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THE CITY OF SAN DIEGO

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**OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT**

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Date Issued: June 11, 2018

IBA Report Number: 18-17

City Council Docket Date: June 12, 2018

Item Number: S502

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# **Proposed Actions for the City's Acquisition of a Long-Term Leasehold Interest in Tidelands Property Needed for the Convention Center Phase III Expansion Project and for the Settlement of Pending Litigation**

## **OVERVIEW**

The City Council is being asked to approve resolutions in support of a proposed transaction to acquire a long-term leasehold interest in tidelands property needed for the Convention Center Phase III expansion. If approved, the transaction would also settle a lawsuit filed by Fifth Avenue Landing LLC (FAL) against the City and the San Diego Convention Center Corporation (SDCCC). Although compelling reasons were not provided (see attached Supplemental Docketing Request), the request for supplemental docketing was granted and final documents were first made available to the Council/public in the afternoon on June 7, 2018. Councilmembers and the IBA were provided a high-level preliminary briefing on the contemplated transaction weeks earlier.

Details of the proposed transaction are complicated and result from intensive/mediated negotiations since January of 2018. The proposed transaction involves: three parties (City, FAL and the Port District); a purchase price of up to \$33.2 million for a long-term leasehold interest and other expense obligations; numerous conditions and contingencies; uncertainties; and requests that the Council make certain statements and findings. The staff report, coupled with several lengthy attachments, endeavors to comprehensively explain most of the transactional detail. However, given the complicated nature of the proposed transaction and the late release of documentation, our Office provides this report to highlight key elements of the proposed transactions; comment on the sufficiency of the funding and "at-risk" scenarios associated with plans to fulfill the purchase obligation if the transaction is approved and necessary conditions are met; and raise a few additional questions for Council consideration.

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## BACKGROUND

FAL leases certain tidelands property from the Port District (Port) and is seeking Port approval to develop two hotels (a market rate hotel of 830 to 850 rooms and a low-cost, visitor-serving hotel with 560 beds) and a marina expansion on the property (FAL Project). The City's plan to contiguously expand the Convention Center (Phase III Expansion) requires development control of the same property. Working with the Mayor's Office, SDCCC had previously negotiated and paid for a multi-year option to purchase the property from FAL for about \$14 million, however that option was allowed to expire in May of 2015 when the court disapproved the previous Phase III Expansion financing plan involving an increase in the Transient Occupancy Tax (TOT).

The City Council received little notice and was not involved in the decision to allow the option to lapse. SDCCC's Board explained at the time that there was no longer a financing plan for the Phase III Expansion and they did not feel they had the funds, or City direction, to make the \$14 million balloon payment for control of the FAL property. In January 2017, the Mayor's Office indicated they would begin working to reacquire control of the FAL property. The transaction that is currently before the Council is the end result of those efforts. It involves a payment of up to \$33.2 million for a long-term leasehold interest in the FAL property and there are other payment obligations totaling more than \$1 million (most of which are explained on page 6 of the staff report).

## KEY ELEMENTS OF THE PROPOSED TRANSACTION

### Payment for FAL's Leasehold Property

The proposed transaction involves a City payment to the Port of up to \$33.2 million to be completed by October 1, 2019. The payment has two major components with different due dates to the Port. The first major component involves a \$5 million Promissory Note obligation plus interest accruing at 3% per year. The Promissory Note payment is due within 60 days of signing of the Purchase and Sale Agreement and Escrow Instructions (PSA) - it will likely be due by mid-August 2018. The second major component is a three-installment payment obligation to the Port for the remainder of the purchase price up to \$28.2 million - with \$9.4 million due on April 1 and July 1 of 2019, and up to \$9.4 million due on October 1, 2019.

Citing the proposed settlement of the FAL lawsuit, staff is requesting Council authorize an appropriation of up to \$5.4 million from the City's Public Liability Fund to cover the Promissory Note and up to \$100,000 of any incidental costs (title, survey, and escrow expenses related to Transaction Documents). This money could be returned to the City if Alternative A Transactions (defined on pages 4 and 5 of the staff report) are completed. However, the Promissory Note obligation for the City to pay the Port \$5 million, plus 3% interest per year, remains in effect until a certificate of occupancy is issued for the expanded Convention Center, no later than December 31, 2028. There are at least three "at risk" scenarios where the City could lose the \$5 million. These "at-risk" scenarios are listed below and discussed beginning on page 8 of the staff report:

- Initiative signatures are insufficient to qualify for the November 2018 ballot
- Required voter support for the potential ballot measure is not received
- If any pending or future litigation is successful in thwarting the proposed Phase III Expansion
- If FAL is unable to deliver a "clean" title for the subject property

If the "For a Better San Diego" citizens' initiative (Initiative) qualifies for the ballot and is subsequently approved by the voters, then 59% of the resulting additional TOT proceeds can be used to fund the City's three-installment payment obligation to the Port. The additional TOT tax would become effective January 1, 2019 and the City could receive its first remittance by the end of February 2019. The CFO is estimating the City will receive approximately \$18 million in additional tax proceeds dedicated to the Convention Center expansion between February and June 2019, and \$38 million in FY 2020. If received as estimated, the CFO believes the City will have sufficient funds to satisfy the three-installment payment obligation to the Port.

### **What Happens if Alternative A Transactions are Cancelled?**

In the event Alternative A Transactions do not occur or are cancelled, including if voters do not approve the potential Initiative ballot measure, the Transaction Documents envision that the Port and FAL will complete the Alternative B Transaction described on page 5 of the staff report. The Alternative B Transaction requires the Port's Board to promptly schedule a public hearing to consider approval of the FAL Project. If the Alternative B Transactions occur and FAL obtains the necessary approvals from the Port and the California Coastal Commission, then the following will happen:

- The Phase III Expansion will be removed from the Port Master Plan
- The City will have no land use authorization to proceed with the Phase III Expansion
- The City will pay the Port all principal and interest on the City Promissory Note
- The City will not take possession of the FAL property
- The City agrees under the Settlement Agreement to neither oppose FAL's effort to obtain discretionary approvals for the FAL Project nor pursue the Phase III Expansion on FAL's existing leasehold through December 31, 2026.

### **Other Questions for Council Consideration**

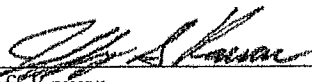
While staff has endeavored to be responsive to our questions since the documents were released last Thursday, we still have a few questions that the Council may wish to ask directly of the staff that has been most involved in negotiating the proposed transaction. Some of these questions are presented below for City Council consideration:

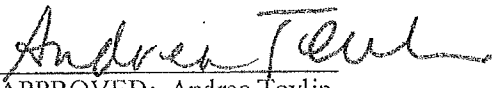
- The proposed transaction has been under development for months. What is the urgency that forced staff to request supplemental docketing (limited review time) for such a complex transaction? Could this item have been reasonably scheduled for a later City Council docket date?
- Proposed action #9 on page 2 of the staff report states the City Council is not taking any position for or against the "For a Better San Diego" citizens' initiative or any ballot measure resulting from that initiative. Would it be fair to say that the City is pursuing a transaction that provides the best opportunity for realizing the contemplated Phase III transaction if the City's voters choose to support it in the November 2018 election?
- In the fiscal impact section, the staff report indicates there are scenarios in which the City's three option installment payments in 2019 will be at risk to the City, however it states that it is premature to meaningfully assess the future installment payment risks at this time. Instead, it is suggested that these risks will be identified to the Council if the ballot measure is approved and when the Council is asked to appropriate the Special Tax funds. Despite the represented difficulty of commenting at

this time, the Council may wish to inquire about the general nature and likelihood of these risks as they are currently understood.

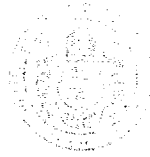
## CONCLUSION/RECOMMENDATIONS

Given the complexity of the proposed transaction and very limited time for the City Council to review documents and requested actions, our Office has issued this report to highlight certain key elements of the proposed transaction. Additionally, we comment on the plan to fund the purchase obligation, associated "at-risk" scenarios, and some of the potential consequences if the Alternative A Transactions cannot be completed. Finally, we raise a few additional questions for Council consideration and encourage the City Council to ask any other questions they might have because of the complexity and significance of the requested actions. The IBA views the requested actions as a policy decision for the Council relating to a proposed legal settlement and furthering efforts to realize the potential of the Phase III Expansion, and therefore does not offer a recommendation for action.

  
Jeff Kavar  
Deputy Director

  
APPROVED: Andrea Tevlin  
Independent Budget Analyst

Attachment: 1. Supplemental Docketing Request dated June 5, 2018




## THE CITY OF SAN DIEGO

## M E M O R A N D U M

DATE: June 5, 2018

TO: Honorable Council President Myrtle Cole

FROM:   
Almis Udrys, Deputy Chief of Staff, Office of Mayor Kevin Faulconer

SUBJECT: Supplemental Docketing Request for *Approval of proposed transaction documents among the City of San Diego, Fifth Avenue Landing, LLC, a California limited liability company (FAL), and the San Diego Unified Port District (Port District) for the City's acquisition of a long-term leasehold interest in tidelands property needed for the Convention Center Phase III expansion project and for the settlement of pending litigation and any related claims between the City and FAL, and approval of related actions.*

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This memorandum shall serve as the formal request to docket "*Approval of proposed transaction documents among the City of San Diego, Fifth Avenue Landing, LLC, a California limited liability company (FAL), and the San Diego Unified Port District (Port District) for the City's acquisition of a long-term leasehold interest in tidelands property needed for the Convention Center Phase III expansion project and for the settlement of pending litigation and any related claims between the City and FAL, and approval of related actions*" as a supplemental item at City Council on Tuesday, June 12, 2018.

This item is to approve an agreement among the City of San Diego, FAL, and the Port District for the City's acquisition of a long-term leasehold interest in tidelands property on which the City desires to construct and operate the Convention Center Phase III Expansion. The detailed transaction documents which will be presented to the Council for approval reflect the successful outcome of mediation among these three parties. This agreement is structured to limit the City's financial exposure and provides the best opportunity for the City to pursue the Phase III expansion project and to resolve the FAL Lawsuit.

Thank you for your assistance with docketing this matter.

AU/jl

cc: Aimee Faucett, Chief of Staff, Office of the Mayor  
Kris Michell, Chief Operating Officer  
Andrea Tevlin, Independent Budget Analyst  
Stacey LoMedico, Assistant Chief Operating Officer  
Jessica Lawrence, Director of Finance Policy & Council Affairs, Office of the Mayor  
Erin Demorest, Director of Legislative Affairs, Office of the Council President  
Katie Keach, Director, Communications Department  
Libby Borg, Docket Liaison, Docket Office

