

CITY AND COUNTY OF SAN FRANCISCO
BOARD OF SUPERVISORS
BUDGET AND LEGISLATIVE ANALYST

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June 14, 2016

TO: Budget and Finance Committee

FROM: Budget and Legislative Analyst



SUBJECT: June 16, 2016 Budget and Finance Committee Meeting

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Item 9
File 16-0645

Department:
Real Estate Division

EXECUTIVE SUMMARY

Legislative Objectives

- The proposed resolution would execute and accept a Purchase and Sale Agreement between the City and various parties in Trust as Trustees for the real property located at 450 Sixth Street for \$2,403,333; and find the proposed transactions are in conformance with the City's General Plan and the eight priority policies of Planning Code Section 101.1.

Key Points

- The City's Capital Planning Committee has determined that County Jails No. 3 and No. 4 located in the Hall of Justice at 850 Bryant Street are seismically deficient and outdated.
- In 2016, the Board of Supervisors urged City staff to convene a working group to (a) develop a plan to provide effective and humane investments in mental health; (b) identify what new facilities are needed; (c) seek to maintain San Francisco's eligibility to use State financing for those facilities; (d) provide a report to the Board of Supervisors and (d) continue to pursue acquisition of four adjacent properties at (1) 814-820 Bryant Street, (2) 444 6th Street, (3) 450 6th Street and (4) 470 6th Street. The acquisition of the property at 450 6th Street is the subject of this resolution.

Fiscal Impact

- The appraised market value for the property is \$2,750,000. The purchase price will be \$2,403,333 or \$346,667 less than the appraised value because the appraisal assumed a higher potential rental income than the existing lease provides. Up to an additional \$25,000 transaction fees are estimated.
- City transfer taxes are due on sale by the seller. However, the sale of land to a public entity does not require the seller to pay transfer tax. For this transaction, the City negotiated a credit at escrow for the City's transfer taxes, which is estimated at \$18,023. Net costs to the City would therefore be \$2,410,310.
- If the existing lease extends for the entire term, or through April 30, 2026, the City is projected to receive a total of \$1,086,008 of net rental revenues.
- Remaining General Fund-County Jails 3 and 4 replacement project funds of \$2,867,419 are available for this acquisition of 450 6th Street.

Policy Consideration

- A City working group is actively meeting to identify potential options for the Board of Supervisors to consider regarding the closure of County Jails 3 and 4 at the Hall of Justice, which may be available for consideration in approximately six months. Whether or not a new jail facility is constructed on this site, additional space will likely be needed adjacent to the Hall of Justice for a jail support facility, a hybrid mental health/rehabilitation facility, or for District Attorney and/or Adult Probation offices, or for a new criminal courthouse, all currently located in the Hall of Justice.

Recommendation

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

MANDATE STATEMENT

City Administrative Code Section 23.1 requires Board of Supervisors approval of all real property transactions. Administrative Code Section 23.4 requires Board of Supervisors approval of the granting of real property to the City before the Director of Real Estate can accept the deed to the property.

BACKGROUND

The City's Capital Planning Committee has determined that County Jails No. 3 and No. 4 located in the Hall of Justice at 850 Bryant Street are seismically deficient and outdated. As a result, replacing the Hall of Justice, including County Jails No. 3 and No. 4, has been a high priority in the City's Ten-Year Capital Plan since 2006. However, in late 2015, the Board of Supervisors rejected legislation to (a) accept a State grant to construct a new jail, (b) issue \$215,000,000 Certificates of Participation and commercial paper to fund the balance of the costs, and (c) purchase four adjacent properties to locate the new jail facility.

Instead, on January 12, 2016, the Board of Supervisors approved a resolution (File 15-1286; Resolution 2-16) urging the Director of the Department of Public Health and the Sheriff to convene a working group, which includes mental health providers and advocates, former inmates, District Attorney, Public Defender, Police, Adult Probation, Pre-Trial Diversion, Controller, Department of Public Works and Capital Planning representatives to (a) develop a plan to provide effective and humane investments in mental health; (b) identify what new facilities are needed; (c) seek to maintain San Francisco's eligibility to use State financing for those facilities; and (d) provide an initial report to the Board of Supervisors no later than March 31, 2016¹. This working group, co-chaired by Sheriff Hennessey, Department of Public Health Director Barbara Garcia and Roma Guy, Taxpayers for Public Safety, meets monthly and Sheriff Hennessey advises that the working group will likely be developing alternative options for the Board of Supervisors to consider in approximately six months.

This resolution also indicated that the Board of Supervisors verbally urged the Department of Real Estate to begin negotiating the acquisition of the four adjacent properties at: (1) 814-820 Bryant Street, (2) 444 6th Street, (3) 450 6th Street and (4) 470 6th Street such that the Board of Supervisors would soon consider legislation approving these acquisitions.

DETAILS OF PROPOSED LEGISLATION

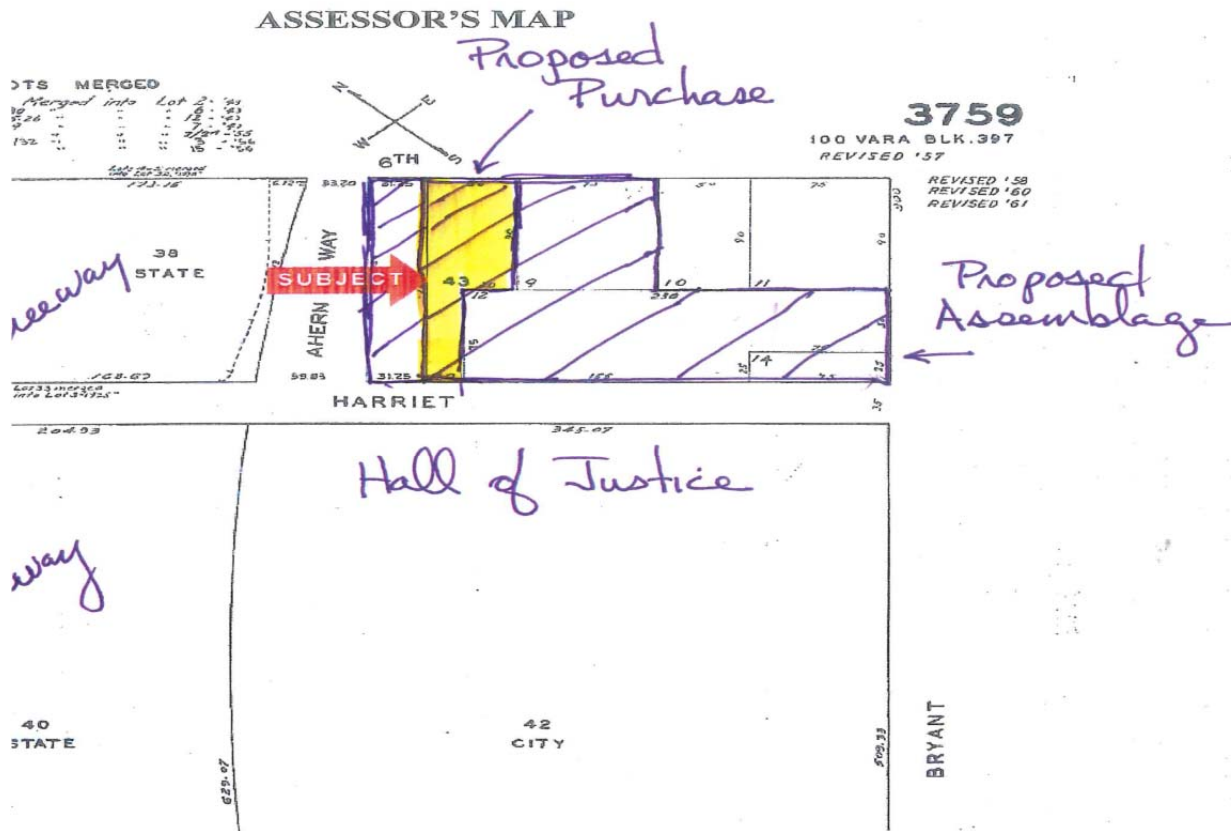
The proposed resolution would (1) authorize the execution and acceptance of a Purchase and Sale Agreement to acquire the real property at 450 6th Street (Block 3759, Lot 043) for \$2,403,333 from (a) Joan Spargo, in Trust, as Trustee of the "Stella Arnold 1987 Exempt Trust FBO Joan Spargo" dated April 4, 2001 as to an undivided 3/8 interest, (b) Walter A Arnold, in Trust, as Trustee of the "Stella Arnold 1987 Exempt Trust FBO Walter A Arnold" dated April 4,

¹ On March 30, 2016, this working group submitted a report to the Board of Supervisors outlining the goals, decision making process, support groups, meeting roadmap, interviews, information sharing and deliverables for this working group.

2001 as to an undivided 3/8 interest, (c) Kenneth Musso, as to an undivided 1/12 interest, (d) David Musso as to an undivided 1/12 interest, and (e) Arlene Ripley as to an undivided 1/12 interest; and (2) find the proposed transactions are in conformance with the City's General Plan and the eight priority policies of the Planning Code Section 101.1.

Existing and Proposed Use of Property

The proposed property at 450 6th Street, located one lot south of Ahern Way in the south of Market neighborhood, is one of the four properties listed above for planned acquisition, located adjacent to the Hall of Justice as shown in the map below.



The subject property at 450 6th Street includes a 4,500 square foot single-story concrete masonry commercial building constructed in 1956 on approximately 6,000 square feet (0.14 acres) of land. The property is currently leased to Beauty Systems Group Inc. for a wholesale beauty supply business and surface parking for \$9,250 per month or \$1.54 per square foot based on 6,000 sf. The existing lease extends through April 30, 2026, or for approximately ten more years, with one escalation in rent to \$10,000 per month on May 1, 2021. Under the proposed resolution, the Board of Supervisors places the subject property under the jurisdiction of the Real Estate Division and assignment of the lease under the existing lease terms.

Mr. John Updike, Director of Real Estate advises that the acquisition of this property is being proposed now because the Real Estate Division was able to reach an agreement with the current owners for a fair market purchase of this property. Mr. Updike advises that his office is continuing to negotiate with two other owners for the three other properties listed above and hopes to acquire such properties, subject to Board of Supervisors approval, in the near future. Acquisition of all four properties (proposed assemblage in above map) is likely to be necessary to develop a potential project adjacent to the existing Hall of Justice facilities.

Environmental and Planning Code Provisions

On July 21, 2015, the Board of Supervisors approved the Final Mitigated Negative Declaration for the jail replacement project (File 15-0701). On May 26, 2016, the Planning Department verified that the proposed acquisition of 450 Sixth Street is consistent with the City's General Plan and the eight priority policies in Section 101.1 of the Planning Code. The proposed resolution would incorporate the findings in the Final Mitigated Negative Declaration, and the Planning Department's findings regarding consistency with the City's General Plan and the Planning Code.

FISCAL IMPACT

Appraisal and Purchase Price

In October 2015, the Real Estate Division contracted with Carneghi and Partners Inc. to conduct an appraisal of the 450 6th Street property, which determined the market value for this property was \$2,750,000. The appraisal defines market value as the most probable price which a property should bring in a competitive and open market under all conditions requisite to a fair sale. This appraisal also assumes the subject property is vacant and available for lease at market rent, and unencumbered by any lease.

The proposed purchase price is \$2,403,333 or \$346,667 less than the recent appraisal of \$2,750,000. Mr. Updike advises that the reduction in purchase price was negotiated because the appraisal assumed a higher potential rental income based on current market conditions. As noted above, the City would assume the existing lease, which is less than current market rates. In addition, Mr. Updike estimates incurring up to \$25,000 for escrow fees, title insurance and other related transaction expenses.

Real Property Transfer Taxes

The practice in San Francisco is for the seller of property to pay real property transfer taxes to the City, generated by the sale. However, because the City is a public entity, the sale of this property does not generate real property transfer taxes. The estimated transfer tax is \$18,023, based on a purchase price of \$2,403,333.

This amount of \$18,023 represents a benefit to the sellers of the property, which would otherwise have been paid by the sellers if the properties were sold to a private entity instead of being sold to the City. Under the proposed acquisition, the City negotiated a credit of \$18,023 at escrow for the City's transfer taxes, which would otherwise be due on sale by the seller.

Net City Costs

As shown in Table 1 below, the net cost to the City for the subject property would be approximately \$2,410,310.

Table 1: Net Purchase Costs to City

Appraisal	\$2,750,000
Proposed Purchase Price	2,403,333
Transaction Fees and Expenses	<u>25,000</u>
Subtotal City Cost	\$2,428,333
Credit for Transfer Taxes	<u>(18,023)</u>
Net City Cost	\$2,410,310

Source of Funding

\$12,690,000 in General Fund monies were previously appropriated by the Board of Supervisors in FY 2012-13 through FY 2015-16 to fund County Jails 3 and 4 Replacement project costs. Remaining project funds of \$2,867,419 are currently available to fund the acquisition of the subject property at 450 6th Street.

Projected Lease Revenues

Table 2 below shows the projected annual rent, operating expenses, net annual revenues and cumulative revenues to be received by the City each year through April 30, 2026, when the current lease at 450 6th Street expires. As shown in Table 2 below, if the lease extends for the entire term, the City is projected to receive a total of \$1,086,008 of net cumulative rental revenues. The actual amount of total revenues to be realized by the City from this lease will depend on whether and when the existing lease is terminated by the City. According to Mr. Updike, the City would only terminate the subject lease at 450 6th Street, after a specific plan and design are approved by the Board of Supervisors and permits are secured for construction of a new facility on this site.

Table 2: Projected Rent and Revenues from 450 6th Street Lease

Year	Projected Annual Rent	Projected Annual Operating Expenses*	Net Annual Income	Net Cumulative Revenues
2016**	\$37,000	\$713	\$36,287	\$36,287
2017	111,000	2,935	108,065	144,352
2018	111,000	3,024	107,976	252,328
2019	111,000	3,114	107,886	360,214
2020	111,000	3,207	107,793	468,007
2021***	117,000	3,304	113,696	581,703
2022	120,000	3,403	116,597	698,600
2023	120,000	3,505	116,495	815,095
2024	120,000	3,610	116,390	931,485
2025	120,000	3,719	116,281	1,047,766
2026	40,000	958	39,042	1,086,008

* Based on estimates from Real Estate and increased by 3% annually.

** Assumes start date of September 1, 2016 at \$9,250 per month.

*** Rent increases to \$10,000 per month on May 1, 2021.

POLICY CONSIDERATION

One policy consideration for the Board of Supervisors is whether to pursue the acquisition of this one parcel at 450 6th Street, within a larger intended acquisition of four properties, if the other properties cannot be acquired and if a specific plan for construction of a new facility on these properties has not yet been approved.

The Board of Supervisors verbally urged the Real Estate Division to continue to pursue the acquisition of the four identified properties adjacent to the Hall of Justice. As summarized above, the proposed purchase of one of these parcels at 450 6th Street is for less than the fair market value and has an existing tenant which provides rental revenue to partially offset the City's cost to purchase and own. In addition, Mr. Updike notes that this parcel is strategic within the block and is an opportunity that might not arise later.

As noted above, a working group is actively meeting to identify potential options for the Board of Supervisors to consider regarding the closure of County Jails 3 and 4 at the Hall of Justice. Such alternative options for the Board of Supervisors to consider may not be available for approximately six months. Sheriff Hennessey also notes that whether or not a new jail facility is constructed on this site, additional space will likely be needed adjacent to the Hall of Justice for a jail support facility, a hybrid mental health/rehabilitation facility, or for District Attorney and/or Adult Probation offices, or for a new criminal courthouse, all currently located in the Hall of Justice.

RECOMMENDATION

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