

**CITY AND COUNTY OF SAN FRANCISCO**  
**BOARD OF SUPERVISORS**

**BUDGET AND LEGISLATIVE ANALYST**

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July 19, 2013

**TO:** Budget and Finance Committee  
**FROM:** Budget and Legislative Analyst  
**SUBJECT:** July 24, 2013 Budget and Finance Committee Meeting

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| <b>Item 1</b><br><b>File 13-0516</b><br><i>(continued on July 10, 2013)</i>   | <b>Department:</b><br><b>Public Utilities Commission (PUC)</b> |
| <b>EXECUTIVE SUMMARY</b>  |  |
| <p><b>Legislative Objectives</b></p> <ul style="list-style-type: none"> <li>• The proposed resolution would approve an emergency public work contract for the San Francisco Public Utilities Commission (PUC) in accordance with Administrative Code Section 6.60 to replace the insulation in the Phases A and C transformers of Hetch Hetchy Power Holm Powerhouse Unit 1 (HPH1), which was completed on January 17, 2013, for a not to exceed amount of \$521,465.</li> </ul> <p><b>Key Points</b></p> <ul style="list-style-type: none"> <li>• On July 31, 2012, HPH1 automatically shutdown to protect the transformer from further damage due to a sudden pressure change in the transformer. On August 23, 2012, the PUC retained Systems 3 to remove and monitor the oil from the transformers for Delta Star, Inc. (Delta Star) to determine the cause of problem. Delta Star determined that the increase of combustible gasses was due to the deterioration of the transformer insulation in the Phase A and Phase C transformers.</li> <li>• On September 6, 2012, the PUC General Manager declared an emergency to repair the Phases A and C transformers of the HPH1. PUC decided to also rehabilitate the Phase B transformer because all three phases were manufactured at the same time 15 years ago and given that all three phases showed deterioration now.</li> <li>• On February 12, 2013, the repairs to the Phases A, B, and C transformers of the HPH1 was completed by Delta Star.</li> </ul> <p><b>Fiscal Impacts</b></p> <ul style="list-style-type: none"> <li>• Delta Star provided an original estimate of \$732,517 which included rewinding the transformer, which entails replacing the main components of the transformer. The total project cost was \$521,465, because rewinding was not required. To date, the PUC has paid Delta Star \$250,000.</li> <li>• The funding for the project is PUC's FY 2012-13 capital budget, which is funded by power revenues.</li> </ul> <p><b>Recommendations</b></p> <ul style="list-style-type: none"> <li>• On July 10, 2013, the Budget and Finance Committee amended the proposed resolution on Page 2, lines 9 and 10 to reflect (a) the correct completion date of February 12, 2013, instead of January 17, 2013, and (b) that the repairs included work on all three transformer Phases A, B, and C, instead of only the Phases A and C transformers.</li> <li>• Approve the proposed resolution as amended.</li> </ul> |  |

## MANDATE STATEMENT/BACKGROUND

### Mandate Statement

In accordance with Administrative Code Section 6.60, an emergency contract awarded by a City department that exceeds \$250,000 requires approval by the Board of Supervisors. Administrative Code provisions also authorize department heads responsible for such emergency work to award and proceed with emergency contracts, which are not subject to the City's regular competitive bidding procedures. The Administrative Code defines an emergency as a sudden, unforeseeable and unexpected occurrence or a discovery of a condition involving a clear and imminent danger, demanding immediate action to prevent or mitigate loss or damage to, life, health, property or essential public services.

### Background

The San Francisco Public Utilities Commission's (PUC) Hetch Hetchy Water and Power Project (HHWP) is a hydro power generating system located in Tuolumne County, California, which consists of two hydro-generators, the Hetch Hetchy Power Holm Powerhouse Unit 1 (HPH1) and the Hetch Hetchy Power Holm Powerhouse Unit 2 (HPH2). The HPH1 transformer bank<sup>1</sup> consists of three transformers, Phase A, B, and C, all of which must be in service to produce generation from HPH1. HPH1 produces about 360,000,000 kilowatt hours per year of the total 1,700,000,000 kilowatt hours per year, or approximately 21% of the clean hydro-generation that HHWP produces.

On July 31, 2012, the HPH1 tripped offline, or automatically shut off to protect the transformer from further damage, due to a sudden pressure change on the transformer bank. On August 1, 2012, HHWP crews performed oil tests on the transformer bank and detected combustible gasses trapped in the oil insulation on the Phases A and C transformers. According to Mr. Ed Harrington, then General Manager at the PUC, the Institute of Electrical and Electronics Engineers (IEEE) standards recommend combustible gasses less than 720 parts per million (ppm) for continued use. On August 1, 2012, HHWP crews found that the combustible gasses had increased from 88 ppm on April 20, 2012, to 9,197 ppm in the Phase A transformer and to 1,061 ppm in the Phase C transformer. According to Ms. Margaret Hannaford, Division Manager of HHWP, because the Phase A and Phase C transformers were not in compliance with the IEEE standards, the HPH1 remained out of service.<sup>2</sup>

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<sup>1</sup> A transformer is essential for the transmission, distribution, and utilization of electrical energy and is a device used to change the voltage of an alternating current in one circuit to a different voltage in a second circuit. The HPH1 generates energy at 13.8 kilovolts, and the HPH1 transformer bank transforms the energy to 230 kilovolts to transmit the energy to and interconnect with the California electrical grid.

<sup>2</sup> The shutdown of HPH1 did not affect the PUC's ability to generate electricity from HPH2 and the three other PUC powerhouses. During the outage between July 1, 2012 and February 12, 2013, the PUC provided electricity from the remaining HHWP hydro-generating units and the City and County of San Francisco (CCSF) deferred energy account available to HHWP through their CCSF-Pacific Gas & Electric Interconnection Agreement.

On August 2, 2012, PUC contacted Delta Star, Inc. (Delta Star), the original manufacturer of the transformer to support HHWP staff in their investigation of the cause of the problem. Based on these initial investigations, on August 23, 2012, the PUC then retained another contractor, Systems 3, with whom PUC had an existing contract for HHWP repairs to remove and monitor the oil from the transformers for Delta Star to determine the cause of problem. Delta Star determined that the increase of combustible gasses was due to the deterioration of the transformer insulation in the Phase A and Phase C transformers.<sup>3</sup> According to Ms. Hannaford, insulation deterioration is a common failure of older transformers, which were 15 years old at the time of failure.

On September 6, 2012, Delta Star inspected the transformers and informed PUC that remedies to the insulation deterioration included (a) replacing the transformer entirely or (b) rewinding the transformer, which entails replacing the main components of the transformer. As a result, on September 6, 2012, the PUC General Manager declared an emergency to repair the Phase A and Phase C transformers of the HPH1 and awarded an emergency contract to Delta Star in an amount not-to-exceed \$732,517.

According to Ms. Hannaford, Delta Star provided an original estimate of \$732,517 which included the price for rewinding the transformers. However, during the week of October 30, 2012, Delta Star determined that Phase A transformer only required rehabilitation of the core, one component of the transformer, and not rewinding of the transformer. During the week of November 26, 2012, the Phase A transformer was returned and the Phase C transformer was removed for rehabilitation. Delta Star determined the Phase C transformer only required rehabilitation of the core and not rewinding of the transformer. During the week of December 24, 2012, the Phase C transformer was returned and the Phase B transformer was removed for rehabilitation. According to Ms. Hannaford, the PUC decided to rehabilitate the Phase B transformer at this time because all three phases had been manufactured at the same time 15 years ago and given that all three phases showed deterioration now. During the week of January 21, 2013, the Phase B transformer was returned. According to Ms. Hannaford, all of the HPH1 repairs on the Phases A, B, and C transformers were completed on February 12, 2013, for a total cost of \$521,465.

## DETAILS OF PROPOSED LEGISLATION

The proposed resolution would approve an emergency public work contract awarded by the PUC to Delta Star in accordance with Administrative Code Section 6.60, to replace the insulation in the Phases A and C transformers of the Hetch Hetchy Power Holm Powerhouse Unit 1 (HPH1), which was completed on January 17, 2013, in the amount of \$521,465.

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<sup>3</sup> If the core of a transformer is poorly insulated, a type of current called an eddy current is created which leads to localized overheating. This overheating generates combustible gasses in the transformer insulating oil, and the presence of these gasses caused the sudden pressure change on the transformer bank leading HPH1 to automatically shut down.

However, as noted above, the HPH1 repairs, which also included work on the Phase B transformer, were finally completed on February 12, 2013. Therefore, the proposed resolution should be amended on Page 2, lines 9 and 10 to specify the work to all three transformer Phases A, B, and C and to specify the February 12, 2013 completion date.

## FISCAL IMPACTS

As shown in the Table below, to date, Delta Star has submitted invoices to PUC totaling \$521,465. According to Ms. Hannaford, all of the repairs to the HPH1 were completed on February 12, 2013, such that no additional expenditures will be incurred.

### Total Actual Expenditures to Date

| Item         | Total Expenditures |
|--------------|--------------------|
| Labor        | \$156,811          |
| Equipment    | 320,408            |
| Materials    | 11,300             |
| Tax          | 32,946             |
| <b>Total</b> | <b>\$521,465</b>   |

As noted above, the original estimate provided by Delta Star was \$732,517, but rewinding the Phase A and C transformers was later determined to be unnecessary, such that the total cost was \$521,465, which is \$211,052 less than originally estimated. To date, PUC has paid Delta Star \$250,000. Ms. Hannaford advises that if the proposed resolution is approved, the PUC will pay Delta Star the balance owed of \$271,465 (\$521,465 total less \$250,000 already paid).

According to Ms. Cheryl Sperry, Principal Administrative Analyst with PUC, the funding for this emergency work was PUC's FY 2012-13 capital budget, as previously appropriated by the Board of Supervisors.

## RECOMMENDATIONS

1. On July 10, 2013, the Budget and Finance Committee amended the proposed resolution on Page 2, lines 9 and 10 to reflect (a) the correct completion date of February 12, 2013, instead of January 17, 2013, and (b) that the repairs included work on all three transformer Phases A, B, and C, instead of only the Phases A and C transformers.
2. Approve the proposed resolution as amended.

**Item 2**  
**File 13-0569**  
*(continued from July 10, 2013)*

**Department:**  
 San Francisco Public Utilities Commission (SFPUC)

## EXECUTIVE SUMMARY

### Legislative Objective

- The proposed resolution would authorize the SFPUC to enter into an amendment to an existing quarry lease with Oliver de Silva, Inc. as tenant, to (a) add approximately 58 acres to the existing 308.5 acre leased premises, for a total of 366.5 acres in the Sunol Valley, unincorporated Alameda County, (b) increase the depth of excavation from 140 feet to between 225 and 400 feet below ground, (c) extend the lease term by approximately 21 years from June 1, 2021 through July 16, 2042, or completion of reclamation, (d) add ancillary uses, including the installation and operation of asphalt and concrete plants, (e) take certain actions in furtherance of this proposed resolution, and (f) adopt findings pursuant to the California Environmental Quality Act (CEQA).

### Key Points

- The Board of Supervisors approved the existing lease (File 09-0832) with Oliver de Silva, Inc., as tenant, to operate 308.5 acres of the Sunol Valley Aggregate Quarry for an initial term of approximately 10.5 years from December 15, 2010 through June 1, 2021. The existing lease includes (a) two conditional extensions of the term for additional mining, stockpiling, processing, and selling of gravel, asphalt, and concrete for: (1) an approximately 21-year extension related to a first SMP 30 revision (subject resolution) through July 16, 2042, and (2) an approximately 22.5-year extension related to a second expected SMP 30 revision through December 31, 2064; and (b) a separate two-year reclamation period, that would include reclamation and restoration activities following the termination of mining and processing activities to create a SFPUC water storage lake at the subject quarry site beginning no later than December 31, 2066.

### Fiscal Impacts

- Under the existing and proposed amended lease, Oliver de Silva, Inc. pays the SFPUC the greater of either the (a) base rent or (b) royalty rent, based on percent of gross revenues. Oliver de Silva, Inc. paid the SFPUC \$1,870,651 in both base and royalty rents for the approximately 2.5 years of the existing lease from December 15, 2010 through June 30, 2013.
- Annual royalty rental payments are projected to exceed annual base rent payments to the SFPUC throughout the 31.5 years duration of the subject amended lease. Total lease rent payments of \$153,960,633 are estimated to be paid by Oliver de Silva to the SFPUC from December 15, 2010 through June 16, 2042.
- If the proposed amended lease is approved by the Board of Supervisors, Oliver de Silva, Inc. will also be required to implement specified environmental mitigation measures, estimated to cost \$6,310,000. However, if the proposed amended lease is not approved by the Board of Supervisors, SFPUC would be required to pay for these environmental mitigation measures.

### Recommendation

- Approve the proposed resolution.

## MANDATE STATEMENT / BACKGROUND

### Mandate Statement

In accordance with City Charter Section 9.118(c), any lease of real property for a period of ten or more years, including options to renew, or having anticipated revenues to the City in excess of \$1,000,000, is subject to Board of Supervisors approval.

### Background

The Sunol Valley Aggregate Quarry site is located within the San Francisco Public Utilities Commission's (SFPUC) Alameda Watershed lands, in an unincorporated area located in Alameda County, within the 47,000 acre watershed that is tributary to the San Antonio and Calaveras Reservoirs.

Since the 1960s, the SFPUC-owned Sunol Valley Aggregate Quarry site has been leased by the SFPUC to private quarry operators and used for sand and gravel extraction. The active sand and gravel mining operation is comprised of active excavation areas, maintenance and operations buildings, silt/holding basins, processing facilities and other outdoor equipment and materials storage areas. The existing plant at the quarry site is actively sorting and producing various aggregate materials, and the material product is being hauled to various locations throughout the Bay Area.

Since 1992, private operations at the Sunol Valley Aggregate Quarry have obtained a California Surface Mining Permit 30 (SMP 30)<sup>1</sup> from the Alameda County Planning Commission which (a) authorizes the mining of sand and gravel on 323 acres at the SMP 30 site to a depth of up to 140 feet and (b) allows quarrying operations through June 1, 2021 or upon completion of reclamation, whichever occurs first.

In December of 2005, the SFPUC issued a Request for Proposals (RFP) for (a) an 11.5-year lease (expected to begin in early 2010) and operation of the SMP 30 quarry and (b) the exclusive right to negotiate for future mining expansion at the SMP 30 site through June 1, 2021 with a conditional extension<sup>2</sup> of the term for up to 32 additional years, for a total potential lease term of 43.5 years. Oliver de Silva, Inc., a private company that mines, processes, and sells quarry products, was selected as the potential tenant following a competitive bid process.<sup>3</sup>

On November 24, 2009, the Board of Supervisors approved the existing lease (File 09-0832) with Oliver de Silva, Inc., as tenant, to operate the Sunol Valley Aggregate Quarry, for 308.5 acres (of the 323 acres permitted to be mined under SMP 30) for an initial term of approximately

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<sup>1</sup> The original SMP 30 was secured by the Santa Clara Sand and Gravel Company, which operated the quarry at the time, under a lease agreement with the SFPUC.

<sup>2</sup> These conditional extensions require the tenant, Oliver de Silva, Inc., to pursue regulatory and environmental review to extend the terms and expand mining activity at the quarry site. The tenant does not have the option to not pursue these extensions. However, the SFPUC and the City, have the right to not approve these extensions.

<sup>3</sup> Four years elapsed between the RFP issuance and the Board of Supervisors approval of the new quarry lease because (a) over a year elapsed between the PUC's issuance of the RFP and the PUC's selection committee's scoring of the proposals; and (b) negotiations took approximately 21 months to complete due to the complex nature of the lease and quarry development.



11.5 years through June 1, 2021. The existing lease, which did not commence until December 15, 2010, allowing for an initial term of approximately 10.5 years, includes (a) two conditional extensions of the term of the lease for additional mining, stockpiling, processing, and selling of gravel, asphalt, and concrete for: (1) an approximately 21-year extension related to a first SMP 30 revision (subject resolution) through July 16, 2042, and (2) an approximately 22.5-year extension related to a second expected SMP 30 revision through December 31, 2064; and (b) a separate two-year reclamation period, that would include reclamation and restoration activities following the termination of mining and processing activities to create a storage lake so that the SFPUC can use the subject quarry site for water storage beginning no later than December 31, 2066. Under the resolution previously approved by the Board of Supervisors, the existing lease was expected to commence in early 2010 allowing for a total possible lease term of approximately 57 years, however the lease did not commence until December 15, 2010, allowing for a total possible lease term of up to 56 years.

Following the Board of Supervisors approval of the existing lease, which does not expire until June 1, 2021, in October 2011, Oliver de Silva, Inc. applied to the Alameda County Planning Commission for a Revised SMP 30 mining permit. Alameda County Planning Commission is the lead agency for the environmental review under the California Environmental Quality Act (CEQA). The revised SMP 30 would allow for extension of the quarry operations beyond June 1, 2021, increased mining of a greater amount of land, and additional related quarry operations such as mining, stockpiling, processing, and selling of gravel, asphalt, and concrete.

On July 16, 2012, the Alameda County Planning Commission (a) certified the Final Environmental Impact Report (FEIR) for the Revised SMP 30 permit, (b) adopted CEQA findings and a Mitigation Monitoring and Reporting Program (MMRP), and (c) approved the mining and reclamation plan as proposed in the Oliver de Silva, Inc. application for Revised SMP 30.<sup>4</sup> The certified FEIR concluded that with mitigation, no significant and unavoidable impacts would result from the Revised SMP 30.

The Alameda County Planning Commission approval of the Revised SMP 30 is subject to concurrence by the SFPUC and Board of Supervisors' which is the subject of the proposed resolution. On May 28, 2013, the SFPUC formally adopted Alameda County's CEQA findings and approved the subject lease amendment.

## **DETAILS OF PROPOSED LEGISLATION**

The proposed resolution would authorize the General Manager of the SFPUC to enter into an amendment to an existing quarry lease with Oliver de Silva, Inc. as tenant, to (a) add approximately 58 acres to the existing 308.5 acre leased premises, for a total of 366.5 acres located in the Sunol Valley, unincorporated Alameda County, (b) increase the depth of excavation from 140 feet to between 225 feet and 400 feet below ground, (c) extend the lease term by approximately 21 years from June 1, 2021 through July 16, 2042, or completion of reclamation, (d) add ancillary uses, including the installation and operation of asphalt and concrete plants, (e) execute documents, make certain modifications, and take certain actions in

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<sup>4</sup> The Alameda County Planning Commission approved and adopted the mitigation measures to reduce both the permanent and temporary environmental impacts of the Revised SMP 30 Project to less-than-significant levels that were identified in the Final Environmental Impact Report (FEIR) for Revised SMP 30.

furtherance of this proposed resolution, and (f) adopt findings pursuant to the California Environmental Quality Act (CEQA).

As noted above, the existing lease includes (a) two conditional extensions to the term of the lease for additional mining, stockpiling, processing, and selling of gravel, asphalt, and concrete for: (1) an approximately 21-year extension related to a first SMP 30 revision (subject resolution) through July 16, 2042, and (2) an approximately 22.5-year extension related to a second expected SMP 30 revision through December 31, 2064; and (b) a separate two-year reclamation period, that would include reclamation and restoration activities following the termination of mining and processing activities to create a storage lake so that the SFPUC can use the subject quarry site for water storage beginning no later than December 31, 2066.

The proposed resolution would approved the first of two extensions to the term of the lease with Oliver de Silva, Inc. from June 1, 2021 through July 16, 2042, or for approximately 21 years, for Oliver de Silva, Inc. to conduct additional mining, stockpiling, processing, and selling of gravel, asphalt, and concrete. The base rent and royalty revenue provisions included in the existing lease, as previously approved by the Board of Supervisors, would remain the same in the proposed lease amendment.

#### First Permit Revision

Under the proposed resolution, the Board of Supervisors adoption of findings pursuant to CEQA provides the necessary review and approval of the FEIR. With the Board of Supervisor's approval of the FEIR, the Alameda County Planning Commission approval of the Revised SMP 30 becomes effective and includes the following actions<sup>5</sup>:

- Expand the overall production potential of the quarry by (a) increasing the area under permit by approximately 58 acres along the southeast boundary of the current quarry, from 308.5 acres to a total of 366.5 acres, and (b) deepening the depth of excavation from 140 feet to between 225 feet and 400 feet below ground surface (see Attachment I);
- Extend the expiration date of the mining permit through July 16, 2042 ; and
- Add additional ancillary uses at the site including the installation and operation of an asphalt batch plant and a concrete plant.

According to Mr. Anthony Bardo, Senior Real Estate Analyst for the SFPUC, currently a portion of the 58 acre parcel that would be added under the proposed lease amendment is being used for temporary construction staging for the New Irvington Tunnel project as part of the SFPUC's Water System Improvement Plan (WSIP). Mr. Bardo reports that delivery of the 58 acre parcel is to occur in three increments, as shown in Attachment I: (1) the northern most portion of the 58 acre parcel will be delivered immediately to the tenant for the tenant's use upon approval of the lease amendment; (2) the next increment is planned to be delivered by July, 2014; and (3) the remaining increment will be delivered by August, 2015, or possibly sooner if certain conditions are met.

The installation of the proposed asphalt batch plant and concrete plant would mix quarry materials mined from the SMP 30 site (Sunol Valley Aggregate Quarry) with other materials which would be transported to the SMP 30 site by Oliver de Silva, Inc. Mining, processing,

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<sup>5</sup> The Revised SMP 30 would become effective 30 days after Board of Supervisors approval.

stockpiling, and sales of gravel would continue under the Revised SMP 30. Additionally, if the revised permit is approved, processing and sales of asphalt and concrete would commence.

If the proposed amended lease is approved by the Board of Supervisors, Oliver de Silva, Inc. would: (a) be required to perform specified improvements to the quarry at the sole expense of Oliver de Silva, Inc., which include the (1) construction of a slurry cutoff wall to reduce water flow from Alameda Creek into the mining pit, (2) perimeter plantings, and (3) creek bank restoration; and (b) not be permitted to begin mining the SMP 17<sup>6</sup> site until the later of January 1, 2030, or the date upon which Oliver de Silva, Inc. completes mining of the SMP 30 site. However, if the proposed amended lease is not approved by the Board of Supervisors, Oliver de Silva, Inc. would be required to (a) promptly submit an application to Alameda County to revise the Mining and Reclamation Plan, that was approved as part of the Revised SMP 30 to provide for expanded mining operations and the larger water storage capacity, and (b) seek approval from Alameda County to construct certain minimum improvements, the cost of which the SFPUC would reimburse to Oliver de Silva, Inc. through royalty credits included in the existing lease.<sup>7</sup>

## FISCAL IMPACTS

Under the terms of the existing and the proposed amended lease, each year's required rental payment to be made by Oliver de Silva, Inc. to the SFPUC is the greater of (a) the base rent or (b) the royalty rent, based on a percent of gross sales.

The proposed resolution would approve the first 21-year extension to the term of the lease for additional mining, stockpiling, processing, and selling of gravel, asphalt, and concrete. The base rent and royalty revenue provisions included in the existing lease are the same as in the proposed lease amendment.

### **Base Rent**

Under the existing lease, as previously approved by the Board of Supervisors, base rent paid by Oliver de Silva, Inc. to the SFPUC is based on a negotiated fixed schedule for the first 11 years of the lease. The base rent schedule includes \$500,000 per year for the first three years of the lease, commencing on December 15, 2010. Beginning in the fourth year of the existing lease, and unchanged in the proposed lease amendment, the base rent would escalate annually for the next eight years, as shown in Table 1 below. According to Mr. Bardo, the base rent increases are lower during the first five years of the lease in acknowledgement of the significant initial capital and permitting expenses incurred by Oliver de Silva, Inc.

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<sup>6</sup> California Surface Mining Permit 17 (SMP 17), the Apperson Ridge Site, contains approximately 680 acres of privately owned unmined ranch land, owned by William H. Apperson and leased to Oliver de Silva, Inc., within the San Antonio Reservoir watershed in Alameda County, which is adjacent to the PUC-owned SMP 30 site. The subject amended lease does not include lands on the SMP 17 site; however, under the proposed lease amendment, materials mined on the SMP 17 site could be processed and sold on the subject SMP 30 site.

<sup>7</sup> According to Mr. Bardo, SFPUC uses rental credits or royalty credits in PUC leases to pay for improvements, which allows for the improvements to be self-funded and does not require special funding arrangements outside of the lease agreement.

| Calendar Year | Lease Years | Base Rent Amount |
|---------------|-------------|------------------|
| 2011          | 1           | \$500,000        |
| 2012          | 2           | \$500,000        |
| 2013          | 3           | \$500,000        |
| 2014          | 4           | \$515,000        |
| 2015          | 5           | \$530,450        |
| 2016          | 6           | \$1,000,000      |
| 2017          | 7           | \$1,175,509      |
| 2018          | 8           | \$1,259,274      |
| 2019          | 9           | \$1,344,052      |
| 2020          | 10          | \$1,479,874      |
| 2021          | 11          | \$1,616,770      |

Under the existing lease, and unchanged in the proposed lease amendment, beginning in the 12<sup>th</sup> lease year, or 2022 and for the remaining 20 years of the proposed amended lease, which is through July 16, 2042, the base rent paid by Oliver de Silva, Inc. to the SFPUC would be the greater of (a) a 3 percent increase of the prior year's base rent or (b) beginning in the seventh lease year, or 2017, and every three years thereafter to increase the base rent by the average total royalty amounts paid over the preceding three lease years.

Under the proposed lease amendment, the total base rent to be paid by Oliver de Silva, Inc. to SFPUC from December 15, 2010 through July 16, 2042, for a term of 31.5 years, is estimated to range between \$56,671,275 (based on a 3 percent increase of the prior year's base rent) and \$134,921,251 (based on average total royalty payments).

Additionally, the proposed lease includes a provision that allows for a temporary reduction in base rent in acknowledgement of the cyclical nature of the quarry business. Beginning in the sixth lease year, or 2016, if the mining and processing royalties do not exceed the base rent payable in two consecutive lease years, the base rent is reduced to \$1,000,000. If such a reduction is triggered, the scheduled base rent payments are restored once the royalties again exceed the base rents that would have been payable for two consecutive lease years.

Under the existing lease, and unchanged in the proposed lease amendment, for the not-to-exceed two year restoration period when quarry mining activities would cease and Oliver de Silva, Inc. would perform reclamation and restoration operations, the base rent payable by Oliver de Silva, Inc. to the SFPUC would decline to \$250,000 per year. However, Oliver de Silva, Inc. may continue selling stockpiled materials during this time provided that the required royalty payments, are remitted to the SFPUC.

### Royalty Rates

The existing and proposed lease royalty rates, payable by Oliver de Silva, Inc. to the SFPUC are (a) 15 percent of gross sales revenue for quarry products derived from the SMP 30 site, and (b) 10.5 percent of gross sales revenues for quarry products derived from the SMP 17 site. Attachment II lists the projected royalty revenue expected to be generated by the above-listed royalty rates.

Under the proposed lease amendment, estimated royalty revenues to be paid by Oliver de Silva, Inc. to the SFPUC from December 15, 2010 through June 16, 2042, or over approximately 31.5 years, is estimated to total \$153,460,633, or an average of \$4,871,766 per year. According to Mr. Bardo, annual royalty rental payments are projected to exceed annual base rent payments to the SFPUC throughout the duration of the subject amended lease. Such lease revenues would be deposited into the SFPUC's Water Enterprise Revenue Fund, which is used to defray capital and operating expenses of the SFPUC's Water Enterprise, subject to appropriation approval by the Board of Supervisors.

### Actual SFPUC Revenue through June 30, 2013

As stated above, each year's lease payment by Oliver de Silva, Inc. to the SFPUC would be the greater of either the (a) base rent or (b) royalty rent. As shown in Table 2 below, Oliver de Silva, Inc. paid the SFPUC \$1,870,651 in base rent and royalty revenue for the approximately 2.5 years of the existing lease from December 15, 2010 through June 30, 2013. SFPUC received base rent of \$500,000 from Oliver de Silva, Inc. in 2012 due to the quarry ceasing operations for 13 months from January 2012 through February 2013 to allow for modernization upgrades to the processing plant. Mr. Bardo reports that the poor condition of the plant necessitated a complete rebuild at a cost of \$30 million to Oliver de Silva, Inc. According to Mr. Bardo, annual royalty rental payments are projected to exceed annual base rent payments to the SFPUC throughout the 31.5 years duration of the subject amended lease.

| Calendar Year     | Lease Years | Amount Paid to SFPUC |                 |                    |
|-------------------|-------------|----------------------|-----------------|--------------------|
|                   |             | Base Rent            | Royalty Revenue | Total Revenue      |
| 2011              | 1           | \$0                  | \$797,318       | \$797,318          |
| 2012              | 2           | \$500,000            | \$0             | \$500,000          |
| 2013 <sup>1</sup> | 3           | \$0                  | \$573,333       | \$573,333          |
| <b>Total</b>      |             |                      |                 | <b>\$1,870,651</b> |

The revenue for 2013 is through June 30, 2013 and is not a full year and the revenue for the month of June 2013 is estimated. As seen in Attachment II, revenue for 2013 is projected to total \$994,719.

### Total Projected Revenue through June 2042

In summary, \$153,960,633 in total rent and royalty revenue is estimated to be paid by Oliver de Silva to the SFPUC from December 15, 2010 through June 16, 2042. The \$153,960,633 total revenue includes \$500,000 in base rent paid in 2012 when the quarry was closed and

\$153,460,633 in estimated royalty revenues that are expected to be paid by Oliver de Silva, Inc. to the SFPUC because annual royalty rental payments are projected to exceed annual base rent payments to the SFPUC throughout the 31.5 years duration of the subject amended lease.

#### Required Minimum Improvements

As discussed above, if the proposed amended lease is approved by the Board of Supervisors, Oliver de Silva, Inc. would be required to perform specified improvements for environmental mitigation measures, that Oliver de Silva, Inc. estimated to cost \$6,310,000. However, if the proposed amended lease is not approved by the Board of Supervisors, Oliver de Silva, Inc. would be required to promptly submit an application to Alameda County to revise the Mining and Reclamation Plan, and seek approval from Alameda County to construct certain minimum improvements for environmental mitigation measures. The cost to construct such minimum improvements for environmental mitigation is estimated at \$6,310,000, which would be reimbursed by the SFPUC to Oliver de Silva, Inc. through royalty credits. According to Mr. Bardo, the existing and proposed amended lease includes the provision that SFPUC will pay for these required minimum improvements if the Revised SMP 30 is not approved because without approval of Revised SMP 30, Oliver de Silva, Inc. would not have the available funds for the extensive habitat restoration projects required for the environmental mitigation measures at the site. Mr. Bardo states that it is the prospect of earning revenues from the expanded mining permitted by Revised SMP 30 that provides incentive for Oliver de Silva, Inc. to complete the extensive habitat restoration projects.

## **POLICY CONSIDERATIONS**

### **Second Permit Revision – Extension of the Lease through December 31, 2064**

As discussed above, the existing lease includes (a) two conditional extensions to the term of the lease for additional mining, stockpiling, processing, and selling of gravel, asphalt, and concrete for: (1) an approximately 21-year extension related to a first SMP 30 revision (subject resolution) through July 16, 2042, and (2) an approximately 22.5-year extension related to a second expected SMP 30 revision through December 31, 2064; and (b) a separate two-year reclamation period, that would include reclamation and restoration activities following the termination of mining and processing activities to create a storage lake so that the SFPUC can use the subject quarry site for water storage.

According to Mr. Bardo, Oliver de Silva, Inc. must apply to the Alameda County Planning Department for a second permit revision, including environmental and regulatory review, one year after the subject Revised SMP 30 becomes effective. Any subsequent revisions to the SMP 30 would also be subject to review and approval by Alameda County, the SFPUC, and the Board of Supervisors.

The second permit revision would authorize Oliver de Silva, Inc. to pursue permits and environmental clearance from the Alameda County Planning Department to (a) continue mining, stockpiling, processing, and selling gravel, asphalt, and concrete from the SMP 30 site through July 16, 2042, (b) construct a conveyor system to transport quarry materials from the

SMP 17 site to the SMP 30 site, and (c) begin processing and selling gravel extracted from the SMP 17 site at the SMP 30 site.

This second permit revision, which would be subject to separate future approval by the Board of Supervisors, would extend the permit through December 31, 2064 for the stockpiling, processing and sale of materials extracted from the SMP 17 site.

On December 31, 2064, when the second permit revision expires, or when mining and processing activity are terminated, Oliver de Silva, Inc. would be granted up to two additional years, ending no later than December 31, 2066, to (a) complete all aspects of the reclamation plan and (b) remove all property and leave the remainder of the site in good condition. Reclamation and restoration activities would include construction of engineered levees to create a storage lake so that the PUC could use the subject quarry site for water storage. During the reclamation period, further extraction of mining products would be prohibited but sales of stockpiled materials would be authorized and subject to the applicable royalty rate. The existing lease therefore includes possible extensions through December 31, 2066, or a total period of up to 56 years.

As mentioned above, according to Mr. Bardo, annual royalty rental payments are projected to exceed annual base rent payments to the SFPUC throughout the duration of the subject lease, including all options to extend. If all phases and lease extensions are approved as described above, as shown in Attachment II, rental payments (based on royalty revenues) to the SFPUC from December 15, 2010 through December 31, 2064, or over approximately 54 years is estimated to total \$339,849,810, or an average of approximately \$6,293,515 per year. Including the one year of \$500,000 base rent paid in 2012 when the quarry was closed, the total expected revenue to be paid by Oliver de Silva Inc. to the SFPUC is \$340,349,810. Mr. Bardo reports that such revenues would be deposited into the SFPUC's Water Enterprise Revenue Fund, which is used to defray capital and operating expenses of the SFPUC's Water Enterprise, subject to appropriation approval by the Board of Supervisors.

### **Environmental Impact**

In the issuance of the original SMP 30 in 1992, the Alameda County Planning Commission determined that although the proposed mining activities to be performed under the original permit could have a significant effect on the environment, the project sponsor, Santa Clara Sand and Gravel Company, which operated the quarry at the time under a lease agreement with the SFPUC, agreed to mitigation measures that were incorporated into the permit to reduce the environmental impacts to a less than significant level. The Alameda County Planning Commission is the lead agency for the environmental review under the California Environmental Quality Act (CEQA).

The proposed certified FEIR for the Revised SMP 30 concluded that with mitigation, no significant and unavoidable impacts would result from the revised permit. The mitigation measures include the following specified minimum required improvements: (1) construction of a slurry cutoff wall to reduce water flow from Alameda Creek into the mining pit, (2) perimeter plantings, and (3) creek bank restoration. These improvements, discussed above, are estimated to cost \$6,310,000 that would be reimbursed by the SFPUC to Oliver de Silva, Inc. through royalty credits if the proposed lease is not approved.

The proposed certified FEIR for the Revised SMP 30 also identified additional mitigation measures as part of the two conservation plans that Oliver de Silva, Inc. entered into as a

companion measure to the exiting lease with the nonprofit Alameda Creek Alliance and the Center for Biological Diversity relating to the environmental impacts of the quarry activities proposed under the lease. The plans include: (1) funding for projects to help restore steelhead trout to Alameda Creek, including up to \$2,000,000 for fish passage projects and up to \$1,000,000 for retrofitting the Pacific Gas & Electric (PG&E) pipeline crossing in the Sunol Valley; (2) funding for re-vegetation of stream banks and restoration of more natural stream function to enhance habitat quality along Alameda and San Antonio Creeks adjacent to the SMP 30 quarry; and (3) financial support for a SFPUC Sunol Valley Restoration Plan to stabilize and restore the Sunol Valley reach of Alameda Creek. According to Mr. Bardo, if the subject lease and Revised SMP 30 are not approved by the Board of Supervisors, these additional mitigation measures will not be implemented.

In addition, if the second permit revisions are approved and processing of SMP 17 materials is permitted at SMP 30, Oliver de Silva, Inc. agrees to not open the SMP 17 quarry site until the later of January 1, 2030, or the date upon which Oliver de Silva Inc. completes mining of the SMP 30 site. The second revised permit application will also include a conveyor system transport approach instead of the previously authorized truck haul road, which will greatly reduce the impact from the transport of materials. By potentially postponing the commencement of operations at SMP 17 to at least 2030 and limiting the truck traffic through the San Antonio watershed lands through the use of a conveyor system, the PUC advises that the CEQA findings in the approved FEIR identifies that the proposed lease represents an opportunity to greatly reduce the environmental impact from Oliver de Silva, Inc.'s rights to access and operate SMP 17.

### **SFPUC's Water Storage Objectives**

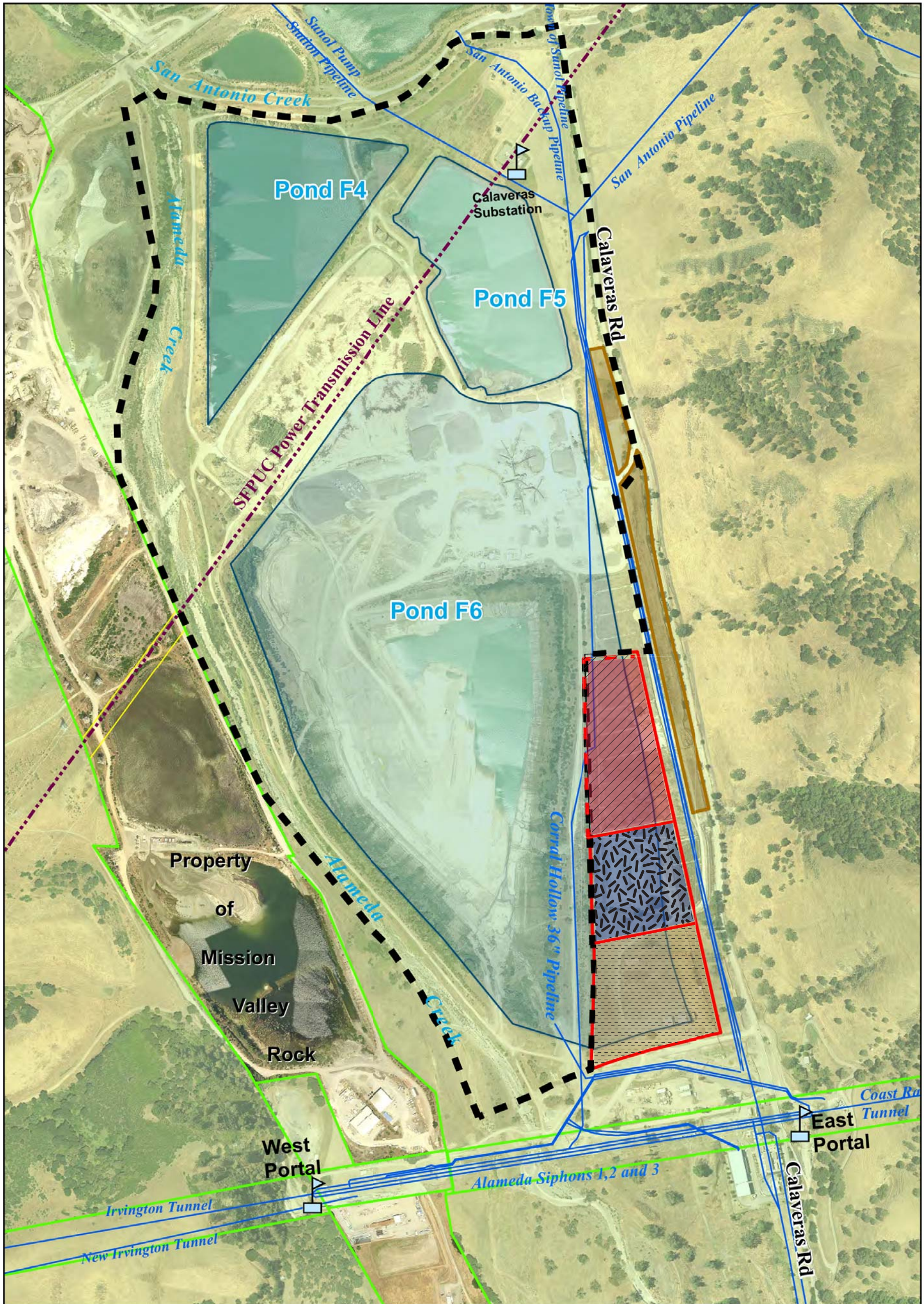
According to Mr. Bardo, the proposed amended lease will provide for the expansion of mining activities that will have a positive impact toward meeting SFPUC's water storage objectives. In September 2000, the SFPUC adopted the Sunol Resources Management Element of the Alameda Watershed Management Plan. In this plan, the SFPUC weighed the competing land uses in the Sunol Valley area and selected, as a preferred alternative, the development of water storage assets (reservoirs) at the subject Sunol Valley Aggregate Quarry site because it is a strategically important juncture of the City's water system.

According to the PUC, the expansion to the adjacent 58-acre parcel provides the opportunity to increase aggregate water reserves and to expand the quarry basin, ultimately to be used for SFPUC water storage upon completion of mining and reclamation activities. Mr. Bardo reports that SFPUC expects the water storage to be 27,000 acre feet.

## **RECOMMENDATION**

Approve the proposed resolution.





Initial Premises of Lease (L4074) to Oliver de Silva

Initial Delivered Expansion Premises of Lease (L4074) to Oliver de Silva

Short-Term Reserved Expansion Premises of Lease (L4074) to Oliver de Silva

Long-Term Reserved Expansion Premises of Lease (L4074) to Oliver de Silva

Potential Water Storage Ponds

SFPUC Spoils Areas

SFPUC Buildings

SFPUC Pipelines (Existing and Proposed)

SFPUC Parcels - Fee Owned

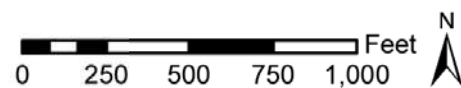
SFPUC Parcels - Easement

Aerial Photo Date: 2011



Real Estate Services

**Exhibit A-4 Revised**



The City does not guarantee that the information is accurate or complete. The City provides this information on an "as is" basis and disclaims all warranties, express or implied, including but not limited to warranties of merchantability, fitness for a particular purpose and non-infringement. The City is not responsible for any damages arising from the use of data. Users should verify the information before making project commitments.

Drawing No: B-4910

Date: 4/22/2013

## Attachment II

| Lease Revenue Projections      |               |                                    |                      |                      |
|--------------------------------|---------------|------------------------------------|----------------------|----------------------|
| SFPUC Sunol Quarry; EPS #17155 |               |                                    |                      |                      |
| Lease Year                     | Calendar Year | Variable Price and Production Rate |                      |                      |
|                                |               | SMP 30                             | SMP 17               | Total                |
| 1                              | 2011          | \$797,318                          | \$0                  | \$797,318            |
| 2                              | 2012          | \$0                                | \$0                  | \$0                  |
| 3                              | 2013          | \$994,719                          | \$0                  | \$994,719            |
| 4                              | 2014          | \$3,594,695                        | \$0                  | \$3,594,695          |
| 5                              | 2015          | \$3,953,047                        | \$0                  | \$3,953,047          |
| 6                              | 2016          | \$3,614,326                        | \$0                  | \$3,614,326          |
| 7                              | 2017          | \$3,465,143                        | \$0                  | \$3,465,143          |
| 8                              | 2018          | \$3,182,757                        | \$0                  | \$3,182,757          |
| 9                              | 2019          | \$3,931,390                        | \$0                  | \$3,931,390          |
| 10                             | 2020          | \$4,443,025                        | \$0                  | \$4,443,025          |
| 11                             | 2021          | \$4,405,419                        | \$0                  | \$4,405,419          |
| 12                             | 2022          | \$4,398,256                        | \$0                  | \$4,398,256          |
| 13                             | 2023          | \$4,806,371                        | \$0                  | \$4,806,371          |
| 14                             | 2024          | \$5,274,379                        | \$0                  | \$5,274,379          |
| 15                             | 2025          | \$4,856,714                        | \$0                  | \$4,856,714          |
| 16                             | 2026          | \$4,762,227                        | \$0                  | \$4,762,227          |
| 17                             | 2027          | \$4,367,108                        | \$0                  | \$4,367,108          |
| 18                             | 2028          | \$5,137,692                        | \$0                  | \$5,137,692          |
| 19                             | 2029          | \$5,250,370                        | \$0                  | \$5,250,370          |
| 20                             | 2030          | \$5,293,312                        | \$0                  | \$5,293,312          |
| 21                             | 2031          | \$6,244,560                        | \$0                  | \$6,244,560          |
| 22                             | 2032          | \$6,676,154                        | \$0                  | \$6,676,154          |
| 23                             | 2033          | \$7,373,342                        | \$0                  | \$7,373,342          |
| 24                             | 2034          | \$6,770,254                        | \$0                  | \$6,770,254          |
| 25                             | 2035          | \$6,568,770                        | \$0                  | \$6,568,770          |
| 26                             | 2036          | \$4,673,902                        | \$0                  | \$4,673,902          |
| 27                             | 2037          | \$7,350,412                        | \$0                  | \$7,350,412          |
| 28                             | 2038          | \$7,744,871                        | \$0                  | \$7,744,871          |
| 29                             | 2039          | \$0                                | \$5,495,536          | \$5,495,536          |
| 30                             | 2040          | \$0                                | \$5,702,864          | \$5,702,864          |
| 31                             | 2041          | \$0                                | \$5,824,519          | \$5,824,519          |
| 32                             | 2042          | \$0                                | \$6,507,184          | \$6,507,184          |
| 33                             | 2043          | \$0                                | \$6,047,342          | \$6,047,342          |
| 34                             | 2044          | \$0                                | \$5,927,689          | \$5,927,689          |
| 35                             | 2045          | \$0                                | \$6,098,382          | \$6,098,382          |
| 36                             | 2046          | \$0                                | \$6,713,434          | \$6,713,434          |
| 37                             | 2047          | \$0                                | \$7,073,709          | \$7,073,709          |
| 38                             | 2048          | \$0                                | \$7,170,428          | \$7,170,428          |
| 39                             | 2049          | \$0                                | \$7,440,944          | \$7,440,944          |
| 40                             | 2050          | \$0                                | \$7,599,677          | \$7,599,677          |
| 41                             | 2051          | \$0                                | \$8,490,399          | \$8,490,399          |
| 42                             | 2052          | \$0                                | \$7,890,410          | \$7,890,410          |
| 43                             | 2053          | \$0                                | \$7,734,289          | \$7,734,289          |
| 44                             | 2054          | \$0                                | \$7,957,006          | \$7,957,006          |
| 45                             | 2055          | \$0                                | \$8,759,509          | \$8,759,509          |
| 46                             | 2056          | \$0                                | \$9,229,585          | \$9,229,585          |
| 47                             | 2057          | \$0                                | \$9,355,782          | \$9,355,782          |
| 48                             | 2058          | \$0                                | \$9,708,744          | \$9,708,744          |
| 49                             | 2059          | \$0                                | \$9,915,854          | \$9,915,854          |
| 50                             | 2060          | \$0                                | \$11,078,045         | \$11,078,045         |
| 51                             | 2061          | \$0                                | \$10,295,196         | \$10,295,196         |
| 52                             | 2062          | \$0                                | \$10,091,493         | \$10,091,493         |
| 53                             | 2063          | \$0                                | \$10,382,088         | \$10,382,088         |
| 54                             | 2064          | \$0                                | \$11,429,172         | \$11,429,172         |
| <b>Total (Nominal Dollars)</b> |               | <b>\$129,930,529</b>               | <b>\$209,919,281</b> | <b>\$339,849,810</b> |

|   |   |
|---|---|
| <b>Item 3</b><br><b>File 13-0623</b>  | <b>Department:</b><br>Planning Department |
| <b>EXECUTIVE SUMMARY</b>  |   |
| <p style="text-align: center;"><b>Legislative Objective</b></p> <ul style="list-style-type: none"> <li>• The proposed resolution would (a) approve a Mills Act historical property agreement with Jason H. Stein and Howard Stein, the owners of the residential property located at 201 Buchanan Street, and (b) authorize the Director of Planning and the Assessor to execute the subject historical property agreement, which would reduce the assessed value of the property according to a formula established in the Mills Act, thereby reducing property taxes payable by the property owner to the City, provided that owners rehabilitate, restore, preserve, and maintain their qualified historical properties.</li> </ul> <p style="text-align: center;"><b>Key Points</b></p> <ul style="list-style-type: none"> <li>• The proposed Mills Act historical property agreement would be in effect for 10 years, with an additional year added automatically to the initial term on each anniversary date of the proposed historical property agreement execution date.</li> <li>• The property owners of 201 Buchanan Street have completed \$306,322, or 48.1 percent of the total \$636,949 in estimated costs of the rehabilitation program to date. Ongoing maintenance is currently estimated to cost \$3,500 per year.</li> </ul> <p style="text-align: center;"><b>Fiscal Impacts</b></p> <ul style="list-style-type: none"> <li>• The first year annual property taxes to be paid to the City by the property owners would be reduced by \$7,148, or 37.3 percent, from the \$19,155 in estimated annual property taxes that would otherwise be paid to the City, if the proposed historical property agreement is not authorized. The estimated reduction in property taxes to be received by the City would be approximately \$71,480 (\$7,148 annually x ten years) over the initial ten-year period of the proposed Mills Act Historical Property agreement.</li> <li>• The proposed Mills Act Historical Property agreement includes an estimated \$612,000 in costs to complete the rehabilitation program, which is inaccurate. The Mills Act Historical Property Agreement should be amended to reflect the current \$636,949 estimate of the rehabilitation program, including the \$306,322 in actual costs of work completed to date.</li> </ul> <p style="text-align: center;"><b>Recommendations</b></p> <ul style="list-style-type: none"> <li>• Amend the proposed resolution to request that the Planning Department amend the proposed Mills Act Historical Property agreement to reflect that \$306,322 in actual costs have been incurred for work included in the rehabilitation program, with a total of \$636,949 in estimated expenditures expected upon completion instead of the \$612,000 estimate currently included.</li> <li>• Approve the proposed resolution as amended.</li> </ul> |   |

## MANDATE STATEMENT/BACKGROUND

### Mandate Statement

The Mills Act, codified in State Government Code Section 50280, authorizes local governments to enter into historical property agreements with owners of qualified historical properties, in which local governments reduce the assessed value of the property according to a formula established in the Mills Act, thereby reducing property taxes payable by the property owner to the City, provided that owners rehabilitate, restore, preserve, and maintain their qualified historical properties.

The City's Administrative Code<sup>1</sup> specifies (a) required qualifications for properties to allow for approval of a Mills Act historical property agreement, (b) the Mills Act historical property application and approval processes, and (c) the terms and fees for individual property owners to apply for Mills Act historical property agreements with the City in order to receive such Mills Act Property Tax reductions, subject to Board of Supervisors approval.

### Background

In order for a Mills Act historical property agreement to be approved<sup>2</sup>, the property must be designated a qualified historical property by being listed or designated in one of the following ways on or before December 31 of the year before the application is made:

- Individually listed in the National Register of Historic Places or the California Register of Historical Resources;
- Listed as a contributor to a historic district included on the National Register of Historic Places or the California Register of Historical Resources;
- Listed as a City landmark pursuant to Planning Code Article 10;
- Designated as contributory to a historic district; or
- Designated as significant<sup>3</sup> (Categories I and II) or contributory<sup>4</sup> (Categories III or IV).

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<sup>1</sup> Administrative Code Chapter 71

<sup>2</sup> Administrative Code Section 71.2

<sup>3</sup> Planning Code Section 1102(a) designates a building as Category I significant if it is (1) at least 40 years old and (2) judged to be a building of individual importance, and (c) is rated excellent in architectural design or as very good in both architectural design and relationship to the environment. Planning Code Section 1102 (b) designates a building as Category II significant if it (1) meets the standards in Section 1102(a) and (2) if it is feasible to add different and higher replacement structures or additions to the height at the rear of the structure without affecting the architectural quality or relationship to the environment and without affecting the appearance of the retained portions as a separate structure when viewing the principal facade.

<sup>4</sup> Planning Code Section 1102(c) designates a building as Category III contributory if it is (1) located outside a designated conservation district, (2) is at least 40 years old, (3) judged to be a building of individual importance, and (4) is rated either Very Good in architectural design or excellent or very good in relationship to the environment. Planning Code Section 1102(d) designates a building as Category IV contributory if it is (1) located in a designated conservation district, (3) judged to be a building of individual importance, (4) judged to be a building of contextual importance, and (4) is rated either Very Good in architectural design or excellent or very good in relationship to the environment.

In addition, eligibility for Mills Act historical property agreements is limited to sites, buildings, or structures with an assessed valuation, as of December 31 of the year before the application is made, of \$3,000,000 or less for single-family dwellings and \$5,000,000 or less for multi-unit residential, commercial, or industrial buildings, unless the Board of Supervisors grants an exemption.

**Historical Property Agreement Application for 201 Buchanan Street was Originally Submitted on July 8, 2011 and Rehabilitation Work has Already Commenced**

The property which is the subject of the proposed resolution, 201 Buchanan Street, was designated a historical landmark by the Board of Supervisors on August 28, 1972 (Resolution No. 256-72) and is listed on the California Register of Historical Resources. Therefore, 201 Buchanan Street qualifies as a historical property under the Administrative Code and is eligible for Mills Act historical property agreement approval without an exemption being necessary.

According to Ms. Shelley Caltagirone, Historic Preservation Planner for the Planning Department, a Mills Act historical property agreement application was submitted to the Planning Department on July 8, 2011, which included a rehabilitation program detailing estimates of the necessary improvements to preserve 201 Buchanan Street as well as an annual maintenance plan. However, due to a pending ordinance before the Board of Supervisors that included amendments to the City's Administrative Code to streamline the Mills Act historical agreement application process, the Mills Act historical property agreement application was put on hold by the Planning Department pending Board of Supervisors' approval. The Board of Supervisors approved the ordinance on September 4, 2012 (Ordinance No. 190-12), which became effective on October 1, 2012. The Planning Department resumed processing the Mills Act historical property agreement application for 201 Buchanan Street shortly after the effective date of the ordinance.

In order to begin work on the rehabilitation program included in the Mills Act historical property agreement application, the property owners of 201 Buchanan Street received a Certificate of Appropriateness<sup>5</sup> from the Historic Preservation Commission<sup>6</sup> and have completed several components in the past two years. Table 1 below summarizes actual and estimated costs of the work included in the rehabilitation program. \$306,322, or 48.1 percent of the total estimated cost at completion of \$636,949, has been completed to date.

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<sup>5</sup> A Certificate of Appropriateness is the entitlement required to alter an individual landmark and any property within a landmark district.

<sup>6</sup> The Historic Preservation Commission is a 7-member body, appointed by the Mayor and subject to Board of Supervisors approval, that makes recommendations directly to the Board of Supervisors on the designation of landmark buildings, historic districts, and significant buildings.

**Table 1: Actual and Estimated Costs of Rehabilitation Program at 201 Buchanan Street**

|                                    | <b>Expenditures<br/>to Date</b> | <b>Estimated<br/>Remaining<br/>Expenditures</b> | <b>Total</b>     |
|------------------------------------|---------------------------------|---|------------------|
| Roof                               | \$122,599                       |   | \$122,599        |
| Chimneys                           | 29,000                          |   | 29,000           |
| Gutters/Downspouts/Drainage        | 42,682                          |   | 42,682           |
| Soffits <sup>7</sup>               |                                 | \$18,000  | 18,000           |
| Moldings/Ornaments                 |                                 | 85,000  | 85,000           |
| Porch Deck                         |                                 | 9,954   | 9,954            |
| Siding                             |                                 | 15,000  | 15,000           |
| Double Hung Window Sashes          | 65,006                          | 71,660  | 136,666          |
| Fencing                            |                                 | 24,080  | 24,080           |
| Balconies                          | 25,435                          | 46,019  | 71,454           |
| Jib doors <sup>8</sup>             |                                 | 14,283  | 14,283           |
| Gable Finials and Metal Ridge Caps |                                 | 20,000  | 20,000           |
| Foundation Repairs                 | 21,600                          | 11,631  | 33,231           |
| Landscaping                        | 0                               | 15,000  | 15,000           |
| <b>Total</b>                       | <b>\$306,322</b>                | <b>\$330,627</b>                                | <b>\$636,949</b> |

The City's Historic Preservation Commission reviewed the Mills Act historical property agreement application for 201 Buchanan Street, including the proposed rehabilitation program and annual maintenance plan. On January 16, 2013, the Historic Preservation Commission recommended approval of the proposed Mills Act historical property agreement, rehabilitation program, and maintenance plan (Historic Preservation Commission Resolution No. 0701).

## DETAILS OF PROPOSED LEGISLATION

The proposed resolution would (a) approve a Mills Act historical property agreement with Jason H. Stein and Howard Stein, the owners of the residential property located at 201 Buchanan Street, and (b) authorize the Director of Planning and the Assessor to execute the subject historical property agreement.

As required by State law, the proposed Mills Act historical property agreement would be in effect for 10 years, with an additional year added automatically to the initial term on each anniversary date of the proposed historical property agreement execution date<sup>9</sup>, unless either party terminates the agreement by submitting a notice of nonrenewal<sup>10</sup>, subject to Board of Supervisors approval. In other words, the reduced property taxes would continue annually, in perpetuity, until the Mills Act historical property agreement is terminated.

According to the Planning Department's Mills Act Agreement Case Report on 201 Buchanan Street, the existing building at the corner of Buchanan and Waller Streets, built in 1882 by John

<sup>7</sup> A soffit is the underside of a construction element, including overhanging roof eaves and flights of stairs.

<sup>8</sup> A jib door is a concealed door made flush with the wall surface and treated to resemble it.

<sup>9</sup> According to State Government Code Section 50282

<sup>10</sup> The City must submit a nonrenewal notice 60 days prior to the date of renewal and the owners must submit a nonrenewal notice 90 days prior to the date of renewal.

Nightingale, Sr., is a one-story-over-basement-with-attic-two-family Eastlake-style residence which also incorporates Carpenter Gothic, Second Empire and late Italian Villa styles (See Picture below).

**Picture: 201 Buchanan Street**



In addition to the rehabilitation plan detailed above in Table 1, the property owners have agreed to a maintenance plan with annual inspections for maintenance which needs to be done on an ongoing basis, including maintenance of sheet metal, doors, and wood sheathing, as well as inspections to be done every 15 years for long-term maintenance, such as roof maintenance. Inspections would be done by (a) the Historic Preservation Commission, (b) the Office of the Assessor-Recorder, (c) the Department of Building Inspection, (d) the Planning Department, (e) the Office of the Historic Preservation of the California Department of Parks and Recreation, and (f) the State Board of Equalization with 72 hours advance notice to ensure compliance with the proposed historic property agreement.

Ongoing maintenance is currently estimated to cost \$3,500 per year.

## FISCAL ANALYSIS

### The Property Owners Would Owe Approximately \$7,148 Less in Property Taxes Annually if Proposed Resolution Is Approved

According to Mr. Timothy Landregan, Real Property Appraiser for the Office of the Assessor-Recorder, the property at 201 Buchanan Street is currently assessed at \$1,638,460, with property taxes payable to the City in the amount of \$19,155 for FY 2013-14<sup>11</sup>.

Table 2 below reflects the estimated assessed value of 201 Buchanan Street both with and without the requested Mills Act Historical Property agreement, after the proposed improvements are completed. As shown in Table 2 below, the first year annual property taxes to be paid to the City by the property owners would be \$7,148, or 37.3 percent less than the \$19,155 in estimated annual property taxes that would otherwise be paid to the City, if the proposed historical property agreement is not authorized. The estimated reduction in property taxes to be received by the City would be at least \$71,480 (\$7,148 annually x ten years) over the initial ten-year period<sup>12</sup> of the proposed Mills Act Historical Property agreement.

**Table 2: Summary of Estimated Assessed Value of 201 Buchanan Street**

|   | Estimated Assessed Property Value | Estimated Property Taxes Payable to the City |
|---|-----------------------------------|--|
| Without a Mills Act Historical Property Agreement | \$1,638,460                       | \$19,155                                     |
| With a Mills Act Historical Property Agreement    | 1,027,000                         | 12,007                                       |
| <b>Reduction</b>                                  | <b>\$611,460</b>                  | <b>\$7,148</b>                               |

As shown in Table 1 above, the rehabilitation program is currently estimated to cost a total of \$636,949 and is to be fully paid by the property owners. In addition, ongoing maintenance costs estimated to be \$3,500 annually are to be fully paid by the property owners, with annual total maintenance costs estimated to be \$35,000 (\$3,500 annually x 10 years) over the initial ten-year period. Therefore, total estimated costs to the property owner of rehabilitating and maintaining 201 Buchanan Street over the initial ten-year period of the proposed Mills Act Historical Property agreement are \$671,949.

According to Ms. Diala Batshoun, Property Tax & License Director for the Office of the Treasurer & Tax Collector, all property taxes assessed to 201 Buchanan St. have been paid to the City with no remaining balance outstanding.

<sup>11</sup> Mr. Landregan advises that property tax rates have not been finalized for FY 2013-14 and the estimated property taxes assessed to 201 Buchanan Street are based on the FY 2012-13 property tax rate of 1.1691 percent of assessed value.

<sup>12</sup> The actual reduction in Property Taxes payable to the City fluctuates annually based on (a) variables in the formula specified in the Mills Act which determine the assessed value of the subject property, such as market rental rates and conventional mortgage interest rates, (b) the factored base year value of the subject property (which increases by no more than 2 percent per year) had a Mills Act Historical Property Contract not been approved, and (c) the Property Tax rate each year. Therefore, the actual annual reductions in Property Taxes payable to the City over the ten-year term of a Mills Act Historical Property Contract and payable annually thereafter, are not equal to the first year reduction in Property Taxes.



### **Estimate of Rehabilitation Program in Proposed Mills Act Historical Property Agreement is Inaccurate and Should be Amended**

The proposed Mills Act Historical Property agreement includes an estimated \$612,000 in costs to complete the rehabilitation program. This estimate is inaccurate because (1) it includes an estimated cost of \$175,000 for painting the exterior of the building, which the estimate states is only for context and not part of the scope of the application and (2) actual costs incurred for work performed are not reflected. Therefore, the Mills Act Historical Property Agreement should be amended to reflect the current \$636,949 estimate of the rehabilitation program, including the \$306,322 in actual costs of work completed to date.

#### **RECOMMENDATIONS**

1. Amend the proposed resolution to request that the Planning Department amend the proposed Mills Act Historical Property agreement to reflect that \$306,322 in actual costs have been incurred for work included in the rehabilitation program, with a total of \$636,949 in estimated expenditures expected upon completion instead of the \$612,000 estimate currently included.
2. Approve the proposed resolution as amended.

|  |  |
|--|--|
| <b>Item 4</b><br><b>File 13-0617</b>   | <b>Department:</b><br>Department of Public Works (DPW) |
| <b>EXECUTIVE SUMMARY</b>   |  |
| <p style="text-align: center;"><b>Legislative Objectives</b></p> <ul style="list-style-type: none"> <li>• The proposed resolution would authorize the Director of Public Works to execute an amendment to the design Agreement between the Department of Public Works (DPW) and Hellmuth, Obata &amp; Kassabaum, Inc. (HOK) for construction of a new public safety building under the Earthquake Safety Emergency Response Bond Program. The amendment would increase the Agreement amount by \$1,813,485 from \$17,205,152 to \$19,018,637.</li> </ul> <p style="text-align: center;"><b>Key Points</b></p> <ul style="list-style-type: none"> <li>• This new Public Safety Building will provide (a) a new Police Headquarters, including a new Southern District Police Station, which are both currently located in the Hall of Justice, and (b) a new Mission Bay Fire Station. The new Public Safety Building project is being managed by the Department of Public Works (DPW).</li> <li>• DPW entered into an interim agreement with HOK for preliminary design and engineering services for the Public Safety Building in 2009, based on a competitive Request for Qualifications process. The interim agreement and its subsequent modifications totaled \$3,947,600 with an end date in February 2011.</li> <li>• The Board of Supervisors approved the permanent agreement with HOK in December 2010, which (a) combined the interim agreement and interim modifications with the permanent agreement, (b) increased the agreement not-to-exceed amount to \$17,205,152, and (c) extended the term through December 31, 2014. DPW has entered into four modifications to the permanent agreement that were not subject to Board of Supervisors approval.</li> <li>• The proposed fifth modification to the permanent agreement would increase the amount by \$1,813,485 from \$17,205,152 to \$19,018,637 to pay for increased design, engineering and construction administration costs associated with additional service requests by the City, new work due to unforeseen site conditions, and relocation to the new building.</li> </ul> <p style="text-align: center;"><b>Fiscal Impact</b></p> <ul style="list-style-type: none"> <li>• The not-to-exceed amount of the agreement between DPW and HOK under the proposed fifth modification of \$19,018,637 is within the original Public Safety Building project budget for architectural and engineering design services of \$25,117,025.</li> <li>• The total Public Safety Building project budget is \$239 million. According to Mr. Samuel Chui, DPW Project Manager, the project is on-track to be delivered within this amount.</li> </ul> <p style="text-align: center;"><b>Recommendation</b></p> <ul style="list-style-type: none"> <li>• Approve the proposed resolution.</li> </ul> |  |

## MANDATE STATEMENT/BACKGROUND

### Mandate Statement

In accordance with Charter Section 9.118(b), any contracts or agreements entered into by a department, board or commission requiring anticipated expenditures by the City and County of \$10,000,000, or the modification of amendments to such contract or agreement having an impact of more than \$500,000 shall be subject to approval of the Board of Supervisors by resolution.

### Background

On June 8, 2010, voters of San Francisco approved Proposition B, which authorized the issuance of \$412,300,000 of Earthquake Safety and Emergency Response (ESER) General Obligation Bonds. The single largest project under the \$412,300,000 ESER General Obligation Bonds is the construction of a new \$243,000,000 Public Safety Building in the South Redevelopment Project Area in Mission Bay. This new Public Safety Building will provide (a) a new Police Headquarters, including a new Southern District Police Station, which are both currently located in the Hall of Justice, and (b) a new Mission Bay Fire Station. The new Public Safety Building project is being managed by the Department of Public Works (DPW). Also part of the project is the rehabilitation of historic fire station #30 which will be repurposed as the new location at Mission Bay of the Fire Department's Arson Task Force Unit and which will also contain a community meeting room.



Planned Public Safety Building in Mission Bay

(Image from HOK)

DPW selected the firm of Hellmuth, Obata & Kassabaum (HOK) through a Request for Qualifications (RFQ) for initial planning and design of the Public Safety Building. On July 22, 2009, DPW entered into an initial architectural and engineering design services agreement

(interim agreement) with HOK for \$1,140,100, funded through a capital planning request from the General Fund, with an end date of February 1, 2011.

### **Previous Modifications to the Interim Agreement with Hellmuth, Obata & Kassabaum**

The initial interim agreement for \$1,140,100 was for the preliminary planning and design option phase to establish the basis of design for the Public Safety Building. DPW modified the interim agreement four times, as shown in Table 1 below. According to Charles Higuera, Project Manager at DPW, this initial agreement was entered into with the understanding that funding for future architectural and engineering design services would be awarded through modifications to this agreement. Table 1 below details the initial interim agreement and modifications, totaling \$3,947,600.

**Table 1: Modifications to Interim Agreement**

|                        | Amount of Original and Modifications | Total Modified Agreement |
|------------------------|--------------------------------------|--------------------------|
| Interim Agreement      | \$1,140,100                          | \$1,140,100              |
| Interim Modification 1 | \$1,858,300                          | \$2,998,400              |
| Interim Modification 2 | \$121,100                            | \$3,119,500              |
| Interim Modification 3 | \$75,000                             | \$3,194,500              |
| Interim Modification 4 | \$753,100                            | \$3,947,600              |

In December 2010, the Board of Supervisors approved the permanent agreement (File 10-1387), which (a) combined the interim agreement and interim modifications with the permanent agreement, (b) increased the agreement not-to-exceed amount to \$17,205,152, as shown in Table 2 below, and (c) extended the term through December 31, 2014.

**Table 2: Permanent Agreement (File 10-1387)**

|  |                     |
|--|---------------------|
| Interim Agreement through Modification 4 | \$3,947,600         |
| Permanent Agreement (File 10-1387)       | \$12,052,320        |
| Subtotal                                 | \$15,999,920        |
| Contingency (10% of \$12,052,320)        | \$1,205,232         |
| <b>Total</b>                             | <b>\$17,205,152</b> |

## DETAILS OF PROPOSED LEGISLATION

DPW has previously modified the permanent agreement four times, as shown in Table 3 below. Board of Supervisors approval was not required for the first through third modifications to the

permanent agreement, because the modifications did not increase the total agreement amount<sup>1</sup>. Board of Supervisors approval for the fourth modification was not required because it was for less than \$500,000.

The proposed resolution would approve the fifth modification to the existing permanent agreement of \$1,388,855. The agreement not-to-exceed amount would be \$19,018,637, as shown in Table 3 below.

**Table 3: Permanent Agreement**

|                                    | <b>Modification Amount</b> | <b>Total Amount</b> |
|------------------------------------|----------------------------|---------------------|
| Permanent Agreement (File 10-1387) | N/A                        | \$15,999,920        |
| Modifications 1 - 3                | 1,191,416                  | \$17,191,337        |
| Modification 4                     | 438,446                    | \$17,629,782        |
| Modification 5 (File 13-0617)      | 1,388,855                  | \$19,018,637        |
| <b>Total</b>                       | <b>\$3,018,717</b>         | N/A                 |

## FISCAL IMPACT

The not-to-exceed amount of the agreement between DPW and HOK under the proposed fifth modification of \$19,018,637 is within the original Public Safety Building project budget for architectural and engineering design services of \$25,117,025.

The total Public Safety Building project budget is \$239 million. According to Mr. Samuel Chui, DPW Project Manager, the project is on-track to be delivered within this amount. Total project expenditures as of May 31, 2013 are \$79,203,869. Notice To Proceed (NTP) for Construction started in December 2011. The structural steel was completed in May 2013, and the exterior “cladding installation”, or protective exterior covering, is slated to begin in end of July 2013. According to Mr. Chui, no additional funds are required beyond the allocated funding for the Public Safety Building.

Table 4 below contains a description of the components of the proposed fifth modification for needed architectural and engineering design services, which totals \$1,388,855.

<sup>1</sup> Because the budgets for the three modifications, totaling \$1,191,416 (see Table 3), were less than the contingency of \$1,205,232 (see Table 2), the total agreement amount did not exceed the previously-approved not-to-exceed amount of \$17,205,152.

**Table 4: Architectural and Design Services under Fifth Modification**

| <b>Description</b>  | <b>Amount Requested</b> |
|---|-------------------------|
| <b>A.</b> Additional architect and sub-consultant design and construction administration services for additional City-requested low voltage components related to security, communication, and emergency management.  | \$60,000                |
| <b>B.</b> Additional architect and sub-consultant design and construction administration services for additional City-requested building components in the basement and first level parking areas, including gas-fueling tank for SFFD, two-level car-stacking system for 45 additional parking spaces, and implementation of 10 electric charging stations.  | \$75,000                |
| <b>C.</b> Consultant services to manage relocation, not previously secured.   | \$100,000               |
| <b>D.</b> Construction administration services for waterproofing in response to site condition at Fire Station #30, not previously secured.   | \$70,150                |
| <b>E.</b> Additional architect and sub-consultant design and construction administration services to coordinate the City's required three Art Commission projects.  | \$140,000               |
| <b>F.</b> Additional architect and sub-consultant work scope to respond to an extended bid schedule. Due to unforeseen additional work, the number of bid packages (corresponding to the number of contractors sourced) has increased from that which was originally anticipated, resulting in additional services rendered.  | \$110,750               |
| <b>G.</b> Additional architect and sub-consultant work scope to respond to an extended construction schedule. The additional contract administration services to be rendered results from an extension of construction schedule due to (i) pre-construction work performed by utility companies on-site; (ii) extended time required for Site-Permit issuance; and (iii) structural design modifications. | \$530,955               |
| <b>H.</b> Contingency for additional architect and sub-consultant construction administration services (from substantial completion to move-in date) and to coordinate any unforeseen issues during furniture installation and move-in (estimated at 10% of total of modifications 1 - 4, to be billed as time and material at a not-to-exceed limit).  | \$302,000               |
| <b>Total Modification 5</b>   | <b>\$1,388,855</b>      |

The Budget and Legislative Analyst considers these proposed costs to be reasonable.

## RECOMMENDATION

Approve the proposed resolution.

|   |   |
|---|---|
| <b>Item 5</b><br><b>File 13-0648</b>  | <b>Department(s):</b><br>Sheriff's Department |
| <b>EXECUTIVE SUMMARY</b>  |   |
| <p style="text-align: center;"><b>Legislative Objectives</b></p> <ul style="list-style-type: none"> <li>• The proposed resolution (File 13-0648) would approve a five-year agreement (with two one-year options for extension) between the Sheriff's Department and Aramark Correction Services, LLC (Aramark) for inmate and staff meal services at the City's five active jails, for an amount not-to-exceed \$19,659,606. The agreement term is retroactive from July 1, 2012 through June 30, 2017.</li> </ul> <p style="text-align: center;"><b>Key Points</b></p> <ul style="list-style-type: none"> <li>• The Sheriff's Department had a previous agreement with Aramark from July 1, 2006, which was extended through June 30, 2012 for a total not-to-exceed amount of \$30,500,000. The Department is proposing a new five-year agreement with Aramark, based on a competitive Request for Proposals (RFP) process, retroactive to July 1, 2012. According to Ms. Bree Mawhorter, Sheriff's Department Deputy Director, the Department is submitting the proposed resolution to approve this agreement more than one-year after the agreement commencement date due to the election of the new Sheriff and turnover in Department management that delayed negotiations and completion of the agreement.</li> <li>• Under the proposed agreement, Aramark provides inmate and staff meals on a cost-per-meal basis. Inmates are supposed to receive three meals a day; however many inmates receive "double rations" in exchange for routine maintenance tasks like cleaning or painting. As a result, the daily total for meals served to inmates under the proposed contract averages 5,743 meals, or approximately 3.8 meals per inmate per day, at an average cost of \$1.56 per meal. Jail staff receive one meal per day at an average cost of \$3.24.</li> </ul> <p style="text-align: center;"><b>Fiscal Impact</b></p> <ul style="list-style-type: none"> <li>• The annual agreement costs beginning in FY 2012-13 of \$3,931,921 are \$8,300 more than FY 2011-12 costs of \$3,923,621 under the prior agreement. The annual agreement amount is fixed for the five-year term of the agreement, for a total not-to-exceed amount of \$19,659,606.</li> </ul> <p style="text-align: center;"><b>Recommendations</b></p> <ul style="list-style-type: none"> <li>• Amend the proposed resolution to specify that the agreement is retroactive to July 1, 2012.</li> <li>• Approve the proposed resolution, as amended.</li> </ul> |   |

## MANDATE STATEMENT AND BACKGROUND

### Mandate Statement

In accordance with City Charter Section 9.118(b), (a) any contract or agreement requiring \$10,000,000 in anticipated expenditures, and (b) any contract amendment that exceeds \$500,000 is subject to Board of Supervisors approval.

### Background

#### *Aramark Contract from 2005-2010*

On March 23, 2005, the Board of Supervisors approved a four-year agreement (File 05-0216) between the Sheriff's Department and Aramark Correctional Services, LLC (Aramark) in an amount not-to-exceed \$15,367,132. Under the agreement, Aramark provided to the City's five active jails (a) inmate meals, (b) staff meals, and (c) staff coffee. Under the terms of this agreement, inmate meals were provided at a fixed annual rate, regardless of the actual numbers of meals served (unless the inmate population exceeded 2,500 at any point). The agreement also stipulated that the parties would renegotiate the cost of inmate meals once a year if the cost of food went up 5% plus the USDA's Regional Wholesale Food Price Index (a measure of food inflation).

On October 30, 2008, the Board of Supervisors approved of an amendment that extended the contract through June 30, 2010, and raised the not-to-exceed amount to \$22,885,229. The amendment also suspended the clause requiring renegotiation of the contract terms if the cost of food went up above the previously mentioned threshold.

#### *Aramark Agreement from 2010-2012*

On August 11, 2010, the Board of Supervisors approved a resolution (File 10-0919) that allowed the Sheriff's Department to exercise an option to extend the contract for another two years, from July 1, 2010 through June 30, 2012. This amendment increased the not-to-exceed amount to \$30,500,000. This amendment replaced the fixed-cost model of providing meals with a cost-per-meal model which fluctuated with the number of meals served. Aramark would keep track of how many meals were served to inmates and staff and charge for each meal served.

#### *Request for Proposal (RFP)*

Prior to the end of the Aramark contract on June 30, 2012, the Sheriff's Department issued an RFP for meal services for inmates and staff the City's five active jails for FY 2012-13 through FY 2016-17. The RFP resulted in two bids, one from Aramark, and the other from Trinity Services Group. Scoring was based on four categories: experience of the firm, price, project staff, and project approach. Out of a possible score of 400, Aramark received a score of 374.02. Trinity received a score of 361.02.



## DETAILS OF PROPOSED LEGISLATION

The proposed resolution (File 13-0648) would approve a five-year agreement (with two one-year options for extension) between the Sheriff's Department and Aramark Correction Services, LLC for inmate and staff meal services at the City's five active jails, for an amount not-to-exceed \$19,659,606. The agreement term is retroactive from July 1, 2012 through June 30, 2017.

## FISCAL IMPACT

The budget for the proposed agreement is \$3,931,921 per year and \$19,659,605 for five years, as shown in Table 2 below. The annual costs are unchanged over the five-year term of the agreement.

**Table 2: Annual Service Costs in FY 2012-2013 through FY 2016-17 (Five Years)**

|   | Annual Cost        | Five-Year Total     |
|---|--------------------|---------------------|
| Inmate Meal Costs                       | \$3,266,773        | \$16,333,865        |
| Staff Meal Costs                        | \$622,348          | \$3,111,740         |
| <b>Meals Subtotal</b>                   | <b>\$3,889,121</b> | <b>\$19,445,605</b> |
| Staff Coffee Service and Paper Products | \$42,800           | \$214,000           |
| <b>Total<sup>1</sup></b>                | <b>\$3,931,921</b> | <b>\$19,659,605</b> |

The annual agreement costs beginning in FY 2012-13 of \$3,931,921 are \$8,300 more than FY 2011-12 costs of \$3,923,621 under the prior agreement.

### *Retroactivity*

The agreement between the Sheriff's Department and Aramark is effective from July 1, 2012 through June 30, 2017. According to Ms. Bree Mawhorter, Sheriff's Department Deputy Director, the Department is submitting the proposed resolution to approve this agreement more than one-year after the agreement commencement date due to the election of the new Sheriff and turnover in Department management that delayed negotiations and completion of the agreement.

According to Ms. Mawhorter, the Sheriff's Department reached a tentative agreement with Aramark on July 1, 2012 to provide inmate and staff meals at the City's five active jails on a per-cost basis and has been operating under that tentative agreement up to the present day.

### *Number of Meals Served*

According to Ms. Mawhorter, inmates are supposed to receive three meals a day; however many inmates receive "double rations" in exchange for routine maintenance tasks like cleaning or painting. As a result, the daily total for meals served to inmates under the proposed contract averages 5,743 meals, or approximately 3.8 meals per inmate per day, at an average cost of \$1.56 per meal.

Jail staff receive one meal per day at an average cost of \$3.24.

<sup>1</sup> The budget of \$19,659,605 is \$1 less than the not-to-exceed amount of \$19,659,606 due to rounding.

*MOU Side Letter*

On November 16, 2009, the Sheriff's Department and the Deputy Sheriff's Association (the union representing Deputy Sheriffs) agreed to a comprehensive package of reduced benefits to help keep the Department solvent during the City's financial crisis. As outlined in a MOU side letter, Deputy Sheriffs agreed to forego employer paid meals from January 1, 2010 through June 30, 2011. Meals for Deputy Sheriffs resumed in July of 2011 and were paid for by the Department from general funds.

**RECOMMENDATIONS**

1. Amend the proposed resolution to specify that the agreement is retroactive to July 1, 2012.
2. Approve the proposed resolution, as amended.

|  |   |
|--|---|
| <b>Item 8</b><br><b>File 13-0324</b>   | <b>Department:</b><br>San Francisco International Airport (Airport) |
| <b>EXECUTIVE SUMMARY</b>   |   |
| <p style="text-align: center;"><b>Legislative Objectives</b></p> <p>The proposed resolution would amend an existing ground lease between the San Francisco Airport (Airport) and United Airlines, Inc. (United Airlines): (1) to cede property from United Airlines to the Airport for various uses; (2) to extend the term of the lease; (3) to increase the base rent per acre; and (4) to allow United Airlines to cede up to 30 percent of its leased property to the Airport at a future date with Board of Supervisors approval.</p> <p style="text-align: center;"><b>Key Points</b></p> <ul style="list-style-type: none"> <li>• On March 20, 1973, the Airport and United Airlines entered into a 20-year ground lease for 129.02 acres (subsequently amended four times to add 5.50 acres for a total of 134.52 acres) to be used for operations, maintenance, and other uses. The initial lease included two 10-year options to extend the term of the lease, which United Airlines exercised. The Board of Supervisors authorized an additional 10-year option during the most recent amendment to the lease in 2004 (File 04-0321).</li> <li>• The proposed fifth amendment to the lease would exercise the final option to extend the term by ten years from July 1, 2013 through June 30, 2023 and increase the rent from \$82,686 per acre to \$93,000 per acre.</li> <li>• Under the proposed fifth amendment, the Airport will reclaim 5.05 acres of land from United Airlines, Inc. to be used for (1) equipment laydown and parking support; (2) a new convenience store; and (3) a new solar power station collection site.</li> <li>• United Airlines would have a one-time option to relinquish up to 30 percent of the leased premises on July 1, 2018 or July 1, 2019, subject to future Board of Supervisors approval, in the event that there is a contraction in the air transportation industry or if the Airline's business practices change.</li> </ul> <p style="text-align: center;"><b>Fiscal Impact</b></p> <ul style="list-style-type: none"> <li>• Under the proposed ordinance, the rent per acre for FY 2013-14 would be \$93,000, which is approximately 12.5 percent more than the FY 2012-13 rent per acre of \$82,686. After adjusting for the reduction in acreage from 134.52 acres to 129.02 acres, the FY 2013-14 rent will be \$12,040,710 which is \$917,758, or 8.3 percent, more than the FY 2012-13 rent of \$11,122,952.</li> <li>• The rent per acre will remain fixed at \$93,000 for the next three years after which the rent will increase to reflect inflation capped at 3 percent annually as calculated by the Consumer Price Index.</li> </ul> <p style="text-align: center;"><b>Recommendations</b></p> <ul style="list-style-type: none"> <li>• Amend the proposed resolution to retroactively approve the proposed lease commencement date of July 1, 2013.</li> <li>• Approve the proposed resolution as amended.</li> </ul> |   |

## MANDATE STATEMENT / BACKGROUND

### Mandate Statement

City Charter Section 9.118(c) states that leases, which would result in revenues to the City of \$1,000,000 or more are subject to Board of Supervisors approval.

### Background

On March 20, 1973 the Airport entered into a 20-year lease with United Airlines, Inc. (United Airlines) for 129.02 acres of real property to be used by United Airlines for maintenance, operations, and other uses. The original lease included two 10-year options to extend the term of the lease, which United Airlines has exercised, resulting in a total term of 40 years. The lease has been previously amended four times to make adjustments including increasing the premises by 5.50 acres to 134.52 acres. The most recent amendment in 2004 (File 04-0321) included a third 10-year option to extend the lease term an additional 10 years from July 1, 2013 to June 30, 2023.

## DETAILS OF PROPOSED LEGISLATION

The proposed resolution would approve the fifth amendment to the existing lease between the Airport and United Airlines to reflect the following changes retroactive to July 1, 2013:

- The Airport would reclaim 5.05 acres for (1) equipment laydown and parking support; (2) a new convenience store; and (3) a new solar power station collection site.
- United Airline would pay a new base rent of \$93,000 per acre that will be held constant for three years and adjusted annually for inflation up to 3 percent each year thereafter. The current rental rate is \$82,686 per acre.
- United Airlines and the Airport would exercise its last 10-year lease extension option from July 1, 2013 through June 30, 2023.
- United Airlines would have a one-time option to relinquish up to 30 percent of the leased premises on July 1, 2018 or July 1, 2019, subject to future Board of Supervisors approval, in the event that there is a contraction in the air transportation industry or if the Airline's business practices change.

## FISCAL IMPACT

Table 1 below shows the leased premises will decrease by 5.05 acres from 134.52 to 129.47, or 3.8 percent. The rent per acre increases by \$10,314, or 12.5 percent, for a total annual rent increase of \$917,758, or 8.3 percent, after adjusting for the change in acreage.

**Table 1: United Airlines Land Change Impacts**

| <b>Premises - July '12 to June '13</b> | <b>FY 2012-13</b>   | <b>FY 2013-14</b>   | <b>Change</b>    |
|--|---------------------|---------------------|------------------|
| Parcel 1                               | 121.94              | 117.94              | -4.00            |
| Parcel 2                               | 7.24                | 6.19                | -1.05            |
| Employee Parking Equivalent            | 5.34                | 5.34                | 0.00             |
| Total Acreage                          | <b>134.52</b>       | <b>129.47</b>       | <b>-5.05</b>     |
| Rent Per Acre                          | \$82,686            | \$93,000            | \$10,314         |
| <b>Total Rent</b>                      | <b>\$11,122,952</b> | <b>\$12,040,710</b> | <b>\$917,758</b> |

According to Diane Artz, Senior Property Manager at the Airport, the proposed rent of \$93,000 per acre is \$4,696 less than the fair market rent of \$97,696, based on the third-party appraisal conducted by CBRE, Inc., resulting in reduced rent to the Airport over the 10-year term of the lease extension of \$6,079,911. Ms. Artz states that the Airport and United Airlines negotiated the reduced rent per acre because (1) the fair market valuation represented a 17.9 percent increase over the current rate, which was far greater than what United Airlines had projected or budgeted, and (2) to maintain a long-standing relationship between the parties, long-term lease for the property, and stable revenue for the Airport.

## RECOMMENDATIONS

1. Amend the proposed resolution to retroactively approve the proposed lease commencement date of July 1, 2013.
2. Approve the proposed resolution as amended.

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| <b>Item 9</b><br><b>File 13-0332</b> | <b>Department:</b><br>San Francisco International Airport (Airport) |
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## EXECUTIVE SUMMARY

### Legislative Objective

- The proposed resolution would authorize two seven-year and ten-month Lease and Use Agreements (Leases) from September 1, 2013 through June 30, 2021, between the Airport and (a) China Eastern Airlines and (b) Scandinavian Airlines, as signatories to the 2011 Lease and Use Agreements.

### Key Points

- Airlines can operate at the Airport either by: (a) entering into a lease with the Airport as a signatory airline, or (b) obtaining a month-to-month Airline Operating Permit as a non-signatory airline. Non-signatory airlines pay the Airport a 25 percent premium on landing fees.
- The Board of Supervisors approved a 2011 Lease and Use Agreements with 43 signatory airlines for ten years, from July 1, 2011 through June 30, 2021. In addition, 9 other airlines operate at the Airport as non-signatory airlines, for a total of 52 airlines currently operating at the Airport.
- China Eastern Airlines currently operates at the Airport as a non-signatory airline under a month-to-month Airline Operating Permit, which commenced April 22, 2013. Scandinavian Airlines currently operates at the Airport as a non-signatory airline under a month-to-month Airline Operating Permit, which commenced April 8, 2013. The Airport waived Scandinavian Airlines' first year landing fees through April 2014 under the Air Carrier Incentive Program because they created a new non-stop international flight from Copenhagen to San Francisco.

### Fiscal Impacts

- China Eastern Airlines and Scandinavian Airlines will pay monthly landing fees to the Airport under the proposed lease agreements that are \$24,290 less than under the existing month-to-month permits in accordance with the 2011 Lease and Use Agreements.
- Under the proposed lease agreements, China Eastern Airlines will pay an average of \$51,649 per month in landing fees for FY 2013-14 as a signatory airline, a reduction of \$12,882 per month.
- Under the proposed lease agreements, Scandinavian Airlines will pay an average of \$45,738 per month in landing fees for FY 2013-14 as a signatory airline, a reduction of \$11,408 per month; however, as noted previously, the Airport has waived Scandinavian Airlines' landing fees for one year from April 2013 to April 2014.

### Recommendation

- Approve the proposed resolution.

## MANDATE STATEMENT / BACKGROUND

### Mandate Statement

Section 2A.173 of the City's Administrative Code authorizes the Airport to execute leases of Airport lands and space in Airport buildings without undergoing a competitive bid process, as long as the original term of the lease does not exceed 50 years.

City Charter Section 9.118 states that leases which would result in revenues to the City in excess of \$1,000,000 are subject to Board of Supervisors approval.

### Background

Airlines can operate at the Airport either by: (a) entering into a lease with the Airport as a "signatory airline" authorizing the airline to operate flights in and out of the Airport, and to rent an amount of exclusive and non-exclusive space for use by the airline, or (b) obtaining a month-to-month Airline Operating Permit for the operation of flights in and out of the Airport and to rent terminal space as a "non-signatory airline."

According to Ms. Diana Chow, Property Manager at the Airport, there are currently 52 airlines operating at the Airport. Of the 52 airlines, 43 airlines are signatory airlines under the Airport's 2011 Lease and Use Agreements and nine are non-signatory airlines operating under month-to-month Airline Operating Permits. The initial 2011 Lease and Use Agreements were between the Airport and 38 airlines for a term of ten years from July 1, 2011 through June 30, 2021. Effective December 1, 2011, Swiss International Airline was added and effective April 1, 2012, four additional airlines - JetBlue, WestJet, World Airways, and MN Airlines - were added to the agreement. The Board of Supervisors previously approved five resolutions between 2010 and 2012 for the 43 signatory airlines under the 2011 Lease and Use Agreements (File 10-0351, File 10-1213, File 11-0210, File 11-1152 and File 12-0253).

Ms. Chow notes that previous to the 2011 Lease and Use Agreements, there was little incentive for airlines to enter into a lease with the Airport as a signatory airline because both signatory and non-signatory airlines paid the same landing fee rates. However, as part of the 2011 Lease and Use Agreements, as of July 1, 2011, each non-signatory airline is required to pay a 25 percent premium on landing fees in excess of the landing fees paid by the signatory airlines to the Airport. According to Ms. Chow, the 25 percent premium on landing fees for non-signatory airlines was intended to create a financial incentive for non-signatory airlines to enter into long term leases with the Airport instead of operating at the Airport under a month-to-month permit.

## DETAILS OF PROPOSED LEGISLATION

The proposed resolution would add two airlines, China Eastern Airlines Corporation Limited (China Eastern Airlines) and Scandinavian Airlines of North America, Inc. (Scandinavian Airlines) that are currently non-signatory airlines operating under month-to-month Airline Operating Permits, as signatory airlines to the Airport's 2011 Lease and Use Agreements (Lease).

### **China Eastern Airlines**

China Eastern Airlines Corporation Limited (China Eastern Airlines) has operated passenger service in the International Terminal at the Airport as a non-signatory airline under a month-to-month Airline Operating Permit and has occupied 379 square feet of Exclusive Use Space since April 22, 2013.

China Eastern Airlines would become a signatory airline, for (a) the right to operate flights at the Airport's International Terminal, and (b) occupy a total of 379 square feet of Exclusive Use Space in the International Terminal for a period of approximately seven years and ten months from the date of approval of the proposed resolution by the Board of Supervisors through June 30, 2021.

### **Scandinavian Airlines**

Scandinavian Airlines of North America, Inc. (Scandinavian Airlines) has operated passenger service in the International Terminal at the Airport as a non-signatory airline under a month-to-month Airline Operating Permit since April 8, 2013. Scandinavian Airlines does not rent Airport Terminal space.

The proposed resolution would approve a lease between the Airport and Scandinavian Airlines, under which Scandinavian Airlines would become a signatory airline, for the right to operate flights at the Airport for a period of approximately seven years and ten months from the date of approval of the proposed resolution by the Board of Supervisors through June 30, 2021. Scandinavian Airlines will not rent any Exclusive Use space at the Airport.

According to Ms. Chow, Scandinavian Airlines began operating a new route to and from Copenhagen in April 2013, which is a non-stop international service previously not served from the Airport. Therefore, the Airport waived Scandinavian Airlines first year landing fees pursuant to the Air Carrier Incentive Program, which provides a 100 percent discount on landing fees for a term of one year from the service commencement date. This waiver of landing fees expires in April 2014.

## **FISCAL IMPACT**

Under the terms of the existing Lease and Use Agreements with the signatory airlines, non-signatory airlines, which have operated at the Airport under month-to-month Airline Operating Permits, are required to pay a 25 percent premium on landing fees in excess of the landing fees paid by the signatory airlines. However, as discussed above, Scandinavian Airlines' first year landing fees are waived pursuant to the Air Carrier Incentive Program, such that the waiver will expire in April 2014.

As shown in Table 1 below, China Eastern Airlines and Scandinavian Airlines will pay monthly landing fees to the Airport under the proposed lease agreements that are \$24,290 (\$12,882 plus \$11,408) less than under the existing month-to-month permit in accordance with the aforementioned lease agreements. As noted previously, the Airport has waived Scandinavian Airlines' landing fees for one year from April 2013 to April 2014.



**Table 1: Landing Fees under the Proposed Lease Agreements**

|                                    | <b>Proposed Lease Agreement as Signatory Airlines</b> | <b>Existing Month to Month Permit as Non-Signatory Airlines</b> | <b>Difference</b> |
|------------------------------------|---|---|-------------------|
| China Eastern Airlines             | \$51,649  | \$64,531  | (\$12,882)        |
| Scandinavian Airlines <sup>1</sup> | \$45,738  | \$57,146  | (\$11,408)        |

<sup>1</sup>Landing fees waived from April 2013 to April 2014

### *Airport's Break Even Policy*

As a result of the Airport's "residual rate setting methodology" (the breakeven policy) used by the Airport to determine rental rates, landing fees, and related fees for all Airlines, the proposed leases between the Airport and China Eastern Airlines and Scandinavian Airlines, will not result in any budgetary shortfall for the Airport as a result of the reduced landing fees. 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, any reductions in landing fees do not have a direct fiscal impact on the Airport.

## **RECOMMENDATION**

Approve the proposed resolution.

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| <b>Item 10</b><br><b>File 13-0333</b>  | <b>Department:</b><br>San Francisco International Airport (Airport) |
| <b>EXECUTIVE SUMMARY</b>   |   |
| <p style="text-align: center;"><b>Legislative Objectives</b></p> <p>The proposed resolution would approve amendments to existing leases between the Airport and four tenants for the sale of goods and services located in Boarding Area E of Terminal 3 due to the extended construction schedule in Boarding Area E: (1) ILJ San Francisco, LLC (ILJ); (2) Marilla Chocolate Company, Inc.(Marilla); (3) Pacific Gateway Concessions, LLC (PGC); and (4) XpresSpa SF International, LLC (XpresSpa).</p> <p style="text-align: center;"><b>Key Points</b></p> <ul style="list-style-type: none"> <li>• On April 14, 2011, the Airport Commission closed Boarding Area E in Terminal 3 of the San Francisco International Airport for seismic retrofitting. At the time, the Airport Commission estimated that the renovations would last one year until May 2012. During the renovations, the Minimum Annual Guarantee (MAG) for ILJ, Marilla, PGC, and XpresSpa was suspended.</li> <li>• Subsequent review of the retrofitting plans required the Airport to expand the scale of the retrofits, which the Airport Commission estimates will conclude in January 2014.</li> <li>• The proposed resolution would amend the four leases with ILJ, Marilla, PGC, and XpresSpa to (1) extend the MAG suspension through the end of the renovations, and (2) reimburse ILJ and PGC for unamortized construction costs. The leases were previously amended to reflect the initial one-year MAG exemption. The amendments included in the proposed resolution would extend the MAG exemption from May 2012 through the end of the renovations, which the Airport estimates to be January 2014.</li> <li>• The proposed resolution would (1) extend the term of each lease to five years from approximately January 2014 through approximately December 2019, and (2) eliminate the prior provisions allowing the Airport to extend the leases by two years.</li> </ul> <p style="text-align: center;"><b>Fiscal Impact</b></p> <ul style="list-style-type: none"> <li>• The proposed resolution would (1) extend the MAG suspension for ILJ, Marilla, PGC, and XpresSpa by approximately 20 months from May 2012 to January 2014, resulting in estimated rent reductions of \$1,328,264; and (2) reimburse ILJ and PGC \$269,403 for unamortized construction costs, for total estimated costs to the Airport of \$1,597,667.</li> <li>• Because the Airport's residual rate setting methodology ensures that Airport revenues are equal to the Airport's total costs, the estimated costs of \$1,597,667 will not have a direct impact on the Airport's budget.</li> </ul> <p style="text-align: center;"><b>Recommendations</b></p> <ul style="list-style-type: none"> <li>• Amend the proposed resolution to retroactively approve the amendments to the four leases.</li> <li>• Approve the proposed resolution, as amended.</li> </ul> |   |

## MANDATE STATEMENT / BACKGROUND

### Mandate Statement

City Charter Section 9.118(c) states that leases that would result in revenues to the City of \$1,000,000 or more are subject to Board of Supervisors approval.

### Background

On April 14, 2011, the Airport closed Boarding Area E of Terminal 3 for seismic retrofitting for a period then estimated to span one year until May 2012. During that time, the Airport suspended the Minimum Annual Guarantee (MAG) rent for four leases with four different tenants: (1) ILJ San Francisco, LLC (ILJ); (2) Marilla Chocolate Company, Inc.(Marilla); (3) Pacific Gateway Concessions, LLC (PGC); and (4) XpresSpa SF International, LLC (XpresSpa).

The Board of Supervisors approved the suspension of the MAG during the renovation period for ILJ and XpreSpa in July 2011 (File 11-0536). The other two lease amendments to suspend the MAG for PGC and Marilla were not subject to Board of Supervisors approval.

Subsequently, the Airport determined that the renovation was going to be more extensive and require an additional estimated 20 months from May 2012 until approximately January 2014.

Each of the tenants eventually closed the premises in Boarding Area E of Terminal 3: ILJ and PGC closed during the initial year of renovation; Marilla closed in May 2013, and XpresSpa closed in April 2013. Because they did not close until April and May of 2013, the Airport continued to collect percentage rent from Marilla and XpresSpa.

## DETAILS OF PROPOSED LEGISLATION

The proposed resolution would approve an amendment to each of the existing leases between the Airport and four tenants for the sale of goods and services located in Boarding Area E of Terminal 3: (1) ILJ, (2) Marilla, (3) PGC, and (4) XpresSpa.<sup>1</sup>

The proposed lease amendments for each of the four tenants would:

- Suspend the MAG for an approximate 20-month period during renovations to Boarding Area E of Terminal E retroactively from May 2012 to approximately January 2014;
- Reinstate the MAG when Boarding Area E of Terminal 3 renovations are completed (the tenants will pay the Airport the greater of the MAG or a percentage of gross revenues);
- Provide for a new lease term of five years, commencing when the Airport renovations on Boarding Area E of Terminal 3 are completed and the tenants can re-occupy the space; and
- Delete prior lease provisions for the Airport's option to extend the leases by two years.

The proposed resolution would also (1) replace or provide new premises in Boarding Area E of Terminal 3 for each of the four tenants, and (2) reimburse ILJ and PGC for the unamortized costs

<sup>1</sup> ILJ is the corporate name for the Techshowcase offering support and sales of mobile device accessories. Marilla Chocolate Company and PGC are chocolate retailers, and XpresSpa offers massages and related accessories.

incurred by the tenants for space improvements made at the Airport since the tenant could not recover such costs when the Airport closed Boarding Area E of Terminal 3.

Under the proposed amendments to three of the four leases (ILJ, Marilla, and PGC) the reinstated MAG would be the same as in the original lease. Under the proposed amendment to the XpresSpa lease, the MAG will increase from \$100,000 to \$202,720 due to the increased square footage of the leased space.

## FISCAL IMPACT

Table 1 below shows the estimated costs to the Airport, totaling \$1,597,667, which include the suspended MAG and reimbursements to the tenants for the unamortized improvements which the tenants had previously made.

**Table 1: Suspended MAG and Construction Reimbursement under Proposed Resolution**

| Retailer / Concessionaire | MAG per Month   | MAG Suspension (Months) | MAG Subtotal       | Collected Rent    | Unamortized Construction | Grand Total        |
|---------------------------|-----------------|-------------------------|--------------------|-------------------|--------------------------|--------------------|
| ILJ                       | \$41,667        | 20                      | \$833,340          | \$-               | \$206,461                | \$1,039,801        |
| Marilla                   | 6,000           | 20                      | 120,000            | (21,572)          | -                        | 98,428             |
| PGC                       | 15,167          | 20                      | 303,340            | -                 | 62,942                   | 366,282            |
| XpresSpa                  | 8,333           | 20                      | 166,660            | (73,504)          | -                        | 93,156             |
| <b>Total</b>              | <b>\$71,167</b> | <b>20</b>               | <b>\$1,423,340</b> | <b>(\$95,076)</b> | <b>\$269,403</b>         | <b>\$1,597,667</b> |

The proposed amendments to the leases with ILJ, PGC, XpresSpa, and Marilla suspended the MAG but not percentage rent, and therefore, XpresSpa and Marilla paid the Airport percentage rent based on their gross revenues prior to closing of their concessions in Boarding Area E in April 2013 and May 2013 respectively.

### Airport Break Even Policy

As a result of the Airport's "residual rate setting methodology" (a breakeven policy) used by the Airport to determine rental rates, landing fees, and related fees for all Airlines, the proposed resolution amending the concession leases, 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, any shortfall in concession revenues such as those advanced by the proposed resolution will not have a direct impact on the Airport's budget.

## RECOMMENDATIONS

1. Amend the proposed resolution to provide for retroactivity to May 1, 2012.
2. Approve the proposed resolution, as amended.

**Item 11**  
**File 13-0334**

**Department:**  
San Francisco International Airport (Airport)

## EXECUTIVE SUMMARY

### Legislative Objectives

- The proposed resolution would amend an existing lease between the Airport and Pelican Communications to decrease the Minimum Annual Guarantee (MAG) from 55 percent of gross revenues to 20 percent of gross revenues retroactive to December 1, 2012.

### Key Points

- On September 15, 2009, the Airport entered into a four-year lease agreement with Pelican Communications Inc. to provide payphones, pre-paid calling card vending machines, and coin-changing units at the San Francisco International Airport. The existing lease is effective from January 1, 2010 through December 31, 2013 with two one-year options to extend through December 31, 2013 at the sole discretion of the Airport.
- The existing lease does not include a base rent but has a MAG of 55 percent of the annual gross revenues.
- Pelican Communications' gross revenues for payphones and pre-paid calling cards decreased by 55 percent since the beginning of the lease. The vendor and Airport attribute the loss to increased cell phone use and Wi-Fi availability. According to the Airport, as a result of decreased revenues and fixed operating costs, Pelican Communications has been operating at a net loss since calendar year 2011. In order to offset the net operating loss, the Airport proposes to reduce the MAG from 55 percent of gross revenues to 20 percent of gross revenues retroactive to December 1, 2012.
- The proposed resolution would reduce the MAG from 55 percent to 20 percent for the lease from December 1, 2012 through December 31, 2013.

### Fiscal Impact

- Pelican Communications' operating loss in 2012 was \$76,422. If the MAG paid by Pelican Communications to the Airport had been 20 percent rather than 55 percent of gross revenues in 2012, Pelican Communications would have realized an operating surplus of \$11,064.
- If the MAG paid by Pelican Communications to the Airport had been 20 percent rather than 55 percent of gross revenues in 2012, the Airport would have received rent of \$49,992 rather than \$137,479, a reduction of \$87,487, or approximately 67 percent.
- Because the Airport's residual rate setting methodology ensures that Airport revenues are equal to the Airport's total costs, the estimated rent reduction of \$87,487 will not have a direct impact on the Airport's budget.

### Recommendations

- Amend the proposed resolution to specify that the reduction in the MAG from 55 percent to 20 percent of gross revenues is retroactive, effective from December 1, 2012 to December 31, 2013.
- Approve the proposed resolution as amended.

## MANDATE STATEMENT / BACKGROUND

### Mandate Statement

City Charter Section 9.118(c) states that leases that would result in revenues to the City of \$1,000,000 or more are subject to Board of Supervisors approval.

### Background

The Airport has an existing four-year lease agreement with Pelican Communications, Inc. (Pelican Communications) to provide payphones and pre-paid calling card vending machines throughout the San Francisco International Airport. Pelican Communications also provides coin-changing units free of charge to airport passengers. The existing lease term is for four years from January 1, 2010 through December 31, 2013 with two one-year options to extend the term through December 31, 2015 at the Airport's sole discretion.

Under the existing lease, Pelican Communications pays the Airport a Minimum Annual Guarantee (MAG), defined by the lease as 55 percent of Pelican Communications' total gross revenues. Pelican Communications' gross revenues have decreased significantly from \$559,098 in 2010 to \$249,962 in 2012, resulting in a related decrease in rent to the Airport, as shown in Table 1 below.

**Table 1: Pelican Communications Gross Revenue and Paid Rent**

| Calendar Year | Gross Revenues     | Rent @ 55 Percent |
|---------------|--------------------|-------------------|
| 2010          | \$559,098          | \$307,504         |
| 2011          | 400,641            | 220,352           |
| 2012          | 249,962            | 137,479           |
| 2013*         | 54,195             | 29,807            |
| <b>Total</b>  | <b>\$1,263,896</b> | <b>\$695,143</b>  |

*\*Revenues and rent are only for January through May.*

Pelican Communications and Airport staff state that the decline in revenues is largely due to increased cell phone use and Wi-Fi availability at the Airport.

## DETAILS OF PROPOSED LEGISLATION

The proposed resolution would approve the first amendment to the existing lease between Pelican Communications and the Airport to reduce the MAG paid by Pelican Communications to the Airport from 55 percent of gross revenues to 20 percent of gross revenues retroactive to December 1, 2012.

## FISCAL IMPACT

According to Sam El Gord, Principal Property Manager at the Airport, the Airport is proposing the reduction in the MAG because Pelican Communications' combined MAG and annual fixed operating expenditures exceed Pelican Communications gross revenues, resulting in a 2012 operating loss of \$76,422, as shown in Table 2 below.

**Table 2: Pelican Communications' Calendar Year 2012 Revenues and Expenditures**

|                       |                   |
|-----------------------|-------------------|
| Gross Revenues        | \$249,962         |
| Rent @ 55 %           | (137,479)         |
| Operating Fees        | (113,249)         |
| Overhead              | (75,656)          |
| <b>Operating Loss</b> | <b>(\$76,422)</b> |

Based on 2012 revenues, Pelican Communications would have paid the Airport a MAG of \$49,992 at 20 percent of gross revenues or \$87,487 less than the existing payment of \$137,479 based on the 55 percent of gross revenues.

If the MAG paid by Pelican Communications to the Airport had been 20 percent rather than 55 percent of gross revenues in 2012, Pelican Communications would have realized an operating surplus of \$11,065 in 2012.

According to Mr. El Gord, even with the reduced MAG, Pelican Communications will operate at a loss if gross revenues continue to decline. Mr. El Gord advises that such a loss might be offset by removing payphones, thereby reducing overhead costs as well as services to travelers.

#### Airport's Break Even Policy

As a result of the Airport's "residual rate setting methodology" (a breakeven policy) used by the Airport to determine rental rates, landing fees, and related fees for all Airlines, the proposed resolution amending the lease, 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, any shortfall in revenues such as those advanced by the proposed resolution will not have a direct impact on the Airport.

## RECOMMENDATIONS

1. Amend the proposed resolution to specify that the reduction in the MAG from 55 percent to 20 percent of gross revenues is retroactive to December 1, 2012.
2. Approve the amended resolution.

**Item 14**  
**File 13-0688**

**Department(s):**  
Office of Contract Administration (OCA)

## EXECUTIVE SUMMARY

### Legislative Objectives

- The proposed resolution would approve (a) the award of a contract between the City, through OCA, and Golden Gate Petroleum to provide gasoline, biofuels and diesel fuel to the City, in an amount not-to-exceed \$94,000,000 for the three-year period from September 1, 2013 through August 31, 2016, and (b) two one-year options, or up to a maximum term of five years.

### Key Points

- The \$94,000,000 not-to-exceed three-year agreement with Golden Gate Petroleum includes a projected cost of fuel of \$85,101,252 and a total contingency amount of \$8,898,748 in order to address possible increases in market prices or changes in usage by Departments.
- Although the OCA had one additional option under the existing agreement with Western States Oil through August 31, 2014, the final one-year option was not exercised, and the existing agreement will terminate after the third one-year extension, on August 31, 2013.
- The proposed agreement was awarded to Golden Gate Petroleum through a competitive bid process. Bid prices are fixed as a mark-up or a mark-down from market prices for the entire term of the agreement, including options to extend, and include all overhead and/or delivery of fuel costs.
- The proposed agreement differs from the existing agreement in that the existing agreement uses the Oil Price Information Services (OPIS) index for just San Francisco, whereas the proposed agreement references the average of three SF Bay Area Locations (San Francisco, Richmond and San Jose) as a benchmark for fair market prices.

### Fiscal Impact

- The proposed agreement for the initial three-year not-to-exceed amount of \$94,000,000 is consistent with the City's actual expenditures on gasoline and diesel fuel in Calendar Year 2012; and would be funded from monies included in various City Departments' FY 2013-14 and FY 2014-15 budgets for purchasing fuel. The proposed agreement is an indefinite quantity contract, such that City departments are not obligated to purchase any specific quantities.
- Separate from this legislation, OCA will also be entering into secondary and tertiary fuel supplier contracts for less than \$10 million to serve as standby resources for the City's fuel needs. Under existing standby agreements, the City has never purchased fuel.

### Policy Consideration

- The proposed contract assumes that the City's overall fuel consumption rates will continue at approximately the same rate as occurred in 2012, at an average rate of \$3.693 per gallon. However, the Healthy Air and Clean Transportation Ordinance (HACTO) phases out high polluting diesel buses, reduces the City's overall vehicle fleet, replaces older inefficient vehicles, encourages the use of bicycles, and facilitates the development of alternative fuels to reduce emissions. Given that HACTO is likely to result in the reduction of the City's fuel consumption, the total actual consumption of fuel may be less than the amount projected in the proposed agreement.

### Recommendation

- Approve the proposed resolution.



## MANDATE STATEMENT/ BACKGROUND

### Mandate Statement

In accordance with Charter Section 9.118(b), City agreements with anticipated expenditures of \$10,000,000 or more are subject to approval by the Board of Supervisors.

### Background

According to Mr. Hermilo Rodis, Purchaser at the Office of Contract Administration (OCA), the OCA has an existing contract with Western States Oil, previously awarded through a competitive bid process, as the City's primary fuel (gasoline, biodiesel and diesel fuel) contractor for a total not-to-exceed amount of \$107.5 million. The existing contract was for an initial one-year term from September 1, 2009 through August 31, 2010, and included four one-year options to extend, or through August 31, 2014. The City has exercised three of the four one-year options, such that the existing contract with Western States Oil expires August 31, 2013.

The average cost per gallon of fuel charged by Western States Oil to the City, based on the Calendar Year 2012 data, was approximately \$3.693 per gallon. This agreement provides fuel for over 7,000 City vehicles and pieces of equipment, including generators, used by City Departments.

Mr. Rodis advises that the OCA also has an existing agreement, previously awarded through a competitive bid process, with Flyers Energy, LLC (previously Nella Oil Co. LLC), which serves as the City's secondary fuel contractor to provide fuel for a not-to-exceed amount of \$9 million for the four-year term from September 1, 2009 through August 31, 2013. No fuel has been purchased by the City under this secondary agreement.

Although the OCA had one additional option under the existing agreement through August 31, 2014, the final one-year option was not exercised, and the existing agreement will terminate after the third one-year extension, on August 31, 2013. A new Invitation to Bid was issued by OCA on February 19, 2013, for an agreement effective September 1, 2013 to provide gasoline, biodiesel and diesel fuel for over 7,000 total vehicles and pieces of equipment, including generators, used by City Departments. According to Mr. Rodis, OCA chose to implement a competitive bid process instead of extending the final one-year option under the existing agreement in order to ensure that the City continues to obtain its needed fuels at the lowest possible cost.

Based on the competitive Invitation to Bid, OCA received seven offers to provide the needed gasoline and fuel to the City. Based on OCA's evaluation of the seven vendors' fixed prices, expressed as a markup or markdown from the daily price per gallon published by the industry group known as the Oil Price Information Services (OPIS),<sup>1</sup> OCA issued a notice of conditional

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<sup>1</sup> The OPIS purchase price is a standard market purchase price for a particular fuel and is not controlled by the City or the fuel distribution vendor. While the markup or markdown price will remain fixed, the OPIS price per gallon

award to Golden Gate Petroleum on June 27, 2013 as the lowest bidder. The bid prices are fixed as a mark-up or a mark-down from OPIS prices for the entire term of the agreement, including options to extend, and include all overhead and/or delivery of fuel costs. OPIS prices are subject to variation according to the market price of fuel.

## DETAILS OF PROPOSED LEGISLATION

Based on the competitive Invitation to Bid above, the proposed resolution would approve (a) the award of a contract between the City, through OCA, and Golden Gate Petroleum to provide gasoline, biodiesel and diesel fuel to the City, in an amount not-to-exceed \$94,000,000 for the three-year period from September 1, 2013, through August 31, 2016, with (b) two one-year options to extend, or up to a maximum term of five years.

Under the proposed contract, Golden Gate Petroleum would be the primary City provider of gasoline, diesel and biodiesel fuel for the City's over 7,000 vehicles and pieces of equipment, including generators.

### Comparison of Existing to Proposed City-Wide Fuel Contracts

The existing agreement with Western States Oil specified an initial term of only one year with four one-year options to extend the agreement, or a total of five years. The proposed agreement with Golden Gate Petroleum specifies an initial term of three years with two one-year options to extend the agreement, for the same total term of five years. Mr. Rodis advises that the shorter initial term under the existing agreement was driven by the possibility of sourcing a local biodiesel contractor within the initial year, which did not materialize.

The existing agreement also differs from the proposed agreement in that the existing agreement uses the OPIS index for just San Francisco, whereas the proposed agreement references the average of three SF Bay Area Locations (San Francisco, Richmond and San Jose). Mr. Rodis advises that the reason for changing is that an average of Bay Area prices from OPIS would be more representative of fair market value than prices from a single location.

According to Mr. Rodis, OCA will also be entering into separate secondary and tertiary fuel supplier contracts which will not be subject to Board of Supervisors approval as each of those contracts are expected to be less than \$10 million.<sup>2</sup> Such secondary and tertiary contracts will serve as standby resources in the event that Golden Gate Petroleum is unable to deliver the City's needed gasoline, biodiesel and diesel fuel according to the terms of this proposed agreement.

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fluctuates daily. Therefore, the actual price that the City pays for fuel fluctuates throughout the term of the agreement.

<sup>2</sup> Based on the competitive bid prices, the secondary contractor will be Western States Oil and the tertiary contractor will be SC Fuels.

## FISCAL IMPACTS

The proposed resolution authorizes the OCA to enter into a proposed three-year agreement with Golden Gate Petroleum for a not-to-exceed amount of \$94,000,000. The \$94,000,000 not-to-exceed three-year agreement includes a base amount of \$85,101,252 and a 10.5% contingency amount of \$8,898,748 in order to address possible increases in OPIS market prices or changes in usage by Departments. According to Mr. Rodis, the most likely source of variation in City fuel use is the SFMTA, which uses approximately 65% of the gasoline, diesel and biodiesel fuel consumed by City departments.

According to Mr. Rodis, the funding source for the proposed agreement is monies included in the City departments' annual budgets from FY 2013-2016 for purchasing gasoline, diesel and biodiesel fuel, subject to appropriation approval by the Board of Supervisors.

The proposed agreement is an indefinite quantity contract, such that City departments are not obligated to purchase any specific quantities.

As shown in Table 1 below, a projected total quantity of 7,681,018 gallons of gasoline, diesel and biodiesel fuel at approximately \$3.693 per gallon reflects the total average yearly fuel expenditure of \$28,367,084 for each of the years under the proposed three-year agreement. The projected cost for the full three-year period of the agreement is three times this yearly cost of \$28,367,084, or \$85,101,252. As noted above, OCA has added a contingency amount of 10.5 percent of \$85,101,252, which is \$8,898,748, for a proposed total agreement not-to-exceed amount of \$94,000,000.

| Gallons   | Average Price/Gallon | Total Yearly Cost | Three-year Cost | 10.5% Contingency | Proposed Agreement Amount |
|-----------|----------------------|-------------------|-----------------|-------------------|---------------------------|
| 7,681,018 | \$3.693              | \$28,367,084      | \$85,101,252    | \$8,898,748       | \$94,000,000              |

Therefore, as shown in Table 1 above, the proposed agreement for the initial three-year not-to-exceed amount of \$94,000,000 (a) assumes a continued average annual consumption of 7,681,018 total gallons of fuel at an average price of \$3.693 per gallon, and (b) is consistent with the City's actual expenditures on gasoline and diesel fuel in Calendar Year 2012.

## POLICY ISSUE

### Healthy Air and Clean Transportation Ordinance

The proposed resolution would approve a new contract with Golden Gate Petroleum for a total not-to-exceed \$94,000,000 for a period of three years based on an assumption that the City's overall fuel consumption rates will continue at approximately the same rate as occurred in 2012, at an average rate of \$3.693 per gallon. However, the Budget and Legislative Analyst notes that

on November 18, 2010, the Board of Supervisors approved the Healthy Air and Clean Transportation Ordinance (HACTO), which is intended to assist the City in achieving its air pollution and greenhouse gas reduction goals (Ordinance 278-10; File 10-1009). HACTO specifically contains provisions for phasing out high polluting diesel buses, reducing the City's overall vehicle fleet, replacing older inefficient vehicles with high energy efficient vehicles, encouraging the use of bicycles, and facilitating the development of alternative fuels in order to reduce such overall emissions. Given that HACTO is likely to result in the reduction of the City's fuel consumption over the next three years, the Budget and Legislative Analyst notes that the total annual consumption of fuel under the proposed contract, which will extend for three years, may be less than the 7,681,018 annual gallons of fuel being projected by the City, as reflected above in Table 1. However, given the volatility of fuel prices over the last several years, the Budget and Legislative Analyst does not recommend a reduction in the proposed not-to-exceed \$94,000,000 contract with Golden Gate Petroleum.

## RECOMMENDATION

Approve the proposed resolution.

|  |  |
|--|--|
| <b>Item 15</b><br><b>File 13-0704</b>  | <b>Department:</b><br>Risk Management Division (RMD) |
| <b>EXECUTIVE SUMMARY</b>   |  |
| <b>Legislative Objectives</b>  |  |
| <ul style="list-style-type: none"> <li>• The proposed resolution would approve a new two-year, two-month agreement between the City's Risk Management Division and Alliant for insurance brokerage services for an amount not-to-exceed \$22,000,000 commencing June 1, 2013 and extending through July 30, 2015.</li> </ul>   |  |
| <b>Key Points</b>  |  |
| <ul style="list-style-type: none"> <li>• The City's Risk Management Division purchases insurance for City departments, including property, liability, and other forms of third-party insurance. The Risk Management Division entered into an agreement with Alliant Insurance Services, Inc. (Alliant) in July 2011, as the result of a Request for Qualifications (RFQ), to provide insurance brokerage services for an initial \$9,500,000 for an approximately two-year term from July 28, 2011 through July 21, 2013. On September 11, 2012, the Board of Supervisors authorized an increase of \$5,600,000 in this contract, from \$9,500,000 to \$15,100,000, including a \$500,000 contingency for unanticipated insurance needs.</li> </ul>                |  |
| <b>Fiscal Impact</b>   |  |
| <ul style="list-style-type: none"> <li>• The total expenditures for insurance premiums for the initial two-year term under the existing agreement for FY 2011-12 and FY 2012-13 are \$14,029,895.</li> <li>• The total estimated expenditures for insurance premiums under the proposed agreement for FY 2013-14 and FY 2014-15 are currently projected to be \$18,520,840. The Risk Management Division cannot project what the required City premiums and costs for the subject Alliant contract will be in FY 2015-16 due to constantly changing insurance market conditions and the effect of any potential losses.</li> <li>• The funding for the subject Alliant contract is paid from work orders by City departments in the annual City budget.</li> </ul> |  |
| <b>Recommendations</b>   |  |
| <ul style="list-style-type: none"> <li>• Amend the proposed resolution to provide for retroactive approval effective as of June 1, 2013.</li> <li>• Amend the proposed resolution to provide for two additional two-year options to extend the subject agreement through June 30, 2019.</li> <li>• Amend the proposed resolution to reduce the contract length by one month, to commence retroactively on June 1, 2013 and terminate on June 30, 2015, instead of July 31, 2015.</li> <li>• Amend the proposed resolution to reduce the not-to-exceed amount by \$2,479,160 from \$22,000,000 to \$19,520,840, which includes a \$1,000,000 contingency.</li> <li>• Approve the proposed resolution, as amended.</li> </ul>  |  |

## MANDATE STATEMENT/BACKGROUND

### Mandate Statement

In accordance with City Charter Section 9.118(b), (a) any contract or agreement requiring \$10,000,000 in anticipated expenditures, and (b) any amendment to such contract or agreement that exceeds \$500,000 in anticipated expenditures is subject to Board of Supervisors approval.

### Background

The City's Risk Management Division purchases insurance for City departments, including property, liability, and other forms of third-party insurance. The Risk Management Division entered into an agreement with Alliant Insurance Services, Inc. (Alliant) in July 2011, as the result of a Request for Qualifications (RFQ), to provide insurance brokerage services. Under the existing agreement, Alliant is responsible for evaluating City departments' insurance needs and assuring that City departments' have the appropriate level of insurance coverage. In accordance with the existing agreement, Alliant obtains and maintains insurance policies on behalf of City departments with qualified insurance providers.

The existing Alliant agreement is for an approximately two-year period from July 28, 2011 through July 21, 2013, with two additional two-year options to extend through July 21, 2017. The original not-to-exceed amount was \$9,500,000, which did not require Board of Supervisors approval because the amount was less than \$10,000,000.

On September 11, 2012, the Board of Supervisors approved a resolution (File 12-0863) authorizing the Risk Management Division to increase the not-to-exceed amount by \$5,600,000, from \$9,500,000 to \$15,100,000 for the original two-year term from July 28, 2011 through July 21, 2013, including a \$500,000 contingency for unanticipated insurance needs for art exhibits, construction projects, and other events that are not yet known. The funding for this \$15,100,000 contract was fully paid from work orders by City departments that purchase insurance on their property.

On February 20, 2013, based on the City's previous RFQ process in 2011, Alliant was again selected as the preferred vendor. According to Mr. Matt Hansen, Director of the Risk Management Division, the Risk Management Division did not exercise either of the additional two-year options under the existing agreement with Alliant based on the advice of the City Attorney that it would be simpler to enter into a new contract with Alliant. Mr. Hansen advises that the current and future year increases are driven primarily by rises in insurance rates in the market, as well as by claims being filed, most notably the Pier 29 fire in June of 2012.

## DETAILS OF PROPOSED LEGISLATION

The proposed resolution would approve a new two-year, two-month agreement between the City's Risk Management Division and Alliant for insurance brokerage services for an amount not-to-exceed \$22,000,000 commencing June 1, 2013 and extending through July 31, 2015.

Although the existing contract between the Risk Management Division and Alliant extends through July 21, 2013, the Risk Management Division is requesting that the proposed new contract commence on June 1, 2013 and extend through July 30, 2015. However, the proposed resolution does not state that this contract will be enacted retroactively. Therefore, the Budget and Legislative Analyst recommends that the proposed resolution be amended to provide for retroactive approval effective June 1, 2013.

According to Mr. Hansen, the proposed changes in the terms of the subject contract are to provide for payment of the insurance premiums for FY 2013-14, which are bound or committed in June and paid in July of each year. As a result, the proposed contract would cover the annual insurance premiums and professional services for FY 2013-14, FY 2014-15, and FY 2015-16, to be paid by the City to Alliant in June and July of 2013, 2014, and 2015.

In addition, the proposed contract with Alliant contains two options to extend the proposed services for two additional years each, or a total option extension of four years, or through July 30, 2019. Therefore, the total proposed contract would be for six years and two months. The Budget and Legislative Analyst recommends amending the proposed resolution to provide for these two options to extend the proposed contract for up to four additional years.

## FISCAL IMPACTS

The total expenditures for insurance premiums placed by the proposed broker, Alliant, for the initial two-year term under the existing agreement for FY 2011-12 and FY 2012-13 were \$14,029,895, as shown in Table 1 below.

**Table 1: Expenditures for Insurance Premiums for the Existing Contract**

| Insurance Premiums            | FY 2011-12         | FY 2012-13         | Total               |
|-------------------------------|--------------------|--------------------|---------------------|
| Property                      | \$5,032,288        | \$5,517,256        | \$10,549,544        |
| Art Collection                | 853,793            | 1,199,991          | 2,053,784           |
| Electronic Data Processing    | 294,615            | 224,004            | 518,619             |
| Exhibits, Events and Projects | 480,234            | 427,714            | 907,948             |
| <b>Total</b>                  | <b>\$6,660,930</b> | <b>\$7,368,965</b> | <b>\$14,029,895</b> |

Source: Risk Management Division

As noted above, the proposed new contract with Alliant would cover the annual insurance premiums and professional services for FY 2013-14, FY 2014-15 and FY 2015-16. According to Mr. Hansen, the Risk Management Division cannot project what the required City premiums and costs for the subject Alliant contract will be in FY 2015-16, due to constantly changing insurance market conditions and the effect of any potential future losses. Therefore, the total estimated expenditures for insurance premiums under the proposed agreement for FY 2013-14 and FY 2014-15 are \$18,520,840, as shown in Table 2 below.

**Table 2: Expenditures for Insurance Premiums for the Proposed Contract**

| <b>Insurance Premiums</b>     | <b>FY 2013-14</b>  | <b>FY 2014-15<br/>(Estimated**)</b> | <b>Total</b>        |
|-------------------------------|--------------------|-------------------------------------|---------------------|
| Property                      | \$7,163,889        | \$7,880,278                         | \$15,044,167        |
| Art Collection                | 1,201,585          | 1,321,743                           | 2,523,328           |
| Electronic Data Processing*** | 0                  | 0                                   | 0                   |
| Exhibits, Events and Projects | 453,974*           | 499,371                             | 953,345             |
| <b>Total</b>                  | <b>\$8,819,448</b> | <b>\$9,701,392</b>                  | <b>\$18,520,840</b> |

Source: Risk Management Division

\*Expenditures for Exhibits, Events, and Projects are unknown at this point, such that this amount reflects the average premiums paid in FY 2011-12 and FY 2012-13.

\*\*FY 2014-15 Estimates reflect FY 2013-14 amounts, inflated by an additional 10%.

\*\*\*Insurance Premiums for Electronic Data Processing, which were previously obtained through Alliant were transferred to Merriwether Williams Insurance Services, for FY 2013-14 and FY 2014-15

Table 3 below outlines the City departments' budgets for work orders for the Risk Management Division as proposed in the FY 2013-14 and FY 2014-15 budgets to only pay for the known Property and Art Collection insurance premiums under the subject Alliant brokerage insurance services contract. The anticipated expenditures shown in Table 2 above are greater than the budgeted amount of work orders to pay for premiums shown in Table 3 below for both FY 2013-14 and FY 2014-15 because, according to Mr. Hansen, the City departments will adjust work orders based on actual premiums to be paid, once the actual costs of the Exhibits, Events and Projects are known. The projected expenditures reflect average premiums paid over the past two fiscal years for Exhibits, Events and Projects. Mr. Hansen advises that as additional events are scheduled, insurance premiums will be paid by the respective City departments (i.e. Airport, Art Commission, Asian Art Museum, Fine Arts Museum) work orders to cover such costs.



**Table 3: Actual and Estimated City Department's Work Order Budgets to cover Insurance Premiums in FY 2013-14 and FY 2014-15**

| <b>Department</b>               | <b>FY 2013-14</b>  | <b>FY 2014-15<br/>(Estimated)*</b> | <b>Total</b>        |
|---------------------------------|--------------------|------------------------------------|---------------------|
| Airport                         | \$1,689,634        | \$1,858,597                        | \$3,548,231         |
| Art Commission                  | 7,700              | 8,470                              | 16,170              |
| Asian Art Museum                | 313,348            | 344,683                            | 658,031             |
| Controller (Public Finance)     | 147,440            | 162,184                            | 309,624             |
| Convention Facilities           | 401,566            | 441,723                            | 843,289             |
| Emergency Communications        | 13,924             | 15,316                             | 29,240              |
| Fine Art Museums                | 783,902            | 862,292                            | 1,646,194           |
| Juvenile Probation              | 27,963             | 30,759                             | 58,722              |
| Law Library                     | 10,336             | 11,370                             | 21,706              |
| Library                         | 26,175             | 28,793                             | 54,968              |
| Municipal Transportation Agency | 1,918,772          | 2,110,649                          | 4,029,421           |
| Port                            | 1,501,670          | 1,651,837                          | 3,153,507           |
| Public Health                   | 179,248            | 197,173                            | 376,421             |
| Public Utilities Commission     | 821,664            | 903,830                            | 1,725,494           |
| Public Works                    | 84,349             | 92,784                             | 177,133             |
| Real Estate Division            | 191,459            | 210,605                            | 402,064             |
| Recreation and Park             | 110,650            | 121,715                            | 232,365             |
| Redevelopment Agency            | 110,076            | 121,084                            | 231,160             |
| Sherriff Department             | 93,656             | 103,022                            | 196,678             |
| Superior Court                  | 24,496             | 26,946                             | 51,442              |
| <b>Total</b>                    | <b>\$8,458,028</b> | <b>\$9,303,831</b>                 | <b>\$17,761,859</b> |

Source: City Risk Manager

\* Work orders for FY 2014-15 are estimates assuming a 10% increase in work orders from FY 2013-14. Risk Management will work with departments to adjust these work orders once premium increases for FY 2014-15 are known. Work Orders for FY 2013-14 will increase as more departments request insurance services.

As noted above, in September of 2012, the Board of Supervisors approved an increase in the existing Alliant agreement by \$5,600,000, from \$9,500,000 to \$15,100,000, including a \$500,000 contingency for unanticipated insurance needs for art exhibits, construction projects, and other events that were not yet known for FY 2012-13. Given that the Risk Management Division cannot fully anticipate all future insurance needs, the Budget and Legislative Analyst's Office again believes that a contingency is warranted. Therefore, the Budget and Legislative Analyst recommends providing an additional \$500,000 per fiscal year (\$1,000,000 total) as a contingency under the subject Alliant contract, which would increase the total projected expenditures to \$19,520,840 as shown in Table 4 below.

**Table 4: Expenditures for Insurance Premiums and Other Risk Management Services for the Proposed Contract with Added Contingency**

| <b>Insurance Premiums</b>     | <b>FY 2013-14</b>  | <b>FY 2014-15<br/>(Estimated)</b> | <b>Total</b>        |
|-------------------------------|--------------------|-----------------------------------|---------------------|
| Property                      | \$7,163,889        | \$7,880,278                       | \$15,044,167        |
| Art Collection                | 1,201,585          | 1,321,743                         | 2,523,328           |
| Electronic Data Processing    | 0                  | 0                                 | 0                   |
| Exhibits, Events and Projects | 453,974            | 499,371                           | 953,345             |
| Added Contingency             | 500,000            | 500,000                           | 1,000,000           |
| <b>Total</b>                  | <b>\$9,319,448</b> | <b>\$10,201,392</b>               | <b>\$19,520,840</b> |

Source: Risk Management Division

According to Mr. Hansen, this contract is designed to cover brokerage services and premiums for which payment is due in July of 2013, 2014, and 2015. However, as noted above, the Risk Management Division cannot project what the required City premiums and costs for the subject Alliant contract will be in FY 2015-16 due to constantly changing insurance market conditions and the effect of any potential losses. Furthermore, the proposed not-to-exceed amount of \$22,000,000 will not be sufficient to cover the third year, if expenditures continue at their current rate.

As a result, the Budget and Legislative Analyst recommends reducing the contract length by one month to cover two years and one month from June 1, 2013 through June 30, 2015 so that the contract only covers services and premiums for FY 2013-14 and FY 2014-15, and the binding of the insurance premiums for FY 2015-16, but not the payment of the premiums for FY 2015-16. This will allow the City's Risk Management Division sufficient time to develop more accurate estimates for services and premiums for FY 2015-16.

## RECOMMENDATIONS

1. Amend the proposed resolution to provide for retroactive approval effective as of June 1, 2013.
2. Amend the proposed resolution to provide for two additional two-year options to extend the subject agreement through June 30, 2019.
3. Amend the proposed resolution to reduce the contract length by one month, to commence retroactively on June 1, 2013 and terminate on June 30, 2015, instead of July 31, 2015.
4. Amend the proposed resolution to reduce the not-to-exceed amount by \$2,479,160 from \$22,000,000 to \$19,520,840, which includes a \$1,000,000 contingency.
5. Approve the proposed resolution, as amended.

**Item 16 & 17**  
**File 13-0707 & 13-0709**

**Department(s):**  
 Controller's Office of Public Finance (OPF)

## EXECUTIVE SUMMARY

### Legislative Objective

- 13-0709: The proposed resolution would (a) authorize the issuance by the City of Refunding Certificates of Participation (COPs) in a not-to-exceed amount of \$236,000,00 to refinance in whole or part COPs previously issued to finance various capital improvements to the City (2013 Refunding COPs), (b) approve four separate facility leases, four separate lease agreements, an escrow agreement, a trust agreement, one or more official notices of sale, and one or more notices of intention to sell the 2013 Refunding COPs (c) provide for the manner of sale of 2013 Refunding COPs, whether by competitive or negotiated sale, (d) direct the publication of the notice of intention to sell the 2013 Refunding COPs, (e) approve the form of the official statement in preliminary and final form, (f) approve the form of the continuing disclosure certificate, and (g) authorize the costs of issuance.
- 13-0707: The proposed ordinance would (a) appropriate \$236,000,000 of COPs proceeds, (b) de-appropriate \$2,386,750 in 2001 COPs prior reserve funds and re-appropriate \$2,386,750 to fund the 2013 Refunding COPs issuance, and (c) de-appropriate \$2,627,798 in 2003 COPs prior reserve funds and re-appropriate \$2,627,798 to fund the 2013 Refunding COPs issuance for a total amount of \$241,014,548 to be placed on Controllers Reserve pending the sale of the Refunding Certificates of Participation.

### Fiscal Impact

- The City would issue \$83,055,000 in 2013 Refunding COPs to refund the 2001 and 2003 COPs and 2004 Refunding COPs, issued simultaneously in three separate issuances on the expected delivery and closing date of September 11, 2013. The City would issue up to \$152,945,000 of the remaining authorized \$236,000,000 in 2013 Refunding COPs when positive economic savings can be achieved.
- The initial \$83,055,000 in 2013 Refunding COPs would have an estimated annual interest rate of 3.88 percent, resulting in a total debt service cost of \$113,594,000 including (a) estimated total interest costs of \$30,539,000 and (b) estimated total principal costs of \$83,055,000, and would result in an estimated total savings to the City of approximately \$4,291,000.
- The proposed appropriation of \$241,014,548, including the proceeds of the 2013 Refunding COPs in an amount not-to-exceed \$236,000,000 along with the prior reserve funds of \$5,014,548 to be used to refund the 2001 and 2003, and 2004 Refunding COPs. The \$241,014,548 would be placed on Controller's reserve pending the sale of the 2013 Refunding COPs.

### **Policy Considerations**

- No date is currently available for when the issuance of up to \$152,945,000 in 2013 Refunding COPs would occur. In order to allow for maximum flexibility in scheduling the issuance, the Budget and Legislative Analyst recommends approval of the proposed resolution and ordinance. However, the Office of Public Finance should provide an update to the Board of Supervisors on the details of the issuance once that information is known.

### **Recommendations**

- 13-0709: Amend the proposed resolution to require the Office of Public Finance to report to the Board of Supervisors on all planned issuances of 2013 Refunding COPs above the currently planned \$83,055,000 in 2013 Refunding COPs, once details are known.
- 13-0709: Approve the proposed resolution as amended.
- 13-0707: Approve the proposed ordinance as amended.

## MANDATE STATEMENT & BACKGROUND

### Mandate Statement

13-0709: According to San Francisco Charter Section 9.118, any lease with a term of over ten years or expenditures of over \$10,000,000 is subject to approval by the Board of Supervisors. The proposed not-to-exceed issuance of \$236,000,000 of Refunding Certificates of Participation requires the City to enter into a lease which exceeds ten years and \$10,000,000, due to the asset transfer described in the Background Section below.

13-0707: Charter Section 9.105 requires that amendments to the annual appropriation ordinance be approved by ordinance of the Board of Supervisors.

### Background

Certificates of Participation (COPs) are a form of long-term debt sold to investors in consideration for a portion of the lease revenues from a specific City-owned property. Investors participate in lease revenues in the form of debt service payments. Under a typical COPs structure, the City leases a City-owned property to a trustee in consideration for a one-time lease payment from the trustee to the City that is equal to the proceeds from the issuance of such COPs. The trustee subsequently subleases the same City-owned property back to the City in return for semi-annual rent payments equal to the debt service (including principal and interest) due on the COPs. This lease-sublease structure is known as an asset transfer model. Under this type of asset transfer model, the City-owned property leased to the trustee serves as collateral to the trustee on the issued COPs. After the COPs are fully repaid by the City, the City-owned property, previously leased to the trustee, reverts back to the City.

Refunding COPs are identical to standard COPs with one difference: the proceeds from the issuance of Refunding COPs are used to refund previously issued COPs. The issuance of Refunding COPs is generally contingent upon the City realizing debt service savings based on that refinancing, when compared to the debt service costs of the original COPs.

### Previous COPs Issuances

#### *30 Van Ness Avenue 2001 COPs Issuance*

In October 2001, the City issued \$35,320,000 in COPs (2001 COPs) to finance the acquisition and improvement of the office building located at 30 Van Ness Avenue<sup>1</sup>. As of June 2013, \$28,895,000 in principal amount of the 2001 COPs remains outstanding.

#### *Juvenile Hall Replacement Project 2003 COPs Issuance*

In May 2003, the City issued \$41,965,000 in COPs (2003 COPs) to partially finance the costs of acquisition, improvement, construction and/or reconstruction of a new juvenile detention facility and related improvements at 375 Woodside Avenue (Juvenile Hall<sup>2</sup>) as well as the phased demolition and replacement of the building and infrastructure on the former Juvenile Hall site

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<sup>1</sup> 30 Van Ness Avenue is a five-story building of 181,000 rentable square feet and a two-level parking garage with capacity for 40 vehicles.

<sup>2</sup> Juvenile Hall is an approximately 82,550 gross square feet facility with 110 sleeping rooms and 150-bed capacity along with a gymnasium, outdoor recreation areas, learning center, medical and dental facilities, central control station, and other related areas.

(Juvenile Hall Replacement Project). The Juvenile Hall Replacement Project was completed in February 2008. As of June 2013, \$34,850,000 in principal amount of the 2003 COPs remains outstanding.

### ***San Francisco Courthouse Project 2004 COPs Issuance***

In July 2004, the City issued \$39,350,000 in Refunding COPs (2004 Refunding COPs) to refund prior City COPs that had originally financed the construction financing, and equipping of the San Francisco Courthouse<sup>3</sup> building located at 400 McAllister Street. The original project was completed in December 1997. As of June 2013, \$18,670,000 in principal amount of the 2004 Refunding COPs remains outstanding.

### ***City Office Buildings 2007 COPs Issuance***

In May 2007, the City issued \$152,120,000 in COPs (2007 COPs) to finance the acquisition of office buildings located at One South Van Ness Avenue<sup>4</sup> and 1650 Mission Street<sup>5</sup> as well as improvements to portions of One South Van Ness Avenue, 1650 Mission Street, and 30 Van Ness Avenue. As of June 2013, \$142,575,000 in principal amount of the 2007 COPs remains outstanding.

## **\$224,025,000 of Principal Remains Outstanding on 2001, 2003, and 2007 COPs and 2004 Refunding COPs**

Table 1 summarizes the principal remaining on the four issuances whose refunding is the subject of the proposed resolution and ordinance.

**Table 1: Remaining Principal as of June 2013 on COPs Proposed for Refunding**

|                     | <b>Principal</b>     |
|---------------------|----------------------|
| 2001 COPs           | \$28,895,000         |
| 2003 COPs           | 34,850,000           |
| 2004 Refunding COPs | 18,670,000           |
| 2007 COPs           | 142,575,000          |
| <b>Total</b>        | <b>\$224,990,000</b> |

## **DETAILS OF PROPOSED LEGISLATION**

13-0709: The proposed resolution would (a) authorize the issuance by the City of Refunding COPs in a not-to-exceed amount of \$236,000,00 to refinance in whole or part COPs previously issued to finance various capital improvements to the City (2013 Refunding COPs), (b) approve four separate facility leases, four separate lease agreements, an escrow agreement, a trust agreement, one or more official notices of sale, and one or more notices of intention to sell the 2013 Refunding COPs (c) provide for the manner of sale of Refunding COPs, whether by

<sup>3</sup> The San Francisco Courthouse is a six-story building with approximately 230,000 square feet of space, including 38 courtrooms and hearing rooms that serves as a forum for the hearing for all civil, small claims, family law, probate and juvenile dependency matters by the City's courts.

<sup>4</sup> One South Van Ness Avenue is an eight-story office building with 508,000 rentable square feet and a multi-level parking garage with a 120-vehicle capacity.

<sup>5</sup> 1650 Mission Street is a five-story office building with approximately 217,000 rentable square feet and a parking garage with a 118-vehicle capacity.

competitive or negotiated sale, (d) direct the publication of the notice of intention to sell the 2013 Refunding COPs, (e) approve the form of the official statement in preliminary and final form, (f) approve the form of the continuing disclosure certificate, and (g) authorize the costs of issuance.

13-0707: The proposed ordinance would (a) appropriate \$236,000,000 of 2013 Refunding COPs proceeds, (b) de-appropriate \$2,386,750 in 2001 COPs prior reserve funds and re-appropriate \$2,386,750 to fund the 2013 Refunding COPs issuance, and (c) de-appropriate \$2,627,798 in 2003 COPs prior reserve funds and re-appropriate \$2,627,798 to fund the 2013 Refunding COPs issuance.

The funds to be re-appropriated of \$2,386,750 in 2001 COPs and \$2,627,798 in 2003 COPs, totaling \$5,014,548, are debt service reserves that are no longer needed and would serve as a source of funds for the refunding of the previously-issued COPs, as shown in Table 3 below.

The total appropriation under the proposed ordinance is \$241,014,548, including \$236,000,000 in 2013 Refunding COPs and \$5,014,548 in prior COPs' debt service reserves. \$241,014,548 would be placed on Controller's Reserve pending the sale of the 2013 Refunding COPs.

## FISCAL IMPACTS

### **13-0709: Issuance of Not-to-Exceed \$236,000,000 in 2013 Refunding COPs**

Ms. Nadia Sesay, Director of the Controller's Office of Public Finance, currently anticipates that the City would issue \$83,055,000 of the up to \$236,000,000 in 2013 Refunding COPs to refund the 2001 and 2003 COPs and 2004 Refunding COPs. The proposed 2013 Refunding COPs would be issued simultaneously in three separate issuances on the expected delivery and closing date of September 11, 2013, based on the separate authorizations for the 2001 and 2003 COPs, and 2004 Refunding COPs.

Ms. Sesay states that the City would issue up to \$152,945,000 of the remaining authorized \$236,000,000 in 2013 Refunding COPs when positive economic savings can be achieved.<sup>6</sup> The \$152,945,000 in 2013 Refunding COPs includes refunding of the \$142,575,000 in 2007 COPs remaining principal, associated financing costs, and reserves for potential market fluctuations between the time of the Board of Supervisors approval of the proposed COPs and the anticipated COPs issuance dates.

#### *Financing Agreements and Structure*

The proposed not-to-exceed \$236,000,000 issuance of 2013 Refunding COPs by the City would lease the following five City-owned properties summarized in Table 2 below to the trustee, serving as collateral under the asset transfer model described above:

- 30 Van Ness Avenue;
- 375 Woodside Avenue;
- 400 McAllister Street;
- 1650 Mission Street; and

<sup>6</sup> According to Ms. Sesay, Refunding COPs would only be issued for the 2007 COPs if a minimum of 3 percent net present value savings can be achieved.

- One South Van Ness Avenue.

According to Mr. John Updike, Director of the Department of Real Estate, the approximate total value of the five properties is \$393,000,000.

***Amount of 2001 and 2003 COPs and 2004 Refunding COPs to be Refunded***

As shown in Table 2 below, the amount of the COPs to be refunded in the first issuance is \$82,183,861, including the principal as of September 2013 and the interest expense.

**Table 2: Amount of COPs to be Refunded**

|                             | Principal                 | Interest Expense from<br>9/11/2013 – 10/11/2013 | Total Cost of Redeeming COPs |
|-----------------------------|---------------------------|---|------------------------------|
| 2001 COPs                   | \$27,930,000 <sup>7</sup> | \$149,336                                       | \$28,079,336                 |
| 2003 COPs                   | 34,850,000                | 174,655   | 35,024,655                   |
| 2004 Refunding COPs         | 18,670,000                | 409,870   | 19,079,870                   |
| <b>Total Estimated Cost</b> | <b>\$81,450,000</b>       | <b>\$733,861</b>                                | <b>\$82,183,861</b>          |

***Sources and Uses: Issuance of \$83,055,000 in 2013 Refunding COPs***

The estimated costs to refund the 2001 and 2003 COPs and 2004 Refunding COPs are \$88,069,547, as shown in Table 3 below, which includes \$83,055,000 in 2013 Refunding COPs and \$5,014,548 in prior debt service reserve funds for the 2001 and 2003 issuances.

**Table 3: Sources and Uses of Initial Refunding COPs Issuance**

|                           | 2001 COPs           | 2003 COPs           | 2004 COPs           | Total                           |
|---------------------------|---------------------|---------------------|---------------------|---------------------------------|
| <b>Sources</b>            |                     |                     |                     |                                 |
| Issuance Amount           | \$28,295,000        | \$35,415,000        | \$19,345,000        | \$83,055,000                    |
| Prior Reserve Fund        | 2,386,750           | 2,627,798           | -                   | 5,014,548                       |
| <b>Total Sources</b>      | <b>\$30,681,750</b> | <b>\$38,042,798</b> | <b>\$19,345,000</b> | <b>\$88,069,548</b>             |
| <b>Uses</b>               |                     |                     |                     |                                 |
| Refunding Fund Deposit    | \$28,078,874        | \$35,024,079        | \$19,079,562        | \$82,182,516 <sup>8</sup>       |
| <b>Financing Costs</b>    |                     |                     |                     |                                 |
| Debt Service Reserve Fund | 2,216,863           | 2,536,314           | -                   | 4,753,177                       |
| Costs of Issuance         | 216,243             | 269,914             | 149,368             | 635,525                         |
| Underwriter's Discount    | 169,770             | 212,490             | 116,070             | 498,330                         |
| Financing Costs Subtotal  | 2,602,876           | 3,018,718           | 265,438             | 5,887,032                       |
| <b>Total Uses</b>         | <b>\$30,681,750</b> | <b>\$38,042,797</b> | <b>\$19,345,000</b> | <b>\$88,069,547<sup>9</sup></b> |

<sup>7</sup> The \$965,000 difference between the \$27,930,000 principal noted in Table 2 and the \$28,895,000 principal noted in Table 1 is due to the expectation of a debt service payment being made prior to the refunding.

<sup>8</sup> Ms. Sesay advises that the difference of approximately \$1,345 between the total cost of redeeming the 2001, 2003, and 2004 COPs of \$82,183,861 (See Table 3 above) and the refund amount of \$82,182,516 (See Table 4 above) represents interest earned between the expected closing date and the redemption date.

<sup>9</sup> The \$1.00 discrepancy between sources and uses is due to rounding.



***Anticipated Annual Debt Service and Total Costs***

Ms. Sesay anticipates that the initial \$83,055,000 in 2013 Refunding COPs would have an estimated annual interest rate of 3.88 percent, resulting in a total debt service cost of \$113,594,000 including (a) estimated total interest costs of \$30,539,000 and (b) estimated total principal costs of \$83,055,000.

Table 4 below summarizes the interest rate savings expected due to the refunding of the 2001, 2003, and 2004 COPs.

**Table 4: Summary of Estimated Interest Rate Savings**

|           | <b>Average Interest Rate</b> | <b>Estimated Interest Rate on Refunding COPs</b> | <b>Savings</b> |
|-----------|------------------------------|--|----------------|
| 2001 COPs | 4.91%                        | 3.88%  | <b>1.03%</b>   |
| 2003 COPs | 4.63%                        | 3.88%  | <b>0.75%</b>   |
| 2004 COPs | 4.29%                        | 3.88%  | <b>0.41%</b>   |

Ms. Sesay estimates that the City's proposed 2013 Refunding COPs would result in an estimated total savings to the City of approximately \$4,291,000 over the 21-year term of the \$83,055,000 in 2013 Refunding COPs to be issued. Ms. Sesay stated that the annual debt service payments would be paid over the next 21 years with both General Fund and non-General Fund revenues appropriated annually, subject to appropriation approval by the Board of Supervisors<sup>10</sup>.

**13-0707: Proposed Appropriation of \$241,014,548**

Table 5 below summarizes the proposed appropriation of \$241,014,548, including the proceeds of the 2013 Refunding COPs in an amount not-to-exceed \$236,000,000 along with the prior reserve funds of \$5,014,548 to be used to refund the 2001 and 2003, and 2004 Refunding COPs. The \$241,014,548 would be placed on Controller's reserve pending the sale of the 2013 Refunding COPs.

**Table 5: Summary of Proposed Appropriation Ordinance**

|                     |                      |
|---------------------|----------------------|
| 2013 Refunding COPs | \$236,000,000        |
| Prior Reserve Funds | 5,014,548            |
| <b>Total</b>        | <b>\$241,014,548</b> |

<sup>10</sup> Debt service on the 2013 Refunding COPs which would refund the 2003 COPs would be paid with General Fund revenues with debt service on the 2013 Refunding COPs refunding the 2001, 2004, and 2007 issuances all paid with non-General fund revenues.

## POLICY CONSIDERATIONS

As noted above, the issuance of up to \$152,945,000 in 2013 Refunding COPs, including the refunding of the remaining principal of \$142,575,000 in 2007 COPs, would occur when positive economic savings can be achieved and no date is currently available for when that refunding would occur. In order to allow for maximum flexibility in scheduling the issuance of up to \$152,945,000 in 2013 Refunding COPs to achieve the maximum amount of savings for the City, the Budget and Legislative Analyst recommends approval of the proposed resolution and ordinance. However, the Office of Public Finance should provide an update to the Board of Supervisors on the details of the issuance once that information is known.

## RECOMMENDATIONS

1. 13-0709: Amend the proposed resolution to require the Office of Public Finance to report to the Board of Supervisors on all planned issuances of 2013 Refunding COPs above the currently planned \$83,055,000 in 2013 Refunding COPs, once details are known.
2. 13-0709: Approve the proposed resolution as amended.
3. 13-0707: Approve the proposed ordinance as amended.

**Item 23**  
**File 13-0743**

**Department:**  
Municipal Transportation Agency

## EXECUTIVE SUMMARY

### Legislative Objective

- The proposed resolution would approve the contract between the San Francisco Municipal Transportation Agency (SFMTA) and Alstom Transportation, Inc. (Alstom) for vendor managed inventory services to provide rail parts and supplies. The contract provides for an initial term of two years from August 1, 2013 through July 31, 2015, with the option to extend the contract for up to three additional one-year terms at the Director of Transportation's sole discretion, for a total contract amount not to exceed \$39,158,000.

### Key Points

- Currently, SFMTA purchases all bus and rail parts and supplies through separate competitive bids, which takes 87 days on average from the request for bids to the purchase of the parts and supplies. SFMTA is proposing a new vendor managed inventory services program in which the vendor will purchase, inventory and warehouse rail parts and supplies for light rail vehicles, historic street cars and cable cars. SFMTA expects the vendor managed inventory services program to result in more timely delivery of rail parts and supplies at a lower total cost.
- SFMTA selected Alstom based on a competitive Request for Proposals (RFP) process to provide vendor managed inventory services. Under the contract, Alstom would maintain the parts and supplies in a warehouse on Mare Island in Vallejo and deliver 200 designated critical parts to SFMTA within 24 hours and other parts within 30 days.

### Fiscal Impact

- The FY 2013-14 costs of \$8,678,000 include (a) one-time costs of \$1,058,000 for program start-up and implementation of a bar-code system; and (b) annual purchasing costs of \$7,620,000 for parts and an administrative fee. According to SFMTA, the FY 2013-14 contract budget of \$8,678,000 is \$48,424 less than the estimated costs of \$8,726,424 to purchase parts and supplies under the current competitive bid process.
- The contract budget provides for annual purchasing costs of \$7,620,000 for parts and the administrative fee. However, SFMTA anticipates that the actual costs will be less due to increased vendor efficiencies and economies of scale.

### Recommendations

- Amend the proposed legislation to specify that the initial two year contract term is from August 1, 2013 through July 31, 2015. The proposed legislation currently does not specify any dates for the initial contract term of two years.
- Amend the proposed legislation to specify that the option to extend the initial two year term is "for up to three additional one-year terms at the Director of Transportation's sole discretion for a total contract amount not to exceed \$39,158,000." (revised language underlined)
- Amend the report to require SFMTA to report to the Board of Supervisors on actual savings from the proposed contract, based on the SFMTA's contract evaluation at the end of FY 2014-15.
- Approve the proposed legislation, as amended.

## MANDATE STATEMENT/BACKGROUND

### Mandate Statement

In accordance with Charter Section 9.118(b), any contracts entered into by a department, board or commission requiring anticipated expenditures of \$10,000,000, or the modification to the contract having an impact of more than \$500,000 shall be subject to approval of the Board of Supervisors by resolution.

### Background

The San Francisco Municipal Transportation Agency (SFMTA) directly oversees five municipal transit modes: (1) buses, (2) trolley buses, (3) light rail vehicles, (4) historic streetcars, and (5) cable cars. The maintenance and repair of the vehicles for these transit modes require the continuous procurement and inventory of parts from a variety of vendors. Currently, the SFMTA Materials Management Division purchases parts and supplies for all five municipal transit modes by issuing competitive bids for the items required. However, according to Mr. Ashish Patel, SFMTA Contracts & Procurement Office Manager, the competitive bid process has posed difficulties in procuring parts in a timely manner due to the following reasons:

- (1) Parts are often obsolete and no longer produced due to the age of the transit vehicle fleet<sup>1</sup> and thus difficult to find;
- (2) Various parts must be acquired from foreign countries and thus are not readily available;
- (3) The large volume of requests for frequently needed parts and supplies pose difficulty in identifying timely sources<sup>2</sup>;
- (4) Parts can have long delivery lead times<sup>3</sup> of up to 24 months; and
- (5) Smaller vendors find the City's purchasing requirements complex and are therefore reluctant to bid or do not provide timely responses to the SFMTA's requests for bids.

The Rail Maintenance Division is responsible for maintenance and repairs for the light rail vehicles, historic street cars, and cable cars (Rail Vehicles, collectively). According to Mr. Patel, the competitive bid process for Rail Vehicles takes 87 days on average from the date of request by SFMTA to the date of delivery by a vendor. The length of the competitive bid process results in delays in repair and maintenance of Rail Vehicles and in an overall reduction of transit vehicles in service.

To remedy the difficulties in procuring parts, SFMTA issued a competitive request for proposals (RFP) on June 6, 2012 to solicit potential vendors for SFMTA's pilot efforts to provide vendor

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<sup>1</sup> The average age of a (a) light rail vehicle is 12-14 years old, (b) historic street car is 50 years old, and (c) cable car is 100 years old.

<sup>2</sup> The Rail Maintenance Division receives an average of 516 materials requests per month.

<sup>3</sup> A delivery lead time is the time between the placement of a product order and the delivery of the product.

managed inventory services<sup>4</sup> for the Rail Vehicles handled by the Rail Maintenance Division. SFMTA states that vendor managed inventory services would provide (a) needed parts in a cost-effective and efficient manner, (b) inventory planning, and (c) an automated replenishment of spare parts with strict performance guidelines requiring defined response times and fill rates.<sup>5</sup>

Two firms, Alstom Transportation, Inc. (Alstom) and AnsaldoBreda, Inc., submitted proposals in response to the RFP by the August 24, 2012 deadline. The RFP required a percentage-based pricing—i.e., the company would charge SFMTA the cost of a part plus a percentage mark-up. The mark-up percentage submitted by Alstom was 39.5% and by AnsaldoBreda, Inc. was 32%.

A group of panelists consisting of three SFMTA employees and one Santa Clara Valley Transit Authority manager scored the written proposals and oral interviews of both proposals. On October 11, 2012, the panelists selected Alstom<sup>6</sup> as the higher scoring vendor. According to Mr. Patel, Alstom was selected, even though its proposed mark-up of 39.5% was higher than the 32% mark-up proposed by AnsaldoBreda, Inc., because Alstom received a higher score for (1) demonstrating an understanding of SFMTA needs, (2) having previous experience with and resources to provide vendor managed inventory services for rail fleets, and (3) having more experienced staff in rail fleet maintenance and/or engineering.

Mr. Patel advises that SFMTA and Alstom finally negotiated a flat administrative fee rather than a percentage mark-up because the costs to SFMTA, based on the percentage mark-up, would vary based on parts purchased. As shown in Table 2 below, the actual administrative fee negotiated by Alstom and SFMTA is a flat fee of \$1,620,000 per annum, or 27% of the budgeted amount for parts of \$6,000,000 per annum.

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<sup>4</sup> In a vendor managed inventory model, SFMTA provides the vendor supplier information on necessary quantities of parts and supplies, and the vendor supplier takes full responsibility for maintaining an agreed-upon inventory of the parts and supplies.

<sup>5</sup> The SFMTA considered hiring additional staff to expedite requests for parts but determined that this action would not address the five above-mentioned root causes of SFMTA's inability to obtain parts in a timely manner. Additionally, any attempt by the SFMTA to reproduce the technological aspects of the services offered by the vendor managed inventory would require a significant investment in technology and training, and any potential savings from the investment would not be realized for several years if at all. Furthermore, SFMTA believes that vendor managed inventory services would enhance the reliability of the rail fleet because it will streamline parts acquisition and inventory management processes.

<sup>6</sup> Alstom is an international company with more than 92,000 employees in 100 countries, with 6,000 of employees located across the United States. Alstom has provided full vendor managed inventory services since 2006 to Amtrak and has provided parts and supplies under similar terms and conditions for trains it has built or assisted in building for such fleets as Amtrak's High Horsepower locomotive fleet; Strasburg, France's Citadis 403 Trams; Helsingborg, Sweden's Coradia Nordic X61 regional trains; and Santo Domingo, Dominican Republic's Metropolis trainsets. Alstom also provided emergency retrofit and overhaul services from 1999 to 2001 for Muni's former Boeing light rail vehicle fleet.

## DETAILS OF PROPOSED LEGISLATION

Based on a competitive RFP process, the proposed resolution would approve a contract between SFMTA and Alstom for vendor managed inventory services wherein Alstom would provide SFMTA rail parts and supplies for light rail vehicles, historic street cars, and cable cars for an initial term of two years from August 1, 2013 through July 31, 2015, with the option to extend the term for up to three additional one-year terms at the Director of Transportation's sole discretion, for a total contract term of five years and a total contract not to exceed amount of \$39,158,000, as shown in Table 2 below. Approval of the proposed resolution would authorize SFMTA to exercise the three one-year options to extend the agreement at its sole discretion, without further Board of Supervisors approval.

According to Mr. Patel, Alstom would purchase needed parts based on an annual projected use of these parts and supplies and would store the parts and supplies in Alstom's warehouse in Mare Island in Vallejo. When SFMTA requests parts and supplies, Alstom would deliver the parts and supplies to SFMTA. According to Mr. Patel, the vendor managed inventory services model would allow for more timely procurement of materials and would result in first year cost savings to the SFMTA in the amount of \$48,424. Under the contract with Alstom, Alstom is to deliver 200 designated critical parts and supplies within 24 hours and all other parts and supplies within 30 days or less, compared to the average of 87 days under the current competitive bid process.<sup>7</sup>

Other terms of the contract with Alstom include:

- (1) Inventory planning,
- (2) Automated replenishment of spare parts with strict performance guidelines,
- (3) Maintenance of an in-stock balance of high demand/critical parts and supplies identified by the SFMTA equal to two months of the annual projected demand,
- (4) Implementation of a barcoding system, and
- (5) Analysis of material usage and recommendations for alternative sourcing of parts and supplies.

Alstom will also enter into subcontracts with the local business enterprises certified by the San Francisco General Services Agency's Contract Monitoring Division, and shown in Table 1 below. The certified local business enterprises subcontracting participation goal for the contract is 17%.

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<sup>7</sup> The performance standard for high usage parts delivered under this contract is an overall 98 percent fill rate, and for critical and high demand parts fulfillment, within 24 hours. These terms are subject to liquidated damages of \$1,000 per day, as well as the costs for SFMTA procuring the necessary part from another source to meet operational needs.

| <b>Table 1: Alstom Contract Subcontractors</b>  |   |                  |
|---|---|------------------|
| <b>Firm</b>                                     | <b>Portion of Work</b>                                  | <b>% of Work</b> |
| All Counties Trucking, Inc.                     | Trucking and Hauling                                    | 2.94             |
| Omega Pacific Electrical Supply, Inc.           | Electrical Equipment and Supplier                       | 0.04             |
| T & S Trading Co.                               | Transportation Vehicle Sales,<br>Equipment and Supplies | 1.27             |
| Parthex   | Transportation Vehicle Sales,<br>Equipment and Supplies | 12.64            |
| East Bay Sign Co. d.b.a. Borden Decal           | Signs   | 0.05             |
| Center Hardware and Supply Co., Inc.            | Construction, Building Materials and<br>Supplies        | 0.02             |
| Bonini-Rusake, Inc. d.b.a. Harrison &<br>Bonini | Construction, Building Materials and<br>Supplies        | 0.05             |
| <b>Total:</b>                                   |   | <b>17.01%</b>    |

Furthermore, SFMTA has stated that staff currently purchasing materials and supplies for the Rail Maintenance Division will be assigned purchasing duties for other SFMTA Divisions because, according to Mr. Patel, SFMTA currently has a backlog of purchase requests ranging from 800 to 1,000 requests every two weeks. Staff will be reassigned to reduce this backlog and support other SFMTA services like busses, trolley busses, facilities, sustainable streets, and other administrative purchases. Storeroom staff will continue to operate in their current capacity. SFMTA staff have met and conferred on several occasions with both the International Federation of Professional and Technical Employees (IFPTE) Local 21 and Service Employees International Union (SEIU) Local 1021 to assure them that employees will not lose jobs due to the Alstom contract, given the representation by the SFMTA Board that the SFMTA is understaffed.

SFMTA will evaluate the performance of this contract prior to the end of the second year in FY 2014-15 to determine if the service being provided to SFMTA has resulted in cost savings for the purchase of the parts and supplies and more timely delivery of parts and supplies. Some of items that will be measured include:

- (1) Costs associated with provision of parts, as compared to prior years;
- (2) Performance related to receipt of parts;
- (3) 98% fill rate of parts;
- (4) 24 hour delivery of critical and high usage parts; and
- (5) Total number of Rail Vehicles held for parts not delivered.

According to the contract, the City can terminate the contract at any time during the term for convenience and without cause.

## FISCAL IMPACT

Table 2 below shows the contract not-to-exceed amount of \$39,158,000 over the five-year term of the contract, including the initial two-year term and the three additional one-year terms.

| <b>Table 2: Contract Budget</b>         |  |   |
|---|--|---|
| <b><u>Task</u></b>                      | <b><u>Frequency</u></b>                    | <b><u>Amount</u></b>                                  |
| <u>FY 2013-14</u>                       |  |   |
| Mobilization                            | One time                                   | \$300,000   |
| Bar Coding Cost                         | 1st store room                             | 398,000   |
|   | 3 Additional store rooms at \$120,000 each | 360,000   |
|   |  | <b><i>Subtotal, Start-up costs</i></b>                |
|   |  | <b><i>\$1,058,000</i></b>                             |
| Parts cost                              | \$500,000/month x 12 months                | 6,000,000   |
| Fixed administrative fee (27% of parts) | \$135,000/month x 12 months                | 1,620,000   |
|   |  | <b><i>Subtotal, Parts and Administrative Fees</i></b> |
|   |  | <b><i>\$7,620,000</i></b>                             |
|   |  | <b><i>Subtotal, FY 2013-14</i></b>                    |
|   |  | <b><i>\$8,678,000</i></b>                             |
| <u>FY 2014-15</u>                       |  |   |
| Parts cost                              | \$500,000/month x 12 months                | 6,000,000   |
| Fixed administrative fee (27% of parts) | \$135,000/month x 12 months                | 1,620,000   |
|   |  | <b><i>Subtotal, FY 2014-15</i></b>                    |
|   |  | <b><i>\$7,620,000</i></b>                             |
| <u>FY 2015-16</u>                       |  |   |
| Parts cost                              | \$500,000/month x 12 months                | 6,000,000   |
| Fixed administrative fee (27% of parts) | \$135,000/month x 12 months                | 1,620,000   |
|   |  | <b><i>Subtotal, FY 2015-16</i></b>                    |
|   |  | <b><i>\$7,620,000</i></b>                             |
| <u>FY 2016-17</u>                       |  |   |
| Parts cost                              | \$500,000/month x 12 months                | 6,000,000   |
| Fixed administrative fee (27% of parts) | \$135,000/month x 12 months                | 1,620,000   |
|   |  | <b><i>Subtotal, FY 2016-17</i></b>                    |
|   |  | <b><i>\$7,620,000</i></b>                             |
| <u>FY 2017-18</u>                       |  |   |
| Parts cost                              | \$500,000/month x 12 months                | 6,000,000   |
| Fixed administrative fee (27% of parts) | \$135,000/month x 12 months                | 1,620,000   |
|   |  | <b><i>Subtotal, FY 2017-18</i></b>                    |
|   |  | <b><i>\$7,620,000</i></b>                             |
| <b>Total Contract Amount</b>            |  | <b>\$39,158,000</b>                                   |

The FY 2013-14 estimated costs of \$8,678,000 include one-time costs of \$1,058,000 and annual purchasing costs of \$7,620,000 for parts and the administrative fee. According to Mr. Patel, the FY 2013-14 contract budget of \$8,678,000 is \$48,424 less than the estimated costs of \$8,726,424 to purchase parts and supplies under the City's current competitive bid process, which requires SFMTA to issue a purchase order for each procurement of parts and supplies.

The contract budget provides for estimated annual purchasing costs of \$7,620,000 for parts and supplies and the administrative fee. However, Alstom anticipates that the actual costs will be less due to increased vendor efficiencies and economies of scale.



**RECOMMENDATIONS**

1. Amend the proposed legislation to specify that the initial two year contract term is from August 1, 2013 through July 31, 2015. The proposed legislation currently does not specify any dates for the initial contract term of two years.
2. Amend the proposed legislation to specify that the option to extend the initial two year term is “for up to three additional one-year terms at the Director of Transportation’s sole discretion for a total contract amount not to exceed \$39,158,000.” (revised language underlined)
3. Amend the report to require SFMTA to report to the Board of Supervisors on actual savings realized as a result of the proposed contract, based on the SFMTA’s contract evaluation at the end of FY 2014-15.
4. Approve the proposed legislation, as amended.

**Item 26**  
**File 13-0711**

**Departments:**  
Department of Human Resources (DHR) and  
Real Estate Division (RED)

## EXECUTIVE SUMMARY

### Legislative Objective

- The proposed resolution would authorize a new five-year lease for approximately 11,000 square feet on the ground floor of 1740 Cesar Chavez Street between the City as tenant, on behalf of the Department of Human Resources and Potrero Investor I, LLC and Potrero Investor II, LLC, as landlord from approximately September 15, 2013 through September 14, 2018.

### Key Points

- The Department of Human Resources (DHR) currently has 7,680 square feet of leased space on the 2nd floor of 1740 Cesar Chavez Street for conducting exams for public safety and other civil service classifications. The existing lease includes one five-year option to extend for a term from approximately September 15, 2013 through September 14, 2018 with the rent reset to fair market value.
- DHR is requesting to relocate to a larger space of 11,000 square feet on the first floor of 1740 Cesar Chavez Street. According to the Mr. John Kraus, DHR Assistant Deputy Director, the increased space on the first floor would increase the number of computer testing sites, oral interview rooms, and capacity of the main exam room. Mr. Kraus states that the existing space on the second floor is insufficient because, when the large exam room is in use, the computer and oral interview rooms cannot be used. Also, according to Mr. Kraus, the existing testing center on the second floor was used 190 days in 2012, an increase of 69 days compared to 121 days of use in 2009; the increase in use results in delays in scheduling tests, which in turn can delay the generation of eligible lists and delay overall hiring.

### Fiscal Impact

- The existing lease for second floor space provides for a five-year extension with an increase in rent to market rate, which according to Mr. John Updike, Director of Real Estate, is approximately \$24 per square foot. According to Mr. Updike, the City has notified the landlord that the City wishes to exercise the option to extend the existing lease in the event that the Board of Supervisors does not approve the proposed new lease for first floor space.
- According to Mr. Updike, the rent per square foot would be the approximately the same whether the City exercises the option to extend the existing lease for second floor space or enters into a new lease for the proposed first floor space. The proposed rent per square foot is \$23.40 per year, an increase of \$7.44 or 47 percent compared to current rent of \$15.96 per square foot.
- Funds for the subject lease are included in DHR's FY 2013-14 and FY 2014-15 budget.

- Under the proposed new lease, the space increases by 3,320 square feet, or 43 percent, from 7,680 for the existing second floor space to 11,000 square feet for the proposed new first floor space. The increased rent in the first year of the proposed new lease due to the increase in square footage is \$77,688 and over the five-year term of the proposed lease is \$414,336.
- The landlord will pay for tenant improvements to the first floor space up to \$575,500.

### **Policy Consideration**

- Mr. Updike states that the tenant improvement package will provide more functional, better oriented space, and lower the utility costs. Mr. Updike states that the more functional and better oriented space on the first floor space also increases the likelihood of securing other City training uses at this location, providing an intangible benefit to the City organization
- However, because the proposed new leases increases City costs by \$77,688 in the first year and \$414,336 over the five-year term, without specific and sufficient information on how the increased space would contribute to increased testing and generation of civil service eligibility lists, the Budget and Legislative Analyst does not recommend approval of the proposed new five-year lease for the first floor of 1740 Cesar Chavez Street. As an alternative, the Board of Supervisors should request the Director of Real Estate to enter into negotiations with the landlord to exercise the option to extend the existing lease for the second floor of 1740 Cesar Chavez Street.

### **Recommendations**

- Disapprove the proposed resolution, authorizing a new five-year lease for the first floor of 1740 Cesar Chavez Street for DHR's testing center.
- Request the Director of Real Estate to enter into negotiations with the landlord to exercise the option under the existing lease to extend the lease by five years for the second floor of 1740 Cesar Chavez Street.

## MANDATE STATEMENT / BACKGROUND

### Mandate Statement

Under Administrative Code Section 23.27, leases with a term of more than one year or rent of more than \$5,000 per month, in which the City is the tenant, are subject to the Board of Supervisors approval, by resolution.

### Background

The Board of Supervisors previously approved the Department of Human Resources' (DHR) five-year lease for the second floor of 1740 Cesar Chavez Street in 2008 for a five-year term from September 15, 2008 through September 14, 2013 (File 08-0263). DHR uses the leased space to conduct recruitment and testing of public safety classifications and other civil service classifications.

Although the City has the option to renew the existing lease for the second floor of 1740 Cesar Chavez Street for five years, DHR is proposing to relocate and enter into a new five-year lease for increased space on the first floor of 1740 Cesar Chavez Street, as discussed further below. According to Mr. John Updike, Director of Real Estate, the City has met the legal requirement of providing notice to exercise the five-year option to extend the existing lease for the second floor in the event that the Board of Supervisors does not approve the proposed new lease for the first floor.

## DETAILS OF PROPOSED LEGISLATION

The proposed resolution would authorize a new five-year lease between the City and Potrero Investor I, LLC and Potrero Investor II, LLC for 1740 Cesar Chavez Street from approximately September 15, 2013 through September 15, 2018. Under the proposed lease, DHR would lease a portion of the first floor of 1740 Cesar Chavez Street to conduct exams for public safety and other civil service classifications.

A summary of the proposed new lease is shown in Table 1 below.

**Table 1: Summary of Proposed DHR Five-Year Lease at 1740 Cesar Chavez Street**

|                                     |   |                       |                         |
|-------------------------------------|---|-----------------------|-------------------------|
| <b>Term</b>                         | 5 years<br>(Approximately September 15, 2013 through<br>September 14, 2018)                         |                       |                         |
| <b>Square feet (approximate)</b>    | 11,000  |                       |                         |
| <b>Rent</b>                         | <u>Per Square Foot<br/>per Year</u>   | <u>Total per Year</u> | <u>Percent Increase</u> |
| 1st Lease Year                      | \$23.40   | \$257,400             | n/a                     |
| 2nd Lease Year                      | \$24.00   | \$264,000             | 2.6%                    |
| 3rd Lease Year                      | \$25.20   | \$277,200             | 5.0%                    |
| 4th Lease Year                      | \$25.80   | \$283,800             | 2.4%                    |
| 5th Lease Year                      | \$26.40   | \$290,400             | 2.3%                    |
| <b>Utilities and Services</b>       | Utilities and janitorial services are paid by the City.   |                       |                         |
| <b>Insurance and Property Taxes</b> | Prorata share (18.16%) of operating expenses paid by the City.                                      |                       |                         |
| <b>Tenant Improvements</b>          | Tenant improvements paid by landlord of up to \$52.27 per square foot, or total of up to \$575,000. |                       |                         |
| <b>Options to Extend</b>            | One five-year option to extend, rent adjusted to 95% of fair market value.                          |                       |                         |

*Tenant Improvements*

Under the proposed lease, the landlord will pay for tenant improvements, up to \$575,500 or approximately \$52.27 per square foot, for the total 11,000 square feet. According to Mr. John Updike, Director of Real Estate, tenant improvements will include the following: the placement of walls, doors, paint and carpet; as well as, new electrical, plumbing and mechanical systems and a HVAC distribution system.

**FISCAL IMPACT**

Total estimated costs in the first year of the lease are \$292,383 as follows:

|                                      |              |
|--------------------------------------|--------------|
| Rent                                 | \$257,400    |
| Utilities and Janitorial             | 33,000       |
| Prorata Share of Insurance and Taxes | <u>1,983</u> |
| Total                                | \$292,383    |

Rent and associated costs have been included in the FY 2013-14 and FY 2014-15 DHR budget.

**The proposed lease results in a 47 percent increase in rent per square foot and a 43 percent increase in square footage**

First year rent of \$257,400 for the first floor of 1740 Cesar Chavez Street is an increase of \$134,827, or 110 percent, compared to current rent of \$122,573 for the second floor of 1740 Cesar Chavez Street. This increase is due to an increase in the rent per square foot, as shown in Table 2 below, based on fair market value, and an increase of 3,320 square feet.

**Table 2: Comparison of Existing and Proposed Annual Rent and Space**

|                               | <b>Current rent<br/>(2<sup>nd</sup> Floor)</b> | <b>Proposed<br/>rent<br/>(1<sup>st</sup> Floor)</b> | <b>Increase</b> | <b>Percent<br/>increase</b> |
|-------------------------------|--|---|-----------------|-----------------------------|
| Rent per Square Foot per Year | \$15.96  | \$23.40   | \$7.44          | 47%                         |
| Total Square Feet             | 7,680  | 11,000  | 3,320           | 43%                         |
| Total Rent                    | \$122,573                                      | \$257,400   | \$134,827       | 110%                        |

**Fair Market Rent**

Under the existing lease, DHR occupies space on the second floor of 1740 Cesar Chavez Street to conduct tests for civil service classifications. The existing lease provides for a five-year extension with the rent to be increased to market rate. According to Mr. Updike, the Real Estate Division has notified the landlord that the City wishes to exercise the option to extend the existing lease, pending approval by the Board of Supervisors of the proposed new lease for the first floor space. If the Board of Supervisors does not approve the proposed new lease for the first floor space, DHR could continue to occupy their existing space on the second floor at a rental rate reset to market. According to Mr. Updike, the estimated rent under an extension of the existing lease for the second floor would be approximately \$24 per square foot.

However, if the Board of Supervisors approves the proposed new lease for the first floor space, the City would not exercise the five-year option to extend the existing lease for the second floor space.

As shown in Table 2 above, the increase in rent per square foot is 47 percent. According to Mr. Updike, the proposed rent represents fair market value, based on a Real Estate Division survey of comparable properties in the area. Mr. Updike states the rent per square foot would be approximately the same whether the City exercises the option to extend the existing lease for second floor space or enters into a new lease for the proposed first floor space.

**Increased Square Footage**

Under the proposed lease, the square footage increases by 3,320 square feet or 43 percent, as shown in Table 2 above. The increased rent in the first year of the proposed lease due to the increase in square footage is \$77,688 and over the five-year term of the proposed lease is \$414,336.

According to Mr. John Kraus, DHR Assistant Deputy Director, the increased space on the first floor would increase (1) computer testing sites (from 28 computer sites to approximately 70 computer sites); (2) oral interview rooms (from 10 rooms to approximately 20 rooms); and (3) testing room space for 226 candidates compared to current space for 150 candidates. Because

more candidates could be processed in one sitting, DHR could reduce the number of test sessions for each test.

According to Mr. Kraus, the existing space on the second floor is insufficient for DHR because it contains one large testing room with adjacent oral exam and computer testing rooms. Mr. Kraus states that “when the large testing room is in use none of the other rooms can be used because traffic would disrupt the administration of the exam in the large room. Consequently, the current facility only allows one test to be administered at a time and this can delay list generation and hiring.”

According to Mr. Kraus, the existing testing center on the second floor of 1740 Cesar Chavez was used 190 days in 2012, an increase of 69 days compared to 121 days of use in 2009. Mr. Kraus states that “Due to its extensive usage, there are times when, unfortunately, test administration is delayed because of competing demands for the facility. This, in turn, can delay the generation of eligible lists and delay overall hiring.”

While DHR has shown that the increased first floor space would allow more testing capacity, DHR does not have specific information on current delays in testing and generation of civil service eligibility lists due to insufficient space on the second floor, or how testing and generation of civil service eligibility lists would be increased due to increased space on the first floor.

According to Mr. Updike, the landlord proposed the relocation from the second floor to the first floor for DHR’s testing center; and in exchange agreed to pay for \$575,500 in tenant improvements. Mr. Updike states that the tenant improvement package will provide more functional, better oriented space, and lower the utility costs. Mr. Updike states that the more function and better oriented space on the first floor space also increases the likelihood of securing other City training uses at this location, providing an intangible benefit to the City organization.

Because the proposed new lease increases City costs by \$77,688 in the first year of the lease and \$414,336 over the five-year term of the lease, without sufficient information on how the increased space under the proposed new lease would contribute to increased testing and generation of civil service eligibility lists, the Budget and Legislative Analyst does not recommend approval of the proposed new five-year lease for the first floor of 1740 Cesar Chavez Street. As an alternative, the Board of Supervisors should request the Director of Real Estate to enter into negotiations with the landlord to exercise the option to extend the existing lease for the second floor of 1740 Cesar Chavez Street.

## RECOMMENDATIONS

- Disapprove the proposed resolution, authorizing a new five-year lease for the first floor of 1740 Cesar Chavez Street for DHR’s testing center.
- Request the Director of Real Estate to enter into negotiations with the landlord to exercise the option under the existing lease to extend the lease by five years for the second floor of 1740 Cesar Chavez Street.