine that pursuant to CEQA, the proposed action qualifies under a Categorical Exemption (Class 1, Section 15301 of the State CEQA Guidelines).

CEQA determination for Option #2:

None required

Board Options

Option #1

Adopt the CEQA determination and authorize the General Manager to enter into Farm Lease No. R.L. 2480 over MWD Parcel Nos. PVID-1-110 and PVID-1-130.
Fiscal Impact: Up to $957,000 annual revenue over the five-year term of the lease
Business Analysis: Ensures continuity of annual market-based revenue, Metropolitan's participation in the Fallowing Program, and maintenance of the property by tenant

Option #2

Staff to prepare a management plan for the property including alternatives to long-term ownership, seeking other uses and/or tenants through advertisements and issuance of Request for Proposals
Fiscal Impact: Increased ownership and maintenance costs paid by Metropolitan
Business Analysis: Regular process to study other uses and cost-benefit of long term ownership; increased maintenance costs paid by Metropolitan

Staff Recommendation

Option #1

8/10/2006
Jill T. Wicke *Date*
Manager, Real Property Development and Management

8/16/2006
Jeffrey Kightlinger *Date*
General Manager

Attachment 1 – Location Map

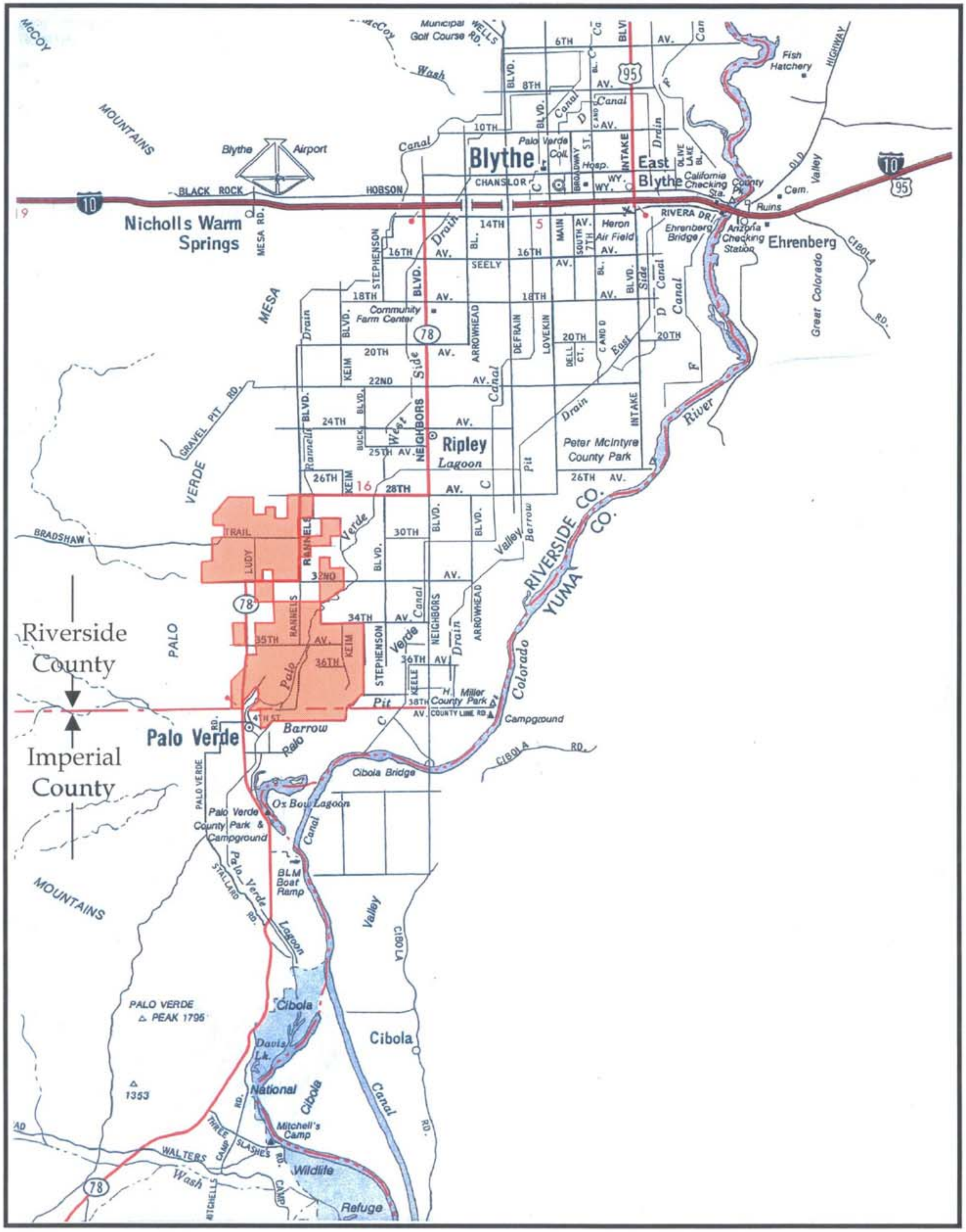
Attachment 2 – Exhibit Map of MWD Fee Parcel Nos. PVID-1-110 & 130

Attachment 3 – Appraisal Summary

Attachment 4 – Questions and Answers

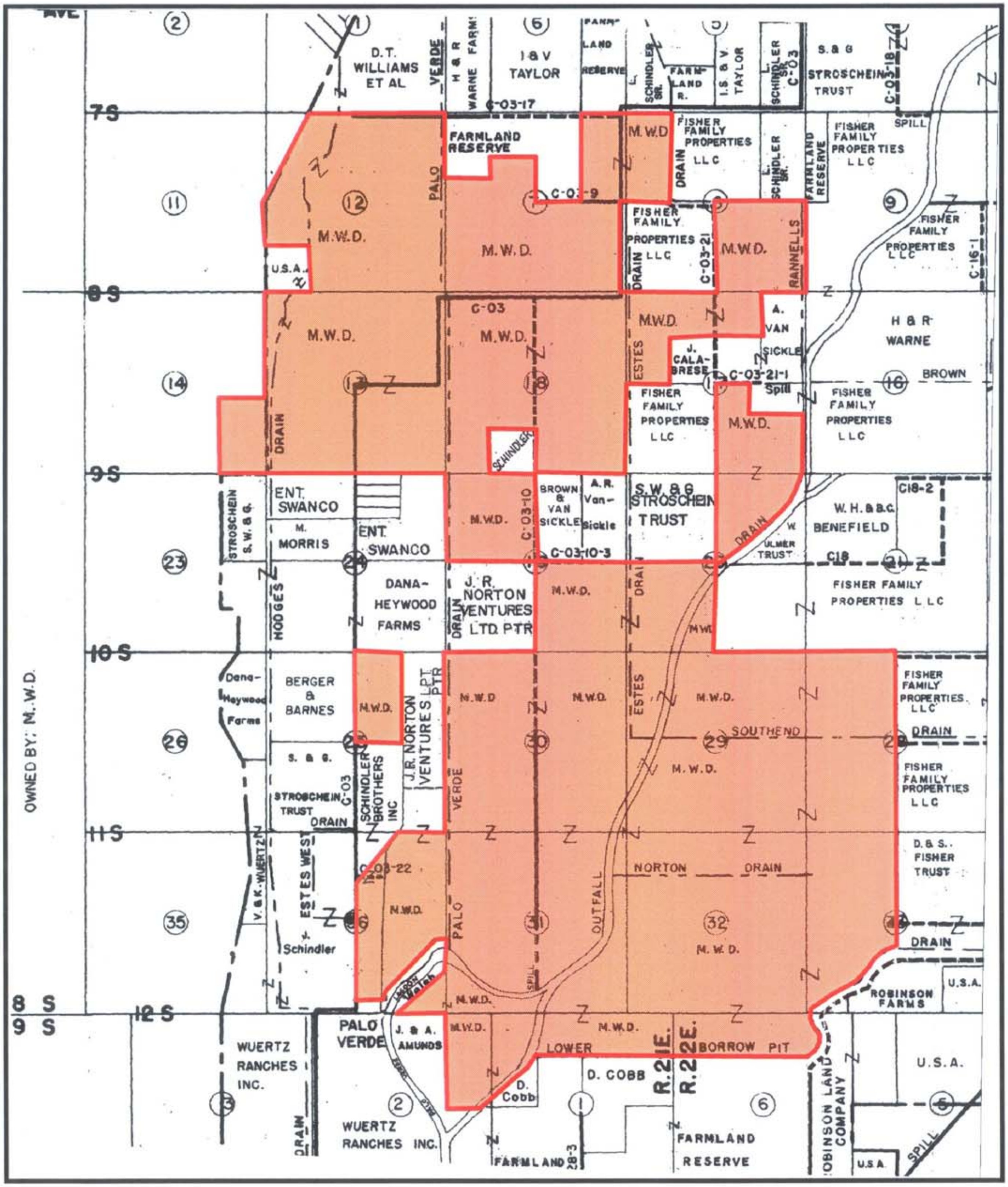
BLA #4569

Locational Map
Norton-Henderson Ranches
Hayday Farms Lease



SCHENBERGER, TAYLOR, McCORMICK & JECKER, INC.

PVID Ownership Map
Norton-Henderson Ranches
Hayday Farms Lease



Rental Value/Market Rent Conclusions

After carefully evaluating all relevant factors affecting the current market rent of the subject property, the estimated current market rent of the property, as of May 10, 2006, is:

Market Rent Range

$140 to $155 per WTA per year

6,598 WTA x $140 = $923,720
6,598 WTA x $155 = $1,022,690

$923,720 to $1,022,690

Market Rent Conclusion

$145 per WTA per year

6,598 WTA x $145 = $956,710

Thank you for this opportunity to be of service. Please contact me with any questions at (805) 544-2472, Extension 15.

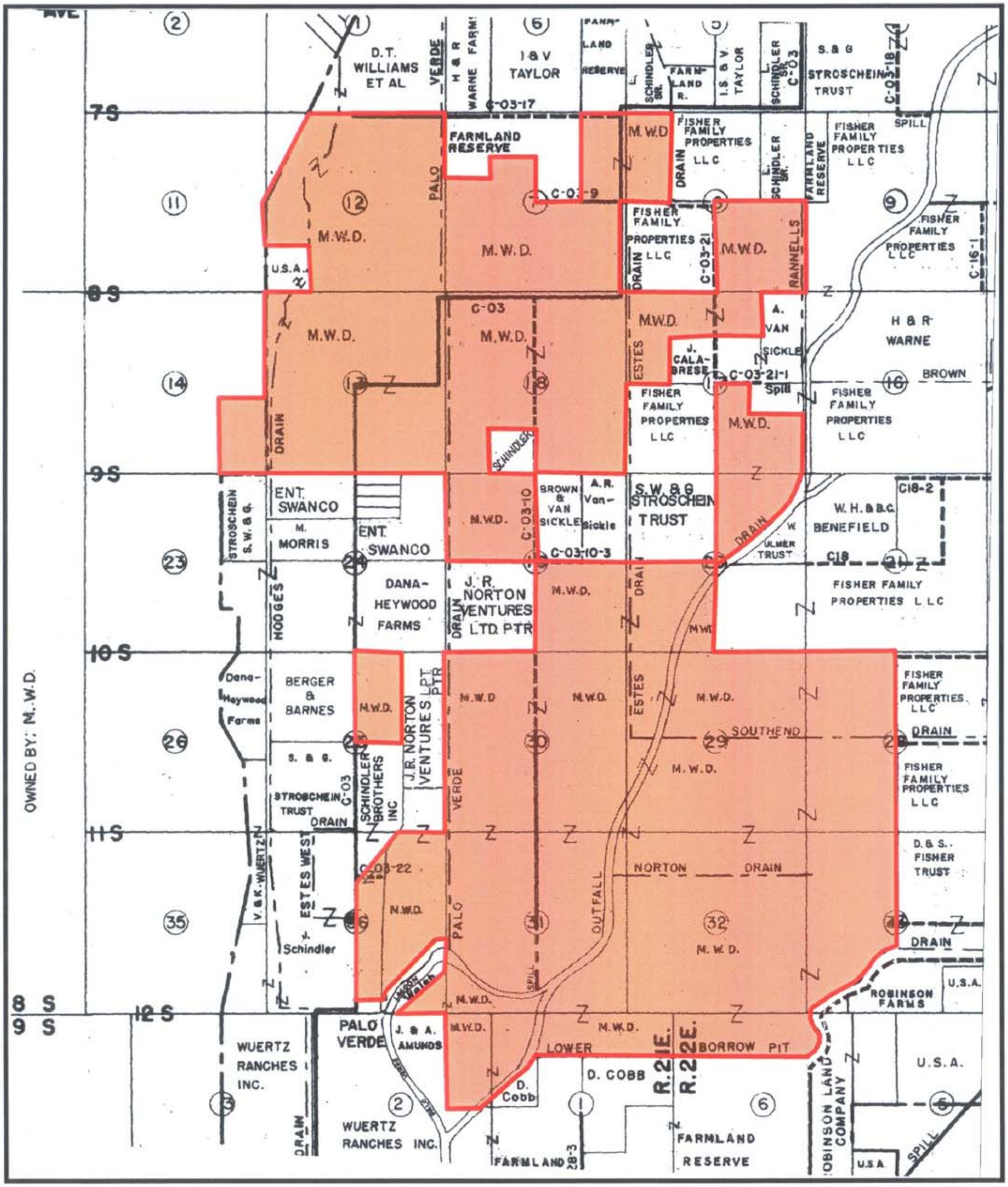
Respectfully submitted,

Todd O. Murphy

Todd O. Murphy, MAI
Principal of the Firm
California License #AG002286

TOM:jsi

PVID Ownership Map
Norton-Henderson Ranches
Hayday Farms Lease



Farm Lease Questions and Answers

1. Does the farm lease dictate the type of crops that can be planted?

   No, the lease terms do not dictate the type of crops that can be planted. The tenant independently makes all market and business decisions regarding the farming operations.

2. Does the tenant receive any signup or annual payments from the Fallowing Program?

   No, the tenant does not receive direct payments from the Fallowing Program. There are separate lease terms for reimbursements provided to the tenant to manage the fallowed land (see Question Nos. 3 & 4).

3. What payments are made to the tenant when Metropolitan makes a call that fallows up to 1/3 of the land (crop losses, land management costs, etc.)?

   The tenant does not receive any compensation for crops on fallowed acres. This is due to the 12-month notice on fallowing calls that provide the tenant with sufficient notice to harvest the crops on the fallowed land. Metropolitan will reimburse the tenant for land management and overhead costs on fallowed acres at an agreed upon fixed rate of $175 per fallowed acre per year.

4. Does tenant continue to pay rent on fallowed acres? If not, how expensive to Metropolitan is that scenario?

   The tenant would not pay rent or water tolls on fallowed acres. The rent revenue forgone is $145 per acre per year and water tolls are about $55 per acre per year that translates to about $44 per acre-foot cost of water to Metropolitan.

5. Do lease terms control the types of crops allowed and planted (alfalfa, rice, etc.)? If not, how is that reimbursement expense considered because alfalfa is a very expensive first year crop?

   No, the lease terms do not control the types of crops allowed or planted. The tenant does not receive any compensation for crops on fallowed acres, so the tenant is at risk of a fallowing call in the event a multi-year crop is planted. Either party may terminate the lease without cause on a one-year notice. In case of early termination of the lease by Metropolitan, a fixed amount of $200 per acre for each remaining year of an alfalfa crop based on a four-year cycle from planting would be paid to the tenant by Metropolitan.

6. Does any money go to the tenant from the Fallowing Program?

   No. The tenant does not receive direct payments from the Fallowing Program. There are separate lease terms for reimbursements provided to the tenant (see Question Nos. 3 & 4).

7. Can we put a term into the lease that exclusively establishes Metropolitan as the sole decision maker regarding where and when crops are fallowed?

   Metropolitan is the sole authority regarding the amount of acreage called for fallowing. The fallowing calls are made with a 12-month notice. The tenant is allowed discretion as to where those acres are taken out of production. Adding any crop type restrictions to the lease would significantly diminish the rental rate and the market desirability of the lease.

8. What are current crop prices for Alfalfa per ton (first cutting)?

   The price of alfalfa and other crops changes and fluctuates with market trends; $130 per ton is an approximate price for Alfalfa.

9. What is the typical quantity of alfalfa being produced on the 7,000-acre farm, e.g., ten to twelve tons/acre in the Palo Verde Valley?

   Alfalfa production varies based on the number of harvests within the production year; an approximate quantity of alfalfa produced is eight to ten tons/acre per year.

10. Is the reimbursement based on gross dollars per acre produced or expenses incurred planting the crop or some other threshold or date?

    The tenant does not receive any compensation for crops on fallowed acres. In case of early termination of the lease by Metropolitan, a flat amount of $200 per acre for each remaining year of an alfalfa crop based on a four-year cycle from planting would be paid to the tenant by Metropolitan.

11. Is it permissible to use biosolids at the site, and describe why or why not?

    The use of bio-sludge or any form of human waste on the property would be considered only with Metropolitan's consent and on a case-by-case basis and would comply with all applicable rules and regulations.

12. Can staff proceed with a Request for Proposals (RFP) to select the lessee? How long to complete a Request For Proposal? What farming methods and crops are allowed or not allowed?

    The RFP and agreement process could require 8-9 months and is subject to unforeseen delays in negotiations. Toshin Farms (former lessee) has discontinued operations under that name and changed its corporate designation to HayDay Farms. However, the same on-site tenant has expressed his desire to continue farming the leased property.

    This farm lease does not dictate the type of crops that are planted. Adding such a term to the lease would result in the reduction in the value and flexibility of the lease agreement. Also, the types of crops that produce better yields are constrained by the soil types of the land.

13. What is the estimated cost of waiting until December 2007 to have a new lease agreement? (e.g., cost estimate of overhead and crop reimbursements due to planned fallowing calls under current lease terms)

    The outgoing lease (inherited from San Diego Gas and Electric) included reimbursement for long-term crops on fallowed acres to be determined by negotiation with tenant. To date, tenant has agreed to rotate fallowed acres on the farm without any crop compensation from Metropolitan. In addition, tenant is participating in the supplemental fallowing call issued by Metropolitan for the period August 1, 2006 through July 31, 2007 at no cost to Metropolitan for crop compensation. The cost of waiting until December 2007 to have a new lease agreement will depend on Metropolitan's future fallowing calls under the existing lease and the negotiated price with the tenant for crop reimbursements.

14. Will waiting until December 2007 limit or cause a detriment in the Fallowing Program? If yes, what are those limits and detriments?

    Having a new lease in place of the existing one would ensure the continued smooth integration of the leased properties into the Fallowing Program (which the current lease does not provide) and the continued cooperation of the tenant in meeting our fallowing calls in a timely manner at no crop reimbursement cost to Metropolitan.

15. Provide further detail used to establish the proposed rent/acre on new lease.

    The market rent per acre was appraised by an independent agricultural appraiser consulting for Metropolitan, and was the result of evaluation of various relevant factors affecting the current market rent for the leased property as of May 10, 2006. The appraisal relied on comparisons with eleven recent rental prices for similar properties in the Palo Verde Valley area.

16. What is typical production cost for harvested tons/acre and market price for alfalfa and/or other typical crops in the Palo Verde Valley?

    Production costs and market prices vary; therefore we use the published values of the local extension service for production cost of various crops. For example, the cost of the alfalfa ranges from $700 to $800 per acre for land preparation and crop establishment. For crop prices, including alfalfa, we use the values as published by the County Agricultural Commissioner.