File #: HD-19-002, Version: 1

DATE: December 10, 2018

TO: Board of Harbor Commissioners

FROM: Eamonn Killeen, Director of Real Estate

SUBJECT: Tesoro Refining & Marketing Company LLC
New Lease Agreement

Executive Summary
Tesoro Refining & Marketing Company LLC (Tesoro) occupies approximately 18 acres of land and 1.91 acres of submerged land at 1300 Pier B Street under Lease HD-5470 (Current Lease) for a liquid bulk petroleum terminal. The current Lease also grants a preferential assignment of one-half of Berth B77 and Berths B78 to B80 inclusively.

The Current Lease commenced January 1, 1995 for an initial 20-year term, and has remained on holdover status since its expiration on December 31, 2014. Following an extensive negotiation period, Port staff and Tesoro have reached agreement on the terms and conditions of a proposed new lease agreement (New Lease) to extend Tesoro’s use of the terminal an additional 20 years.

As provided in further detail below, the New Lease will eliminate the existing wharfage breakpoint, charge 100% of all wharfage and dockage charges assessed in accordance with the Port’s Tariff, increase the Guaranteed Minimum Annual Compensation (GMAC) by sixty percent (60%) to correspond with the fair market value of the premises, transfer maintenance and repair responsibilities of the berth structures from the Port to Tesoro, provide for one-time repairs to be performed by the Port to damaged wharf components, and include Clean Air Action Plan (CAAP) measures and environmental covenants.

Key Points
- The Current Lease allows for a liquid bulk petroleum terminal located on Pier B.
- The Current Lease expired December 31, 2014, and has remained on holdover status during negotiations of a new agreement.
- Port staff and Tesoro have reached agreement on a proposed New Lease, commencing retroactively to January 1, 2015, and expiring December 31, 2034.
- Tesoro’s use of the leased premises shall remain the same under the New Lease.
- The salient terms changes of the Current Lease as compared to the New Lease are an increase in GMAC, the elimination of a wharfage Break Point, the transfer of maintenance and repair responsibilities of the berth structures to Tesoro, and the inclusion of environmental covenants.
- The New Lease marginally increases the land area by 28,587 square feet (0.66 acres) to include a shared access driveway.
- Commencing retroactively as of January 1, 2015, the proposed New Lease will increase the GMAC to $3,000,697, totaling $15,003,485 of guaranteed compensation for the first five-year segment of the term.
Recommendation

This item requests the Board of Harbor Commissioners’ approval of a Lease covering 20.57 acres of land and submerged land located at 1300 Pier B Street with Tesoro Refining & Marketing Company LLC for a term commencing retroactively to January 1, 2015, and expiring December 31, 2034, make the determination that the action is categorically exempt pursuant to the California Environmental Quality Act, and adopt the authorizing Ordinance.

Financial Impact

Break Point: The Current Lease provides for Tesoro paying rent as an amount equal to 100% of all wharfage and dockage tariff charges until tariff charges reach $1,327,466 (the “Break Point”), plus 50% of all such wharfage and dockage charges thereafter for the remainder of the year.

Commencing retroactively as of January 1, 2015, the proposed New Lease eliminates any Break Point and requires Tesoro to pay 100% of all dockage and wharfage tariff charges on vessels handled at the premises and berths.

GMAC: Notwithstanding the above tariff charges, the Current Lease provides for a Guaranteed Minimum Annual Compensation (GMAC) of $1,875,286. If the actual tariff amounts paid by Tesoro are less than the GMAC, Tesoro would pay the difference within thirty days.

Commencing retroactively to January 1, 2015, the proposed New Lease will increase the GMAC to $3,000,697, totaling $15,003,485 of guaranteed compensation for the first five-year segment of the term.

This equates to a $1,125,411 (or 60%) annual increase to the GMAC.

<table>
<thead>
<tr>
<th>Current GMAC:</th>
<th>$1,875,286</th>
</tr>
</thead>
<tbody>
<tr>
<td>Proposed GMAC:</td>
<td>$3,000,697</td>
</tr>
<tr>
<td>Increase:</td>
<td>1,125,411</td>
</tr>
</tbody>
</table>

As required by the provisions of Long Beach City Charter Section 1207(d), the rent provisions and GMAC will be renegotiated for each subsequent five-year period.

Background

Richfield Oil Corporation (predecessor in interest to Atlantic Richfield Company (ARCO)) originally occupied the leased premises under Ordinance No. HD-352, under a 40-year permit commencing January 1, 1955, and expiring December 31, 1994. The original berth structures, including but not limited to all wharves, piers, bulkheads, sea walls, fender system, and mooring dolphins, were built by ARCO. The original Ordinance No. HD-352 granted that upon expiration, all berth structure improvements constructed and maintained by ARCO shall become the property of the Port.

Tesoro, successor lessee to ARCO Terminal Services Corporation, currently occupies the leased premises under the Current Lease (Harbor Department Doc. No. HD-5470). The Current Lease commenced January 1, 1995 for an initial 20-year term, and has remained on holdover status during negotiations for a new agreement.

With the exception of the berth structures, all improvements placed upon the leased premises are owned by Tesoro with the majority constructed by predecessor entities.
The Current Lease is guaranteed by Andeavor (formerly known as Tesoro Corporation).

**Detailed Discussion of Current Issues**
Port staff and Tesoro have reached agreement on the terms of a proposed new lease agreement. After a long negotiation period.

The proposed New Lease will have the following terms and conditions for Tesoro’s continued use of the marine terminal:

**Term:** Twenty years, commencing retroactively to January 1, 2015

**Premises:** The Premises will expand slightly to a total of 812,819 square feet (18.66 acres) of land and 83,243 square feet (1.91 acres) submerged land. In addition, a preferential assignment of one-half of Berth B77 and Berths B78 to B80 inclusive, are covered by the lease.

**Compensation:** Tesoro shall pay as rent an amount equal to 100% of all wharfage and dockage tariff charges for products handled at the Premises, the Berths, and Tesoro’s Berth’s B76 and their half of Berth B77.

**GMAC:** $3,000,697

The proposed new guaranteed minimum annual compensation reflects a $24 per square foot land value, a $12 per square foot submerged land value, with a 10% rate of return. In addition, a 12% return on Port-owned berth structures valued at $7,917,000.

Please note, these fair market land values are retroactive to January 1, 2015.

<table>
<thead>
<tr>
<th>GMAC (1)</th>
<th>Land Value (2)</th>
<th>Submerged Land Value (2)</th>
<th>Improvements (3)</th>
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</thead>
<tbody>
<tr>
<td>$3,000,697</td>
<td>$1,950,765</td>
<td>$99,892</td>
<td>$950,040</td>
</tr>
</tbody>
</table>

Tesoro shall pay the difference between the new compensation and the compensation paid during the holdover period. The total payment due for 2018 has yet to be determined, but the estimated total payment due for years 2015 through 2017 is approximately $3,250,000.

**Maintenance:** Tesoro shall be responsible for all maintenance and repairs of the entire Premises, including all maintenance to those sections of the wharf structure and fender system to which Tesoro has preferential berthing rights.

**Berth Repairs:** The Port will provide a one-time maintenance and repair service to address the damaged components identified by Tesoro and mutually agreed upon by the Port. The estimated repair cost to be borne by the Port is $970,000. A complete list of repairs is provided in Exhibit C of the proposed New Lease.

**Quay Wall:** Commencing July 1, 2018, the Port will provide a 10-year warranty for the quay wall and its existing condition and capacity. This warranty is subject to the Port’s satisfaction of specific and stringent conditions. Additionally, if the aggregate costs to repair any defect during the 10-year period are greater than $3 million, the Port and Tesoro shall split equally the cost of
aggregate repairs which exceeds $3 million, but does not exceed $5 million. If the aggregate costs are expected to exceed $5 million and Tesoro elects to not pay all costs in excess of $5 million, either party may terminate the agreement upon 120 days’ notice.

Environmental Covenants: The proposed New Lease addresses the following emission reduction activities:

- Vessel Low Sulfur Fuel regulations issued by CARB and IMO
- Vessel Speed Reduction Program
- Vessel IMO compliance
- Green Ship Incentive Program
- Periodic technology review
- EPA’s Tier 4 diesel-powered engine standards
- LEED requirements for new buildings
- Efficiency improvements such as the installation of low-energy demand lighting
- Indirect GHG emission mitigation and the purchase of green commodities

Insurance:

- Commercial general liability with minimum limits of $25 million per occurrence and $50 million general aggregate.
- Business Automobile Liability with minimum limits of $5 million per accident.
- Environmental Impairment Liability with minimum limits of $25 million per claim and $50 million general aggregate.
- Workers’ Compensation & Employer’s Liability with minimum limits of $1 million per accident.
- Property Insurance on an all-risk, full replacement cost with no coinsurance clause.

Guaranty: The New Lease will be guaranteed by Marathon Petroleum Corporation.

The Current Lease is guaranteed by Andeavor. On October 1, 2018, Marathon Petroleum Corporation acquired Andeavor. The Andeavor corporation entity survived as a limited liability company and wholly owned subsidiary of Marathon Petroleum Corporation.