

**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: September 14, 2017 Budget and Finance Committee Meeting

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Item 5 File 17-0831	Department: Port
EXECUTIVE SUMMARY	
<p style="text-align: center;">Legislative Objectives</p> <ul style="list-style-type: none"> • The proposed resolution approves a new lease between IDEO, LP, and the Port for approximately 26,901 square feet of office space in the Pier 26 Annex Building for a term of eight years from approximately September 2017 through August 2025. <p style="text-align: center;">Key Points</p> <ul style="list-style-type: none"> • The Port originally entered into an office space lease with IDEO at the Pier 26 Annex in 1995 without a competitive solicitation 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 2010 the Board of Supervisors approved the extension of the lease through 2020. The proposed new eight-year lease would combine the original 19,434 square feet of lease space with 7,467 square feet of space from a second lease agreement with IDEO, totaling 26,901 square feet. • The Port is recommending a new lease with IDEO at current market rates without undergoing a competitive solicitation because (a) IDEO originally leased space at the Pier 26 Annex in 1995 and funded the development of office space in the vacant shed space, thus increasing the value of the Port property; (b) IDEO is a tenant in good standing, which according to the Port's Tenant in Good Standing Policy allows for consideration of lease amendments, additional term, and change in leasehold size; (c) competitive bidding for office space rarely occurs in the private market; and (d) IDEO will pay fair market rent as determined by a comprehensive market study approved by the Port Commission. <p style="text-align: center;">Fiscal Impact</p> <ul style="list-style-type: none"> • The Port Commission approves the Port's Rental Rate Schedule each fiscal year, which sets the minimum fair market rent for lease of Port properties. Under the proposed lease between IDEO and the Port for the Pier 26 Annex, the first year rent is \$3.35 per square foot per month (\$40.20 per square foot per year), which exceeds the FY 2017-18 Rental Rate Schedule minimum rate of \$3.25 per square foot per month for the Pier 26 Annex. • Total first year rent paid by IDEO to the Port is \$1,081,420; total rent to the Port over eight years is \$9,997,487. <p style="text-align: center;">Recommendation</p> <ul style="list-style-type: none"> • Approve the proposed resolution. 	

MANDATE STATEMENT

City 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.

According to City Administrative Code Section 23.33, leases of City property with rent of at least \$2,500 per month should be awarded through a competitive solicitation unless such competitive solicitation is impractical and impossible. The terms “impractical and impossible” are not defined in the Administrative Code.

Administrative Code Section 23.33 also specifies that any leases of City-owned property awarded without a competitive solicitation shall have rent equal to fair market value or more.

The proposed new lease would be awarded to the existing lessee through direct negotiations rather than through a competitive process. Rent would be set at fair market value based on the Port’s Rental Rate Schedule.

BACKGROUND

IDEO, LLC (IDEO), a design and innovation 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. The Port awarded the original IDEO lease without a competitive solicitation 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. The lease was subsequently renewed in 2001, 2002, and 2004, but never 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 October 2010, the Board of Supervisors approved a five year lease extension through November 2015, with an option for an additional five year extension through November 2020, and the addition of 7,074 square feet of office space, bringing the total leased area to 19,434 square feet (File No. 10-0692; Res. 493-10). In July 2012, the Port and IDEO entered into a four year lease, which did not require Board of Supervisors approval, for 7,467 square feet of office space in the Pier 26 Annex to occupy the entire premises of 26,901 square feet. Between the two leases, IDEO currently pays \$69,775 per month, for an average rental rate of \$2.59 per square foot.

DETAILS OF PROPOSED LEGISLATION

The proposed resolution would approve a new lease between the Port and IDEO for 26,901 square feet of office space in the Pier 26 Annex for a term of eight years from approximately

September 2017 through August 2025. The terms of the proposed lease are summarized in Table 1 below.

Table 1: Proposed Lease Terms

Lease Terms	
Premises	26,901 square feet of office space
Term	Eight years from approximately September 2017 through August 2025
First Year Rent	\$3.35 square foot per month (\$90,118 per month)
Rent Increase	7.5 percent in year two and 3.0 percent in years three through eight
Utilities and Operating Costs	Paid by tenant
Maintenance	Pier substructure and utility infrastructure on Pier 26 maintained by Port Pier 26 Annex office building maintained by tenant
Option to Renew	Tenant has right to make an offer to extend or renew the lease, subject to negotiation between the Port and the tenant of the terms of the lease extension

FISCAL IMPACT

As shown in Table 2 below, under the proposed lease IDEO would pay to the Port monthly rent in the first year of \$90,118. The total first year rent paid by the tenant to the Port would be \$1,081,420. Over the term of the eight year lease, the tenant would pay the Port rent of \$9,997,487.

Table 2: Rents Payable to the Port over Eight Year Lease

Year	Monthly Rate (per square foot)	Total Monthly Rent	Total Annual Rent	Percentage Change from Previous Year
1	3.35	90,118	1,081,420	n/a
2	3.60	96,844	1,162,123	+7.5%
3	3.71	99,803	1,197,633	+3.0%
4	3.82	102,761	1,233,142	+3.0%
5	3.94	105,990	1,271,879	+3.0%
6	4.06	109,218	1,310,617	+3.0%
7	4.18	112,446	1,349,354	+3.0%
8	4.31	115,943	1,391,320	+3.0%
Total			\$9,997,487	

* Totals may not add due to rounding.

Fair Market Rent

The Port Commission approves the Port's Rental Rate Schedule each fiscal year, which sets the minimum fair market rent for lease of Port properties. In order to determine fair market rent for Port properties, the Port reviewed market reports published by seven San Francisco commercial real estate firms, as well as its own leasing activity, supply and demand, and vacancy rates. The proposed rate schedule was peer reviewed by third party consultant Keyser Marston Associates.

Under the proposed lease between IDEO and the Port for the Pier 26 Annex, the first year rent is \$3.35 per square foot per month (\$40.20 per square foot per year), which exceeds the FY 2017-18 Rental Rate Schedule minimum rate of \$3.25 per square foot per month for the Pier 26 Annex.

No Competitive Solicitation

According to Ms. Elsa Lamb, Port Commercial Property Manager, when an existing office lease term is coming to an end, the Port typically attempts to negotiate an extension of the existing lease or a new sequential lease with the current tenant if the tenant is in good standing. According to Ms. Lamb, the Port is recommending a new lease with IDEO at current market rates without undergoing a competitive solicitation because (a) IDEO originally leased space at the Pier 26 Annex in 1995 and funded the development of office space in the vacant shed space, thus increasing the value of the Port property; (b) IDEO is a tenant in good standing, which according to the Port's Tenant in Good Standing Policy allows for consideration of lease amendments, additional term, and change in leasehold size; (c) competitive bidding for office space rarely occurs in the private market; and (d) IDEO will pay fair market rent as determined by a comprehensive market study approved by the Port Commission.

In the resolution setting the Port's FY 2017-18 Rental Rate Schedule, the Port Commission "finds that competitively bidding the real property agreements covered by the delegated authorities and the rental rate schedules approved by this Resolution is impractical." The Synopsis of Port Leasing Policies, an attachment to the rental rate schedule provided to the Port Commission, notes: "The Port has a high volume of leases (about 550) for relatively small leased areas at nominal rental rates. To competitively bid such a large volume of leases would be impractical because the benefit of doing so does not outweigh the cost of resources that would be required just for this effort. Moreover, Port is generally able to accommodate most entities that wish to enter into leases for general special events, offices, and pier and open land storage space. As such, it is the policy of the Port not to competitively bid leases or licenses for special events, office, warehouse space, or unimproved land."

RECOMMENDATION

Approve the proposed resolution.