

| | |
|---|---|
| <p>Item 7 File 17-1110</p> | <p>Departments: Real Estate Division Police Department</p> |
| <p>EXECUTIVE SUMMARY</p> | |
| <p style="text-align: center;">Legislative Objectives</p> | |
| <ul style="list-style-type: none"> • The proposed resolution would authorize the Director of Property to negotiate a lease between the City as tenant and LCL Global-777 Brannan Street, LLC (LCL Global) as landlord for up to 27,154 square feet consisting of the entire three floors of 777 Brannan Street. The proposed lease would be used for the San Francisco Police Department’s Property Control unit for evidence storage. The lease is for 10 years from July 1, 2018 through June 30, 2028 with two five-year options to extend to June 2038. The initial annual rent is \$37/sf. | |
| <p style="text-align: center;">Key Points</p> | |
| <ul style="list-style-type: none"> • The City’s 10-Year Capital Plan called for the relocation of the Adult Probation Department, District Attorney’s Office, and Police Department units from the Hall of Justice by 2019 due to the worsening conditions in the building. The Director of Real Estate has identified three lease locations to relocate these departments. • The City has not yet entered into a lease with LCL Global; the proposed resolution states that the Director of Property is authorized to negotiate a lease consistent with the terms outlined in a Letter of Intent (LOI). | |
| <p style="text-align: center;">Fiscal Impact</p> | |
| <ul style="list-style-type: none"> • Over the term of the 10-year lease, the City would pay LCL Global rent of \$11,517,737 and estimated operating costs of \$4,358,063. One-time expenses are \$3 million to \$5 million. These costs are not included in the FY 2017-18 budget. According to the Capital Planning Director, the City’s current capital budget includes \$16 million in FY 2017-18 and FY 2018-19 to cover these costs. • The proposed LOI provides for a property management fee of 3 percent of base rent, which is included in the estimated operating costs of \$14 per square foot per year. | |
| <p style="text-align: center;">Policy Consideration</p> | |
| <ul style="list-style-type: none"> • LCL Global has requested a Zoning Text Amendment to preserve self-storage use at the site, which conflicts with the Mayor’s Five-Point Plan to promote and preserve Production-Distribution-Repair (PDR) uses. • According to the LOI, the landlord will consider a right by the City to purchase the property, to be negotiated. | |
| <p style="text-align: center;">Recommendations</p> | |
| <ul style="list-style-type: none"> • Amend the proposed resolution to not include the proposed 3 percent property management fee from the anticipated lease. • Amend the proposed resolution to state that the Director of Real Estate should evaluate and pursue the purchase option if feasible. • Approval of a Zoning Text Amendment to permit long-term grandfathering of self-storage at 777 Brannan Street is a policy matter for the Board of Supervisors. • Approval of the proposed resolution as amended is a policy matter for the Board of Supervisors | |

MANDATE STATEMENT

City Charter Section 9.118(c) requires that any lease for a period of ten or more years, including options to renew, or with anticipated expenditures of \$10,000,000 or more be subject to approval of the Board of Supervisors.

City Administrative Code 23.27 states that any lease with a term of one year or longer or with rent of \$5,000 or more and where the City is the tenant is subject to Board of Supervisors approval.

BACKGROUND

The City's Hall of Justice (HOJ), located at 850 Bryant Street, was constructed in 1958, and is seismically deficient. Due to the aging infrastructure, the HOJ also has serious health, safety and working condition problems, requiring significant renovation and capital investment. The City's Justice Facilities Improvement Program, a part of the 10-Year Capital Plan calls for debt issuance to begin in FY 2020-21 in anticipation of fully relocating all City departments from the HOJ into new City facilities by 2024. However, in January of 2017, given the serious concerns about the safety and working conditions in the building, the City Administrator declared the offices and jail located at the HOJ be closed as quickly as possible (ideally by the end of 2019). As a result, the Capital Plan was updated in 2017 to target an expedited exit in 2019 from the HOJ for all staff and inmates.

The HOJ currently houses the State Superior Court and five City departments: the District Attorney's Office, Adult Probation, various offices of the Police Department, Office of the Chief Medical Examiner (OCME), and the Sheriff's Department (County Jails #3 and #4). OCME is scheduled to begin moving out of the HOJ in November 2017 and into their new City-owned facility at 1 Newhall Street. The Police Department will relocate its Traffic Company and Forensic Services Division into a new City-owned facility at 1955 Evans Avenue, which is anticipated to begin construction in November 2017, and be occupied by the end of 2020.

DETAILS OF PROPOSED LEGISLATION

The proposed resolution would authorize the Director of Property to negotiate a lease between the City as tenant and LCL Global-777 Brannan Street, LLC (LCL Global) as landlord for up to 27,154 square feet consisting of the entire three floors of 777 Brannan Street. The proposed lease would be used for the San Francisco Police Department's Property Control unit for evidence storage. The lease is for 10 years from July 1, 2018 through June 30, 2028 with two five-year options to extend to June 2038. The initial base rent is \$37 per square foot per year.

The City has not yet entered into a lease with LCL Global; the proposed resolution states that the Director of Property is authorized to negotiate a lease consistent with the terms outlined in a Letter of Intent (LOI). The terms of the anticipated lease, as outlined in the LOI, are summarized in Table 1 below.

Table 1: Anticipated Lease Terms

| Lease Terms | |
|--|--|
| Premises | 3-story building at 777 Brannan Street |
| Square Footage | 27,154 square feet |
| Term | 10 years from July 2018 through June 2028 |
| Option to Renew | Two five-year renewal options |
| Tenant Improvements | Landlord will pay for new fire sprinkler service and new exit staircase; City will for all other improvements |
| Base Rent | \$37 per square foot per year (\$1,004,698 first year) |
| Rent Increase | 3.0 percent per year |
| Option Rent | Set at 95 percent of market but no less than 103 percent of base rent in year 10 |
| Utilities, Property Taxes, and Operating Costs | City will pay an estimated \$14 per square foot for insurance, utilities, property taxes, repairs and maintenance, property management fees, security, and other operating costs |
| Parking | Loading dock |

The 27,154 square feet of leased space at 777 Brannan Street would accommodate the 30 full-time equivalent (FTE) Police staff in the Property Control unit currently located in approximately 21,000 square feet of space at the HOJ. While the amount of square feet per FTE is high, the anticipated lease for the Property Control unit is for storage of supplies and property.

General Plan Conformance

The proposed resolution would also find that the lease is in conformance with the City’s General Plan and the eight priority policies of Planning Code Section 101.1. Mr. John Updike, Director of Real Estate reports that the Planning Department has advised that consistency with the General Plan and Planning Code is anticipated. However, as of the writing of this report, these determinations have not yet been made by the Planning Department

FISCAL IMPACT

Ongoing Lease and Operating Expenses

Table 2 below shows the projected total leasing costs based on initial monthly base rent of \$37 per square foot at 777 Brannan Street by the Police Property Control unit. Over the term of the 10-year lease, the City would pay LCL Global rent of \$11,517,737. According to Mr. Updike, annual operating costs, including a property management fee set at 3 percent of base rent and property taxes, are estimated to be \$14 per square foot, or \$380,156 in the first year. Assuming that operating costs would increase at the same rate as the base rent (3 percent per year), over the term of the 10-year lease, operating costs are estimated to total \$4,358,063.

As noted above, there are two 5-year options to extend the lease, at an initial base rent of 95 percent of then fair market value for comparable buildings in the vicinity, but not less than 103 percent of the base rent paid during the last month of the initial lease term. This report assumes that the base rent would continue to escalate at 3 percent for each year of the two 5-year options.

Table 2: Leasing Costs Payable by the City over 10-Year Lease and Two 5-Year Options

| Year | Base Rent (per SF) | Total Rent Payments | Operating Costs (per SF) | Total Operating Costs | Total Leasing Costs |
|------------------|--------------------|---------------------|--------------------------|-----------------------|---------------------|
| 1 | \$37.00 | \$1,004,698 | \$14.00 | \$380,156 | \$1,384,854 |
| 2 | 38.11 | 1,034,839 | 14.42 | 391,561 | 1,426,400 |
| 3 | 39.25 | 1,065,884 | 14.85 | 403,308 | 1,469,192 |
| 4 | 40.43 | 1,097,861 | 15.30 | 415,407 | 1,513,267 |
| 5 | 41.64 | 1,130,796 | 15.76 | 427,869 | 1,558,665 |
| 6 | 42.89 | 1,164,720 | 16.23 | 440,705 | 1,605,425 |
| 7 | 44.18 | 1,199,662 | 16.72 | 453,926 | 1,653,588 |
| 8 | 45.51 | 1,235,652 | 17.22 | 467,544 | 1,703,196 |
| 9 | 46.87 | 1,272,721 | 17.73 | 481,570 | 1,754,292 |
| 10 | 48.28 | 1,310,903 | 18.27 | 496,017 | 1,806,920 |
| 10-Year Subtotal | | \$11,517,737 | | \$4,358,063 | \$15,875,799 |
| 11 | 49.72 | 1,350,230 | 18.81 | 510,898 | 1,861,128 |
| 12 | 51.22 | 1,390,737 | 19.38 | 526,225 | 1,916,962 |
| 13 | 52.75 | 1,432,459 | 19.96 | 542,012 | 1,974,471 |
| 14 | 54.34 | 1,475,433 | 20.56 | 558,272 | 2,033,705 |
| 15 | 55.97 | 1,519,696 | 21.18 | 575,020 | 2,094,716 |
| 16 | 57.64 | 1,565,287 | 21.81 | 592,271 | 2,157,557 |
| 17 | 59.37 | 1,612,245 | 22.47 | 610,039 | 2,222,284 |
| 18 | 61.16 | 1,660,613 | 23.14 | 628,340 | 2,288,953 |
| 19 | 62.99 | 1,710,431 | 23.83 | 647,190 | 2,357,621 |
| 20 | 64.88 | 1,761,744 | 24.55 | 666,606 | 2,428,350 |
| Options Subtotal | -- | \$15,478,875 | -- | \$5,856,872 | \$21,335,746 |
| 20-Year Total | -- | \$26,996,612 | -- | \$10,214,934 | \$37,211,546 |

One-Time Expenses

In addition to the ongoing lease and operating expenses shown in Table 2 above, Mr. Updike estimates up to \$400,000 (approximately \$15 per square foot) of one-time expenses to move the Property Control unit from the HOJ to 777 Brannan Street. According to Mr. Updike, the City expects to spend \$3 to 5 million on tenant improvements at 777 Brannan Street. The scope of the improvement project has not yet been determined.

Comparison of Leasing Costs to HOJ Operating Costs

The Real Estate Division currently spends approximately \$8.4 million per year to operate the HOJ, including jails, Superior Court and emergency repairs. These costs are charged to the client City departments and the Superior Court based on their share of square footage occupied in the

HOJ. Based on all Police Investigation units and the District Attorney's space in the HOJ, a comparison of these HOJ costs with the anticipated leases is shown in Table 3 below.

Table 3: Comparison of HOJ Operating Costs and Leasing Costs, FY 2020-21*

| | Police Property Control | Police Investigations | District Attorney | Adult Probation | Total |
|--------------------------|-------------------------|-----------------------|--------------------|--------------------|--------------------|
| HOJ Operating Cost | \$643,174 | \$2,073,472 | \$1,118,083 | \$432,852 | \$4,267,581 |
| Brannan DA Lease | | | <u>1,000,000</u> | | <u>1,000,000</u> |
| Subtotal HOJ and Brannon | | | 2,118,083 | | 5,267,581 |
| Leasing Cost | 1,576,416 | 3,095,639 | 5,812,090 | 3,408,912 | 13,893,057 |
| Difference | \$933,242 | \$1,022,167 | \$3,694,007 | \$2,976,060 | \$8,625,476 |

* Projected costs in the Hall of Justice for FY 2020-21 based on 3% annually increases are shown because leasing for Police Investigations is expected to begin in FY 2020-21 (Year 3 of the leases).

Under the current proposal the District Attorney and Police Investigations will relocate from the HOJ to leased space at 350 Rhode Island Street (File 17-1101), the Adult Probation Department will relocate from the HOJ leased space at 945 Bryant Street (File 17-1111), and Police Property Control will relocate to leased space at 777 Brannan Street (File 17-1109). The first year cost for these three proposed leases of \$13,893,057, is \$8,625,476 more than the FY 2017-18 operating costs of \$5,267,581 for these three departments in the HOJ.

Source of Funding

According to Ms. Heather Green, Capital Planning Director, the specific funding for these one-time and ongoing lease expenses are not currently included in the department's budget. However, Ms. Green advises that the City's current Capital Budget includes \$8,001,545 in FY 2017-18 and \$7,934,308 in FY 2018-19 for the Justice Facilities Improvement Program that could be potentially reallocated for these one-time and ongoing lease expenses.

Fair Market Rent

The proposed first year rent of \$37 per square foot is below the threshold established by the Administrative Code that requires a third party appraisal. According to Mr. Updike, recent comparable lease rates for storage and office space in SoMa in the vicinity of the HOJ range from \$24 to \$68 per square foot per year net of electrical and janitorial costs, so the adjusted base rent of approximately \$51 per square foot is within the range of comparable lease rates.

As noted above, the proposed LOI provides for a property management fee of 3 percent of base rent, which is included in the estimated operating costs of \$14 per square foot per year. Because the City will pay market rate for the leased space and will be responsible for all operating, insurance, utility, tax, and maintenance and repair expenses under the proposed LOI, the Budget and Legislative Analyst recommends amending the proposed resolution to not include the proposed 3 percent property management fee from the anticipated lease.

POLICY CONSIDERATION

Zoning Text Amendment for Self-Storage

777 Brannan Street is zoned for Service Arts and Light Industrial (SALI) use. The current grandfathered use of 777 Brannan Street is self-storage, which is not permitted in SALI zones. According to the Letter of Intent, final acceptance of the anticipated lease by LCL Global depends on the Board of Supervisors and Mayor adopting a Zoning Text Amendment to allow the long-term grandfathering of self-storage use on the property in order to facilitate reversion to self-storage after the City ends its tenancy of the building.

A Zoning Text Amendment to preserve self-storage use would conflict with the Mayor's Five-Point Plan to promote and preserve Production-Distribution-Repair (PDR) uses. When PDR and SALI zones were established in 2008, self-storage use was purposefully excluded as a permitted use because self-storage provides a low density of jobs per square foot of space and is able to out-compete more job-intense PDR uses on price. Therefore, the proposed resolution should be amended to state that final acceptance of the anticipated lease will not include a Zoning Text Amendment to permit long-term grandfathering of self-storage at 777 Brannan Street.

Option to Purchase

According to the LOI, the landlord will consider a right by the City to purchase the property, to be negotiated. The proposed resolution should be amended to state that the Director of Real Estate should evaluate and pursue the purchase option if feasible.

Plan for HOJ

According to Mr. Updike, the City's 20 to 25 year plan for the Hall of Justice is:

1. Administrative exit of OCME, Crime Lab/Traffic Company, District Attorney's Office, Adult Probation, and Police;
2. Internally (1) restack flex space above the Superior Court for Sheriff's Department, District Attorney's Office, and Police, and (2) re-use vacated OCME space for Police ID Bureau and Sheriff's Department Warrant Bureau, which must remain immediately proximate to the Superior Court;
3. Vacate jail space (plan forthcoming, subject to Board of Supervisors approval);
4. Demolish Bryant Street wing (leaving only Superior Court and ancillary City uses above/below Court);
5. Wait for State to rebuild Superior Court on vacated portion of the HOJ property;
6. Demolish former Court wing on Harriet Street; and
7. Rebuild new office building on former Court site for return to site by Adult Probation, some Police functions, and the District Attorney's Office.

This plan is contingent upon the State rebuilding the Superior Court on the site of the demolished administrative wing of the HOJ. The Superior Court will continue to operate in the HOJ until the State develops a new facility and the Superior Court will continue to rely on the City-run building systems and will continue to make reimbursement payments to the City for building operation costs. Under this plan, the City would not begin constructing a new City-owned office building until the Superior Court has constructed and occupied their new facility.

Summary

The Budget and Legislative Analyst considers approval of the proposed resolution to be a policy matter for the Board of Supervisors because the General Plan and Planning Code determinations have not been completed by the Planning Department.

RECOMMENDATIONS

1. Amend the proposed resolution to not include the proposed 3 percent property management fee from the anticipated lease.
2. Amend the proposed resolution to state that the Director of Real Estate should evaluate and pursue the purchase option if feasible.
3. Approval of a Zoning Text Amendment to permit long-term grandfathering of self-storage at 777 Brannan Street is a policy matter for the Board of Supervisors.
4. Approval of the proposed resolution as amended is a policy matter for the Board of Supervisors.