



DATE: SEPTEMBER 11, 2015

FROM: WATERFRONT & COMMERCIAL REAL ESTATE

**SUBJECT: RESOLUTION NO. _____ - PROPOSED FIRST AMENDMENT
TO PERMIT NO. 896 WITH CRAFTED AT THE PORT OF LOS
ANGELES**

SUMMARY:

Permit No. 896 was granted to Crafted at the Port of Los Angeles (Crafted) for use of City of Los Angeles Harbor Department (Harbor Department) property as a sub-landlord of a visitor-serving arts and crafts public marketplace and tourist attraction with incidental specialty commercial uses including, but not limited to, restaurant and/or food carts, parking, special events, and other ancillary uses. Permit No. 896 became effective December 16, 2011 for a term of 25 years with two five-year options to extend.

Due to various market and development issues, a wider range of uses is necessary to attract a more diversified and substantial tenant base. The proposed expansion of uses permitted to operate on the premises are intended to broaden and increase Crafted's project revenue to offset higher than expected development costs related to the condition and age of the warehouses. An expanded tenant base should also bolster the existing craft marketplace, which has experienced delayed market absorption. Consent for sublease for proposed new uses including a brewery and solar development will be considered by the Board along with a first amendment that will propose revisions to the use, compensation, indemnification and insurance provisions of Permit 896.

RECOMMENDATION:

It is recommended that the Board of Harbor Commissioners (Board):

1. Approve the First Amendment to Crafted at the Port of Los Angeles Permit No. 896;
2. Direct the Board Secretary to transmit the First Amendment to the City Council for approval pursuant to Charter Section 606 of the City Charter;
3. Authorize the Executive Director to execute and the Board Secretary to attest to the First Amendment to Permit No. 896;
4. Consent to the sublease with The Brewery at Warehouse Nine, LLC;

SUBJECT: FIRST AMENDMENT TO PERMIT NO. 896

5. Consent to the solar facilities sublease with PermaCity Construction Corp., and the assignment of PermaCity's sublease to California PV Energy, LLC;
6. Adopt the matters set forth in this Board Letter and findings set forth herein, including the finding that the deviation from the Board's policy rate of return is justified given that the rate of return valuation methodology using comparable land values is not a generally accepted valuation methodology for this type of commercial ground lease by appraisers or similarly situated municipal ground lessors; and
7. Adopt Resolution No. _____.

DISCUSSION:

Background/Context – As part of the San Pedro Waterfront Project, Warehouse Nos. 9 & 10 (Transmittal 1) were identified for adaptive reuse. Crafted was the successful respondent to the Request for Interest (RFI) released by the Harbor Department. On December 16, 2011, the Harbor Department granted Crafted Permit No. 896 to transform the premises into an arts & crafts center to bring a new mix of visitors and more interest to the waterfront. Permit No. 896 has a 25-year term with two five-year renewal option periods. The warehouses were slated to host a community of one-of-a-kind local artists, handmade goods, gourmet concessions, live music, and entertainment. The planned indoor venue has 140,000 square feet (s.f.) between both warehouses, with vendor stalls and a large outdoor courtyard.

Change in Use – The initial development cost to renovate the warehouses was anticipated to be \$3,500,000. Permit No. 896 requires Crafted to invest \$4,000,000 in the property by the end of 2016. Significant additional costs were incurred following commencement of construction due to deferred maintenance and the 70-year age of the building. Crafted's estimated investment to date is approximately \$4,100,000, with significant internal improvements remaining at Warehouse 9. Crafted projects to spend an additional \$1,000,000 to complete renovation of both warehouses. Additional funding will be required to complete grounds improvements.

Initially, it was anticipated that there would be 500 subtenants selling unique handmade crafts occupying both warehouses by the project's full build-out. Within two years of commencement of operations, it became evident that the market demand for subtenants was not achievable and Crafted would need to revise their business plan to be successful. As part of its business plan revision, subleases have been secured with Brouwerij West and PermaCity. These proposed subleases will provide additional sources of revenue and will increase utilization of Crafted's premises.

Consent to the Subleases – Section 13.2 of Permit No. 896 provides for the procedure to obtain the Board's consent to subleases, which shall not be unreasonably withheld.

Tenant Transfers of Interest – Section 13 of the Permit (Transmittal 2) provides the process for approving transfers of interests, such as the non-craft vendor subleases between Crafted and Brouwerij West, PermaCity and Cal PV Energy, respectively. Transfers of interest in the Permit are prohibited unless processed and approved pursuant to Section 13. Under Section 13.2, Crafted was required to submit a document called a "Transfer Notice" that provided specific items of information

SUBJECT: FIRST AMENDMENT TO PERMIT NO. 896

concerning each transfer for which it desires the Board's approval. Section 13 requires Crafted to submit Transfer Notices prior to the transfer, but does allow after-the-fact submittals on a case-by-case basis. Should the Board consent to the transfers recommended herein, certain limitations will apply, pursuant to Section 13.2.2.

As a general matter, staff performs independent due diligence after receipt of a Transfer Notice to determine the transaction's compliance with Section 13 and the other terms of the Permit. As set forth in Section 13.3, the factors germane in determining whether to grant, deny or condition consent to a transfer include: (a) the net worth, financial condition and creditworthiness of the transferee and the existence of any guaranty provided by the transferee's parent or related entity(ies); (b) the character, experience and reputation of the transferee (or its operator) in operating the business contemplated by the transfer; (c) whether the transfer will negatively impact the short-term or long-term development, land use or other plans of the Harbor Department, and whether consent to such transfer would violate any of the legal duties of the Harbor Department, including duties owed to other tenants; (d) whether the proposed transfer is consistent with the terms and conditions of the Permit in existence when the tenant submitted the Transfer Notice and with the laws, rules and regulations applicable to the premises and the tenant's use thereof; (e) whether the information provided by tenant in connection with the Transfer Notice justifies such consent; (f) the transferee's level of commitment and specific plans to invest to improve the premises following approval of the proposed transfer, if any.

1. In December 2013, Crafted secured a sublease agreement with the Brewery at Warehouse 9, LLC for approximately half of the 60,000 s.f. (indoor) Warehouse No. 9. The lease agreement has been amended three times since its commencement in 2013. The Brewery at Warehouse 9, LLC will operate under the name Brouwerij West, which is a craft beer brand created in 2010 by Brian Mercer, who serves as Chief Executive Officer and Brew Master of Brouwerij West. Brouwerij West's President and Director of Finance and Business Operations is Dave Holop, a graduate of the Wharton School at the University of Pennsylvania and UCLA Law School. Prior to joining Brouwerij West, Mr. Holop worked in the investment banking industry in New York and as a practicing attorney in Los Angeles.

Currently, Brouwerij West has raised approximately \$2,300,000 in funding for construction of the brewery facility and preopening operations. Brouwerij West has spent approximately \$1,850,000 to date constructing the brewery and preparing for opening, leaving approximately \$450,000 to complete brewery construction and to commence operations. Crafted has made significant landlord improvements to accommodate the brewery, and Brouwerij West secured sufficient funding to construct and install the necessary utilities and the majority of the required equipment through private investors and a loan from the City of Los Angeles, Economic and Workforce Development Department for \$442,000.

According to documentation provided through the Transfer Notice process, the following background and market information was provided regarding the proposed brewery use. Brian Mercer has produced the Brouwerij West brand of beer since 2010 through various facilities throughout California. The Brouwerij West brand focuses on Belgium inspired craft beers and produces eight distinct

SUBJECT: FIRST AMENDMENT TO PERMIT NO. 896

craft beer products with confirmed distribution in 30 states and six countries. Brouwerij West intends to grow the brand's market presence, quality, and supply capabilities through production in the proposed Warehouse 9 location. Brouwerij West also sees the Port of Los Angeles location as strategic due to the unique setting and no other Belgium inspired craft breweries in the region, which provides an opportunity to put Los Angeles on the map as a destination for visitors coming from outside the region. Brouwerij West believes the generally underserved Los Angeles craft brewery market also provides regional opportunities for significant market share growth over a short period of time. Further, craft beer market share is significantly increasing on a national level with year over year (2013-2104) volume growth at 18 percent and sales growth at 22 percent. Based on the information provided by Brouwerij West, there appears to be an opportunity for significant market growth for the Brouwerij West brand at the proposed location.

Brouwerij West is currently constructing a brewery for both beer and other fermented beverages, and a tasting room, with plans for a café and/or restaurant, and related ancillary uses. This operation will initially bring a full-scale production brewery to the LA Waterfront, a beer-tasting room with a bar and seating areas, a bottle shop to take packaged beer home, and retail merchandise sales. The brewery will provide Crafted with additional minimum rent of \$251,100 a year for the first four years of operation, and thereafter, additional revenue from a percentage of the gross receipt sales. The brewery operation is expected to attract significant unique regional and outside the region visitor traffic based on the Brouwerij West business overview. This proposed sublease provides an opportunity to bolster visitor traffic to both the adjacent Crafted marketplace and the LA Waterfront, which aligns with the land use and programming goals for the larger waterfront development program.

The proposed sublease is consistent with the terms of Crafted's Permit No. 896 and includes a provision stating that the sublease is subject and subordinate to the terms of Permit 896. Section 24.1 of the sublease states that if Crafted at some point transfers its rights under the Permit to another entity or operator, subject to the Board's discretion, the terms and conditions of the Brewery West sublease will remain unaltered, and Brewery West will receive a right of first refusal to purchase Crafted's interests subject to Board discretion. Section 24.1 does not alter any future processes or the Board's discretion under Section 13.3. Either future speculative event would be subject to Board discretion through the terms of the sublease and any and all such speculative future transfer transactions whether expressly contemplated in the sublease or not would be subject to Board discretion under the master Permit No. 896.

The information provided through the Transfer Notice process is responsive to the requirements of Section 13.3 of Permit No. 896, and based on this information, staff recommends consent to the proposed sublease for Brouwerij West.

SUBJECT: FIRST AMENDMENT TO PERMIT NO. 896

2. In consultation with the Harbor Department, Crafted secured a sublease with PermaCity in February 2015 for the construction and operation of a 1.25 Mega Watt (MW) photovoltaic solar power system on the rooftops of both warehouses totaling 155,000 s.f. The sublease has been amended one time since the commencement in February 2015.

The proposed solar system will help fulfill a portion of the Harbor Department's commitment to install 10 MW of solar power within the Port of Los Angeles. PermaCity is one of two companies selected by the Los Angeles Department of Water and Power to develop solar installations on 4,000,000 s.f. of rooftops in the Los Angeles basin. The proposed installation is equivalent to powering 130 homes and will help maintain reduced temperatures in the warehouses.

PermaCity has requested permission to assign the sublease to Cal PV Energy upon completion of the solar panel permitting, which also requires Board consent. Cal PV Energy is a subsidiary of Exelon, a Chicago based energy company. Exelon is a publicly-traded utility with 24,000 employees nationwide and \$25 billion in annual revenues in 2013. The sublease will provide Crafted with 12.5 percent of revenues derived from the sale of power generated by the solar power system. New revenue to Crafted will be approximately \$600,000 over a 20-year period.

The proposed sublease is consistent with the terms of Crafted's Permit No. 896 and includes a provision stating that the sublease is subject and subordinate to the terms of Permit No. 896.

The information provided through the Transfer Notice process is responsive to the requirements of Section 13.3 of Permit No. 896, and based on this information, staff recommends consent to the proposed sublease for PermaCity and eventual assignment to Cal PV Energy.

The proposed changes in the permitted uses as delineated in the First Amendment (Transmittal 3) and the proposed subleases will enable Crafted to secure alternative sources of revenue. The modification of the compensation schedule discussed below will provide temporary financial relief for Crafted to remain viable and achieve profitability while the proposed new subleases and resulting revenue sources are established. The changes in the indemnification and insurance provisions discussed below offers additional protection for the Harbor Department for the proposed expanded uses and subleases.

Crafted will continue to generate additional revenue by making their public areas available for events, such as music performances, community meetings, private events such as weddings, birthday parties, and corporate events. All of these events are visitor-serving and low-intensity commercial uses, consistent with the Port Master Plan goals to develop the LA Waterfront as a destination.

SUBJECT: FIRST AMENDMENT TO PERMIT NO. 896

Proposed New Permit Terms and Conditions

Uses: The permitted uses provision shall be amended to reclassify specialty commercial uses as being a permitted primary use and not simply incidental to the arts and crafts public marketplace. These specialty commercial uses include restaurants, food carts, food and beverage production facilities, specialty grocery; consumer alcohol manufacturing operations, including but not limited to a brewery, tours thereof, tasting room, wholesale distribution and retail sales of such alcoholic beverages and alcohol-containing consumables and complementary merchandise, goods and wares; special events, and entertainment facilities.

Rent: The annual minimum rent proposal reduces rent for the initial period of September 1, 2015 to August 31, 2020 from \$50,000 to \$17,500. The new proposed minimum rent is based on Crafted's past economic performance and a market rate percentage of gross revenues. The proposed percentage rent is not charged on total revenues until 2020 to allow Crafted time to solidify new revenue sources. The permit will now include annual adjustments based on the Consumer Price Index (CPI) for the next five years and following that, annual adjustments based on the greater of CPI or 75 percent of the past three-year average annual percentage rent paid by Crafted to the Harbor Department. The new rent proposal also includes five-year compensation resets. Percentage rent, subject to future compensation resets, has also been adjusted throughout the term of the permit as depicted below.

Comp period	Period	Comparison	Annual Base Rent	Operator	Gross Receipts				
					\$0-4,999,999		\$5M-6,999,999	\$7M & up	
Comp period 3	Sep 2015-Aug 2020		\$17,500	+	0	+	6.5%	+	7.5%
Comp period 4	Sep 2020-Aug 2025	greater of	\$50,000	or	3.5%	+	6.5%	+	7.5%
Comp period 5	Sep 2025-Dec 2036* *plus holdover	greater of	75% of annual average rent paid in prior 3 years	or	5.0%	+	6.5%	+	7.5%

Proposed revisions to minimum rent, percentage rent, annual rent adjustments, and compensation resets will result in future flexibility to adjust rent based on Crafted's economic performance. Recent appraisals have determined that the economic performance valuation methodology is the preferred and most applicable valuation method to establish ground lease market rent for commercial uses including marinas, sportfishing, charter landings, retail sales, and restaurants. The economic performance methodology is also the predominant valuation method used for establishing market rent for the above mentioned commercial uses by other public agencies managing waterfront ground leases in Southern California, including Los Angeles County (Marina Del Rey), Orange County (Dana Point), the City of San Diego (Mission Bay) and the San Diego Unified Port District (various locations).

SUBJECT: FIRST AMENDMENT TO PERMIT NO. 896

Utilizing a comparable land value based valuation method would result in a rate of return of 3.33 percent, which is a deviation from the Board policy rate of return for land and improvements established at 10 percent and 12 percent, respectively. The comparable land valuation appraisal methodology, which results in the rate of return percentage, assumes all comparable parcels have generally similar characteristics and amenities, which is generally not the situation when comparing ground leases for different commercial uses, containing different economic potential based on inherent use limitation imbedded in the respective ground lease permits. Although this methodology of valuation does result in a rate of return deviating from the Board's policy, the valuation process used to determine this rate of return is not generally applicable to the subject permitted uses and is not generally accepted as a useful valuation methodology for establishing market rent in comparable municipal ground leases.

Indemnification and Insurance: In consideration of the change in use for alcohol service operations that were originally classified as being occasional in nature but will now be part of the primary operations, Crafted's insurance has been revised to address the risks associated with such uses. Crafted will require subtenants selling alcoholic beverages and alcohol-containing consumables to provide on and off premises liquor liability insurance and name the Harbor Department as additional insured on its policy. Crafted will also indemnify the Harbor Department for on and off premises liability related to alcohol sales and service on the premises. Insurance requirements for pyrotechnics and construction periods have also been established to address the additional risk.

ENVIRONMENTAL ASSESSMENT:

The proposed action is approval of amendment to Permit No. 896 with Crafted to reclassify the primary use as specialty commercial and to consent to subleases with Brouwerij West for operation of a craft brewery/café and PermaCity Construction Corp. for installation of a photovoltaic solar power system. Crafted at Warehouse Nos. 9 and 10, including commercial uses such as a restaurant and/or café, was previously assessed in the Final Environmental Impact Statement/Environmental Impact Report (EIS/EIR) for the San Pedro Waterfront Project certified by the Board on September 29, 2009 and the Addendum to the San Pedro Waterfront Project Final EIR, Warehouse Nos. 9 and 10, Crafted, that was considered by the Board on December 1, 2011. As an activity for which the underlying project has previously been evaluated for environmental significance and processed according to the requirements of the California Environmental Quality Act (CEQA), the Director of Environmental Management has determined that the proposed action is exempt from CEQA in accordance with Article II Section 2(i) of the Los Angeles City CEQA Guidelines. Furthermore, the installation of a photovoltaic system involves the placement of a minor structure accessory to an existing commercial and industrial facility and is exempt from CEQA in accordance with Article II Class 11(6) of the Los Angeles City CEQA Guidelines.

ECONOMIC BENEFITS:

This Board action will have no direct employment effect in the five-county region.

SUBJECT: FIRST AMENDMENT TO PERMIT NO. 896

FINANCIAL IMPACT:

The proposed compensation schedule is expected to yield an annual rate of return of 3.33 percent, an increase from 3.13 percent without new revenue sources. The minimum annual rent from the brewery and the estimated percentage rent from the solar company will increase Crafted's gross receipts by approximately 60 percent in the first year, and up to 125 percent in the fourth year when Crafted receives a portion of the brewery's gross receipt sales.

CITY ATTORNEY:

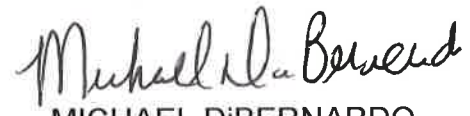
The Office of the City Attorney has reviewed and approved the First Amendment as to form and legality.

TRANSMITTALS:

- 1. Site Map
- 2. Section 13 Permit 896
- 3. First Amendment

FIS Approval: *MB* (Initials)
 CA Approval: *JM* (Initials)


 MICHAEL J. GALVIN
 Director of Waterfront & Commercial Real Estate


 MICHAEL DiBERNARDO
 Deputy Executive Director

APPROVED:


 EUGENE D. SEROKA
 Executive Director

ES:MD:MG:RV:cb
 Author: Rica Viola
 BL526cb Crafted 1st Amendment