



Administrative Report

Council Action Date: December 18, 2007

To: MAYOR AND CITY COUNCIL

From: GWENDOLYN PARKER, DIRECTOR OF HARBOR BUSINESS & TRANSIT

Subject: KOSMONT & ASSOCIATES, INC. PIER AND HARBOR ASSET MANAGEMENT PLAN

RECOMMENDATION

1. Receive and File the Kosmont & Associates Pier and Harbor Asset Management Plan
2. Refer Kosmont & Associates' proposed Pier and Harbor Asset Management Plan to the Harbor Commission for policy review and feedback to the City Council and City Manager

EXECUTIVE SUMMARY

The City of Redondo Beach is responsible for the management of a variety of properties in the Pier and Harbor area. The City Council approved an agreement with Kosmont & Associates (Kosmont) to prepare recommendations on managing these assets. Completed for the City Council's review is a proposed Pier and Harbor Asset Management Plan (Plan). The proposed Plan describes findings and strategies for the City to pursue in managing these assets. It is recommended that the City Council request the Harbor Commission's policy review and feedback prior to the City Council's final action on the Plan.

BACKGROUND

The completion of the Plan for the Pier and Harbor was identified as a City Council priority in the Strategic Plan, Annual Budget and Harbor Working Group's findings. Kosmont was selected to prepare recommendations on managing the City's assets in the Pier and Harbor area. The proposed Plan is attached for the City Council's review.

Kosmont's research and data gathering included multiple visits to the Pier and other properties, discussions with City staff, community stakeholders and RRM Design Group, review of the Harbor Zoning amendment, market research and examination of examples of public/private management of public land. Kosmont assessed properties located at 655 N. Harbor Drive, the former Triton Oil site, 230 Portofino Way, 135-9 N.

International Boardwalk and the Municipal Pier, evaluating opportunities and constraints. The report also makes recommendations for short-term use and strategies, long-term use and strategies, and next steps.

The Harbor Commission's review of the proposed Plan can provide the City Council and City Manager with additional important policy advice on this subject. Therefore, it is recommended that the City Council refer the proposed Plan to the Harbor Commission for policy review and feedback. The Plan would return to the City Council for final action in February.

COORDINATION

The Harbor, Business & Transit Department coordinated with the City Manager's Office on this study.

FISCAL IMPACT

The contracted consulting work required for preparation of the Plan was paid for from funding appropriated in the adopted FY2007-08 Departmental Budget (Harbor Fund).

Submitted by:


Gwendolyn Parker
Harbor, Business & Transit Director

gparker

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Approved for forwarding by:


Office of the City Manager

Attachment:

- Proposed Pier and Harbor Asset Management Plan

CITY OF REDONDO BEACH

PIER AND HARBOR ASSET MANAGEMENT PLAN



SUMMARY OF FINDINGS



KOSMONT COMPANIES

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1.0 Executive Summary

The City of Redondo Beach (“City”) Harbor Department (“Harbor Department”) retained Kosmont Companies to evaluate the potential highest and best use of five properties under direct City control, to provide an analysis of whether properties on and around the Redondo Beach Pier (“Harbor Area”) should be controlled exclusively by the City or disposed of to a private entity, whether the City should attempt to aggregate leaseholds either for City or private entity control, and under what circumstances it should undertake any of these activities.

As part of its analysis Kosmont evaluated existing conditions in the Harbor Area, market conditions at similar harbor/marina areas, examples of private management of public assets, and examples of public management structures of public assets. As a result of this analysis a series of recommendations for obtaining the highest and best use for each of the properties is provided. In general these recommendations provide strategies for the City and Harbor Department to utilize to attract high quality tenants to the properties in question, and ultimately throughout the Harbor Area.

The central theme of Kosmont’s recommendations is that there exist high quality tenants and amenities within the Harbor Area which, through deliberate strategic actions, can likely be utilized to attract additional high quality tenants and ultimately result in a meaningful and apparent revitalization of the Harbor Area. Initially the City and Harbor Department may have to proactively manage the redevelopment process, and in some targeted cases provide public incentives to attract desired tenants.

In addition to attracting new high quality tenants to certain key properties, Kosmont also recommends that the City and Harbor Department pursue long-term strategies of aggregating leaseholds and selectively granting master leaseholds to private entities with the goal of increasing operational efficiencies, increasing City revenue, and helping to ensure amenities are maintained in a manner appealing to the market.

In summary, it is Kosmont’s opinion that significant portions of the Harbor Area are functionally obsolete, and in need of significant investment and redevelopment. Fortunately, based on the analysis contained herein it is Kosmont’s conclusion that if certain key properties are redeveloped through active City efforts, and certain general policy recommendations are implemented, the ultimate result could be a dramatic revitalization of the entire Harbor Area within a 20 year horizon.

2.0 Introduction

2.1 Purpose

The City of Redondo Beach (“City”) Harbor Department (“Harbor Department”) retained Kosmont Companies (“Kosmont”) to evaluate the highest and best use of five properties under City Control, and provide general strategy and policy recommendations about how the City and Harbor Department should manage the five properties and other properties which comprise the Redondo Beach Harbor (“Harbor Area”). In addition to an initial highest and best use analysis for the five properties, the Harbor Department is interested in answering the following questions:

1. Should the City continue to acquire parcels over time, and retain direct control?
Under what circumstances should acquisition occur? Should the acquisitions occur as part of a general policy, or should they occur on a case by case basis? In either case, what criteria should be used?
2. Should the City consider combining leaseholds over time, as conditions warrant and acquisition opportunities present themselves to allow for fewer fragmented leasehold areas?
Should the leaseholds be combined with existing private entities, or independently under direct City control?
3. Should the City divest itself of its direct tenant leases entirely and trust all Harbor Enterprise lands to the private sector under ground leases?
4. Should the City consider a hybrid policy which combines elements of each of the alternatives above? *What criteria should the City utilize in determining the direction for each property?*

In order to evaluate these questions and provide appropriate recommendations, Kosmont analyzed each of the five properties individually, the Harbor Area as a whole, similar regional locations, similar publicly operated facilities, and current market conditions. Kosmont’s conclusions and recommendations follow in this report.

2.2 Sources of Information

The information utilized for the completion of this report was obtained from the following sources:

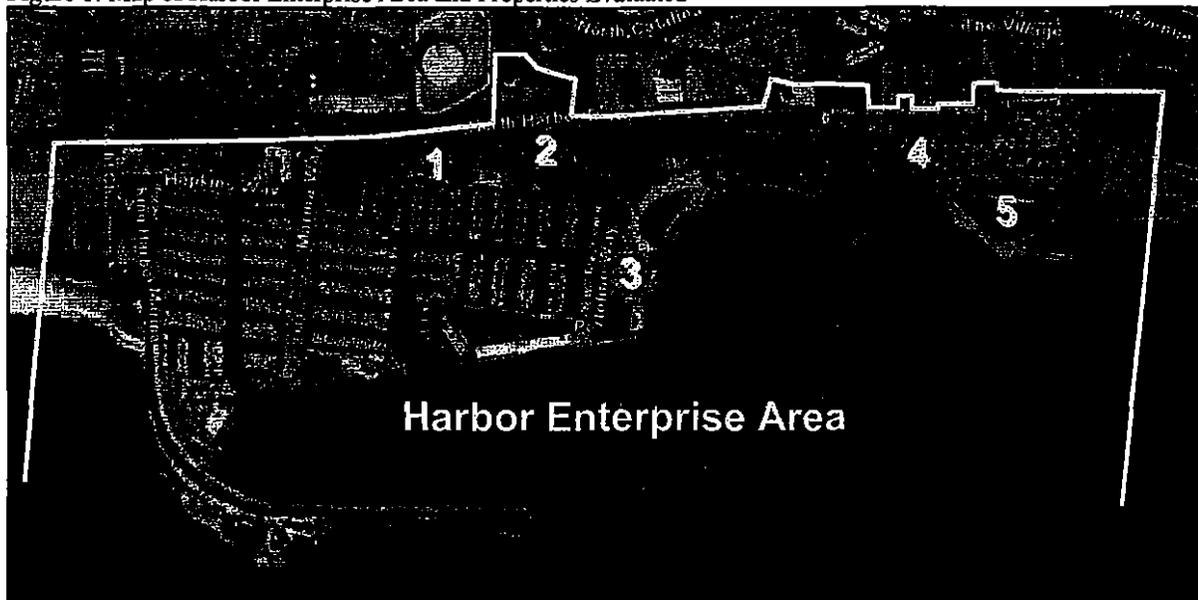
- California Real Estate Journal
- Harbor Department Staff
- Kosmont Companies
- Loopnet
- Los Angeles Business Journal
- Presentations at Harbor Commission Meetings

- Presentations/Discussion at City Council Meetings
- RRM Design Group
- Site Visits
- Various Commercial Real Estate Brokerage Houses
- Interviews with Various Stakeholders

2.3 Harbor Enterprise

The Harbor Enterprise occupies greater than 150 acres of land and water area located west of Harbor Drive, south of the boundary between the City and the City of Hermosa, to just south of the Redondo Beach Pier ("Pier") (please see Figure 1: Map of Harbor Enterprise Area and Properties Evaluated). The Harbor Enterprise includes the properties on and around the Pier. The Harbor Department manages the Harbor Enterprise, and serves as the landlord for all properties within the Harbor Enterprise. All of the land within the Harbor Enterprise occupied by private entities is done so through rights conveyed by ground leases of various terms. The Harbor Department is responsible for overseeing these ground leases. A map of the Harbor Enterprise area follows in Figure 1: Map of Harbor Enterprise Area and Properties Evaluated.

Figure 1: Map of Harbor Enterprise Area and Properties Evaluated



2.4 Properties Evaluated

As part of its analysis Kosmont evaluated five specific properties of particular interest to the Harbor Department and/or properties currently without tenants. These properties are identified as (1) 655 N. Harbor Drive, (2) the Former Triton Oil Site, (3) 230 Portofino Way, (4) 135-9 N. International Boardwalk, and (5) the Municipal Pier. These properties are discussed in greater detail in section 4.0 Highest and Best Use. The location of the properties evaluated is shown above in Figure 1: Map of Harbor Enterprise Area and Properties Evaluated.

3.0 Harbor Conditions

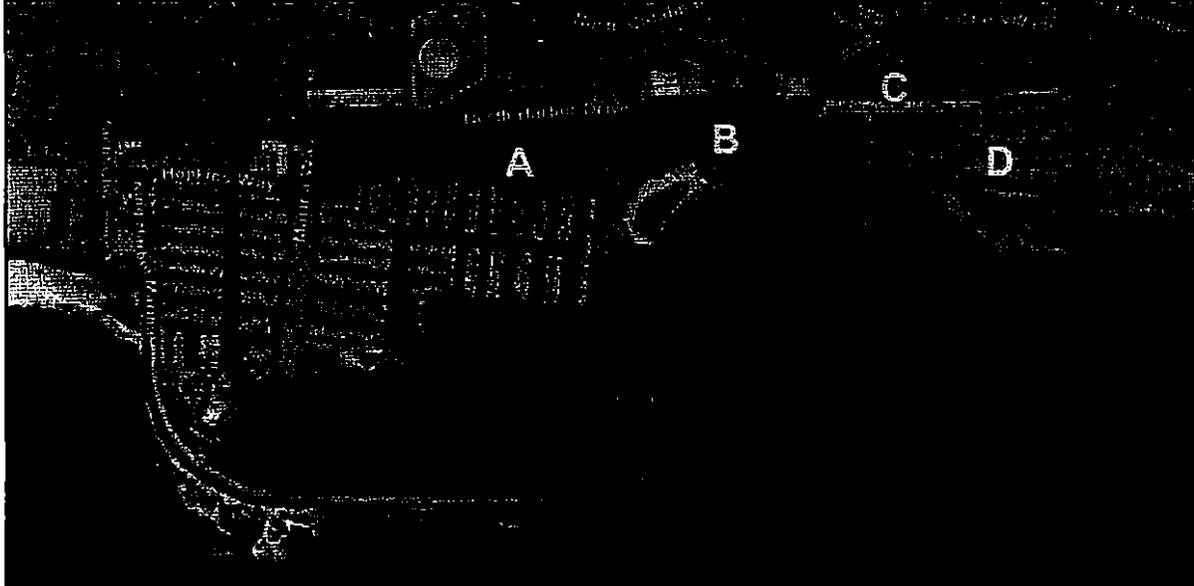
As part of its analysis Kosmont analyzed conditions specific to the Harbor, and current market conditions at certain similar waterfront locations throughout Southern California.

3.1 Existing Conditions

In general the Harbor Area is functional and serves as an attraction for some local, regional, national patrons. However, it is Kosmont's opinion that while the Harbor Area has excellent potential, many of the existing facilities and amenities are tired, aging, disconnected, and not sufficiently appealing to much of the mainstream local and regional patrons. The City and Harbor Department are currently undertaking several efforts to improve the Harbor Area and Pier, including the establishment of consistent zoning standards across the Harbor Area, creating a new façade/theme for the Pier, and a citywide branding effort to establish identity for the community. Additionally, one of the largest ground lease holders is in the process of soliciting offers to sell its ground lease. Should a transaction be consummated the new owner may have interest in undertaking significant redevelopment activities within the Harbor Area. All of these efforts and activities have the potential to result in dramatic improvements to the Harbor Area.

In an effort to area to fully understand the Harbor Area and develop optimum strategies and recommendations, Kosmont visited the various components which comprise the Harbor Area on multiple occasions (various times of the day, the week, and the year). Based on these visits, Kosmont identified four "Study Areas" which are each unique in their use, quality, and ripeness for either leasing or redevelopment. A discussion of each of the Study Areas follows. Figure 2: Map of Harbor Study Areas depicting the location and boundaries of the Study Areas is below.

Figure 2: Map of Harbor Study Areas



Study Area A - This area lies between Marina Way to the north, Harbor Drive to the east, Portofino Way to the south, and the Port Royal Marina to the west, and currently contains several A-Credit and other quality tenants including the Bluewater Grill, the Cheesecake Factory, Joe's Crabshack, the Port Royal Marina, and the Portofino Hotel. Other than public improvements and signage/theming geared toward better identification of this "restaurant district", this study area has the potential to attract additional A-credit tenants in its current state. Consequently, the need for redevelopment activities is limited to aesthetic/promotional enhancements.

Study Area B - This is a comparatively large area (termed "Redondo Beach Marina" by the current owner) encompassing approximately 7.09 acres under the control one entity, generally located south of Portofino Way, west of Harbor Drive, North of the Redondo Beach Marina, and east of the harbor. This ground lease underlying this area (and the boat slips in the Redondo Beach Marina) is currently for sale, and presents the primary opportunity to reinvigorate the overall area. This area currently includes some A-Credit tenants, but primarily local tenants. The potential of the waterfront attraction of the real estate is underutilized. Should the zoning standards be made consistent in the Harbor Area, thereby creating certainty for the private sector of allowable density and uses, the possibility of redevelopment activity within this area exists, and may occur without significant City and Harbor Department inducements. Kosmont believes that the redevelopment of this area is pivotal to the development of Study Areas C, and D to the south, and additionally, would directly benefit the quality of new tenants to Study Area A. Additionally, the redevelopment of this Study Area would help to provide the critical linkage between the four Study Areas. Kosmont finds that this is a primary opportunity for the City to interact with a potential buyer, and seek to leverage the private sectors investment. Passive response to this opportunity could leave the City with a buyer that maintains a strategy based on maximizing existing lease revenue instead of some mix of redevelopment and expansion of leaseable footprint.

Study Area C – This area consists of the boardwalk adjacent to the Redondo Beach Marina. It is characterized by small tourist shops, restaurants and bars, located adjacent to a collection of boat slips. In general this area appears run down and unattractive to many pedestrian patrons. Significant rehabilitation coupled with development of a different tenant mix is desirable. However, Kosmont believes that redevelopment activities in this area will not likely be successful unless Study Areas B and D are reactivated first and even after redevelopment of the adjacent areas, redevelopment of this Study Area may require fairly aggressive City and Harbor Department investment and leadership to complete.

Study Area D – This Study Area is comprised of the various portions of the Pier. It is characterized by the presence of the ocean and a collection of nautically themed tourist shops, restaurants and bars located along the southern portion of the pier. This area is somewhat attractive for many visitors, yet portions of the Pier appear tired and in need of a significant expenditures on façade and public space amenities. The revitalization of this study area needs to occur primarily as a result of City and Harbor Department led activities, which could significantly influence further redevelopment of Study Areas B and ultimately C.

In general the Harbor Area has significant potential for improvement. At this time there are several initiatives and activities which have the potential to serve as the catalyst for substantial redevelopment and improvement. The City and Harbor Department will need to be the initial catalyst for change, which can ultimately inspire a greater level of private sector investment in redevelopment. This involvement must be done on a timely basis, seizing opportunity based on circumstances, such as the advent for a new owner of the approximately 7.09 acre property in Study Area B.

In terms of long-term revenue generation, as discussed in Section 3.2 “Lease Rates”, a majority of existing lease rates are below those found in other similar harbor and marina markets. Should Harbor Area redevelopment activities be successful, the potential for more desirable uses and tenants, and higher lease revenues from uses throughout the Harbor Area is realistic. A more passive approach will not yield significant improvement in revenues over time

3.2 Lease Rates

As part of its analysis Kosmont performed a market study of Southern California harbor cities, including Venice Beach, Manhattan Beach, Hermosa Beach, Long Beach, Laguna Beach, Huntington Beach, Dana Point, Newport Beach, Corona Del Mar, Mission Bay, and San Diego (collectively “Sample Markets”), to understand current market lease rates of waterfront or boardwalk accessible properties in a variety of appropriate asset classes. This information was then compared to available lease information in the Harbor Area. It should be noted that in many cases the sample size of properties evaluated was very small due to the limited number of properties available for lease at any given time in this very specific market niche.

Kosmont evaluated a sample of leases available in the Sample Markets in order to obtain a general understanding of current rental rates of similar properties in Southern California coastal areas. The leases evaluated fall into three general categories: triple net leases, full service gross leases, and modified gross leases. The triple net lease (“NNN”) is a lease agreement whereby the

Lease Rates, cont'd

tenant pays all taxes, insurance, and the maintenance on the property (in addition to rent). When evaluating two similar properties, NNN lease income received by the landlord is typically less than under other lease structures, however the landlord has very few expenses associated with operating the property. Triple net leases are typically utilized by landlords with premium properties, and for A-Credit tenants. The full service gross (“FSG”) lease is a lease agreement whereby the tenant pays a certain rental amount and the landlord pays for all expenses associated with owning and maintaining the property. Finally, the modified gross (“MG”) lease is a hybrid between the NNN and FSG lease whereby the landlord agrees to pay some of the expenses associated with the property. Lease income under a MG lease is typically greater than under the NNN lease, but less than income under a FSG lease.

Table 1: Sample Market & Harbor Area Lease Rates below provides a summary of the leases evaluated. A full listing of all leases evaluated both within the Sample Markets and the Harbor Area is not provided due to the desire by many information sources to keep actual income information confidential. The wide range in rents is as a result of small sample sizes due to the localized and limited nature and size of specialized and unique harbor/marina markets. All lease figures include both base and percentage rents.

Table 1: Sample Market & Harbor Area Lease Rates

Asset Class	Sample Markets				Harbor Area			
	Average Size (Sq. Ft.)	Average \$/Sq. Ft./Mo.	Weighted Average \$/Sq. Ft./Mo.	Sample Size	Average Size (Sq. Ft.)	Average \$/Sq. Ft./Mo.	Weighted Average \$/Sq. Ft./Mo.	Sample Size
Restaurants	3,900	\$ 4.25	\$ 4.25	1				
Modified Gross	4,500	\$ 2.65	\$ 2.65	1				
Wholesale	2,650	\$ 2.25	\$ 2.25	1	6,438	\$ 1.75	\$ 1.73	9
Retail	2,499	\$ 3.01	\$ 2.64	12				
Wholesale					1,056	\$ 1.81	\$ 1.79	4
Offices	5,412	\$ 3.23	\$ 2.73	3				
Modified Gross	1,902	\$ 2.70	\$ 2.89	4	1,813	\$ 2.60	\$ 2.61	2
Full Service Gross	5,862	\$ 2.81	\$ 2.34	8				

The three Restaurant leases evaluated suggest lease rates ranging from around \$2.25 to \$4.25 per square foot per month across the various lease types. The nine existing leases for restaurants over 1,000 square feet evaluated within the Harbor Area range from a low of approximately \$.75 per square foot per month to a high of \$3.10 with an average of \$1.75 per square foot per month, and a weighted average (by square feet) of \$1.73 per square foot per month. While the sample size in the Sample Market was small, the lower rents found in the Redondo Harbor Area suggests that there are factors keeping rents below those found in other similar harbor/marina markets. For reference, A-Credit restaurant tenants in desirable/market competitive locations typically pay between \$3.00 and \$4.00 per square foot per month under a NNN lease.

Though retail space in a few harbor markets can be as low as \$2.00 per square foot per month NNN, more desirable and pedestrian friendly areas are seeing rents as high as \$5.00 per square foot under a NNN lease. As shown above the average rent per square foot per month within the Sample Markets was \$3.01, and the weighted average rent (by square feet) was slightly lower at \$2.64 per square foot. The four retail leases evaluated within the Harbor Area range from \$1.01

per square foot per month to \$2.25 per square foot per month. Again, the lower rents found in the Redondo Harbor Area suggests that there are factors keeping rents below those found in other similar harbor/marina markets. For reference, A-Credit retail tenants in desirable/premium locations typically pay between \$3.00 and \$4.00 per square foot per month under a NNN lease.

The office market is the one land use class where rents in the Harbor Area appear to be in line with those found in the Sample Markets. In this case the modified gross rents of \$2.60 per square foot per month (\$2.61 weighted by square footage) are within close range to those found in the Sample Markets of \$2.70 per square foot (\$2.89 weighted by square footage). While a limited sample size, the data suggest that office space in the Harbor Area may be competitive to the other harbor/marina markets. For reference, during the third quarter of 2007, office rents in the South Bay submarket averaged \$2.38 per square foot, and in Los Angeles County averaged approximately \$2.80 per square foot for Class-A space, and \$2.25 for Class-B Space (the Harbor Area samples were Class-B).

4.0 Highest and Best Use

In order to determine the highest and best use of the five properties, Kosmont considered a multitude of interrelated factors. By considering the multiple factors Kosmont developed recommendations which should prove to be the most beneficial to the City over the long-term. These recommendations help to ensure that leases with less desirable tenants providing limited revenue today are not executed just for the sake of generating revenue. Instead the recommendations are designed to attract more desirable tenants over the long-term, providing greater revenue for the Harbor Enterprise in general, and helping, over time to serve as a catalyst for creating a revitalized Harbor Area and a desired community asset.

The factors evaluated include the existing proximate uses, market conditions, long-term value generation, inherent site opportunities, inherent site constraints, timing, and other City and Harbor Department initiatives. Each of these factors is generally discussed below, as a preamble to the site specific observations and recommendation that following in Sections 4.1 through 4.5 herein.

Proximate Uses – In evaluating a property it is critical to consider the type and proximity of adjacent properties and users. For example an appropriate restaurant may be complimentary to a hotel as hotel guests might help support the restaurant. Additionally, it has been shown that a supportable number of restaurants in close proximity together results in greater revenue for each of the restaurants, as similar to a shopping mall, the destination as a whole is a more powerful attractor than the shop or restaurant individually.

Long-Term Value Generation – As part of this assignment, Kosmont endeavored to provide recommendations that identify value creation potential over the long-term (i.e. more revenue, a nicer/more competitive urban center), even if at the expense of immediate revenues. For example there may be tenants interested in paying a certain rent for a particular property; however that tenant may not help to serve as a catalyst for a better Harbor Area in the future. Alternatively a desired tenant may require incentives or lower rent now to occupy a particular property, but over the long-term that tenant may generate greater revenues and/or value opportunities for the City, while serving as a catalyst for positive change to the Harbor Area in general.

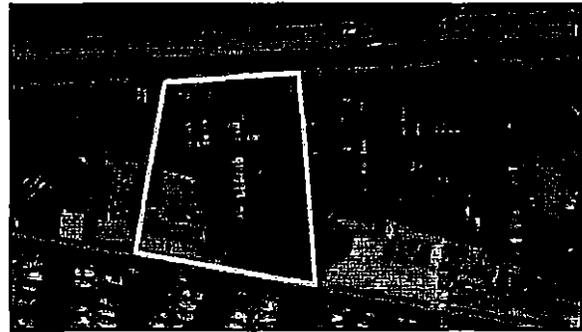
Inherent Site Advantages – Some of the sites are intrinsically positioned for certain uses for reasons such as abundant parking, existing buildings, and proximity to the water. For example one of the properties has a building on it which could not be constructed today due to changes in the allowable building height on the property. As it exists this building is two stories, and the second story has views of the ocean. While the existing building will likely require substantial renovation prior to occupation by any tenant, to suggest a use that would require the demolition of the existing building would likely result in the elimination of long-term opportunities, and therefore could place limitations on the long-term value of the property.

Inherent Site Disadvantages – Some sites have restrictions on potential uses due to the size of the lot, limited access to parking, and/or lack visibility. Some of these constraints can be mitigated, while others are permanent, terminal impairments. For example isolated parcels could become less isolated by increasing the density of uses on proximate parcels. To remedy a small site or access constraint may require transferring said site or combining it with an adjacent parcel that is under different ownership. Part of this strategy could consider an exchange for a different parcel.

Timing – Some of the sites are economically undevelopable without increases in traffic flow or would directly and significantly benefit from the improvement of proximate parcels prior to the utilization of the site. For example an empty parcel may have little value to a potential tenant today, however should the density of use of an adjacent parcel increase or change, it may provide enough residual traffic or create a complimentary use and support the use of the previously economically challenged parcel.

Other City and Harbor Department Initiatives – The City and Harbor Department are in the process of the undertaking significant redevelopment initiatives including the establishment of consistent zoning standards across the Harbor Area, and creating a new façade/theme for the Pier area. The results of these initiatives could have a significant impact on the highest and best use of the surrounding properties. For example should consistent and reasonably reliable zoning standards be established, significant redevelopment may occur including the development of additional hotel rooms, and residential units which could drive demand for support amenities on adjacent parcels.

4.1 655 N. Harbor Drive



Site Description – The property is located on Harbor Drive between the Bluewater Grill to the North and the Cheesecake Factory to the south. A 12,000 square foot building sits on the approximately 1.5 acre lot located adjacent to the Port Royal Marina. The building is currently occupied by a restaurant on a short-term lease.

Opportunities

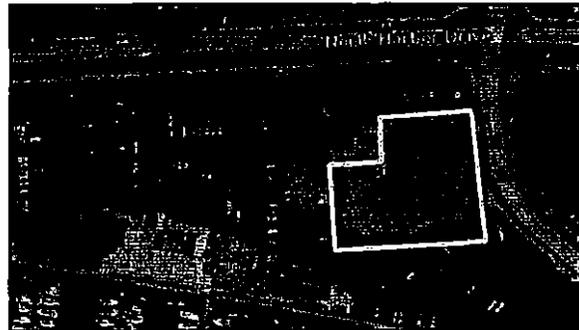
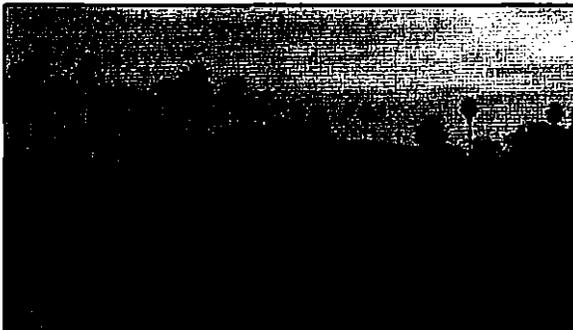
- Proximity to Restaurants - The property is sandwiched between two viable restaurants. Maintaining this property for restaurant use has the potential to help create a dining destination.
- Property is Independently Viable - The frontage on Harbor Avenue, waterfront location, and isolation from the Pier makes this property viable without adjacent redevelopment, or any other significant incentives.
- Property Appears Sufficiently Parked - Based on the current or a similar future use the property appears sufficiently parked. Additionally, parking is located immediately adjacent to the building so patron travel distance is not a concern.

Constraints

- Existing Building Conditions -- While the existing building is in decent shape, in order to attract an A-Credit (highest quality) tenant the building will likely have to undergo significant and costly rehabilitation or complete replacement.

Recommendations - Should the existing tenant decide not extend its current lease the Harbor Department should pursue A-Credit restaurant tenants to occupy the space. The property is viable for an A-Credit tenant at the current time, and therefore there is no need for a transitional tenant. However, the existing building may require significant rehabilitation or complete replacement. As such an A-Credit tenant may require fairly significant concessions to sign a ground lease at this location. The City and Harbor Department should seriously consider providing such concessions as an A-Credit tenant has the potential to help catalyze the redevelopment of the northern Harbor Area. The ground lease should likely be a long-term lease with relatively higher percentage rents and lower base rents. This lease structure should help the Harbor Department attract an A-Credit tenant yet provide some long-term participation in the increased revenues that will likely be realized as the Harbor Area becomes more attractive destination.

4.2 Former Triton Oil Site



Site Description – This property is an approximately 3/4 acre parcel that is currently vacant and unimproved. The property has frontage on Portofino Way, and is surrounded by parking for the Port Royal Marina to the west, parking for the Cheesecake Factory to the North, and a parking lot/bike rental facility to the east. The ground lease for the bike rental facility to the east is controlled by the Port Royal Marina.

Opportunities

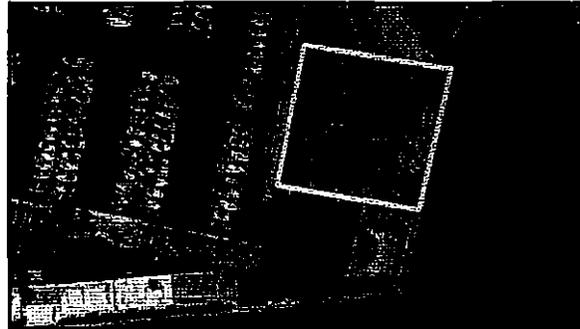
- Proximity to Other Users – This property is adjacent to both the Port Royal Marina and the Cheesecake Factory. The property is currently under a month-to-month ground lease to the Cheesecake Factory, however a long-term lease may be of interest to either the Port Royal Marina, or the Cheesecake Factory.
- Proximity to Intersection of Harbor Drive and Portofino Way – The property is within approximately 50' from the intersection of Harbor Drive and Portofino way. The 50' separation is currently occupied by a bike rental facility on a ground lease controlled by the Port Royal Marina. As the property currently separates the Port Royal Marina's leases the Port Royal Marina may be interested in some sort of swap or other ground lease related transaction involving some or all of its leasehold interests (e.g. purchase, co-investment). If a swap or other mutually acceptable transaction be viable, the Harbor Department could control a more economically viable corner parcel on a fairly active corner. This strategy needs to be structured and then considered in detail as to benefits, costs and risks.
- Proximity to Potential Development – The property is located immediately north of the Redondo Beach Marina. Should land use documents for the Harbor Area be brought into consistency, the Redondo Beach Marina could experience significant redevelopment activity. The proximity to this potential redevelopment activity has the potential to substantially increase the economic viability of this parcel.

Constraints

- Limited Site Size – The site is fairly small (approximately 3/4 acres) and therefore potential uses are limited unless combined with other adjacent properties.
- Property is in an Odd Location – Despite the property's frontage on Portofino Way the property is in an odd location with limited frontage due its layout and the layout of the surrounding properties. The property also isolates the adjacent properties.

Recommendations – The first alternative the Harbor Department should pursue is some sort of swap with the Port Royal Marina giving the Port Royal Marina a contiguous parking field, and the Harbor Department control of a corner location. Whether or not the Harbor Department is successful in swapping the ground lease, the Harbor Department should maintain a short-term interim ground lease until the ultimate development plan of the properties to the south of the site are known. Once the long-term development potential is known there may be opportunities for a complimentary long-term tenant on the site. Should this not be the case, the next best scenario will likely be a ground lease (likely for use as a parking field) with the one of the adjacent lessees.

4.3 230 Portofino Way



Site Description – The site is located on Portofino Way, west of the Seaside Lagoon, and east of the Portofino Hotel. The property is an approximately 1.4 acre rectangle and has an approximately 10,000 square building on it. The site is currently occupied by Joe’s Crabshack, who is an A-Credit tenant, with approximately 14 years left on the initial term of the ground lease, and two five-year extension options.

Opportunities

- Frontage on Water – The property has approximately 250 feet of frontage on the harbor. This attribute increases the potential value of the property, and is especially conducive to certain uses including restaurant and/or banquet facilities.
- Proximity to Portofino Hotel – The site is located adjacent to the Portofino Hotel and is fairly accessible by hotel guests.
- Location between Portofino Hotel and Potential Development – The property is located between the Portofino Hotel and the Redondo Beach Marina. Should consistent zoning standards be put into place, properties proximate to this site could be redeveloped for additional hotel, restaurant, retail, and office uses. Additionally, both the City and Portofino Hotel have expressed interest in developing a conference facility in the Harbor Area. This property’s location makes it ideal for such a facility.

Constraints

- Existing Building – While the existing building is in good condition, if the site were to be utilized for a conference facility, demolition of the existing building would be required.
- Isolated Location – The site is located on Portofino Way well away from Harbor Boulevard. Patrons must typically have prior awareness of the amenity in order to utilize it.
- Existing Lease – The site is currently under a lease with a minimum duration of approximately 14 more years and a maximum duration of approximately 24 years. If any other use of the site is desired the existing lease must be bought out.

Recommendations – The existing tenant is an A-Credit tenant that takes advantage of the site and existing building. Maintaining this lease will not be to the detriment of the Harbor Area. However, should adjacent uses result in a desire to redevelop the property into a convention facility or other similar use, the City should consider the economics of buying out the existing leaseholder, and providing a long-term lease for a potentially upgraded use. For example, should a future leaseholder desire to develop a conference facility on the site, a lease with a fixed base rent will likely be most appropriate. Absent a substantial investment proposal involving denser upgraded visitor uses (hotel, and or conference facilities), this site is currently at its highest and best use. In its current state the major enhancement would be as a result of re-tenanting with a restaurant concept that would be more viable based on current day diner preferences. Accordingly, in light of existing conditions, which are generally positive, without an aggressive public agency investment or a straight out sale by the existing user Kosmont views this as a limited opportunity.

4.4 135-9 N. International Boardwalk



Site Description – This property is located between the harbor to the north, Pier to the west and south, and the boardwalk to the east. The property is currently occupied by a two story, 13,000 square foot octagonal building. The building is considered existing, non-conforming and thus while current regulations would not permit the construction of a building of the same height at this location, as the structure is already in place it is allowed to remain. The first story of the building is on grade with the boardwalk, and the second story is essentially on grade with the Pier.

Opportunities

- **Waterfront Location** – The building is located along the water in the Harbor, and views of the water are possible from the second story. This attribute definitely increases the potential value of the property, and is especially conducive to certain uses including restaurant, bar and/or banquet facilities.
- **Proximity to Kincaid's** – The property is within close proximity to Kincaid's, an existing and successful restaurant operation. The proximity to an existing, successful operation could help to attract an A-Credit tenant.

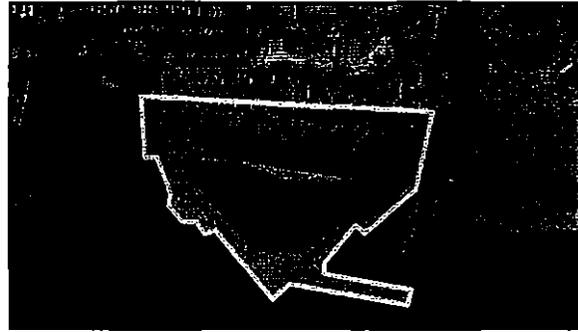
- Proximity to Parking – The building is located within close proximity to the Pier parking structure. This convenient access to parking will be a requirement for most quality tenants.
- Linkage Between Pier and Boardwalk – Currently the boardwalk and Pier are functionally isolated, and many visitors to the Pier are completely unaware of the amenities available along the boardwalk. Visitor activity tends to be user specific, mostly related to the offices to the east and Kincaid's restaurant, which benefits from convenient if not somewhat obscure parking lot (once you know it, access is straightforward). The successful redevelopment of this location will rely on bringing a user that is a powerful draw and effectively serve as the activity link between the Pier and the boardwalk.

Constraints

- Existing Building Conditions – The existing building will require substantial rehabilitation in order to attract an A-Credit tenant. While potentially more expensive than tearing down and reconstructing the building, the rehabilitation, if physically feasible is recommended in order to maintain the existing height of the building.
- Two Story Design – The building's two story design and limited footprint (approximately 6,500 square feet) make attracting certain users and A-Credit tenants difficult. Future tenants must be flexible in their requirements, and compromises as well as incentives may be required by the City and Harbor Department.

Recommendations - The Harbor Department should pursue A-Credit restaurant/bar tenants to occupy the space. Even with significant renovation the property will be marginally viable for an A-Credit tenant. As such an A-Credit tenant may require fairly significant concessions to sign a ground lease at this location. The City and Harbor Department should seriously consider providing such concessions as an A-Credit tenant has the potential to help catalyze the redevelopment of both the Pier and boardwalk. The ground lease should be a long-term lease with relatively higher percentage rents and lower base rents. This lease structure should help the Harbor Department attract an A-Credit tenant yet provide some long-term participation in the increased revenues that will likely be realized as the Pier becomes a more attractive destination. Further, a more aggressive but reasonable approach, would be to initiate a redesign analysis of the building, which could demonstrate the viability of a rehabilitation project. This exercise would also identify the likely cost and potential of a significant rehabilitation effort. The results, if positive, would be used to attract a specific user.

4.5 Municipal Pier



Site Description – This leasehold encompasses the majority of the Pier and includes approximately 25,000 square feet of commercial and restaurant/retail space. The 25,000 square feet is comprised of a wide variety of aging harbor and nautically themed buildings located primarily along a wooden pier. Most of the tenants in these buildings are under individual leases with terms ranging from month-to-month to 2012 (2029 for Kincaid’s Bay House). Additionally, there is an approximately 6,000 square foot pad (“Pad 2”) that remains undeveloped along the northwestern portion of the Pier.

Opportunities

- Waterfront Location – The buildings are located along the waterfront. This attribute increases the potential value of the properties.
- Pier Location – The location on the Pier results in high levels of pedestrian traffic for the existing 25,000 square feet of commercial and restaurant/retail space. This traffic helps to provide a potential customer base which is beneficial to the tenants, thereby increasing the potential value of the properties.
- Facade Improvement Program – A new facade/theme program is currently being developed for the Pier area. Should a new facade/theme program be implemented it has a potential to increase interest in the Pier. Clearly there is need to improve the visual aspect of the area and restore its “charm”.

Constraints

- Existing Building Conditions – The existing buildings are aging and will require substantial rehabilitation in order to attract higher quality tenants, and thus generate higher rents.
- Pad 2 Proximity to Parking – The undeveloped pad is fairly small and located relatively far from parking. This limited access to parking may make it difficult to attract A-Credit tenants.
- Existing Pier Conditions – In general significant portions of the Pier appear in need of significant renovation and rehabilitation. Without a significant effort by the City and Harbor Department it will be difficult to create enough change required to bring about significant enough revitalization to result in higher quality tenants and higher lease revenues. The undeveloped pad should be part of the revitalization strategy, but on a

standalone basis, Kosmont does not view it as the silver bullet savior, replacing the need to reinvest in substantial portions of the Pier.

Recommendations - The Harbor Department should focus on the long-term redevelopment of the Pier properties. The implementation of a façade/theme program coupled with the attraction and retention of quality tenants should help revitalize the Pier. In the interim the Harbor Department should continue to provide shorter term leases which will provide flexibility in re-tenanting as improvements are implemented. Once fully revitalized the Harbor Department should consider pooling ground leases into a single leasehold which could then be leased-off and managed by a private entity, ideally resulting in benefits which will be discussed in Section 5.0 Strategic Management.

Pad 2 does not appear ripe for development. The Harbor Department should reevaluate development of this location at a later date upon completion of revitalization efforts that could potentially make development of this pad economically viable due to increased pedestrian traffic along the northwest portion of the Pier as well as increased general interest in the Pier.

5.0 Strategic Management

5.1 General Recommendations

The City and Harbor Department currently maintain direct control of multiple tenant leases within the Harbor Enterprise while other portions of the Harbor Enterprise are leased to tenants through the use of aggregated ground leases controlled by private entities. Several questions were presented in Section 2.1 Purpose which are answered directly below. Additional discussion, indirect analysis and general strategic recommendations are presented in the sections that follow, which should be considered collectively.

1. Should the City continue to acquire parcels over time, and retain direct control?

Under what circumstances should acquisition occur? Should the acquisitions occur as part of a general policy, or should they occur on a case by case basis? In either case, what criteria should be used?

In general the City should acquire leases and retain direct control in instances where private entities have not been able to produce desired results (despite attempts from the City and/or Harbor Department). In such cases the City will need to act as a catalyst for change which can come in the form of zoning changes, public subsidy, or other similar public policy tools. In general once the City has been able to achieve the desired outcome, disposition to a private entity can tend to result in higher revenues and more efficient management of City and Harbor Department assets. Additionally, control by a private entity can eliminate some of the inefficiencies that frequently occur with public management due to variety of factors including timing and process constraints presented by formal public sector procedures, and uncertainties that arise from political turbulence (elections, changes in city leadership, redirection of public policy, legislation). Finally, the City must be selective in the disposition process to ensure selection of a private entity with capital resources, relevant experience/expertise, and ensure agreements and transactions are structured with terms and conditions that appropriately motivate performance and preserve desirable outcomes while penalizing unwanted activity.

2. Should the City consider combining leaseholds over time, as conditions warrant and acquisition opportunities present themselves to allow for fewer fragmented leasehold areas? *Should the leaseholds be combined with existing private entities, or independently under direct City control?*

As feasible, the City should attempt to aggregate leaseholds over time whether held under direct control or private control. This aggregation should lead to greater uniformity amongst the various proprietries, thereby simplifying interface between the Harbor Department and any private management entities, which should effectuate greater efficiencies by the managing parties. As properties are developed or tenanted to their desired uses, they can be released from direct City control to existing or new private entities. New aggregated ground leases should be

written in such a way that additional leaseholds can be added to the leases at future dates in order to allow for as much aggregation as possible while requiring as few ongoing disposition selection processes as feasible. Additional properties should be aggregated in this manner only as long as the City and Harbor Department are satisfied with the management strategies and/or use of the leaseholder.

3. Should the City divest itself of its direct tenant leases entirely and trust all Harbor Enterprise lands to the private sector under ground leases?

Private entities will tend to manage and capitalize on assets more efficiently than the public sector. However, some private entities will manage assets in a way that ultimately leads to the failure of those assets. The City and Harbor Department will benefit greater from private entity control the better the following criteria are met.

Quality of the Landlord - The City and Harbor Department needs to successfully attract a landlord with the appropriate experience and track record of managing assets in high quality manner. Financial wherewithal and stay power is typically an essential ingredient.

Clarity and Power of Conditions in the Ground Lease – The ground leases must be written with conditions sufficient to ensure assets are managed in a manner agreeable to the City and Harbor Department. This can be achieved by including provisions to ensure the quality of tenants, credit worthiness of tenants and management, requirements for certain levels and uses of repair reserves, and rights to revocation under certain indicators of a landlord's failure to maintain the assets at its agreed upon potential.

Size of Leasehold – In general the larger the leasehold, the more ability the private entity will have to induce necessary changes. Should a single private entity control significant portions of the currently fractured Harbor Area that entity would have the opportunity and the incentive to create necessary changes to improve its assets in the Harbor Area.

4. Should the City consider a hybrid policy which combines elements of each of the alternatives above? *What criteria should the City utilize in determining the direction for each property?*

In general it is Kosmont's recommendation that the City acquire direct tenant control in instances where a private entity is not maximizing the potential of an asset, not operating an asset in a manner conducive to other elements of the Harbor Area, and/or not in a manner consistent with the plans and goals of the City and Harbor Department. Once City control has resulted in the desired repositioning and change it is then possible to return the assets back to control by a private entity in a manner consistent with the recommendations above.

5.2 Private Management of Public Assets

Kosmont researched examples of private entity management of various public assets throughout the region and found that while private management of similar harbor/marina facilities are limited, there are many examples of assets being successfully managed by private entities. In general the success of private management is contingent on a few critical factors including the

alignment of public and private goals and objectives, the implementation and monitoring by the public entity of rules and regulations related to acceptable management practices, the public agency's right to disapprove of potential buyers the public agency's ability to terminate the lease as a result of unacceptable management practices, and the inclusion of provisions in agreements that allow for long-term planning flexibility.

Alignment of Public and Private Goals – For every real estate asset there are a variety of potential owners. Each of these potential owners will have different objectives primarily related to the desired hold period of assets, the motivation to improve the assets to realize potential returns, and the desired risk tolerance. The most success will be achieved if the asset management goals of the public entity and the private entity are in relative alignment

Implementation and Monitoring of Rules and Regulations – Private entities are traditionally interested in maximizing profit. While frequently the maximization of profit will result in actions which benefit both the public entity and private entity, there are certain situations where the two entities interests are not completely aligned. As a result, in order to ensure the interests of the public entity are protected, contractual agreements must contain specific provisions designed to explain and protect public policy and constituent interests. Finally, the public entity must be prudent in monitoring the rules and regulations to ensure the private entity is actually adhering to them.

Public Agency's Right to Disapprove of Potential Buyers - Real estate assets are long lived, markets change, and entities evolve over time. As a result a desired private entity that has control of an asset may elect to sell the asset to another private entity whose goals and/or capacity to manage are not in alignment with the public entity. In order to ensure the interests of the public entity are preserved any agreements should contain provisions for the public entity to be selective of potential buyers or to preempt such transaction based on viable terms (diluted first rights provisions are not valuable to this effort).

Right to Terminate Due to Poor Management Practices – Real estate assets are long-lived, management practices evolve overtime, and in some cases undesirable and/or incompatible entities gain control of assets. Should the management of an asset be undertaken in a manner reasonably undesirable to the public entity, the public entity must have provisions in its operating agreements that provide for a termination of the agreement. These provisions may need to be extensive and specific. Such provisions may result in a reduction in the amount of the payment to the public entity, however such provisions should help to preserve the long-term value of the asset.

Long-Term Planning Flexibility – Over time uses of properties change resulting in among other things, changes in desired circulation, public space, and other public amenities. Agreements with leaseholders should include provisions to accommodate long-term planning goals of the public entity. As an example should the City want to realign its bike path or provide shared parking rather than dedicated parking, ground leases should include provisions which allow for flexibility in accommodating these types of anticipated changes through partial taking clauses, provisions on the location of new building, etc.

5.3 Harbor Area Oversight

As part of its analysis Kosmont evaluated public management structures overseeing public assets and developed conclusions pertinent to the public oversight of the Harbor Area. With limitations, Kosmont found that given appropriate management, the more decision making authority that was available without board oversight, the more efficient an asset was operated. Currently management of the Harbor Area is conducted on a staff level by the Harbor Department, with a Harbor Commission serving in an advisory role to the City Council which has approval authority.

The interests of the staff of the Harbor Department are assumed to be aligned with the interests of the Harbor, City and Community. Expanding their authority to make routine management decisions independent of the political public forum could be to the benefit of the operation of the Harbor Area and result in additional operation efficiencies, and greater tenant and master leaseholder satisfaction.

As it stands the Harbor Commission is comprised of seven members from a required variety of backgrounds whose interests would typically be aligned with those of the Harbor, City, and Community. Kosmont found that similar assets were frequently managed by either a single commission with approval authority or some oversight was granted to non-profit operating entities. Examples of the two styles include the Oakland-Alameda County Coliseum Authority, the Rose Bowl Operating Company, and the Santa Monica Pier Restoration Corporation. As it stands the City has in essence two levels of oversight which likely impede rapid decision making, and introduce additional opportunities for inefficiencies and political uncertainty. Kosmont recommends that the existing oversight structure be evaluated for potential opportunities to streamline processes and improve management efficiency.

5.4 Recommended Short-Term Strategies

In order to realize the highest and best use for the five properties evaluated, and the Harbor Area in general, Kosmont recommends that the City and Harbor Department take a two phase approach by implementing short-term and long-term strategies. Kosmont recommends this approach as the timing is not yet right to fully take advantage of the potential of some of the Harbor Area properties, and some strategies cannot be implemented without first undertaking other foundational steps.

As an example there are some properties that may require the City and Harbor Department to take some risk and make some investment in redevelopment before they will be suitable to attract the desired quality of tenant. Ultimately once these properties have been repositioned and re-tenanted, it will then be possible to implement the long-term strategies. As a result Kosmont recommends implementing the following short-term strategies first.

Work With Existing Landlords to Reposition Undesired Properties – The City and Harbor Department should work directly with existing landlords to redevelop and re-tenant properties occupied by tenants that are not the highest and best use of particular properties, or otherwise do

not fit with the long-term goals and objectives of the City. Potential tools to assist landlords include marketing assistance, public incentives for new tenants, and the renegotiation of land leases if mutually agreeable by both parties.

Work With Existing Landlords to Maximize Value of Properties – The City and Harbor Department should continue to actively maintain communications with existing landlords to understand the goals and objectives of master leaseholders. If the goals and objectives are in alignment with City goals and objectives the City should work with the master leaseholder to determine what the City and Harbor Department can do to help achieve the objectives. If the goals and objectives are not in alignment and the City desires to pursue an aggressive strategy the City should attempt to buyout the leaseholder. A candid assessment of each lessee in comparison to desired outcomes is the baseline for this strategy.

Acquire Leaseholds on Properties Where Private Entities Have Not Produced Desired Results and Reposition the Properties – Based on the foregoing, should the existing landlords not be able to reposition an asset, or should a leasehold on an underperforming asset become available, the City and Harbor Department should attempt to acquire that leasehold. Once under the City's control the City can either immediately re-lease the asset to another private entity for redevelopment (preferably a successful adjacent master leaseholder), or if it is not possible to attract a suitable private entity to implement the repositioning, the City and Harbor Department may have to implement the change itself. In many cases the City and Harbor Department will have tools to implement change which are superior to options available to private entities, including opportunities for lower ground lease rates, assistance with entitlement activities, and/or other forms of public incentives.

5.5 Recommended Long-Term Strategies

Upon completion of the short-term strategies discussed above, the City and Harbor Department should pursue the implementation of the following long-term strategies.

Aggregate Leaseholds – As reasonably possible the City and Harbor Department should attempt to aggregate leaseholds over time. This can be done by either acquiring direct control of additional adjacent properties, or by allowing a desired adjacent master leaseholder to gain control of additional adjacent properties through mechanisms in existing master ground leases. As it stands the properties around the Harbor Area are controlled by a variety of leaseholders. As a result the City must take on some redevelopment risk instead of solely relying on its capacity to entice private entities to redevelop portions of the Harbor. In many cases the rule of adjacencies apply, wherein one private entity may not develop a high quality project if there is a risk that a neighboring low quality project, not controlled or controllable, by that private entity, will not also be redeveloped.

Larger leaseholds are beneficial in that they allow for more universally themed treatments to buildings and improvements which make them more appealing as a cohesive destination for patrons. Larger leaseholds also provide a diverse income streams thereby reducing risk to the master leaseholder, allow for additional development options including the alteration of lot lines

and subdivisions, and provide greater probability for a master leaseholder to successfully implement beneficial changes across a critical mass of properties. Finally, the type of private entity desired to serve as master leaseholder will typically be an entity with significant financial capacity. Potential leaseholds must cover a greater area/number of properties and therefore be high in value to attract the investment of time and capital by this scale of private entity.

Encourage Private Management – In general, a private sector entity is better able and more immediately incentivized to manage an asset in an optimal fashion. Typically managing an asset in an optimal fashion will result in amenities that are attractive and desirable to the general public and in this case the City and Community. This improvement in management is typically a result of a variety of opportunities and efficiencies available to the private entity, but not the public entity. These factors include the ability to solicit and retain certain tenants through existing broker and tenant relationships, pooled leasing opportunities (i.e. a tenant will be given incentives to, or restricted from leasing at one location if or unless they lease at another), avoidance of formalities associated with public sector management and/or procedures, direct incentive to maximize profit, capacity to take advantage of tax incentives (depreciation, amortization) and if made possible by the local political authority, the ability of the private sector to avoid some political turbulence by streamline approval processes which enable timely decisions in an atmosphere of certainty.

Recruit Desired Master Leaseholder – Like any other business, a desired master leaseholder can be attracted and retained through outreach activities, and as necessary, supported by appropriate incentives and/or concessions. Recruiting the optimal master leaseholder can result in some of the greatest redevelopment opportunities to the Harbor Area. If the appropriate entity is retained, provided the leasehold area is large enough in size, the private entity can supply the vision, experience, perseverance and capital necessary to effectuate significant, long-term change to the Harbor Area.

Deliberate Action, Patience and Vision - In real estate, significant changes which produce great results takes vision, consistency in action, and time. The changes needed to be made to the Harbor and Pier Area could take 20 years to result in the desired outcome, with instrumental changes happening in stages well before, but overall will not likely happen unless the appropriate strategies are put in place now and consistently managed over time.

6.0 Conclusion

In conclusion, the Harbor Area and Pier represent an excellent opportunity for redevelopment for the City and Harbor Department. It is Kosmont's opinion that there are certain portions of the Harbor Area that are in need of significant redevelopment. Fortunately redevelopment is not unfeasible as there are existing tenants and amenities within the Harbor Area of the high quality ultimately desired that can serve as the anchors for attracting additional quality tenants. To attract additional high quality tenants requires a systematic plan of improving key properties to create a critical mass and ultimately cohesive corridor of appealing amenities.

This strategic plan will initially require active participation by the City and Harbor Department. The City and Harbor Department must assume some of the risk associated with redeveloping obsolete assets in order to attract private sector tenants and investment. Additionally, the City may need to acquire leases of ineffective lease holders in order to bring about complete redevelopment of the area. However, should certain key parcels and properties be redeveloped, the value of the adjacent leaseholders may increase in value enough, and present enough of an opportunity for private investment that existing leaseholders may be incentivized to sell to more opportunistic and visionary master leaseholders.

Over time the City and Harbor Department should attempt to aggregate the various leases to create a Harbor Area that is more resistant to obsolescence than the current structure. By aggregating leases into large leaseholds with critical mass, effective management companies can be attracted to invest capital in redevelopment activities as required. The larger leaseholds attract investment as redevelopment efforts can result in actual change of significant portions of the Harbor Area rather than just small sections, resulting in a critical mass of change that has the potential to result in a return on investment, and thus long-term improvement of the Harbor Area.