

CITY AND COUNTY OF SAN FRANCISCO
BOARD OF SUPERVISORS
BUDGET AND LEGISLATIVE ANALYST

1390 Market Street, Suite 1150, San Francisco, CA 94102 (415) 552-9292
FAX (415) 252-0461

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TO: Budget and Finance Committee

FROM: Budget and Legislative Analyst



SUBJECT: February 5, 2020 Budget and Finance Committee Meeting

TABLE OF CONTENTS

Item	File	Page
1	20-0042 Acquisition of Real Property - 1939 Market Street - Sheet Metal Workers' International Association, Local Union No. 104 - \$12,000,000	1

<p>Item 1 File 20-0042</p>	<p>Department: Real Estate Division Mayor’s Office of Housing and Community Development</p>
<p>EXECUTIVE SUMMARY</p>	
<p style="text-align: center;">Legislative Objectives</p> <ul style="list-style-type: none"> • The proposed resolution would (1) allow the City to purchase 1939 Market Street for \$12 million, (2) place the property under the jurisdiction of the Mayor’s Office of Housing and Community Development, (3) find that the acquisition is consistent with the City’s General Plan and eight priority policies of the Planning Code, (4) authorize the Director of Real Estate to executive documents related to the property acquisition, including a Leaseback Agreement with the seller and assigning the property’s other existing leases and contracts to the City, and (5) affirm the Planning Department’s determination that the purchase is exempt from review under the California Environmental Quality Act (CEQA). <p style="text-align: center;">Key Points</p> <ul style="list-style-type: none"> • The property at 1939 Market is a two-story office building and adjacent paved parking area of approximately 12,050 square feet. The Mayor’s Office of Housing and Community Development (MOHCD) intends to purchase the property and convert it to affordable housing, though it has not yet finalized the design and target population. The affordable housing project’s gap financing and ground lease will be subject to future Board of Supervisors’ approval. • Under the proposed Purchase and Sale Agreement, the City would pay \$12 million to acquire the property at 1939 Market Street. The purchase price is consistent with the appraisal and appraisal review that were completed by independent third-party appraisers contracted by the Real Estate Division. Under the Purchase and Sale Agreement, the City will enter into a Leaseback Agreement with the current owner and assume responsibility for the leases with the three existing tenants through April 2022. The appraisal assumes that the City will receive rents under the Leaseback Agreement and existing leases, which were incorporated into the concluded value in the appraisal report. <p style="text-align: center;">Fiscal Impact</p> <ul style="list-style-type: none"> • The source of the \$12 million purchase of 1939 Market Street is Excess Education Augmentation Revenue funds (ERAF). • Estimated net income from the Leaseback Agreement and existing leases for the two-year period from April 2020 to April 2022 is \$221,876. Any net income from the property would accrue to MOHCD. <p style="text-align: center;">Recommendation</p> <ul style="list-style-type: none"> • Approve the proposed resolution. 	

MANDATE STATEMENT

City Charter Section 9.118(b) states that any contract entered into by a department, board or commission that (1) has a term of more than ten years, (2) requires expenditures of \$10 million or more, or (3) requires a modification of more than \$500,000 is subject to Board of Supervisors approval.

Administrative Code Section 23.3 states that the Board of Supervisors must approve acquisitions of real property by resolution. An appraisal of the property is required if the Real Estate Division determines that the fair market value is greater than \$10,000 and an appraisal review if the fair market value is greater than \$200,000.

Administrative Code Section 23.30 states that the Board of Supervisors shall approve all leases on behalf of the City as landlord by resolution for which the term is longer than a year and costs over \$15,000 per month. The Real Estate Division must obtain an appraisal of the fair market rent if the rent exceeds \$45 per square foot per year and appraisal review if the rent exceeds \$60 per square foot per year.

City Administrative Code Section 23.30 states that leases of City-owned property can be for less than market rent if the lease is for a proper public purpose with Board of Supervisors' approval.

BACKGROUND

Current and Intended Use of 1939 Market Street

The property at 1939 Market is a two-story office building and adjacent paved parking area of approximately 12,050 square feet. The Sheet Metal Workers' International Association Local Union No. 104 ("Sheet Metal Workers Association") is the current owner of 1939 Market Street and one of the building's tenants. The property has three other tenants that lease office space: District Council 16, a labor organization; Dark, Inc., a software company; and The Key PR, a public relations company. The Mayor's Office of Housing and Community Development (MOHCD) intends to purchase the property and convert it to affordable housing, though it has not yet finalized the design and target population. The affordable housing project's gap financing and ground lease will be subject to future Board of Supervisors' approval.

DETAILS OF PROPOSED LEGISLATION

The proposed resolution would (1) allow the City to purchase 1939 Market Street for \$12 million, (2) place the property under the jurisdiction of the Mayor's Office of Housing and Community Development, (3) find that the acquisition is consistent with the City's General Plan and eight priority policies of the Planning Code¹, (4) authorize the Director of Real Estate to

¹ The eight priority policies of the Planning Code are: (1) That existing neighborhood-serving retail uses be preserved and enhanced and future opportunities for resident employment in and ownership of such businesses enhanced; (2) That existing housing and neighborhood character be conserved and protected in order to preserve the cultural and economic diversity of our neighborhoods; (3) That the City's supply of affordable housing be preserved and enhanced; (4) That commuter traffic not impede Muni transit service or overburden our streets or neighborhood parking; (5) That a diverse economic base be maintained by protecting our industrial and service

executive documents related to the property acquisition, including a Leaseback Agreement with the seller and assigning the property's other existing leases and contracts to the City, and (5) affirm the Planning Department's determination that the purchase is exempt from review under the California Environmental Quality Act (CEQA). In January 2020 the Planning Department found that the proposed purchase is exempt from CEQA review and that the project is consistent with the eight priority policies of the Planning Code and the City's General Plan.

Purchase and Sale Agreement

Under the proposed Purchase and Sale Agreement, the City would pay \$12 million to acquire the property at 1939 Market Street. The purchase price is consistent with the appraisal and appraisal review that were completed by independent third-party appraisers contracted by the Real Estate Division, as required by Administrative Code Section 23.3. The appraisal assumes that the City will enter into a Leaseback Agreement with the current owner at \$5,000 per month for 24 months, described below, and that the other three existing tenants will continue to occupy the space and pay rent (shown in Exhibit 2 below).

Leaseback Agreement

Under the proposed Purchase and Sale Agreement, the City would enter into a separate Leaseback Agreement with the current owner, the Sheet Metal Workers Association. Under the proposed Leaseback Agreement, the City would lease the current owner the space it currently occupies at 1939 Market Street for \$5,000 per month for 24 months, as shown below.

Exhibit 1: Proposed Leaseback Terms for 1939 Market Street

Landlord	City
Tenant	Sheet Metal Workers Association
Lease Term	24 months
Rentable Square feet	6,292 square feet
Rent	\$5,000 per month (approximately \$9.54 per square foot per year)
Annual Rent Increase	None
Options to Extend Term	None
Tenant Improvements	None

Source: Proposed Leaseback Agreement

The leaseback period will allow MOHCD to procure a qualified developer to convert the property 1939 Market Street from office space to affordable housing. No material changes to the property would occur until after the 24 month leaseback period.

sectors from displacement due to commercial office development, and that future opportunities for resident employment and ownership in these sectors be enhanced; (6) That the City achieve the greatest possible preparedness to protect against injury and loss of life in an earthquake; (7) That landmarks and historic buildings be preserved; and, (8) That our parks and open space and their access to sunlight and vistas be protected from development.

Existing Leases with Current Tenants

Under the proposed Purchase and Sale Agreement, the City will assume responsibility for the existing leases with the current tenants of 1939 Market Street and enter into a Leaseback Agreement with the owner. The estimated annual rent is \$308,231, as shown below in Exhibit 2. The leases would terminate at the end of the leaseback period in April 2022, resulting in lease rent to the City over the two-year leaseback period of \$616,642.

Exhibit 2: The City’s Leases at 1939 Market Street

Tenant	Annual Rent	Square Feet	\$ per Square Foot
Sheet Metal Workers Association	\$60,000	6,292	\$9.54
District Council 16	88,546	1,849	\$47.89
Dark, Inc.	82,830	1,506	\$55.00
The Key PR, LLC	76,855	1,478	\$52.00
Total	\$308,231	11,125	

Source: MOHCD

As shown above, the rent per square foot of the leaseback agreement with the Sheet Metal Workers Association is \$9.54. According to Mr. Joshua Keene, Special Projects and Transactions Manager at the Real Estate Division, the proposed Leaseback Agreement rent, which is below market rate, was negotiated as part of the final sales price for the property.

The three existing leases have expiration dates of December 31, 2019 for District Council 16; May 31, 2021 for Dark, Inc.; and December 31, 2020 for The Key PR, LLC. According to Ms. Joyce Slen, Project Manager at MOHCD, the City is still finalizing the lease provisions for the three leases that it is taking over from the Sheet Metal Works Association for District Council 16, Dark, Inc., and The Key PR, LLC, including extending the lease terms through April 2022. While Administrative Code Section 23.30 requires appraisals for leases with rent above \$45 per square foot, the appraisal conducted for the purchase of 1939 Market Street assumes that the City will receive rents under the Leaseback Agreement and existing leases, which were incorporated into the concluded value in the appraisal report.

Existing Service Contracts

Under Section 5.1(l) of the proposed Purchase and Sale Agreement, the City may be assigned existing contracts for the following services:

1. Property Management
2. Janitorial
3. Roving Engineer
4. Elevator maintenance
5. Fire alarm testing & annual monitoring
6. Fire sprinkler annual monitoring
7. Water Backflow testing
8. Electric Vehicle Charging Maintenance & Management

- 9. HVAC Maintenance
- 10. Security Monitoring system

According to Ms. Slen, the City is still negotiating with providers for the service contracts noted above.

FISCAL IMPACT

The source of the \$12 million purchase of 1939 Market Street is Excess Education Augmentation Revenue funds (ERAF).

Estimated net income to the City over the two-year leaseback period is \$221,876, as shown in Exhibit 3 below.

Exhibit 3: Property Operating Revenue and Costs

Tenant	April 2020 – April 2021	April 2021 – April 2022	Total
Sheet Metal Workers Local Union	\$60,000	\$60,000	\$120,000
District Council 16	88,546	88,546	177,092
Dark, Inc.	82,830	82,830	165,660
The Key PR, LLC	76,855	76,855	153,710
Total Tenant Revenues (estimated)	\$308,231	\$308,231	\$616,462
Utilities	\$21,300	\$22,046	\$43,346
Taxes	10,000	10,350	20,350
Service Contracts*	162,600	168,291	330,891
Total Operating Expenses (estimated)	\$193,900	\$200,687	\$394,587
Net Income	\$114,331	\$107,545	\$221,876

Sources: Proposed Leaseback Agreement; Current leases with District Council 16, Dark, Inc., and the Key PR, LLC.; MOHCD.

Note: Service Contracts includes the ten service contracts listed above as well as trash removal. Utilities refers to electricity, water, and gas.

As shown above, the total expected rent during the two-year leaseback is \$308,231 per year. Operating expenses total an estimated \$193,900 in the first year of the leaseback period and \$200,687 in the second year of the lease back period, leaving an \$114,331 and \$107,545 in estimated net income in years 1 and 2 of the leaseback period, respectively. Any net income from the property would accrue to MOHCD.

RECOMMENDATION

Approve the proposed resolution.