



Legislation Text

File #: 2019-0414, Version: 1

DATE: November 5, 2019

SUBJECT:

SEAPORT VILLAGE:

- A) ORDINANCE GRANTING A LEASE TO MIKE HESS BREWING CO, LLC, (MIKE HESS BREWING) FOR A CRAFT BEER TASTING ROOM AND BONA-FIDE EATING ESTABLISHMENT LOCATED AT 849 W. HARBOR DRIVE, SUITE W-14E IN SAN DIEGO FOR A 10-YEAR TERM PLUS ONE 5-YEAR OPTION (FOR A TOTAL POTENTIAL TERM OF 15 YEARS)**
- B) ORDINANCE GRANTING A LEASE TO SIGNORE MOTO CORPORATION DBA MR. MOTO PIZZA (MR. MOTO PIZZA) FOR A PIZZERIA LOCATED AT 849 W. HARBOR DRIVE, SUITE W-14C IN SAN DIEGO FOR A 10.5-YEAR TERM PLUS TWO 2-YEAR OPTIONS (FOR A TOTAL POTENTIAL TERM OF 14.5 YEARS)**
- C) ORDINANCE GRANTING A LEASE TO STB & POT HEAD COFFEE SEAPORT LLC DBA SPILL THE BEANS (SPILL THE BEANS) FOR A SPECIALTY COFFEE AND BAGEL SHOP LOCATED AT 849 W. HARBOR DRIVE, SUITE C-7 IN SAN DIEGO FOR A 10-YEAR TERM**
- D) RESOLUTION AUTHORIZING AMENDMENT NO. 2 TO THE AGREEMENT WITH R.I. PROPERTIES, INC., DBA RETAIL INSITE (RETAIL INSITE) FOR COMMERCIAL REAL ESTATE BROKER SERVICES FOR SEAPORT VILLAGE TO AMEND THE COMMISSION FEE STRUCTURE FOR LEASES OF MORE THAN FIVE YEARS, AND WAIVING BOARD OF PORT COMMISSIONERS POLICY NO. 114 PAYMENT OF COMMISSIONS FOR THE LEASING OF TIDELANDS**

EXECUTIVE SUMMARY:

Seaport Village is a tourist-oriented retail shopping center consisting of approximately 90,000 square feet of specialty retailers, restaurants, outdoor entertainment, and parking on an approximately 14-acre bayfront site located at 849 West Harbor Drive in San Diego, California. On October 1, 2018, the District assumed ownership of the Seaport Village assets, which consist of 32 buildings, including one over-water structure. Since then, the District has made strategic operational and financial investments to improve the overall experience and success of the shopping center for both locals and visitors alike. An essential component to this success is the District's ability to secure tenancies quickly to increase occupancy, attract additional foot traffic, and generate higher revenue to the District. As a result, one of staff's primary objectives has been to fill the existing vacancies at Seaport Village with new high-caliber tenants with Public Trust compliant uses.

Over the past several months, in collaboration with the District's broker, Retail Insite, staff has

successfully filled five vacant spaces. Staff has also engaged with dozens of prospective tenants, resulting in several competitive letters of intent (LOI) for the District's consideration. Today, staff seeks the Board of Port Commissioner's (Board) approval of three ordinances granting leases to three experienced, exceptional operators to fill current vacancies at Seaport Village. These prospective tenants, Mike Hess Brewing, Mr. Moto Pizza, and Spill the Beans, will fill key vacancies and generate a positive fiscal impact for the District, increase market demand for the remaining vacancies, and generate momentum and energy for the shopping center as a vibrant, waterfront destination with new and exciting offerings for its visitors.

Combined, the three leases are projected to generate cumulative cash flow to the District of \$1.75M in rent over a 10-year term, a highly competitive internal rate of return (IRR) to the District of 22% with a net present value (NPV) of \$803,000. Consistent with past Board feedback to staff, the proposed leases include termination provisions which would enable the District to terminate the leases after a maximum of seven years. This lease structure provides the District with flexibility in the event of future redevelopment of the Central Embarcadero. Therefore, staff recommends the Board adopt the ordinances granting the leases to Mike Hess Brewing, Mr. Moto Pizza and Spill the Beans.

In addition, in order to support the District's leasing initiatives, staff is seeking the Board's approval of Amendment No. 2 to the Agreement between San Diego Unified Port District and R.I. Properties, Inc., dba Retail Insite for Real Estate Broker Services (Retail Insite Agreement).¹ Please see Attachment A - Amendment No. 2 to the Retail Insite Agreement (Amendment No. 2). Under the current Retail Insite Agreement commission structure, Retail Insite receives the greater of six percent (6%) of the total minimum annual rent (excluding option terms and operating expense reimbursements), or \$7,500. When approved, the Retail Insite Agreement and commission structure did not contemplate leases in excess of five years being executed, and applying the current commission structure to leases in excess of five years would not result in fair and reasonable commissions. Therefore, Amendment No. 2 would amend the commission fee structure to pay Retail Insite six percent (6%) of the total minimum annual rent *for the first five years* of the term and three percent (3%) of the total minimum annual rent *for the remaining years* of the term (excluding option terms and excluding operating expense reimbursements) per lease. Staff believes this commission structure provides fair and reasonable commission fees on leases of more than five years.

RECOMMENDATION:

- A) Adopt an Ordinance Granting a Lease to Mike Hess Brewing Co, LLC for a Craft Beer Tasting Room and Bona-Fide Eating Establishment Located at 849 W. Harbor Drive, Suite W 14-E in San Diego for a 10-Year Term with One 5-Year Option (For a Total Potential Term of 15 Years)
- B) Adopt an Ordinance Granting a Lease to Signore Moto Corporation DBA Mr. Moto Pizza for a Pizzeria Located at 849 W. Harbor Drive, Suite W 14-C in San Diego for a 10.5-Year Term with Two 2-Year Options (For a Total Potential Term of 14.5 Years)
- C) Adopt an Ordinance Granting a Lease to STB & Pot Head Coffee Seaport LLC DBA Spill the Beans for a Coffee Shop Located at 849 W. Harbor Drive, Suite C-7 in San Diego for a 10-Year Term
- D) Resolution Authorizing Amendment No. 2 to the Agreement With R.I. Properties, Inc., DBA Retail Insite for Commercial Real Estate Broker Services for Seaport Village to Amend the Commission Fee Structure for Leases of More Than Five Years, and Waiving Board of Port Commissioners Policy (BPC) No. 114 Payment of Commissions for the Leasing of Tidelands

FISCAL IMPACT:

Adopting these ordinances for leases at Seaport Village will have a positive fiscal impact for the District. If approved, the District will incur cash outflows for broker commissions as well as tenant improvement (TI) allowances. Staff anticipates broker commissions will be approximately \$107,000, which will be paid during FY 2020 and funded by the approved Seaport Village FY 2020 Operating Budget. Total TI allowances would be \$810,000. Due to lease structures and tenants' construction timelines, staff anticipates these TI allowances will be paid during both FY 2020 and FY 2021. Any TI allowances paid out during FY 2020 will be drawn from the \$3 million TI allowance fund (funded by the FY 2020 Equipment Outlay and Other Capital Projects), as was approved by the Board at the July 24, 2019 Board meeting. The remaining TI allowances for future fiscal years will be budgeted for in the appropriate year subject to Board approval upon adoption of each fiscal year's budget.

If these ordinances are adopted, staff anticipates a cumulative cash flow to the District of approximately \$1.75M in rent over the 10-year term of these leases. Incorporating all of the cash inflows and outflows, staff estimates a 10-year IRR of 22% and an NPV of \$803,000 (using an 8% discount rate). Please see Attachments C, D, and E for the economic terms and projections of each specific lease.

COMPASS STRATEGIC GOALS:

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

- A Port that the public understands and trusts.
- A vibrant waterfront destination where residents and visitors converge.
- A Port that is a safe place to visit, work and play.
- A financially sustainable Port that drives job creation and regional economic vitality.

DISCUSSION:

Background

On October 1, 2018, the District assumed ownership of the Seaport Village assets. To date, the District has lease agreements in place with 61 tenants at Seaport Village and approximately 17 vacancies. Most of these vacancies are concentrated in the East Village area of Seaport Village, now referred to as the "Lighthouse District". The current tenant mix is comprised of 41 retail tenants, 16 food and beverage tenants (including restaurants, walk-up cafes, and specialty foods), and one second-floor office tenant for related Seaport Village projects. In collaboration with staff and the Seaport Village property manager, Protea Property Management, Inc., Retail Insite has continued to actively market and list the existing vacancies to identify and source high caliber tenants with Public Trust compliant uses. As part of these joint efforts, staff has returned to the Board for multiple Seaport Village strategic initiatives over the past year.

Seaport Village Strategic Initiatives

At the February 12, 2019 Board meeting, staff presented an update on the interim management and operations of Seaport Village, which included current leasing efforts with Retail Insite and proposed

leasing initiatives for the Board's consideration to secure tenancies quickly to increase occupancy, attract additional foot traffic, and generate higher revenue to the District. The Board provided feedback to staff to consider creative deal structures utilizing various strategies, including longer lease terms and TI allowances, to attract and secure leases with experienced, prospective tenants.

At its July 24, 2019 meeting, the Board approved a budget amendment that allocated \$3M towards the establishment of a TI allowance fund providing staff with the ability to achieve the District's goal of executing new market rate leases involving TI allowances to bring existing vacancies up to a reasonable condition within the time parameters expected of retail landlords in the market. These initiatives have resulted in increased interest in Seaport Village. Consistent with the Board's feedback to staff at the February 12th Board meeting to consider longer lease terms of up to five years, staff successfully negotiated and executed 37 new five-year leases with existing tenants whose previous lease agreements expired on September 30, 2019. In addition to these lease renewals, eight existing tenants exercised options to extend their leases for an additional one-year. Four tenants elected to not renew their leases. In collaboration with Retail Insite, the District has also filled a total of five vacancies within the last few months, further demonstrating that momentum and interest from prospective tenants has increased dramatically just over the past three months.

Leasing Efforts

As Retail Insite continues to present staff with competitive LOIs from prospective tenants, staff recognizes that for most market rate leases with exceptional operators, shorter lease terms of up to five years are a significant constraint for those tenants to sufficiently amortize their up-front investment. As a result, the District is at risk of losing these prospective tenants to competing landlords, unless longer lease terms for more than five years can be negotiated into the lease. With the understanding that construction may commence in the Central Embarcadero in the future, if approved by the Board, and consistent with prior Board feedback, staff intends to negotiate leases for more than five years with high-caliber tenants, with the expectation that the leases will include a termination provision, enabling the District to terminate the lease after, at a maximum, seven years.

Proposed Leases

As a result of staff and Retail Insite's joint efforts, staff has negotiated leases with three exciting prospective tenants to fill key vacancies at Seaport Village: Mike Hess Brewing, Mr. Moto Pizza, and Spill the Beans (locations of each space are shown in Attachment B). Summaries and descriptions of each tenant are provided below and full economic terms and projections for each lease are provided in Attachments C, D, and E.

Mike Hess Brewing - W-14E

One of San Diego's first craft brewers, Mike Hess Brewing has provided great beers and a welcoming atmosphere since its founding in 2010. Since opening its first tasting room in Miramar, San Diego, Mike Hess has gone on to open new locations throughout San Diego County, including North Park and Ocean Beach. Located along the boardwalk in the West Village of Seaport Village, now referred to as the "Carousel District," the 1,034 square foot Suite W-14E will include a beer tasting room and patio area along with a full-service restaurant. Staff has negotiated a 10-year lease with one 5-year option to extend for a total potential term of 15 years. The option to extend will be exercisable at the tenant's discretion (provided the tenant is not in default under the terms of the

lease). However, the District will maintain the right to terminate the lease, with 180 days' notice, any time after the end of Lease Year 6. In the event the District terminates the lease during Lease Years 7, 8, or 9, the District will be responsible for paying the tenant a termination fee (\$100,000, \$75,000, and \$50,000 respectively). The proposed lease contemplates a TI allowance of \$250,000, and staff estimates a 10-year IRR of 27% and an NPV of \$359,000 (using an 8% discount rate). A summary of the economic terms and projections for the Mike Hess Brewing lease is provided in Attachment C. A copy of the proposed lease with Mike Hess Brewing is attached as Attachment F.

Mr. Moto Pizza - W-14C

Founded in 2015, Mr. Moto Pizza has quickly become one of San Diego's favorite pizza restaurants. Mr. Moto makes New York-style pizza, sold by the slice or as an entire pie. At 906 square feet, Suite W-14C at Seaport Village will be its sixth location, where Mr. Moto will offer pickup and delivery in addition to dining-in along its waterfront patio, adjacent to Mike Hess Brewing. Staff has negotiated a 10.5-year lease with two 2-year options to extend for a total potential term of 14.5 years. The options to extend will be exercisable at the tenant's discretion (provided the tenant is not in default under the terms of the lease). However, the District will maintain the right to terminate the lease, with 120 days' notice, any time after the end of Lease Year 6. In the event the District terminates the lease during Lease Years 7, 8, or 9, the District will be responsible for paying the tenant a termination fee (\$200,000, \$150,000, and \$100,000 respectively). The tenant will also have the right to terminate the lease in the event that both of the following conditions are met: 1) construction associated with the redevelopment of the shopping center has commenced and significantly impacts the tenant's operations; and 2) the tenant's sales fall below \$413,000 during any 6-month period following the commencement of the aforementioned construction. If the tenant terminates the lease and both conditions outlined above are satisfied, the District will be responsible for paying a termination fee, pursuant to the termination fee schedule mentioned above. The proposed lease contemplates a TI allowance of \$320,000, which staff estimates will result in a 10-year IRR of 16% and an NPV of \$155,000 (using an 8% discount rate). A summary of the economic terms and projections for the Mr. Moto Pizza lease is provided in Attachment D. A copy of the proposed lease with Mr. Moto Pizza is attached as Attachment G.

Spill the Beans - C-7

Spill the Beans is a specialty coffee and bagel shop with one location in the Gaslamp District. They have built a successful and unique brand since launching in 2017 and will lease a key boardwalk vacancy in the Lighthouse District, Suite C-7 (approximately 518 square feet). Staff has negotiated a 10-year lease with Spill the Beans, which staff estimates will result in a 10-year IRR of 26% and an NPV of \$289,000 (using an 8% discount rate). The lease contemplates a TI allowance of \$240,000 and District termination right after Lease Year 7, with no termination fee. A summary of Spill the Beans economic terms and projections for the lease is provided in Attachment E. A copy of the proposed lease with Spill the Beans is attached as Attachment H.

Retail Insite Amendment - Commission Fee Structure

At its May 14, 2019 meeting, the Board authorized Amendment No. 1 to the Retail Insite Agreement, which increased the maximum amount payable based on the revised scope of services and compensation structure, as proposed by Retail Insite, to support the District's leasing initiatives at Seaport Village. In order to ensure market rates for commissions on lease terms of more than five

years, Retail Insite has proposed a revised compensation structure. For satisfactory performance and completion of services, Amendment No. 2 would amend the commission structure for new leases negotiated with terms of more than five years. For such leases, Retail Insite would receive six percent (6%) of the total minimum annual rent for the first five years of the term and three percent (3%) of the total minimum annual rent for the remaining years of the term (excluding option terms and excluding operating expense reimbursements) per lease. This revision would provide fair and reasonable commission fees to Retail Insite on lease terms of more than five years.

In accordance with BPC Policy No. 110, the existing Agreement must be amended and presented to the Board for authorization. Therefore, staff recommends the Board authorize Amendment No. 2 to the Agreement with Retail Insite to amend the commission fee structure and waive BPC Policy No. 114.

Staff Recommendation and Next Steps

The proposed leases would allow the District to achieve its objectives of securing high-caliber, catalyst tenants to increase occupancy, generate greater momentum and energy for the shopping center, and secure higher revenue to the District. The Board's adoption will also demonstrate to prospective tenants in the visitor serving commercial market that Seaport Village has viable and attractive leasing opportunities that are competitive and worth pursuing. For these reasons, staff recommends the Board adopt ordinances granting leases to Mike Hess Brewing, Mr. Moto Pizza, and Spill the Beans.

Staff also recommends the Board approve Amendment No. 2 to the Retail Insite Agreement to amend the commission fee structure to provide for fair and reasonable commission fees on leases of more than five years. This recommendation requires the waiving of BPC Policy No. 114 Payment of Commissions for the Leasing of Tidelands.

As staff progresses toward meeting the District's goals for leasing at Seaport Village, staff will keep the Board updated as to the operations, leasing activity and efforts for Seaport Village.

General Counsel's Comments:

The General Counsel's Office has reviewed the agenda sheet and attachments, as presented to it, and approves them as to form and legality.

Environmental Review:

Seaport Lease Ordinances

The proposed Board actions to approve ordinances granting leases to Mike Hess Brewing Co, LLC, Signore Moto Corporation DBA Mr. Moto Pizza, and STB & Pot Head Coffee Seaport LLC, are within the scope of the Coastal Act Categorical Determination of Exclusion (Categorical Determination) issued by the District on August 9, 2018 and a revised Categorical Determination was issued on October 30, 2019 for lease agreements for the continuation of existing uses at the shopping center currently known as Seaport Village (the Seaport Leasing Project). The District concluded that the Seaport Leasing Project, as described in the Categorical Determination, was categorically exempt from the California Environmental Quality Act (CEQA) pursuant to CEQA Guidelines Section 15301

and/or Section 3.a. (Existing Facilities) of the District's Guidelines for Compliance with CEQA. The proposed Board action is not a separate "project" for CEQA purposes but is a subsequent discretionary approval related to a previously approved project. (CEQA Guidelines § 15378(c); *Van de Kamps Coalition v. Board of Trustees of Los Angeles Comm. College Dist.* (2012) 206 Cal.App.4th 1036.) Accordingly, the proposed Board action is merely a step-in furtherance of the original project for which environmental review was performed, and no further environmental review is required.

The proposed Board actions comply with sections 21, 35, and 87 of the Port Act, which allow the Board to pass ordinances and to do all acts necessary and convenient for the exercise of its powers, and for the use of tidelands 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 actions are consistent with the Public Trust Doctrine.

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 (CDP) Regulations because they will not result in, without limitation, a physical change, change in use or increase the intensity of uses. A Categorical Determination was previously issued for this project on August 9, 2018, and a revised Categorical Determination was previously issued for this project on October 31, 2019; therefore, issuance of a Coastal Development Permit or subsequent Exclusion is not required for the proposed Board action. However, development within the District requires processing under the District's CDP Regulations. Future development, as defined in Section 30106 of the Coastal Act, will remain subject to its own independent review pursuant to the District's certified CDP Regulations, PMP, and Chapters 3 and 8 of the Coastal Act. The proposed Board actions in no way limit the exercise of the District's discretion under the District's CDP Regulations.

Resolution Regarding Services Contract With Retail Insite

The proposed Board action, a resolution approving Amendment No. 2 to the Agreement With R.I. Properties, Inc. dba Retail Insite for Commercial Real Estate Broker Services for Seaport Village, does not constitute a "project" under the definition set forth in California Environmental Quality Act (CEQA) Guidelines Section 15378 because it will not have a potential to result in a direct or indirect physical change in the environment and is, therefore, not subject to CEQA. No further action under CEQA is required.

In addition, the proposed Board action complies with Sections 21, 35, and 81 of the Port Act, which allow the Board to pass resolutions and to do all acts necessary and convenient for the exercise of its powers, and for the use of funds for the expenses of conducting the District. The Port Act was enacted by the California Legislature and is consistent with the Public Trust Doctrine. Consequently, the proposed Board action is consistent with the Public Trust Doctrine.

Finally, the proposed Board direction or 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:

N/A

PREPARED BY:

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Attachment(s):

Attachment A:	Amendment No. 2 to Agreement with Retail Insite
Attachment B:	Seaport Village Site Map and Proposed Premises Map
Attachment C:	Lease Information Summary for Mike Hess Brewing
Attachment D:	Lease Information Summary for Mr. Moto Pizza
Attachment E:	Lease Information Summary for Spill the Beans
Attachment F:	Lease Agreement with Mike Hess Brewing
Attachment G:	Lease Agreement with Mr. Moto Pizza
Attachment H:	Lease Agreement with Spill the Beans

¹Agreement between District and R.I. properties, Inc., DBA Retail Insite for Real Estate Broker Services on file in the Office of the District Clerk as Document No. 68690