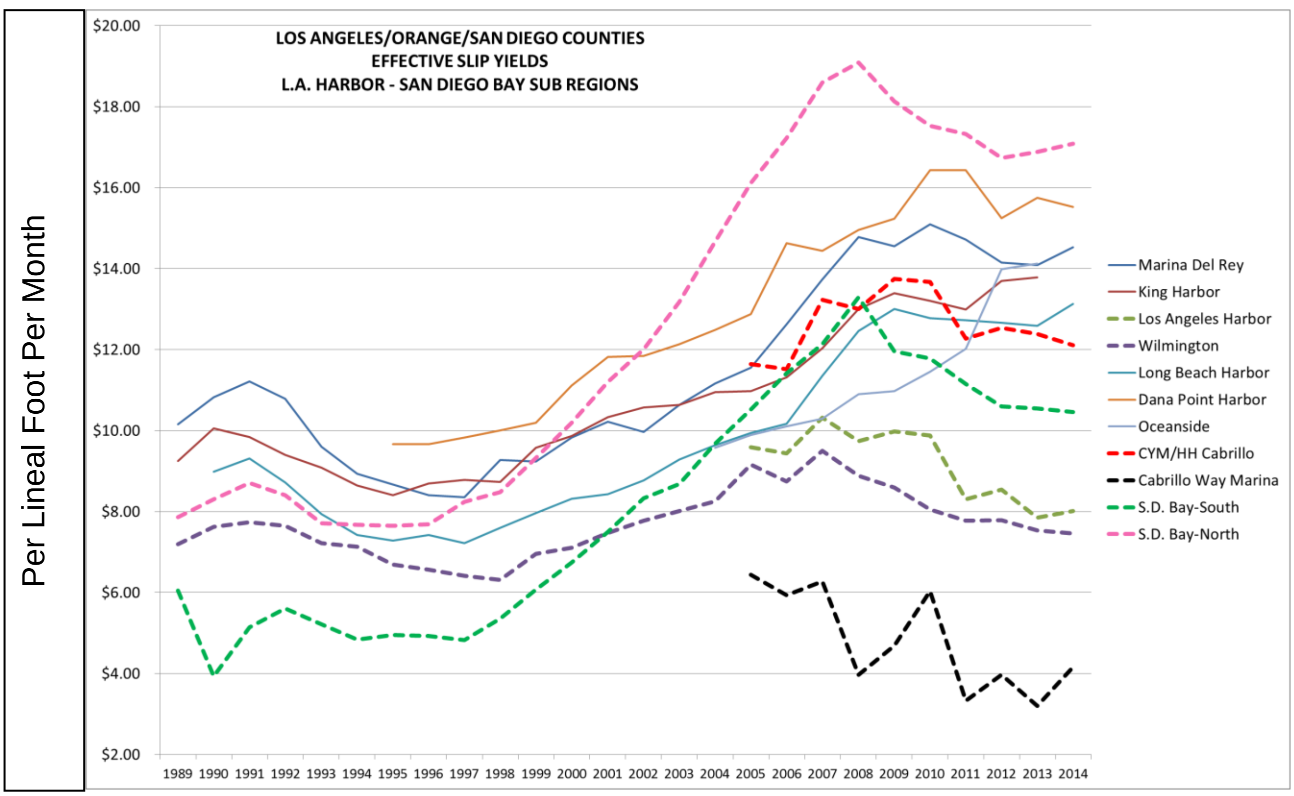
Wilmington Marinas Supplemental Material

<u>Marina Slip Yields</u>

An effective comparison unit for measuring financial and physical health of marinas is monthly effective lineal foot slip yield revenue (Effective Slip Yield). Each marina in a municipal setting has verifiable gross annual slip revenue and a verifiable total slip lineal foot measurement. The gross annual slip revenue is divided by twelve, and then divided by the marina's lineal footage to determine the dollar amount that each marina produces per lineal foot of slips per month. This measurement is not representative of what the marina's charge on a lineal foot basis which differs from larger to smaller slips and based on vacancy rates of any given marina. Instead this valuation methodology shows what each marina effectively achieves in revenue per lineal foot per month with all variable charges and vacancy inherently imbedded in the final Effective Slip Yield result.

Table 1, below reflects Effective Slip Yields since 1989 for all municipal recreational marinas in Southern California including both municipal operated marinas and privately operated marinas under municipal leaseholds. This rental revenue information for marinas outside the Port of Los Angeles was provided by the Marina Recreation Association, which is a national organization representing the marina industry. While comparable regional marinas have achieved significant Effective Slip Yield increases since 1989 between 35 percent and 75 percent, the Wilmington Marinas' Effective Slip Yield has remained stagnant for approximately 25 years. Since 2005 the Effective Slip Yields for the Wilmington Marinas have declined 18 percent while the rest of the regional market has increased by an average of 24 percent.



Transmittal 3

With 10 years remaining on the current permits, continuing under the established compensation structure is unlikely to achieve different results and it is likely declining slip revenue will continue. As part of an ongoing discussion with the Wilmington Marinas regarding strategies for changing the current downward trend while lacking an agreed to long term plan, the operators have requested several permit modifications to reverse the declining physical conditions and revenue generation trends. Marina operators have requested a reduction in percentage rent over a ten year period that would be set aside to fund approved deferred maintenance and capital improvement projects. Additionally, the marina operators have requested a ten year extension to their existing permit term which would extend the current term to 2035.

This memo will provide additional background on the circumstances that resulted in the current situation and a proposed interim strategy to reverse the current downward trend while a longer term plan for the Wilmington Marinas can be developed. When comparing these marinas to other concentrated marina facilities with multiple operators, the Wilmington Marinas are distinguished based on the large number of operators compared with the overall amount of slips. From a landlord's perspective, it is administratively burdensome to manage this many individual leases. Further, it may be too economically disorganized to create longer term stabilization of this market area with this many parties with diverse economic agendas. These issues and others will need to be further analyzed to develop a longer term development strategy that is attractive enough to encourage quality developers/operators to compete to take on the task of redeveloping the area into a modern and economically viable marina facility. The Harbor Department's long-term goal is to remove future barriers to development of cargo terminals on the northern side of Terminal Island while creating long term viability in the remaining Wilmington Marina complex. Harbor Department staff intends to achieve these goals by providing long term predictability and security in new marina permits in areas that do not conflict with current cargo operations. The strategy will target existing or new developers/operators that are willing and able to modernize the Wilmington Marina complex with limited or no cost to the Harbor Department.

Additional Background:

The Wilmington Marinas were generally developed between the 1930's and 1950's. These marinas were mainly built, owned and operated by families; some of whom are still operating the marinas in their third and fourth generations. In March of 1995, a Task Force, directed by the Mayor and the Board of Harbor Commissioners (Board) published its recommendations for ways to increase commercial development and economic activity at the Port of Los Angeles. It concluded that the highest and best use for the Wilmington Marinas was to maintain and evolve the marina leaseholds for commercial recreation use in the East Basin/Cerritos Channel location. The Task Force also recommended long term leases with the marina operators in return for commitments by the operators to make additional substantive improvements within the marina leaseholds.

Board Orders executed on July 6, 2001 granted 30-year permits to the ten recreational marinas (Permit Nos. 800 through 808 and No. 825), effective retroactive to November 1, 1995 to October 31, 2025. The new permits also obligated the Harbor Department to make significant infrastructure improvements in the Wilmington Marina area. Since that time, Colonial Yacht Anchorage has ceased operations through an eviction process resulting from failure to pay rent.

The nine remaining marinas occupy a combined total of 15.27 acres of land and 48.42 acres of water in Wilmington's East Basin/Cerritos Channel area. Collectively, the marinas provide approximately 1,434 boat slips of which 87 (6 percent) are currently occupied by live a boards.

Table 1

	Tenant	Permit No.	Premises (s.f.)
1	California Yacht Marina, L.P.	801	Land: 82,231 Water: 387,705
2	Island Yacht Anchorage I, Inc.	802	Land: 30,465 Water: 27,907
3	Island Yacht Anchorage II, Inc.	825	Land: 0 (Land POLB) Water: 227,753
4	Lighthouse Yacht Landing, Inc.	803	Land: 24,388 Water: 67,011
5	Marina Ventures Partnership, dba Holiday Harbor	808	Land: 62,810 Water: 171,513
6	Perel Marinas, Inc., dba Pacific Yacht Landing	804	Land: 62,700 Water: 197,192
7	Yacht Centre, Inc.	807	Land: 97,480 Water: 467,166
8	Yacht Haven Marina, Inc.	806	Land: 52,532 Water: 257,650
9	Cerritos Yacht Anchorage, Inc.	805	Land: 29,812 Water: 82,350

Leeward Bay Marina, which is on a 30-day Revocable Permit, is not included in this compensation reset: their compensation will be reset in accordance with the Revocable Permit on similar terms to what is agreed to with the rest of the Wilmington Marinas.

The 30-year permit required the marina operators to prepare and implement a plan to repair, refurbish, and/or replace improvements according to a design criteria specified by the Harbor Department and the California Department of Boating and Waterways.

While these permits were being finalized in 2000, the feasibility study for the U.S. Army Corps of Engineers/Port of Los Angeles Main Channel Deepening project indicated a need to widen the Cerritos Channel by 75 feet. Subsequent navigational studies and a wave impact study indicated the need for further modifications to the navigation channel including the need to widen the turning basin to accommodate the larger 6,600 TEU vessels at Berth 206-209. The implementation of the above mentioned channel widening and turning basin enlargement necessitated the relocation or redevelopment of nearby marinas, including repairs to failing rock slopes.

In January 2005, in consideration of the potential for a reconfiguration of the East Basin and Cerritos Channel, the Harbor Department notified the affected marinas to cease work on their permit required improvement projects pending the outcome of the Harbor Department's studies. To date, the Harbor Department has not finalized a plan to accommodate larger ships in the Cerritos Channel or provided the improvements or security required to allow the affected marinas to remain viable.

Preliminary plans to improve rock slope revetments that support the land around the marinas required to allow larger cargo ships in this area would result in effectively destroying existing slip improvements while they were relocated to allow rock slope work to be completed. The cost to replace these existing slips was not contemplated by either party. This became another uncertain condition that delayed forward progress to improve the physical conditions of the Wilmington Marinas.

The latest conceptual plan which was completed in 2008 provided a full scale redevelopment and reconfiguration of the Wilmington Marinas. The estimated cost was approximately $100 million and was not financially feasible. (Transmittal 3)

The proposed marina redevelopment projects required in the current permits remain at a standstill and the permit terms have dwindled down from an effective term of 25 years to just 10 years remaining. Consequently, the marinas continue to function without the material and financial benefits of those anticipated improvements or the security of a long-term lease, and the gross revenues and percentage rent revenue have suffered accordingly with slip percentage rent declining by 18 percent from 2005 to 2014 from $1.17 million to $962,000.

Current Compensation:

Current compensation is primarily based on percentage rent on gross slip rental revenue set at 20 percent which is collected in lieu of minimum rent. The permit's minimum rent was originally set based on a benchmark land and water rate as is typical on Port industrial properties. The benchmark approach sets land values based on a market comparable appraisal approach using comparable land sale values in the private industrial market and applying the Board policy rate of return to achieve the annual market land rental rate. The market land rental rate is then reduced to 1/3 of the applicable land value to arrive at the water rental rate. For percentage rent type leases the land and water rental rate is then multiplied by 75 percent to arrive at the minimum rent amount. This methodology is inherently flawed in valuing marina rent as it focuses the highest value or rental amount on land and a much lesser value on water for an operation that generates the great majority of its revenue from slips in the water.

In the 2010 compensation reset analysis, the benchmark valuation approach began to create situations where operators were not producing enough percentage rent to make minimum rent payments which essentially created higher percentage rent rates. Further, the benchmark valuation approach created inequities between marinas where tenants with much more land that generated little rental revenue paid much higher minimum rent than other tenants with more water and inherently higher revenue generating capabilities.

In order to address these marina specific valuation issues, an alternative Economic Performance Methodology was employed to compare against the results of the typical benchmark valuation methodology. The Benchmark Appraisal Methodology is most commonly used by the Harbor Department in determining minimum land rent for industrial or cargo related land rent. In this methodology, an annual rate of return of 10 percent is multiplied by the estimated fee simple value of the land and/or water. The product obtained is then multiplied by the size of the subject parcel(s). For percentage rent leases, the total amount is then multiplied by 75 percent to arrive at the minimum rent amount.

In the Economic Performance Methodology, the three most recent years of reported gross percentage rent income is averaged to arrive at the average annual economic performance total which is then multiplied by 75 percent to determine the new minimum rent as depicted below. In some cases a minimum adjustment by the Consumer Price Index (CPI) is also warranted meaning that minimum rent will be the greater of 1) 75 percent of the past three year average percentage rent; 2) the past minimum rent; or 3) the past minimum rent adjusted by cumulative CPI.

Example: $100,000 (2012 Gross Receipts) + $95,000 (2013) + $50,000(2014) = $95,000 (average past 3 years)

$95,000 x 75% = $71,250 (minimum rent result)

This Economic Performance Methodology is consistent with the current approach used to establish rents for recreational marinas in the municipal controlled marinas of San Diego, Marina Del Rey and King Harbor. In 2008, this methodology was also used to establish rent for the Port's outer harbor marina leases including Cabrillo Beach Yacht Club (Concession Agreement 517), Holiday Harbor (Concession Agreement 796) and California Yacht Marina – Cabrillo (Concession Agreement 791). The outer harbor marinas also employ a minimum CPI adjustment if percentage rents are not growing in line with CPI.

In the 2010 compensation reset for the Wilmington Marinas, it was agreed to use the Economic Performance Methodology to reset minimum rent only for operators that were not producing sufficient revenue to meet their minimum rent threshold, but not to apply CPI to minimum rent until the downward Effective Slip Yield trend reversed itself. This issue was intended to be reviewed in the current compensation reset analysis. The slip yield revenue trend has not reversed itself and has continued to decline from 2010-2015 resulting in minimum rents in several cases significantly exceeding percentage rent. The general result here is that the effective percentage rent has increased leaving less revenue for basic maintenance much less capital improvements. If revenue trends were healthy, the minimum rent should be (prior to reset) somewhere below 75 percent of the percentage rent collected. In this situation, total minimum rent is 94 percent of gross percentage rent collected.

Table 2

	Tenant	Per mit No.	Current Min. Fixed Annual Rent	2014 Gross Receipts Totals	Current Minimum / Current Gross (%)	Proposed Minimum Rent (75% of Past 3 Year Average Gross Receipts Revenue)	Monthly Rent
1	California Yacht Marina, L.P.	801	$157,380	$186,912	85.27%	$138,799.56	$11,566.63
2	Cerritos Yacht Anchorage, Inc.	805	$42,612	$44,976	94.74%	$37,283.28	$3,106.94
3	Island Yacht Anchorage, Inc. (I)	802	$32,328	$10,436	309.77%	$8,091.24	$674.27
4	Island Yacht Anchorage, Inc. (II)	825	$39,864	$26,493	150.46%	$16,875.72	$1406.31
5	Lighthouse Yacht Landing, Inc.	803	$43,296	$53,709	80.6%	$39,783.72	$3,315.31
6	Marina Ventures Partnership dba Holiday Harbor-Wilmington	808	$89,196	$72,719	122.65%	$58,110.96	$4,842.58
7	Perel Marinas, Inc. dba Pacific Yacht Landing	804	$103,500	$126,802	81.62%	$95,898	$7,991.50
8	Yacht Centre, Inc.	807	$152,460	$174,966	87.13%	$134,498.04	$11,208.17
9	Yacht Haven Marina, Inc.	806	$104,376	$118,330	88.20%	$89,733.48	$7,477.79
	Annual Totals		$765,012	$815,343	94%	$619,073.52	

The current and proposed minimum compensation for the respective Permits is as follows:

<u>Proposed Minimum Rent Adjustment</u> :

Adopting the Economic Performance Methodology for all Wilmington Marinas would result in lower minimum fixed annual rent for each tenant. This would, for the first time, reset all marinas' minimums in line with the actual economic performance and avoid tenants paying minimum rent in excess of their total remitted percentage rent if the downward trend continues. However, this adjustment will not effectively stop the downward trend in per linear foot slip revenue which is jointly caused by the declining permit term and the uncertain future plans for the Wilmington Marinas. Failure to address the larger issue of the declining physical conditions coupled with intertwined downward trend in Effective Slip Yield will likely put the Harbor Department in a worse financial position in five years with even less term left on the permits. Past history at other Port of Los Angeles marinas have been marked by significant Effective Slip Yield drop off as the permits moved towards the expiration date.

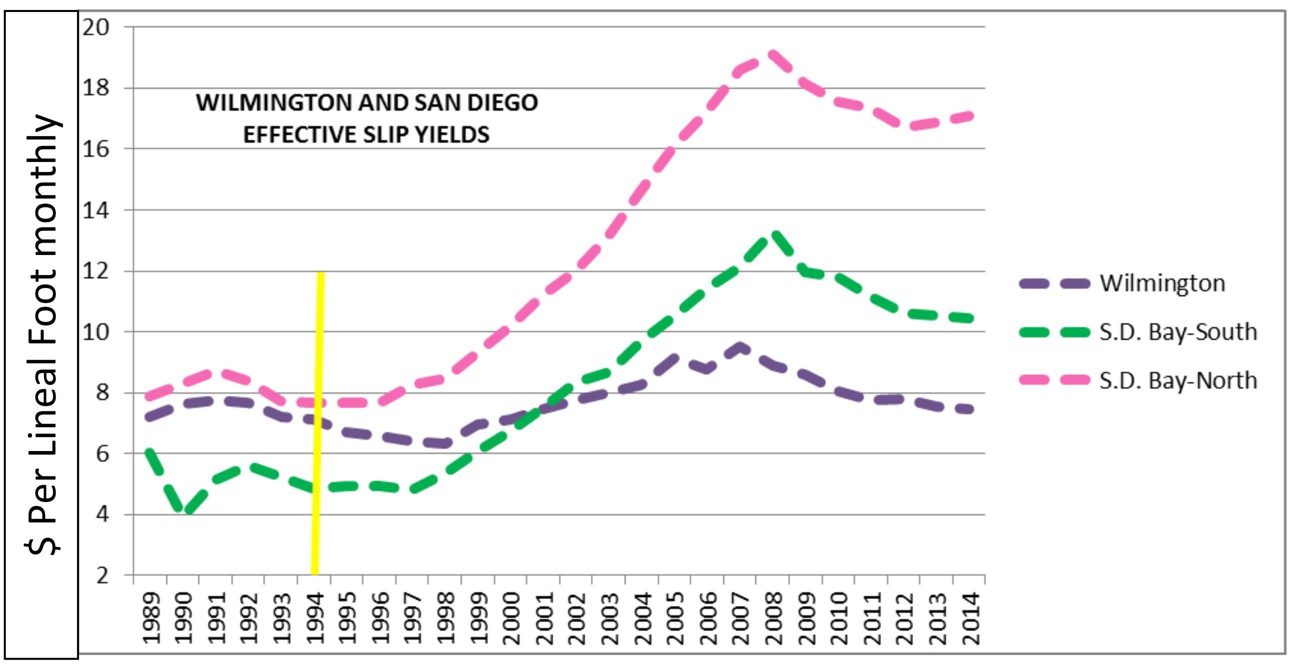
<u>Effective Slip Yields Market Comparison</u>:

Since the January 2005 Harbor Department's "cease work" instruction, the Tenants have suspended work on their projects and waited on the future development plans for the East Basin/Cerritos Channel. In the interim, physical conditions and Effective Slip Yields have declined. To date, due to the dynamic market conditions, the Harbor Department has not finalized a development plan for the East Basin/Cerritos Channel or

Berths 206-209 which is located across the Cerritos Channel from the Wilmington Marinas. No container operation has been established at Berths 206-209; but, the tenants have not been instructed to resume the marina improvement projects. Many tenants spent considerable amounts of time and money on sets of Harbor Department approved working drawings which were never implemented. Consequently, many of the marinas have deteriorated to the point where the ten years remaining on the permits will not justify the significant investments required without an incentive to reinvest. Over the past ten years, upgrades have been mainly limited to "fix and patch" solutions. Going forward, the motivation to even fix and patch is reduced as the term of the permit draws closer to the expiration date.

Comparing Effective Slip Yields is a useful method of comparison to analyze the effect of the absence of a long term direction in the Wilmington Marinas development plan in comparison to other marina districts that have proactively incentivized reinvestment by their operators. This type of comparison provides management with an effective metric to analyze how similarly situated marinas perform relative to one another.

The graph below demonstrates Wilmington's comparative market position with San Diego Bay North and South marinas dating back to 1989. San Diego south county marinas in Chula Vista and National City represent similarities to the working class Wilmington community with a surrounding environment less developed than the San Diego north county marinas. These differently situated San Diego marina facilities provide some similarities to our two marina sectors in Wilmington and San Pedro.



Since 1989, Effective Slip Yields in Wilmington have remained stagnant at approximately $7 per linear foot over a 25 year period. During the same time frame, Effective Slip Yields in both San Diego marina districts have increased substantially from a range of $6 to $8 to between $11 and $17 per linear foot or a 50 percent to 75 percent increase in Effective Slip Yields over a 25 year period.

These opposite trends are likely not a result of chance or regional marina market trends, but instead the market reacting to the San Diego Port District's proactive rental adjustment strategy that initially lowered percentage rent in the early 1990's from 20 percent to 25 percent (south and north) to 16 percent for all marinas. The San Diego Port District faced similar market challenges, to those we see today, in the early 1990's as the marina business began to retract for the first time since its inception. With limited alternative revenue stream to rely on such as our diversified cargo assets, the San Diego Port District's had to develop a strategy to incent immediate reinvestment to stabilize Effective Slip Yields in the short term. The San Diego Port District also implemented a longer term ground lease policy to incent continual reinvestment over time and increased Effective Slip Yields in the long term. The effect of the initial percentage rent reduction strategy coupled with a leasing policy that encourages continual reinvestment by tenants is significant. Since these reductions, percentage rents have also been readjusted to their original percentages in the 20 percent to 25 percent range. The end result is increased rental revenue to the Harbor Department, increased revenue to operators, and increased reinvestment in the marinas which creates higher value in the San Diego Port District's waterfront assets.

To combat further decaying of physical assets, shrinking revenues to the Harbor Department and its tenants, and to allow time to develop a longer term development strategy for the Wilmington Marinas, it is proposed to develop a solution to this issue using the San Diego model. If the Harbor Department continues to maintain the status quo, the probable future of the Wilmington Marinas can be foreseen by looking at past expiring term marinas in the Port of Los Angeles including the San Pedro Marina and former Fleitz Brothers outer Harbor Marina. When there is no certainty of a future, regardless of best intentions, it is only a matter of time before deferred maintenance gives way to minimal maintenance and no capital improvements. As history has shown, revenue declines follow and sharpen with time.

To counter the downward trend by creating incentives for the tenants to upgrade their marinas, staff proposes to develop a "Capital Credit Account" to allow 25 percent of the percentage rent to be set aside for infrastructure improvements, such as, pile replacement, utility upgrades, and environmental compliance. The incentive intends to reverse the physical deterioration trend and allow the Harbor Department time to evaluate a long-term development plan for the Wilmington Marinas. The Capital Credit Account, set aside percentage, and the resulting improvements, would be assessed on an ongoing basis and the Capital Credit Account would be discontinued at the end of the five-year reset and reviewed to determine if satisfactory improvement to the Wilmington Marinas has materialized.

Should this program prove to be successful and run for the remaining term of the permits (ten years), it is anticipated that approximately $3 million would be contributed to this upgrade process through these percentage rent credits by the Harbor Department. In addition, these investments may precipitate additional capital contribution by the marina operators to improve the viability of the Wilmington Marinas. The Wilmington Marina tenant's project that the facilities improvements will lead to slip rental revenue improvements as the marinas will become more competitive with other municipal marinas. This may eventually lead to increased rent to the Harbor Department to offset the loss of 25 percent percentage rent credit.

Below are projections, provided by the Wilmington Marina tenants, of what the potential result of doing nothing versus a range of projections for taking a proactive approach to the declining conditions in the Wilmington Marinas.