

Q & A City of Davis Solar Lease 4/15/20

At the February 11, 2020, City Council meeting, Mayor Brett Lee reported that the Davis City Council voted 5-0 to direct staff to move forward with a preliminary agreement with BrightNight Energy to lease unused City land for the purpose of planning a solar farm.

On March 24, 2020, a Lease Option Agreement with BrightNight was brought back to the Council for approval and was passed 4-1. The public was able to give comment on this item.

The next step in this project is that once a ground lease with BrightNight is finalized, it will be brought back to the Council for approval after BrightNight has secured all of its necessary and applicable entitlements from Yolo County, including compliance with the California Environmental Quality Act (CEQA).

What follows are questions and answers that are specific to this project:

Q. Did the City enter into a lease for a solar farm?

A. The City did not enter into a lease. The City entered into a Lease Option Agreement with BrightNight, which gives the City and BrightNight the option to enter into a ground lease if certain specific conditions are met during the option period. This Lease Option Agreement is not a ground lease and is not the document that will govern the relationship, rights and obligations of the City and BrightNight during any potential ground lease entered into in the future. The Lease Option Agreement only details the rights and obligations between the City and BrightNight during the option period.

Q. Is the lease rate at market value? Were all uses considered?

A. The City conducted market research to assess what the appropriate market rate should be. Staff looked at a number of things to try and determine what the appropriate lease rate should be, including:

- allowable uses under Yolo County zoning
- comparable solar lease rates
- comparable long-term orchard rates
- discussion with local land brokers/appraisers and Yolo County officials in an effort to ascertain values and determine how the lease rate should be derived

Q. How was the lease rate determined?

A. Research recommended valuing the solar lease similar to a long-term orchard lease, which can also tie up the land for 50 years. According to the most recent Yolo County crop report, the average annual revenue per acre for orchard products is about \$2,050. Using 22.5% as the property owner's share of that revenue, the rental rate comes out to about \$460 per acre per year. In the Lease Option Agreement with BrightNight, the City receives a rate of \$454/acre on the farmable portion of the premises.

Q. The City did not utilize the RFP process for this solar deal. Why?

A. The City Council can seek a competitive process for leasing City land and/or buildings, or it can seek a negotiated process with one tenant. The process chosen depends on circumstances and the City Council's priorities and goals. Some City assets have been leased through a competitive process and others have been leased through a negotiated process.

Q. Is a sole-source procurement process consistent with the City's procurement policy?

A. The City's procurement policy, with its sole-source provisions, applies to the purchase of goods and services. In the case of the land lease, the City is not purchasing anything. It is selling an option to a possible future leasehold interest in a piece of City-owned property. The City is the landlord, not the buyer.

Q. What are the allowable uses for this land under Yolo County zoning?

A. The site is zoned "Public/Quasi Public (PQP)" under Yolo County zoning and that land use designation does not allow for many revenue-generating uses. Allowed or permitted land uses on PQP-zoned land include: passive recreation (hiking, biking, etc.), active recreation (sports fields, campgrounds, golf courses, etc.), public and quasi-public uses (airports, wastewater treatment plants, landfills, government buildings, schools, churches, etc.), and other uses (agriculture, solar fields, cemeteries, and park-related retail/commercial uses). Large-scale, private, commercial development is not allowed under this zoning designation, so commercial rates are not comparable.

Q. Were there other land uses that were considered?

A. The City Council determined that using some of the property for solar generation was preferable to other potential uses (with little investment of City funds) and was consistent with the City's Climate Action Plan. The Lease Option Agreement does not preclude using a portion of the property for other uses. Final terms and amount of acreage used for solar has yet to be determined.

Other options that had been noted in the past were an organics processing facility, expansion of existing solar on the site, habitat conversion, and stormwater/agricultural runoff. The City has continued to explore its organics processing options and is currently discussing potential opportunities to partner with UCD on an organics facility.

Q. Why is the City using a fixed-rate rental rate escalator?

A. The City prefers a fixed-rent escalator in lease agreements. That fixed-rent escalator is usually between 2-3%. Given the long length of the proposed lease term (49 years), staff believe 2% is reasonable and will more or less reflect inflation over the next 50 years. Calculating escalations to the Consumer Price Index (CPI) is an administrative burden, and there is usually a lag time in announcing the CPI rate.

Q. What is the Term Sheet in the Lease Option Agreement?

A. Its purpose is to outline some (not all) of the main deal points, which will then serve as a template for creating a final ground lease (if such a ground lease is created). The Term Sheet attached to the Lease Option Agreement is not meant to encompass all of the possible terms in the future ground lease. The Term Sheet attached as an exhibit to the Lease Option Agreement is

also not meant to be a complete agreement or encompass all of the terms of any future ground lease.

Q. Were there any other solar leases to comparable to the City's deal with BrightNight?

A. Staff was not able to find any comparable "arms-length" solar leases in Yolo County. That means that the City was not able to find any straight leases between two independent parties, a landlord and a solar company as the tenant. According to one of the land brokers/appraisers the City worked with, solar leases exist in Yolo County, but none that they knew of were "arms-length" transactions and/or at a market value (i.e., they were instead used as a mechanism to finance the solar infrastructure).

Q. How does the City solar deal compare to the County's project at the Grasslands Regional Park?

A. These projects are very different from one another.

- The City's deal is a simple land lease with no financial risk to the City. The Yolo County deal was a very complicated \$25 million public-private financing of solar infrastructure using the County's land as collateral.
- The County does not lease Grasslands and thus, there is no comparable lease rate to the City deal.
- Unlike in the City/BrightNight deal, the County owns the solar infrastructure, operates it and maintains it.
- The financial benefit to the County in its solar deal is primarily the savings the County achieves by generating its own solar power as opposed to purchasing that same power from PG&E. The County also generates revenue by selling solar electricity to PG&E.
- Revenue from the County's Power Purchase Agreement is in part used to pay off the bonds used to finance the construction of the solar infrastructure.

Q. The option period and lease period seem long. Are they typical for this industry?

A. The option structure is customary for these types of projects and a five-year option period was requested to account for the uncertainty of project permitting, interconnection, and power sale process. The average time for developing and bringing a renewable project into operation in California is four to six years, and it is in the lessee's interest to shorten this period of time. In addition, during the option period, the City has the right to use and rent the property for agricultural or other purposes allowed under Yolo County zoning.

Solar leases are usually long-term with a common initial term of 20 years with an option to renew for another 20 to 25 years. A landowner who enters into a solar lease should expect to have solar panels on the property for 40 to 50 years (source: Strategic Solar Group).

Q. What are the City's rights to decommission the site or restore it down the road?

A. The details of site decommissioning, site restoration, and security will be addressed through the Yolo County permitting process and will be a condition to the issuance of final project permits. Responsibility for decommissioning and restoration at the end of the term of the potential lease is addressed in the Term Sheet section titled, "Removal of the Generating Facility and Site Restoration." BrightNight is required to restore the site to its original condition, at BrightNight's sole cost and expense within three months of the end of the lease.

Q. What if the lessee defaults on the project?

A. The City and BrightNight have not entered into a lease, so there is currently no risk to the City at all under the Lease Option Agreement. The agreement the City entered into gives BrightNight the option to enter into a ground lease if certain conditions are met. The ground lease, with all of its myriad and complex terms, has yet to be fully negotiated. The specific conditions of default will be negotiated between the City and BrightNight during the negotiation of the ground lease.

Q. Why doesn't the agreement stipulate that Davis residents will benefit from the solar power generated at the site? Can the lessee sell power to Valley Clean Energy?

A. The agreement that was entered into only gives the City and BrightNight the option of entering into a ground lease in the future if certain specific conditions are met during the option period. It does not spell out all the terms of the possible future ground lease. The possible future ground lease could include more details about how the City or its residents will directly benefit from the solar farm, but it is too early in the process to define such details.

The benefits that could be defined at this stage in the process are detailed in the Term Sheet attached to the Lease Option Agreement. Those include a commitment to work in good faith with the City and Valley Clean Energy to facilitate the direct sale of energy from the solar farm to the City's wastewater treatment plant under a net metering arrangement at the same rate and terms given to the primary buyer of the power. This provides the City an opportunity to procure clean energy to meet the power needs of the wastewater treatment plant at a substantial discount from retail pricing.

Q. What will happen to the deal if the lessee goes out of business?

A. BrightNight anticipates receiving financing for the solar field, and BrightNight's lenders would likely step into the shoes of BrightNight should it default on the lease, which is referenced in the section of the Term Sheet titled, "Mortgage Provisions."

Finally, as part of future lease negotiations, the City will likely require a set-aside fund or other similar mechanism that will ensure funds are available for decommissioning and restoration in the event that BrightNight goes out of business.

Q. It appears that the term sheet attached to the lease option agreement contains two conflicting assignment clauses. Can you clarify this?

A. There are two sections that reference assignment, which could be consolidated. The intent of the City and BrightNight agreement was that BrightNight would not be allowed to sublease, assign or otherwise allow use of the site, except that the City acknowledged allowing a potential arrangement with PVEL. It is important to note that in any circumstance, the City would retain approval rights over any arrangement, and the conditions of any such arrangement would be described in the lease agreement.

Q. How is the City protected from any future claims made against this project?

A. BrightNight’s indemnification responsibilities are set forth in the agreement section titled, “Indemnity and Insurance.” The indemnification language is broad, excluding only claims caused by the City’s sole negligence or willful misconduct. BrightNight would also be required to maintain insurance and list the City as an additional insured party. “The Quiet Enjoyment” section of the agreement is a standard clause in leases and addresses only that the City will not do anything to interfere with or allow BrightNight’s use of the site to be disturbed. It is distinct and consistent with BrightNight’s obligation to indemnify the City.

Q. What was the hurry to apply for connection to the California Independent System Operation (Cal ISO)?

A. Without a site selected, developers can’t conduct accurate engineering studies and submit competitive power sale proposals. City staff were aware that the application window to Cal ISO was April 1-15; however, BrightNight had made it clear to City staff during the negotiations process that it wanted to submit its application early in the submittal window in order to give the solar company time to correct any deficiencies identified in its application. Demonstrating site control was an essential part of the application. According to the application, BrightNight had to show “documentation reasonably demonstrating: (1) ownership of, a leasehold interest in, or a right to develop a site for the purpose of constructing the Generating Facility; (2) an option to purchase or acquire a leasehold site for such purpose; or (3) an exclusivity or other business relationship between Interconnection Customer and the entity having the right to sell, lease or grant Interconnection Customer the right to possess or occupy a site for such purpose.”

Q. What is BrightNight’s track record? Isn’t it a new company?

A. The City understood that BrightNight itself was a relatively young company started by an experienced renewable energy entrepreneur. The staff report should have been clearer that the experience noted in the staff report was attributable to the founder and owner of BrightNight, Martin Hermann, as opposed to BrightNight itself. During his career, Mr. Hermann has developed many renewable energy projects across the United States, which together generate 3,000 megawatts of renewable energy. Those projects are attributable to Mr. Hermann, who was the signatory on the Lease Option Agreement. In total, the team of professionals who work for BrightNight has been key players in the development of renewable energy projects around the world generating more than 6,700 megawatts of renewable energy. That includes 22 solar projects generating 2,380 megawatts of solar power in California, Nevada, Texas, New Mexico, and North Carolina, and 17 wind projects generating about 3,238 megawatts of wind power in California, Washington, Arizona, Oregon, Minnesota, Missouri and Wyoming. The BrightNight team also has completed 20 renewable energy storage projects in the United States and around the world.

BrightNight is the third company that Mr. Hermann has founded. The first company was sold to Intel in 2003. He founded the second company (8minutenergy) in 2009. He sold his interest in 8minutenergy in 2018 and is the sole investor in BrightNight.

Q. The negotiating party identified on the February 11, 2020, City Council closed session agenda is listed as Davis Energy Technology Center. What is that?

A. The February 11, 2020, City Council meeting agenda under “Closed Session” actually states the negotiating party is: “Davis Energy Technology Center, LLC. or an Affiliate, in Either Case a Subsidiary of BrightNight, LLC (“BrightNight”). The Davis Technology Energy Center, LLC is a Delaware corporation wholly owned by BrightNight, LLC and licensed to do business in California.

Q. Are there potential conflicts of interest between BrightNight and its affiliates and PVEL and its affiliates?

A. In Section 15(m) of the Lease Option Agreement, BrightNight represents that it does not have a conflict of interest for purposes of the Lease Option Agreement. Should any questions arise during the option period or negotiation of the lease, they would be addressed at that time.

Q. What about CEQA concerns?

A. The Lease Option Agreement addresses CEQA, along with any other consents, approvals, permits or entitlements that would need to be obtained before the City would consent to enter into any lease. The potential solar field will be evaluated under CEQA during the option period, which may extend up to five years.