



Legislation Text

File #: 2020-0427, Version: 1

DATE: December 28, 2020

SUBJECT:

ORDINANCE GRANTING A 23-YEAR TERM EXTENSION FOR A NEW 40-YEAR LEASE BETWEEN THE SAN DIEGO UNIFIED PORT DISTRICT AND SUNROAD MARINA PARTNERS, L.P. FOR THE SUNROAD RESORT MARINA LOCATED AT 955 HARBOR ISLAND DRIVE, IN THE CITY OF SAN DIEGO

EXECUTIVE SUMMARY:

Sunroad Marina Partners, L.P. (Sunroad) has a 50-year lease with the District that commenced on February 1, 1987 and expires on January 31, 2037. There is approximately 17 years of term remaining on the existing lease. Sunroad operates a 600-slip marina (Sunroad Resort Marina) at 955 Harbor Island Drive, in the City of San Diego (Attachment A - Location Map).

In September 2019, Sunroad submitted a request for a lease term extension to extend the lease by 23 years. This request requires replacing the existing lease with a new lease containing updated lease provisions for a total term of 40-years.

Board of Port Commissioner's (Board) Policy No. 355 (BPC 355) states:

"The District should utilize the lease extension process to (a) promote investment in leasehold improvements, (b) encourage development, and (c) update out-of-date leases"

Consistent with BPC 355, staff has negotiated a market-based lease term extension for a new 40-year lease including the District's most current lease provisions. As consideration for the lease term extension, Sunroad would be required to either (1) obtain term through proposed qualified capital investment per BPC 355, as may be approved by the Board in its sole and absolute discretion, or (2) pay a purchase of term fee required for any term not earned through approved capital investment, if any, at the end of lease year 6. Any proposed capital investment must be presented to the Board for its consideration before the end of lease year 5 and any approved capital investment, if any, must be completed by the end of lease year 8. Board approval of a capital investment in the leasehold would include the description of all approved project components, estimated cost, and amount of term qualified for consistent with the standards of BPC 355. If Board-approved capital investment projects (if any) do not qualify for the full 23 years of term, Sunroad would be required to purchase any remaining term by the end of the lease year 6. Any required purchase of term fee would include a 4% interest rate, accruing from Lease Commencement until the purchase of term fee is paid by Sunroad. With required interest, and assuming no approved capital investment, the purchase of term fee would be \$7,051,357, which is consistent with the methodology and standards of BPC 355. The purchase of term fee would decrease proportionally with approval of capital investment, if any, based

upon the value of approved capital investment. Finally, if any outstanding purchase of term fee is not paid by the end of lease year 6, the percentage rental rate on marina slips would automatically increase such that the unpaid fee would be recouped by the end of the lease term.

Sunroad is an exceptional marina operator, keeps the marina very well-maintained, and the Sunroad Resort Marina is one of the District's highest performing marinas. The proposed 40-year lease, including a combination of capital investment and purchase of term, represents a favorable deal for the District. First, it encourages capital investment in tidelands by providing a well-positioned tenant with long-term security in its leasehold interest. Second, the new lease updates out-of-date language in the old lease. Finally, the new lease represents a market-based deal that generates additional revenue to the District over the term of the lease. Therefore, staff recommends the Board adopt an ordinance granting a 23-year lease term extension for a new 40-year lease to Sunroad.

RECOMMENDATION:

Adopt an Ordinance Granting a 23-Year Term Extension for a New 40-Year Lease to Sunroad Marina Partners, L.P. located at 955 Harbor Island Drive, in the City of San Diego

FISCAL IMPACT:

The proposed Board action may result in additional rent paid to the District ranging from \$0 to up to \$7,051,357 paid as a lump sum fee within 6 years of the lease commencement date. The lump sum fee amount may decrease proportionally with approval of capital investment, if any, based upon the value of approved capital investment as further described in the discussion section of this Agenda. It is expected that the Minimum Annual Rent (MAR) will increase by \$243,211 to a new total of \$1,143,211.

COMPASS STRATEGIC GOALS:

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

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

DISCUSSION:

Background

Sunroad Resort Marina's leasehold is comprised of 259,090 square feet of land and 1,029,239 square feet of water area for their marina operations. Sunroad Resort Marina has 600 boat slips with approximately 19,816 square feet of marina buildings located at 955 Harbor Island Drive. There are two additional non-exclusive water areas under the lease with 27,024 square feet used for mitigation purposes and 220 square feet used for maintaining a submerged bulkhead easement. The Sunroad Resort Marina lease commenced on February 1, 1987 and expires on January 31, 2037, with 17 years of remaining term.

Lease Term Extension

In September 2019, Sunroad submitted a request for a lease term extension to extend the lease by 23-years. The stated purpose for this request is to increase the value of the leasehold interest and refinance their existing loan encumbering the leasehold to free up additional funds to invest in tidelands. Sunroad has stated, that in order to successfully refinance the marina loan and free up additional funds, Sunroad must achieve all of the lease term up front.

Staff worked diligently to negotiate a creative deal structure that would allow Sunroad to obtain the requested additional lease term and the District to receive market rate consideration for an extension. Utilizing the practices outlined in BPC 355 and after extensive negotiations with Sunroad, as consideration for the 23-years of additional term, the proposed transaction relies on a combination of:

1. Qualifying Capital Investment; and/or
2. Purchase of Lease Term

A high-level summary of the proposed structure of each of these terms is outlined below:

Qualifying Capital Investment

Sunroad has the option to qualify for some, all, or none of the extended term through capital investment in the leasehold. To qualify for the additional term through capital investment, Sunroad may submit proposed projects for consideration by the Board, in its sole and absolute discretion, within five years of the lease commencement date. Sunroad's proposed capital investment may be either part of a comprehensive redevelopment project or individual improvements, with the caveat that any proposed investment must meet the standards and requirements of BPC 355. When the projects are brought to the Board for approval, they will include the description of all project components, estimated cost, and the recommended amount of term they qualify for through capital investment pursuant to the calculation requirements of BPC 355. To be consistent with BPC 355, the projects will need to increase the value or the life expectancy of the leasehold improvements, cannot be reasonably amortized during the term, and are not recurring in nature. Sunroad has indicated they intend to propose projects that meet the standards of BPC 355. Sunroad would be required to complete any approved qualifying capital investment project within eight years of lease commencement and must spend at a minimum the estimated cost of the project as approved by the Board.

Sunroad may also submit, for the Board's consideration and satisfaction of the term extension requirement, past improvements, provided such past improvements meet the standards and criteria of BPC 355 (including that the improvements must have been implemented within the last five years and cannot reasonably be amortized).

Purchase of Lease Term

In the event that Sunroad does not propose a qualifying capital investment project(s) within the first five years or if they do not qualify for the full 23-year term through approved capital investment projects, Sunroad would be required to pay a lump sum fee no later than the last day of the sixth lease year to the District. The lump sum fee, which could be between \$0 to \$7,051,357 based on the number of years that must be purchased, includes a 4% interest rate, accruing from the start of lease commencement until any outstanding fee is paid (not to exceed the last day of the lease year 6). Staff has calculated the lump sum fee consistent with the approach included in BPC 355 and

concluded it represents the District's reversionary interest in the leasehold, as described in Attachment B - Term Extension Table.

The District is required to provide Sunroad with written notification of the amount of term they have qualified for through capital investment and the lump sum fee to be paid within sixty days of the commencement of the sixth lease year.

In the event that Sunroad does not pay the lump sum fee owed for the remaining term, the percentage rental rate for marina slips will automatically adjust to an increased rate, which could be between 22% to 37.38%, starting on the first day of lease year 7. The percentage rental rate on marina slips would be increased to a rate that would pay off the lump sum fee owed through the increased rent while taking into consideration time value of money. The increased percentage rental rates for marina slips are further described in Attachment B - Term Extension Table.

Lease Updates

As part of the request for additional term, the existing lease will be replaced with a new lease which staff has negotiated to include a total 40-year term (includes the 23-year term extension) and contains the most current lease provisions (Attachment C - Lease Information Summary). The new lease includes 2.5% participation fees for both applicable refinancing transactions and assignment/sale proceeds, which also gives the District the right to update the lease after the first refinance within five years of the new lease and to update the lease upon an assignment/sale at any time. The percentage rental rate on parking has been updated from 20% of net sales to 10% of gross sales, which benefits the District. Rent adjustment provisions have been updated to include the greater of a Consumer Price Index (CPI) Adjustment or 75% MAR lookback adjustment every five years which is also an improvement compared to the existing lease. The lease also includes new provisions on Demolition and Remediation Security Funding for demolition of the improvements at the end of the lease term. The rent for the lease will increase MAR from \$900,000 to \$1,143,211, which represents 75% of the average percentage rent paid during the last three accounting years.

Additionally, several other provisions in the lease have been modified as part of negotiations with Sunroad including Force Majeure and Prevailing Wage. A summary of these modifications has been outlined below:

- ***Force Majeure:*** Language in this provision has been modified to include government closures as a Force Majeure event.
- ***Prevailing Wage:*** The provisions specifying when the District may notice a default related tenant's failure to comply with applicable prevailing wage law was revised to first require, before any notice of default, (1) a final, non-appealable or non-reviewable judicial or administrative decision finding tenant violated applicable prevailing wage law and (2) Sunroad's failure to cure any such violation, including complying with any applicable judicial or administrative order, within the timeframes specified in the lease.

While the lease includes some revisions to the current standard lease, the new 40-year lease provides updated language to many of the out-of-date provisions of the existing lease and includes rent provisions that are beneficial to the District (Attachment D - Proposed Lease). The proposed

lease is presented in substantially final form, but for the inclusion of an updated plat map and legal description, which will replace the plat map and legal description currently in Attachment D - Proposed Lease. The updated plat map and legal description will be replaced prior to execution of the lease.

Recommendation

Board of Port Commissioner's Policy No. 355 states:

"The District should utilize the lease extension process to (a) promote investment in leasehold improvements, (b) encourage development, and (c) update out-of-date leases."

Staff has negotiated a market-based lease term extension consistent with BPC 355. The unique structure of this lease term extension allows Sunroad to achieve 40-years of term upfront, which will increase the value of the leasehold. It will also allow Sunroad to refinance their existing loan and free up additional funds to invest in tidelands. This deal will benefit the District and achieves the goals of BPC 355 by (1) encouraging potential investment in tidelands by providing a well-positioned tenant with long-term security in its leasehold interest, (2) updating an existing lease, and (3) generating additional revenue to the District over the term of the lease. Therefore, staff recommends that the Board adopt an ordinance granting a lease term extension to Sunroad extending the existing term by 23-years and enter into a new lease for a total term of 40-years.

General Counsel's Comments:

The General Counsel's Office has reviewed this agenda sheet and approves as to form and legality.

Environmental Review:

The proposed Board action, including without limitation, an ordinance granting a term extension for a new lease between the San Diego Unified Port District and Sunroad Marina Partners, L.P., is Categorically Exempt pursuant to California Environmental Quality Act (CEQA) Guidelines Section 15301 (Existing Facilities) and Section 3.a. of the District's Guidelines for Compliance with CEQA because the project would consist of an extension of a lease for an existing resort marina that does not propose or authorize any specific new development, construction, or expansion of use beyond that previously existing and would not result in a significant cumulative impact due to the continuation of the existing use. Any future development projects, as may be proposed by the tenant during the term of the lease, would be subject to CEQA compliance and review, as applicable. 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.

The proposed Board action complies with Sections 21, 35, and 87 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 which authorizes the use of tidelands for 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 action is consistent with the Public Trust Doctrine.

The proposed Board action is considered “excluded development” pursuant to Section 8.a. (Existing Facilities) of the District’s Coastal Development Permit Regulations because the project would consist of an extension of a lease for an existing resort marina that does not propose or authorize any specific expansion of use beyond that previously existing. No further action under the Coastal Act is required.

Equal Opportunity Program:

Not Applicable.

PREPARED BY:

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Attachment(s):

Attachment A:	Location Map
Attachment B:	Term Extension Table
Attachment C:	Lease Information Summary
Attachment D:	Proposed Lease