



Executive Director's
Report to the
Board of Harbor Commissioners

DATE: DECEMBER 1, 2010

FROM: REAL ESTATE DIVISION

**SUBJECT: ORDER NO. _____ - RESETTING COMPENSATION UNDER
CONCESSION AGREEMENT NO. 518 WITH CATHAY BANK**

SUMMARY:

Concession Agreement No. 518 (CA 518) between the City of Los Angeles Harbor Department (Harbor Department) and Cathay Bank grants use of 16,465 square feet (s.f.) of land and 10,698 s.f. of water located at Berth 31 (210 Whaler's Walk), San Pedro, for the purposes of construction and operation of marine-related office space, a recreational marine fueling station, sale of marine supplies, a convenience restaurant, and purposes incidental thereto. CA 518 requires that compensation be reset every five years.

The proposed Order resetting compensation is for three consecutive five-year periods beginning January 1, 2001 through December 31, 2015. Minimum annual rent for the three compensation reset periods is proposed to be reduced to reflect rental rates charged to adjacent properties for the same periods: \$24,201, \$29,041, and \$29,041 increased by the Consumer Price Index (CPI), respectively. Beginning January 1, 2011, and annually thereafter, minimum annual rent would be increased by the CPI. Since the annual rent paid by Cathay Bank for those periods is greater than the minimum annual rent currently proposed, the proposed compensation rates would result in a rent credit due to Cathay Bank, resulting in Cathay Bank not being required to make monthly rental payments through approximately August 2011.

RECOMMENDATION:

It is recommended that the Board of Harbor Commissioners:

1. Adopt the Order resetting compensation under CA 518 for the three consecutive five-year periods of January 1, 2001 through December 31, 2015;
2. Authorize the Board Secretary to attest to the Order resetting compensation to be paid by Cathay Bank pursuant to Section 4(a) of CA 518; and
3. Adopt Order No. _____.

DISCUSSION:

Background – CA 518 has a 30-year term, extending from January 1, 1986 to December 31, 2015. The premises is improved with a tenant-owned, two-story 15,000 s.f. building, which historically has been used as restaurant and office space. Recently, the second floor restaurant space was converted to office space.

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At the end of the 1996-2001 compensation period, the Harbor Department initiated compensation reset discussions. However, those discussions were subsequently deferred while environmental contamination at the site was addressed. In 2007, after resolution of the site contamination issues, compensation reset discussions were reinitiated and an appraisal was completed in 2008. Cathay Bank disagreed with the results of the appraisal and requested rates consistent with those of adjacent tenants.

On July 22, 2010, the Board of Harbor Commissioners (Board) approved compensation resets for the period of 2007-2012 for Via Cabrillo Marina 2500 (CA 521) and for the period of 2003-2013 for the Los Angeles Yacht Club (Permit No. 724). The proposed Order resetting compensation for CA 518 for 2001-2015 is largely based upon the land and water values and rates of return utilized for those adjacent tenant compensation resets.

Current Compensation – Current compensation is based upon the greater of minimum annual rent or a percentage of gross receipts (percentage rent). Minimum annual rent of \$34,716 was established for the 1996-2001 compensation period based upon a land value of \$25 per s.f. and a water value of \$4.80 per s.f., with a ten percent rate of return (ROR), discounted by 25 percent for participation in gross receipts.

The following percentage rent rates were established for various activities as follows: one percent on commission received of new and used boats, ten percent on insurance brokerage, five percent boat rental on a base-boat basis for 24 hours or less, five percent on boat chartering, 3.5 percent of from ship chandlery and bait and tackle sales, ten percent from office space, three percent of food and five percent of beverages sale from restaurant operation, three percent from general retail sales, 25 percent of operate coin operated vending, service or game machines or devices, or five percent from any coin operated machines or devices owned, leased or rented by Concessioner, \$0.025/gallon of gasoline dispensed from premises and \$0.015/gallon of diesel dispensed from premises, five percent from any and all activities and business allowed under this Agreement and not otherwise provided for in this section

Compensation Reset (2001 – 2010) – The proposed Order reduces minimum annual rent for January 1, 2001 through December 31, 2005 to \$24,201, based upon a land value of \$15.00 per s.f. and a water value of \$5.00 per s.f., with a ten percent rate of return. Based upon historic review of gross receipts, no percentage of gross receipt payments would be achieved. Therefore, consistent with actions taken for adjacent tenants and similar facilities, the 25 percent discount for participation in gross receipts is proposed to be discontinued.

The proposed Order establishes a minimum annual rent of \$29,041 for January 1, 2006 through December 31, 2010; based upon a land value of \$22.50 and a water value of \$7.50, with an eight percent rate of return. As discussed above, the 25 percent discount for participation in gross receipts is not applied.

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Compensation Reset (2011 – 2015) – Beginning on January 1, 2011, and annually thereafter, it is proposed that the minimum annual rent and one component of percentage rent be adjusted annually in accordance with the change in the CPI. In no event shall the minimum annual rent be lower than the prior year's minimum annual rent.

Further, beginning on January 1, 2011, it is proposed that percentage rent be modified. Consistent with actions taken for adjacent tenants with office facilities, it is recommended that participation in gross receipts related to office space be discontinued. However, with development of the new Cabrillo Way Marina, operation of the Cathay Bank recreational boat fueling station could experience an increase in revenue over the coming years. Percentage rent for the marine fueling station and other related retail activities is proposed to remain unchanged, as the current rates are consistent with rates of similar facilities and other jurisdictions.

Based on the information above, all percentage rent categories related to office space will be set to 0%, while all other percentages will remain unchanged as follows: 0 percent of commission received of new and used boats, 0 percent of insurance brokerage, 0 percent of boat rentals on a base-boat basis for 24 hours or less, 0 percent on boat chartering, 3.5 percent from ship chandlery and bait and tackle sales, 0 percent from office space, 3 percent of food and 5 percent of beverage sales from restaurant operations, 3 percent from general retail sales, 25 percent from coin-operated vending, service or game machines or devices, or 5 percent from any coin-operated machines or devices owned, leased, or rented by Concessioner, \$0.025/gallon of gasoline dispensed from premises, \$0.015/gallon of diesel dispensed from premises, 5 percent from any and all activities and business allowed under CA 518 and not otherwise provided for in this section.

These proposed changes requires percentage rent to be compared to only that portion of minimum annual rent attributable to marine fueling station operations, or \$13,428 annually. Therefore, beginning on January 1, 2011, compensation is based upon the minimum annual rent of \$29,041 adjusted by CPI, plus percentage rent in excess of \$13,428 (escalated by CPI concurrent with minimum annual rent).

Rate of Return – The eight percent rate of return used to establish the minimum annual rent for the last two, five-year compensation reset periods deviates from the Board's adopted policy of a ten percent rate of return on land value. The proposed rate is consistent with the appraisal conclusions, which found that both rate of return surveys and comparable ground lease data indicated a general decrease in rates of return to eight percent. Further, similar to other commercial facilities in the area, the Cathay Bank building has experienced difficulties in the current economic climate, including high vacancy rates, as well as a history of change in ownership, and foreclosures. In consideration of the economic conditions, deviation from the ten percent return is recommended.

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Rent Credit Due – Beginning on January 1, 2001, the proposed minimum annual rent for the three consecutive reset periods (\$24,201, \$29,041, and \$29,041 increased by CPI, respectively) would be less than current minimum annual rent (\$34,716), resulting in a total rent reduction for the ten-year period of January 1, 2001 to December 31, 2010 of \$80,950. Therefore, the proposed compensation reset would result in a rent credit to Cathay Bank.

Cathay Bank paid \$34,716 in annual rent through May 2009 and has paid no rent since that time. Taking into account past due rent and associated penalties, the rent credit due as a result of the proposed compensation reset Order would be approximately \$17,837 as of January 1, 2011. This credit would result in Cathay Bank not being required to make monthly rental payments through approximately August 2011.

ENVIRONMENTAL ASSESSMENT:

The proposed action is an Order to reset compensation rates under Permit No. 518 for three, five-year periods. 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) under Article II Section 2(f) of the Los Angeles City CEQA Guidelines.

ECONOMIC BENEFITS:

This Board action will have no employment impact for the five-county region.

FINANCIAL IMPACT:

Beginning on January 1, 2001, the proposed Order resetting compensation for the three consecutive five-year periods reduces minimum annual rent to a rate below the current minimum annual rent. This results in a total revenue reduction for the ten-year period of January 1, 2001 to December 31, 2010 of \$80,950. This revenue reduction would be realized in the Fiscal Year 2010-2011 budget year, as the associated rent credit due to Cathay Bank would be accomplished by relief from past due rent, penalties, and monthly rental payments through approximately August 2011.

Beginning on January 1, 2011, the proposed Order would result in a minimum annual rent of \$29,041 increased by CPI. Therefore, revenues to the Harbor Department would be reduced prospectively by approximately \$5,675 annually through termination of CA 518 on December 31, 2015.

CITY ATTORNEY:

The proposed Order is subject to approval as to form and legality by the Office of the City Attorney.

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
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TRANSMITTALS:

1. Order
2. Site maps



MICHAEL J. GALVIN II
Director of Real Estate

FIS Approval:  (initials)



KATHRYN McDERMOTT
Deputy Executive Director

APPROVED:

GERALDINE KNATZ, Ph.D.
Executive Director

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