



STAFF REPORT

June 27, 2022
File Number 0600-10

SUBJECT

WESTFIELD / NORTH COUNTY SHOPPING CENTER GROUND LEASE AMENDMENTS

DEPARTMENT

City Manager's Office

RECOMMENDATION

Request City Council adopt Resolution No. 2022-94, authorizing the Mayor and/or Authorized Officers to execute lease amendments and related documents to (1) extend the 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, and (2) authorize a lease term of twenty years with seven five-year options for Costco Wholesale Corporation ("Costco") and, declare the leasehold interests as Exempt Surplus Land pursuant to Government Code section 54221(f)(1)(G).

Staff Recommendation: Approval (City Manager's Office - Jennifer Schoeneck, Deputy Director of Economic Development)

Presenter: Christopher McKinney, Deputy City Manager and Utilities Director

FISCAL ANALYSIS

The current Lessee for most of the Westfield Property is North County Fair, LP and EWH Escondido Associates, LP (referred to throughout this Report for convenience as "Westfield") which agrees to make capital investments in the Westfield property of at least \$64,000,000 prior to the exercise of its Second Option and the Lessee, Costco, upon satisfactory application for entitlements, will be making approximately \$35,000,000 in capital investments in the existing Sears property. In addition to fixed rent payments, projected annual sales tax revenue in the first year of stabilized operation for Costco is anticipated to be approximately \$1,500,000 and the business is projected to produce 314 total jobs.

PREVIOUS ACTION

On January 11, 2012, Ordinance 2012-02 was adopted by Council, authorizing the execution of a Lease Amendment and related documents to provide an option to extend the ground lease for the Westfield North County shopping mall for an additional 15 years.

Westfield proposed a major renovation project that included the renovation and releasing of the May tract (formerly Robinsons-May South) as a new, three-story Target store; improvements to the mall common areas and entrances; resurfacing of the parking lot; new restaurants; and a remodel of the food



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court. The total value of the project, including acquisition costs of the May tract, was approximately \$56,000,000. The proposal also included an increase in the fixed and percentage rent payable to the City of Escondido ("City"). Upon successful completion of the project, Westfield requested that the City extend the Ground Lease term for an additional 15 years.

BACKGROUND

Escondido's Westfield North County shopping mall ("Westfield Property") is located on approximately 83 acres at the south end of the City. The City owns approximately 74 acres and the Macy's Tract of approximately 8 acres is under separate ownership. It was originally developed by Ernest Hahn and designed by architect Jon Jerde in the mid-1980's on land owned primarily by the City. The Westfield Property mall development includes approximately 1.2 million square feet of retail commercial space and at the time of development was touted as the largest enclosed mall in the San Diego region.

The Westfield Property mall came about pursuant to Proposition A in June 1979. The voters approved the sale of an undeveloped 75.5-acre portion of Kit Carson Park abandoning it as park use and both specifying the planned development of a retail center and replacing the previous park property by acquiring 77.5 acres of adjacent property and dedicating that newly acquired property for park purposes.

The ground lease between the City and the then-developer (Hahn) was for a term of 55 years. The ground lease provided for a combination of fixed rent and percentage rent. Beginning in calendar year 2016, the fixed rent amount is equal to \$1,390,000 with annual increases of 2.5% or CPI, whichever is less. Four anchor stores pay a fixed amount of \$98,000 and the fifth location, J.C. Penney, pays an annual rent of \$10. Since 2016, the rent paid to the City has been an average of \$1,382,000 annually.

The six major department stores at the time the Westfield Property mall opened in 1985 included Sears, J.C. Penney, Nordstrom, Robinsons, Broadway and May Company. Five of these stores were not part of the mall ground lease but were on their own parcels, leased directly from the City. The sole exception was May Company, which owned the parcel on which their store was situated. The term of each department store ground lease is similar to the primary ground lease, which is 55 years. Cooperation between the department stores and the shopping center is assured through a Reciprocal Easement Agreement ("REA").

The department stores were seen as "anchors" for the shopping center and thus desirable tenants. Rents for the department stores were set very low to induce these stores to locate in the mall. With the exception of J.C. Penney, rents for each department store lease was fixed at \$98,000 per year. J.C. Penney pays virtually no rent at \$10.00 per year. However, all department stores provide significant sales tax revenues to the City and have "anchored" the shopping center since its opening.

There has been significant consolidation in the department store market sector since the shopping center was first developed. May Company consolidated with Robinsons, resulting in two anchors being owned by a single company. The Broadway was then acquired by Macy's. Federated Department Stores, which



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owns Macy's, subsequently acquired Robinsons-May. More recently, Sears and Nordstrom discontinued operations at the shopping center. Thus, of the original six independent anchors at the shopping center in 1985, there are now two department store ownerships: J.C. Penney and Macy's.

In 2012, a renovation project at the Westfield Property was completed, including a new Target store; improvements to the mall common areas and entrances; resurfacing of the parking lot; new restaurants and a remodel of the food court. In association with the renovation project, terms of the original lease were revised, which included a lease extension and an increased ground rent. The original ground lease term was extended for an additional 15 years, as requested by Westfield, and will now expire on June 30, 2053.

In addition, the City arranged to trade the City-owned Broadway tract for the Federated-owned May tract. This exchange enabled Macy's to continue operating on land they own while transferring the previous Macy's tract to the City, with leasehold interests to Westfield. Westfield then sub-leased a portion of the property for the development of a Target store.

PROPOSED GROUND LEASE AMENDMENTS

The proposed series of lease amendments and related documents for this item pertain to the City-owned parcels at the Westfield Property.

Currently, the City has multiple ground leases related to the Westfield Property. The map on the following page shows approximate parcel boundaries on the Westfield Property. For reference, these parcels have been numbered 1 through 8. A brief description of these parcels follows. The City owns all parcels with the exception of Parcel 6.

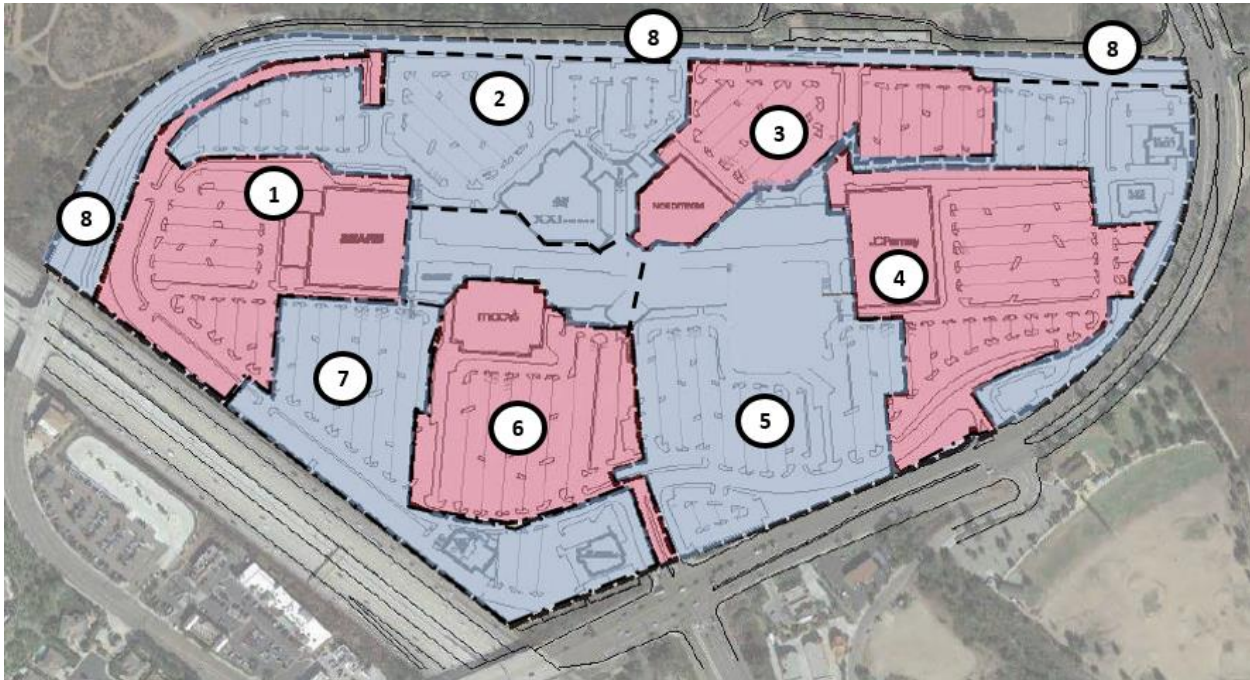
Parcel 1	– Leased to Transformco a.k.a. Sear site
Parcels 2, 5, 7, 8	– Leased to Westfield
Parcel 3	– Currently no lease
Parcel 4	– Leased to J.C. Penny
Parcel 6	– Owned by Macy's West

The leases for Parcels 1, 2, 5, 7, and 8 are all under consideration here for amendment. The details of these leases and the proposed amendments follow.



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Westfield / 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 approximate.

First, the City has a ground lease with Westfield dated February 2, 1981 for **Parcels 7 and 8**. The term of this lease has been amended four times over the years, the last being dated February 13, 2012. This lease currently expires on June 30, 2053.

Second, the City has a ground lease with Westfield for **Parcel 2** dated November 26, 1986, amended once on February 13, 2012.

Third, the City assumed a ground lease for **Parcel 5** between the City's predecessor-in-interest, Macy's West Store, Inc., and Developer/Lessee's predecessor-in-interest Macy's Escondido Inc. dated October 5, 2011, amended once on April 30, 2014. These first three leases are referenced collectively as the "Westfield Leases."

Finally, the City has a ground lease for **Parcel 1** with Transform Operating Stores LLC ("Transformco") as successor-in-interest to Sears, Roebuck and Co. ("Sears") dated November 26, 1986. This lease was amended and renewed by an Assignment and Assumption of Lease dated May 13, 2019, between Transformco and Sears. This lease is referenced as the "Transformco Lease."



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Westfield holding the “Westfield Leases” has sought, and the City is obligated to grant pursuant to the lease, an option to extend the current lease terms for a period of twenty-four (24) years from the current expiration date of June 30, 2053, to June 30, 2077 (“Second Option”) given the new term for the Costco Lease discussed below. Under the proposed terms of the extension, the City has sought and Westfield has agreed to make, capital investments into the Westfield Property of at least \$64,000,000 if and when they give the City written notice to exercise the Second Option, on or before June 30, 2052.

Transformco has agreed to enter into an Assignment and Assumption Agreement with Costco. Under the terms of this agreement, Transformco will assign all of its interests under the Transformco Lease to Costco (“Costco Lease”). Costco will accept the assignment and assume the liabilities and obligations under the Transformco Lease. The proposed agreements under consideration here by the City Council include a First Amendment to the underlying Ground Lease for the benefit of Costco. The term of this First Amendment is 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.

There are several important terms in the proposed Costco Lease amendment. 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.

Staff recommend these lease amendments because they provide certainty to the tenant and subtenants. This certainty will encourage additional investment in the Westfield Property, thus increasing rent revenues and sales tax revenues for the City. These revenues are unrestricted General Fund revenues which can be used for the benefit of the residents of the City.

Staff analysis has determined that no further notices, hearings or competitive bidding for these leases are required under State law or the Escondido Municipal Code because the proposed term of the agreements is not to exceed 55 years. In any case, such competitive bidding would be impractical and not in the City’s interests given that the existing Westfield Leases and Transformco lease do not expire until June 30, 2053.

Importantly, this action has no effect on, and provides no right to, the City’s Planning Commission or City Council’s decisions in their future review of any entitlements package, including permits, authorizations and approvals, to allow for the construction of any improvements on the former Sears site. Resolution No. 2022-94 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 it reserves the right, is legally obligated to, and will undertake an independent, vigorous and fully lawful examination of any redevelopment project for this site.



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Staff analysis has also found that the Westfield Property, and the parcels subject to the proposed lease amendments 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 Westfield Property for “the planned development of a retail center,” thus prohibiting its use for housing.

Staff recommend adoption of Resolution 2022-94 authorizing the Mayor, subject to final negotiation and approval as to form by the City Attorney, the following documents:

- a. Exhibit “A” – Amendment No. 5 to Ground Lease (Parcels 7 and 8)
- b. Exhibit “B” – Amendment No. 2 to Ground Lease (Parcel 2)
- c. Exhibit “C” – Amendment No. 2 to Ground Lease (Parcel 5)
- d. Exhibit “D” – First Amendment to Ground Lease (Transformco/Costco)

RESOLUTION

- a. Resolution 2022-94
- b. Resolution 2022-94 Exhibit “A” Amendment No. 5 to Ground Lease (Parcels 7 and 8)
- c. Resolution 2022-94 Exhibit “B” Amendment No. 2 to Ground Lease (Parcel 2)
- d. Resolution 2022-94 Exhibit “C” Amendment No. 2 to Ground Lease (Parcel 5)
- e. Resolution 2022-94 Exhibit “D” First Amendment to Ground Lease (Transformco/Costco)