ITEM NO. 27

STAFF REPORT

CITY OF OCEANSIDE

DATE: August 16, 2006

TO: Chairman and Members, Community Development Commission

FROM: Economic Development and Redevelopment Department

SUBJECT: **APPROVAL OF A MEMORANDUM OF UNDERSTANDING BETWEEN S.D. MALKIN PROPERTIES, INC., AND THE COMMUNITY DEVELOPMENT COMMISSION; APPROVAL OF AMENDMENT 2 TO THE NEGOTIATION AGREEMENT TO EXTEND THE TIME PERIOD TO FILE ALL DEVELOPMENT-RELATED PERMIT APPLICATIONS; AND APPROVAL TO MOVE TO THE SECOND NEGOTIATION PERIOD.**

SYNOPSIS

Staff recommends that the Community Development Commission (CDC) approve a Mémorandum of Understanding with S.D. Malkin Properties, Inc; approve Amendment 2 to the Negotiation Agreement to extend the time to submit all development-related permit applications; grant approval to move to the Second Negotiation Period; and authorize the Executive Director to execute the documents.

BACKGROUND

On September 7, 2005, the CDC entered into a Negotiation Agreement with S.D. Malkin Properties, Inc., for the development of a resort hotel on property owned by the CDC, bounded by Pacific Street on the west, Seagaze Drive on the south, Meyers Street on the east, and Pier View Way on the north. The Negotiation Agreement set forth a process to develop an MOU that would be a non-binding recital of the proposed investment by the CDC and City of Oceanside, the financial mechanisms to be used, and the framework for the lease of the Community Development Commission-owned real property and development of a downtown beach resort hotel. The Agreement also contemplated that upon acceptance of the MOU the CDC and the developer would have an opportunity to move to the Second Negotiating Period, at which time a more detailed lease and financial commitments would be documented into the Development and Disposition Agreement (DDA).

At this time the CDC and the developer are at a point to choose to move to the Second Negotiating Period. If the CDC approves moving to the Second Negotiating Period, the developer will prepare and submit all development applications including the Regular Coastal Permit and the Draft Environmental Impact Report (EIR). At this time the developer has requested an additional 60 days to complete all the detailed submittal requirements such as traffic reports, historic reports, etc. The formal way to allow the added time is to extend the term of the Negotiation Agreement by 60 days. The new

maximum amount of time, with the amendment, to complete the application, the EIR, the DDA, and getting the approvals would now be 600 days. These are maximum times and through diligence on the part of the developer and the City, the time frames may be shorter.

In addition, should the inclusion of the fractional time shares or any other vacation ownership use be contemplated and require clarification in the Local Coastal Plan, the time to incorporate such a clarification would need to be accounted for in the schedule. Assuming that any other approvals such as Coastal approvals could be done concurrently, at the time of entitlement the developer would submit grading and building plans and upon approvals, would then begin the twenty-four-month construction process. The entire schedule has been extended by 90 days due to one 30-day extension and the requested 60-day extension. While it is possible that the hotel could be completed by the end of 2009, it may be spring 2010.

This has been a deliberate process starting with direction from the Council, community and stakeholder outreach; the distribution of a Request for Qualifications; receipt and review of fourteen proposals; selection and review of finalists; a public meeting with the finalists; and the ultimate selection on April 20, 2005, of S.D. Malkin Properties, Inc.

Since September 7, 2005, staff and consultants have met approximately 45 times. Consultants on the project include Delmar Williams, of Best Best and Krieger; Paul Marra and Curt Lewis of Keyser Marston Associates, Inc.; C.Jay Scott of Scott Hospitality Consultants; Maurice Robinson of Maurice Robinson and Associates, LLC; Brian Forbath of Stradling Yocca Carlson & Rauth; and Keith Curry of Public Financial Management, Inc. Core staff to the Financial Negotiating Team included John Mullen, City Attorney; Mike Blessing, Deputy City Manager; and Jane McVey, Economic Development and Redevelopment Director. Other participating City staff includes Jerry Hittleman, Acting City Planner; Kathy Baker, Redevelopment Manager; Peter Weiss, Public Works Director; Doug Eddow, Real Property Manager; and Michele Lund, Treasury Manager.

The core tasks since September 7, 2005, were for the developer to make the design as final as possible; to analyze the costs and revenues based on the final design; and to develop a plan for the infusion of the Community Development Commission/City investment. To do that required the developer, S.D. Malkin, to move from a broad concept of the layout and site plan to a more refined concept, including determining the preferred alternative for placement of the Top Gun/Graves House.

ANALYSIS

Financial Commitment

The financial commitment required has risen due to a significant increase in construction costs and the increased size of the hotel project since originally envisioned. The estimate for the cost of the hotel in April 2005, based on construction costs immediately prior to that time, was $110,000,000. At this time the cost of the

construction of the project is estimated to be $187,000,000. Given the expected revenues at the cost of $110,000,000 a $9.9 million investment was needed to fill the gap. At this time the Agency and City will need to invest an additional $17.1 million for a total investment of $27 million.

The project has increased in size from 302 hotel rooms and 72 time shares to 336 hotel rooms (including the boutique hotel of 47 rooms) and 48 fractional time shares. Component parts include a 289-room hotel on the south block, including a space suitable to seat 500 plus a dance floor. The parking requirement of the ballroom space is a driving factor in the construction of a $22 million two-level underground parking garage. The north block contains a 47-unit boutique hotel, a 48-unit fractional time share building, a shared lobby and amenities, and the Top Gun/Graves House.

In addition, the Local Coastal Plan requires that thirty percent of the site be left as public open space and that 18,000 sq. ft. of Visitor Serving Commercial space be included.

Redevelopment Agency Tax Increment Extension

The City of Oceanside has had a Redevelopment Agency since November 1975, as allowed in State law. The Redevelopment Agency was created to eliminate blight in the downtown and to further the economic goals of the City in a specific area, the 375-acre core downtown area. In that area, the increase in the property tax from the Redevelopment Project Area can only be used to enhance the downtown. Major projects such as moving the train switching yard from the downtown, environmental cleanup, a portion of the new parking garage at the Transit Center, North Coast Highway landscaping, and certain catalyst projects like the San Miguel condominiums and the Pacific Village Row Homes are examples of projects that have been done through the Redevelopment Agency. The City Council sits as the Board of Directors, or Commissioners, of the Redevelopment Agency, which is technically called the Community Development Commission (CDC). In essence, a Redevelopment Agency is a financing tool to achieve specific goals. The main source of revenue has been the increase in property tax since the inception of the Agency. The use of the money is tightly controlled by State law and can only be used in the Redevelopment Area. The Redevelopment Agency is set to expire in November 2015.

Redevelopment Agencies under California Law are allowed to invest in projects that meet the goals of the Agency. The goal of having a destination resort hotel has been in the Redevelopment Plan since it commenced in November, 1975. For a variety of reasons, it has not yet been achieved.

Due to the age of the Agency, a procedure to extend the ability of the Agency to incur debt must be undertaken, no matter what the investment. The Agency's ability to incur debt expired on December 31, 2003. There are two separate mechanisms to extend the ability to incur debt based on two separate provisions in the law. The Legislature has now allowed Agencies who have paid a portion of their property tax increment to the State as required by the State imposed Educational Revenue Augmentation Fund (ERAF) to extend the life of the Redevelopment Plan by one year for each year an

agency has paid ERAF. The Oceanside Agency, along with all other agencies, has been forced to pay three years of ERAF money to the State, and as such will be allowed through ordinance to extend the life of the Redevelopment Plan by three years.

In addition, the Agency may, through ordinance, extend the ability of the Agency to incur debt by an additional ten years. Therefore, the Redevelopment Plan, which was due to expire in November 2015, through the use of both of these mechanisms may be extended to November 2028. This is significant as the ability to receive tax increment and re-invest in the project is governed by State law. As the Oceanside Agency is quite old, there is a limited time horizon that is allowed to the Agency at this time. When the Redevelopment Plan expires the City will assume the Agency's rights and responsibilities. For purposes of this report, the term Agency also means City at the end of the Redevelopment Plan.

In order to extend the life of the ability of the Agency to incur debt, the Agency, which up to now has been able to keep all the Tax Increment, must now share that increment with other districts such as the school district, the county and all other taxing districts that would have otherwise received property taxes from the 375-acre Redevelopment area. The extension of the ability to incur debt will require that payments back to 2004 to be made to those agencies. From that time forward, the Tax Increment to the Agency will be net of not only the 20% Set Aside money, but also the amounts to be distributed to other taxing jurisdictions. All revenue amounts noted in this report are net numbers. The mechanism and procedure to extend the life of the agency will be brought forward to the CDC in the coming months.

FISCAL ANALYSIS

Annual Revenues

The following presents a summary of potential revenues from the hotel project. At year four the hotel project is expected to stabilize with Average Daily Rates at $271 and fractional time share values of $154,000. At stabilization the hotel project will yield the Agency and the City the following gross revenues on an annual basis:

Source	City of Oceanside	Redevelopment Agency
Transient Occupancy Tax (TOT)	$2.5 M	
Net Property Tax Increment		$ 1.0 M
Sales Tax	.173 M	

75-Year Net Present Value Revenues

The life of the lease is proposed to be 75 years, with a re-appraisal and an option for a 24-year extension. In Net Present Value, or at today's dollars, deflated for future inflation, over the 75-year term the hotel will yield the following gross revenues:

Source	City of Oceanside	Agency	Total
Transient Occupancy Tax	$40.4 M		$40.4 M
Property Tax	$ 3.0 M	$11.8M	$14.8 M
Sales Tax	$ 2.8 M		$ 2.8 M
Lease Revenue		$14.7 M	$14.7 M
Total	$46.2 M	$26.4 M	$72.6 M

Based on the proformas, the CDC will recapture the $27 million investment in year 10 of the lease, which is year 8 of operations. With 8 percent interest added, the CDC will recapture the $27 million in year 14 of the lease or year 12 of operations.

Additional Revenue

In addition to these revenues, there are provisions in the MOU that are not able to be quantified, but will add additional revenue to the amounts noted above as follows:

- Bonus Rent, to be paid if the project does better than the proforma.
- Participation in refinancings (one half of one percent of net refinancing after the first refinancing)
- Participation in sales (one percent of sale of the lease)

These provisions are complex and are spelled out in the MOU, but in essence are mechanisms to assure that the Agency and City receive a portion of any windfall profits and are also a way to recoup the initial investment into the Public Private partnership.

To put the participation in sales in some perspective, the original San Miguel condo project on The Strand was a Redevelopment project, as were the Pacific Village row homes which were the advent of the row homes north of Pier View and east of the railroad tracks. Both of those projects were required, for a thirty-year period, to pay 1.5 percent and 1 percent respectively of sale price to the agency for all sales. Since 1998 the Agency has received $ 927,665 and the properties have a combined 2006 value of $94 million, with 2006 tax increment estimated to be $1,015,340. While bonus rent and participation from the hotel project cannot be quantified at this time, there will be additional revenue potential to the City and the Agency above the amount previously noted.

Under this proposed financing structure, 81 percent of the investment comes out of the Redevelopment Agency, and the General Fund is the recipient of 63 percent of the financial benefit.

Indirect Benefits

None of the dollars represented in the fiscal analysis are indirect revenues such as spin-off effects or multiplier effects. There is one indirect benefit, however, that must be pointed out. In the Local Coastal Plan is a subset called the Nine Block Master Plan, which states that 240 hotel rooms must be built within the 9 blocks before any given block can pull building permits or that block/project must build their pro rata share of the

240 hotel rooms. Adjacent to this project is the five-block Citymark project, which must either contain 133 hotel rooms (five-ninths of 240 rooms) or wait until the hotel project has begun. This project is a significant one that will establish an urban tourist and resident village in the downtown area. In addition, the proposed second parking garage on Lot 23 at Cleveland and Pier View also cannot proceed unless it produces 27 hotel rooms or waits until the hotel project is built. This requirement and the difficulty in achieving it have created the existing donut effect within the downtown area with the middle remaining empty.

The construction of the hotel project meets the goals of the Redevelopment Agency and also adds a customer base for the existing merchants in the downtown area.

Investment Mechanisms

The investment was structured with a goal to use money coming out of the project itself as the principal source of revenue to re-invest in the project. But for the financial partnership of the Agency and the City, a hotel of this quality would not be built, and this money would not be available. In addition, the selected financial structure puts the burden of performance on the developer.

The following summarizes the uses of funds:

Use	Source	Amount
Environmental Impact Report	Redev. Funds	$200,000
Off-site infrastructure	CFD reimbursed by tax increment from project	$4.8M
Garage	Agency issues bond to net money for a portion of garage	$17M
	City receives 1st $1M annually in TOT. City contributes 75 percent of remainder until developer is repaid	$ 5M
Total		$27M

No existing revenues will be used, except for $200,000 in Oceanside Redevelopment Agency Tax Increment.

Off-site infrastructure – Community Facilities District

A Community Facilities District (CFD) is a Mello Roos district, allowed by State Law, and has been used to finance the construction of infrastructure as required by the City in industrial and residential projects in Oceanside. Under this proposal, the lessee, S.D. Malkin, as the owner of the long-term lease, would apply to the City Council to request the creation of a CFD after the environmental process has been completed and the project is entitled. The developer will pursue the construction of the off-site infrastructure with construction loans and its own money. Off-site infrastructure includes such items as drainage enhancements, sewer lines, water lines, traffic signals, etc. After the appropriate and required legal documents have been prepared and the City Council votes to create the CFD, a bond can be issued, secured by special taxes levied on the hotel site and based on the projected value of the hotel construction that would net the amount needed to buy the off-site infrastructure from the developer. The CFD tax is a special tax on the developer's tax bill, and the Agency would rebate tax increment from the hotel project back to the developer in an amount to pay the CFD tax plus interest. In that way the value of the hotel project generates tax increment to pay the developer back for building the off-site infrastructure and the legal responsibility to pay the CFD tax is with the developer.

Parking Garage Tax Anticipation Bonds

The Agency proposes to contribute $17 million toward a portion of the parking garage. After the extension of the limitation to incur debt, the Agency would issue Tax Anticipation Bonds (TABs) and use the money raised to contribute up to $17 million toward the garage.

When the Agency issues bonds, it receives funds from the sale of the bonds, and then uses the annual increment from the Redevelopment Project Area to pay the debt service on the bonds. While some non-hotel tax increment would be used to pay the debt service on the new bonds, the hotel will generate $1,043,000 in tax increment annually at year 4, which would be a large portion of the tax increment to pay the debt service on the new bonds.

Typically these bonds are 30-year bonds. However, even with the extension of the ability of the Agency to incur debt, there is only a 20-year window for the longest length of a bond before the Redevelopment Plan expires. Therefore, the impact is that as the time period shortens, the debt service must rise. It would be similar to the difference between a 30-year mortgage and a 20-year mortgage; however, in this instance a 30-year bond will not be available to the Agency.

Parking Garage – TOT

The Agency proposes that $5 million of Transient Occupancy Tax (TOT) be contributed to the parking garage. The TOT is a tax on the revenue paid by hotel guests that goes into the General Fund. The formula would be that the City keeps the first $1,000,000 of TOT annually, and contributes 75 percent of the amount over the first million. In year

two and each succeeding year, the million is proposed to be indexed by a Consumer Price Index (CPI). For example, in year one, the hotel is expected to produce $1.8 million in TOT. The General Fund would get $1.2 million ($1million plus 25 percent of $800,000) and the contribution to the garage would be $600,000. In year two, assuming a CPI of 3 percent, the City would keep the first $1,030,000 and 75 percent of the amount over that would be pledged to the garage. Under this approach, the developer is fronting the cost of the construction of the parking garage, and getting paid back after the fact through the TOT that the hotel itself produces. Until the developer has received the full $5 million, it will want 12 percent interest on the remaining balance. The TOT contribution is expected to be complete in year 13 and will expire no later than year 15.

Lease Provisions

The lease term is 75 years, with an appraisal at that time and a 24-year extension opportunity. The lease begins at the time the property is made available for construction. There are several components of the rent.

Fixed Rent

The first component is a fixed rent provision which is an absolute amount that grows quite slowly to allow the hotel time to construct, which is about 2 years, and to become established in the marketplace. For the first 12 years of the lease there is no fixed rent provision. In year 13 the rent begins at $100,000 a year and increases as follows:

Fixed Rent

Lease Years	**Rent**
1 - 12	$0
13	$100,000
14	$200,000
15	$300,000
16	$400,000
17	$500,000
18	$600,000
19	$700,000
20 - 75	75 percent previous 5 years average total rent - every 10 years

Percentage rent

In addition to the fixed rent is a percentage rent, which is paid on the margin between the fixed rent and the percentage rent. As with the fixed rent, the percentage rent is zero for the first 12 years to allow for construction and to become established in the marketplace. At the 13th year the developer will pay 0.5 percent on the gross room revenue and 0.25 percent on the food and beverage and other revenue. It increases as follows:

Percentage Rent Lease Years	Rooms	F&B/Other
1 - 12	0.0%	0.00%
13 - 15	0.5%	0.25%
16 - 18	1.0%	0.50%
19 - 22	2.0%	1.00%
23 - 26	3.0%	1.50%
27 - 30	4.0%	2.00%
31 - 35	5.0%	2.50%
36 - 50	6.0%	3.00%
51 - 75	7.0%	3.50%

Time share rent

The developer/master lease holder will pay to the Agency $350 per interval, per year, on sold intervals only. In addition, the developer/master lease holder will pay 1 percent of the proceeds of any resale.

Bonus Rent

To assure that the Agency has a mechanism to recapture the investment should the hotel make more money than projected, for every lease year that gross revenues exceed 110 percent of proforma projects, the rent for that year will move to 7 percent of room revenues and 3.5 percent of food and beverage and other revenues exceeding 100 percent of proforma. This is a recapture mechanism.

Revenue Sharing on Sale

It is contemplated that the hotel developer will sell the project between year 9 and 13. The return is both the return on operations and also the return they make on the sale. In the spirit of partnership, as the Agency has invested in the project to make it successful, the CDC will participate in the sale. The tenant will be allowed to recapture their equity plus a 20 percent return on equity from the first sale. Above that the CDC will receive 10 percent of the proceeds of the sale. If the return on equity is above 25 percent, the CDC will receive 15 percent of the proceeds of the sale until the CDC receives $27 million plus 6 percent compounded interest.

This proposal to participate in sales continues with subsequent buyers throughout the 75 years. However, if at the first sale the original tenant (S.D. Malkin), does not receive at least a 17.5 percent compounded return, then the buyer of the lease from Malkin is not subject to having the CDC take a portion of the sale, until lease year 20. For all later sales the CDC receives 1 percent of gross sale proceeds net of transaction costs.

Sharing in Refinancing Proceeds

S.D. Malkin will have a construction loan and when the project is finished/almost finished will take out the construction loan with permanent financing. The CDC will not participate in this refinancing. However, later refinancings by S.D. Malkin will be treated the same as a sale. For any subsequent tenant, the CDC will receive 0.5 percent of the gross refinancing proceeds net of transaction costs, with amounts received by the CDC from refinancings credited against amounts due to the CDC from the same tenant on a future sale of the lease. In this way, the CDC is hedged against the tenant withdrawing equity from the project, or selling the project incrementally over time. The mathematical impact will be that if the tenant pays 0.5 percent for refinancings, and they are credited against the 1 percent at sale, effectively the CDC will always get at least 1 percent of sale.

Renovations

The tenant will be required to establish a reserve fund for renovations, furnishings and capital improvements as a percentage of gross revenues. The tenant will then have to submit a Furnishings Plan for review in year 7 and every 5 years afterward. For major renovations, the tenant shall submit a Renovation Plan in year 12 and every 10 years thereafter. Pragmatically, renovations and replacement of furnishings, fixtures and equipment will likely be controlled by the franchise agreement with the operator and brand. However, in the event that the hotel is ever unbranded and there is no franchise agreement, this provision allows control to assure timely update.

CITY ATTORNEY'S ANALYSIS

The City Attorney and outside legal counsel have approved as to form the Memorandum of Understanding and Amendment 2 to the Negotiation Agreement.

COMMITTEE/COMMISSION REPORT

The Redevelopment Advisory Committee will hear this report at their August 14, 2006, meeting. The Economic Development Commission will hear this report at a special meeting on August 15, 2006.

RECOMMENDATION

Staff recommends that the Community Development Commission approve the Memorandum of Understanding with S.D. Malkin Properties, Inc.; approve the Second Amendment to the Negotiation Agreement; approve moving to the Second Negotiation Period; and authorize the Executive Director to execute the documents.

PREPARED BY:

Jane McVey
Economic Development &
Redevelopment Director

SUBMITTED BY:

Barry Martin
Interim City Manager

REVIEWED BY:

Michelle Skaggs Lawrence, Assistant to the City Manager
Mike Blessing, Deputy City Manager

Attachments:
Attachment 1: Memorandum of Understanding
Attachment 2: Second Amendment to the Negotiation Agreement

COMMUNITY DEVELOPMENT COMMISSION OF THE CITY OF OCEANSIDE

NON-BINDING GROUND LEASE NEGOTIATION MEMORANDUM OF UNDERSTANDING

(S.D. Malkin Properties, Inc.)

THIS NON-BINDING GROUND LEASE NEGOTIATION MEMORANDUM OF UNDERSTANDING (S.D. Malkin Properties, Inc.) (this "MOU") is dated as of August 16, 2006, for reference purposes only, and is prepared by the COMMUNITY DEVELOPMENT COMMISSION OF THE CITY OF OCEANSIDE, a public body, corporate and politic ("Landlord"), and S.D. MALKIN PROPERTIES, INC., a Delaware corporation ("Tenant"), in furtherance of their negotiation of a contemplated future ground lease, to provide a non-binding summary of the basic terms and conditions being considered for such a future ground lease, pursuant to that certain Negotiation Agreement (S.D. Malkin Properties, Inc.), dated September 7, 2005, entered into between Landlord and Tenant, as amended pursuant to that certain Amendment No. 1 to Negotiation Agreement (S.D. Malkin Properties, Inc.), dated as of May 10, 2006.

ARTICLE 1

SUMMARY OF CONTEMPLATED BASIC LEASE TERMS

1.1 **Premises**: The North Parcel and the South Parcel. The Premises shall be delivered to Tenant free of any tenancies, except tenancies consented to by Tenant. Tenant will accept the Premises with any existing improvements on the Premises, as of the date of this MOU. Any easements or consents required from public entities or utilities, if any, for construction of the contemplated Parking Structure underneath the portion of Mission Avenue running between the North Parcel and the South Parcel are anticipated to be determined in the future.

1.2 **Landlord**: The Community Development Commission of the City of Oceanside, California, a public body, corporate and politic, or the City of Oceanside, a California municipal corporation, as successor in interest to the original Landlord.

1.3 **Tenant**: S.D. Malkin Properties, Inc., a Delaware Corporation, or an Affiliate approved by Landlord.

1.4 **Lease Term**: Seventy-five (75) years (the "Initial Term"), starting when both Landlord and Tenant have signed the Lease (the "Commencement Date").

1.5 **Renewal Option:** Tenant shall have the option (the "Renewal Option") to extend and renew the Lease upon all the same terms and conditions (except as the Lease otherwise expressly states), for one (1) additional successive period of twenty-four (24) years (the "Renewal Term") following expiration of the Initial Term. Tenant shall exercise the Renewal Option, if at all, by giving Landlord notice of such exercise at most twenty-four (24) months, and at least twelve (12) months, before the first day of the Renewal Term. After the Renewal Term, Tenant shall have no further right or option to renew or extend the Term. On the first day of the Renewal Term, the Stipulated Percentage Rate for Room Revenue and Other Revenue shall be

increased to the greater of: (i) the Stipulated Percentage Rate for Room Revenue and Other Revenue, as applicable, in effect on the immediately preceding day or (ii) the market percentage rate for Room Revenue and Other Revenue, as applicable, as determined by an independent appraisal process that may be determined in the future.

1.6 **Expenses**: The Lease will be absolutely "triple net." During the Term of the Lease, Tenant pays all taxes, insurance, utilities, maintenance and repairs and bears all other risks, expenses and responsibilities of the Premises, except property taxes arising solely from any Transfer of the Fee Estate occurring after the Commencement Date.

1.7 **Condition of Premises**: "AS IS" at the Commencement Date. No representations or warranties from Landlord regarding the condition of the Premises, except that Landlord owns the Premises. Any additional representations and warranties between Landlord and Tenant regarding the condition of the Premises, if any, may be determined in the future.

1.8 **Permitted Use**: Tenant shall use the Premises for:

1.8.1 Construction of the Main Hotel Building on the South Parcel, in accordance with the Resort Plans and Specifications. The Main Hotel Building shall be operated as a "Westin" or comparable brand/flag hotel (which may also encompass the Boutique Hotel) of a character and quality equivalent to the Hotel Competitive Set, as may be approved by Landlord, in Landlord's reasonable discretion; provided, however, that it shall not be unreasonable for Landlord to disapprove any brand/flag that is not equivalent to or better than the brands/flags of the hotels of the Hotel Competitive Set. The Executive Director shall be authorized to approve any change in the brand/flag of the Hotel on behalf of Landlord, pursuant to a process that may be determined in the future, subject to the Executive Director's retained and reserved sole and absolute discretion to seek the approval of Landlord's governing body regarding any such matter. The Lease shall provide for periodic changes in the Hotel Competitive Set, pursuant to a process that may be determined in the future.

1.8.2 Construction of the North Building on the North Parcel, in accordance with the Resort Plans and Specifications.

1.8.3 The southern portion of the North Building shall be operated as the Boutique Hotel (either under the same brand/flag as the Main Hotel Building or under a different brand/flag than the Main Hotel) of a character and quality equivalent to the Hotel Competitive Set, as may be approved by Landlord, in Landlord's reasonable discretion; provided, however, that it shall not be unreasonable for Landlord to disapprove any brand/flag that is not equivalent to or better than the brands/flags of the hotels of the Hotel Competitive Set. The Executive Director shall be authorized to approve any change in the brand/flag of the Hotel on behalf Landlord, pursuant to a process that may be determined in the future, subject to the Executive Director's retained and reserved sole and absolute discretion to seek the approval of Landlord's governing body regarding any such matter.

1.8.4 The northern portion of the North Building shall be operated as a Time-Share Project of a character and quality equivalent to the Time-Share Project Competitive Set.

The Lease shall provide for periodic changes in the Time-Share Project Competitive Set, pursuant to a process that may be determined in the future.

1.8.5 Construction and operation of retail uses consistent with the character and quality of the other elements of the Resort.

1.8.6 Landlord shall have the right to approve the brand/flag of either Hotel and any changes to such brands/flags, at all times during the Term, in Landlord's reasonable discretion; provided, however, that it shall not be unreasonable for Landlord to disapprove any brand/flag that is not equivalent to or better than the brands/flags of the hotels of the Hotel Competitive Set. The Executive Director shall be authorized to approve any change in the brand/flag of either Hotel on behalf of Landlord, pursuant to a process that may be determined in the future, subject to the Executive Director's retained and reserved sole and absolute discretion to seek the approval of Landlord's governing body regarding any such matter.

1.8.7 Tenant shall have the right to operate either Hotel as an independent hotel (without a brand or flag), with Landlord's prior written consent, which may be given, withheld or conditioned in Landlord's sole and absolute discretion, or following the later of: (i) the expiration of the initial Franchise Agreement, following completion of the full term of such Franchise Agreement (not as a result of termination of such Franchise Agreement by either unilateral action by a party to the Franchise Agreement or joint action by the parties to the Franchise Agreement) or (ii) the last day of Lease Year 22; provided that Tenant demonstrates to the reasonable satisfaction of Landlord that such independent hotel operation will maintain the operation of the Main Hotel or the Boutique Hotel, as applicable, at a level of quality equivalent to the Hotel Competitive Set and will not have any adverse impact on Landlord's revenues or Tenant's performance under the Lease. The Executive Director shall be authorized to consent to any operation of either Hotel as an independent hotel on behalf of Landlord, pursuant to a process that may be determined in the future, subject to the Executive Director's retained and reserved sole and absolute discretion to seek the approval of Landlord's governing body regarding any such matter.

1.8.8 In conjunction with the permitted uses set forth in this Section 1.8, Tenant shall also use the Premises for restaurant, Spa and retail uses consistent with the character and quality of the other elements of the Resort.

1.9 **Fixed Rent**:

1.9.1 Starting on the Commencement Date, Tenant shall pay a net annual fixed rent to Landlord pursuant to the following schedule, in equal monthly installments, in advance, without notice or demand (the "Fixed Rent"):

Lease Year	**Fixed Rent Amount Payable**
Lease Years 1-12:	$0
Lease Year 13:	$100,000
Lease Year 14:	$200,000
Lease Year 15:	$300,000

Lease Year 16:	$400,000
Lease Year 17:	$500,000
Lease Year 18:	$600,000
Lease Year 19:	$700,000
Lease Years 20 – end of Term:	As adjusted per Section 1.12 and Section 1.5

1.9.2 The Lease shall provide for Tenant to pay certain Rent to Landlord following a default and expiration of applicable notice and cure periods, during Lease Years 1 through 12, on terms to be determined in the future.

1.10 **Percentage Rent**: Commencing with Lease Year 13 and continuing throughout the remainder of the Term, Tenant shall pay to Landlord, in addition to Fixed Rent and any Additional Rent, the amount by which the sum of the Stipulated Percentage Rate of Room Revenues and Other Revenues received during each individual Lease Year exceeds the amount of Fixed Rent paid for that same Lease Year ("Percentage Rent"). Percentage Rent shall be paid annually, within ninety (90) calendar days following the end of each Lease Year. For the last Lease Year of the Term, Percentage Rent shall be paid within ninety (90) calendar days following the Expiration Date.

1.11 **Time-Share Rent:** Commencing in the Lease Year in which a Time-Share Interest is sold, Tenant shall begin paying to Landlord regarding such Time-Share Interest for the remainder of the Term, in addition to Fixed Rent, Percentage Rent and any Additional Rent, both: (i) the amount determined by multiplying Four Thousand Two Hundred Dollars ($4,200) by the product of the total number of weeks comprising the Time-Share Interest (partial weeks rounded up to the next full week) divided by forty-eight (48) (the "Annual Time-Share Rent") and (ii) one percent (1%) of the Gross Consideration for each sale of such Time-Share Interest following the first sale of such Time-Share Interest (the "Time-Share Resale Rent"). Annual Time-Share Rent shall be payable in annual installments, in advance, without notice or demand. The first payment of Annual Time-Share Rent for a Time-Share Interest shall be due and payable from Tenant to Landlord within sixty (60) calendar days following the close of the sale of such Time-Share Interest and all subsequent payments of Annual Time-Share Rent shall be due and payable from Tenant to Landlord on the first day of each subsequent Lease Year. Commencing on the first day of Lease Year 13 (the first adjustment occurring on such date) and on the first day of every fifth (5th) Lease Year thereafter, Annual Time-Share Rent shall be increased by the cumulative percentage increase in the CPI during the immediately preceding five (5) Lease Years, not to exceed fifteen percent (15%) for any five (5) year adjustment period. Time-Share Resale Rent shall be due and payable on the date of the closing of each sale of the subject Time-Share Interest (following the first sale).

1.12 **Adjustments to Fixed Rent**: On the first day of Lease Year 20 (the first adjustment occurring on such date) and on the first day of every tenth (10th) Lease Year, thereafter (including during any Renewal Term), Fixed Rent shall be increased to the amount equal to the greater of: (i) 75% of the average annual Fixed Rent plus Percentage Rent paid during the immediately preceding five (5) Lease Years or (ii) the Fixed Rent in effect during the immediately preceding Lease Year increased by the cumulative percentage increase in the CPI

since the later of: (x) the first day of Lease Year 10 or (y) the date of the most recent adjustment to Fixed Rent pursuant to this Section 1.12, with any adjustment under (ii) not to exceed an increase of thirty percent (30%) for any single 10-year adjustment period.

1.13 **Landlord Participation in Significant Revenues, Sales Proceeds and Refinancing Proceeds**: In addition to Fixed Rent, Percentage Rent, Time-Share Rent and any other form of Additional Rent, Landlord shall receive, as an element of Additional Rent, each of the following:

1.13.1 If Gross Revenues equal or exceed one hundred ten percent (110%) of Pro-Forma Gross Revenue in any Lease Year, then Landlord shall receive seven percent (7%) of Room Revenues and three and one-half percent (3.5%) of Other Revenues above the Pro-Forma Gross Revenue for such Lease Year. The provisions of this Section 1.13.1 shall only be applicable through Lease Year 35. Landlord and Tenant may consider, in the future, whether or not Pro-Forma Gross Revenue will be adjusted to account for extraordinary and unanticipated expenses incurred in operation of the Resort that are beyond Tenant's reasonable control.

1.13.2 On any Transfer by Tenant, other than to an Affiliate or the granting of a Permitted Leasehold Mortgage, Net Transfer Proceeds regarding such Transfer shall be paid, as follows:

(a) Upon any such Transfer by the original Tenant:

(i) One hundred percent (100%) of any Net Transfer Proceeds shall be retained by Tenant, until Tenant has received the amount of the Tenant Investment;

(ii) One hundred percent (100%) of any Net Transfer Proceeds shall be retained by Tenant, until Tenant has received a twenty percent (20%) compounded return on the Tenant Investment, accruing from the date of Tenant's advance of such funds, but not earlier than the Commencement Date;

(iii) Then, ten percent (10%) of any remaining Net Transfer Proceeds shall be paid to Landlord, as Additional Rent, and ninety percent (90%) of any remaining Net Transfer Proceeds shall be retained by Tenant, until Tenant has received a twenty-five percent (25%) compounded return on the Tenant Investment, accruing from the date of Tenant's advance of such funds, but not earlier than the Commencement Date;

(iv) Then, fifteen percent (15%) of any remaining Net Transfer Proceeds shall be paid to Landlord, as Additional Rent, and eighty-five percent (85%) of any remaining Net Transfer Proceeds shall be retained by Tenant, until Landlord has received the Landlord Investment, plus six percent (6%) compounded return on the Landlord Investment accruing from the date of Landlord's advance of such funds, but not earlier than the Commencement Date;

(v) Then, one hundred percent (100%) of any remaining Net Transfer Proceeds shall be retained by Tenant.

(b) If the original Tenant does not receive a seventeen and one-half percent (17.5%) compounded return on the Tenant Investment, accruing from the date of Tenant's advance of such funds, but not earlier than the Commencement Date, on its Transfer of the Lease, then the purchaser of the Lease from such original Tenant shall not be subject to the provisions of Section 1.13.2(c) or Section 1.13.4(b), until Lease Year 20.

(c) Upon any such Transfer by any Tenant other than the original Tenant, Landlord shall receive one percent (1%) of any Net Transfer Proceeds, except as provided in Section 1.13.2(b).

1.13.3 On any Transfer occurring as the result of the Transfer of more than twenty-five percent (25%) of the Equity Interests of the original Tenant, other than to a Permitted Leasehold Mortgagee, the holder of any Equity Interest in Tenant or an Institutional Lender, each as security for financing for construction and furnishing of the Resort Improvements, all amounts paid to or on behalf of the Transferor shall be subject to distribution, on a pro-rata basis, pursuant to the provisions of Section 1.13.2(a) (i.e., investment recovery and return determinations shall be based solely on the Transferor's pro-rata portion of the Tenant Investment [determined by multiplying the amount of the Tenant Investment by the percentage of Equity Interests in Tenant transferred by the Transferor] subject to the Transfer, instead of the total Tenant Investment). Landlord and Tenant anticipate attempting to agree on a mechanism to avoid double counting any amounts received by Landlord or the holder of any Equity Interests of the original Tenant, pursuant to this Section 1.13.3, relative to any Transfer subject to Section 1.13.2.

1.13.4 On the refinancing of any Leasehold Mortgage, the Net Refinancing Proceeds shall be paid, as follows:

(a) Upon any such refinancing by the original Tenant:

(i) One hundred percent (100%) of any Net Refinancing Proceeds shall be paid to Tenant, until Tenant has received the amount of the Tenant Investment;

(ii) One hundred percent (100%) of any Net Refinancing Proceeds shall be retained by Tenant, until Tenant has received a twenty percent (20%) compounded return on the Tenant Investment, accruing from the date of Tenant's advance of such funds, but not earlier than the Commencement Date;

(iii) Then, ten percent (10%) of any remaining Net Refinancing Proceeds shall be paid to Landlord, as Additional Rent, and ninety percent (90%) of any remaining Net Refinancing Proceeds shall be retained by Tenant, until Tenant has received a twenty-five percent (25%) compounded return on the Tenant Investment, accruing from the date of Tenant's advance of such funds, but not earlier than the Commencement Date;

(iv) Then, fifteen percent (15%) of any remaining Net Refinancing Proceeds shall be paid to Landlord, as Additional Rent, and eighty-five percent (85%) of any remaining Net Refinancing Proceeds shall be retained by Tenant, until Landlord has received the Landlord Investment, plus six percent (6%) compounded return on the Landlord Investment accruing from the date of Landlord's advance of such funds, but not earlier than the Commencement Date;

(v) Then, one hundred percent (100%) of any remaining Net Refinancing Proceeds shall be retained by Tenant.

(b) Upon any such refinancing by any Tenant other than the original Tenant, Landlord shall receive one-half of one percent (0.5%) of the Net Refinancing Proceeds.

1.13.5 Notwithstanding the foregoing, Landlord shall not receive any percentage of any Net Refinancing Proceeds from the first refinancing of the initial construction debt relating to the initial construction of the Resort.

1.13.6 All refinancing transactions shall be subject to the limitations set forth in Section 1.14.

1.13.7 The amount of proceeds from the sale of Time-Share Interests, any other Net Transfer Proceeds, net operating income from the Resort and any Net Refinancing Proceeds received by Tenant shall reduce the amounts to be subsequently retained or received by Tenant pursuant to Sections 1.13.2(a), 1.13.3 or 1.13.4(a). Any Net Transfer Proceeds and any Net Refinancing Proceeds received by Landlord shall reduce the amounts to be subsequently received by Landlord pursuant to Sections 1.13.2(a), 1.13.3 or 1.13.4(a).

1.14 **Leasehold Encumbrance.**

1.14.1 Landlord shall have no obligation to join in any Leasehold Mortgage or to "subordinate the fee."

1.14.2 Permitted Leasehold Mortgages will be allowed, subject to certain limitations, and may have certain normal and customary lender protections, all as may be determined in the future.

1.14.3 At no time may the total outstanding principal balance of obligations secured by Leasehold Mortgages against the Leasehold Estate exceed eighty percent (80%) of the then current appraised fair market value of the Leasehold Estate.

1.15 **Resort Construction Obligations**:

1.15.1 Tenant shall start construction and installation of the Resort within nine (9) months after the Commencement Date, subject to any Unavoidable Delay.

1.15.2 Tenant shall substantially complete construction and installation of the Main Hotel Building on the South Parcel, the North Building on the North Parcel and the Parking Structure under both the North Parcel and the South parcel, within thirty-six (36) months following the Commencement Date, subject to Unavoidable Delays.

1.15.3 Tenant shall pay and contractually require its contractors and subcontractors to pay any and all applicable Federal or State of California prevailing wages in the construction of the Resort and shall reasonably enforce all such contractual obligations of its contractors and subcontractors. Tenant shall indemnify, defend and hold harmless Landlord

against any and all claims for wages arising from or related to the construction or installation of the Resort.

1.15.4 Tenant shall obtain, at least, a Temporary Certificate of Occupancy from the City for the entirety of Main Hotel Building that allows Tenant to use and occupy the Main Hotel Building for its intended commercial transient hotel purpose, prior to obtaining a Certificate of Occupancy (temporary or otherwise) from the City for any other portion of the Resort.

1.16 **Assurances of Completion**: Until completion of the Resort, as evidenced by the passage of one hundred twenty (120) days after the date of the recording of the last Notice of Completion relating to the construction of the Resort, issuance of certificates of occupancy (or equivalent) by the City for all elements of the Resort and issuance of a certification from Tenant's architect that all of the Resort Improvements are complete, in accordance with the Resort Plans and Specifications, Tenant shall maintain faithful performance and labor and material payment surety bonds, in accordance with such requirements as may be determined in the future, for the benefit of Landlord in the amount of one hundred percent (100%) of the guaranteed maximum price or stipulated price contract with the prime contractor for construction of the Resort Improvements. Instead of the faithful performance bond required in the immediately preceding sentence, Tenant may provide a guaranty of such performance for the benefit of Landlord, from a Person reasonably acceptable to Landlord in the amount of one hundred percent (100%) of the guaranteed maximum price or stipulated price contract with the prime contractor for construction of the Resort Improvements. Any and all such bonds or guaranties shall be in form and substance reasonably acceptable to Landlord. Landlord and Tenant contemplate future negotiations regarding the possible phased release of any surety bonds provided pursuant to this Section 1.16.

1.17 **Subsequent Construction Rights**: Tenant shall not construct or materially alter any improvements on the Premises, without prior written approval from Landlord, which approval shall not be unreasonably withheld or delayed; provided, however, Tenant shall have the right to make the following alterations to the improvements on the Premises, without the approval of Landlord: (a) reasonable and customary alterations. to the interior spaces of the Hotel; (b) alterations required by applicable Laws; (c) alterations reasonably required to restore or repair improvements on the Premises after a casualty or condemnation; or (d) reasonable and customary alterations required by Tenant's then current Franchise Agreement in order to maintain compliance with the requirements of such Franchise Agreement. All alterations or improvements on the Premises by Tenant shall comply with all applicable Laws.

1.18 **Management Agreements**:

1.18.1 The Main Hotel and the Boutique Hotel shall each be operated under a management agreement with an Approved Hotel Operator.

1.18.2 The Time-Share Project shall be operated under a management agreement with an Approved Time-Share Operator.

1.19 **Operating Standard:**

1.19.1 The Lease shall contain covenants requiring the Hotels to be operated at a standard of quality substantially consistent with the hotels of the Hotel Competitive Set.

1.19.2 Tenant shall operate in the Resort, directly or through a subtenant permitted by the Lease, the following restaurants serving the general public:

(a) At least one (1) three-meal restaurant with a standard of quality substantially consistent with the level of quality of the three-meal restaurants operated by or associated with the hotels of the Hotel Competitive Set.

(b) At least one (1) specialty restaurant with a standard of quality substantially consistent with the level of quality of the specialty restaurants operated by or associated by the hotels of the Hotel Competitive Set.

(c) Each Restaurant within the Resort shall carry and offer for sale at all times a full and complete stock of food and beverages and shall maintain a sufficient staff of competent personnel for prompt service of its customers.

1.19.3 Both the Main Hotel and the Boutique Hotel shall provide room service to occupants of the Hotel's Guest Rooms, with a standard of quality substantially consistent with the hotels of the Hotel Competitive Set.

1.19.4 Both the Main Hotel and the Boutique Hotel shall provide food and beverage service to meetings, banquets and other events at the Hotel, with a standard of quality substantially consistent with the hotels of the Hotel Competitive Set.

1.19.5 Tenant shall operate, directly or through a subtenant or licensee, a Spa and Spa program in the Main Hotel, serving the general public, including retail products and personal services consistent with the level of sophistication, aesthetic appeal and price point consistent with the then existing standard of operations of the Main Hotel. If Tenant reasonably determines that the operation of a Spa and Spa program, as described in the immediately preceding sentence, is non-economic, then Tenant may reasonably reduce the scope of or close the Spa, provided Tenant replaces the Spa with either: (i) another amenity or (ii) with additional revenue producing meeting space or Guest Rooms.

1.19.6 The Lease shall provide for the operation in each Hotel of a retail gift and sundry shop, together with minimum operating covenants with respect to such shop. The standard of operations for said gift and sundry shop shall be substantially consistent with the standard of quality of the hotels of the Hotel Competitive Set.

1.20 **Agreement Not to Compete**: Prior to Lease Year 8, neither Tenant nor any Affiliate of Tenant shall, directly or indirectly, develop, construct, operate, manage or own any interest in any hotel located within ten (10) miles of the Premises that is concurrently operated under the same flag as either the Main Hotel or the Boutique Hotel (i.e., "Westin" full service or other name).

1.21 **Furnishings and Capital Improvement Reserve Fund**: Tenant shall establish and maintain, at a bank reasonably acceptable to Landlord and the Senior Permitted Leasehold Mortgagee, an escrow reserve account that shall be funded (in arrears) on an annual basis during the Term of the Lease for the purpose of providing funds for: (i) replacement of the Furnishings within the Hotels pursuant to Section 1.22 and (ii) Renovation of the Hotels pursuant to Section 1.23 (the "Reserve Fund"). To the extent that the Franchise Agreement or the Senior Permitted Leasehold Mortgagee requires the Tenant to maintain a reserve fund for any or all of the same purposes as the Reserve Fund required in this Section 1.21 that is reasonably satisfactory to Landlord, Landlord will allow Tenant to credit any funds actually reserved for any or all of the same purposes pursuant to such Franchise Agreement or pursuant to the requirements of the Senior Permitted Leasehold Mortgagee against Tenant's obligation to make deposits to the Reserve Fund under this Section 1.21, subject to agreement between Landlord, the franchisor and/or the Senior Permitted Leasehold Mortgagee that, upon expiration or termination of the Lease, the funds in the Reserve Fund shall be the property of Landlord and that on Transfer, the Reserve Fund shall be transferred to and maintained by the transferee Tenant. Tenant shall have the right to assign its rights in the Reserve Fund to Permitted Leasehold Mortgagees, as security for bona fide loans from such Permitted Leasehold Mortgagees, subject to the limitations on Tenant's rights in the Reserve Fund, as set forth in the Lease, and the agreement required in the immediately preceding sentence. Additionally, in the Time-Share Project governing documents, Tenant shall require customary and reasonable reserves for replacement of Furnishings and Renovation of the Time-Share Project. Tenant shall make annual deposits into the Reserve Fund pursuant to, at least, the following schedule:

In Lease Years 3 and 4 - at least 1% of Reserve Gross Revenues;

In Lease Years 5 and 6 - at least 2% of Reserve Gross Revenues;

In Lease Years 7 and 8 - at least 3% of Reserve Gross Revenues;

In Lease Years 9 through the end of the Term - at least 4% of Reserve Gross Revenues.

1.22 **Replacement of Furnishings**. Tenant shall periodically replace and add to the Furnishings in the Hotels in accordance with the Franchise Agreement(s). Commencing on the first day of Lease Year 7 (the first such plan to be submitted on this date), and on the first day of each fifth (5th) Lease Year thereafter, Tenant shall submit to Landlord a Furnishings Plan for Landlord's review and approval, in Landlord's reasonable discretion. The Executive Director shall be authorized to approve any Furnishings Plan on behalf of Landlord, pursuant to a process that may be determined in the future, subject to the Executive Director's retained and reserved sole and absolute discretion to seek the approval of Landlord's governing body regarding any such matter. Tenant shall have the right to use funds in the Reserve Fund to replace and add to Furnishings in the Hotels, consistent with the then current Furnishings Plan. If, at any time during the Term of the Lease, a dispute arises between Landlord and Tenant regarding a Furnishings Plan or the implementation thereof, either party may submit such dispute to an independent arbitration process that may be determined in the future.

1.23 **Renovation Obligations**:

1.23.1 Tenant shall periodically undertake and complete Renovations of the Hotels in accordance with the Franchise Agreement(s). Commencing on the first day of Lease Year 12 (the first such plan to be submitted on this date), and on the first day of tenth (10th) Lease Year thereafter, Tenant shall submit to Landlord a Renovation Plan for review and approval by Landlord, in Landlord's reasonable discretion. The Executive Director shall be authorized to approve any Renovation Plan on behalf of Landlord, pursuant to a process that may be determined in the future, subject to the Executive Director's retained and reserved sole and absolute discretion to seek the approval of Landlord's governing body regarding any such matter. Tenant shall have the right to use funds in the Reserve Fund to accomplish Renovations, consistent with the then current Renovation Plan. If, at any time during the Term of the Lease, a dispute arises between Landlord and Tenant regarding a Renovation Plan or the implementation thereof, either party may submit such dispute to an independent arbitration process that may be determined in the future.

1.23.2 Tenant shall obtain Landlord's prior written approval of all plans and specifications for each Renovation. The Executive Director shall be authorized to approve all plans and specifications for Renovations on behalf of Landlord, pursuant to a process that may be determined in the future, subject to the Executive Director's retained and reserved sole and absolute discretion to seek the approval of Landlord's governing body regarding any such plans and specifications.

1.23.3 Tenant's obligation to expend funds on Renovation shall be characterized as Additional Rent.

1.24 **Subleasing**: Tenant may enter into subleases for the retail, Restaurant, Spa and the Time-Share Project elements of the Resort, subject to certain limitations. Landlord must approve in writing any sublease of any Restaurant, any Spa or any sublease of more than 10,000 leasable square feet within any building located on the Premises.

1.25 **Tenant Assignment of Lease**: Tenant may not assign or Transfer all or any portion of the Lease or the Leasehold Estate until after issuance of a Temporary Certificate of Occupancy (or equivalent) by the City that allows occupancy of all portions of the Resort for their respective commercial purposes consistent with the permitted uses set forth in Section 1.8, except in trust to an Institutional Lender as security for financing for the initial construction of the Resort Improvements or any refinancing of the obligation secured by such security interest or to any entity in which Tenant or its principals or Affiliates are the manager, general partner or a shareholder, so long as following any such Transfer, the same Persons retain and maintain management and control of the Leasehold Estate, and subject to the other terms and conditions of the Lease. After issuance of a Temporary Certificate of Occupancy (or equivalent) by the City that allows occupancy of all portions of the Resort for their respective commercial purposes consistent with the permitted uses set forth in Section 1.8, Tenant will be allowed to assign or Transfer the Lease or Leasehold Estate, on terms as may be determined in the future, which may include, without limitation, the Landlord's approval of each assignee, delivery of customary assignment and assumption documents, satisfaction of objective criteria (e.g., minimum years of experience in owning and operating similar resorts, financial strength, good industry reputation

and not within a specified class of prohibited transferees), payment of the amount set forth in Section 1.13.2, and satisfaction of other conditions within Tenant's control (e.g., cure of defaults).

1.26 **Landlord Transfers**: Landlord shall have the right to Transfer the Fee Estate and/or Landlord's interest in the Lease. Upon Landlord's Transfer of the entire Fee Estate, the grantor shall be automatically freed and relieved from all liability for performance of any covenants or obligations to be performed by Landlord under the Lease, following the date of such Transfer.

1.27 **Casualty and Condemnation**: Tenant shall be responsible for restoration after casualty or condemnation on terms as may be determined in the future. Neither casualty nor condemnation shall terminate the Lease, except on terms as may be determined in the future. The Lease shall provide for allocation of casualty insurance and condemnation proceeds between Landlord and Tenant on terms as may be determined in the future.

1.28 **Fee Mortgages**: Landlord may encumber the Fee Estate with fee mortgages, at any time during the Term. Fee mortgagees shall be entitled to notice of Landlord defaults under the Lease and opportunity to cure, in the same manner as Leasehold Mortgagees. Any fee mortgagee and Tenant shall be required to enter into a reasonable non-disturbance and attornment agreement.

1.29 **Equipment Liens**: Tenant shall have the right, from time to time, to grant liens on personal property acquired by Tenant for use within the Resort directly associated with the Permitted Uses. No equipment financing may be recorded against or create a lien against the Fee Estate.

1.30 **Disposition of Improvements, FF&E and Building Equipment at End of Lease**: All improvements, FF&E and Building Equipment shall become Landlord's property upon expiration or termination of the Lease; provided, however, that Tenant shall have the opportunity to remove any FF&E, prior to the Expiration Date.

1.31 **Landlord Assistance**:

1.31.1 Landlord will agree to provide approximately Twenty-Seven Million Dollars ($27,000,000) in financial assistance towards the costs of the initial construction of the Resort Improvements, in accordance with the Resort Plans and Specifications. In no event shall Landlord's financial assistance to the initial construction of the Resort Improvements exceed Twenty-Seven Million Dollars ($27,000,000). Landlord will exercise reasonable efforts to, generally, provide such assistance through financing methods similar to the following described financing methods and associated dollar amount allocations; provided that any of the following described financing methods or associated dollar amount allocations are subject to change, as a result of any change in applicable Laws, any change in the anticipated cost of any such financing method, request or recommendation of bond counsel, underwriters, other legal counsel or financial consultants, failure or adversity of any vote of property owners or the public required to provide any such financing method or dollar amount, or in the sole and absolute discretion of Landlord, as Landlord must grant subsequent discretionary approvals to effect each such

financing method and each such exercise of subsequent discretion by Landlord may not be contracted away through either this MOU or the Lease:

(a) Up to Two Hundred Thousand Dollars ($200,000) towards the costs of preparation of an Environmental Impact Report regarding development of the Resort;

(b) approximately Four Million Eight Hundred Thousand Dollars ($4,800,000) towards the costs of eligible off-site public improvements, to be financed through the formation of a Community Facilities District ("CFD"). Also, each Lease Year that there is a CFD special tax against the Resort that is paid by Tenant, tax increment revenues received by Landlord and attributable to the Resort would be credited (to the extent any Rent is due to Landlord for such Lease Year) or paid, at Landlord's option, to Tenant annually, within ninety (90) calendar days following the end of each applicable Lease Year, up to the lesser of: (1) the amount of the CFD special tax paid by Tenant regarding the Resort for such Lease Year or (2) the amount of tax increment revenues received by Landlord and attributable to the Resort for such Lease Year. Nothing in this Section 1.31.1(b) shall require any payments of tax increment revenues received by Landlord and attributable to the Resort to Tenant following the release of the Premises from the CFD special tax lien or expiration of the Landlord's right to receive tax increment revenues under the Redevelopment Plan. The CFD would acquire certain agreed upon eligible off-site public improvements from Tenant following completion of construction and installation of such improvements;

(c) approximately Seventeen Million Dollars ($17,000,000) towards the costs of constructing the Parking Structure, to be financed through issuance of a taxable tax allocation bond secured by tax increment revenues to be received by Landlord from the Oceanside Downtown Redevelopment Project Area. The CDC would reimburse Tenant for certain costs of construction of the Parking Structure in a manner as may be determined in the future; and

(d) for each of the first 15 Lease Years, an amount equal to seventy-five percent (75%) of the transient occupancy tax revenues exceeding One Million Dollars ($1,000,000) received by the City from the operation of the Resort during such Lease Year, as a credit (to the extent any Rent is due to Landlord for such Lease Year) or payment, at Landlord's option, made within ninety (90) calendar days following the end of each applicable Lease Year. One Million Dollar ($1,000,000) floor amount would be increased by three percent (3%) each Lease Year. Any credits or payments under this paragraph (iv) will only occur until the earlier of: (1) the credit or payment becoming due for Lease Year 15, if any, is made or (2) the Tenant receives an aggregate amount of net present value (determined as of the calendar year in which the Commencement Date occurs) Five Million Dollars ($5,000,000), calculated at a discount rate of twelve percent (12%). Also, any credits or payments under this provision will be from available funds of Landlord, the amount of which is indexed to City transient occupancy tax revenues solely for quantitative purposes. There will not be any pledge or commitment of any tax revenues of or by the City. Further, to the extent that tax increment revenues of Landlord may be used to satisfy Landlord's prospective Lease obligations, the Lease obligations will be subject to senior pledges to existing bonded indebtedness and to any future tax allocation bonds, as described in paragraph (iii), above.

1.31.2 Upon the occurrence of a Development Cost Savings, the Tenant shall pay or credit to Landlord thirty-three and three quarters percent (33.75%) of the Development Cost Savings, on terms as may be determined in the future.

ARTICLE 2

GENERAL PROVISIONS

2.1 **Statement of Non-Binding Intent**. The Parties state their mutual intent that this MOU not create any binding obligation on either of them, as follows:

2.1.1 Any terms, conditions, covenants, restrictions or agreements set forth in this MOU for potential inclusion in a definitive Lease are not intended to constitute a binding agreement, but rather to serve as the basis for negotiating and drafting a definitive Lease between the Parties potentially containing the terms stated in this MOU, as well as other terms and conditions to be determined. Neither Party will rely on any terms, conditions, covenants, restrictions or agreements set forth in this MOU for potential inclusion in a definitive Lease as binding on the other; any such reliance would be imprudent and unreasonable. Neither Party will be bound by any such provisions, unless and until a definitive Lease has been approved, executed and delivered by both Parties, in their respective sole and absolute discretion.

2.1.2 It is understood and agreed that this MOU does not contain all of the essential terms that the Parties expect or intend will be part of a Lease. Further negotiations between the Parties are contemplated before a binding Lease will be prepared. Further efforts by either Party to perform due diligence, arrange or obtain financing, or carry out other acts in contemplation of the possible lease or development of the Premises or the Resort may not be deemed evidence of intent by either Party to be bound by any terms, conditions, covenants, restrictions or agreements set forth in this MOU for potential inclusion in a definitive Lease.

2.1.3 The performance by either Party, before execution of a definitive Lease, of any of the obligations that may be included in a Lease between the Parties when negotiations are completed, will not be considered evidence of intent by either Party to be bound by any terms, conditions, covenants, restrictions or agreements set forth in this MOU for potential inclusion in a definitive Lease.

2.1.4 No binding Lease will be entered into unless and until each Party has reviewed, approved (in its sole discretion), and executed a definitive written Lease. Neither Party has any obligation to conclude any business arrangement described in this MOU. Nothing contained in this MOU shall impose any obligation on either Party to agree to a definitive Lease in the future, regardless of whether or not any provisions set forth in this MOU are included as part of such a future agreement. Each Party acknowledges that it will not take action or refrain from taking action in reliance on this MOU and that any such reliance will be at its own risk.

2.1.5 The Parties enter into this MOU acknowledging and intending that a complete and definitive Lease may not be entered into between them and may not become binding on either Party, if at all, prior to the Landlord's certification of an Environmental Impact

Report pursuant to the California Environmental Quality Act for the Resort and all necessary entitlements and discretionary approvals have been granted for the development of the Resort.

2.2 **No Transfer of any Right, Interest or Estate in Property**.

2.2.1 The Tenant acknowledges and agrees that no provision of this MOU shall be deemed to be an offer by the Landlord, nor an acceptance by the Landlord of any offer or proposal from the Tenant for the Landlord to convey any estate or interest in the Premises to the Tenant or for the Landlord to provide any financial or other assistance to the Tenant for redevelopment of the Resort on the Premises.

2.2.2 The Tenant acknowledges and agrees that the Tenant has not acquired, nor will acquire, by virtue of the terms of this MOU, any legal or equitable interest in any real or personal property from the Landlord.

2.2.3 The Landlord shall not be deemed to be a party to any agreement for the acquisition of, lease of or disposition of any real or personal property, the provision of financial assistance to the Tenant or development of the Resort on the Premises or elsewhere, until the terms and conditions of a complete future Lease are considered and approved by both the City Council and the Landlord's governing body, in their respective sole and absolute discretion, following the conclusion of one or more duly noticed public hearings, as required by law. The Tenant expressly acknowledges and agrees that the Landlord will not be bound by any statement, promise or representation made by any elected official that is a member of Landlord's governing body or Landlord's staff or representatives during the course of negotiations of a future Lease and that the Landlord shall only be legally bound upon the approval of a complete Lease by both the City Council and the Landlord's governing body, in their respective sole and absolute discretion, following one or more duly noticed public hearings, as required by law.

2.2.4 The Landlord and the Tenant agree that, if a future Lease is not approved and executed by both the Landlord and the Tenant, for any reason, neither the Landlord nor the Tenant shall be under any obligation, nor have any liability to each other or any other person regarding the lease or other disposition of the Premises or the redevelopment of the Resort on the Premises.

2.3 **Warranty Against Payment of Consideration for MOU.** The Tenant warrants that it has not paid or given, and will not pay or give, any third party any money or other consideration for obtaining this MOU. Third parties, for the purposes of this Section 2.3, shall not include Persons to whom fees are paid for professional services, if rendered by attorneys, financial consultants, accountants, engineers, architects and other consultants, when such fees are considered necessary by Tenant.

2.4 **Amendment**. No amendment or modification of this MOU shall be effective, unless it is made in writing, approved by Landlord's governing body at a public meeting and signed by both Parties. The Party benefited by any condition or obligation may waive the same, but such waiver shall not be enforceable by another Party, unless it is made in writing and signed by the waiving Party. No waiver of any default or breach of any term or condition contained in

this MOU shall be deemed a waiver of any preceding or succeeding default or breach of such term or condition, or of any other term or condition contained in this MOU.

2.5 **Construction**. Unless otherwise indicated, all article and section references are to the articles and sections of this MOU. The headings used in this MOU are provided for convenience of reference only and this MOU shall be interpreted without reference to any headings. Whenever required by the context of this MOU, the singular shall include the plural and the masculine shall include the feminine and vice versa. This MOU shall not be construed as if it had been prepared by one of the Parties, but rather as if both Parties had prepared it. All exhibits referred to in this MOU are attached to this MOU. The use of the word "or" in this MOU shall also include the word "and." The use of the word "including" in this MOU shall be interpreted as though followed by the phrase "without limitation."

2.6 **Governing Law**. The Parties acknowledge and agree that this MOU was negotiated, entered into and is to be fully performed in the City of Oceanside, County of San Diego, State of California. The Parties also agree that this MOU shall be governed by, interpreted under, and construed and enforced in accordance with the laws of the State of California, without application of conflicts of laws principals.

2.7 **Execution in Counterparts**. This MOU may be executed in one or more counterparts, each of which shall be deemed an original, but all of which together shall constitute one and the same document.

[Signatures on following page]

SIGNATURE PAGE
TO
NON-BINDING GROUND LEASE NEGOTIATION
MEMORANDUM OF UNDERSTANDING
(S.D. Malkin Properties, Inc.)

The Landlord and Tenant sign this MOU, by and through the signatures of their authorized representatives set forth below, to acknowledge their non-binding discussion of the contemplated basic terms and conditions for a potential future ground lease between them, as set forth in this MOU:

LANDLORD:

COMMUNITY DEVELOPMENT COMMISSION OF THE CITY OF OCEANSIDE, a public body, corporate and politic

By:_____
Jim Wood
Chairperson

Dated:_____

ATTEST:

By: _____
Assistant Secretary

APPROVED AS TO FORM:

By: _____
General Counsel

TENANT:

S. D. MALKIN PROPERTIES, INC., a Delaware corporation

By:_____
Jeremy Cohen
Vice President

Dated:_____

EXHIBIT "A"
TO
NON-BINDING GROUND LEASE NEGOTIATION
MEMORANDUM OF UNDERSTANDING
(S.D. Malkin Properties, Inc.)

NORTH PARCEL LEGAL DESCRIPTION

Lots 1 through 12, inclusive, in Block, 17 of Oceanside, in the City of Oceanside, County of San Diego, State of California, according to Map thereof No. 344, filed in the Office of the County Recorder of San Diego County, July 1, 1885. [APN: 147-076-01 through 3 and 147-076-10 through 12]

EXHIBIT "B"
TO
NON-BINDING GROUND LEASE NEGOTIATION
MEMORANDUM OF UNDERSTANDING

(S.D. Malkin Properties, Inc.)

SOUTH PARCEL LEGAL DESCRIPTION

Lots 1 through 12, inclusive, in Block, 16 of Oceanside, in the City of Oceanside, County of San Diego, State of California, according to Map thereof No. 344, filed in the Office of the County Recorder of San Diego County, July 1, 1885. [APN: 147-261-01 through 12]

EXHIBIT "C"
TO
NON-BINDING GROUND LEASE NEGOTIATION
MEMORANDUM OF UNDERSTANDING

(S.D. Malkin Properties, Inc.)

GLOSSARY

"Additional Rent" means all sums that the Lease requires Tenant to pay Landlord or a third Party, whether or not expressly called Additional Rent, except Fixed Rent, Percentage Rent and Time-Share Rent.

"Affiliate" means and refers to any Person Controlling or Controlled by or under common Control with the Tenant, whether by direct or indirect ownership of equity interests, by contract or otherwise.

"Annual Time-Share Rent" shall have the meaning ascribed to the term in Section 1.11.

"Approved Hotel Operator" means and refers to any of the hotel operating companies set forth in Exhibit "F" attached to this MOU, as may be amended, from time to time, pursuant to the terms of the Lease.

"Approved Time-Share Operator" means and refers to any of the Time-Share operating companies set forth in Exhibit "G" attached to this MOU, as may be amended, from time to time, pursuant to the terms of the Lease.

"Boutique Hotel" means and refers to the Hotel Guest Rooms and other Hotel components to be constructed on the North Parcel, as specifically described in the Resort Plans and Specifications.

"Building Equipment" means all fixtures incorporated in the Premises by either Landlord or Tenant and used, useful, or necessary to operate the Main Hotel Building, the North Building or the Parking Structure as such (including boilers; compactors; compressors; conduits; ducts; elevators; engines; equipment; escalators; fittings; heating, ventilating and air conditioning systems; machinery; and pipes) as opposed to trade fixtures of any business operating within the Main Hotel Building, the North Building or the Parking Structure.

"Capital Improvements" shall have a meaning as may be determined in the future, pursuant to mutual agreement between Landlord and Tenant.

"Commencement Date" shall have the meaning ascribed to the term in Section 1.4.

"Competitive Set" means and refers to: (i) with respect to the Hotel, the peer group of competitive hotels designated in Exhibit "D" to this MOU, and (ii) with respect to the Time-

Share Project, the time-share properties designated in Exhibit "E" to this MOU, as may be amended, from time to time, pursuant to the terms of the Lease.

"Control" means and refers to possession of the power to direct or cause the direction of the management and policies of a Person, whether by ownership of equity interests, by contract or otherwise.

"Controlling" and **"Controlled"** mean and refer to exercising or having Control.

"CPI" means the United States Department of Labor, Bureau of Labor Statistics "Consumer Price Index" for Urban Wage Earners and Clerical Workers (CPI-W) published for the San Diego-Carlsbad-San Marcos Metropolitan Statistical Area, with a base of 1982-1984 = 100. If the CPI ceases to be published, with no successor index, then the Parties shall reasonably agree upon a reasonable substitute index. The CPI for any date means the CPI last published before the calendar month that includes such date.

"Development Cost Savings" means the amount determined by subtracting the actual cost of construction of the Resort from the amount of ninety-five percent (95%) of the Estimated Development Costs, where such difference is a positive number.

"Equity Interest" means all or any part of any direct or indirect equity or ownership interest(s) (whether stock, partnership interest, beneficial interest in a trust, membership interest, or other interest of an ownership or equity nature) in any entity at any tier of ownership that directly or indirectly owns or holds any ownership or equity interest in a Person.

"Estimated Development Costs" is intended to mean the total costs of initial construction and furnishing of the Resort, as mutually agreed between Landlord and Tenant, as of the Commencement Date, but is subject to future negotiation.

"Executive Director" means the Executive Director, from time to time, of the Community Development Commission of the City of Oceanside or such Persons designee or successor in function or, if the City of Oceanside becomes Landlord under the Lease, then the City Manager of the City of Oceanside, from time to time, or such Persons designee or successor in function, or, if the Fee Estate is transferred to a Person other than the Community Development Commission of the City of Oceanside or the City of Oceanside, then such future owner's designated representative.

"Expiration Date" means and refers to the date when the Lease terminates or expires in accordance with its terms, whether on a scheduled date, by Landlord's exercise of remedies for a default or otherwise.

"Fee Estate" means Landlord's fee estate in the Premises, including Landlord's reversionary interest in the Premises after the Expiration Date.

"FF&E" means all movable furniture, furnishings, equipment, and personal property of Tenant or anyone claiming through Tenant (excluding Building Equipment) that may be removed without material damage to the Premises and without adversely affecting: (a) the

structural integrity of the Premises; (b) any electrical, plumbing, mechanical, or other system in the Premises; (c) the present or future operation of any such system; or (d) the present or future provision of any utility service to the Premises. FF&E includes items such as furniture, movable equipment, telephone, telecommunications and facsimile transmission equipment, point of sale equipment, televisions, radios, network racks, computer systems and peripherals.

"Fixed Rent" shall have the meaning ascribed to the term in Section 1.7.

"Franchise Agreement" means and refers to a current agreement between the Tenant and Starwood Hotels and Resorts Worldwide, Inc., a Maryland corporation, for use of its "Westin Hotels & Resorts" brand/flag or between Tenant and such other hotel franchisor for use of another brand/flag, all as may be approved by Landlord, from time to time, pursuant to the terms of the Lease, regarding operation of either Hotel.

"Furnishing Plan" means a plan for periodic replacement or addition of Furnishings in the Hotels prepared by Tenant that includes the proposed timing and estimated costs of all replacements or additions identified in the plan and shall include copies of any similar plans and updates to such plans required by the Franchise Agreement or other agreement or Person. The specific elements of a Furnishing Plan are subject to negotiation in the future.

"Furnishings" means and refers to furniture and fixtures used in any Guest Rooms, Public Facilities or related hallways, walkways or corridors, including chests, armoires, chairs, beds, headboards, desks, tables, television sets, mirrors, pictures, wall decorations, floor coverings, window coverings and all other unspecified items of the same class.

"Gross Consideration" means and refers to the sum of all of the following: (i) the gross amount of the cash paid, or to be paid, (ii) the fair market value of other property transferred, or to be transferred, (iii) the outstanding amount of any liability assumed, or to be assumed, by the transferee or to which the property interest is subject immediately before and after the Transfer or, in the case of a Transfer without any of the previously described forms of consideration, the fair market value of the estate or interest in the property transferred. Any fair market value determination shall be as of the date of the subject Transfer.

"Gross Revenues" means all amounts received by Tenant from the use or occupancy of or right to use or occupy all or any portion of the Premises, including all revenue, income and receipts from Hotel, Time-Share Project and other operations on the Premises, including Guest Room rental revenue, meeting room revenue, food revenue, beverage revenue, telephone revenue, facsimile or internet service charges, parking revenue, retail sales revenue, Spa revenue, recreational facility revenue, program revenue (net of reasonable and customary fees paid to third-party program providers), sublease revenue (including rental revenue), miscellaneous revenue and other revenue, income and receipts of every kind that accrue or are accounted for on an accrual basis in conformity with the Uniform System of Accounts for the Lodging Industry or Generally Accepted Accounting Principles, as applicable. To the extent a matter is not addressed by the Uniform System of Accounts for the Lodging Industry, GAAP shall control, to the extent applicable. In the event of and to the extent of any inconsistency between the Uniform System of Accounts for the Lodging Industry or GAAP and the terms of the Lease, the terms of the

Lease shall control. Each credit or installment transaction shall be treated as revenue for the full price in the month during which such credit or installment transaction is made, regardless of whether or when Tenant receives actual payment therefor. Gross Revenues shall not include, or if included there shall be deducted (but only to the extent the same have been included in Gross Revenues):

a. transaction privilege, transient occupancy, sales, use, excise and gross receipts taxes on any of the foregoing described transactions that are paid by Tenant to governmental taxing authorities (no other taxes shall be excluded from Gross Revenues, including property taxes, special taxes, possessory interest taxes, income taxes, corporate taxes, franchise taxes, etc.);

b. service charges, interest and collection expenses received or receivable for credit transactions, as well as other charges or fees paid by Tenant to credit card companies, banks and similar organizations resulting from the use of credit or debit cards by guests, patrons or customers;

c. bad debts and chargebacks, to the extent previously included in Gross Revenues;

d. gross receipts of Tenant's subtenants, licensees or concessionaires (but all rents or fees payable to Tenant by its subtenants, licensees and concessionaires shall be included in Gross Revenues);

e. gratuities paid to and retained by Hotel employees, including, without limitation, gratuities or service charges added to a customer's bill or statement in lieu of gratuities or tips, that the Hotel Operator or Tenant is obligated to turn over to an employee as compensation and that is retained by such employee;

f. insurance proceeds (except any insurance proceeds received in reimbursement for lost revenues);

g. Net Transfer Proceeds;

h. Net Refinancing Proceeds;

i. receipts from condemnation (other than those for temporary use or occupancy of Guest Rooms);

j. all sums and credits received in settlement of claims for loss or damage of merchandise, or otherwise against third parties arising out of or during the course of operation of the Premises;

k. travel agent discounts and commissions paid by the Hotel Operator or Tenant; provided, however, that any such commissions shall not be paid to any Affiliate of Tenant or the Hotel Operator or any owner of an Equity Interest in Tenant or

the Hotel Operator, shall reasonably conform to industry standards in the Southern California hotel market, and shall not exceed three percent (3%) of Gross Revenue; and

l. advance deposits, until forfeited or applied;

m. sale of investments;

n. proceeds of asset sales incident to replacement of such assets; and

o. loan proceeds.

"Guest Room" means and refers to each rentable unit in the Hotel consisting of a room or suite of rooms generally used for overnight guest accommodation, entrance to which is controlled by the same key. Adjacent rooms with connecting doors that can be locked and rented as separate units shall be deemed to be separate Guest Rooms.

"Hotel" means and refers to, individually, either the Main Hotel or the Boutique Hotel.

"Hotel Operator" means and refers to the Person operating the Hotel, from time to time, pursuant to a management agreement with the Tenant.

"Hotels" means and refers to, collectively, the Main Hotel and the Boutique Hotel.

"Initial Term" shall have the meaning ascribed to the term in Section 1.4.

"Institutional Lender" means: (1) a bank (state, federal or foreign), trust company (in its individual or trust capacity), insurance company, credit union, savings bank (state or federal), pension, welfare or retirement fund or system, real estate investment trust (or an umbrella partnership or other entity of which a real estate investment trust is the majority owner), federal or state agency regularly making or guaranteeing mortgage loans, investment bank or a subsidiary of a Fortune 500 company (such as AT&T Capital Corporation or General Electric Capital Corporation); (2) any Person (including investment funds) having total assets (on the date when its Leasehold Mortgage is executed and delivered, or on the date of such Leasehold Mortgagee's acquisition of its Leasehold Mortgage by assignment, but excluding the value of any Leasehold Mortgage encumbering this Lease) of at least $50,000,000; or (3) any Person that is a wholly owned subsidiary of or is a combination of any one or more of the Persons described in (1).

"Land" means the real property of the Premises, exclusive of any private commercial improvements constructed by Tenant.

"Landlord Investment" is, currently, anticipated to be approximately Twenty-Seven Million Dollars ($27,000,000).

"Laws" means all laws, ordinances, requirements, orders, proclamations, directives, rules, and regulations of any government affecting the Premises, this Lease, or any construction in any way, including any use, maintenance, taxation, operation, or occupancy of, or

environmental conditions affecting, the Premises, or relating to any real estate taxes, or otherwise relating to this Lease or any Party's rights or remedies under this Lease, or any Transfer of any of the foregoing, whether in force at the Commencement Date or passed, enacted, or imposed at some later time, subject in all cases, however, to any applicable waiver, variance, or exemption.

"Lease Year" means: (a) the twelve calendar months starting on the first day of the first full calendar month after the Commencement Date; and (b) every subsequent period of twelve calendar months during the Term. Each Lease Year is referred to in the Lease in consecutive chronological order, starting with "Lease Year 1" and continuing with "Lease Year 2," "Lease Year 3," etc.

"Lease" means and refers to a potential future ground lease between the Landlord and the Tenant regarding the Premises that contains some or all of the terms and conditions described in ARTICLE 1 of this MOU.

"Leasehold Estate" means Tenant's leasehold estate, and all of Tenant's rights and privileges under the Lease, if any, upon and subject to all the terms and conditions of the Lease, and any direct or indirect interest in such leasehold estate.

"Main Hotel" means the hotel to be operated in the Main Hotel Building, pursuant to the terms of the Lease.

"Main Hotel Building" means the building to be constructed on the South Parcel, as specifically described in the Resort Plans and Specifications, that is to be operated as the Hotel, in conjunction with the Boutique Hotel.

"Mortgage" means any mortgage, deed of trust, security deed, contract for deed, deed to secure debt, or other voluntary real property (including leasehold) security instrument(s) or agreement(s) intended to grant real property (including leasehold) security for any obligation (including a purchase-money or other promissory note) encumbering the Leasehold Estate or the Fee Estate, as entered into, renewed, modified, consolidated, increased, decreased, amended, extended, restated, assigned (wholly or partially), collaterally assigned, or supplemented from time to time, unless and until paid, satisfied, and discharged of record. If two or more such mortgages are consolidated or restated as a single lien or held by the same Leasehold Mortgagee or Fee Mortgagee (as applicable), then all such mortgages so consolidated or restated shall constitute a single Mortgage. A Mortgage may be either a Fee Mortgage or a Leasehold Mortgage or both. A participation interest in a Mortgage (or partial assignment of the secured loan) does not itself constitute a Mortgage.

"Mortgagee" means a holder of any Mortgage and its successors and assigns.

"Net Refinancing Proceeds" means and refers to the gross proceeds of any refinancing, less the amount of any reasonable and customary fees and costs associated with obtaining such refinancing that are actually paid by Tenant and not rebated or refunded to Tenant, the aggregate amount of such fees and costs not to exceed three percent (3%) of the gross financing proceeds.

"Net Transfer Proceeds" means the Gross Consideration for any Transfer, less the amount of the Gross Consideration paid by the Transferring Tenant for acquisition of the Leasehold Estate (not applicable to the initial Tenant), less the costs of any Capital Improvements made by the Transferring Tenant and less any normal and customary transaction costs, such as brokerage commissions, title insurance or escrow fees actually paid by Tenant and not rebated to Tenant, the aggregate amount of such transaction costs not to exceed three percent (3%) of the Gross Consideration.

"North Building" means and refers to the building to be constructed and installed on the North Parcel, as specifically described in the Resort Plans and Specifications, that will be operated, in part, as the Boutique Hotel and, in part, as the Time-Share Project and, in part, as retail and restaurant space.

"North Parcel" means and refers to that certain real property specifically described in Exhibit "A" attached to this MOU.

"Notice of Completion" shall have the meaning ascribed to the term in California Civil Code Section 3093.

"Other Revenue" means that portion of Gross Revenues derived from all sources other than Room Revenue.

"Parking Structure" means and refers to that certain parking garage to be constructed by Tenant beneath the North Parcel, the South Parcel and the bisecting portion of Mission Avenue, as specifically described in the Resort Plans and Specifications.

"Party" means and refers to, individually, the Landlord or the Tenant.

"Parties" means and refers to, collectively, the Landlord and the Tenant.

"Percentage Rent" shall have the meaning ascribed to the term in Section 1.8.

"Permitted Leasehold Mortgage" means any Mortgage: (a) that encumbers the Leasehold Estate or any interest in the Leasehold Estate; (b) that contains or incorporates by reference, and fully complies with, the lien priority provisions of the Lease (as applicable to Leasehold Mortgages) and contains no provisions (and secures no other document containing any provisions) inconsistent with the lien priority provisions of the Lease; (c) a copy of which (recorded or unrecorded) is promptly after execution delivered to Landlord, with a certification by the Leasehold Mortgagee that the copy is accurate and stating Leasehold Mortgagee's name and notice address; and (d) that is held by a Leasehold Mortgagee that is an Institutional Lender, subject to the jurisdiction of the courts of the State of California and not immune from suit.

"Permitted Leasehold Mortgagee" means the holder of a Permitted Leasehold Mortgage.

"Permitted Uses" means and refers to the uses of the Premises expressly authorized in Section 1.15.

"Person" means and refers to any association, corporation, governmental entity or agency, individual, joint venture, joint-stock company, limited liability company, partnership, trust, unincorporated organization, or other entity of any kind.

"Pro-Forma Gross Revenue" is intended to mean the annual Gross Revenues reasonably projected for specified Lease Years, as may be mutually agreed between Landlord and Tenant in the future.

"Public Facilities" means and refers to any meeting rooms, conference rooms, convention or banquet facilities, restaurants, bars, spa, lounges, patios, related hallways, walkways and corridors and all other similar public facilities associated with the Resort.

"Renewal Option" shall have the meaning ascribed to the term in Section 1.5.

"Renewal Term" shall have the meaning ascribed to the term in Section 1.5.

"Renovation" means and refers to renewing and restoring the exterior and interior elements and public spaces of the Resort, including structural building components of the Main Hotel Building, the North Building and the Parking Structure, Building Equipment, exterior façade components and coverings, hardscape, public and private open space, swimming pools and swimming pool equipment, roofs, windows, awnings, patio covers, gazebos, signage, landscaping, painting, pipes, wiring and other building components.

"Renovation Plan" means a plan for the periodic Renovation of the Resort (including the Main Hotel Building, the entirety of the North Building and the Parking Structure) prepared by Tenant and specifying the timing and estimated costs of each Renovation identified in the plan and shall include copies of any similar plans and updates to such plans required by the Franchise Agreement or other agreement or Person. The specific elements of a Renovation Plan are subject to future negotiation.

"Reserve Fund" shall have the meaning ascribed to the term in Section 1.13.

"Reserve Gross Revenues" means Gross Revenues, less revenues derived from retail space located on the North Parcel (as shown on May 2006 concept plans).

"Resort" means and refers to, collectively, the Hotel, the Time-Share Project, the Parking Structure and all associated retail space, restaurant space, Spa, hardscape, landscaping and on-site and off-site public and private improvements.

"Resort Improvements" means and refers to, collectively, the Main Hotel Building, the North Building, the Parking Structure and all associated hardscape, landscape, utility infrastructure and public improvements.

"Resort Plans and Specifications" means plans and specifications for the Resort, prepared by Tenant's architect, submitted to the Landlord in such machine-readable format as is then customary in the architectural profession, consisting of architectural plans; elevations and sections indicating principal areas, core design and location; location, number, and capacity of

elevators; basic structural system; minimum estimated electrical capacity and distribution system; general type of plumbing system; façade, placement, and orientation; gross and rentable square foot analysis; and principal types of HVAC systems.

"Room Revenue" means and refers to Gross Revenue derived from Guest Room rental at either Hotel.

"Senior," when referring to multiple Mortgage(s), means the Mortgage that is most senior in lien of the same type (Fee or Leasehold). Where "Senior" is used as a comparative term as against any specified Mortgage, such term refers to any Mortgage of the same type (Fee or Leasehold) that is senior in lien to such specified Mortgage. Priority of liens shall be determined under the Lease. If only one Mortgage of a particular type exists, then it shall be deemed the "Senior" Mortgage of such type.

"South Parcel" means and refers to that certain real property specifically described in Exhibit "B" attached to this MOU.

"Spa" means and refers to each spa amenity facility, if any, associated with or located in the Hotel.

"Stipulated Percentage Rate" means the following:

		Rooms	Other
(a)	For Lease Years 1-12:	0%	0%
(b)	For Lease Years 13-15:	0.5%	0.25%
(c)	For Lease Years 16-18:	1.0%	0.50%
(d)	For Lease Years 19-22:	2.0%	1.00%
(e)	For Lease Years 23-26:	3.0%	1.50%
(f)	For Lease Years 27-30:	4.0%	2.00%
(g)	For Lease Years 31-35:	5.0%	2.50%
(h)	For Lease Years 36-50:	6.0%	3.00%
(i)	For Lease Years 51 - 75:	7.0%	3.50%

"Structure" means only the concrete floors, footings, foundation, load-bearing walls, roof, roof support system, and structural steel or other structural support system of any Improvements located on the Premises.

"Tenant Investment" means the amount of the total hard and soft costs of the initial construction and furnishing of the Resort Improvements, in accordance with the Resort Plans and

Specifications, and any Capital Expenditures, to the extent not paid for from the Reserve Fund, actually paid by Tenant from sources other than debt that is secured by the Leasehold Estate (no fees, costs, charges or interest payable on any debt of Tenant that is not secured by the Leasehold Estate shall be included in determining the amount of the Tenant Investment), as evidenced by audited financial statements prepared by a certified public accounting firm mutually agreed to by Landlord and Tenant.

"Term" means the Initial Term and each Renewal Term, if any.

"Time-Share Interest" means and refers to each individual fractional time-share interest or other vacation ownership interest, as may be approved by Landlord, in its sole and absolute discretion, that is or is to be sold regarding use or ownership of the Time-Share Project.

"Time-Share Operator" means and refers to the Person operating the Time-Share Project, from time to time, pursuant to a management agreement with the Tenant.

"Time-Share Project" means and refers to a fractional time-share property, as defined in California Business and Professions Code Section 11212, or other vacation ownership unit project, as may be approved by Landlord, in its sole and absolute discretion, for operation on the North Parcel (exclusive of the Boutique Hotel). The terms and conditions of the use and occupancy of any such Time-Share property or other vacation ownership unit project are subject to future negotiation.

"Time-Share Rent" means, collectively, Annual Time-Share Rent and Time-Share Resale Rent. **[NOTE: IF ANOTHER FORM OF VACATION OWNERSHIP INTEREST IS ADDED TO THE RESORT OR REPLACES THE CURRENTLY CONTEMPLATED FRACTIONAL TIME-SHARE INTERESTS, TIME-SHARE RENT WILL BE ADJUSTED IN ACCORDANCE WITH THE ECONOMIC EFFECTS OF SUCH OCCURRENCE.]**

"Time-Share Resale Rent" shall have the meaning ascribed to the term in Section 1.11.

"Time-Share Unit" means and refers to each individual lodging unit within the Time-Share Project.

"Transfer" means and refers to any of the following:

Any total or partial sale, assignment, conveyance, trust, power, or transfer in any other mode or form, by Tenant of Tenant's interest in the Lease, the Leasehold Estate or the Resort Improvements; or

Any total or partial sale, assignment, conveyance, or transfer in any other mode or form, of or with respect to any interest in Tenant or a series of such sales assignments or the like that, in the aggregate, result in a disposition of more than a 25% interest in Tenant; or **[NOTE: THE PROVISIONS OF THIS PARAGRAPH ARE SUBJECT TO CHANGE IN THE FUTURE, AS THE ENTITY STRUCTURE OF TENANT IS ESTABLISHED.]**

Any merger, consolidation, sale or lease of all or substantially all of the assets of Tenant or a series of such sales, assignments or the like that, in the aggregate, result in a disposition of more than a 25% interest of all or substantially all of the assets of Tenant.

"Unavoidable Delay" means and refers to a delay in either Party performing any obligation under this MOU, except payment of money, arising from or on account of any cause whatsoever beyond the Party's reasonable control, despite such Party's reasonable diligent efforts, including industry-wide strikes, labor troubles or other union activities (but only to the extent such actions do not result from an act or omission of the Party), casualty, war, acts of terrorism, riots, litigation, governmental action or refusal to act when or as required by Law or inability to obtain materials. Unavoidable Delay shall not include delay caused by a Party's financial condition, illiquidity, or insolvency.

"Uneconomic" means that the Premises or any substantial part of the Premises: (1) is materially diminished in value or utility; (2) cannot be used for its previously intended purpose; (3) is subject to material impairment of access to, parking facilities benefiting, or any material service(s) necessary or appropriate for economic operation; (4) requires Restoration whose cost Tenant reasonably estimates in writing would exceed 1.5 times the then-current aggregate fair market value of the Fee Estate and the Leasehold Estate; (5) does not comply with any operating requirements under any license or franchise held by Tenant; (6) cannot reasonably be operated as the Resort, whether in a manner substantially consistent with past practice or on a scale that is smaller but nevertheless profitable (after taking into account the payment of all expenses, including Rent as adjusted after any Condemnation) and reasonably feasible; or (7) cannot be developed or operated in a commercially reasonable manner.

EXHIBIT "D"
TO
NON-BINDING GROUND LEASE NEGOTIATION
MEMORANDUM OF UNDERSTANDING
(S.D. Malkin Properties, Inc.)

HOTEL COMPETITIVE SET

1. Loews Coronado Bay Resort, Coronado, California;
2. Marriott Coronado Island Resort, Coronado, California;
3. Paradise Point Resort & Spa, San Diego, California;
4. Hilton Waterfront Beach Resort, Huntington Beach, California;
5. Hyatt Regency Huntington Beach, Huntington Beach, California; and
6. San Diego Marriott Del Mar, Del Mar, California.

EXHIBIT "E"
TO
NON-BINDING GROUND LEASE NEGOTIATION
MEMORANDUM OF UNDERSTANDING
(S.D. Malkin Properties, Inc.)

TIME-SHARE PROJECT COMPETITIVE SET

1. Marriott's Newport Coast Villas, Irvine, California;
2. Residence Club at PGA West, La Quinta, California; and
3. Grand Pacific Palisades Resort & Hotel, Carlsbad, California.

EXHIBIT "F"
TO
NON-BINDING GROUND LEASE NEGOTIATION
MEMORANDUM OF UNDERSTANDING
(S.D. Malkin Properties, Inc.)

APPROVED HOTEL OPERATORS

1. Interstate Hotels & Resort, Inc., a Delaware corporation.

2. Starwood Hotels & Resorts Worldwide, Inc., a Maryland corporation.

DISCUSSION DRAFT NO. 4
July 31, 2006

EXHIBIT "G"
TO
NON-BINDING GROUND LEASE NEGOTIATION MEMORANDUM OF UNDERSTANDING
(S.D. Malkin Properties, Inc.)

APPROVED TIME-SHARE OPERATORS

1. Interstate Hotels & Resort, Inc., a Delaware corporation.

2. Starwood Hotels & Resorts Worldwide, Inc., a Maryland corporation.

COMMUNITY DEVELOPMENT COMMISSION OF THE CITY OF OCEANSIDE

AMENDMENT NO. 2
TO
NEGOTIATION AGREEMENT
(S.D. Malkin Properties, Inc.)

This AMENDMENT NO. 2 TO NEGOTIATION AGREEMENT (S.D. Malkin Properties, Inc.) (this "Amendment No. 2") is dated as of August 16, 2006, for reference purposes only, and is entered into by and between the COMMUNITY DEVELOPMENT COMMISSION OF THE CITY OF OCEANSIDE, a public body corporate and politic, existing and acting pursuant to Health and Safety Code Sections 33000, et seq. (the "Agency"), and S.D. MALKIN PROPERTIES, INC., a Delaware corporation (the "Developer"), to amend that certain Negotiation Agreement (S.D. Malkin Properties, Inc.) by and between the Agency and the Developer, dated September 7, 2005, as amended by that certain Amendment No. 1 to Negotiation Agreement (S.D. Malkin Properties, Inc.) by and between the Agency and the Developer, dated May 10, 2006 (these latter two agreements are referred to, collectively, as the "Agreement"). This Amendment No. 2 is entered into by the Agency and the Developer with reference to the following recited facts:

RECITALS

A. The Agency owns that certain real property located within the City of Oceanside Downtown Redevelopment Project Area generally located between Pier View Way, Myers Street, Seagaze Drive and Pacific Street and specifically defined in the Agreement as the "Property"; and

B. The Developer has proposed the redevelopment of the Property as a mixed-use hotel, timeshare and retail project, defined in the Agreement as the "Project"; and

C. The Agency and the Developer entered into the Agreement to establish a specific, limited period of time to negotiate regarding a future agreement between them governing the potential lease of the Property from the Agency to the Developer and the potential redevelopment of the Project on the Property by the Developer, all subject to mutually agreeable terms, conditions, covenants, restrictions and agreements to be negotiated and documented in the future; and

D. Agency staff and the Developer have determined that the size of the Project and the additional requirements of development in the coastal zone may require more time than initially contemplated for the Developer to submit a complete development application for the Project to the City Planning Department;

E. To provide additional time that may be required for the Developer to submit a complete development application to the City Planning Department, the Agency and the

Developer desire to modify certain deadlines for the Developer to submit certain items to the City or the Agency during the Second Negotiation Period.

NOW, THEREFORE, IN CONSIDERATION OF THE PROMISES SET FORTH IN THIS AMENDMENT NO. 2 AND OTHER VALUABLE CONSIDERATION, THE AGENCY AND THE DEVELOPER AGREE, AS FOLLOWS:

1. **Incorporation of Recitals.** The Recitals set forth above are true and correct and are incorporated into this Amendment No. 2 by this reference, as though fully set forth in this Amendment No. 2.

2. **Incorporation of Defined Terms.** All terms, phrases and words indicated to be defined terms by initial capitalization in this Amendment No. 2 that are not specifically defined in this Amendment No. 2 shall have the meaning ascribed to the same term, phrase or word in the Agreement.

3. **Confirmation of Agreement**. The Agreement, as amended by this Amendment No. 2, is in all respects confirmed and all of the terms, provisions and conditions of the Agreement, as amended by this Amendment No. 2, shall be and remain in full force and effect.

4. **Estoppel**. The Agency and the Developer each acknowledge and agree that, as of the date of this Amendment No. 2, no default exists under the Agreement and no event or condition has occurred that, with the giving of notice or passage of time or both, would constitute a default by either the Agency or the Developer under the Agreement.

5. **Amendments to the Agreement.**

(a) Section 3(b) of the Agreement is amended to read, in its entirety, as follows:

> (b) If the Developer has timely submitted to the Agency all of the documents and information required to be submitted by the Developer to the Agency pursuant to Section 6(a), made all Monthly Deposits, pursuant to Section 2(b), and the Agency and the Developer have both approved and executed a MOU, in their respective sole and absolute discretion, then, upon the mutual agreement of the Agency and the Developer, in their respective sole and absolute discretion, the Agency and the Developer may enter into a second period of negotiations, upon all of the terms and conditions of this Agreement, for an additional five hundred ten (510) consecutive calendar days commencing on the date immediately following the date of expiration of the First Negotiation Period (the "Second Negotiation Period"), except as otherwise expressly provided in Section 10, but subject to the limitations of Sections 3(f) and 3(h). Approval of a MOU and entry into the Second Negotiation Period shall each require official action of the Agency governing body, subject to all legally required notices and other legal requirements.

(b) Section 3(f) of the Agreement is amended to read, in its entirety, as follows:

(f) The Second Negotiation Period may be extended upon the mutual written agreement of the Agency's Executive Director and the Developer for up to an additional sixty (60) calendar days, in the aggregate. If the Second Negotiation Period is extended pursuant to this Section 3(f), the Executive Director and the Developer may also mutually agree to modify the deadlines for any remaining actions to be taken by either the Agency or the Developer, within such extended Second Negotiation Period. Notwithstanding the first sentence of this Section 3(f), Section 10 or any other part of this Agreement, in no event (including any Unavoidable Delay(s)), shall the Second Negotiation Period exceed six hundred (600) consecutive calendar days.

(c) Section 3(h) of the Agreement is amended to read, in its entirety, as follows:

(h) Notwithstanding any other term, provision, condition, covenant, restriction or agreement contained in this Agreement, the aggregate time period of the combined First Negotiation Period and any Second Negotiation Period shall not exceed nine hundred ninety (990) consecutive calendar days.

(d) Section 6(b) of the Agreement is amended to read, in its entirety, as follows:

(b) If the Agency and the Developer enter into the Second Negotiation Period, then during the Second Negotiation Period, the Developer shall proceed diligently and in good faith to do all of the following:

(i) Within ninety (90) calendar days following the commencement of the Second Negotiation Period, submit to the City Planning Department, a complete Development application, a complete Tentative Parcel Map or Subdivision Map application (as appropriate), a complete Conditional Use Permit application, a complete Historic Use Permit application, a complete Coastal Permit application, and technical reports and studies (not including an Environmental Impact Report) necessary for preparation of an Environmental Impact Report ("EIR") for the proposed Project, pursuant to the California Environmental Quality Act, Public Resources Code Sections 21000, *et seq.* ("CEQA"). Whether or not any required application or other required information is "complete" or "final" shall be determined by City and Agency staff; and

(ii) Within ninety (90) days following issuance of the Notice of Preparation pursuant to Section 9, submit a screen-check draft EIR for the Project to Agency staff for review and comment; and

(iii) Within sixty (60) days following receipt of Agency staff comments to the draft screen-check EIR submitted pursuant to Section 6(b)(ii), submit a second screen-check draft EIR for the Project to Agency staff for review and comment; and

(iv) Within sixty (60) days following receipt of Agency staff comments to the draft screen-check EIR submitted pursuant to Section 6(b)(iii), submit a draft EIR for the Project to Agency staff for circulation for public review and comment under CEQA; and

(v) Within sixty (60) days following the close of the public comment/review period applicable to the draft EIR, submit a final EIR for the Project to Agency staff, including proposed responses to any comments and a proposed Mitigation Monitoring and Reporting Program relative to potential certification of the final EIR; and

6. **Execution in Counterparts**. This Amendment No. 2 may be executed by the Parties in multiple counterpart originals, each of which shall be considered an original, but all of which together shall constitute one and the same instrument.

7. **Interpretation**. The agreements contained in this Amendment No. 2 shall not be construed in favor of or against any Party, but shall be construed as if each Party prepared this Amendment No. 2.

8. **Entire Agreement**. The Agreement, as amended by this Amendment No. 2, represents the entire understanding between the Parties as to the subject matter of the Agreement, as so amended.

9. **Governing Law**. The Agency and the Developer agree that this Amendment No. 2 shall be governed by, interpreted under, and construed and enforced in accordance with the laws of the State of California, without application of conflicts of laws principles.

10. **No Intended Third-Party Beneficiaries**. None of the terms or provisions of this Amendment No. 2 are intended to benefit any person or entity other than the Agency or the Developer.

[Signatures on following page]

SIGNATURE PAGE
TO
AMENDMENT NO. 2
TO
NEGOTIATION AGREEMENT
(S.D. Malkin Properties, Inc.)

IN WITNESS WHEREOF, the Agency and the Developer execute this Amendment No. 2, by and through the signatures of their authorized representatives, as follow:

AGENCY:

COMMUNITY DEVELOPMENT COMMISSION OF THE CITY OF OCEANSIDE, a public body, corporate and politic

By:_____
Jim Wood
Chairperson

DEVELOPER:

S. D. MALKIN PROPERTIES, INC., a Delaware corporation

By:_____
Jeremy Cohen
Sr. Vice President

ATTEST:

By:_____
Secretary

APPROVED AS TO FORM:

By:_____
General Counsel