CITY AND COUNTY OF SAN FRANCISCO
BOARD OF SUPERVISORS
BUDGET AND LEGISLATIVE ANALYST
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October 2, 2015

TO: Budget and Finance Committee

FROM: Budget and Legislative Analyst

SUBJECT: October 7, 2015 Budget and Finance Committee Meeting

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Item 1 **File 15-0949**	**Department:** Public Utilities Commission (PUC)

EXECUTIVE SUMMARY

Legislative Objectives

- The proposed resolution authorizes the San Francisco Public Utilities Commission (PUC) to accept and expend an additional award of $123,042 in California Department of Water Resources grant funds through PUC's Memorandum of Understanding with the Solano County Water Agency in order to reimburse the City for a portion of the cost of its high-efficiency toilet installation program.

Key Points

- In September 2012, the Board of Supervisors PUC to accept and expend $863,000 in grant funds from the California Department of Water Resources for high-efficiency toilet installation programs.
- PUC achieved a greater number of toilet installations than were eligible for reimbursement from the original grant award of $863,000. Under an amended grant agreement, PUC was awarded an additional $123,042 in grant funds for reimbursement of toilet installation costs.

Fiscal Impact

- Of the $5,300,000 budget for the high-efficiency toilet installation programs, $986,042 of program costs will be reimbursed by grant funding.
- PUC committed $1,150,625 from the Water Enterprise, Water Conservation operating budget to match the $986,042 in State grand awards.
- The remaining cost of $3,163,333 was funded by previous appropriations of the PUC Water Enterprise, Water Conservation operating budget.

Recommendation

- Approve the proposed resolution.

MANDATE STATEMENT

City Administrative Code Section 10.170-1(b) states that the acceptance and expenditure of federal, State, or other grant funds in the amount of $100,000 or more, including any City matching funds required by the grant, is subject to Board of Supervisors approval.

BACKGROUND

In 2011, the Bay Area Clean Water Agencies (BACWA) applied for and received a Proposition 84 Integrated Regional Water Management Grant from the California Department of Water Resources (State grant) in the amount of $9,191,685 to fund water conservation programs administered by 13 participating regional utility agencies, including the San Francisco Public Utilities Commission (PUC).

In May 2012, BACWA and the Solano County Water Agency (SCWA) entered into an implementation agreement under which BACWA agrees to disburse the State grant funds to SCWA for SCWA to administer to participating agencies for eligible projects. Participating agencies are required to match 25 percent of the State grant award with operating funds.

In September 2012, the Board of Supervisors authorized PUC to accept and expend $863,000[1] in State grant funds to reimburse PUC for installation of high-efficiency toilets (File 12-0828; Resolution 340-12). PUC achieved a greater number of toilet installations than were eligible for reimbursement from the original grant award of $863,000. Under an amended grant agreement executed in January 2015 between the California Department of Water Resources and BACWA, PUC was awarded an additional $123,042 in grant funds[2] for reimbursement of toilet installation costs for total grant funds of $986,042. PUC installed 9,025 high-efficiency toilets primarily for single-family residences on the PUC's rate discount program, affordable housing providers, and facilities serving the affordable housing community, including shelters, transitional housing, residential treatment clinics, and medical clinics in San Francisco. State grant funds of $986,042 reimbursed PUC for approximately 4,382 of the 9,025 high-efficiency toilet installations, or $225 per toilet.

DETAILS OF PROPOSED LEGISLATION

The proposed resolution authorizes PUC to accept and expend an additional award of $123,042 in California Department of Water Resources grant funds through PUC's Memorandum of Understanding (MOU) with SCWA in order to reimburse the City for a portion of the cost of its high-efficiency toilet installation program.

[1] Although the Board of Supervisors approved a grant award of $863,100, the actual grant award was $863,000.

[2] The water conservation programs of some participating agencies did not receive sufficient customer participation or performance to seek reimbursement for the agency's total grant award in the implementation agreement. As a result, grant funds for each of the water conservation programs in the grant agreement between California Department of Water Resources and BACWA were modified in a January 2015 amendment, allowing utilities to surrender grant funding for programs that did not have sufficient participation and apply it to different programs and/or participating agencies.

FISCAL IMPACT

The total budget of the PUC high-efficiency toilet installation program is $5,300,000, of which $986,042 will be reimbursed by grant funding from the California Department of Water Resources and $4,313,958, comes from monies previously appropriated by the Board of Supervisors from the PUC's Water Enterprise operating budget, as shown in Table 1 below.

The MOU between PUC and Solano County Water Agency required matching funds equal to 25 percent of the grant award. According to Ms. Julie Ortiz, Project Manager in the Water Enterprise, PUC provided matching funds of $1,150,625, or 117 percent of the grant award of $986,042, because on average the actual cost of high-efficiency toilet installation was greater than the State grant amount of $225 per toilet.

Table 1: High-Efficiency Toilet Installation Program Funding

Previous State Grant Award	$863,000
Proposed State Grant Award	*$123,042*
Total State Grants	$986,042
Grant-matching PUC Water Enterprise Operating Funds	$1,150,625
Additional PUC Water Enterprise Operating Funds	$3,163,333
Total PUC Funds Previously Appropriated by the Board of Supervisors	$4,313,958
Total High-Efficiency Toilet Installation Program Budget	**$5,300,000**

RECOMMENDATION

Approve the proposed resolution.

Item 2 File 15-0895	Department: General Services Agency - Real Estate Division

EXECUTIVE SUMMARY

Legislative Objectives

- The proposed resolution would approve a 5-year lease with one 5-year option to extend between the City and County of San Francisco (the City) and Twin Peaks Petroleum, Inc. to continue operation of a gasoline service station and related convenience store and garage on a 14,499 square foot property located at 598 Portola Drive.

Key Points

- The City has leased the property at 598 Portola Drive for use as a gasoline service station since 1972. In 1994, the City approved the existing 10-year lease with one 5-year extension that was amended to one 10-year extension with Twin Peaks Petroleum, which expired on June 30, 2014. This lease has been on holdover since June 30, 2014.
- The Real Estate Division began negotiating the proposed lease with the tenant in 2013 and finalized the terms in July 2015. In July 2013, the Real Estate Division had the subject property appraised at $103,675 per year, which was negotiated down to the proposed $100,913 annual rental rate because the rentable area was reduced from 15,000 square feet to 14,499 square feet.

Fiscal Impact

- Based on a rental rate of $100,913 per year plus 3 percent annual increases, the proposed lease would generate an estimated total of $535,761 in rental revenue for the City over the 5-year lease term.

Policy Consideration

- The lease of the site for use as a gasoline station has continued for the past 43 years, or since 1972, without competitive bidding since the initial sealed bid offering in 1972 established the station under an initial 15-year lease.
- The Budget and Legislative Analyst's Office considers approval of the subject lease to be a policy decision for the Board of Supervisors because the proposed lease would be awarded based on a 2013 appraisal without cost of living adjustments over the past two years which is less than the existing tenant paid the City in FY 2014-15 and without a competitive bid process.

Recommendations

- Amend the proposed resolution to make a finding that utilizing competitive bidding procedures for the proposed new lease would be impractical or impossible.
- Amend the proposed resolution to urge the City Administrator to work with the Director of Real Estate to identify the highest and best use of the site and to consider rezoning the site to conform with the highest and best use.
- Approval of the proposed resolution, as amended, is a policy decision for the Board of Supervisors.

MANDATE STATEMENT

City Charter Section 9.118(c) states that any lease of real property for a period of ten or more years, including options to renew, or having anticipated revenue to the City of $1,000,000 or more, is subject to Board of Supervisors approval.

Administrative Code Section 23.33 states that it is City policy that all leases of real property that are expected to produce more than $2,500 per month in revenue be awarded in accordance with competitive bidding procedures, unless such procedures are impractical or impossible.

BACKGROUND

According to Mr. John Updike, Director of Real Estate, the proposed lease site at 598 Portola Drive was originally acquired by the City and County of San Francisco (the City) as part of the Laguna Honda site in the late 1800s. An approximately 15-acre corner of the Laguna Honda site along Woodside Avenue and Portola Drive was jurisdictionally transferred to the Juvenile Probation Department in 1947 for development of the Youth Guidance Center, with the proposed lease site retained by the Department of Public Health. At that time, horse stables were located on the proposed lease site.

In June 1972, the City received bids to lease the 15,000-square-foot site at 598 Portola Drive. In August 1972, the Board of Supervisors approved a 15-year lease of the site between the City and Mobil Oil for use as a gasoline station (Resolution 466-72), or through 1987.[1] The base rent was $300 per month for the first six months of the lease and $900 per month thereafter.

In 1985, Mr. Michael Gharib acquired the Mobil Oil franchise at 598 Portola Drive. At an unknown time between 1985 and 1994, British Petroleum bought the leasehold from Mobil Oil.[2] In 1994, Mr. Gharib purchased the equipment on the site from British Petroleum.

In August 1994, the Board of Supervisors approved a new 10-year lease of 15,000 square feet at 598 Portola Drive between the City, as landlord, and Twin Peaks Petroleum, Inc., a California corporation doing business as Twin Peaks Auto Care, successor in interest to Mr. Michael Gharib, as tenant, for use as a gasoline service station and related convenience store and garage, without competitive bidding (File 65-94-11/Ordinance 279-94). This new lease had one 5-year option to extend the term, for a total term of up to 15 years, or through June 2009. The base rent was $3,000 per month ($0.20 per square foot per month) for years 1 through 5 of the lease, or $0.0189 per gallon of gasoline delivered each month, whichever was greater. For years 6 through 10 of the lease, the base rent was $4,000 per month (approximately $0.27 per square foot per month) or $0.0283 per gallon of gasoline delivered each month, whichever was greater, with annual adjustments to the base rent based on the Consumer Price Index. Rent for the 5-year extension term was subject to reappraisal. At the time this ordinance was approved, the Board of Supervisors found that it was in the best interests of the City to enter into this

[1] According to Mr. Updike, it is unknown based on available records whether multiple parties submitted bids, or whether the City solicited bids for a gas station or other uses.

[2] Mr. Updike was unable to locate lease records to account for the tenancy during the seven-year period between expiration of the 1972 lease in 1987 and authorization of a new lease in 1994.

lease based on direct negotiations with the current operator of the gasoline station, Mr. Michael Gharib, without a competitive bid process, because competitive bidding would be impractical or impossible.

In June 2004, the Board of Supervisors approved an amendment to the 1994 lease to increase the 5-year lease extension option by an additional 5 years for a 10-year extension, and then exercised this 10-year extension through June 2014, to allow the operator to amortize the cost of State-mandated underground fuel tank replacement over a longer lease term (File 04-0636/Resolution 364-04). As shown in Table 1 below, the rental rate for the 2004 lease extension was $6,806 per month (approximately $0.45 per square foot per month) with annual adjustments to reflect the Consumer Price Index. As of FY 2014-15, the rental rate was $8,467 per month (approximately $0.56 per square foot per month), resulting in annual rent to the City of $101,603. Table 1 below summarizes the previous lease agreements with Twin Peaks Petroleum.

Table 1: Summary of Previous Lease Agreements with Twin Peaks Petroleum

	August 1994 Lease	June 2004 Lease Amendment
Premises	Approximately 15,000 square feet at 598 Portola Drive	Approximately 15,000 square feet at 598 Portola Drive
Term	10 years	10 years
Option to Extend	One 5-year extension	Amended to 10-year extension, exercised in 2004
Rental Rate Payable to the City	Years 1 through 5: \$3,000 per month (\$0.20 per square foot) or \$0.0189 per gallon of gasoline delivered, whichever was greater Years 6 through 10: \$4,000 per month (\$0.27 per square foot) or \$0.0283 per gallon of gasoline delivered, whichever was greater, with annual CPI adjustments	In 2004, \$6,806 per month (\$0.45 per square foot per month), or \$101,603 annually, with annual CPI adjustments In FY 2014-15, \$8,467 per month (\$0.56 per square foot per month)
Utilities	Tenant responsible for all utilities and services	Tenant responsible for all utilities and services
Security Deposit	\$10,000	\$10,000
Tenant's Insurance Payable by Tenant	<u>Minimum commercial general liability:</u> \$1,000,000 per occurrence <u>Rental interruption:</u> 12 months base rent <u>Worker's compensation:</u> \$1,000,000 per accident <u>Comprehensive automotive liability:</u> \$1,000,000 per occurrence <u>Liability for gradual pollution or contamination</u>: \$1,000,000 per occurrence	<u>Minimum commercial general liability:</u> \$1,000,000 per occurrence <u>Rental interruption:</u> 12 months base rent <u>Worker's compensation:</u> \$1,000,000 per accident <u>Comprehensive automotive liability:</u> \$1,000,000 per occurrence <u>Liability for gradual pollution or contamination</u>: \$1,000,000 per occurrence
Permitted Use	Operation of a retail gasoline station, oil service station, including the sale of merchandise generally sold at service stations	Operation of a retail gasoline station, oil service station, including the sale of merchandise generally sold at service stations

The existing lease term, including the additional 10-year extension period expired on June 30, 2014, and the lease has continued on a month-to-month holdover tenancy for the past 15 months. In May 2015, the Real Estate Division confirmed through a survey that the size of the rentable property decreased from 15,000 square feet to 14,499 square feet, a reduction of 501 square feet, due to right-of-way and other improvements made by the City on the property. The improvements include three accessible parking spaces to serve the adjacent Youth Guidance Center.

DETAILS OF PROPOSED LEGISLATION

The proposed resolution would approve the award of a new 5-year lease, with one 5-year option to extend the term, commencing approximately October 1, 2015 between the City and the existing tenant, Twin Peaks Petroleum, Inc., to enable Twin Peaks Petroleum to continue to operate a gasoline service station and related convenience store and garage on 14,499 square feet located at 598 Portola Drive. Table 2 below summarizes the provisions of the proposed new lease.

Table 2: Summary of Proposed Lease Provisions

Premises	Approximately 14,499 square feet at 598 Portola Drive
Term	Five years from approximately October 1, 2015 through September 30, 2020
Options to Extend	One (1) five-year option to extend
Base Rent Payable to the City	$8,409 per month (approximately $0.58 per square foot per month), or $100,913 annually
Annual Adjustment	Three percent per year
Utilities	Tenant responsible for all utilities and services
Security Deposit	$50,000
Tenant's Insurance Payable by Tenant	Minimum commercial general liability: $2,000,000 per occurrence Explosion, collapse and underground coverage: $1,000,000 per accident Business interruption: 1 year base rent Worker's compensation: $1,000,000 per accident Business automotive liability: $1,000,000 per occurrence Liability for gradual pollution or contamination: $1,000,000 per occurrence
Permitted Use	Operation of a retail gasoline station, oil service station, including the sale of merchandise generally sold at service stations, excluding tobacco products and alcoholic beverages.

As noted above, the existing lease term expired 15 months ago, and the lease has continued on a month-to-month holdover basis since June 2014. According to Mr. Updike, the City did not competitively bid the proposed lease but instead began negotiating the proposed lease terms with the tenant in 2013 and only finalized the terms in July 2015. According to Ms. Claudia Gorham, Assistant Director of Real Estate, it took almost two years to complete these lease negotiations with the existing tenant because of the following new terms: (1) the tenant may no longer sell cigarettes[3] on the premises; (2) a $40,000 increase in the security deposit (from $10,000 to $50,000); and (3) new insurance requirements, such as increasing commercial general liability insurance coverage limits from a minimum of $1,000,000 to $2,000,000 per occurrence and adding explosion, collapse and underground coverage of at least $1,000,000 per accident.

[3] In accordance with SF Health Code Article 19K, Sec 1010.1 (2008), tobacco sales are banned on City property.

FISCAL IMPACT

In July 2013, the Real Estate Division retained Clifford Advisory, LLC to conduct an independent rental appraisal of the 15,000 square foot 598 Portola Drive parcel, which determined an annual rental value of $103,675, or approximately $6.91 per square foot per year. Mr. Updike advises that the appraised rental value of $103,675 was negotiated down to the proposed annual rent of $100,913 plus 3 percent annual increases because the rentable area of the property decreased from 15,000 square feet (as appraised) to 14,499 square feet, a reduction of 501 square feet. Based on the reduced square footage of 14,499, the proposed annual rent of $100,913 is approximately $6.96 per square foot per year. However, the proposed rent of $100,913 is $690 lower than the rent of $101,603 actually paid by the existing tenant in FY 2014-15, which was based on annual Consumer Price Index adjustments to the base rent of $81,675 from FY 2004-05.

According to Ms. Gorham, the proposed annual rental rate of $100,913, which is $690 less than the prior annual rent of $101,603, was agreed to relatively early in the two-year negotiation process with the tenant, based on the results of the 2013 appraisal. Although the proposed new lease will not be entered into until approximately October 1, 2015, or over two years after the 2013 appraisal was completed, the City decided not to increase the rent during the negotiation of the final terms as a sign of the City's good faith. Mr. Updike advises that the proposed annual base rent of $100,913 reflects the current fair market value of the subject property.

Based on the proposed annual rental rate of $100,913 per year plus 3 percent annual increases, the proposed lease would generate an estimated total of $535,761 in rental revenue for the City over the 5-year lease term, as shown in Table 3 below. If the tenant exercises the 5-year option to extend, the City will adjust the base rent for the extension period based on the prevailing market rate at that time, as determined by independent appraisal, with annual Consumer Price Index adjustments thereafter.[4]

Table 3: Proposed Lease Rental Revenues

Year	Rent
1	$100,913
2	103,940
3	107,059
4	110,270
5	113,579
Total	**$535,761**

[4] The option to extend would not be subject to Board of Supervisors approval because the proposed resolution includes the total lease period of ten years or more, in accordance with City Charter Section 9.118(c).

POLICY CONSIDERATION

Proposed Sole-Source Lease

The 598 Portola Avenue parcel contains the only privately-operated gasoline station located on City-owned property. In addition, the lease of this City property at 598 Portola Drive for use as a gasoline station, convenience store and garage has continued for the past 43 years, or since 1972, without any competitive bidding since the original establishment of the station in 1972 under an initial 15-year lease. Furthermore the proposed new 5-year lease with one 5-year extension option would be awarded without undergoing a competitive bidding process.

In accordance with Administrative Code Section 23.33, all leases of City real property resulting in more than $2,500 per month in revenue must be awarded in accordance with competitive bidding procedures, unless such competitive bidding procedures are impractical or impossible. According to Mr. Updike, a competitive bid process is impractical or impossible because the City would essentially be removing the existing community-serving service station use and more likely seeking alternative development of the property. The property is currently zoned P (Public), so a non-public use such as commercial or residential use would require rezoning, which Mr. Updike advises would be expensive and time consuming. According to Mr. Updike, offering the property through a competitive process for continued service station use is impractical, as the existing occupant controls the equipment on the property, such that a new operator would be required to invest capital in replacement facilities, necessitating a longer-term lease, which may not be in the City's best interest. Furthermore, a newly constructed service station may also not be practical or possible in light of current planning and building codes and the limited size of the site.

Termination of the lease with Twin Peaks Petroleum would require the tenant to pay for the removal of their equipment, including underground tanks, from the premises. According to Mr. Updike, the City is concerned that equipment removal could necessitate remediation of the site, during which time the City would not be able to collect rent or lease the property to another tenant. However, under the terms of both the existing and proposed new lease, the tenant would also be responsible for performing and paying for any remediation costs of the site upon termination of the lease.

In addition, Mr. Updike notes that the Real Estate Division has received significant community support for the continued City lease of this site with the existing gasoline station operator. There is one gasoline and service station located 1 mile driving distance to the southwest of the subject lease property at 800 Ulloa Street. There are six other gasoline and service stations located within a 2-mile driving distance of the subject lease property (2399 19th Avenue, 2301 19th Avenue, 2000 19th Avenue, 1855 Taraval Street, 4199 Mission Street, and 2399 Market Street).

To avoid the potential loss of rental revenue for an unknown period of time and in support of the community, the Real Estate Division is proposing to grant a sole-source lease to Twin Peaks Petroleum, without competitive bidding, for 5 years with a 5-year option to extend, or a total of an additional 10 years.

The proposed new lease will continue the grandfathered use of the gasoline station, which is non-conforming with the current P (Public) zoning of the property. Without competitive bidding, the Budget and Legislative Analyst's Office has insufficient evidence to conclude that the current non-conforming use of the site is its highest and best use and serving the best interests of the City.

Because the proposed lease would be awarded based on a 2013 appraisal without cost of living adjustments over the past two years which is less than the existing tenant paid the City in FY 2014-15 and without the use of competitive bidding process, the Budget and Legislative Analyst's Office considers approval of the proposed new lease to be a policy decision for the Board of Supervisors.

If the Board of Supervisors decides to approve the proposed new lease, the Board of Supervisors is required to make a finding that competitive bidding would be impractical or impossible and that it is in the best interests of the City to enter into the proposed new sole source lease based on direct negotiations with the current operator of the gasoline station, Mr. Michael Gharib, without a competitive bid process.

RECOMMENDATIONS

1. Amend the proposed resolution to make a finding that utilizing competitive bidding procedures for the proposed new lease would be impractical or impossible.
2. Amend the proposed resolution to urge the City Administrator to work with the Director of Real Estate to identify the highest and best use of the site and to consider rezoning the site to conform with the highest and best use.
3. Approval of the proposed resolution, as amended, is a policy decision for the Board of Supervisors.