



City of Del Mar



December 20, 2018

Ms. Dena Harris
Head of School
The Winston School
215 Ninth Street
Del Mar, CA 92014

Subject: City of Del Mar Response to Winston School Lease Restructuring

Dear Ms. Harris:

Thank you for your written proposal dated November 13, 2018 asking for changes to the existing lease agreement between the Winston School and the City of Del Mar. The Del Mar City Council and staff have carefully considered your proposal. Recognizing the Winston School's noble mission and role in the Del Mar community, the City Council would very much like to find revised lease terms that are acceptable to both Winston and the City. In this regard some of the requested revisions in your proposal are acceptable. As to those that the City cannot accept, as explained below, we present a counter proposal that we think can meet Winston's goals and needs while respecting the constraints that apply to the City as a municipal government.

As we understand it from Winston representatives, Winston has concluded that it cannot secure necessary donations and outside financing under the terms of the existing lease so as to ensure Winston is able to perform the terms of the existing lease. Winston wants to stay in Del Mar if financially possible and is, therefore, asking the City for significant revisions in the lease that Winston believes will enable it to secure the donations and financing needed so that Winston can perform its obligations.

The key lease revisions Winston seeks would:

- **Rent.** Change the annual rent due from the estimated amount of \$266,910.31 per year starting in 2023 (after Winston's pre-paid rent is fully recouped), to an annual rent going forward of \$1 per year.
- **Lease Term.** Extend the lease term from 55 years (currently expiring in 2063) to a 99-year term with two 25-year extension options in favor of Winston with the revised lease running to 2107, or if extended to the maximum, to 2157.

Our calculation is that these two changes would effect a transfer of \$10 million or more of value, at present value, from the City to Winston. This would be a significant change.

The City made it clear in our initial meetings that in order for these kinds of significant changes to be considered favorably, three things would be needed:

1. Any lease revisions would need to be agreed upon soon so that the City can know it is either progressing forward with Winston as a partner in the Shores Park development

process, or the City knows it can proceed on its own to plan and develop the park without Winston as a partner. At present, park planning is on hold until these concerns are resolved.

2. Any value being transferred to Winston as a result of lease revisions needs to be offset by a roughly equivalent value coming back to the City. Otherwise, the transfer is an illegal gift of public funds from the City to Winston that we would not and could not do. The City encouraged Winston to be as creative as it wished in proposing offsetting value to balance this equation, noting the City is not necessarily insisting on cash or equivalent, but is open to considering other forms of public benefit to the community.
3. Winston needs to make a basic prove-up to the City that it is capable of performing the current lease as written, or if it is revised, that Winston can perform the revised lease. We agreed there is no point in negotiating lease revisions unless Winston is able to perform under the current agreement or any agreed upon revisions.

We appreciate that Winston's proposal made an effort to address these three key deal points.

Brief History Recap.

Prior to 2008 when the 5.3 acre Shores property was sold to the City, the Shores property was owned by the Del Mar Union School District (DMUSD). From 1947 to the 1970's the DMUSD operated a school on site. From 1988 until the sale of the property to the City, the DMUSD leased the school site and buildings to Winston. When the DMUSD began to investigate selling the property for development purposes in the mid-2000s, the City, the community, and Winston worked together to pursue a purchase option to avoid development of the site and to meet two broad objectives: a park for the City and a long-term home for the Winston School.

A Memorandum of Understanding (MOU), dated February 21, 2006, was entered into between Winston and the City. Both parties were represented by legal counsel and each had their own financial advisers. The MOU addressed the terms upon which Winston and the City were to proceed to raise funds for the purchase and the terms of a long-term lease for Winston. When the purchase was completed a lease was drafted and signed, again with both parties having their own legal counsel and financial advisers. That lease is dated July 12, 2010. The lease has operated successfully since it was signed. This is the lease that Winston now seeks to modify.

The purchase was completed on July 31, 2007. The purchase price was \$8,500,000, of which the Winston School raised \$2,954,023.93, credited to Winston as pre-paid rent under the new lease at the then existing lease rate of \$197,245.39 per year. It is projected that Winston's pre-paid rent credit will run out in mid-2023 at which point rent will be due at the lease rate of \$266,910 per year with an annual CPI inflator thereafter. The balance of the purchase price was contributed by community donations and by the City. The amounts of current annual prepaid rent credit and anticipated lease payment are consistent with Winston's former lease payment to the DMUSD and are consistent with the terms of the 2006 MOU.

ALTERNATE PROPOSAL

Rent: Stays as per existing lease.

Lease Term: Extension to 80 years from current 55 years.

Winston Redevelopment Obligation (*Cost to Winston School for planning, design, demolition, and school reconstruction estimated at +\$20 million*): To be waived.

Security (new): Winston will provide security to the City in the form a performance bond, letter of credit, or other security acceptable to the City Attorney in the amount of \$1 million to cover the cost of demolition and clearing of the school site should Winston, for any reason, leave early or if Winston stays for the lease term, at the end of Winston's lease.

Off-street Parking: To be provided per Del Mar Code; off-street loading/unloading area for buses/vans; change from buses to vans to be provided.

Park Planning: Section 2c of the lease to be amended to reflect that the City's consultation with Winston regarding the park master plan is complete.

Rent Reductions: The options for rent reductions set forth in the attached Term Sheet and discussed briefly below are acceptable if Winston wishes to pursue them.

These City proposed terms reflect releasing Winston from its current obligation to plan and redevelop the school site, a commitment we estimate to be valued at \$20 million or more. Releasing Winston from this obligation, we believe, should allow Winston to secure donations and financing to cover the remaining lease obligations without a reduction in rent.

Attached is a Term Sheet with more detail on the City's counter proposal for your review.

DISCUSSION

As the custodian of public assets, the City of Del Mar is precluded from making gifts of public funds. We are simply not in a position to accept your proposal as submitted, as it would result in a significant transfer of value from the City to Winston constituting a gift of public funds. Moreover, the Del Mar community has many significant priority projects which require financial resources. The future lease payments from the Winston School starting in 2023 have been relied upon as part of the City's budget. Giving up that revenue stream would impede achieving other planned City priorities and is unacceptable. That said, recognizing the School's financial challenge, the City Council is willing to offer: 1) Three options to allow lease credits for certain elements that further the City of Del Mar's objectives and therefore would not be considered a gift of public funds, and 2) Waiver of the redevelopment requirements as identified in the original lease.

The City Council has identified several tools the Winston School could consider to off-set the anticipated lease payment, all of which are consistent with the City's responsibilities as a municipal government and which provide public benefit to offset the value of the lease rent reductions. The combined value of these three options as presented would be \$96,291, though the exact amount would vary based on the degree to which the School might elect to use these options. We present these to you in the attachment as options for your consideration.

In response to the offer within Winston's proposal for a lease credit for off-school hours space for recreational programming or other community-serving activities, after much consideration, the City has significant practical concerns regarding this offer and quantifying the value of that space due to limitations on when that space would be available compared to when it is anticipated to be of

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greatest need for the community at-large. We note as well that the current lease already gives the City the right to certain off-hours use of some Winston facilities (Lease, Section 7e).

Similarly, regarding the Winston School's offer for full-time use of parking and the ability to use space for emergency shelter and storage, since the concept diagram included with the School's proposal only reflects 32 parking spaces, which appears too few even to meet the School's minimally required parking per the Del Mar Municipal Code, that is not a viable option to off-set the anticipated quantity of parking spaces to serve the envisioned park amenities. However, it would be desirable to the City to be able to use additional school parking after-hours as over-flow for the community, so the City would be willing to entertain a proportional value for those spaces.

The community is eager to move forward with the park master planning effort. The City is equally as committed as the school to facilitating a long term relationship with the Winston School that will serve both the City and Winston. If the terms of this counterproposal are amenable to the School, the next step will be to prepare a formal lease amendment which will then be brought forth to the City Council in open session. We look forward to your response.

Sincerely,



Ellie Haviland
Deputy Mayor

Attachment

c: Del Mar City Council
Scott W. Huth, City Manager
Kristen M. Crane, Assistant City Manager

Winston School Lease Restructuring - Terms for Counterproposal – 12-20-18

- The City Council cannot make the finding to support the School's proposal for a lease of \$1.00 per year, which would be a gift of public funds. However, on page 2, three optional tools are listed that the School could exercise to reduce the annual lease payment.
- The City Council cannot make the finding to support the School's proposal for a lease term of 99-years, plus two 25-year extensions.
- The City is open to changing the terms of the lease in the following manner:
 - The City Council is amenable to adding the option for a 25-year extension to the current term, therefore extending the term of the current contract from 2063 to 2088, which would be 70 remaining years versus 45 years currently, to help the School secure financing and to enable longer use of the facilities.
 - The City Council is willing to waive the redevelopment requirements identified in *Section 3 – Commencement Date and Term* of the current lease, including the redevelopment milestones.
 - The two proposed term changes above are in exchange for the following terms:
 - At the time of the agreement, the school shall provide to the City a performance bond for \$1 million (or amount as determined by engineer's estimate to be completed at School's expense) for the estimated cost to demolish the existing buildings within the school's leasehold area.
 - The School needs to provide within its leasehold area: a) sufficient off-street parking to meet its parking requirement per the Del Mar Municipal Code, b) an off-street loading/unloading area for buses, vans, etc. for students triggered when south parking lot is no longer available for use, and c) School needs to change how students arrive at the school (such as disallowing large buses in favor of small vans).
 - Section 2c of the current lease shall be amended to reflect that the City's consultation with the School regarding the park master plan design is complete. The City will be proceeding with the park design based on what the community at-large wants. The City will include in the park design an open space turf area that can be used non-exclusively by the School. School will have non-exclusive use of the park area. The City will work cooperatively with the School on scheduling.
 - References to the non-exclusive parking area shall be removed.

- *Section 14 – Assignment and Subletting* will be removed from an amended lease. These amended lease terms are not transferable. Therefore, if the School is to assign or sublet their lease per the terms of the current lease, the redevelopment terms, lease payment term, and all other provisions remain in full effect.

- If the redevelopment requirement is waived, rent terms remain the same. The City Council offers the following options for the school to reduce the estimated annual payment that will be due in 2023:

Estimated 2023 Lease Payment = \$266,910.31

Current School leasehold area = 1.8 acres

Options

- Reduce square footage of School leasehold area to gain square footage that could be developed as part of the park, as determined by the City to be beneficial (e.g., square footage on the eastern or southern lease boundary). School needs to make a commitment to the City on this topic in 60-days with execution of lease. Hypothetical at 10% Reduction
-\$26,691 per year

For example, 10% reduction of leasehold area = \$26,691 lease reduction per year

- Build 28 public parking spaces for the community in addition to school required parking that would be available when school is in session. Requires a binding commitment and communication of intent at time of agreement. This option remains available until City has committed to building its required parking spaces. -\$33,600 per year

In-lieu parking fee rate = \$1,200 per space per year

28 x \$1,200 = \$33,600 lease reduction per year

- Build and manage affordable housing units. Units need to be affordable for duration of lease term. Incorporating housing units helps the City toward its affordable housing requirements. This option could provide housing for school faculty or staff. The school can keep the rent. Hypothetical at 3 units =
-\$36,000 per year

Value of one affordable housing unit = \$11,000-\$12,000 lease reduction per year (based on extrapolation from “22 in 5” study).

** Annual credits for these options would increase annually per the same methodology as the terms of the lease.*

- For whatever terms are agreed upon to proceed, including continuation of the current lease, the School will be required to provide a pro forma financial statement demonstrating financial capacity to meet the obligations.