CITY AND COUNTY OF SAN FRANCISCO

BOARD OF SUPERVISORS

BUDGET AND LEGISLATIVE ANALYST

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TO: Budget and Finance Committee

FROM: Budget and Legislative Analyst

SUBJECT: June 8, 2022 Budget and Finance Committee Meeting

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Item 1 **File 22-0438**	**Department:** Port

EXECUTIVE SUMMARY

Legislative Objectives

- The proposed resolution would approve a Mutual Termination Agreement between the Port of San Francisco (Port) and Alioto Fish Company Ltd. (Alioto) for the leases of the restaurant premises at 2829 Taylor Street and the warehouse premises located at 360 Jefferson Street, and authorize the Port Director to enter into amendments or modifications of the Mutual Termination Agreement that do not materially increase the obligations or liabilities to the City and are necessary to effectuate the purposes of the resolution.

Key Points

- Alioto has operated in Fisherman's Wharf since 1925. The current 66-year lease lasts from May 1970 through April 2036. In 1990, Alioto assumed a warehouse lease that also expires in April 2036. Alioto has not operated since the onset of the COVID-19 pandemic in March 2020 and, as of March 2022, owes the Port $771,269 in outstanding rent and late fees. After discussions on a path forward, Alioto and the Port have agreed to a Mutual Termination Agreement.
- Under the proposed Mutual Termination Agreement, Alioto would forfeit the $25,975 security deposit it had paid to the Port and pay a termination fee of $250,000. In exchange, the Port would forgive all unpaid rent and late fees owed by Alioto, which will total approximately $861,427 through June 2022.

Fiscal Impact

- The net cost of the Mutual Termination Agreement to the Port would be $585,452. The estimated improvement cost to re-lease the premises is approximately $350,000.
- Over the approximately 13 years and 10 months remaining on the leases, the Port would forego approximately $4,988,743 in base rent by terminating early, not including escalation. This amount would be offset if the Port is able to find new tenants that pay comparable base rent.

Policy Consideration

- According to the Port, the goal of a mutual termination agreement is to seek a compromise whereby the Port can regain control of the site at an early date and seek a new revenue-generating tenant without the time, expense, and controversy of legal action, by forgiving a portion of the payment and repair obligations due under the lease. The Port believes that this forgiveness will be outweighed by the ability to re-lease the Alioto site and generate rental revenues more quickly than further negotiations and/or litigation would allow.

Recommendation

- Approval of the proposed resolution is a policy matter for the Board of Supervisors.

MANDATE STATEMENT

City Charter Section 9.118(c) states that (1) any lease of real property for ten or more years, including options to renew, or having anticipated revenues to the City of $1,000,000, or (2) the modification, amendment, or termination of these leases is subject to Board of Supervisors approval.

BACKGROUND

Alioto Fish Company Ltd. (Alioto) has operated in Fisherman's Wharf since 1925, beginning with a fish stand, and later with a restaurant that opened in 1938. The restaurant, located at 2829 Taylor Street, operated under a 66-year lease with the Port of San Francisco (Port) that was signed on May 1, 1970 and expires April 30, 2036. In 1990, Alioto assumed the lease of a warehouse located at 360 Jefferson Street, which also expires April 30, 2036.

At the onset of the COVID-19 pandemic in March 2020, Alioto suspended operations and has not reopened. Alioto has not paid rent and owes the Port $545,905 for the restaurant lease and $225,364 for the warehouse lease, for a total outstanding balance of $771,269, as of March 31, 2022. Alioto did not apply to the Port's rent forgiveness program, which was approved by the Board of Supervisors in November 2020 (File 20-1163). In April 2021, Port staff contacted restaurant tenants with delinquent rent and invited them to engage with Port staff to determine a path forward. After discussion of the options, Alioto requested a mutual termination agreement, similar to the one reached for the Ferry Plaza Limited Partnership lease with the Port (File 21-0560). After a series of facilities inspections, Port staff negotiated financial terms of a Mutual Termination Agreement. In April 2022, the Port Commission approved the Mutual Termination Agreement.

DETAILS OF PROPOSED LEGISLATION

The proposed resolution would approve a Mutual Termination Agreement between the Port and Alioto for the leases of the restaurant premises at 2829 Taylor Street and the warehouse premises at 360 Jefferson Street. The proposed resolution would also authorize the Port Director to enter into any additions, amendments, or other modifications to the Mutual Termination Agreement that do not materially increase the obligations or liabilities to the City or the Port and are necessary or advisable to effectuate the purposes of the resolution.

Under the proposed Mutual Termination Agreement, Alioto would forfeit the security deposit paid to the Port, which is $18,385 for the restaurant lease and $7,590 for the warehouse lease, or a total of $25,975. Alioto would also pay a termination fee of $200,000 for the restaurant lease and $50,000 for the warehouse lease, or a total of $250,000. In exchange, the Port would forgive all unpaid rent and late fees owed by Alioto, which will total $861,427 through June 2022. Alioto would remove personal property and furniture, but the Port may retain certain fixtures that could be beneficial to a future tenant. Alioto has also attested that it has returned a $5 million Small Business Administration Restaurant Revitalization Fund loan and that it has received no other COVID-19 relief funds. The lease would officially be terminated once the Port receives the

termination fee. If the Board of Supervisors does not approve the proposed resolution by July 31, 2022, the Mutual Termination Agreement would automatically expire.

In July and August 2021, staff from the Port Maintenance and Engineering Divisions inspected the facilities to estimate the costs of improvements needed to lease the premises again. They identified the following repairs and upgrades: minor water intrusion at the roof, ductwork and insulation replacement, minor electrical code violations, carpentry work to address step irregularities, ceiling height issues, and door/frame replacement, repair of one exterior column, repair/replacement of structural steel framing elements and concrete spall repair of substructure, and American Disabilities Act (ADA) upgrades of doors, handrails, and an elevator. Port Maintenance and Engineering estimate the total cost to improve the facilities is approximately $350,000.

According to Mike Martin, Port Chief Operating Officer, the Port has received informal inquiries about the availability of the premises, but the Port expects to pursue a competitive solicitation process to select a new tenant for the restaurant site. The warehouse premises would be offered separately for lease, though it is likely that a subsequent operator of the restaurant would also pursue the storage facility if it were available at that time. Improvements to the restaurant would be completed once a new tenant is selected, as the tenant would likely have its own conceptual plans for the space. Chief Operating Officer Martin anticipates that the premises would be reactivated by Spring or Summer 2023.

FISCAL IMPACT

The proposed Mutual Termination Agreement would forgive approximately $861,427 in unpaid rent and late fees through June 2022. Alioto would pay a termination fee of $250,000 and forfeit the security deposit of $25,975. The net cost to the Port would be $585,452. As mentioned above, the estimated improvement cost to lease the premises is approximately $350,000. At this time, the Port expects that a new tenant would pay this improvement cost.

The combined annual base rent for the Alioto leases is $360,632. Over the approximately 13 years and 10 months remaining on the leases, the Port would forego approximately $4,988,743 in base rent by terminating early, not including escalation. This amount would be offset if the Port is able to find new tenants that pay comparable base rent.

POLICY CONSIDERATION

As noted above, the Board of Supervisors previously approved a mutual termination agreement for Ferry Plaza Limited Partnership (FPLP), a Port tenant, in June 2021. FPLP held a lease for a facility behind the Ferry Building that had not been operating for over 10 years so continued nonoperation does not create as much of a negative impact to the Port's revenues as does the closure of a high-performing restaurant in a visitor serving area like Alioto's. In the FPLP case the tenant had continued to pay base rent in hopes of establishing a new operator but eventually decided to terminate. Exhibit 1 below compares the terms of that agreement and the proposed termination agreement (specific to the restaurant premises).

Exhibit 1: Termination Agreement Comparison

Alioto Termination Agreement (restaurant premises, proposed agreement)	Amount	Ferry Plaza Termination Agreement (21-0560)	Amount
Unpaid Rent (March 2020-April 2022)	($609,719)	Unpaid rent (Jan 2021 to July 2021)	($111,432)
Security Deposit	18,385	Security Deposit	222,866
Termination Fee to Port	200,000	Termination Fee to Port	0
Site Improvement Costs[1]	(350,000)	Site Improvement Costs	(709,000)
Net Fiscal Impact to Port	**($741,334)**	**Net Fiscal Impact to Port**	**(597,566)**
Annual Base Rent	$255,256	Annual Base Rent	$222,864
Remaining Base Rent (through 2036)	$3,531,041	Remaining Base Rent (through 2040)	$4,122,984

Source: Files 21-0560 and 22-0438

Note: The $741,334 net cost to the Port shown above is different than the $585,452 note in the Fiscal Impact section above because the net fiscal impact value in Exhibit 1 only includes the restaurant's rent, security deposit, and termination fee as well as the site improvement costs. Site improvement costs are included in the table above even though the Port expects them to be paid by a new tenant because those costs would likely result in a lower base rent than if the site did not need any tenant improvements.

As shown above, similar to the proposed termination agreement with Alioto, the Ferry Plaza termination agreement includes the forfeiture of the security deposit. However, Ferry Plaza agreed to pay base rent on the Port property through December 2020, leaving approximately six months of lost rent to the Port, primarily due to seeking approval from the Port Commission and Board of Supervisors. The net cost to the Port of terminating the Ferry Plaza lease, including the cost to bring the site to the surrender condition called for under the lease was $597,566 or $143,768 less than the cost to the Port of terminating the restaurant lease with Alioto, which will cost the Port $741,334. If the warehouse space is included, the net cost to the Port for proposed agreement is $935,452, or $337,886 more than the termination of the Ferry Plaza lease. "Net cost" in this instance refers to the amounts provided under the proposed termination agreement as compared to the total recovery to which the Port would argue it is entitled if it were to take legal action; there is no guarantee that the Port would realize those amounts if it did pursue litigation.

According to Chief Operating Officer Martin, the goal of a mutual termination agreement is to seek out a compromise whereby the Port can regain control of the site at an early date and seek a new revenue-generating tenant without the time, expense, and controversy of legal action, by forgiving some portion of the payment and repair obligations due under the lease. The Port believes that this difference in forgiveness will be outweighed by the ability to re-lease the Alioto's site and begin generating rental revenues more quickly than further negotiations and/or litigation would allow. The Port has a much greater interest in reactivating the Alioto's site, which had been performing strongly before the COVID-19 pandemic and is centrally located in a major commercial area, than the Ferry Plaza site, which had been vacant for over 10 years. The termination also provides an opportunity to modernize the lease terms for a new tenant. For

[1] According to Chief Operating Officer Martin, the site improvement costs would likely be paid directly by the new tenant, but indirectly by the Port through a rent reduction.

example, the Port's lease with Boudin (File 20-1210) has a shorter term (10 years) than the Alito lease (66 years), a higher percentage rent (9 percent versus the current 5.0 – 6.5 percent) and includes transfer participation fees to the Port.

RECOMMENDATION

Approval of the proposed resolution is a policy matter for the Board of Supervisors.