

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: January 14, 2015 Budget and Finance Committee Meeting

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Item 2 File 14-1257	Department: Controller's Office (Controller)
EXECUTIVE SUMMARY	
<p style="text-align: center;">Legislative Objectives</p> <ul style="list-style-type: none"> • The proposed resolution would establish the City's FY 2014-15 appropriations limit at \$2,842,635,601 as calculated by the Controller. <p style="text-align: center;">Key Points</p> <ul style="list-style-type: none"> • Article XIII B of the California State Constitution places annual limits on the appropriations of tax proceeds made by the State, school districts, and local governments in California. The annual appropriations limit is based on the appropriations limit for the preceding fiscal year and adjusted for (1) the change in population, and (2) the change in the cost of living. • Local governments are allowed to calculate the change in the cost of living using (1) the percentage change in California per-capita personal income or (2) the percentage change for the local jurisdiction's assessment roll for non-residential new construction. In 2013, change in per-capita personal income was -.23 percent and change in assessment roll was .25 percent. <p style="text-align: center;">Fiscal Impact</p> <ul style="list-style-type: none"> • The Controller calculated the FY 2014-15 appropriations limit to be \$2,842,635,601, using the change to the local assessment roll. <p style="text-align: center;">Policy Consideration</p> <ul style="list-style-type: none"> • The Controller has discretion to calculate the change in the cost of living using (1) the percentage change in California per-capita personal income or (2) the percentage change for the local jurisdiction's assessment roll for non-residential new construction. • The Controller calculated the appropriations limit of \$2,842,635,601 using the change to the local assessment roll. This resulted in a limit \$505,033 higher than if it had used the change to per-capita personal income, which totaled \$2,842,130,568. <p style="text-align: center;">Recommendation</p> <ul style="list-style-type: none"> • Approve the proposed resolution. 	

MANDATE STATEMENT

California Constitution Article XIII B states that each local government must set an annual appropriations limit as calculated using the preceding year's appropriations limit adjusted for (1) the change in population and (2) the change in the cost of living.

BACKGROUND

On November 6, 1979, California voters approved Proposition 4, known as the Gann Initiative, which added Article XIII B to the California Constitution. Article XIII B (later amended by State Proposition 111, as approved by the voters in June of 1990) places annual limits on the appropriations of tax proceeds made by the State, school districts, and local governments in California. The annual appropriations limit is based on the appropriations limit for the preceding fiscal year and adjusted for (1) the change in population, and (2) the change in the cost of living.

Per Article XIII B Section 9 and California Government Code Section 7901, the appropriations limit does not apply to any tax proceeds appropriated for (a) debt service, (b) federally-mandated services, (c) qualified capital outlays, and (d) various hazardous waste programs administered by the Department of Public Health.

California Government Code Section 7901(b) defines the change in population as the population growth for the calendar year preceding the beginning of the fiscal year for which the appropriations limit is to be determined. According to the California Department of Finance, in calendar year 2013, San Francisco's population growth was 1.29 percent.

California Constitution Article XIII B Section 8(e)2 allows the local government to use one of the two following definitions to calculate the cost of living adjustment:

Definition 1: The percentage change in California per-capita personal income from the preceding year, estimated to be -.23 percent in 2013, or

Definition 2: The percentage change for the local jurisdiction in the assessment roll from the preceding year due to non-residential new construction, estimated to be .25 percent in 2013.

DETAILS OF PROPOSED LEGISLATION

The proposed resolution would establish the City's FY 2014-15 appropriations limit at \$2,842,635,601 as calculated by the Controller. The appropriations limit for FY 2014-15 is based on the amount of the FY 2013-14 appropriations limit and adjusted to reflect changes in (1) the population and (2) cost of living adjustment (calculated using the increase in assessment roll of non-residential new construction).

FISCAL IMPACT

Per California Constitution Article XIII B, the appropriations limit does not apply to tax proceeds appropriated for: (a) debt service, (b) federally-mandated services, (c) qualified capital outlays, and (d) various hazardous waste programs administered by the Department of Public Health. Consequently, the Controller excluded \$493,121,151 from the City's total FY 2014-15 tax proceeds of \$3,254,786,471 as shown in Table 1 below.

Table 1: Estimated Tax Proceeds Subject to the Proposed Appropriations Limit

FY 2014-15 Estimated Total Tax Proceeds*	\$3,254,786,471
Exclusions	
(a) Debt Service	(245,442,021)
(b) Federally-Mandated Services	(64,150,094)
(c) Qualified Capital Outlays	(180,349,879)
(d) Hazardous Waste Program	(3,179,157)
Subtotal Exclusions	(\$493,121,151)
FY 2014-15 Net Tax Proceeds Subject to Appropriations Limit	\$2,761,665,320

*Includes property taxes, business taxes, other local taxes, rents & concessions, interest, and state grants.

The City's FY 2014-15 net proceeds of taxes, as determined by the Controller, are \$2,761,665,320 as shown in Table 1 above. As shown in Table 2 below, the proposed resolution would establish the City's appropriations limit in FY 2014-15 at \$2,842,635,601, as calculated by the Controller.

Table 2: Proposed FY 2014-15 Appropriations Limit

FY 2013-14 Appropriations Limit^a	\$2,799,495,180
Adjustment Factors	
Increase in Population	1.29%
Increase in Assessment Roll (Cost of Living)	.25%
FY 2014-15 Appropriations Limit^a	\$2,842,635,601

Source: Controller's Office

^a The annual appropriations limit is a formula set by the California Constitution. The Controller calculated the FY 2014-15 appropriations limit based on the increase in the City's population and assessed value of new construction as follows: \$2,799,495,180 x 1.0129 x 1.0025 equals \$2,842,635,601 (actual total may vary due to rounding).

As shown in Table 1 and Table 2 above, the City's estimated FY 2014-15 net tax proceeds of \$2,761,665,320 are \$80,970,281 less than the proposed FY 2014-15 appropriations limit of \$2,842,635,601.

POLICY CONSIDERATION

As noted in the background section, the Controller has discretion to calculate the cost of living adjustment factor using one of two following definitions:

Definition 1: The percentage change in California per-capita personal income from the preceding year, estimated to be -.23 percent in 2013, or

Definition 2: The percentage change for the local jurisdiction in the assessment roll from the preceding year due to local non-residential new construction, estimated to be 0.25 percent in 2013.

Table 3 below shows the FY 2014-15 appropriations limit using both definitions.

Table 3: The FY 2014-15 Appropriations Limit Can Vary Depending on Definition

	<u>Definition 1</u>	<u>Definition 2</u>
	Per-Capita Personal Income	Local Assessment Roll from Non- Residential New Construction ^a
FY 2013-14 Appropriations Limit	\$2,799,495,180	\$2,799,495,180
Adjustment Factors		
Increase in Population	1.29%	1.29%
Increase in Per-Capita Personal Income	-.23%	-
Increase in Local Assessment Roll	-	0.25%
FY 2014-15 Appropriations Limit	\$2,842,130,568	\$2,842,635,601

^a Difference due to rounding

For the FY 2014-15 appropriations limit, the Controller elected to use the percentage change in local assessment roll from the preceding year to calculate the cost of living adjustment, consequently calculating the appropriations limit at \$2,842,635,601, as shown in Table 3 above. Had the Controller elected to use the percentage change in the per-capita personal income from the preceding year, the appropriations limit, as shown in Table 3 above, would have been calculated at \$2,842,130,568, which is (a) \$505,033 less than the proposed appropriations limit of \$2,842,635,601 and (b) \$80,465,248 more than the Controller’s estimate of net tax proceeds subject to the appropriations limit of \$2,761,665,320, as shown in Table 1 above.

RECOMMENDATION

Approve the proposed resolution.

Item 3 File 14-1078	Department: San Francisco International Airport
EXECUTIVE SUMMARY	
<p>Legislative Objectives</p> <ul style="list-style-type: none"> • The proposed resolution would authorize an early termination and buyout of the lease between the San Francisco International Airport (Airport) and BaySubway Airport (Subway) in an amount not-to-exceed \$1,200,000. <p>Key Points</p> <ul style="list-style-type: none"> • The Airport entered into a ten-year lease with GDDC, Inc. in 2014 to sell food and beverages at two locations located in Airport Terminal 3. The Airport subsequently assigned the lease to Subway in 2007 after GDDC, Inc. sold the franchise to Subway. The Airport began its planned renovation of Terminal 3 Boarding Area E in 2011, which required the closure, demolition, and relocation of existing food and beverage tenants in Boarding Area E. The Airport subsequently executed an amendment to the lease with Subway in March 2012 to close their Boarding Area E location during the renovation period. This amendment provided for replacement locations in Boarding Area E and a new ten-year lease term to commence upon completion of renovations to Boarding Area E. • Prior to Subway commencing their tenant improvements to the new location, the Airport executed an agreement with United Airlines to build its United Club in Boarding Area E, located next to Subway’s proposed location. As a result, the Airport was unable to deliver the proposed replacement premises to Subway. The Airport and Subway were not able to find a viable, comparable location in another part of the Airport for the replacement premises. At that point, the Airport and Subway agreed that an early termination of the lease was necessary. The Airport Commission approved an early termination and buyout of BaySubway’s lease on September 9, 2014 in an amount not-to-exceed \$1,200,000. • The proposed resolution would authorize an early termination and buyout of Subway’s lease with the Airport in an amount not-to-exceed \$1,200,000. The buyout would cancel the existing Subway lease, and as a result, Subway would permanently close its two locations and waive any further claims associated with this lease. <p>Fiscal Impact</p> <ul style="list-style-type: none"> • The buyout amount of \$1,200,000 was based on an analysis of Subway’s earnings performed by an independent consulting firm, LeighFisher, LLC, retained by the Airport. • As a result of the Airport’s “residual rate setting methodology” (breakeven policy) used by the Airport to determine rental rates, landing fees, and related fees for all Airlines, approving payment of \$1,200,000 to Subway will not result in any budgetary shortfall for the Airport. <p>Recommendation</p> <ul style="list-style-type: none"> • Approve the proposed resolution. 	

MANDATE STATEMENT

According to City Charter Section 9.118, contracts entered into by a department, board or commission having anticipated revenue to the City and County of one million dollars or more, or the modification, amendment or termination of any contract which when entered into had anticipated revenue of one million dollars or more, shall be subject to Board of Supervisors approval by resolution.

BACKGROUND

The San Francisco International Airport (Airport) entered into a ten-year lease with GDDC, Inc. in 2003, based on a competitive process to sell food and beverages at two locations for 1,307 total square feet located in Airport Terminal 3, one on the mezzanine level and a second location in Boarding Area E.

GDDC, Inc. sold its franchise to BaySubway Airport (Subway), and the Airport Commission approved assignment of the lease to Subway in 2007. Ms. Cheryl Nashir, Director of Resource Development at the Airport, reports that assignment of the lease was not subject to approval by the Board of Supervisors because such assignments are not considered to be lease modifications by the City Attorney's Office.

The lease required the tenant to commit a Minimum Investment Amount (\$250 per square foot) to build out their premises. The lease also stipulated rent and fees to be paid to the Airport on an annual basis, which included:

- (a) Base rent calculated as the greater of:
 - a. Minimum Annual Guarantee (MAG) rent, or;
 - b. Percentage rent based on gross revenue:
 - 6% of gross revenues up to \$600,000
 - 8% of gross revenues from \$600,001 to \$1,000,000
 - 10% of gross revenues from \$1,000,001 and above
- (b) Various fees including:
 - Tenant Infrastructure Fee (\$15 per square foot),
 - Food Court Fee (\$15 per square foot)
 - Promotional Charge (\$1 per square foot)

The Airport began its planned renovation of Terminal 3 Boarding Area E in 2011, which required the closure, demolition, and relocation of existing food and beverage tenants in Boarding Area E. The renovation period was expected to last one year. Due to the closure of Boarding Area E, the Airport and Subway executed the first amendment to the existing lease to suspend the MAG rent, percentage rent, and fees paid by Subway during the renovation period. The rent and fees were to be reinstated at the end of the renovation period when Subway was able to resume its operations. The amendment was approved by the Board of Supervisors on July 20, 2011.

The Airport and Subway executed the second amendment to the lease in 2012, which provided for replacement locations¹ in Boarding Area E and a new ten-year lease term to commence upon completion of the renovations to Boarding Area E of Terminal 3. The amendment also provided an Unamortized Construction Reimbursement of \$154,907 to Subway to compensate for the initial investments to build out their Boarding Area E location required under the existing lease. The second amendment was approved by the Board of Supervisors on July 27, 2012.

Prior to Subway commencing their renovations, the Airport executed an agreement with United Airlines (United) to build its United Club in Boarding Area E, located next to Subway's proposed location. According to Ms. Sharon Perez, Principal Property Manager at the Airport, the Airport and United Airlines subsequently agreed that there was not adequate square footage available for the United Club, a United customer service office and Subway. As a result, the Airport was unable to deliver the proposed replacement premises to Subway.

The Airport and Subway were not able to find a viable, comparable location in another part of the Airport for the replacement premises. At that point, the Airport and Subway agreed that an early termination of the lease was necessary. The Airport Commission approved an early termination and buyout of Subway's lease on September 9, 2014 in an amount not-to-exceed \$1,200,000.

DETAILS OF PROPOSED LEGISLATION

The proposed resolution would authorize an early termination and buyout of Subway's lease with the Airport in an amount not-to-exceed \$1,200,000. The buyout would cancel the existing Subway lease, and as a result, Subway would permanently close its two locations and waive any further claims associated with this lease.

As noted above, the Airport determined that Subway and the United Club were not able to be located adjacent to each other in Boarding Area E. Subway and the Airport have not been able to locate a comparable space elsewhere in the Airport space for Subway to lease, which necessitated the termination of the existing lease.

FISCAL IMPACT

According to Ms. Perez, the buyout amount of \$1,200,000 was based on an analysis of Subway's earnings performed by an independent consulting firm, LeighFisher, LLC, retained by the Airport. The analysis estimated net present value of the Subway lease to be \$1,565,000². Airport staff negotiated with Subway and reached an agreement to buy out the ten-year term of the lease for an amount of \$1,200,000, which is \$365,000 or 23 percent less than the net

¹ Replacement locations were to be constructed by Subway. Per the lease amendment, the minimum investment amount for these premises was to be \$350 per square foot.

² The LeighFisher analysis calculated the earnings before interest, taxes and depreciation as a percentage of Subway's sales for its last three years of operation. This percentage was applied to projected ten years of forgone earnings for the ten-year lease term. A discount factor of 12 percent was applied to determine the net present value of lost earnings, which totaled \$1,565,000.

present value of the \$1,565,000 of the Subway lease. The buyout will provide compensation for the lost earnings during the ten-year term of the lease. Funding for the \$1,200,000 buyout payment was included in the Airport's Fiscal Year 2014-15 budget, which was approved by the Board of Supervisors.

Impact of Loss of Subway Rental Revenue

As a result of the Airport's "residual rate setting methodology" (breakeven policy) used by the Airport to determine rental rates, landing fees, and related fees for all Airlines, approving payment of \$1,200,000 to Subway will not result in any budgetary shortfall for the Airport. The residual rate setting methodology is a formula which sets the schedule of all rental rates, landing fees, and related fees to a level which ensures that Airport revenues received from all of the airlines at the Airport, plus the non-airline revenues received by the Airport, is equal to the Airport's total costs, including debt service and operating expenditures. Therefore, the payment of \$1,200,000 to Subway and lost rental revenue from Subway, will not have a direct impact on the Airport's budget.

Impact on City General Fund

In accordance with the Lease and Use Agreement between the Airport and the airlines, 15 percent of all concessions revenues realized by the Airport are transferred to the City's General Fund as an Annual Service Payment. According to Mr. Bruce Robertson, Budget Director at the Airport, due to the closure of the tenants' operations as part of the Airport's Terminal 3 East renovation, the Airport will lose concessions revenues. However, Mr. Robertson reports that this loss of revenues will be offset by higher concessions revenues elsewhere in the Airport. In FY 2014-15, the Airport estimates providing an Annual Service Payment of approximately \$38,400,000, based on 15 percent of the Airport's total concessions revenue, to the City's General Fund.

RECOMMENDATION

Approve the proposed resolution.

Item 4 File 14-1013	Department: San Francisco International Airport (Airport)
EXECUTIVE SUMMARY	
<p style="text-align: center;">Legislative Objectives</p> <p>The proposed resolution would approve the first amendment to the existing concession lease between the Airport and Emporio Rulli to (1) add a second location of 405 square feet of space in the food court in Terminal 3, (2) increase the MAG amount by \$20,322 from \$120,031 to \$140,353 and (3) authorize the Airport to add the second location to Emporio Rulli's lease without undergoing a competitive process that would otherwise be required under City Administrative Code Section 2A.173.</p> <p style="text-align: center;">Key Points</p> <ul style="list-style-type: none"> • Based on a competitive process, the Board of Supervisors approved a resolution (File 03-1710) in December 2003 that authorized the San Francisco International Airport (Airport) to enter into 28 concession leases with various vendors including Emporio Rulli, Inc. (Emporio Rulli) for a term of ten years with one option to extend the term of the lease by two years for 2,392 square feet of space in Boarding Area F of Terminal 3 to provide food concessions. • United Airlines, which leases Gates 76 through 79, began ramp construction work in September 2012 and diverted planes to other gates in Terminal 1 and Terminal 3. According to Mrs. Evelyn Reyes-Dizadji, Airport Principal Property Manager, since September 2012 when United Airlines began construction, foot traffic and associated revenues in Terminal 3 where Emporio Rulli is located have decreased by an estimated 40 percent. • Under the proposed amendment, the Airport would allocate to Emporio Rulli a second concession location of 405 square feet in the food court in Terminal 3 as compensation for the declining foot traffic and related reduced sales at the current Emporio Rulli location in Boarding Area F of Terminal 3. <p style="text-align: center;">Fiscal Impact</p> <ul style="list-style-type: none"> • Under the provisions of the amendment, Emporio Rulli would pay an additional \$85,041 per year in MAG rent and other fees to the Airport. <p style="text-align: center;">Recommendation</p> <ul style="list-style-type: none"> • Approve the proposed resolution. 	

MANDATE STATEMENT / BACKGROUND**Mandate Statement**

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

Administrative Code Section 2A.173 requires the Airport to conduct a competitive process for concession leases on Airport property.

Background

Based on a competitive process, the Board of Supervisors approved a resolution (File 03-1710) in December 2003 that authorized the San Francisco International Airport (Airport) to enter into 28 concession leases with various vendors including Emporio Rulli, Inc. (Emporio Rulli) for a term of ten years with one option to extend the term of the lease by two years. The lease with Emporio Rulli was for 2,392 square feet in Boarding Area F of Terminal 3 to provide food concession. The Airport delivered the space to Emporio Rulli in May 2006 after completion of the Airport's renovations in Boarding Area F. The lease commencement date began on completion of Emporio Rulli's tenant improvements on November 19, 2006 and extended for ten years through November 18, 2016 with one option to extend the term by an additional two years through November 18, 2018. Rent was the greater of the Minimum Annual Guarantee (MAG), which is \$120,031,¹ or percentage rent.

United Airlines, which leases Gates 76 through 79, began ramp construction work in September 2012 and diverted planes to other gates in Terminal 1 and Terminal 3. According to Mrs. Evelyn Reyes-Dizadji, Airport Principal Property Manager, since September 2012 when United Airlines began construction, foot traffic and associated revenues in Terminal 3 where Emporio Rulli is located have decreased by an estimated 40 percent.

DETAILS OF PROPOSED LEGISLATION

The proposed resolution would approve the first amendment to the existing concession lease between the Airport and Emporio Rulli to (1) add a second location of 405 square feet of space in the food court in Terminal 3, (2) increase the MAG amount by \$20,322 from \$120,031 to \$140,353 and (3) authorize the Airport to add the second location to Emporio Rulli's lease without undergoing a competitive process that would otherwise be required under City Administrative Code Section 2A.173.

Under the proposed amendment, the Airport would allocate to Emporio Rulli a second concession location of 405 square feet in the food court in Terminal 3 as compensation for the declining foot traffic and related reduced sales at the current Emporio Rulli location in Boarding

¹ Under the provisions of the concession lease between the Airport and Emporio Rulli, the MAG is adjusted annually to reflect inflation in the previous year.

Area F of Terminal 3. Under the proposed amendment, Emporio Rulli would be able to operate the 405 square feet of space in the food court through the end of the term of the previously awarded concession lease on November 18, 2016.

As noted above, the Airport is requesting that the Board of Supervisors waive the competitive process requirements for the added 405 square feet of food court space. According to Ms. Reyes-Dizadji, the Airport staff believe that this request is appropriate because (1) because the initial contract awarded to Emporio Rulli was approved under the competitive process required under the City's Administrative Code, (2) the United Airlines construction work has reduced the revenues to Emporio Rulli by approximately 40 percent, and (3) the Airport is increasing the MAG by \$20,322.

FISCAL IMPACT

The proposed resolution would add a second location to the existing concession lease between the Airport and Emporio Rulli comprised of 405 square feet of food and beverage space in the food court of Terminal 3.

Under the provisions of the amendment, Emporio Rulli would pay an additional \$85,041 per year in MAG rent and other fees to the Airport as shown in Table 1 below.

Table 1: Annual MAG and Other Fees Paid by Emporio Rulli to the Airport under the Proposed First Amendment

	Annual Amount Per Square Foot	Current Square Footage	Current Total Amount	Additional Square Footage	Additional Amount	New Total Amount
Minimum Annual Guarantee	\$50.18	2,392	\$120,031	405	\$20,322	\$140,353
Promotional Charge	1.00	2,392	2,392	405	405	2,797
Tenant Infrastructure Fee	15.00	-	-	405	6,075	6,075
Food Court Fee	15.00	-	-	405	6,075	6,075
Food Court Maintenance Fee	128.80	-	-	405	52,164	52,164
Total	\$209.98		122,423		\$85,041	\$207,464

RECOMMENDATION

Approve the proposed resolution.

Item 5 File 14-1077	Department: San Francisco International Airport (Airport)
EXECUTIVE SUMMARY	
<p style="text-align: center;">Legislative Objectives</p> <p>The proposed resolution would (a) approve the first amendment to the existing concession lease between the Airport and Marina's Café to add the second location; and (2) exempt the Airport from the competitive process requirements under the City Administrative Code Section 2A. 173. The proposed first amendment would add concession space on the first floor of the Rental Car Center, increasing the total square footage under the lease by 88 percent, or 207 square feet, from 235 square feet to 442 square feet; and increase the MAG by 88 percent, or \$9,936, from \$11,280 to \$21,216.</p> <p style="text-align: center;">Key Points</p> <ul style="list-style-type: none"> • The Airport entered into a concession lease with the Marina's Café in October 2012 through a competitive process to provide food and beverage services at the Airport's Rental Car Center. • In July 2014, Hertz Rent-A-Car (Hertz) moved its operations to the first floor of the Rental Car Center in order to relieve congestion on the fourth floor. Consequently, foot traffic on the fourth floor of the Rental Car Center has dropped by approximately 38 percent with a similar and corresponding decline in revenues at the Marina's Café fourth floor location. • To compensate for the decline in foot traffic, the Airport allowed the Marina's Café to add a second location comprised of 207 square feet on the first floor of the Rental Car Center. • Although the Airport's lease with Marina's Café does not generate more than \$1 million in revenues to the Airport and therefore, does not require Board of Supervisors approval under City Charter Section 9.118, the Airport cannot execute the proposed first amendment to the lease unless the Board of Supervisors waives the competitive requirements under Administrative Code Section 2A.173. • Under this proposed resolution, the Airport is requesting that the Board of Supervisors waive the competitive process to lease the additional 207 square feet of space because of the decline in revenues and because the original concession lease was awarded under a competitive process. <p style="text-align: center;">Fiscal Impact</p> <ul style="list-style-type: none"> • The subject lease would (1) increase the MAG amount payable by Marina's Café to the Airport by \$9,936, or 88 percent, from \$11,280 to \$21,216, and (2) increase the promotional fee charge of \$1 per square foot by \$207, or 88 percent, from \$235 to \$442 <p style="text-align: center;">Recommendations</p> <ul style="list-style-type: none"> • Amend the proposed resolution to be retroactive to August 1, 2014. • Approve the proposed resolution as amended. 	

MANDATE STATEMENT / BACKGROUND**Mandate Statement**

Charter Section 9.118(c) requires Board of Supervisors approval for leases with a term of ten years or more, including options to renew, or having anticipated revenue to the City of \$1,000,000 or more; or the modification or termination of these leases.

Administrative Code Section 2A.173 requires the Airport to conduct a competitive bid process for concession leases on Airport property.

Background

The Airport entered into a concession lease with the Marina's Café in October 2012 through a competitive process to provide food and beverage services at the Airport's Rental Car Center. The lease was for 235 square feet on the fourth floor of the Rental Car Center, and for a term of five years. Under the conditions of the existing concession lease, Marina's Café pays the Airport the greater of the Minimum Annual Guarantee (MAG) or a percentage of gross revenue.

At the time when the Airport and Marina's Café entered into the concession lease in October 2012, all of the rental car companies kept their rental offices on the fourth floor of the Rental Car Center. However, Hertz Rent-A-Car (Hertz) moved its operations beginning in July 2014 to the first floor of the Rental Car Center in order to relieve congestion on the fourth floor. Consequently, according to Ms. Sharon Perez, Airport Principal Property Manager, foot traffic on the fourth floor of the Rental Car Center has dropped by approximately 38 percent with a similar and corresponding decline in revenues at the Marina's Café fourth floor location.

To compensate for the decline in foot traffic, the Airport allowed the Marina's Café to add a second location comprised of 207 square feet on the first floor of the Rental Car Center. Marina's Café occupied this second location and opened for business on August 1, 2014. Therefore the proposed resolution should be amended for retroactivity.

DETAILS OF PROPOSED LEGISLATION

The proposed resolution would (a) approve the first amendment to the existing concession lease between the Airport and Marina's Café to add the second location; and (2) exempt the Airport from the competitive process requirements under the City Administrative Code Section 2A. 173. The proposed first amendment would add concession space on the first floor of the Rental Car Center, increasing the total square footage under the lease by 88 percent, or 207 square feet, from 235 square feet to 442 square feet; and increase the MAG by 88 percent, or \$9,936, from \$11,280 to \$21,216.

Under this proposed resolution, the Airport is requesting that the Board of Supervisors waive the competitive process to lease the additional 207 square feet of space because:

- (1) As a result of moving the Hertz rental counter from the fourth floor to the first floor of the Airport Rental Center, the Airport estimates that revenues to be realized Marina's Café will decrease by approximately 38 percent, and
- (2) The Airport awarded the initial concession lease on the fourth floor through a competitive process.

Although the Airport's lease with Marina's Café does not generate more than \$1 million in revenues to the Airport and therefore, does not require Board of Supervisors approval under City Charter Section 9.118, the Airport cannot execute the proposed first amendment to the lease unless the Board of Supervisors waives the competitive requirements under Administrative Code Section 2A.173.

FISCAL IMPACT

Under the proposed first amendment, the total lease space will increase by 88 percent, or 207 square feet, from 235 square feet to 442 square feet. Therefore, the subject lease would (1) increase the MAG amount payable by Marina's Café to the Airport by \$9,936, or 88 percent, from \$11,280 to \$21,216, and (2) increase the promotional fee charge of \$1 per square foot by \$207, or 88 percent, from \$235 to \$442.

Under this lease, Marina's Café pays the Airport the greater of the MAG or percentage rent. For the 12-month term from August 2013 through July 2014, for the existing 235 square feet of space, Marina's Café paid the Airport percentage rent of \$39,514, which is \$28,234 more than the MAG of \$11,280.

RECOMMENDATIONS

1. Amend the proposed resolution to be retroactive to August 1, 2014.
2. Approve the proposed resolution as amended.

<p>Item 7 File 14-1269 <i>(Continued from January 7, 2015)</i></p>	<p>Department: Department of Administrative Services Real Estate Division</p>
<p>EXECUTIVE SUMMARY</p>	
<p style="text-align: center;">Legislative Objectives</p>	
<p>The proposed resolution authorizes the Director of Real Estate to enter into a purchase and sale agreement for three contiguous lots located at 1945-1995 Evans Street for a purchase price of \$15,475,000.</p>	
<p style="text-align: center;">Key Points</p>	
<ul style="list-style-type: none"> • Under the proposed resolution, the Real Estate Division would enter into a purchase and sale agreement to purchase 1995 Evans Street in the Bayview Hunter’s Point neighborhood from the current property owner, Claire A. Spencer, consisting of three adjacent lots that comprise 2.05 acres of land. • Since August 1, 2013, the City leased this property as an interim storage space for the Department of Technology and the Department of Administrative Services’ Central Shops. A purchase option for \$16,000,000 was included in the original lease, which the City exercised on June 23, 2014. • General Bond Obligation Measure Proposition A, the Earthquake Safety and Emergency Response Bond II (ESER II), identified 1995 Evans Street as the future location for the City’s Forensic Services Division (FSD) and Traffic Company (TC) of the San Francisco Police Department (SFPD). General Bond Obligation projects require fee ownership of property by the City which is why the City seeks to purchase, rather than continue to rent, this property. 	
<p style="text-align: center;">Fiscal Impact</p>	
<ul style="list-style-type: none"> • An appraisal in August, 2014 concluded the value of the property to be \$11,360,000, or \$4,640,000 less than the current lease’s purchase option of \$16,000,000 negotiated in the summer of 2013. Mr. Updike reported that after negotiations with the landowner, the two parties mutually agreed to a purchase price of \$15,475,000. This is \$525,000 less than the original purchase option of \$16,000,000, but \$4,115,000 more than the recent appraised value. Funding for the purchase of this property would come from ESER II. 	
<p style="text-align: center;">Policy Consideration</p>	
<ul style="list-style-type: none"> • On January 7, 2015, the Budget and Finance Committee continued the resolution to the call of the Chair, requesting the Director of Real Estate to undertake further negotiations with the owner. Based on these negotiations, Mr. Updike reports that the owner will not reduce the \$15,475,000 purchase price, but will waive the \$70,000 General Fund rent which would otherwise be owed for January 2015. 	
<p style="text-align: center;">Recommendations</p>	
<ul style="list-style-type: none"> • Request the Director of Real Estate to include language in future purchase option agreements to require appraisals, and other due diligence procedures, prior to negotiating and agreeing to specified purchase prices for the City. • Approval of the proposed resolution is a policy decision for the Board of Supervisors. 	

MANDATE STATEMENT / BACKGROUND**Mandate Statement**

Administrative Code Section 23.1 requires Board of Supervisors approval of all resolutions and ordinances approving real property transactions. Administrative Code Section 23.4 requires Board of Supervisors approval of the granting of real property to the City before the Director of Real Estate can accept the deed to the property.

Background

The City has an existing lease with Claire A. Spencer for the property at 1945-1995 Evans Street ("1995 Evans Street") in the Bayview Hunter's Point neighborhood, which the City uses for interim storage for the Department of Administrative Services' (DAS) Central Shops and the Department of Technology's (DT) Public Safety Communications Division. The existing lease, which was previously approved by the Board of Supervisors for the 17 month period from August 1, 2013 through December 31, 2014 (File 13-1038), contained an option to purchase the property for \$16,000,000 by no later than December 31, 2014. The City exercised the option to purchase the property on June 23, 2014 at a renegotiated price of \$15,475,000.

Proposed Use of the Property

The City's Capital Plan identified 1995 Evans Street as the future location for the San Francisco Police Department (SFPD) Forensic Services Division's Crime Lab, and the SFPD Traffic Company, which houses the SFPD's motorcycle fleet. Development of 1995 Evans Street for the Crime Lab and Traffic Company will be funded by the Earthquake Safety and Emergency Response Bond II (ESER II), approved by the San Francisco voters on June 3, 2014. As General Bond Obligation projects require fee ownership of property by the City, the City seeks to purchase this property rather than continue to lease it.

Currently, the Crime Lab is spread out over two locations, one in the seismically deficient Hall of Justice, and one in Hunter's Point Shipyard which is scheduled for demolition to make way for a new residential development. Combining the two Crime Lab facilities in one location would provide uninterrupted service to residents while allowing the Crime Lab to modernize facilities and accommodate evolving technologies. Relocating the Police Department's Traffic Company to the 1995 Evans Street is important, as it will house the motorcycle fleet in a new seismically safe facility rather than the current seismically deficient Hall of Justice, ensuring that motorcycles are available to assist in recovery efforts in the event of a major disaster.¹

DETAILS OF PROPOSED LEGISLATION

The proposed resolution (1) authorizes the purchase of three adjacent lots located at 1945-1995 Evans Street (Lots 004, 005 and 006, all in Block 321) ("1995 Evans Street") by the City from Claire A. Spencer, Surviving Trustee of the William D. Spencer and Claire A. Spencer 1995

¹ San Francisco Earthquake Safety and Emergency Response Bond Program.
<http://www.sfearthquakesafety.org/motorcycle-police-and-crime-lab.html>.

Living Trust (“landowner”) for a purchase price of \$15,475,000; (2) adopt findings that the purchase and improvements on this property will not have a significant effect on the environment under the California Environmental Quality Act (CEQA); and (3) adopt findings that the acquisition of the property by the City is consistent with the City’s General Plan and Eight Priority Policies of City Planning Code Section 101.1.

Under the proposed resolution, the City would enter into a purchase and sale agreement with the landowner to purchase three adjacent lots located at 1995 Evans Street. This property would be used for the future location for the San Francisco Police Department (SFPD) Forensic Services Division’s Crime Lab, and the SFPD Traffic Company, which houses the SFPD’s motorcycle fleet. The property consists of 89,198 square feet, or approximately 2.05 acres of land, one existing two-story office building and a smaller building. The property is zoned PDR-2, Production, Distribution, and Repairs, and is currently being used as an interim storage space for both the Central Shops and DT’s Public Safety Communications Division. Under the purchase and sale agreement, the City would buy the property “as-is” from the landowner.

The City plans to demolish the existing structures on site and construct a new four-story, 90,000 square foot (sf) building, along with a separate 42,000 sf parking structure. The parking structure will consist of 82 spaces for sworn officers and City vehicles, 110 spaces for Traffic Company motorcycles, and storage space for 25 Forensic Services Division evidence impound vehicles.

Project Timeline

According to Mr. John Updike, Director of Real Estate, the City expects to complete the purchase of the property in January 2015. Arrangements have been made with the landowner to pay a prorated rental amount for January as part of the closing of escrow.

Environmental review under the California Environmental Quality Act (CEQA) was completed in September 2013 and the Final Mitigated Negative Declaration was published in November 2013. Upon finalizing the purchase and sale agreement, the City will begin development of 1995 Evans Street with project completion and occupancy by October 2018.

The Department of Public Works (DPW) selected HOK in November 2014 through a competitive Request for Qualifications (RFQ) process to provide architectural and engineering services. The Board of Supervisors approved an ordinance in October 2014, authorizing DPW to procure construction work through a hybrid Construction Manager/General Contractor and Design/Build approach (File 14-0846). DPW issued an RFQ in October 2014 for these services and plans to select a contractor in Spring of 2015. Table 1 below outlines the expected project timeline.

Table 1: Project Timeline

Project Phase	Date
Complete Purchase of Property	January 2015
Start Construction	May 2016
Complete Construction	July 2018
Building Occupancy	October 2018

Source: ESER 2014: Safeguarding San Francisco Bond Report

Relocation of the Items Currently Stored at 1995 Evans Street

Under the current lease, DAS's Central Shops and DT's Public Safety Communications Division are granted temporary use of the property for storage purposes. Items stored at 1995 Evans Street will be relocated to their new office near Pier 80 by early 2016, when construction will begin at the site.

Details of Proposed Property Purchase

The purchase price shall be allocated in the manner outlined in Table 2 below:

Table 2: Sales Price and Square Footage by Lot Number at 1995 Evans Street

Lot Number	Square Feet	Price
Lot 004	33,449	\$5,477,000
Lot 005	33,449	\$4,999,000
Lot 006	22,300	\$4,999,000
Total	89,198	\$15,475,000

Source: SF Real Estate Division, SF Planning Department

According to Mr. Updike, the variation in each lot's price was requested by the landowner for tax purposes. As the breakdown of the payment is not material to the City and was important to the landowner, the City agreed to this request.

Conformance with the General Plan, Area Plan, and Requirements under CEQA

The proposed resolution finds the purchase and improvements on the property at 1995 Evans Street are in conformance with the City's General Plan and the priority policies of Planning Code Section 101.1. The property is located within the Bayview Hunter's Point Area Plan within the Oakinba Activity Node.² The industrial nature of the proposed project is consistent with the objectives of the Bayview Hunter's Point Area Plan.

In November 2013, the Planning Department determined the proposed project at 1995 Evans Street would not have a significant effect on the environment under the California Environmental Quality Act (CEQA), and adopted a Final Mitigated Negative Declaration.

Except for the subject request for Board of Supervisors approval, no further approvals are required to finalize the purchase of the property.

FISCAL IMPACT

The proposed purchase price of \$15,475,000 is part of the total \$165,000,000 budget for development of 1995 Evans Street as shown in Table 3. The project will be funded by ESER II bond proceeds. The Board of Supervisors approved sale and appropriation of \$106,095,000 in ESER II bonds in August 2014 (Files 14-0801, 14-0802, 14-0811, 14-0812, and 14-0840), of which

² An "Activity Node" is a community-identified catalyst area in which to focus public investment. SF Planning Department, Environmental Planning Division, Bayview Hunters Point Area Plan Available online at: http://www.sf-planning.org/ftp/General_Plan/Bayview_Hunters_Point.htm.

\$30,319,674 was allocated to the Forensic Services Division and Traffic Company project at 1995 Evans Street.

Table 3: SFPD's Traffic Company and Forensic Services Division Project Budget

Service/Task Description	Amount
Purchase, Construction, & Installation	\$103,345,991
Project Control	\$38,399,373
Site Control (Property Purchase and Associated Costs)	\$16,500,000
Other Program Costs	\$3,949,636
Finance Costs	\$2,805,000
Total Program Budget	\$165,000,000

Source: DPW

January 2015 Rent During Closing Period

Closing for the property will not be complete until January 2015, which is after the December 31, 2014 purchase option date identified in the original lease. The City and the landowner have agreed that the City will continue to pay the landowner a prorated rental amount between December 31, 2014 and the closing of the property.

Ongoing Costs of Ownership

According to Mr. Updike, the ongoing costs to the City, as owner of the property, have not yet been determined, as this property will not be ready for occupancy until approximately 2018. When the design process is farther along closer to this date, future costs will be better known. Ongoing costs will be built into the FY 2017-2018 budget once the facility is constructed and ready for occupancy.

POLICY CONSIDERATION

Property Appraisal and Purchase Option

The Real Estate Division selected CBRE through a competitive process to prepare an appraisal of the three lots under consideration. The appraisal in August, 2014 concluded the value of the property to be \$11,360,000. This amount is \$4,640,000 less than the agreed upon price in the current lease's purchase option of \$16,000,000 negotiated in the summer of 2013. Mr. Updike reported that after negotiations with the landowner, the two parties mutually agreed to a purchase price of \$15,475,000. This is \$525,000 less than the original purchase option of \$16,000,000 agreed upon in the current lease, but \$4,115,000 more than the CBRE appraised value. The purchase options and appraisal values are outlined in Table 4 below.

Table 4: Purchase Option & Appraisal Values for 1995 Evans Street

Purchase Option	Price	Price per Square Foot for 89,198 Square Feet
Original Purchase Option (2013)	\$16,000,000	\$179.38
CBRE Appraisal (2014)	\$11,360,000	\$127.36
Renegotiated Purchase Option (2014)	\$15,475,000	\$173.49
Reduction between Original and Renegotiated Purchase Options	\$525,000	-
Difference between CBRE Appraisal and Renegotiated Purchase Option	\$4,115,000	-

Mr. Updike has expressed concerns with the methodology and conclusion of the CBRE appraisal, including:

- The CBRE appraisal considered the value of the three lots separately, rather than as one contiguous 89,198 sf site. Mr. Updike believes the ability to assemble 89,189 sf greatly increases the value of the property as a whole, and that is not reflected in the appraisal.
- The comparable sales used were some of the lowest in the market at the time. Mr. Updike found other sales he thought to be more comparable to this site that were valued closer to the purchase option price of \$16,000,000. However the appraiser disagreed, and did not find Mr. Updike's suggestions to be comparable.

The landowner was not required to reduce the price of 1995 Evans Street based on the CBRE appraisal after the City exercised its option to acquire the property. However, Mr. Updike was able to renegotiate the purchase option price down to \$15,475,000, \$525,000 less than the originally agreed upon price due to the appraisal information.

However, the proposed purchase price of \$15,475,000 is \$4,115,000 or 36.2 percent more than the CBRE appraised price of \$11,360,000.

Given the difference between the originally negotiated price and the CBRE appraisal of the property, Mr. Updike believes the renegotiated purchase option of \$15,475,000 (\$173.49 per sf) is a fair price for the City to pay for the subject property at 1995 Evans Street.

Comparison with Five Other Industrial Properties

The negotiated purchase price of \$173.49 per sf is higher than five other comparable industrial properties identified in the appraisal. As shown in Table 5 below, the average price per sf is \$154 for five comparable industrial properties, which would translate into an estimated \$13,736,492 for the 89,198 sf property at 1995 Evans Street. If the lowest priced property at 6000 3rd Street at \$113 per sf is not included, the average price for the other four properties is \$164 per sf, or an estimated \$14,628,472 for the 89,198 sf property at 1995 Evans Street. The \$15,475,000 proposed purchase price is still \$846,528 or 5.8 percent more than the \$14,628,472 amount.

Table 5: Comparison of Properties

Address	Size of Property (acres)	Price per Square Foot
1995 Evans Street	89,198 (2.05 acres)	\$173
6000 3 rd Street	2.00	113
1680 Evans Street	0.68	172
400 Alabama	0.57	175
888 Tennessee	0.87	156
200 Kansas	1.50	155
Average of 5 Other Properties		\$154
Average of 4 Other Properties		\$164

Option to Purchase Did Not Include Appraisal

As noted above, when the Board of Supervisors approved the lease for the 1995 Evans Street property in November of 2013, the lease included the option to purchase the property for \$16,000,000 (File 13-1038). The Real Estate Division indicated the \$16,000,000 option price was based on negotiations regarding land values of approximately \$180 per square foot for comparable properties and anticipated market conditions in 2014 or 2015. However, at that time, the Real Estate Division also advised that an appraisal would be conducted prior to entering into a purchase agreement. In addition, the Real Estate Division advised that the purchase of the property would be subject to other evaluations and “substantial due diligence”.

This language in the option to purchase agreement has not allowed the Real Estate Division to base the actual purchase price on the August 2014 appraised value of \$11,360,000. Rather, according to Mr. Updike, the option to purchase agreement simply allows the City not to exercise the option if the due diligence process discovers a matter that is not satisfactory to the City and cannot be mitigated.

The proposed purchase of 1995 Evans Street is now being requested for \$15,475,000, an average price of \$173.49 per sf. This price is \$4,115,000 or 36.2 percent more than the recent appraised value of \$11,360,000 (\$127.36 per sf), and 5.8% more than four other comparable industrial properties’ average value of \$14,628,472 (\$164 per sf).

Ideally, when options to purchase properties are included in future lease agreements, such options should not specify agreed purchase prices, without actual appraisals and/or ability to employ subsequent due diligence regarding the specified price. An appraisal of current day value does not mitigate the fact that both parties to a purchase agreement are taking risks as to future price increases or decreases in the real estate market. The Board of Supervisors should request the Director of Real Estate to include language in future purchase option agreements to require appraisals, and other due diligence procedures, prior to negotiating and agreeing to specified purchase prices for the City.

Eminent Domain

Eminent domain legally provides the City with the power to take private property for public use, with fair compensation to the private property owner for the taking of the property. According to Mr. Updike, the City most recently used eminent domain to acquire the Transbay Terminal properties and in 2005, the City used eminent domain to acquire private property for the new North Beach Branch Library. Over the past ten years, the City has also infrequently used eminent domain to purchase property for water and wastewater lines for the Public Utilities Commission. However, Mr. Updike notes that it is generally the City's policy to not use eminent domain except in extreme circumstances, when there is no other alternative.

Alternative Options

On January 7, 2015, the Budget and Finance Committee considered the following four alternative policy options:

1. Continue the Proposed Resolution and Exercise Eminent Domain - While generally not the City's policy unless there is no other alternative, the City could legally use eminent domain procedures to obtain the subject property at a potentially lower cost than the proposed \$15,475,000. However, the City has an existing lease agreement with the private owner of the property, which includes a purchase option for \$16,000,000 that the City has exercised. In addition, the use of eminent domain is a legal procedure, which will require significant legal time and expense, resulting in considerable delay in obtaining this property. Mr. Jim Buker, Senior Architect at the Department of Public Works advises that each 12 month delay results in an estimated 5% increase in the remaining project costs, or an estimated \$7 million per year.

2. Continue the Proposed Resolution and Request Further Negotiations – Although the existing lease agreement includes a purchase option for \$16,000,000, the Real Estate Division was able to negotiate a price reduction of \$525,000, to \$15,475,000 based on the recent appraisal. The recent appraised value was \$11,360,000 (\$127.36 per sf). Four other comparable industrial properties' reflect an average value of \$14,628,472 (\$164 per sf) for the subject property. Mr. Updike advises that he believes the proposed \$15,475,000 purchase price is a fair price for the subject property, given there are not any other properties of this size on the market. However, the Board of Supervisors could request the Real Estate Division to renegotiate with the existing property owner to attempt to further reduce the City's purchase price for the subject property.

3. Do Not Approve the Proposed Resolution – The proposed purchase price of \$15,475,000 is \$4,115,000 or 36.2 percent more than the recent appraised value of \$11,360,000 (\$127.36 per sf) and \$846,528 more than the \$14,628,472 (\$164 per sf) average price for four comparable industrial properties. When the Board of Supervisors approved the lease agreement, with the \$16,000,000 purchase option, the Real Estate Division advised that a subsequent appraisal and other evaluations and "substantial due diligence" would be conducted prior to entering into a purchase agreement. As noted, not approving the subject resolution will delay the completion of the subject project, resulting in additional costs.

4. Approve the Proposed Resolution – San Francisco voters approved General Obligation bonds for the subject Crime Lab and Traffic Company project in June 2014. The CEQA process

for the proposed project has now been completed for the 1995 Evans Street site and Mr. Buker advises that the City has expended an estimated \$1.1 million for site-specific design and related environmental review expenses for the project at 1995 Evans Street. If the Crime Lab and Traffic Company project is relocated to a different site, the estimated \$1.1 million of site-specific design and environmental expenses already incurred would be forfeited and new design and environmental expenses at a different site would be incurred. According to Mr. Buker, the project schedule would also be delayed by an estimated 12-30 months, resulting in building construction inflation costs of an estimated 5% per year, or between \$7 million to \$19 million in additional costs to the overall project, depending on the length of the delay. In addition, Mr. Updike notes that there are no comparable properties of this size (2 acres) on the market for a comparable price, and any further negotiations with the existing owner are not realistic.

Further Negotiations with Owner

On January 7, 2015, the Budget and Finance Committee continued this resolution to the call of the Chair and requested the Director of Real Estate to undertake additional negotiations with the owner to attempt to further reduce the City's purchase price.

Based on these negotiations, Mr. Updike advises that the owner of 1995 Evans Street will not reduce the proposed \$15,475,000 purchase price. However, as noted above, the City and the landowner previously agreed that the City will continue to pay the landowner prorated rent between December 31, 2014 and the closing of the property. Based on these further negotiations, Mr. Updike advises that the owner has now agreed to waive the City's lease payment for January 2015, a \$70,000 General Fund savings.

Mr. Updike further notes that the owner advises that if the City does not approve the pending \$15,475,000 purchase offer, the owners will exercise their rights to terminate the City's existing lease at 1995 Evans Street, thereby providing the City with only the required 30 day notice to vacate the 1995 Evans Street property. As discussed above, under the existing lease, DAS's Central Shops and DT's Public Safety Communications Division currently use the 1995 Evans Street property for storage. The current plan is to relocate these storage facilities in early 2016, when construction is anticipated to begin on the 1995 Evans Street site. According to Mr. Updike, the City does not have an alternative location for 40,000 sf of interior storage on a two acre lot at this time.

RECOMMENDATIONS

1. Request the Director of Real Estate to include language in future purchase option agreements to require appraisals, and other due diligence procedures, prior to negotiating and agreeing to specified purchase prices for the City.
2. Approval of the proposed resolution is a policy decision for the Board of Supervisors.