

## MEMORANDUM

May 4, 2017

**TO:** MEMBERS, PORT COMMISSION  
Hon. Willie Adams, President  
Hon. Kimberly Brandon, Vice President  
Hon. Leslie Katz  
Hon. Eleni Kounalakis  
Hon. Doreen Woo Ho

**FROM:** Elaine Forbes  
Executive Director

**SUBJECT:** Request approval of an Eight (8) Year Lease (No. L-16159) between the Port of San Francisco and IDEO, LP for approximately 26,901 square feet of office space located at the Pier 26 Annex Building, subject to Board of Supervisors' approval

**DIRECTOR'S RECOMMENDATION:** Approve Attached Resolution

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At its meeting on April 11, 2017, the Port Commission heard a presentation regarding approval of a five (5) year lease with IDEO for space at Pier 26 Annex. The Commission had a number of comments regarding the rental rate structure and the assignment of rates to the various parcels within the Premises. This staff report has been amended to reflect the current proposal for an eight (8) year lease with IDEO for approximately 26,901 square feet of space located at Pier 26 Annex. Material updates to the April 11, 2017 memorandum are presented herein as strikethrough and underlined text.

The comments the Port Commission made encouraged Port staff and the management of IDEO to re-evaluate the rate structure and "patchwork" nature of the current lease. For example, currently Parcels A and B comprise an existing lease, which still has a remaining term of four (4) years with a low average rate of \$2.47 per square foot. It was agreed that it is to the benefit of both parties to create a logically succinct lease that meets the needs of both the Port and IDEO. The Port and IDEO have now renegotiated the lease to create a more streamline and functional rate structure. This new lease proposal attempts to eliminate those "patchwork" elements of the last proposal presented to the Port Commission on April 11, 2017, which included a number of parcels within the Premises and separate rates assigned to those parcels. This lease will aggregate all existing parcels into one single parcel with one overall rate for the entire Premises.

Under the current leases the tenant is paying an average rate of \$2.59 per square foot for the entire space. This equates to \$69,774.50 per month in rent, which is \$837,294.00 in annual rent.

Under this proposal, the monthly rate for the entire Premises under the new Lease will be \$3.35 per square foot for the first year and escalate to \$3.60 per square foot in the second year. This equates to a first year monthly rent of \$90,118.35 (\$1,081,420.20 annually). This is a 29.16% increase for the first year of the Lease from the existing rental rate. In year two the monthly rent is again increased to \$96,843.60 (\$1,162,123.20 annually). This represents a 7.46% increase from year one and a collective increase of 36.62% for years one and two of the Lease. The rental rate will be increased by 3% per year thereafter. The current Port approved Parameter Rates for the Premises are between \$3.15 and \$3.75 per square foot. The proposed rate of \$3.35 for year one is in the mid-range of Parameter rates and the \$3.60 for year two is at the high end of the Parameter range.

For the significant increase in the rental rate the Port and IDEO will also agree to a slightly longer lease term of eight (8) years, from the previously proposed five (5) year term. Unlike the requirements under the Retail Leasing Policy that require a retail tenant to make capital improvements to justify an increased term of the lease, the office market is quite different. Private sector office landlords commonly provide tenant improvement allowances to tenants of between \$30 to \$60, sometimes as high as \$95 per square foot. Aside from carpet and paint credits, the Port does not allow for landlord tenant improvement allowances or concessions within its standard leasing policies.

It should be noted that the Premises are compromised by virtue of the seawall running directly under the western border of the Premises. The Port has added very strong language in the new lease allowing the Port unfettered access to the seawall to perform inspections and possibly undertake repairs should they be required.

## **EXECUTIVE SUMMARY**

Port staff requests approval of Lease No. L-16159 ("Lease") between the Port of San Francisco ("Port") and IDEO, LP, a Delaware Limited Partnership ("IDEO"), to renew its office lease at Pier 26 Annex for a term of ~~five (5)~~ eight (8) years.

## **BACKGROUND**

IDEO, a design and innovation consultancy, has leased office space from the Port since the 1990's. IDEO wishes to renew its office lease at Pier 26 Annex for a term of ~~five (5)~~ eight (8) years.

Pier 26 Annex, built between 1928-1930, is located south of the Ferry Building and adjacent to and just north of Pier 28. The Pier 26 Annex building contains approximately 26,901 square feet of pile-supported, enclosed pier space, which IDEO occupies entirely.

The Lease requires approval by the City’s Board of Supervisor (“Board”) under Charter Section 9.118 because rent revenues over the Term will exceed one million dollars (\$1,000,000). All terms and conditions of the Lease, including parameter rental rates, conform to the Port Commission’s previously approved terms and conditions. The Port Commission adopted the current parameter rental rate schedule on July 12, 2016 (Resolution # 16-27).

**STRATEGIC PLAN**

This lease achieves the goals and objective of the Port's Strategic Plan as follows:

**Economic Vitality** - by planning and executing a holistic and balanced strategy to the real estate portfolio and asset management to maximize asset value and income stream to the Port.

**Stability** - by increasing Port revenues to \$125 million and continuing to expand ongoing revenue sources, and by retaining a diversified tenant base that will perform through economic cycles.

**PROPOSED LEASE TERMS**

Port Real Estate staff and representatives of IDEO, LP have negotiated the proposed Lease No. L-16159 providing for the following terms and conditions:

<i>Tenant:</i>	<b>IDEO, LP</b> , a Delaware limited partnership
<i>Premises :</i>	Approximately 26,901 rentable square feet of office at Pier 26 Annex, located on The Embarcadero. <del>consisting of the following:</del> <del>Parcel A: Approx. 12,360 rentable square feet of first floor office space;</del> <del>Parcel B: Approx. 7,074 rentable square feet of first floor office space;</del> <del>Parcel C: Approx. 6,713 rentable square feet of first floor office space; and</del> <del>Parcel D: Approx. 754 rentable square feet of mezzanine office space.</del> and <u>Tenant</u> will also have an non-exclusive right to the north and south stringers adjacent to the Facility and the ramp/staircase on the westerly side of the Facility subject to the same terms and conditions as if they are part of the Premises.
<i>Length of Term:</i>	Five (5) <u>Eight (8)</u> years

<i>Lease and Rent Commencement Date:</i>	The first day of the first calendar month following Tenant and Port execution and after Port Commission and Board of Supervisors' approval.			
<i>Lease Expiration Date:</i>	The last day of the <del>sixtieth (60<sup>th</sup>)</del> <u>ninety sixth (96<sup>th</sup>)</u> month after the Commencement Date.			
<i>Right of First Offer:</i>	At the end of the Term, Tenant shall have a one-time right to make a written offer to extend or renew the Lease. Such extension or renewal is subject to Port Commission and/or Board approval if rent revenues over the term of the new lease, exceed one million dollars (\$1,000,000).			
<i>Monthly Base Rent:</i>	Months	Sq. Ft.	Monthly Base Rate	Total Monthly Base Rent
Parcel A	1-12	12,360	<del>\$3.095/sf</del>	<del>\$38,254.20</del>
Parcel B		<del>7,074</del>	<del>1.373/sf</del>	<del>9,712.60</del>
Parcel C		<del>6,713</del>	<del>3.15/sf</del>	<del>21,146.00</del>
Parcel D		<del>754</del>	<del>3.15/sf</del>	<del>2,375.00</del>
<u>Entire Premises</u>		<u>26,901</u>	<u>\$3.35</u>	<u>\$71,487.80</u>
Parcel A	13-24	12,360	<del>\$3.188/sf</del>	<del>\$39,403.68</del>
Parcel B		<del>7,074</del>	<del>1.414/sf</del>	<del>10,002.64</del>
Parcel C		<del>6,713</del>	<del>3.245/sf</del>	<del>21,783.68</del>
Parcel D		<del>754</del>	<del>3.245/sf</del>	<del>2,446.73</del>
<u>Entire Premises</u>		<u>26,901</u>	<u>\$3.60</u>	<u>\$73,636.73</u>
Parcel A	25-36	12,360	<del>\$3.284/sf</del>	<del>\$40,590.24</del>
Parcel B		<del>7,074</del>	<del>1.457/sf</del>	<del>10,306.82</del>
Parcel C		<del>6,713</del>	<del>3.343/sf</del>	<del>22,441.56</del>
Parcel D		<del>754</del>	<del>3.343/sf</del>	<del>2,520.62</del>
<u>Entire Premises</u>		<u>26,901</u>	<u>\$3.71</u>	<u>\$75,859.24</u>
Parcel A	37-48	12,360	<del>\$3.383/sf</del>	<del>\$41,813.88</del>
Parcel B		<del>7,074</del>	<del>1.500/sf</del>	<del>10,611.00</del>
Parcel C		<del>6,713</del>	<del>3.443/sf</del>	<del>23,112.86</del>
Parcel D		<del>754</del>	<del>3.443/sf</del>	<del>2,596.02</del>
<u>Entire Premises</u>		<u>26,901</u>	<u>\$3.71</u>	<u>\$99,802.71</u>

<u>Entire Premises</u>		<u>26.901</u>	<u>\$3.82</u>	<u>\$78,133.76</u> <u>\$102,761.00</u>
Parcel A	49-60	12,360	\$3.485/sf	\$43,074.60
Parcel B		<del>7,074</del>	<del>1.545/sf</del>	<del>10,929.33</del>
Parcel C		<del>6,713</del>	<del>3.546/sf</del>	<del>23,805.64</del>
Parcel D		<del>754</del>	<del>3.546/sf</del>	<del>2,673.68</del>
<u>Entire Premises</u>		<u>26.901</u>	<u>\$3.94</u>	<u>\$80,483.25</u> <u>\$105,989.94</u>
<u>Entire Premises</u>	61-72	<u>26.901</u>	<u>\$4.06</u>	<u>\$109,218.06</u>
<u>Entire Premises</u>	73-84	<u>26.901</u>	<u>\$4.18</u>	<u>\$112,446.18</u>
<u>Entire Premises</u>	85-96	<u>26.901</u>	<u>\$4.31</u>	<u>\$115,943.31</u>
<i>Security Deposit:</i>	<del>One Hundred Sixty Thousand Nine Hundred Sixty Six and 50/100 Dollars (\$160,966.50) — Two Hundred Thirty One Thousand Eight Hundred Eighty Six Dollars and 62/100 (\$231,886.62)</del>			
<i>Permitted Use:</i>	The Premises shall be used solely for general office use and as a model making workshop.			
<i>Utilities:</i>	Tenant, at its sole cost and expense, shall make arrangements and pay for all Utilities and services to be furnished on, in or to the Premises.			
<i>Maintenance and Repair:</i>	Port is required to maintain the substructure (including the structural portions of the pier underlying the Premises), roof and exterior walls of the Premises, with the exception of all doors, windows and the ramp/staircase on the westerly side of the Facility, which shall be maintained by Tenant. Tenant shall be solely responsible for all other repair and maintenance as further described in the Lease. The overall rating for the substructure for the wood deck area supporting the office building is Green (unrestricted use) except for a 20' x 20' area around a failed pile which is rated Yellow with Green Hatching, restricting load in this area to 40 PSF.			
<i>Seawall:</i>	The Seawall runs underneath the Pier 26 Annex building. In the Lease, the Port reserves the rights to enter and use the Premises as needed for the purpose of inspecting, repairing, and rebuilding the Seawall and/or to terminate the Lease as needed due to the Seawall repair project. These new			

	provisions will be added to all leases that could be impacted by the Seawall Resiliency Project.
<i>Occupancy Limitations:</i>	The Pier 26 Annex building has a maximum occupancy of two hundred eight (208) without additional permitting by the Port's Fire Marshall.
<i>Insurance:</i>	Tenant shall provide insurance coverage acceptable to Port and City Risk Manager.
<i>City Requirements:</i>	The Lease includes provisions requiring Tenant to comply with all applicable City laws (including, but not limited to, Non-Discrimination, First Source Hiring, Health Benefits Coverage, Limitation on Contributions, Prevailing Wages and other applicable laws).
<i>Standard Lease Provisions:</i>	The Lease contains all current lease provisions on the standard form approved by the City Attorney's office including provisions regarding: compliance with laws, Port's Right to Terminate, Indemnity and Exculpation and Hazardous Materials.

**Tenant in Good Standing:** Tenant is a Tenant in Good Standing pursuant to Port Commission policy.

**Environmental Review:** The use is a continuation of existing and related uses and is therefore not a project subject to review under the California Environmental Quality Act.

**RECOMMENDATION**

Port staff recommends that the Port Commission approve proposed Lease No. 16159 between the Port and IDEO, LP and authorize the Executive Director to forward the Lease to the Board of Supervisors for approval and upon the effectiveness of such approval, authorize the Executive Director or designee to execute the Lease.

Prepared by: Elsa Lamb  
Commercial Property Manager

Prepared for: Mark Lozovoy  
Acting Deputy Director of Real Estate

**PORT COMMISSION  
CITY AND COUNTY OF SAN FRANCISCO**

**RESOLUTION NO. 17-18**

WHEREAS, Charter Section B3.581 empowers the Port Commission with the power and duty to use, conduct, operate, maintain, manage, regulate and control the Port area of the City and County of San Francisco; and

WHEREAS, Pier 26 Annex is located south of the Ferry Building and adjacent to and north of Pier 28 in the City and County of San Francisco and has provided IDEO, LP, a tenant in good standing, with leased office space since the mid-1990's; and

WHEREAS, Port Staff has negotiated a new eight (8) year office lease for approximately 26,901 rentable square feet with IDEO, LP, the terms of which are described in the Memorandum to the Port Commission dated May 4, 2017; and

WHEREAS, The use is a continuation of existing and related uses and is therefore not a project subject to review under the California Environmental Quality Act; and

RESOLVED, The Port Commission hereby approves the Lease and authorizes the Executive Director or her designee to forward the Lease to the Board of Supervisors ("Board") for approval, pursuant to the Board's authority under Charter Section 9.118, and upon the effectiveness of such approval, to execute the Lease; and be it further

RESOLVED, that the Port Commission authorizes the Executive Director or her designee, to enter into any additions, amendments or other modifications to the Lease that the Executive Director, in consultation with the City Attorney, determines are in the best interest of the Port, do not materially increase the obligations or liabilities of the Port or materially decrease the public benefits accruing to the Port, and are necessary and advisable to complete the transaction and effectuate the purpose and intent of this Resolution, such determination to be conclusively evidenced by the execution and delivery by the Executive Director of any such documents.

***I hereby certify that the foregoing resolution was adopted by the Port Commission at its meeting of May 9, 2017.***

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**Secretary**