



Legislation Text

File #: 2020-0420, **Version:** 1

DATE: December 28, 2020

SUBJECT:

RESOLUTION CONSENTING TO ASSIGNMENT AND ASSUMPTION OF THE LEASEHOLD INTERESTS FROM HII SAN DIEGO SHIPYARD INC. TO HELIOS ACQUISITION, LLC, WHICH WILL BE RENAMED CONTINENTAL MARITIME OF SAN DIEGO, LLC UPON THE EFFECTIVENESS OF THE ASSIGNMENT

ORDINANCE GRANTING AMENDED AND RESTATED LEASE TO HELIOS ACQUISITION, LLC, WHICH WILL BE RENAMED CONTINENTAL MARITIME OF SAN DIEGO, LLC, FOR CONTINUED OPERATION OF A SHIPYARD AT 1995 BAYFRONT STREET IN SAN DIEGO

EXECUTIVE SUMMARY:

HII San Diego Shipyard Inc., a California corporation (HII SDSY), is an existing District tenant which operates a shipyard facility at 1995 Bayfront Street, San Diego, as further described on Attachment A - Location Map (Premises). HII SDSY has been operating at the Premises since 1985 and currently has a 22-year lease with the District which expires December 31, 2032 (Existing Lease). The Existing Lease covers approximately 12 acres of landside area that includes industrial facilities, production shops, offices and other related utilities. The waterside parcel is approximately 18 acres and currently has three working piers to moor large naval and commercial vessels. HII SDSY provides a broad set of naval sustainment services which include topside maintenance and modernization to naval surface vessels, amphibious ships and auxiliary ships as well as advanced naval logistics.

HII SDSY is proposing to transfer its assets, including its leasehold interest under the Existing Lease, to Helios Acquisition, LLC, a Delaware limited liability company (Helios) and subsidiary of MHI Holdings, LLC, a Delaware limited liability company (MHI Holdings), which is in turn owned by Titan Acquisition Holdings, LP, a Delaware limited partnership (Titan). Attachment B - Post Assignment Organization Chart reflects Titan's organizational structure as it will exist should the transactions described in this agenda be approved and consummated. Concurrently with closing of the transactions and transfer of assets, Helios would be renamed to Continental Maritime of San Diego, LLC (Continental Maritime SD).

MHI Holdings, through its subsidiaries, has extensive experience operating shipyards and marine industrial businesses including, but not limited to, MHI Ship Repair in Norfolk, Virginia, and Vigor Industrial in various locations throughout the Pacific Northwest. Staff believes that Continental Maritime SD, through Titan, has the financial and operational wherewithal to operate a world-class ship repair facility on District tidelands. In addition, Titan has conveyed that it intends to pursue capital investments in the leasehold in the future, which may include placement of a new drydock on

the Premises to address the Navy's need for additional dry dock capacity in San Diego.

As a condition of the District's consent to the assignment of the Existing Lease, the District has the right to update the rent to market and, as the District deems necessary, update the Existing Lease to include new or revised lease provisions. As such, staff has negotiated an Amended and Restated Lease (Amended and Restated Lease) on the District's current lease template (modified as necessary through negotiation and to address particular issues) that would provide multiple benefits to the District, including, but not limited to: (i) increased rent; (ii) provisions that entitle the District to 2.5% of the proceeds from a future lease assignment to non-Titan affiliates or an applicable financing transaction; and (iii) a tenant funded demolition and remediation fund to cover required end of term demolition costs and environmental remediation. It should be noted that this transaction is an assignment of the Existing Lease and is not a new lease or lease extension. Under these circumstances, the District's rights are different than if the transaction were a new lease or lease extension; that is, the Existing Lease provides that the District cannot unreasonably withhold consent to the assignment, and therefore, new lease terms must be deemed reasonably necessary by the District.

In addition to the benefits noted above, all of Continental Maritime SD's obligations under the Amended and Restated Lease will be guaranteed by Titan, and with respect to obligations related to hazardous materials, guaranteed by HII SDSY's corporate parent, Huntington Ingalls Industries, Inc., a Delaware corporation and publicly traded company (HII Inc.). As further described below, the Amended and Restated Lease also requires Continental Maritime SD to comply with governmental orders relating to the contamination of the Premises in the event HII SDSY or HII Inc. fail to comply with or be named in such orders. HII SDSY will remain obligated under the Existing Lease for all obligations accruing or arising on or prior to the effective date of the Amended and Restated Lease or which by their terms survive any termination or surrender of the Premises.

In connection with the foregoing, staff recommends the Board adopt a resolution consenting to the assignment and assumption of the HII SDSY's leasehold to Continental Maritime SD and adopt an ordinance granting an Amended and Restated Lease to Continental Maritime SD under the terms presented.

RECOMMENDATION:

Adopt a Resolution consenting to the assignment and assumption of the leasehold interests from HII San Diego Shipyard Inc. to Helios Acquisition, LLC which will be renamed to Continental Maritime of San Diego LLC upon the effectiveness of the assignment; and

Adopt an Ordinance granting Amended and Restated Lease to Helios Acquisition, LLC, which will be renamed to Continental Maritime of San Diego, LLC, for continued operation of a shipyard at 1995 Bayfront Street in San Diego.

FISCAL IMPACT:

The proposed Board action would grant an Amended and Restated Lease which includes an increase in flat rent paid to the District from \$105,141 per month to \$109,347 per month. Additionally, the flat rent would be further adjusted by annual CPI adjustments between 2% and 4% occurring

January 1, 2021 and every January 1 thereafter.

This 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 thriving and modern maritime seaport.
- A Port with a healthy and sustainable bay and its environment.
- A financially sustainable Port that drives job creation and regional economic vitality.

DISCUSSION:

Background

HII SDSY is an existing District tenant which operates a shipyard facility at the Premises located at 1995 Bayfront Street, San Diego. HII SDSY has been operating at the Premises since 1985 and is currently governed by the 22-year Existing Lease with the District which expires December 31, 2032. The Existing Lease covers approximately 12 acres of landside area that includes industrial facilities, production shops, offices and other related utilities. The waterside parcel is approximately 18 acres and currently has three working piers to moor large naval and commercial vessels. HII SDSY provides a broad set of naval sustainment services which include topside maintenance and modernization to naval surface vessels, amphibious ships and auxiliary ships as well as advanced naval logistics.

Proposed Assignment

HII SDSY proposes to assign its lease to Helios, a recently created subsidiary of MHI Holdings, which is in turn owned by Titan. Pursuant to the Asset Contribution Agreement between HII SDSY's parent, HII Inc. and Titan, HII Inc. will transfer all of its interest in the business operations at the Premises, including HII SDSY's leasehold interest, to Titan, with Helios becoming the tenant under the Amended and Restated Lease. Concurrently with the completion of the transaction, Helios will be renamed Continental Maritime of San Diego, LLC, and HII SDSY will become a limited partner of Titan.

MHI Holdings, through its subsidiaries, has experience operating multiple shipyards and marine industrial businesses including, but not limited to, MHI Ship Repair in Norfolk, Virginia, and Vigor Industrial in various locations throughout the Pacific Northwest. Staff believes that Continental Maritime SD and its parent companies (including Titan as guarantor) have the financial and operational wherewithal to operate a world-class ship repair facility on District tidelands. In addition, Continental Maritime SD, through Titan, has indicated its intention to pursue a capital investment in the leasehold after completing the assignment, which may include a new floating dry dock. Any future projects would be subject to review and approval by the District as well as review under the California Environmental Quality Act (CEQA) and the Coastal Act. Titan has represented that all current employees of HII San Diego will continue in their employment with the new entity after the lease transfer.

Amended and Restated Lease Terms

As a condition of the District's consent to the assignment, the District has the right to update the rent to market and, as the District deems necessary, update the lease to include new or revised lease provisions, including, for example, our current standard lease language. As such, staff has negotiated the Amended and Restated Lease with Continental Maritime SD. Continental Maritime SD would be the first industrial or maritime tenant to utilize the District's new lease template, which in comparison to the Existing Lease, includes numerous beneficial provisions to the District (see Attachment C - Amended and Restated Lease). The Amended and Restated Lease would entitle the District to receive 2.5% of the proceeds from a future lease assignment to a non-Titan affiliate or applicable financing transaction as well as a fixed participation fee of \$400,000 in the event of a change of the majority ownership of Titan. Additionally, the Lease would further establish market rent and shipyard rent comparisons by increasing rent by 4% from \$105,141 per month to \$109,347, with future rent subject to annual CPI adjustments between 2% and 4%. The Amended and Restated Lease also, in addition to the environmental benefits listed below, requires Continental Maritime SD to fund a demolition and remediation account to cover end of term demolition costs and environmental remediation. Last, the District would benefit by securing a tenant with extensive experience in the shipyard industry that has expressed a strong desire to make substantial investments into the Premises.

Environmental Conditions

Recent sampling conducted pursuant to a Regional Water Quality Control Board (RWQCB) investigation order issued to HII SDSY, the City of San Diego, and Caltrans has demonstrated high levels of sediment contamination within the Premises that will likely require remediation. In the Amended and Restated Lease, the District has maintained and clarified the broad rights it has under the Existing Lease to require investigation and remediation of sediment contamination that was generated during the shipyard operations since HII SDSY's original lease dated September 10, 1985 and also the contamination pre-existing the 1985 lease that was or is in the future impacted by the use, occupancy, possession, or operation of the Premises (Pre-Existing Hazardous Materials). In addition, the Amended and Restated Lease maintains and clarifies the tenant's indemnification obligations owing the District relating to hazardous materials and requires Continental Maritime SD to step into the shoes of HII SDSY (and HII Inc.) with respect to future governmental orders related to site contamination should those entities fail to perform obligations thereunder or if they are not named in a future governmental order for the leasehold. Additionally, the Amended and Restated Lease not only includes a Continuing Guaranty from Titan of all of Continental Maritime SD's obligations under the Amended and Restated Lease, but also a Continuing Guaranty by HII SDSY's parent company, HII Inc. to guaranty the full and prompt payment and performance of the obligations to clean-up and indemnify the District for any Pre-Existing Hazardous Materials.

The Amended and Restated Lease also clarifies that Continental Maritime SD's obligation to investigate, remove or remediate contamination at or from the Premises must be in compliance with all applicable environmental laws, and in a manner and with results that do not impair reasonably anticipated future public trust uses of the Premises, satisfactory to the District in the District's reasonable, good faith discretion. Last, the Amended and Restated Lease includes express acknowledgements and agreements by HII SDSY and HII Inc. to release and to not to sue the District, and not to seek to have any regulatory agency or third party impose liability upon the District for any contamination or violation of environmental laws existing at or arising from hazardous materials at or arising from the Premises.

In light of the foregoing, staff recommends the Board adopt a resolution consenting to the assignment

and assumption of the leasehold and adopt an ordinance granting an Amended and Restated Lease to Continental Maritime SD under the terms presented.

General Counsel's Comments:

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

Environmental Review:

The proposed Board actions, including without limitation, a resolution consenting to assignment and assumption of leasehold interests and an ordinance granting an amended and restated lease, do not constitute a "project" under the definition set forth in California Environmental Quality Act (CEQA) Guidelines Section 15378 because they would not have the 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.

The proposed Board actions comply with Sections 21 and 35 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. 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 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:	Location Map
Attachment B:	Post-Assignment Organization Chart
Attachment C:	Amended and Restated Lease