

**FILE NUMBER: 2025-126**

**DATE:** Tuesday, April 15, 2025

**SUBJECT: Ordinance Approving Second Amendment to Option to Lease Agreement with Sunroad HIE Hotel Partners, L.P. for A 66-Year Lease**

**DESCRIPTION: Adopt an Ordinance Approving Second Amendment to Option to Lease Agreement with Sunroad HIE Hotel Partners, L.P. for a 66-Year Lease to Develop an up to 450-Room Hotel on Harbor Island to Extend the Term of the Option and Update Other Terms**

**EXECUTIVE SUMMARY:**

Sunroad HIE Hotel Partners, L.P. ("**Sunroad**") is proposing the development of the Sunroad Harbor Island East Hotel, which would include development, operation, and maintenance of an up to 450-room hotel and associated amenities, including a walk-up restaurant and bar area, swimming pool, jacuzzi spa, retail space, conference space, parking lot(s), waterfront promenade, and landscaping (collectively, the "**Project**"). The Project is located at the eastern corner of Harbor Island Drive, consisting of two parcels totaling approximately 7.55 acres ("**Project Site**") commonly referred to as the "Elbow Parcel" (see Attachment A – Location Map).

On July 21, 2021, Sunroad entered into an Option to Lease Agreement ("**Option**")<sup>1</sup> with the San Diego Unified Port District ("**District**") for the redevelopment of the Project Site. The Option includes and attaches a 66-year ground lease ("**Original Lease**") to be executed and effective after (1) Sunroad's satisfaction of all conditions precedent specified in the Option and (2) Sunroad's exercise of the Option. The Option, which was later amended by Amendment No. 1 to the Option to Lease Agreement<sup>2</sup>, currently expires on May 31, 2025.

At the November 9, 2021 Board meeting, the Board adopted a resolution (BPC Resolution No. 2021 -144) authorizing the issuance of appealable Coastal Development Permit No. 2021-07 for the Project ("**CDP**"), which, CDP is on file in the Office of the District Clerk as Document No. 73453. The CDP was later amended to extend the termination from December 7, 2024 to December 7, 2026.

During the time elapsed since entering into the Option, the hospitality market has changed considerably, with substantial increases in hotel construction costs and to interest rates for hotel financing. Due to these changes in market conditions, as well as unknowns related to what qualifies as low cost overnight visitor accommodations ("**LCOVA**") to determine what, if any, in-lieu fee is due under the CDP, the Project is no longer feasible based on the current terms of the Option and Original Lease. In order for the Project to be able to continue to move forward and ultimately be successful, staff and Sunroad have renegotiated the terms of the Option and Original Lease.

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<sup>1</sup> Office of the District Clerk Document No. 72948.

<sup>2</sup> Office of the District Clerk Document No. 75951.

The renegotiated terms include a Second Amendment to the Option to Lease Agreement (“**Second Amendment**”) that extends the Option term from May 31, 2025 to December 31, 2026 and revises the Option’s assignment provisions to facilitate equity investment. The Second Amendment also includes, as an attachment, a revised Lease (“**Revised Lease**”) that, as compared to the Original Lease, provides for a longer fixed rent period, increases percentage rental rates for room rental, and includes a cost sharing between the District and Sunroad of any LCOVA in-lieu fees due under the CDP. Staff recommends adopting an Ordinance approving the Second Amendment to Option to Lease Agreement with the Revised Lease attached thereto, all in substantial form as Attachment B to this agenda.

### **RECOMMENDATION:**

Adopt an Ordinance Approving Second Amendment to Option to Lease Agreement with Sunroad HIE Hotel Partners, L.P. for a 66-Year Lease to Develop an up to 450-Room Hotel on Harbor Island to Extend the Term of the Option and Update Other Terms

### **FISCAL IMPACT:**

If the Board adopts the Ordinance approving the Second Amendment and should Sunroad exercise the Option and execute the Revised Lease, the District would be responsible for paying 50% of any LCOVA in-lieu fee due five years following completion of the hotel, with an anticipated cost of approximately \$1,640,000 to \$3,250,000 net present value (“**NPV**”). The LCOVA in-lieu fee will be based on the number of hotel rooms in the Project determined to be “high-cost” using the methodology established by the California Coastal Commission. Funds required for future fiscal years will be budgeted in the appropriate fiscal year, subject to Board approval upon adoption of each fiscal year’s budget.

As compared to the Current Lease, the updated rent structure under the Revised Lease would result in an estimated total NPV of rent to the District over the 66-year lease term of \$27.7 million net of the upper range of the in-lieu fee and not including potential additional rent as detailed below. This is a reduction of \$9.8 million NPV over the 66-year term which includes both the renegotiated rent and payment of the upper range of the in-lieu fee; however, this reduction assumes that the Project could be successfully completed under the terms of the Current Lease, which as noted above, is infeasible.

### **COMPASS STRATEGIC GOALS:**

This agenda item supports the following Strategic Goal(s).

- A vibrant waterfront destination where residents and visitors converge.
- A financially sustainable Port that drives job creation and regional economic vitality.

### **DISCUSSION:**

The District and Sunroad entered into the Option on July 2, 2021. Since then, the Project has faced numerous challenges, including project redesigns, a global pandemic, significant cost increases, unknowns related to LCOVA requirements, and, most recently, large fluctuations in the hospitality financing market. These factors have had a significant impact on the Project's feasibility under the terms of the original Option and its accompanying Original Lease. The District and Sunroad have renegotiated the terms set forth in the Option and Original Lease to ensure the Project remains feasible given current market conditions and in order to aid in the delivery of a new waterfront Project that will provide enhanced public access and amenities as well as future rental revenue to the District.

The revised terms set forth in the Revised Lease aid feasibility by including a longer fixed rent period to allow for stabilization of the hotel. The updated rent terms also include higher percentage rental rates for room rental in the later lease years after hotel stabilization and necessary refinancing events have occurred.

Since an onsite solution to the LCOVA requirement is challenging, the likely need to pay an LCOVA in-lieu fee further impacted feasibility. District and Sunroad agreed to split the cost of any in-lieu fee due under the CDP, calculated at \$100,000 per room for 25% of the high-cost rooms. The Project currently includes a 225 room micro-hotel component as part of the planned dual-branded hotel Project, which would not likely require mitigation as the associated rooms would be considered "moderate-cost" by the Coastal Commission. Staff anticipates that the District's contribution toward the in-lieu fee would only be required for mitigating approximately 225 "high-cost" rooms; however, if the micro-hotel does not qualify as "moderate-cost", the District's 50% contribution toward the LCOVA in-lieu fee would be for a mitigation of a maximum of 450 rooms. Payment of the LCOVA in-lieu fee would not be required until five years following Project completion.

Additional updates contained in the Second Amendment and Revised Lease are set forth below:

	<b>Current Option</b>	<b>Second Amendment</b>
Term Expiration*	May 31, 2025, with an additional one year of extensions in three-month increments for \$100,000 each at the discretion of the Executive Director	December 31, 2026, with an additional one year of extensions in three-month increments for \$100,000 each at the discretion of the Executive Director
Fixed Rent Period	Lease Years 1 – 7 Year 1: \$250,000 Year 2: \$250,000 Year 3: \$500,000 Year 4: \$500,000 Year 5: \$500,000 Year 6: \$1,000,000 Year 7: \$1,500,000	Lease Years 1 – 10 Year 1: \$0 Year 2: \$0 Year 3: \$0 Year 4: \$250,000 Year 5: \$500,000 Year 6: \$500,000 Year 7: \$750,000 Year 8: \$750,000

		Year 9: \$1,000,000 Year 10: \$1,000,000
Minimum Annual Rent Look Back Adjustments	Commence Lease Year 8	Commence Lease Year 11
Percentage Room Rental Rates	7% Year 1 – 15 7.25% Year 16 – 20 7.5% Year 21 – 35 7.75% Year 36 – 45 8.0% Year 46 – 55 8.25% Year 56 – 66	7% Year 1 – 20 7.25% Year 21 – 30 7.5% Year 31 – 40 7.75% Year 41 – 50 8% Year 51 – 55 8.5% Year 56 – 60 9% Year 61 – 66
Additional Rent	3% of gross sales beyond specified gross sales threshold for Lease Years 1-7	3% of gross sales beyond specified gross sales threshold for Lease Years 1-10
LCOVA In Lieu Fee	N/A	District and Sunroad split cost of in-lieu fee for mitigation of up to 450 rooms.

Since entering into the Option and following the issuance of the CDP, Sunroad has been diligently working to satisfy the conditions in both the Option and CDP. However, conditions outside of the District and Sunroad's control have resulted in the need to revisit the terms of the Option and Original Lease. Staff believes the terms set forth in the proposed Second Amendment and Revised Lease will aid in the delivery of a successful hotel project to District tidelands. As a result, staff recommends that the Board approve the Second Amendment to Option to Lease Agreement and the Revised Lease attached thereto, all in substantial form and substance as Attachment B to this agenda sheet.

#### **General Counsel's Comments:**

The Office of the General Counsel has revised this agenda sheet and the attachments as presented to it and approves the same as to form and legality.

#### **Environmental Review:**

The proposed Board action, to adopt an ordinance granting a Second Amendment to Option to Lease Agreement with Sunroad HIE Hotel Partners, L.P. to extend the term of the option and update other terms, was adequately analyzed in the First Addendum to the Final Environmental Impact Report (FEIR) for the Sunroad Harbor Island Hotel Project and East Harbor Island Subarea Port Master Plan Amendment (UPD# 83356-EIR-783; SCH# 2006021027, Clerk Document No. 61175) prepared and adopted by the District on April 13, 2021 (Resolution No. 2021-059). The proposed project is not a separate project for CEQA purposes but is a subsequent discretionary approval related to a previously approved project. (CEQA Guidelines § 15378(c); *Van de Kamps Coalition v. Board of Trustees of Los Angeles Comm. College Dist.* (2012) 206 Cal.App.4th 1036.) Additionally, the proposed Board action does not require further environmental review pursuant to CEQA Guidelines Sections 15162 and 15163 based on the review of the entire record,

including without limitation the First Addendum, as: 1) no substantial changes are proposed to the project and no substantial changes have occurred that require major revisions to the First Addendum due to new significant environmental effects or an increase in severity of previously identified significant effects; and 2) no new information of substantial importance has come to light that (a) shows the project will have one or more significant effects not discussed in the previous First Addendum, (b) identifies significant impacts more severe than those analyzed in the previous First Addendum, (c) shows that mitigation measures or alternatives are now feasible that were identified as infeasible and those mitigation measures or alternatives would reduce significant impacts, or (d) shows mitigation measures or alternatives which are considerably different from those analyzed in the previous First Addendum would substantially reduce one or more significant effects on the environment. Because none of these factors have been triggered, pursuant to CEQA Guidelines Section 15162(b), the District has determined no further analysis or environmental documentation is necessary. The proposed Board action is merely a step in the furtherance of the original project for which environmental review was performed and no supplemental or subsequent CEQA has been triggered; accordingly, no further environmental review is required.

The proposed Board action complies with Section 87(a)(2) of the Port Act which allows for all visitor-serving commercial and industrial uses and purposes, and the construction, reconstruction, repair, and maintenance of commercial and industrial buildings, plants, and facilities. The Port Act was enacted by the California Legislature and is consistent with the Public Trust Doctrine. Consequently, the proposed Board action is also consistent with the Public Trust Doctrine.

The proposed Board action was covered in the Coastal Development Permit (CDP) for Sunroad Harbor Island East Hotel Project (CDP-2021-07, dated December 7, 2021; Clerk Document No. 73453) approved for issuance by the District on November 9, 2021 (Resolution No. 2021-144). The proposed Board action is consistent with the CDP. No additional action under the California Coastal Act is required at this time.

#### **Diversity, Equity, and Inclusion Program:**

This agenda sheet has no direct impact on District workforce or contract reporting at this time.

#### **PREPARED BY:**

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#### **Attachment(s):**

Attachment A: Location Map

Attachment B: Second Amendment to Option to Lease Agreement