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

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TO: Budget and Finance Committee

FROM: Budget and Legislative Analyst

SUBJECT: October 10, 2012 Budget and Finance Committee Meeting

TABLE OF CONTENTS

Item 1 **File 12-0904** *(Continued from October 3, 2012)*	**Department:** San Francisco Municipal Transportation Agency (SFMTA)

EXECUTIVE SUMMARY

Legislative Objectives

- The proposed resolution would authorize the execution of an Industrial Lease between the City and County of San Francisco (City), on behalf of the San Francisco Municipal Transportation Agency (SFMTA) as tenant, and Prologis, L.P. (Prologis), as landlord, of an approximately 12.72 acre property with 255,420 rentable square feet of warehouse and office space and 320 exterior parking spaces at 2650 Bayshore Boulevard, Daly City, California for the SFMTA's towed vehicle operations and other transit-related uses, for a 20-year term, plus two five-year extension options, at an initial annual base rent of $2,449,642 with annual increases.

Key Points

- The SFMTA and the Port of San Francisco (Port) entered into a Memorandum of Understanding (MOU No. M-13828) for the use of approximately 13 acres property on Pier 70 to house the SFMTA's towed vehicle operations through July 31, 2015. The Port has plans to redevelop Pier 70, and the SFMTA has been searching for an equivalent-sized site since 2004 to house its towed vehicle operations, as Pier 70 is not ideal for vehicle towing and storage functions.
- According to Ms. Sonali Bose of the SFMTA, 2650 Bayshore Boulevard is more suitable for housing the SFMTA's towed vehicle operations than alternative sites, which were evaluated by the SFMTA and found to have major issues making them unsuitable for housing the SFMTA's towed vehicle operations.
- The proposed lease has an initial term of 20 years, plus two five-year extension options and an early termination option at Year 10 that includes an early termination fee of $276,696 payable by the SFMTA to Prologis. The proposed annual base rent in Year 1 is $2,449,642 and would increase by three percent annually, plus an additional four percent increase (or a seven percent increase in total) every five years. The cumulative base rent to be paid over the initial 20-year lease term would total $70,245,708 as shown in Table 1 below.

Fiscal Impact

- The SFMTA currently pays the Port an annual rent of $1,759,572 for its use of Pier 70, which is equal to and offset by the license fee AutoReturn, the SFMTA's towed vehicle contractor, pays the SFMTA. The difference between the proposed Year 1 base rent at 2650 Bayshore Boulevard and the license fee AutoReturn currently pays the SFMTA is $690,070 ($2,449,642 minus $1,759,572). This difference of $690,070 would be paid from SFMTA revenues, unless SFMTA is able to consolidate other existing leases at 2650 Bayshore Boulevard, thus saving rent from these other leases, or is able to increase the license fee to be paid by AutoReturn. According to Ms. Bose, the base rent for 2650 Bayshore Boulevard for Years 1 and 2 has been incorporated in the SFMTA's FY 2012-2013 and FY 2013-2014 operating budgets.

Policy Considerations

- The proposed lease agreement increases the SFMTA's costs for towed vehicle operations and storage. The increased annual rent of $690,070 for leasing 2650 Bayshore Boulevard results in expenditures for the SFMTA's towed vehicle operations exceeding vehicle towing and storage fee revenues. Ms. Bose advises that the SFMTA is unlikely to consider increasing AutoReturn's license fee to cover the additional $690,070 cost of renting the property at 2650 Bayshore Boulevard because (a) only a portion of the space at 2650 Bayshore Boulevard will be used for towed vehicle operations, and (b) increasing AutoReturn's license fee would require increasing the City's vehicle towing and storage fees.
- Also, the SFMTA's expenditures for the 20-year lease totaling $70,245,708 for 2650 Bayshore Boulevard significantly exceed estimated costs for purchasing comparable property. Under the proposed lease agreement, the SFMTA's costs of $70,245,708 to lease 2650 Bayshore Boulevard for the first 20 years of the lease are an estimated $34,137,583, or 94.5 percent, more than estimated costs to purchase comparable property, including principal and interest[1]. Under the proposed lease, the SFMTA has the right of first negotiation if the landlord, Prologis, were to sell the property. However, should SFMTA locate another property to purchase for its towed vehicle operations, the SFMTA does not have the right to terminate the lease prior to Year 10. According to Ms. Bose, the SFMTA proposed, during negotiations with Prologis, that the SFMTA have termination at any time while Prologis proposed no termination rights during the 20 year term. Ms. Bose states that SFMTA and Prologis reached a compromise, allowing SFMTA lease termination rights in Year 10. Further, according to Ms. Bose, the SFMTA anticipates growth in demand for transportation services, with includes using the 2650 Bayshore Boulevard space for other SFMTA uses in addition to the towed vehicle operations and storage. Ms. Bose projects that SFMTA will need to lease or purchase further space to meet the growth in demand for transportation services in addition to the proposed lease of 2650 Bayshore Boulevard
- The proposed lease provides for high interest costs if the landlord, at the request of the SFMTA, makes improvements to the property at the landlord's expense, subject to reimbursement by the SFMTA. If Prologis were to make future tenant improvements, totaling up to $1,000,000, at its own cost, at the request of the SFMTA, the SFMTA would reimburse Prologis for the cost of these improvements over 10 years at 9 percent interest. Also, any replacement of the building systems that is required after the expiration of any warranty periods would be paid for initially by Prologis and incorporated in the excess operating expenses for which the SFMTA is required to reimburse Prologis, amortized over the lesser of (a) the useful life of the replacement system or (b) 10 years, plus 10 percent interest each year.
- Because, according to the SFMTA, the proposed 2650 Bayshore Boulevard lease between the SFMTA and Prologis is the best existing option for housing the SFMTA's towed vehicle operations, but at the same time commits the SFMTA to paying rents that significantly exceed the estimated cost of purchasing comparable property, with the option to terminate only at Year 10 of a 20-year lease, the Budget and Legislative Analyst considers approval of the proposed lease to be a policy matter for the Board of Supervisors.

[1] Estimated costs of $36,108,125 include purchase price of $21,000,000 and interest costs of $15,108,125 at an estimated interest rate of 6 percent, amortized over 20 years.

Recommendations

Amend the proposed resolution to require:

1. The SFMTA Director to report back to the Budget and Finance Committee of the Board of Supervisors on the SFMTA Real Estate and Facilities Vision for the 21st Century Report prior to December 31, 2012, and explain (a) how the SFMTA will reorganize its leased space to reduce total leasing costs; and (b) how the proposed lease fits into the SFMTA's long term space needs; and

2. That the SFMTA pay for all necessary Phase II Landlord Tenant Improvements and building systems replacements up front, rather than reimbursing Prologis at high interest rates of 9 to 10 percent.

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

MANDATE STATEMENT / BACKGROUND

Mandate Statement

Section 9.118(c) of the City's Charter requires that any lease of real property for a period of ten or more years shall first be approved by resolution of the Board of Supervisors.

Background

The SFMTA and the Port of San Francisco (Port) entered into a five-year Memorandum of Understanding (MOU No. M-13828) on July 30, 2005 for the use of approximately 13 acres of Port property on Pier 70, including 406,810 square feet of paved land and 112,518 square feet of shed space, for the SFMTA's towed vehicle operations, storage, and weekly vehicle auctions. The first amendment to the MOU, enacted in 2010, extended the term to July 31, 2015 and included a one-year early termination clause with no termination fee. Under the existing MOU between the SFMTA and the Port, the SFMTA currently pays the Port monthly rent of $146,631 or $1,759,572 per year for fiscal year (FY) 2012-2013.

According to Ms. Sonali Bose, SFMTA Director of Finance and Information Technology, the SFMTA was made aware of the Port's plan to redevelop Pier 70 during negotiations in 2010 to extend the term of the MOU. Ms. Bose advises that the SFMTA and AutoReturn, the SFMTA's towed vehicle contractor, had already been searching for an equivalent-sized site to house the SFMTA's towed vehicle operations since the two parties entered into a contract in 2004, as Pier 70 is not ideal for towing and storage functions and is subject to various legal restrictions which make needed modifications very difficult.

Ms. Bose advises that several alternatives have been considered. However, Ms. Bose advises that there are few sites that are large enough and in suitable locations for towing and storing vehicles. Properties of 12 to 13 acres in San Francisco or nearby are rare and typically are already occupied by industrial and light industrial users. According to Ms. Bose, sites considered by the SFMTA included (a) 749 Toland Street and 2000 McKinnon Avenue, which together had 12 acres of property with warehouses, (b) the former site of PG&E's Potrero Hill Power Plant, and (c) Piers 94-96. According to the August 21, 2012 SFMTA Report to the SFMTA Board of Directors on the proposed lease of the property at 2650 Bayshore Boulevard (August 21 SFTMA Report), alternative sites that were analyzed were found to have any number of major issues making them unsuitable for housing the SFMTA's towed vehicle operations, including (a) owners who did not want to sell, (b) the existence of hazardous materials that would require expensive remediation, (c) the need for infrastructure improvements that would cost the City millions of dollars, or (d) recent rezoning for uses other than industrial or light industrial use.

According to Ms. Bose, the property at 2650 Bayshore Boulevard (2650 Bayshore Boulevard) was vacated by the United States Postal Service in July of 2010 at which time the SFMTA considered a lease and option to purchase the property because the site was found to be ideal for housing the SFMTA's towed vehicle operations. However, according to Ms. Bose, Prologis, L.P. (Prologis) was able to move faster than the City and purchased the property for $21,000,000. The SFMTA then negotiated with Prologis for the lease and right of first negotiation.

According to the August 21 SFMTA Report, Prologis contracted with URS Corporation Americas and conducted a Phase I Environmental Site Assessment and limited Phase II testing on July 29, 2011. Based on the findings of the Phase II testing, URS concluded that the historical incidents and prior uses of fuel storage tanks are unlikely to pose an ongoing environmental threat. The August 21 SFMTA Report notes that the San Francisco Department of Public Works concurred with the conclusion that significant environmental concerns related to historic operations at the subject property are unlikely to exist.

Pier 70 is not ideal for the SFMTA's towed vehicle operations.

According to Ms. Bose, relocating the SFMTA towed vehicle operations and storage from Pier 70 earlier than the scheduled July 31, 2015 termination date would allow the Port to execute its waterfront revitalization plan sooner.

Furthermore, as noted above, Pier 70 is not ideal for towing and storage functions. Ms. Bose advises that the relocation of the SFMTA's towed vehicle operations, storage and vehicle auctioning to 2650 Bayshore Boulevard would enable the SFMTA and AutoReturn to improve conditions for employees and the public. While using Pier 70, AutoReturn employees have worked out of a temporary trailer and have had to use portable bathroom facilities. According to Ms. Bose, at the 2650 Bayshore Boulevard lease site, AutoReturn would have a permanent structure out of which to work with indoor plumbing and lunchroom facilities.

In addition, Ms. Bose advises that at the Pier 70 site, the SFMTA and AutoReturn have had to work around buildings and structures that do not allow modifications due to legislative and legal constraints. At 2650 Bayshore Boulevard, the SFMTA and AutoReturn would be able to design the facility to best meet vehicle towing and storage needs. Relocating to a site that is on land would also allow the SFMTA more flexibility to design the facility for towed vehicle operations, than being located on the Pier 70 site, which has required environmental safeguards that have constrained the SFMTA's use of the site. Additionally, there would be ample space for parking at the 2650 Bayshore Boulevard site, so that parking does not spill into surrounding neighborhoods on auction days.

DETAILS OF PROPOSED LEGISLATION

The proposed resolution would authorize the execution of a new Industrial Lease between the City, on behalf of the SFMTA as tenant, and Prologis, as landlord, of an approximately 12.72 acre property, which includes warehouse and office space and 320 exterior parking spaces at 2650 Bayshore Boulevard, Daly City, for the SFMTA's towed vehicle operations, storage, vehicle auctions, and other transit-related uses to be set forth in the SFMTA Real Estate and Facilities Vision for the 21st Century Report, which Ms. Bose advises will be completed in late 2012.

The proposed lease has an initial term of 20 years, which would commence on the "rent commencement date," approximately two months after Prologis and the SFMTA execute the lease, allowing Prologis two months to complete agreed upon "Phase I Landlord Tenant Improvements" (see below). The proposed lease includes two five-year extension options beyond the initial 20-year term, for a total term of 30 years if the options are exercised. Under the proposed lease, in order to exercise these 5-year extension options, the SFMTA would be required to give Prologis notice of SFMTA's decision to exercise the options at least 12 months but not more than 18 months before the scheduled lease expiration date. The proposed lease also includes an early termination option at the end of Year 10, with one-year advance notice and an early termination fee of $276,696 payable by the SFMTA to Prologis, plus any remaining unpaid amount for "Phase 2 Landlord Tenant Improvements" requested by the SFMTA (see below).

As shown in Table 1 below, the proposed monthly base rent in Year 1 would be $204,137 or $2,449,642 per year. Average annual rent per square foot in Year 1 is $4.41, which is approximately 30 percent more than the $3.39 average annual rent per square foot in FY 2012-13 for the Pier 70 location.[2] However, as noted above, the proposed 2650 Bayshore Boulevard location is a more suitable location for towed vehicle operations than Pier 70.

The base rent would increase by three percent annually, plus an additional four percent increase (or a seven percent increase in total) every five years (in Year 6, Year 11, and Year 16). As shown in Table 1 below, the cumulative base rent paid over the initial 20-year lease term would total $70,245,708.

[2] The Pier 70 location consists of 519,328 square feet with annual rent of $1,759,572, equal to $3.39 per square foot. 2650 Bayshore Boulevard consists of approximately 2.72 acres, equal to 555,228 square feet, with annual rent of $2,449,642, equal to $4.41 per square foot.

Table 1: Proposed Base Rent[3]

Year	Monthly Base Rent	Annual Base Rent
1	$204,137	$2,449,642
2	$210,261	$2,523,132
3	$216,569	$2,598,825
4	$223,066	$2,676,790
5	$229,758	$2,757,094
6	$245,841	$2,950,090
7	$253,216	$3,038,593
8	$260,813	$3,129,751
9	$268,637	$3,223,644
10	$276,696	$3,320,353
11	$296,065	$3,552,777
12	$304,947	$3,659,361
13	$314,095	$3,769,142
14	$323,518	$3,882,216
15	$333,224	$3,998,682
16	$356,549	$4,278,590
17	$367,246	$4,406,948
18	$378,263	$4,539,156
19	$389,611	$4,675,331
20	$401,299	$4,815,591
Total		**$70,245,708**

According to an appraisal prepared for the SFMTA by Mansbach Associates, Inc. dated June 20, 2012, the monthly market rental value for the subject property is $204,336, or $199 more than the proposed initial monthly base rent of $204,137. Mansbach Associates, Inc. also advises that for leases of up to ten years, the market data show annual rent increases of three percent, which is equal to the annual rent increases in the proposed lease agreement, excluding the additional four percent every five years.

According to Ms. Bose, the proposed additional four percent annual increase every five years (in Year 6, Year 11, and Year 16), which is less common in comparable leases, is to alleviate Prologis' risk of foregoing higher rents over the next 20 years in a market where historically rents have increased in excess of three percent per year. Ms. Bose advises that the SFMTA initially tried to negotiate for a reappraisal at Year 10 instead of locking in additional four percent rent increases every five years. However, according to Ms. Bose, the SFMTA had little negotiating leverage because it was competing with other prospective tenants to lease the property and had no other suitable alternatives for housing its towed vehicle operations. Ms. Bose advises that the SFMTA does not know who the competing prospective tenants were.

[3] Addendum 1, Industrial Lease between Prologis, L.P. and the City and County of San Francisco.

Ms. Bose advises that although the SFMTA conceded the additional four percent rent increases every five years, it was also able to gain a number of concessions from Prologis, including:

1. An "industrial gross lease" structure, whereby Prologis would be responsible for base operating expenses, instead of a "triple net lease" structure, whereby the SFMTA would have been responsible for all base operating expenses (estimated to be $372,026 in Year 1 and total $7,440,520 over 20 years).

2. A Phase I Landlord Tenant Improvement allowance of $800,000, instead of only $200,000 initially offered by Prologis (see below).

3. The right of first negotiation, whereby if Prologis decided to sell the property, Prologis would be required to negotiate with the SFMTA before negotiating with other interested parties.

Reimbursement of Excess Operating Expenses after Year 1

The proposed lease is structured as an "industrial gross lease," whereby (a) the SFMTA would be responsible for all services and utilities, and (b) the SFMTA would be responsible for reimbursing Prologis for all operating expenses in excess of the base operating expenses paid by Prologis in Year 1. According to the proposed lease, operating expenses include maintenance and operation of the property, such as real estate taxes, insurance, fees payable to tax consultants and attorneys, and the maintenance and repair of all exterior portions of the building for which Prologis is responsible as set forth in the lease agreement. Prologis estimates that the total base operating expenses in Year 1 would be $372,025, and that total operating expenses would increase by two percent each year. Table 2 below shows the estimated annual total operating expenses and excess operating expenses for Years 1 through 20.

Table 2: Estimated Excess Operating Expenses

Year	Annual Operating Expenses Paid by Prologis	Excess Operating Expenses Paid by the SFMTA
1	$372,025	
2	$379,466	$7,441
3	$387,055	$15,030
4	$394,796	$22,771
5	$402,692	$30,667
6	$410,746	$38,721
7	$418,961	$46,936
8	$427,340	$55,315
9	$435,887	$63,862
10	$444,605	$72,579
11	$453,497	$81,471
12	$462,567	$90,541
13	$471,818	$99,793
14	$481,254	$109,229
15	$490,879	$118,854
16	$500,697	$128,672
17	$510,711	$138,686
18	$520,925	$148,900
19	$531,344	$159,318
20	$541,971	$169,945
Total cost to the SFMTA		**$1,598,730**

As Table 2 above shows, the estimated excess operating expenses in Year 2, for which the SFMTA would reimburse Prologis, are $7,441. By Year 20, the estimated annual excess operating expenses would increase to $169,945, such that the estimated cost to the SFMTA for excess operating expenses over the initial 20-year lease term would total $1,598,730.

Under the proposed lease, Prologis would be responsible for maintaining any portion of the building systems (heating, ventilating, air conditioning, plumbing, electrical, fire protection, life safety, and security) located outside the warehouse and office building, and for maintaining the exterior and structural portions of the building. All such costs would be considered operating expenses, and would be subject to reimbursement by the SFMTA if they result in the annual operating expenses exceeding the Year 1 base operating expenses. Under the proposed lease, the SFMTA would be responsible for maintaining the heating, ventilating, air conditioning, plumbing, electrical, fire protection, life safety, and security systems within the building. Any replacement of the building systems that is required after the expiration of any warranty periods would be paid for initially by Prologis and incorporated in the excess operating expenses for which the SFMTA is required to reimburse Prologis, amortized over the lesser of (a) the useful life of the replacement system or (b) 10 years, plus 10 percent interest each year.

Initial and Subsequent Tenant Improvements

Under the proposed lease agreement, Prologis would expend up to $800,000 for the SFMTA's requested tenant improvements prior to the rent commencement date. These tenant improvements are referred to in the proposed lease agreement as "Phase I Landlord Tenant Improvements." The SFMTA would not be required to reimburse Prologis for the cost of any Phase I Landlord Tenant Improvements up to a maximum of $800,000. If Prologis determines that the cost of Phase I Landlord Tenant Improvements will exceed $800,000, the SFMTA would have the option of paying the excess costs. If the SFMTA elects not to pay the excess costs, Prologis would reduce the scope of the tenant improvements. The agreed upon Phase I Landlord Tenant Improvements include the construction and installation of lunchroom cabinets and countertops, doors, windows, walls, blinds, plumbing, gas lines, fire protection systems, HVAC systems, lighting fixtures, electrical fixtures, and a telephone board.[4]

Within three years after the rent commencement date, the SFMTA would have the right to request additional tenant improvements, referred to in the proposed lease agreement as "Phase II Landlord Tenant Improvements." Phase II Landlord Tenant Improvements, costing up to $1,000,000, could be paid upfront by the SFMTA, or, at the request of the SFMTA, could be paid initially by Prologis and later reimbursed by the SFMTA. Any Phase II Landlord Tenant Improvements paid for initially by Prologis would be reimbursed by the SFMTA in 120 monthly installments immediately following the completion of Phase II Landlord Tenant Improvements, at an interest rate of 9 percent per annum. After the third anniversary of the rent commencement date, the SFMTA would no longer have the right to request tenant improvements paid for initially by Prologis.

FISCAL IMPACT

As shown in Table 1 above, the annual base rent in Year 1 would be $2,449,642 and the proposed base rent over the initial 20-year lease term would total $70,245,708.

Under the existing MOU between the SFMTA and the Port for the SFMTA's use of Pier 70, the SFMTA currently pays the Port annual rent of $1,759,752. These rent payments are equal to and offset by the license fee AutoReturn, the SFMTA's towed vehicle contractor, pays the SFMTA. According to Ms. Bose, the existing agreement with AutoReturn expires July 31, 2015. AutoReturn also pays for operating and maintenance expenses at Pier 70. Ms. Bose advises that at 2650 Bayshore Boulevard, AutoReturn would pay (a) operating and maintenance expenses and (b) the excess operating expenses reimbursable by the SFMTA to Prologis, proportionate to its use of the space at 2650 Bayshore Boulevard for towed vehicle operations. The SFMTA would pay the balance of both (a) the operating and maintenance expenses and (b) the excess operating expenses not paid by AutoReturn. The estimated excess operating expenses payable

[4] Schedule 2 Finish Standards, Industrial Lease between Prologis, L.P. and the City and County of San Francisco.

by the SFMTA to Prologis over the initial 20-year term of the proposed lease are $1,598,730, as shown on Table 2 above.

The difference between the proposed base rent for 2650 Bayshore Boulevard and the rent currently paid for Pier 70 by the SFMTA and offset by AutoReturn's license fee is $690,070 ($2,449,642 minus $1,759,572). This difference of $690,070 would be paid from SFMTA revenues rather than from increasing AutoReturn's license fee.

The SFMTA FY 2012-13 budget includes six months of rent for 2650 Bayshore Boulevard ($1,224,821, or 50 percent of Year 1 rent of $2,449,642) and one year of rent for Pier 70 ($1,759,572) to account for an estimated six-month overlap in the transfer of towed vehicle storage and other functions from Pier 70 to 2650 Bayshore Boulevard. However, the SFMTA now anticipates a later rent commencement date for 2650 Bayshore Boulevard, resulting in a three-month rather than six-month overlap. Therefore, it is anticipated that the SFMTA will pay rent for both Pier 70 and 2650 Bayshore Boulevard for a period of at least three months, and AutoReturn's license fee payment will not cover any portion of the rent payments for 2650 Bayshore Boulevard until July 1, 2013.

According to Ms. Bose, the SFMTA, in addition to the vehicle towing and storage operations, is considering relocating other operations to the 2650 Bayshore property in order to economize its use of space and reduce its overall rent expenditures. According to the August 21 SFMTA report, the SFMTA can generate $368,877 in savings per year by relocating its parking enforcement operations (Enforcement) to 2650 Bayshore Boulevard and terminating Enforcement's three existing leases. Taking this action would reduce the annual fiscal burden of relocating to 2650 Bayshore Boulevard by $368,877, from $690,070 to $321,193. However there are no guarantees that the pending relocation or lease terminations to save money will in fact take place.

The SFMTA is also considering relocating training for Muni operators and maintenance from various locations to 2650 Bayshore Boulevard in order to have consolidated classrooms, offices, and space for simulators and equipment for various types of transit vehicles. Relocating the SFMTA's training activities would not generate rent savings because the City owns and thee SFMTA has jurisdiction over the buildings that house its training activities; however, relocating its training activities could generate efficiency savings. Ms. Bose advises that the SFMTA Real Estate and Facilities Vision for the 21st Century Report, which will be completed in late 2012, will make final recommendations as to how the remaining space at 2650 Bayshore Boulevard should be used in order to better economize the SFMTA's use of space and reduce its overall rent expenditures.

POLICY CONSIDERATIONS

The proposed lease agreement increases SFMTA's costs for towed vehicle operations and storage

The increased annual rent of $690,070 for leasing 2650 Bayshore Boulevard results in expenditures for the SFMTA's vehicle towing and storage operations exceeding vehicle towing and storage fee revenues. Presently the SFTMA costs vehicle towing and storage operations, including rental costs, have been fully reimbursed from the license fees paid by the towing contractor AutoReturn.

Currently, the annual license fee of $1,759,572 that AutoReturn pays the SFMTA is equal to and offsets the rent that the SFMTA pays the Port for its use of Pier 70. Although the $2,449,642 rent for the proposed 2650 Bayshore Boulevard lease exceeds AutoReturn's annual license fee by $690,070, Ms. Bose advises that the SFMTA is unlikely to consider increasing AutoReturn's license fee of $1,759,572 payable to the SFMTA to cover the additional $690,070 cost of renting the property at 2650 Bayshore Boulevard because (a) only a portion of the space at 2650 Bayshore Boulevard will be used for towed vehicle operations, and (b) increasing AutoReturn's license fee would require increasing the City's vehicle towing and storage fees.

However, if the SFMTA does not reduce its rent expenditures by $690,070 to compensate fully for the higher rent at 2650 Bayshore Boulevard, the SFMTA's towed vehicle operations costs will be less than the revenues generated by towed vehicles, resulting in the SFMTA subsidizing its towed vehicle operations through other revenues.

The SFMTA's expenditures for leasing 2650 Bayshore Boulevard significantly exceed estimated costs for purchasing comparable property.

The SFMTA initially intended to purchase, rather than lease, property for towed vehicle operations and storage, but as noted above, was unable to purchase 2650 Bayshore Boulevard. According to Ms. Bose, the property at 2650 Bayshore Boulevard was vacated by the United States Postal Service in July of 2010 at which time the SFMTA considered a lease and option to purchase the property because the site was found to be ideal for housing the SFMTA's towed vehicle operations. However, according to Ms. Bose, Prologis was able to move faster than the City and purchased the property for $21,000,000. The SFMTA then negotiated with Prologis for the lease and right of first negotiation. Under the proposed lease agreement, the SFMTA's costs of $70,245,708 (see Table 1 above) to lease 2650 Bayshore Boulevard for the first 20 years of the lease are an estimated $34,137,583, or 94.5 percent, more than Prologis' purchase in 2011, including principal and interest, of $36,108,125[5].

Under the proposed lease, the SFMTA has the right of first negotiation if the landlord, Prologis, were to sell the property. However, should SFMTA locate another property to purchase for its towed vehicle operations, the SFMTA does not have the right to terminate the lease prior to

[5] Based on initial purchase price of $21,000,000 and six percent loan costs, amortized over 20 years.

Year 10. According to Ms. Bose, the SFMTA proposed during negotiations with Prologis that the SFMTA have termination at any time while Prologis proposed no termination rights during the 20 year term. Ms. Bose states that SFMTA and Prologis reached a compromise, allowing SFMTA lease termination rights in Year 10.

According to Ms. Bose, the SFMTA anticipates growth in demand for transportation services, with includes using the 2650 Bayshore Boulevard space for other SFMTA uses in addition to the towed vehicle operations and storage. Ms. Bose projects that SFMTA will need to lease or purchase further space to meet the growth in demand for transportation services in addition to the proposed lease of 2650 Bayshore Boulevard.

The proposed lease provides for high interest costs if the Prologis makes improvements to the property at the Prologis' expense, subject to reimbursement by the SFMTA.

As noted above, if Prologis were to make additional Phase II Landlord Tenant Improvements, totaling up to $1,000,000, at its own cost at the request of the SFMTA, the SFMTA would reimburse Prologis for the cost of said improvements over 10 years at 9 percent interest. Also, any replacement of the building systems that is required after the expiration of any warranty periods would be paid for initially by Prologis and incorporated in the excess operating expenses for which the SFMTA is required to reimburse Prologis, amortized over the lesser of (a) the useful life of the replacement system or (b) 10 years, plus 10 percent interest each year.

The proposed lease would result in up to a six-month overlap of the Pier 70 and 2650 Bayshore leases.

Under the existing MOU for Pier 70 between the SFMTA and the Port, the SFMTA was required to give one-year notice to terminate the MOU. The SFMTA sent the Port a notice letter on April 5, 2012, and met with the Port on April 26, 2012 regarding the SFMTA's future termination of the MOU and proposed lease of 2650 Bayshore Boulevard. The effective MOU termination date is June 30, 2013. The SFMTA FY 2012-13 budget includes one-year rent for the Pier 70 MOU with the Port ($1,759,572) and six-months rent for the proposed 2650 Bayshore Boulevard lease ($1,224,821). According to SFMTA, the actual rent commencement date is expected for approximately March 1, 2013, resulting in three-months rent for the proposed 2650 Bayshore Boulevard lease of $612,410.

Because the proposed lease significantly increases the SFMTA's rental expenditures, the Budget and Legislative Analyst considers approval of the proposed resolution to be a policy matter for the Board of Supervisors.

Because, according to the SFMTA, the proposed 2650 Bayshore Boulevard lease between the SFMTA and Prologis is the best existing option for housing the SFMTA's towed vehicle operations, but at the same time commits the SFMTA to paying rents that significantly exceed the estimated cost of purchasing comparable property, with the option to terminate only at Year 10 of a 20-year lease, the Budget and Legislative Analyst considers approval of the proposed lease, subject to the amendments to the proposed resolution recommended above, to be a policy matter for the Board of Supervisors.

The SFMTA Director should report back to the Budget and Finance Committee of the Board of Supervisors on the SFMTA Real Estate and Facilities Vision for the 21st Century Report prior to December 31, 2012, including (a) how the SFMTA will reorganize its leased space to reduce total leasing costs; and (b) how the proposed lease fits into the SFMTA's long term space needs.

Also, in order to avoid the high interest costs of 9 to 10 percent, the proposed resolution should be amended to require that the SFMTA pay for all necessary Phase II Landlord Tenant Improvements and building systems replacement up front, rather than reimbursing Prologis at high interest rates of 9 to 10 percent.

RECOMMENDATIONS

Amend the proposed resolution to require:

1. The SFMTA Director to report back to the Budget and Finance Committee of the Board of Supervisors on the SFMTA Real Estate and Facilities Vision for the 21st Century Report prior to December 31, 2012, and explain (a) how the SFMTA will reorganize its leased space to reduce total leasing costs; and (b) how the proposed lease fits into the SFMTA's long term space needs; and

2. That the SFMTA pay for all necessary Phase II Landlord Tenant Improvements and building systems replacements up front, rather than reimbursing Prologis at high interest rates of 9 to 10 percent.

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

Item 2 **File 12-0906** *(Continued from October 3, 2012)*	**Department:** Department of Public Works (DPW) Department of Public Health (DPH)

EXECUTIVE SUMMARY

Legislative Objectives

- The proposed resolution would authorize the Director of Public Works to execute Modification No. 16 to the Construction Management Services Agreement with Cooper Pugeda Management, Inc. (CPM) for the Laguna Honda Hospital (LHH) Replacement Program, to increase the Agreement by $608,969 from a not-to-exceed $16,196,764 to a not-to-exceed $16,805,733.

Key Points

- On June 15, 2011, DPW executed Modification No. 15 to the Construction Management Services Agreement with CPM to increase the Agreement by $497,657 from a not-to-exceed $16,196,764 to a not-to-exceed $16,694,421, which was not subject to Board of Supervisors approval because the Agreement was increased by less than $500,000. Since the latest authorized Agreement amount is a not-to-exceed $16,694,421 and since the new requested not-to-exceed amount is $16,805,733, the proposed resolution should therefore be amended to authorize the Director of Public Works to execute Modification No. 16 to the Construction Management Services Agreement with CPM to increase the Agreement by $111,312 from $16,694,421 to a not-to-exceed $16,805,733, an increase of $111,312.

Fiscal Impact

- Based on a competitive Request for Proposal (RFP) process, the initial Construction Management Services Agreement between DPW and CPM was awarded in the not-to-exceed $601,000. If the proposed Modification No. 16 authorizing a new not-to-exceed Agreement amount of $16,805,733 is approved, the total amount of the Agreement would increase by $111,312 from $16,694,421 to a not-to-exceed $16,805,733. Mr. John Thomas of DPW advises that the original Agreement amount of $601,000 has significantly increased because the Agreement was intended to be initiated in stages, in which the Agreement would be modified annually based on the work plan for the particular year involved.

Policy Consideration

- DPW requested Board of Supervisors approval of Modification No. 10 to cover DPW-authorized Modification No.'s 10, 11, 12 to the subject Agreement, which should have each been subject to separate Board of Supervisors approval. In addition, Modification No. 13, which DPW authorized, should have been subject to Board of Supervisors approval.

Recommendations

- Amend the proposed resolution to reflect that the subject Modification No. 16 would result in an increase of $111,312 (instead of an increase of $608,969) from a not-to-exceed amount of $16,694,421 (instead of $16,196,764) to a not-to-exceed amount of $16,805,733.

- Approve the proposed resolution, as amended.

MANDATE STATEMENT/BACKGROUND

Section 9.118(b) of the City's Charter requires that all agreements in excess of $10,000,000 or amendments to said agreements in excess of $500,000 be subject to approval by the Board of Supervisors.

Background

The Laguna Honda Hospital (LHH) Replacement Program comprises demolition, construction, and renovation of LHH, including (a) the construction of four new buildings: South, Link, East, and West, and (b) renovations to existing facilities.

As shown in Table 1 below, the total estimated LHH Replacement Program budget is $584,946,602.

Table 1: Laguna Honda Hospital Replacement Program Budget

	Budgeted Expenditures
Professional Services	
Design Agreement	$50,800,000
Construction Management	20,716,795[1]
Permits and Fees	7,995,831
DPW Program Management	7,956,227
Special Inspection and Testing	6,360,579
Surveys, Reproduction, Activation	2,515,295
DPW Architecture	2,428,642
Hazardous Materials	1,734,813
Environmental Impact Report	289,503
Subtotal	**$100,797,685**
Construction	
Construction	$484,148,917
Subtotal	**$484,148,917**
Total	**$584,946,602**

Table 2 below summarizes the sources of funding for the $584,946,602 LHH Replacement Program.

[1] Budgeted expenditures for Construction Management include $14,596,548 or 70.5 percent in agreements with private contractors and $6,120,247 or 29.5 percent in City employee staff time.

Table 2: Sources of Funding for LHH Replacement Program

General Obligations Bonds*	$296,083,671
Interest Earned from General Obligation Bonds	26,771,514
Tobacco Settlement Revenues**	133,554,943
Interest Earned from Tobacco Settlement Revenues	7,437,788
Certificates of Participation	120,000,000
Grants***	1,098,686
Total	**$584,946,602**

*–General Obligation Bonds approved by the San Francisco voters on November 2, 1999.

**–Tobacco Settlement Revenues are funds received under a 1998 Master Settlement Agreement between the Attorney General of the State of California and various manufacturers of tobacco products, which is administered by the State of California.

***–Grants are from the US Health Resources and Service Administration (HRSA) and the US Department of Housing and Urban Development (HUD).

Following a competitive Request for Proposal (RFP) process in May of 2001, the Department of Public Works (DPW) awarded a Construction Management Services Agreement to Cooper Pugeda Management, Inc. (CPM)[2] to provide construction management services throughout the planning, design, bid, construction and post-construction phases of the LHH Replacement Program.

According to Mr. John Thomas, DPW Program Manager for the LHH Replacement Program, the LHH Replacement Program commenced construction in the fall of 2002. Mr. Thomas advises that due to unanticipated significant structural repairs, the estimated completion of the LHH Replacement Program has been delayed from the previously estimated completion date of late 2013 to early 2014.

The initial Construction Management Services Agreement between DPW and CPM was for a not-to-exceed amount of $601,000. Since the original Construction Management Services Agreement for $601,000 was approved in 2001, there have been 15 modifications to the Agreement. Only two of the previous 15 modifications to the Agreement were subject to Board of Supervisors approval (Modification No. 10, Resolution No. 357-08, and Modification No. 14, Resolution No. 202-11). The Budget and Legislative Analyst notes that the first 9 modifications to the Agreement were not subject to Board of Supervisors approval because the Agreement did not exceed $10,000,000.

[2] The original Construction Management Services Agreement awarded by DPW in May, 2002 was with Turner Construction Company/Cooper Pugeda Management, Inc. a joint venture. However, the joint venture was severed in May, 2003 to enable Turner Construction Company to compete in the selection of another project. The DPW approved an Assignment and Assumption Agreement dated May 9, 2003 severing the joint venture and assigning the terms and conditions of the Agreement solely to Cooper Pugeda Management, Inc.

The Budget and Legislative Analyst notes that Modification No. 10 (Resolution No. 357-08), which was approved by the Board of Supervisors on August 8, 2008, authorized DPW to increase the Construction Management Services Agreement by $4,789,098 from a not-to-exceed $9,995,383 to a not-to-exceed $14,784,481. Because Modification No. 10 resulted in the Agreement exceeding $10,000,000, Board of Supervisors approval was required for Modification No. 10.

However, rather than increasing the Agreement to $14,784,481 with a single modification, as previously approved by the Board of Supervisors in Resolution No. 357-08, DPW instead executed Modification No. 10 in August of 2008 to increase the Construction Management Services Agreement with CPM by only $670,810 from a not-to-exceed $9,995,383 to a not-to-exceed $10,666,193. Subsequently, DPW executed two additional modifications (Modifications No. 11 and No. 12), which were not subject to Board of Supervisors approval, as follows:

- Modification No. 11, executed on December 23, 2008, increased the Agreement by $2,838,534 from a not-to-exceed $10,666,193 to a not-to-exceed $13,504,727.

- Modification No. 12, executed on December 11, 2009, increased the Agreement by $1,298,710, from a not-to-exceed $13,504,727 to a not-to-exceed $14,803,437. The Budget and Legislative Analyst notes that the new not-to-exceed amount of $14,803,437 was $18,956 greater than the not-to-exceed amount of $14,784,481 previously approved by the Board of Supervisors on August 8, 2008 (Resolution No. 357-08).

Mr. Thomas advises that DPW considered the authorization by the Board of Supervisors in August 2008 under Resolution No. 357-08, which increased the Agreement to a not-to-exceed $14,784,481, to cover the three modifications to the actual Construction Management Services Agreement with CPM, which were made separately in August 2008, December 2008, and December 2009, respectively, to a not-to-exceed $14,803,437, because DPW's approach to the Agreement had been, and remained, to modify the Agreement annually based on the work plan for the particular year involved.

Modification No. 13, executed by DPW on July 21, 2010, subsequently increased the Agreement by $499,992, from a not-to-exceed $14,803,437 to a not-to-exceed $15,303,429. Although the new not-to-exceed 15,303,429 was $518,948 greater than the last Board of Supervisors-approved not-to-exceed $14,784,481, DPW did not request Board of Supervisors approval, apparently because the $499,992 specific increase in Modification No. 13 was less than $500,000. However, Modification No. 13 should have been subject to Board of Supervisors approval because the new not-to-exceed $15,303,429 was more ($518,948) than $500,000 over the last not-to-exceed $14,784,481 previously approved by the Board of Supervisors.

The Budget and Legislative Analyst notes that on May 17, 2011 the Board of Supervisors approved a resolution (Resolution No. 202-11) authorizing DPW to execute Modification No. 14, which increased the Construction Management Services Agreement with CPM by an additional $893,335 from a not-to-exceed $15,303,429 to a not-to-exceed $16,196,764.

DETAILS OF PROPOSED LEGISLATION

The proposed resolution would authorize the Director of Public Works to execute Modification No. 16 to the Construction Management Services Agreement with Cooper Pugeda Management, Inc. (CPM) for the LHH Replacement Program, to increase the Construction Management Services Agreement by $608,969, from a not-to-exceed $16,196,764 to a not-to-exceed $16,805,733.

Mr. Thomas advises that the proposed increase of $608,969 to the Construction Management Services Agreement would fund continued construction management services, including (a) independent construction cost estimates, (b) construction scheduling support, (c) general administrative support, and (d) Office of Statewide Health Planning and Development (OSHPD) inspections related to the remodel of the existing LHH building.

However, Mr. Thomas advises that on June 15, 2011, DPW executed Modification No. 15 to the Construction Management Services Agreement with CPM to increase the Agreement by $497,657 from a not-to-exceed $16,196,764 to a not-to-exceed $16,694,421. Modification No. 15, which increased the Agreement by $497,657 from a not-to-exceed $16,196,764 to a not-to-exceed $16,694,421, was not subject to Board of Supervisors approval because the Agreement was increased by less than $500,000.

Since the latest authorized Agreement amount is a not-to-exceed $16,694,421 and since the new requested not-to-exceed amount is $16,805,733 the proposed resolution should be amended to authorize the Director of Public Works to execute Modification No. 16 to the Construction Management Services Agreement with CPM for the LHH Replacement Program, from a not-to-exceed $16,694,421 to a not-to-exceed $16,805,733, an increase of $111,312. The proposed Modification No. 16, which would increase the Agreement by $111,312, is subject to Board of Supervisors approval because it would increase the Agreement to a not-to-exceed $16,805,733, which is $608,969 greater than the last not-to-exceed amount of $16,196,764 previously approved by the Board of Supervisors on May 17, 2011 (Resolution No. 202-11).

FISCAL IMPACTS

The proposed Modification No. 16 for an increase of $111,312 would increase the existing Construction Management Services Agreement from a not-to-exceed $16,694,421 to a not-to-exceed $16,805,733. The proposed $111,312 increase would be funded through a reallocation of existing LHH Replacement Program funds previously appropriated by the Board of Supervisors. Mr. Thomas advises that the total LHH Replacement Program cost is not anticipated to exceed the budgeted $584,946,602 as shown in Table 1 above.

Mr. Thomas advises that the proposed increase of $111,312 under Modification No. 16, combined with the increase of $497,657 from Modification No. 15, which totals $608,969, would fund approximately three full-time equivalent CPM employees through the first quarter of calendar year 2013. As noted above, the initial Construction Management Services Agreement between DPW and CPM was for a not-to-exceed amount of $601,000. If the proposed Modification No. 16 for $111,312 is approved, the total Construction Management Services Agreement would increase to a not-to-exceed amount of $16,805,733. However, Mr.

Thomas notes that the original Agreement amount of $601,000 has significantly increased because the Agreement was intended to be initiated in stages, in which the Agreement was modified annually based on the work plan for the particular year involved.

POLICY CONSIDERATIONS

The proposed amendment is the result of direct negotiations with CPM rather than through a competitive process.

As with previous amendments, DPW is requesting a $111,312 increase in the existing agreement rather than undergoing a new competitive Request for Proposal (RFP) process for construction management services. Mr. Thomas advises that this professional service agreement provides construction management support for the LHH Replacement Program, which is a multi-year, multi-phased program. According to Mr. Thomas, an RFP was originally issued to select the most qualified contractor to support the LHH Program over its duration. The current Cooper Pugeda Management staff-members assigned to the LHH Replacement Program are familiar with the program and are an integral component of the project team.

The Budget and Legislative Analyst concurs with the negotiation process utilized by DPW.

Clarification is needed on Board of Supervisors approval of increases to agreements exceeding $10,000,000.

As discussed above, six modifications (Modification No.'s 10-15) have been made to the LHH Replacement Program Construction Management Services Agreement since the Agreement exceeded $10,000,000.

Resolution No. 357-08, which was previously approved by the Board of Supervisors on August 8, 2008, authorized an increase to the Construction Management Services Agreement with CPM from a not-to-exceed $9,995,383 to a not-to-exceed $14,784,781, an increase of $4,789,098.

However, Modification No. 10 to the Construction Management Services Agreement actually executed by DPW on August 22, 2008 increased the not-to-exceed amount by only $670,810. Modification No. 11, executed by DPW on December 23, 2008, subsequently increased the not-to-exceed amount by $2,838,534 from $10,666,193 to $13,504,727, and Modification No. 12, executed by DPW on December 11, 2009 subsequently increased the not-to-exceed amount by $1,298,710 from $13,504,727 to $14,803,437.

According to Mr. Jon Givner, Deputy City Attorney, the not-to-exceed agreement amount included in resolutions previously approved by the Board of Supervisors should be consistent with actual agreements executed by City departments. In addition, Mr. Givner advises that for agreements in excess of $10,000,000, although individual amendments that are less than $500,000 are not subject to Board of Supervisors approval, if the collective amendments are greater than $500,000, then the amendment that exceeds the $500,000 threshold is subject to Board of Supervisors approval. Therefore, DPW should have requested approval for Modification No.'s 10, 11 and 12 by the Board of Supervisors separately.

In addition, Modification No. 13, which increased the Agreement by $499,992 from a not-to-exceed $14,803,437 to a not-to-exceed $15,303,429, should have been subject to Board of Supervisors approval because although the increase was for $499,992, the new not-to-exceed $15,303,429 was $518,948 greater than the latest not-to-exceed amount of $14,784,481 previously approved by the Board of Supervisors.

RECOMMENDATIONS

1. Amend the proposed resolution to reflect that the subject Modification No. 16 would result in an increase of $111,312 (instead of an increase of $608,969) from a not-to-exceed amount of $16,694,421 (instead of $16,196,764) to a not-to-exceed amount of $16,805,733.

2. Approve the proposed resolution, as amended.