

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: April 17, 2024 Budget and Finance Committee Meeting

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<p>Item 8 File 24-0347</p>	<p>Department: Real Estate Division (RED)</p>
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EXECUTIVE SUMMARY

Legislative Objectives

- The proposed resolution would authorize the Director of Property to execute a lease with Trinity Center, LLC for approximately 45,691 square feet of office space at 1145 Market Street, for a term of approximately 10 years and three months from May 2024 through July 2034, with two five-year options to extend through July 2044, with base annual rent of \$1,368,445, and three percent annual escalation.

Key Points

- The Real Estate Division (RED) has identified space at 1145 Market Street to relocate the Office of Civic Engagement and Immigrant Affairs (OCEIA) and the Drug Market Agency Coordination Center (DMACC) from 1155 Market Street. Additionally, the proposed lease at 1145 Market Street would allow the Department of Public Health (DPH) to consolidate office space from 101 Grove Street (which is seismically unsafe), 101 New Montgomery Street, and 1360 Mission Street into one location.
- An appraisal has determined that the proposed annual rent of \$29.95 per square foot is at or below fair market rent. Of the 45,961 square feet of office space, approximately 27,927 square feet (Floors 9-11) would be occupied by DPH, which would be relocated from 101 Grove Street, 101 New Montgomery Street, and 1360 Mission Street. 11,358 square feet would be occupied by DMACC (Floor 8), which would be relocated from 1155 Market Street. 6,405 square feet would be occupied by OCEIA (Floor 1), which would also be relocated from 1155 Market Street. The lease includes an allowance that is anticipated to be sufficient to cover all costs associated with the move and buildout.

Fiscal Impact

- The proposed lease would have an initial annual rent of \$29.95 per square foot, or \$1,368,445, with three percent escalation. Over the 10-year term of the lease, the City would pay \$15,687,693 in total rent. The City would also pay its percentage share of the increase in the building’s operating expenses over the base year, which are unknown at this time.

Recommendations

- (a) Request the Real Estate Director to amend the lease to require Board of Supervisors approval to exercise the extension options and (b) amend the proposed resolution to state that Board approval is required to exercise any option to extend the lease.
- Approve the proposed resolution, as amended.

MANDATE STATEMENT

City Administrative Code Section 23.27 states that any lease with a term of one year or longer and where the City is the tenant is subject to Board of Supervisors approval by resolution.

BACKGROUND

The City has leased office space at 1155 Market Street since 1999. The City's most recent lease was for 103,501 square feet of office space, which expired on January 31, 2023. The Real Estate Division (RED) negotiated an amended and restated lease for a term of five years, from February 2023 through January 2028, with a five-year option to extend through January 2033. In September 2023, the Board of Supervisors rejected the proposed lease because the initial annual rent of \$64.60 per square foot was likely higher than fair market rent, which had declined in 2022 and 2023 (File 23-0915).

RED has identified office space at 1455 Market Street to relocate most departments from 1155 Market Street (File 24-0312). RED also identified space at 1145 Market Street to relocate the Office of Civic Engagement and Immigrant Affairs (OCEIA) and the Drug Market Agency Coordination Center (DMACC). Additionally, the proposed lease at 1145 Market Street would allow the Department of Public Health (DPH) to consolidate office space from City-owned 101 Grove Street (which is seismically unsafe) and leased space at 101 New Montgomery Street and 1360 Mission Street into one location.¹

DETAILS OF PROPOSED LEGISLATION

The proposed resolution would authorize the Director of Property to execute a lease with Trinity Center, LLC for approximately 45,691 square feet of office space at 1145 Market Street for a term of approximately 10 years and three months from May 2024 through July 2034, with two five-year options to extend through July 2044. The base annual rent would be \$1,368,445, with a three percent annual escalation. The proposed resolution also authorizes the Director of Property to enter into further immaterial amendments to the lease.

Under the draft lease, Board of Supervisors' approval is not required to exercise the optional term extensions. We recommend that the Board request that the lease be amended to require Board approval to exercise the extension options and amend the resolution to state that Board approval is required to exercise any option to extend the lease.

The key terms of the proposed lease are shown in Exhibit 1 below.

¹ The City currently has two leases at 1145 Market Street: (1) Floors 2-4 for the Health Services System (HSS) and Law Library, and (2) Floors 5-7 for the Retirement System (which will be relocated and replaced with the Human Services Agency). RED has submitted resolutions for new leases of these spaces to the Board of Supervisors for future introduction.

Exhibit 1: Key Terms of Proposed Lease

Premises	45,961 square feet on floors 1, 8, 9, 10, and 11
Term	Approx. 10 years and 3 months, from May 2024 through July 2034
Options to Extend	Two 5-year options to extend through July 2044. Rent reset to 95% of fair market value.
Annual Base Rent	\$1,368,445 (\$29.95 per square foot)
Rent Escalation	3% Annually
Tenant Improvement /Moving Allowance	\$266,445
Additional Construction Allowance	\$500,000, if needed
Electrical Costs	City pays Landlord as a passthrough cost without markup
Operating Costs	City pays percentage share of increase in operating costs over base year (2025)

Source: Proposed Lease

An appraisal conducted by Colliers International has determined that the proposed annual rent of \$29.95 per square foot is at or below fair market rent. An appraisal was not required under Administrative Code Section 23.27 because the proposed rent is less than \$45 per square foot.

According to Jeff Suess, Transaction Team Manager, RED anticipates that the tenant improvement and moving allowance of \$266,445 will be sufficient to cover all costs associated with the move and buildout. RED anticipates that improvements will be complete for Floors 1 and 8 in May 2024 and for Floors 9, 10, and 11 in July 2024. Rent would commence for each floor once RED has determined that improvements are substantially complete.

Of the 45,961 square feet of office space, approximately 27,927 square feet (Floors 9-11) would be occupied by DPH, which would be relocated from 101 Grove Street, 101 New Montgomery Street, and 1360 Mission Street. 11,358 square feet would be occupied by DMACC (Floor 8), which would be relocated from 1155 Market Street. 6,405 square feet would be occupied by OCEIA (Floor 1), which would also be relocated from 1155 Market Street.

The current floor plan assumes DMACC will temporarily occupy the 8th floor of 1145 Market through June 2025, after which DPH staff currently renting office space at 1360 Mission will move in.

FISCAL IMPACT

The proposed lease would have an initial annual rent of \$29.95 per square foot, or \$1,368,445, with three percent annual escalation. Over the 10-year term of the lease, the City would pay

\$15,687,693 in total rent.² If an option to extend the term is exercised, the rent for the extension term would be set at 95 percent of fair market rent at that time.

Under the lease, the City would pay its percentage share of the increase in the building's operating expenses over the base year. Based on the percentage of leased premises in the building, the percentage share is 34.97 percent. The base year would be calendar year 2025, so the City would begin paying operating costs in 2026. RED cannot estimate the operating costs at this time. The City would also pay electrical costs as a direct passthrough from the landlord. RED estimates that initial annual electrical costs are approximately \$1 per square foot, or \$45,961.

Rent would be paid by the various City departments occupying the leased space. Costs would primarily be funded by the City's General Fund.

RECOMMENDATIONS

1. (a) Request the Real Estate Director to amend the lease to require Board approval to exercise the extension options and (b) amend the proposed resolution to state that Board approval is required to exercise any option to extend the lease.
2. Approve the proposed resolution, as amended.

² This amount excludes rent during the phased move-in period from May through July 2024.