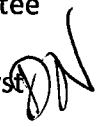


**CITY AND COUNTY OF SAN FRANCISCO**  
**BOARD OF SUPERVISORS**  
**BUDGET AND LEGISLATIVE ANALYST**

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January 23, 2014

**TO:** Budget and Finance Committee  
**FROM:** Budget and Legislative Analyst   
**SUBJECT:** January 29, 2014 Budget and Finance Committee Meeting

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<p><b>Item 1</b>  <b>File 13-1218</b>  <i>(Continued from January 15, 2014)</i></p>	<p><b>Departments:</b>                  San Francisco Employees' Retirement System (SFERS)</p>
<p><b>EXECUTIVE SUMMARY</b></p>	
<p><b>Legislative Objectives</b></p>	
<ul style="list-style-type: none"> <li>• The proposed resolution would approve a lease between the City and 1145 Market St, LP to provide office space for the San Francisco Employees' Retirement System (SFERS) staff for an initial term of ten years.</li> </ul>	
<p><b>Key Points</b></p>	
<ul style="list-style-type: none"> <li>• The SFERS staff currently occupies 23,241 square feet of office space at 30 Van Ness Ave, a City-owned building. Since 1999, SFERS staff numbers have increased from 61 to 97 budgeted positions and the current space at 30 Van Ness Ave is reportedly insufficient to accommodate the number of employees.</li> <li>• SFERS advises that the current leased space also does not provide adequate room to: offer private retirement counseling, conduct retirement seminars to groups greater than 30, or accommodate full public participation in monthly Retirement Board meetings.</li> <li>• The proposed resolution would approve a new lease for 37,289 square feet of space on three floors at 1145 Market Street for SFERS office space, which would accommodate current staff as well as the activities listed above.</li> </ul>	
<p><b>Fiscal Impacts</b></p>	
<ul style="list-style-type: none"> <li>• The proposed lease includes a first-year rent amount of \$1,311,510.31, or \$119,228.21 per month for 11 months. Per the provisions of the lease, SFERS will not pay rent in the first month.</li> <li>• The proposed lease requires that the landlord pay \$2,040,335 toward tenant improvements. In addition, the landlord will pay up to \$1,112,910, for a total amount of \$3,153,245, toward the tenant improvements, which SFERS will reimburse to the landlord in monthly installments over the initial 10-year term of the lease at 8 percent annual interest for a total of \$1,620,320.32.</li> <li>• Based on the Budget and Finance Committee's concerns reflected on January 15, 2014, the Director of Real Estate is currently renegotiating the proposed lease at 1145 Market Street, to potentially reduce the amount of space, rental costs and required tenant improvements.</li> </ul>	
<p><b>Recommendation</b></p>	
<ul style="list-style-type: none"> <li>• Continue the proposed resolution to the Call of the Chair, pending renegotiation of the new lease by the Real Estate Division.</li> </ul>	

## MANDATE STATEMENT / BACKGROUND

### Mandate Statement

San Francisco Administrative Code Section 23.27 requires Board of Supervisors approval by resolution for all leases on behalf of the City as tenant.

### Background

The San Francisco Employees' Retirement System (SFERS) has occupied 23,241 square feet of space at 30 Van Ness Ave, a City-owned building, since 1999. Mr. John Updike, Director of Real Estate, advises that the current space at 30 Van Ness is insufficient to accommodate:

- Current and future staffing levels: In 1999, when SFERS first moved into the current space at 30 Van Ness Ave, SFERS employed 61.00<sup>1</sup> Full-Time Equivalent (FTE) staff. The FY 2013-14 Annual Salary Ordinance shows that the number of FTE staff increased by 59.8 percent, or 36.46 FTE, from 61.00 in FY 1998-99 to 97.46<sup>2</sup> in FY 2013-14.
- Private retirement counseling: SFERS staff currently conducts retirement counseling in the general working area with little to no privacy for the clients receiving counseling.
- Seminars: SFERS staff currently conducts seminars for clients in the boardroom, which limits the number of attendees to no more than 30.
- Board meetings: The Retirement Board meets in the boardroom, which is not always large enough to accommodate the Board and members of the public.

## DETAILS OF PROPOSED LEGISLATION

The proposed resolution would approve a ten-year lease between the City (the tenant) and 1145 Market Street, LP (the landlord) for SFERS to lease office space at 1145 Market Street. The lease terms and provisions are shown in Table 1 below.

**Table 1: Summary of Lease Terms and Provisions**

Term	Ten-years
Premises	37,289 square feet at 1145 Market St
Commencement Date	July 1, 2014
Option to Terminate	At City discretion after July 1, 2017
Option to Extend	One City option to extend the lease by five years
Monthly Rent	\$119,228.21
First Year Total Rent (First month abated)	\$1,311,510.31
Rent Increase	Three percent annual increase

<sup>1</sup> The 1998-99 Annual Salary Ordinance lists 61.00 permanent staff and 5.19 temporary staff.

<sup>2</sup> The 2013-14 Annual Salary Ordinance lists 97.46 permanent staff and 6.67 temporary staff.

Table 1 above includes the first-year rent amount of \$1,311,510.31, which represents 11 months of rent. Per the provisions of the lease, SFERS will not pay first-month rent to the landlord.

The subject lease includes provisions that require the landlord to make tenant improvements. Mr. Updike advises that the tenant improvements will include improvements to: the HVAC system, the electrical system, the fire and life-safety systems, and other improvements to make space usable for the SFERS staff. Additionally, the lease states that the improvements must be up to a LEED Gold standard<sup>3</sup>.

Mr. Updike advises that that the proposed 37,289 square feet at 1145 Market St is large enough for SFERS to: accommodate current staffing levels, conduct client retirement counseling in private, offer seminars to 60 people at a time, and to accommodate attendance at Retirement Board meetings.

***Lease Will Be Updated After Board Approval***

Several of the provisions included in the proposed resolution are different from provisions in the draft lease submitted by the Real Estate Division. Mr. Updike confirms that the provisions of the lease will be updated to reflect the terms and provisions approved by the Board in the proposed resolution. The Budget and Legislative Analyst’s report is based on the provisions in the proposed resolution.

**FISCAL IMPACT**

***Rent Payments***

Currently, SFERS pays \$524,317 in annual rent for the City-owned building at 30 Van Ness Avenue. As shown in Table 2 below, under the proposed lease, SFERS will increase their office space by 60 percent and their rent by 173 percent.

**Table 2: Comparison of Current and Proposed Lease**

	<b>Current Lease at 30 Van Ness</b>	<b>Proposed Lease at 1145 Market Street</b>	<b>Increase</b>	<b>Percent</b>
Annual Rent	\$524,317	\$1,430,739	\$906,422	173%
Square Feet	23,241	37,289	14,048	60%
Annual Rent/ Square Foot	\$22.56	\$38.37	\$15.81	70%

According to Mr. Updike, the increase in square footage is necessary to accommodate the increase in SFERS staff between 1999 and 2014, and the services provided to SFERS members, as noted above. Additionally, according to Mr. Updike, SFERS pays less than market rate for the

<sup>3</sup> The LEED (Leadership in Energy and Environmental Design) program provides third party verification of the environmental efficiency of buildings, which includes access to public transit, water efficiency, lighting and energy efficiency and other standards.

City-owned building at 30 Van Ness because the City’s costs to operate and maintain City owned buildings are less than commercial buildings.

Mr. Updike advises that staff from the Recreation and Park Department (RPD) and the Department of Public Works (DPW) will occupy the space at 30 Van Ness Ave being vacated by SFERS. Currently, the RPD staff share office space with DPW staff at 30 Van Ness Avenue but RPD and DPW require the additional space as new, bond-funded positions are being hired.

The proposed resolution would approve a new ten-year lease between SFERS and 1145 Market Street, LP, in which SFERS will pay to 1145 Market Street, LP, first-year rent of \$1,311,510.31, or \$119,228 per month for 11 months. Per the provisions of the lease, the rent amount will increase annually by three percent, resulting in total estimated rent paid by SFERS to 1145 Market Street, LP of \$16,282,525.51 over the 10-year term of the lease as shown in Table 3 below.

**Table 3: Total Rent to be Paid by SFERS to 1145 Market Street, LP  
Includes Three Percent Annual Increase**

	Monthly Rent	Annual Rent
<b>Year 1 (11 Months)</b>	\$119,228.21	\$1,311,510.31
<b>Year 2</b>	122,805.06	1,473,660.68
<b>Year 3</b>	126,489.21	1,517,870.50
<b>Year 4</b>	130,283.88	1,563,406.61
<b>Year 5</b>	134,192.40	1,610,308.81
<b>Year 6</b>	138,218.17	1,658,618.07
<b>Year 7</b>	142,364.72	1,708,376.62
<b>Year 8</b>	146,635.66	1,759,627.91
<b>Year 9</b>	151,034.73	1,812,416.75
<b>Year 10</b>	\$155,565.77	\$1,866,789.25
<b>Total Rent to be Paid</b>		<b>\$16,282,585.51</b>

**Tenant Improvement Costs**

The estimated costs of tenant improvements under the proposed lease are up to \$3,153,245, of which \$2,040,335 are the landlord’s responsibility and up to \$1,112,910 are SFERS responsibility. The estimated costs for the tenant improvements are shown in Table 4 below.

**Table 4: Estimated Tenant Improvement Costs**

Tenant Improvement	Estimated Cost (Rounded)
HVAC, Electrical, Fire/Life Safety, and General Improvements	\$2,200,000
Architect, Engineer, Project Manager, LEED Fees and Permits	300,000
Data and Telecommunication Infrastructure	600,000
<b>Total</b>	<b>\$3,100,000</b>

Under the proposed lease, the landlord will make all tenant improvements and SFERS will reimburse the landlord for the City’s share of tenant improvement costs up to \$1,112,910.

These reimbursements will be made over the ten-year term of the lease at 8 percent annual interest. Based on tenant improvement costs of \$1,112,910, reimbursable by SFERS to the landlord at 8 percent annual interest, the Budget and Legislative Analyst calculates that SFERS will pay the landlord \$1,620,320.32 over the initial 10-year term of the lease. According to Mr. Updike, the Real Estate Division evaluated the use of Certificates of Participation (COPS) to pay for the tenant improvements, rather than reimbursing the landlord for tenant improvements at 8 percent annual interest, but the Controller’s Office determined that the use of COPS for this purpose is constrained by City’s debt limit. The Real Estate Division also evaluated a one-time budget appropriation but determined that annual payments of \$162,032 per year distributed over ten years (\$1,620,320 over ten years) was preferable to a one-time, upfront appropriation of \$1,112,910.

Mr. Updike advises that the tenant improvements should be completed prior to the lease commencement date of July 1, 2014. As such, SFERS should know the full cost of the tenant improvements as well as the amortized amount to include in the SFERS FY 2014-15 budget subject to Board of Supervisors approval.

**Additional Costs**

SFERS will also be responsible for the following variable costs:

- 100 percent of the electricity used by SFERS at the premises,
- 115 percent (includes a 15 percent administrative fee) of the cost of lighting and HVAC use on Saturdays,
- 27.5 percent of any annual increase in costs required to operate the building, and
- 27.5 percent of any annual increase in real estate taxes.

**POLICY CONSIDERATION**

The proposed lease for 1145 Market Street increases the square footage of leased space for SFERS by 60 percent, from 23,241 square feet under lease to 37,289 square feet under the proposed lease, which increases the square footage per employee from 238 square feet to 383 square feet as shown in Table 4 below.

**Table 4: Allocated Space per Employee Current vs. Proposed Office Space<sup>1</sup>**

	<b>Current Lease at 30 Van Ness</b>	<b>Proposed Lease at 1145 Market Street</b>	<b>Increase</b>	<b>Percent</b>
Total Square Feet	23,241	37,289	14,048	60%
Number of Employees	97.46	97.46	0	0%
Square Feet per Employee	238	383	144	60%

<sup>1</sup> Numbers in the table may not add due to rounding.

Mr. Updike advises that the Real Estate Division works with client departments to achieve a square footage to employee ratio of 250 square feet, but accepts rates as high as 350 square feet. According to Mr. Updike, the Real Estate Division considers 383 square feet per employee

at 1145 Market Street to be reasonable because the space will be used for member counseling, seminars and Retirement Board meetings, all of which are space-intensive activities.

Mr. Updike states that DPW and RPD do not currently have sufficient space to accommodate the hire of new bond-funded employees. Mr. Updike advises that allowing DPW and RPD to expand into the space being vacated by SFERS and other available space at 30 Van Ness Avenue will provide sufficient space to accommodate these new employees for DPW and RPD, as shown in Table 5 below.

**Table 5: RPD and DPW Office Space Expansion at 30 Van Ness Avenue**

Department	Current Employees	Current Square Footage	Current Square Feet per Employee	Proposed Square Footage	Proposed Square Feet per Employee
Recreation and Park	26.00	4,420.00	170.00	7,750.00	298.08
Public Works	327.00	84,000.00	256.88	110,571.00	338.14
<b>Combined</b>	<b>353.00</b>	<b>88,420.00</b>	<b>250.48</b>	<b>118,321.00</b>	<b>335.19</b>

***Renegotiated New Lease***

On January 15, 2014, the Budget and Finance Committee met to consider the proposed resolution and recommended that the resolution be continued until January 29, 2014, in order to provide additional time to review the subject lease and potentially reduce the need for the expanded space and related cost increases. Based on the Budget and Finance Committee's concerns on January 15, 2014, the Director of Real Estate advises that he is currently renegotiating the proposed lease at 1145 Market Street, to potentially reduce the amount of space, rental costs and required tenant improvements.

**RECOMMENDATION**

Continue the proposed resolution to the Call of the Chair, pending renegotiation of the new lease by the Real Estate Division.