21. REVIEW OF MARINE LOADING SITE VALUATION PRACTICES - W 5125.3.

During consideration of Calendar Item 19 attached, Mr. E. N. Gladish, Executive Officer, State Lands Commission, presented a statement in which he reviewed with the Commission the State's marine loading site valuation practices. This review resulted from a report prepared by the Auditor General and presented to the Joint Legislative Audit Committee on the State's marine petroleum terminal leases. In essence, Mr. Gladish commented that the report had many inadequacies and showed a lack of sufficient research. At that time, Mr. James F. Trout, Manager Land Operations, presented a statement on the specifics of the current valuation approach to marine sites. After Mr. Trout's statement, Mr. Gladish presented the following alternatives:

1. Commission arbitrarily set a per barrel charge for the transfer of petroleum and related products to be paid by oil companies and utilities.

2. Imposition of a tax on products.

3. Charge for marine terminal sites on the same basis as any other use of tide and submerged lands.

Mr. Gladish recommended that the Commission adopt Alternative 3.

Appearances in opposition to the Auditor General's Report

Patrick J. Matthews, Supervising Permit Agent, Pacific Gas & Electric Company

John M. Burns, Associate Engineer, San Diego Gas & Electric Company

Philip K. Verleger, Counsel, Western Oil and Gas Association

Upon motion duly made and carried, the following resolution was adopted:

THE COMMISSION REAFFIRMS EXISTING VALUATION APPROACH USED BY THE DIVISION FOR MARINE TERMINAL FACILITIES.

Attachment:
Calendar Item 19 (2 pages)

CALENDAR ITEM

3/74
JFT
W 5125.3

19.

REVIEW OF MARINE LOADING SITE VALUATION PRACTICES

In January, Auditor General Harvey M. Rose submitted a report of State marine petroleum terminal leases to the Joint Legislative Audit Committee. The Auditor General concluded that the rental returns received by the State for the 27 marine loading site leases were ". . . low and are not in the best interests of the state." The basis for this allegation is that California ports are receiving substantially higher revenues for their marine loading facilities than is the State. The comparison which leads to this conclusion is no more valid than comparing oranges with bananas. The State Lands Commission does not lease marine terminal facilities--it leases marine terminal sites. The difference is substantial.

An apt comparison can be made between port leases and State leases. Consider, for example, two identical building sites in an urban area. One lot is improved with a major office building in which the rental rate for space includes parking, all services, maintenance and janitorial work. All the tenant need do is sign a lease and move in. This is comparable to port facilities where filled and paved land is provided, wharves and docks are furnished, together with maintenance and replacement of worn equipment.

The second lot is leased as is. The tenant must fill and grade it, building plans must be developed and approved, financing must be obtained, and construction contracts negotiated. All maintenance and janitorial services are the responsibility of the lessee. The lot owner's only investment is in the lot itself. This second example is typical of the marine terminal sites leased by the Commission.

It is obvious that the rental rates charged for the two leases would not be the same; the improved lot can be expected to produce substantially higher revenues. The landowner anticipates receiving a reasonable return for the use of his property in both cases. His investment in the first case is many times that of the second. His charge for the leases should reflect this difference. No knowledgable lessee would pay the same rental for unimproved property as for an improved facility. Yet, the Auditor General suggests the State charge one-quarter cent per barrel more for undeveloped property than the port tariff for developed land.

It is surprising that the Auditor's report chooses to compare two such dissimilar situations. Further, it is also noteworthy that no port or oil company we can find charges throughput other than for use of facilities owned and constructed by the lessor--a factor not applicable to State marine terminal site leases.

The Auditor General's report is grossly inadequate in its failure to consider the components which make up the rental rates charged by the major ports of

California when compared with facilities for similar purposes located on State-managed lands. It is noted that the Auditor General makes no breakdown of the benefits provided by the port leases cited. This inadequacy is carried throughout other comparisons in the report which seems unusually shallow in its development of facts.

There are at least three components to port rental rates; often there are others. The three major components are land rental, wharfage and dockage. Together these components are designed to recover the costs of capital improvements on or benefiting the site, along with a reasonable return on the investment. In the case of the Atlantic Richfield facility at Long Beach Harbor, the capital outlay by the port was nearly $2,000,000. For the 27 State leases considered by the Auditor General, the State's capital investment is zero. An argument has been made by the lessees that the State should make no charge for use of tide and submerged lands other than possibly the recovery of permit processing costs. In fact, they have so argued for many years. However, the Commission has instead adopted a leasing policy which has in the last five years increased average annual rental to reflect current land values.

The analysis made by the Division compares the Division's leasing program with those of the ports of Long Beach and Los Angeles. We have considered alternatives to existing practice including the throughput concept suggested by the Auditor General. It is our conclusion that leasing policies and procedures of the Commission are consistent with accepted leasing practice and should be continued. Current leasing schedules are based on a reasonable return for the loss of use to the public of tide and submerged lands and have resulted in increased income that is fair and equitable to the State for use of those lands.

Clearly Los Angeles and Long Beach gross harbor revenues from developed marine petroleum facility leases are many times higher than those of the State for unimproved sites. However, as was pointed out, one needs to look behind this income to determine both what is being leased and the basis for the established rates. This the Auditor General did not do.

The Auditor General report received much publicity which placed the Commission's management and leasing practices in an unfavorable light. The Commission's aggressive approach to its leasing program probably has less news value than the Auditor's inadequate allegations already reported. The facts are that non-extractive lease revenues for the 1973-1974 fiscal year are expected to be $750,000. In 1963-1964, this revenue was $287,000. Compared with this nearly 200% increase for all non-extractive lease revenue, the 1400% increase in marine terminal site income reflects the Commission's aggressive approach to this segment of the leasing program. These nontax revenues are another example of the increased public benefits for which the Commission has been responsible.

IT IS RECOMMENDED THAT THE COMMISSION REAFFIRM EXISTING VALUATION APPROACH USED BY THE DIVISION FOR MARINE TERMINAL FACILITIES.