

CITY OF MORRO BAY HARBOR DEPARTMENT LEASE MANAGEMENT POLICY

BACKGROUND

Tracing back to English Common law the Public Trust Doctrine establishes that navigable water or lands subject to tidal influence are “sovereign”, held open to the public for commerce, fisheries or navigation. In 1942-44, the federal government constructed a revetment along the Morro Bay waterfront and filled most of the area now known as the commercial strip along the Embarcadero. The State of California claimed ownership of the newly created land as at least a portion of it had previously been below the high tide line. After many years of dispute with private property owners, who also claimed an interest in the land, most title issues were settled in the 1950s-1960s by designating those lands west of Embarcadero Road as public trust lands owned by the State, and those lands east of Embarcadero Road as privately owned. Attached is a map of the tidelands grant in Morro Bay.

In 1947, the State of California granted those public trust lands in Morro Bay to the County of San Luis Obispo. The City of Morro Bay assumed trusteeship of the granted lands upon incorporation in 1964-1965. The tidelands grant in Morro Bay is in perpetuity, provided the City conforms to the terms of the legislative grant. The granted lands must be used for commerce, fisheries, navigation, recreational purposes, parklands, public access, public parking and environmental protection or enhancement. Residential use of these public lands is specifically prohibited. The City may lease out these lands to private businesses for a period up to 50 years and all revenues from such leases must be expended within the area of the granted lands for the purposes of the public trust. Much of the granted lands were leased to established businesses in the 1960s on long-term leases that provided low rental rates in exchange for tenant investment in the business on the sites or settlement of previous land ownership or county lease disputes. Some of these old long-term leases have accrued significant “bonus” value to the benefit of the private party because waterfront property values have increased far in excess of the contractual rental return to the City.

Over the years, the City has changed its leasing practices and policies to better protect the public interest by adopting modern lease formats and standards for fair market rent and periodic rental adjustments. There has been some resistance on the part of existing tenants to changes in the City's leasing practices and many issues regarding granted land use and City policy have been difficult to make clear to the general public because of their complexity. In 1985, the City created the Harbor Department to focus property management efforts in the tidelands and to assure the State that tidelands revenues were properly accounted for. The Harbor Department is operated through a City enterprise fund known as the Harbor Fund. Similar to the Water and Wastewater enterprise funds, all Harbor services are funded with either users fees or property management income (no tax revenues). In FY88-89 Harbor Fund lease revenues were \$427,634 increasing to \$777,784 in lease revenues in FY98-99. The aggressive modernization of the City's property management practices over the last 15 years have allowed the Harbor Department to expand services to the boating public and improve existing harbor/park facilities.

While many coastal cities in California manage tidelands grants similar to that in Morro Bay, such a property management role is not necessarily a natural fit for local government. Familiarity with the history and terms of the various contract forms allows for resolution on contract interpretation issues before they become problems.

The Harbor Department routinely handles five to ten lease “questions” a week. If these questions were put through a political or bureaucratic process, the result would replicate the situation in Morro Bay in the mid-1980s when the Harbor Commission reviewed all lease actions. The City Council reorganized the Harbor Commission into the current Harbor Advisory Board and took lease management issues out of the Board’s purview to streamline City responsiveness and improve lease management. Inability to answer contract interpretation questions, or to process City required contractual approvals in a timely manner could cripple tenants’ ability to succeed on the tidelands lease sites.

On the one hand, the purpose of the tidelands grant is to develop harbor facilities and with percentage rents, the City is essentially a partner with the lessees along the tidelands. On the other hand, facility development and the desire to increase harbor lease revenues through tidelands lease improvement and business success must be balanced with City planning and land use policies requiring public benefit on sites and good community projects. In the 1990s the City demonstrated it can successfully achieve that balance by working cooperatively with tenants to renegotiate long-term leases (with increased rental revenues) for commercial redevelopment.

The City Manager coordinates the various interests by delegating lease management to the Harbor Director with the understanding that planning, zoning and land use issues shall be determined in accordance with adopted City Plans and Policies administered by the City Planning Staff, legal issues by the City Attorney and insurance issues by the City Risk Manager. The City has previously adopted a lease negotiation policy and a master lease format as policy but has never attempted a more comprehensive statement of management policy. The purpose of this document is an attempt to integrate existing policy with broader statement of public leasing policy to enhance public understanding and provide a framework for future actions.

The City of Morro Bay will use the following policy guidelines in management of the tidelands and Harbor Fee leases in the Harbor Department lease management program.

GENERAL POLICY

The City will manage the tidelands leases to provide and support harbor facilities and enhancement.

The City shall appropriately account for tidelands revenues and expenses in compliance the state law and the tidelands grant.

The Harbor Department will actively work with and attempt to enhance marine dependent or marine related uses in compliance with the adopted City Plans and Policies, and the City’s goals of maintaining a small commercial fishing harbor and working waterfront.

The City shall at all times be governed in its management of the tidelands properties by the granting statutes as interpreted and managed by the State Lands Commission.

The Harbor Department will manage leases in a way that will strive to support tidelands visitor serving lease businesses to increase revenues consistent with adopted City Plans and Policies, and coordinated with City planning and land use policies.

Many property management functions of the City such as: lease assignment, sublease approval, lease renewal, extension or renegotiations contractually require City Council review and approval. The City Council approval process can sometimes be misconstrued by the public or the lessees to mean the City Council approves other issues, required permits or plans for the site. The Harbor Department will process lease contract administration issues requiring City Council approval in a timely fashion so lessees are not unduly burdened in their business operations. Any such approval shall not waive any and all other permits, approvals or governmental regulations such as planning and land use permits, building permits, etc.

SPECIFIC POLICIES FOR CONTRACT ADMINISTRATION

Master Lease Format: The City has developed a master lease format based on modern leasing practices and similar formats used by other public agencies. The City master lease format adopted in 1986 is hereby amended and attached to this policy statement. Any lease agreements in the future will be in the approved master lease format. The City may use a license agreement for temporary, interim or non-exclusive use of property when appropriate.

Approved Uses: Uses on the lease sites shall be in conformance with the Tidelands Trust and the City Conditional Use Permit for the site. Proposed new uses for lease sites must be in conformance with the then planning, zoning and land use policies of the City. Lessees proposing or considering new uses for a site will be referred to the Planning Division or Department of the City for review and approval.

Negotiation: Following is the lease negotiation policy adopted by the City Council July 10, 1987:

“It is the policy of the City Council of the City of Morro Bay that negotiations relative to leasing public tidelands shall commence and remain at the appropriate staff level, as managed by the City Administrator. The City Administrator is to serve as the initial level of negotiation appeal, with the City Attorney participating when legal issues arise. Differences of opinion shall be resolved to the maximum extent possible between the parties at the staff level, *prior* to any City Council consideration of the lease.

In the event certain lease issues remain unresolved upon exhaustion of administrative review, the lessee (tenant) may submit a written document to the City Council outlining their points and perspectives concerning the outstanding lease issues. Upon City receipt of the written report, the City Clerk shall cause the item to be placed on the City Council agenda, and the lessee or his/her representative may provide a brief verbal summary of their perspectives to the City Council during a public meeting. It is the policy of the City Council to receive under advisement any written or verbal report at that time, but not to comment on or negotiate in public.

Following receipt of this input from the lessee, the City Council will exercise its authority under California Government Code Section 54956.8, to meet in Closed Session to give instructions to the City’s negotiator(s) regarding negotiations for lease of real property (public tidelands). Upon conclusion of the Closed Session considering the points submitted by the tenant, the City’s negotiators will be properly instructed and authorized to finalize negotiations and the lease with the tenant.”

The following two sub paragraphs are added for clarification on the negotiation process:

- A. In many cases parties who are considering buying a tidelands leasehold interest desire to renegotiate the lease (to extend the term, change rent or uses) prior to completing the sale/assignment of the lease. Normally, City staff will not negotiate with prospective tenants due to limited staff time and the potential impact on the “sale” price of a lease. **Prospective buyers of leasehold interest are buying the existing lease agreement only.**

- B. All lease sites eventually need to be reconstructed or significantly remodeled. In general, the City desires such reconstruction to bring improvements up to modern building codes, design criteria, and market conditions. The City acknowledges that tenants will need to renegotiate leases to new longer terms to amortize and collateralize their investment on the public property. The normal stage for lease negotiation to commence in a reconstruction redevelopment situation is when the tenant has received Planning Commission and/or City Council approval of a Concept Plan for a Conditional Use Permit to redevelop the site. The project will therefore be at a stage when the CUP can be attached to a new lease and the tenant can be required to construct improvements in compliance with the CUP in a given period of time. The appropriate term for the new lease will be determined by the size of the lease site and the level of private investment proposed for the public property.

Lease Renewal: The practice of the City in the past has been to automatically renew or renegotiate a lease with an existing tenant. This has led to a false sense of private ownership of the lease site and sometimes leads to tenants not maintaining lease or reconstructing prior to the expiration of a given lease term. The City should set some standards for renewing a lease. Lease expiration dates should be encouraged to coincide where adjoining sites may have mutual planning benefits. In some cases, the City should not renew a lease, either for the purpose of consolidating sites or to pursue other extenuating public benefit.

The City will use the following standards for determining whether it should negotiate a new lease with a tenant:

- A. The tenant has a good history of performance and lease compliance and the improvements on the site are well maintained. Example standards for determining “good history” of lessee performance are:
 - 1. The tenant’s record with respect to the prompt and accurate payment of rent due the City;
 - 2. The tenant’s record of compliance with existing lease conditions;
 - 3. The appropriateness of the proposed tenant business with respect to the total mix of uses and services available to the public and with respect to the long-term planning goals of the City;
 - 4. The tenant’s financial and personal investment in tenant business and the leasehold improvements;
 - 5. The contribution to the surrounding business community made by the tenant’s business;
 - 6. The quality of direct services to the public provided by the tenant and its business;
 - 7. The value received by the public in goods or services.
 - 8. The total financial return to City from the leasehold;
 - 9. Other pertinent considerations as may be appropriate as determined by the City Council.

B. In addition to the above, the City recognizes that there are three distinct zoning areas on the waterfront that require different considerations in lease renewals issues. As follows:

1. Tidelands Park south water area only leases. In this area the City leases only the water areas as the upland property and access to the water areas is owned and controlled by private parties. The City will encourage continuation/enhancement of marine dependent uses such as boats slips and boat repair facilities where feasible. However, this area is not suitable for large redevelopment projects and in most cases the City will negotiate a new 10 to 30 year lease extension with existing tenants when they meet the above criteria.
2. Embarcadero from Beach Street to Tidelands Park. In this area, the City controls land and water areas. In this area tenants are encouraged to propose redevelopments of lease sites to improve public benefits on these sites, enhance the Embarcadero business environment, and renegotiate leases to modern terms. To help accomplish this, and to provide tenants motivation not to let long-term leases run to the very end of their terms with degraded building/improvements, and under market lease terms, the City will generally not renew leases with existing tenants in this area if they allow their leases to run to a term of less than five years remaining.
3. Embarcadero from Beach Street north. This area is designated with zoning to preserve commercial fishing/marine dependent uses. In addition, existing restaurants or retail uses are grandfathered in. The City will strongly encourage tenants who propose enhancement of commercial fishing uses or marine dependent uses by considering new long-term leases that facilitate these types of projects. Existing restaurant/retail sites shall be extended or renewed if the tenant can develop plans for enhancement of the site within the constraints of CF District zoning. Within the general outlines of this policy the City Council will provide specific direction to the City's designated negotiator on the Morro Bay Power Plant outfall lease.

In general, leases that are not renewed should be put out to public bid or kept in short-term interim lease arrangements until adjacent sites become available for consolidation. In addition, the City has many long-term ground leases (known as the County or Pipkin leases), which provide low rent in exchange for tenant investment or settlement of previous disputes. These long-term leases provide that the tenant-constructed improvements revert to City ownership upon lease termination and this was a critical part of the consideration in allowing the tenant such a long-term lease at the specified rents. The County and Pipkin leases were 50-year leases (the maximum term set by the tidelands grant) and may not be extended or renewed. The City shall encourage tenants to renegotiate these leases into the new City master lease format well before the termination date of that lease.

In the CF District the City should attempt to consolidate leases in the area between the T-Piers to facilitate marine dependent redevelopment such as a seafood processing plant.

Fair Market Rent: State Law requires that fair market rent be charged for use of the granted tidelands. Fair market rental shall be determined through the use of an independent appraiser to appraise the fair market value of the property and the City will set a minimum annual rent equal to 8% of the appraised value of the land or improvements if the improvements have reverted to the City. The lease rent will be structured to provide for a minimum annual rent as outlined above or a percentage of gross sales rent as shown on the attached Schedules entitled Standard City percentage of gross sales rent.

In cases where the tenant is proposing complete redevelopment of a site to eminent modern design criteria at significant private investment the City may allow both temporary reductions in the outlined minimum rent to offset tenants period of reduced revenues during construction and reduction in the standard retail percentage of gross sales to 3% for the first 10 years of a new long-term lease agreement.

Maintenance of Improvements: The City has a paramount interest in ensuring that the improvements on the lease site are being properly maintained and are in a safe and secure condition. The City shall contract to have the lease sites inspected and a report made on such inspections every five years. City staff will require significant deficiencies noted in the lease site inspection reports to be repaired or cured by the tenants. As long-term leases draw close to expiration tenants tend to defer maintenance and the City must carefully monitor and strictly enforce lease maintenance provisions to protect the reversionary interest in the lease site improvements.

Percentage of Gross Sales Audits: Where tenants are subject to percentage of gross sales rent, the City will contract to have the business accounting records examined for lease compliance at least every five years. City staff will require tenants to comply with or cure any deficiencies noted in the accounting records examinations.

Lease Assignment/Sale: All City leases require City Council approval of the sale or assignment of a lease agreement. Any tenant requesting such approval will be required to pay fees noted in the master fee schedule, to submit financial documentation to indicate qualifications to the satisfaction of the Finance Director, and be in full compliance with the terms and conditions of their lease agreement. If the proposed assignment or sale includes a change in use of the site, then the change in use will be reviewed by the Public Services Department of the City for conformance with planning and zoning regulations. Proposed changes in uses for lease sites must comply with City planning and zoning ordinances, the City's adopted Local Coastal Plan and Measure D limitations for properties north of Beach Street. Where zoning allows a variety of uses, preference will be given to coastal related uses whenever possible.

Sublease Approval: All leases require City approval of sublease agreements. Prior to approval of the sublease, the tenant shall pay any fees noted in the master fee schedule; submit a properly executed copy of the City standard Consent to Sublease form and a copy of the Sublease Agreement. Future lease agreements may provide for the City Manager or designee to approve sublease agreements which meet the stated qualifications for approval and which comply with the terms and conditions of the lease agreements.

Financing: The City will not approve financing related to or using the lease site, or leasehold interest as collateral unless such financing is for sole investment upon the lease site or for City requested public improvements.

SCHEDULE A

PERCENTAGE RENT FOR GROUND LEASES

| | | % GROSS SALES |
|-------------------------|-------------------------------|----------------------|
| FOOD SERVICE: | Restaurant, Dining Room | 3 |
| | Snack Bar, Delicatessen, | 5 |
| | Fast Food, Convenience Food | 5 |
| | Bar/Lounge, Beer & Wine Sales | 5 |
| RETAIL SALES & SERVICE: | Tenant | 3-5 |
| FISH & SEAFOOD: | Retail Sales | 3-5 |
| | Wholesale Sales | 0 |
| MOORINGS, TIES & SLIPS: | Pier/Fixed Piles | 10 |
| | Pier/Floating | 10 |
| BOAT REPAIR & SALES: | Boat & Marine Repair | 3 |
| | New Boat Sales | 1 |
| | Used Boat Sales | 2 |
| FUEL: | Gasoline | \$0.02/gal. |
| | Diesel | \$0.015/gal. |
| MOTEL: | | 5 |
| ALL OTHER USES: | | 5 |

Percentage Rental is to be based on the gross amount received from any and all sources of income derived from the lease site.

SCHEDULE B

PERCENTAGE RENT FOR BUILDING LEASES

| | | % GROSS SALES |
|-------------------------|-------------------------------|----------------------|
| FOOD SERVICE: | Restaurant, Dining Room | 5 |
| | Snack Bar, Delicatessen, | 7 |
| | Fast Food, Convenience Food | 7 |
| | Bar/Lounge, Beer & Wine Sales | 10 |
| RETAIL SALES & SERVICE: | Tenant | 7 |
| | Sublease | 7 |
| FISH & SEAFOOD: | Retail Sales | 5 |
| | Wholesale Sales | 0.5 |
| MOORINGS, TIES & SLIPS: | Pier/Fixed Piles | 20 |
| | Pier/Floating | 20 |
| BOAT REPAIR & SALES: | Boat & Marine Repair | 5 |
| | New & Used Boat Sales | 2 |
| FUEL: | Gasoline | .02/gal. |
| | Diesel | \$0.015/gal. |
| MOTEL: | | 10 |
| RV PARK: | | 25 |
| ALL OTHER USES: | | 10 |

Percentage Rental is to be based on the gross amount received from any and all sources of income derived from the lease site.