



# STAFF REPORT

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May 10, 2023

File Number 0600-10; A-3452-a; A-43452-b; and 0470-65

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## SUBJECT

**TERMINATING THE GROUND LEASE BETWEEN THE CITY OF ESCONDIDO AND TRANSFORMCO;  
ENTERING INTO A GROUND LEASE BETWEEN THE CITY OF ESCONDIDO AND COSTCO WHOLESALE  
CORPORATION; AND DECLARATION OF EXEMPT SURPLUS PROPERTY**

## DEPARTMENT

City Manager's Office

## RECOMMENDATION

Request the City Council adopt Resolution No. 2023-47 authorizing the Mayor and other Authorized Officers to execute two documents:

1. An agreement terminating the existing Ground Lease between the City of Escondido and Transform Operating Stores ("Transformco") for the former Sears site at 210 East Via Rancho Parkway (herein referred to as the "Sears Site") at the North County Mall Property in Escondido; and
2. A Ground Lease between the City of Escondido and Costco Wholesale Corporation ("Costco") for the same site.

Request that the City Council further declare the subject property as Exempt Surplus Property pursuant to Government Code section 54221(f)(1)(G).

Staff Recommendation: Approval (City Manager's Office: Christopher W. McKinney, , Deputy City Manager / Director of Utilities)

Presenter: Christopher W. McKinney, Deputy City Manager / Director of Utilities

## PREVIOUS ACTION

On June 27, 2022, the City Council adopted Resolution No. 2022-94 to:

1. Authorize extension of the (then) Westfield / North County Shopping Center Ground Lease for a period of twenty-four years from the current expiration date of June 30, 2053 to June 20, 2077;
2. Authorize a new Ground Lease with a term of twenty years, with seven five-year options, between the City and Costco, and
3. Declare the leasehold interests as Exempt Surplus Land pursuant to Government Code section 54221(f)(1)(G).

## FISCAL ANALYSIS

The proposed transfer of the Transformco Ground Lease at the Sears Site was contemplated when the City Council approved the Ground Lease extension and the new Costco Ground Lease at the Sears Site in



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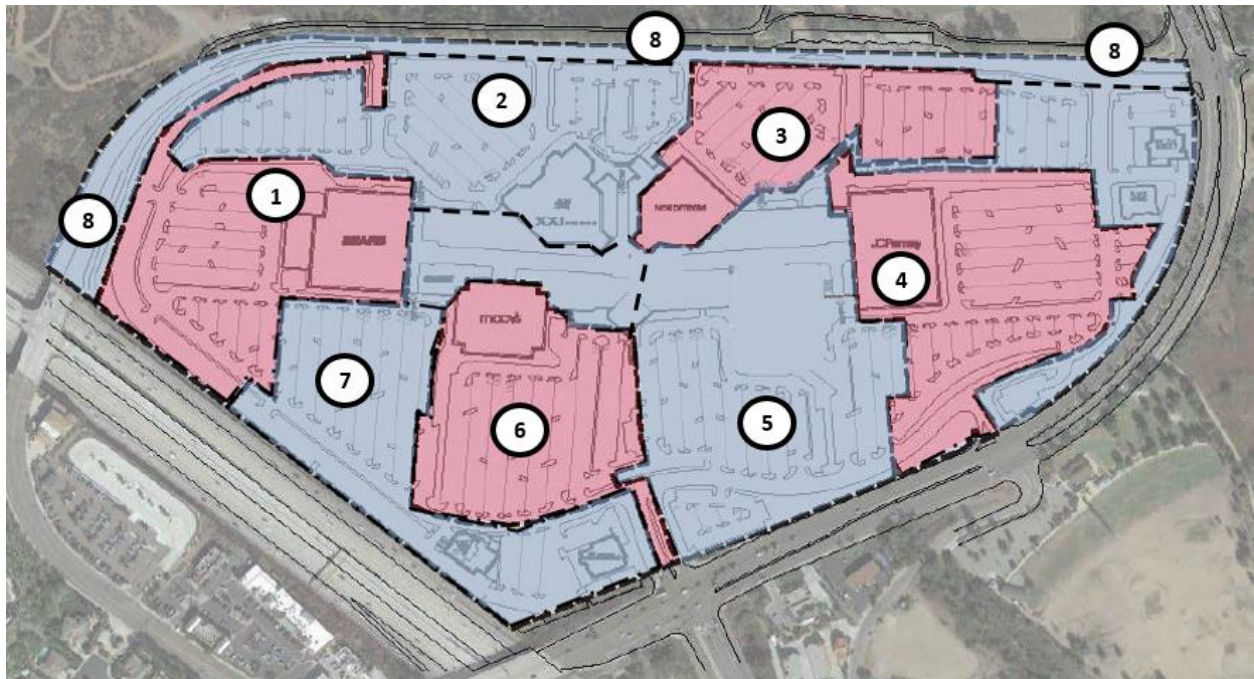
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June 2022. The anticipated fiscal benefits and lessee commitments to the City have not changed since that time. If the entitlements to the project are approved, the specific commitments by Costco include approximately \$35,000,000 in capital investments at the Sears Site. Fixed rent payments are required by the lease terms, and if the project entitlements are approved, projected annual sales tax revenue for the City in the first year of stabilized operation by Costco is anticipated to be approximately \$1,500,000. The business is projected to produce 314 total jobs.

### BACKGROUND

Costco desires to construct and operate a wholesale warehouse store at the Sears Site at 210 East Via Rancho Parkway, as described to the City Council at its meeting on June 27, 2022. The Sears Site is presently leased from the City by Transformco, who assumed the Ground Lease from Sears when the store closed in 2019.

Currently, the City has multiple ground leases related to the North County Mall Property. The map below shows approximate parcel boundaries at the mall property. For reference, these parcels have been numbered 1 through 8. The Ground Leases under consideration here, both the one to be terminated and the proposed new lease, cover Parcel 1. The City owns all parcels with the exception of Parcel 6.



### North County Shopping Mall Parcel Map

*Parcel numbers correspond to those used in this report. Red parcels denote ground leases with anchor stores. Blue parcels denote ground leases with Westfield. Parcel boundaries are approximate.*



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The City's Ground Lease for Parcel 1 with Transformco, as successor-in-interest to Sears, Roebuck and Co. ("Sears") was executed in 1986. This lease was amended and renewed by an Assignment and Assumption of Lease dated May 13, 2019, between Transformco and Sears.

The City was advised that Transformco agreed in 2022 to enter into an Assignment and Assumption Agreement with Costco for Transformco's interests in the Sears Site. The City was not a direct party to those negotiations. As a result, staff recommended, and the City Council adopted, Resolution No. 2022-94 to, in part, amend the existing ground lease to substitute Costco for references to Sears, Roebuck & Co and/or Transformco and update certain other provisions relative to Costco's obligations under a lease with the City.

Costco and Transformco thereafter entered into prolonged negotiations as to the terms of an Assignment and Assumption Agreement and the City is now advised that those negotiations have been finalized. The result of those negotiations is a somewhat different transactional model than the agreements envisioned in 2022 whereby now, the Transformco ground lease with the City will be terminated and the City will enter into a new ground lease with Costco. However, while the transaction documents are slightly different, the terms of the Costco lease remain the same as previously approved by the City Council with slight exceptions noted below.

The proposed Costco Ground Lease has the same term of 20 years, with Costco having 7 successive options to extend the term for additional periods of five years each, bringing the total term to a period not to exceed 55 years. Although the Mayor was authorized in June 2022 to execute a First Amended Ground Lease with Costco, the lease approved at that time was never executed because (1) the negotiations between Transformco and Costco were not finalized; and (2) the Construction, Operation and Reciprocal Easement Agreement ("REA") among the City and leaseholders at the North County Mall Property had not yet been negotiated. Negotiations to amend the REA are nearing completion and will come before the City Council for consideration.

The new Costco Ground Lease under consideration here is substantially similar to the agreement approved by the City Council in June 2022. The proposed agreement has been changed to clarify that all references to the REA will include the planned Second Amendment to the REA when it is complete. Language was also added to clarify that Rights of First Refusal granted in the original lease agreement are subject to the California Surplus Land Act (Government Code sections 54220-54234) and future amendments of that Act.

There are several other important terms in the proposed Costco Lease. The minimum base rent is \$100,000 annually beginning in the first year of operation. No rent will be charged by the City for a period of up to 36 months from Costco's obtaining the necessary development entitlements to account for the predevelopment and construction period. Additionally, Costco (or its sub-tenants) will be responsible for environmental remediation related to the proposed gas station, as required, when the use of the space is changed or on expiration of the lease. The City will be entitled to 1.25% of the gross proceeds from the sale of Costco's interest in the property, as long as that sale is at least half of Costco's interest.



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Transformco is current on its lease payments to the City and the property is in good condition, so there are no barriers to terminating the Transformco lease to make way for the new Costco lease.

Importantly, the actions proposed and recommended herein have no effect on, and provides no right to, the City's Planning Commission's or the City Council's decisions in their future review of any entitlements package, including permits, authorizations and approvals, environmental review, or other discretionary actions to consider the construction of any improvements at the Sears Site or in the North County Mall Property. Resolution No. 2023-47 includes specific language and findings related to the City's obligation as a governing body reviewing entitlements, including environmental review, to not pre-approve any such applications and the City reserves the right, is legally obligated to, and will in fact undertake an independent, vigorous and fully lawful examination of any development project for this location.

As the case in June 2022, staff analysis has also found that all parcels of the North County Mall Property, including are the Sears Site on Parcel 1, are Exempt Surplus Land pursuant to Government Code section 54221(f)(1)(G). Proposition A, passed by Escondido voters on June 5, 1979, restricts use of the North County Mall Property for "the planned development of a retail center," thus prohibiting its use for housing. Here, the proposed Costco lease is consistent with the underlying land use restriction for this property.

Staff recommends adoption of Resolution 2023-47 authorizing the Mayor and such other Authorized Offices, subject to final negotiation and approval as to form by the City Attorney, the following documents:

- A. Exhibit "A" – Termination of Lease
- B. Exhibit "B" - Ground Lease by and between the City of Escondido, Lessor, and Costco Wholesale Corporation, Lessee

Staff further recommends that the City Council, based on the record before it, declare the Sears Site as Exempt Surplus Property pursuant to Government Code section 54221(f)(1)(G).

## **RESOLUTIONS**

- A. Resolution 2023-47
- B. Resolution No. 2023-47 Exhibit "A" Termination of Lease
- C. Resolution No. 2023-47 Exhibit "B" Ground Lease by and between the City of Escondido, Lessor, and Costco Wholesale Corporation, Lessee