- **Board of Directors**
  ***Engineering and Capital Programs Committee***

January 13, 2009 Board Meeting

**8-3**

## Subject

Authorize agreement with Ritchie Bros. Auctioneers to sell surplus materials and equipment from the Inland Feeder Arrowhead Tunnels Project

## Description

This action authorizes an agreement with Ritchie Bros. Auctioneers to provide services to sell salvaged and surplus equipment and materials used for construction of the Arrowhead Tunnels. No funds are required in this action, as all fees paid by Metropolitan to Ritchie Bros. will be deducted from proceeds resulting from the auction sales.

### Background

The Inland Feeder Program consists of approximately 44 miles of pipelines and tunnels to convey up to 1,000 cfs of supplies from the State Water Project from Devil Canyon Afterbay to Diamond Valley Lake. To date, approximately 36.3 miles of the Inland Feeder have been completed including four pipeline reaches and one tunnel segment.

The Arrowhead Tunnels are the final segment of the Inland Feeder Program to be completed. The project is currently under construction and consists of two tunnels through the San Bernardino Mountains north of the city of San Bernardino: the 3.8-mile-long Arrowhead West Tunnel (AWT) and the 4.3-mile-long Arrowhead East Tunnel (AET). Tunnel mining using two tunnel boring machines was completed on the AET and AWT in May 2008 and August 2008, respectively. The remaining work consists of installation of the pipe liner and restoration of the portal areas.

In August 2006, Metropolitan's Board authorized a settlement agreement and amendment to the existing Arrowhead Tunnels construction contract with the contractor, a joint venture of Shea-Kenny. This action resolved past contractual issues between the two parties and revised the method of payment for work going forward on the project. Under the provisions of the amended contract, ownership of equipment and materials that were purchased by Shea-Kenny for use in the project, and were reimbursed by Metropolitan, will transfer to Metropolitan ownership when no longer needed for the project. Accordingly, Metropolitan will dispose of the items as they become surplus to the project. Surplus items which cannot be reasonably redeployed within Metropolitan will need to be sold on the open market or disposed of for scrap value. In accordance with Metropolitan Operating Policy F-01, revenues from sales will be returned to the Inland Feeder Program appropriation.

### Direct Resale of Equipment to Contractors

One alternative method for salvaging the equipment is to sell all or part of the equipment package to an interested contractor. Over the past year, staff has held discussions with Shea-Kenny, with other contractors, and with scrap vendors concerning potential sale of specific pieces of equipment or scrap material. Where attractive pricing to Metropolitan could be negotiated, staff sold selected pieces of equipment (mine cars, cement silos, and rail ties) to Shea-Kenny and to other contractors. To date, this method of salvage has returned approximately $350,000 to Metropolitan. However, most of the transaction offers that Metropolitan has received from Shea-Kenny and other contractors on remaining equipment have been far below market value. Staff believes that it has maximized the sale of equipment by this approach.

Staff does not recommend that Metropolitan directly take responsibility for the sale of all remaining materials and equipment, as significant additional costs could be incurred in order to facilitate these sales. For example, Metropolitan would face significant costs to transport, off-load, repair and refurbish, and store the equipment and materials. Finally, while Metropolitan staff has experience selling surplus equipment and materials common to our core business, staff does not have the requisite experience to market and sell heavy construction and mining equipment and materials at the highest market value and at lowest cost and risk.

**Strategy for Auctioning Equipment**

Staff's recommendation is to move forward with an agreement to salvage the surplus equipment and materials from the Arrowhead Tunnels construction contract through a series of auctions. Under this approach, Metropolitan proposes to enter into an agreement with a professional auction company experienced in the sale of heavy construction plant, equipment, and materials to sell the project's excess property. Towards this end, Metropolitan issued Request for Qualifications (RFQ) No. PL-876 in July 2008 to provide comprehensive auctioneering services for the Arrowhead Tunnels surplus materials and equipment. Services to be provided include, but are not limited to: appraisal of all articles to be sold; receiving, off-loading, and storing articles to be sold; cleaning and refurbishing articles to be sold; marketing and advertising articles both nationally and internationally for sale at auction; performing title searches, auctioning articles at public competitive sales, collecting and remitting sale proceeds, collecting and remitting taxes and fees, vehicle licensing, and other services appurtenant to public auction of articles.

Responses to the RFQ were received from three firms. Based on a review of each firm's Statement of Qualifications employing pre-established evaluation criteria, staff selected Ritchie Bros. Auctioneers as the most qualified firm to provide the resale services. Ritchie Bros. demonstrated a clear superiority in terms of auction capabilities, including the ability to conduct the auction through either on-site or internet bidding. Ritchie Bros. has conducted similar sales of specialized construction equipment in the recent past. Additionally, Ritchie Bros. demonstrated the ability to advertise and market this specialized equipment on a world-wide basis prior to the sale date in an attempt to maximize interest in the sale. Finally, the potential terms and conditions placed on the sale by Ritchie Bros. were the most favorable to Metropolitan of the three firms that responded to the RFQ.

Two types of auction scenarios appear appropriate for the surplus equipment and materials: either the Guaranteed-Minimum-Return option or the No-Guaranteed-Return option. Under the Guaranteed-Minimum-Return arrangement, Ritchie Bros. would appraise the equipment and guarantee Metropolitan a minimum price for the sale of all items. Ritchie Bros. would receive a commission of approximately 13 percent on this sales arrangement and would receive reimbursement for fees and costs for document and title search, and for repair and restoration of articles to be sold. Should sales receipts exceed the guaranteed minimum return, Metropolitan and the auctioneer would share the proceeds in a negotiated split of approximately 87 percent to Metropolitan and 13 percent to the auctioneer. If the sales receipts fall below the guaranteed minimum amount, the auctioneer would be obligated to pay the difference between the actual sales receipt and the guaranteed minimum. This approach guarantees a minimum, fixed return to Metropolitan, transferring major market-decline risk to the auctioneer, at a cost of approximately 3 percent in higher commission. Under this approach, the auctioneer would appraise the sales value of all articles to be sold no more than 45 days prior to auction. The auctioneer would then offer a contract to Metropolitan guaranteeing sales receipts of a specified percent of the appraised value at auction, negotiated at 70 to 80 percent of appraisal. Metropolitan would have the right to review the appraisal and either accept or reject the agreement. To aid in this decision, Metropolitan could commission an independent appraisal of the articles to be sold. **Attachment 1** is included to present three hypothetical cash flow scenarios, both to Metropolitan and to the auctioneer, under the Guaranteed-Minimum-Return arrangement. Metropolitan will be responsible for all costs to ship the surplus materials to the auction company site.

Under the No-Guaranteed-Return arrangement, Ritchie Bros. would not guarantee a minimum sale amount, leaving Metropolitan's return based on market conditions at the time of the sale. The auctioneer would receive a commission which is typically 10 percent of total sales, and would receive reimbursement for fees and costs for document and title search, and for repair and restoration of articles to be sold. This option is best suited for highly specialized equipment (tunneling equipment), for which accurate independent appraisals will be difficult to obtain.

Under both auction arrangements, Ritchie Bros. would receive, in addition to the above commission from Metropolitan, a 10 percent commission on lots of items selling for less than $2,500, and a 2 percent fee on all internet transactions payable by the purchaser of the property. While internet bids are a possibility for some of the equipment, staff does not anticipate that any of the lots will be sold for less than $2,500.

It is anticipated that up to three separate auctions will be conducted by the auctioneer to liquidate the project equipment. The first auction will consist largely of the tunneling equipment and the equipment that supported the tunneling operations from both the East and West tunnels. The subsequent auctions will include more conventional construction equipment, spare parts, office trailers and storage boxes. The equipment in the first auction will be difficult to accurately appraise, due to its specialized construction and intended use. Based on input from the Board regarding issues with appraisal of specialized tunneling equipment, staff has determined that the best approach for auctioning this equipment is to utilize the No-Guaranteed-Return approach. Subsequent auction of the non-tunneling equipment may be conducted with the Guaranteed-Minimum-Return approach, if it can be determined by staff that an accurate appraisal of this equipment is feasible.

With the recent economic downturn, demand for heavy construction equipment by domestic buyers at Southern California auctions has dropped substantially. Staff considered postponing the early 2009 auction for six months to one year, which would incur storage costs in excess of $4,000 per month. In addition, transportation would cost approximately $300,000 to move items from their current temporary storage site to a location more suitable for long-term storage. Many potential buyers of the tunneling equipment are expected to be from outside of the United States, where economic conditions are more robust and where significant infrastructure improvement projects are underway. Consequently, it is anticipated that in early 2009, demand for the tunneling equipment at the auction may be strong despite the current economic climate in the United States.

This program has been evaluated and recommended by Metropolitan's Capital Investment Plan Evaluation Team, and funds have been included within the fiscal year 2008/09 capital budget.

## Policy

Metropolitan Water District Administrative Code Section 8271: Disposal of Surplus Personal Property

## California Environmental Quality Act (CEQA)

CEQA determination for Options #1 and #2:

The environmental effects from the construction of the Arrowhead Tunnels were evaluated in the Inland Feeder Project Final Environmental Impact Report/Environmental Assessment (Final EIR/EA), which was certified by the Board in February 1993. The Board also approved the Findings of Fact (findings), the Mitigation Monitoring and Reporting Program (MMRP), the Statement of Overriding Considerations (SOC), and the Inland Feeder Project itself. Addenda have been prepared during the course of construction to address minor technical changes and additions to the project. In February 2008, Addendum No. 7 to the Final EIR/EA was prepared addressing the disposal of construction equipment acquired by Metropolitan under the contract amendment with Shea-Kenny Joint Venture. The change in ownership and disposal by Metropolitan of the construction equipment will not result in any new significant effects or any substantial increase in the severity of any significant effects previously identified in the Final EIR/EA and Addenda prepared for this project. The present proposed board action is solely based on entering into an agreement to auction or sell surplus material and equipment from construction of the Arrowhead Tunnels and not on any substantial changes to the original Inland Feeder Project. Hence, the previous Inland Feeder Project environmental documentation and the proposed actions fully comply with CEQA and the State CEQA Guidelines. Accordingly, no further environmental documentation is necessary for the Board to act on the proposed actions.

The CEQA determination is: Determine that the proposed actions have been previously addressed in the 1993 certified Final EIR/EA and related environmental documentation (i.e., findings, MMRP, SOC and Addendum No. 7) and that no further environmental analysis or documentation is required.

## Board Options

**Option #1**

Adopt the CEQA determination and authorize agreement with Ritchie Bros. Auctioneers to conduct multiple auctions of Metropolitan's Arrowhead Tunnels surplus equipment and materials. Depending on the economic conditions prior to the sale and the type of equipment to be included in each sale, staff will make a determination as to whether to implement the Guaranteed-Minimum-Return auction arrangement, or to utilize the No-Guaranteed-Return approach.

**Fiscal Impact:** Revenue in a range of $1.5 million to $3.5 million based on market-driven auction results, less Ritchie Bros.' commission, will be returned to the Inland Feeder appropriation**.** If the Guaranteed-Minimum-Return approach is utilized, a guaranteed minimum return (based on a percentage of the appraised value of the property) to Metropolitan will be established prior to the auction. If the No-Guaranteed-Return approach is selected, Metropolitan is not guaranteed a return and receipts are solely dependent upon market-driven auction results.

**Business Analysis:** Staff has identified two potential auction methods that may be applicable for liquidation of the surplus project equipment for the Arrowhead Tunnels. The No-Guaranteed-Return approach is applicable for equipment that is difficult to appraise or otherwise determine its value on the open market in auction environment. Staff recommends using this approach for such equipment. For auctions that are comprised of a majority of equipment that can be accurately appraised, staff recommends the use of the Guaranteed-Minimum-Return approach. The minimum return to Metropolitan under this approach will be determined shortly before the auction based on an appraisal of the equipment and analysis of market conditions.

**Option #2**

Do not authorize an auction agreement at this time, and instead store equipment until economic conditions improve and more favorable sale conditions can be anticipated.

**Fiscal Impact:** Storage costs of up to approximately $4,000 per month will be incurred for duration of storage. Additionally, Metropolitan will incur a transportation cost of up to $300,000 to move equipment from its present "temporary" storage location to a location that is more suitable for long-term storage.

**Business Analysis:** Delaying the first of several equipment auctions may not significantly improve the final sale price of the equipment. It is projected that the economic downturn in the economy of the United States will continue into 2010.

## Staff Recommendation

Option #1

Roy L. Wolfe 12/18/2008

*Roy L. Wolfe* *Date*
*Manager, Corporate Resources*

Jeffrey Kightlinger 12/26/2008

*Jeffrey Kightlinger* *Date*
*General Manager*

**Attachment 1 – Equipment Auction Scenarios – Examples**

BLA #6297

# Equipment Auction Scenarios - Examples

***Guaranteed-Minimum-Return approach:***

**Value Appraised by Auctioneer (example): $1,000,000**

**Discounted Appraised Value (@ 70%): $ 700,000 ← Guaranteed Minimum Sales Price**

**Initial Auctioneer Commission: $ 91,000**
**(@ 13% Of Discounted Appraised Value)**

**Estimated Repairs by Auctioneer (@ 3% of Appraised Value): $ 30,000**

**Initial Gross Return to Auctioneer: $ 121,000**

**Metropolitan's Guaranteed Return: $ 579,000**

| **Final Sale Amount $1,000,000** | | **Final Sale Amount $700,000** | | **Final Sale Amount $500,000** | |
|---|---|---|---|---|---|
| Sales Receipts Above Guaranteed Minimum Sales Price | $300,000 | Sales Receipts Above Guaranteed Minimum Sales Price | $ 0 | Sales Receipts Above Guaranteed Minimum Sales Price | ($200,000) |
| Additional Auctioneer Commission @ 13% (based on difference between Guaranteed Minimum Sales Price and Final Sale Amount) | $ 39,000 | Additional Auctioneer Commission @13% (based on difference between Guaranteed Minimum Sales Price and Final Sale Amount) | $ 0 | Additional Auctioneer Commission @13% (based on difference between Guaranteed Minimum Sales Price and Final Sale Amount) | ($79,000) |
| **Net Return to Auctioneer** (includes repairs and commission) | $160,000 | **Net Return to Auctioneer** (includes repairs and commission) | $121,000 | **Net Return to Auctioneer** (includes repairs and commission) | $42,000 |
| **Return to Metropolitan with Guaranteed-Minimum-Return approach** | **$840,000** | **Return to Metropolitan with Guaranteed-Minimum-Return approach** | **$ 579,000** | **Return to Metropolitan with Guaranteed-Minimum-Return approach** | **$579,000** |
| **Return to Metropolitan with No-Guaranteed-Return approach** ***(Assumes 10% commission and 3% repairs)*** | **$870,000** | **Return to Metropolitan with No-Guaranteed-Return approach** ***(Assumes 10% commission and 3% repairs)*** | **$609,000** | **Return to Metropolitan with No-Guaranteed-Return approach** ***(Assumes 10% commission and 3% repairs)*** | **$435,000** |