File No. 120980

Committee Item No. 3
Board Item No. _____

COMMITTEE/BOARD OF SUPERVISORS

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Committee: Budget and Finance Committee **Date** 10/24/2012

Board of Supervisors Meeting **Date** _____

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Completed by: Victor Young **Date** October 19, 2012
Completed by: Victor Young **Date** _____

FILE NO. 120980 RESOLUTION NO.

[Expansion of Authority Regarding Lease - 1455 Market Street]

Resolution authorizing additional allowance of up to $10.00 per rentable square foot for construction of improvements amortized by Landlord over initial term of seven years at eight percent to be paid as additional rent in the amount of $3,809.27 per month for property located at 1455 Market Street.

WHEREAS, The San Francisco Board of Supervisors adopted Resolution Number 208-12 (File Number 120454) on June 5, 2012 authorizing the Lease Agreement ("Lease") between the City and County of San Francisco ("City") and Hudson 1455 Market LLC ("Landlord") for 24,400 square feet at 1455 Market Street to be occupied by the San Francisco Department of Environment (DOE) for office purposes; and,

WHEREAS, Landlord provided a Tenant Improvement Allowance ("Allowance") of $1,502,571.20 or $61.48 per square foot of 24,400 rentable square feet; and,

WHEREAS, Subsequent to adoption of Resolution Number 208-12, DOE, working with the Landlord and the City's Real Estate Division, solicited competitive construction bids for required tenant improvements; and,

WHEREAS, The Landlord working with the successful bidder, BCCI Builders, prepared a rough order of magnitude of construction budget ("ROM Budget") for the tenant improvements and all related costs in the amount of $2,027,814.77

WHEREAS, The terms of the Lease provide the City an additional allowance of up to $10.00 per rentable square foot for construction of improvements amortized by Landlord over the Initial Term of seven (7) years ("Initial Term") at eight (8%) percent to be paid as additional rent in the amount of $3,809.27 per month; and,

WHEREAS, Taking into consideration the potential available funds, including but not limited to the Allowance, as detailed below, will still leave a shortfall for construction of tenant improvements in the amount of $244,399.57; now, therefore, be it

ROM Budget	$2,027,814.77
Landlord Tenant Improvement Allowance	$1,502,571.20
Rent Savings	$ 51,775.00
Rent Abatement	$ 171,080.00
In-kind Donations and Funds Raised	$ 57,989.00
	_____
Amortized Amount:	$ 244,399.57

RESOLVED, That the Director of DOE and Director of Property are hereby authorized to execute the provision in the Lease amortizing the additional construction allowance up to $10 per rentable square foot over the Initial Term at eight (8%) payable as additional rent in the amount of $3,809.27 per month for completion of the required tenant improvements, which would commence March 1, 2013; and, be it

FURTHER RESOLVED, That the City shall continue to occupy the entire Premises for the full term of the Lease unless funds for rental payments are not appropriated in any subsequent fiscal year at which time the City may terminate the Lease with advance notice to Landlord. Said Lease shall be subject to certification as to funds by the Controller, pursuant to Section 6.302 of the City Charter.

$15,237.08 Available

Index No.220005 and 220201

Controller

RECOMMENDED:

John Updike
Acting Director
Real Estate Division

RECOMMENDED:

Melanie Nutter
Director
Department of the Environment

Item 3 File 12-0980	Department: Department of the Environment

EXECUTIVE SUMMARY

Legislative Objectives

- The proposed resolution would authorize a tenant improvement allowance of up to $244,400, or $10 per square foot for the Department of Environment's planned tenant improvements at 1455 Market Street, amortized by the landlord, Hudson 1455 Market, LLC (Hudson 1455 Market), over the initial term of seven years at eight percent interest to be paid by the Department of the Environment as additional rent to Hudson 1455 Market in the amount of $3,809.27 per month.

Key Points

- On June 5, 2012, the Board of Supervisors approved a resolution authorizing the City, on behalf of the Department of the Environment, to enter into a new lease for 24,440 square feet of office space on the 12th floor at 1455 Market Street with Hudson 1455 Market, LLC (Hudson 1455 Market), as lessor, for a seven-year term commencing from the date that the tenant improvements are substantially completed, with one option to extend the lease by an additional five years.
- The current estimate for the tenant improvements is $2,027,815, or $82.97 per square foot.
- The Department of the Environment has secured $1,783,415 in funding for the tenant improvements, with a remaining balance of $244,400 where funding has not been identified.

Fiscal Analysis

- A total of $5,452,381 in rent would be paid over the seven-year term under the lease previously approved by the Board of Supervisors, including an additional $319,978 for the tenant improvements. The eight percent interest rate which the Department of the Environment must pay to Hudson 1455 Market results in an additional $75,578 ($319,978 less $244,400) in interest being paid on the $244,400 tenant improvement allowance over the seven-year term of the lease.

Policy Considerations

- Rather than choosing to borrow $244,400 at an interest rate of eight percent, the Department of the Environment should (a) make additional design decisions to mitigate construction costs, (b) continue to attempt to raise additional outside funding, and/or (c) re-evaluate other cost-cutting options in order to, at a minimum, reduce the amount borrowed from the landlord or, ideally, complete the tenant improvements within the $1,783,415 of identified funding available.

Recommendation

- Disapprove the proposed resolution.

MANDATE STATEMENT / BACKGROUND

Mandate Statement

In accordance with Section 23.27 of the City's Administrative Code, except in specified limited term cases, all leases, in which the City is the tenant, are subject to Board of Supervisors approval. On June 5, 2012, the Board of Supervisors approved a resolution authorizing the City, on behalf of the Department of the Environment, as the tenant, to enter into a new lease for 24,440 square feet of office space on the 12th floor at 1455 Market Street with Hudson 1455 Market, LLC (Hudson 1455 Market), as the landlord, for a seven-year term commencing from the date that the tenant improvements are substantially completed, then estimated to be October 1, 2012, and expiring seven years later, then estimated to be September 30, 2019, with one option to extend the lease by an additional five years, then estimated to be through September 30, 2024 (Resolution No. 208-12)

Included in the previously approved lease was a provision allowing the Department of the Environment to borrow up to $244,400, or $10 per square foot for the 24,400 square feet, from the landlord, Hudson 1455 Market, such that the Department of the Environment would amortize the borrowed $244,400 at an eight percent interest rate and repay those monies to Hudson 1455 Market by paying an increase in rent per square foot over the seven-year term of the proposed lease. However, when the Board of Supervisors approved the lease, the authority to have the landlord, Hudson 1455 Market, advance the additional $244,400 in tenant improvements, in exchange for the Department of the Environment paying additional rent costs to amortize the Hudson 1455 Market's advance, would be subject to Board of Supervisors approval under the proposed resolution.

Background

A New Lease at 1455 Market Street Was Approved on June 5, 2012

The Department of the Environment's lease, as previously approved by the Board of Supervisors on June 5, 2012, for 24,400 square feet of space at 1455 Market will replace the two existing leased spaces at 11 Grove Street and at 401 Van Ness Avenue in the War Memorial Building, which currently house the Department of Environment staff.

Table 1 below summarizes the monthly and annual rents, as well as the rate per square foot over the 7-year term of the lease. As shown in Table 1, the Department of the Environment is projected to pay a total of $5,132,403 in rent over the seven-year term of the lease. Included in the lease is a three-month rent credit for the first three months of the lease resulting in a $171,081 rent savings in FY 2012-13.

Table 1: Rent Under Existing Lease at 1455 Market Street

Year Under Lease	Monthly Rent	Annual Base Rent	Rate Per Square Foot
1	$57,027	$513,243*	$28
2	59,063	708,756	29
3	61,100	733,200	30
4	63,137	757,644	31
5	65,173	782,076	32
6	67,210	806,520	33
7	69,247	830,964	34
Total		$5,132,403	

* Year 1 results in $513,243 in annual rent due to the first three months' rent of $171,081 being credited by Hudson 1455 Market.

As shown in Table 1 above, the rent under the lease will increase by $1 per square foot per year, ranging from $513,243 in annual rent in the first year, after accounting for a three-month rent credit included in the proposed first year of the lease, to $830,964 in annual rent in the seventh year of the lease.

Tenant Improvements for 1455 Market Street Have Increased by $194,815 and Are Not Fully Funded

The lease also provides for Hudson 1455 Market to provide $1,502,571 or $61.48 per square foot for the 24,440 square feet to fund one-time tenant improvements. At the time of the lease's approval by the Board of Supervisors, the Department of Real Estate estimated that the Department of the Environment's tenant improvements would cost a total of $1,833,000, or $75 per square foot, leaving $330,429 ($1,833,000 less $1,502,571), or $13.52 per square foot in additional funding to be provided by the Department of the Environment. However, that original estimate was not determined by actual bids, but rather on the Department of Real Estate's preliminary estimates based on discussions with Hudson 1455 Market.

At the time of the lease's approval by the Board of Supervisors, there were three possibilities for funding the original estimated $330,429 for tenant improvements, or $13.52 per square foot, shortfall: (1) the Department would raise in-kind donations, grants, or reductions in construction cost through the donation of needed materials, (2) Hudson 1455 Market would pay up to an additional $244,400, or $10 per square foot, of the $330,429 needed, such that the Department of the Environment would amortize the lessor's additional contribution at an eight percent interest rate and repay those monies to Hudson 1455 Market by paying an increase in rent per square foot over the seven-year term of the proposed lease and the City would pay the remaining shortfall,$86,029 ($3 30,429 less $244,400) which would be funded from the Department of the Environment's FY 2012-13 budget, or (3) some combination of the above. When the Board of Supervisors approved the lease, the authority to have the landlord, Hudson 1455 Market, pay for an additional $244,400 in tenant improvements in exchange for the Department of the Environment paying additional rent costs to amortize the

lessor's additional contribution was to be subject to Board of Supervisors approval, which is the subject of the proposed resolution.

According to Ms. Marta Bayol, District General Manager from the Department of Real Estate, the current estimate to complete the tenant improvements based on actual bids is now $2,027,815, or $82.97 per square foot, which is $194,815, or 10.6 percent, more than the original estimate of $1,833,000 provided to the Board of Supervisors at the time of the lease's approval, leaving a total $525,244 ($2,027,815 current estimate less $1,502,571 to be provided by Hudson 1455 Market) where funding is not available. Table 2 below details the current estimate of the tenant improvements.

Table 2: Current Estimate of Tenant Improvements at 1455 Market Street

Architectural/Engineering/Consultant fees	$118,954
Mayor's Office on Disability's Plan Check and Inspections	45,883
Permit allowance included	23,550
Construction Costs	1,718,425
Landlord Project Management Fee[1]	24,440
Subtotal	**$1,931,252**
Project Contingency (5% of $1,931,252)	96,563
Total	**$2,027,815**

In addition, the tenant improvements detailed in Table 2 above are now estimated to be completed by February 28, 2013, a four-month delay from the previous October 1, 2012 estimated completion date. Therefore, the lease would not take effect until March 1, 2013.

As shown in Table 3 below, the Department of the Environment has identified funding sources of $1,783,415 for the tenant improvements, with a remaining balance of $244,400 where funding has not been identified out of a total $2,027,815 in tenant improvements, which must be paid by the Department of the Environment. Hudson 1455 Market is willing to lend the $244,400 to the Department of the Environment at an interest rate of eight percent.

[1] Under the lease, Hudson 1455 Market would receive a 10 percent Project Management fee on the additional $244,400 paid by Hudson 1455 Market, as compensation for staff review of plans, specifications, construction, and construction costs as well as any other costs incurred as a result of the construction work.

Table 3: Proposed Funding for the Tenant Improvements at 1455 Market

Current Estimate for Tenant Improvements	**$2,027,815**
Landlord's Contribution to Tenant Improvements	1,502,571
Rent Savings from Three-Month Rent Credit[1]	171,080
Additional Rent Savings in FY 2012-13[2]	51,775
In-Kind Donations and Funds Raised[3]	57,989
Total Funding Secured	**-$1,783,415**
Total Remaining Shortfall	**$244,400**

[1]-The Department of the Environment will realize $171,080 in savings from rent budgeted in FY 2012-13 due to a three-month rent credit in the first year of the lease.

[2]-The Department of the Environment will realize an additional $51,775 in rent savings in FY 2012-13 due to surplus funding budgeted for rent.

[3]-Mr. Guillermo Rodriguez, Director of Policy and Communications for the Department of the Environment, advised that the Department launched a capital campaign to secure funds, as well as in-kind donated products and services, to cover the estimated shortfall for tenant improvements of up to $525,244, and has received $57,989 to date from that capital campaign.

DETAILS OF PROPOSED LEGISLATION

The proposed resolution would authorize a tenant improvement allowance of up to $244,400, or $10 per square foot, based on 24,440 square feet to be advanced by the landlord, Hudson 1455 Market, LLC (Hudson 1455 Market), for the Department of Environment's planned tenant improvements at 1455 Market Street. The advance would be amortized by Hudson 1455 Market over the initial seven-year term of the lease at eight percent interest to be paid by the Department of the Environment, resulting in additional rent to Hudson 1455 Market at a total added cost of $319,978, or $3,809.27 per month for seven years (84 months).

FISCAL ANALYSIS

The Department of the Environment's Rent Would Increase by $319,978.44 Over the Seven-Year Term of the Existing Lease

As shown in Table 1 above, the Department of the Environment will pay a total of $5,132,403 in base rent over the initial seven-year term of the subject lease, as previously approved by the Board of Supervisors. As noted in Table 3 above, of the total estimated $2,027,815 for tenant improvements, the Department of the Environment has identified funding of $1,783,415 leaving a shortfall of $244,400. Under the proposed resolution, the Department of the Environment would borrow $244,400 from Hudson 1455 Market at an interest rate of eight percent, resulting in total additional rent payments of $319,978, including the principal of $244,400 and eight percent interest of $75,578 to be paid by the Department of the Environment to Hudson 1455 Market. Therefore, as shown in Table 4 below, the Department of the Environment would pay total rent of $5,452,381 ($5,132,403 plus an additional $319,978) over the initial seven-year term under the lease at the rate of an additional $45,711.24 annually over the seven-year term of the lease

Table 4: Summary of $5,452,381.44 in Rent if the Proposed Resolution Were Approved

Year Under Lease	Monthly Rent (Previously approved by the Board of Supervisors)	Monthly Payment on Tenant Improvement Allowance	Total Monthly Rent Plus Monthly Payment on Tenant Improvement Allowance	Annual Rent Plus Annual Payment on Tenant Improvement Allowance	Additional Annual Rent Due to Tenant Improvement Allowance
1	$57,027	$3,809.27	$60,836.27	$558,954*	$45,711.24
2	59,063	3,809.27	62,872.27	754,467.24	45,711.24
3	61,100	3,809.27	64,909.27	778,911.24	45,711.24
4	63,137	3,809.27	66,946.27	803,355.24	45,711.24
5	65,173	3,809.27	68,982.27	827,787.24	45,711.24
6	67,210	3,809.27	71,019.27	852,231.24	45,711.24
7	$69,247	3,809.27	73,056.27	876,675.24	45,711.24
Total			**$468,621.89**	**$5,452,381.44**	**$319,978.44****

*-Year 1 results in $558,954.24 in annual rent due to the three months' rent of $171,081 being credited by Hudson 1455 Market.
**-Includes $244,400 in principal and eight percent interest of $75,578.

In addition to the $75,578 in interest that the Department of the Environment would be paying to Hudson 1455 Market at an eight percent interest rate, an additional $24,440 (See Table 2 above), or ten percent of the proposed borrowed amount of $244,400 for the tenant improvements, would be paid by the Department of the Environment to Hudson 1455 Market as a project management fee for the tenant improvements. This ten percent project management fee payable to Hudson 1455 Market would be avoided if the Department of the Environment kept the cost of the tenant improvements within the $1,783,415 (See Table 3 above) that the Department of the Environment has identified as being available.

Mr. Rodriguez advises that the rental costs and tenant improvement costs are funded in the Department of the Environment's rent budget from the Solid Waste Impound Fees, Public Goods charges[2], work-orders and ongoing grant funds.

Ms. Bayol advises that the Department of the Environment would be allowed to pre-pay part or all of the additional tenant improvement allowance at any time and without any pre-payment penalty rather than adhering strictly to the payment schedule detailed above in Table 4 if, for example, there were unexpended funds left after the tenant improvements were completed.

[2] Public Goods charges are a state-imposed utility surcharge imposed on all retail electricity sales to fund research and technology development, renewable energy sources of electricity and the encouragement of energy efficiency.

POLICY CONSIDERATIONS

As shown in Table 2 above, the project contingency included in the current $2,027,815 tenant improvement budget at 1455 Market Street is $96,563, or five percent of the total tenant improvement budget of $1,931,252, rather than a ten percent contingency of $193,125, which was originally included. Ms. Bayol advises that project contingencies typically range between five and ten percent of the total project cost. Significantly reducing the project contingency for the subject tenant improvements leaves less money available if the final cost of the tenant improvements is higher than the current budgeted amount of $2,027,815. Mr. Rodriguez advises that the Department of the Environment is working closely with the general contractor and Hudson 1455 Market to ensure that the tenant improvements are completed at the current budget amount of $2,027,815.

However, Mr. Rodriguez advises that if the cost of the tenant improvements exceeds the current $2,027,185 tenant improvement budget, depending on the nature of the cost overruns, the Department of the Environment would (a) make design decisions to mitigate construction costs, (b) attempt to raise additional outside funding, and/or (c) re-evaluate other cost-cutting options.

According to Mr. Rodriguez, the Department of the Environment was able to further minimize the costs of the tenant improvements by (a) using currently owned furniture, (b) incorporating existing infrastructure into the design, and (c) making some design changes. In the professional judgment of the Budget and Legislative Analyst, rather than choosing to borrow $244,400 at an interest rate of eight percent, the Department of the Environment should (a) make additional design decisions to mitigate construction costs, (b) continue to attempt to raise additional outside funding, and/or (c) re-evaluate other cost-cutting options in order to, at minimum, reduce the amount borrowed from the landlord or, ideally, complete the tenant improvements within the $1,783,415 funds that the Department of the Environment has available.

RECOMMENDATION

Disapprove the proposed resolution.

City and County of San Francisco
REAL ESTATE DIVISION

John Updike
Acting Director of Real Estate

September 27, 2012

1455 Market Street
Department of Environment
Expansion of Authority

Through Naomi Kelly,
City Administrator

Honorable Board of Supervisors
City and County of San Francisco
City Hall, Room 244
1 Carlton B. Goodlett Place
San Francisco, CA 94102

RECEIVED
BOARD OF SUPERVISORS
SAN FRANCISCO
2012 OCT -1 PM 12:05
AK

Dear Board Members:

Attached for your consideration is a Resolution authorizing the additional allowance of up to $10.00 per rentable square foot for construction of tenant improvements as provided in the Lease Agreement ("Lease") between the City and County of San Francisco on behalf of the Department of Environment ("DOE") and Hudson 1455 Market LLC (the "Landlord") approved by the Board of Supervisors through Resolution No. 208-12 on June 5, 2012. The additional allowance of $10.00 per rentable square foot would be amortized by the Landlord over the initial term of seven (7) years at eight (8%) percent to be paid as additional rent. The Lease is for approximately 24,440 square feet at 1455 Market Street for the DOE for ongoing use as the centralized administration area for staff, services, training, and public programs.

The Landlord provided a tenant improvement allowance in the amount of $1,502,571.2 or $61.48 per square foot. After solicitation of competitive construction bids for the required tenant improvements, the successful bidder, BCCI Builders, prepared a rough order of magnitude budget ("ROM Budget") for the tenant improvements and related costs of $2,027,814.77. The terms of the lease provide the City an additional tenant improvement allowance of up to $10.00 per rentable square foot amortized by Landlord over the initial term at 8% to be paid as additional rent in the amount of $3,809.27.

The breakout of funds is as follows:

ROM Budget	$2,027,814.77
Available Funds	
Landlord Tenant Improvement Allowance	$1,502,571.20
Rent Savings	$ 51,775.00
Rent Abatement (Months 1 through 3 of Initial Term)	$ 171,080.00
In-Kind Donations and Funds Raised	$ 57,989.00
Amortized Amount	$ 244,399.57

We recommend approval of the proposed expansion of authority in order to complete the required tenant improvements. If you have any questions regarding this matter, please contact Marta Bayol of our office at 554-9865.

Sincerely,

for John Updike
Acting Director of Real Estate

cc. Melanie Nutter, Department of the Environment
David Assmann, Department of the Environment

File No. 120980

FORM SFEC-126:
NOTIFICATION OF CONTRACT APPROVAL
(S.F. Campaign and Governmental Conduct Code § 1.126)

City Elective Officer Information *(Please print clearly.)*	
Name of City elective officer(s): Members, Board of Supervisors	City elective office(s) held: Members, Board of Supervisors

Contractor Information *(Please print clearly.)*	
Name of contractor: **Hudson 1455 Market LLC**	
Please list the names of (1) members of the contractor's board of directors; (2) the contractor's chief executive officer, chief financial officer and chief operating officer; (3) any person who has an ownership of 20 percent or more in the contractor; (4) any subcontractor listed in the bid or contract; and (5) any political committee sponsored or controlled by the contractor. Use additional pages as necessary. 1. Victor Coleman, Chairman; Howard Stern, Mark Linehan, Ted Antenucci, Matthew Moran, Mark Burnett, Jonathan Glaser, Barry Porter, Richard Fried – Directors. 2. Victor Coleman, CEO; Howard Stern, President; Mark Lammas, CFO. 3. The Contractor, Hudson 1455 Market LLC is owned entirely by Hudson Pacific Properties, LP Hudson Pacific Properties, Inc, the General Partner and a publicly trade real estate investment trust. 4. None.	
Contractor address: 11601 Wilshire Boulevard, Suite 1600, Los Angeles, CA 90025	
Date that contract was approved: *(By the SF Board of Supervisors)*	Amount of contract: $5,303,480 Base Rent over 7 years.
Describe the nature of the contract that was approved: Lease of 24,440 sf at 1455 Market Street for CCSF, Department of the Environment.	
Comments:	

This contract was approved by (check applicable):

☐ the City elective officer(s) identified on this form

☑ a board on which the City elective officer(s) serves: San Francisco Board of Supervisors
Print Name of Board

☐ the board of a state agency (Health Authority, Housing Authority Commission, Industrial Development Authority Board, Parking Authority, Redevelopment Agency Commission, Relocation Appeals Board, Treasure Island Development Authority) on which an appointee of the City elective officer(s) identified on this form sits

_____
Print Name of Board

Filer Information *(Please print clearly.)*	
Name of filer: Angela Calvillo, Clerk of the Board	Contact telephone number: (415) 554-5184
Address: City Hall, Room 244, 1 Dr. Carlton B. Goodlett Pl., San Francisco, CA 94102	E-mail: Board.of.Supervisors@sfgov.org

_____ _____
Signature of City Elective Officer (if submitted by City elective officer) Date Signed

_____ _____
Signature of Board Secretary or Clerk (if submitted by Board Secretary or Clerk) Date Signed