



Information Item

Date: December 24, 2013

To: Mayor and City Council
From: Martin Pastucha, Director of Public Works
Subject: Santa Monica Airport Lease Audit and Property Appraisal, Including the Lease of 3026 Airport Avenue

Introduction

This Information Item provides information about the on-going audit of Airport leases, appraisal of Airport leaseholds, and the lease of 3026 Airport Avenue (3026AA) to Santa Monica Art Studios (SMAS). An audit of leases is being conducted to document current practices and evaluate possible terms for leasehold renewals. The appraisal is being conducted to ensure market rate rents are being charged consistent with the Federal Aviation Administration (FAA) leasing policies for aviation and non-aviation lands. Staff is also evaluating the existing Santa Monica Airport Leasing Guidelines for Council consideration. Staff anticipates returning to Council in early 2014 with an update on the future of Santa Monica Airport, which would include an approach to address expiring leaseholds on the Airport Campus.

Background and Discussion

The City owns the Santa Monica Airport and operates it in conformity with the Santa Monica Airport Agreement with the federal government entered into on January 31, 1984 ("1984 Agreement"), various federal grant conditions, and other legal requirements and constraints, including private leases. However, the requirements and constraints will change on July 1, 2015 with the expiration of the 1984 Agreement and all of the Airport leases. The extent of control that the City will regain in 2015 is disputed. Nonetheless, with lease expiration dates starting as early as June 2014, the City initiated an audit and appraisal effort to explore the range of options for the Airport's leaseholds.

The lease with SMAS will be the first to expire on June 30, 2014. This leasehold reflects the Council's policy decision to maintain artist studios in Santa Monica and to make space available on non-aviation land for artists, prioritizing opportunities for relocation of Bergamot artists who faced displacement resulting from development in the area.

In April of 2000, the City advertised the availability of 3026AA. SMAS responded and met with Economic Development staff. However, the leasing process was suspended pending Council consideration of Leasing Guidelines for non-aviation land and other City property. Guidelines were approved in December of 2000. Among other things, the guidelines established that 3026AA must be leased as is, that the lease would be "at lowest feasible rent," and that the tenant at 3026AA would receive credit for improvements. A Request for Proposals (RFP) was issued for 3026AA. SMAS responded, proposing to replace its existing facility in the Bergamot area by making extensive improvements to the shell structure at 3026AA and to ensure affordability by offering an average rent to its subtenants averaging \$1.50 per square foot.

On March 27, 2001, Council authorized the City Manager to negotiate and execute a ten-year lease with SMAS for Artist Day Studio and Artist Service Center space. Thus, SMAS inherited a building that required substantial renovations to convert an industrial shell into modern artist studios to house displaced artists from 18th Street and the prior Santa Monica Fine Arts Studios. As articulated in the [March 27, 2001](#), staff report, substantial private capital investment was necessary to convert the structure for this purpose for which appropriate rent credits could be negotiated as part of the lease. It also called for the rental rate to be determined after actual build-out costs for the space had been confirmed.

Many months of negotiation followed Council's approval of the basic lease structure. Much of the discussion involved the anticipated improvement costs. Another focal point was the square footage actually useable for studios, which proved to be much less than anticipated. Additionally, the discussions included the Art Commission consideration, of

among other things, which artists should have a preference for studio space and whether there should be means testing. The Commission recommended that all current Santa Monica Fine Art Studio artists be grandparented without means testing.

Ultimately, SMAS and the City entered into an agreement on June 18, 2002 to lease the space at 3026 Airport Avenue with the lease incorporating by reference the lessor's proposal. There was a subsequent modification on November 13, 2003. Among other things, the modification lowered the monthly rent and deferred the commencement date, apparently to reflect unanticipated construction costs and delays. Staff handled this modification on the assumption that Council authorization was unnecessary because Council had already adopted leasing guidelines and directed the City Manager to negotiate lease terms reflecting the lessor's improvement costs.

In the years since the lease was executed and amended, staff has not received complaints about rental rates from any of the subtenants of SMAS. Thus, staff that administers the lease has no evidence that the rents were or are unaffordable to the artists that use the space. Moreover, the remedy for violations of the affordability requirement is unclear. The rent due to the City under the lease has been paid and it is not clear whether the City could sue on behalf of subtenants.

The lease to SMAS and the modification are perceived by some as being overly favorable to the lessee, but Council and staff were apparently focused primarily on preserving studio space for artists within the City as land values rose and studio space was redeveloped. So the City accomplished its primary goal despite extremely high renovation costs, and the lessee has met its basic obligations to the City. The on-going audit and appraisal will provide more information to help assess past performance and guide future choices.

Anticipated Timeline and Next Steps

Conducting the appraisal, audit, and Leasing Guidelines review is a collaborative effort by the Housing and Economic Development (HED), Finance, and Public Works Departments, which jointly handle responsibility for administering Airport (and other) City leases.

Staff anticipates the following project timeline:

- Appraisal: Submissions from the Request for Proposals are expected by the HED Department in early January 2014 with completed reports by late April 2014.
- Lease Audit: Staff is currently drafting the Request for Proposals and expects completed reports by May 2014. The selection and oversight of the audit consultant will be conducted by the HED Department in coordination with Finance.
- Leasing Guidelines: Staff is currently reviewing existing guidelines. Upon completion of the appraisal and audit, Leasing Guidelines recommendations will be prepared for Council consideration.

Staff will provide Council the findings and reports in early 2014.

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