

<p>Item 6 Files 20-0604</p>	<p>Department: Department of Public Health (DPH), Real Estate Division (RED)</p>
<p>EXECUTIVE SUMMARY</p>	
<p style="text-align: center;">Legislative Objectives</p> <ul style="list-style-type: none"> • The proposed resolution would approve a lease agreement between the City, as tenant, and 333 Valencia Owner LLC, as landlord, for the DPH program staff occupying 30 Van Ness to relocate to 333 Valencia Street for a term of 15 years, commencing in February 2021, with the option to extend for ten years. According to the proposed lease agreement, initial annual base rent is \$2,209,239 (\$49.95 per square foot) and increases three percent annually thereafter. DPH will pay for 79.41 percent of operating costs and real estate taxes, along with electricity. <p style="text-align: center;">Key Points</p> <ul style="list-style-type: none"> • The Board of Supervisors previously approved the sale of the city-owned building at 30 Van Ness Avenue for the sales proceeds to be used as a source of funds for development of the new City office building at 49 South Van Ness Avenue. Under the terms of the purchase as sale agreement, the City occupants at 30 Van Ness, including DPH staff, would continue to lease space pending relocation to another site. The DPH programs at 30 Van Ness Avenue were not intended to move into 49 South Van Ness Avenue. • The proposed lease for 333 Valencia Street is for up to 25 years, including extension option. The proposed lease provides an option for the City to purchase 333 Valencia Street from the lease commencement date in approximately February 2021 to October 2021, a nine-month period. The purchase price would be \$56,000,000, plus the landlord’s costs for tenant improvements, less rent paid by the City <p style="text-align: center;">Fiscal Impact</p> <ul style="list-style-type: none"> • Initial rent of \$49.95 per square foot is at or below fair market value based on a third party appraisal obtained by the Real Estate Division. Total rent and operating expenses over the initial 15-year term are \$58.3 million. • Tenant improvement costs are \$9.1 million, of which the City’s share is approximately \$6.5 million. The sources of funding for the lease will be distributed across the DPH programs occupying the building, and includes a mix of grant revenue, General Fund, and fees in case of Emergency Medical Services. <p style="text-align: center;">Recommendation</p> <ul style="list-style-type: none"> • Approve the proposed resolution. 	

MANDATE STATEMENT

City Administrative Code 23.27 states that any lease with a term of one year or longer and where the City is the tenant is subject to Board of Supervisors approval of a resolution.

BACKGROUND

The Board of Supervisors authorized the sale of the City-owned building at 30 Van Ness Avenue in 2017, and use of the sale proceeds as a source of funds for the development of a new City office building at 49 South Van Ness Avenue.¹ Several City departments occupied 30 Van Ness Avenue at the time of the sale, including the Department of Public Works, Recreation and Park Department, Department of Public Health, Department of Emergency Management, Office of Civic Engagement and Immigrant Affairs, and Administrative Services Contract Monitoring Division. The purchase and sale agreement between the City and the purchaser provided for the City to continue to lease space at 30 Van Ness Avenue through April 2020, with two one-year options to extend the lease through April 2022. According to Mr. Andrico Penick, Director of the City's Real Estate Division, the first option to extend expires after one year or ninety (90) days after Substantial Completion of the 49 South Van Ness project. 49 South Van Ness Avenue was substantially complete on June 9, 2020 making the expiration date for the lease at 30 Van Ness, September 7, 2020.

According to Mr. Penick, four City departments currently located at 1660 Mission Street, 1680 Mission Street, and 30 Van Ness Avenue – Public Works, Building Inspection, Planning, and Recreation and Park - are all consolidating into office space at the new 49 South Van Ness building. The Office of Civic Engagement and Immigrant Affairs and Contracting Monitoring Division are relocating to 1155 Market into space that was previously occupied by Public Works. Department of Emergency Management is relocating to City Hall, Rm 348 which was space previously occupied by Public Works. Recreation and Park Department staff are moving to 49 South Van Ness Avenue.

The Department of Public Health (DPH) presently maintains office space at 30 Van Ness for its Maternal, Child and Adolescent Health, Public Health Emergency Preparedness and Response, Emergency Medical Services, Primary Care leadership, and related Administrative staff. The space at 30 Van Ness is under a leaseback that is anticipated to expire in early September 2020. These DPH programs are not moving into the space at 49 South Van Ness Avenue, and according to Mr. Penick, cannot be supported long-term at any existing City-owned or leased spaces, which requires them to move into a new space.

DPH is the only department for which the City did not have an initial relocation plan for when making the 30 Van Ness sale. According to Ms. Kathy Jung, Director of Facilities and Capital Planning for DPH, DPH programs currently located at 30 Van Ness Avenue have been working

¹ The Board also authorized the sale of two other City-owned buildings at 1660 Mission Street and 1680 Mission Street, for which the sales proceeds were used as sources of funds for the development of 49 South Van Ness Avenue.

together for ten years, and their co-location facilitates collaboration and creates synergy across areas.

DETAILS OF PROPOSED LEGISLATION

The proposed resolution would approve a lease agreement between the City, as tenant, and 333 Valencia Owner LLC, as landlord, for the DPH program staff occupying 30 Van Ness to relocate to 333 Valencia Street for a term of 15 years, commencing in February 2021, with the option to extend for ten years. According to the proposed lease agreement, initial annual base rent is \$2,209,239 (\$49.95 per square foot) and increases three percent annually thereafter. DPH will pay for 79.41 percent of operating costs and real estate taxes, along with electricity. Key terms of the proposed lease are show in Table 1 below.

The agreement also includes approximately \$6.5 million in tenant improvement costs to reconfigure and complete interior construction at the 333 Valencia Street space. According to Mr. Penick and Ms. Jung, the interior of the building is new and requires build out, and interior construction is planned to configure the space to best meet the needs of the DPH programs that will be located in the office (i.e. creating conference room and training space needed by PHEPR and EMS but shared across all programs) and also includes open workspace that better allows for social distancing.

Table 1: Key Terms of Proposed Lease

	Terms Specified in Proposed Lease
Square Feet	44,229
Term	15 Years, from approximately February 2021 through 2035 (with an optional 10-year extension)
Annual Base Rent	\$2,209,239 (\$49.95 per square foot)
Rent Increases	3 percent annually
Tenant Improvement Costs	<ul style="list-style-type: none"> Total Tenant Improvement costs budgeted at \$9.1 million No more than \$6.5 million paid by the City \$2.6 million paid by the landlord
Utilities and Janitorial Services	<ul style="list-style-type: none"> City will contract and pay for any electricity and any other utility services necessary. Building owner will provide heating, ventilation and air conditioning, along with Building elevators and water services.
Operating Costs and Real Estate Taxes	79.42 percent based upon square footage of the premises divided by the square footage of the building

Source: Draft Lease Agreement

The space at 333 Valencia Street is similar to the current size of the space at 30 Van Ness that these programs occupy. According to Mr. Penick, the plan is for DPH to move out of 30 Van Ness at the end of August, temporarily relocate some staff at existing office space while others work remotely. Targeted move-in to the space at 333 Valencia Street is for February 2021.

Appraisal

Administrative Code Section 23.27 requires the Director of Real Estate to obtain a third party appraisal of the fair market value of leases in which the City is tenant if the base rent is greater than \$45 per square foot. An appraisal conducted by Mateo Advisors for the Real Estate Division as of May 2020 determined that the rent under the proposed lease, equal \$49.95 per square foot plus the City's tenant improvement costs, was at or below the fair market rent.

Purchase Option

The proposed lease provides an option for the City to purchase 333 Valencia Street from the lease commencement date in approximately February 2021 to October 2021, a nine-month period. The purchase price would be \$56,000,000, plus the landlord's costs for tenant improvements, less rent paid by the City.

FISCAL IMPACT

Under the proposed lease agreement, DPH would pay \$2,182,116 (\$49.95 per square foot) in initial base rent with a three percent annual increase. The first year's rent will include six months' rent abatement. DPH will pay 79.42 percent of operating costs. The operating costs include real estate taxes, insurance and shared utilities. The Landlord will pay for janitorial and security services but these are pass through costs billed to DPH. DPH will arrange and pay for electricity directly. Operating costs are projected to increase by 3 percent annually according to Mr. Penick. Table 2 below summarizes the costs associated with the lease agreement in year one and years 2 through 15. Year one costs, including the City's share of the tenant improvement costs, are projected to be \$8,68,639 and the total costs of leasing 333 Valencia for 15 years are projected to be \$67,026,397, including tenant improvement costs.

Table 2: Projected Expenditures over Lease Term of 15 Years

	Year 1*	Years 2-15	Total Costs over 15 Years
Rent per Square Foot	\$49.95	\$62.79 (average)	\$61.93 (average)
Base Rent*	\$1,104,619	\$38,880,199	\$78,865,017
Operating Expenses	530,748	9,340,588	9,871,336
Utilities	331,718	5,837,868	12,007,453
Custodial & Security	243,260	4,281,103	4,524,362
Tenant Improvement Costs	6,476,295	N/A	6,476,295
Total Cost	\$8,686,639	\$58,339,758	\$67,026,397

*Year 1 includes 6-month free rent

Source: Real Estate Division

Table 3 details the budget for the tenant improvement costs. These costs will be shared by the DPH and the building, which has agreed to pay \$60 per square foot of these improvement costs. Total tenant improvement costs are anticipated to be \$9,130,035 with the building owner paying \$2,653,740, and DPH paying the remainder, \$6,476,295, using General Fund sources

Table 3: Year 1 Tenant Improvement Costs**Contractor Portion of Tenant Improvements**

Construction and Office Build-Out*	\$6,213,127
Bonds, Insurance, Taxes	\$696,798
Contingency	
Overhead and Fees	
Subtotal	\$6,909,925

Building Management Portion of Tenant Improvements

Communications (AV, Data Cabling) and Security Improvements	\$962,331
Tenant Contingency	\$197,771
Indirect Costs**	\$695,345
Project Management Fee	\$364,663
Subtotal	\$2,220,110
Total Costs	\$9,130,035

Share of Total Cost

Building Owner, Tenant Improvement Allowance (\$60 per square foot)	\$2,653,740
City Contribution (General Fund) (\$146.43 square foot)	\$6,476,295
Total	\$9,130,035

*Construction and Office Build-Out includes constructing offices and conference space, flooring, finishing, electrical, HVAC, etc.

**Indirect Costs include soft costs of architect, engineers, city construction manager, and consultants.

Source: Real Estate Division

According to Ms. Jenny Louie, DPH Budget Director, the sources of funding for the lease will be distributed across the DPH programs occupying the building, and includes a mix of grant revenue, General Fund, and fees in case of Emergency Medical Services. Table 4 breaks down the DPH programs, the percent of the lease each anticipates covering and the source of funds.

Table 4. Sources of Funding for 333 Valencia Lease, excluding tenant improvement costs

Program	Share of Lease	Dollar Amount over 15 Years	Source
Maternal, Child and Adolescent Health	62%	\$37,541,063	Grant
Primary Care	18%	\$10,899,018	General Fund and Medical
Emergency Medical Services	9%	\$5,449,509	Fees
Public Health Emergency Preparedness and Response	7%	\$4,238,507	Grant
Population Health Admin	4%	\$2,422,004	General Fund and Grant Overhead
Total	100%	\$60,550,102	

Source: DPH

RECOMMENDATION

Approve the proposed resolution.