

DATE ISSUED: September 6, 2000

REPORT NO. 00-175

ATTENTION: Honorable Mayor and City Council
Docket of September 12, 2000

SUBJECT: Lease Agreement - San Diego Hilton Resort

SUMMARY

Issues - Should the City Manager be authorized to enter into a new 50-year lease agreement with Hilton San Diego Corporation, d.b.a. San Diego Hilton Resort?

Manager's Recommendation - Approve the new lease agreement.

Other Recommendations - None.

Fiscal Impact - Revenue has steadily increased since the improvements were completed at the San Diego Hilton Resort. In addition, the proposed lease agreement provides for increases in certain percentage rent categories in the year 2011.

BACKGROUND

In March, 1994, the City Council authorized exclusive negotiations with the lessee at the San Diego Hilton Resort. The lessee proposed to invest \$25 million in improvements to the hotel interior and exterior and requested a 25 year lease extension. It was anticipated that rental revenue to the City would increase by \$1 million over the first six years as a result of the renovation. Staff began negotiations with the lessee for a new lease and the lessee began the \$25 million renovation project.

The project included a complete exterior and interior renovation of all the buildings and guest rooms including an expansion of the guest restrooms, a new pool and pool area, ADA improvements, ballroom, lobby and hotel renovations. Site amenities included enhanced landscaping, new fountains and enriched paving areas.

DISCUSSION

Due to protracted negotiations by both parties, the new lease agreement was not brought to the City Council. The lessee completed the renovation project in 1995 and the City's rental revenue has dramatically increased since the renovation was completed. In the three years before renovation, the average annual rent to the City was \$900,000. Since the renovation, the average annual rent to the City is \$1.57 million. This figure does not include increased T.O.T. as a result of the increased room rates. The City's rent for fiscal year 2000 was \$1.8 million and \$1.9 million in fiscal year 1999.

The lease agreement has been finalized and staff is recommending entering into a new 50 year lease. (A new 50 year lease term would actually be a 25 year extension, since the Hilton's existing lease does not expire until 2019). The basic terms and conditions of the proposed new lease are as follows:

Term - 50 years, with the lease commencement date retroactive to January 1, 1996.

Rent -The lessee will pay the greater of:

- 1) an annual guaranteed minimum rent ranging from \$1.1 million to \$1.4 million in the first 10 lease years; or
- 2) various percentage rates of the lessee's gross revenue.

Rent Adjustments - The annual minimum rent will be adjusted every 5 years. The percentage rent has stepped up increases in the 15th lease year and market adjustments every 10 years thereafter.

Insurance - The proposed lease requires \$5 million public liability insurance.

Additional Consideration - The City will receive 1% of gross proceeds from the sale, encumbrance or majority sublease of the leasehold interest.

Water Quality Best Management Practices (BMP's) - This lease agreement contains a requirement that the lessee prepare and adhere to BMP's to provide increased water quality protection.

Acreage - There will be no increase to the land or water leased areas.

The 1996 renovation greatly enhanced the San Diego Hilton Resort, making it a gem in Mission Bay. It has also increased the City's rental revenue dramatically. The proposed new lease provides for additional consideration, water quality best management practices and will further increase revenue due to the stepped up increases.

ALTERNATIVE

Do not authorize the new lease. This alternative is not recommended since the City will not benefit from the rent increases in the 15th lease year, the additional consideration lease language and the water quality best management practice lease language.

Respectfully submitted,

William T. Griffith Approved: George I. Loveland
Real Estate Assets Director Assistant City Manager.....

GRIFFITH/LMF