

**CITY AND COUNTY OF SAN FRANCISCO**

**BOARD OF SUPERVISORS**


**BUDGET AND LEGISLATIVE ANALYST**

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April 12, 2024

**TO:** Budget and Finance Committee

**FROM:** Budget and Legislative Analyst



**SUBJECT:** April 17, 2024 Budget and Finance Committee Meeting

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<b>Item 9</b> <b>File 24-0312</b>	<b>Department:</b> Real Estate Division (RED)
<b>EXECUTIVE SUMMARY</b>	
<p style="text-align: center;"><b>Legislative Objectives</b></p> <ul style="list-style-type: none"> <li>The proposed resolution would authorize the Director of Property to execute a lease with Hudson 1455 Market, LLC (Hudson) as landlord for approximately 157,154 square feet of office space, storage, and parking at 1455 Market Street, for a term of 21 years from May 2024 through April 2045, with two five-year options to extend through April 2055, annual base rent of \$6,474,745, with one year of rent credit and three percent annual escalation, a three-year option to add additional space, and a three-year option to purchase the property subject to subsequent Board of Supervisors approval.</li> </ul> <p style="text-align: center;"><b>Key Points</b></p> <ul style="list-style-type: none"> <li>The City has leased office space at 1155 Market Street since 1999. In September 2023, the Board of Supervisors rejected a new lease at 1155 Market Street because the initial annual rent of \$64.60 per square foot was likely higher than fair market rent. The Real Estate Division (RED) has identified office space at 1455 Market Street to relocate City departments from 1155 Market Street.</li> <li>An appraisal has determined that the proposed initial annual rent of \$40 per square foot is at or below fair market rent. Of the 157,154 rentable square feet of office space, approximately 105,365 square feet would be used to relocate City departments from 1155 Market Street, and 51,789 square feet would be used for a new SFMTA consultant team. The City may expand premises in the building for three years under the same lease terms. The lease includes tenant improvement and moving allowances, which are anticipated to be sufficient to cover all costs associated with the move and buildout.</li> <li>The proposed lease contains a three-year option for the City to purchase the building if it has rented at least 400,000 square feet in the building, cumulative of all leases. RED has identified additional leases that potentially could be relocated to 1455 Market Street in early 2025. The option window provides an opportunity to analyze the feasibility of purchasing the building and to incorporate a potential purchase into the Capital Plan.</li> </ul> <p style="text-align: center;"><b>Fiscal Impact</b></p> <ul style="list-style-type: none"> <li>The proposed lease would have an initial annual rent of \$40 per square foot, or \$6,286,100, with three percent annual escalation and one year of waived rent. Over the initial 21-year term of the lease, the City would pay \$162,625,313 in total rent, assuming no expansions. The City would also pay its percentage share of the increase in the building's operating expenses over the base year, which are unknown at this time.</li> </ul> <p style="text-align: center;"><b>Recommendation</b></p> <ul style="list-style-type: none"> <li>Approve the proposed resolution.</li> </ul>	

**MANDATE STATEMENT**

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

**BACKGROUND**

The City has leased office space at 1155 Market Street since 1999. The City's most recent lease was for 103,501 square feet of office space, which expired on January 31, 2023. The Real Estate Division (RED) negotiated an amended and restated lease for a term of five years, from February 2023 through January 2028, with a five-year option to extend through January 2033. In September 2023, the Board of Supervisors rejected the proposed lease because the initial annual rent of \$64.60 per square foot was likely higher than fair market rent, which had declined in 2022 and 2023 (File 23-0915).

RED has identified office space at 1455 Market Street, which had been vacated by large technology companies such as Uber and Square, to relocate City departments from 1155 Market Street. The City currently leases 66,807 square feet of office space at 1455 Market Street for the San Francisco Municipal Transportation Agency (SFMTA) and San Francisco County Transportation Authority (SFCTA) for a total annual rent of approximately \$2,720,899 or an average of \$40.73 per square foot. RED has agreed to terms with the 1455 Market Street landlord for a 21-year lease, with two five-year options to extend, and a three-year option to purchase the property.

**DETAILS OF PROPOSED LEGISLATION**

The proposed resolution would authorize the Director of Property to execute a lease with Hudson 1455 Market, LLC (Hudson) as landlord for approximately 157,154 square feet of office space, storage, and parking at 1455 Market Street, for a term of 21 years from May 2024 through April 2045, with two-five year options to extend through April 2055, annual base rent of \$6,474,745, with one year of rent credit and three percent annual escalation, a three-year option to add additional space, and a three-year option to purchase the property, subject to subsequent Board of Supervisors approval. The proposed resolution would also authorize the Director of Property to expend an amount not to exceed \$100,000 for digital technology costs, tenant improvements, and furniture, fixtures and equipment, affirm the Planning Department's determinations under the California Environmental Quality Act (CEQA) and findings of consistency with the General Plan and Planning Code, and authorize the Director of Property to make further immaterial amendments to the lease.

The key terms of the proposed lease are shown in Exhibit 1 below.

**Exhibit 1: Key Terms of Proposed Lease**

<b>Premises</b>	157,154 square feet on floors 7, 12, 13, 16, & 17
<b>Term</b>	21 years, from approx. May 2024 through April 2045 Lease is effective upon Mayor and Board approval.
<b>Options to Extend</b>	Two 5-year options to extend through April 2055, subject to Board approval. Rent reset to 95% market value.
<b>Annual Base Rent</b>	\$6,286,160 (\$40 per square foot)
<b>Rent Escalation</b>	3% annually
<b>Rent Start</b>	The later of 1 year after lease effective or completion of tenant improvements, estimated rent credit for one-year at \$6,286,160
<b>Option to Expand</b>	City may expand premises in the building under same terms of the lease through December 2027. Optional premises include four sites across four floors and total 394,349 rentable square feet. Expansions are subject to Board approval.
<b>Option to Purchase</b>	If City has rented at least 400,000 square feet in the building, City has the option to purchase the building at appraised fair market value if provided notice by March 1, 2027. City must close escrow 255 days after notice or by December 31, 2027.
<b>Parking</b>	City may lease one parking space per 3,000 square feet at a rate of \$350 per space per month
<b>Tenant Improvement Allowance</b>	\$100 per square foot, or \$15,715,400 for initial premises. If additional space is leased by the City, that space is also eligible for the same TI allowance.
<b>Moving Allowance</b>	\$15 per square foot, or \$2,357,310 If additional space is leased by the City, that space is also eligible for the same moving allowance.
<b>Swing Space</b>	7,660 square feet on 8 <sup>th</sup> floor for City to use during buildout at no cost
<b>Storage Space</b>	103,000 square feet for City to use during buildout
<b>Electrical Costs</b>	City pays Landlord as a passthrough cost without markup
<b>Operating Costs</b>	City pays percentage share of increase in operating costs over base year, which starts 2025 or 2027, depending on the amount of leased space. Operating costs include heat, water, HVAC, janitorial services, and security.
<b>Furniture Purchase</b>	City may purchase existing furniture for \$1 per floor
<b>Communications Equipment</b>	City may install communications equipment on roof with Landlord approval

Source: Proposed Lease

An appraisal conducted by Colliers International has determined that the proposed initial rent of \$40 per square foot is at or below fair market rent. An appraisal was not required under Administrative Code Section 23.27 because the proposed rent is less than \$45 per square foot.

According to Andrico Penick, Director of Property, RED anticipates that the tenant improvement and moving allowances will be sufficient to cover all costs associated with the move and buildout. The City would seek to utilize existing furniture from both 1155 Market Street and 1455 Market Street to reduce costs. Director Penick anticipates that City departments will move into the space in approximately September 2024.

Of the 157,154 in rentable square feet of office space, approximately 105,365 square feet would be used to relocate City departments from 1155 Market Street and 51,789 square feet would be used by SFMTA for a new consultant team for the Transit Center Upgrade Project. The space plan is shown in Exhibit 2 below.

### Exhibit 2: Lease Space Plan

<b>Floor 7</b>	SFMTA	51,789
	<b>Floor 7 Total</b>	<b>51,789</b>
<b>Floor 12</b>	Department of Human Resources (DHR)	16,507
	General Services Agency (GSA) Human Resources	8,719
	Shared Space	1,126
	<b>Floor 12 Total</b>	<b>26,352</b>
<b>Floor 13</b>	Department of the Environment	22,074
	Mayor's Office of Disability	4,265
	<b>Floor 13 Total</b>	<b>26,337</b>
<b>Floor 16</b>	Treasurer-Tax Collector (TTX)	17,565
	Contract Monitoring Division (CMD)	7,713
	Shared Space	1,059
	<b>Floor 16 Total</b>	<b>26,337</b>
<b>Floor 17</b>	Assessor-Recorder	16,291
	Department of Children, Youth and their Families (DCYF)	10,046
	<b>Floor 17 Total</b>	<b>26,337</b>
<b>Total</b>		<b>157,154</b>

Source: RED

### Option to Purchase

The Board of Supervisors has previously requested RED to consider purchasing a building in the Civic Center area to relocate leased office space, if economically feasible (File 20-1394). The proposed lease contains an option for the City to purchase the building if it has rented at least 400,000 square feet in the building, cumulative of all leases. The City must provide notice to Hudson by March 1, 2027 and close escrow within 255 days of notice or by December 31, 2027. The purchase price would be determined by an appraisal conducted at that time by a firm mutually agreed upon by the City and Hudson. The proposed lease would increase the City's total leasehold at 1455 Market Street to approximately 223,961 square feet, which would require the City to lease an additional 176,039 square feet for the purchase option to take effect.<sup>1</sup> According to Director Penick, RED has identified other City office leases that will expire and potentially could be relocated to 1455 Market Street before March 2027 to meet this requirement. The three-year option window provides an opportunity for RED and the Capital Planning Committee to analyze

<sup>1</sup> The initial premises of the proposed lease are 157,154 square feet, plus MTA and CTA's current leases total 66,807 square feet, for a total of 223,961 square feet at 1455 Market that will be leased by the City.

the feasibility of purchasing the building and to incorporate a potential purchase into the Capital Plan.

Additional leased space and purchase of the building are subject to Board of Supervisors' approval.

### **FISCAL IMPACT**

The proposed lease would have an initial annual rent of \$40 per square foot, or \$6,286,100, with three percent annual escalation. Rent would be waived for the first year of the lease, so the City would begin paying annual rent of \$6,474,745 in Year 2. Over the 21-year term of the lease, the City would pay \$162,625,313 in total rent, assuming no expansion of the lease. Any expanded space over the three-year option to expand would be rented at the same rate per square foot. If an option to extend the term is exercised, the rent for the extended term would be set at 95 percent of appraised fair market rent at that time.

Under the lease, the City would pay its percentage share (13.98 percent) of the increase in the building's operating expenses over the base year. The base year would be calendar year 2025, so the City would begin paying operating costs in 2026. However, if the City exercises the option to expand the lease, the base year would be delayed until calendar year 2027 and the City would begin paying operating costs in 2028. RED cannot estimate the operating costs at this time. The City would also pay electrical costs as a direct passthrough from the landlord. RED estimates that initial annual electrical costs are approximately \$1 per square foot, or \$157,154.

Rent would be paid by the various City departments occupying the leased space. We estimate that approximately 53 percent of the rent would be funded by the City's General Fund, 33 percent by SFMTA funds, and 14 percent by SF Environment funds. For departments relocated from 1155 Market Street, the proposed lease would reduce the total annual rent by approximately \$2.5 million compared to the rental rate of \$64.60 per square foot in the previous lease that was rejected by the Board of Supervisors.

### **RECOMMENDATION**

Approve the proposed resolution.