CITY AND COUNTY OF SAN FRANCISCO
BOARD OF SUPERVISORS
BUDGET AND LEGISLATIVE ANALYST
1390 Market Street, Suite 1150, San Francisco, CA 94102 (415) 552-9292
FAX (415) 252-0461

October 20, 2017

TO: Budget and Finance Committee

FROM: Budget and Legislative Analyst

SUBJECT: October 26, 2017 Budget and Finance Committee Meeting

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EXECUTIVE SUMMARY

Legislative Objectives

- The proposed resolution would (1) approve a Development and Disposition Agreement (DDA) between the Port and FC Pier 70, LLC (FC) for development of the Pier 70 Waterfront Site; (2) adopt findings under the California Environmental Quality Act (CEQA) and the Mitigation Monitoring and Reporting Program (MMRP); (3) adopt findings of consistency with the General Plan and the eight priority polices of Planning Code Section 101.1(b); and (4) adopt public trust consistency findings.

Key Points

- The Waterfront Site Project is 28 acres within the 69-acre proposed Pier 70 Special Use District. The Project is a mixed use residential commercial project, consisting of office space, retail and restaurant space, art and community space, market rate condominiums and rental units, and affordable housing. The DDA's Affordable Housing Plan requires at least 30 percent of residential development to be below market rate.
- In addition to the 28-acre Waterfront Site on Pier 70, two adjacent sites – Parcel K and the Hoedown Yard, located at 20th Street and Illinois Street – are being rezoned to the Pier 70 Special Use District.
- Under the proposed DDA, FC is responsible to obtain project entitlements, and construct horizontal infrastructure and other public facilities over three phases, funded by project-generated revenues. Private developers will construct commercial and residential buildings (vertical development). FC has the option to enter into ground leases and vertical DDAs with the Port for construction of commercial and residential buildings.

Fiscal Impact

- Estimated costs to construct public infrastructure and facilities over the term of the project are $672.3 million (in 2017 dollars). These costs are for project entitlements, and construction of horizontal infrastructure (such as streets, sewers, and water lines), arts and community space, affordable housing, other Pier 70 and seawall improvements and shoreline protection, and transportation projects. This does not include future costs for potential projects, such as the second phase of Crane Cove Park improvements, shipyard improvements, or additional rehabilitation of historic buildings.
- Estimated project-generated funding sources of $672.3 million (in 2017 dollars) include proceeds from land sales and prepaid ground leases; tax increment and bonds generated by Port Infrastructure Financing District (IFD) subproject areas and an Infrastructure and Revitalization Financing District; special taxes levied on Community Facilities District (CFD) and Development Impact Fees.

Fiscal Impact (continued)

- Estimated project-generated revenues to develop affordable housing are $99,178,147, or $303,297 per unit for 327 affordable housing units. Based on an estimated cost of $577,105 to construct an affordable housing unit (not including land costs), an additional $273,808 in funding per affordable housing unit will be needed, or $89,535,372 for 327 affordable housing units. Additional funding sources consist of both City gap funding and non-City sources, including state and federal tax credits allocated to low income housing, other state grants and loans, affordable housing developer equity, and other sources.

Policy Consideration

- The proposed DDA between FC and the Port provides a complex financing scheme to develop public projects. Funding for public projects comes from project-generated revenues. The developer, FC, invested $33.4 million in its own equity between 2011 and 2017 for entitlement costs, and will invest additional equity for horizontal infrastructure development subject to reimbursement from project-generated revenues. FC receives a return on its equity investment, which continues to accrue on the unreimbursed balance. Delays in project-generated revenues, such as delays in establishing CFDs and assessing special taxes, will delay reimbursements to FC, increase the return on investment for outstanding equity, and potentially reduce funding for other uses.
- Special tax revenues from CFDs and property tax increment from the IFD and IRFD could be less than estimated if the number of condominium units or the square footage for leased and commercial units is less than estimated. Also, IFD and IRFD bonds are a new debt instrument, and whether investors will be interested in purchasing these bonds is not known.

Recommendations

- Amend the proposed resolution to request the Port Executive Director to report to the Board of Supervisors annually in May of each year on the status of the project and project financing.
- Approval of the proposed resolution, as amended, is a policy matter for the Board of Supervisors.

MANDATE STATEMENT

City Charter Section 9.118(b) states that any agreement entered into by a department, board or commission that (1) has a term of more than ten years, (2) requires expenditures of $10 million or more, or (3) requires a modification of more than $500,000 is subject to Board of Supervisors approval.

BACKGROUND

Pier 70 is an approximately 69-acre site on the Port's Central and Southern Waterfront, bounded by Mariposa, Illinois, and 22nd Streets. In 2014, Pier 70 was listed as the Union Iron Works Historic District on the National Register of Historic Places. Pier 70 includes the Ship Repair Facility[1], the Historic Core[2], Crane Cove Park[3], Irish Hill[4], and the Waterfront Site for mixed use development.

The Port selected Forest City Development California, Inc. (Forest City) in 2011 to develop the 28-acre Waterfront Site within Pier 70, and entered into an Exclusive Negotiating Agreement for the development. The development consists of commercial and office; production, distribution and repair; retail, and arts[5]; and residential uses. In 2013, the Board of Supervisors found the proposed development of the Waterfront Site by Forest City to be fiscally feasible and endorsed the proposed terms of the development (File 13-0495).

Development of the Waterfront Site and two adjacent parcels – the Port's Parcel K at Illinois & 20th Street, and PG&E-owned Hoedown Yard at Illinois & 22nd Street – will be subject to limitations imposed by legislation pending before the Board of Supervisors: (1) the Pier 70 Special Use District; (2) the Pier 70 Trust Exchange; and (3) the Pier 70 Development Agreement between Forest City and the City, acting through the Planning Department.

DETAILS OF PROPOSED LEGISLATION

The proposed resolution would (1) approve a Development and Disposition Agreement (DDA) between the Port and FC Pier 70, LLC (FC) [6], for development of the Pier 70 Waterfront Site; (2) adopt findings under the California Environmental Quality Act (CEQA) and the Mitigation

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[1] The Port issued a Request for Proposals in July 2017 to select a new operator for the ship repair facility.

[2] The Historic Core of the Union Iron Works Historic District consists of the Bethlehem Steel Main Office Building and Powerhouse, the Union Iron Works Administration building, and the Union Iron Works Machine Shop and Foundry. The Board of Supervisors approved a 66 year lease with Orton Development, Inc., in 2014 to rehabilitate the five buildings. Rehabilitation of these historic buildings (except for the Powerhouse) is anticipated to be completed and the buildings ready for occupancy between fall 2017 and late 2018.

[3] Crane Cove Park is a 9-acre waterfront park; construction of phase 1 of the park, which is partially funded by 2008 Clean and Safe Neighborhood General Obligation Bonds, is expected to be completed in March 2018.

[4] Irish Hill Park is a 1.5 acre site adjacent to Illinois Street planned for open space. Irish Hill is a contributing resource to the Historic District.

[5] PDR, retail, and arts include a combination of small scale local production, arts and cultural uses, small business incubator uses, and other publicly-accessible uses to be located primarily in the existing historic structures.

[6] FC Pier 70, LLC was formed by Forest City in 2014.

Monitoring and Reporting Program (MMRP) and imposes the MMRP requirements as a condition to approve this action; (3) adopt findings of consistency with the General Plan and the eight priority polices of Planning Code Section 101.1(b); and (4) adopt public trust consistency findings.

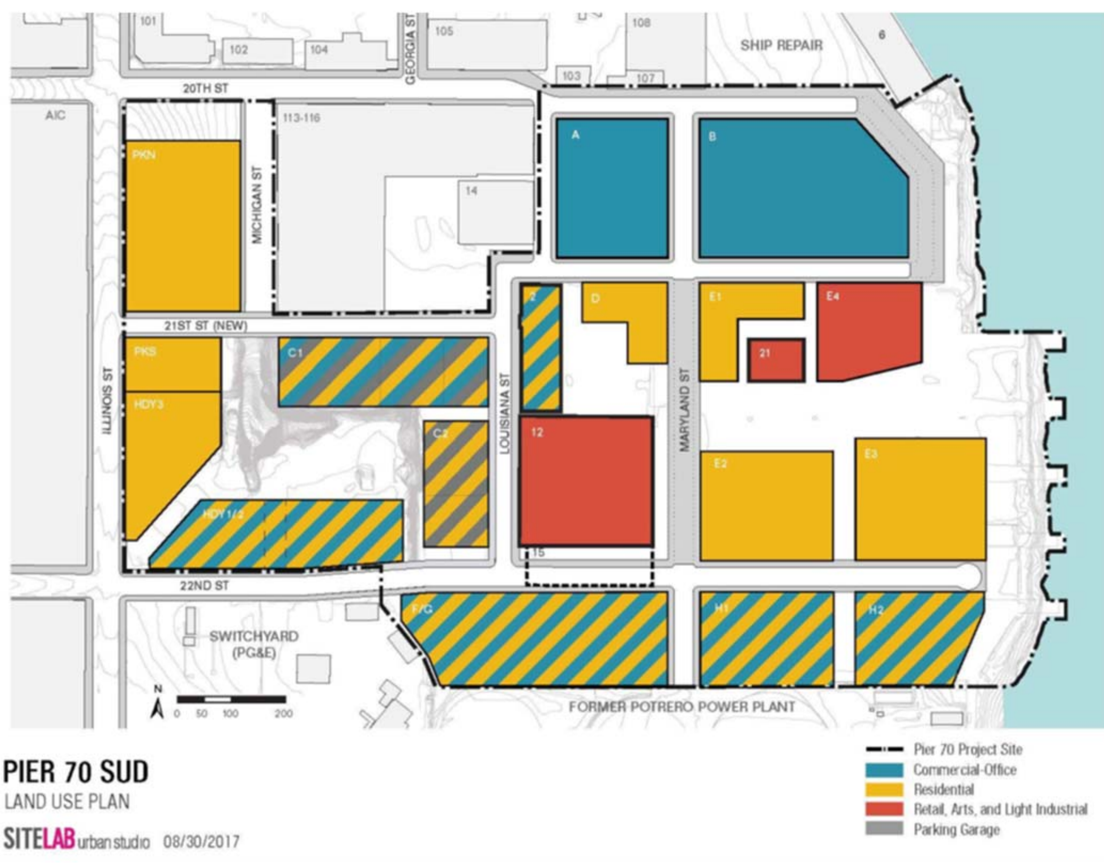
The proposed resolution authorizes the Port Executive Director to execute the master lease between FC and the Port, and the ground leases and vertical DDAs with vertical developers without further Board of Supervisors approval if these leases and agreements conform to the subject DDA between FC and the Port. The proposed resolution also authorizes the Port Executive Director to enter into amendments to the DDA between FC and the Port without further Board of Supervisors approval if the amendments do not materially decrease the benefits or increase the obligations to the Port.

The proposed DDA between the Port and FC is for approximately 25 years, during which FC will plan, design, entitle, and construct street, utility, site grading, and other infrastructure improvements to the Waterfront Site. The proposed DDA sets the terms of the Waterfront Site Project, including project scope and financing.

Project Description

The Waterfront Site project is 28 acres within the Union Iron Works Historic District, bounded by Michigan Street on the west, the Bay on the east, 20th Street on the north, and 22nd Street and the former Potrero Power Plant on the south, as shown in Exhibit 1 below.

Exhibit 1: Proposed Waterfront Site Project



Proposition F

San Francisco voters approved Proposition F in November 2014 – the Union Iron Works Historic District Housing, Waterfront Parks, Jobs, and Preservation Initiative – which allowed for an increase in height limits on the Waterfront Site to up to 90 feet subject to environmental review and established City policy to encourage development with the following features:

- 1,000 to 2,000 new residential units, most of which would be rental units, and 30 percent would be below market rate and affordable to middle- and low-income households;
- Restoration and re-use of historic structures;
- Space for arts and cultural activities, nonprofits, small-scale manufacturing, retail, and neighborhood services;
- Preservation of the artist community presently located in the Noonan Building;
- Between 1 million and 2 million gross square feet (gsf) of new commercial and office space;
- Parking and transportation improvements; and
- Creation of new jobs.

Residential Development

The Waterfront Site development provides flexibility between development of commercial and residential uses on some of the parcels within the Site. The number of residential units on the Waterfront Site ranges from 1,100 to 2,150, depending on whether the development maximizes commercial or residential development on these parcels.

The DDA's Affordable Housing Plan requires at least 30 percent of residential development to be below market rate.

- Market rate rental properties must include 20 percent of the rental units as on-site below market rate units.
- Market rate condominium properties must pay affordable housing fees to be deposited into the City's Affordable Housing Trust Fund and used to construct affordable housing.
- Two Waterfront Site parcels and Parcel K South will be designated for affordable housing development. According to the DDA, at least 327 affordable housing units will be built on these three parcels.

Re-use of Historic Structures

The proposed DDA provides for FC to rehabilitate Building 12, which is a complex formerly used to make ship hull plates and is now leased by Forest City for community events, and Building 21, the Risdon Building. FC may elect to rehabilitate Historic Building 2, a six-story concrete warehouse constructed during World War II, as an option, which is discussed further below.

Art, Cultural, Nonprofit and Small-scale Manufacturing, Retail, and Neighborhood services

Parcel E4 (located between 21st Street and 22nd Street, and Maryland Street and the Bay, as noted in Exhibit 1 above) is set aside for retail, restaurant, arts/light-industrial, and public uses. Under the proposed DDA, FC is responsible for development of the Arts Building on Parcel E4. In addition, under the proposed DDA, FC is responsible for a minimum of 50,000 gross floor feet of space restricted to Production, Distribution, and Repair (PDR) uses.

Noonan Building

The Noonan Building on Pier 70 was built in 1941 and is currently used by the Noonan Building Artists for art, design, and other craft work. The proposed DDA provides for FC to provide replacement space for to the Noonan Building Artists. Replacement space may be made available in the Arts Building to be constructed on Parcel E4, or elsewhere on the Waterfront Site. Replacement space is required to be at permanently subsidized rents.

Transportation Program

The Pier 70 Mixed-Use District Project Environmental Impact Report (EIR) requires the implementation of a Transportation Demand Management (TDM) Plan, which is attached to the proposed DDA and is to be implemented by the Pier 70 Transportation Management Agency (TMA). The Transportation Program detailed in the TDM Plan begins when the Port or the City's Department of Building Inspection issues a temporary certificate of occupancy for the first building to be completed at the Waterfront Site.

In addition, vertical developers (as described below) will pay a transportation impact fee to the San Francisco Municipal Transportation Agency to pay for transportation improvements.

Office Development

New office development at Pier 70 will count against the City's annual limit on new office space as provided in the City's Planning Code. The DDA provides a process in which FC's timeframe for developing new office space is balanced against other large office developments in the City.

Preservation of Jobs

The DDA's Workforce Development Plan sets the employment and contracting requirements for construction and operation of the Waterfront Site project. Among other provisions, Forest City and the vertical developers will make contributions to City job training programs CityBuild and TechSF, and will be required to include First Source Hiring and, if applicable, TechSF hiring requirements in all leases and subleases.

The Workforce Development Plan also specifies that the City's prevailing wage requirements, a 30 percent local hiring requirement, as well as a 17 percent LBE utilization goal apply to Waterfront Site projects.

Other Project Sites

In addition to the 28-acre Waterfront Site on Pier 70, two adjacent sites – Parcel K and the Hoedown Yard, located at 20th Street and Illinois Street – are being rezoned to the Pier 70 Special Use District.

Parcel K, which is owned by the Port of San Francisco, is divided into two sections:

(1) Parcel K North is designated for market rate housing. Legislation to approve the sale by the Port to a private developer is pending before the Board of Supervisors (File 17-0893).

(2) Parcel K South is designated for affordable housing.

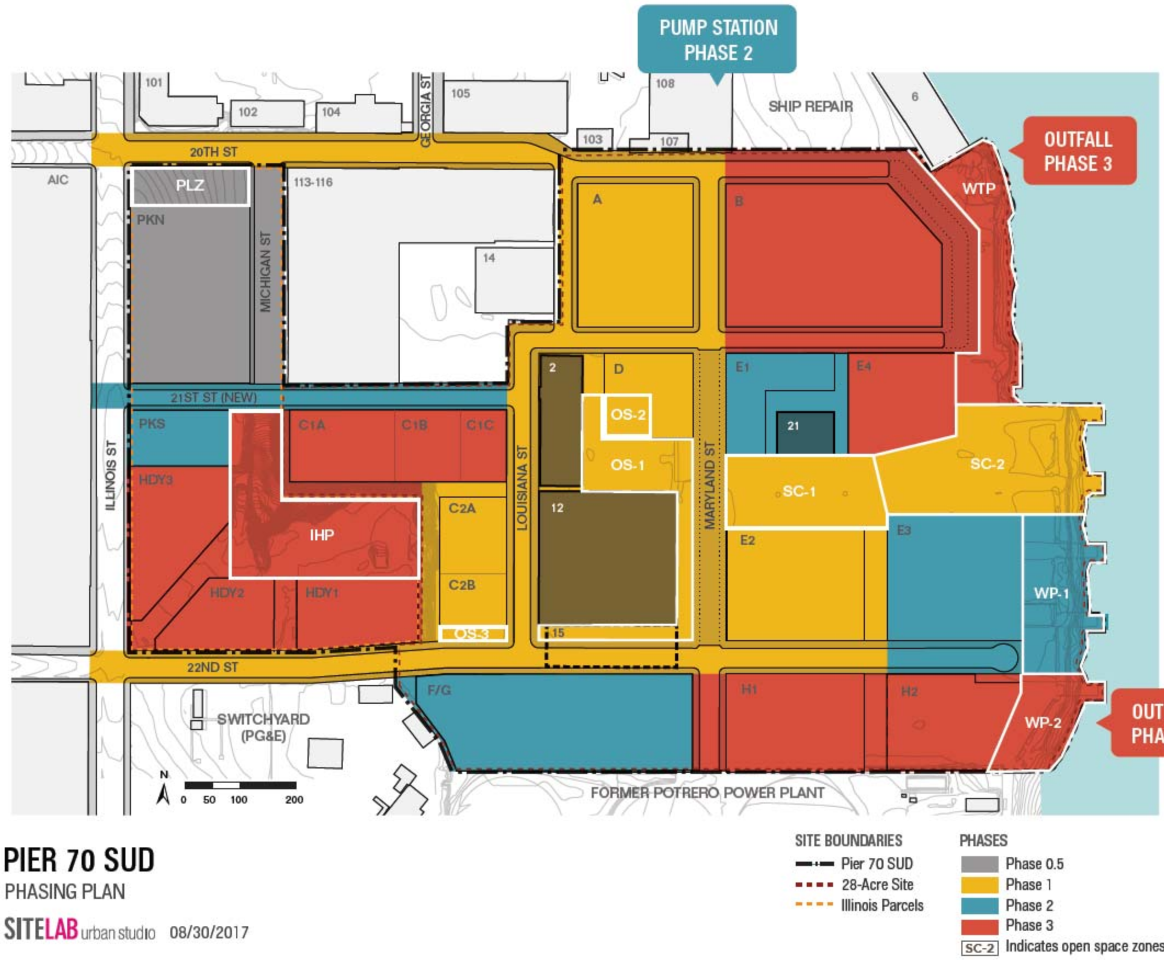
The Hoedown Yard is owned by PG&E. The Board of Supervisors approved an option agreement between the City and PG&E in 2014 (File 14-0750) in which the City could exercise the option for approximately $8,283,726, or sell the option through a competitive sale to a third party. The sale of the Hoedown Yard option to a third party is subject to future Board of Supervisors approval.

Project Approach

The Waterfront Site Project consists of (1) horizontal development, such as streets and utilities, and (2) vertical development, including office and residential buildings. Horizontal and vertical development is divided into three phases. FC is the master developer for the Waterfront Site Project, and is responsible for ensuring the horizontal development is coordinated with vertical development.

FC is obligated to complete construction of the horizontal improvements for all phases of the project. FC may transfer its development rights and obligations to another developer meeting net worth and experience requirements in Phase 1, subject to Port approval in its sole discretion, and in Phase 2 and subsequent phases, subject to Port approval in its reasonable discretion. Exhibit 2 below shows the phases of the Waterfront Site development.

Exhibit 2: Map of Waterfront Site Development Phases



Master Lease, Vertical DDAs, and Ground Leases

Forest City and the Port will initially enter into a master lease for most of the Waterfront Site parcels, with the exception of the Noonan Building, Building 21[7], the Affordable Self Storage lease area and the site of ongoing remediation by PG&E in part of the Affordable Self-Storage lease area along the southern edge of the project site.[8] When each of these leases terminates, the areas will then be added to the Master Lease premises.

Under the proposed DDA, FC is obligated to construct the horizontal improvements, detailed in the Infrastructure Plan (discussed below) during the first phase of the Waterfront Site Project. FC, through its vertical developer affiliates, has the option to enter into Vertical DDAs for certain development parcels (option parcels) except for parcels designated for affordable

[7] The development plan for the Waterfront Site calls for the relocation of the historic Building 21 to another location on the Waterfront Site.

[8] The lease between the Port and Affordable Self-Storage terminates in 2019, and allows prior to that for a 180-day notice to terminate. According to Brad Benson of the Port, the Port is negotiating an earlier termination of this lease to accommodate remediation efforts in this area.

housing, parking, the Arts Building, Historic Building 12 and 21, Parcel K North, or the Hoedown Yard.

As the Port conveys Waterfront Site parcels to FC or third party developers to construct residential, office and other buildings (vertical developers), these parcels are released from the master lease between FC and the Port. The Port will enter into a Vertical DDA with each vertical developer to set the terms of vertical development and horizontal (or infrastructure) development adjacent to or serving their parcel. After an option period, the Vertical DDAs will result in either (1) a 99 year Parcel Lease (ground lease) between the Port and a vertical developer, or (2) for condominium parcels, a sale by quitclaim, subject to certain covenants.

Infrastructure Plan

An Interagency Cooperation Agreement, defining the obligations of various City agencies to the Waterfront Site Project, is pending before the Board of Supervisors (File 17-0988). The Interagency Cooperation Agreement describes how the City agencies will coordinate their review and approvals in relation to the Pier 70 Infrastructure Plan, which details the infrastructure (horizontal improvements) requirements of the 28-acre Waterfront Site as well as adjacent sites.

The Pier 70 Infrastructure Plan requires Forest City to design and construct certain infrastructure improvements within the plan area through the City’s Subdivision Code. Forest City’s obligation to design and construct horizontal improvements is limited to the 28-acre Waterfront Site and the portions of 20th Street, 21st Street, and 22nd Street. Vertical developers of Parcel K North and the Hoedown Yard will develop adjacent infrastructure, including the new Michigan Street, the 20th & Illinois Street Plaza and Irish Hill Park.

Horizontal improvements to be constructed by Forest City include: demolition and abatement of existing and unusable structures, demolition of substandard utility infrastructure, grading of site to address sea level rise, improvements to address seismic stability, new street and transportation systems, low pressure water system, non-potable water system, sewer and storm water infrastructures, and Auxiliary Water Supply System (AWSS) infrastructure.

In addition, Forest City will construct associated offsite improvements to serve infrastructure at the Waterfront Site, including: AWSS improvements, sewer pump station and sewer main work, and traffic signals.

Project Approvals

The following legislation related to the Waterfront Site Project requires Board of Supervisors approval:

Exhibit 3: Pending Legislation to Approve Actions Related to the Waterfront Site Project

File Number	Action
File No. 170930	General Plan Consistency Findings and General Plan Amendment
File No. 170864	Planning Code and Zoning Map Amendments
File No. 170863	Development Agreement
File No. 170986 (Subject of this report)	Disposition and Development Agreement • Financing Plan • Form of Vertical DDA and Parcel Lease • Form of Master Lease • Phasing Plan • Schedule of Performance • Infrastructure Plan • Affordable Housing Plan • Workforce Development Plan • Transportation Program (including TDM Plan) • Arts Program • Map of Potential Childcare Locations
File No. 170983	Port Public Offering of Parcel K North Ordinance
File No. 170987	Pier 70 Trust Exchange Agreement Resolution
File No. 170988	MOU re Interagency Cooperation Resolution
Not Introduced	MOU re Tax Allocation Resolution
	Sub-Project Area G-2 of Infrastructure Financing District No. 2 (28-Acre Site and Parcel K North)
File No. 170879	Resolution of Intention - Establish Sub-Project Areas G-2, G-3, and G-4
File No. 170878	Resolution of Intention - Issue Bonds for Sub-Project Areas G-2, G-3, and G-4
Not Introduced	Hearing to Consider Legislation to Establish Sub-Project Areas G 2, G-3, and G-4
Not Introduced	Ordinance Establishing Sub-Project Areas G-2, G-3, and G-4
Not Introduced	Resolution Authorizing Issuance of Bonds for Sub-Project Areas G-2, G-3, and G-4
	Infrastructure and Revitalization Financing District No. 2 (Hoedown Yard)
File No. 170880	Resolution of Intention -Establish IRFD
File No. 170882	Resolution of Intention -Issue Bonds for IRFD
File No. 170881	Resolution Authorizing Preparation of Infrastructure Financing Plan
Not Introduced	Hearing to Consider Legislation to Establish IRFD
Not Introduced	Resolution Approving IRFD as a Taxing Entity
Not Introduced	Resolution Proposing IRFD and Adopting IFP
Not Introduced	Resolution Calling for a Special Election
Not Introduced	Resolution Declaring Results of Special Election
Not Introduced	Ordinance Establishing IRFD and Adopting IFP
Not Introduced	Resolution Authorizing Issuance of Bonds

Planning Approval

The Planning Commission at its August 24, 2017 meeting took the following actions regarding the Waterfront Site Project (a) certified the Final Environmental Impact Report, (b) adopted CEQA findings and the MMRP, (c) recommended approval of Planning Code text amendments and amendments to the Zoning Maps to establish the Pier 70 Special Use District; (d) recommended approval of the Development Agreement; and (e) approved the Design for Development.

Project Overview

This report focuses on sources and uses of project funds to implement the Waterfront Site Project. In addition to major funding sources discussed below, the DDA Financing Plan provides for (a) special taxes levied on certain parcels to fund project and shoreline reserves, (b) special taxes on certain parcels to augment funding for the Arts Building and community space, and (c) community facilities district assessments for ongoing maintenance and services. Longer-term financial benefits to the Port include (a) participation in project revenues once project costs have been funded (55 percent to Port and 45 percent to FC), and (b) receipt of proceeds from the sale or lease of Parcel C1A for office use or market rate condominiums.

According to the September 22, 2017 staff report to the Port Commission, the ground leases for Waterfront Site parcels will provide for the Port to receive (a) 1.5 percent of net proceeds from the refinancing of ground leases and associated improvements; (b) 1.5 percent transfer fee payment for all transfers of fee parcels (including residential condominiums) after three years; (c) 1.5 percent of modified gross revenues on all buildings beginning in year 30; and (d) 2.5 percent of modified gross revenues on all buildings beginning in year 60.

FISCAL IMPACT

The Waterfront Site Project consists of public and private development costs. Public development costs consist of horizontal infrastructure (utilities, streets, site grading, other), art and historic buildings, parks and open space, transportation, and affordable housing.

Sources of funds to pay for public infrastructure and facility costs include sale and lease of public land, assessment of affordable housing and transportation fees on private development, incremental property tax revenues generated by new development and proceeds from tax increment bonds in the proposed Port Infrastructure Financing District (IFD) subproject and Hoedown Yard Infrastructure and Revitalization Financing District (IRFD), and special property assessments through the formation of three proposed community facilities districts (CFD).

Estimated sources and uses of public funds for horizontal development and other Waterfront Site projects are shown in Exhibit 4 below.

Exhibit 4: Estimated Sources and Uses of Funds (2017 Dollars)

	Land Proceeds	IFD Property Tax Increment and Bonds	CFD Special Taxes and Bonds	IRFD Property Tax Increment and Bonds	Development Impact Fees	TOTAL
Sources	$48,779,906	$355,122,717	$124,490,998	$15,682,353	$128,219,146	$672,295,120
Uses						
Entitlements		$33,440,730				$33,440,730
Horizontal Infrastructure	4,400,000	248,542,621				252,942,621
Developer Return on Investment	44,379,906		28,572,526			72,952,432
Affordable Housing				15,682,353	83,495,794	99,178,147
Arts Building			20,000,000			20,000,000
Historic Buildings		9,479,914				9,479,914
Other Pier 70 Improvements		23,900,000	10,000,000			33,900,000
Hunters Point Power Plan Shoreline Property Purchase			5,896,899			5,896,899
Seawall and Shoreline Protection		39,759,452	60,021,573			99,781,025
Transportation Projects					44,723,352	44,723,352
Total Uses	$48,779,906	$355,122,717	$124,490,998	$15,682,353	$128,219,146	$672,295,120

Source: Budget and Legislative Analyst's estimates based on information provided by the Port

Horizontal Infrastructure (Phase 1 Timeframe: 2018 to 2021)

Under the proposed DDA, FC is obligated to obtain entitlements and complete construction of horizontal infrastructure development. Between 2011 and 2017, FC has incurred costs of $33,440,730 for entitlements. Estimated horizontal infrastructure costs are $252,942,621, as shown in Exhibit 5 below.

Exhibit 5: Estimated Horizontal Infrastructure Costs (2017 Dollars)

Cost Category	Amount
Demolition and Abatement	$9,376,239
Auxiliary Water Supply System	3,584,914
Low Pressure Water	5,354,594
Reclaimed Water	3,434,478
Combined Sanitary Sewer	19,299,758
Joint Trench	6,137,741
Earthwork, Soil Disposal, and Retaining Walls	16,312,684
Roadways	13,255,612
Streetscape	7,225,630
Parks & Open Space	49,260,755
City Infrastructure Review/Acceptance Costs	11,210,000
Testing, Inspection and Site Offices	3,209,873
Subtotal Construction	$147,662,277
Construction Contingency (15% of Construction Costs)	$21,889,829
Design Contingency (5% of Construction Costs)	7,296,610
Subtotal Construction and Contingencies	$176,848,715
Architecture and Engineering	$15,699,455
Insurance	2,295,788
Bonding Costs	3,434,256
Legal	2,097,775
Financing (not reimbursed by CFD/IFD)	1,100,000
Construction Management Fee	13,700,948
Soft Cost Contingency	4,748,227
Subtotal Soft Costs (24.4% of Construction Costs)	$43,076,449
Miscellaneous (appraisals, etc.)	$7,245,000
Community Outreach/Marketing	4,400,000
Development Management Fee	11,417,457
Noonan Relocation	1,000,000
Contributions to SFMTA Buses or AWSS	7,845,000
Workforce	1,110,000
Total Project	**$252,942,621**

Source: Port

A third party review of the $252,942,621 budget by Parsons-Lotus Water Joint Venture Partnership (Parsons) found the construction costs, soft costs and contingencies to be reasonable. The review did not assess the costs for community outreach and marketing, development management fee, relocation of Noonan tenants, contributions to SFMTA for buses and to the auxiliary water supply system, or workforce development.

The Parsons report recommended capping the combined construction management fee and development management fee at 15 percent of hard costs. Under the proposed budget in Exhibit 5 above, combined construction management fees and development management fees are $25,118,405, equal to 14 percent of construction costs of $176,848,715. Under the DDA, development management costs and construction management costs will be charged as actual costs, not to exceed 15 percent of hard costs, except that FC will have right to submit for reimbursement of actual costs in excess of this threshold and Port will provide reimbursement subject to the Port's confirmation of the charges as commercially reasonable.

Sources of Funds for Horizontal Infrastructure

FC financed the costs of entitlements of $33,440,730 between 2011 and 2017, and will finance the costs of horizontal infrastructure. The DDA's Financing Plan provides for property tax increment and bond proceeds from the Port IFD subproject areas to reimburse the costs of horizontal infrastructure but these funds are not available until development on the parcels within the Port IFD subproject areas is complete and assessed for tax purposes.

Developer Equity and Return on Investment

FC is eligible to receive an 18 percent return on investment, compounded quarterly on the balance of equity invested by FC. To date, FC has accrued $18,574,258 in return on investment. The Port estimates that FC's return on investment will be nearly $73,000,000 over the life of the project.

In order to limit costs to the project for the developer's return on investment, the Port plans to advance proceeds from land sales to the horizontal infrastructure to pay down FC's equity and return on investment. Port IFD subproject area property tax increment and bond proceeds, when available, will be used to reimburse the advance land sale proceeds.

State law limits the use IFD property tax increment to pay the developer's return on investment. Therefore, the Port plans to use land sale proceeds and CFD special tax proceeds, when available, to pay FC's return on investment.

Affordable Housing (Timeframe: 2020 to 2030)

The Affordable Housing Plan provides for 30 percent of housing developed on the Waterfront Site to be affordable. Three parcels on the Waterfront Site will be designated for 100 percent affordable housing, financed by developer impact fees, property tax increment generated by development within the Hoedown Yard IRFD, and other City sources. According to the DDA, 327 units of affordable housing will be built on these three parcels. Based on the August 31, 2017 Berkson Associates report to the Port Commission, the Waterfront Site will generate $83,495,794 in revenues allocated to affordable housing (2017 dollars), resulting in an estimated available construction funds of $303,297 per affordable housing unit, as shown in Exhibit 6 below.

Exhibit 6: Estimated Funds Available for Affordable Housing Construction (2017 Dollars)

Source of Funds	Amount
Affordable Housing Fees	$48,065,654
Jobs Housing Linkage Fees	35,430,140
Subtotal Development Impact Fees	83,495,794
IRFD Property Tax Increment	15,682,353
Total	$99,178,147
Number of Housing Units	327
Estimated Available Construction Funds per Unit	$303,297

Source: August 31, 2017 Berkson Associates report, September 22, 2017 Port staff report, Port information to Budget and Legislative Analyst's Office on October 11, 2017

Based on an estimated cost of $577,105 to construct an affordable housing unit (not including land costs)[9], an additional $273,808 in funding per affordable housing unit will be needed, or $89,535,372 for 327 affordable housing units. Additional funding sources consist of both City gap funding[10] and non-City sources, including state and federal tax credits allocated to low income housing, other state grants and loans, affordable housing developer equity, and other sources.

Arts Building and Historic Buildings (Timeframe: 2020 to 2026)

Parcel E4 on the Waterfront Site has been designated for arts, community and public space, and some retail and restaurant uses. The DDA allows FC to develop Parcel E4 in (a) two separate phases, with one building to relocate the Noonan tenants and the second building serve as the Arts Building, or (b) a single Arts Building to house both the Noonan tenants and other programs. Either FC, through an affiliate vertical developer, or an arts master tenant will enter into a vertical DDA and a ground lease with the Port for up to 66 years at $1 per year. The vertical developer or arts master tenant must obtain a minimum of $17,500,000 in cash and pledges to develop the Arts Building. The Port's share of funding is $20,000,000, for which CFD special taxes and bonds will be the source of funds.

The Waterfront Site Project consists of three historic buildings: 2, 12, and 21. Under the proposed DDA, FC has the option to develop Historic Building 2. If FC exercises the option, the DDA requires the developer to submit an application to the National Park Service to seek Historic Tax Credits.

The proposed DDA requires FC to rehabilitate Historic Buildings 12 and 21 through an affiliate vertical developer. The affiliate vertical developer will enter into a vertical DDA with the Port and a ground lease for 66 years at $1 per year, plus participation rent. The DDA assumes "feasibility gap" between the developer's costs to rehabilitate Historic Buildings 12 and 21, and

[9] The estimated construction cost per affordable housing unit is based on 20 affordable housing developments in San Francisco between approximately 2015 and 2017.

[10] According to the projections developed by Berkson Associated, development on Parcel K North and the Hoedown Yard could generate an additional $25,000,000 in development impact fees. These development impact fees will be allocated to the Mayor's Office of Housing and Community Development and deposited into the Affordable Housing Trust Fund.

the developer's revenues generated by the rehabilitated historic buildings; and sets out a formula to calculate the feasibility gap. Public funding to close the feasibility gap, as estimated by the Port, is approximately $9,479,914, which would be funded by special taxes generated by the buildings and Port IFD subproject area property tax increment and bond proceeds.

Other Pier 70 and Seawall/ Sea Level Rise Projects (Timeframe: 2025 to 2050)

Other projects included in the Waterfront Site Project include improvements to Irish Hill Park and Crane Cove Park, shipyard improvements, and Pier 70 interpretation and public realm improvements. The Port's current financing plan class for allocation of up to $10,000,000 in CFD special taxes and bond proceeds from the Hoedown Yard, as shown in Exhibit 4 above, and if needed Port IFD subproject area property tax increment, to build Irish Hill Park.

The Port proposes to allocate $60,021,573 in CFD special taxes and bonds to seawall repairs and projects to address sea level rise projects. IFD property tax increment and bonds may be used for seawall repairs and improvement and projects to address sea level rise. The Port proposes to allocate $39,759,452 in IFD property tax increment and bonds to seawall repairs and projects to address sea level rise, once all Pier 70 projects have been fully funded. Total allocation in CFD and IFD funds is $99,781,026, as shown in Exhibit 4 above.

The Port has negotiated to utilize a portion of the Port IFD subproject area property tax increment and bond proceeds, estimated at $23,900,000 to fund other Pier 70 projects outside of the Waterfront Site, including Irish Hill Park, as shown in Exhibit 4 above. Port staff has developed a list of other potential projects to be funded through Port IFD subproject area property tax increment and bond proceeds; these projects include Crane Cove Park Phase 2, shipyard improvements and other historic building rehabilitation projects. These projects are not included in the sources and uses of funds shown in Exhibit 4 above. According to Mr. Brad Benson of the Port, funding approval of these projects will be subject to future Board of Supervisors approval.

Transportation Improvements (Timeframe: 2019 to 2026)

The transportation plan for the Waterfront Site includes a shuttle service that would connect the site to regional transit hubs like the Transbay Terminal and the 16th Street/Mission Street BART station. The shuttle service would be funded by fees collected from tenants.

The proposed DDA provides for a transit development impact fee to be assessed on Waterfront Site projects, other than affordable housing and historic building projects. Estimated fees revenues are $44,723,352. San Francisco Municipal Transportation Agency (SFMTA) projects that may be funded include a 16th Street ferry landing, T-Third metro enhancements, and improvements to existing bus lines. The SFMTA is also planning for bicycle and pedestrian improvements.

POLICY CONSIDERATION

Project Risks to the City

The proposed DDA between FC and the Port provides a complex financing scheme to develop public projects. Revenues generated by the Waterfront Site Project are intended to cover most public project costs. FC invested its own equity for entitlements and will invest its own equity for horizontal infrastructure development, which will be reimbursed from available project-generated taxes. The DDA states that FC cannot compel the City to use General Fund or Harbor Fund monies to reimburse FC for its costs to develop the horizontal infrastructure or other FC obligations under the DDA**.**

Changes to the project's financing assumptions, especially in Phase I, could delay completion of the project and potentially reduce the amount of public funding for the horizontal infrastructure and future projects.

For example, the DDA Financing Plan includes a Proforma, which contains key revenue and expenditure assumptions for the Waterfront Site Project. According to the Financing Plan, the Proforma incorporates certain assumptions that informed the drafting of the Financing Plan, including that FC's entitlement costs would be reimbursed by CFD special tax revenues and an advance of proceeds from the sale of Parcel K North. The Proforma projects CFD revenues beginning in 2018 to repay FC's entitlement costs. According to the Port, the only way to issue debt based on CFD revenues this early in the Project will be to form the CFDs in 2018 and seek Board of Supervisors authorization to sell a CFD bond repaid by a special tax levy on undeveloped property in the Waterfront Site. The Budget and Legislative Analyst considers it unlikely that the CFDs will be formed and that debt can be issued in 2018.

Also, FC has the option to enter into ground leases for the parcels slated for vertical development; according to the proposed DDA, FC must close escrow on the ground lease for the first parcel to be optioned in Phase I and Phase II within two years of the beginning of horizontal infrastructure construction. FC must close escrow on the other ground leases within two years of completion of horizontal infrastructure construction for each development phase. If FC does not exercise the option within that timeframe, the Port may offer the parcels through a public offering. Rent on all ground leases is prepaid until the project achieves certain financial milestones; this prepaid rent is a source of project funds. The Financing Plan, based on the Proforma, assumes that FC will exercise its option for all development parcels included in Phase I in 2019 and 2020, thus generating prepaid rent within the first three years of the project. However, if FC does not exercise its option for these parcels, offering the parcels through a public offering extends the time in which prepaid rent will be received from other vertical developers by up to six months.

Because FC's return on investment continues to accrue, delays in funding to reimburse FC for its equity investment and return on investment will increase the developer return on project costs, potentially reducing funding for other uses.

Risks of Insufficient CFD, IFD, and IFRD Revenues

The Port estimated that the Condominium CFD special tax rates would equal approximately $6,000 per unit per year, which according to estimates is the maximum rate to avoid discounting the purchase price. If fewer condominium units are developed than are assumed, then the Condominium CFD would generate less revenue than projected[11]. Likewise, the Leased Property and the Hoedown Yard CFD special tax rates are tied to square footage, so if less development occurs than anticipated, revenues would fall short.

IFD and IRFD tax increment will depend on the assessed value of properties on the tax roll, which could be lower than projected if (1) fewer units than assumed are developed, and/or (2) property values are lower than assumed due to market conditions when certificates of occupancy are issued.

Potential Lack of Financial Investors for IFD and IRFD Bonds

IFD and IRFD bonds are a new debt instrument. Whether investors will be interested in purchasing these bonds is not known, especially if the credit markets are tight at the time that the City is ready to issue the bonds. The Infrastructure Financing Plan assumes that IFD and IRFD bonds will have a 30-year term at an interest rate of 7 percent, with a debt service coverage ratio of 130 percent of annual debt service, and issuance costs/reserves equal to 13 percent of the bond proceeds. IFD and IRFD bond sales will occur when developed properties are added to the tax roll, which could take until 2027 or 2028. Market conditions that far in the future are uncertain, and investors may not be willing to purchase the bonds or only willing to purchase the bonds at high interest rates, thus reducing bond proceeds to be used for projects.

Summary

The Waterfront Site Project is a complex project, subject to financing risks, as noted above, and other development risks. The Project plan under the proposed DDA generally conforms to the 2013 Term Sheet endorsed by the Board of Supervisors and the conditions set by Proposition F. For the Waterfront Site Project to be implemented, the Board of Supervisors needs to authorize pending legislation, outlined in Exhibit 3 above, as well as future legislation for the exercise by the City of the option to purchase the Hoedown Yard. Because this legislation has not yet been considered by the Board of Supervisors, approval of the proposed resolution is a policy matter for the Board of Supervisors.

RECOMMENDATIONS

1. Amend the proposed resolution to request the Port Executive Director to report to the Board of Supervisors annually in May of each year on the status of the project and project financing.
2. Approval of the proposed resolution, as amended, is a policy matter for the Board of Supervisors.

[11] According to the Port, the reduction in the number of condominiums may be offset by an increase in rental units, thus increasing the CFD special tax revenues from CFDs on leased property.

Implementation of Board of Supervisors Recommended Changes to 2013 Term Sheet

When the Board of Supervisors endorsed the Waterfront Site Project Term Sheet in 2013, the Board of Supervisors made the following recommendations. Below is a summary of how these recommendations have been incorporated into the proposed DDA.

Recommendation 1: Other than the 28-Acre Site, only the Port-owned 20th/Illinois Parcel and the Hoedown Yard will be eligible for inclusion in an expanded 28-Acre Site.

- The Pier 70 Special Use District incorporates the 28-acre Waterfront Site, the 20th and Illinois Street site (Parcel K) and the Hoedown Yard.

Recommendation 2: Transfer fees will be payable to the Port from the proceeds of the second and each subsequent transfer of condominium parcels in the amount of 1.5 percent of the gross sales price, net of costs of sale only.

- Section 7.9 (b) (3) of the proposed DDA requires a restrictive covenant to be placed on market rate condominium units developed on Parcel K North, requiring that each condominium owner will pay a transfer fee to the Port equal to 1.5 percent of the net purchase price.
- While the City has an option to purchase the Hoedown Yard, the site is not owned by the City. According to the proposed DDA, if the Hoedown Yard option is offered through a public offering for development of market rate condominiums, then Section 7.9(b) (3) will apply to the Hoedown Yard, but transfer fee proceeds will accrue to the Mayor's Office of Housing and Community Development to fund affordable housing, in perpetuity.
- According to the September 22, 2017 staff report to the Port Commission, the ground leases for the development parcels provide for the Port to participate in 1.5 percent of net sale proceeds for sales, recapitalization and refinancing of leases.

Recommendation 3: Developer Return will be calculated only on outstanding Developer Capital.

- Section 2.3(a) (iii) of the Financing Plan states that Developer Return will accrue on the unpaid balance of the entitlement cost, and Section 8.5 of the Financing Plan states that Developer Return will accrue on any unpaid balance (of horizontal development costs) until the Developer Balance is satisfied by all available Project Payment Sources.

Recommendation 4: Project-generated Public Financing Sources will be the sole source of public funds to reimburse Developer's historic rehabilitation costs of Building 12 and Building 21, and only to extent necessary for Developer to achieve a 10% profit.

- The Financing Plan and Appendix (containing definitions) expand on the Term Sheet provision related to public subsidies for Historic Buildings 12 and 21.
- "Historic Building Costs" means, calculated separately for Historic Building 12 and Historic Building 21, (i) all reasonable and customary costs of rehabilitation (which, for Building 12 shall include build-out to a warm shell for Floors 1 and 3 and build-out to a turnkey condition for Floor 2), and (ii) 10% developer profit on rehabilitation costs.
- Section 7.14 of the proposed DDA requires the developer to rehabilitate Historic Buildings 12 and 21. Section 12 of the Financing Plan provides a formula to calculate the

"feasibility gap" between the developer's costs to rehabilitate Historic Buildings 12 and 21, based on the developer's actual costs, contributions to the costs from Historic Tax Credit investors, net operating income (based on a 7% capitalization rate), and participation rent to the Port.

Recommendation 5: Project-generated Public Financing Sources will be the sole source of public funds to reimburse the costs to construct a new building on Parcel E4, contingent on the building containing retail, restaurant, and arts/light-industrial or public uses.

- The proposed DDA requires the vertical developer or master arts tenant to contribute $17,500,000 to the Arts Building on Parcel E4. Public financing sources include special taxes levied on certain parcels to augment funding for the Arts Building and community space and Port IFD subproject area property tax increment and bond proceeds.

Recommendation 6: If the Board of Supervisors approves a Pier 70 financing plan to provide General Fund financing based on projected revenues from payroll (business) and hotel taxes to the Port under Charter section B7.310, authorized uses of the General Fund financing will be limited to improvements to Pier 70 areas outside of the 28-Acre Site except to the extent authorized by the approved plan.

- The Financing Plan does not provide for General Fund financing based on hotel or business taxes.

Item 6 File 17-1109	Departments: Real Estate Division Police Department District Attorney

EXECUTIVE SUMMARY

Legislative Objectives

- The proposed resolution would authorize a new lease between the City as tenant and Lexington Lion San Francisco LP, a Delaware limited partnership, (Lexington) as landlord to relocate the District Attorney's Office and the Police Investigations Unit from the Hall of Justice to 350 Rhode Island Street. The new location is for up to 125,122 square feet consisting of a portion of the first floor and the entire second, third and fourth floors at 350 Rhode Island Street. The lease term is for 15 years from July 1, 2018 through June 30, 2033, with one five-year option to renew for a total 20 year term through 2038. The District Attorney's Office and Police Investigations Unit would occupy 350 Rhode Island Street in phases, as the leases with existing tenants at that location expire. The initial base rent is $51 per square foot per year; first year base rent is $4,319,445 for approximately 84,695 square feet.

Key Points

- 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, including 350 Rhode Island Street to provide office space to the District Attorney's Office and Police Investigations.

Fiscal Impact

- Estimated first year rent, operating expenses, and parking expenses are $5.5 million, increasing to $8.9 million in the third year of the lease, as the City occupies the full leased space. The City would also incur one-time expenses for tenant improvements and relocation costs of approximately $4 million. These are General Fund costs.
- 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 Budget and Legislative Analyst considers approval of the proposed resolution to be a policy matter for the Board of Supervisors because (a) the General Plan and Planning Code determinations have not been completed by the Planning Department, and (b) the appraisal and appraisal review of 350 Rhode Island Street was not available as of the writing of this report.

Recommendation

Approval of the proposed lease is a policy decision for the Board of Supervisors.

MANDATE STATEMENT

City Charter Section 9.118(b) requires that any contract or agreement having a term of ten or more years or requiring anticipated expenditures of $10,000,000 or more is subject to approval by 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. Before adoption, the Director of Property shall determine the market rent of the proposed lease based on a review of available and relevant data. If the lease's base rent is more than $45 per square foot per year, the Director of Property shall obtain an appraisal for the market rent. If the lease's base rent is more than $60 per square foot per year, the Director of Property shall also obtain an appraisal review. Both the appraisal and appraisal review's effective date must be within nine months of the lease's submittal to the Board of Supervisors.

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. In addition, the 2017-28 10-Year Capital Plan included an allocation of $308 million in Certificates of Participation (COPs) in FY 2020-21 for the development of new Hall of Justice administrative space.

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 a new lease between the City as tenant and Lexington Lion San Francisco LP, a Delaware limited partnership, (Lexington) as landlord to relocate the District Attorney's Office and the Police Investigations Unit from the Hall of Justice to 350 Rhode Island Street. The new location is for up to 125,122 square feet consisting of a portion of the first floor and the entire second, third and fourth floors at 350 Rhode Island

Street. The lease term is for 15 years from July 1, 2018 through June 30, 2033, with one five-year option to renew for a total 20 year term through 2038. The District Attorney's Office and Police Investigations Unit would occupy 350 Rhode Island Street in phases, as the leases with existing tenants at that location expires. The initial base rent is $51 per square foot per year; first year base rent is $4,319,445 for approximately 84,695 square feet. A summary of the lease terms shown in Table 1 below.

The terms of the proposed lease for the District Attorney and Police Investigations at 350 Rhode Island Street – North are summarized in Table 1 below.

Table 1: Proposed Lease Terms

Lease Terms	
Premises	350 Rhode Island Street- North, including a portion of the first floor and the entire second, third and fourth floors[1]
Square Footage	125,122 total square feet, including up to 84,695 square feet initially in Phase I beginning in July 2018 for the District Attorney and up to 40,427 square feet in Phase II in April 2020 for the Police Department
Term	15 years from July 2018 through June 2033
Option to Renew	One five-year renewal option, pursuant to appraisal procedures
Capital improvement allowances	Up to $10,010,000 beyond the core and shell (entire interior facilities will be removed and replaced) based on $80 per square foot paid by landlord. An additional $20 per square foot or $2,502,440 to be paid by City for additional construction allowance. Total improvements based on cost estimates of $80-$100 per square foot.
First Year Rent	$51 square foot per year ($4,319,445 first year)
Rent Increases	3% per year for the first 12 years, then $1.00 per year for 3 years
Utilities and Operating Costs	City will pay for utilities, janitorial, security and other operating costs
Property Taxes	City liable for increase in taxes, upon sale of building, only after year 3
Parking	Right to two parking spaces for every 1,200 square feet of rentable space, at prevailing market rates (currently $220/month/parking space or $2,640 annually per parking space)

As shown in Table 1 above, the proposed lease would be implemented in two phases, beginning with Phase 1 commencing in July 2018 for up to 84,695 square feet for the District Attorney on the second, third and fourth floors, including Suites 200, 210, and the entire third and fourth floors. Phase II is for the remaining up to 40,427 square feet of space on the first and second floors for the Police Department Investigations units (Special Investigations, Special Victims Unit, Homicide, Gang Task Force, Night Investigations, Patrol Bureau Task Force and Narcotics). However, the proposed lease includes provisions in case the existing subtenants in the building do not agree to early termination of their respective subleases. Mr. John Updike, Director of

[1] As specified in the lease, this includes Suites 100, 110, 130, 140, 200, 210, 220, 230, 300, 350, 360 and 400.

Real Estate, explains that Police will relocate into the building as existing tenants vacate and space becomes available through March 1, 2020.

According to Mr. Updike, the District Attorney currently has 230 full-time equivalent (FTE) staff located at both the Hall of Justice and a leased site at 732 Brannan Street[2] that would all be relocated to the proposed 350 Rhode Island leased facility. Currently, the District Attorney occupies 57,993 square feet of space at the Hall of Justice and 17,625 square feet of space at 732 Brannan Street, or a total of 75,618 square feet. The proposed lease at 350 Rhode Island would provide 71,357 square feet of space for the District Attorney, a reduction of 4,261 square feet or 5.6 percent.

Mr. Updike advises that the various Police Department Investigations units are projected to have 267 FTEs in various Investigation units. These units currently occupy approximately 60,000 square feet of space at the Hall of Justice over two floors. The proposed lease at 350 Rhode Island would provide 53,690 square feet for these various Police Investigation units, a reduction of 6,310 square feet or 10.5 percent.[3]

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. Updike 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 $51 per square foot and the phased move into the space at 350 Rhode Island by the District Attorney and Police Investigations. According to Mr. Updike, annual operating costs are projected at $12.50 per square foot in the first year, and are assumed to increase at the same rate as the base rent (3 percent per year) over the term of the lease. In addition, the costs assume 40 parking spaces for the District Attorney and 133 parking spaces for Police, or a total of 173 parking spaces at the initial annual rate of $2,640 per parking space.

As summarized in Table 2 below, the City would pay $5.5 million in the first year of the proposed lease, increasing to $8.9 million by the third year, when the Police move into the

[2] The District Attorney's Brannan Street lease comprises 17,625 square feet of office space and 32 adjacent parking spaces at an annual rent of $906,240. Operating costs in 2016 were $31,000. This lease expires on June 30, 2018.

[3] Mr. Updike notes that the use of space in the Hall of Justice is extremely inefficient. The Budget and Legislative Analyst report dated June 2017 indicated the Police units in the Hall of Justice occupied more space than needed, such that a more efficient use of space could reduce the amount of square footage required by the Police Investigations units

building. Over the term of the 15-year lease, the City is projected to incur rent and operating costs of $149,467,245. All of these costs would be General Fund expenses.

As noted above, there is also one five-year option to extend the lease, based on appraisals conducted at that time, allowing for up to 20 total years for the proposed lease. The Attachment provides further details on rent and operating costs over the 15-year lease term.

Table 2: Rents Payable by the City over 15-Year Lease

Year	Base Rent (per SF)	Operating Costs (per SF)	Rent & Operating (per SF)	Rent	Operating Costs	Parking	Total Leasing Costs
1	$51.00	$12.50	$63.50	$4,319,445	$1,058,688	$105,600	$5,483,733
2	52.53	12.88	65.41	4,449,028	1,090,448	108,768	5,648,244
3	54.10	13.26	67.36	6,769,838	1,659,275	484,218	8,913,331
4	55.72	13.66	69.38	6,972,933	1,709,052	498,745	9,180,731
5	57.39	14.07	71.46	7,182,121	1,760,324	513,707	9,456,153
6	59.11	14.49	73.6	7,397,586	1,813,134	529,118	9,739,837
7	60.88	14.93	75.81	7,619,513	1,867,527	544,992	10,032,032
8	62.71	15.37	78.08	7,848,099	1,923,553	561,342	10,332,993
9	64.59	15.83	80.42	8,083,541	1,981,260	578,182	10,642,983
10	66.53	16.31	82.84	8,326,047	2,040,698	595,527	10,962,273
10-Year Sub-total				$68,968,151	$16,903,959	$4,520,199	$90,392,310
11	68.53	16.80	85.33	8,575,829	2,101,918	613,394	11,291,141
12	70.59	17.30	87.89	8,833,104	2,164,976	631,795	11,629,875
13	71.59	17.82	89.41	8,958,226	2,229,925	650,748	11,838,900
14	72.59	18.36	90.95	9,083,348	2,296,823	670,271	12,050,442
15	73.59	18.91	92.5	9,208,470	2,365,728	690,379	12,264,577
15-Year Total				**$113,627,128**	**$28,063,329**	**$7,776,786**	**$149,467,245**

**Annual increases in the last three years of the lease are $1.00 per year.*

One-Time Expenses

In addition to the ongoing lease and operating expenses shown in Table 2 above, Real Estate estimates up to $250,000 of one-time expenses to move the Police and District Attorney from the Hall of Justice to 350 Rhode Island. As shown in Table 1 above, there will also be up to $2,502,440 one-time expenses for additional tenant improvements, beyond those paid by the landlord. The estimated additional one-time expenses for furniture, fixtures and equipment (FF&E) for the new space at 350 Rhode Island have not yet been determined. However, a preliminary estimate of FF&E is $10 per square foot, or approximately $1,251,220 for 125,122 square feet. Overall, these one-time expenses would total approximately $4 million.

One Year Comparison of Proposed 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	-	-	1,000,000	-	1,000,000
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.

Sources of Funding

According to Ms. Heather Green, Capital Planning Director, funding for these one-time and ongoing lease expenses have not yet been appropriated in the Police or District Attorney's budgets. Such appropriations would be subject to future Board of Supervisors appropriation approval. The source of funds would be the City's General Fund.

Ms. Green also 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.

Appraisal of Market Rent

In accordance with Section 23.27 of the Administrative Code, if the base rent to be paid by the City for a lease is more than $45 per square foot per year, an appraisal of the market rent is required prior to approval of the lease resolution by the Board of Supervisors. As shown in Table 2 above, the initial base rent to be paid for the 350 Rhode Island lease is $51 per square foot per year. An appraisal report for 350 Rhode Island was not available for review by the Budget and Legislative Analyst prior to finalizing this report. However, Mr. Updike advises that an appraisal for the subject property at 350 Rhode Island will be available before the Budget and Finance Committee hearing on October 26, 2017.

POLICY CONSIDERATION

The City's Capital Plan originally provided for the City to construct City-owned facilities to relocate the Adult Probation Department, and the District Attorney's Office and Police Investigations from the Hall of Justice, with the planned issuance of COPs in FY 2018-19 through FY 2020-21, totaling $282.5 million. However, due to the worsening conditions in the Hall of Justice, the City's Capital Plan now provides for the relocation of these departments in 2019.

According to the City's 10-Year Capital Plan FY 2018-2027,

> "In recent weeks, conditions at the Hall have worsened dramatically, compounding the facility's already critical problems and hastening the need to vacate the building. Beyond the known seismic risk, subsystems including plumbing and elevators, have repeatedly failed and require substantial investment to repair. Rather than invest more than necessary in a facility ultimately unfit for occupation, in January 2017 the City Administrator declared the building's City's offices and jails should be shuttered as quickly as possible.
>
> The target date for expedited exit from the Hall is 2019, the fastest possible to line up alternative locations for all staff and prisoners. City staff are exploring ways to meet this deadline; solutions may involve the allocation of General Fund Debt and/or Capital Planning Fund capacity to meet the cost of this ambitious schedule."

The prior 10-Year Capital Plan FY 2016-2025 planned to relocate:

- The Adult Probation Department to a City-owned location, funded by an estimated $55.5 million in COPs to be issued in FY 2018-19; and
- The District Attorney's Office and Police Investigations to a City-owned location, funded by an estimated $227 million in COPs to be issued in FY 2020-21.

The City has not considered the option of eminent domain to purchase the three leased properties. Under California eminent domain laws (Title 7 of Code of Civil Procedure), government agencies can acquire property through eminent domain for public purposes, subject to a resolution adopted at a public hearing declaring the necessity of exercising eminent domain. The local government agency must find: (1) that the project for which the property is to be acquired is necessary; (2) that the property is necessary for the public project; (3) that the project is located in such a manner as to offer the greatest public benefit with the least private detriment; and (4) that an offer to purchase the property has been made.

Generally, the government agency must offer fair market value to acquire the property based on a third party appraisal. Purchase of 350 Rhode Island Street through eminent domain could be cost effective for the City. We estimate that the purchase price for 350 Rhode Island Street would be $87,585,400, which is approximately 7 percent less than the present value of estimated lease costs over 20 years of $93,850,945.[4]

According to Mr. Updike, acquisition of property through eminent domain was not deemed fiscally or logistically feasible because the City would need available cash to acquire the property. Also, Mr. Updike reports that the City would need approval under the California Environmental Quality Act (CEQA) before using eminent domain.

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 (a) the General Plan and Planning Code determinations have not been completed by the Planning Department, and (b) the appraisal and appraisal review of 350 Rhode Island Street was not available as of the writing of this report.

[4] Estimated purchase price of 350 Rhode Island is based on 125,122 square feet at $700 per square foot; present value of lease costs is based on 20 years of lease payments, discounted by 6 percent.

RECOMMENDATION

Approval of the proposed lease is a policy decision for the Board of Supervisors.

Item 7 **File 17-1110**	**Departments:** Real Estate Division Police Department

EXECUTIVE SUMMARY

Legislative Objectives

- 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.

Key Points

- 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).

Fiscal Impact

- 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.

Policy Consideration

- 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.

Recommendations

- 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 and Operating Costs	City will pay an estimated $14 per square foot for insurance, utilities, repairs and maintenance, property management fees, security, and other operating costs
Property Taxes	City will pay
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, 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.

According to the anticipated terms of the lease agreement, the City is required to pay property taxes for 777 Brannan Street. In FY 2017-18, the assessed value of the property is $8,618,961, so at the FY 2017-18 tax rate of 1.1723 percent, the amount of property taxes owed is $101,040. Assuming the assessed value increases by 2 percent per year and the tax rate does not change, the City would owe $103,061 in the first year of the lease and a total of $1,128,487 in property taxes over the 10-year term of the lease, as shown in Table 2 below.

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	Assessed Value	Property Tax	Total Leasing Costs
1	$37.00	$1,004,698	$14.00	$380,156	8,791,340	103,061	$1,487,915
2	38.11	1,034,839	14.42	391,561	8,967,167	105,122	1,531,522
3	39.25	1,065,884	14.85	403,308	9,146,510	107,224	1,576,416
4	40.43	1,097,861	15.30	415,407	9,329,440	109,369	1,622,636
5	41.64	1,130,796	15.76	427,869	9,516,029	111,556	1,670,222
6	42.89	1,164,720	16.23	440,705	9,706,350	113,787	1,719,213
7	44.18	1,199,662	16.72	453,926	9,900,477	116,063	1,769,651
8	45.51	1,235,652	17.22	467,544	10,098,486	118,384	1,821,580
9	46.87	1,272,721	17.73	481,570	10,300,456	120,752	1,875,044
10	48.28	1,310,903	18.27	496,017	10,506,465	123,167	1,930,088
10-Year Subtotal		$11,517,737		$4,358,063		$1,128,487	$17,004,286
11	49.72	1,350,230	18.81	510,898	10,716,594	125,631	1,986,759
12	51.22	1,390,737	19.38	526,225	10,930,926	128,143	2,045,105
13	52.75	1,432,459	19.96	542,012	11,149,545	130,706	2,105,177
14	54.34	1,475,433	20.56	558,272	11,372,536	133,320	2,167,025
15	55.97	1,519,696	21.18	575,020	11,599,986	135,987	2,230,702
16	57.64	1,565,287	21.81	592,271	11,831,986	138,706	2,296,264
17	59.37	1,612,245	22.47	610,039	12,068,626	141,480	2,363,765
18	61.16	1,660,613	23.14	628,340	12,309,998	144,310	2,433,263
19	62.99	1,710,431	23.83	647,190	12,556,198	147,196	2,504,817
20	64.88	1,761,744	24.55	666,606	12,807,322	150,140	2,578,490
Options Subtotal	--	$15,478,875	--	$5,856,872	--	$1,375,619	$22,711,366
20-Year Total	--	$26,996,612	--	$10,214,934	--	$2,504,106	9,715,652

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			1,000,000		1,000,000
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.

Item 8 **File 17-1111**	**Departments:** Real Estate Division Adult Probation

EXECUTIVE SUMMARY

Legislative Objectives

- The proposed resolution would (a) authorize the Director of Property to negotiate a lease between the City as tenant and Bridgeton 945 Bryant Fee LLC (Bridgeton) as landlord for up to 41,744 square feet consisting of the entire three floors of 945 Bryant Street for the San Francisco Adult Probation Office; and (b) find that the anticipated lease in conformance with the City's General Plan and the eight priority policies of Planning Code Section 101.1.

Key Points

- 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, including 945 Bryant Street to provide office space to the Adult Probation Department.
- The City has not yet entered into a lease with Bridgeton; 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). According to the LOI, the lease term would be for 20 years from July 1, 2018 to June 30, 2038.
- The 35,482 square feet of office and other usable space is an increase of approximately 13,031 square feet (or 58 percent) from the Adult Probation Department's current space.
- The anticipated lease includes a tenant improvement allowance of up to $30 per square foot, which will be amortized over the term of the lease at an 8 percent interest rate.
- The proposed lease provides for up to 33 parking spaces in the lot adjacent to the building; however, the Adult Probation Department has only 18 vehicles at this time.

Fiscal Impact

- Over the first ten years of the proposed lease, the City would pay Bridgeton up to $35,200,249 in estimated rent, operating expenses, amortization of tenant improvement costs, and parking First year lease 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,

Recommendations

- Amend the proposed resolution to (1) request the Director of Real Estate and the Director of Capital Planning to use up to an estimated 13,031 square feet of leased space at 945 Bryant Street to relocate other department units, such as the Sheriff's Department's Warrants Unit or the Police Department's ID Bureau, from the HOJ to the proposed leased space; (2) state that the City will pay for tenant improvement costs upfront and not amortize the costs over the lease term; and (3) state that the City will only lease 18 parking spaces.
- Approval of the proposed resolution as amended is a policy matter for the Board of Supervisors.

MANDATE STATEMENT

City Charter Section 9.118(b) requires that any contract or agreement having a term of ten or more years or requiring anticipated expenditures of $10,000,000 or more is subject to approval by 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. Before adoption, the Director of Property shall determine the market rent of the proposed lease based on a review of available and relevant data. If the lease's base rent is more than $45 per square foot per year, the Director of Property shall obtain an appraisal for the market rent. If the lease's base rent is more than $60 per square foot per year, the Director of Property shall also obtain an appraisal review. Both the appraisal and appraisal review's effective date must be within nine months of the lease's submittal to the Board of Supervisors.

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 (a) authorize the Director of Property to negotiate a lease between the City as tenant and Bridgeton 945 Bryant Fee LLC (Bridgeton) as landlord for up to 41,744 square feet consisting of the entire three floors of 945 Bryant Street for the San Francisco Adult Probation Office; and (b) find that the anticipated lease in conformance with the City's General Plan and the eight priority policies of Planning Code Section 101.1.

The City has not yet entered into a lease with Bridgeton; 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). According to the LOI, the lease term would be for 20 years from July 1, 2018 to June 30, 2038. The Adult Probation Department would occupy approximately 27,517 square feet of space, beginning July 1, 2018 at $64 per square foot per year, or $1,763,968 in the first year. Beginning in early 2020 (or approximately 18 months after the Adult Probation Department began occupying space in the building), the Adult Probation Department would increase its space by an additional 14,227 square of space, for total space of 41,744 square feet.

The terms of the anticipated lease at 945 Bryant Street for Adult Probation space needs are summarized in Table 1 below.

Table 1: Anticipated Lease Terms

Lease Terms	
Premises[1]	3-story building at 945 Bryant Street
Square Footage	41,744 square feet
Term	20 years from July 2018 through June 2038
Option to Renew	None
Tenant improvement allowances	$30 per square foot ($1,252,350) amortized over term of the lease at 8 percent annual interest
Base Rent	$64 per square foot per year
Rent Increase	3.0 percent per year, with a fair market value reset after Year 10, followed by 3.0 percent per year
Utilities and Operating Costs	City will pay for utilities and janitorial, estimated to be $8 per square foot per year
Property Taxes	Landlord will pay
Parking	33 spaces in adjacent lot at rate of $225 per space per month, increasing at 3.0 percent per year with a fair market value reset after Year 10

The 41,744 square feet of leased space at 945 Bryant Street would accommodate the 135 full-time equivalent (FTE) Adult Probation staff currently located at the HOJ. According to Mr. John Updike, Director of Real Estate, because the City is leasing the entire building at 945 Bryant Street, the 41,744 square feet consists of approximately 6,262 square feet (or 15 percent) used for elevators, stairwells, and other vertical infrastructure and 35,482 for office and other usable space. The 35,482 square feet of office and other usable space is an increase of approximately

[1] Two suites on the third floor of the building (approximately 14,228 square feet) are leased through October 1, 2019 and October 1, 2020, respectively. Bridgeton will use reasonable efforts to deliver these premises to the City prior to the lease expiration dates.

13,031 square feet (or 58 percent) from the Adult Probation Department's current space in the HOJ. Therefore, the proposed resolution should be amended to request the Director of Real Estate and the Director of Capital Planning to use the additional space to relocate other HOJ staff, such as the Sheriff's Department's Warrants Unit or the Police Department's ID Bureau, from the HOJ to the proposed leased space at 945 Bryant Street.

Consistency with the General Plan

Mr. Updike 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

Over the first ten years of the proposed lease, the City would pay Bridgeton up to $35,200,249 in estimated rent, operating expenses, amortization of tenant improvement costs, and parking, as shown in Table 2 below.

Table 2: Leasing Costs Payable by the City over 20-Year Lease*

Year	Base Rent (per SF)	Square Feet	Total Rent Payments	OC (per SF)**	Total OC	TI***	Parking (33 spaces)	Total Leasing Costs
1	$64.00	27,517	$1,761,088	$8.00	$220,136	$127,550	$89,100	$2,197,874
2	65.92	34,631	2,282,843	8.24	285,355	127,550	91,773	2,787,521
3	67.90	41,744	2,834,418	8.49	354,298	127,550	94,526	3,410,792
4	69.93	41,744	2,919,158	8.74	364,927	127,550	97,362	3,508,997
5	72.03	41,744	3,006,820	9.00	375,875	127,550	100,283	3,610,528
6	74.19	41,744	3,096,987	9.27	387,151	127,550	103,291	3,714,979
7	76.42	41,744	3,190,076	9.55	398,766	127,550	106,390	3,822,782
8	78.71	41,744	3,285,670	9.84	410,729	127,550	109,582	3,933,531
9	81.07	41,744	3,384,186	10.13	423,051	127,550	112,869	4,047,656
10	83.51	41,744	3,486,041	10.44	435,742	127,550	116,255	4,165,588
10-Year Subtotal			$29,247,288	--	$3,656,030	$1,275,500	$1,021,431	$35,200,249

** May not add due to rounding error.*
*** Operating Costs*
****Tenant Improvements*

According to Mr. John Updike, Director of Real Estate, the proposed lease would reset the rent in year 11 at market rate; because the rent reset does not set a minimum amount, the rent could be less than year 10 rent of $83.51 per square foot.

The anticipated lease includes a tenant improvement allowance of up to $30 per square foot, which will be amortized over the term of the lease at an 8 percent interest rate. At 41,744 square feet, Bridgeton will spend up to $1,252,320 on tenant improvements, which would total $2,551,000 in amortized payments from the City to Bridgeton over the 20-year lease, or approximately $127,550 per year. The proposed resolution should be amended to state that the City will pay for tenant improvement costs upfront and not amortize the costs over the lease term.

The proposed lease provides for up to 33 parking spaces in the lot adjacent to the building at a rate of $225 per space per month, or $2,700 per year, increasing at 3 percent per year with a fair market value reset after Year 10. However, the Adult Probation Department has only 18 vehicles at this time. The proposed resolution should be amended to state that the City will only lease 18 parking spaces, and that an increase in the number of parking spaces will be requested and justified when the Adult Probation Department's budget is submitted to the Board of Supervisors for approval.

One-Time Expenses

In addition to the ongoing lease and operating expenses shown in Table 2 above, Mr. Updike estimates up to $83,490 of one-time expenses to move Adult Probation from the HOJ to 945 Bryant Street. The estimated additional one-time expenses for furniture, fixtures and equipment (FF&E) for the new space at 945 Bryant Street have not yet been determined. A preliminary estimate of FF&E is $10 per square foot, or approximately $417,440 for 41,744 square feet. Overall, these one-time expenses would be approximately $500,000.

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			1,000,000		1,000,000
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

In accordance with Section 23.27 of the Administrative Code, if the base rent to be paid by the City for a lease is more than $45 per square foot per year, an appraisal of the market rent is required prior to approval of the lease resolution by the Board of Supervisors, and an appraisal review is required if the base rent is more than $60 per square foot per year. As shown in Table 2 above, the initial base rent to be paid for the 945 Bryant Street lease is $64 per square foot per year. Neither the appraisal report or appraisal review for 945 Bryant Street were available for review by the Budget and Legislative Analyst prior to finalizing this report. However, Mr. Updike advises that an appraisal for the subject property at 945 Bryant Street will be available before the Budget and Finance Committee hearing on October 26, 2017.

POLICY CONSIDERATION

The City's Capital Plan originally provided for the City to construct City-owned facilities to relocate the Adult Probation Department, and the District Attorney's Office and Police Investigations from the Hall of Justice, with the planned issuance of COPs in FY 2018-19 through FY 2020-21, totaling $282.5 million. However, due to the worsening conditions in the Hall of Justice, the City's Capital Plan now provides for the relocation of these departments in 2019.

According to the City's 10-Year Capital Plan FY 2018-2027,

> "In recent weeks, conditions at the Hall have worsened dramatically, compounding the facility's already critical problems and hastening the need to vacate the building. Beyond the known seismic risk, subsystems including plumbing and elevators, have repeatedly failed and require substantial investment to repair. Rather than invest more than necessary in a facility ultimately unfit for occupation, in January 2017 the City Administrator declared the building's City's offices and jails should be shuttered as quickly as possible.
>
> The target date for expedited exit from the Hall is 2019, the fastest possible to line up alternative locations for all staff and prisoners. City staff are exploring ways to meet this deadline; solutions may involve the allocation of General Fund Debt and/or Capital Planning Fund capacity to meet the cost of this ambitious schedule."

The prior 10-Year Capital Plan FY 2016-2025 planned to relocate:

- The Adult Probation Department to a City-owned location, funded by an estimated $55.5 million in COPs to be issued in FY 2018-19; and

- The District Attorney's Office and Police Investigations to a City-owned location, funded by an estimated $227 million in COPs to be issued in FY 2020-21.

The City has not considered the option of eminent domain to purchase the three leased properties. Under California eminent domain laws (Title 7 of Code of Civil Procedure), government agencies can acquire property through eminent domain for public purposes, subject to a resolution adopted at a public hearing declaring the necessity of exercising eminent domain. The local government agency must find: (1) that the project for which the property is to be acquired is necessary; (2) that the property is necessary for the public project; (3) that the project is located in such a manner as to offer the greatest public benefit with the least private detriment; and (4) that an offer to purchase the property has been made.

According to Mr. Updike, acquisition of property through eminent domain was not deemed fiscally or logistically feasible because the City would need available cash to acquire the property. Also, Mr. Updike reports that the City would need approval under the California Environmental Quality Act (CEQA) before using eminent domain.

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 (a) the General Plan and Planning Code determinations have not been completed by the Planning Department, and (b) the appraisal and appraisal review of 945 Bryant Street was not available as of the writing of this report.

RECOMMENDATIONS

1. Amend the proposed resolution to request the Director of Real Estate and the Director of Capital Planning to use up to an estimated 13,031 square feet of leased space at 945 Bryant Street to relocate other department units, such as the Sheriff's Department's Warrants Unit or the Police Department's ID Bureau, from the HOJ to the proposed leased space.
2. Amend the proposed resolution to state that the City will pay for tenant improvement costs upfront and not amortize the costs over the lease term.
3. Amend the proposed resolution to state that the City will only lease 18 parking spaces, and that an increase in the number of parking spaces will be requested and justified when the Adult Probation Department's budget is submitted to the Board of Supervisors for approval
4. Approval of the proposed resolution as amended is a policy matter for the Board of Supervisors.

Implementation of Board of Supervisors Recommended Changes to 2013 Term Sheet

When the Board of Supervisors endorsed the Waterfront Site Project Term Sheet in 2013, the Board of Supervisors made the following recommendations. Below is a summary of how these recommendations have been incorporated into the proposed DDA.

Recommendation 1: Other than the 28-Acre Site, only the Port-owned 20th/Illinois Parcel and the Hoedown Yard will be eligible for inclusion in an expanded 28-Acre Site.

- The Pier 70 Special Use District incorporates the 28-acre Waterfront Site, the 20th and Illinois Street site (Parcel K) and the Hoedown Yard.

Recommendation 2: Transfer fees will be payable to the Port from the proceeds of the second and each subsequent transfer of condominium parcels in the amount of 1.5 percent of the gross sales price, net of costs of sale only.

- Section 7.9 (b) (3) of the proposed DDA requires a restrictive covenant to be placed on market rate condominium units developed on Parcel K North, requiring that each condominium owner will pay a transfer fee to the Port equal to 1.5 percent of the net purchase price.
- While the City has an option to purchase the Hoedown Yard, the site is not owned by the City. According to the proposed DDA, if the Hoedown Yard option is offered through a public offering for development of market rate condominiums, then Section 7.9(b) (3) will apply to the Hoedown Yard, but transfer fee proceeds will accrue to the Mayor's Office of Housing and Community Development to fund affordable housing, in perpetuity.
- According to the September 22, 2017 staff report to the Port Commission, the ground leases for the development parcels provide for the Port to participate in 1.5 percent of net sale proceeds for sales, recapitalization and refinancing of leases.

Recommendation 3: Developer Return will be calculated only on outstanding Developer Capital.

- Section 2.3(a) (iii) of the Financing Plan states that Developer Return will accrue on the unpaid balance of the entitlement cost, and Section 8.5 of the Financing Plan states that Developer Return will accrue on any unpaid balance (of horizontal development costs) until the Developer Balance is satisfied by all available Project Payment Sources.

Recommendation 4: Project-generated Public Financing Sources will be the sole source of public funds to reimburse Developer's historic rehabilitation costs of Building 12 and Building 21, and only to extent necessary for Developer to achieve a 10% profit.

- The Financing Plan and Appendix (containing definitions) expand on the Term Sheet provision related to public subsidies for Historic Buildings 12 and 21.
- "Historic Building Costs" means, calculated separately for Historic Building 12 and Historic Building 21, (i) all reasonable and customary costs of rehabilitation (which, for Building 12 shall include build-out to a warm shell for Floors 1 and 3 and build-out to a turnkey condition for Floor 2), and (ii) 10% developer profit on rehabilitation costs.
- Section 7.14 of the proposed DDA requires the developer to rehabilitate Historic Buildings 12 and 21. Section 12 of the Financing Plan provides a formula to calculate the

"feasibility gap" between the developer's costs to rehabilitate Historic Buildings 12 and 21, based on the developer's actual costs, contributions to the costs from Historic Tax Credit investors, net operating income (based on a 7% capitalization rate), and participation rent to the Port.

Recommendation 5: Project-generated Public Financing Sources will be the sole source of public funds to reimburse the costs to construct a new building on Parcel E4, contingent on the building containing retail, restaurant, and arts/light-industrial or public uses.

- The proposed DDA requires the vertical developer or master arts tenant to contribute $17,500,000 to the Arts Building on Parcel E4. Public financing sources include special taxes levied on certain parcels to augment funding for the Arts Building and community space and Port IFD subproject area property tax increment and bond proceeds.

Recommendation 6: If the Board of Supervisors approves a Pier 70 financing plan to provide General Fund financing based on projected revenues from payroll (business) and hotel taxes to the Port under Charter section B7.310, authorized uses of the General Fund financing will be limited to improvements to Pier 70 areas outside of the 28-Acre Site except to the extent authorized by the approved plan.

- The Financing Plan does not provide for General Fund financing based on hotel or business taxes.