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Re:

REMARKS: ☐ *Urgent* ☐ *For your review* ☐ *Reply ASAP* ☐ *Please Comment*

October 2, 2007

Mr. Roger Jeanson, Esq.
Department of Industrial Relations
Office of the Director-Legal Unit
455 Golden Gate Avenue, Suite 9516
San Francisco, CA 94102

Re: Hilton San Diego Convention Center Hotel
Public Works Case No. 2006-021

Dear Mr. Jeanson:

Port staff reviewed the documents and letters submitted to your office in conjunction with the above-referenced case. The Port's representatives during the negotiations believe that it may be helpful for you to be aware of the history that led up to issuance of a Request for Proposals (RFP) and the Port's intentions during the negotiations with Hilton San Diego Convention Center, LLC (Hilton Proposal, Hilton). This letter will not address the opinions expressed by any of the other parties involved in this matter.

Port staff recommended the District enter into an Option and Lease Agreement with Hilton after conducting an RFP and eleven months of negotiations. Port staff believes the lease negotiated with the Hilton represented market value for this particular site and ensured the most benefits for the District for these reasons:

1. The Hilton project was likely to generate the most rent to the Port;
2. The developer substantiated its capability and intent to develop the project with private financing and participation from Hilton;
3. The developer was willing to enter into an unsubordinated ground lease with the Port's percentage rent structure; and provide increased percentage rents if revenues exceed projections;
4. The developer agreed to construct and maintain a 4.5 acre park and promenade at no cost to the Port throughout the 66 year term of the lease; and
5. The developer agreed that the Port would own the public parking structure.

Staff's analysis at the time indicated that with no direct cost to the Port, the Hilton proposal provided the highest rate of return and substantially higher cash flows through both the first ten years and the entire lease term when compared to the other proposals. In exchange for amortizing $26.5 million in up-front rent credits over time, (resulting in the $46.5 million credit) the Port will receive additional rent if actual revenues exceed projections when the hotel opens, and have the public park built and maintained for 66 years.

Background:

The Port has an extensive history in its efforts to develop a hotel on the Campbell Shipyard site to provide additional hotel rooms to support the San Diego Convention Center (SDCC). The SDCC is an economic engine to the region and generates demand for a significant number of hotel rooms, which are satisfied by the surrounding hotels. The Port paid $165 million cash to develop the first phase of the SDCC, and currently pays $4.5 million annually for twenty years to pay the debt service for the second phase of the SDCC. In return for this investment, the Port receives ground rental income from the development of hotel rooms on tidelands and revenues from the SDCC public parking facilities which it owns and operates. The Port's lease with the Marriott Hotel allows Marriott to use a portion of the spaces in the SDCC public parking facility with rent payment based on additional percentage rent charges based on room revenues. This is the model that Port staff used for the parking arrangements in the negotiations with Hilton.

Further, to support development of the Ballpark, the Port entered into an agreement with the City of San Diego in 1999 promising the Port would accelerate development of a convention center hotel on the Campbell Shipyard site. The projected Transient Occupancy Tax and Possessory Interest Tax revenues from a hotel on the Campbell site were a targeted source of revenue for the City to repay the ballpark bonds. After negotiating unsuccessfully for several years with Tishman to develop the hotel, the Port granted an option to Manchester. Negotiations were ultimately terminated. The Port subsequently reimbursed Manchester $5 million in pre-development costs.

Request for Proposals:

In furtherance of the Port's agreement with the City, in September 2001 the Port issued an RFP for the hotel development. The RFP contained a number of unique requirements:

- All structures were required to be built above-grade;
- The hotel location was restricted to the southerly 5 acres of the 10-acre site, outside the prolongation of the view corridor from Park Boulevard;
- An above-grade 2,000-car public parking facility would be built and owned by the Port at the intersection of Harbor Drive and Park Boulevard to support public access to the waterfront, convention center, and parking for the hotel;
- The developer would be required to construct and maintain a 4.5 acre public park/plaza over the 66-year lease; and

- The developer was required to complete pre-development activities without assurances that the site would actually be available for development due to environmental issues that were not resolved until much later in the development process.

The Port received four proposals for development of the hotel. Port staff recommended the Hilton-led proposal because it provided the most rent to the Port; the developer agreed to execute an unsubordinated ground lease and privately finance the project with credit enhancements provided by Hilton; the developer agreed to construct and maintain the 4.5 acre park over the 66-year lease; the developer agreed that the Port would own the parking structure and the hotel parking spaces would be in the facility; and the developer agreed to the Port's rent structure.

In contrast, the other development proposals included requirements or recommendations to finance the project using public financing at substantial risk and cost to the Port; to decrease the Port's percentage rental structure which would set an undesirable precedent; required that the Port subordinate rental payments in favor of the loan at substantial risk to the Port; and that the Port directly reimburse the developer for infrastructure costs for public improvements including the park.

<u>Option & Lease with One Park Boulevard, LLC:</u>

The Port negotiated a lease with Hilton that was assigned to One Park Boulevard, LLC concurrent with the financing of the project and exercise of the Option. The ultimate terms and conditions of the final lease remained substantially similar to the original negotiations, except that the percentage rents to the Port above negotiated hotel revenues were increased from the original agreement to offset the application of the rent credit. In addition, rents for spaces in the parking structure were derived by a combination of building (space) rent and the District's percentage rent for parking.

<u>Summary:</u>

Throughout its history, the Port has invested in development and maintenance of infrastructure to ignite private redevelopment on its leaseholds. All Port-owned assets and infrastructure are built according to Public Works Law. The SDCC, Harbor and Shelter Islands, parks, roadways, piers and airport represent billions of investment in the public sector. In contrast, long term leaseholds are developed with private, not public financing and generate revenues to the Port. At the end of the lease, the Port has the discretion to take ownership of the property.

Each hotel on tidelands is a result of a unique negotiation that reflects market demand and financing considerations at the time. Throughout almost fifty years of negotiations, the Port has been a leader with a reputation of meeting or exceeding the market in its negotiations.

Port staff believes that given the specific conditions of the RFP; challenges caused by extensive site remediation; the extent of public improvements; location; and size of the site, the transaction that was negotiated with Hilton represents the market for this particular site.

Port staff has received inquiries from other tenants, who are in the process of developing leaseholds, regarding this matter. We are concerned that attempts to treat private leaseholds as public projects will set off a chain reaction and have a chilling effect on redevelopment and reduce rental revenue to the Port, which will in turn negatively impact the Port's ability to further its own capital projects. Given the short amount of time allowed to review the data received in connection with the case, the Port respectfully requests additional time to discuss this matter and would appreciate the Department of Industrial Relations delaying its decision to a later date. Please contact Christine Anderson at (619) 686-6205 or Karen Weymann at (619) 686-6540 if you have further questions regarding this request.

Sincerely,

M. Christine Anderson
Vice President and Chief Operating Officer

Karen J. Weymann
Acting Director, Real Estate

MCA/KJW/jlv
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