



AGENDA NO: A-5

MEETING DATE: May 12, 2020

**AGENDA CORRESPONDENCE
RECEIVED BY THE CITY COUNCIL
FOLLOWING POSTING OF THE AGENDA IS ATTACHED
FOR PUBLIC REVIEW PRIOR TO THE MEETING**

Dana Swanson

From: betty winholtz [REDACTED]
Sent: Tuesday, May 12, 2020 8:35 AM
To: John Headding; Robert Davis; Marlys McPherson; Jeffrey Heller; Dawn Addis
Cc: Tom.Luster@coastal.ca.gov; Kahn Kevin@Coastal; Scott Collins; Dana Swanson
Subject: agenda item a-5

Dear City Council:

I appreciate your bringing this forward. The power plant site is a key feature of Morro Bay. Its development, whatever that might be, is of curiosity and importance to residents.

What is of curiosity to me, is why the City and the CA Coastal Commission are willing to let PG&E off the hook for contamination clean up beyond industrial use. The CA Department of Toxic Substance Control (DTSC) states in the "Public Notice" attached to the staff report, "PG&E remains responsible for investigating and addressing environmental conditions resulting from historical power generation activities." However, the Land Use Covenant (LUC) releases PG&E from further responsibility. The LUC throws that burden to the owner/developer, a likely deterrent to getting redevelopment accomplished. And, as is stated in the staff report, that developer could end up being the City of Morro Bay itself. Since "The City also retains its land use entitlement regulatory control of the MBPP site," why not submit official comment now and exercise that authority?

In addition, common sense would suggest that injecting clean water next to or near but not in AOC areas (polluted areas) does not prevent the water/chemicals from co-mingling underground. "The wells and WRF components (pipeline and injection sites) are not located in any of the AOCs." (staff report) Also, what of salt water intrusion?

Is the City asking for a bigger problem down the road by not insisting PG&E do a higher level of clean up now?

I have a concern that the WRF has become an albatross around the neck of the City. By this I mean that appropriate responses or decisions are made only in light of the WRF, not what common sense or a wise fiscal decision would be under other circumstances.

Sincerely,
Betty Winholtz
resident

cc: Kevin Kahn, CCC District Supervisor
Tom Luster, CCC Senior Environmental Scientist

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AGENDA NO: C-1

MEETING DATE: May 12, 2020

**THE STAFF PRESENTATION AND
AGENDA CORRESPONDENCE
RECEIVED BY THE CITY COUNCIL
FOLLOWING POSTING OF THE AGENDA IS
ATTACHED FOR PUBLIC REVIEW PRIOR
TO THE MEETING**



Agenda No: C-1

Presentation of Harbor Department Lease
Management Policy Working Group Final Draft
Document for City Council Review, Input
and Direction
May 12, 2020



C-1 Lease Management Policy Update

Purpose

- Present the City Council with the final draft of the Lease Management Policy from the policy working group.
- Consider public comments on the draft policy document.
- Obtain Council input and direction on the draft policy document for incorporation into a final-final version for future Council consideration and approval.
- Acknowledge the fine and hard work of the working group members...



C-1 Lease Management Policy Update

Recommendations

Staff Recommend Council:

- Review the final draft of the lease management policy document.
- Provide staff input and direction for a final-final draft to be brought back for future approval.



C-1 Lease Management Policy Update

Alternatives

None presented.



C-1 Lease Management Policy Update

Fiscal Impact

No fiscal impact associated with this item at this time.



C-1 Lease Management Policy Update

Background

- Starting ~2018 Council set a goal objective to update the waterfront lease auditing.
- Council subsequently set a 2019/2020 goal objective to update the whole lease management policy:
 - Goal #1 Achieve Financial and Economic Sustainability
 - Objective #9 Establish Waterfront Lease Site Policies and Implementation Plan
- November 2018 Council accepted proposed policy update timeline, and directed staff to engage former Interim City Manager Marty Lomeli to facilitate.
- Mr. Lomeli and staff canvassed the community and established a working group to execute the policy update.



C-1 Lease Management Policy Update

Background

- Initial working group members and their representation were:
 - Marty Lomeli, Facilitator
 - Mark Blackford – Harbor Advisory Board
 - Erica Crawford – Morro Bay Chamber of Commerce
 - Bob Fowler – Leaseholder, Morro Bay Landing
 - Cherise Hansson – Harbor Advisory Board
 - Smith held – Leaseholder, Harbor Center
 - Joan Solu – Morro Bay citizen and former hotelier
 - Staffers Lori Stilts and Eric Endersby
- Working group operated entirely on a consensus basis, and although there was disagreement and dissent on some issues, all agreed on all policy language.



C-1 Lease Management Policy Update

Background

- First group meeting held in January, 2019. A few months in, Mr. Blackford and Mr. Held resigned for personal reasons.
 - Harbor Advisory Board appointed Ron Reisner to replace Mr. Blackford
 - Mr. Held's position not replaced
- Council Subcommittee assigned to the policy update, Councilmembers McPherson and Davis, provided review and input.
- Updates on the process brought to the HAB on several occasions.
- City Attorney provided review, input and recommendations.
- Chamber of Commerce and their Government Affairs Committee provided review and recommendations (Attachment #3).
- McCarty Davis commercial real estate provided review and input.



C-1 Lease Management Policy Update

Discussion

- Conveyance letter from working group (attachment #1) largely sums-up the process, key findings and detailed analysis on the key issues. Policy document included as Attachment #2. Original lease policy document included as Attachment #6. Key issues:
 1. Policy Implementation and Future Lease Management
 - Successful implementation is key
 - “In-house” or contracted private lease management?
 - If contract, working group and staff recommend overall oversight of the waterfront leasing program remain with the Harbor Department
 - Working group and staff recommend policy implementation strategies and future lease management structures be researched and brought back to Council for future consideration.

SEEKING COUNCIL DIRECTION TO PURSUE THOSE ISSUES



C-1 Lease Management Policy Update

Discussion

- Conveyance letter key findings and detailed analysis (con't)
 2. Formula for Determining Lease Term (duration)
 - Acknowledge Council's desire for a formulaic approach
 - No widespread systematic formulaic "spend this-get that" approach identified
 - Staff have historically relied upon several factors to determine lease term
 - A set formula could hamper negotiation flexibility and tie future Council's hands



C-1 Lease Management Policy Update

Discussion

- Conveyance letter key findings and detailed analysis (con't)
 3. Lease Site Financing
 - Can loan proceeds from lease site financing be used for other than lease site purposes?
 - Important, and controversial, issue for the working group
 - State Lands Commission and existing lease management policy say “no” State Lands’ letter on the issue included as Attachment #5
 - City Attorney’s analysis included in Attachment #4
 - Relaxation of the policy to allow loan proceeds from lease financing to be used anywhere in the Tidelands, and not just the leasehold in question, deemed consistent with Tidelands Trust

SEEKING COUNCIL’S CONCURRENCE TO RELAX THE EXISTING POLICY AS-
OUTLINED



C-1 Lease Management Policy Update

Discussion

- Conveyance letter key findings and detailed analysis (con't)
 4. City Control of Future Lease Site Development and Redevelopment
 - Consensus the City needs to more “in the driver’s seat” with regard to development and redevelopment
 - Historically we have primarily let the tenant decide what they want to develop

IF COUNCIL AGREES WITH THIS NEW POLICY COURSE DIRECTION, STAFF WILL NEED COUNCIL GUIDANCE AS TO HOW AND TO WHAT DEGREE THE CITY SHOULD BE IN CONTROL

- Don't need that guidance or decision-making tonight
- To be determined and developed for future lease site redevelopment projects
- Opportunity to consider developing overall lease and lease management vision of the waterfront area



C-1 Lease Management Policy Update

Discussion

- Conveyance letter key findings and detailed analysis (con't)

- 5. Financial Auditing

- Aim of new policy language was to simplify, make more efficient and less costly the financial auditing process for both the City and tenants
 - Tap existing resources – the City's HdL Companies sale tax auditors and Finance personnel – to accomplish that

SEEKING COUNCIL'S INPUT AND/OR DIRECTION REGARDING THE AUDITING PROCESS CHANGES BEING PROPOSED. IF COUNCIL AGREES, STAFF WILL RESEARCH AND BRING BACK TO COUNCIL ITS FINDINGS



C-1 Lease Management Policy Update

Conclusion

- Several lease policy exhibits are still a “work in progress” and not included in this draft.
 - New Master Lease template is the most important of these as it will implement the policy through lease terms
- Exhibits will be brought back with the final-final lease policy document for approval.
- STAFF WOULD LIKE TO AGAIN THANK THE WORKING GROUP MEMBERS FOR THEIR MANY DEDICATED VOLUNTEER HOURS OF EFFORT, AND INCLUDING MR. LOMELI AS VOLUNTEER FACILITATOR. WITHOUT THEIR EFFORT STAFF COULD NOT HAVE EXECUTED THIS POLICY UPDATE.

QUESTIONS?

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MMBS, LLC

May 11, 2020

Mayor and City Council
City of Morro Bay
845 Harbor Blvd.
Morro Bay, CA. 93442

Re: Lease Policy; Refinancing

Mr. Mayor and Members of the City Council,

The Council will be considering the revised Lease Policy document that the Lease Policy Group has been working on for the past 18 months or so. I am proud to have been on that group and proud of the work that we've accomplished.

An issue that was considered by the group was the current policy's prohibition against refinancing debt against the leasehold where the loan proceeds are not being used necessarily within the leasehold that is being financed. While the majority of the group came to the conclusion that it would be good policy to allow unrestricted refinancing, the City Attorney has provided you with a memo that concurs with the staff of the State Lands Commission discouraging such practice. (please note that they do not say that you cannot approve refinancing, just that they don't like the idea.)

There are three reasons why I disagree with their position:

1. **The City and other Tidelands Trust trustees are already doing so with the consent of the State Lands Commission.** What I mean by this is that they approve of financing at the purchase of a leasehold or for construction of a leasehold. There is no difference between allowing financing to purchase a leasehold or in refinancing it sometime after the purchase. For example they approve of a sale of a leasehold where the buyer is making a 30% downpayment and financing the balance. But they would then disapprove of the same leaseholder who having bought a leasehold with 100% cash and then comes back a year or two down the line to put the same financing in place.
2. **There is no risk whatsoever to the Tidelands Trust asset with the financing.** The security for the financing is not the fee title to the Tidelands Trust property and the City's **revenue** is never impaired by the financing. If a loan were to be foreclosed the lender has as its only recourse to step into the shoes of the lessee and perform in place of the lessee. The City would have all the same remedies if the lender would default as it would have had with the original tenant.
3. **It's in the City's best interest to allow and to encourage the refinancing.** The City needs to develop the waterfront under this tried and true Master Lease development program and to do so it needs to attract the best developers and investors as they can to get it done. Those investors are looking at other competing development projects when deciding where to make their investment, any of which do not take away a normal part of the financing alternatives in

MMBS, LLC

developing properties. Restricting refinancing of these interests takes away a normal and useful tool used for investing and developing properties. That reduced ability to utilize an investment asset reduces the ultimate value of the asset. That's certainly not in the City's best interest. Particularly when there is no risk to the City or the Tidelands assets in doing so.

The State Lands Commission has cited the two lawsuits with the City of Long Beach as being precedents that might mean the courts would disallow such refinancing. They claim that the use of loan proceeds from refinance outside of the leasehold constitute a 'gift of public funds'. I strongly disagree. These lawsuits are about the City of Long Beach taking **revenues** from oil and gas leases and using those **revenues** for infrastructure improvements elsewhere in the city and not to benefit the Tidelands Trust as is required under the Tidelands Grant. That is **not** what's happening in the case of a refinance because loan proceeds are **not revenues**, they are a loan that will have to be repaid. This is apples vs. oranges and the citation is simply not germane to the issue of refinancing.

I know it's difficult for the City Council to act against the advice of counsel, but I think in this case your City Attorney is guiding you so as not to be contrary to the State Lands Commission's staff. I don't think the issue has been thought through by either from the standpoint of maximizing the investment dollars that are otherwise available to do the development on the waterfront that we would all like to see.

That's how I see it.

Sincerely,

Bob Fowler

Bob Fowler
MMBS, LLC

Dana Swanson

From: Erica Crawford <erica@morrochamber.org>
Sent: Friday, May 08, 2020 6:53 PM
To: John Heading; Dawn Addis; Jeffrey Heller; Robert Davis; Marlys McPherson; Scott Collins
Cc: Dana Swanson; Stephen Peck
Subject: Public Comment for 5/12 Agenda Item C-1
Attachments: LMP and Waterfront Review - MB Chamber (1).pdf

Hello Honorable Mayor, Council and Mr. Collins,

Please find the Chamber's review of the Lease Management Policy and issues related to the Waterfront attached. The attached document was created by our twelve person Governmental Affairs Committee, then amended and approved by the twelve member Chamber Board of Directors on March 17th, 2020.

With all of the hustle and rapid effort of the emergency state we're in, it feels satisfying to be able to submit this work for your consideration that was done prior to the pandemic in relation to the item before you. I feel similarly proud of the quality of work achieved in collaboration with my fellow members of the LMP working group.

The Chamber's hope is that there are solutions or opportunities for improvement revealed in policy work and review created during a more "normal" time that could serve the community well in our new economic reality.

With gratitude,
Erica

--

Erica D. Crawford
President/CEO
w: 805.772.4467
m: 917.378.2454



Morro Bay Chamber of Commerce
Tidelands Trust Lease Policy and Administration

Recommendations

Revised and Adopted: March 17, 2020

The recommendations contained in this document are the result of research by the Chamber and by the Tidelands Lease Policy (TLP) subcommittee. We commend the work of the TLP subcommittee and believe it is time for the Council to deal with some of the needed surgical updates to the TLP recommended by the subcommittee, to consider others that the Chamber thinks are needed, and to resolve some the structural and sustainability issues associated with maintenance and improvement of the waterfront. The TLP and the financial solvency of the waterfront are inextricably tied together.

First, let us say that in terms of comprehensiveness and sophistication the City of Morro Bay's Lease Management Policies compare favorably to larger and better-funded agencies. For a smaller jurisdiction with a smaller Tidelands lease area, and with a small Harbor Department staff, TLP is an exceptional document. That being said, the community, staff and Council recognize that it is time to freshen it up, modernize it and make it fairer and more predictable.

The Chamber provided comments in 2019 about various waterfront issues, and those are restated and updated below, followed by the new ones proposed by the TLP committee and Harbor administration. Note that the Chamber is not providing an item by item review of the new TLP. We leave that to the TLP committee and City staff. We are fortunate to have many existing and former Tidelands master lease holders and sub-lease holders (tenants) on our committee and board, as well as commercial brokers, and others familiar with this special and peculiar type of real estate and municipal function. Some of these recommendations involve future studies and work, and some of them can be used to modify the existing lease management policy and lease template. For those items that affect the actual leases, the City should allow leaseholders to modify their leases to comply with these changes, and the changes should apply to all future leases.

Since 2018, the City has been consulting with a group of local stakeholders on updating the Tidelands Least Policy (TLP). This policy is intended to provide guidance to the City and the Harbor Department to fairly and equitably administer leases for the Tidelands Trust properties that were granted (given) to it by the State of California. The proposed TLP still contains many unanswered questions, and the Chamber has taken initiative to address some of those here.

We have also reviewed some to the waterfront/Harbor Department's structural budget issues, although we have not had the benefit of a deep dive into this. Followup work is needed.

The GAC reviewed the existing TLP in July of last year, the full report of which is attached. The Chamber makes the following updated observations and recommendations:

1. The Harbor District is currently running on empty. There are insufficient scheduled revenues to pay for Harbor District operations (enforcement, administration and management of the waterway), for services and amenities that are necessary for the visiting public to enjoy their State lands (normal sanitation, public bathrooms, sidewalk maintenance, signage and roads), and to pay for the depreciation and repairs on the Lease assets such as fixed piers and docks, buildings, lease site sea walls and revetments. All of these types are necessary for a thriving and successful business district on the waterfront. There is also a reliance on added revenue from percentage rents each year to balance the Harbor Department's budget, revenues that may not occur in slower years.
2. The City should evaluate the cost allocation and fair market rents for the Tidelands Lease sites and ensure that, over time, they are comparable to, and do not exceed market rates. The City has a statutory duty to charge no less than fair market value for franchises, leases and other uses of improvements. In our Cost Allocation Study comments, we recommended that any substantial adjustments that are needed be phased in over a five-year period, and that those rates not exceed those for similar facilities elsewhere in the County. We also recognize that there is a difference in "fair market value" of an improvement such as a slip, dock or mooring, and allocated cost analysis. Based on information provided by the City, some sites have not had a formal re-appraisal in decades.
3. The City should re-evaluate the decision to eliminate the Business Services position in the Harbor Department, or it should outsource that function to a professional property management firm. It is believed that there will be increased efficiencies, greater revenues, more certainty, fairness, and greater collections. It is believed that outsourcing will also reduce conflicts between the City's "landlord" functions and its "enforcement" functions, add an element of objectiveness to lease administration, and ensure timely completion of the City's obligations under the leases. It is also believed that this function/position should be responsible for developing a long-term business plan for the waterfront's commercial areas (there are at least

- three), which is essential to halting the decline and decay of Harbor assets. Under its current staffing model, the City is attempting to perform an essential real estate management function on a \$12 million commercial asset without added expense. The burdens of this function can be reduced (possibly making this a part-time position) by setting up the leases so that they do not require the intensity of monitoring and auditing that is required now (for example, no percentage rents).
4. The City should evaluate the appropriate use and sources for Tidelands Lease revenues and determine which portion of the revenues should be reserved to maintain and improve the asset being leased, which portion is for “common area maintenance” such as Harbor operations and maintenance, and which portion is for base rent of the asset. The City should also establish a financing mechanism so that non-Tidelands Lease properties pay an equitable share of Waterfront area’s maintenance and operations through a Business Improvement District, Parcel Tax, paid parking or other mechanism so that all properties contribute to such funding. The city owned parking areas should be converted to paid parking. It is believed that this would not have a material impact on waterfront businesses and would create a revenue stream for parking lot maintenance and improvement, and for other improvements. We believe that the assumption that paid parking only covers enforcement expenses is incorrect. For example, the City of Pismo Beach reported parking revenues of \$1.1 million against expenses of \$682,000 for their 2018/2019 fiscal year, generating net operating income of over \$400,000 per year.
 5. The City should create sub-funds for the lease facilities in the Measure D/CF zone district, and the remainder of the Waterfront. This would eliminate commingling reserve funds and treatment of each of these sub-areas as their own internal funds. Each geographic area is functionally and economically different, with the measure D area functioning like an industrial park with a substantial amount of city owned fixed assets (piers, moorings, slips, parking, etc.), compared to the non-Measure D areas with are primarily land and water leases with the master lease holders responsible for the “rocks to the roof” improvements. The visitor-serving area south of Beach Street represents 78% of the appraised value of the Tidelands properties, while the Measure D area represents approximately 16%. (Note: the information provided on the leases appraisals and rent was incomplete and these percentages may vary somewhat.) This kind of analysis will reinforce the appreciation for the critical con-

tribution that existing restaurants and retail in the Measure D area make towards maintaining the facilities necessary for the commercial fishing fleet. This kind of analysis does not seek to jeopardize nor diminish the significant contribution of the commercial fishing fleet to the city.

6. The City should (more) pro-actively time the renewal of the lease sites so that they can be combined, comprehensively redeveloped, and placed on longer term master leases. Combining lease sites has economic, financial and administrative advantages. It also provides smaller tenants who may not be economically able to lease and redevelop a lease site with opportunities. It will also insulate the City and Harbor District from wide variations in lease revenues as individual properties sit vacant for months or years. The current proposal is to make this permissive; stronger language is called for to encourage consolidation of lease sites.

New comments and recommendations to the above, based on the TLP committee's report and recommendations are as follows:

1. **Harbor Facilities Funding.** The Harbor District is currently running on empty, and the City has not yet identified a feasible business plan to ensure operation of the Harbor, maintenance of depreciating and decaying infrastructure. There are insufficient scheduled base revenues to pay for Harbor District operations (enforcement, administration and management of the waterway), to pay for services and amenities that are necessary for the visiting public (normal sanitation, public bathrooms, sidewalk maintenance, signage and roads), and to pay for the depreciation and repairs on the Lease assets such as fixed piers and docks, buildings, lease site sea walls and revetments. **The update of the Cost Allocation Plan relative to Harbor facilities is still unresolved, as is how the City will maintain the value of the assets granted to it by the State.** Using Tidelands Lease monies for the exclusive purpose of operating the Harbor Department is unsustainable. Other revenue sources must be identified, including parking revenues, Business Improvement District Revenues, or other sources. All of the Harbor facilities and the Tidelands assets need to be leased at fair market return, and the City should not "discount" any rents, slip charges, leases or other facility charges unless the user and operator is providing remedial improvements that would otherwise be the responsibility of the City. The Harbor Advisory Committee has done a significant amount of work on identifying need, but a sustainable revenue model is not yet established.

2. **Cost Allocation and Fair Market Rent.** City should evaluate and conclude the cost allocation and fair market rents for the slips, docks and other rental facilities that was started last year. These should be at fair market rents, which may be different than the “Cost Allocation” basis. If there are substantial increases, they should be phased in over time consistent with the Chamber’s previous recommendations. Although the TLP committee spent a considerable amount of time assessing lease rates, percentage rents, etc., they demurred on making a recommendation because they believed this needed be determined by a qualified appraiser. The City should also provide a third-party analysis of the fair market rent for lease sites, including the depreciated fair market value of the Tidelands Lease sites assets (including water land and improvements owned by the City) for each lease site, and reconfirm the fair market annual lease rate. These fair market leases should be based on local economic conditions. Currently the City uses an eight percent (8%) lease rate; however, it is noteworthy that the State Lands Commission uses a 9% lease factor (but without apparent percentage rents). The percentage rents should also be validated, as well as the City’s target rate of return. The TLP is not clear when the last appraisal was done to determine fair market rents, if that is done during each lease negotiation. According to the City’s records some of the lease sites have not been re-appraised in decades.

3. **Fixed Rent vs. Percentage Rents.** The Lease Management Policy should provide for a fixed percentage rent as the preferred basis determining lease payments. This approach would set the rents at a standard percentage of the appraised value. The current “base rent” is set at eight percent (8%) with those paying sales taxes being assessed an additional amount based on reported taxable sales. Converting to a fixed rent would solve a number of current problems: 1) it would provide more stability and predictability for the Harbor Department and enterprise fund; 2) provide businesses with a more predictable rent structure, and potentially reduce turnover and vacancies by sublease holder businesses along the waterfront; 3) treat all lease holders more equitably and not penalize retailers and restaurants; and, 4) would eliminate much of the “auditing” and “enforcement” associated with lease administration. Such a fixed rent would be established at some level above the current base rent, and below the current maximum. For example, the State Lands Commission uses a base nine percent (9%) lease rate for the properties that it administers. This adjustment would also provide the Harbor Department with less volatility in its annual revenue (see attached historical trends). Certainly, the goal is not to substantially increase everyone’s rent, but to make the rent revenue more predictable and easier to enforce, and more like typical commercial leasing practices. The City should provide all current leaseholders with the option to convert to a fixed lease.

4. **Tidelands Lease Management Entity.** The City has a daunting task of trying to effectively manage a complicated \$12 million real estate asset (really multiple assets if you consider the Measure D area an “industrial park”, the non-Measure D area as a “shopping center”, and the moorings and slips as a separate asset), but on a part-time basis. The Harbor Director is challenged with trying to do too many things—chief Harbor law enforcement officer, first responder, chief code enforcer, chief rent collector, chief land use compliance enforcer, diplomat, politician and goodwill ambassador to visitors and tenants. Commercial leasing is a skill and a licensed profession. We should not expect that skill in a Harbor Director or staff; and, few commercial leasing agents have special knowledge in ground leasing and other special intricacies of the Tidelands properties. The position also requires an advocate for development of a sound and sustainable Harbor business plan. There should not be the kind of reliance on volunteers to assist with this. Commercial property leasing is normally budgeted at between 5% and 10% of base monthly rent, which means that the City should be allocating at least \$80,000 for this function. The City should reinstate the Business Services position, either in the Finance Department or the City Manager’s office. The City should also contract out the lease development function to a qualified commercial brokerage company, and a professional business plan for the Harbor.

5. **Use of Tidelands Funds.** Up until the mid-1990s, the City regularly augmented the Harbor Department budget to make improvements and the cover operations. With the elimination funds from the power plant, such transfers have been eliminated, and Tidelands lease revenues cover only the daily operations of the Harbor Department. This means that no money is being regularly set aside to fund the depreciation of the assets being leased and rented, and the City will eventually only own the granted “mud”. This situation is unwise and unsustainable. The first obligation of the City under the State Tidelands trust is to “...construct and maintain” the lands and improvements. Operations at the expense of maintaining these improvements is not a viable alternative, nor is it in the best economic interest of the City’s businesses.

The City should also take a broad view how these funds can be used to promote the purposes of the trust, including improving and maintaining the trust and upland lands so that the citizens of the state (our visitors) can enjoy their State lands. The City should also consider how it can broaden the definition of the uses compatible with Measure D to encourage redevelopment and new development in the Measure D/CF area so that additional revenues can be generated. We should recognize that the actual needed “footprint” of commercial fishing has changed substantially because of new technology, change in business practices and efficiencies, and the reduced value of commercial fishing “landings” in Morro Bay. Properties that are underdeveloped and do not generate adequate revenues to sup-

port operations. “Grandfathered” restaurant and retail properties (Tognazzini’s, Dockside Too, GAFCo, Harbor Hut, etc.) provide significant revenues to support commercial fishing operations and Measure D Tidelands properties. The City should create sub-funds for the lease facilities in the Measure D/CF zone district, and for the remainder of the Waterfront. This would eliminate commingling reserve funds and treatment of each of these sub-areas as their own internal funds. Each geographic area is functionally and economically different.

6. **Timing and Length of Leases.** The City should continue to pro-actively time the renewal of the lease sites so that they can be combined and comprehensively redeveloped. Combining lease sites has economic, financial and administrative advantages. It also provides smaller tenants who may not be economically able to lease and redevelop a lease site with opportunities. It will also insulate the City and Harbor District from wide variations in lease revenues as individual properties sit vacant for months or years. “Pop-up” and short-term leases should be encouraged, such as the arrangement with Three Stacks and a Rock, as licensing agreements with users who are not brick and mortar tenants but are water oriented commercial contractors. Lease terms should be set with specific regard to enabling a leaseholder to realize a return at least equal to 2.5 times the city established lease rate (given the relative risk of each investment type). The City should commission a professional appraisal and financial analysis to boil this down. The current version of the LMP does not appear to provide any specific guidance on this matter, and there should be some formulaic guidance to ensure that investors have an adequate length of lease to fully amortize their investment and realize an acceptable rate of return (measured as an “Internal Rate of Return” (IRR)).

7. **Financings and Refinancings.** While the City may not pledge its Tidelands assets as collateral for someone else’s private investment, there are no state restrictions that otherwise prevent a leaseholder from pledging his/her owned improvements and rents to secure financings. However, the City’s current policy does exactly that. In fact, many agencies that administer Tidelands leases have explicit policies that permit conventional financing and refinancings if they are not pledging the City’s revenue or the City’s asset (the “rocks”). Both Newport Beach and the San Diego Unified Port Authority have such policies (See, for example Section III of San Diego Unified Port District’s “Real Estate Leasing Policy”, attached.) There is also a presumption in the City’s current and proposed TLP that the City is legally prohibited from allowing leaseholds to convert their invested cash to debt that is secured by net lease revenues. This is an inaccurate assessment of the Tidelands lease restrictions and an unnecessary and onerous restriction on business and development. Other Tidelands grantees have more “business friendly” provisions that allow a leaseholder to finance and

refinance over time. The City's current position that such financings and refinancings can only be used to pay for improvements on the lease site is legally incorrect, punitive and anti-business. These sorts of projects are normally paid for in different ways and structures depending on the phase of development as follows: 1) during the "entitlement", permitting and preconstruction phase, the leaseholder normally pays for all expenses out of his/her own funds; 2) during "construction" of the leaseholder improvements (buildings, etc.), the leaseholder may use funds from a lender with security provided by other leaseholder assets; 3) after construction and before full lease-up and stabilization, the leaseholder will be on some sort of extended construction loan, "mini-perm" or "bridge loan" of a limited term; and, 4) after "stabilization" the leaseholder will attempt to place bank debt on the property and recover the equity that he/she has had to commit to the project. Any City/lease limitations on the ability to eventually borrow money that is secured by the leaseholder net lease revenue from a project is inappropriate, punitive and does not recognize the difficulties and realities of a commercial real estate development on the waterfront on a Tidelands Lease property. (We have reviewed the court case referenced by staff and legal counsel and believe that it does not apply to this matter.)

Attached: Morro Bay Harbor Department Budget History
San Diego Unified Port District, "Real Estate Leasing Policy"
Chamber Waterfront Policy Recommendations, August, 2019.

	2004/2005	2005/2006	2006/2007	2007/2008	2008/2009	2009/2010	2010/2011	2011/2012	2012/2013	2013/2014	2014/2015	2015/2016	2016/2017	2017/2018	2018/2019	2019/2020 (Budget)
Revenues																
Intergovernmental	61,200	18,000				18,820	71,778	144,462					48,122	343,000	33,000	28,000
Charges for Services (Leases)	1,241,585	1,213,611	1,930,192	1,580,500	1,726,000	1,358,185	1,387,292	1,802,399	1,379,835	1,636,512	1,875,848	1,949,963	1,845,581	2,017,851	1,928,955	1,950,800
Charges for Services (Boat Launch)						2,208	24,392	25,875	25,000	27,000	30,962	29,250	24,204	28,000	30,000	30,000
Fines and Forfeitures											38,032	14,924	8,855	8,000	5,000	1,200
Use of Money and Property	48,465	29,242	2,000								3,220	5,870	2,980	2,000		
Other Revenues	295	5,795	15,000	7,500	7,500	406,458	309,866	7,884	363,450	4,300	22,086	10,226	9,572	4,118	4,300	
Other Revenues-Lifeguards																
Castlewind Contribution (In Capital)												1,125				1,000
Interest																
Total Revenues	1,351,545	1,266,648	1,947,192	1,588,000	1,733,500	1,785,671	1,793,328	1,980,620	1,768,285	1,667,812	1,970,148	2,012,276	1,929,755	2,402,969	2,001,255	2,011,000
Transfers In																
Boat Launch											27,924	25,697	19,518			
Interfund Transfers In														45,000		
Operating/Capital	443,099					115,128		39,503			113,708	107,052	14,778	11,624		
Revenues and Transfer In	1,794,644	1,266,648	1,947,192	1,588,000	1,733,500	1,900,799	1,793,328	2,020,123	1,768,285	1,667,812	2,111,780	2,237,685	1,974,051	2,459,593	2,001,255	2,011,000
Expenditures																
Salaries and Benefits	1,748,433	2,399,086	2,171,735	1,067,631	1,179,515	1,007,712	917,443	923,603	885,141	916,444	931,221	977,764	1,320,736	1,137,603	1,058,070	1,060,016
Supplies						54,545	86,981	66,231	55,100	66,400	90,458	86,354	98,430	76,128	63,830	68,735
Services						255,196	422,686	458,066	265,090	254,723	358,175	415,390	389,660	383,860	404,947	410,378
Capital Outlay (See Capital Accum Fund)																7,000
Other	17,538	17,538	87,859			129,860	90,216	15,534			252,885	261,227	174,500	1,000	5,000	500
Debt Service	135,000	135,000	135,000	135,000	135,000	135,000	135,000	135,000	135,000	135,000	40,027	35,760	31,300	134,859	134,859	134,859
Total Expenditures	1,900,971	2,551,624	2,394,594	1,202,631	1,314,515	1,582,313	1,652,326	1,598,434	1,340,331	1,372,267	1,672,766	1,776,495	2,014,626	1,733,450	1,666,706	1,681,488
Transfers Out	271,428	897,715	393,684	385,369	242,734	273,704	304,714	645,919	424,295	291,986	555,538	418,593	309,804	323,708	334,168	309,758
Expenditures and Transfers Out	2,172,399	3,449,339	2,788,278	1,588,000	1,557,249	1,856,017	1,957,040	2,244,353	1,764,626	1,664,253	2,228,304	2,195,088	2,324,430	2,057,158	2,000,874	1,991,246
Annual Net Cash	[377,755]	[2,182,691]	[841,086]	-	176,251	44,782	[163,712]	[224,230]	3,659	3,559	[116,524]	42,597	[350,379]	402,435	381	19,754
Cumulative Net Cash	2,836,234	653,543	[187,543]	[187,543]	[11,292]	33,490	[130,222]	[354,452]	[50,793]	[347,230]	[463,758]	[421,161]	[771,540]	[369,102]	[368,724]	[348,970]



BPC Policy No. 355

SUBJECT: REAL ESTATE LEASING POLICY

PURPOSE: To Establish General Policies for Leasing the San Diego Unified Port District (District) Real Estate Assets

INTRODUCTION: The Real Estate Leasing Policy establishes general real estate leasing policies that have been adopted by resolution of the Board of Port Commissioners (Board). The Real Estate Leasing Policy does not supersede the District's existing leases. The attached *Administrative Practices -- Real Estate Leasing*, describes the practices and procedures to be used in establishing rent; conducting rent reviews; extending existing leases and granting options; and states the conditions for the District's approval of subleases, leasehold financing, lease assignment and lease amendment, including processing fees associated with the above. The Practices also state the District's commitment to meet and confer in good faith with the San Diego Port Tenants Association (SDPTA) regarding changes to the Practices and to conduct a public workshop on the changes when requested by the SDPTA.

POLICY STATEMENT:

1. Leasing Authority

- a. *Short-Term Leases (Five Years or Less)* – The Executive Director may, without prior Board approval, enter into leases and use permits (including Tideland Use and Occupancy Permits; rental agreements; easements; licenses; and other similar types of real estate agreements) for terms five (5) years or less in duration. The Executive Director shall provide the Board with a report each month that identifies each such tenant; location; use; area; rent; and term.
- b. *Long-Term Leases (More than Five Years)* – All leases for terms more than five (5) years in duration shall be presented to the Board for approval at a public meeting.

2. Tenant Qualifications

To become a District tenant or subtenant, the prospective tenant or subtenant and its principals shall: (i) be reputable (the absence of a reputation for dishonesty, criminal conduct, or association with criminal elements); (ii) possess sufficient

experience to conduct the proposed business; and (iii) possess the financial means to perform the tenant's obligations under the lease.

3. Rents

The District shall seek market rent when leasing its real estate assets and the District's leases shall reflect market terms and conditions. The Board retains the right to grant rent discounts, waivers or other concessions, but only after the Board has been advised of the value of the discount, waiver or concession and the reasons supporting it.

In considering whether to grant a rent discount, waiver or other concession, the Board should consider its duty to balance the promotion of fishing, navigation, commerce and public access with the obligation to the citizens of California to be fiscally self-supporting, to optimize revenues⁽¹⁾ and to reinvest proceeds in the tidelands.

4. Leasehold Improvements

District leases shall provide for tenants to maintain all improvements on their leaseholds, except for multi-tenant buildings where the District's rent includes specific maintenance responsibilities.

District leases shall provide that when a lease terminates, the District shall have the option to: (i) require the tenant to remove the tenant-owned improvements at the tenant's expense; or (ii) take title to the improvements.

5. Subleases

Short-Term Subleases (Five Years or Less) – The Executive Director may, without prior Board approval, consent to subleases for terms five (5) years or less in duration. The Executive Director shall provide the Board with a report each month that identifies each such subtenant, location, use and term.

Long-Term Subleases (More than Five Years) – All subleases for terms more than five (5) years in duration shall be presented to the Board for consent.

Subleases shall contain, as a minimum, provisions that: (i) meet current District lease requirements; (ii) provide that the subtenant shall be obligated to pay any master lease rent increases that are applicable to the subleased premises; and (iii) provide that in the event of a conflict between the master lease and the sublease, the master lease shall prevail.

¹"Optimizing revenues" refers to the District's consideration of maintaining the highest revenue stream possibly while balancing the strategic goals and objectives of the Board in managing the District's operations. Certain goals and objectives may not maximize revenues compared to other land use options; however, they may be given a higher priority due to the District's desire to maintain "balanced" operations.

6. Lease Amendments

Short-Term Leases (Five Years or Less) – The Executive Director may, without prior Board approval, consent to amendments to leases with terms five (5) years or less in duration. The Executive Director shall provide the Board with a report each month that identifies each such tenant, location, use, area, rent and term.

Long-Term Leases (More than Five Years) – The Executive Director or his or her designee may, without prior Board approval, consent to amendments to leases with terms more than (5) years in duration that benefit the District, provided that terms shall not be amended to: reduce rent; increase term, reduce insurance requirements afforded to the District; or reduce indemnity granted to the District. All amendments which reduce rent, increase term, reduce insurance afforded to the District, or reduce indemnity granted to the District, must be presented to the Board for approval. The Executive Director or Port Auditor shall provide a report of all such transactions at the next available BPC meeting.

7. Transaction Processing Fees

With exceptions noted below, the District shall charge a transaction processing fee of not less than five hundred dollars (\$500.00). Exceptions include: (i) rent reviews, (ii) transactions that benefit the District (e.g., a new or renewal lease that will result in additional rent to the District), or (iii) transactions that benefit the District's properties (e.g., an easement for utilities that will serve District tenants).

Fees and costs for services and administrative activities shall be paid in accordance with any applicable District ordinance.

8. Option Term and Consideration

When entering into an option to lease agreement, the District shall charge monetary or other consideration and shall establish initial terms and extensions consistent with the processing requirements of each project, subject to adjustment as described in the Administrative Practices.

RESOLUTION NUMBER AND DATE: Resolution 2017-012, dated January 10, 2017 (Supersedes BPC Policy No. 355, Resolutions 2015-178, 2015-179 and 2015-180, dated December 8, 2015; Resolution 2013-85, dated May 7, 2013; Resolution 2011-16, dated February 8, 2011; Resolution 2010-150, dated October 5, 2010; Resolution 2008-176, dated September 2, 2008, Resolution 2004-43, dated March 30, 2004; Resolution 2002-311 dated November 5, 2002; Resolution 98-28, dated January 27, 1998; BPC Policy No. 350, Resolution 95-244, dated July 25, 1995; BPC Policy No. 351, Resolution 95-268, dated August 22, 1995; BPC Policy No. 352, Resolution No. 92-47, dated February 18, 1992; and BPC Policy No. 354, Resolution 81-328, dated October 6, 1981)

SAN DIEGO UNIFIED PORT DISTRICT

SUBJECT: ADMINISTRATIVE PRACTICES – REAL ESTATE LEASING

PURPOSE: To Establish Fair and Consistent Guidelines for Leasing the District's Real Estate Assets

INTRODUCTION

The *Administrative Practices* are practical guidelines that implement BPC Policy No. 355, *District Real Estate Leasing Policy*. The Policy consists of general statements that are intended to encourage private investment; to promote high standards of development, operation and maintenance; and to assure that public trust assets are managed responsibly. The Practices are intended to provide clear guidelines and procedures for implementation of the Policy.

In the event the District proposes to make changes to the Practices, the District shall notify the San Diego Port Tenants Association (SDPTA) in advance and will meet and confer in good faith with the SDPTA to discuss the proposed changes. The SDPTA may request a public workshop on the changes. However, in individual lease negotiations, the foregoing does not in any way preclude the District from negotiating terms that vary in some respects from the Practices as long as the District and the tenant are in agreement.

- I. The Practices are divided into nine categories as outlined below: I. Establishing Rent and Conducting Rent Reviews
- II. Lease Extensions
- III. Leasehold Financing
- IV. Assignment of Leasehold Interest
- V. Subleasing
- VI. Lease Amendments
- VII. Trust Obligations
- VIII. Transaction Processing Fees, Port Master Plan Amendment (PMPA) Fees, and Security Deposits
- IX. Option Term and Consideration

The Practices follow:

I. ESTABLISHING RENT AND CONDUCTING RENT REVIEWS

A. Market Rent

The District should receive market rent for the leasing of its property, and rent should be adjusted to market periodically during the term of the lease. Market rent should be based on a current appraisal that complies with the *Uniform Standards of Professional Appraisal Practice*, published by the Appraisal Institute. District staff may consider other relevant information in arriving at the appropriate rent for a property. However, rent reviews for operating leaseholds shall not consider public improvements constructed by tenant either on or off the leasehold, the cost of remediation or any other incentives or concessions granted at the inception of the lease. Other exceptions to the appraisal requirement are noted below.

B. Calculation of Rent

Most District leases are either percentage leases or flat rent leases and may combine both percentage and flat rents. In a percentage lease, the District receives the greater of a minimum rent or percentages of gross income generated by the economic activities that are conducted on the premises. In a flat rent lease, the rent is a fixed amount which increases annually in accordance with the Consumer Price Index (CPI). Specific practices for percentage rent leases and flat rent leases follow.

C. Percentage Rent Leases

Market percentage rental rates tend to be relatively constant over time, and market validation of percentage rates for all of the District's revenue categories by appraisal is a major undertaking. Therefore, for determining percentage rates for new leases and rent reviews for existing leases, the District should establish benchmark appraisals by general geographic location and property type. The benchmark appraisals should be conducted on an ongoing basis by comparing the District's percentage rental rates with the percentage rental rates of other agencies including cities, counties, ports, and special districts, and should be utilized in determining rent at the rent review date stipulated in the lease:

1. Minimum rents in new percentage leases and in rent reviews should be set at no less than 75 percent of market rent as determined by the average of the tenant's previous three accounting years' rental payments, appraisal or other relevant information. For substantial redevelopment and new construction, the District may abate a portion of the minimum rent during construction when it is deemed appropriate.
2. Percentage rent leases should provide for market rent reviews every ten (10) years with mid-term adjustments to the minimum rent for changes in the consumer price index.
3. Appraisals of properties that normally rent for percentages of gross revenues (e.g., hotels, restaurants, marinas and retail stores) should

consider rents and percentage rates paid on comparable ground leased properties, in addition to economic analysis and other appraisal techniques.

4. The Executive Director or his or her designee may, without prior Board approval, approve rent reviews for percentage rent tenants paying less than \$1,000,000 in annual rent, provided that the following conditions are met:
 - a) The proposed rent shall comport with all BPC policies including without limitation, those establishing levels of authority delegated to the Executive Director; and
 - b) The proposed leases for which rent will be adjusted that otherwise would have gone to the BPC for approval shall be provided to the BPC at least ten (10) days in advance of the Executive Director's or his or her designee's approval; and
 - c) The Executive Director or Port Auditor shall provide a report of all such tenant lease rental adjustments at the next available BPC meeting.

D. Flat Rent Leases

In lieu of the appraisal-based rent review process described above, flat rent tenants and the District may amend their leases to provide for adjustment to rent annually by applying the Los Angeles All-Urban Consumer Price Index (CPI) to current rent, the annual adjustments to be no less than 2% or more than 4%. Leases will be amended only in those cases where the District and the tenant agree on the amount of the starting rent as the last adjusted rent brought current by adjusting it for CPI increases from the last date of the last adjustment to the date of the lease amendment. In those cases where the District and the tenant cannot agree on the starting rent, the lease will not be amended and the current rent adjustment provisions will continue to be in force.

The Executive Director or his or her designee may, without prior Board approval, approve rent reviews for flat rent tenants paying less than \$1,000,000 in annual rent, provided that the following conditions are met:

1. The proposed rent shall comport with all BPC policies including without limitation, those establishing levels of authority delegated to the Executive Director; and
2. The proposed leases for which rent will be adjusted that otherwise would have gone to the BPC for approval shall be provided to the BPC at least ten (10) days in advance of the Executive Director's or his or her designee's approval; and
3. The Executive Director or Port Auditor shall provide a report of all such tenant lease rental adjustments at the next available BPC meeting.

E. Appraisals

1. Appraisal Exception – If the cost of an appraisal is not justified by the anticipated rents, other less expensive analysis methods may be employed to establish rent at the discretion of the Executive Director, as long as adequate market information is available to support a reasonable and fair conclusion.
2. Timely Completion of Rent Review Appraisals – The District should be prepared to submit its rent proposal to the tenant no less than sixty (60) calendar days in advance of the commencement date of the rental period under review.
3. Appraisal Assumptions Regarding Status of Property – The appraisal should reflect the value of the land as-if vacant and available for new development. The appraisal should assume that all regulatory approvals that allow the existing use have been obtained, and there should be no discount for costs and time delays associated with obtaining the regulatory approvals.

The appraisal should be consistent with the highest and best use of the property, as if vacant, on the date of value. Market conditions may support a highest and best use that differs from the existing use.

The appraisal shall not consider public improvements constructed by tenant either on or off the leasehold, the cost of remediation or any other incentives or concessions granted at the inception of the lease.

Notwithstanding the above, the appraisal must be consistent with the use restrictions and other contractual burdens placed on the land by the terms of the ground lease and Port Master Plan.

4. Appraisal of Maritime Properties – Properties that are managed by the Maritime Division, that are used for maritime purposes, should be appraised by comparison with other seaport and/or maritime industrial properties, and should consider total potential revenues including but not limited to wharfage and dockage.

F. Rent Review Process

District leases shall provide for binding “baseball appraisal” when the District and the tenant cannot agree on the new rent for a rental period under review. In baseball appraisal, a panel of three appraisers must select by majority vote either the District’s rent proposal or the tenant’s rent proposal, whichever is judged to be the closest to market rent, as the rent for the next rental period of the lease. The District and tenant each shall select one appraiser and the two appraisers will mutually select the third appraiser. All appraisers must be qualified real estate appraisers and licensed to practice in the state of California. If the District or tenant fails to initiate the baseball appraisal process within the timeframes provided in the lease or fails to meet any

of the other prescribed deadlines relating to the rent review in the lease, or fails to present an appraisal pursuant to the terms of the lease, the failing party's right to utilize the baseball appraisal process shall be deemed to be waived. Tenant shall be afforded the opportunity to meet and informally discuss with the District and three appraisers within the prescribed deadlines relating to rent review in the lease.

II. LEASE EXTENSIONS

A. Overview

The District should utilize the lease extension process to (a) promote investment in leasehold improvements, (b) encourage redevelopment, and (c) update out-of-date leases. This section provides a narrative explanation of the process the District should follow in determining whether a proposed development or redevelopment qualifies for an extended lease term, the length of the extended term, and whether there should be compensation to the District for extending the term. A decision tree flowchart outlining the general process to be followed when a tenant requests a lease extension is presented in this section.

B. Lease Extension Practice and Decision Criteria

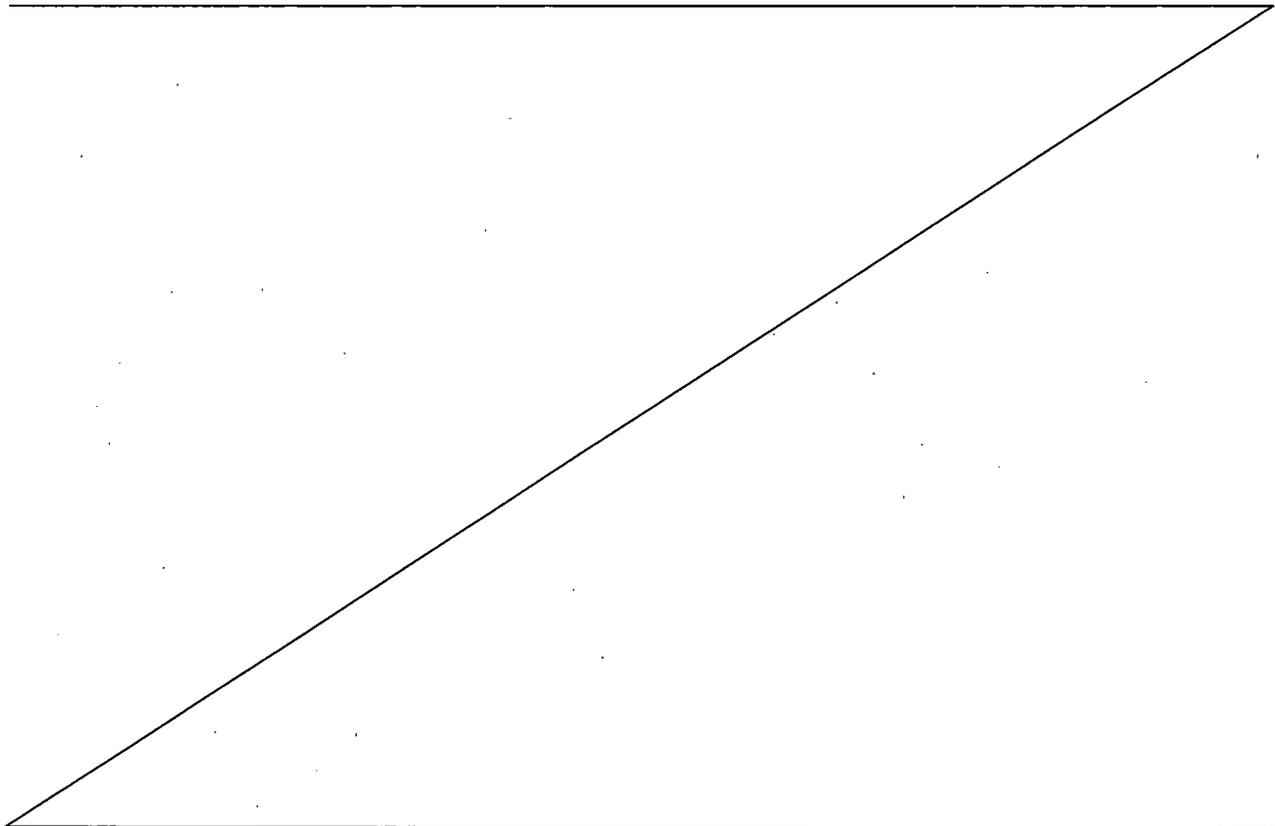
1. Tenant Requests a Lease Extension – The submission package should include the following information:
 - a) Description of the development concept and the proposed project sufficient for the District to understand precisely the scope of the entire development concept, which may include renderings and drawings showing a scaled site layout, interiors and exteriors of all significant buildings, parking lot layout, landscape development and layout, preliminary sign concept, pier and marina slip layout (if applicable) and any other prominent features.
 - b) Evidence that the tenant qualifies as a “tenant in good standing” (defined below).
 - c) Any proposed changes to ownership.
 - d) Description of the development team and its qualifications.
 - e) Proposed lease extension terms (including if applicable minimum rent, percentage rent by use, and compensation to the District for deferral of its reversionary improvement value as provided in this section), and justification for such terms.
 - f) Financial feasibility of the extension including pro forma cash flows (if applicable).
 - g) Anticipated development cost with qualifying Capital Investments (as defined in Section II(C)2), repair and maintenance, and

furniture, fixture and equipment items separately identified. To the extent that District does not believe that a submittal is a qualifying Capital Investment, at the request of the District, tenant shall be required to submit supporting documentation for items characterized as Capital Investment in the proposal.

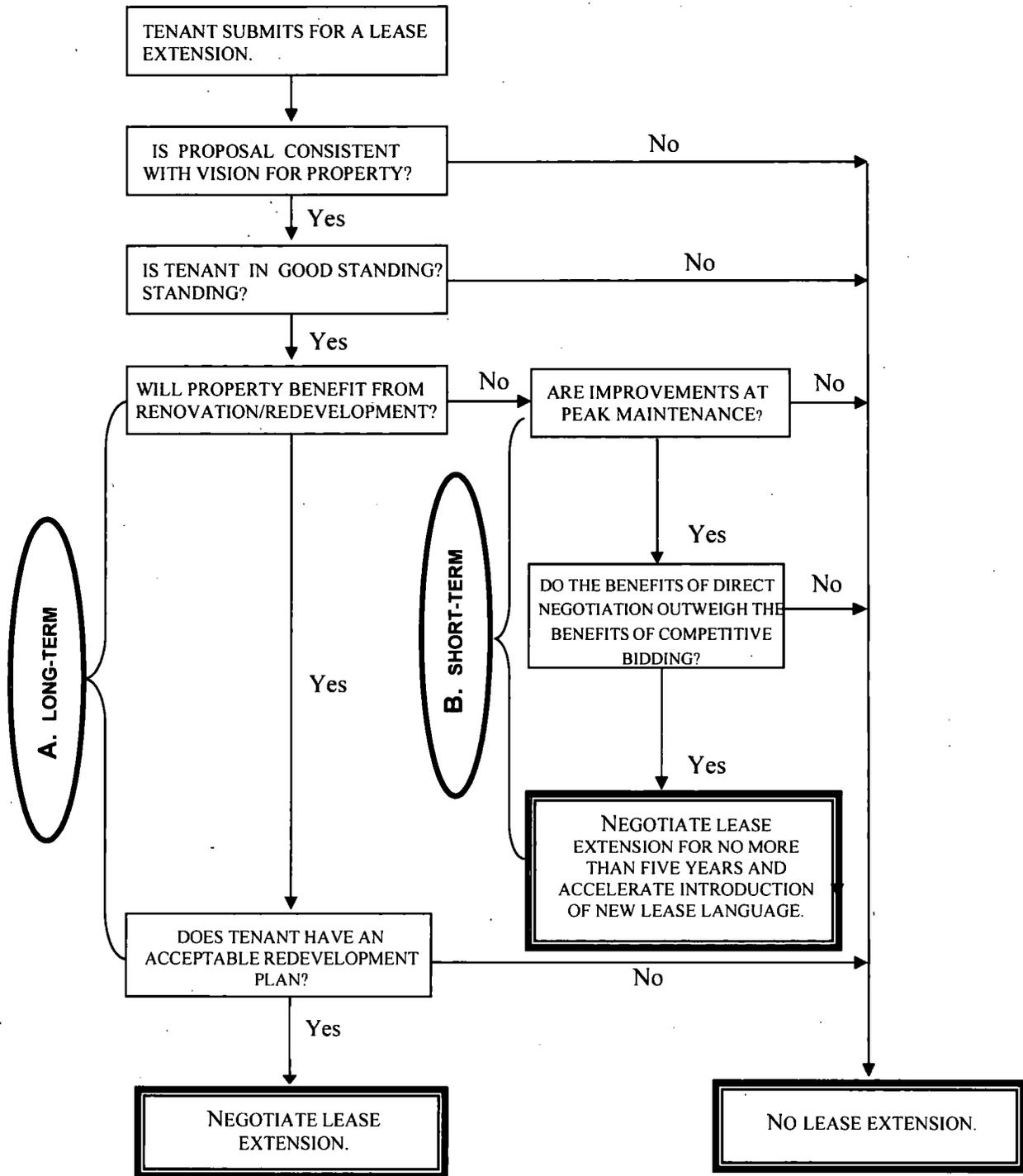
- h) Justification that the existing operator is capable of optimizing the use and return to the District, thereby negating the need for a Request for Proposal process.
 - i) Justification that the tenant has the expertise and financial capability to develop and operate the property, when the proposed development is different from the existing use.
2. Proposal Consistent with Master Plan – Initially, the District should determine if the proposal is consistent with the Port Master Plan. Inherent in this decision is the assumption that the planning process utilized in developing the Master Plan evaluated the potential for the highest and best use for the property, the goals of the District and the input of the local community. If the proposal is not consistent with the Master Plan, the District may reject the proposal at its sole discretion.
3. Proposal Consistent with the District's Vision for Future Use of the Property – If the proposal is not consistent with the District's vision for the future use of the property as determined by the Board in its sole and absolute discretion, the District should not negotiate a lease extension.
4. Qualification as a "tenant in good standing" – To qualify for a lease extension, the tenant should be considered a "tenant in good standing." The criteria should include a review of the tenant's history with respect to the following:
- a) Maintenance of the leasehold in good condition, free of deferred maintenance.
 - b) Prompt payment history.
 - c) Compliance with the provisions of the current lease, including use provisions, insurance requirements and regulatory permitting processes.
 - d) Maximization of the gross revenue of the tenant's business.
 - e) Maintenance of accurate financial records that are accessible to the District.
 - f) Compliance with District policies on public accommodation and non-discriminatory employment and contracting.

If the existing tenant does not meet the requirements for a "tenant in good standing," then no lease extension should be negotiated.

5. Benefit from Renovation or Redevelopment – Renovation or redevelopment contemplates making capital investments in the property that would allow for business expansion, modernization of facilities, aesthetic enhancement; or that maintain or increase the existing revenue stream to the District by expansion of the existing improvements or repositioning the property to a higher standard of quality.
6. Acceptable Development Plan Presented by the Tenant – If the property would benefit from renovation or redevelopment, the District must decide if the existing tenant has presented an acceptable redevelopment plan. The District and the tenant would then enter into negotiations that would result either in a plan acceptable to the District, or a decision that the existing tenant is not capable of implementing an acceptable redevelopment plan.
7. Process for Extending Leases – If a proposed project is consistent with the District's vision for the future use of the property, and the proposal meets the other criteria described above, the District should negotiate a new lease based on the following flow chart and requirements:



LEASE EXTENSION PROCESS



C. Lease Extension Negotiation

If the District and tenant agree to an acceptable redevelopment plan, lease extension negotiations should proceed, with the following considerations:

1. **Calculation of Extended Term** – The extended lease term should be based on the magnitude of Capital Investment in the property to be made by the tenant and the life expectancy of the development. The extended lease term may include past Capital Investment in the property submitted to the District for approval in accordance with District policy and the process outlined in the lease and approved by the District as long as it has not already been credited towards a previous lease extension. The District may wish to consider other relevant information in determining if a longer lease term is warranted, such as if the Capital Investment is expected to generate above average returns to the District, or will reposition the property to a higher standard of quality. Improvements completed without following submittal guidelines to the District, including notification to the District and a determination by the District whether the improvements qualify for a lease term extension, will not be considered for a lease term extension. A method of calculating the potential lease term extension is outlined below:
 - a) Determination of the estimated total replacement cost of the leasehold improvements as renovated/redeveloped. Cost figures can be determined utilizing resources such as tables provided by Marshall Valuation Service (or other industry standard cost estimating resources), or known development costs of comparable projects.
 - b) Determination of the life expectancy of the fully redeveloped project. The maximum lease term should be consistent with life expectancy of the improvements that qualify as Capital Investment in the property. Life expectancy guidelines are presented in a table at the end of this section. Lease term extensions granted after five years of the District's approval of the tenant's redevelopment plan will consider depreciation in improvements unless they were approved as part of a larger project. Depreciation shall be calculated utilizing the straight line depreciation method.
 - c) Computation of the ratio of Capital Investment in the property to total replacement cost.
 - d) Determination of the additional lease term by multiplying the ratio obtained in (c) by the life expectancy obtained in (b). The term in an extended lease shall not exceed the life expectancy of the development.

2. Qualifying Capital Investment

- a) "Capital Investment" for purposes of calculating the lease extension term should only include expenditures that usually increase the value (efficiency, productivity, or use utility) or the life expectancy of the improvements; cannot reasonably be amortized during the existing remaining term; are not recurring in nature; and are: (a) \$100,000 or more, or (b) 10% of the value of the improvements or more. It should specifically exclude deferred maintenance and expenditures for repairs to keep the existing improvements in good condition. Items that separately would not qualify for lease term extension may be considered collectively as part of an overall plan of renovation or redevelopment. In a renovation or redevelopment project, qualifying Capital Investment may include, at the sole discretion of the District, the value of superior improvement condition. The intent is to recognize the efforts of a tenant who maintains improvements in like-new condition in the latter stages of the lease term. The value of superior improvement condition may be measured by documented costs, or by replacement cost and depreciation tables such as those published by Marshall Valuation Service. Public art expenditures should be included as Capital Investment. Non-realty property may be given consideration depending on property type. An example of this would be the purchase by industrial tenants of specialized fixtures or equipment that are necessary for its operation. If lease term is granted for a Capital Investment in non-realty property, the new lease should include a provision requiring that the non-realty property (or an equivalent replacement as approved by the District) remain in place for the entire lease term. Purchase of District-owned improvements may be considered a qualifying Capital Investment. The cost of environmental cleanup is specifically excluded as a qualifying Capital Investment.
- b) If the Capital Investment will be undertaken in phases, then the tenant must identify the timeline for completion of all improvements in the tenant project application.
- c) The District may consider a lease term extension without Capital Investment in exchange for payment for deferral of the District's reversionary interest.

3. Payment for the Deferral of the District's Reversionary Interest – The standard District lease gives the District the right to assume ownership of the improvements at the end of the lease. During the lease, this reversionary interest in the improvements may have a value that can be estimated using accepted appraisal techniques. In exchange for granting a lease extension, the tenant should recognize that the District may be deferring the realization of a valuable

reversionary interest in the existing improvements. The tenant should compensate the District by an amount equal to the value of the interest being deferred. This amount can be paid in full at the commencement of the lease, incorporated as additional rent with interest over a specified period of time, or may be used to offset the tenant's cost of developing new public access infrastructure on or off the leasehold such as parks and promenades at the District's sole and absolute discretion.

If there is an economic benefit to the District, such as higher rent or the prevention of deteriorating rent, as a result of a Capital Investment by the tenant and the term extension, the economic benefit should be used to offset all or part of the compensation for deferral of the reversionary interest.

In estimating the reversionary improvement value, the market capitalization rate used should reflect value components that are related to superior management on the part of the tenant, including going-concern value, goodwill, and above-average maintenance; and for furniture, fixtures and equipment.

a) Percentage Rent Leases – A conceptual method of calculating the value of the deferral of the reversionary interest in percentage rent leases would be as follows:

(1) *Value of Deferred Reversionary Interest* – The value of the deferred reversionary interest can be estimated by projecting the operating income and expenses, based on the existing development, to the end of the existing lease term, using market-supported assumptions about operating income, expenses and inflation; and capitalizing the net income into an indication of leased fee value. The present value of the leased fee interest at the end of the existing lease term can then be calculated. Following the same procedures, the present value of the leased fee interest at the end of the extended lease term can be calculated. The value of the District's deferral of the reversionary interest is the difference between the present value at the end of the existing term and the present value at the end of the extended term, and represents the amount to be compensated to the District, subject to any offsetting economic benefit described below.

(2) *Value of Economic Benefit to the District* – The difference between the present value of the rent to the District for the proposed development, projected over the remainder of the existing term, and the present value of the rent to the District for the existing development projected over the remainder of the existing term, is a measure of the economic benefit to the District

resulting from the investment by the tenant. The economic benefit should be used to offset all or part of the value of the compensation for deferral of the District's reversionary interest.

b) Flat Rent Leases – A conceptual method of calculating the value of the deferral of the reversionary interest in flat rent leases would be as follows:

(1) *Value of Deferred Reversionary Interest* – The projected replacement cost of the improvements at the end of the existing term can be estimated by trending the current replacement cost by the anticipated rate of inflation. The projected reversionary improvement value can be estimated by subtracting depreciation from the projected replacement cost. The present value of the reversionary improvement value at the end of the existing term can then be calculated. Following the same procedures, the present value of the reversionary improvement value at the end of the extended lease term can be calculated. The value of the District's deferral of the reversionary interest is the difference between the present value at the end of the existing term and the present value at the end of the extended term, and represents the amount to be compensated to the District.

(2) *Value of Economic Benefit to District* – The present value of increased rent through the end of the current rental period, negotiated as part of a lease extension, shall be used to offset compensation for deferral of the reversionary interest in flat rent leases.

4. Timely Submission by Tenant and Response by District – District staff will respond to a request for a lease extension within thirty (30) calendar days following receipt of a request for a lease extension. The initial response shall either recommend the proposal for project review and California Environmental Quality Act (CEQA) review, or request additional information that the District believes was not included or was not adequately addressed in the initial submittal. The Tenant may re-submit within sixty (60) calendar days of the District's initial response. District staff will respond to the re-submittal within thirty (30) calendar days. Subsequent responses to project submittals will follow the same schedule.
5. Market Rent – The rent in an extended lease should be updated to the current market rent as negotiated between the tenant and the District.
6. New Lease Provisions – Upon negotiation of the extended lease term, the new rent and the amount of payment, if any, for deferral of the District's reversionary interest in the improvements, the existing lease shall be superseded by a new lease incorporating the District's

current standard lease terms. The tenant's liability for hazardous materials in the prior lease shall continue in the new lease. The tenant will indemnify the District against potential third party challenges to the CEQA review and/or determination process and agrees to reimburse the District for actual, reasonable and necessary third-party out-of-pocket expenses associated with processing a redevelopment project including but not limited to the preparation and certification of the CEQA document by the Board, the preparation and approval of the PMPA by the Board and the California Coastal Commission (CCC), the preparation and issuance of an appealable CDP by the Board or, if appealed, the CCC, and any other third-party expenses arising out of the entitlement process in the District's determination. District shall use commercially reasonable efforts to manage expenses.

7. "Basket of Issues" – While it is desirable to have a "standard" negotiation process, the lease extension process involves a "basket of issues" with each tenant. The District should be willing to negotiate each extension separately and take into account the unique circumstances of each request.

8. Short-Term Lease Negotiation – An existing tenant may qualify for an extended term under the criteria outlined above, but the property may not qualify as the highest and best use under the Port Master Plan, or may not be consistent with the District's vision for the future use of the site. In other cases, all the criteria for a long-term lease extension may have been met but the property may not benefit from renovation or redevelopment (i.e., the improvements are in excellent condition and represent highest and best use). In either event, upon lease expiration, the District may consider a new short-term lease with the existing tenant with the following four considerations:
 - a) *Lease Term* – The lease term should be no more than five years. This will create a term short enough to enable the District to periodically evaluate if the current use remains the highest and best use of the property consistent with the District's goals and objectives and the Port Master Plan.
 - b) *Payment for District-Owned Improvements* – The tenant should pay market rent for improvements it occupies that are owned by the District after expiration of the existing lease term.
 - c) *Rent* – The rent would be updated to the current market rent as negotiated between the tenant and the District.
 - d) *New Lease* – A new lease shall be executed including the District's current standard lease language.

9. Recommended Life Expectancy Guidelines – The length of a new or extended lease term should be based on the reasonable life expectancy of the improvements that qualify as Capital Investment. Life expectancies vary by use. Improvements that are subject to relatively high physical deterioration or functional obsolescence caused by market changes have *relatively* short life expectancies. Improvements that are physically more substantial and less affected by market changes have relatively long life expectancies.

The guidelines shown below were developed based on practical experience and observations, and by reference to the life expectancy tables published by *Marshall Valuation Service*.

ECONOMIC LIFE EXPECTANCY GUIDELINES

PROPERTY TYPE	TERM*
HOTEL	40 TO 66 YEARS
FULL SERVICE RESTAURANT	20 TO 40 YEARS
RETAIL SALES	30 TO 45 YEARS
COMMERCIAL OFFICE	30 YEARS
LAND SERVICE STATION	20 YEARS
MARINE SERVICE STATION	20 YEARS
MARINA	40 YEARS
SPORTFISHING LANDING	20 YEARS
BOAT EXCURSION LANDING	15 YEARS
BOATYARD	30 YEARS
SHIPYARD	50 YEARS
LUMBERYARD	25 YEARS
AIRPORT INDUSTRIAL	25 YEARS
OTHER INDUSTRIAL	50 YEARS
YACHT CLUB	35 - 45 YEARS

* The Terms outlined above represent the recommended length of term a tenant may receive for each respective property type. Shorter terms, or a combination of shorter terms with options to extend, may be appropriate to ensure an appropriate level of quality and maintenance of the improvements.

III. LEASEHOLD FINANCING

A. Consent to Financing Subject to Specific Criteria

The required minimum documentation to be submitted by the tenant in support of a request of the District to consent to new financing and standards for financing consent are as follows:

1. Initial documentation should include the term sheet, application or commitment, cash flow projections, appraisal submitted to the lender, and the most recent annual financial statements of the tenant (if it is a percentage lease) for at least the past two years.
2. When available, final loan documents should be provided.
3. Maximum loan proceeds should not be in excess of the greater of 75% loan-to-value as determined by the lender's appraisal, or the amount of repayment of existing financing (provided that such financing was initially consented to by the District).
4. A loan should have a maturity date that does not exceed the remaining ground lease term.
5. A tenant should acknowledge that it will not seek rent relief as a result of not being able to meet its debt service or debt repayment obligations.
6. The District shall either:
 - a) Receive a share of the proceeds of refinancing, except proceeds which are reinvested in District-owned land or water, replace existing financing, or reimburse the tenant for documented equity investment, or
 - b) Have the right to adjust the rent to market rent.
7. There should not be any restrictions on how the tenant utilizes the proceeds of financing (as long as the District is satisfied that proper underwriting guidelines are met).

If the District staff is satisfied that the above criteria have been met, its recommendation for consent to the new financing shall not be unreasonably withheld.

B. Timely Response to Request for Leasehold Financing

District Staff should have completed its recommendation on consent to the financing of a leasehold interest within forty-five (45) calendar days of

receipt of all required information. Staff's recommendation for consent shall not be unreasonably withheld.

C. Administrative Approval of Routine Financing

The Executive Director or his or her designee may, without prior Board approval, approve tenant leasehold financing, provided that the following conditions are met:

1. The proposed tenant leasehold financing shall comport with all BPC policies including without limitation, those establishing levels of authority delegated to the Executive Director; and
2. The proposed tenant leasehold financing that otherwise would have gone to the BPC for approval shall be provided to the BPC at least ten (10) days in advance of the Executive Director's or his or her designee's approval; and
3. The Executive Director or Port Auditor shall provide a report of all such tenant leasehold financing approvals at the next available BPC meeting.

IV. ASSIGNMENT OF LEASEHOLD INTEREST

A. Consent to Assignment Subject to Specific Criteria

The required documentation to be submitted by the tenant in support of a request of the District to consent to an assignment of the leasehold and standards for assignment consent are as follows:

1. The tenant shall complete UPD Form No. 317, Lessee's and Sublessee's Questionnaire for All Leases (and Subleases of More than Five Years).
2. If new financing is involved in the sale, the proposed tenant shall provide the information required above under Leasehold Financing.
3. The District must be satisfied that the lessee possesses the financial capacity, a good reputation and managerial ability to operate successfully on the leased premises.
4. The District shall either receive a share of the proceeds of a sale or have the right to adjust the rent to market rent as a condition of its consent. This right does not apply to an assignment that changes the method of holding title but does not change the proportional ownership interests of the individuals, nor does it apply to transfers between spouses or immediate family members.

- B. Timely Response to Request for Assignment of Leasehold Interest**
District staff should have completed its recommendation on consent to the assignment of a leasehold interest within forty-five (45) calendar days of receipt of all required information. Staff's recommendation for consent shall not be unreasonably withheld.
- C. Administrative Approval of Routine Assignments of Leasehold Interest**
The Executive Director may, without prior Board approval, approve an assignment of leasehold interest if the assignment results in no change of control, operations or management of the ownership entity of the tenant.

V. SUBLEASING

A tenant may sublease all or part of its leased premises to a qualified subtenant, subject to consent by the District. The appropriate District-supplied Sublease Questionnaire form must be completed and submitted to the District. Consent by the District must be obtained prior to occupancy by the sublessee.

- A. Sublease Consent Criteria**
Staff's recommendation for consent to a sublease shall be made in accordance with the following criteria:
1. The District must be satisfied that the sublessee will use the property in a manner that is consistent with uses allowed by the lease.
 2. The District must be satisfied that the sublessee possesses the financial capacity, a good reputation and managerial ability to operate successfully on the subleased premises.
 3. The District reserves the right to adjust the rent the District receives to market for the subleased portion of the property.
 4. The District must be satisfied that the sublease transaction will not have a significant negative impact on the District.
- B. Timely Response by the District**
For a short-term sublease (five years or less), District staff should respond with its recommendation regarding consent within thirty (30) calendar days of receipt of all necessary information, and for a long-term sublease (more than five years), District staff should respond within sixty (60) days.

VI. LEASE AMENDMENTS

A tenant may request amendments to a lease that could range from minor changes to extensive revisions. The District's consent to a request for lease amendment may be contingent upon updating sections of the lease to incorporate current standard lease provisions, and may include an adjustment to market rent, depending upon the extent of the proposed tenant requested revisions.

A. Lease Amendment Consent Criteria

Staff's recommendation for consent to a lease amendment shall be made in accordance with the following minimum criteria:

1. The allowed uses of the property stated in the amended lease must be in compliance with the Port Master Plan and with the District's vision for the future use of the property.
2. Amended sections of the lease must conform with the District's standard lease language in effect when the request for a lease amendment is made.
3. For a change in the method of holding title that does not change the proportional ownership of the individuals, or that represents a transfer between spouses or immediate family members, a complete lease update and rent adjustment would not be made. Standard provisions regarding hazardous materials, underground storage tanks and above-ground storage tanks should be added (unless they are already in the lease).
4. In some cases (e.g., changing from a sole proprietorship to a limited liability company), it may be advisable to have the principals personally guarantee lease performance.
5. A proposed lease amendment for financing or for a transfer or a partial or full interest in the leasehold would be governed by Sections III and IV of these Practices.

B. Timely Response by the District

For a short-term lease (five years or less), District staff should respond with its recommendation regarding consent within thirty (30) calendar days of receipt of all necessary information, and for a long-term lease (more than five years), District staff should respond within sixty (60) days.

VII. TRUST OBLIGATIONS

For tenants claiming special treatment under the Port District Act, the District should determine market rents consistent with the property's land use. Any discount to market rent or other concession should be supported by a tenant's written proposal that would outline why the discount is warranted, if there is a public benefit, the financial rationale for the request and the proposed economic terms. The proposal should be presented to the Board, which would determine if a concession is warranted.

VIII. TRANSACTION PROCESSING FEES, PORT MASTER PLAN AMENDMENT (PMPA) FEES, AND SECURITY DEPOSITS

A. Transaction Processing Fees

With exceptions noted below, the District shall charge a transaction processing fee of not less than five hundred dollars (\$500.00). Exceptions

include (i) rent reviews, (ii) transactions that benefit the District (e.g., a new or renewal lease that will result in additional rent to the District), or (iii) transactions that benefit the District's properties (e.g., an easement for utilities that will serve District tenants).

B. Port Master Plan Amendment (PMPA) Fees

If a tenant project requires a PMPA, then the tenant must pay for the cost of preparing the PMPA and any associated CEQA documentation. If a tenant project requires a PMPA, and the District is currently pursuing or will be pursuing a PMPA into which the tenant's project will be incorporated, then the tenant must pay for a pro-rata share of the cost of preparing the PMPA and any associated CEQA documentation. If a tenant project does not require a PMPA, but the District is currently pursuing or will be pursuing a PMPA into which the tenant's leasehold will be incorporated, then the tenant will not be charged a pro-rata share of the cost of preparing the PMPA and any associated CEQA documentation.

C. Security Deposits

The standard security deposit for a new rental agreement is three months' rent. A security deposit may be waived for a short-term rental of property that supports a tenant's long-term lease. The security deposit may be reduced for a tenant that has been in good standing for five or more years. For a tenant making a substantial investment in improvements, the security deposit will be refunded upon completion of the improvements.

IX. OPTION TERM AND CONSIDERATION

Generally, proposed projects including but not limited to a change in use, additional lease term, financing, and issuance of permits will be memorialized in an option agreement and lease. If District staff negotiates an option, then recommendations regarding option term and consideration, including extensions, must be based on this section of the Practices. Recommendations which include adjustments to option term and consideration, if any, must be based on the factors described in Section (3) below.

A. Term

Calculating Initial Option Term and Option Term Extensions. The District recognizes that there is uncertainty in every entitlement process. As a result, District staff's recommendation regarding initial option term and extensions must be based on a cooperative assessment of the approval process and timeline for a proposed project and its associated risks.

For existing tenants with options with no change in use or a change in use that does not require a Port Master Plan Amendment, the initial minimum option term will be 18-24 months. In all other cases, the term will be 24-36 months. Term extensions are subject to negotiation as needed.

B. Consideration

Calculating Initial Option Consideration and Option Term Extension Consideration.

1. **Consideration** – Consideration may take the form of a monetary payment or a quantifiable benefit to the District. Examples of quantifiable benefits include but are not limited to construction of or enhancements to a District-owned asset and assuming contingent legal liabilities for District actions. Consideration does not include transaction processing fees, which may be assessed independently according to a schedule established by the District.
2. **Initial Option Consideration** – Initial option consideration is determined by whether the option covers a tenant's existing premises, new premises, or a combination of new and existing premises.

c) *Existing Premises Only* - If the option covers the existing premises only, then consideration is not required unless a Port Master Plan Amendment is required for the option. If a Port Master Plan Amendment is required, consideration is based on the following table:

Lease Type	Consideration
Percentage Rent	25% of difference between projected first year's minimum annual rent and current minimum annual rent
Flat Rent	25% of annual rent difference if an appraisal is performed or 5% of annual rent

d) *New Premises Only* - Whether or not a Port Master Plan Amendment is required, if the option covers new premises only, then consideration is based on the following table:

Solicitation Type	Consideration
Sole Source	25% of projected first operating year's minimum annual rent
RFQ/RFP	25% of projected first operating year's minimum annual rent

e) *New Premises and Existing Premises* - Whether or not a Port Master Plan Amendment is required, if the option combines both new premises and existing premises, then consideration is 25% of the difference between the projected combined first year's

minimum annual rent and the existing premises minimum annual rent.

3. Option Term Extension Consideration – Option term extension consideration is subject to negotiation. The following establishes a baseline for calculating option term extension consideration which may be subject to adjustment.

For existing tenants with proposed projects that do not require a Port Master Plan Amendment, extension consideration is not required.

In all other cases, option term extension consideration will be prorated based on the initial option term and consideration. For example, if the initial option term is 24 months and the consideration is \$240,000, then each additional month of option term extension would require an additional \$10,000 in consideration.

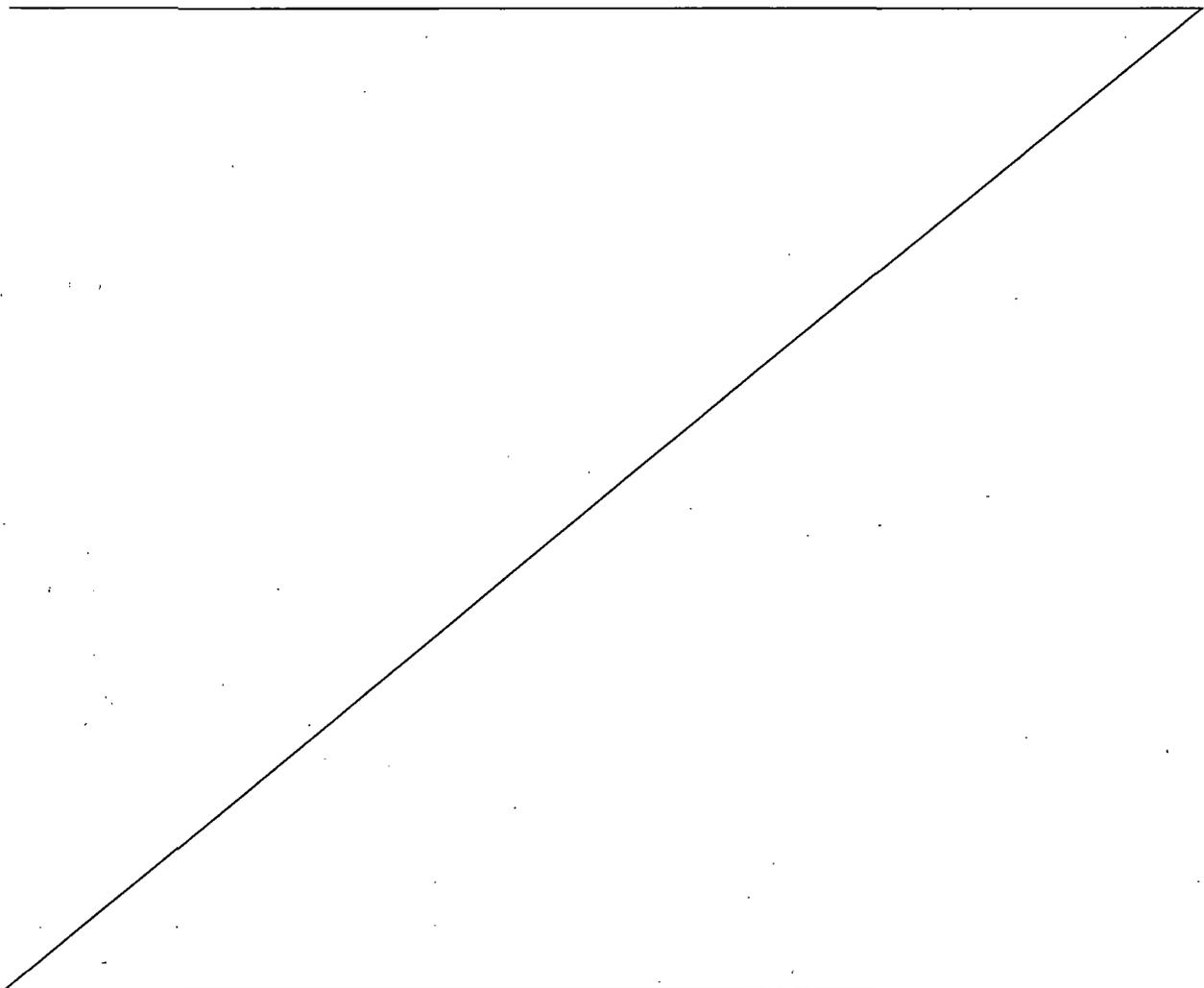
C. Adjustments

Factors Justifying Adjustments to Option Term and Consideration. District staff may recommend to the Board reducing or increasing the term and consideration for options and extensions described in Sections (1) and (2) above. Any recommended adjustment must be justified by one or more of the following factors:

1. Assumption of District Obligation – An optionee may assume the liability for the cost of a District obligation.
2. Improvements or Work Performed at Tenant's Risk – An optionee may construct improvements or perform work with no guarantee that the option may be exercised.
3. Accelerated Performance – An optionee may be incentivized to exercise its option prior to the scheduled expiration.
4. Social or Community Benefits – Non-profit tenants such as yacht clubs, museums, and performance of obligations that benefit the public - including development and maintenance of public parks or promenades - may justify a reduction in consideration.
5. Market Conditions – Market conditions may impact the District's bargaining position including, but not limited to, inferior site locations, difficult markets, economic conditions, and costly entitlement processes.
6. Inability to Obtain Financing – The District's option agreements do not allow the optionee's lack of ability to obtain financing to serve as a reason for not exercising an option. However the District has extended options because financing was not yet in place or ready to

close. In instances where a documented catastrophic market cycle (such as the market cycle impacting financing during 2009-2010) prohibits an optionee's ability to obtain financing the District should consider the status of financing in its justification for granting additional term and for reducing or eliminating consideration for an extension. The optionee's inability to obtain financing because of inadequate equity investment in a project should not be considered as a justification for force majeure extensions.

7. Force Majeure Delays – Listed are examples of Force Majeure delays that could result in the reduction or elimination of option consideration if an extension is issued (i) delays caused by litigation that prevents the optionee from performing under the option terms (CEQA or CCC challenges); (ii) documented delays in permitting outside the optionee's control and beyond the time frames agreed to for complete application submittals, including administrative appeals; (iii) documented delays to obtain entitlements from regulatory agencies outside the optionee's control.



**ADDENDUM TO BPC POLICY NO 355 ADMINISTRATIVE PRACTICES REAL
ESTATE LEASING**

REPORT OF YACHT CLUB LEASING POLICY AD HOC SUBCOMMITTEE

**RECOMMENDATION TO THE BOARD OF PORT COMMISSIONERS OF THE
SAN DIEGO UNIFIED PORT DISTRICT**

At its December 8, 2003 meeting, the Subcommittee voted to recommend that the Board adopt a resolution directing staff to supplement the BPC Policy 355 leasing practices as follows:

1. The present yacht club leases shall be amended to delete the rent review provision for 2006 and substitute a rent adjustment equal to the change in the Consumer Price Index for the Los Angeles area for the years 2001 - 2005.
2. Upon the grant of a new lease, whether after expiration of the current lease or by reason of the satisfaction of option requirements for redevelopment of the leasehold that result in a new lease earlier than expiration of the current lease, rent shall be paid at the greater of Fair Market Rent or Minimum Rent. Fair Market Rent shall be percentage rent calculated as follows:
 - (a) From the commencement of the new lease to December 31, 2011, 8.25% of gross revenues;
 - (b) From January 1, 2012 through December 31, 2012, 8.80% of gross revenues;
 - (c) From January 1, 2013 through December 31, 2013, 9.35% of gross revenues;
 - (d) From January 1, 2014 through December 31, 2014, 9.90% of gross revenues;
 - (e) From January 1, 2015 through December 31, 2015, 10.45% of gross revenues;
 - (f) From January 1, 2016 through December 31, 2016, 11.0% of gross revenues;

- (g) From January 1, 2017 through December 31, 2026, Fair Market Rent shall be calculated by multiplying gross revenues by a blended rate adjusted by an appraisal of the concession rates on each revenue category; the new blended rate shall be adjusted by applying an adjustment as follows:

(The sum of all current concession rates plus the sum of all changes to the concession rates divided by the sum of all concession rates) multiplied by the current blended rate will equal the new blended rate. The current concession rate is comprised of the following: dues @ 5.0%; slips, dry storage and lockers @ 22.0%; member food and beverage @ 3.0% and 5.0% respectively; catered food @ 7.0%; catered beverage @ 7.0%; and ships store @ 10.0%. The sum of all concession rates equals 59.0%

Example: Currently, the blended rate is 11.0% and the sum of the concession rates is 59.0%. If, for example, the slips, dry storage and locker concession rate increases by 2.0% (from 22.0% to 24.0%), the computation of the new blended rate would be expressed arithmetically:

$$[(59+2) \div 59] \times 11.0\% = 1.0338 \times 11.0\% = 11.37\%$$

- (h) On January 1, 2027 and each succeeding tenth anniversary thereafter, the concession rates shall be reappraised and adjusted as set forth in (g) above.
- (i) Minimum Rent starting on January 1, 2022 and every ten years thereafter shall be adjusted by the corresponding increase in the Consumer Price Index for the Los Angeles area for the prior ten years from the minimum rent in effect in 2012. For purposes of determining the CPI base for calculating the Minimum Rent in 2022, the Fair Market Rent in 2012 shall be adjusted by the appropriate CPI increase over the 10-year period. The increase shall not be less than 3.0% per annum or greater than 5.0% per annum. In any year immediately following a rent adjustment as the result of an appraisal of the concession rates, the rent for that year and each successive year shall be determined by the greater of 75.0% of the actual rent paid the prior year or the Minimum Rent or the Fair Market Rent; and

- (j) For purposes of calculating rent, gross revenues shall only include: dues, member food and beverage, catered food and beverage, slips, dry storage and lockers and ships store. Gross revenues shall not include revenues for junior sailing programs, outstation locations not on District property, initiation fees or interest income as well as any amounts set aside by the yacht clubs for Capital Investment or the debt on Capital Investment, whether such amounts are collected as special assessments, dues, percentage of slip rents, or otherwise.
- 3. New yacht club leases shall be for a maximum term of 40 years provided all the requirements for achieving maximum lease term are met.
 - 4. Financial statements detailing operating revenues and sources, cash flows, capital reserves and capital expenditures, as well as sources of capital amounts, shall be provided annually no later than 120 days following the end of each club's fiscal year.

(2)

RESOLUTION 2017-012**RESOLUTION AMENDING BOARD OF PORT COMMISSIONER'S (BPC) POLICY NO. 355 - REAL ESTATE LEASING POLICY AND ADMINISTRATIVE PRACTICES - REAL ESTATE LEASING TO INCLUDE:****II. ADMINISTRATIVE APPROVAL OF ALL FINANCING**

WHEREAS, the San Diego Unified Port District (District) is a public corporation created by the legislature in 1962 pursuant to Harbors and Navigation Code Appendix 1, (Port Act); and

WHEREAS, Section 21 of the Port Act authorizes the Board of Port Commissioners (BPC) to pass all necessary ordinances and resolutions for the regulation of the District; and

WHEREAS, BPC Policy No. 355 Real Estate Leasing Policy and Administrative Practices Real Estate Leasing (collectively, BPC Policy No. 355) is the District's current leasing policy for real estate and maritime assets; and

WHEREAS, currently, BPC Policy No. 355 allows staff to administratively approve all refinancing that is no more than 10% or \$250,000 greater than the existing loan amount, whichever amount is lesser, regardless of the total loan amount; and

WHEREAS, based on feedback from tenants and the amount of staff time necessary to prepare a routine item for Board approval, staff recommends that BPC Policy No. 355 be updated to allow all financing to be administratively approved as long as it is consistent with the criteria already contained in the BPC Policy No. 355; and

WHEREAS, this change to BPC Policy No. 355 would directly benefit tenants by shortening timelines for financing approvals; and

WHEREAS, financing approved administratively would be reported to the Board on a monthly basis. As always, staff reserves the right to bring an item to the Board for consent; and

WHEREAS, of the twelve requests for consent to financing that went to the Board in FY 2016, none were pulled for additional discussion prior to the Board approval.

NOW, THEREFORE, BE IT RESOLVED by the Board of Port Commissioners (BPC) of the San Diego Unified Port District, as follows:

That the BPC consents to amending BPC Policy No. 355 - Real Estate Leasing Policy and Administrative Practices - Real Estate Leasing to include administrative approval of all financing.

APPROVED AS TO FORM AND LEGALITY:



PORT ATTORNEY

PASSED AND ADOPTED by the Board of Port Commissioners of the San Diego Unified Port District, this 10th day of January, 2017, by the following vote:

AYES: Bonelli, Nelson, Castellanos, Malcolm, Merrifield, Moore, and Valderrama

NAYS: None.

EXCUSED: None.

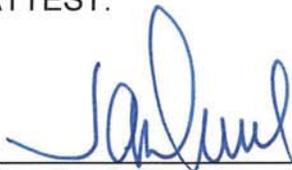
ABSENT: None.

ABSTAIN: None.



Robert Valderrama, Chair
Board of Port Commissioners

ATTEST:



Timothy A. Deuel
District Clerk

(seal)

RESOLUTION 2017-013**RESOLUTION AMENDING BOARD OF PORT COMMISSIONER'S (BPC) POLICY NO. 355 - REAL ESTATE LEASING POLICY AND ADMINISTRATIVE PRACTICES - REAL ESTATE LEASING TO INCLUDE:****I. ADMINISTRATIVE APPROVAL OF ALL RENT REVIEWS FOR TENANTS PAYING LESS THAN \$1,000,000 IN ANNUAL RENT**

WHEREAS, the San Diego Unified Port District (District) is a public corporation created by the legislature in 1962 pursuant to Harbors and Navigation Code Appendix 1, (Port Act); and

WHEREAS, Section 21 of the Port Act authorizes the Board of Port Commissioners (BPC) to pass all necessary ordinances and resolutions for the regulation of the District; and

WHEREAS, BPC Policy No. 355 Real Estate Leasing Policy and Administrative Practices Real Estate Leasing (collectively, BPC Policy No. 355) is the District's current leasing policy for real estate and maritime assets; and

WHEREAS, currently, BPC Policy No. 355 provides that rent reviews for fixed rent tenants paying less than \$250,000 in annual rent and may be administratively approved by the Executive Director, but tenants paying more than \$250,000 in annual rent must have Board approval for rent reviews; and

WHEREAS, based on staff's analysis, it takes approximately 46 days and at least 10 hours of staff time per transaction to prepare a routine rent review item for Board approval; and

WHEREAS, approximately 90% of the District's tenants pay less than \$1,000,000 in annual rent; and

WHEREAS, staff recommends that BPC Policy No. 355 be updated to allow all rent reviews for tenants paying less than \$1,000,000 in annual rent to be administratively approved; and

WHEREAS, rent reviews for tenants paying less than \$1,000,000 in annual rent are almost universally approved by the Board on consent; and

WHEREAS, if the Board delegated the authority to approve those transactions to staff, the number of consent items calendared for Board approval from Real Estate Development will be reduced by approximately 15% per year; and

WHEREAS, BPC Policy No. 355 contains guidelines for determining market rent and conducting rent reviews; and

WHEREAS, Staff considers rents and percentage rates paid on comparable properties in addition to economic analysis and appraisals when determining the appropriate rent for a property; and

WHEREAS, Staff has managed the District's commercial real estate portfolio to annual revenue increases averaging approximately 4.5% per year over the last five years; and

WHEREAS, Staff has access to up-to-date comparable data and utilizes on-call agreements with several professional appraisers when determining the appropriate rent for a leasehold.

NOW, THEREFORE, BE IT RESOLVED by the Board of Port Commissioners (BPC) of the San Diego Unified Port District, as follows:

That the BPC consents to amending BPC Policy No. 355 - Real Estate Leasing Policy and Administrative Practices - Real Estate Leasing to include administrative approval of all rent reviews for tenants paying less than \$1,000,000 in annual rent.

APPROVED AS TO FORM AND LEGALITY:
GENERAL COUNSEL



By: Deputy

2017-013

PASSED AND ADOPTED by the Board of Port Commissioners of the San Diego Unified Port District, this 10th day of January, 2017, by the following vote:

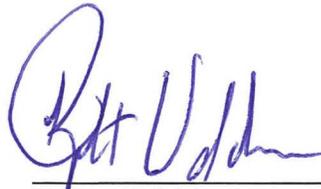
AYES: Bonelli, Nelson, Castellanos, Malcolm, Merrifield, Moore, and Valderrama

NAYS: None.

EXCUSED: None.

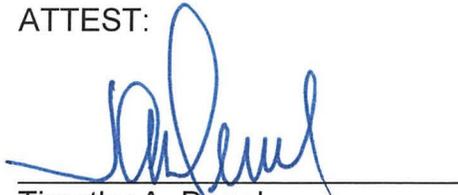
ABSENT: None.

ABSTAIN: None.



Robert Valderrama, Chair
Board of Port Commissioners

ATTEST:



Timothy A. Deuel
District Clerk

(seal)

SAN DIEGO UNIFIED PORT DISTRICT

ORDINANCE 2886

ORDINANCE GRANTING THE EXECUTIVE DIRECTOR OF THE SAN DIEGO UNIFIED PORT DISTRICT AUTHORITY UNDER BOARD OF PORT COMMISSIONER'S POLICY NO. 355 TO APPROVE AMENDMENTS TO LEASES IN EXCESS OF FIVE (5) YEARS PROVIDED THAT THE AMENDED TERMS DO NOT REDUCE RENT, INSURANCE OR INDEMNITY OF THE DISTRICT, OR INCREASE THE TENANT'S LEASE TERM, IN ACCORDANCE WITH THE SAN DIEGO UNIFIED PORT DISTRICT ACT, SECTION 21 ORDINANCES AND RESOLUTIONS

WHEREAS, the San Diego Unified Port District (District) is a public corporation created by the Legislature in 1962 pursuant to Harbors and Navigation Code Appendix I (Port Act); and

WHEREAS, Section 21 of the Port Act authorizes the Board of Port Commissioners (BPC) to pass all necessary ordinances and resolutions for the regulation of the District; and

WHEREAS, Section 21 of the Port Act also requires that all grants, franchises, leases, permits or privileges for more than five years shall be made by ordinance of the Board of Port Commissioners (BPC); and

WHEREAS, based on the requirements of the Section 21 of the Port Act, changes to leases which require amendments are made by ordinance adopted by the Board; and

WHEREAS, BPC Policy No. 355 is updated to allow administrative approval of rent reviews for tenants paying less than \$1,000,000 in annual rent and financing, the lease amendment triggered would still require Board approval, causing the resulting time savings to be minimal; and

WHEREAS, due to the amount of lease amendments processed by the Real Estate Development Department, staff requests the Board adopt an ordinance granting the Executive Director the authority to approve amendments to long-term leases as long as there is no reduction in rent, increase in lease term, or reduction in indemnity or insurance coverage; and

WHEREAS, granting the Executive Director this authority will eliminate the need for Board approval of routine lease amendments while preserving the District's ability to update the lease; and

WHEREAS, the proposed ordinance granting the Executive Director the ability to approve amendments to leases in excess of five years, enable the Real Estate department to realize the full benefit of the time savings afforded by streamlining rent reviews and approval of consents to encumbrances; and

WHEREAS, this proposed ordinance would reduce the number of consent items from the Real Estate Development department alone by 35% per year and save more than 160 full time equivalent (FTE) hours per year for staff; and

WHEREAS, staff would also provide a list of all amendments administratively approved on a monthly basis to the Board; and

WHEREAS, all amendments to rent, term, insurance, and indemnity not to the benefit of the District would still be presented to the Board for approval; and

WHEREAS, the Executive Director would reserve the right to bring any amendments to the Board for approval, even if they meet the criteria for an administrative approval.

NOW, THEREFORE, the Board of Port Commissioners of the San Diego Unified Port District does ordain as follows:

1. That the Executive Director and/or her designated representative is hereby authorized on behalf of the District to approve all amendments to leases in excess of five (5) years that benefit the District, provided that the following terms shall not be amended: reduction in rent, changes to term, reduction in insurance requirements, and reduction to indemnity. All amendments to rent, term, insurance, and indemnity not to the benefit of the District, must be presented to the Board for approval.
2. The Executive Director reserves the right to authorize the Board of Port Commissioners to review and approve amendments to leases at her discretion.
3. The Executive Director shall provide a list of all amendments administratively approved on a monthly basis to the Board of Port Commissioners.
4. This Ordinance shall take effect on the 31st day from its passage by the Board of Port Commissioners.

APPROVED AS TO FORM AND LEGALITY:
GENERAL COUNSEL



By: Deputy

PASSED AND ADOPTED by the Board of Port Commissioners of the San Diego Unified Port District, this 10th day of January, 2017, by the following vote:

AYES: Bonelli, Nelson, Castellanos, Malcolm, Merrifield, Moore, and Valderrama

NAYS: None.

EXCUSED: None.

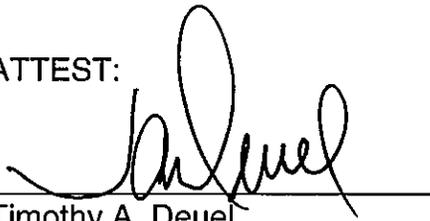
ABSENT: None.

ABSTAIN: None.

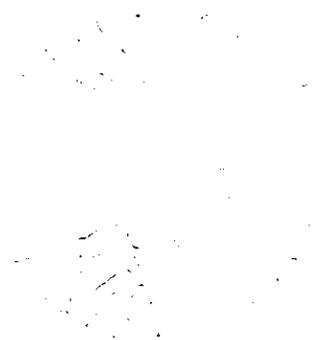


Robert Valderrama, Chair
Board of Port Commissioners

ATTEST:



Timothy A. Deuel
District Clerk



(Seal)

ACTION AGENDA

21. 2016-0668 INFORMATIONAL PRESENTATION FROM WORLD TRADE CENTER SAN DIEGO (WTCSD) ON THE WTCSD 2016 WORKPLAN OUTCOMES AND ANNUAL REPORT

Bella Heule, Chief Marketing Officer / Vice President, addressed the Board regarding Action Agenda Item 21 - File No. 2016-0668 and turned the presentation over to Nikia Clarke, Ph.D., Executive Director, World Trade Center, San Diego. (A copy of the staff report, presentations and any agenda related materials are on file with the Office of the District Clerk.)

Commissioner Merrifield, offered varied comments regarding Action Agenda Item 21 - File No. 2016-0668.

Presentation Only.

22. 2016-0704 BOARD OF PORT COMMISSIONER'S (BPC) POLICY NO. 355 - REAL ESTATE LEASING POLICY AND ADMINISTRATIVE PRACTICES - REAL ESTATE LEASING

A) RESOLUTION AMENDING BPC POLICY NO. 355 - REAL ESTATE LEASING POLICY AND ADMINISTRATIVE PRACTICES - REAL ESTATE LEASING TO INCLUDE:

- I. ADMINISTRATIVE APPROVAL OF ALL RENT REVIEWS FOR TENANTS PAYING LESS THAN \$1,000,000 IN ANNUAL RENT
- II. ADMINISTRATIVE APPROVAL OF ALL FINANCING

B) ORDINANCE GRANTING THE EXECUTIVE DIRECTOR OF THE SAN DIEGO UNIFIED PORT DISTRICT AUTHORITY UNDER BPC POLICY NO. 355 TO APPROVE AMENDMENTS TO LEASES IN EXCESS OF FIVE (5) YEARS PROVIDED THAT THE AMENDED TERMS DO NOT REDUCE RENT, INSURANCE OR INDEMNITY OF THE DISTRICT, OR INCREASE THE TENANT'S LEASE TERM, IN ACCORDANCE WITH THE SAN DIEGO UNIFIED PORT DISTRICT ACT, SECTION 21 ORDINANCES AND RESOLUTIONS

Tony Gordon, Principal, Portfolio Manager, addressed the Board regarding Action Agenda Item 22 - File No. 2016-0704 and turned the presentation over to Alexa Paulus, Asset Manager, Real Estate-Portfolio Management. (A copy of the staff report, presentations and any agenda related materials are on file with the Office of the District Clerk.)

The following member(s) of the public addressed the Board with agenda related comments: Uri Feldman, President, Sunroad; Sharon Cloward, President, San Diego Port Tenants Association.

Commissioner Merrifield, Commissioner Bonelli, Commissioner Malcolm, Commissioner Nelson and Chairman Valderrama offered varied comments regarding Action Agenda Item 22 - File No. 2016-0704.

The following members of staff responded and provided clarification to the Board regarding Action Agenda Item 22 – File No. 2016-0704: Randa Coniglio, Executive Director, Mr. Gordon and Ms. Paulus.

On a motion by Commissioner Malcolm, seconded by Commissioner Moore, the Board adopted Resolution 2017-012, Resolution 2017-013 and Ordinance 2886 as amended:

Part 1 – All financing and rent reviews must fully comport with all current District policies, as currently promulgated;

Part 2 - To provide advanced reporting for proposed financing and rent reviews, to the Board of Port Commissioners, in the weekly packet at least (10) days in advance of approval and in the next available Board of Port Commissioners meeting agenda, in addition, provide a report summarizing completed transactions ninety (90) days after the end of the fiscal year, to ensure public transparency.

The motion carried by the following vote:

Yeas: 7 - Bonelli, Castellanos, Malcolm, Merrifield, Moore, Nelson, and Valderrama

Nays: 0

Excused: 0

Absent: 0

Abstain: 0

Recused: 0

23. 2016-0674 PRESENTATION REGARDING THE PORT MASTER PLAN UPDATE, INCLUDING A PROGRESS REPORT, A FORECAST OF THE 2017 WORK PLAN AND DIRECTION TO STAFF

Jason Giffen, Assistant Vice President, Planning & Green Port, addressed the Board with staff's report and turned the presentation over to Lesley Nishihira, Principal, Planning and Green Port, regarding Action Agenda Item 23 – File No. 2016-0674. (A copy of the staff report, presentations and any agenda related materials are on file with the Office of the District Clerk.).

Chairman Valderrama, Commissioner Castellanos, Commissioner Moore, Commissioner Nelson, and Commissioner Merrifield, offered varied comments regarding Action Agenda Item 23 – File No. 2016-0674.

Presentation only.

24. 2016-0686 REVIEW AND CONSIDERATION OF DRAFT PROPOSED BOARD AGENDA FOR THE FEBRUARY 7, 2017 MEETING

On a motion by Commissioner Malcolm, seconded by Commissioner Bonelli, the Board adopted the draft agenda for February 7, 2017 as presented. The motion carried by the following vote:

Yeas: 7 - Bonelli, Castellanos, Malcolm, Merrifield, Moore, Nelson, and Valderrama



File #:2016-0704

DATE: January 10, 2017

SUBJECT:

BOARD OF PORT COMMISSIONER'S (BPC) POLICY NO. 355 - REAL ESTATE LEASING POLICY AND ADMINISTRATIVE PRACTICES - REAL ESTATE LEASING

A) RESOLUTION AMENDING BPC POLICY NO. 355 - REAL ESTATE LEASING POLICY AND ADMINISTRATIVE PRACTICES - REAL ESTATE LEASING TO INCLUDE:

- I. ADMINISTRATIVE APPROVAL OF ALL RENT REVIEWS FOR TENANTS PAYING LESS THAN \$1,000,000 IN ANNUAL RENT
- II. ADMINISTRATIVE APPROVAL OF ALL FINANCING

B) ORDINANCE GRANTING THE EXECUTIVE DIRECTOR OF THE SAN DIEGO UNIFIED PORT DISTRICT AUTHORITY UNDER BPC POLICY NO. 355 TO APPROVE AMENDMENTS TO LEASES IN EXCESS OF FIVE (5) YEARS PROVIDED THAT THE AMENDED TERMS DO NOT REDUCE RENT, INSURANCE OR INDEMNITY OF THE DISTRICT, OR INCREASE THE TENANT'S LEASE TERM, IN ACCORDANCE WITH THE SAN DIEGO UNIFIED PORT DISTRICT ACT, SECTION 21 ORDINANCES AND RESOLUTIONS

EXECUTIVE SUMMARY:

Board of Port Commissioners (BPC) Policy No. 355 - Real Estate Leasing Policy and Administrative Practices - Real Estate Leasing (collectively, BPC Policy No. 355) is the District's leasing policy for real estate and maritime assets. Based on staff's research and analysis, two categories of transactions which require Board approval under the policy - leasehold financing and rent reviews for tenants paying less than \$1,000,000 in annual rent - are almost universally approved by the Board on consent. Approximately 90% of the District's tenants pay less than \$1,000,000 in annual rent. If the Board delegated the authority to approve those transactions to staff, the number of consent items calendared for Board approval from Real Estate Development could be reduced by approximately 15% per year and processing time could be improved which would directly benefit tenants by shortening timelines for financing approvals by allowing them to obtain consent up to 30 days sooner.

Whether approved by staff or the Board, under most existing leases, consent to financing presents the opportunity to update outdated lease language to standard, resulting in enhanced protections for the District. Because most District leases are in excess of five years (long-term), the San Diego Unified Port District Act (Port Act) Section 21 requires that these lease amendments be brought to the Board for approval by way of an ordinance. So, even if BPC Policy No. 355 is updated to allow administrative approval of financing, the lease amendment triggered by consent to financing would still require Board approval, and the resulting time savings would be minimal. An ordinance granting

the Executive Director or designee the authority to approve amendments to long-term leases as long as there is no reduction in rent, increase in lease term, or reduction in indemnity or insurance coverage would eliminate the need for Board approval of more routine lease amendments while preserving the District's ability to update the lease. This approach would allow staff to realize additional savings in staff time and processing time by reducing the number of consent items calendared for Board approval from Real Estate Development by up to 50%, or approximately 16 items per year, when coupled with the proposed changes to the Policy described above. All amendments to rent, term, indemnity or insurance that do not benefit the District would still require Board approval.

Staff met and conferred with the San Diego Port Tenant's Association (PTA) as required by BPC Policy No. 355. The PTA is supportive of the proposed updates to the Policy as well as the proposed ordinance. As more fully discussed below, the proposed changes to BPC Policy No. 355 govern transactions that the Board almost universally approves on consent and would result in a significant reduction in the staff resources and time it takes to process approvals. Any future changes to the Board's minimum financing requirements, such as the 75% loan to value requirement, would require a future amendment to or waiver of the policy. Staff recommends that BPC Policy No. 355 be updated to allow administrative approval of all rent reviews for tenants paying less than \$1,000,000 in annual rent and administrative approval of all financing and that the Board adopt an ordinance granting the Executive Director or designee the authority to approve amendments to long-term leases as long as there is no reduction in rent, increase in lease term, or reduction in indemnity or insurance coverage.

RECOMMENDATION:

- A) Adopt a Resolution amending BPC Policy No. 355 - Real Estate Leasing Policy and Administrative Practices - Real Estate Leasing to include:
 - I. administrative approval of all rent reviews for tenants paying less than \$1,000,000 in annual rent; and
 - II. administrative approval of all financing.

- B) Adopt an Ordinance granting the Executive Director of the San Diego Unified Port District authority under BPC. Policy No. 355 to approve amendments to leases in excess of five (5) years provided that the amended terms do not reduce rent, insurance or indemnity of the District, or increase the tenant's lease term, in accordance with the San Diego Unified Port District Act, Section 21 Ordinances and Resolutions

FISCAL IMPACT:

The proposed Board actions are not expected to result in a direct fiscal impact to the District.

COMPASS STRATEGIC GOALS:

This agenda item supports the following Strategic Goal(s).

- A Port that the public understands and trusts.

- A Port with an innovative and motivated workforce.
- A financially sustainable Port that drives job creation and regional economic vitality.

DISCUSSION:

BPC Policy No. 355 is the District's current leasing policy for real estate and maritime assets. Staff has conducted an internal review of several routine leasehold management transactions governed by BPC Policy No. 355 and identified two transactions that would benefit from streamlining: rent reviews and approval of tenant financing.

Rent Reviews

BPC Policy No. 355 contains guidelines for determining market rent and conducting rent reviews. Rent reviews are typically scheduled every 10 years. Staff considers rents and percentage rates paid on comparable properties in addition to economic analysis and appraisals when determining the appropriate rent for a property. Currently, all rent reviews are presented to the Board for approval with the exception of those for fixed rent tenants paying less than \$250,000 in annual rent.

Staff has managed the District's commercial real estate portfolio to annual revenue increases averaging approximately 4.5% per year over the last five years. Staff has access to up-to-date comparable data and utilizes on-call agreements with several professional appraisers when determining the appropriate rent for a leasehold.

Staff recommends that BPC Policy No. 355 be updated to allow all rent reviews for tenants paying less than \$1,000,000 in annual rent to be administratively approved. This includes approximately 90% of all District tenants. Rent reviews approved administratively would be reported to the Board on a monthly basis. In FY 2016, four rent reviews were brought to the Board for approval.

Approval of Tenant Financing

BPC Policy No. 355 contains specific criteria that must be met in order for tenant financing to qualify for consent. The criteria include the following:

- Tenant must provide a term sheet, cash flow projections, two years of financial statements and appraisal submitted to the lender;
- Final loan documents should be provided upon approval;
- Maximum loan to value ratio shall not exceed 75%;
- The loan maturity date must not exceed the remaining lease term;
- The tenant shall acknowledge that it will not seek rent relief; and
- The District shall update the rent to market or receive a share of the financing proceeds not reinvested in tidelands.

In addition, the Policy currently allows staff to administratively approve all refinancing that is no more than 10% or \$250,000 greater than the existing loan amount, whichever amount is lesser, regardless of the total loan amount. Based on feedback from tenants and the amount of staff time necessary to prepare a routine item for Board approval, staff recommends that BPC Policy No. 355 be updated to

allow all financing to be administratively approved as long as it is consistent with the criteria already contained in the Policy. It should be noted that of the 12 requests for consent to financing that went to the Board in FY 2016, none were pulled for additional discussion at the Board meeting. Financing approved administratively would be reported to the Board on a monthly basis. As always, staff reserves the right to bring an item to the Board for consent.

Impact of BPC Policy No. 355 Updates

Based on staff's analysis, it takes approximately 46 days and at least 10 hours of staff time per transaction to prepare a routine rent review item for Board approval. By administratively approving rent reviews and financing, the agenda preparation, routing, and approval process would be eliminated and time would be allocated towards an internal approval process, allowing staff to meet its objective of improved efficiency and less time to completion of administrative tasks. Furthermore, staff would continue to process and approve documents in accordance with BPC Policy No. 355 and report executed documents to the Board on a monthly basis. Administrative approvals of all rent reviews for tenants paying less than \$1,000,000 in annual rent for both percentage rent and flat rent leases and tenant financing would equate to a 15% reduction of consent items going to the Board and 40 hours of time savings per year.

However, since most District leases allow the District to update the lease as a condition of consent to financing, administrative approval of financing alone will not save a significant amount of time because lease amendments must still be brought to the Board for approval. However, the proposed ordinance described below would address the issue of routine amendments and result in additional time savings.

Administrative Amendment Ordinance

As a condition of consent to an encumbrance, District leases usually allow the District to amend lease terms in accordance with the current lease template. Section 21 of the Port Act requires that all grants, franchises, leases, permits or privileges for more than five years shall be made by ordinance.

Based on the requirements of the Port Act, changes to lease agreements require amendments, and amendments are made by ordinance adopted by the Board. A review of past 2016 Board meeting minutes, for example, shows that seven encumbrances that went to the Board on consent also had amendments to leases included in the agenda item. In those cases, encumbrances would still be required to go to the Board on consent because amendments to leases are made by ordinance and passed by the Board.

The proposed ordinance would grant the Executive Director the ability to approve amendments to leases in excess of five years, provided that the following terms would not be amended to reduce the District's position: rent, lease term, insurance, and indemnity. All amendments to rent, term, insurance, and indemnity not to the benefit of the District would be presented to the Board for approval. In addition, the Executive Director would reserve the right to bring any amendments to the Board for approval, even if they meet the criteria for an administrative approval. Staff would also provide a list of all amendments administratively approved on a monthly basis to the Board. Taken together, the two updates to BPC Policy No. 355 and the proposed ordinance would reduce the number of consent items from the Real Estate Development department alone by 50% per year and

File #:2016-0704

save more than 160 full time equivalent (FTE) hours per year for staff.

Conclusion

As discussed above, the proposed updates to BPC Policy No. 355 and proposed ordinance would optimize staff resources and improve processing time for District tenants, allowing staff to place a higher priority and focus on new development projects and other revenue generating opportunities.

Staff recommends the Board adopt a Resolution amending BPC Policy No. 355 - Real Estate Leasing Policy and Administrative Practices - Real Estate Leasing to include: administrative approval of all rent reviews for tenants paying less than \$1,000,000 in annual rent and administrative approval of all financing.

Staff also recommends the Board adopt an Ordinance granting the Executive Director of the District authority to approve amendments to leases in excess of five years (with certain exceptions) in accordance with the San Diego Unified Port District Act, Section 21 Ordinances and Resolutions

General Counsel's Comments:

The Office of the General Counsel has reviewed the proposed changes to BPC Policy No. 355 and the requirements of Port Act Section 21, and approves the proposed changes to BPC Policy No. 355 as to form and legality.

Environmental Review:

The proposed Board actions do not constitute a "project" under the definition set forth in California Environmental Quality Act (CEQA) Guidelines Section 15378 because the actions will not have a potential to result in a direct or indirect physical change in the environment and are, therefore, not subject to CEQA. No further action under CEQA is required at this time. All future administrative approvals by the executive director will be subject to environmental review pursuant to CEQA.

In addition, the proposed Board actions allow for the District to implement its obligations under the Port Act and/or other laws. The Port Act was enacted by the California Legislature and is consistent with the Public Trust Doctrine. Consequently, the proposed Board actions are consistent with the Public Trust Doctrine.

Finally, the proposed Board actions do not allow for "development," as defined in Section 30106 of the California Coastal Act, or "new development," pursuant to Section 1.a. of the District's Coastal Development Permit Regulations. Therefore, issuance of a Coastal Development Permit or exclusion is not required. All future administrative approvals by the executive director will be subject to review for compliance with the District's Coastal Development Permit Regulations.

Equal Opportunity Program:

Not applicable.

PREPARED BY:

File #:2016-0704

Tony Gordon, Principal, Real Estate Development
Alexa Paulus, Asset Manager, Real Estate Development

Attachment(s):
Attachment A: BPC Policy No. 355 Redline Version

Attachment A to Agenda Sheet No. 2016-0704



BPC Policy No. 355

SUBJECT: REAL ESTATE LEASING POLICY

PURPOSE: To Establish General Policies for Leasing the San Diego Unified Port District (District) Real Estate Assets

INTRODUCTION: The Real Estate Leasing Policy establishes general real estate leasing policies that have been adopted by resolution of the Board of Port Commissioners (Board). The Real Estate Leasing Policy does not supersede the District's existing leases. The attached *Administrative Practices -- Real Estate Leasing*, describes the practices and procedures to be used in establishing rent; conducting rent reviews; extending existing leases and granting options; and states the conditions for the District's approval of subleases, leasehold financing, lease assignment and lease amendment, including processing fees associated with the above. The Practices also state the District's commitment to meet and confer in good faith with the San Diego Port Tenants Association (SDPTA) regarding changes to the Practices and to conduct a public workshop on the changes when requested by the SDPTA.

POLICY STATEMENT:

1. Leasing Authority

- a. *Short-Term Leases (Five Years or Less)* – The Executive Director may, without prior Board approval, enter into leases and use permits (including Tideland Use and Occupancy Permits; rental agreements; easements; licenses; and other similar types of real estate agreements) for terms five (5) years or less in duration. The Executive Director shall provide the Board with a report each month that identifies each such tenant; location; use; area; rent; and term.
- b. *Long-Term Leases (More than Five Years)* – All leases for terms more than five (5) years in duration shall be presented to the Board for approval at a public meeting.

2. Tenant Qualifications

To become a District tenant or subtenant, the prospective tenant or subtenant and its principals shall: (i) be reputable (the absence of a reputation for dishonesty,

criminal conduct, or association with criminal elements); (ii) possess sufficient experience to conduct the proposed business; and (iii) possess the financial means to perform the tenant's obligations under the lease.

3. Rents

The District shall seek market rent when leasing its real estate assets and the District's leases shall reflect market terms and conditions. The Board retains the right to grant rent discounts, waivers or other concessions, but only after the Board has been advised of the value of the discount, waiver or concession and the reasons supporting it.

In considering whether to grant a rent discount, waiver or other concession, the Board should consider its duty to balance the promotion of fishing, navigation, commerce and public access with the obligation to the citizens of California to be fiscally self-supporting, to optimize revenues⁽¹⁾ and to reinvest proceeds in the tidelands.

4. Leasehold Improvements

District leases shall provide for tenants to maintain all improvements on their leaseholds, except for multi-tenant buildings where the District's rent includes specific maintenance responsibilities.

District leases shall provide that when a lease terminates, the District shall have the option to: (i) require the tenant to remove the tenant-owned improvements at the tenant's expense; or (ii) take title to the improvements.

5. Subleases

Short-Term Subleases (Five Years or Less) – The Executive Director may, without prior Board approval, consent to subleases for terms five (5) years or less in duration. The Executive Director shall provide the Board with a report each month that identifies each such subtenant, location, use and term.

Long-Term Subleases (More than Five Years) – All subleases for terms more than five (5) years in duration shall be presented to the Board for consent.

Subleases shall contain, as a minimum, provisions that: (i) meet current District lease requirements; (ii) provide that the subtenant shall be obligated to pay any master lease rent increases that are applicable to the subleased premises; and (iii) provide that in the event of a conflict between the master lease and the sublease, the master lease shall prevail.

¹"Optimizing revenues" refers to the District's consideration of maintaining the highest revenue stream possibly while balancing the strategic goals and objectives of the Board in managing the District's operations. Certain goals and objectives may not maximize revenues compared to other land use options; however, they may be given a higher priority due to the District's desire to maintain "balanced" operations.

6. Lease Amendments

Short-Term Leases ~~Subleases~~ (Five Years or Less) – The Executive Director may, without prior Board approval, consent to amendments to leases with terms five (5) years or less in duration. The Executive Director shall provide the Board with a report each month that identifies each such tenant, location, use, area, rent and term.

Long-Term Leases ~~Subleases~~ (More than Five Years) – ~~All proposed amendments to leases with terms more than five (5) years in duration shall be presented to the Board for consent.~~ The Executive Director may, without prior Board approval, consent to amendments to leases with terms more than (5) years in duration that benefit the District, provided that the following terms shall not be amended: reduction in rent, changes to term, reduction in insurance requirements, and reduction to indemnity. All amendments to rent, term, insurance, and indemnity not to the benefit of the District, must be presented to the Board for approval. The Executive Director shall provide the Board with a report each month that identifies each such tenant, location, use, area, rent, and term.

7. Transaction Processing Fees

With exceptions noted below, the District shall charge a transaction processing fee of not less than five hundred dollars (\$500.00). Exceptions include: (i) rent reviews, (ii) transactions that benefit the District (e.g., a new or renewal lease that will result in additional rent to the District), or (iii) transactions that benefit the District's properties (e.g., an easement for utilities that will serve District tenants).

Fees and costs for services and administrative activities shall be paid in accordance with any applicable District ordinance.

8. Option Term and Consideration

When entering into an option to lease agreement, the District shall charge monetary or other consideration and shall establish initial terms and extensions consistent with the processing requirements of each project, subject to adjustment as described in the Administrative Practices.

RESOLUTION NUMBER AND DATE: 2015-178, 2015-179 and 2015-180 dated December 8, 2015 (Supersedes BPC Policy No. 355, Resolution 2013-85 dated May 7, 2013; Resolution 2011-16, dated February 8, 2011; Resolution 2010-150, dated October 5, 2010; Resolution 2008-176, dated September 2, 2008, Resolution 2004-43, dated March 30, 2004; Resolution 2002-311 dated November 5, 2002; Resolution 98-28, dated January 27, 1998; BPC Policy No. 350, Resolution 95-244, dated July 25, 1995; BPC Policy No. 351, Resolution 95-268, dated August 22, 1995; BPC Policy No. 352, Resolution No. 92-47, dated February 18, 1992; and BPC Policy No. 354, Resolution 81-328, dated October 6, 1981)

SAN DIEGO UNIFIED PORT DISTRICT

SUBJECT: ADMINISTRATIVE PRACTICES – REAL ESTATE LEASING

PURPOSE: To Establish Fair and Consistent Guidelines for Leasing the District's Real Estate Assets

INTRODUCTION

The *Administrative Practices* are practical guidelines that implement BPC Policy No. 355, *District Real Estate Leasing Policy*. The Policy consists of general statements that are intended to encourage private investment; to promote high standards of development, operation and maintenance; and to assure that public trust assets are managed responsibly. The Practices are intended to provide clear guidelines and procedures for implementation of the Policy.

In the event the District proposes to make changes to the Practices, the District shall notify the San Diego Port Tenants Association (SDPTA) in advance and will meet and confer in good faith with the SDPTA to discuss the proposed changes. The SDPTA may request a public workshop on the changes. However, in individual lease negotiations, the foregoing does not in any way preclude the District from negotiating terms that vary in some respects from the Practices as long as the District and the tenant are in agreement.

- I. The Practices are divided into nine categories as outlined below: I. Establishing Rent and Conducting Rent Reviews
- II. Lease Extensions
- III. Leasehold Financing
- IV. Assignment of Leasehold Interest
- V. Subleasing
- VI. Lease Amendments
- VII. Trust Obligations
- VIII. Transaction Processing Fees, Port Master Plan Amendment (PMPA) Fees, and Security Deposits
- IX. Option Term and Consideration

The Practices follow:

I. ESTABLISHING RENT AND CONDUCTING RENT REVIEWS

A. Market Rent

The District should receive market rent for the leasing of its property, and rent should be adjusted to market periodically during the term of the lease. Market rent should be based on a current appraisal that complies with the *Uniform Standards of Professional Appraisal Practice*, published by the Appraisal Institute. District staff may consider other relevant information in arriving at the appropriate rent for a property. However, rent reviews for operating leaseholds shall not consider public improvements constructed by tenant either on or off the leasehold, the cost of remediation or any other incentives or concessions granted at the inception of the lease. Other exceptions to the appraisal requirement are noted below.

B. Calculation of Rent

Most District leases are either percentage leases or flat rent leases and may combine both percentage and flat rents. In a percentage lease, the District receives the greater of a minimum rent or percentages of gross income generated by the economic activities that are conducted on the premises. In a flat rent lease, the rent is a fixed amount which increases annually in accordance with the Consumer Price Index (CPI). Specific practices for percentage rent leases and flat rent leases follow.

C. Percentage Rent Leases

Market percentage rental rates tend to be relatively constant over time, and market validation of percentage rates for all of the District's revenue categories by appraisal is a major undertaking. Therefore, for determining percentage rates for new leases and rent reviews for existing leases, the District should establish benchmark appraisals by general geographic location and property type. The benchmark appraisals should be conducted on an ongoing basis by comparing the District's percentage rental rates with the percentage rental rates of other agencies including cities, counties, ports, and special districts, and should be utilized in determining rent at the rent review date stipulated in the lease.

1. Minimum rents in new percentage leases and in rent reviews should be set at no less than 75 percent of market rent as determined by the average of the tenant's previous three accounting years' rental payments, appraisal or other relevant information. For substantial redevelopment and new construction, the District may abate a portion of the minimum rent during construction when it is deemed appropriate.
2. Percentage rent leases should provide for market rent reviews every ten (10) years with mid-term adjustments to the minimum rent for changes in the consumer price index.

3. Appraisals of properties that normally rent for percentages of gross revenues (e.g., hotels, restaurants, marinas and retail stores) should consider rents and percentage rates paid on comparable ground leased properties, in addition to economic analysis and other appraisal techniques.

~~3.4.~~ The Executive Director may, without prior Board approval, approve percentage rent reviews for tenants paying less than \$1,000,000 in annual rent.

D. Flat Rent Leases

In lieu of the appraisal-based rent review process described above, flat rent tenants and the District may amend their leases to provide for adjustment to rent annually by applying the Los Angeles All-Urban Consumer Price Index (CPI) to current rent, the annual adjustments to be no less than 2% or more than 4%. Leases will be amended only in those cases where the District and the tenant agree on the amount of the starting rent as the last adjusted rent brought current by adjusting it for CPI increases from the last date of the last adjustment to the date of the lease amendment. In those cases where the District and the tenant cannot agree on the starting rent, the lease will not be amended and the current rent adjustment provisions will continue to be in force.

The Executive Director may, without prior Board approval, approve flat rent reviews for tenants paying less than ~~\$1,000,000~~ \$250,000 in annual rent.

E. Appraisals

1. Appraisal Exception – If the cost of an appraisal is not justified by the anticipated rents, other less expensive analysis methods may be employed to establish rent at the discretion of the Executive Director, as long as adequate market information is available to support a reasonable and fair conclusion.

2. Timely Completion of Rent Review Appraisals – The District should be prepared to submit its rent proposal to the tenant no less than sixty (60) calendar days in advance of the commencement date of the rental period under review.

3. Appraisal Assumptions Regarding Status of Property – The appraisal should reflect the value of the land as-if vacant and available for new development. The appraisal should assume that all regulatory approvals that allow the existing use have been obtained, and there should be no discount for costs and time delays associated with obtaining the regulatory approvals.

The appraisal should be consistent with the highest and best use of the property, as if vacant, on the date of value. Market conditions may support a highest and best use that differs from the existing use.

The appraisal shall not consider public improvements constructed by tenant either on or off the leasehold, the cost of remediation or any other incentives or concessions granted at the inception of the lease.

Notwithstanding the above, the appraisal must be consistent with the use restrictions and other contractual burdens placed on the land by the terms of the ground lease and Port Master Plan.

4. Appraisal of Maritime Properties – Properties that are managed by the Maritime Division, that are used for maritime purposes, should be appraised by comparison with other seaport and/or maritime industrial properties, and should consider total potential revenues including but not limited to wharfage and dockage.

F. Rent Review Process

District leases shall provide for binding “baseball appraisal” when the District and the tenant cannot agree on the new rent for a rental period under review. In baseball appraisal, a panel of three appraisers must select by majority vote either the District’s rent proposal or the tenant’s rent proposal, whichever is judged to be the closest to market rent, as the rent for the next rental period of the lease. The District and tenant each shall select one appraiser and the two appraisers will mutually select the third appraiser. All appraisers must be qualified real estate appraisers and licensed to practice in the state of California. If the District or tenant fails to initiate the baseball appraisal process within the timeframes provided in the lease or fails to meet any of the other prescribed deadlines relating to the rent review in the lease, or fails to present an appraisal pursuant to the terms of the lease, the failing party’s right to utilize the baseball appraisal process shall be deemed to be waived. Tenant shall be afforded the opportunity to meet and informally discuss with the District and three appraisers within the prescribed deadlines relating to rent review in the lease.

II. LEASE EXTENSIONS

A. Overview

The District should utilize the lease extension process to (a) promote investment in leasehold improvements, (b) encourage redevelopment, and (c) update out-of- date leases. This section provides a narrative explanation of the process the District should follow in determining whether a proposed development or redevelopment qualifies for an extended lease term, the length of the extended term, and whether there should be compensation to the District for extending the term. A decision tree flowchart outlining the general process to be followed when a tenant requests a lease extension is presented in this section.

B. Lease Extension Practice and Decision Criteria

1. Tenant Requests a Lease Extension – The submission package should include the following information:
 - a) Description of the development concept and the proposed project sufficient for the District to understand precisely the scope of the entire development concept, which may include renderings and drawings showing a scaled site layout, interiors and exteriors of all significant buildings, parking lot layout, landscape development and layout, preliminary sign concept, pier and marina slip layout (if applicable) and any other prominent features.
 - b) Evidence that the tenant qualifies as a “tenant in good standing” (defined below).
 - c) Any proposed changes to ownership.
 - d) Description of the development team and its qualifications.
 - e) Proposed lease extension terms (including if applicable minimum rent, percentage rent by use, and compensation to the District for deferral of its reversionary improvement value as provided in this section), and justification for such terms.
 - f) Financial feasibility of the extension including pro forma cash flows (if applicable).
 - g) Anticipated development cost with qualifying Capital Investments (as defined in Section II(C)2), repair and maintenance, and furniture, fixture and equipment items separately identified. To the extent that District does not believe that a submittal is a qualifying Capital Investment, at the request of the District, tenant shall be required to submit supporting documentation for items characterized as Capital Investment in the proposal.
 - h) Justification that the existing operator is capable of optimizing the use and return to the District, thereby negating the need for a Request for Proposal process.
 - i) Justification that the tenant has the expertise and financial capability to develop and operate the property, when the proposed development is different from the existing use.
2. Proposal Consistent with Master Plan – Initially, the District should determine if the proposal is consistent with the Port Master Plan. Inherent in this decision is the assumption that the planning process utilized in developing the Master Plan evaluated the potential for the highest and best use for the property, the goals of the District and the input of the local community. If the proposal is not consistent with the Master Plan, the District may reject the proposal at its sole discretion.

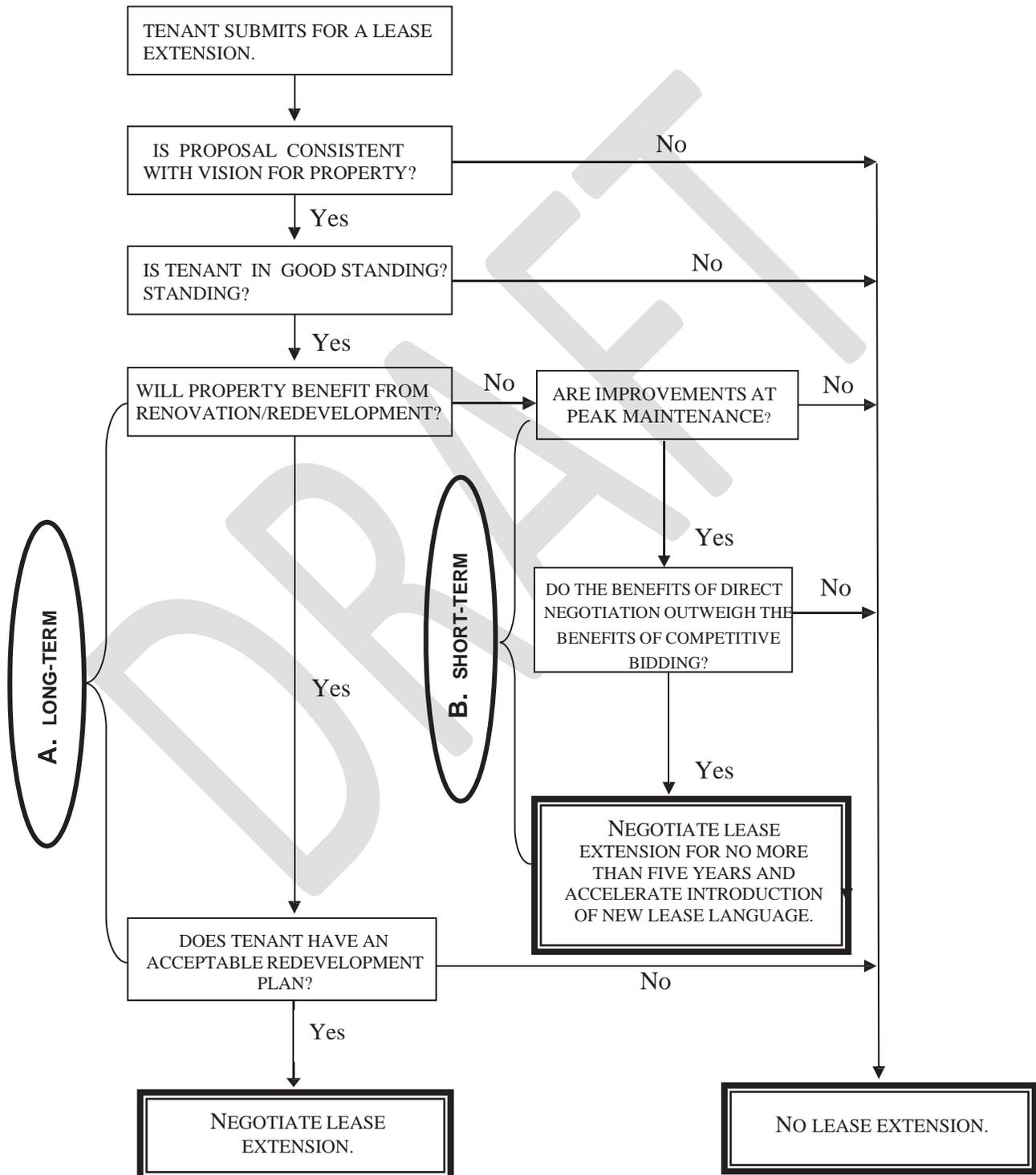
3. Proposal Consistent with the District's Vision for Future Use of the Property – If the proposal is not consistent with the District's vision for the future use of the property as determined by the Board in its sole and absolute discretion, the District should not negotiate a lease extension.
4. Qualification as a "tenant in good standing" – To qualify for a lease extension, the tenant should be considered a "tenant in good standing." The criteria should include a review of the tenant's history with respect to the following:
 - a) Maintenance of the leasehold in good condition, free of deferred maintenance.
 - b) Prompt payment history.
 - c) Compliance with the provisions of the current lease, including use provisions, insurance requirements and regulatory permitting processes.
 - d) Maximization of the gross revenue of the tenant's business.
 - e) Maintenance of accurate financial records that are accessible to the District.
 - f) Compliance with District policies on public accommodation and non-discriminatory employment and contracting.

If the existing tenant does not meet the requirements for a "tenant in good standing," then no lease extension should be negotiated.

5. Benefit from Renovation or Redevelopment – Renovation or redevelopment contemplates making capital investments in the property that would allow for business expansion, modernization of facilities, aesthetic enhancement; or that maintain or increase the existing revenue stream to the District by expansion of the existing improvements or repositioning the property to a higher standard of quality.
6. Acceptable Development Plan Presented by the Tenant – If the property would benefit from renovation or redevelopment, the District must decide if the existing tenant has presented an acceptable redevelopment plan. The District and the tenant would then enter into negotiations that would result either in a plan acceptable to the District, or a decision that the existing tenant is not capable of implementing an acceptable redevelopment plan.

7. Process for Extending Leases – If a proposed project is consistent with the District’s vision for the future use of the property, and the proposal meets the other criteria described above, the District should negotiate a new lease based on the following flow chart and requirements:

LEASE EXTENSION PROCESS



C. Lease Extension Negotiation

If the District and tenant agree to an acceptable redevelopment plan, lease extension negotiations should proceed, with the following considerations:

1. Calculation of Extended Term – The extended lease term should be based on the magnitude of Capital Investment in the property to be made by the tenant and the life expectancy of the development. The extended lease term may include past Capital Investment in the property submitted to the District for approval in accordance with District policy and the process outlined in the lease and approved by the District as long as it has not already been credited towards a previous lease extension. The District may wish to consider other relevant information in determining if a longer lease term is warranted, such as if the Capital Investment is expected to generate above average returns to the District, or will reposition the property to a higher standard of quality. Improvements completed without following submittal guidelines to the District, including notification to the District and a determination by the District whether the improvements qualify for a lease term extension, will not be considered for a lease term extension. A method of calculating the potential lease term extension is outlined below:
 - a) Determination of the estimated total replacement cost of the leasehold improvements as renovated/redeveloped. Cost figures can be determined utilizing resources such as tables provided by Marshall Valuation Service (or other industry standard cost estimating resources), or known development costs of comparable projects.
 - b) Determination of the life expectancy of the fully redeveloped project. The maximum lease term should be consistent with life expectancy of the improvements that qualify as Capital Investment in the property. Life expectancy guidelines are presented in a table at the end of this section. Lease term extensions granted after five years of the District's approval of the tenant's redevelopment plan will consider depreciation in improvements unless they were approved as part of a larger project. Depreciation shall be calculated utilizing the straight line depreciation method.
 - c) Computation of the ratio of Capital Investment in the property to total replacement cost.
 - d) Determination of the additional lease term by multiplying the ratio obtained in (c) by the life expectancy obtained in (b). The term in an extended lease shall not exceed the life expectancy of the development.

2. Qualifying Capital Investment

- a) "Capital Investment" for purposes of calculating the lease extension term should only include expenditures that usually increase the value (efficiency, productivity, or use utility) or the life expectancy of the improvements; cannot reasonably be amortized during the existing remaining term; are not recurring in nature; and are: (a) \$100,000 or more, or (b) 10% of the value of the improvements or more. It should specifically exclude deferred maintenance and expenditures for repairs to keep the existing improvements in good condition. Items that separately would not qualify for lease term extension may be considered collectively as part of an overall plan of renovation or redevelopment. In a renovation or redevelopment project, qualifying Capital Investment may include, at the sole discretion of the District, the value of superior improvement condition. The intent is to recognize the efforts of a tenant who maintains improvements in like-new condition in the latter stages of the lease term. The value of superior improvement condition may be measured by documented costs, or by replacement cost and depreciation tables such as those published by Marshall Valuation Service. Public art expenditures should be included as Capital Investment. Non-realty property may be given consideration depending on property type. An example of this would be the purchase by industrial tenants of specialized fixtures or equipment that are necessary for its operation. If lease term is granted for a Capital Investment in non-realty property, the new lease should include a provision requiring that the non-realty property (or an equivalent replacement as approved by the District) remain in place for the entire lease term. Purchase of District-owned improvements may be considered a qualifying Capital Investment. The cost of environmental cleanup is specifically excluded as a qualifying Capital Investment.
- b) If the Capital Investment will be undertaken in phases, then the tenant must identify the timeline for completion of all improvements in the tenant project application.
- c) The District may consider a lease term extension without Capital Investment in exchange for payment for deferral of the District's reversionary interest.

3. Payment for the Deferral of the District's Reversionary Interest – The standard District lease gives the District the right to assume ownership of the improvements at the end of the lease. During the lease, this reversionary interest in the improvements may have a value that can be estimated using accepted appraisal techniques. In exchange for granting a lease extension, the tenant should recognize that the District may be deferring the realization of a valuable

reversionary interest in the existing improvements. The tenant should compensate the District by an amount equal to the value of the interest being deferred. This amount can be paid in full at the commencement of the lease, incorporated as additional rent with interest over a specified period of time, or may be used to offset the tenant's cost of developing new public access infrastructure on or off the leasehold such as parks and promenades at the District's sole and absolute discretion.

If there is an economic benefit to the District, such as higher rent or the prevention of deteriorating rent, as a result of a Capital Investment by the tenant and the term extension, the economic benefit should be used to offset all or part of the compensation for deferral of the reversionary interest.

In estimating the reversionary improvement value, the market capitalization rate used should reflect value components that are related to superior management on the part of the tenant, including going-concern value, goodwill, and above-average maintenance; and for furniture, fixtures and equipment.

a) Percentage Rent Leases – A conceptual method of calculating the value of the deferral of the reversionary interest in percentage rent leases would be as follows:

(1) *Value of Deferred Reversionary Interest* – The value of the deferred reversionary interest can be estimated by projecting the operating income and expenses, based on the existing development, to the end of the existing lease term, using market-supported assumptions about operating income, expenses and inflation; and capitalizing the net income into an indication of leased fee value. The present value of the leased fee interest at the end of the existing lease term can then be calculated. Following the same procedures, the present value of the leased fee interest at the end of the extended lease term can be calculated. The value of the District's deferral of the reversionary interest is the difference between the present value at the end of the existing term and the present value at the end of the extended term, and represents the amount to be compensated to the District, subject to any offsetting economic benefit described below.

(2) *Value of Economic Benefit to the District* – The difference between the present value of the rent to the District for the proposed development, projected over the remainder of the existing term, and the present value of the rent to the District for the existing development projected over the remainder of the existing term, is a measure of the economic benefit to the District

resulting from the investment by the tenant. The economic benefit should be used to offset all or part of the value of the compensation for deferral of the District's reversionary interest.

b) Flat Rent Leases – A conceptual method of calculating the value of the deferral of the reversionary interest in flat rent leases would be as follows:

(1) *Value of Deferred Reversionary Interest* – The projected replacement cost of the improvements at the end of the existing term can be estimated by trending the current replacement cost by the anticipated rate of inflation. The projected reversionary improvement value can be estimated by subtracting depreciation from the projected replacement cost. The present value of the reversionary improvement value at the end of the existing term can then be calculated. Following the same procedures, the present value of the reversionary improvement value at the end of the extended lease term can be calculated. The value of the District's deferral of the reversionary interest is the difference between the present value at the end of the existing term and the present value at the end of the extended term, and represents the amount to be compensated to the District.

(2) *Value of Economic Benefit to District* – The present value of increased rent through the end of the current rental period, negotiated as part of a lease extension, shall be used to offset compensation for deferral of the reversionary interest in flat rent leases.

4. Timely Submission by Tenant and Response by District – District staff will respond to a request for a lease extension within thirty (30) calendar days following receipt of a request for a lease extension. The initial response shall either recommend the proposal for project review and California Environmental Quality Act (CEQA) review, or request additional information that the District believes was not included or was not adequately addressed in the initial submittal. The Tenant may re-submit within sixty (60) calendar days of the District's initial response. District staff will respond to the re-submittal within thirty (30) calendar days. Subsequent responses to project submittals will follow the same schedule.
5. Market Rent – The rent in an extended lease should be updated to the current market rent as negotiated between the tenant and the District.
6. New Lease Provisions – Upon negotiation of the extended lease term, the new rent and the amount of payment, if any, for deferral of the District's reversionary interest in the improvements, the existing lease shall be superseded by a new lease incorporating the District's

current standard lease terms. The tenant's liability for hazardous materials in the prior lease shall continue in the new lease. The tenant will indemnify the District against potential third party challenges to the CEQA review and/or determination process and agrees to reimburse the District for actual, reasonable and necessary third-party out-of-pocket expenses associated with processing a redevelopment project including but not limited to the preparation and certification of the CEQA document by the Board, the preparation and approval of the PMPA by the Board and the California Coastal Commission (CCC), the preparation and issuance of an appealable CDP by the Board or, if appealed, the CCC, and any other third-party expenses arising out of the entitlement process in the District's determination. District shall use commercially reasonable efforts to manage expenses.

7. "Basket of Issues" – While it is desirable to have a "standard" negotiation process, the lease extension process involves a "basket of issues" with each tenant. The District should be willing to negotiate each extension separately and take into account the unique circumstances of each request.

8. Short-Term Lease Negotiation – An existing tenant may qualify for an extended term under the criteria outlined above, but the property may not qualify as the highest and best use under the Port Master Plan, or may not be consistent with the District's vision for the future use of the site. In other cases, all the criteria for a long-term lease extension may have been met but the property may not benefit from renovation or redevelopment (i.e., the improvements are in excellent condition and represent highest and best use). In either event, upon lease expiration, the District may consider a new short-term lease with the existing tenant with the following four considerations:
 - a) *Lease Term* – The lease term should be no more than five years. This will create a term short enough to enable the District to periodically evaluate if the current use remains the highest and best use of the property consistent with the District's goals and objectives and the Port Master Plan.

 - b) *Payment for District-Owned Improvements* – The tenant should pay market rent for improvements it occupies that are owned by the District after expiration of the existing lease term.

 - c) *Rent* – The rent would be updated to the current market rent as negotiated between the tenant and the District.

 - d) *New Lease* – A new lease shall be executed including the District's current standard lease language.

9. Recommended Life Expectancy Guidelines – The length of a new or extended lease term should be based on the reasonable life expectancy of the improvements that qualify as Capital Investment. Life expectancies vary by use. Improvements that are subject to relatively high physical deterioration or functional obsolescence caused by market changes have *relatively* short life expectancies. Improvements that are physically more substantial and less affected by market changes have relatively long life expectancies.

The guidelines shown below were developed based on practical experience and observations, and by reference to the life expectancy tables published by *Marshall Valuation Service*.

ECONOMIC LIFE EXPECTANCY GUIDELINES

PROPERTY TYPE	TERM*
HOTEL	40 TO 66 YEARS
FULL SERVICE RESTAURANT	20 TO 40 YEARS
RETAIL SALES	30 TO 45 YEARS
COMMERCIAL OFFICE	30 YEARS
LAND SERVICE STATION	20 YEARS
MARINE SERVICE STATION	20 YEARS
MARINA	40 YEARS
SPORTFISHING LANDING	20 YEARS
BOAT EXCURSION LANDING	15 YEARS
BOATYARD	30 YEARS
SHIPYARD	50 YEARS
LUMBERYARD	25 YEARS
AIRPORT INDUSTRIAL	25 YEARS
OTHER INDUSTRIAL	50 YEARS
YACHT CLUB	35 - 45 YEARS

* The Terms outlined above represent the recommended length of term a tenant may receive for each respective property type. Shorter terms, or a combination of shorter terms with options to extend, may be appropriate to ensure an appropriate level of quality and maintenance of the improvements.

III. LEASEHOLD FINANCING

A. Consent to Financing Subject to Specific Criteria

The required minimum documentation to be submitted by the tenant in support of a request of the District to consent to new financing and standards for financing consent are as follows:

1. Initial documentation should include the term sheet, application or commitment, cash flow projections, appraisal submitted to the lender, and the most recent annual financial statements of the tenant (if it is a percentage lease) for at least the past two years.
2. When available, final loan documents should be provided.
3. Maximum loan proceeds should not be in excess of the greater of 75% loan-to-value as determined by the lender's appraisal, or the amount of repayment of existing financing (provided that such financing was initially consented to by the District).
4. A loan should have a maturity date that does not exceed the remaining ground lease term.
5. A tenant should acknowledge that it will not seek rent relief as a result of not being able to meet its debt service or debt repayment obligations.
6. The District shall either:
 - a) Receive a share of the proceeds of refinancing, except proceeds which are reinvested in District-owned land or water, replace existing financing, or reimburse the tenant for documented equity investment, or
 - b) Have the right to adjust the rent to market rent.
7. There should not be any restrictions on how the tenant utilizes the proceeds of financing (as long as the District is satisfied that proper underwriting guidelines are met).

If the District staff is satisfied that the above criteria have been met, its recommendation for consent to the new financing shall not be unreasonably withheld.

B. Timely Response to Request for Leasehold Financing

District Staff should have completed its recommendation on consent to the financing of a leasehold interest within forty-five (45) calendar days of

receipt of all required information. Staff's recommendation for consent shall not be unreasonably withheld.

C. Administrative Approval of Routine Financing

The Executive Director may, without prior Board approval, approve all financing. ~~new financing that replaces construction financing or refinancing of an existing loan, provided, however, the loan under consideration is no more than 10% or \$250,000 greater than the existing loan amount, whichever amount is lesser.~~

IV. ASSIGNMENT OF LEASEHOLD INTEREST

A. Consent to Assignment Subject to Specific Criteria

The required documentation to be submitted by the tenant in support of a request of the District to consent to an assignment of the leasehold and standards for assignment consent are as follows:

1. The tenant shall complete UPD Form No. 317, Lessee's and Sublessee's Questionnaire for All Leases (and Subleases of More than Five Years).
2. If new financing is involved in the sale, the proposed tenant shall provide the information required above under Leasehold Financing.
3. The District must be satisfied that the lessee possesses the financial capacity, a good reputation and managerial ability to operate successfully on the leased premises.
4. The District shall either receive a share of the proceeds of a sale or have the right to adjust the rent to market rent as a condition of its consent. This right does not apply to an assignment that changes the method of holding title but does not change the proportional ownership interests of the individuals, nor does it apply to transfers between spouses or immediate family members.

B. Timely Response to Request for Assignment of Leasehold Interest

District staff should have completed its recommendation on consent to the assignment of a leasehold interest within forty-five (45) calendar days of receipt of all required information. Staff's recommendation for consent shall not be unreasonably withheld.

C. Administrative Approval of Routine Assignments of Leasehold Interest

The Executive Director may, without prior Board approval, approve an assignment of leasehold interest if the assignment results in no change of control, operations or management of the ownership entity of the tenant.

V. SUBLEASING

A tenant may sublease all or part of its leased premises to a qualified subtenant, subject to consent by the District. The appropriate District-supplied Sublease Questionnaire form must be completed and submitted to the District. Consent by the District must be obtained prior to occupancy by the sublessee.

A. Sublease Consent Criteria

Staff's recommendation for consent to a sublease shall be made in accordance with the following criteria:

1. The District must be satisfied that the sublessee will use the property in a manner that is consistent with uses allowed by the lease.
2. The District must be satisfied that the sublessee possesses the financial capacity, a good reputation and managerial ability to operate successfully on the subleased premises.
3. The District reserves the right to adjust the rent the District receives to market for the subleased portion of the property.
4. The District must be satisfied that the sublease transaction will not have a significant negative impact on the District.

B. Timely Response by the District

For a short-term sublease (five years or less), District staff should respond with its recommendation regarding consent within thirty (30) calendar days of receipt of all necessary information, and for a long-term sublease (more than five years), District staff should respond within sixty (60) days.

VI. LEASE AMENDMENTS

A tenant may request amendments to a lease that could range from minor changes to extensive revisions. The District's consent to a request for lease amendment may be contingent upon updating sections of the lease to incorporate current standard lease provisions, and may include an adjustment to market rent, depending upon the extent of the proposed tenant requested revisions.

A. Lease Amendment Consent Criteria

Staff's recommendation for consent to a lease amendment shall be made in accordance with the following minimum criteria:

1. The allowed uses of the property stated in the amended lease must be in compliance with the Port Master Plan and with the District's vision for the future use of the property.
2. Amended sections of the lease must conform with the District's standard lease language in effect when the request for a lease amendment is made.

3. For a change in the method of holding title that does not change the proportional ownership of the individuals, or that represents a transfer between spouses or immediate family members, a complete lease update and rent adjustment would not be made. Standard provisions regarding hazardous materials, underground storage tanks and above-ground storage tanks should be added (unless they are already in the lease).
4. In some cases (e.g., changing from a sole proprietorship to a limited liability company), it may be advisable to have the principals personally guarantee lease performance.
5. A proposed lease amendment for financing or for a transfer or a partial or full interest in the leasehold would be governed by Sections C and D of these Practices.

B. Timely Response by the District

For a short-term lease (five years or less), District staff should respond with its recommendation regarding consent within thirty (30) calendar days of receipt of all necessary information, and for a long-term lease (more than five years), District staff should respond within sixty (60) days.

VII. TRUST OBLIGATIONS

For tenants claiming special treatment under the Port District Act, the District should determine market rents consistent with the property's land use. Any discount to market rent or other concession should be supported by a tenant's written proposal that would outline why the discount is warranted, if there is a public benefit, the financial rationale for the request and the proposed economic terms. The proposal should be presented to the Board, which would determine if a concession is warranted.

VIII. TRANSACTION PROCESSING FEES, PORT MASTER PLAN AMENDMENT (PMPA) FEES, AND SECURITY DEPOSITS

A. Transaction Processing Fees

With exceptions noted below, the District shall charge a transaction processing fee of not less than five hundred dollars (\$500.00). Exceptions include (i) rent reviews, (ii) transactions that benefit the District (e.g., a new or renewal lease that will result in additional rent to the District), or (iii) transactions that benefit the District's properties (e.g., an easement for utilities that will serve District tenants).

B. Port Master Plan Amendment (PMPA) Fees

If a tenant project requires a PMPA, then the tenant must pay for the cost of preparing the PMPA and any associated CEQA documentation. If a tenant project requires a PMPA, and the District is currently pursuing or will be pursuing a PMPA into which the tenant's project will be incorporated, then the tenant must pay for a pro-rata share of the cost of preparing the

PMPA and any associated CEQA documentation. If a tenant project does not require a PMPA, but the District is currently pursuing or will be pursuing a PMPA into which the tenant's leasehold will be incorporated, then the tenant will not be charged a pro-rata share of the cost of preparing the PMPA and any associated CEQA documentation.

C. Security Deposits

The standard security deposit for a new rental agreement is three months' rent. A security deposit may be waived for a short-term rental of property that supports a tenant's long-term lease. The security deposit may be reduced for a tenant that has been in good standing for five or more years. For a tenant making a substantial investment in improvements, the security deposit will be refunded upon completion of the improvements.

IX. OPTION TERM AND CONSIDERATION

Generally, proposed projects including but not limited to a change in use, additional lease term, financing, and issuance of permits will be memorialized in an option agreement and lease. If District staff negotiates an option, then recommendations regarding option term and consideration, including extensions, must be based on this section of the Practices. Recommendations which include adjustments to option term and consideration, if any, must be based on the factors described in Section (3) below.

A. Term

Calculating Initial Option Term and Option Term Extensions. The District recognizes that there is uncertainty in every entitlement process. As a result, District staff's recommendation regarding initial option term and extensions must be based on a cooperative assessment of the approval process and timeline for a proposed project and its associated risks.

For existing tenants with options with no change in use or a change in use that does not require a Port Master Plan Amendment, the initial minimum option term will be 18-24 months. In all other cases, the term will be 24-36 months. Term extensions are subject to negotiation as needed.

B. Consideration

Calculating Initial Option Consideration and Option Term Extension Consideration.

1. Consideration – Consideration may take the form of a monetary payment or a quantifiable benefit to the District. Examples of quantifiable benefits include but are not limited to construction of or enhancements to a District-owned asset and assuming contingent legal liabilities for District actions. Consideration does not include transaction processing fees, which may be assessed independently according to a schedule established by the District.

2. Initial Option Consideration – Initial option consideration is determined by whether the option covers a tenant’s existing premises, new premises, or a combination of new and existing premises.

- c) *Existing Premises Only* - If the option covers the existing premises only, then consideration is not required unless a Port Master Plan Amendment is required for the option. If a Port Master Plan Amendment is required, consideration is based on the following table:

Lease Type	Consideration
Percentage Rent	25% of difference between projected first year’s minimum annual rent and current minimum annual rent
Flat Rent	25% of annual rent difference if an appraisal is performed or 5% of annual rent

- d) *New Premises Only* - Whether or not a Port Master Plan Amendment is required, if the option covers new premises only, then consideration is based on the following table:

Solicitation Type	Consideration
Sole Source	25% of projected first operating year’s minimum annual rent
RFQ/RFP	25% of projected first operating year’s minimum annual rent

- e) *New Premises and Existing Premises* - Whether or not a Port Master Plan Amendment is required, if the option combines both new premises and existing premises, then consideration is 25% of the difference between the projected combined first year’s minimum annual rent and the existing premises minimum annual rent.

3. Option Term Extension Consideration – Option term extension consideration is subject to negotiation. The following establishes a baseline for calculating option term extension consideration which may be subject to adjustment.

For existing tenants with proposed projects that do not require a Port Master Plan Amendment, extension consideration is not required.

In all other cases, option term extension consideration will be prorated based on the initial option term and consideration. For example, if the initial option term is 24 months and the consideration is \$240,000, then each additional month of option term extension would require an additional \$10,000 in consideration.

C. Adjustments

Factors Justifying Adjustments to Option Term and Consideration. District staff may recommend to the Board reducing or increasing the term and consideration for options and extensions described in Sections (1) and (2) above. Any recommended adjustment must be justified by one or more of the following factors:

1. Assumption of District Obligation – An optionee may assume the liability for the cost of a District obligation.
2. Improvements or Work Performed at Tenant’s Risk – An optionee may construct improvements or perform work with no guarantee that the option may be exercised.
3. Accelerated Performance – An optionee may be incentivized to exercise its option prior to the scheduled expiration.
4. Social or Community Benefits – Non-profit tenants such as yacht clubs, museums, and performance of obligations that benefit the public - including development and maintenance of public parks or promenades - may justify a reduction in consideration.
5. Market Conditions – Market conditions may impact the District’s bargaining position including, but not limited to, inferior site locations, difficult markets, economic conditions, and costly entitlement processes.
6. Inability to Obtain Financing – The District’s option agreements do not allow the optionee’s lack of ability to obtain financing to serve as a reason for not exercising an option. However the District has extended options because financing was not yet in place or ready to close. In instances where a documented catastrophic market cycle (such as the market cycle impacting financing during 2009-2010) prohibits an optionee’s ability to obtain financing the District should consider the status of financing in its justification for granting additional term and for reducing or eliminating consideration for an extension. The optionee’s inability to obtain financing because of inadequate equity investment in a project should not be considered as a justification for force majeure extensions.
7. Force Majeure Delays – Listed are examples of Force Majeure delays that could result in the reduction or elimination of option consideration

if an extension is issued (i) delays caused by litigation that prevents the optionee from performing under the option terms (CEQA or CCC challenges); (ii) documented delays in permitting outside the optionee's control and beyond the time frames agreed to for complete application submittals, including administrative appeals; (iii) documented delays to obtain entitlements from regulatory agencies outside the optionee's control.

DRAFT

**ADDENDUM TO BPC POLICY NO 355 ADMINISTRATIVE PRACTICES REAL
ESTATE LEASING**

REPORT OF YACHT CLUB LEASING POLICY AD HOC SUBCOMMITTEE

**RECOMMENDATION TO THE BOARD OF PORT COMMISSIONERS OF THE
SAN DIEGO UNIFIED PORT DISTRICT**

At its December 8, 2003 meeting, the Subcommittee voted to recommend that the Board adopt a resolution directing staff to supplement the BPC Policy 355 leasing practices as follows:

1. The present yacht club leases shall be amended to delete the rent review provision for 2006 and substitute a rent adjustment equal to the change in the Consumer Price Index for the Los Angeles area for the years 2001 - 2005.
2. Upon the grant of a new lease, whether after expiration of the current lease or by reason of the satisfaction of option requirements for redevelopment of the leasehold that result in a new lease earlier than expiration of the current lease, rent shall be paid at the greater of Fair Market Rent or Minimum Rent. Fair Market Rent shall be percentage rent calculated as follows:
 - (a) From the commencement of the new lease to December 31, 2011, 8.25% of gross revenues;
 - (b) From January 1, 2012 through December 31, 2012, 8.80% of gross revenues;
 - (c) From January 1, 2013 through December 31, 2013, 9.35% of gross revenues;
 - (d) From January 1, 2014 through December 31, 2014, 9.90% of gross revenues;
 - (e) From January 1, 2015 through December 31, 2015, 10.45% of gross revenues;
 - (f) From January 1, 2016 through December 31, 2016, 11.0% of gross revenues;

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- (g) From January 1, 2017 through December 31, 2026, Fair Market Rent shall be calculated by multiplying gross revenues by a blended rate adjusted by an appraisal of the concession rates on each revenue category; the new blended rate shall be adjusted by applying an adjustment as follows:

(The sum of all current concession rates plus the sum of all changes to the concession rates divided by the sum of all concession rates) multiplied by the current blended rate will equal the new blended rate. The current concession rate is comprised of the following: dues @ 5.0%; slips, dry storage and lockers @ 22.0%; member food and beverage @ 3.0% and 5.0% respectively; catered food @ 7.0%; catered beverage @ 7.0%; and ships store @ 10.0%. The sum of all concession rates equals 59.0%

Example: Currently, the blended rate is 11.0% and the sum of the concession rates is 59.0%. If, for example, the slips, dry storage and locker concession rate increases by 2.0% (from 22.0% to 24.0%), the computation of the new blended rate would be expressed arithmetically:

$$[(59+2) \div 59] \times 11.0\% = 1.0338 \times 11.0\% = 11.37\%$$

- (h) On January 1, 2027 and each succeeding tenth anniversary thereafter, the concession rates shall be reappraised and adjusted as set forth in (g) above.
- (i) Minimum Rent starting on January 1, 2022 and every ten years thereafter shall be adjusted by the corresponding increase in the Consumer Price Index for the Los Angeles area for the prior ten years from the minimum rent in effect in 2012. For purposes of determining the CPI base for calculating the Minimum Rent in 2022, the Fair Market Rent in 2012 shall be adjusted by the appropriate CPI increase over the 10-year period. The increase shall not be less than 3.0% per annum or greater than 5.0% per annum. In any year immediately following a rent adjustment as the result of an appraisal of the concession rates, the rent for that year and each successive year shall be determined by the greater of 75.0% of the actual rent paid the prior year or the Minimum Rent or the Fair Market Rent; and

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- (j) For purposes of calculating rent, gross revenues shall only include: dues, member food and beverage, catered food and beverage, slips, dry storage and lockers and ships store. Gross revenues shall not include revenues for junior sailing programs, outstation locations not on District property, initiation fees or interest income as well as any amounts set aside by the yacht clubs for Capital Investment or the debt on Capital Investment, whether such amounts are collected as special assessments, dues, percentage of slip rents, or otherwise.
3. New yacht club leases shall be for a maximum term of 40 years provided all the requirements for achieving maximum lease term are met.
4. Financial statements detailing operating revenues and sources, cash flows, capital reserves and capital expenditures, as well as sources of capital amounts, shall be provided annually no later than 120 days following the end of each club's fiscal year.

[SDUPD Docs D2 No. 1128084](#)

RESOLUTION 20xx-xxx

RESOLUTION AMENDING BOARD OF PORT COMMISSIONER'S (BPC) POLICY NO. 355 - REAL ESTATE LEASING POLICY AND ADMINISTRATIVE PRACTICES - REAL ESTATE LEASING TO INCLUDE:

I. ADMINISTRATIVE APPROVAL OF ALL RENT REVIEWS FOR TENANTS PAYING LESS THAN \$1,000,000 IN ANNUAL RENT

WHEREAS, the San Diego Unified Port District (District) is a public corporation created by the legislature in 1962 pursuant to Harbors and Navigation Code Appendix 1, (Port Act); and

WHEREAS, Section 21 of the Port Act authorizes the Board of Port Commissioners (BPC) to pass all necessary ordinances and resolutions for the regulation of the District; and

WHEREAS, BPC Policy No. 355 Real Estate Leasing Policy and Administrative Practices Real Estate Leasing (collectively, BPC Policy No. 355) is the District's current leasing policy for real estate and maritime assets; and

WHEREAS, currently, BPC Policy No. 355 provides that rent reviews for fixed rent tenants paying less than \$250,000 in annual rent and may be administratively approved by the Executive Director, but tenants paying more than \$250,000 in annual rent must have Board approval for rent reviews; and

WHEREAS, based on staff's analysis, it takes approximately 46 days and at least 10 hours of staff time per transaction to prepare a routine rent review item for Board approval; and

WHEREAS, approximately 90% of the District's tenants pay less than \$1,000,000 in annual rent; and

WHEREAS, staff recommends that BPC Policy No. 355 be updated to allow all rent reviews for tenants paying less than \$1,000,000 in annual rent to be administratively approved; and

WHEREAS, rent reviews for tenants paying less than \$1,000,000 in annual rent are almost universally approved by the Board on consent; and

WHEREAS, if the Board delegated the authority to approve those transactions to staff, the number of consent items calendared for Board approval from Real Estate Development will be reduced by approximately 15% per year; and

WHEREAS, BPC Policy No. 355 contains guidelines for determining market rent and conducting rent reviews; and

WHEREAS, Staff considers rents and percentage rates paid on comparable properties in addition to economic analysis and appraisals when determining the appropriate rent for a property; and

WHEREAS, Staff has managed the District's commercial real estate portfolio to annual revenue increases averaging approximately 4.5% per year over the last five years; and

WHEREAS, Staff has access to up-to-date comparable data and utilizes on-call agreements with several professional appraisers when determining the appropriate rent for a leasehold.

NOW, THEREFORE, BE IT RESOLVED by the Board of Port Commissioners (BPC) of the San Diego Unified Port District, as follows:

That the BPC consents to amending BPC Policy No. 355 - Real Estate Leasing Policy and Administrative Practices - Real Estate Leasing to include administrative approval of all rent reviews for tenants paying less than \$1,000,000 in annual rent.

APPROVED AS TO FORM AND LEGALITY:

PORT ATTORNEY

PASSED AND ADOPTED by the Board of Port Commissioners of the San Diego Unified Port District, this 10th day of January, 2017, by the following vote:

RESOLUTION 20xx-xxx

RESOLUTION AMENDING BOARD OF PORT COMMISSIONER'S (BPC) POLICY NO. 355 - REAL ESTATE LEASING POLICY AND ADMINISTRATIVE PRACTICES - REAL ESTATE LEASING TO INCLUDE: II. ADMINISTRATIVE APPROVAL OF ALL FINANCING

WHEREAS, the San Diego Unified Port District (District) is a public corporation created by the legislature in 1962 pursuant to Harbors and Navigation Code Appendix 1, (Port Act); and

WHEREAS, Section 21 of the Port Act authorizes the Board of Port Commissioners (BPC) to pass all necessary ordinances and resolutions for the regulation of the District; and

WHEREAS, BPC Policy No. 355 Real Estate Leasing Policy and Administrative Practices Real Estate Leasing (collectively, BPC Policy No. 355) is the District's current leasing policy for real estate and maritime assets; and

WHEREAS, currently, BPC Policy No. 355 allows staff to administratively approve all refinancing that is no more than 10% or \$250,000 greater than the existing loan amount, whichever amount is lesser, regardless of the total loan amount; and

WHEREAS, based on feedback from tenants and the amount of staff time necessary to prepare a routine item for Board approval, staff recommends that BPC Policy No. 355 be updated to allow all financing to be administratively approved as long as it is consistent with the criteria already contained in the BPC Policy No. 355; and

WHEREAS, this change to BPC Policy No. 355 would directly benefit tenants by shortening timelines for financing approvals; and

WHEREAS, financing approved administratively would be reported to the Board on a monthly basis. As always, staff reserves the right to bring an item to the Board for consent; and

WHEREAS, of the twelve requests for consent to financing that went to the Board in FY 2016, none were pulled for additional discussion prior to the Board approval.

20xx-xxx

NOW, THEREFORE, BE IT RESOLVED by the Board of Port Commissioners (BPC) of the San Diego Unified Port District, as follows:

That the BPC consents to amending BPC Policy No. 355 - Real Estate Leasing Policy and Administrative Practices - Real Estate Leasing to include administrative approval of all financing.

APPROVED AS TO FORM AND LEGALITY:

PORT ATTORNEY

PASSED AND ADOPTED by the Board of Port Commissioners of the San Diego Unified Port District, this 10th day of January, 2017, by the following vote:

SAN DIEGO UNIFIED PORT DISTRICT

ORDINANCE xxxx

ORDINANCE GRANTING THE EXECUTIVE DIRECTOR OF THE SAN DIEGO UNIFIED PORT DISTRICT AUTHORITY UNDER BOARD OF PORT COMMISSIONER'S POLICY NO. 355 TO APPROVE AMENDMENTS TO LEASES IN EXCESS OF FIVE (5) YEARS PROVIDED THAT THE AMENDED TERMS DO NOT REDUCE RENT, INSURANCE OR INDEMNITY OF THE DISTRICT, OR INCREASE THE TENANT'S LEASE TERM, IN ACCORDANCE WITH THE SAN DIEGO UNIFIED PORT DISTRICT ACT, SECTION 21 ORDINANCES AND RESOLUTIONS

WHEREAS, the San Diego Unified Port District (District) is a public corporation created by the Legislature in 1962 pursuant to Harbors and Navigation Code Appendix I (Port Act); and

WHEREAS, Section 21 of the Port Act authorizes the Board of Port Commissioners (BPC) to pass all necessary ordinances and resolutions for the regulation of the District; and

WHEREAS, Section 21 of the Port Act also requires that all grants, franchises, leases, permits or privileges for more than five years shall be made by ordinance of the Board of Port Commissioners (BPC); and

WHEREAS, based on the requirements of the Section 21 of the Port Act, changes to leases which require amendments are made by ordinance adopted by the Board; and

WHEREAS, BPC Policy No. 355 is updated to allow administrative approval of rent reviews for tenants paying less than \$1,000,000 in annual rent and financing, the lease amendment triggered would still require Board approval, causing the resulting time savings to be minimal; and

WHEREAS, due to the amount of lease amendments processed by the Real Estate Development Department, staff requests the Board adopt an ordinance granting the Executive Director the authority to approve amendments to long-term leases as long as there is no reduction in rent, increase in lease term, or reduction in indemnity or insurance coverage; and

XXXX

WHEREAS, granting the Executive Director this authority will eliminate the need for Board approval of routine lease amendments while preserving the District's ability to update the lease; and

WHEREAS, the proposed ordinance granting the Executive Director the ability to approve amendments to leases in excess of five years, enable the Real Estate department to realize the full benefit of the time savings afforded by streamlining rent reviews and approval of consents to encumbrances; and

WHEREAS, this proposed ordinance would reduce the number of consent items from the Real Estate Development department alone by 35% per year and save more than 160 full time equivalent (FTE) hours per year for staff; and

WHEREAS, staff would also provide a list of all amendments administratively approved on a monthly basis to the Board; and

WHEREAS, all amendments to rent, term, insurance, and indemnity not to the benefit of the District would still be presented to the Board for approval; and

WHEREAS, the Executive Director would reserve the right to bring any amendments to the Board for approval, even if they meet the criteria for an administrative approval.

NOW, THEREFORE, the Board of Port Commissioners of the San Diego Unified Port District does ordain as follows:

1. That the Executive Director and/or her designated representative is hereby authorized on behalf of the District to approve all amendments to leases in excess of five (5) years that benefit the District, provided that the following terms shall not be amended: reduction in rent, changes to term, reduction in insurance requirements, and reduction to indemnity. All amendments to rent, term, insurance, and indemnity not to the benefit of the District, must be presented to the Board for approval.
2. The Executive Director reserves the right to authorize the Board of Port Commissioners to review and approve amendments to leases at her discretion.
3. The Executive Director shall provide a list of all amendments administratively approved on a monthly basis to the Board of Port Commissioners.
4. This Ordinance shall take effect on the 31st day from its passage by the Board of Port Commissioners.

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APPROVED AS TO FORM AND LEGALITY:
GENERAL COUNSEL

By: Assistant/Deputy

PASSED AND ADOPTED by the Board of Port Commissioners of the San Diego Unified Port District, this 10th day of January, 2017, by the following vote:

Draft Recommendation

Waterfront Development Issues

The following are discussions and recommended Chamber positions for consideration by the Governmental Affairs Committee. The summary of each issue is from the discussion on June 5th, background material provided, and the presentation by the Harbor Director.

Measure D

Measure D states that there are certain portions of the Waterfront, generally those tidelands areas west of the Embarcadero and north of Beach Street, that are to be reserved for uses that primarily serve or facilitate commercial and recreational fishing. Uses that are “clearly incidental” to commercial and recreational fishing are allowed. General Plan Land Use Policy 4 addresses some of these issues. Non fishing uses in existence at the time of passage of the Measure are grandfathered in. The Commercial/Recreational Fishing designation in the General Plan and the “CF” zone district shows the uses that are permitted in this zone. While existing uses are considered “non-conforming”, such uses may remain and be redeveloped provided that they are not expanded, or enlarged, or moved and parking is provided pursuant to Chapter 17.28, Parking and Loading.

Measure D is a form of land use regulation that is intended to reserve areas for employment, economic development, or other activities that could not otherwise compete economically with other uses. This is very much like other cities designating industrial parks or business parks to ensure adequate areas for commerce, or certain kinds of commerce. Measure D was put into place during a time of significantly greater commercial fishing activity (see historical charts for economic impact report prepared by MBCFA), and during a time when there was fear that the commercial fishing activity would be forced out, economically, by recreational boating, and uses typical of the southern portion of the Embarcadero.

Practical issues with Measure D include the treatment of non-conforming uses, some of which are essential (financially) in paying for the maintenance and improvement of the improvements that serve the Measure D area, debates over what “clearly incidental” means, or which uses are “primarily for the purpose of serving or facilitating recreational and commercial fishing.” Is a fish market that sells fish from local boats “serving” the commercial fishing fleet? Is a restaurant that buys fresh fish from local boats facilitating commercial fishing? How much non-local catch can they serve/sell before they no longer “facilitate” or “serve” the local fishing fleet?

The GAC had the following comments on the Measure D/CF land use and zoning provisions: 1) Inability to enlarge or expand existing operations (restaurant retail and commercial recreational fishing) on a Tidelands Lease diminishes incentive to maintain a structure or operation and grow a business (ED unfriendly); 2) Non-fishing (but compatible) uses directly support the commercial/recreational fishing infrastructure through their lease payments and direct revenues to commercial fisherman. If they are demolished there will be a significant loss in Harbor Department revenue; and 3) Commercial Fishing interests state, convincingly, that assessment of full fair market value for rent/leases, and the full burden of maintenance of the Measure D area by fishing activities alone is unrealistic and uneconomical.

Recommendation: **Overturning or modifying Measure D is probably unrealistic in the short term. Much could be gained by clarifying the vague terms of Measure D, providing more flexibility allowing for expansion of existing uses, or establishment of new compatible uses, and creating a more stable revenue base for improving the commercial fishing infrastructure. However, this effort would need to be led by the commercial/recreational fishing industry itself. Chamber should support that approach. Chamber should also support flexibility in the interpretation of uses that serve and facilitate the commercial fishing industry and recognize that any logical step between catch and consumption serves and facilitates the industry.**

Tidelands Lease Policy and Lease Administration

The City has employed a “Tidelands Lease Policy” to serve as a template to standardize leases that are made in the State Tideland Grant areas. The policy is intended as an advisory tool to provide guidance for future lease site management, development, and redevelopment decisions considered by the City, with the ultimate dual goals of maintaining the vitality of the City’s waterfront and the fiscal health of the department charged with managing it. Erica Crawford of the MB Chamber of Commerce serves on that committee. Significant issues in the review of the Tidelands Lease Policy include: 1) Computational basis for determining lease payments such as minimum base rate (calculated as a percentage of estimated market value) and “percentage rents” that are calculated on the sales for each tenant; 2) Number of years of lease renewal per amount of investment (lower levels result in shorter renewals); 3) Benefits of

aggregating individual lease sites into “master leases” (such as Marina Square), the Harbor Department managing the Master Lease, and the Master Lease holder managing the subleases and responsible for all lease payments; and, 4) Administration and accounting in the administration of the leases.

According to the Lease Management Policy “Vision Statement”, the long-term vision of the City of Morro Bay is “...to manage and maintain the Embarcadero Tidelands lease sites as a vibrant working waterfront, incorporating tourism and various commercial and recreational uses. Positive cash flow to the Harbor Department is crucial to maintain the integrity of the Embarcadero and environmental health of the bay and its resources. In order to provide a quality experience for the public, tourism and other recreational uses of the Embarcadero are encouraged and considered in lease management decisions. The Embarcadero will be pedestrian-friendly with ample access and view corridors to coastal resources.”

Although an attempt is made for standardization, each lease or master lease is the subject of complex negotiations relating to lease term, lease conditions, condition of leased premises (sometimes it is deficient), and public policy or promotional goals for individual lease sites. There is also a practical internal conflict in the use of the Tidelands Lease revenue for daily operations as opposed to funding depreciation and maintaining an adequate capital reserve to fund needed repairs, and structural degradation and obsolescence that are the legal responsibility of the City as the “landlord”.

There is also a practical matter of lease administration. Many harbors and waterfront districts contract this function to outside real estate property managers, or at least to a staff specialist. The Tidelands Lease areas are in fact a large shopping and commercial district. The Harbor District previously had a Business Manager with experience in business administration and real estate contracts. That position was eliminated, and the Harbor Director spends most of his time fulfilling those duties and running the operations of the Harbor. There is a rightful hesitance to add more City staff that may exacerbate the City’s PERS pension shortfall.

Questions that come up include: 1) Is the City well equipped to be a landlord, a taxing authority, a regulatory agency and a political entity, and could the Lease Management function be more effectively handled by additional personnel in the department or by contracting with a property management company? 2) Is there proper accounting of and reserves for the maintenance and improvement of buildings and improvements in the Tidelands Lease area? 3) Should the City strategically time lease terminations to facilitate aggregation of lease sites into Master Leases?; 4) How do the effective lease rates (\$/square foot of building area or percentage of sales) compare to market rate leases of equal term and conditions?; and, 5) In order to fulfill

the Harbor District's mission of providing a quality experience for the public and to maintain the fiscal health of the Waterfront, how should the cost of operations and capital improvements be financed? The above issues are complicated by the fact that commercial uses outside of the Tidelands Lease sites do not pay directly into the Harbor Fund for the enhancement of the Waterfront; 100 percent of the revenue to maintain comes from a small subset of the commercial businesses on the Waterfront, and the preferential financial treatment for Measure D uses (to ensure their feasibility) places a higher burden on those uses.

- Recommendation:** **The Harbor District is currently running on empty. There are insufficient scheduled revenues to pay for Harbor District operations (enforcement, administration and management of the waterway), to pay for services and amenities that are necessary for the visiting public (normal sanitation, public bathrooms, sidewalk maintenance, signage and roads), and to pay for the depreciation on the Tidelands Lease assets such as fixed piers and docks, buildings, lease site sea walls and revetments. The Chamber of Commerce recommends the following:**
- a. City should evaluate the cost allocation and fair market rents for the Tidelands Lease sites and ensure that, over time, they are comparable, and do not exceed market rates.**
 - b. The City should re-evaluate the decision to eliminate the Business Services position in the Harbor Department or outsource that function to a professional property management firm. It is believed that the increased efficiencies will lead to greater revenues and greater collections.**
 - c. The City should establish a paid parking program in and adjacent to the Waterfront on all City parking lots, and on-street parking. These revenues would pay for maintenance of the parking lots (currently paid for out of the Harbor Department or the Public Works budgets), street maintenance, sanitation, transit/trolley subsidy, and funding of capital improvements.**

- d. The City should evaluate the appropriate use and sources for Tidelands Lease revenues and determine which portion of the revenues should be reserved to maintain and improve the asset being leased, which portion is for “common area maintenance” such as Harbor operations and maintenance, and which portion is for base rent of the asset. The City should also establish a financing mechanism so that non-Tidelands Lease properties pay an equitable share of Waterfront area’s maintenance and operations through a Business Improvement District, Parcel Tax or other mechanism so that all properties contribute to such funding.**

- e. The City should consider whether or not it makes sense to create sub-funds for the lease facilities in the Measure D/CF zone district, and the remainder of the Waterfront. This would eliminate commingling reserve funds and treatment of each of these sub-areas as their own internal funds. Each geographic area is functionally and economically different.**

- f. The City should pro-actively time the lease sites so that they can be comprehensively redeveloped. Combining lease sites has economic, financial and administrative advantages. It also provides smaller tenants who may not be economically able to lease and redevelop a lease site with opportunities. It will also insulate the City and Harbor District from wide variations in lease revenues as individual properties sit vacant for months or years.**