



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

Board of Harbor Commissioners

**DATE: MAY 16, 2016**

**FROM: WATERFRONT & COMMERCIAL REAL ESTATE**

**SUBJECT: RESOLUTION NO. \_\_\_\_\_ - APPROVAL OF A PERMIT BETWEEN THE CITY OF LOS ANGELES HARBOR DEPARTMENT AND SAN PEDRO PUBLIC MARKET, LLC FOR THE COMMERCIAL REDEVELOPMENT OF THE PORTS O'CALL SITE**

**SUMMARY:**

On September 29, 2009, the Board approved the San Pedro Waterfront Project Environmental Impact Statement/Environmental Impact Report (SPWP EIS/EIR) (APP# 041122-208, SCH# 2005061041) with a horizon year of 2037. The report assessed the first comprehensive redevelopment of the Ports O'Call site and other development/infrastructure projects intended to transform the San Pedro waterfront into a vibrant, world-class, urban visitor-serving waterfront destination. The project description for the Ports O'Call site evaluated up to 300,000 square feet of restaurant, retail and entertainment space, up to 75,000 square feet for a conference center, and a 30-foot-wide waterfront promenade.

This Lease would allow for the first comprehensive redevelopment of the approximately 30-acre Ports O'Call site since its original development in the 1960s. The proposed scope of the work includes approximately 300,000 square feet of commercial uses in multiple phases. The initial phase is envisioned to include restaurants, retail, entertainment, office uses, open spaces, over water uses, and parking linked together by a promenade.

The Developer's plans for Phase 1 include approximately 168,600 square feet of new buildings. The breakdown of uses would include approximately 100,000 square feet of restaurants, 38,600 square feet of retail and 30,000 square feet of creative office. Phase 2 would include the remaining 131,400 square feet and would be programmed based on market conditions. The Developer will maintain the premises inclusive of the Developer's improvements, as well as the Waterfront Promenade and visitor boat slips.

As explained further in this report, the Lease deviates from the Harbor Department Leasing Policy and Standard Lease Provisions in eleven aspects: rate of return (ROR) requirements, security deposit requirements; lease-end demolition of improvements by Tenant, standard environmental requirements, standard indemnity requirements, standard insurance requirements, standard restoration, compliance with Executive Directives requirements to Applicable Law, subleases, Tariff fees, and force majeure. These deviations are necessary to provide a framework in the Lease that will allow the Developer the ability to finance a high quality commercial development under current and future market conditions.

Staff recommends approval of the deviations to the Harbor Department Leasing Policy and Standard Leasing Provisions as structured in this Lease. Staff also recommends



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Staff recommends approval of the deviations to the Harbor Department Leasing Policy and Standard Leasing Provisions as structured in this Lease. Staff also recommends

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approval of a 50-year ground lease (Lease) for the Ports O'Call site, between the City of Los Angeles Harbor Department (Harbor Department) and San Pedro Public Market, LLC (Developer).

**RECOMMENDATION:**

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

1. Find that, in accordance with the provisions of the California Environmental Quality Act Guidelines Section 15164, the proposed 50-year Lease will not result in any new significant environmental effects or any substantially more severe effects than previously analyzed in the certified Environmental Impact Report;
2. Find, pursuant to City Charter Section 607(a), that a 50-year term for the Lease with San Pedro Public Market, LLC is in the best interest of the City of Los Angeles Harbor Department and the City of Los Angeles, in consideration of the need for substantial investment and expertise in commercial real estate development;
3. Find that it is in the best interest of the City of Los Angeles Harbor Department to deviate from the Rate-of-Return, minimum guarantee targets, and security deposit requirements, of the Harbor Department Leasing Policy Section VIII (1) (2) (3) to allow for a lower Rate-of-Return during development stage in order to realize a potentially higher Rate-of-Return during the operational stage of the Lease;
4. Find that it is in the best interest of the City of Los Angeles Harbor Department to deviate from the required Security Deposit of the Harbor Department Leasing Policy Section XI (1) to allow those funds to be utilized for development costs;
5. Find that it is in the best interest of the City of Los Angeles Harbor Department to deviate from the end of Lease Tenant demolition requirements of the Harbor Department Leasing Policy Section XIV (2) and Standard Lease Provisions Section 17.2.1 to allow for retention of the improvements and provide continuity in the operation of the development at the end of the Lease;
6. Find that it is in the best interest of the City of Los Angeles Harbor Department to deviate from the standard Environmental requirements of the Harbor Department Standard Lease Provisions Section 4.6 to differentiate responsibility for existing environmental conditions against future environmental conditions during the possessory period of the Lease;
7. Find that it is in the best interest of the City of Los Angeles Harbor Department to deviate from the standard Indemnity requirements of the Standard Lease Provisions Section 11.1 to reflect the commercial, retail, and entertainment aspects of the development;
8. Find that it is in the best interest of the City of Los Angeles Harbor Department to deviate from the standard Insurance requirements of the Standard Lease provisions Section 11.2 to reflect the availability of commercially reasonable insurance policies throughout the various stages of construction and operation of the development;

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9. Find that it is in the best interest of the City of Los Angeles Harbor Department to deviate from the compliance requirements of the Standard Lease provisions Section 2.1 to limit compliance requirements for Executive Directives to Applicable Law in order to reflect the commercial, retail, and entertainment nature of the development;
10. Find that it is in the best interest of the City of Los Angeles Harbor Department to deviate from the sub-lease Board approval requirements of the Harbor Department Leasing Policy Section XII (1) and Standard Lease Provisions Section 13.1.2 to allow for the Developer to lease-up and fill vacancies to maximize the operation of the development;
11. Find that it is in the best interest of the City of Los Angeles Harbor Department to deviate from the Harbor Department's Leasing Policy Section VII and the Standard Lease provisions Section 13.1 to allow for the assignments and transfers to entities with certain expertise in commercial development and commercial operations.
12. Find that it is in the best interest of the City of Los Angeles Harbor Department to deviate from the force majeure requirements of the Standard Lease provisions Section 10 to allow for limited rent offset under certain conditions in order to not adversely impact the revenue stream shared by both the Developer and Harbor Department.
13. Find that it is in the best interest of the City of Los Angeles Harbor Department to deviate from the Tariff requirements of the Standard Lease provisions Section 3.1 to provide consistency in a fee structure beneficial to the encouragement of quality commercial, retail and entertainment development.
14. Consider the Third Addendum to the certified Environmental Impact Report prepared for the San Pedro Waterfront Project;
15. Authorize the Environmental Management Division to file a Notice of Determination with the Los Angeles County Clerk and the Los Angeles City Clerk;
16. Approve the Permit with San Pedro Public Market, LLC, as substantially attached;
17. Direct the Board Secretary to transmit the Permit to the City Council for approval pursuant to Charter Sections 606 and 607 of the City Charter;
18. Authorize the Executive Director to execute and the Board Secretary to attest to the Permit upon approval by City Council; and
19. Adopt Resolution No. \_\_\_\_\_.

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**DISCUSSION:**

**Background/Context** – The Ports O’Call area is located along the Port of Los Angeles’ Main Channel between 6<sup>th</sup> Street and the Southern Pacific Berth Slip 73, east of Sampson Way (Transmittal 1). The site was first developed as a major restaurant and retail visitor serving destination in the 1960s and was a popular regional destination for several decades. The 30-acre site currently features approximately 135,000 square feet of restaurant and retail space. The existing tenant leases are currently on Revocable Permits or are holdover tenancies on a month-to-month basis. The current improvements are at the end of their functional life, dated, and in need of major repair and upgrading.

**San Pedro Waterfront Project** – On September 29, 2009, the Board approved the San Pedro Waterfront Project Environmental Impact Statement/Environmental Impact Report (SPWP EIS/EIR) (APP# 041122-208, SCH# 2005061041) with a horizon year of 2037. The report assessed the first comprehensive redevelopment of the Ports O’Call site and other development/infrastructure projects intended to transform the San Pedro waterfront into a vibrant, world-class, urban visitor-serving waterfront destination. The project description for the Ports O’Call site evaluated up to 300,000 square feet of restaurant, retail and entertainment space, up to 75,000 square feet for a conference center, and a 30-foot-wide waterfront promenade.

**Tenant, San Pedro Public Market, LLC (Developer)** – Subsequent to the approval of the SPWP EIS/EIR a Request for Qualifications (RFQ) to select a private developer for the Ports O’Call area was released in 2012. Eight responses were received from interested parties and the Developer, a partnership of The Ratkovich Company and Jerico Development, was selected. The Ratkovich Company is a Los Angeles-based development company with 40 years of experience in commercial property development, construction, renovation, and operations. Jerico Development is a San Pedro-based development firm that specializes in rehabilitating commercial buildings. The Harbor Department, following completion of its RFQ process, recommended that the Board select the Developer as the RFQ awardee based on the Developer’s qualifications and proposed plan to develop the site as a visitor-serving commercial development. In March 2013, the Harbor Department began negotiations with the Developer under an Exclusive Negotiations Agreement.

At its meeting held on February 21, 2013 the Board approved an Exclusive Negotiating Agreement (ENA), Agreement No. 13-3238, for the purpose of finalizing the development concept, preparing financial and market analyses and an initial business plan, conducting public outreach, initiating the evaluation of the development concept to determine if further environmental assessment is required and preparing a term sheet to be used in support of further entitlement agreements, including an option agreement and ground lease for the Ports O’Call development site.

Given the complexity and challenges of the contemplated commercial development, the initial 240 day ENA was amended three times as follows:

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1 <sup>st</sup> Amendment	14-3238-A	March 6, 2014	120 Days
2 <sup>nd</sup> Amendment	14-3238-B	May 1, 2014	120 Days
3 <sup>rd</sup> Amendment	14-3238-C	November 5, 2014	125 Days

**Financial Feasibility Analysis** – In November 2014, the Harbor Department produced a Financial Feasibility Analysis (FFA) for the proposed redevelopment of the Ports O’Call site as part of the ongoing negotiations. Based on the findings of the FFA, the Harbor Department identified three critical infrastructure projects to prepare the Ports O’Call site for redevelopment and support the near term projected visitor growth estimated in the FFA. The projects were the Sampson Way & 7<sup>th</sup> Street Intersection Improvements, Town Square at 6<sup>th</sup> Street project, and Promenade and Parking project. On February 19, 2015, the Board approved a funding plan for these (and other) projects through the Public Access Investment Plan, which provides budgetary guidelines for the continued investment in public access and visitor-serving elements of the LA Waterfront.

Upon completion of the ENA period and following completion of the FFA, the Harbor Department and the Developer memorialized the progress made with a Letter of Intent, outlined as follows.

**First and Amended Letter of Intent** – During the February 19, 2015 meeting, the Board also approved a Letter of Intent (LOI) for the redevelopment of the Ports O’Call site with the Developer. The LOI recognized progress made to date and the parties’ intent to reach agreement on a defined project scope and term sheet within four months. On July 13, 2015, the Board approved a First Amended and Restated LOI with the Developer. The Harbor Department and the Developer had come to agreement on a term sheet, and the parties shifted their focus to the delivery of a final project concept and other necessary steps including continued negotiations for a ground lease.

Subsequent to Board approval of the amended LOI, the parties progressed in completing the necessary actions required to bring a ground lease for action to the Board.

- The Developer finalized the project concept in alignment with likely market demand and the agreed upon scope of infrastructure that allowed for the initiation of the design process;
- On March 2, 2016, the Developer held a public presentation of the proposed design concept;
- The Harbor Department and Developer reached agreement on coordinated construction phasing to ensure expedited commencement of operations for the new development;
- The Developer began marketing the new concept to existing and potential new tenants to determine actual market demand and financial feasibility of their specific development concept; and
- The Harbor Department and Developer have come to an agreement on all commercial and standard terms for a new Permit.

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**DEVELOPMENT:**

**Project Scope** - As originally envisioned in the San Pedro Waterfront Project EIS/EIR, the project scope would include up to 300,000 square feet of redeveloped and new commercial uses. Divided into phases, Phase 1 would include approximately 168,600 square feet of restaurant, retail and entertainment uses. The breakdown of uses would include approximately 100,000 square feet of restaurants, 38,600 square feet of retail and 30,000 square feet of maritime-related office uses. Phase 2 would include the remaining 131,400 square feet and would be programmed based on market conditions. Phase 1 of the Project is envisioned to be a series of waterfront buildings, open spaces, over water uses and parking linked together by a promenade. Ancillary restaurants, kiosks, retail and entertainment uses may be incorporated within the proposed open space and waterside improvements may include incorporating overwater structures and floating vessels. The Developer's estimated investment to the project is \$85 million to \$100 million.

The Harbor Department will construct four public access infrastructure projects related to the Ports O'Call site: the continuous pedestrian waterfront promenade along the main channel's water's edge, the Town Square at the foot of 6<sup>th</sup> Street, south of the recently completed Downtown Harbor, the Sampson Way and 7<sup>th</sup> Street intersection project, and waterside boat slip improvements. The Harbor Department's estimated cost for these four public access infrastructure projects is \$52 million.

Additionally, the Harbor Department will incur site restoration and remediation costs of approximately \$4 million. Remediation costs are reimbursable from the responsible party, and demolition costs were accounted for in a separate settlement agreement with the former tenant. The Harbor Department will spend an aggregate Five Million Seven Hundred Thousand Dollars (\$5,700,000) for waterside improvements and enhancements of the City Improvements for the Project.

The Developer plans on beginning Phase 1 design and construction in 2016 and finishing in 2020. Phase 2 construction is anticipated to begin within 5 to 10 years after the completion of Phase 1. Duration of Phase 2 construction is expected to be 2 to 3 years. The Harbor Department began design of the Sampson Way & 7<sup>th</sup> Street Intersection Improvements in 2014, and will begin construction this year. Funding for the design of the promenade and town square is included in the fiscal year (FY) 2015/2016 budget. The Harbor Department projects are anticipated to be completed no later than FY 2019/2020.

**California Environmental Quality Act Guidelines Section 15164 (CEQA)** – The proposed 50-year Lease will not result in any new significant environmental effects or any substantially more severe effects than previously analyzed in the certified Environmental Impact Report. Detailed information is outlined in the Environmental Assessment section of this report.

**PROPOSED LEASE:**

**Term** - The proposed Lease Term is for 50 years, and includes a 42 month Option Period. City Charter Section 607(a) requires that City Council approve, by a two-thirds

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vote, lease terms that exceed 30 years. The Lease's maximum term of 50 years is necessary so that the Developer can amortize funds borrowed for development of Phase I of the project, as well as providing for the ability to procure future funding needed for development of Phase 2, and future repositioning of the development to keep it economically viable and updated. The proposed 50-year Lease term is fundamental to the ability of the Developer to amortize funds borrowed for development of Phase I of the project, as well as providing for the ability to procure future funding needed for development of Phase 2, and future repositioning of the development to keep it economically viable and updated.

During the Option Period, the Developer is required to advance the project design, secure the necessary financing, and solicit tenants while the Harbor Department prepares the site for development. The Developer shall not receive any possessory interest or right to rent or occupy the premises during the Option Period.

Generally, after the Developer exercises the Option, all remaining lease provisions become effective. The Lease provides conditions to be satisfied prior to the exercise of the Option. During the Option Period, the Developer shall have obtained an acceptable construction and term loan relative to the proposed project scope and entered into a Project Labor Agreement; and the Harbor Department shall have provided the Developer six (6) months' notice prior to Substantial Completion of a designated portion of the Premises that is economically viable for development by the Developer at the time the designated portion of the premises is delivered to the Developer. The Developer may exercise the Option to trigger commencement of the Lease after receiving 6 months' notice and can choose for earlier exercise at their discretion.

If the Harbor Department's performance of required Option conditions is delayed beyond 42 months, and the Harbor Department has not provided a notice of substantial completion as mentioned above, the Developer may terminate the Lease and require reimbursement of development costs not to exceed \$4 million. If the Developer fails to exercise the option after the Harbor Department has provided the required notice of substantial completion of a designated parcel, the Harbor Department will receive the difference between \$2 million and documented development costs incurred by the developer subsequent to the Term Sheet dated July 9, 2015.

It is recommended that the Board, pursuant to City Charter Section 607 (a), find that a 50-year term for the Lease with the Developer is in the best interest of the City of Los Angeles Harbor Department and the City of Los Angeles, in consideration for substantial investment and expertise, by the Developer, in commercial real estate development.

**Security Deposit, Rent and Rate-of-Return**— Generally, the compensation provisions of the proposed Lease are as follows:

A Security Deposit will not be required in consideration of the Developer's significant upfront costs for design and construction of the proposed development and the Developer's significant investment into increasing the value of the improved Premises. Deviation from the Harbor Department's Leasing Policy in requiring a Security Deposit is beneficial to the Harbor Department by allowing the funds covered by a Security

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Deposit to be expended directly into design and development necessary to support the improvements that will add value to the site.

Rent is not charged during the Option Period. After possessory interest begins, base rent is 3 percent of total gross receipts. The projected Rate-of-Return based upon 3 percent of total receipts is 5.8 percent. Upon the establishment of a Minimum Annual Guarantee (MAG), which is 50 percent of the average base rent paid over the preceding five years, rent is the greater between the base rent and MAG. Additionally, the base rent increases to 33 percent of annual gross receipts after the Developer receives a 12 percent return on capital invested, as described in the Lease. The Rate-of-Return based upon 33 percent of gross receipts is 13.8 percent. Minimum compensation shall be readjusted every five (5) years.

Basing rent and rate-of-return on gross receipts rather than land and improvement values results in the Developer retaining greater cash flow during the construction and start-up phases of the development while allowing the Harbor Department greater participation in revenue during the operational phases. The deviation from the Harbor Department Leasing Policy on minimum rent and rate-of-return is also comparable with development projects of similar size and is beneficial to the Harbor Department in attracting high quality commercial development of its land and assets, and promoting the Port as a favorable and preferred place to do business, as well as enhancing the neighboring community.

It is recommended that the Board, in consideration of the progressive compensation structure included in the Lease as well as the economic benefits and public benefits of the redevelopment of the site into a commercial, retail, and dining destination approve the deviations from the Harbor Department's Leasing Policy Section VIII: 1) no Security Deposit required in lieu of Developer's upfront development costs; and 2) no rent paid by the Developer during the Option Period; and 3) less than 10 percent ROR on current land value and less than a 12 percent ROR on improvements for the proposed Lease in lieu of progressive percentages (3% - 33%) of Developer's gross receipts.

**Environmental** – Historically there have been many industrial uses at the site. These industrial uses have contributed to the environmental characteristics of the site with varying degrees of contamination typical of industrial use. The Developer will be providing a commercial development and commercial use to the site. The Developer is willing to assume responsibility of any contamination resulting from their commercial development. However, the Developer's cost of development, as well as the Developer's ability to finance their development, would be severely impacted if the Developer was also held responsible for the industrial contamination found on the site.

The Developer has reviewed the Harbor Department's written depiction of the known environmental condition of the premises (Baseline Report). Staff and the Developer have agreed that Developer bears no responsibility for the existing contamination in the Baseline Report. It has also been agreed that the Developer will be responsible for any contamination occurring during the possessory period of the Lease. However, contamination during the possessory period must be proven by the Harbor Department to be the Developer's contamination. In order for the Harbor Department to be able to make those determinations it is part of the structure of this Lease that the Developer will

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report through their Environmental Compliance Program all subtenants on their premises, the permitted uses subscribed to those subtenants, and location of the subtenants within the Developer's premises. The Developer's reports will track subtenant status annually.

It is beneficial to the Harbor Department to reflect existing and future contamination in a way that insures responsibility for clean up as well as allowing for development of the Harbor Department's environmentally impacted property. It is recommended that the Board approve the deviation in the Standard Lease Provisions, Section 4.6 to differentiate the responsibility for existing environmental conditions against future environmental conditions during the possessory period of the Lease.

**Indemnity** – The Harbor Department's Standard Lease provisions are reflective of the Harbor Department's core cargo business, its transitory nature, and its business model as a passive landlord. The indemnity provisions in the standard leases are applicable to the industrial and transitory nature of the core business of the Harbor Department. However, this Lease pertains to a commercial development rather than an industrial development. Great effort and thought has been put into adjusting the Harbor Department's standard indemnity requirements to allow for the constraints and demands of a commercial retail development while maintaining protection to the Harbor Department.

Generally, requisite indemnity requirements in the Lease are linked to the insurability of those indemnity requirements by insurance that is commercially available to the Developer at commercially reasonable rates. The Lease requires the Developer and the Harbor Department to meet and assess insurance availability every five years for the duration of the Lease in order to assess and discuss adequate indemnity to the Harbor Department. As a result of the discussions in the five year meetings and the placement of expanded insurance coverage that is commercially available, indemnity requirements may broaden in applicability as the development is constructed, subtenants are retained, and the development becomes fully operational.

To properly address indemnity the Lease is separated into two categories: 1) on-site premises and 2) off-site premises. On-site indemnity to the Harbor Department is required, regardless of availability of insurance or its coverage limits, during the construction and operational periods of the Lease. Off-site indemnity to the Harbor Department is required, but limited to the amount of insurance coverage that is commercially available at reasonable commercial rates to the Developer. Indemnity and insurance levels will be jointly re-evaluated by both the Developer and the Harbor Department every five years.

It is recommended that the Board approve the modifications to the standard indemnity requirements found in the Standard Lease provisions Sections 11.1 in order to recognize and further the commercial, retail, and entertainment aspects of the development.

**Insurance** – As previously stated in the discussion on Indemnity, the insurance requirements in this Lease correlate directly with the Lease's indemnity requirements to the Developer. The Harbor Department's Standard Lease provisions delineate the types

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of insurance and corresponding coverage limits, which are required under the Lease. The difference, here, from the Harbor Department's Standard Lease provisions, is in the On-site and Off-site applications of the insurance requirements. Insurance levels and additional availability will be jointly evaluated by both the Developer and the Harbor Department every five years of the term of this Lease.

Additionally, in order for the Developer to procure the appropriate funds necessary for the development, the Developer's financing requirements mandate certain levels of insurance be kept by the Developer during construction and operation of the development. The Harbor Department, cognizant of a financial institutions potential financing requirements, has tailored this Lease to augment rather than conflict with financing insurance requirements.

Staff recommends that it is in the best interest of the Harbor Department to make these deviations and recommends that the Board deviate from the standard Insurance requirements of the Standard Lease provisions Section 11.2 to reflect the availability of commercially reasonable insurance policies throughout the various stages of construction and operation of the development for offsite liabilities.

**Executive Directives; Applicable Law** – The Harbor Department's Standard Lease provisions require that a tenant comply with Applicable Law as well as any Executive Directive that may be issued from time to time. The Harbor Department's core business is unique and significantly different from a commercial, retail, and entertainment endeavor. A unilateral Executive Directive that is reasonable and necessary when applied to the Harbor Department's core business, may have counter-productive effects on a commercial, retail, and entertainment development and its funding structure. The challenges of commercial development in an industrial setting are amplified by directives of an industrial nature that conflict with the goals of commercial development. Traditional funding sources recognize the need to comply with Applicable Law, in large part because Applicable Law(s) are easily identifiable. Future or potential Executive Directives of an unknown nature make it difficult for traditional funding sources to ascertain the level of possible impact to their collateral. Adjusting the Harbor Department's Standard Lease provisions to exclude Executive Directives reflect the commercial nature of this Lease while maintaining compliance with Applicable Laws as defined in the Lease, which an Executive Directive would not contradict. The compensation structure of this Lease could offset any substantial negative economic effect from a future or potential Executive Directive.

Staff recommends that it is in the best interest of the Harbor Department to deviate from the compliance requirements of the Standard Lease provisions Section 2.1 and limit compliance requirements to Applicable Law as defined in the Lease to reflect the commercial, retail, and entertainment nature of the development.

**Approval of Subleases** – The Harbor Department's Leasing Policy Section XII (1) and Standard Lease provisions Section 13.1.2 require Board consent to subleases within a Lease. The commercial, retail, and entertainment nature of this Lease are different than the industrial nature of the majority of the Harbor Department's leases where the occasional and limited amount of sublease requests allow time for Board evaluation and consent without a burden on the business operation. Turnover in commercial and retail

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leases is a common occurrence, and the ability of the Developer to quickly fill vacancies is critical to the on-going success of the development. The commercial nature of the subleases is a non-conflicting use to the Harbor Department's core business and is consistent with the land use designation for this area. The capacity to quickly fill vacancies is a benefit to the revenue stream of the Developer and subsequently to the Harbor Department.

Recognizing the nature of the Lease as a visitor-serving commercial development consisting of various and numerous restaurant, retail and entertainment uses as well as the Developer's expertise in this type of development; it is beneficial to the development that subleasing by the Developer will not require Board approval during the term of the lease.

Deviation from the Harbor Department's Leasing Policy and Standard Lease Provisions regarding subleases is favorable to the Harbor Department as it allows the Developer to conduct business and fill vacancies in a manner that is typical of commercial retail establishments, which in turn allows for less impact to the development's revenue stream.

Staff recommends that it is in the best interest of the City of Los Angeles Harbor Department to deviate from the sub-lease Board approval requirements of the Harbor Department Leasing Policy Section XII (1) and Standard Lease Provisions Section 15.1.2 to allow for the Developer to lease-up and fill vacancies to maximize the operation of the development.

**Transfer of Lease**— Board consent for assignments or transfer of the lease is required for the purpose of 1) mortgaging their leasehold, 2) assignments resulting in a transfer of more than 49 percent of the ownership interest or 3) assignments resulting in a change of manager or managing member of the lease.

If Developer proposes a transfer, Harbor Department approval may be withheld only on the basis of the transferee's character, financial capability, and experience as better defined as follows:

1. **Character.** The prospective Transferee must be a person or persons of good character and reputation; absent of any conviction in a federal or state felony criminal proceeding (including a conviction entered on a plea of nolo contendere) including a crime of moral turpitude. Transferee will be evaluated based upon the standards of the laws and regulations of the United States including the sanctions lists and files administered by the Office of Foreign Assets Control ("OFAC") which the Transferee shall not be listed on such OFAC sanctions or guidelines, the State of California, and the City of Los Angeles.
2. **Financial Capability.** The Transferee must have sufficient verifiable financial resources or commitments to carry out the development and operation of the Project in accordance with the terms of this Lease. The Transferee shall not have been a debtor in a bankruptcy proceeding and has not defaulted under any other contract or lease with the Harbor Department. If the Transferee must have, at minimum, a verifiable net worth of \$25 million dollars adjusted every five (5) years of this Lease for CPI-U.

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3. The Transferee must have at least three (3) years' experience and in excess of One Million (1,000,000) square feet experience in any one of the following:
  - i. Ownership, operating, maintaining and constructing retail centers, or
  - ii. Owning, operating, maintaining, and constructing dining, retail and entertainment venues, as applicable to the obligations which the Transferee is assuming, and such experience must have occurred fully within the ten years preceding the proposed date of the Transfer.

Staff recommends that it is in the best interest of the City of Los Angeles Harbor Department to deviate from the Harbor Department's Leasing Policy Section VII and the Standard Lease provisions Section 13.1 to allow for the assignments and transfers to entities with certain expertise, as defined above, in commercial development and commercial operations.

**Force Majeure** – The Harbor Department's Standard Lease provisions Section 10, in general terms, do not provide for Rent Offsets in the case of Force Majeure. Similarly the Lease provides that any Force Majeure provision or principle shall not apply to any of Lessee's Rent payment obligations. However, if there is a directive, order, or policy issued by the Executive Director or the Board and exclusive to the Harbor District property only, rather than a change in law affecting all businesses within the City of Los Angeles, which has an economic effect resulting in a cost of compliance of more than \$10,000, Lessee shall be entitled to deduct or offset against Rent coming due in an amount not to exceed \$150,000 annually ("Rent Offset"), provided Lessee support such Rent Offset with invoices or further written documentation as may be reasonably requested by City evidencing such costs.

In the event the total Rent Offset exceeds \$150,000 annually, Lessee and City will enter into negotiations on a rent credit amount to offset a portion of or all direct costs, which may require amendment to this Lease subject to the approval of the Board and Council in their sole discretion. In the event the Parties are unable to reach agreement, City or Lessee may seek arbitration by third-party arbiter to determine the respective offset. Arbitration shall be complete within sixty (60) days unless extended by mutual agreement of the Parties. The arbitration shall be binding on the Parties.

This modification to the Standard Lease provisions Section 10, is beneficial to the Harbor Department by insuring a relatively uninterrupted revenue stream to the development. The rent structure of gross receipt payments to the Harbor Department is reliant on a steady revenue stream. Additionally, the development's operations are equally, if not more, dependent on a healthy revenue stream with little to no disruption. The Harbor Department's interests remain secure by the requirement that any Rent Offset is substantiated through invoices, as well as the Harbor Department's ability to seek arbitration by a third party arbiter in the event of dispute.

Staff recommends that it is in the best interest of the City of Los Angeles Harbor Department to deviate from the force majeure requirements of the Standard Lease provisions Section 10 to allow for limited rent offset under certain conditions in order to

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not adversely impact the revenue stream shared by both the Developer and Harbor Department.

**Tariff** – Section 3.1 of the Harbor Department’s Standard Lease provisions state that the tenant shall be subject to each and every applicable rate, terms and conditions of the Tariff as it now exists and as may be amended or superseded. The Harbor Department’s core industrial business is subject to change in the Tariff, such as; wharfage, dockage, and pilotage. The Tariff rates in these categories are not applicable to a commercial, retail, entertainment type development. Additionally, for the Developer to adequately project revenue streams that would allow the Developer to obtain financing of the development at favorable rates, a level of certainty regarding total rent charged is required.

The rent, as stated in the ground lease, is therefore in lieu of the current or future Tariff fees or Charges. This provides a level of certainty as to actual rent payments as the development progresses forward. All other applicable terms, conditions, as well as current and future regulatory action enacted through the Tariff shall apply to the Lease.

Staff recommends that it is in the best interest of the City of Los Angeles Harbor Department to deviate from the Tariff requirements of the Standard Lease provisions Section 3.1 to provide consistency in a fee structure and rent beneficial to the encouragement of high quality commercial, retail and entertainment development.

**Restoration** – The Harbor Department Leasing Policy, Section XIV and the Standard Lease provisions, Section 17.2.1 allow for the discretion of the Executive Director in determining the final disposition of any improvements existing at the end of the Lease term. The Executive Director may require, as part of the Tenant’s restoration obligations that all improvements be demolished, only a portion of the improvements be demolished, or none of the improvements would be demolished. Any undemolished improvements would become property of the Harbor Department at the end of the Lease.

Under the terms of this Lease, the Developer will not be required to demolish any of the improvements and all the Developer’s improvements will become the property of the Harbor Department at the end of the Lease. The Developer, in lieu of demolition of the buildings, shall be obligated to return the premises, inclusive of improvements, to the Harbor Department in good and usable condition consistent with a comparable retail, dining, entertainment facility of a comparable age. This is beneficial to the Harbor Department by enabling the continued existence of a well maintained commercial development during any future transitional period at Lease expiration.

It is recommended that in consideration of; 1) the time needed for determination of use of the site at the end of the Lease by a future Board, and 2) the community benefit of continued operation of the Development at the ex of the Lease while such determination is made by a future Board; that the Board approve acceptance, at the end of the Lease, of the Developer’s improvements, which will be maintained as stated in the Lease.

**SUBJECT: APPROVAL OF PERMIT WITH SAN PEDRO PUBLIC MARKET, LLC****ENVIRONMENTAL ASSESSMENT:**

The proposed action is approval of a 50-year ground lease with San Pedro Public Market, LLC for a 50-year ground lease for the redevelopment of Ports O'Call. The redevelopment and operation of Ports O'Call through 2037 was assessed in the San Pedro Waterfront EIS/EIR which was certified by the Board on September 29, 2009 before a developer for the Ports O'Call site had been identified. Since Board certification, the Developer has been chosen to redevelop the site. The Developer has refined the design for the redevelopment and lease negotiations have resulted in a proposed Option Agreement for a 50-year ground lease. These proposed changes were analyzed in a Third Addendum to the San Pedro Waterfront EIR attached hereto as Transmittal 3 for the Board's consideration. According to Section 15164(a) of the State CEQA Guidelines, the lead agency will prepare an Addendum to a previously certified EIR if changes or additions are necessary but none of the conditions described in Section 15162 calling for the preparation of a subsequent or supplemental EIR have occurred. An addendum does not need to be circulated for public review but can be included in or attached to the EIR. Based on the findings of this Third Addendum, the proposed action will not result in any new significant environmental effects or any substantially more severe effects than previously analyzed in the certified EIR and therefore, does not trigger any of the conditions described in CEQA Guidelines Section 15162 calling for the preparation of a subsequent or supplemental EIR. All previously approved mitigation measures and project conditions would not change and are incorporated into the proposed Lease, as applicable. The Addendum has been made publicly available and is posted on the Harbor Department's website.

**FINANCIAL IMPACT:**

The proposed Lease will commit the Harbor Department to a fifty-year ground lease with the Developer for the commercial redevelopment of the Ports O'Call site. The Harbor Department's obligations under the Lease include site preparation costs and the construction of four public access infrastructure projects supporting the Ports O'Call site. These improvements have an estimated cost in excess of \$56 million and consist of the continuous pedestrian waterfront promenade along the main channel's water's edge, the Town Square at the foot of 6<sup>th</sup> Street, south of the recently completed Downtown Harbor, the Sampson Way and 7<sup>th</sup> Street Intersection project, and visitor boat slips. These Harbor Department projects are anticipated to be completed no later than Fiscal Year 2019/2020, the same year in which the LA Waterfront Alliance also plans on completing its share of improvements to the site.

Compensation to the Harbor Department would initially be set at three percent of gross receipts with the possibility of being set at thirty-three percent of gross receipts upon meeting certain conditions, including the Developer meeting its twelve percent return on capital target. In the case of the Developer meeting its twelve percent return on capital target, the Harbor Department would share in thirty-three percent of its gross receipts thereby enabling the Harbor Department to realize an estimated 13.8 percent rate of return while an estimated 5.8 percent rate of return is expected should the Harbor Department's share of gross receipts remains at three percent over the term of the ground lease.

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Currently, the Harbor Department's estimated rate of return for the Ports O'Call is below 2 percent assuming that operations continue absent the redevelopment proposed in the ground lease.

**Approval Process** – If approved by the Board, the Lease must receive City Council approval pursuant to Charter Sections 606 and 607 of the City Charter which applies to all leases over five years in length and 30 years in length, respectively. Charter Section 607 also requires a two-thirds majority vote by the City Council.

**CITY ATTORNEY:**

The Office of the City Attorney has prepared and approved the Permit as to form and legality.

**TRANSMITTALS:**

- 1. Site Map
- 2. Permit
- 3. EIR Addendum



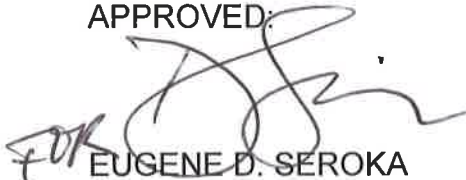
MICHAEL J. GALVIN  
Director of Waterfront & Commercial Real Estate

FIS Approval: MB (initials)  
CA Approval:            (initials)



DOANE LIU  
Deputy Executive Director  
& Chief of Staff

APPROVED:



EUGENE D. SEROKA  
Executive Director

ES:DL:MG:raw  
Author: M. Galvin  
BL584raw San Pedro Public Market Permit