



BPC Policy No. 355

SUBJECT: REAL ESTATE LEASING POLICY

PURPOSE: To Establish General Policies for Leasing the San Diego Unified Port District (District) Real Estate Assets

INTRODUCTION: The Real Estate Leasing Policy establishes general real estate leasing policies that have been adopted by resolution of the Board of Port Commissioners (Board). The Real Estate Leasing Policy does not supersede the District's existing leases. The attached *Administrative Practices -- Real Estate Leasing*, describes the practices and procedures to be used in establishing rent; conducting rent reviews; extending existing leases and granting options; and states the conditions for the District's approval of subleases, leasehold financing, lease assignment and lease amendment, including processing fees associated with the above. The Practices also state the District's commitment to meet and confer in good faith with the San Diego Port Tenants Association (SDPTA) regarding changes to the Practices and to conduct a public workshop on the changes when requested by the SDPTA.

POLICY STATEMENT:

1. Leasing Authority

- a. *Short-Term Leases (Five Years or Less)* – The Executive Director may, without prior Board approval, enter into leases and use permits (including Tideland Use and Occupancy Permits; rental agreements; easements; licenses; and other similar types of real estate agreements) for terms five (5) years or less in duration. The Executive Director shall provide the Board with a report each month that identifies each such tenant; location; use; area; rent; and term.
- b. *Long-Term Leases (More than Five Years)* – All leases for terms more than five (5) years in duration shall be presented to the Board for approval at a public meeting.

2. Tenant Qualifications

To become a District tenant or subtenant, the prospective tenant or subtenant and its principals shall: (i) be reputable (the absence of a reputation for dishonesty,

criminal conduct, or association with criminal elements); (ii) possess sufficient experience to conduct the proposed business; and (iii) possess the financial means to perform the tenant's obligations under the lease.

3. Rents

The District shall seek market rent when leasing its real estate assets and the District's leases shall reflect market terms and conditions. The Board retains the right to grant rent discounts, waivers or other concessions, but only after the Board has been advised of the value of the discount, waiver or concession and the reasons supporting it.

In considering whether to grant a rent discount, waiver or other concession, the Board should consider its duty to balance the promotion of fishing, navigation, commerce and public access with the obligation to the citizens of California to be fiscally self-supporting, to optimize revenues⁽¹⁾ and to reinvest proceeds in the tidelands.

4. Leasehold Improvements

District leases shall provide for tenants to maintain all improvements on their leaseholds, except for multi-tenant buildings where the District's rent includes specific maintenance responsibilities.

District leases shall provide that when a lease terminates, the District shall have the option to: (i) require the tenant to remove the tenant-owned improvements at the tenant's expense; or (ii) take title to the improvements.

5. Subleases

Short-Term Subleases (Five Years or Less) – The Executive Director may, without prior Board approval, consent to subleases for terms five (5) years or less in duration. The Executive Director shall provide the Board with a report each month that identifies each such subtenant, location, use and term.

Long-Term Subleases (More than Five Years) – All subleases for terms more than five (5) years in duration shall be presented to the Board for consent.

Subleases shall contain, as a minimum, provisions that: (i) meet current District lease requirements; (ii) provide that the subtenant shall be obligated to pay any master lease rent increases that are applicable to the subleased premises; and (iii) provide that in the event of a conflict between the master lease and the sublease, the master lease shall prevail.

¹"Optimizing revenues" refers to the District's consideration of maintaining the highest revenue stream possibly while balancing the strategic goals and objectives of the Board in managing the District's operations. Certain goals and objectives may not maximize revenues compared to other land use options; however, they may be given a higher priority due to the District's desire to maintain "balanced" operations.

6. Lease Amendments

Short-Term Subleases (Five Years or Less) – The Executive Director may, without prior Board approval, consent to amendments to leases with terms five (5) years or less in duration. The Executive Director shall provide the Board with a report each month that identifies each such tenant, location, use, area, rent and term.

Long-Term Leases (More than Five Years) - The Executive Director or their designee may, without prior Board approval, consent to amendments to leases with terms more than (5) years in duration that benefit the District, provided that terms shall not be amended to: reduce rent; increase term, reduce insurance requirements afforded to the District; or reduce indemnity granted to the District. All amendments which reduce rent, increase term, reduce insurance afforded to the District, or reduce indemnity granted to the District, must be presented to the Board for approval. The Executive Director or Port Auditor shall provide a report of all such transactions at the next available BPC meeting.

7. Transaction Processing Fees

With exceptions noted below, the District shall charge a transaction processing fee of not less than five hundred dollars (\$500.00). Exceptions include: (i) rent reviews, (ii) transactions that benefit the District (e.g., a new or renewal lease that will result in additional rent to the District), or (iii) transactions that benefit the District's properties (e.g., an easement for utilities that will serve District tenants).

Fees and costs for services and administrative activities shall be paid in accordance with any applicable District ordinance.

8. Option Term and Consideration

When entering into an option to lease agreement, the District shall charge monetary or other consideration and shall establish initial terms and extensions consistent with the processing requirements of each project, subject to adjustment as described in the Administrative Practices.

RESOLUTION NUMBER AND DATE: Resolution 2023-068, dated August 8, 2023 (Supersedes BPC Policy No. 355, Resolution 2017-012, dated January 10, 2017; Resolutions 2015-178, 2015-179 and 2015-180, dated December 8, 2015; Resolution 2013-85, dated May 7, 2013; Resolution 2011-16, dated February 8, 2011; Resolution 2010-150, dated October 5, 2010; Resolution 2008- 176, dated September 2, 2008, Resolution 2004-43, dated March 30, 2004; Resolution 2002-311 dated November 5, 2002; Resolution 98-28, dated January 27, 1998; BPC Policy No. 350, Resolution 95-244, dated July 25, 1995; BPC Policy No. 351, Resolution 95-268, dated August 22, 1995; BPC Policy No. 352, Resolution No. 92-47, dated February 18, 1992; and BPC Policy No. 354, Resolution 81-328, dated October 6, 1981)

SAN DIEGO UNIFIED PORT DISTRICT

SUBJECT: ADMINISTRATIVE PRACTICES – REAL ESTATE LEASING

PURPOSE: To Establish Fair and Consistent Guidelines for Leasing the District's Real Estate Assets

INTRODUCTION

The *Administrative Practices* are practical guidelines that implement BPC Policy No. 355, *District Real Estate Leasing Policy*. The Policy consists of general statements that are intended to encourage private investment; to promote high standards of development, operation and maintenance; and to assure that public trust assets are managed responsibly. The Practices are intended to provide clear guidelines and procedures for implementation of the Policy.

In the event the District proposes to make changes to the Practices, the District shall notify the San Diego Port Tenants Association (SDPTA) in advance and will meet and confer in good faith with the SDPTA to discuss the proposed changes. The SDPTA may request a public workshop on the changes. However, in individual lease negotiations, the foregoing does not in any way preclude the District from negotiating terms that vary in some respects from the Practices as long as the District and the tenant are in agreement.

- I. The Practices are divided into nine categories as outlined below: I. Establishing Rent and Conducting Rent Reviews
- II. Lease Extensions
- III. Leasehold Financing
- IV. Assignment of Leasehold Interest
- V. Subleasing
- VI. Lease Amendments
- VII. Trust Obligations
- VIII. Transaction Processing Fees, Port Master Plan Amendment (PMPA) Fees, and Security Deposits
- IX. Option Term and Consideration

The Practices follow:

I. ESTABLISHING RENT AND CONDUCTING RENT REVIEWS

A. Market Rent

The District should receive market rent for the leasing of its property, and rent should be adjusted to market periodically during the term of the lease. Market rent should be based on a current appraisal that complies with the *Uniform Standards of Professional Appraisal Practice*, published by the Appraisal Institute. District staff may consider other relevant information in arriving at the appropriate rent for a property. However, rent reviews for operating leaseholds shall not consider public improvements constructed by tenant either on or off the leasehold, the cost of remediation or any other incentives or concessions granted at the inception of the lease. Other exceptions to the appraisal requirement are noted below.

B. Calculation of Rent

Most District leases are either percentage leases or flat rent leases and may combine both percentage and flat rents. In a percentage lease, the District receives the greater of a minimum rent or percentages of gross income generated by the economic activities that are conducted on the premises. In a flat rent lease, the rent is a fixed amount which increases annually in accordance with the Consumer Price Index (CPI). Specific practices for percentage rent leases and flat rent leases follow.

C. Percentage Rent Leases

Market percentage rental rates tend to be relatively constant over time, and market validation of percentage rates for all of the District's revenue categories by appraisal is a major undertaking. Therefore, for determining percentage rates for new leases and rent reviews for existing leases, the District should establish benchmark appraisals by general geographic location and property type. The benchmark appraisals should be conducted on an ongoing basis by comparing the District's percentage rental rates with the percentage rental rates of other agencies including cities, counties, ports, and special districts, and should be utilized in determining rent at the rent review date stipulated in the lease.

1. Minimum rents in new percentage leases and in rent reviews should be set at no less than 75 percent of market rent as determined by the average of the tenant's previous three accounting years' rental payments, appraisal or other relevant information. For substantial redevelopment and new construction, the District may abate a portion of the minimum rent during construction when it is deemed appropriate.
2. Percentage rent leases should provide for market rent reviews every ten (10) years with mid-term adjustments to the minimum rent for changes in the consumer price index.

3. Appraisals of properties that normally rent for percentages of gross revenues (e.g., hotels, restaurants, marinas and retail stores) should consider rents and percentage rates paid on comparable ground leased properties, in addition to economic analysis and other appraisal techniques.
4. The Executive Director or their designee may, without prior Board approval, approve rent reviews for percentage rent tenants paying less than \$1,000,000 in annual rent, provided that the following conditions are met:
 - a) The proposed rent shall comport with all BPC policies including without limitation, those establishing levels of authority delegated to the Executive Director; and
 - b) The proposed leases for which rent will be adjusted that otherwise would have gone to the BPC for approval shall be provided to the BPC at least ten (10) days in advance of the Executive Director's or their designee's approval; and
 - c) The Executive Director or Port Auditor shall provide a report of all such tenant lease rental adjustments at the next available BPC meeting.

D. Flat Rent Leases

In lieu of the appraisal-based rent review process described above, flat rent tenants and the District may amend their leases to provide for adjustment to rent annually by applying the Los Angeles All-Urban Consumer Price Index (CPI) to current rent, the annual adjustments to be no less than 2% or more than 4%. Leases will be amended only in those cases where the District and the tenant agree on the amount of the starting rent as the last adjusted rent brought current by adjusting it for CPI increases from the last date of the last adjustment to the date of the lease amendment. In those cases where the District and the tenant cannot agree on the starting rent, the lease will not be amended and the current rent adjustment provisions will continue to be in force.

The Executive Director or their designee may, without prior Board approval, approve rent reviews for flat rent tenants paying less than \$1,000,000 in annual rent, provided that the following conditions are met:

1. The proposed rent shall comport with all BPC policies including without limitation, those establishing levels of authority delegated to the Executive Director; and
2. The proposed leases for which rent will be adjusted that otherwise would have gone to the BPC for approval shall be provided to the BPC at least ten (10) days in advance of the Executive Director's or their designee's approval; and

3. The Executive Director or Port Auditor shall provide a report of all such tenant lease rental adjustments at the next available BPC meeting.

E. Appraisals

1. Appraisal Exception – If the cost of an appraisal is not justified by the anticipated rents, other less expensive analysis methods may be employed to establish rent at the discretion of the Executive Director, as long as adequate market information is available to support a reasonable and fair conclusion.
2. Timely Completion of Rent Review Appraisals – The District should be prepared to submit its rent proposal to the tenant no less than sixty (60) calendar days in advance of the commencement date of the rental period under review.
3. Appraisal Assumptions Regarding Status of Property – The appraisal should reflect the value of the land as-if vacant and available for new development. The appraisal should assume that all regulatory approvals that allow the existing use have been obtained, and there should be no discount for costs and time delays associated with obtaining the regulatory approvals.

The appraisal should be consistent with the highest and best use of the property, as if vacant, on the date of value. Market conditions may support a highest and best use that differs from the existing use.

The appraisal shall not consider public improvements constructed by tenant either on or off the leasehold, the cost of remediation or any other incentives or concessions granted at the inception of the lease.

Notwithstanding the above, the appraisal must be consistent with the use restrictions and other contractual burdens placed on the land by the terms of the ground lease and Port Master Plan.

4. Appraisal of Maritime Properties – Properties that are managed by the Maritime Division, that are used for maritime purposes, should be appraised by comparison with other seaport and/or maritime industrial properties, and should consider total potential revenues including but not limited to wharfage and dockage.

F. Rent Review Process

District leases shall provide for binding “baseball appraisal” when the District and the tenant cannot agree on the new rent for a rental period under review. In baseball appraisal, a panel of three appraisers must select by majority vote either the District’s rent proposal or the tenant’s rent proposal, whichever is judged to be the closest to market rent, as the rent for the next rental period of the lease. The District and tenant each shall select one appraiser and the two appraisers will mutually select the third appraiser. All appraisers

must be qualified real estate appraisers and licensed to practice in the state of California. If the District or tenant fails to initiate the baseball appraisal process within the timeframes provided in the lease or fails to meet any of the other prescribed deadlines relating to the rent review in the lease, or fails to present an appraisal pursuant to the terms of the lease, the failing party's right to utilize the baseball appraisal process shall be deemed to be waived. Tenant shall be afforded the opportunity to meet and informally discuss with the District and three appraisers within the prescribed deadlines relating to rent review in the lease.

II. LEASE EXTENSIONS

A. Overview

The District should utilize the lease extension process to (a) promote investment in leasehold improvements, (b) encourage redevelopment, and (c) update out-of-date leases. This section provides a narrative explanation of the process the District should follow in determining whether a proposed development or redevelopment qualifies for an extended lease term, the length of the extended term, and whether there should be compensation to the District for extending the term. A decision tree flowchart outlining the general process to be followed when a tenant requests a lease extension is presented in this section.

B. Lease Extension Practice and Decision Criteria

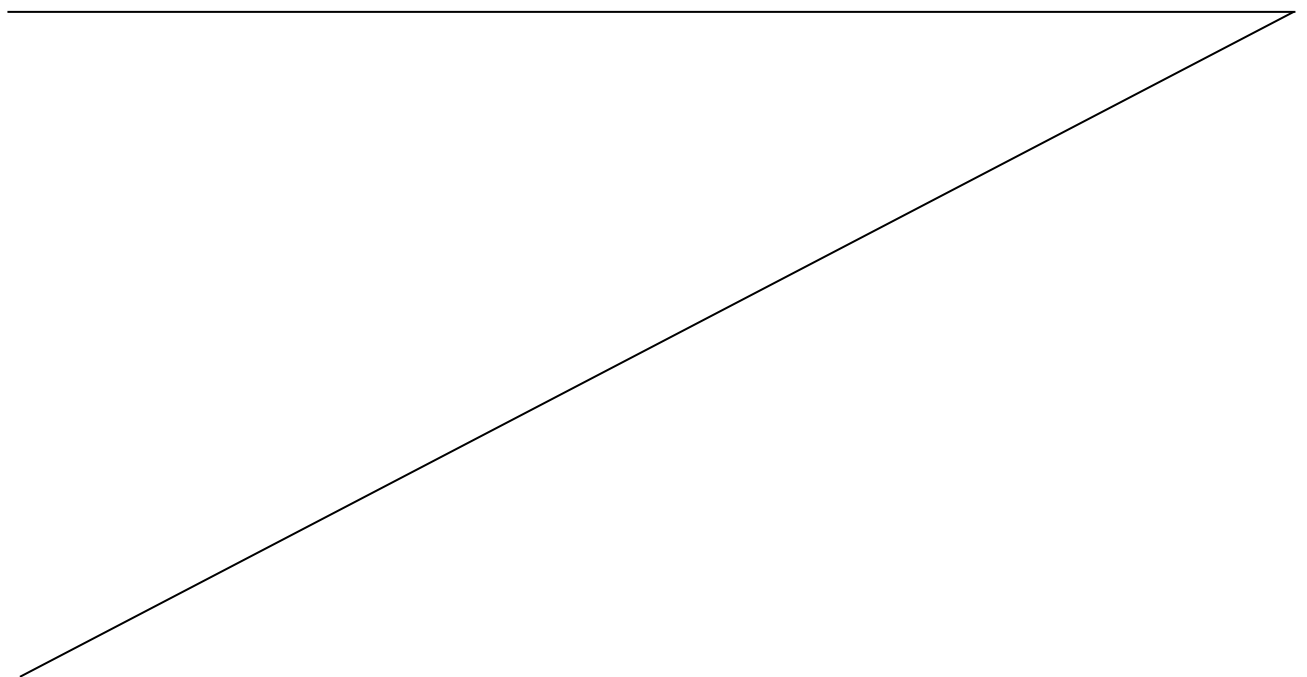
1. Tenant Requests a Lease Extension – The submission package should include the following information:
 - a) Description of the development concept and the proposed project sufficient for the District to understand precisely the scope of the entire development concept, which may include renderings and drawings showing a scaled site layout, interiors and exteriors of all significant buildings, parking lot layout, landscape development and layout, preliminary sign concept, pier and marina slip layout (if applicable) and any other prominent features.
 - b) Evidence that the tenant qualifies as a “tenant in good standing” (defined below).
 - c) Any proposed changes to ownership.
 - d) Description of the development team and its qualifications.
 - e) Proposed lease extension terms (including if applicable minimum rent, percentage rent by use, and compensation to the District for deferral of its reversionary improvement value as provided in this section), and justification for such terms.

- f) Financial feasibility of the extension including pro forma cash flows (if applicable).
 - g) Anticipated development cost with qualifying Capital Investments (as defined in Section II(C)2), repair and maintenance, and furniture, fixture and equipment items separately identified. To the extent that District does not believe that a submittal is a qualifying Capital Investment, at the request of the District, tenant shall be required to submit supporting documentation for items characterized as Capital Investment in the proposal.
 - h) Justification that the existing operator is capable of optimizing the use and return to the District, thereby negating the need for a Request for Proposal process.
 - i) Justification that the tenant has the expertise and financial capability to develop and operate the property when the proposed development is different from the existing use.
2. Proposal Consistent with Master Plan – Initially, the District should determine if the proposal is consistent with the Port Master Plan. Inherent in this decision is the assumption that the planning process utilized in developing the Master Plan evaluated the potential for the highest and best use for the property, the goals of the District and the input of the local community. If the proposal is not consistent with the Master Plan, the District may reject the proposal at its sole discretion.
 3. Proposal Consistent with the District's Vision for Future Use of the Property – If the proposal is not consistent with the District's vision for the future use of the property as determined by the Board in its sole and absolute discretion, the District should not negotiate a lease extension.
 4. Qualification as a "tenant in good standing" – To qualify for a lease extension, the tenant should be considered a "tenant in good standing." The criteria should include a review of the tenant's history with respect to the following:
 - a) Maintenance of the leasehold in good condition, free of deferred maintenance.
 - b) Prompt payment history.
 - c) Compliance with the provisions of the current lease, including use provisions, insurance requirements and regulatory permitting processes.
 - d) Maximization of the gross revenue of the tenant's business.

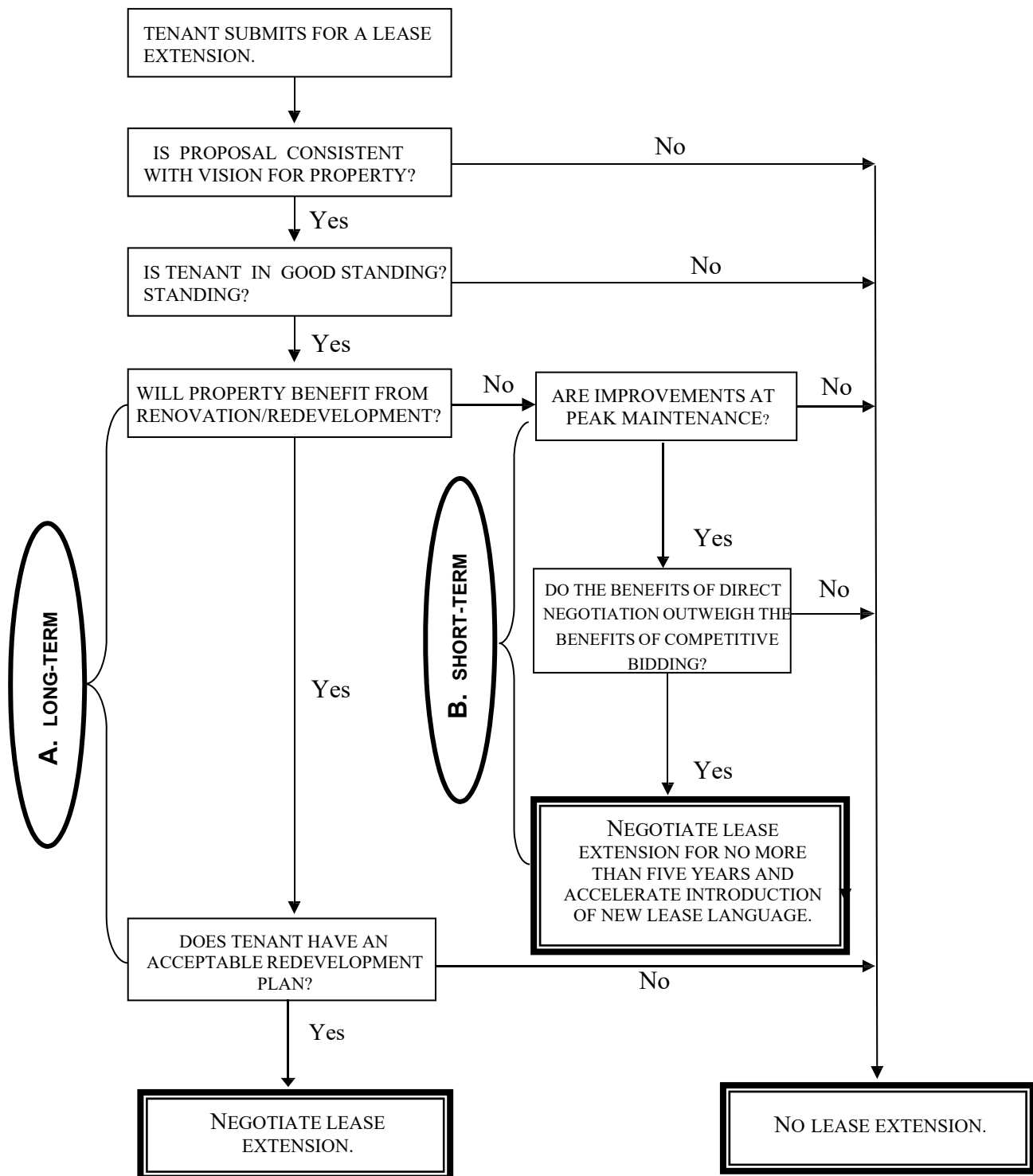
- e) Maintenance of accurate financial records that are accessible to the District.
- f) Compliance with District policies on public accommodation and non-discriminatory employment and contracting.

If the existing tenant does not meet the requirements for a “tenant in good standing,” then no lease extension should be negotiated.

- 5. Benefit from Renovation or Redevelopment – Renovation or redevelopment contemplates making capital investments in the property that would allow for business expansion, modernization of facilities, aesthetic enhancement; or that maintain or increase the existing revenue stream to the District by expansion of the existing improvements or repositioning the property to a higher standard of quality.
- 6. Acceptable Development Plan Presented by the Tenant – If the property would benefit from renovation or redevelopment, the District must decide if the existing tenant has presented an acceptable redevelopment plan. The District and the tenant would then enter into negotiations that would result either in a plan acceptable to the District, or a decision that the existing tenant is not capable of implementing an acceptable redevelopment plan.
- 7. Process for Extending Leases – If a proposed project is consistent with the District’s vision for the future use of the property, and the proposal meets the other criteria described above, the District should negotiate a new lease based on the following flow chart and requirements:



LEASE EXTENSION PROCESS



C. Lease Extension Negotiation

If the District and tenant agree to an acceptable redevelopment plan, lease extension negotiations should proceed, with the following considerations:

1. Calculation of Extended Term – The extended lease term should be based on the magnitude of Capital Investment in the property to be made by the tenant and the life expectancy of the development. The extended lease term may include past Capital Investment in the property submitted to the District for approval in accordance with District policy and the process outlined in the lease and approved by the District as long as it has not already been credited towards a previous lease extension. The District may wish to consider other relevant information in determining if a longer lease term is warranted, such as if the Capital Investment is expected to generate above average returns to the District, or will reposition the property to a higher standard of quality. Improvements completed without following submittal guidelines to the District, including notification to the District and a determination by the District whether the improvements qualify for a lease term extension, will not be considered for a lease term extension. A method of calculating the potential lease term extension is outlined below:
 - a) Determination of the estimated total replacement cost of the leasehold improvements as renovated/redeveloped. Cost figures can be determined utilizing resources such as tables provided by Marshall Valuation Service (or other industry standard cost estimating resources), or known development costs of comparable projects.
 - b) Determination of the life expectancy of the fully redeveloped project. The maximum lease term should be consistent with life expectancy of the improvements that qualify as Capital Investment in the property. Life expectancy guidelines are presented in a table at the end of this section. Lease term extensions granted after five years of the District's approval of the tenant's redevelopment plan will consider depreciation in improvements unless they were approved as part of a larger project. Depreciation shall be calculated utilizing the straight-line depreciation method.
 - c) Computation of the ratio of Capital Investment in the property to total replacement cost.
 - d) Determination of the additional lease term by multiplying the ratio obtained in (c) by the life expectancy obtained in (b). The term in an extended lease shall not exceed the life expectancy of the development.

2. Qualifying Capital Investment

- a) “Capital Investment” for purposes of calculating the lease extension term should only include expenditures that usually increase the value (efficiency, productivity, or use utility) or the life expectancy of the improvements; cannot reasonably be amortized during the existing remaining term; are not recurring in nature; and are: (a) \$100,000 or more, or (b) 10% of the value of the improvements or more. It should specifically exclude deferred maintenance and expenditures for repairs to keep the existing improvements in good condition. Items that separately would not qualify for lease term extension may be considered collectively as part of an overall plan of renovation or redevelopment. In a renovation or redevelopment project, qualifying Capital Investment may include, at the sole discretion of the District, the value of superior improvement condition. The intent is to recognize the efforts of a tenant who maintains improvements in like-new condition in the latter stages of the lease term. The value of superior improvement condition may be measured by documented costs, or by replacement cost and depreciation tables such as those published by Marshall Valuation Service. Public art expenditures should be included as Capital Investment. Non-realty property may be given consideration depending on property type. An example of this would be the purchase by industrial tenants of specialized fixtures or equipment that are necessary for its operation. If lease term is granted for a Capital Investment in non- realty property, the new lease should include a provision requiring that the non-realty property (or an equivalent replacement as approved by the District) remain in place for the entire lease term. Purchase of District-owned improvements may be considered a qualifying Capital Investment. The cost of environmental cleanup is specifically excluded as a qualifying Capital Investment.
- b) If the Capital Investment will be undertaken in phases, then the tenant must identify the timeline for completion of all improvements in the tenant project application.
- c) The District may consider a lease term extension without Capital Investment in exchange for payment for deferral of the District’s reversionary interest.

- 3. Payment for the Deferral of the District’s Reversionary Interest – The standard District lease gives the District the right to assume ownership of the improvements at the end of the lease. During the lease, this reversionary interest in the improvements may have a value that can be estimated using accepted appraisal techniques. In exchange for granting a lease extension, the tenant should recognize that the District may be deferring the realization of a valuable

reversionary interest in the existing improvements. The tenant should compensate the District by an amount equal to the value of the interest being deferred. This amount can be paid in full at the commencement of the lease, incorporated as additional rent with interest over a specified period of time, or may be used to offset the tenant's cost of developing new public access infrastructure on or off the leasehold such as parks and promenades at the District's sole and absolute discretion.

If there is an economic benefit to the District, such as higher rent or the prevention of deteriorating rent, as a result of a Capital Investment by the tenant and the term extension, the economic benefit should be used to offset all or part of the compensation for deferral of the reversionary interest.

In estimating the reversionary improvement value, the market capitalization rate used should reflect value components that are related to superior management on the part of the tenant, including going-concern value, goodwill, and above-average maintenance; and for furniture, fixtures and equipment.

a) *Percentage Rent Leases* – A conceptual method of calculating the value of the deferral of the reversionary interest in percentage rent leases would be as follows:

(1) *Value of Deferred Reversionary Interest* – The value of the deferred reversionary interest can be estimated by projecting the operating income and expenses, based on the existing development, to the end of the existing lease term, using market-supported assumptions about operating income, expenses and inflation; and capitalizing the net income into an indication of leased fee value. The present value of the leased fee interest at the end of the existing lease term can then be calculated. Following the same procedures, the present value of the leased fee interest at the end of the extended lease term can be calculated. The value of the District's deferral of the reversionary interest is the difference between the present value at the end of the existing term and the present value at the end of the extended term, and represents the amount to be compensated to the District, subject to any offsetting economic benefit described below.

(2) *Value of Economic Benefit to the District* – The difference between the present value of the rent to the District for the proposed development, projected over the remainder of the existing term, and the present value of the rent to the District for the existing development projected over the remainder of the existing term, is a measure of the economic benefit to the District

resulting from the investment by the tenant. The economic benefit should be used to offset all or part of the value of the compensation for deferral of the District's reversionary interest.

- b) Flat Rent Leases – A conceptual method of calculating the value of the deferral of the reversionary interest in flat rent leases would be as follows:

(1) *Value of Deferred Reversionary Interest* – The projected replacement cost of the improvements at the end of the existing term can be estimated by trending the current replacement cost by the anticipated rate of inflation. The projected reversionary improvement value can be estimated by subtracting depreciation from the projected replacement cost. The present value of the reversionary improvement value at the end of the existing term can then be calculated. Following the same procedures, the present value of the reversionary improvement value at the end of the extended lease term can be calculated. The value of the District's deferral of the reversionary interest is the difference between the present value at the end of the existing term and the present value at the end of the extended term, and represents the amount to be compensated to the District.

(2) *Value of Economic Benefit to District* – The present value of increased rent through the end of the current rental period, negotiated as part of a lease extension, shall be used to offset compensation for deferral of the reversionary interest in flat rent leases.

4. Timely Submission by Tenant and Response by District – District staff will respond to a request for a lease extension within thirty (30) calendar days following receipt of a request for a lease extension. The initial response shall either recommend the proposal for project review and California Environmental Quality Act (CEQA) review, or request additional information that the District believes was not included or was not adequately addressed in the initial submittal. The Tenant may re-submit within sixty (60) calendar days of the District's initial response. District staff will respond to the re-submittal within thirty (30) calendar days. Subsequent responses to project submittals will follow the same schedule.
5. Market Rent – The rent in an extended lease should be updated to the current market rent as negotiated between the tenant and the District.
6. New Lease Provisions – Upon negotiation of the extended lease term, the new rent and the amount of payment, if any, for deferral of the District's reversionary interest in the improvements, the existing lease shall be superseded by a new lease incorporating the District's

current standard lease terms. The tenant's liability for hazardous materials in the prior lease shall continue in the new lease. The tenant will indemnify the District against potential third party challenges to the CEQA review and/or determination process and agrees to reimburse the District for actual, reasonable and necessary third-party out-of-pocket expenses associated with processing a redevelopment project including but not limited to the preparation and certification of the CEQA document by the Board, the preparation and approval of the PMPA by the Board and the California Coastal Commission (CCC), the preparation and issuance of an appealable CDP by the Board or, if appealed, the CCC, and any other third-party expenses arising out of the entitlement process in the District's determination. District shall use commercially reasonable efforts to manage expenses.

7. "Basket of Issues" – While it is desirable to have a "standard" negotiation process, the lease extension process involves a "basket of issues" with each tenant. The District should be willing to negotiate each extension separately and take into account the unique circumstances of each request.
8. Short-Term Lease Negotiation – An existing tenant may qualify for an extended term under the criteria outlined above, but the property may not qualify as the highest and best use under the Port Master Plan, or may not be consistent with the District's vision for the future use of the site. In other cases, all the criteria for a long-term lease extension may have been met but the property may not benefit from renovation or redevelopment (i.e., the improvements are in excellent condition and represent highest and best use). In either event, upon lease expiration, the District may consider a new short-term lease with the existing tenant with the following four considerations:
 - a) *Lease Term* – The lease term should be no more than five years. This will create a term short enough to enable the District to periodically evaluate if the current use remains the highest and best use of the property consistent with the District's goals and objectives and the Port Master Plan.
 - b) *Payment for District-Owned Improvements* – The tenant should pay market rent for improvements it occupies that are owned by the District after expiration of the existing lease term.
 - c) *Rent* – The rent would be updated to the current market rent as negotiated between the tenant and the District.
 - d) *New Lease* – A new lease shall be executed including the District's current standard lease language.

9. Recommended Life Expectancy Guidelines – The length of a new or extended lease term should be based on the reasonable life expectancy of the improvements that qualify as Capital Investment. Life expectancies vary by use. Improvements that are subject to relatively high physical deterioration or functional obsolescence caused by market changes have *relatively* short life expectancies. Improvements that are physically more substantial and less affected by market changes have relatively long-life expectancies.

The guidelines shown below were developed based on practical experience and observations, and by reference to the life expectancy tables published by *Marshall Valuation Service*.

ECONOMIC LIFE EXPECTANCY GUIDELINES

PROPERTY TYPE	TERM*
HOTEL	40 TO 66 YEARS
FULL-SERVICE RESTAURANT	20 TO 40 YEARS
RETAIL SALES	30 TO 45 YEARS
COMMERCIAL OFFICE	30 YEARS
LAND SERVICE STATION	20 YEARS
MARINE SERVICE STATION	20 YEARS
MARINA	40 YEARS
SPORTFISHING LANDING	20 YEARS
BOAT EXCURSION LANDING	15 YEARS
BOATYARD	30 YEARS
SHIPYARD	50 YEARS
LUMBERYARD	25 YEARS
AIRPORT INDUSTRIAL	25 YEARS
OTHER INDUSTRIAL	50 YEARS
YACHT CLUB	35 - 45 YEARS

* The Terms outlined above represent the recommended length of term a tenant may receive for each respective property type. Shorter terms, or a combination of shorter terms with options to extend, may be appropriate to ensure an appropriate level of quality and maintenance of the improvements.

III. LEASEHOLD FINANCING

A. Consent to Financing Subject to Specific Criteria

The required minimum documentation to be submitted by the tenant in support of a request of the District to consent to new financing and standards for financing consent are as follows:

1. Initial documentation should include the term sheet, application or commitment, cash flow projections, appraisal submitted to the lender, and the most recent annual financial statements of the tenant (if it is a percentage lease) for at least the past two years.
2. When available, final loan documents should be provided.
3. Maximum loan proceeds should not be in excess of the greater of 75% loan-to-value as determined by the lender's appraisal, or the amount of repayment of existing financing (provided that such financing was initially consented to by the District).
4. A loan should have a maturity date that does not exceed the remaining ground lease term.
5. A tenant should acknowledge that it will not seek rent relief as a result of not being able to meet its debt service or debt repayment obligations.
6. The District shall either:
 - a) Receive a share of the proceeds of refinancing, except proceeds which are reinvested in District-owned land or water, replace existing financing, or reimburse the tenant for documented equity investment, or
 - b) Have the right to adjust the rent to market rent.
7. There should not be any restrictions on how the tenant utilizes the proceeds of financing (as long as the District is satisfied that proper underwriting guidelines are met).

If the District staff is satisfied that the above criteria have been met, its recommendation for consent to the new financing shall not be unreasonably withheld.

B. Timely Response to Request for Leasehold Financing

District Staff should have completed its recommendation on consent to the financing of a leasehold interest within forty-five (45) calendar days of

receipt of all required information. Staff's recommendation for consent shall not be unreasonably withheld.

C. Administrative Approval of Routine Financing

The Executive Director or their designee may, without prior Board approval, approve tenant leasehold financing, provided that the following conditions are met:

1. The proposed tenant leasehold financing shall comport with all BPC policies including without limitation, those establishing levels of authority delegated to the Executive Director; and
2. The proposed tenant leasehold financing that otherwise would have gone to the BPC for approval shall be provided to the BPC at least ten (10) days in advance of the Executive Director's or their designee's approval; and
3. The Executive Director or Port Auditor shall provide a report of all such tenant leasehold financing approvals at the next available BPC meeting.

IV. ASSIGNMENT OF LEASEHOLD INTEREST

A. Consent to Assignment Subject to Specific Criteria

The required documentation to be submitted by the tenant in support of a request of the District to consent to an assignment of the leasehold and standards for assignment consent are as follows:

1. The tenant shall complete UPD Form No. 317, Lessee's and Sublessee's Questionnaire for All Leases (and Subleases of More than Five Years).
2. If new financing is involved in the sale, the proposed tenant shall provide the information required above under Leasehold Financing.
3. The District must be satisfied that the lessee possesses the financial capacity, a good reputation and managerial ability to operate successfully on the leased premises.
4. The District shall either receive a share of the proceeds of a sale or have the right to adjust the rent to market rent as a condition of its consent. This right does not apply to an assignment that changes the method of holding title but does not change the proportional ownership interests of the individuals, nor does it apply to transfers between spouses or immediate family members.

B. Timely Response to Request for Assignment of Leasehold Interest

District staff should have completed its recommendation on consent to the assignment of a leasehold interest within forty-five (45) calendar days of

receipt of all required information. Staff's recommendation for consent shall not be unreasonably withheld.

C. Administrative Approval of Routine Assignments of Leasehold Interest

The Executive Director may, without prior Board approval, approve an assignment of leasehold interest if the assignment results in no change of control, operations or management of the ownership entity of the tenant.

V. SUBLEASING

A tenant may sublease all or part of its leased premises to a qualified subtenant, subject to consent by the District. The appropriate District-supplied Sublease Questionnaire form must be completed and submitted to the District. Consent by the District must be obtained prior to occupancy by the sublessee.

A. Sublease Consent Criteria

Staff's recommendation for consent to a sublease shall be made in accordance with the following criteria:

1. The District must be satisfied that the sublessee will use the property in a manner that is consistent with uses allowed by the lease.
2. The District must be satisfied that the sublessee possesses the financial capacity, a good reputation and managerial ability to operate successfully on the subleased premises.
3. The District reserves the right to adjust the rent the District receives to market for the subleased portion of the property.
4. The District must be satisfied that the sublease transaction will not have a significant negative impact on the District.

B. Timely Response by the District

For a short-term sublease (five years or less), District staff should respond with its recommendation regarding consent within thirty (30) calendar days of receipt of all necessary information, and for a long-term sublease (more than five years), District staff should respond within sixty (60) days.

VI. LEASE AMENDMENTS

A tenant may request amendments to a lease that could range from minor changes to extensive revisions. The District's consent to a request for lease amendment may be contingent upon updating sections of the lease to incorporate current standard lease provisions, and may include an adjustment to market rent, depending upon the extent of the proposed tenant requested revisions.

A. Lease Amendment Consent Criteria

Staff's recommendation for consent to a lease amendment shall be made in accordance with the following minimum criteria:

1. The allowed uses of the property stated in the amended lease must be in compliance with the Port Master Plan and with the District's vision for the future use of the property.
2. Amended sections of the lease must conform with the District's standard lease language in effect when the request for a lease amendment is made.
3. For a change in the method of holding title that does not change the proportional ownership of the individuals, or that represents a transfer between spouses or immediate family members, a complete lease update and rent adjustment would not be made. Standard provisions regarding hazardous materials, underground storage tanks and above-ground storage tanks should be added (unless they are already in the lease).
4. In some cases (e.g., changing from a sole proprietorship to a limited liability company), it may be advisable to have the principals personally guarantee lease performance.
5. A proposed lease amendment for financing or for a transfer or a partial or full interest in the leasehold would be governed by Sections III and IV of these Practices.

B. Timely Response by the District

For a short-term lease (five years or less), District staff should respond with its recommendation regarding consent within thirty (30) calendar days of receipt of all necessary information, and for a long-term lease (more than five years), District staff should respond within sixty (60) days.

VII. TRUST OBLIGATIONS

For tenants claiming special treatment under the Port District Act, the District should determine market rents consistent with the property's land use. Any discount to market rent or other concession should be supported by a tenant's written proposal that would outline why the discount is warranted, if there is a public benefit, the financial rationale for the request and the proposed economic terms. The proposal should be presented to the Board, which would determine if a concession is warranted.

VIII. TRANSACTION PROCESSING FEES, PORT MASTER PLAN AMENDMENT (PMPA) FEES, AND SECURITY DEPOSITS

A. Transaction Processing Fees

With exceptions noted below, the District shall charge a transaction processing fee of not less than five hundred dollars (\$500.00). Exceptions include (i) rent reviews, (ii) transactions that benefit the District (e.g., a new or renewal lease that will result in additional rent to the District), or (iii)

transactions that benefit the District's properties (e.g., an easement for utilities that will serve District tenants).

B. Port Master Plan Amendment (PMPA) Fees

If a tenant project requires a PMPA, then the tenant must pay for the cost of preparing the PMPA and any associated CEQA documentation. If a tenant project requires a PMPA, and the District is currently pursuing or will be pursuing a PMPA into which the tenant's project will be incorporated, then the tenant must pay for a pro-rata share of the cost of preparing the PMPA and any associated CEQA documentation. If a tenant project does not require a PMPA, but the District is currently pursuing or will be pursuing a PMPA into which the tenant's leasehold will be incorporated, then the tenant will not be charged a pro-rata share of the cost of preparing the PMPA and any associated CEQA documentation.

C. Security Deposits

The standard security deposit for a new rental agreement is three months' rent. A security deposit may be waived for a short-term rental of property that supports a tenant's long-term lease. The security deposit may be reduced for a tenant that has been in good standing for five or more years. For a tenant making a substantial investment in improvements, the security deposit will be refunded upon completion of the improvements.

IX. OPTION TERM AND CONSIDERATION

Generally, proposed projects including but not limited to a change in use, additional lease term, financing, and issuance of permits will be memorialized in an option agreement and lease. If District staff negotiates an option, then recommendations regarding option term and consideration, including extensions, must be based on this section of the Practices. Recommendations which include adjustments to option term and consideration, if any, must be based on the factors described in Section (3) below.

A. Term

Calculating Initial Option Term and Option Term Extensions. The District recognizes that there is uncertainty in every entitlement process. As a result, District staff's recommendation regarding initial option term and extensions must be based on a cooperative assessment of the approval process and timeline for a proposed project and its associated risks.

For existing tenants with options with no change in use or a change in use that does not require a Port Master Plan Amendment, the initial minimum option term will be 18-24 months. In all other cases, the term will be 24-36 months. Term extensions are subject to negotiation as needed.

B. Consideration

Calculating Initial Option Consideration and Option Term Extension Consideration.

1. Consideration – Consideration may take the form of a monetary payment or a quantifiable benefit to the District. Examples of quantifiable benefits include but are not limited to construction of or enhancements to a District-owned asset and assuming contingent legal liabilities for District actions. Consideration does not include transaction processing fees, which may be assessed independently according to a schedule established by the District.
2. Initial Option Consideration – Initial option consideration is determined by whether the option covers a tenant's existing premises, new premises, or a combination of new and existing premises.
 - c) *Existing Premises Only* - If the option covers the existing premises only, then consideration is not required unless a Port Master Plan Amendment is required for the option. If a Port Master Plan Amendment is required, consideration is based on the following table:

Lease Type	Consideration
Percentage Rent	25% of difference between projected first year's minimum annual rent and current minimum annual rent
Flat Rent	25% of annual rent difference if an appraisal is performed or 5% of annual rent

- d) *New Premises Only* - Whether or not a Port Master Plan Amendment is required, if the option covers new premises only, then consideration is based on the following table:

Solicitation Type	Consideration
Sole Source	25% of projected first operating year's minimum annual rent
RFQ/RFP	25% of projected first operating year's minimum annual rent

- e) *New Premises and Existing Premises* - Whether or not a Port Master Plan Amendment is required, if the option combines both new premises and existing premises, then consideration is 25% of the difference between the projected combined first year's minimum annual rent and the existing premises minimum annual rent.

3. Option Term Extension Consideration – Option term extension consideration is subject to negotiation. The following establishes a baseline for calculating option term extension consideration which may be subject to adjustment.

For existing tenants with proposed projects that do not require a Port Master Plan Amendment, extension consideration is not required.

In all other cases, option term extension consideration will be prorated based on the initial option term and consideration. For example, if the initial option term is 24 months and the consideration is \$240,000, then each additional month of option term extension would require an additional \$10,000 in consideration.

C. Adjustments

Factors Justifying Adjustments to Option Term and Consideration. District staff may recommend to the Board reducing or increasing the term and consideration for options and extensions described in Sections (1) and (2) above. Any recommended adjustment must be justified by one or more of the following factors:

1. Assumption of District Obligation – An optionee may assume the liability for the cost of a District obligation.
2. Improvements or Work Performed at Tenant's Risk – An optionee may construct improvements or perform work with no guarantee that the option may be exercised.
3. Accelerated Performance – An optionee may be incentivized to exercise its option prior to the scheduled expiration.
4. Social or Community Benefits – Non-profit tenants such as yacht clubs, museums, and performance of obligations that benefit the public - including development and maintenance of public parks or promenades - may justify a reduction in consideration.
5. Market Conditions – Market conditions may impact the District's bargaining position including, but not limited to, inferior site locations, difficult markets, economic conditions, and costly entitlement processes.
6. Inability to Obtain Financing – The District's option agreements do not allow the optionee's lack of ability to obtain financing to serve as a reason for not exercising an option. However, the District has extended options because financing was not yet in place or ready to close. In instances where a documented catastrophic market cycle (such as the market cycle impacting financing during 2009-2010) prohibits an optionee's ability to obtain financing the District should

consider the status of financing in its justification for granting additional term and for reducing or eliminating consideration for an extension. The optionee's inability to obtain financing because of inadequate equity investment in a project should not be considered as a justification for force majeure extensions.

7. Force Majeure Delays – Listed are examples of Force Majeure delays that could result in the reduction or elimination of option consideration if an extension is issued (i) delays caused by litigation that prevents the optionee from performing under the option terms (CEQA or CCC challenges); (ii) documented delays in permitting outside the optionee's control and beyond the time frames agreed to for complete application submittals, including administrative appeals; (iii) documented delays to obtain entitlements from regulatory agencies outside the optionee's control.

**ADDENDUM TO BPC POLICY NO 355 ADMINISTRATIVE PRACTICES REAL
ESTATE LEASING**

REPORT OF YACHT CLUB LEASING POLICY AD HOC SUBCOMMITTEE

**RECOMMENDATION TO THE BOARD OF PORT COMMISSIONERS OF THE
SAN DIEGO UNIFIED PORT DISTRICT**

At its December 8, 2003 meeting, the Subcommittee voted to recommend that the Board adopt a resolution directing staff to supplement the BPC Policy 355 leasing practices as follows:

1. The present yacht club leases shall be amended to delete the rent review provision for 2006 and substitute a rent adjustment equal to the change in the Consumer Price Index for the Los Angeles area for the years 2001 - 2005.
2. Upon the grant of a new lease, whether after expiration of the current lease or by reason of the satisfaction of option requirements for redevelopment of the leasehold that result in a new lease earlier than expiration of the current lease, rent shall be paid at the greater of Fair Market Rent or Minimum Rent. Fair Market Rent shall be percentage rent calculated as follows:
 - (a) From the commencement of the new lease to December 31, 2011, 8.25% of gross revenues;
 - (b) From January 1, 2012 through December 31, 2012, 8.80% of gross revenues;
 - (c) From January 1, 2013 through December 31, 2013, 9.35% of gross revenues;
 - (d) From January 1, 2014 through December 31, 2014, 9.90% of gross revenues;
 - (e) From January 1, 2015 through December 31, 2015, 10.45% of gross revenues;
 - (f) From January 1, 2016 through December 31, 2016, 11.0% of gross revenues;

- (g) From January 1, 2017 through December 31, 2026, Fair Market Rent shall be calculated by multiplying gross revenues by a blended rate adjusted by an appraisal of the concession rates on each revenue category; the new blended rate shall be adjusted by applying an adjustment as follows:

(The sum of all current concession rates plus the sum of all changes to the concession rates divided by the sum of all concession rates) multiplied by the current blended rate will equal the new blended rate. The current concession rate is comprised of the following: dues @ 5.0%; slips, dry storage and lockers @ 22.0%; member food and beverage @ 3.0% and 5.0% respectively; catered food @ 7.0%; catered beverage @ 7.0%; and ships store @ 10.0%. The sum of all concession rates equals 59.0%

Example: Currently, the blended rate is 11.0% and the sum of the concession rates is 59.0%. If, for example, the slips, dry storage and locker concession rate increases by 2.0% (from 22.0% to 24.0%), the computation of the new blended rate would be expressed arithmetically:

$$[(59+2) \div 59] \times 11.0\% = 1.0338 \times 11.0\% = 11.37\%$$

- (h) On January 1, 2027 and each succeeding tenth anniversary thereafter, the concession rates shall be reappraised and adjusted as set forth in (g) above.
- (i) Minimum Rent starting on January 1, 2022 and every ten years thereafter shall be adjusted by the corresponding increase in the Consumer Price Index for the Los Angeles area for the prior ten years from the minimum rent in effect in 2012. For purposes of determining the CPI base for calculating the Minimum Rent in 2022, the Fair Market Rent in 2012 shall be adjusted by the appropriate CPI increase over the 10-year period. The increase shall not be less than 3.0% per annum or greater than 5.0% per annum. In any year immediately following a rent adjustment as the result of an appraisal of the concession rates, the rent for that year and each successive year shall be determined by the greater of 75.0% of the actual rent paid the prior year or the Minimum Rent or the Fair Market Rent; and

- (j) For purposes of calculating rent, gross revenues shall only include: dues, member food and beverage, catered food and beverage, slips, dry storage and lockers and ships store. Gross revenues shall not include revenues for junior sailing programs, outstation locations not on District property, initiation fees or interest income as well as any amounts set aside by the yacht clubs for Capital Investment or the debt on Capital Investment, whether such amounts are collected as special assessments, dues, percentage of slip rents, or otherwise.
- 3. New yacht club leases shall be for a maximum term of 40 years provided all the requirements for achieving maximum lease term are met.
- 4. Financial statements detailing operating revenues and sources, cash flows, capital reserves and capital expenditures, as well as sources of capital amounts, shall be provided annually no later than 120 days following the end of each club's fiscal year.