



THE PORT
OF LOS ANGELES
Executive Director's
Report to the

Board of Harbor Commissioners

DATE: NOVEMBER 15, 2012

FROM: REAL ESTATE

SUBJECT: ORDER NO. _____ - PROPOSED RESETTING COMPENSATION UNDER PERMIT NO. 520 WITH SAN PEDRO OWNERSHIP, INC. DBA DOUBLETREE HOTEL SAN PEDRO

SUMMARY:

Permit No. 520 (Permit) between the City of Los Angeles Harbor Department (Harbor Department) and San Pedro Ownership, Inc. dba Doubletree Hotel San Pedro (SPOI) grants a 50-year lease to SPOI, the assignees from the original tenant. The Permit commenced on January 24, 1997 and terminates on January 23, 2047.

Section 4(k) of the Permit requires that compensation be reset every five years.

This proposed Order resets compensation for the five-year period which commenced on January 24, 2012 through January 23, 2017. The proposed compensation for this period is as follows: (1) The minimum annual guaranteed rent (MAG) will remain unchanged at \$170,724; (2) the percentage rent for all revenue sources other than room, food and beverage will remain unchanged; and (3) the percentage rent for room, food and beverage will be reset to the following amounts:

<u>Room, Food and Beverage Revenue Thresholds</u>	<u>Percentage</u>
\$0 - \$4,999,999	2.0%
\$5,000,000 - \$7,499,999	2.5%
\$7,500,000 - \$8,999,999	3.0%
\$9,000,000 and over	3.5%

RECOMMENDATION:

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

1. Adopt the Order resetting compensation under Permit No. 520 for the five-year period from January 24, 2012 through January 23, 2017;
2. Authorize the Board Secretary to attest to the Order resetting compensation to be paid by San Pedro Ownership, Inc. dba Doubletree Hotel San Pedro pursuant to Section 4(k) of Permit No. 520; and
3. Adopt Order No. _____.

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DISCUSSION:

Context – The Permit has a term of 50 years that commenced on January 24, 1997 and expires on January 23, 2047. The Premises consist of 327,508 square feet comprised of: 1) 119,382 square feet of a plaza and surface parking used by the general public and maintained by SPOI for which there is no rental charge; 2) 112,820 square feet of parking for the hotel complex; and 3) 95,306 square feet of hotel and other improvements upon which SPOI pays compensation to the Harbor Department (Transmittals 2 and 3).

Since SPOI was assigned the Permit, they have been a tenant in good standing pursuant to the requirements set forth in the Port of Los Angeles Leasing Policy. SPOI has made capital investments to improve the hotel, estimated at approximately \$5 million, improved the economic performance from the prior tenant, and made all rental payments to the Harbor Department on a timely basis.

Appraisal and Negotiation – The Real Estate Division (RED) obtained an appraisal for the purposes of determining just compensation for the reset period. The appraiser analyzed other ocean front hotels and determined that the market percentage rate for rooms, food and beverage was approximately 7 percent. The appraiser advised, however, that this property is situated in a difficult location for the successful operation of a hotel due to the geographic limitations of the site and the lack of adjacent amenities to draw visitors. Therefore, the appraisal noted that the location of this hotel is a primary obstacle to having a high performing facility and, as a consequence, it would not be able to sustain market percentage rental rates. The appraisal recommended that the Harbor Department consider maintaining the current MAG and offering either a fixed 3.5 percent rent for all revenue sources, or maintaining the current MAG and adjusting the percent rents so that the percentages increase at lower thresholds than the current formula.

During negotiations it became apparent that a change from the percentage collected on room revenues up to \$7,499,999 from 2.0 percent to 3.5 percent would result in nearly a 50 percent increase in rent because the majority of income is derived from room revenues. After consultation with the appraiser, RED proposed the following rental rate reset to ensure that the hotel facility would remain viable for the next five years.

Current v. Proposed Compensation – The compensation under the Permit is currently made up of a percentage rent formula, but not less than the MAG. The MAG rent under the last compensation period was established at \$170,724 (\$14,227 per month from January 24, 2007 through January 23, 2012).

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It is proposed that compensation under the Permit for the period of January 24, 2012 through January 23, 2017 be reset as shown in the following chart which compares the current and proposed compensation (Transmittal 1):

CURRENT COMPENSATION		PROPOSED COMPENSATION	
MAG	\$170,724 (\$14,227/mo)	MAG	\$170,724 (\$14,227/mo)
PERCENTAGE RENT FOR ROOMS		PERCENTAGE RENT FOR ROOMS	
• \$0 - \$7,499,999	2.0%	• \$0 - \$4,999,999	2.0%
		• \$5,000,000 - \$7,499,999	2.5%
• \$7,500,000 - \$8,999,999	3.0%	• \$7,500,000 - \$8,999,999	3.0%
• \$9,000,000 and above	4.0%	• \$9,000,000 and above	3.5%
PERCENTAGE RENT FOR FOOD AND BEVERAGE		PERCENTAGE RENT FOR FOOD AND BEVERAGE	
• \$0 - \$7,499,999	3.0%	• \$0 - \$4,999,999	2.0%
		• \$5,000,000 - \$7,499,999	2.5%
• \$7,500,000 - \$8,999,999	4.0%	• \$7,500,000 - \$8,999,999	3.0%
• \$9,000,000 and above	5.0%	• \$9,000,000 and above	3.5%
PERCENTAGE RENT FOR OTHER REVENUE SOURCES		PERCENTAGE RENT FOR OTHER REVENUE SOURCES	
• Office rental	10%	• Office Rental	10%
• Retail sales	3.0%	• Retail sales	3.0%
• Vessel Insurance brokerage	10%	• Vessel Insurance brokerage	10%
• Sale of vessels/yacht brokerage	10%	• Sale of vessels/yacht brokerage	10%
• Vending machine commission	25%	• Vending machine commission	25%
• All other revenues	5.0%	• All other revenues	5.0%

Under this formula, the Harbor Department would realize higher rent for room revenues in the range of \$5,000,000 to \$8,999,999 and encourage additional growth by reducing the rent percentage for revenues above \$9,000,000.

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Comparison – A rate of return analysis was performed by Harbor Department Financial Management staff. The financial analysis determined that over the next five years, the MAG of \$170,724 would yield a rate of return of 5.9 percent. However, SPOI has been paying more annually than the MAG, and even with an overly conservative assumption of no growth, it is anticipated that the reset rent will result in increased revenues for the Harbor Department. This is demonstrated in the following chart based on SPOI's 2009-2011 revenues.

Year	Income		Current Rent			Proposed Rent		
	Food	Beverage	Revenue		Final	Revenue		Final
			From			From		
			Percentages			Percentages		
2009	\$9,093,357	\$174,824	\$207,495	\$170,724	\$207,495	\$219,508	\$170,724	\$219,508
2010	\$9,259,450	\$137,323	\$212,264	\$170,724	\$212,264	\$223,446	\$170,724	\$223,446
2011	\$9,266,951	\$145,565	\$212,976	\$170,724	\$212,976	\$224,121	\$170,724	\$224,121
				Total:	\$632,735		Total:	\$667,075

ENVIRONMENTAL ASSESSMENT:

The proposed action is approval of an Order resetting compensation with SPOI under the Permit for a five-year period. As an administrative action, the Director of Environmental Management has determined that the proposed action is exempt from the requirements of the California Environmental Quality Act (CEQA) in accordance with Article II Section 2(f) of the Los Angeles City CEQA Guidelines.

ECONOMIC BENEFITS:

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

FINANCIAL IMPACT:

The proposed Order resetting compensation is expected to have a positive financial impact upon the Harbor Department, since the compensation rates for room and food and beverage will increase at a lower threshold than the prior five-year period. Based on SPOI's 2009-2011 performance, the proposed reset is estimated to result in 5 percent higher revenues annually.

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CITY ATTORNEY:

The Office of the City Attorney has reviewed and approved the proposed Order resetting compensation as to form and legality.

TRANSMITTALS:

1. Order
2. Site Map
3. Doubletree Hotel Photos

FIS Approval: ML (initials)
CA Approval: JMC (initials)


KATHRYN McDERMOTT
Deputy Executive Director


JACK C. HEDGE
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APPROVED:

GERALDINE KNATZ, Ph.D.
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BL427mnm SPOI Comp Order