

DATE ISSUED: July 28, 2004

REPORT NO. 04-166

ATTENTION: Honorable Mayor and City Council

SUBJECT: Wave House Belmont Park, LLC – Consent to Encumbrance of the Leasehold

### SUMMARY

Issues – Should the City Manager be authorized to approve the leasehold encumbrance at Belmont Park? A \$9 million loan has been secured to refinance the leasehold acquisition financing of \$6.5 million, with the \$2.5 million balance along with \$1.9 million of lessee equity invested in improvements to the property. As a condition to making the loan, the lender, Imperial Capital Bank, requires the City to subordinate rent in excess of \$140,000 per year to debt service. In return for doing so, the lessee will provide personal and corporate guarantees securing the payment of all rent.

Manager's Recommendation - Approve the encumbrance of the leasehold.

Fiscal Impact – None with this action. If the Manager's recommendation is adopted, \$4.4 million will be invested in the property to renovate the Plunge swimming pool building and to fund the design and construction of new water features as stipulated in the development plan of the lease. It is anticipated that the investment will enhance revenue generated from the property. The cash payments currently received by the City will not be affected by this action. If in the future net operating income actually decreases, the subordination could come into effect. Staff has addressed this unlikely event through the personal and corporate guarantee of rent payments.

### BACKGROUND

The City leases its property at Belmont Park to Wave House Belmont Park, LLC, pursuant to a percentage lease authorized by the City Council which expires in 2038. The leasehold includes the historic Plunge swimming pool and 70,000 square feet of commercial space to house specialty retail shops, restaurants, game rooms, miscellaneous attractions, and water features in the common areas. In May 2002, the leasehold was assigned to Wave House San Diego, LLC and will be subsequently assigned to Wave House Belmont Park in August 2004 as part of the

financing. Tom Lochtefeld, principal of Wave House of Belmont Park, has over 20 years experience in designing and operating water parks in United States and overseas.

Belmont Park has been an under performing asset since the inception of the lease in 1987. The current lessee is in the process of creating a water-themed recreational and visitor oriented commercial complex at Belmont Park to generate business and improve the property. The first permanent water feature at Belmont Park, an artificial wave called the "Flow Rider," opened on June 3, 2004. Temporary water features were tested during the summers of 2001 and 2002. Additional water-themed features will be designed, developed and installed by the lessee over the next several years including one additional wave, opening summer 2005. Completion of all phases of the development on the leasehold will occur by 2010. It is envisioned that Belmont Park will become a popular destination for San Diegans and tourists that will provide new jobs, increase economic activity, and enhance lease revenue to the City.

## DISCUSSION

Wave House Belmont Park, LLC, has secured a commitment for a \$9 million loan from Imperial Capital Bank to cover financing and construction costs (Letter of Interest from Imperial Capital Bank is attached as Exhibit "A"). These costs include designing and engineering new water features, renovating the Plunge swimming pool building and completing Phase 1 of the water-themed attractions described in the Fifth Operating Memorandum to the lease approved by the Council in 2000 (attached as Exhibit "B"). The acquisition loan of \$6.5 million with La Jolla Loans, Inc. is due on August 15, 2004 and needs to be refinanced. The proposed lender has requested that Wave House Belmont Park, LLC provide additional security in the form of an encumbrance against the rental obligations to the City in excess of \$140,000 per year. The City currently receives \$140,000 of the annual minimum rent payment of \$775,638 in cash, with the remainder applied to the existing rent credit balance. The subordination will not effect the amount the City currently receives in cash. The subordination would only come into play if in the future there is not sufficient cash flow to cover debt service payments of \$837,323 per year. Imperial Bank's underwriting requirements assume that the existing cash flow continues for the 20-year amortization period of the loan. They also require a debt service ratio of 1.32 over these revenue assumptions to make the loan. As long as the leasehold produces the current gross revenues of \$10.5 million per year and the operating expenses track revenue growth, the debt service coverage is at least 1.42, which means that the subordination will not be a factor. It is anticipated that the current reinvestment in the property will significantly enhance revenues. Despite it being highly unlikely, the remote possibility of a shortfall occurring has led City staff to take additional steps to minimize the City's risk. In an abundance of caution, the City has required both a personal guarantee from Mr. Tom Lochtefeld and a corporate guarantee from Wave Loch, Inc. as additional security ensuring the payment of all rent (attached as Exhibit "C"). The total current value of personal and corporate guarantees is \$5.38 million. The lessee has also committed to investing in excess of \$1.9 million of personal equity in the project along with \$2.5 million from the loan which will result in \$4.4 million being immediately invested in the property.

Under the terms of the Fifth Operating Memorandum to the lease, the lessee is obligated to construct water themed improvements at Belmont Park. Phase 1 of the development plan is underway. By 2006 the lessee will submit Phase 2 of the development plan to the City. Phase 2 is anticipated to include structural refurbishment/adaptive reuse of the Plunge building, new water features, and parking improvements.

The Wave House San Diego, LLC, lease allows the City Manager to approve encumbrances of the leasehold under the following circumstances:

1. the net proceeds of the loan are devoted to developing the leased premises according to the development plan,
2. that the loan does not exceed 80% of the appraised value of the leasehold estate,
3. the operating income is adequate to cover the loan payments and the rent due under the lease, and
4. the encumbrance must be subject to all terms of the lease.

The financing sought by Wave House Belmont Park meets these required criteria as follows:

1. lessee is not pulling equity out of the property, lessee's equity and loan proceeds of \$4.4 million will be invested to implement the development plan,
2. based upon the most recent independent outside appraisal dated August 16, 2003, the value of the leasehold is \$19.4 million. The new \$9 million loan is equal to 46% of the of the appraised value of the leasehold, it does not exceed 80% of the appraised value as stipulated in the lease,
3. \$1.38 million annual net operating income from the leasehold is sufficient to pay the \$140,000 annual rent to the City and service the \$837,323 debt service, and
4. the encumbrance is consistent with all terms of the lease except for the subordination of a portion of the rent to the loan payment.

Since the proposed encumbrance includes the subordination provision, City Council approval is required. The City Manager recommends that the City Council authorize the proposed encumbrance provided that the City receives the personal guarantee of Mr. Lochtefeld and corporate guarantee of Wave Loch for the rent being subordinated.

#### ALTERNATIVE

Do not approve the subordination for the encumbrance of the leasehold. If the subordination is not authorized, the loan with the Imperial Capital Bank will likely not proceed. It is unlikely that

another lender can be secured within the time frame required to keep the project on the current schedule.

Respectfully submitted,

Approved:

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William T. Griffith  
Real Estate Assets Director

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Bruce Herring  
Deputy City Manager

Note: The attachments are not available in electronic format. A copy is available for review in the Office of the City Clerk.

Attachments:

- Exhibit A – Letter of Interest from Imperial Capital Bank
- Exhibit B – Fifth Operating Memorandum to the Lease Agreement
- Exhibit C – Personal/Corporate Guarantee

GRIFFITH/VEB