



London N. Breed, Mayor
Naomi M. Kelly, City Administrator



Andrico Q. Penick
Director of Real Estate

September 9, 2019

Through City Administrator Naomi Kelly

Honorable Board of Supervisors
City and County of San Francisco
City Hall, Room 244
1 Carlton B. Goodlett Place
San Francisco, CA 94102

**Subject: Amendment to Lease – 350 Rhode Island Street-North
Rent Credit to City of \$2,600,000**

Dear Board Members:

Attached for your consideration is a Resolution approving and authorizing an Amendment to Lease for the subject property.

Background

Pursuant to unanimously approved Resolution No. 388-17, dated November 3, 2017, the Board of Supervisors approved a lease of up to 125,122 square feet of the subject property (accepted in phases as natural lease terminations occurred). The lease primarily served to enable the District Attorney's Office to relocate from the deteriorating Hall of Justice at 850 Bryant Street. That lease formally commenced on July 24, 2018.

Current ownership has engaged in a sales process for the building. In connection with such a potential sale, ownership and Real Estate staff negotiated terms and conditions of a modest Amendment to Lease that would facilitate the sale and modify certain expense protections provided to the City going forward.

Resolution

Specifically, the Resolution approves the provision of a rent credit in the total negotiated amount of \$2,600,000, payable to the City as a credit against rent owed over the course of 48 months, in a schedule developed in coordination with budget staff and included in the Amendment to Lease. In consideration for this credit, the City would waive its current real

estate expense pass-through protections related to property tax increases. Under the existing lease, those provisions expire on July 25, 2021.

The City's existing lease provides limited fiscal protection (until July, 2033) against a pass-through tax impact from a sale (Prop 13 Protection) – only in the event a sale occurs prior to July 25, 2021. Recognizing this, the existing owner has the opportunity to sell the property today, which would result in a sales price reduction estimated at roughly \$10 M (to reflect the cost of 18 years of Prop 13 Protection which would be a discount to the buyer), or the owner can wait and effect a sale after July, 2021 (and probably at a higher sales price), in which case the City receives no protection (City would absorb the tax increase immediately upon sale in summer, 2021).

Given the large fiscal impact from the Prop 13 Protection resulting from an immediate sale, it is most likely that the owner will simply wait for the Protection period to expire in July, 2021, absent this Amendment to Lease. We see no evidence that the market for prime, fully-leased office buildings will be in decline prior to that date, further supporting the notion that the owner's patience would be rewarded. Additionally, the Amendment to Lease facilitates the receipt of transfer taxes from this pending sale, in the amount of \$4,000,000 this fiscal year.

The owner and City staff have negotiated a proposed rent credit to facilitate an earlier sale of the property and thus a waiver of the Prop 13 Protection, in an amount that is favorable to the City as compared to the outcome of a deferred sale in summer of 2021 – a credit that is the equivalent of 48 months of Protection (until approximately October, 2023).

If you have any questions regarding this lease amendment, please contact me or John Updike at john.updike@sfgov.org.

Respectfully,



Andrico Q. Penick
Director of Property