Item 1 File 12-0038	Department: San Francisco Sheriff's Department (SFSD); Real Estate Division (RED);

EXECUTIVE SUMMARY

Legislative Objective

- The proposed resolution would authorize the first of two five-year options to extend the lease of 18,862 square feet of space at 1740 Folsom Street between the City, on behalf the Sheriff's Department, as lessee, and Mark Nelson Development & New California Land Company, as lessor, from July 1, 2012 through June 30, 2017.

Key Points

- On May 28, 2002, the Board of Supervisors approved a ten-year lease from July 1, 2002 through June 30, 2012, with two five-year options, between the Sheriff's Department, as lessee, and Mark Nelson Development & New California Land Company (Mark Nelson), as lessor, at 1740 Folsom Street for approximately 18,862 square feet of space for use as (a) the Sheriff's Department's State-mandated Operation Center for use in an emergency, (b) a consolidated training facility to provide State-mandated annual training to members of the Sheriff's Department, (c) office space for the Sheriff's Department's Training Unit, Background Unit, and Field Support Services Unit, and (d) the site for the Sheriff's Department's Survivor Restoration Program (SRP), which provides services to victims of domestic violence and other random acts of violence.
- Rent paid by the Sheriff's Department to Mark Nelson during the first five years of the existing ten-year lease was $20.00 per square foot per year, or $377,240 per year. For each of the last five years, from July 1, 2007 through June 30, 2012, the rent has been $23.00 per square foot per year, or $433,826 per year.

Fiscal Impacts

- Under the proposed five-year option, rent would be set at 95 percent of the market rate, determined by the Real Estate Division to be $25.18 per square foot per year, or $474,945 for the first year, an increase of $41,119 or 9.5 percent, from the current annual rent of $433,826.
- Under the proposed lease, rent would increase by $1 per square foot per year beginning in the second year of the five-year option, such that in FY 2013-14, the rent would be $26.18 per square foot per year, or $493,807. The total cost to the Sheriff's Department of the five-year lease extension would be rent is $2,563,346.
- The proposed five-year lease option results in a reduction in the effective rent to the Sheriff's Department in the first year, equal to 95 percent of fair market value which is less than the City would have to pay for comparable space if the Sheriff's Department were to relocate, the City would otherwise incur costs to install an emergency generator if the Sheriff's Department were to relocate, and the City will not pay taxes or insurance, which are normally passed through from the lessor to the lessee.

Policy Issue

- During the original ten-year lease and proposed five year lease extension, the City will pay the lessor approximately $6,618,676 of General Fund revenues to lease the subject facility for the Sheriff's Department. While acknowledging that the original lease contained two options to extend the subject lease for additional five year terms, the Budget and Legislative Analyst raises the question of at what point is it worth purchasing City property for ongoing City uses rather than continuing to enter into increasingly costly annual leases. Mr. Dunn advises that the proposed lease is more cost effective than purchasing property for the Sheriff's Department.

Recommendation

- Approve the proposed resolution.

MANDATE STATEMENT / BACKGROUND

Mandate Statement

In accordance with Sections 23.26 and 23.27 of the City's Administrative Code, all leases of $5,000 or more per month that extend for more than one year in which the City is the lessee are subject to Board of Supervisors approval by resolution.

Background

On May 28, 2002, the Board of Supervisors approved a ten-year lease (Resolution 356-02) from July 1, 2002 through June 30, 2012, between the Sheriff's Department, as lessee, and Mark Nelson Development & New California Land Company (Mark Nelson), as lessor, at 1740 Folsom Street (also known as 120 14th Street) for approximately 18,862 square feet of space for use as (a) the Sheriff's Department's State-mandated Operation Center for use in an emergency, (b) a consolidated training facility to provide State-mandated annual training to members of the Sheriff's Department, (c) office space for the Sheriff's Department's Training Unit, Background Unit, and Field Support Services Unit, and (d) the site for the Sheriff's Department's Survivor Restoration Program (SRP), which provides services to victims of domestic violence and other random acts of violence. According to Ms. Maureen Gannon, Chief Financial Officer for the Sheriff's Department, the facility at 1740 Folsom Street is essential to the Sheriff's Department based on its size, central location, and the range of services it provides. Ms. Gannon estimated that the 1740 Folsom Street facility is used for approximately 160 training courses and 220 meetings per year.

Rent paid by the Sheriff's Department to Mark Nelson under the existing ten-year lease between the Sheriff's Department and Mark Nelson, was $31,436.67 per month (approximately $1.67 per square foot per month), totaling $377,240 ($20.00 per square foot per year) for each of the first five years of the existing lease. According to Mr. Charlie Dunn, Senior Real Property Officer, Real Estate Division, the rent was determined to be market rate at that time based on comparable office space, including size and location.

Under the existing lease, there was a one-time increase in the rental rate on July 1, 2007 based on the percentage increase in the Consumer Price Index (CPI). The lease terms stipulated that this increase was to be not less than 15 percent and not more than 30 percent. For each of the last five years of the existing ten-year lease, from July 1, 2007 through June 30, 2012, the rental rate was $36,152.17 per month (approximately $1.92 per square foot per month), totaling $433,826 per year ($23 per square foot per year).

DETAILS OF PROPOSED LEGISLATION

The proposed resolution would authorize the Director of Real Estate to exercise the first of two five-year options under the existing lease previously approved by the Board of Supervisors, between the Sheriff's Department, as lessee, and Mark Nelson, as lessor, to extend the lease term for an additional five years from July 1, 2012 through June 30, 2017.

FISCAL IMPACTS

Under the existing lease, as previously approved by the Board of Supervisors, the rental rate would be set at 95 percent of market rate for the initial year of the proposed five-year lease extension period, as, determined by the Real Estate Division to be $2.10 per square foot per month or $25.18 per square foot per year based on comparable office space, including size and location. As shown in the Table below, the annual rent under the proposed lease option would begin at $25.18 per square foot per year, or $474,945 for the first year in FY 2012-13. This represents an increase of $41,119 (approximately $2.18 per square foot per year), or 9.5 percent, from the current FY 2011-12 rent of approximately $23.00 per square foot per year, or $433,826.

Under the proposed five-year lease option, the rent payable from the Sheriff's Department to Mark Nelson would increase by $1 per square foot per year.[1] As shown in the Table below, the $1 per square foot per year rent increase results in annual percentage rent increases ranging from 4.0 percent in Year 2, or FY 2012-13, to 3.5 percent in Year 5, or FY 2015-16. According to Mr. Dunn, the Real Estate Division commonly uses one of two methods to negotiate rent adjustments in leases in which the City is the lessee: (a) CPI, or (b) "market escalations" of $1 per square foot per year, as under the proposed five-year lease option. Mr. Dunn stated that, in addition to the proposed five-year lease option, the City has previously agreed to annual rent increases of $1 per square foot in leases at 208 Utah Street, 1550 Bryant Street, and 1390 Market Street.

Based on the initial year's rent set at 95 percent of market rate, and then increasing by $1 per square foot per year, the total cost of the rent over the proposed five-year lease term would be $2,563,346, as shown in the Table below.

Table: Annual and Total Cost of the Proposed Five-Year Lease Option

	Monthly Rent	Cost per Square Foot Per Month	Yearly Rent	Cost Per Square Foot Per Year	Percent Increase
Year 1	$39,579	$2.10	$474,945	$25.18	9.5%
Year 2	$41,151	$2.18	$493,807	$26.18	4.0%
Year 3	$42,722	$2.27	$512,669	$27.18	3.8%
Year 4	$44,294	$2.35	$531,531	$28.18	3.7%
Year 5	$45,866	$2.43	$550,393	$29.18	3.5%
Total Cost over the Five Year Extension			**$2,563,346**		
Utilities ($2,834 per month)			170,040		
Total Cost Including Utilities			**$2,733,386**		

Under the proposed five-year lease extension, the lessor is responsible for all other janitorial, maintenance, and operating costs.

In accordance with the terms of the existing lease, all other terms of the lease would remain unchanged, such that the Sheriff's Department would continue to be responsible for the cost of utilities. As shown in the Table above, utilities are estimated at $2,834 per month or approximately $34,008 annually. Over the five-year term of the proposed lease, utilities are estimated to cost the Sheriff approximately $170,040, resulting in a total cost of $2,733,386 for the proposed lease extension, as shown in the Table above. This total cost, including utilities,

[1] The existing lease did not specify a method of adjusting the rent year to year to reflect CPI or other adjustments.

would be paid from the City's General Fund, which would need to be appropriated for the Sheriff's Department in the annual budget.

According to Mr. Dunn, the proposed five-year lease option results in a reduction in the effective rent to the Sheriff's Department in the first year, equal to 95 percent of fair market value, which is less than the City would have to pay for comparable space if the Sheriff's Department were to relocate. In addition, Mr. Dunn stated that, under the existing lease and the proposed five-year option, the City does not pay taxes and insurance, which are normally passed through from the lessor to the lessee. If the Sheriff's Department were to relocate, Mr. Dunn notes that the Sheriff's Department would likely have to pay taxes and insurance on a new location as well as additional costs to install an emergency generator at the new location.

POLICY ISSUES

As discussed above, the current annual cost of the proposed lease is $433,826 of General Fund expenses. As shown in the Table above, under the proposed five year lease extension, the City's annual costs would increase to $550,393 by FY 2015-16. During the original ten-year lease and proposed five year lease extension, the City will pay the lessor approximately $6,618,676[2] of General Fund revenues to lease the subject facility for the Sheriff's Department.

While acknowledging that the original lease contained two options to extend the subject lease for additional five year terms, the Budget and Legislative Analyst raises the question of at what point is it worth purchasing City property for ongoing City uses rather than continuing to enter into increasingly costly annual leases.

According to Mr. Dunn, given the cost of issuing Certificates of Participation (COPs), the likely source to fund the purchase of a small to medium-sized building, coupled with the fact that this lease includes the lessor's costs for insurance, taxes, janitorial and other operating expenses, at this time, the proposed lease is more cost effective than purchasing property for the Sheriff's Department.

RECOMMENDATION

Approve the proposed resolution.

[2] Based on $377,240 per year for the first five years ($1,886,200), plus $433,826 per year for the second five years ($2,169,130), plus $2,563,346 for the proposed five year lease term, shown in the Table above.