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Title: ORDINANCE GRANTING AN AMENDED, RESTATED AND COMBINED LEASE WITH BARTELL HOTELS, A CALIFORNIA LIMITED PARTNERSHIP, TO COMBINE THE BEST WESTERN ISLAND PALMS AND ISLAND PALMS WEST LEASES, UPDATE LEASE PROVISIONS, AND EFFECTIVELY EXTEND THE TERM OF THE BEST WESTERN ISLAND PALMS LEASE BY 9 YEARS AND 5 MONTHS FOR AN EXTENSION FEE OF \$1.4 MILLION

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| Date | Ver. | Action By | Action | Result |
|-----------|------|-----------------------------|---------|--------|
| 10/9/2018 | 1 | Board of Port Commissioners | adopted | Pass |

DATE: October 9, 2018

SUBJECT:

ORDINANCE GRANTING AN AMENDED, RESTATED AND COMBINED LEASE WITH BARTELL HOTELS, A CALIFORNIA LIMITED PARTNERSHIP, TO COMBINE THE BEST WESTERN ISLAND PALMS AND ISLAND PALMS WEST LEASES, UPDATE LEASE PROVISIONS, AND EFFECTIVELY EXTEND THE TERM OF THE BEST WESTERN ISLAND PALMS LEASE BY 9 YEARS AND 5 MONTHS FOR AN EXTENSION FEE OF \$1.4 MILLION

EXECUTIVE SUMMARY:

Bartell Hotels, a California limited partnership (Bartell Hotels) operates the Best Western Island Palms which has a 50-year lease¹ (BW Lease) with the District at 2051 Shelter Island Drive for a 97-room hotel and marina which expires in 2048. Bartell Hotels also operates the Island Palms West which has a 50-year lease² (IP Lease) with the District at 1901 Shelter Island Drive (Attachment A - Location Map) for a 125 guest room hotel which expires in 2058. The two hotels are dependent on each other as they operate as one hotel and each contain essential facilities for the operations of the other.

Richard Bartell, President and CEO of Bartell Hotels, submitted a request on May 1, 2017 to purchase 9 years and 5 months of lease term for the BW Lease. The BW Lease commenced on December 1, 1998 and terminates on November 30, 2048. Richard Bartell's intent for purchasing 9 years and 5 months of lease term is to make the BW Lease coterminous with the neighboring leasehold, IP Lease, which expires on April 30, 2058. Staff conducted analysis to calculate the purchase of term fee based on the District practices outlined in Board Policy No. 355 which resulted in a fee of \$1.4 million to extend the BW Lease

for an additional 9 years and 5 months. The District has prepared an amended, restated and combined lease (ARC Lease) that combines the BW Lease and the IP Lease since the two leases would now be coterminous and the properties operate as one hotel. The ARC Lease includes updated lease provisions, including 2.5% participation in both refinance and sale proceeds, updated rent with scheduled percentage rental rate increases and increased minimum annual rent (MAR), and the purchase of term fee which will be paid as additional rent over 15 years with 6.00% interest. The increases to the percentage rent categories are expected to generate approximately \$1.43 million in net present value as additional rent, and when combined with the additional \$1.40 million in net present value from the purchase of term fee, the District will receive approximately \$2.83 million in additional rent over the term of the ARC Lease.

RECOMMENDATION:

Ordinance granting an amended, restated and combined lease with Bartell Hotels, a California limited partnership, to combine the Best Western Island Palms and Island Palms West leases, update lease provisions, and effectively extend the Best West Island Palms lease by 9 years and 5 months for an extension fee of \$1.4 million.

FISCAL IMPACT:

The proposed Board action is expected to result in approximately \$2.83 million in additional rent to the District due to the \$1.40 million in net present value from payment of the purchase of term (9 years and 5 months) fee to be paid over 15 years, and approximately \$1.43 million in net present value as additional rent due to the increases in percentage rent categories over the term of the ARC Lease. The MAR has increased for both the BW Lease and IP Lease, which has been combined into a new MAR of \$1,042,231 for the ARC Lease.

This agenda item is subject to Board of Port Commissioners Policy No. 106 - Cost Recovery User Fee Policy.

COMPASS STRATEGIC GOALS:

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

- A vibrant waterfront destination where residents and visitors converge.
- A financially sustainable Port that drives job creation and regional economic vitality.

DISCUSSION:

Background

The BW Lease covers approximately 128,009 square feet of land area and 467,650 square feet of water area located at 2051 Shelter Island Drive in San Diego. The Lease commenced on December 1, 1998 and has a term of 50 years, which expires on November 30, 2048. The BW Lease includes two two-level wood buildings, restaurant, meeting rooms, offices, pool, dock and pier system, and parking. The IP Lease covers approximately 148,867 square feet of land area located at 1901 Shelter Island Drive in San Diego. The IP Lease commenced on May 1, 2008 and has a term of 50 years, which expires on April 30, 2058. The IP Lease includes a three-story building with 48 guest rooms, a two-story building with 77 guest rooms, and marina offices and facilities (Attachment B - Existing and

Proposed Lease Information Summary - BW Lease and IP Lease). The Best Western Island Palms and Island Palms West are both owned by Bartell Hotels and operate together as one hotel.

Purchase of Lease Term

On May 1, 2017, Bartell Hotels requested to purchase 9 years and 5 months of lease term for BW Lease with the intent of making the two hotel leases coterminous. Staff then performed the analysis of the reversionary interest and purchase of term fee for a 9 year and 5 month extension to the BW Lease term. The analysis was conducted based on the District practices outlined in Board Policy No. 355 and after some negotiating with Bartell Hotels, the District and Bartell Hotels agreed on the following purchase of term fee and payment structure.

| Purchase of Term Fee | |
|--|--|
| Payoff Period in Years | 15 |
| Interest Rate | 6.00% |
| Annual Additional Rent | \$141,768 |
| NPV* of Payments Discounted at 6% | \$1.40 million (purchase of term fee) |

The proposed purchase of term fee would be a total of \$1.40 million which Bartell Hotels would pay as additional rent for a period of 15 years with an interest rate of 6.00%.

Amended, Restated, and Combined Lease

As part of the request for additional term, staff negotiated the ARC Lease with Bartell Hotels which would combine the BW Lease and IP Lease since both hotels would be coterminous and already operate as one hotel. The ARC Lease contains the District’s most current lease provisions which include 2.5% participation fees for both refinance and sale proceeds, updated rent adjustment provisions, new provisions on Demolition and Remediation Security Funding. The rent for the ARC Lease will include a MAR of \$1,042,231 which represents 75% of the average percentage rental paid during the last three accounting years of both the BW Lease and the IP Lease. Several percentage rent categories were increased and some included scheduled increases over the term of the ARC Lease in exchange for removing the rent review provision (Attachment C - ARC Lease). The increases to the percentage rent categories are expected to generate approximately \$1.43 million in net present value in additional rent to the District over the term of the ARC Lease. See below for additional details to the updated rent provisions.

| | |
|------|--|
| Rent | <p>Minimum Annual Rent: \$1,042,231</p> <p><u>Percentage Rent for Rooms:</u> 7.25% (5/01/2018-4/30/2028) 7.50% (5/01/2028-4/30/2038) 7.75% (5/01/2038-4/30/2048) 8.00% (5/01/2048-4/30/2058)</p> <p><u>Percentage Rent for Food:</u> 3.0% (5/01/2018-4/30/2038) 3.5% (5/01/2038-4/30/2058)</p> <p><u>Percentage Rent for Beverage:</u> 5.0% (5/01/2018-4/30/2038) 5.5% (5/01/2038-4/30/2035)</p> <p><u>Percentage Rent for Conference and Banquet Rooms:</u> 7.5% (5/01/2028-4/30/2058)</p> <p><u>Percentage Rent for Parking:</u> 15% (5/01/2028-4/30/2058)</p> |
|------|--|

Conclusion

Staff believes that the purchase of term fee and ARC Lease represents a favorable deal for the District because it would combine both leases with the most current lease provisions, update rent with scheduled increases to percentage rental rates, and would generate a net present value of \$2.83 million in additional rent to the District over the remaining term of the ARC Lease. Staff recommends the Board adopt an Ordinance granting the ARC Lease with Bartell Hotels to combine the Best Western Island Palms and Island Palm West leases, update lease provisions, and extend the Best West Island Palms lease by 9 years and 5 months for an extension fee of \$1.4 million.

General Counsel’s Comments:

The Office of the General Counsel has reviewed the terms and conditions of the ARC Lease and approves as to form and legality.

Environmental Review:

The proposed Board direction or action, including without limitation, an ordinance granting an amended, restated, and combined lease to Bartell Hotels for the Western Island Palms and Island Palms West, is Categorical Exempt pursuant to California Environmental Quality Act (CEQA) Guidelines Section 15301 (Existing Facilities) and Section 3.a. (Existing Facilities) of the District’s Guidelines for Compliance with CEQA because the project in question would involve no expansion of use beyond that previously existing. The District has determined none of the six exceptions to the use of a categorical exemption apply to this project (CEQA Guidelines Section 15300.2).

The proposed Board direction or action complies with Section 87 of the Port Act, which allows for all visitor-serving commercial and industrial uses and purposes, and the construction, reconstruction, repair, and maintenance of commercial and industrial buildings, plants, and facilities and the establishment, improvement, and conduct of small boat harbors, marinas, aquatic playgrounds, and

similar recreational facilities, and for the construction, reconstruction, repair, maintenance, and operation of all works, buildings, facilities, utilities, structures, and appliances incidental, necessary, or convenient for the promotion and accommodation of any of those uses, including, but not limited to, snack bars, cafes, restaurants, motels, launching ramps, and hoists, storage sheds, boat repair facilities with cranes and marine ways, administration buildings, public restrooms, bait and tackle shops, chandleries, boat sales establishments, service stations and fuel docks, yacht club buildings, parking areas, roadways, pedestrian ways, and landscaped areas. The Port Act was enacted by the California Legislature and is consistent with the Public Trust Doctrine. Consequently, the proposed Board direction or action is consistent with the Public Trust Doctrine.

Finally, the proposed Board direction or action is considered “excluded development” pursuant to Section 8.a. (Existing Facilities) of the District’s Coastal Development Permit Regulations because the project in question would involve no expansion of use beyond that previously existing. Issuance of a Coastal Development Permit is not required for the proposed Board direction or action.

Equal Opportunity Program:

Not applicable.

PREPARED BY:

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Attachment(s):

- Attachment A: Location Map
- Attachment B: Existing and Proposed Lease Information Summary - BW Lease and IP Lease
- Attachment C: ARC Lease

¹ Lease by and between San Diego Unified Port District and Bartell Hotels, on file in the Office of the District Clerk bearing Document No. 61061, filed January 29, 2014, as amended by Lease Amendment No.1, on file in the Office of the District Clerk bearing Document No. 64031, filed October 13, 2015.

² Lease by and between San Diego Unified Port District and Bartell Hotels, on file in the Office of the District Clerk bearing Document No. 64032, filed October 13, 2015.