CITY AND COUNTY OF SAN FRANCISCO

BOARD OF SUPERVISORS

BUDGET AND LEGISLATIVE ANALYST

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TO: Budget and Finance Committee

FROM: Budget and Legislative Analyst

SUBJECT: October 2, 2019 Budget and Finance Committee Meeting

TABLE OF CONTENTS

Item 1 **File 19-0906**	**Department:** Port Commission (Port)

EXECUTIVE SUMMARY

Legislative Objectives

- The proposed resolution would authorize the Amended and Restated Lease between the Port and Frankie's Java House, LLC (Frankie's) for the Java House Restaurant located at Pier 40½ at Embarcadero and Townsend Street including a conditional option to extend the term for ten years, through August 31, 2033. To exercise the conditional extension option, the proposed owners (Frankie's) would be required to invest at least $737,000 into the facility and complete all specified capital improvements within one year of the commencement of the amended lease agreement. Under the terms of the amended lease, the monthly base rent would be $4,000 plus 7.5 percent of gross revenues to the extent that amount exceeds the base rent.

Key Points

- In October 2007, the Board of Supervisors approved a 15-year lease between the Port and Java House, LLC (Java House) for a restaurant space located at Pier 40 ½ at the Embarcadero and Townsend Street (File 07-1311). The current monthly base rent is $3,314. Percentage rent of the current lease was set at 7.5 percent of gross sales but has never been paid due to poor business performance. The current lease also requires the tenant to make capital improvements of at least $346,120 to the facility by September 1, 2010. According to the Port, Java House has not completed the required capital improvements and is thus currently not in compliance with the original lease.
- The owners of the Java House wish to sell the current lease to a new entity, which is Shareheffholder LLC Series E, dba: Frankie's Java House, LLC (Frankie's).

Fiscal Impact

- According to the economic analysis conducted by Seifel Consulting, Inc. and C.H. Elliott & Associates, the Port is projected to receive additional value from the tenant's capital improvements and lease extension when compared to the existing lease. The Port would receive from the tenant estimated rent revenues of approximately $1.42 million under the proposed lease amendment compared to $1.11 million if the existing lease runs its term and the Port conducts a competitive solicitation for new tenants after 2023.

Policy Consideration

- According to City Administrative Code Section 23.33, leases of City property with rent of at least $2,500 per month should be awarded through a competitive solicitation unless such competitive solicitation is impractical and impossible. According to the Port Commission's Retail Leasing Policy, the Port Commission determines whether a direct negotiation exception from competitive solicitation is granted based on three criteria According to the Port, the proposed extension of the Java House lease term meets two out of the three criteria of the Port Retail Leasing Policy. The Port has therefore granted a direct negotiation exception from competitive solicitation.

Recommendation

- Approve the proposed resolution.

MANDATE STATEMENT

City Charter Section 9.118(c) states that any modification, amendment or termination of a lease that had an initial term of ten years or more, including options to extend, or that had anticipated revenues of $1 million or more is subject to Board of Supervisors approval.

BACKGROUND

In October 2007, the Board of Supervisors approved a lease between the Port and Java House, LLC (Java House) for a restaurant space located at Pier 40 ½ at the Embarcadero and Townsend Street (File 07-1311). The current term of the lease is for 15 years and expires on August 31, 2023. The lease provides for the Port to receive the greater of guaranteed monthly base rent or percentage rent. The current monthly base rent is $3,314, which equals to $39,772 per year. Percentage rent of the current lease was set at 7.5 percent of gross sales for food, beverage and retail sales but has never been paid due to poor business performance. The current lease also requires the tenant, Java House, to make capital improvements of at least $346,120 to the facility by September 1, 2010. According to the Port, Java House has not completed the required capital improvements and is thus currently not in compliance with the original lease.

New Buyer

The owners of the Java House wish to sell the current lease to a new entity in which the current owners will retain a 15 percent interest. The proposed purchaser entity is Shareheffholder LLC Series E, dba: Frankie's Java House, LLC (Frankie's), with the majority owner being Mr. Michael Heffernan. According to the Port, the proposed sale transaction has not yet been completed. The closing of the sale is contingent on approval of the proposed lease amendment.

DETAILS OF PROPOSED LEGISLATION

The proposed resolution would authorize the Amended and Restated Lease between the Port and Frankie's Java House, LLC (Frankie's) for the Java House Restaurant located at Pier 40½ at Embarcadero and Townsend Street including a conditional option to extend the term for ten years, through August 31, 2033. To exercise the conditional 10-year extension option through August 31, 2033, the proposed owners (Frankie's) would be required to invest at least $737,000 into the facility, which also includes the improvement requirements not completed as required by the current lease. Under the terms of the amended lease, the monthly base rent would be $4,000, which equals $48,000 per year. The tenant would also pay the Port rent of 7.5 percent of gross revenues each month to the extent that amount exceeds the base rent. Monthly base rent will increase each year by 3 percent and on the first and fifth years by a formula equal to the higher of (a) monthly base rent increased by 3 percent, or (b) 85 percent of percentage rent.

As noted above, the current owners of Java House intend to sell the lease to a new entity, Frankie's. Under the proposed Amended and Restated Lease, the Port will receive 12 percent of net sale proceeds In addition, the current owners (Java House) will pay the Port $51,000 due to its failure to complete the tenant improvements required by the original lease. As previously mentioned, upon full completion of the capital improvements – which must be completed within one year of the commencement of the amended lease agreement – Frankie's will have the right to exercise an option to extend the term of the amended lease for ten years. If the required tenant improvements are not completed within one year of the commencement of the amended lease agreement, the extension option is void. The key terms of the proposed lease amendment are shown in Table 1 below.

Table 1: Key Terms of Proposed Lease Amendment

Premises	Pier 40 ½ at the Embarcadero and Townsend Street: Parcel A – Approximately 1,146 square feet of free-standing building comprised of the restaurant located in the vicinity of South Beach Harbor; and Parcel B – Approximately 1,090 square feet of exterior marginal wharf space located adjacent to the restaurant
Lease Term and Extension Option	The original lease is effective on September 1, 2008 and currently expires on August 31, 2023. If the new tenant completes the tenant improvements within one year of the effective date of the commencement of the amended lease, the tenant will have one option to extend the term for 10 years through August 31, 2033. If the initial tenant improvements are not completed within this timeframe, there is no extension option.
Rent	Rent consists of monthly base rent of $4,000 and percentage rent. The amount of percentage rent is the difference between 7.5 percent of gross revenues and base rent.
Rent increases	Base rent is increased annually by 3 percent and on the first and fifth years of the option period by a formula equal to the higher of (a) monthly base rent increased by 3 percent, or (b) 85 percent of percentage rent.
Initial Tenant Improvements	Tenant must complete tenant improvements and expend not less than $737,000
Transfer Participation	Port is entitled to 12 percent of the $525,800 purchase price of the lease (and any future sale), net of "costs of sale" as defined in the lease.
Permitted Use	Parcel A shall be operated as a casual dining restaurant and bar. Parcel B shall be used as an outdoor patio seating area and for other uses directly related to the support of the restaurant and bar operation.

Source: BLA Analysis

FISCAL IMPACT

Economic analysis conducted by Seifel Consulting, Inc. and C.H. Elliott & Associates, on behalf of the Port, estimates that the Port will receive approximately $1.42 million in rent during the period from 2020 through 2033 (if the extension option is approved). The amended lease rent projections are shown in Table 2 below.

Table 2: Rent Projections of Java House Lease Amendment with Extension Option

Year	Gross Sales	Base Rent	Percentage Rent[1]	Total Rent
2020	$783,150	$36,000	$22,736	$58,736
2021	$950,000	$49,440	$21,810	$71,250
2022	$1,150,000	$50,923	$35,327	$86,250
2023	$1,318,375	$52,451	$46,427	$98,878
2024	$1,344,743	$54,024	$46,831	$100,856
2025	$1,371,637	$55,645	$47,228	$102,873
2026	$1,399,070	$57,315	$47,616	$104,930
2027	$1,427,052	$59,034	$47,995	$107,029
2028	$1,455,593	$60,805	$48,364	$109,169
2029	$1,484,704	$62,629	$48,724	$111,353
2030	$1,514,398	$64,508	$49,072	$113,580
2031	$1,544,686	$66,443	$49,408	$115,851
2032	$1,575,580	$68,437	$49,732	$118,169
2033	$1,607,092	$70,490	$50,042	$120,532
Total	**$18,926,080**	**$808,144**	**$611,312**	**$1,419,456**

Source: Port

According to the Port, $361,001 in total rent has been collected to date under the original lease from the effective date of September 9, 2008 to September 2019. According to the Seifel economic analysis, the Port is projected to receive additional value from the tenant's capital improvements and lease extension when compared to the existing lease. Under the proposed lease amendment, the Port would receive from the tenant estimated rent revenues of approximately $1.42 million under the proposed lease amendment compared to $1.11 million if the existing lease runs its term and the Port conducts a competitive solicitation for new tenants after 2023.

In addition to the new total rent of the proposed lease amendment, the Port would be entitled to up to $63,096 in "participation" income from the sale of the lease to the new investor and $51,000 payment to the Port from the current lease holder for failure to comply with the terms of the current lease.

Proposed Improvements to the Site

As noted above, pursuant to the amended lease agreement, Frankie's proposes to invest no less than $737,000 in capital improvements required under the current lease. The proposed improvements include, handicap accessible improvements, a new kitchen, the addition of an outdoor seating area and improvements to the dining and bar areas.

According to the Port, staff of the Port's Finance and Administration division has reviewed Mr. Heffernan's (the majority owner of Frankie's) financial information and verified his financial capacity for the proposed investment and ability to complete the capital improvements. Pursuant to the amended lease agreement, Mr. Heffernan is required to execute a Personal

[1] Base rent plus percentage rent equals total rent payable. Percentage rent equals 7.5 percent of gross sales revenue minus the base rent.

Guaranty, a legally binding document executed by the guarantor making the guarantor financially responsible for completing the capital improvements as detailed in the amended lease agreement.

POLICY CONSIDERATION

Port Retail Leasing Policy

According to City Administrative Code Section 23.33, leases of City property with rent of at least $2,500 per month should be awarded through a competitive solicitation unless such competitive solicitation is impractical and impossible. According to the Port Commission's Retail Leasing Policy, the Port Commission determines whether a direct negotiation exception from competitive solicitation is granted based on the following criteria:

1) Tenant is in compliance with the Port's Tenant in Good Standing Policy;
2) Evaluate whether the tenant is the most suitable economic tenant based on reasonably projected sales and revenues to the Port, using comparable retail rents on a per square foot basis;
3) Request a written business plan and evaluate the plan to determine the cost and value of the capital improvements to Port property and viability of revenue projection.

According to the Port, the proposed extension of the Java House lease term associated with the tenant ownership restructuring and lease amendments meets two out of the three criteria of the policy. Java House does not meet the Tenant in Good Standing criteria due to its failure to complete the tenant improvements required under the original lease. However, Port staff (through the economic analysis conducted by Seifel Consulting, Inc. and C.H. Elliot & Associates in June 2019) has evaluated the projected sales and revenues projections as viable and has determined the proposed capital improvements will likely generate additional revenue that the Port would not otherwise receive. In addition, according to the Port, the benefits of a directly negotiated agreement outweigh the risk and costs associated with a possible default/eviction proceeding, and the loss of time and revenues and the uncertainty associated with a competitive solicitation. The Port states that the prospect of a prolonged eviction solution is further exacerbated when considering the added market risk involved in light of the currently challenging restaurant business environment.

RECOMMENDATION

Approve the proposed resolution.

Item 3 **File 19-0921**	**Department:** Sheriff's Department (Sheriff)

EXECUTIVE SUMMARY

Legislative Objectives

- The proposed resolution would retroactively approve the Sheriff Department's contract with Sentinel Offender Services, LLC for a home and electronic monitoring program services. The term of the contract is August 1, 2019 through July 31, 2022. The City has two optional one-year extensions to the contract term.

Key Points

- California Penal Code, Section 1203.016 authorizes the Sheriff to administer a home detention program with electronic monitoring pursuant to written contracts with private entities, subject to Board of Supervisors' approval.
- The Sheriff's Department implemented the home detention and electronic monitoring program in the early 2000s to provide individuals who qualify for home detention as an alternative to incarceration. At that time, participants would pay fees to participate in the program based on an individuals' ability to pay. In February 2018, the Sheriff and the Board of Supervisors waived all fees for all participants in the home monitoring program.
- The Sheriff's Department issued a Request for Proposals on September 28, 2018 and received proposals from four vendors. Sentinel received the highest score in the RFP.
- The services of the contractor include: installing devices for home detention and electronic monitoring as well as case management services for eligible individuals, pre-trial, post-sentence, and in custody. The contractor will monitor performance in substance abuse and mental health programs and administer drug tests to monitor participants' sobriety. If home/electronic monitoring participants violate the rules of the program, the Sheriff's Department sworn staff will respond and enforce compliance with the program's rules.

Fiscal Impact

- Estimated contract costs over the first three years of the contract from August 1, 2019 through July 31, 2022 are $3,400,000, based on the highest device usage volume from January 1, 2019 to July 31, 2019. Under the terms of the contract, payment to Sentinel will not exceed $3,400,000 through July 31, 2022.

Recommendation

- Approved the proposed resolution.

MANDATE STATEMENT

California Penal Code, Section 1203.016 authorizes the Sheriff to administer a home detention program with electronic monitoring pursuant to written contracts with private entities, subject to the requirement that the Board of Supervisors approve the program and annually review and approve the rules and regulations of the program and the requirement that such contract include a provision requiring that the contractor demonstrate and submit for approval by the Board of Supervisors evidence of financial responsibility.

BACKGROUND

The Sheriff's Department implemented the home detention and electronic monitoring program in the early 2000s to provide individuals who qualify for home detention as an alternative to incarceration. At that time, participants would pay fees to participate in the program based on the individual's ability to pay. The equipment installation and case management portion of the program has always been a contracted function. Following a competitive bid process in August 2019, the Sheriff's Department entered into an agreement with Sentinel Offender Services, LLC ("Sentinel") to administer the electronic monitoring program.

Electronic Monitoring Program Cost Structure

In February 2018, Sheriff Vicki Hennessy and the Board of Supervisors waived all fees for all participants in the home monitoring program. Prior to the waiving of fees, the average cost of the electronic monitoring program was approximately $35,000 per month net of fees paid by participants. Fees paid directly to the electronic monitoring contractor by sentenced individuals required by the Court to wear electronic monitors partially offset the monthly contract cost by approximately 30%. Following the *Humphrey* decision, in which the First Court of Appeal found that high bail amounts violated defendants' due process and equal protection,[1] the number of electronic monitoring participants has increased by approximately three-fold, from 108 monthly participants to 338 monthly participants. As a result of the fee waivers and increased participation, average monthly electronic monitoring contract costs has increased from $35,000 per month to approximately $150,000 per month. These are General Fund costs.

As of July 2019, there were 389 individuals who were monitored.[2] According to Mr. Henry Gong, Sheriff's Department Contract Administer, the Sheriff's Department estimates approximately 330 monthly participants in the program going forward.

Contractor Selection Process

The Sheriff's Department issued a Request for Proposals (RFP) on September 28, 2018 and received proposals from four vendors. The Department considered each vendor's proposed approach, experience, and proposed costs. Table 1 lists the total scores across vendors. As shown below, Sentinel received the highest score in the RFP.

[1] The case is pending before the California Supreme Court.
[2] This number includes 53 individuals under the jurisdiction of the Adult Probation Department. However, as of August 2019 the Adult Probation Department will be using a different contractor for home monitoring.

Table 1: Proposals and Scores from RFP

Proposer	Score (out of 100)
Sentinel	87
LCA	84
Corrective Solution	78
SCRAM of CA	48

Source: Sheriff's Department

Rules and Regulations of the Electronic Monitoring Program and Contractor Financial Responsibility

On July 30, 2019, the Board of Supervisors approved the resolution (File 19-0673) which approved the rules and regulation governing the electronic monitoring program and financial responsibility of the contractor, Sentinel, both of which must be approved annually by the Board of Supervisors.

DETAILS OF PROPOSED LEGISLATION

The proposed resolution would retroactively approve the Sheriff Department's contract with Sentinel Offender Services, LLC, which has a term of August 1, 2019 through July 31, 2022. The City has two optional one-year extensions to the contract term. The Department is now seeking retroactive approval from the Board of Supervisors for this contract on the advice of the City Attorney.

Contract Details

The term of the contract between the Sheriff's Department and Sentinel commenced on August 1, 2019 and will expire on July 31, 2022. The Sheriff's Department has two options to renew the contract for a period of one year each. Under the terms of the contract, payment to Sentinel will not exceed $3,400,000 through July 31, 2022. Additional spending on the contract would require approval from the Board of Supervisors. The City may terminate the contract at any time without cause.

The Sheriff's Department's Community Programs Division, which is responsible for the Department's home and electronic monitoring program, has 22 sworn staff assigned to oversee the program 24 hours per day / 7 days per week. Sentinel is required to meet with Sheriff Department program staff, at a minimum, on a weekly basis for case management briefing for each participant. The Community Program's Supervisor, a Sheriff's Department Captain, will be assigned to review and approve the monthly billing of electronic monitoring services provided.

The services of the contractor include: installing devices[3] for home detention and electronic monitoring as well as case management services for eligible individuals, pre-trial, post-sentence, and in custody. The contractor will monitor performance in substance abuse and mental health programs and administer drug tests to monitor participants' sobriety. Services must be in accordance with the requirements of California Penal Code Sections 1203.018 and

[3] Devices include GPS tracking equipment and equipment to monitor alcohol use.

1203.016, which govern electronic monitoring and home detention programs. If home/electronic monitoring participants violate the rules of the program, the Sheriff's Department sworn staff will respond and enforce compliance with the program's rules.

FISCAL IMPACT

Payments to Contractor

Estimated contract costs over the first three years of the contract from August 1, 2019 through July 31, 2022 are $3,400,000, based on the highest device usage volume from January 1, 2019 to July 31, 2019, as shown in Table 2 below.

Table 2: Projected Contract Costs

Projected Device Cost	CPI (Inflation)	GPS	GPS + Continuous Alcohol Monitoring	Continuous Alcohol Monitoring	Total
Year 1	0%	$606,591	$170,732	$329,690	$1,107,013
Year 2	3.25%	622,765	173,681	337,805	1,134,251
Year 3	3.25%	638,746	175,866	344,124	1,158,736
Total Expected Costs		$1,868,102	$520,279	$1,011,619	**$3,400,000**

Source: Sheriff's Department

RECOMMENDATION

Approved the proposed resolution.

Item 4 File 19-0920	Department: Real Estate Division

EXECUTIVE SUMMARY

Legislative Objectives

- The proposed resolution would authorize the first amendment to the City's lease with Lexington Lion San Francisco LP (Lexington) for 350 Rhode Island Street, providing a $2,600,000 rent credit to the City in exchange for removing the City's protection from increases in rent due to the pass through of increased property taxes from the sale of the property prior to July 2021. All other provisions of the current lease agreement will not change.

Key Points

- In October 2017, the Board of Supervisors approved a lease between the City as tenant and Lexington, as landlord to relocate the District Attorney's Office and the Police Investigations Unit from the Hall of Justice to 350 Rhode Island Street (File 17-1109).
- The current lease protects the City against the pass-through of property tax increases triggered by a property sale if the sale occurs prior to July 25, 2021.
- According to the Real Estate Division, the owner of 350 Rhode Island is planning to sell the property to a new owner, which will trigger a re-assessment of the property and an increase in property taxes. The Real Estate Division agreed to negotiate the $2,600,000 in rent credits in exchange for giving up the City's protection from the pass-through of increased property taxes because the Real Estate Division determined that the rent cost to the City, including rent credits, would likely be less under the proposed first amendment than under the existing lease. According to the Real Estate Division, because commercial property sales prices will likely increase between 2019 and June 2021, when the property tax pass-through protection ends, the City could pay significantly higher rent due to the property tax pass-through if the property sells after June 2021.

Fiscal Impact

- According to the Real Estate Division, the City's determination of the property's market value is approximately $134 million. The property's estimated new assessed value would increase the City's property tax payable by approximately $55,302 per month. The proposed $2,600,000 rent credit is equivalent to approximately 47 months of property tax pass-through protection.

Recommendation

- Approve the proposed resolution.

MANDATE STATEMENT

City Charter Section 9.118(b) requires Board of Supervisors approval of amendments to agreements with a fiscal impact of more than $500,000, if the original agreement had a term of more than ten years or an amount of $10 million or more.

BACKGROUND

350 Rhode Island Lease

In October 2017, the Board of Supervisors approved a lease between the City as tenant and Lexington Lion San Francisco LP (Lexington), a Delaware limited partnership, as landlord to relocate the District Attorney's Office and the Police Investigations Unit from the Hall of Justice to 350 Rhode Island Street (File 17-1109). The lease term is for 15 years from July 25, 2018 through July 24, 2033, with one five-year option to renew for a total 20 year term through 2038. The District Attorney's Office is moving into 350 Rhode Island Street in phases, as the leases with existing tenants at that location expire. The District Attorney's Office has completed Phase I of the relocation implementation and is currently moving some of its operation into its leased location at 350 Rhode Island with Phase II completion and full relocation to be completed before the end of 2020. Under the lease agreement, the City to date has paid approximately $5.5 million in rent and operating costs, increasing to $8.9 million by 2020, when the District Attorney's Office moves into all of the leased space in the building. Over the term of the 15-year lease, the City is projected to incur rent and operating costs of $149,467,245.

Commercial property owners are able to pass through property tax increases resulting from the sale of the property. [1] The current lease includes a provision that protects the City from increased rent due to the pass through of increased property taxes from the sale of the property if the sale occurs prior to July 2021.

DETAILS OF PROPOSED LEGISLATION

The proposed resolution would authorize the first amendment to the City's lease with Lexington for 350 Rhode Island Street, providing a $2,600,000 rent credit to the City in exchange for removing the City's protection from increases in rent due to the pass through of increased property taxes from the sale of the property prior to July 2021. All other provisions of the current lease agreement will not change.

Pending Building Sale

According to Mr. John Updike, Real Estate Division Special Project Manager, the owner of 350 Rhode Island is planning to sell the property to a new owner, which will trigger a re-assessment of the property and an increase in property taxes. Under the existing lease, if the property sells prior to July 25, 2021, the new owner would not be able to pass through the increase in property taxes to the City. Under the proposed first amendment, the new owner could pass-

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[1] Property taxes are levied based on the assessed value of the property. Under Proposition 13, the assessed value of the property is based on the sale price, and can only increase by 2 percent per year or by the Consumer Price Index (CPI), whichever is lower.

through the increase in property taxes to the City in exchange for $2,600,000 in rent credits. According to Mr. Updike, the City agreed to negotiate the $2,600,000 in rent credits in exchange for giving up the City's protection from the pass-through of increased property taxes because the Real Estate Division determined that the rent cost to the City, including rent credits, would likely be less under the proposed first amendment than under the existing lease. According to Mr. Updike, because commercial property sales prices will likely increase between 2019 and June 2021, when the property tax pass-through protection ends, the City could pay significantly higher rent due to the property tax pass-through if the property sells after June 2021.[2]

According to the Real Estate Division, the City only leases a portion of the property located at 350 Rhode Island and the other tenants are private businesses. Therefore, the Real Estate Division would not recommend that the City purchase the 350 Rhode Island property.

FISCAL IMPACT

According to the Real Estate Division, the City's determination of the property's market value is approximately $134 million.[3] As shown below in Table 1, the property's estimated new assessed value would increase the City's share of property taxes for 350 Rhode Island by approximately $55,302 per month. The proposed $2,600,000 rent credit is equivalent to approximately 47 months of property tax pass-through protection.

Table 1: Calculation of Change in Property Taxes

	Estimated Assessed Value	Annual Property Tax[4]	City Share[5]	Property Tax Per Month
Current	$60,000,000	$697,800	$538,074	$44,839
Upon Building Sale[6]	$134,000,000	$1,558,420	$1,201,698	$100,141
Difference	$74,000,000	$860,620	$663,624	$55,302
Value of Rent Credit				$2,600,000
Months of Property Tax Protection[7]				47

Source: Real Estate Division

RECOMMENDATION

Approve the proposed resolution.

[2] According to the Budget and Legislative Analyst's calculations, the net increase in rent to the City under the proposed first amendment is less than the net increase in rent under the existing lease, if the property were to sell after June 2021 for an amount ranging from 10 percent less to 15 percent more than the current estimated sales price.

[3] The estimated transfer taxes to the City in FY 2019-20 from the proposed sale of 350 Rhode Island are $4 million.

[4] Based on property taxes of 1.163 percent of assessed value.

[5] Based on the City occupying 77.11 percent of the building.

[6] This is Real Estate Division's estimated market value if the building was to be sold today.

[7] Months of Property Tax Protection is calculated by dividing the $2.6 million rent credit by the estimated $55,302 increase in property taxes.

Item 6 **File 19-0880**	**Department:** San Francisco International Airport (Airport)

EXECUTIVE SUMMARY

Legislative Objectives

- The proposed resolution would approve the terms of the San Francisco International Airport's (Airport) 2011 Lease and Use Agreement with El Al Israel Airlines Limited (El Al) to conduct flight operations at the Airport for a term of approximately one year and nine months, from approximately October 2019 through June 2021.

Key Points

- In 2011, the Airport negotiated a new Lease and Use Agreement (2011 Lease) with its domestic and international airlines. The 2011 Lease allows airlines to provide flight operations and rent terminal space at the Airport with a common set of provisions, including rent and landing fees, permitted uses, and use of common facilities. The 2011 Lease will expire June 30, 2021. El Al began conducting flight operations at the Airport under an Operating and Use Permit executed in May 2019. El Al now wishes to sign onto the 2011 Lease.
- International Terminal Joint Use Space rent is determined annually by formula, with 20 percent of total rent divided equally between all airlines, and 80 percent assessed proportionally based on the number of passengers travelling on each airline each year. Exclusive Space rent is determined annually as part of the Airport Rates and Charges. El Al would rent 1,940 square feet of Category II space at $248.75 per square foot and 866 square feet of Category III space at $165.83 per square foot.
- Landing Fees are determined annually as part of the Airport Rates and Charges. The current fees for FY 2019-20 are $5.80 per 1,000 pounds for airlines that have signed the 2011 Lease, and $7.25 per 1,000 pound for airlines that have not. El Al would receive a 20 percent fee reduction after signing the lease.

Fiscal Impact

- From October 2019 through June 2020, the Airport expects to receive approximately $469,638 in Exclusive Space rent and approximately $839,016 in Joint Use Space rent. In FY 2020-21, the Airport expects to receive approximately $674,696 in Exclusive Space rent. As the Joint Use Space formula varies depending on the airlines commencing and ceasing operations, the Airport cannot provide reliable rent projections in FY 2020-21.
- As the Landing Fees are highly variable and depend on market conditions, the Airport cannot provide reliable projections.

Recommendation

- Approve the proposed resolution.

MANDATE STATEMENT

City Charter Section 9.118(c) states that any modification, amendment or termination of a lease that had an initial term of ten years or more, including options to extend, or that had anticipated revenues of $1 million or more is subject to Board of Supervisors approval.

BACKGROUND

In 2011, the San Francisco International Airport (Airport) negotiated a new Lease and Use Agreement (2011 Lease) with its domestic and international airlines. The 2011 Lease allows airlines to provide flight operations and rent terminal space at the Airport and provides a common set of lease provisions that are used for these airlines. Such provisions include rent and landing fees paid by the airlines to the Airport, permitted uses of the premises, use of common facilities, and numerous other provisions. The 2011 Lease will expire June 30, 2021.

El Al Israel Airlines Limited (El Al) commenced flight operations at the Airport under an Operating and Space Permit executed in May 2019, which did not require Board of Supervisors' approval. El Al now wishes to sign onto the 2011 Lease. By signing the 2011 Lease, El Al would continue paying the same Joint Use Space rent and Exclusive space rent it currently pays to the Airport, but would receive a 20 percent discount on Landing Fees. The Airport Commission approved the 2011 Lease with El Al on May 21, 2019.

DETAILS OF PROPOSED LEGISLATION

The proposed resolution would approve a 2011 Lease and Use Agreement between the Airport and El Al Airlines to conduct flight operations at the Airport. The key provisions of the 2011 Lease are summarized in Table 1 below.

Table 1: Key Provisions of 2011 Lease for El Al

Term	Approximately one year and nine months, from October 2019 through June 2021
International Terminal Exclusive Space	2,806 square feet, of which 1,940 square feet are Category II space and 866 square feet are Category III space[1]
International Terminal Exclusive Space Rent	Determined annually by Airport Rates and Charges, currently $248.75 per square foot for Category II space and $165.83 for Category III space
International Terminal Joint Use Space	627,414 square feet
International Terminal Joint Use Space Rent	Determined annually by formula; 20% of total rent divided equally between all airlines, 80% assessed proportionally based on number of airline passengers
Landing Fees	Determined annually by Airport Rates and Charges, currently $5.80 per 1,000 lbs. for FY 2019-20
Deposit	Two months of Terminal Area Rentals, Landing Fees, usage fees, per rates and charges

[1] Category II space includes VIP clubs and lounges, baggage claim lobbies, baggage service offices, curbside check-in, and other enclosed space, departure level and above. Category III space includes other enclosed space, arrivals level and below.

FISCAL IMPACT

Exclusive Space and Joint Space Rent

El Al would continue to pay Exclusive Space and Joint Use Space rent in the International Terminal, at the same rates as the El Al's current agreement with the Airport. Exclusive Space rent is determined annually by the Airport Rates and Charges. El Al would pay approximately $1,144,334 in Exclusive Space rent over the approximately one-year and nine-month term of the lease, as shown in Table 2 below.

Table 2: Exclusive Space Rent Paid by El Al

Category	Annual Rent per Square Foot[2]	Square Footage	FY 2019-20 (9 Months)	FY 2020-21 (12 Months)	Total Rent Paid
Category II	$248.75	1,940	$361,931	$519,959	$881,890
Category III	165.83	866	107,707	154,737	262,443
Total			**$469,638**	**$674,696**	**$1,144,334**

**Totals may not add due to rounding*

Joint Use Space Rent is determined annually by formula, with 20 percent of the total rent assessed by the Airport equally to all airlines, and 80 percent assessed proportionally based on the number of inbound and outbound passengers travelling on each airline each year. The Joint Use Space formula is used to determine rent for all airlines in service at the Airport, regardless of whether or not the airline has signed onto the 2011 Lease. According to Mr. Sean Murphy, Airport Property Manager, El Al is expected to pay approximately $839,016 in Joint Use Space rent in from October 2019 through June 2020. As different airlines commence and cease operations throughout the year, the formula will likely be adjusted. According to Mr. Murphy, Joint Use Space Rent cannot be reliably projected for FY 2020-21.

Landing Fees

In addition to Exclusive Space and Joint Use Space rent, airlines also pay Landing Fees to the Airport, which are set annually as part of the Airport Rates and Charges. The Landing Fee for FY 2019-20 is $5.80 per 1,000 pounds for airlines that have signed the 2011 Lease, and $7.25 for Airlines that have not signed the 2011 Lease. By signing onto the 2011 Lease, El Al would receive a 20 percent cost reduction in Landing Fees. According to Mr. Murphy, the number of flights, weights of the aircrafts, and aircraft types used are highly variable and depend on market conditions. Therefore, the Airport cannot provide reliable Landing Fee projections. According to Mr. Murphy, adding El Al to the 2011 Lease Agreement provides greater certainty to future Airport revenues than if the airline were operating through an annual Operating and Space Permit, which has a shorter term than the 2011 Lease.

Deposit: Decrease in Revenue

According to Mr. Murphy, as of this writing, El Al has paid the Airport a deposit of $1,131,504 for six months of fees per the conditions of its Operating and Space Permit. Since the 2011

[2] According to Mr. Murphy, annual Exclusive Space Rent is projected to increase by approximately 7.7 percent in FY 2020-21, to $268.02 per square foot for Category II space and $178.68 per square foot for Category III space.

Lease only requires two months of fees, El Al would be entitled to a $754,336 refund to its deposit.

RECOMMENDATION

Approve the proposed resolution.