CITY AND COUNTY OF SAN FRANCISCO

BOARD OF SUPERVISORS

BUDGET AND LEGISLATIVE ANALYST

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R E V I S E D 10/22/12

October 18, 2012

TO: Budget and Finance Committee

FROM: Budget and Legislative Analyst

SUBJECT: October 24, 2012 Budget and Finance Committee Meeting

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* Revised pages 3-4 and 3-6 – revisions are highlighted

Item 1 File 12-0986	Department: San Francisco International Airport (Airport)

EXECUTIVE SUMMARY

Legislative Objective

- The proposed resolution would approve a new five-year lease between the Airport and the Transportation Security Administration (TSA), for a total of 8,304 square feet of office space, including operating expenses for (a) 7,200 square feet of existing office space on the fifth floor in the International Terminal, (b) 1,104 square feet of new office space on the first floor of Terminal 2, and (c) existing 52 reserved secured parking spaces in the Airport Parking garage, from November 1, 2012 through October 31, 2017.

Key Points

- On November 20, 2007, the Board of Supervisors approved a five-year lease for TSA to occupy 7,200 square feet of office space on the fifth floor in the International Airport Terminal for administrative offices, including 52 reserved secured parking spaces in the Airport Parking garage, which extended from November 1, 2007 through October 31, 2012. This 7,200 square foot lease is at a fixed five-year rate of $990,804 annually, which is $137.61 per square foot per year, for rent and operating expenses. Under this five-year lease, the Airport will receive total revenues of $4,954,020 ($990,804 x 5 years).

Fiscal Impacts

- Under the proposed 8,304 square foot lease, TSA would pay the Airport a flat five-year rate of (a) $118,944 per month for a total of $1,427,328 annually, or $198.24 per square foot per year for the 7,200 square feet of space in the International Terminal, (b) $14,135 per month for a total of $169,620 annually or $153.64 per square foot per year for the 1,104 square feet of space in Terminal 2, and (c) $11.45 per square foot per year, or a total of $95,094 to cover operating expenses for the total 8,304 square feet of space, or an annual total of $1,692,042.
- Assuming a commencement date of (a) November 1, 2012 for the existing 7,200 square feet of space, and (b) March 1, 2013 for the additional 1,104 square feet of space in order to provide sufficient time to complete tenant improvements, the Airport will receive a total of $8,399,443 over the five-year term of the proposed lease.
- The proposed 8,304 square foot lease will generate an average of $203.76 per square foot per year as compared to the existing 7,200 square foot lease at $137.61 per square foot per year, such that the proposed five-year lease will generate $3,445,423 or 69.6 percent more than the Airport currently receives from the existing TSA lease.

Policy Consideration

- Under the proposed lease with TSA, 52 reserved parking spaces on the fourth level of the Domestic Terminal Parking Garage would continue to be provided to the TSA at no additional cost. The Airport’s FY 2012-2013 Rates and Charges schedule provides employee parking at $112 per parking space per month, which would be $69,888 per year or an estimated total of $349,440 over five years, for the subject 52 parking spaces.
- The Board of Supervisors adopted a Transit First Policy in order to give priority to public transit investments and services, rather than single-occupant automobiles, in the City’s transportation policy. However, the proposed lease with TSA would continue the Airport’s practice of providing 52 free, reserved parking spaces at the Airport, for TSA employees. Two Attachments from the Airport address this issue.

Recommendation

- Approve the proposed resolution.

MANDATE STATEMENT / BACKGROUND

Mandate Statement

Section 2A.173 of the City's Administrative Code authorizes the Airport to execute leases of Airport lands and space in Airport buildings, without undergoing a competitive bid process, if the original term of the lease does not exceed 50 years.

City Charter Section 9.118 states that leases, which would result in revenues to the City in excess of $1,000,000, are subject to Board of Supervisors approval.

Background

The Transportation Security Administration (TSA) is required, pursuant to the Federal Aviation and Transportation Security Act, to oversee security measures at the San Francisco International Airport, including airline passenger and baggage screening services.

On November 20, 2007, the Board of Supervisors approved a five-year lease for the Transportation Security Administration to occupy 7,200 square feet of Category II[1] space on the fifth floor in the International Airport Terminal for administrative offices, including 52 reserved secured parking spaces in the Airport Parking garage, which extended from November 1, 2007 through October 31, 2012 (File 07-1461; Resolution No. 647-07). This 7,200 square foot lease was at the fixed five-year rate of $82,567 per month for a total of $990,804 annually, or $137.61 per square foot per year, including rent and operating expenses. Over the five-year term, this lease resulted in total revenues of $4,954,020 ($990,804 x 5 years) to the Airport.

DETAILS OF PROPOSED LEGISLATION

The proposed resolution would approve and authorize execution of a new lease between the Airport and TSA, for a total of 8,304 square feet of administrative office space, and private vehicle parking, including (a) 7,200 square feet of existing Category II space on the fifth floor in the International Terminal, (b) 1,104 square feet of new Category III space[2] on the first floor of Terminal 2, and (c) existing 52 reserved secured parking spaces in the Airport Parking garage, for a term of five years, from November 1, 2012 through October 31, 2017. Under the proposed lease, TSA would pay the Airport to provide maintenance, janitorial, electricity and water and sewage costs.

Although the term of the proposed lease would commence on November 1, 2012, the rent for the additional 1,104 square feet of office space in Terminal 2, which is currently vacant, will commence the earlier of (a) March 1, 2013, or (b) when the TSA completes its tenant improvements. According to Ms. Diane Artz, Senior Property Manager at the Airport, the TSA tenant improvements include partitioning of the finished space, installing cabinetry, electrical wiring, data and voice communication systems, heating, ventilation and air conditioning

[1] Category II space occupied by TSA is consistent with the Airport's Lease and Use Agreements for office space located on the airline departure level and above.
[2] Category III space occupied by TSA is consistent with the Airport's Lease and Use Agreements for office space located on the airline arrival level and below.

systems and fire protection improvements. These tenant improvements are estimated to cost $73,400 and would be completed by and fully paid for by TSA.

Under the proposed lease, the existing 52 reserved parking spaces on the fourth level of the Domestic Terminal Parking Garage would continue to be provided to the TSA at no additional cost (see Policy Considerations).

In addition, the proposed lease permits TSA, with prior written approval of the Airport, to install and maintain telecommunications equipment, at TSA's expense. Ms. Artz advises that, to date, TSA has not submitted a request or outlined a specific need for this additional installation.

According to Ms. Artz, the proposed lease was awarded to the TSA on a sole source basis because the TSA is the sole entity mandated by the Federal government to ensure aviation security at all U.S. airports. Ms. Artz advises that the Airport staff negotiated with the Federal General Services Administration (GSA) staff on behalf of the TSA, which requires that Federal government leases cannot include rent adjustments based on unknown data, such as future Consumer Price Index (CPI) increases, because all Federal funds for the entire lease must be encumbered when the lease is approved. As a result, the proposed flat five-year rental rate was determined based on the Airport's FY 2012-13 approved Rates and Charges for Category II and III space and current Operating Costs for janitorial, maintenance and utilities, and then escalated annually based on the Airport's five-year projected operating budget to determine an average rate for the five-year term. On August 12, 2012, the Airport Commission approved the subject lease with TSA (Airport Resolution No. 12-0185).

FISCAL IMPACTS

As shown in Table 1 below, under the proposed 8,304 square foot lease, the TSA would pay the Airport a flat five-year rate of (a) $118,944 per month for a total of $1,427,328 annually, or $198.24 per square foot per year for the 7,200 square feet of Category II space in the International Terminal, (b) $14,135 per month for a total of $169,620 annually or $153.64 per square foot per year for the 1,104 square feet of Category III space in Terminal 2[3], and (c) $11.45 per square foot per year, or a total of $95,094 to cover operating expenses for the total 8,304 square feet of space. Ms. Artz advises that the proposed fixed five-year operating rate of $11.45 per square foot annually will fully cover the Airport's costs to provide these services.

[3] This Category III rate includes a one-time Airport surcharge fee of $21.48 per square foot, or a total of $23,714 for the 1,104 square feet for construction of basic finishes to this new Category III space for TSA.

Table 1: Proposed Fixed Five-Year Lease and Operating Expenses

Leased Space and Operating Expenses	Monthly Rent	Annual Rent	Per Square Foot Per Year
International Terminal (7,200 square feet)	$118,944	$1,427,328	$198.24
Terminal 2 (1,104 square feet)	14,135	169,620	153.64
Operating Expenses (8,304 square feet)	7,924	95,094	11.45
Total	**$141,003**	**$1,692,042**	

As shown in Table 1 above, once all tenant improvements are completed in the new Terminal 2 space, or March 1, 2013 whichever is earlier, the Airport will receive $1,692,042 annually under the proposed new five-year lease for 8,304 square feet of space.

As noted above, although the proposed lease will commence on November 1, 2012, the rent for the additional new 1,104 square feet of space in Terminal 2 will not commence until the earlier of (a) March 1, 2013, or (b) when the TSA completes its tenant improvements. Assuming a commencement date of March 1, 2013 for the additional 1,104 square feet of space, over the five-year term of the proposed lease, the Airport will receive a total of $8,399,443 of revenue, as shown in Table 2 below.

Table 2: Total Estimated Airport Rent and Operating Expenses Payable by TSA to the Airport in the Proposed Five-Year Lease

	International Terminal (7,200 square feet)	Terminal 2 (1,104 square feet)	Operating Expenses (8,304 square feet)	Total Annual Revenue
November 1, 2012-October 31, 2013	$1,427,328	$113,080*	$90,867*	**$1,631,275**
November 1, 2013-October 31, 2014	$1,427,328	169,620	95,094	**1,692,042**
November 1, 2014-October 31, 2015	$1,427,328	169,620	95,094	**1,692,042**
November 1, 2015-October 31, 2016	$1,427,328	169,620	95,094	**1,692,042**
November 1, 2016-October 31, 2017	$1,427,328	169,620	95,094	**1,692,042**
Total	**$7,136,640**	**$791,560**	**$471,243**	**$8,399,443**

*Assumes eight months of rent and operating expenses based on completion of tenant improvements in the new 1,104 square feet of space in Terminal 2 effective as of March 1, 2013.

As shown in Table 3 below, currently, under the existing 7,200 square foot lease of space in the International Terminal, TSA pays the Airport at a fixed five-year rate of $990,804 annually, or $137.61 per square foot per year, for rent and operating expenses, such that the current lease will result in total revenues of $4,954,020 ($990,804 x 5 years) to the Airport.

Table 3: Comparison of Existing and Proposed Revenues in the Five-Year Leases between the Airport and TSA

	Leased Space	Average Annual Rental Revenue	Average Revenue per Square Foot per Year	Total Revenue Over 5-Year Lease Term
Existing Lease	7,200 sf	$990,804	$137.61	$4,954,020
Proposed Lease	8,304 sf	$1,692,029	$203.76	$8,399,443

As shown in Table 3 above, under the proposed five-year lease for 8,304 square feet, TSA would pay the Airport a total of $8,399,443, or an average of $203.76 per square foot per year, which is $3,445,423 or 69.6 percent more than the Airport's current five-year total revenue of $4,954,020 under the existing TSA lease, which reflects an average of $137.61 per square foot per year. As noted above, the additional 1,104 square feet of space that TSA will lease under the proposed new lease is currently vacant.

POLICY CONSIDERATION

As noted above, under the proposed lease, the existing 52 reserved parking spaces on the fourth level of the Domestic Terminal Parking Garage would continue to be provided by the Airport to the TSA at no additional cost to the TSA. According to Ms. Artz, parking for TSA employees is provided by the Airport without charge given that the functions performed by this Federal agency are essential to Airport operations. The fourth level of the Domestic Terminal Parking Garage is a designated employee parking area for Airport employees and Federal government employees, which contains a total of 766 parking spaces. The Airport's FY 2012-2013 Rates and Charges schedule states that employee parking costs $112 per parking space per month, which would total $69,888 per year, or an estimated $349,440 over five years, of additional revenue for the Airport for the subject 52 parking spaces, if the TSA was to be charged for these parking spaces.

The San Francisco Planning Commission and the Board of Supervisors have adopted a Transit First Policy in order to give priority to public transit investments and services, including bicycling and walking, rather than single-occupant automobiles, in the City's transportation policy. However, the Budget and Legislative Analyst notes that the proposed lease with TSA would continue the Airport's practice of providing 52 free, reserved parking spaces at the Airport, for TSA employees.

In response, Mr. Gary Franzella, Associate Deputy Airport Director, provided Attachment I, which indicates that in addition to the proposed 52 free parking spaces for TSA, (a) the Airport has historically provided free parking for Federal agencies that operate at the Airport, (b) the Airport currently provides 1,021 other parking permits at no charge to other Federal agencies at the Airport, and (b) Covenant Aviation Service, which contracts with the Federal government to provide TSA's security services, has purchased 685 parking permits in the current quarter, for projected Airport parking revenues totaling $616,500[4] in the current fiscal year. In addition, as shown in Attachment II, provided by Ms. Cathy Widener, Governmental Affairs Manager for the Airport, the Airport is not served by the San Francisco Municipal Transportation Agency, and while BART is an expensive commuting travel option, 45 percent of passengers currently take commercial or ground transportation, including BART, SamTrans, taxis, shared-ride vans and courtesy shuttles to the San Francisco Airport, the highest level at any U.S. Airport.

RECOMMENDATION

Approve the proposed resolution.

[4] 685 parking permits x $225 per quarter x 4 quarters = $616,500 annually, which reflects the applicable parking rates at this non-terminal parking lot where Covenant Aviation Service employees park.

Attachment I

San Francisco International Airport

October 17, 2012

Ms. Debra Newman
Budget Analyst
1390 Market Street Suite 1150
San Francisco, CA 94102

Dear Ms. Newman:

The Transportation Security Administration, ("TSA") is one of several Federal Agencies at San Francisco International Airport. Historically Airports have not, to my knowledge, assessed parking fees to Federal Agencies. The TSA, formed in 2003, for security related issues is quite different at San Francisco, compared to other airports, as the main service provided is via Covenant Aviation Security, under contract by the Federal Government.

Under the proposed lease, the same fifty two, (52) reserved parking spaces on the fourth level of the Domestic Terminal Parking Garage would continue to be provided to the TSA at no additional cost. While 52 parking spaces are provided to the TSA; Covenant Aviation Security purchased six hundred and eighty five (685) parking permits for its employees this current quarter.

The following is a summary of parking offered to other Federal Agencies, at no charge, at San Francisco International Airport as well a reference to Covenant Aviation Security:

Federal Agency	**Parking Permits**	**Annual Revenue**
Department of Agriculture (USDA)	39	0
Drug Enforcement Agency (DEA)	16	0
Federal Marshalls	135	0
Federal Aviation Administration (FAA)	205	0
Federal Bureau of Investigation (FBI)	10	0
U.S. Customs	616	0
Total - Federal Agencies	1,021	
Covenant Aviation Security	685	$ 616,500*
* Current quarter with annual projection.		

Sincerely,

Gary Franzella
~~Associate Deputy~~ Airport Director
Aviation & Parking Management

Post Office Box 8097 San Francisco, California 94128 Tel 650.821.5000 Fax 650.821.5005 www.flysfo.com

San Francisco International Airport

Memorandum

October 17, 2012

TO: Debra Newman, Budget Analysts Office

FROM: Cathy Widener, SFO Governmental Affairs

RE: **TSA lease item, file no. 12-0986**

While San Francisco International Airport ("SFO") is a department of the City and County of San Francisco, the airport is located outside of the City's geographical boundaries and is not served by Muni.

SFO is committed to public transit. SFO/BART has one of the largest riderships throughout the BART system and 12% of Airport Commission employees commute by this mode of transportation. SFO is constantly working to provide public transit incentives.

Currently, BART remains an expensive daily option to SFO , with a $8.00 SFO roundtrip surcharge in addition to the base fare. However, in 2010 the Airport successfully negotiated and implemented an amendment, (Amendment No.1 to BART Lease NO. 97-0081), that reduced the surcharge, ($3.00 per day versus $8.00 per day), applicable to City employees as well as the remainder of all employees, issued a badge at the Airport.

Through successful marketing campaigns and outreach, the airport has increased the percentage of air passengers that take commercial or ground transportation to SFO to a 45% level (this includes BART, SamTrans, taxis, shared ride vans and courtesy shuttles.) – the highest of any other airport in the nation.

Item 3 File 12-0980	Department: Department of the Environment

EXECUTIVE SUMMARY

Legislative Objectives

- The proposed resolution would authorize a tenant improvement allowance of up to $244,400, or $10 per square foot for the Department of Environment's planned tenant improvements at 1455 Market Street, amortized by the landlord, Hudson 1455 Market, LLC (Hudson 1455 Market), over the initial term of seven years at eight percent interest to be paid by the Department of the Environment as additional rent to Hudson 1455 Market in the amount of $3,809.27 per month.

Key Points

- On June 5, 2012, the Board of Supervisors approved a resolution authorizing the City, on behalf of the Department of the Environment, to enter into a new lease for 24,440 square feet of office space on the 12th floor at 1455 Market Street with Hudson 1455 Market, LLC (Hudson 1455 Market), as lessor, for a seven-year term commencing from the date that the tenant improvements are substantially completed, with one option to extend the lease by an additional five years.

- The current estimate for the tenant improvements is $2,027,815, or $82.97 per square foot.

- The Department of the Environment has secured $1,783,415 in funding for the tenant improvements, with a remaining balance of $244,400 where funding has not been identified.

Fiscal Analysis

- A total of $5,452,381 in rent would be paid over the seven-year term under the lease previously approved by the Board of Supervisors, including an additional $319,978 for the tenant improvements. The eight percent interest rate which the Department of the Environment must pay to Hudson 1455 Market results in an additional $75,578 ($319,978 less $244,400) in interest being paid on the $244,400 tenant improvement allowance over the seven-year term of the lease.

Policy Considerations

- Rather than choosing to borrow $244,400 at an interest rate of eight percent, the Department of the Environment should (a) make additional design decisions to mitigate construction costs, (b) continue to attempt to raise additional outside funding, and/or (c) re-evaluate other cost-cutting options in order to, at a minimum, reduce the amount borrowed from the landlord or, ideally, complete the tenant improvements within the $1,783,415 of identified funding available.

Recommendation

- Disapprove the proposed resolution.

MANDATE STATEMENT / BACKGROUND

Mandate Statement

In accordance with Section 23.27 of the City's Administrative Code, except in specified limited term cases, all leases, in which the City is the tenant, are subject to Board of Supervisors approval. On June 5, 2012, the Board of Supervisors approved a resolution authorizing the City, on behalf of the Department of the Environment, as the tenant, to enter into a new lease for 24,440 square feet of office space on the 12th floor at 1455 Market Street with Hudson 1455 Market, LLC (Hudson 1455 Market), as the landlord, for a seven-year term commencing from the date that the tenant improvements are substantially completed, then estimated to be October 1, 2012, and expiring seven years later, then estimated to be September 30, 2019, with one option to extend the lease by an additional five years, then estimated to be through September 30, 2024 (Resolution No. 208-12)

Included in the previously approved lease was a provision allowing the Department of the Environment to borrow up to $244,400, or $10 per square foot for the 24,400 square feet, from the landlord, Hudson 1455 Market, such that the Department of the Environment would amortize the borrowed $244,400 at an eight percent interest rate and repay those monies to Hudson 1455 Market by paying an increase in rent per square foot over the seven-year term of the proposed lease. However, when the Board of Supervisors approved the lease, the authority to have the landlord, Hudson 1455 Market, advance the additional $244,400 in tenant improvements, in exchange for the Department of the Environment paying additional rent costs to amortize the Hudson 1455 Market's advance, would be subject to Board of Supervisors approval under the proposed resolution.

Background

A New Lease at 1455 Market Street Was Approved on June 5, 2012

The Department of the Environment's lease, as previously approved by the Board of Supervisors on June 5, 2012, for 24,400 square feet of space at 1455 Market will replace the two existing leased spaces at 11 Grove Street and at 401 Van Ness Avenue in the War Memorial Building, which currently house the Department of Environment staff.

Table 1 below summarizes the monthly and annual rents, as well as the rate per square foot over the 7-year term of the lease. As shown in Table 1, the Department of the Environment is projected to pay a total of $5,132,403 in rent over the seven-year term of the lease. Included in the lease is a three-month rent credit for the first three months of the lease resulting in a $171,081 rent savings in FY 2012-13.

Table 1: Rent Under Existing Lease at 1455 Market Street

Year Under Lease	Monthly Rent	Annual Base Rent	Rate Per Square Foot
1	$57,027	$513,243*	$28
2	59,063	708,756	29
3	61,100	733,200	30
4	63,137	757,644	31
5	65,173	782,076	32
6	67,210	806,520	33
7	69,247	830,964	34
Total		$5,132,403	

* Year 1 results in $513,243 in annual rent due to the first three months' rent of $171,081 being credited by Hudson 1455 Market.

As shown in Table 1 above, the rent under the lease will increase by $1 per square foot per year, ranging from $513,243 in annual rent in the first year, after accounting for a three-month rent credit included in the proposed first year of the lease, to $830,964 in annual rent in the seventh year of the lease.

Tenant Improvements for 1455 Market Street Have Increased by $194,815 and Are Not Fully Funded

The lease also provides for Hudson 1455 Market to provide $1,502,571 or $61.48 per square foot for the 24,440 square feet to fund one-time tenant improvements. At the time of the lease's approval by the Board of Supervisors, the Department of Real Estate estimated that the Department of the Environment's tenant improvements would cost a total of $1,833,000, or $75 per square foot, leaving $330,429 ($1,833,000 less $1,502,571), or $13.52 per square foot in additional funding to be provided by the Department of the Environment. However, that original estimate was not determined by actual bids, but rather on the Department of Real Estate's preliminary estimates based on discussions with Hudson 1455 Market.

At the time of the lease's approval by the Board of Supervisors, there were three possibilities for funding the original estimated $330,429 for tenant improvements, or $13.52 per square foot, shortfall: (1) the Department would raise in-kind donations, grants, or reductions in construction cost through the donation of needed materials, (2) Hudson 1455 Market would pay up to an additional $244,400, or $10 per square foot, of the $330,429 needed, such that the Department of the Environment would amortize the lessor's additional contribution at an eight percent interest rate and repay those monies to Hudson 1455 Market by paying an increase in rent per square foot over the seven-year term of the proposed lease and the City would pay the remaining shortfall, $86,029 ($330,429 less $244,400) which would be funded from the Department of the Environment's FY 2012-13 budget, or (3) some combination of the above. When the Board of Supervisors approved the lease, the authority to have the landlord, Hudson 1455 Market, pay for an additional $244,400 in tenant improvements in exchange for the Department of the Environment paying additional rent costs to amortize the lessor's additional contribution was to be subject to Board of Supervisors approval, which is the subject of the proposed resolution.

According to Ms. Marta Bayol, District General Manager from the Department of Real Estate, the current estimate to complete the tenant improvements based on actual bids is now $2,027,815, or $82.97 per square foot, which is $194,815, or 10.6 percent, more than the original estimate of $1,833,000 provided to the Board of Supervisors at the time of the lease's approval, leaving a total $525,244 ($2,027,815 current estimate less $1,502,571 to be provided by Hudson 1455 Market) where funding is not available. Table 2 below details the current estimate of the tenant improvements.

Table 2: Current Estimate of Tenant Improvements at 1455 Market Street

Architectural/Engineering/Consultant fees	$118,954
Mayor's Office on Disability's Plan Check and Inspections	45,883
Permit allowance included	23,550
Construction Costs	1,718,425
Landlord Project Management Fee[1]	24,440
Subtotal	**$1,931,252**
Project Contingency (5% of $1,931,252)	96,563
Total	**$2,027,815**

In addition, the tenant improvements detailed in Table 2 above are now estimated to be completed by February 28, 2013, a four-month delay from the previous October 1, 2012 estimated completion date. Therefore, the lease would not take effect until March 1, 2013.

As shown in Table 3 below, the Department of the Environment has identified funding sources of $1,783,415 for the tenant improvements, with a remaining balance of $244,400 where funding has not been identified out of a total $2,027,815 in tenant improvements, which must be paid by the Department of the Environment. Hudson 1455 Market is willing to lend the $244,400 to the Department of the Environment at an interest rate of eight percent.

[1] Under the lease, Hudson 1455 Market receives a $1 per square foot as compensation for staff review of plans, specifications, construction, and construction costs as well as any other costs incurred as a result of the construction work.

Table 3: Proposed Funding for the Tenant Improvements at 1455 Market

Current Estimate for Tenant Improvements	**$2,027,815**
Landlord's Contribution to Tenant Improvements	1,502,571
Rent Savings from Three-Month Rent Credit[1]	171,080
Additional Rent Savings in FY 2012-13[2]	51,775
In-Kind Donations and Funds Raised[3]	57,989
Total Funding Secured	**-$1,783,415**
Total Remaining Shortfall	**$244,400**

[1]-The Department of the Environment will realize $171,080 in savings from rent budgeted in FY 2012-13 due to a three-month rent credit in the first year of the lease.
[2]-The Department of the Environment will realize an additional $51,775 in rent savings in FY 2012-13 due to surplus funding budgeted for rent.
[3]-Mr. Guillermo Rodriguez, Director of Policy and Communications for the Department of the Environment, advised that the Department launched a capital campaign to secure funds, as well as in-kind donated products and services, to cover the estimated shortfall for tenant improvements of up to $525,244, and has received $57,989 to date from that capital campaign.

DETAILS OF PROPOSED LEGISLATION

The proposed resolution would authorize a tenant improvement allowance of up to $244,400, or $10 per square foot, based on 24,440 square feet to be advanced by the landlord, Hudson 1455 Market, LLC (Hudson 1455 Market), for the Department of Environment's planned tenant improvements at 1455 Market Street. The advance would be amortized by Hudson 1455 Market over the initial seven-year term of the lease at eight percent interest to be paid by the Department of the Environment, resulting in additional rent to Hudson 1455 Market at a total added cost of $319,978, or $3,809.27 per month for seven years (84 months).

FISCAL ANALYSIS

The Department of the Environment's Rent Would Increase by $319,978.44 Over the Seven-Year Term of the Existing Lease

As shown in Table 1 above, the Department of the Environment will pay a total of $5,132,403 in base rent over the initial seven-year term of the subject lease, as previously approved by the Board of Supervisors. As noted in Table 3 above, of the total estimated $2,027,815 for tenant improvements, the Department of the Environment has identified funding of $1,783,415 leaving a shortfall of $244,400. Under the proposed resolution, the Department of the Environment would borrow $244,400 from Hudson 1455 Market at an interest rate of eight percent, resulting in total additional rent payments of $319,978, including the principal of $244,400 and eight percent interest of $75,578 to be paid by the Department of the Environment to Hudson 1455 Market. Therefore, as shown in Table 4 below, the Department of the Environment would pay total rent of $5,452,381 ($5,132,403 plus an additional $319,978) over the initial seven-year term under the lease at the rate of an additional $45,711.24 annually over the seven-year term of the lease

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Table 4: Summary of $5,452,381.44 in Rent if the Proposed Resolution Were Approved

Year Under Lease	Monthly Rent (Previously approved by the Board of Supervisors)	Monthly Payment on Tenant Improvement Allowance	Total Monthly Rent Plus Monthly Payment on Tenant Improvement Allowance	Annual Rent Plus Annual Payment on Tenant Improvement Allowance	Additional Annual Rent Due to Tenant Improvement Allowance
1	$57,027	$3,809.27	$60,836.27	$558,954*	$45,711.24
2	59,063	3,809.27	62,872.27	754,467.24	45,711.24
3	61,100	3,809.27	64,909.27	778,911.24	45,711.24
4	63,137	3,809.27	66,946.27	803,355.24	45,711.24
5	65,173	3,809.27	68,982.27	827,787.24	45,711.24
6	67,210	3,809.27	71,019.27	852,231.24	45,711.24
7	$69,247	3,809.27	73,056.27	876,675.24	45,711.24
Total			**$468,621.89**	**$5,452,381.44**	**$319,978.44****

*-Year 1 results in $558,954.24 in annual rent due to the three months' rent of $171,081 being credited by Hudson 1455 Market.
**-Includes $244,400 in principal and eight percent interest of $75,578.

Mr. Rodriguez advises that the rental costs and tenant improvement costs are funded in the Department of the Environment's rent budget from the Solid Waste Impound Fees, Public Goods charges[2], work-orders and ongoing grant funds.

Ms. Bayol advises that the Department of the Environment would be allowed to pre-pay part or all of the additional tenant improvement allowance at any time and without any pre-payment penalty rather than adhering strictly to the payment schedule detailed above in Table 4 if, for example, there were unexpended funds left after the tenant improvements were completed.

[2] Public Goods charges are a state-imposed utility surcharge imposed on all retail electricity sales to fund research and technology development, renewable energy sources of electricity and the encouragement of energy efficiency.

POLICY CONSIDERATIONS

As shown in Table 2 above, the project contingency included in the current $2,027,815 tenant improvement budget at 1455 Market Street is $96,563, or five percent of the total tenant improvement budget of $1,931,252, rather than a ten percent contingency of $193,125, which was originally included. Ms. Bayol advises that project contingencies typically range between five and ten percent of the total project cost. Significantly reducing the project contingency for the subject tenant improvements leaves less money available if the final cost of the tenant improvements is higher than the current budgeted amount of $2,027,815. Mr. Rodriguez advises that the Department of the Environment is working closely with the general contractor and Hudson 1455 Market to ensure that the tenant improvements are completed at the current budget amount of $2,027,815.

However, Mr. Rodriguez advises that if the cost of the tenant improvements exceeds the current $2,027,185 tenant improvement budget, depending on the nature of the cost overruns, the Department of the Environment would (a) make design decisions to mitigate construction costs, (b) attempt to raise additional outside funding, and/or (c) re-evaluate other cost-cutting options.

According to Mr. Rodriguez, the Department of the Environment was able to further minimize the costs of the tenant improvements by (a) using currently owned furniture, (b) incorporating existing infrastructure into the design, and (c) making some design changes. In the professional judgment of the Budget and Legislative Analyst, rather than choosing to borrow $244,400 at an interest rate of eight percent, the Department of the Environment should (a) make additional design decisions to mitigate construction costs, (b) continue to attempt to raise additional outside funding, and/or (c) re-evaluate other cost-cutting options in order to, at minimum, reduce the amount borrowed from the landlord or, ideally, complete the tenant improvements within the $1,783,415 funds that the Department of the Environment has available.

RECOMMENDATION

Disapprove the proposed resolution.

Items 5 and 6 **Files 12-1013 and 12-0985**	**Department:** Public Utilities Commission (PUC)

EXECUTIVE SUMMARY

Legislative Objective

- File 12-1013: Request to (a) release $34,897,331 reserved by the Budget and Finance Committee to fund Public Utilities Commission (PUC) Water System Improvement Program (WSIP) program management services, and (b) reallocate $27,356,361, as previously approved by the Board of Supervisors, from the WSIP Program Reserve to six WSIP projects.
- File 12-0985: Resolution adopting findings under the California Environmental Quality Act (CEQA), including the adoption of a mitigation monitoring and reporting program and a statement of overriding considerations, for the San Antonio Backup Pipeline Project, and directing the Clerk of the Board of Supervisors to notify the Controller of this action.

Key Points

- On April 20, 2010, the Board of Supervisors placed $34,897,331 for WSIP program management services on Budget and Finance Committee reserve, pending the PUC submitting detailed WSIP expenditure plans to the Budget and Finance Committee (File 10-0337).
- On November 21, 2011, the Board of Supervisors approved the creation of a WSIP Program Reserve, with an initial appropriation of $144,459,649 (File 11-1031), to provide funds for any WSIP project that exceeds the June 2011 Revised WSIP project budgets. Funds from the WSIP Program Reserve can only be released after the PUC submits detailed expenditure plans to the Budget and Finance Committee.
- The PUC is now requesting that $27,356,361 be reallocated from the $144,459,649 WSIP Program Reserve to six WSIP projects that have exceeded their previously approved budgets: (1) San Joaquin Pipeline, (2) Tesla Treatment Facility, (3) New Irvington Tunnel, (4) Alameda Siphon No. 4, (5) Vegetation Restoration of WSIP Construction Sites, and (6) WSIP Program Management. Explanations for these specific project requests are included in the Attachment to this report.
- The objectives of the San Antonio Backup Pipeline Project are (a) to provide reliable conveyance capacity for Hetch Hetchy, and (b) to increase operational flexibility and delivery reliability. The final Environmental Impact Report (EIR) for the San Antonio Backup Pipeline Project was certified by the San Francisco Planning Commission on September 20, 2012, and adopted by the PUC Commission on September 25, 2012. The PUC is not requesting additional funding to comply with this EIR.

Fiscal Impacts

- Water Revenue Bond proceeds previously approved by the Board of Supervisors are the source of funds for the $34,897,331 release of reserves and for the $27,356,361 reallocation. These Water Revenue Bonds are repaid from water rate revenues paid by the PUC's water customers.

Recommendations

- Approve the requested release of reserved funds and the reallocation of funds (File 12-1013).
- Approve the proposed resolution (File 12-0985).

MANDATE STATEMENT / BACKGROUND

Mandate Statement

Section 3.3 of the City's Administrative Code provides that the committee of the Board of Supervisors that has jurisdiction over the budget (i.e., Budget and Finance Committee) may place requested expenditures on reserve which are then subject to release by the Budget and Finance Committee.

In accordance with the California Environmental Quality Act (CEQA), any public agency, that makes a discretionary decision to approve a project that has a potential to result in a direct physical change in the environment, must comply with CEQA by having the legislative body adopt specific findings prior to the approval of the project.

Background

The San Francisco Public Utilities Commission (PUC)'s Water System Improvement Program (WSIP) consists of 86 projects organized into 11 project regions to repair, replace, and seismically upgrade the Hetch Hetchy water system's aging pipelines, tunnels, pumps, tanks, reservoirs and dams. PUC commenced the WSIP in FY 2002-2003 and is scheduled to complete all projects by the end of July 2016. The approved WSIP project budget is $4,113,856,261. WSIP is funded with PUC Water Revenue Bonds, which will be repaid from water rate revenues paid by PUC water customers.

On November 21, 2011, the Board of Supervisors approved the creation of a WSIP Program Reserve, with an initial appropriation of $144,459,649 from then-existing WSIP project surpluses (File 11-1031). The purpose of the WSIP Program Reserve is to provide funds for any WSIP project costs that exceed the June 2011 Revised WSIP project budgets. Funds from the WSIP Program Reserve can only be released by the Budget and Finance Committee, after the PUC submits detailed expenditure plans to the Budget and Finance Committee. The current balance in the WSIP Program Reserve is $144,459,649.

The San Antonio Backup Pipeline Project is one of 86 separate capital improvement projects included in WSIP. The objectives of the San Antonio Backup Pipeline Project are (a) to provide reliable conveyance capacity for emergency discharges of Hetch Hetchy water supplies during events that impair water quality or during facility outages, and (b) to increase operational flexibility and delivery reliability during emergencies and planned maintenance. The San Antonio Backup Pipeline Project consists of approximately 1.3 miles of steel pipeline extending from the Alameda Siphons to a quarry near San Antonio Creek. All project components are located in the Sunol Valley, an unincorporated area of Alameda County, on Alameda watershed lands owned by the City and County of San Francisco and managed by the PUC. The project is anticipated to be completed in March 2015. As of April 20, 2010, the Board of Supervisors had appropriated a total of $54,867,000 for the San Antonio Backup Pipeline Project (File 10-0337), which is still the current estimated project cost.

The final Environmental Impact Report (EIR) required under CEQA for the San Antonio Backup Pipeline Project was certified by the San Francisco Planning Commission on September 20, 2012, and adopted by the PUC Commission on September 25, 2012.

DETAILS OF PROPOSED LEGISLATION

File 12-1013

The Public Utilities Commission (PUC) is requesting (a) the release of $34,897,331 previously reserved by the Budget and Finance Committee to fund Public Utilities Commission (PUC) Water System Improvement Program (WSIP) program management services, and (b) the reallocation of $27,356,361 from the WSIP Program Reserve for six WSIP projects.

The Board of Supervisors placed $34,897,331 on Budget and Finance Committee reserve on April 20, 2010, pending submission of PUC's detailed expenditure plans to the Budget and Finance Committee (File 10-0337). The PUC is now requesting the release of the entire $34,897,331 reserved for WSIP program management services, as shown in Table 1, below.

Table 1: WSIP Program Management Services Expenditure Plan
October 2012 through June 2016

Use	Amount
Professional Services	$ 8,521,759
Labor Other City Departments	1,176,616
Labor Other Direct Charges	31,636
Professional Services Right-of-Way Costs	500,000
Construction Management	9,968,603
Labor	14,698,717
Total	**$34,897,331**

In addition to the requested release of $34,897,331, presently on reserve, the PUC is also requesting the reallocation of the $27,356,361 from the WSIP Program Reserve for six WSIP projects that have exceeded their previously approved budgets. The reallocation amounts are summarized in Table 2 below. As noted in the Background section above, funds from the Program Reserve can only be released by the Budget and Finance Committee, after the PUC submits detailed expenditure plans to the Budget and Finance Committee. The Attachment to this report, provided by the PUC, details the PUC's six project budgets and expenditure requests.

Table 2: Summary of Proposed Uses for Reallocated Program Reserve Funds

WSIP Project	Amount
San Joaquin Pipeline	$12,557,135
Tesla Treatment Facility	2,042,226
New Irvington Tunnel	6,500,000
Alameda Siphon No. 4	1,600,000
Vegetation Restoration of WSIP Construction Sites	2,200,000
WSIP Program Management Services	2,457,000
Total	**$27,356,361**

File 12-0985

The proposed resolution would (a) adopt findings under the California Environmental Quality Act (CEQA) for the San Antonio Backup Pipeline Project, including the adoption of a mitigation monitoring and reporting program and a statement of overriding considerations, and (b) direct the Clerk of the Board of Supervisors to notify the Controller of this action. The final Environmental Impact Report (EIR) for the San Antonio Backup Pipeline Project was certified by the San Francisco Planning Commission on September 20, 2012, and adopted by the PUC Commission on September 25, 2012.

FISCAL IMPACT

File 12-1013

The PUC is requesting (a) the release of $34,897,331, previously appropriated and reserved by the Budget and Finance Committee to fund WSIP program management services, and (b) the reallocation of $27,356,361 from the WSIP Program Reserve for six WSIP projects, for a total of $62,253,692. The proposed expenditures of these funds are shown in Tables 1 and 2, above. Further detail on the requested reallocation of the $27,356,361 is shown in the Attachment to this report, provided by the PUC.

Water Revenue Bond proceeds are the source of funds for the total request of $62,253,692, including the $34,897,331 appropriation previously placed on reserve and the $27,356,361 requested reallocation. Water Revenue Bonds are funded with revenues received from the PUC's water ratepayers. The $34,897,331 requested release of reserves was previously appropriated to WSIP program management services and placed on Budget and Finance Committee reserve by the Board of Supervisors. The $27,356,361 would be reallocated from the PUC's WSIP Program Reserve for the six WSIP projects listed in Table 2 above. The requested additional funding is needed in addition to the previously approved budgets for these six projects.

The WSIP Program Reserve currently has a balance of $144,459,649. A reallocation of the requested $27,356,361 from the WSIP Program Reserve to the six WSIP projects shown in Table 2 above would result in a new WSIP Program Reserve balance of $117,103,288.

File 12-0985

The proposed resolution would adopt the findings detailed in the project environmental impact report (EIR) in accordance with CEQA for the San Antonio Backup Pipeline Project, and directing the Clerk of the Board of Supervisors to notify the Controller of this action. According to PUC Project Permitting Manager Mr. Jonathan Mates-Muchin, the environmental mitigation required under CEQA is estimated to cost $254,170. According to PUC Budget Director Mr. Carlos Jacobo, these environmental mitigation costs were previously included in the San Antonio Creek Bioregional Habitat Restoration Project budget.

RECOMMENDATIONS

1. Approve the requested release of reserved funds and the reallocation of funds (File 12-1013).
2. Approve the proposed resolution (File 12-0985).

Detailed Program Budgets

San Joaquin Pipeline

Approved Change Orders (COs) are changes that have received all required approvals; Pending COs are changes approved by the SFPUC that have yet to be authorized by the City Controller's Office; Potential COs are changes still being negotiated with the Contractor; and Trends are issues likely to result in future change orders but that have yet to be officially submitted and entered into the WSIP Construction Management Information System (CMIS) as a Proposed Change Order (PCO) or Change Order Request (COR).	
Change Description	**Amount**
Approved Change Orders (August 2012)	$2,983,291
Pending Change Orders	2,964,541
Potential Change Orders	437,442
Trends	2,251,315
10% Contingency of Work Not Yet Performed	1,682,601
Subtotal Change Orders, Trends & Contingency	**$10,319,190**
An increase in the project budget is needed to account for additional costs associated with (1) a required schedule extension to address design and constructability issues, and outstanding disputes (Crossovers contract); (2) the need for additional pipe support at the crossing of the California Aqueduct (West Segment contract); and (3) access restriction due to bird nesting, unanticipated subsurface conditions, and the need to accelerate work so it can be completed within the allowable window imposed by resource agencies for the protection of California Tiger Salamander (East Segment contract). Project management, engineering and operations support, and construction management resources must be extended to support the project through its completion, resulting in increased delivery costs. The construction adjustments that had to be made to address the very challenging and unforeseen permit requirements for working in California Tiger Salamander habitat have also significantly increased the project's construction costs. The proposed budget revisions take into account the costs estimated to address all currently known developing changes and disputed issues on the 3 contracts and any remaining work required to provide the functional integrity of the new SJPL facilities that are being provided by this project.	
Delivery	$4,961,990
Construction	1,100,000
Other	708,895
Subtotal: Additional Project Costs	**$6,770,885**
Less Previously Authorized 10% Pre-Approved Contract Contingency	**$(4,532,942)**
Total Requested Increase	**$12,557,135**

Tesla Treatment Facility

An increase in the project budget is needed to account for additional costs associated with (1) higher than expected costs for staff and professional services contracts to supervise the construction contractor in completing various construction items and to comply with environmental requirements for water discharges, and incorporation of renewable energy technology into the water treatment facility (Tesla Treatment Facility contract); and (2) a required schedule extension to address various facility conflicts and the need for lead abatement, and unanticipated corrosion of the piping manifold at Tesla Portal (Tesla Portal Protection contract). Project management, engineering and operations support, and construction management resources must be extended to support the project through its completion, resulting in increased delivery costs. The construction adjustments that had to be made to address the unforeseen special conflicts of utilities, structures and equipment and the adjustments needed to address the unanticipated conditions of existing piping at the Tesla Portal piping manifold have significantly increased the engineering and construction management workload. The proposed budget revisions take into account the costs estimated to address all currently known developing changes to both contracts. The following table shows the proposed budget changes to the project's major cost categories:

Change Category	Amount
Delivery	$1,085,732
Construction	459,178
Other	497,316
Total Requested Increase	**$2,042,226**

New Irvington Tunnel

Revisions to the schedule and budget of the New Irvington Tunnel project are needed as a result of the construction adjustment necessary to address very challenging and unforeseen site conditions and the tunnel's reclassification from Potentially Gassy to Fully Gassy by the California Occupations Safety and Health Administration (Cal-OSHA), resulting in a 447 calendar day extension to the project schedule. The schedule extension will result in additional costs for the project. The following table shows the proposed budget changes to the project's major cost categories:

Change Description	Amount
Project management and construction management resources must be extended to support the project through its completion, resulting in increased delivery costs.	$1,800,000
The construction adjustments that had to be made to address the very challenging and unforeseen site conditions and Cal-OSHA's reclassification of the tunnel, have significantly increased the projects construction costs. Construction Increase	4,700,000
Total Increase	**$6,500,000**

Alameda Siphon No. 4

Additional contingency in the amount of $1,600,000 is being requested due to unanticipated field changes in Contract No. WD-2552 - Alameda Siphon No. 4. These changes include:

- New scope items requested by SFPUC lease holders and the Water Enterprise Operations Division;
- Changes due to differing geotechnical conditions and differing as-built conditions of the existing siphons and appurtenances from that known at the time of design, including the tie-ins to the mixing chamber piping, soil nail wall, various valve vaults, and tunnel shafts; and
- Changes to resolve conflicts between new and existing electrical, mechanical, and controls equipment.

Change Descriptions	**Amount**
Potential Change Orders – changes that are still being negotiated with the Contractor	$1,030,145
Trends – forecasted changes that have been entered into the WSIP Construciton Management System as place holders and not yet negotiated with the Contractor.	569,855
Total	**$1,600,000**

Vegetation Restoration of WSIP Construction Sites

This is a new project to provide maintenance, monitoring and reporting of onsite mitigation installed at the various WSIP construction sites. These activities, which are necessary to satisfy the California Environmental Quality Act (CEQA) and resource agencies' requirements, typically must extend for 5 years following construction completion and in some cases up to 10 years. The costs for those activities were not included in the WSIP budget because it was assumed that they would be covered in the Water Enterprise operating budget but due to the immediate need to fund these activities, the WSIP will cover the cost of that work through October 2013. The Water Enterprise will provide the funding needed for all required vegetation restoration work at WSIP construction sites following October 2013.

The proposed Vegetation Restoration project will handle permit-required and CEQA-required maintenance and performance obligations for onsite landscaping and habitat installed by 14 WSIP projects that have either recently finished, have partially finished or will finish within the next year. Maintenance may include watering, weeding, or replacement of any dead plants to meet performance criteria, as well as erosion control where needed. Assessment, monitoring, inspection and reporting costs are included.

The following table shows the proposed budget for the new project's major cost categories:

Change Description	**Amount**
Delivery	$200,000
Construction	2,000,000
Total Requested Increase	**$2,200,000**

WSIP Program Management

An increase to the program management budget is needed to fund the additional real estate acquisitions required to convert temporary rights acquired to allow construction to proceed on many projects into permanent rights for the long-term operation of the system

Change Description	**Amount**
Appraisal Costs	$512,000
Acquisition Consultant Service Costs	212,000
Property Purchase Costs	596,000
Attorney's Fees for Property Purchases	704,000
Staff Costs	433,000
Total Cost	**$2,457,000**