



Legislation Text

File #: 2019-0358, **Version:** 1

DATE: October 8, 2019

SUBJECT:

RESOLUTION CONSENTING TO ASSIGNMENTS, SUBLEASE, AND MANAGEMENT AGREEMENT FOR HOST SAN DIEGO HOTEL LLC DBA SHERATON SAN DIEGO HOTEL AND MARINA (MARINA TOWER AND BAY TOWER) LOCATED AT 1380 HARBOR ISLAND DRIVE AND 1590 HARBOR ISLAND DRIVE CONDITIONED ON UPDATE OF LEASE TERMS:

- A) ASSIGNMENT AND ASSUMPTION OF LEASEHOLD INTERESTS FROM HOST SAN DIEGO HOTEL LLC, A DELAWARE LIMITED LIABILITY COMPANY DBA SHERATON SAN DIEGO HOTEL AND MARINA TO SSD HOLDINGS, LLC, A DELAWARE LIMITED LIABILITY COMPANY**
- B) 5-YEAR SUBLEASE WITH TWO 5-YEAR OPTIONS FOR THE ENTIRE LEASED PREMISES BETWEEN SSD HOLDINGS, LLC, A DELAWARE LIMITED LIABILITY COMPANY AND SSD OPERATING CO., LLC, A DELAWARE LIMITED LIABILITY COMPANY**
- C) 10-YEAR MANAGEMENT AGREEMENT BETWEEN SSD OPERATING CO., LLC, A DELAWARE LIMITED LIABILITY COMPANY AND SSD MANAGEMENT, LLC, A DELAWARE LIMITED LIABILITY COMPANY FOR OPERATION OF THE HOTEL**

EXECUTIVE SUMMARY:

The District entered into two 66-year leases ^{1 2} (Leases) with Host San Diego Hotel LLC (Host) on November 1, 2012, to operate the Sheraton San Diego Hotel and Marina on Harbor Island (Sheraton). The two Leases include a 705-room hotel building (Marina Tower) located at 1380 Harbor Island Drive and a 348-room hotel building (Bay Tower) located at 1590 Harbor Island Drive. Host is owned by Host Hotels & Resorts, L.P., a real estate investment trust (REIT), and Host operates the Sheraton through long-term subleases covering both leased premises to REIT subsidiary HST Lessee San Diego LP. Host has a franchise agreement with The Sheraton LLC and a management agreement with Starwood Operator II, LLC to operate and manage the hotel under the Sheraton brand.

Host wishes to sell its interest in the Sheraton, including the leased fee interest under the Leases and certain related property, including intellectual property (Transaction) to SSD Holdings, LLC (SSD Holdings). The beneficial ownership of SSD Holdings is also a REIT and SSD Holdings will enter into one long-term sublease of both leased premises with REIT subsidiary SSD Operating Co., LLC. SSD Operating Co., LLC will then enter into a management agreement with SSD Management, LLC;

a subsidiary of KSL Resorts for the entire leased premises.

At the closing of this Transaction, Host will: (i) assign the Leases to SSD Holdings; (ii) terminate the existing subleases with HST Lessee San Diego LP; (iii) terminate the franchise agreement with The Sheraton LLC; and (iv) terminate the existing management agreement with Starwood Operator II, LLC. As well, at the closing of this Transaction, (1) SSD Holdings will assume the Leases from Host; (2) SSD Holdings will enter into a new sublease with SSD Operating Co., LLC; (3) SSD Operating Co., LLC will enter into a new franchise agreement with The Sheraton LLC or its affiliate; and (4) SSD Operating Co., LLC will enter into a new management agreement with SSD Management, LLC. The proposed Transaction requires Board consent to the two Assignment and Assumption of Tenant's Interest in Ground Leases, the Sublease, and the Management Agreement.

If the Transaction is approved by the Board, SSD Holdings plans to invest significantly in the Sheraton to reposition the entire property as a higher quality hotel experience in keeping with their portfolio of resort properties. The Sheraton is currently in need of updates in order to remain competitive in the industry and would benefit greatly from the investment, while the District would in turn benefit with a higher performing asset on tidelands.

Pursuant to the Leases, upon a consented-to assignment and/or sublease, the District has the right to require the Leases be amended to include new or revised provisions. Final agreement on any such updates is expected to be reached before the October 8, 2019 Board meeting, and any updates will be provided to the Board and public as agenda-related materials.

Therefore, staff recommends that the Board consent to the Transaction conditioned on update of lease terms.

RECOMMENDATION:

Adopt resolution consenting to Assignments, Sublease, and Management Agreement for Host San Diego Hotel LLC dba Sheraton San Diego Hotel and Marina (Marina Tower and Bay Tower) located at 1380 Harbor Island Drive and 1590 Harbor Island Drive conditioned on update of lease terms:

- A) Assignment and Assumption Leasehold Interests from Host San Diego Hotel LLC, a Delaware limited liability company dba Sheraton San Diego Hotel and Marina to SSD Holdings, LLC, a Delaware limited liability company
- B) 5-Year Sublease with Two 5-Year Options for The Entire Leased Premises Between SSD Holdings, LLC, a Delaware limited liability company and SSD Operating Co., LLC, a Delaware limited liability company
- C) 10-Year Management Agreement Between SSD Operating Co., LLC, a Delaware limited liability company and SSD Management, LLC, a Delaware limited liability company for operation of the hotel

FISCAL IMPACT:

The proposed Board action will not result in any fiscal impact to the District.

This agenda item is subject to Board 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

Sheraton began operating on Harbor Island on June 10, 1972 and was acquired by Host in 2006 (Attachment A - Marina Tower and Bay Tower Location Map). The Marina Tower Lease with the District covers approximately 948,352 square feet of land area and 168,291 square feet of water area located at 1380 Harbor Island Drive, in the City of San Diego. The Bay Tower Lease with the District covers approximately 233,001 square feet of land area and 103,070 square feet of water area located at 1590 Harbor Island Drive, in the City of San Diego. Sheraton's current combined accommodations include: 1,053 guest rooms, 5 restaurants, 3 swimming pools, 2 fitness centers, a spa, and 46 marina slips. Host's current 66-year Leases commenced on November 1, 2012 and will expire on October 31, 2078. The Leases are summarized on Attachment B (Attachment B - Marina Tower and Bay Tower Lease Information Summary).

The assignment and sublease provision in the Leases differ from the District's standard assignment and sublease provisions. The District is required to grant consent to up to two assignments per Lease (Designated Assignments) prior to the twenty-fifth (25th) anniversary of the commencement date of November 1, 2012 if; (i) the principal(s) of the assignee are reputable; (ii) the principal(s) of the assignee possess sufficient business experience and financial means to perform the obligations under the Leases; (iii) the assignee agrees in writing to assume all the obligations under the Leases; and (iv) no change in use occurs as a result of the assignments. The Leases state that in the case of these Designated Assignments the District does not have the right to update the rent to market rent. The proposed Transaction constitutes the first of such Designated Assignments with respect to each Lease.

Transaction

On July 23, 2019 Host's parent company entered into an asset purchase agreement (as amended) with SSD Holdings conditioned in part upon the District's consent to: the Assignment and Assumption of the Leases from Host to SSD Holdings (Attachment C - Assignment and Assumption of Tenant's Interest in Ground Lease (Marina Tower)) (Attachment D - Assignment and Assumption of Tenant's Interest in Ground Lease (Bay Tower)). SSD Holdings intends to enter into one sublease of the entire leased premises to REIT subsidiary SSD Operating Co., LLC (Attachment E - REIT Subsidiary Sublease), and such REIT subsidiary intends to enter into a management agreement for the entire leased premises with SSD Management, LLC a subsidiary of KSL Resorts (Attachment F - Management Agreement with SSD Management, LLC). HOST has indicated its desire to close the Transaction this month.

SSD Holdings

SSD Holdings is a subsidiary of the private equity fund company known as KSL Capital Partners V, which fund specializes in travel and leisure enterprises in five primary sectors: hospitality, recreation, clubs, real estate development and travel services. KSL Capital Partners V is sponsored by KSL Capital Partners (KSL), a private equity firm having offices in Denver, Colorado; Stamford, Connecticut; and London, United Kingdom. Since 2005, KSL has raised funds with over \$12 billion of capital commitments and completed over 35 investments in the travel and leisure industry. KSL's current portfolio includes some of the premier properties and businesses in travel and leisure. In North America, KSL funds own the Monarch Beach Resort in Dana Point, California; the Margaritaville Hotel Beach Resort in Hollywood, Florida; Outrigger Hotels and Resorts, an owner and operator of 37 resorts across Hawaii and Asia-Pacific; Courtyard Kauai at Coconut Beach, a Hawaiian oceanfront resort; iFly Indoor Skydiving, the world's leading operator of indoor skydiving facilities; Alterra Mountain Company, a portfolio of premier ski resorts; and Under Canvas, an industry leading glamping and adventure-hospitality company. In the United Kingdom, KSL funds own The Belfry in the West Midlands; Village Hotels; Cameron House in Loch Lomond, Scotland; and Hotels d'en Haut, a portfolio of luxury boutique hotels in France.

As shown on the post-closing organization structure (Attachment G - Pre-Closing and Post-Closing Organization Structures), SSD Holding's investment in the Leases will be indirectly held through SSD Holdings Trust, a Maryland REIT, which is a newly formed REIT created in order to allow KSL Capital Partners V to realize the tax advantages available by virtue of investing in SSD Holdings through the REIT trust structure. This Maryland REIT entity owns 100% of the membership interests in SSD Mezzanine Holdings, LLC, a Delaware limited liability company, which in turn owns 100% of the membership interests in SSD Holdings. SSD Holdings is directly purchasing Host's interest in the Sheraton, including the leasehold interest under the two Leases.

SSD Operating Co., LLC

Given SSD Holdings' ownership structure, the Sheraton must be operated through a taxable REIT subsidiary pursuant to a sublease agreement of the entire leased premises with SSD Operating Co., LLC. SSD Holdings owns 100% of the membership interests in SSD Operating Co., LLC, a Delaware limited liability company (Proposed Sublessee), which will be the taxable REIT subsidiary that operates the Hotel.

SSD Management, LLC

As of the close of the Transaction, SSD Operating Co., LLC will enter into a Management Agreement with SSD Management, LLC, a Delaware limited liability company and subsidiary of KSL Resorts. KSL Resorts is an independent third-party hotel manager affiliated with KSL. The Marina Tower and Bay Tower will continue to be branded and operated as The Sheraton San Diego Hotel & Marina following the closing.

Conclusion

Staff is satisfied that KSL, KSL Capital Partners V, SSD Holdings, LLC, SSD Operating Co., LLC, and SSD Management, LLC possess the financial capacity, a good reputation and managerial ability to operate successfully on the leased premises. Additionally, SSD Holdings intends to invest significantly in the hotel following acquisition and to reposition the hotel as a higher performing asset.

Pursuant to the Leases, upon a consented-to assignment and/or sublease, the District has the right to require the Leases be amended to include new or revised provisions. Final agreement on any such updates is expected to be reached before the October 8, 2019 Board meeting.

Therefore, staff recommends that the Board consent to the Transaction conditioned on update of lease terms.

General Counsel's Comments:

The Office of the General Counsel has reviewed and approved this agenda, as presented, as to form and legality.

Environmental Review:

The proposed Board action, including without limitation, resolutions consenting to assignments, a sublease, and a management agreement for Sheraton San Diego Hotel and Marina is Categorically Exempt pursuant to California Environmental Quality Act (CEQA) Guidelines Section 15301 (Existing Facilities) and Section 3.a. (4) of the District's Guidelines for Compliance with CEQA because the project would consist of various tenancy agreements relating to operation of an existing hotel and marina that would involve no expansion of use beyond that previously existing, would not result in a change in existing use, and would not result in a significant cumulative impact due to continuation of the existing use. 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). No further action under CEQA is required.

In addition, the proposed Board action complies with sections 21, 35, and 87 of the Port Act, which allow the Board to pass resolutions, to do all acts necessary and convenient for the exercise of its powers, and 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. 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 action does 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.

Equal Opportunity Program:

Not applicable.

PREPARED BY:

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Attachment(s):

Attachment A:	Marina Tower and Bay Tower Location Map
Attachment B:	Marina Tower and Bay Tower Lease Information Summary
Attachment C:	Assignment and Assumption of Tenant's Interest in Ground Lease

Attachment D: (Marina Tower)
Assignment and Assumption of Tenant's Interest in Ground Lease
(Bay Tower)
Attachment E: REIT Subsidiary Sublease
Attachment F: Management Agreement with SSD Management, LLC
Attachment G: Pre-Closing and Post-Closing Organization Structures

¹. San Diego Unified Port District Lease to Host San Diego Hotel LLC, dba Sheraton San Diego Hotel and Marina (Marina Tower) located at 1380 Harbor Island Drive on file in the Office of the District Clerk bearing Document No. 60317, filed April 25, 2013.

². San Diego Unified Port District Lease to Host San Diego Hotel LLC, dba Sheraton San Diego Hotel and Marina (Bay Tower) located at 1590 Harbor Island Drive on file in the Office of the District Clerk bearing Document No. 60316, filed April 25, 2013.