File No. 100692

Committee Item No. 3
Board Item No. _____

COMMITTEE/BOARD OF SUPERVISORS

AGENDA PACKET CONTENTS LIST

Committee: Budget and Finance Committee **Date:** October 13, 2010

Board of Supervisors Meeting **Date** _____

Cmte	Board	
☐	☐	**Motion**
☒	☐	**Resolution**
☐	☐	**Ordinance**
☐	☐	**Legislative Digest**
☒	☐	**Budget Analyst Report**
☐	☐	**Legislative Analyst Report**
☒	☐	**Ethics Form 126**
☐	☐	**Introduction Form (for hearings)**
☐	☐	**Department/Agency Cover Letter and/or Report**
☐	☐	**MOU**
☐	☐	**Grant Information Form**
☐	☐	**Grant Budget**
☐	☐	**Subcontract Budget**
☒	☐	**Contract/Agreement** Lease No. L-14796 **
☐	☐	**Award Letter**
☐	☐	**Application**
☐	☐	**Public Correspondence**

OTHER **(Use back side if additional space is needed)**

☐	☐	_____
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☐	☐	_____
☐	☐	_____

Completed by: Victor Young **Date:** October 8, 2010
Completed by: Victor Young **Date:** _____

An asterisked item represents the cover sheet to a document that exceeds 25 pages. The complete document is in the file.

[Lease of Port Real Property - Pier 26 Annex]

Resolution approving Port Commission Lease No. L-14796 with IDEO, LLC for office space located at Pier 26 Annex within the Southern Waterfront with a sixty month term and a sixty month option.

WHEREAS, California Statutes of 1968, Chapter 1333 (the "Burton Act") and the San Francisco Charter Section 4.114 and 33.581 empower the San Francisco Port Commission ("Port Commission") with the power and duty to use, conduct, operate, maintain, manage, regulate and control the lands within Port Commission jurisdiction; and

WHEREAS, IDEO, LLC has occupied premises at Pier 26 Annex for over fifteen years; and

WHEREAS, IDEO, LLC requested a lease renewal, which would increase its current lease premises, containing approximately 12,360 square feet, by the addition of approximately 7,074 square feet of predominantly work shop and storage shed space that IDEO, LLC would renovate into office space at its sole expense; and

WHEREAS, The Port negotiated a lease renewal with an initial term of sixty (60) months with one sixty (60) month extension option wherein IDEO, LLC will renovate the 7,074 square feet of expansion area into office space at its sole expense with the cost of renovation estimated in excess of $900,000 (the 'Lease"), a copy of which is on file with the Clerk of the Board In File No. 100692; and

WHEREAS, The net lease has an initial monthly rent of $32,136.00 ($2.60 per sq. ft.) for the 12,360 square feet of existing lease premises and $8,135.10 ($1.15 per sq. ft.) for the 7,074 square feet of expansion lease premises for a total monthly rent of $40,271.10; and

WHEREAS, San Francisco Charter Section 9.118 requires Board of Supervisors approval of real property leases with terms of ten (10) or more years, including extension options, or having anticipated revenue to the City of One Million Dollars ($1,000,000.00) or more; and

WHEREAS, This Lease may have a lease term of ten (10) years and the revenue will exceed One Million Dollars ($1,000,000.00); now, therefore, be it

RESOLVED, That the Board of Supervisors approves the Lease; and, be it

FURTHER RESOLVED, That the Board of Supervisors authorizes the Executive Director of the Port (the "Executive Director") to execute the Lease in a form approved by the City Attorney and in substantially the form of the lease on file with the Clerk of the Board of Supervisors; and, be it

FURTHER RESOLVED, That the Board of Supervisors authorizes the Executive Director to enter into any additions, amendments or other modifications to the Lease (including, without limitation, preparation and attachment of, or changes to, any or all of the exhibits and ancillary agreements) that the Executive Director, in consultation with the City Attorney, determines is in the best interest of the Port, do not alter the rent or the Port's projected income from the Lease, do not materially increase the obligations or liabilities of the Port or City or materially decrease the public benefits accruing to the Port, and are necessary or advisable to complete the transactions contemplated 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; and, be it

FURTHER RESOLVED, That the Board of Supervisors approves, and ratifies all prior actions taken by the officials, employees and agents of the Port Commission, or the City with respect to the Lease.

File No. 100692

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, SF Board of Supervisors	City elective office(s) held: Members, SF Board of Supervisors

Contractor Information *(Please print clearly.)*	
Name of contractor: **IDEO, 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) Board of directors - James P. Hackett; David M. Kelley, James P. Keane, Tim Brown and Mark A. Baker (2) Tim Brown – CEO; David Strong, CFO/COO (3) Steelcase Inc. owns more than 20% of IDEO. (4) none (5) none	
Contractor address: 100 Forest Avenue, Palo Alto, CA 94301	
Date that contract was approved:	Amount of contract: $1,245,102.50 over the initial 60 months
Describe the nature of the contract that was approved: Renewal of an existing lease, which shall increase the lease premises, for IDEO's lease at Pier 26 Annex, San Francisco.	
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: 1 Dr Carlton B Goodlett Pl., SF 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

Item 3 File 10-0692	Department: Port

EXECUTIVE SUMMARY

Legislative Objectives

- Resolution approving a five-year lease renewal, with one five-year option to extend between the Port and the existing tenant, IDEO, LLC (IDEO), for expanded office space at Pier 26 Annex on the Embarcadero.

Key Points

- Without conducting a competitive process, the Port entered into an office space lease with IDEO at the Pier 26 Annex in 1995, for five years, from October 1, 1995 through September 30, 2000. The Port subsequently approved three lease renewals with IDEO, including three holdover periods, none of which were competitively bid. The term of the existing lease expired on December 31, 2006, and has continued on a month-to-month basis for over 45 months. Currently, IDEO pays base rent of $31,765 per month for 12,360 square feet of office space, or approximately $2.57 per square foot per month. When the lease was awarded in 1995, IDEO paid to the Port $0.38 per square foot per month.

- The Port is proposing to award a sole-source lease renewal to IDEO, without conducting a competitive process, for (a) an initial term of five years, (b) an option to extend the term by five years, (c) monthly rent of (i) $2.60 per square foot (approximately $0.03, or 1.17 percent, increase from the existing rental rate of $2.57 per square foot per month) for the same 12,360 square feet of existing office space and (ii) $1.15 per square foot for 7,074 square feet of additional space or a base rent of $40,271 per month in the first year, (d) annual 3.0 percent rent increases, and (e) required capital improvements by IDEO, estimated to be $900,000.

Fiscal Impact

- Under the proposed lease renewal, the monthly base rent would increase by $8,506, or 26.8 percent, from $31,765 to $40,271 per month in the first year, increasing by three percent in each of the subsequent four years. IDEO would pay the Port total rent of $2,518,146 over the initial five-year lease renewal agreement (December 1, 2010 through November 30, 2015).

- The increase in the monthly base rent is primarily due to the increase of 7,074 square feet of rental space, or 57.2 percent more office space. The increase in monthly rent for the existing offices space is approximately $0.03, or a 1.17 percent increase.

Policy Considerations

- The Port Commission routinely finds that it is impractical to competitively bid leases for office, warehouse, maritime and open space because of the availability of such space at competitive rates near Port property.

- Pursuant to Section 2.6-1 of the City's Administrative Code, prior to approving the proposed lease, the Board of Supervisors is required to make a determination as to whether or not it was impractical to award the proposed IDEO lease through a competitive process.

- The proposed new lease includes a holdover provision wherein the Port could allow the lessee, IDEO, to continue to lease the premises indefinitely on a month-to-month basis after either the (a) initial five-year lease term expires or (b) if the option to extend the lease is exercised, after the total ten-year lease term expires. If such events were to occur, the monthly base rent could increase by (a) $22,706, or 50 percent, from $45,411 to $68,117 after the initial five-year lease term expires, or (b) $26,833, or 50 percent from $53,666 to $80,499 after ten years. However, if the Port and IDEO continue the lease on a month-to-month basis due to the Port's delay, then the monthly rent would not necessarily increase by 50 percent, but rather by the higher of (a) the monthly rent paid to the Port immediately preceding the expiration of the lease or (b) a different rental rate, as approved by the Port Commission.

Recommendations

- Approval of the proposed resolution is a policy matter for the Board of Supervisors because the proposed lease renewal, which was awarded on a sole-source basis, was not subject to a competitive process.
- If the Board of Supervisors approves the proposed resolution, amend the proposed resolution to (a) include a finding to be made by the Board of Supervisors that it is impractical to competitively bid this lease for office space because of the availability of such space at competitive rates near Port property, and (b) require that the Port, at the end of the proposed lease, submit a written report to the Board of Supervisors, no later than 90 days after the termination of the lease term, as to the Port's plan for the future status of this lease including (i) existing rental rates and revenues, (ii) final amount and amortization of the capital improvements, (iii) proposed rental rates and revenues, (iv) length of time the Port anticipates the existing lease will continue on a month-to-month basis with the existing lessee, without undergoing a new competitive process, and (v) explanation of why the Port has delayed executing a lease, which would otherwise be subject to Board of Supervisors approval if the proposed new lease would be more than ten years or generates anticipated revenues of $1,000,000 or more.

MANDATE STATEMENT & BACKGROUND

Mandate Statement

Charter Section 9.118(c) requires that any lease for a period of ten or more years, including options to renew, or with anticipated revenues of $1,000,000 or more be subject to approval of the Board of Supervisors.

Section 2.6-1 of the City's Administrative Code requires that leases of City property submitted to the Board of Supervisors for approval, except where the Board of Supervisors finds that the bidding procedures are "impractical or impossible", must have been awarded to the highest

responsible bidder in accordance with competitive bidding procedures. The terms impractical and impossible are not defined in the Administrative Code.

The proposed new lease would be awarded, on a sole-source basis, to the existing lessee through direct negotiations rather than through a competitive process.

Holdover Lease Project

In January of 2008, the Port implemented a Holdover Lease Project, to reduce the number of Port leases which had expired and continued on a month-to-month basis under the "holdover" provisions of their leases. According to Mr. Brad Benson, Special Projects Manager for the Port:

> "Since the beginning of the Port's Holdover Lease Project, forty nine (49) agreements have been renewed, entered into or amended with existing Port tenants, which have resulted in an increase of $221,497 in monthly revenues. When tenants chose not to enter a new term lease, Port staff increased rents consistent with rental rate charges approved by the Port Commission. Fifty-eight (58) rent increase letters have been sent, which have resulted in an increase of $37,517 in monthly revenues. Finally, thirty-six (36) agreements have been terminated (largely because tenants refused new term leases), resulting in a decrease of $9,796 in monthly revenues.[1]"

Previous and Existing Leases of Pier 26 Annex

IDEO, LLC (IDEO), a design consulting firm, began leasing 12,360 square feet of office space at the Pier 26 Annex, located at Bryant and Embarcadero, in 1995, with an original lease term of five years, from October 1, 1995 through September 30, 2000. According to Mr. Jerry Romani, Commercial Property Manager from the Port, IDEO was awarded this lease without a competitive bidding process because at the time of the original lease, the Port had a large amount of vacant shed space and IDEO proposed to convert the vacant shed space at Pier 26 Annex into commercial office space, with IDEO funding the capital investment in the Port's property, thereby increasing both the value of the space and potential future rent rate. According to Mr. Romani, IDEO paid the Port market rent for the original five-year lease of $0.38 per square foot per month, subject to annual Consumer Price Index (CPI) increases for the shed space during the original five year lease, to allow IDEO to amortize its capital improvement costs from converting the shed space into commercial office space.

According to Mr. Romani, a specific amount of capital investment that IDEO would contribute to convert the Port's shed space into office space was not included in the original IDEO lease. The Port also did not require IDEO to report the amount of such capital investments. Based on statements by IDEO, Mr. Romani advises that IDEO invested an estimated $1,100,000 in the existing office space.

The term of the original Port and IDEO lease, lease renewals and subsequent hold over periods are summarized in Table 1 below.

[1] The Budget and Legislative Analyst notes that based on the Port's data, the Port's Holdover Lease Project has resulted in $2,990,616 of additional annual revenues, including (a) $2,657,964 from the 49 renewed or amended leases, (b) $450,204 from the 58 increased rental leases, offset by (c) $117,552 reduction from 36 terminated leases.

Table 1: Summary of IDEO Lease, Renewals and Hold Over Terms

	Term Period	Months	Years
Lease	January 1, 1996 through December 31, 2000	60	5
Hold Over	January 1, 2001 through January 10, 2001	Less than 1 month	Less than .08
Lease	January 11, 2001 through July 10, 2002	18	1.5
Lease	July 11, 2002 through January 11, 2004	18	1.5
Hold Over	January 12, 2004 through January 31, 2004	Less than 1 month	Less than .08
Lease	February 1, 2004 through December 31, 2006	35	Approx. 3
Hold Over	January 1, 2007 to November 30, 2010	Approx. 45	3.75
	Total	**Approx. 180**	**Approx. 15**

Source: Port

As shown in Table 1 above, the Port entered into three subsequent leases with IDEO, and held over each lease with IDEO on a month-to-month basis, extending for approximately 15 years. Although the Port has been renting the same rental space to the same tenant for almost 15 years, none of the previous leases required Board of Supervisors approval because the lease terms were less than ten years and resulted in revenues of less than $1,000,000.

In addition to awarding the original lease on a sole-source basis, without undergoing a competitive process, Mr. Romani advises that the Port also did not competitively bid the subsequent three leases in 2001, 2002 or 2004 with IDEO because the tenant had a positive history of rental payments and regulatory compliance. In addition, the Port found that it was impractical to competitively bid office space due to the availability of comparable office space near Port property.

As shown in Table 2 below, the existing lease with IDEO has been subject to annual increases according to the Consumer Price Index, ranging from 0.0 percent to 5.1 percent. However, the Budget and Legislative Analyst notes that there are two periods where the rental rate significantly increased or decreased from the previous year's rental rate.

Beginning on January 1, 2001, the rental rate increased approximately 902.3 percent from $0.44 per square foot per month in 2000 to $4.41 per square foot per month in 2001, as shown in Table 2 below. As previously stated, IDEO's capital investments in the shed space were amortized during the original five-year lease period. Mr. Romani advises that January 1, 2001 represents the beginning of a new lease, in which IDEO paid market rental rate for office space. However, according to Mr. Romani, immediately after the 2001 period, because of the economic recession, IDEO and the Port negotiated a new lease with a rental rate that was approximately 49.4 percent less than the previous rental rate of $4.41 in 2001. In addition, Mr. Romani advises that the significant drop from an annual adjustment of 3.7 percent in 2008 to 1.6 percent in 2009 was due to the economy.

Table 2: Summary of IDEO Rental Rates and Annual Rent Revenue for 12,360 square feet of space from January 1, 1996 through November 30, 2010

Annual Revenue period	Approximate Rental Rate per Square Foot	Actual Annual Revenue	Percent Change in Approximate Rental Rate
January 1, 1996 through September 30, 1996	$0.38	$ 42,271	
October 1, 1996 through September 30, 1997	$0.38	$ 56,963	0.0%
October 1, 1997 through September 30, 1998	$0.39	$ 58,824	2.6%
October 1, 1998 through September 30, 1999	$0.41	$ 61,529	5.1%
October 1, 1999 through September 30, 2000	$0.42	$ 63,988	2.4%
October 1, 2000 through December 31, 2000	$0.44	$ 16,272	4.8%
January 1, 2001 through December 31, 2001	$4.41	$653,520	902.3%
January 1, 2002 through December 31, 2002	$2.23	$493,740	-49.4%
January 1, 2003 through December 31, 2003	$2.26	$332,104	1.3%
January 1, 2004 through December 31, 2004	$2.26	$335,646	0.0%
January 1, 2005 through December 31, 2005	$2.31	$340,457	2.2%
January 1, 2006 through December 31, 2006	$2.36	$349,572	2.2%
January 1, 2007 through December 31, 2007	$2.44	$355,583	3.4%
January 1, 2008 through December 31, 2008	$2.53	$370,855	3.7%
January 1, 2009 through December 31, 2009	$2.57	$378,130	1.6%
January 1, 2010 through November 30, 2010	$2.57	$349,417*	0.0%

Source: Port
*This is the projected estimate.

As shown in Table 2 above, under the terms of the existing lease, from January 1, 2010 through November 30, 2010, IDEO currently pays the Port $2.57 per square foot per month, for 12,360 square feet, or approximately $31,765 monthly or $349,417 for 11 months.

As shown in Table 1 above, the term of the existing lease expired on December 31, 2006, and has been extended on a month-to-month basis since January of 2007, or for over 45 months under the holdover provisions in the lease. According to Mr. Romani, IDEO approached the Port in November 2008 stating it needed to expand their existing premises to meet the projected growth of their business. According to Mr. Romani, IDEO stated that if additional space were not provided, IDEO would vacate the Port premises and relocate their business off of Port property. Mr. Romani advises that he does not have information for why IDEO remained on holdover from January 2007 to November 2008.

According to Mr. Romani, the Port believed it could offer IDEO adjacent expansion space, which is currently occupied by City Building, a private general contracting, construction management, and design build firm. However, Mr. Romani advises that it has taken longer than expected to negotiate the lease terms for the expansion premises between the Port, the existing tenant, City Building, and the proposed tenant, IDEO. According to Mr. Romani, City Building

will probably continue to lease reduced space in the Pier 26 Annex and may lease additional space in nearby Port property.

Pursuant to the terms of IDEO's holdover policy in its existing lease, during a holdover period, the Port can charge IDEO a rental rate of 50 percent more than the last rental rate under the terms of its lease, which was $2.33 per square foot. However, the holdover policy also states that if the Port and the tenant desire to enter into a new lease agreement or extend the existing agreement, but have not done so due to the Port's delay to produce such a document, the monthly rent during such a holdover period would be the higher of (a) the base rent payable to the Port immediately preceding the expiration of the lease or (b) the current rate for the space approved by the Port Commission. Mr. Romani advises that the flexible conditions in the holdover policy allow the Port the ability to retain tenants at above market rental rates during tough economic times. Mr. Romani advises that IDEO's rental rates during its current holdover period are within the rental rate schedule[2] approved by the Port Commission, which are based on market rates.

DETAILS OF PROPOSED LEGISLATION

The proposed resolution would approve a sole-source lease renewal between the Port, as the lessor, and IDEO as the lessee, for 12,360 square feet of existing office space, and 7,074 square feet of additional space (expansion space) to be renovated into office space, for a total of 19,434 square feet of space at the Pier 26 Annex. The term of the proposed lease is five years, from a projected start date of December 1, 2010 through November 30, 2015, with one five-year option to extend the term until November 30, 2020.

Under the proposed lease renewal, IDEO would be required to pay the Port a monthly base rent during the first year of (a) $2.60 per square foot for 12,360 square feet of existing office space, which is an increase of $0.03 per square foot per month over the existing rent, or a 1.17 percent increase, and (b) $1.15 per square foot for 7,074 square feet of additional space (expansion space). As shown in Table 3 below, the proposed lease renewal would increase the monthly base rent by $8,506, or 26.8 percent, from $31,765 to $40,271 per month.

The increase in the monthly base rent is primarily due to the increase of 7,074 square feet of rental space, or 57.2 percent more office space, while the increase in the monthly rent for the existing offices space is only 1.17 percent.

According to Mr. Romani, after the proposed initial lease term of five years expires, the tenant could (a) exercise the option to extend the lease term for an additional five years or (b) enter into direct negotiations with the Port for another sole-source lease renewal.

However, the proposed lease renewal includes a holdover provision wherein the Port could allow the lessee, IDEO, to continue to lease the premises indefinitely on a month-to-month basis (see Policy Considerations Section below).

[2] In June 2010, the Port Commission approved rental rates of $2.50 to $2.90 per square foot per month for office space in Pier 26 Annex.

FISCAL IMPACTS

Table 3 below compares the current and proposed leases.

Table 3: Comparison of Current and Proposed Leases

	Current Expired Lease Continued on a Month-to-Month Basis	Proposed Lease	Change
Base Rent Rate Existing Space	$2.57 per square foot	$2.60 per square foot	Increase of $0.03 per square foot, or 1.17%
Base Rent Rate Expansion Space	N/A	$1.15 per square foot	$1.15 per square foot
Annual Increase in Base Rent Rate	According to Consumer Price Index	3% per year	-
Square Footage Subject to Base Rent	12,360 square feet	19,434 square feet	Increase of 7,074, or 57.2%
Monthly Base Rent	$31,765	$40,271 in the First Year	Increase of $8,506, or 26.8%

As shown in Attachment I, page 2, provided by the Port, the proposed rental rate of $2.60 per square foot per month for the existing 12,360 square feet of office space is within the Port Commission's approved rate of $2.50 to $2.90 for office space in the Pier 26 Annex. The Budget and Legislative Analyst notes that the $2.60 proposed rent for the existing space is a 1.17 percent increase from the existing rental rate of $2.57. As shown on page 1 of Attachment I, the proposed rental rate of $1.15 per square foot per month for the expansion space is higher than the approved Port Commission's rental rates of $0.75 to $1.00 for comparable shed space in Piers 26-28.

In addition, the 7,074 square feet of expansion space is currently leased by City Building for a monthly rental rate of $0.52 per square foot. Therefore, the proposed rental rate of $1.15 for IDEO is $0.63, or 121 percent greater than the existing rate paid by City Building.

The proposed lease includes required capital improvements to be paid by IDEO for the 7,074 square feet of expansion space. As stated in the lease, the "tenant estimates the cost of the [sic] work to be $900,000." Further the lease states that, "At the Port's request, the Tenant shall provide Port with a breakdown of its total" work.

During the first six months of the lease in which capital improvements are made, the rental payments of $1.15 per square foot per month for the 7,074 square feet of expansion space would

be waived,[3] which is equivalent to $48,810 ($1.15 per square foot times 7,074 square feet times six months). Therefore, IDEO will be making an estimated net capital contribution of $851,190 ($900,000 less $48,810) to the Port property through the required capital improvements. Mr. Romani advises that the capital improvements will be amortized over ten years. The estimated net cost of $851,190 for the capital improvements is equivalent to a rental rate of approximately $1.00 per square foot per month over the ten-year, or 120-month term ($851,190 divided by 7,074 square feet divided by 120 months). Therefore, the effective rental rate for the expansion space would then be $2.15 ($1.00 plus the $1.15 base rental rate) over a ten-year term.

As shown in Table 3 above, the proposed lease would provide monthly base rent in the first year of $40,271, an increase of $8,506, or 26.8 percent, more than the current monthly base rent of $31,765 for an increase of 7,074 square feet of space, or 57.2 percent more office space. As also shown in Table 4 below, with the first six months of rent waived for the 7,074 square feet of expansion space, total rental revenue in the first year is an estimated $434,442, which is $53,262, or approximately 14.0 percent, more than the estimated annual rental rate of $381,180 ($31,765 times 12 months) under the existing lease. However, the increase in the monthly base and annual rent is primarily due to the increased rental space, while the increase in monthly rent for the existing offices space is approximately $0.03, or a 1.17 percent increase.

As shown in Table 4 below, the proposed five-year lease renewal agreement (December 1, 2010 through November 30, 2015) would require IDEO to pay the Port rental revenues of $2,518,146, while investing an additional estimated $900,000 of capital improvements to convert 7,074 square feet of Port shed space to commercial office space. As also shown below in Table 4, if the Port and IDEO exercise the five-year option to extend the proposed lease through November 30, 2020 IDEO would pay the Port estimated rental revenues of $5,555,922 over the ten-year period.

[3] The lease states that rent for the expansion space would begin upon the earliest of (a) expiration of 180 days from delivery of the expansion space to IDEO and the issuance of the Port Building permit for capital improvement; (b) substantial completion of the capital improvement and the date of issuance of the Certificate of Completion for the capital improvement by the Port; or (c) expiration of 360 days from the Lease Commencement Date. According to Mr. Romani, the 360 day deadline is a firm deadline in the event there are delays in issuing a Port Building permit or other delays. However, Mr. Romani advises that IDEO is highly motivated to move forward and complete the capital improvement work and anticipates a six month construction period. Therefore, the Budget and Legislative Analyst estimates a six-month period in which rent to the Port is waived for the analysis in this report.

Table 4: Rents Payable to the Port Over the 10 Year Lease

Lease Year	Monthly Base Rent (existing 12,360 sq feet)	Monthly Base Rent[4] (expansion of 7,074 sq feet)	Total Monthly Base Rent	Total Annual Base Rent
1	$32,136	$8,135	$40,271	$434,442[5]
2	33,125	8,347	41,472	497,664
3	34,114	8,630	42,744	512,928
4	35,102	8,913	44,015	528,180
5	36,215	9,196	45,411	544,932
			Subtotal	$2,518,146
6[6]	38,026	9,656	47,682	572,184
7	39,166	9,946	49,112	589,344
8	40,341	10,244	50,585	607,020
9	41,552	10,551	52,103	625,236
10	42,798	10,868	53,666	643,992
			Total	**$5,555,922**

POLICY CONSIDERATIONS

The proposed new lease was not competitively bid.

Pursuant to Section 2.6-1 of the City's Administrative Code, prior to approving the proposed lease, the Board of Supervisors is required to make a finding as to whether or not it was impractical to award the proposed IDEO lease through a competitive process, prior to any approval of such a lease. The proposed resolution does not provide for such a finding.

Mr. Benson advises that when the Port Commission makes such a finding, such a determination is included in subsequent lease resolutions to be submitted to the Board of Supervisors. However, Mr. Benson advises that the Port Commission did not include this finding in the proposed resolution because of staff oversight.

According to Mr. Benson, the Port Commission, based on staff reports, routinely finds that it is impractical to competitively bid leases for office space because of the availability of such space near Port property. As shown on page 3 of Attachment II, a memo from Mr. Benson, the Port believes that "most office [sic] users need to secure space in a short period of time and require

[4] Monthly Base Rent includes a 3% annual increase, as required in the proposed lease.

[5] Because the lease would waive rent payments for up to 6 months during the construction period of the required capital improvements for 7,074 square feet of expansion space, the total annual base rent in the first year is $434,442 [(12 x $32,136) plus (6 x $8,135)].

[6] According to the terms of the proposed lease, the monthly base rent in the first year of the lease extension (year six) would be the lesser of (a) 105% of the monthly base rent in year five of the lease or (b) the product of the monthly base rent in year five and the difference between the CPI published during the ninth month of year five and the CPI published during the ninth month of year four. The estimates in the table above assume a 5% increase in the monthly base rent in year six. Subsequent years include a 3% annual increase, as required in the proposed lease.

certainty about relocation plans…Except during periods of extremely low commercial vacancy rates in San Francisco, office [sic] space is ubiquitous both in the City and proximate to Port property." Mr. Benson also states that, "the only result of competitive bidding for [office] space would be to create an uncertain environment for prospective commercial tenants, thus creating an incentive for them to look elsewhere for their space needs." In addition, Mr. Benson provided examples of vacant space near Port property with rental rates ranging from $2.00 to $2.92 per square foot per month, as shown in Attachment II, page 5 (the $1.15 rental rate for the expansion space is for shed space).

As previously stated, the Port entered into an original lease and three subsequent leases with IDEO, and held over each lease with IDEO on a month-to-month basis, extending for approximately 15 years. Although the Port has been renting the same rental space to the same tenant for almost 15 years, none of the previous leases required Board of Supervisors approval because the lease terms were less than ten years and resulted in revenues of less than $1,000,000.

In addition to awarding the original lease on a sole-source basis, without undergoing a competitive process, Mr. Romani advises that the Port also did not competitively bid the subsequent three leases in 2001, 2002 or 2004 with IDEO because the tenant had a positive history of rental payments and regulatory compliance. In addition, the Port found that it was impractical to competitively bid office space due to the availability of comparable office space near Port property.

The Budget and Legislative Analyst would typically recommend that any lease renewal be subject to a competitive selection process. However, if the Board of Supervisors agrees with the Port Commission's finding that it is impractical to competitively bid this specific lease for office space because of the availability of such space at competitive rates near Port property, then the Budget and Legislative Analyst recommends amending the proposed resolution to include such a finding to be made by the Board of Supervisors for the specific lease.

Mr. Benson advises that the Port tries to competitively bid Port retail spaces, such as restaurants or retail stores. The Port Commission adopted a Leasing Policy to determine when it is impractical and impossible to award retail leases through a competitive process, which was not subject to Board of Supervisors approval.

The proposed lease includes a holdover provision which would allow the Port to extend the lease indefinitely, with the current lessee, IDEO, after the proposed lease expires, without further approval by the Board of Supervisors.

The proposed new lease includes a holdover provision wherein the Port could allow the lessee, IDEO, to continue to lease the premises indefinitely on a month-to-month basis after the (a) initial five-year lease term expires or (b) if the option to extend the lease is exercised, after the total ten-year lease term expires. If such events were to occur, the monthly base rent could increase by (a) $22,706, or 50 percent, from $45,411 to $68,117 after the initial five-year lease term expires, or (b) $26,833, or 50 percent from $53,666 to $80,499 after the total ten-year lease term expires. However, the proposed lease also provides that if the Port and IDEO continue the lease on a month-to-month basis due to the Port's delay, then the monthly rent would not necessarily increase by 50 percent, but rather the Port would have the discretion to charge IDEO

the higher of (a) the monthly rent paid to the Port immediately preceding the expiration of the lease or (b) a different rental rate approved by the Port Commission. The different rental rate is not subject to Board of Supervisors approval.

According to Mr. Romani, the holdover provision in this lease, as well as all other Port commercial leases, benefits the City by providing flexibility during adverse real estate conditions or when the use of the property is in transition. Although Mr. Romani stated that after the initial five-year term of the proposed lease expires, the Port could either (a) exercise the option to extend the lease by five years, or (b) enter into direct negotiations with IDEO for another sole-source lease renewal, the Budget and Legislative Analyst notes that the proposed lease does not limit the duration of the holdover period, such that the lease could continue indefinitely with the same lessee, IDEO.

Therefore, if the Board of Supervisors approves the proposed resolution, amend the proposed resolution to require that the Port, at the end of the proposed lease, submit a written report to the Board of Supervisors, no later than 90 days after the termination of the lease term, as to the Port's plan for the future status of this lease including (a) existing rental rates and revenues, (b) final amount and amortization of the capital improvements, (c) proposed rental rates and revenues, (d) length of time the Port anticipates the existing lease will continue on a month-to-month basis with the existing lessee, and (e) explanation of why the Port has delayed executing lease documents, which would be otherwise subject to Board of Supervisors approval if a proposed new lease would be more than ten years or generates anticipated revenues of $1,000,000 or more.

RECOMMENDATIONS

1. Approval of the proposed resolution is a policy matter for the Board of Supervisors because the proposed lease renewal, which was awarded on a sole-source basis, was not subject to a competitive process.

2. In accordance with Section 2.6-1 of the City's Administrative Code, if the Board of Supervisors approves the proposed resolution, amend the proposed resolution to (a) include a finding to be made by the Board of Supervisors that it is impractical to competitively bid this lease for office space because of the availability of such space at competitive rates near Port property, and (b) require that the Port, at the end of the proposed lease, submit a written report to the Board of Supervisors, no later than 90 days after the termination of the lease term, as to the Port's plan for the future status of this lease including (i) existing rental rates and revenues, (ii) final amount and amortization of the capital improvements, (iii) proposed rental rates and revenues, (iv) length of time the Port anticipates the existing lease will continue on a month-to-month basis with the existing lessee, and (v) explanation of why the Port has delayed executing lease documents, which would be otherwise subject to Board of Supervisors approval if a proposed new lease would be more than ten years or generates anticipated revenues of $1,000,000 or more.

   Mr. Benson advises that the Port agrees with the Budget and Legislative Analyst's recommended amendments to the proposed resolution.

Exhibit C

TYPE OF USE & TYPE OF LEASE	CLASS & LOCATION OF FACILITY/SPACE	MINIMUM INITIAL LEASE RENTAL RATES Monthly Per Sq. Ft.	NET EFFECTIVE RENTAL RATES Monthly Per Sq. Ft.*
INDUSTRIAL SHED USES:			
INDUSTRIAL GROSS LEASES:	NORTHEAST WATERFRONT		
	Pier 9	$1.25 - 1.25	$1.25 - 1.25
	Pier 33 – 35	$0.75 - 0.85	$0.70 - 0.80
	Pier 19	$0.60 - 0.75	$0.75 - 0.70
	Pier 23	$0.70 - 0.80	$0.65 - 0.75
	Pier 27 & 29	$0.70 - 0.80	$0.70 - 0.80
	Pier 47 shed storage	$0.75 - 1.00	$0.70 - 0.90
	SWL 302 storage	$0.75 - 1.00	$0.65 - 0.75
	SOUTH BEACH/CHINA BASIN		
	Pier 24 Annex	$1.18 1.25	$1.18 1.25
	Piers 26-28	$0.75 - 1.00	$0.75 - 1.00
	Piers 48	$0.85 - 1.10	$0.85 - 1.00
	Pier 50	$0.75 - 1.00	$0.65 - 0.75
	Pier 54 Shed	$0.60 - 0.75	$0.60 - 0.75
	SOUTHERN WATERFRONT		
	SWLs 343 & 354	$0.75 - 0.85	$0.80 - 0.75
	SWL 345	$0.75 - 1.00	$0.70 - 0.80
	Facility 6019	$0.55 - 0.55	$0.55 - 0.55
	Pier 80	$0.75 - 0.85	$0.80 - 0.75
	Pier 92 & SWLs 344 & 349	$0.75 - 0.85	$0.80 - 0.75
	Pier 96 M & R	$0.75 - 0.85	$0.80 - 0.75
OPEN LAND AND PIER SPACE USES:			
INDUSTRIAL GROSS LEASES: "PORT STANDARD NET LEASE"	UNPAVED LAND	$0.20 - 0.25	$0.18 - 0.20
	PAVED LAND	$0.22 - 0.25	$0.20 - 0.23
	IMPROVED LAND	$0.25 - 0.30	$0.22 - 0.28

Exhibit C

2010-11 MININUM MONTHLY RENTAL RATE SCHEDULE[+]

TYPE OF USE & TYPE OF LEASE	CLASS & LOCATION OF FACILITY/SPACE	MINIMUM INITIAL LEASE RENTAL RATES Monthly Per Sq. Ft.	MINIMUM NET EFFECTIVE RENTAL RATES Monthly Per Sq. Ft.*
OFFICE SPACE USES:			
FULL SERVICE GROSS LEASES:	CLASS B		
	Roundhouse Plaza	$2.25 - 2.75	$2.00 - 2.50
	CLASS C		
	Agriculture Building		
	Window Office	$2.40 - 2.55	$2.20 - 2.35
	Interior Office	$1.50 - 2.00	$0.98 - 1.48
	401 Terry Francois	$2.00 - 2.40	$1.75 - 2.00
	696 Amador	$1.25 - 1.50	$1.00 - 1.40
NET LEASES:	CLASS B		
	Pier 9 Bulkhead Bldg.	$2.50 - 2.75	$2.30 - 2.60
	Pier 9 Pier Offices	$2.50 - 2.75	$2.30 - 2.60
	Pier 26 Annex Bldg.	$2.50 - 2.90	$2.40 - 2.90
	Pier 33 ½ North	$2.50 - 3.00	$2.25 - 2.75
	Pier 35 Bulkhead Bldg.	$2.50 - 2.75	$2.25 - 2.50
	CLASS C		
	Pier 9 Studio/office	$1.75 - 2.00	$1.50 - 1.75
	Piers 23 Bulkhead Bldgs.	$1.25 - 2.00	$1.00 - 1.75
	Pier 27 Admin. Bldg.	$1.35 - 1.60	$1.35 - 1.44
	Pier 29 Annex Bldg.	$1.35 - 1.60	$1.35 - 1.44
	Pier 33 ½	$1.75 - 2.25	$1.50 - 2.00
	Pier 35 Interior office	$1.75 - 2.00	$1.50 - 1.75
	490 Jefferson St.	$1.25 - 1.50	$1.10 - 1.25
	Piers 26 Bulkhead Bldg.	$1.75 - 2.00	$1.50 - 1.75
	Pier 28 Bulkhead Bldg.	$1.75 - 2.00	$1.25 - 1.75
	Piers 50 Bulkhead Bldg.	$1.75 - 2.00	$1.55 - 1.75
	Pier 54 Office	$1.25 1.50	$1.00 1.25
	Pier 70, Building 11	$1.10 - 1.25	$1.00 - 1.20
	501 Cesar Chavez	$1.25 - 1.50	$1.10 - 1.25
	601 Cesar Chavez	$1.00 - 1.25	$0.90 - 1.05
	Pier 96 Admin. Bldg.	$1.25 - 1.40	$01.00 - 1.25
	Pier 96 Gate House Bldg.	$1.10 - 1.25	$0.75 - 1.00
OFFICE STORAGE	All Facilities	$1.00 - 1.00	$1.00 - 1.00

PORT OF SAN FRANCISCO

Memorandum

To: Emilyzen Ignacio

From: Brad Benson

cc: Harvey Rose, Debra Newman, Monique Moyer, Susan Reynolds, Jerry Romani, Jeff Bauer

Date: October 5, 2010

Re: Port of San Francisco Office, Shed, and Industrial Land Leasing Practices – IDEO LLC Lease L-13587

Thank you for the opportunity to explain the Port of San Francisco's (Port) competitive bidding practices and leasing practices for office space, shed (warehouse) space and open land.

Competitive Bidding of Leases

Port leases are subject to approval by the San Francisco Board of Supervisors pursuant to San Francisco Charter Section 9.118 if the subject lease has a term of ten or more years or anticipated revenue of $1 million or more.

Port leases that are subject to approval by the San Francisco Board of Supervisors are subject to the competitive bidding policy provided in San Francisco Administrative Code Section 2.6-1:

> SEC. 2.6-1. - POLICY RELATIVE TO APPROVAL OF LEASE AND CONCESSION AGREEMENTS. Whenever in accordance with the provisions of the Charter, any officer, board or commission of the City and County submits a proposed lease or agreement for concession privileges to be operated in or upon any property or facility of the City and County to the Board of Supervisors for its approval or disapproval, except where the Board of Supervisors finds that the bidding procedures or insurance requirements are impractical or impossible, it shall be the policy of said board (1) to approve only such proposals as have been awarded to the highest responsible bidder in accordance with competitive bidding procedures, and (2) to approve only such leases as require the lessee to provide appropriate insurance naming the City as an additional insured in a form and amount approved by the Office of Risk Management.

Retail Leases

Pursuant to its Policy for Leasing of Retail Business Sites (adopted in 1993), the Port competitively bids new retail opportunities on Port property. The policy, which is currently being revised (see Attachment A), also provides for a direct negotiation exception when the current tenant makes a substantial investment in Port property.

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The purpose of this direct negotiation exception is to: 1) retain successful retail tenants that have developed a regular clientele and substantial goodwill that results in participation rent for the Port, and 2) encourage private sector investment in Port property.

On the whole, the policy tries to balance the benefits of competitive bidding with the Port's need to be a stable, reliable landlord which rewards successful tenants. In this case, the Port views competitive bidding for these retail opportunities as a public benefit principally because the process allows new market entrants an opportunity to establish a business on the waterfront, which is a coveted retail location.

Unlike concession bids (see below), competitive bidding for these types of retail opportunities does not necessarily yield the best rent for the Port. The Port typically uses the retail lease bid process to evaluate the type of retail uses proposed and the qualifications of the bidders; actual lease terms are negotiated after award. Since much of the Port's revenue from retail leases comes in the form of participation rent (usually a percentage of gross receipts), and it often takes several years for a retail tenant to develop the "goodwill" necessary to maintain a highly successful retail operation, a competitively bid retail lease opportunity will not inform the Port about the actual rents it will receive.

In the case when the Port enters a retail lease pursuant to the direct negotiation exception, Port staff will recommend to the Port Commission that it make two findings, as applicable:

1. That the improvements to Port property funded by the tenant serve a public purpose; and

2. That it is impractical to bid the subject lease, consistent with the provisions of San Francisco Administrative Code Section 2.6-1, because to bid the lease would risk the loss of a successful Port tenant which has committed to finance improvements to Port property.

Concession Bids

The Port virtually always bids concession opportunities, where the Port needs only to establish minimum qualifications, and the opportunity is awarded to the operator that provides the best rent proposal. A prime example of this type of concession bid is for parking lots.

The Port structures these types of parking concession bids as a bid for the highest base rent, assuming that the Port will realize the base rent bid by the highest qualified bidder, or 66% of gross receipts, whichever is higher. In this case, bidding serves to maximize revenues from the Port's property.

Commercial and Industrial Development Opportunities

The Port typically competitively bids its development opportunity sites. These opportunities include mixed-use development opportunities defined in the Port's Waterfront Land Use Plan, as well as industrial development opportunities in the port's Southern Waterfront. During the past several years, the Port has undertaken competitive solicitations for Seawall Lot 337 (and Pier 48), Seawall Lot 351, Pier 70, an asphalt or concrete batching facility at Pier 94, and a maritime industrial opportunity at Pier 96. (The latter two solicitations yielded no responses.)

The Port finds that it is useful to bid these opportunities because the process allows the Port to evaluate bidders' qualifications, financial capacity and vision. The development timeline can accommodate the time required to bid these projects.

Office, Shed Space and Open Land

The Port does not competitively bid its office, warehouse shed and open land space because it is impractical to do so. Most office, warehouse and open land users need to secure space in a short period of time and require certainty about relocation plans: potential tenants are typically making decisions on a relatively short time frame allowing 90-120 days to find a location, negotiate a lease, complete improvements and move in. Except during periods of extremely low commercial vacancy rates in San Francisco, office, warehouse and open land space is ubiquitous both in the City and proximate to Port property.

The City's competitive bidding processes can take 3 to 6 months or longer; it is not practical to expect that the standard office, warehouse or open land user will undergo an uncertain process this long, with no guarantee that they will succeed in winning the right to pay rent to the City.

Instead, the Port uses a Port Commission-approved Parameter Rental Rate Schedule to establish rental rates for Port property. In adopting this schedule of rental rates, the Port Commission delegates to Port staff the ability to enter market-rate leases using the Port's boilerplate lease without Commission review, except when the Board of Supervisors must approve a lease. This delegation provides a strong incentive for prospective tenants to agree to market rent terms, because they can avoid the time and the uncertainty of an approval vote.

The Parameter Rental Rate Schedule is assembled based on market analysis of prevailing rents in similar types of commercial space, situated in a like geographic area. This is how the private market values real estate – by examining market comparables for similarly situated, similar properties.

Unlike the case of retail opportunities along the waterfront, which open up fairly infrequently, the Port almost always has office, shed and industrial land, so there are no structural barriers to leasing this type of Port space for new market entrants.

Therefore, competitive bidding of office, warehouse or open land provides no benefits: it neither provides the best mechanism to determine fair market value for real estate, nor does it "level the playing field" for new market entrants. In fact, the only result of competitive bidding for this type of space would be to create an uncertain environment for prospective commercial tenants, thus creating an incentive for them to look elsewhere for their space needs. This uncertainty could erode Port revenues and increase vacancy rates. Furthermore, in many cases the Port is leasing small amounts of space (several hundred square feet of office or shed space), and the City staff time administering a competitive solicitation would be cost-prohibitive.

In light of these facts, the Port always finds it impractical to bid office, warehouse and open land, within the meaning of San Francisco Administrative Code Section 2.6-1.

Private Commercial Real Estate Market

We note that using market comparables to value commercial real estate is standard professional practice in the real estate industry. The industry only resorts to competitive bidding (auctions) when an owner has a need to dispose of an asset quickly, usually for financial reasons unrelated to the subject property.

Commercial office, industrial and retail leasing is a complex process that does not lend itself to a "highest bid" auction. Finalizing a commercial lease involves complex issues that can include tenant improvements, improvement allowances, construction and move in schedule requirements, potential sub-division of space, and negotiation of specialized lease provisions.

As a result, private sector commercial landlords almost never bid even retail opportunities. Instead, the industry relies on niche brokers that can match prospective tenants with certain types of space needs (and budgets) and landlords who can fulfill these needs. The City's own experience as tenant leasing property for City purposes is instructive: the City rarely, if ever, "bids" on commercial real estate it intends to occupy.

Current Commercial Real Estate Market

The practices described above represent Port practice in all types of real estate market conditions. That said, it is particularly important to retain tenants in good standing in the current market. According to the San Francisco Center for Economic Development:

> "Commercial activity continues to show signs of a market recovering from recession, including stable or slightly higher rental rates and stable or slightly lower vacancies. Rental increases are being offset by firms consolidating and reducing space requirements, and by a reduction of sublease inventory. Much of this market activity is being driven by lease expirations and users evaluating their options.
>
> "According to data released by Colliers International, there is considerable action in the South of Market Area driven by the technology industry. While vacancy is high (27%), there are more than 60 companies currently looking for space in premium SOMA buildings and locations.
>
> "The overall citywide vacancy rate was 15.1% for August 2010, for a total of 12 million square feet (or more that 11 Bank of America towers). During the same period the citywide asking rate was $30.61 per square foot, $34.25 per sq foot for Class A space in the Financial District and $32.39 per sq foot in class A space south of Market. Total market absorption was a negative 65,000 sq feet, according to CB Richard Ellis."

Using listings available from Costar Property, Port staff identified the following office listings in the South Beach, Jackson Square and Financial District areas that match the size of the proposed office lease in Pier 26.5:

Address	Type	SF Avail	Rent/SF/Mo	Listing Company	Cls	Submarket
303 2nd St	Office	8,000-17,522	2.83/fs	Jones Lang LaSalle	A	Rincon/South Beach
303 2nd St	Office	12,313	2.92/fs	Jones Lang LaSalle	A	Rincon/South Beach
50 Beale St	Office	28,114	2.92/fs	The CAC Group	A	South Financial District
50 Beale St	Office	28,121	2.92/fs	The CAC Group	A	South Financial District
50 Beale St	Office	29,280	2.92/fs	The CAC Group	A	South Financial District
250 Brannan St	Office	23,362	2.83/ig	Grubb & Ellis	B	Rincon/South Beach
75 Broadway	Office	14,207	2.67-3.08/fs	Cornish & Carey Commercial	A	Jackson Square
75 Broadway	Office	17,388	2.67-3.08/fs	Cornish & Carey Commercial	A	Jackson Square
50 California St	Office	18,871	2.42/fs	Shorenstein Company, LLC	A	Financial District
100 California St	Office	20,173	2.83/fs	Jones Lang LaSalle	A	Financial District
199 Fremont St	Office	16,155	2.75/fs	Cornish & Carey Commercial	A	South Financial District
221 Main St	Office	23,060	2.00-2.33/fs	The CAC Group	A	South Financial District
64-72 Townsend Street	Office	5,600-28,839	2.00/ig	Colliers International	B	Rincon/South Beach

Closing

We thank the Budget Analyst for this opportunity to explain the Port's leasing practices. If you have further questions, please contact me at (415) 274-0498.

ATTACHMENT A

**PROPOSED PORT OF SAN FRANCISCO
2010 RETAIL LEASING POLICY
(PENDING ADOPTION)**

Background

The Port of San Francisco ("Port") is a public enterprise committed to promoting a balance of maritime, recreational, industrial, transportation, public access and commercial activities on a self-supporting basis through appropriate management and development of the waterfront for the benefit of the public.

General Policy

The Port's Retail Leasing Policy provides entrepreneurs that wish to develop and operate a business along the San Francisco waterfront an opportunity to bid on retail lease opportunities, as described in this policy. This policy also permits the Port and its successful, existing retail operators to enter into new leases under specified conditions. Retail opportunities will be available only at locations deemed appropriate for retail activity in accordance with the Port's Waterfront Land Use Plan, as it may be amended from time to time.

Businesses on Port property include uses such as restaurants, galleries, ship chandleries, souvenir shops, food and beverage sales, clothing and apparel shops, on-going special event venues and visitor-serving excursion operators. The Port enjoys a diverse mix of retail uses that serve the public and are consistent with the Burton Act and the public trust for navigation, commerce and fisheries.

Lease revenues are essential for funding the Port's operating and capital budget, which support the Port's public trust maritime mission. The Port's retail tenancies also provide business opportunities for local merchants and employment opportunities for San Francisco residents.

Scope of Retail Leasing Policy

This policy applies to both maritime and non-maritime retail tenancies. This policy does not apply to retail tenancies in mixed-use developments on Port properties that have been master- or ground-leased by the Port Commission.

Competitive Solicitation

Port leases that are subject to approval by the San Francisco Board of Supervisors are subject to the competitive bidding policy provided in San Francisco Administrative Code Section 2.6-1:

SEC. 2.6-1. - POLICY RELATIVE TO APPROVAL OF LEASE AND CONCESSION AGREEMENTS. Whenever in accordance with the provisions of the Charter, any officer, board or commission of the City and County submits a proposed lease or agreement for concession privileges to be operated in or upon any property or facility of the City and County to the Board of Supervisors for its approval or disapproval, except where the Board of Supervisors finds that the bidding procedures or insurance requirements are impractical or impossible, it shall be the policy of said board (1) to approve only such proposals as have been awarded to the highest responsible bidder in accordance with competitive bidding procedures, and (2) to approve only

such leases as require the lessee to provide appropriate insurance naming the City as an additional insured in a form and amount approved by the Office of Risk Management. When conducting a competitive solicitation, Port staff will:

1. Describe a range of desired uses and establish criteria for qualified responses to the competitive solicitation;

2. Provide public notice of the competitive solicitation through the Port's website, the City's designated local newspaper for notices, and community-based media;

3. Invite local business enterprises to participate, in coordination with the Human Rights Commission and Office of Contract Management;

4. Hold a pre-submittal conference;

5. Evaluate responses and award retail leasing opportunities based on criteria specified in the solicitation package; and

6. Present each lease with a successful respondent to the Port Commission and the Board of Supervisors (if required) for approval.

Non-Retail Tenants on Port Property Seeking to Become Retail Tenants

Occasionally, existing Port non-retail tenants express an interest in opening retail businesses within or adjacent to their premises. The Port usually enters into non-retail leases without competitive bidding, based on the Port Commission's approved parameter rental rate policy and a finding, upon public hearing of the Port Commission, that bidding office, warehouse, open land or other (non-retail) leases is impractical.

While the Port understands that many of its tenants may have the business acumen and financial wherewithal to open retail businesses, commencing such a tenancy without bidding potentially conflicts with City and Port policy. Port staff will entertain such proposals only when the proposed use is consistent with the Port's Waterfront Land Use Plan and the Port Commission first approves a resolution authorizing Port staff to enter into a sole source negotiation for a retail use.

Existing Retail Tenants – Renewal Prerequisites

Existing retail tenants often request a lease renewal when a lease is expiring or the tenant desires to make capital improvements and amortize its investment over a period longer than the existing lease term. Port staff will evaluate renewals and extension requests on a case-by-case basis based on proposed improvements, capital costs, the Port's future plans for the site, and tenant history. Tenants must be in compliance with the Port's **Tenant in Good Standing Policy** to be eligible for consideration for a new or extended lease.

Changes in or intensification of use must be consistent with the Port's Waterfront Land Use Plan, San Francisco Bay Conservation and Development Commission (BCDC) requirements and other regulatory limitations applicable to the site, including compliance with the California Environmental Quality Act. The Port, in its sole discretion, may determine that proposed changes in or alterations of use would trigger the need for a competitive solicitation.

Port staff may negotiate with an existing retail tenant in good standing under the fol lowing circumstances:

1. For a short term lease extension, not to exceed 3-5 years, during any period when the National Bureau of Economic Research has determined that the U.S. economy is in a recession or other data support a finding by the Port Commission that the San Francisco Bay Area is experiencing a commercial real estate downturn. Under these conditions, the renewals and extensions will adjust base and percentage rents to then-current market-rates as adopted by the Port Commission.

2. Where the tenant proposes to make capital improvements, a lease extension or renewal may have a term of the greater of 10 years or the time required to amortize planned improvements (using the term of the tenant's financing or, if not financed, straight line depreciation for qualified leasehold improvement property (currently 15 years) if the tenant meets the Port's criteria for a direct negotiation exception (described below). In exercising this extension option, the Port Commission will make a finding at a public hearing that the proposed capital improvements to Port property serve a public purpose.

3. If a tenant fails to meet the Port's criteria for a direct negotiation exception, a lease extension or renewal may have a term of up to 5 years without any additional extension option, if the Port has conducted a Request for Interest and received no expressions of interest from qualified parties.

In exercising each of these renewal or extension options, the Port Commission will make a finding that it is impractical to bid the subject lease, consistent with the provisions of S.F. Administrative Code Section 2.6-1.

Direct Negotiation Exception

Before entertaining a direct negotiation request for a lease renewal or extension, Port staff will:

1. Determine if the tenant is in compliance with the **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 square foot basis; and

3. Request a written business plan and evaluate the plan to determ ine cost and value of capital improvements to Port property, viability of revenue projections including historical audited financial statements and/or the last 3 years' tax returns and use of property.

The Port will not enter into direct negotiations with an existing tenant that has paid average rent per square foot to the Port (base rent and percentage rent) in the three (3) year period immediately preceding the request that is less than the average of rents per square foot for like retail tenants at similar locations on Port property (e.g., with a tenant that generates below-average rents).

Capital Improvement Requirements for Direct Negotiations

The Tenant must make a substantial capital investment approved by the Port, according to the following conditions:

- Improvements may include substructure improvements, improvements to the core and shell of the lease premises, Americans with Disabilities Act access to the facilities, upgrades to utilities serving the premises or improvements to surrounding Port property;
- The Tenant will quantify the cost of the proposed capital improvement as a percentage of leasehold value, with actual expenditures subject to verification pursuant to lease terms;
- The proposed capital improvement must be sufficient to allow Port staff to make a finding that the improvement serves a public purpose; and
- The Tenant must demonstrate the financial capacity to pay for the proposed capital improvement and demonstrate that such improvement can be depreciated within the proposed lease term.

The Tenant will not qualify for rent credits for proposed capital improvements that serve as a basis for direct negotiations.

Port staff will evaluate facility conditions and may propose additional facility investments that would justify a new lease with the existing tenant.

Lease Requirements

1. The Tenant will pay base and percentage rent that is market rent for comparable uses and locations on gross retail income, retail sales and concession revenues, including subtenant rents and sales.
2. The Port reserves the right to approve all sub-tenancies, and all sublease revenues will be separately reported to the Port in a customary and pre-approved manner.
3. Base rent will be based on available industry comparables, site history, best site use and percentage rent history. Base rent will be adjusted annually (either as a fixed percentage increase or as a CPI percentage increase) with no provision for rent reduction or rebate.
4. The Tenant will disclose all gross revenues and related expenses and grant the Port the right to conduct periodic audits and obtain related financial reports.
5. Depending on the type of proposed capital improvements, the new term of the lease may include a construction period, with a deadline to complete required tenant improvements.
6. The Tenant will provide a tenant guarantee and a contractor's surety bond or other financial assurance approved by the Port in its sole discretion in an amount approved by the City's Risk Manager. If the Tenant fails to obtain the approval, permits or financing

of the proposed improvements in the agreed upon time frame, or fails to complete the project in any way, the Tenant may be subject to liquidated damages, lease default or other remedies as provided by the lease.

Sale of Business/Lease, Transfer or Assignment

Subject leases will include provisions that are part of the Port Commission's approved boilerplate lease, as it may be amended from time to time, including but not limited to:

1. The Port shall participate in a portion of the proceeds from the sale, transfer, assignment, restructuring, and refinancing of leaseholds.

2. The proposed transferee shall provide audited financial statements and the Port shall have the right to request a written business plan supported by market analysis.

3. The Port shall approve all ownership and capital changes at its reasonable discretion. The proposed transferee must demonstrate expertise in operating the business and maintaining the asset.

4. The proposed transferee or assignee shall jointly assume any structural, substructure repair/maintenance or seismic upgrade responsibilities that are the obligation of the seller, transferor or assignor. Upon request for the Port's consent to the transfer, sale or assignment of its lease, the Tenant shall provide a written report prepared by a Port-approved engineer detailing the current condition of the physical assets, including any deferred repairs or maintenance along with a remedial plan for repairs as a condition to the Port's consent.

5. All maintenance and/or construction work required in the original lease must be completed, with all permits closed out, prior to the request for the Port's consent, or the transfer agreement will address the obligations of the transferee to complete such work.

CITY AND COUNTY OF SAN FRANCISCO
GAVIN NEWSOM, MAYOR

LEASE NO. L-14796
BY AND BETWEEN

THE CITY AND COUNTY OF SAN FRANCISCO
OPERATING BY AND THROUGH THE
SAN FRANCISCO PORT COMMISSION

AND

IDEO, LLC
A MICHIGAN LIMITED LIABILITY COMPANY

PIER 26 ANNEX

MONIQUE MOYER
EXECUTIVE DIRECTOR

SAN FRANCISCO PORT COMMISSION

RODNEY FONG, PRESIDENT
STEPHANIE SHAKOFSKY, VICE PRESIDENT
KIMBERLY BRANDON, COMMISSIONER
MICHAEL HARDEMAN, COMMISSIONER
ANN LAZARUS, COMMISSIONER

Complete copy of the lease
located in File No. 100692

TABLE OF CONTENTS

Page

1. DEMISE 1
2. DEFINITIONS 1
3. PREMISES; AS-IS CONDITION 8
   3.1. Premises 8
   3.2. Intentionally Omitted 9
   3.3. No Right to Encroach 9
   3.4. No Light, Air or View Easement 10
   3.5. Unique Nature of Premises 10
   3.6. As-Is Condition 10
   3.7. Port's Rights Regarding Premises 10
4. TERM OF LEASE; TERMINATION BY PORT 10
   4.1. Term 10
   4.2. Termination Rights 11
   4.3. Waiver of Relocation Benefits 12
5. RENT 12
   5.1. Base Rent 12
   5.2. Late Charges 12
   5.3. Returned Checks 12
   5.4. Default Interest 12
   5.5. Net Lease 13
   5.6. Additional Charges 13
6. TAXES AND ASSESSMENTS 13
   6.1. Payment of Taxes 13
   6.2. Possessory Interest Tax 14
7. SECURITY DEPOSIT 14
8. USE OF THE PREMISES 16
   8.1. Permitted Use 16
   8.2. Prohibited Use 16
   8.3. Notice of Prohibited Use Charge 16

9. COMPLIANCE WITH LAWS AND REGULATIONS 17
10. PORT ACTING AS OWNER OF PROPERTY; REGULATORY APPROVALS; COMPLIANCE WITH CITY'S RISK MANAGER'S REQUIREMENTS 18
10.1. Port Acting as Owner of Property 18
10.2. Regulatory Approvals 18
10.3. Compliance with City's Risk Manager's Requirements 19
11. MAINTENANCE AND REPAIRS 19
11.1. Tenant Maintenance and Repair Obligations 19
11.2. Port's Right to Inspect 19
11.3. Port's Right to Repair 19
11.4. Acts of Nature 20
12. UTILITIES AND SERVICES 20
12.1. Utilities 20
12.2. On-Site Renewable Energy 21
13. IMPROVEMENTS AND ALTERATIONS 21
13.1. Port Consent Required 21
13.2. Tenant's Obligation to Construct the TI Work 22
13.3. Construction Requirements 22
13.4. Improvements Part of Realty 23
13.5. Removal of Improvements 24
13.6. Removal of Non-Permitted Improvements 24
13.7. Signs 24
13.8. Port's Alterations 24
14. LIENS 24
15. HAZARDOUS MATERIALS 25
15.1. Requirements for Handling 25
15.2. Tenant Responsibility 25
15.3. Tenant's Environmental Condition Notification Requirements 25
15.4. Requirement to Remediate 26
15.5. Port's Right to Audit 27
15.6. Notification of Asbestos 27
15.7. Notification of Lead 28
15.8. Failure to Comply 28

15.9. Survival 29
15.10. Storm Water Pollution Prevention 29
15.11. Presence of Hazardous Materials 29
16. INSURANCE 29
16.1. Required Insurance Coverage 29
16.2. Claims-Made Policies 30
16.3. Annual Aggregate Limits 30
16.4. Payment of Premiums 30
16.5. Waiver of Subrogation Rights 31
16.6. General Insurance Matters 31
17. DAMAGE AND DESTRUCTION 32
17.1. Damage and Destruction 32
17.2. Major Damage and Destruction or Uninsured Casualty to the TI Work or any Subsequent Alterations 33
17.3. Waiver 36
18. EMINENT DOMAIN 36
18.1. General 36
18.2. Partial Takings 36
18.3. Taking of the Facility 36
18.4. Temporary Takings 37
18.5. Award; Waiver 37
19. INDEMNITY AND EXCULPATION 37
19.1. General Indemnity 37
19.2. Hazardous Materials Indemnity 37
19.3. Scope of Indemnities 38
19.4. Exculpation 38
19.5. Effect of Waivers 38
20. ASSIGNMENT AND SUBLETTING 39
20.1. Transfer to Affiliate 39
20.2. Transfer to Non-Affiliate 39
20.3. Sublease 40
20.4. Transfer Agreement Requirements 41
20.5. Transfer Audit 41

20.6. Acknowledgement 41
20.7. Transfer Definitions 41
21. DEFAULT BY TENANT 42
22. PORT'S REMEDIES 43
22.1. Tenant's Right to Possession Not Terminated 43
22.2. Termination of Tenant's Right to Possession 44
22.3. Appointment of Receiver 44
22.4. Port's Right to Cure Tenant's Default 44
22.5. Port's Options for Hazardous Materials Default 45
22.6. No Accord and Satisfaction 45
22.7. Waiver of Redemption 45
22.8. Habitual Late Payer 45
22.9. Remedies Not Exclusive 45
23. LITIGATION EXPENSES; ATTORNEYS' FEES 45
23.1. Litigation Expenses 45
23.2. Appeals 46
23.3. City Attorney 46
24. PORT'S ENTRY ON PREMISES 46
24.1. Entry for Inspection 46
24.2. General Entry 46
24.3. Emergency Entry 46
24.4. No Liability 46
24.5. Nondisturbance 47
25. SURRENDER AND QUITCLAIM 47
25.1. Surrender 47
25.2. Quitclaim 47
25.3. Abandoned Property 47
25.4. Survival 48
26. HOLDING OVER 48
26.1. Terms of Holdover Tenancy 48
26.2. With Consent 48
26.3. Without Consent 48
26.4. Renewal Letter of Credit 48

27. MINERAL RESERVATION 48
28. CITY AND PORT REQUIREMENTS 48
28.1. Nondiscrimination 49
28.2. Requiring Health Benefits for Covered Employees 49
28.3. First Source Hiring 51
28.4. Local Business Enterprises 51
28.5. Resource-Efficient Facilities and Green Building Requirements 51
28.6. Prohibition of Tobacco Sales and Advertising 51
28.7. Prohibition of Alcoholic Beverages Advertising 51
28.8. Graffiti Removal 52
28.9. Pesticide Prohibition 52
28.10. MacBride Principles Northern Ireland 52
28.11. Tropical Hardwood and Virgin Redwood Ban 52
28.12. Preservative-Treated Wood Containing Arsenic 53
28.13. Notification of Limitations on Contributions 53
28.14. Sunshine Ordinance 53
28.15. Conflicts of Interest 53
28.16. Drug-Free Workplace 53
28.17. Wages and Working Conditions 54
28.18. Public Transit Information 54
28.19. Food Service Waste Reduction Ordinance 54
29. NOTICES 54
30. MISCELLANEOUS PROVISIONS 54
30.1. California Law 54
30.2. Entire Agreement 55
30.3. Amendments 55
30.4. Severability 55
30.5. Interpretation of Lease 55
30.6. Successors 56
30.7. Real Estate Broker's Fees 56
30.8. Counterparts 56
30.9. Authority 56
30.10. No Implied Waiver 56

30.11. Time is of Essence 56
30.12. Cumulative Remedies 56
30.13. Survival of Indemnities 56
30.14. Relationship of the Parties 57
30.15. No Recording 57
30.16. Additional Written Agreement Required 57
31. LIMITATION ON DAMAGES 57
31.1. No Recourse Beyond Value of Facility 57
31.2. Non-Liability of City Officials, Employees and Agents 57
31.3. Limitation on Port's Liability Upon Transfer 57
32. TENANT ESTOPPEL CERTIFICATES 57
33. APPROVAL OF BOARD OF SUPERVISORS. 58
34. EXTENSION OPTION 58
34.1. Option to Extend Term 58
34.2. Base Rent and Other Terms 58

EXHIBITS AND SCHEDULES

EXHIBIT A DESCRIPTION OF PREMISES
EXHIBIT B COMMENCEMENT DATE AND EXPIRATION DATE MEMORANDUM
EXHIBIT C ESTOPPEL CERTIFICATE
EXHIBIT D WORK LETTER
EXHIBIT E PORT OF SAN FRANCISCO HISTORIC PRESERVATION REVIEW GUIDELINES FOR PIER AND BULKHEAD WHARF SUBSTRUCTURES
EXHIBIT F AREA OF WORK

SCHEDULE 1 ASBESTOS NOTIFICATION AND INFORMATION
SCHEDULE 2 SUBSTRUCTURE REPORT(S)
SCHEDULE 3 FEMA DISCLOSURE NOTICE

LEASE AGREEMENT
BASIC LEASE INFORMATION

Lease Date:	March 17, 2010
Lease Number:	**L-14796**
Landlord or Port:	**CITY AND COUNTY OF SAN FRANCISCO**, a municipal corporation, operating by and through the **SAN FRANCISCO PORT COMMISSION**
Landlord's Address:	Port of San Francisco Pier 1 San Francisco, California 94111 Attention: Director of Real Estate Telephone: (415) 274-0400 Facsimile: (415) 274-0494
Tenant:	IDEO, LLC, a Michigan limited liability company
Tenant's Contact Person:	David Strong and Yancy Widmer
Tenant's Address:	Pier 26 Annex San Francisco, CA 94105 Yancy Widmer Cell: (415) 305-1209 Pier 26 Annex Telephone: (415) 615-5000 Pier 26 Annex Facsimile: (415) 615-5001
Tenant's Billing Address:	Steelcase, Inc. Colliers International-Corp. Service 1610 Arden Way #242 Sacramento, CA 95815
Premises:	Pier 26 Annex
Facility:	Pier 26 Annex San Francisco, California 94105
Premises Rentable Square Footage:	Approx. 12,360 rentable square feet of existing office space (Parcel A) and approx. 7,074 rentable square feet of space to be renovated into office space (Parcel B) by Tenant under this Lease.
Length of Term:	Sixty (60) months