

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

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April 28, 2017

TO: Budget and Finance Sub-Committee

FROM: Budget and Legislative Analyst



SUBJECT: May 4, 2017 Budget and Finance Sub-Committee Meeting

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| Item 2 File 17-0266 | Department: Department of Public Health (DPH) |
| EXECUTIVE SUMMARY | |
| <p style="text-align: center;">Legislative Objectives</p> <ul style="list-style-type: none"> • The proposed resolution would approve a second amendment to the contract between the Department of Public Health (DPH) and Cerner Health Services, Inc. (Cerner) for the existing electronic health records (EHR) system in order to provide sufficient time to DPH to transition to a new EHR system. The second amendment (i) extends the contract by three years from July 1, 2017 through June 30, 2020, and (ii) increases the contract not-to-exceed amount by \$36,290,626 from \$52,294,980 to \$88,585,606. <p style="text-align: center;">Key Points</p> <ul style="list-style-type: none"> • The existing DPH electronic health records (EHR) system with Cerner has reached the end of its useful life. According to DPH, the timeline to obtain a new EHR system through the competitive selection process does not allow DPH sufficient time to migrate, install and archive data from the existing Cerner system before the end of the existing two-year contract extension option of June 30, 2019. Therefore, DPH is requesting to extend the contract for three years, rather than two years as provided in the existing extension option, to June 30, 2020. <p style="text-align: center;">Fiscal Impact</p> <ul style="list-style-type: none"> • From July 2010 through February 2017, Cerner has expended approximately 92 percent or \$48,007,972 of the total contract's existing not-to-exceed amount of \$52,294,980. DPH projects expenditures of \$39,470,887 over the remaining and proposed three-year extended term of the contract from March 2017 through June 30, 2020, resulting in total actual and projected expenditures of approximately \$87,478,859. The proposed resolution states that the total contract not to exceed amount is \$88,585,606. Therefore, the proposed resolution should be amended to reduce the total not to exceed amount by \$1,106,747 from \$88,585,606. <p style="text-align: center;">Policy Consideration</p> <ul style="list-style-type: none"> • The new DPH EHR system has been recommended for funding under the FY 2018-22 ICT Plan, which was approved by the Board of Supervisors on April 25, 2017. • Under the proposed resolution, the Board would continue to waive Administrative Code Section 21.21, which requires that any software contractors must indemnify the City from infringement and intellectual property claims. <p style="text-align: center;">Recommendations</p> <ul style="list-style-type: none"> • Amend the proposed resolution to reduce the total not to exceed contract amount by \$1,106,747 from \$88,585,606 to \$87,478,859. • Approve the proposed resolution as amended. | |

MANDATE STATEMENT

City Charter Section 9.118(b) states that any contract entered into by a department, board or commission that (1) has a term of more than ten years, (2) requires expenditures of \$10 million or more, or (3) requires a modification of more than \$500,000 is subject to Board of Supervisors approval.

BACKGROUND

Siemens Medical Solutions USA, Inc.

In July 2010, the Board of Supervisors approved a contract between the Department of Public Health (DPH) and Siemens Medical Solutions USA, Inc. (Siemens) for a total not-to exceed amount of \$33,820,487 for seven years from July 1, 2010 through June 30, 2017 to provide software and technical assistance to upgrade DPH's use of electronic health records and coordination of care and payments (File 10-0752). This contract included one two-year option to extend the contract through June 30, 2019. The 2010 contract with Siemens was awarded on a sole source basis, because so much of the DPH's existing information systems were already provided by Siemens, and the possibility of migrating to a competitor was operationally prohibitive. Siemens has been DPH's principal provider of clinical and financial systems for the past 25 years. The electronic health records (EHR) system allows nurses and doctors to keep track of a patient's medical treatments, and to coordinate among providers of care, including those not immediately within DPH hospitals, clinics, and health centers. The embedded financial systems allow staff to generate bills, provide basic accounting, and keep track of revenues.

In July 2013, the Board of Supervisors approved the first amendment to the Siemens contract to (i) increase the total not-to-exceed amount by \$18,474,493 from \$33,820,487 to \$52,294,980, and (ii) include new services related to electronic health records and improving surgical information systems at San Francisco Zuckerberg General Hospital (File 13-0514).

In 2015, Cerner Corporation (Cerner) acquired Siemens and formally assumed all responsibilities for the 2010 electronic health records system contract with DPH.

Competitive Selection Process and Transition to New Electronic Health Record (EHR) System

In March 2016, the Board of Supervisors approved an ordinance (a) waiving the competitive solicitation process and authorizing DPH to award a sole source contract for a new electronic health records system to the University of California, San Francisco (UCSF), and (b) requiring DPH to issue a competitive Request for Proposals (RFP) if DPH was unable to conclude successful negotiations with UCSF within six months (File 16-0043). According to Ms. Winona Mindolovich, DPH Associate Chief Information Officer, after several months of due diligence and negotiations, DPH and UCSF mutually agreed that a contract could not be reached because cost and operational burdens were prohibitive for both parties. Consequently, DPH issued an

RFP in January 2017 for a new enterprise wide¹, integrated and hosted EHR system to replace the existing Cerner system, which has reached the end of its useful life. DPH expects to select a vendor in July or August of 2017 and award a contract by January 2018. According to Ms. Mindolovich, the timeline to obtain an EHR system through the competitive selection process does not allow DPH sufficient time to migrate, install and archive data from the existing Cerner system before the end of the existing two-year contract extension option of June 30, 2019. DPH has negotiated with Cerner to allow the extension of the contract through June 30, 2020 to provide the time to procure and install the new EHR system and decommission the Cerner applications.

DETAILS OF PROPOSED LEGISLATION

The proposed resolution would approve a second amendment to the contract between the Department of Public Health (DPH) and Cerner Health Services, Inc. (Cerner) for the existing electronic health records (EHR) system in order to provide sufficient time to DPH to transition to a new Electronic Health Record (EHR) system. The second amendment which replaces the existing two-year option (i) extends the contract by three years from July 1, 2017 through June 30, 2020, and (ii) increases the contract not-to-exceed amount by \$36,290,626 from \$52,294,980 to \$88,585,606. The proposed resolution also waives Administrative Code Section 21.21, which requires that software contractors must indemnify the City from infringement and intellectual property claims (see policy considerations section below).

FISCAL IMPACT

According to Ms. Mindolovich, the contract increase of \$36,290,626 for the three-year extension from July 1, 2017 through June 30, 2020 is needed for expenditures on licensing, maintenance, and hosting services, as well as migration and transition services for DPH to smoothly transition from its existing electronic health records system to a new electronic health records (EHR) system and decommission the existing Cerner system.

Table 1 below shows the breakdown of the requested additional \$36,290,626 to be expended from July 1, 2017 through June 30, 2020.

¹ According to Ms. Mindolovich, the new EHR system will replace disparate EHR systems located in ambulatory care, the emergency room, intensive care unit and other clinical areas, as well as the Cerner system, for all DPH areas that deliver medical care. This includes Zuckerberg San Francisco General Hospital and Trauma Center, Laguna Honda Hospital, all primary and specialty care clinics, Jail Health services, City Clinic and the TB clinic, Maternal Health and Child Services and Health at Home.

Table 1: Projected Expenditures from FY 2017-18 through FY 2019-20 for Cerner Contract

| Service | Expenditure | Description | DPH Justification |
|-----------------------------------------------------------------------------------------------------------------------------|---------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Expenditures Not Included in Information and Communication Technology Plan (see Policy Considerations section below) | | | |
| Cerner IT Solution (Annual RCO, Software & Support Fees) | \$19,035,991 | Annual support and maintenance of the Cerner system providing patient registration and admitting, clinical orders processing, test results, provider order entry, nurse documentation, inpatient and outpatient pharmacy management, medication administrative check processes, patient reporting and management, patient accounting and financial reporting. | "Patient safety would be at risk without the clinical results and functions provided through the existing Cerner system. Without the current system, DPH operations would be severely impacted. DPH would go from automation to paper." |
| Expenditures Included in Information and Communication Technology Plan (see Policy Considerations section below) | | | |
| Backfill Staffing Services | \$7,098,795 | Consulting services provided by Cerner to support existing modules. Cerner staff will support the pharmacy system, nurse medication charting, interfaces with physiological monitoring, downstream systems, registration, scheduling, computerized provider order entry, patient financial services and revenue management. | "The consulting services provided by Cerner will allow approximately 25 IT resources to participate in the pre-implementation efforts, be trained on the new system, design, build and perform implementation efforts on the new EHR system." |
| Transition Services | 465,923 | Transition services include the following: 1) Patient health records analysis to optimize the migration of patient data; 2) Analysis of the decision support system data utilization and retention requirements; 3) Assistance in defining the legal health record and designated record set | "Analysis of key data is required to prepare for the migration of a new EHR system." |
| Data Extraction Services | 1,360,997 | Services provided by Cerner to extract DPH defined key historical business, clinical and financial data stored in the legacy system. | "DPH IT will be able to extract some information, but since this is a proprietary system a full extraction requires Cerner's assistance." |
| Migration Services/ Application Decommission | 1,669,866 | Migration services provide the validation of data transfer and contextual mapping accuracy and integrity to targeted systems and/or archive solution. | "Validation is required so that key historical business, clinical and financial information stored in legacy systems migrates correctly to targeted system and/or archive system before decommission of legacy system." |
| Optional DataArc (Software, Service & Maintenance 3-years) | 3,619,519 | Archival of data, including annual support and maintenance, retained for compliance, regulatory or patient care reasons. Annual support and maintenance represents hosting, software and technical support, as well as ongoing updates and software fixes. | "DataArc provides a system to archive key data so that it can be accessed after legacy applications is decommissioned. This has been labeled optional to allow DPH the ability to independently determine the best archiving option once the new EHR vendor is known." |
| Subtotal | \$14,215,100 | | |
| Contingency | \$3,039,535 | | |
| Total | \$36,290,626 | | |

Funding for the contract is from the General Fund, monies subject to appropriation approval by the Board of Supervisors.

Contract Expenditures

From July 2010 through February 2017, Cerner has expended approximately 92 percent or \$48,007,972 of the total contract’s existing not-to-exceed amount of \$52,294,980, as shown in Table 2 below. DPH projects expenditures of \$39,470,887 over the remaining and proposed three-year extended term of the contract from March 2017 through June 30, 2020, resulting in total contract expenditures of approximately \$87,478,859, as shown in Table 2 below.

Table 2. Cerner Contract Actual and Projected Expenditures
(July 2010 through June 2020)

| Contract | Actual Contract Expenditures (July 2010 through February 2017) | Projected Expenditures (March 2017 through June 2020) ² | Total Actual and Projected Expenditures (July 2010 through June 2020) |
|-----------------|--------------------------------------------------------------------------|------------------------------------------------------------------------------|---------------------------------------------------------------------------------|
| Total | \$48,007,972 | \$39,470,887 | \$87,478,859 |

Source: Department of Public Health

The proposed resolution states that the total contract not to exceed amount is \$88,585,606. However, as shown in Table 2, the total actual and projected expenditures for the remaining and extended contract term are \$87,478,859. Therefore, the Budget and Legislative Analyst recommends amending the proposed resolution in order to reduce the total not to exceed contract amount by \$1,106,747 from \$88,585,606 to \$87,478,859.

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|--------------------------------------------------------------------|--------------------|
| Resolution Amount | \$88,585,606 |
| Reduction to Correspond to Total Actual and Projected Expenditures | <u>(1,106,747)</u> |
| Recommended Resolution Amount | \$87,478,859 |

POLICY CONSIDERATION

FY 2018-22 Information & Communication Technology (ICT) Plan

The new DPH EHR system has been recommended for funding under the FY 2018-22 ICT Plan, which was approved by the Board of Supervisors on April 25, 2017. According to the plan, the implementation of the new DPH EHR system is projected to take five years, with an overall estimated project budget from FY 2017-18 through FY 2021-22 of \$203.7 million, and an estimated ongoing operating cost of \$20 million per year. The project budget and ongoing operating costs will be subject to future Board of Supervisors approval.

According to Ms. Mindolovich, the \$19,035,991 shown in Table 1 above to fund the annual support and maintenance of the existing Cerner system is not included in the ICT plan but is

² This includes projected expenditures of \$3,180,261 from March through June 2017 and the requested amount of \$36,290,626 for the three-year extension of July 1, 2017 through June 30, 2020.

included in the DPH operating budget. However, the balance of \$14,215,100 to fund migration and transition services is part of the ICT plan because the costs are related to the implementation of the new EHR system.

Waiver of Administrative Code Section 21.21

Under the proposed resolution, the Board would continue to waive Administrative Code Section 21.21, which requires that any software contractors must indemnify the City from infringement and intellectual property claims. The section is intended to protect the City from claims by contractors or third parties that the City is misusing the intellectual property (or using software without proper licensing) that the City has contracted out for. Administrative Code Section 21.21 states:

Each Contractor entering into a contract with the City that could involve the Contractor's provision of intellectual property to the City must save, keep, hold harmless and fully indemnify the City and any of its officers or agents from all damages, or claims for damages, costs or expenses in law or equity that may at any time arise or be set up for infringement of the patent rights, copyright, trademark or other intellectual property claims of any person in consequence of the use by the City, or any of its officers or agents, of articles to be supplied under such contract and of which the contractor is not the patentee or assignee or has not the lawful right to sell the same.

A clause waiving Administrative Code Section 21.21 was included in the original contract between the DPH and Siemens and approved by the Board of Supervisors in 2010 (File 10-0752), as well as in the amended contract approved by the Board of Supervisors in 2013 (File 13-0514). According to Ms. Mindolovich, the DPH has determined that in light of the totality of this contract, the risk of third party software infringement is low. Further, in the event that such a risk was identified, the DPH would stop using the infringing software and would work with Cerner to identify a suitable replacement.

RECOMMENDATIONS

1. Amend the proposed resolution to reduce the total not to exceed contract amount by \$1,106,747 from \$88,585,606 to \$87,478,859.
2. Approve the proposed resolution as amended.

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| <p>Item 7 File 17-0343</p> | <p>Department: Public Utilities Commission (PUC)</p> |
| <p>EXECUTIVE SUMMARY</p> | |
| <p style="text-align: center;">Legislative Objectives</p> <p>The proposed resolution would authorize the San Francisco Public Utilities Commission (SFPUC) General Manager to execute a new professional services agreement with HDR Engineering, Inc. (HDR) to provide construction management services for the replacement of the headworks facilities at the Southeast Water Pollution Control Plant for an amount not to exceed \$17,000,000 and for a duration of six years to commence following Board of Supervisors approval through July 2023.</p> <p style="text-align: center;">Key Points</p> <ul style="list-style-type: none"> • Upgrades to Southeast Water Pollution Control Plant are part of the SFPUC’s Sewer System Improvement Program. The Plant’s headworks facilities are the first step in the wastewater treatment process. The Southeast Water Pollution Control Plant New Headworks Facility would replace two existing headworks facilities, modify the pump station, and construct a new odor control structure, at a cost of \$358.6 million. • SFPUC determined that the Southeast Water Pollution Control Plant New Headworks Facility requires specialized construction management services in constructing a new facility while maintaining an active wastewater treatment facility. SFPUC selected HDR to provide construction management services following a competitive request for proposals process. • Construction management services provided under the contract are pre-construction, construction administration during the construction and project close-out phases, construction inspection, contract management, project controls, and building information modeling. <p style="text-align: center;">Fiscal Impact</p> <ul style="list-style-type: none"> • The contract budget is \$17,000,000, of which \$14,765,269 are labor costs. \$4,691,438 of the \$14,765,269 is allocated to Local Business Enterprise sub-consultants. • Funds of \$17,000,000 for the proposed contract are included in the Southeast Water Pollution Control Plant New Headworks Facility project budget of \$358,630,542. <p style="text-align: center;">Recommendation</p> <ul style="list-style-type: none"> • Approve the proposed resolution. | |

MANDATE STATEMENT

City Charter Section 9.118(b) states that any contract entered into by a department, board or commission that (1) has a term of more than ten years, (2) requires expenditures of \$10 million or more, or (3) requires a modification of more than \$500,000 is subject to Board of Supervisors approval.

BACKGROUND

On March 29, 2011, the Board of Supervisors approved the City's Ten Year Capital Expenditure Plan for FY 2012-2021 (Resolution 151-11), which includes the San Francisco Public Utilities Commission (SFPUC) capital project to upgrade and replace the City's wastewater system, called the Sewer System Improvement Program (SSIP). The SSIP is anticipated to be completed in two phases over a period of 20 years, at an estimated cost of \$6.9 billion to be funded from increases in rates to PUC wastewater customers. Phase I includes planning and construction of sewer treatment facilities, at a total estimated cost of \$2.7 billion.

Phase I of the SSIP includes a series of facility upgrades at the Southeast Water Pollution Control Plant (Plant), located in the Bayview neighborhood of San Francisco. Built in 1952, the Plant treats 80 percent of the City's wastewater. One of these upgrades is the replacement of the headworks facilities, which provide the first step in the wastewater treatment process. According to Mr. Jignesh Desai, Senior Project Manager at SFPUC, the existing screening and grit removal processes are inefficient and significantly impact the performance of downstream processes and further cleaning. Southeast Water Pollution Control Plant New Headworks Facility would replace two existing headworks facilities, modify the pump station, and construct a new odor control structure.

During the planning phase in 2014, the SFPUC determined that the Southeast Water Pollution Control Plant New Headworks Facility requires specialized construction management services in constructing a new facility while maintaining an active wastewater treatment facility. A competitive request for proposals (RFP) was advertised on November 14, 2016. Two firms submitted proposals: CDM Smith Inc., and HDR Engineering, Inc. The proposals were evaluated by four City employees across three departments: two construction managers, one senior engineer, and one division deputy of capital programs and construction. The proposals were scored based on the written proposal, oral interview, and overhead and profit schedule. SFPUC selected HDR Engineering, Inc., to be the most responsible bidder and entered into contract negotiations.

DETAILS OF PROPOSED LEGISLATION

Based on a competitive RFP process, the proposed resolution would authorize the General Manager of the SFPUC to execute a new professional services agreement with HDR Engineering, Inc. (HDR) to provide construction management services for the replacement of the headworks facilities at the Southeast Water Pollution Control Plant for an amount not to exceed \$17,000,000 and for a duration of six years to commence following Board of Supervisors approval through July 2023.

HDR will be providing nine staff to the existing SFPUC construction management staff working on the Southeast Water Pollution Control Plant Project. The positions provided by HDR Engineering, Inc. are the Project Resident Engineer, Construction Cost Estimator, Lead Construction Inspector, Construction Scheduler, Field Contracts Administrator, three (3) Construction Inspectors, and Building Information Modeling (BIM) Specialist.

According to the contract, the SFPUC Construction Manager will identify tasks and request HDR to develop the scope, sub tasks, staffing plan, schedule, deliverables, budgets and costs to complete the task. All costs associated with the development of the scope of work for each task order shall be borne by HDR. Each task order will be negotiated by the SFPUC Construction Manager and HDR before being approved by the SFPUC Bureau Manager. SFPUC has the sole discretion to extend the Agreement term for an additional three years up to a total of nine years to 2026, subject to the funds being appropriated by the Board of Supervisors.

FISCAL IMPACT

Summary budget details for the contract not-to-exceed amount of \$17,000,000 are shown in Table 1 below.

**Table 1: Contract Budget for Construction Management Services
July 2017 to July 2023**

| Expenditure | Amount |
|---------------------------------------------------------------------|---------------------|
| Labor | \$14,765,269 |
| Mark-up on sub-consultant labor costs ^a | 234,572 |
| Other direct costs ^b | 500,000 |
| Contingency (approximately 10 percent of labor costs) ^c | 1,500,159 |
| Total | \$17,000,000 |

Source: Proposed Contract between SFPUC and HDR Engineering

^a The contract between HDR Engineering and SFPUC provides for \$4,691,438 of the total labor costs of \$14,765,269 to be provided by Local Business Enterprise (LBE) sub-consultants. SFPUC allows a markup by the prime consultant of 5 percent of sub-consultant labor costs, equal to \$234,572.

^b Other direct costs consist of task-specific out-of-town travel as requested by the SFPUC, specialty printing, task related permit fees, and expedited courier services when requested by SFPUC staff.

^c According to Mr. Jacobo, the contingency of \$1,500,159, equal to approximately 10 percent of total labor costs, is industry standard. The SFPUC predicts the contingency may be used for specialized inspection services, startup, testing and commissioning services, distributed control system services, or CPI yearly increases.

Of the \$17,000,000 contract not-to-exceed amount, \$14,765,269 will go towards the nine staff members, including LBE sub-consultants, who will be working across seven tasks, as shown in Table 2 below.

**Table 2 Labor Costs by Task paid by SFPUC to HDR Engineering, Inc.
July 2017 to July 2023**

| | Approximate Average Rate per Hour | Hours | Total |
|----------------------------------------------------|-----------------------------------------|---------------|---------------------|
| Pre-Construction Services | \$192 | 3,200 | \$614,622 |
| Construction Contract Administration: Construction | \$220 | 14,880 | 3,273,600 |
| Construction Contract Administration: Closeout | \$212 | 1,760 | 372,496 |
| Construction Inspection | \$171 | 39,280 | 6,734,006 |
| Construction Contract Management | \$220 | 4,960 | 1,091,200 |
| Construction Project Controls | \$194 | 5,456 | 1,058,662 |
| Building Information Modeling | \$163 | 9,920 | 1,620,683 |
| Total | \$186 | 79,456 | \$14,765,269 |

Source: Proposed Contract between SFPUC and HDR Engineering

According to Mr. Jacobo, the proposed professional services agreement with HDR Inc. is within the previously approved project budget and schedule and will not increase the project budget or change the project schedule for the completion of the Southeast Water Pollution Control Plant New Headworks Facility. Therefore there will be no changes to the currently-planned bond financing or water rate charges for customers. The total budget approved for the Headworks Facility of \$358,630,542, including the budgeted \$17,000,000 contract with HDR for construction management services, is shown in Table 3 below.

Table 3: Project Total

| Activity | Approved Budget |
|-------------------------|----------------------|
| Project Management | \$16,884,958 |
| Planning | 7,758,371 |
| Design | 24,352,236 |
| Environmental | 1,489,447 |
| Construction | 266,485,663 |
| Construction Management | 41,659,867 |
| Total | \$358,630,542 |

To date, the SFPUC has spent \$20,882,664 and have encumbered an additional \$6,806,715 for a total of \$27,689,379 out of \$358,630,542. The SFPUC plans to spend the remaining \$330,941,163 by the end of the project in December 2023.

RECOMMENDATION

Approve the proposed resolution.

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| Items 8, 9, 10, 11, 12, 13, 14 & 15 Files 17-0256 through File 17-0263 | Department: San Francisco International Airport (Airport) |
| EXECUTIVE SUMMARY | |
| <p>Legislative Objectives</p> <ul style="list-style-type: none"> • Files 17-0256 through 17-0261 would approve six food and beverage concession leases in Terminal 3, Boarding Area F for quick serve restaurants in the food court (Leases #1 through #6). File 17-0262 would approve a food and beverage lease for a sit-down restaurant and bar in Terminal 3, Boarding Area F (Lease #7). File 17-0263 would approve a food and beverage concession lease for a sit-down restaurant and bar in Terminal 1, Boarding Area C (Lease #8). <p>Key Points</p> <ul style="list-style-type: none"> • The eight food and beverage concession leases were selected through a competitive Request for Proposals process in September 2016 and approved by the Airport Commission in December 2016. • The six quick serve leases in the Terminal 3, Boarding Area F food court are for six-year terms with two one-year options to extend. Rent for each lease is the greater of the Minimum Annual Guarantee (MAG) \$250,000 or percentage rent. The minimum tenant investment for each lease is \$650 per square foot (Files 17-0256 through 17-0261). • The sit-down restaurant and bar in Terminal 3, Boarding Area F is for seven years with two one-year options to extend. Rent is the greater of the MAG of \$650,000 or percentage rent, and the minimum tenant investment is \$650 per square foot (File 17-0262). • The sit-down restaurant and bar in Terminal 1, Boarding Area C is for seven years with two one-year options to extend. Rent is the greater of the MAG of \$1,000,000 or percentage rent, and the minimum tenant investment is \$650 per square foot (File 17-0263). <p>Fiscal Impact</p> <ul style="list-style-type: none"> • Under conservative predictions of changes to the Consumer Price Index, the proposed resolution will generate revenues by the leaseholders to the Airport of \$21,730,612 over the initial lease terms based on the Minimum Annual Guarantee. The actual rent paid by the leaseholders may be higher based on revenue projections. <p>Recommendation</p> <ul style="list-style-type: none"> • Approve the proposed resolutions. | |

MANDATE STATEMENT

City Charter Section 9.118(c) states that any lease of real property for a period of ten or more years, including options to renew, or having anticipated revenue to the City and County of \$1 million or more; the modification, amendment or termination of any lease, which when entered into was for a period of ten or more years, including options to renew, or had anticipated revenue to the City and County of \$1 million or more; and any sale or other transfer of real property owned by the City and County, shall first be approved by resolution of the Board of Supervisors.

BACKGROUND

On April 19, 2016, the Airport Commission authorized staff to commence the competitive selection process and issue a Request for Proposals (RFP) for eight Food and Beverage Concession leases. The current leases are set to expire in May 2017 after approximately 12 years of operation.

Leases No. 1 through No. 6 were for quick serve restaurants in Terminal 3, Boarding Area F, in an established food court. Lease No. 7 was for a sit-down restaurant and bar in Terminal 3, Boarding Area F, in an established restaurant space. Lease No. 8 was for a sit-down restaurant and bar in Terminal 1, Boarding Area C, in an established restaurant space.

On July 19, 2016, the Airport Commission approved the minimum requirements and lease specifications and authorized staff to accept proposals for the eight leases.

By September 14, 2016, Airport staff had received multiple proposals for each of the leases. Leases No. 1 through 6, the quick-serve restaurant spaces, received between 8 and 24 proposals per lease. Lease No. 7 received 13 proposals and Lease No. 8 received 11 proposals.

According to Mr. Matt McCormick, Senior Principal Property Manager with the San Francisco International Airport, the proposals were evaluated by a five-member panel of professionals. They included (1) a local business person and educator at UCSF, (2) a food and beverage professional and food blogger, (3) a designer with airport experience, (4) a former Airport executive employee, and (5) a restaurant owner and developer. The evaluations were based on four criteria: (1) proposed concept, (2) design intention and capital investment, (3) customer service quality and control and (4) business plan. Based on a competitive process, the Airport Commission approved on December 6, 2016 the selection of the eight highest score proposals based on the selection panel's evaluation. Table 1 below lists the eight selected proposers.

Table 1: Proposal Winners and Concept

| Lease No. | Proposer | Name of Restaurant |
|------------------|---------------------------------|------------------------------------|
| 1 | San Francisco Soup Company | Ladle & Leaf |
| 2 | Host International | Super Duper Burger |
| 3 | Paradies Lagadere | Limon Rotisserie |
| 4 | Amoura International | Amoura Café |
| 5 | Bun Mee | Bun Mee Vietnamese Sandwich Eatery |
| 6 | Gate 74 | Pie 5 Pizza Co. |
| 7 | Tastes on the Fly San Francisco | SF Giants Clubhouse |
| 8 | High Flying Foods SFO | Farmerbrown |

DETAILS OF PROPOSED LEGISLATION

File 17-0256 (Lease No. 1): The proposed resolution would approve the Terminal 3 Boarding Area F Food and Beverage Concession Lease between San Francisco Soup Company, dba Ladle & Leaf, and the Airport Commission, for a post-security concession with a term of six years to commence following Board of Supervisors approval with two one-year options to extend and an Initial Minimum Annual Guarantee of \$250,000.

File 17-0257 (Lease No. 2): The proposed resolution would approve the Terminal 3 Boarding Area F Food and Beverage Concession Lease between Host International, Inc., dba Super Duper Burger, and the Airport Commission, for a post-security concession with a term of six years to commence following Board of Supervisors approval with two one-year options to extend and an Initial Minimum Annual Guarantee of \$250,000.

File 17-0258 (Lease No. 3): The proposed resolution would approve the Terminal 3 Boarding Area F Food and Beverage Concession Lease between Paradies Lagardere @ SFO, LLC, dba Limon Rotisserie, and the Airport Commission, for a post-security concession with a term of six years to commence following Board of Supervisors approval with two one-year options to extend and an Initial Minimum Annual Guarantee of \$250,000.

File 17-0259 (Lease No. 4): The proposed resolution would approve the Terminal 3 Boarding Area F Food and Beverage Concession Lease between Amoura International, Inc., dba Amoura Café, and the Airport Commission, for a post-security concession with a term of six years to commence following Board of Supervisors approval with two one-year options to extend and an Initial Minimum Annual Guarantee of \$250,000.

File 17-0260 (Lease No. 5): The proposed resolution would approve the Terminal 3 Boarding Area F Food and Beverage Concession Lease between Bun Mee, LLC, dba Bun Mee Vietnamese Sandwich Eatery, and the Airport Commission, for a post-security concession with a term of six years to commence following Board of Supervisors approval with two one-year options to extend and an Initial Minimum Annual Guarantee of \$250,000.

File 17-0261 (Lease No. 6): The proposed resolution would approve the Terminal 3 Boarding Area F Food and Beverage Concession Lease between Gate 74, Inc., dba Pie 5 Pizza Co., and the Airport Commission, for a post-security concession with a term of six years to commence following Board of Supervisors approval with two one-year options to extend and an Initial Minimum Annual Guarantee of \$250,000.

File 17-0262 (Lease No. 7): The proposed resolution would approve the Terminal 3 Boarding Area F Food and Beverage Concession Lease between Tastes on the Fly San Francisco, LLC, dba SF Giants Clubhouse, and the Airport Commission, for a post-security concession with a term of seven years to commence following Board of Supervisors approval with two one-year options to extend and an Initial Minimum Annual Guarantee of \$650,000.

File 17-0263 (Lease No. 8): The proposed resolution would approve the Terminal 1 Boarding Area C Food and Beverage Concession Lease between High Flying Foods SFO, LLC, dba Farmerbrown, and the Airport Commission, for a post-security concession with a term of seven years to commence following Board of Supervisors approval with two one-year options to extend and an Initial Minimum Annual Guarantee of \$1,000,000.

Leases No. 1 through No. 6 are for quick-service restaurant spaces ranging between 347 and 837 square feet in size in the Terminal 3 Boarding Area F food court. Lease No. 7 is for a sit-down restaurant and bar of 3,298 square feet, also in Terminal 3 Boarding Area F. Lease No. 8 is for a sit-down restaurant and bar of 3,455 square feet in Terminal 1 Boarding Area C. A total of 10,877 square feet of retail space is to be leased.

The RFP required a Minimum Annual Guarantee (MAG) of \$250,000 for Leases No. 1 through No. 6. Lease No. 7 required a MAG of \$650,000 and Lease No. 8 required a MAG of \$1,000,000. According to Mr. McCormick, the MAGs were based on the number of enplanements in the area and the gross receipts of the prior tenants. Rent paid to the Airport is to be the greater of the MAG or a percentage of gross revenue.

Table 2 below summarizes the provisions of Leases No. 1 through No. 6 for the proposed leases between the Airport and the six proposers for quick-service restaurant spaces in the food court in Terminal 3, Boarding Area F: San Francisco Soup Company, Host International, Paradies Lagadere, Amoura International, Bun Mee, and Gate 74.

| Table 2: Summary of Lease Provisions for Leases No. 1 through No. 6 | |
|----------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------|
| Term | Six years from approximately October 2017 to September 2023 |
| Options to Extend | Two (2) one-year options to extend exercisable at the sole discretion of the Airport for a total term of eight years through August 2025 |
| Minimum Annual Guarantee (MAG) | \$250,000 per year |
| MAG Adjustment | Adjusted annually based on the Consumer Price Index (CPI) |
| Revenue Percentage Rent | 6% of Gross Revenues up to and including \$1,000,000.00 |
| | 8% of Gross Revenues from \$1,000,000.01 up to and including \$1,500,000.00 |
| | 10% of Gross Revenues over \$1,500,000 |
| Promotional Fee | \$1 per square foot per year |
| Pest Control Services Fee | \$75 per month |
| Food and Beverage Cleaning Fee | \$80 per square foot per year |
| Deposit Amount | Equal to one-half of the initial MAG (subject to mid-term adjustment) |
| Minimum Initial Investment | \$650 per square foot |

Table 3 below summarizes the provisions of Lease No. 7 for the proposed lease between the Airport and Tastes on the Fly San Francisco for a sit-down restaurant and bar in Terminal 3, Boarding Area F.

| Table 3: Summary of Lease Provisions for Lease No. 7 | |
|-------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------|
| Term | Seven years from approximately October 2017 through September 2024 |
| Options to Extend | Two (2) one-year options to extend exercisable at the sole discretion of the Airport for a total term of nine years through August 2026 |
| Minimum Annual Guarantee (MAG) | \$650,000 per year |
| MAG Adjustment | Adjusted annually based on the Consumer Price Index (CPI) |
| Revenue Percentage Rent | 8% of Gross Revenues up to and including \$3,000,000.00 |
| | 10% of Gross Revenues from \$3,000,000.01 up to and including \$3,500,000.00 |
| | 12% of Gross Revenues over \$3,500,000 |
| Promotional Fee | \$1 per square foot per year |
| Pest Control Services Fee | \$75 per month |
| Deposit Amount | Equal to one-half of the initial MAG (subject to mid-term adjustment) |
| Minimum Initial Investment | \$650 per square foot |

Table 4, below, summarizes the provisions of Lease No. 8 for the proposed lease between the Airport and High Flying Foods SFO for a sit-down restaurant and bar in Terminal 1, Boarding Area C.

| Table 4: Summary of Lease Provisions for Lease No. 8 | |
|-------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------|
| Term | Seven years from approximately October 2017 through September 2024 |
| Options to Extend | Two (2) one-year options to extend exercisable at the sole discretion of the Airport for a total term of nine years through August 2026 |
| Minimum Annual Guarantee (MAG) | \$1,000,000 per year |
| MAG Adjustment | Adjusted annually based on the Consumer Price Index (CPI) |
| Revenue Percentage Rent | 8% of Gross Revenues up to and including \$3,000,000.00 |
| | 10% of Gross Revenues from \$3,000,000.01 up to and including \$3,500,000.00 |
| | 12% of Gross Revenues over \$3,500,000.00 |
| Promotional Fee | \$1 per square foot per year |
| Pest Control Services Fee | \$75 per month |
| Deposit Amount | Equal to one-half of the initial MAG (subject to mid-term adjustment) |
| Minimum Initial Investment | \$650 per square foot |

The six leases for the quick-serve restaurant spaces in the food court in Terminal 3, Boarding Area F, are for six-year terms with two one-year options to extend for total terms of up to eight years, and the two leases for sit-down restaurants and bars in Terminal 3, Boarding Area F and Terminal 1, Boarding Area C, respectively, are for seven-year terms with two one-year options to extend for total terms of up to nine years. Mr. McCormick explained that the leases for this type of concession would normally be for terms of ten years; however, the Airport plans to renovate the Terminal 3, Boarding Area F food court area in approximately 2023, or six years, which is when Leases No. 1 through No. 6 would expire. According to Mr. McCormick, the Airport plans to remodel the restaurant location in (a) Terminal 3, Boarding Area F in approximately 2024, or seven years, which is when Lease No. 7 would expire, and (b) Terminal 1, Boarding Area C in approximately 2024, or seven years, which is when Lease No. 8 would expire. For flexibility, the Airport has two one-year options to extend each of these leases.

The tenants are expected to be operating and paying rent as soon as October of 2017, subject to Board of Supervisors approval.

FISCAL IMPACT

Under the eight proposed leases, the restaurants are required to pay the Airport the greater of the MAG rent or a percentage of gross revenue as shown in Tables 2, 3 and 4 above. The MAG

rent is to be increased annually on January 1 after the first full lease year by a percentage based on the Consumer Price Index.

Using a conservative 1.5 percent estimated increase on annual CPI adjustments; Leases No. 1 through No. 6 will generate MAG rent of \$9,266,382 to the Airport over the initial six-year term of the leases. Lease No. 7 will generate MAG rent of \$4,880,851 and Lease No. 8 will generate MAG rent of \$7,583,379 to the Airport over the initial seven-year terms. As shown in Table 5 below, in total, \$21,730,612 is estimated to be paid to the Airport under the eight leases over their initial lease terms.

Table 5: Summary of Minimal Annual Guarantee (MAG) by Fiscal Year for Initial Lease Period FY 2017/18 through FY 2024-25¹

| Fiscal Year | MAG Leases 1-6 Total ² | MAG Lease 7 | MAG Lease 8 | Total |
|-------------------------|-----------------------------------------|--------------------|--------------------|---------------------|
| FY 2017-18 ³ | \$1,125,000 | \$650,000 | \$1,000,000 | \$2,775,000 |
| FY 2018-19 | \$1,505,625 | \$652,438 | \$1,003,750 | \$3,161,813 |
| FY 2019-20 | \$1,522,584 | \$659,787 | \$1,030,282 | \$3,212,653 |
| FY 2020-21 | \$1,545,423 | \$669,683 | \$1,045,736 | \$3,260,843 |
| FY 2021-22 | \$1,568,604 | \$679,729 | \$1,061,422 | \$3,309,755 |
| FY 2022-23 | \$1,592,134 | \$689,925 | \$1,077,344 | \$3,359,402 |
| FY 2023-24 | \$407,011 ⁴ | \$700,273 | \$1,093,504 | \$1,997,690 |
| FY 2024-25 ⁵ | n/a ⁶ | \$179,017 | \$271,341 | \$450,358 |
| Total | \$9,266,382 | \$4,880,851 | \$7,583,379 | \$21,730,612 |

The Airport pays an annual service payment to the City's General Fund of 15 percent of concession revenues. Based on the estimated MAG rent to the Airport of \$21,730,612 over the initial terms of the eight leases, the Airport will pay the General Fund \$3,259,592 in total annual service payments over the next seven years.

However, according to Mr. McCormick, the Airport estimates that the eight restaurants will pay percentage rent rather than the MAG. The Airport's Revenue Development and Management Department estimates gross revenues of \$47,495,277 by the eight proposed tenants in the first year, resulting in percentage rent to the Airport in the first year of \$4,630,477 or \$1,480,477 more than the MAG rent in the first year.

¹ Assumes annual increase of 1.5 percent to the MAG based on the Consumer Price Index.

² Based on a MAG of \$250,000 for each lease.

³ Assumes that leaseholders will move in by October 1, 2017 at the initial MAG rate and that the 1st MAG increase will take place on January 1, 2019.

⁴ Assumes leaseholders will leave by September 30, 2023.

⁵ Assumes leaseholders will leave by September 30, 2024.

⁶ Leases No. 1 through 6 are for six-year terms.

In addition to rent, each of the eight proposed leases requires tenant investments of \$650 per square foot. At the rate of \$650 per square foot, initial investments for the eight leases would total \$7,070,050.

In addition, the eight leases will pay to the Airport (a) a promotional fee of \$1 per square foot per year (\$10,877 total per year) and (b) a pest control services fee of \$75 per month for each lease (\$7200 total per year). Leases No. 1 through 6, additionally, pay a food and beverage cleaning fee of \$80 per square foot per annum (\$329,920 total per year). Annually, these charges are estimated to total \$347,997. These fees may be adjusted by the Airport Commission.

RECOMMENDATION

Approve the proposed resolutions.