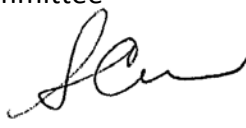


**CITY AND COUNTY OF SAN FRANCISCO**  
**BOARD OF SUPERVISORS**  
**BUDGET AND LEGISLATIVE ANALYST**

1390 Market Street, Suite 1150, San Francisco, CA 94102 (415) 552-9292  
FAX (415) 252-0461

February 2, 2018

**TO:** Government Audit and Oversight Committee  
**FROM:** Budget and Legislative Analyst   
**SUBJECT:** February 7, 2018 Government Audit and Oversight Committee Meeting

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<p><b>Item 3</b> <b>File 18-0092</b></p>	<p><b>Department:</b> Port Commission (Port)</p>
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**EXECUTIVE SUMMARY**

**Legislative Objectives**

- The proposed resolution would (1) approve a Disposition and Development Agreement (DDA) between the Port and Seawall Lot 337 Associates, LLC, for 28 acres of real property known as Seawall Lot 337, located east of Third Street between China Basin Channel and Mission Rock Street, China Basin Park, and the portion of Terry A. Francois Boulevard abutting the park, Pier 48, the marginal wharf between Pier 48 and Pier 50, and Parcel P20; (2) adopt findings under the California Environmental Quality Act; (3) adopt findings of consistency with the General Plan, and the eight priority policies of Planning Code, Section 101.1(b); and (4) adopt public trust consistency findings.

**Key Points**

- The Mission Rock Project comprises two pieces of Port property, Seawall Lot 337 and Pier 48. The project would entail development of a mixed-use, multi-phase project at Seawall Lot 337 and Parcel P20, rehabilitation and re-use of Pier 48, and construction of approximately 5.4 acres of net new open space, for a total of approximately 8 acres of open space on the project site. The DDA’s Affordable Housing Plan requires at least 40 percent of all residential units in the Project to be below market rate.
- Under the proposed DDA, Seawall Lot 337 Associates is responsible to obtain project entitlements and construct horizontal infrastructure and other public facilities over four phases, funded by project-generated revenues. Private developers will construct commercial and residential buildings (vertical development). Seawall Lot 337 Associates has the option to enter into ground leases and vertical DDAs with the Port for construction of commercial and residential buildings.

**Fiscal Impact**

- Estimated costs to construct public infrastructure and facilities over the term of the project are \$697.6 million (in 2017 dollars). These costs are for project entitlements, and construction of horizontal infrastructure (such as streets, sewers, and water lines), parks and open space, affordable housing, seawall improvements and shoreline protection, and transportation projects.
- Estimated project-generated funding sources of \$697.6 million (in 2017 dollars) include sale and lease of public land, assessment of affordable housing and transportation fees on private development, incremental property tax revenues generated by new development and proceeds from tax increment bonds in the proposed Port Infrastructure Financing District (IFD) Project Area I, and special property assessments through the formation of a proposed community facilities district (CFD).

- Under the Term Sheet approved in May 2013 (File 13-0286), Seawall Lot 337 Associates would receive a return on equity for horizontal development equal to the greater of (1) 20 percent of their unreimbursed equity investment, or (2) 1.5 times the highest balance of their unreimbursed equity investment. Under the May 2013 Term Sheet, Seawall Lot 337 Associates would also receive 20 percent of rent exceeding \$4.5 million per year for 45 years, beginning in the year in which total rent first exceeds \$4.5 million. Under the proposed DDA, the Port and Seawall Lot 337 Associates have agreed to a lower developer return of 18 percent on outstanding capital in exchange for a greater share of annual rent. In exchange for the lower developer return of 18 percent, Seawall Lot 337 Associates will receive a share of ground rent revenue above \$2.5 million as follows: (1) 45 percent for years 1 to 25; (2) 35 percent for years 26-50; and (3) 25 percent for years 51 to 75. According to the Port, Seawall Lot 337 Associates and the Port agreed to reduce Seawall Lot 337 Associates' upfront return in exchange for more backend sharing and a cost containment mechanism for Phase 1.

#### **Policy Considerations**

- The proposed DDA between Seawall Lot 337 Associates and the Port provides a complex financing scheme to develop public projects. Funding for public projects comes from project-generated revenues. The developer incurred costs of approximately \$27.4 million for entitlements and is projected to spend approximately \$29 million through project approvals. Changes to the project's financing assumptions, especially in Phase I, could delay completion of the project. Because the developer's return on investment continues to accrue, delays in funding to reimburse Seawall Lot 337 Associates for its equity investment and return on investment will increase the developer return on project equity, potentially reducing funding for other uses.
- Special tax revenues from CFDs and property tax increment from the IFD could be less than estimated if the number of residential units or the square footage for leased and commercial units is less than estimated and/or property values are lower than assumed due to market conditions when certificates of occupancy are issued.
- While the investment market for CFD bonds is established, IFD bonds are a new debt instrument. The extent to which investors will be interested in purchasing these bonds is not known, although the IFD bonds, which are secured by property tax increment, are similar to bonds issued by former redevelopment agencies, which were an established market.

#### **Recommendations**

- Amend the proposed resolution (File 18-0092) to request the Port Executive Director to report to the Board of Supervisors annually in May of each year on the status of the project and project financing.
- Approval of the proposed resolution, as amended, is a policy matter for the Board of Supervisors.

## MANDATE STATEMENT

City Charter Section 9.118(b) states that any agreement 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

### Mission Rock Project Site

The Mission Rock Project comprises two pieces of Port property, Seawall Lot 337 and Pier 48. Seawall Lot 337 is an approximately 16-acre site located south of Mission Creek/China Basin Channel in the Mission Bay. Seawall Lot 337 is currently leased to China Basin Ballpark Company<sup>1</sup>, LLC and is used primarily for AT&T Park parking and special events. Pier 48 is the southernmost pier structure in the Port's San Francisco Embarcadero Waterfront Historic District.

The Mission Rock Project would entail development of a mixed-use, multi-phase project at Seawall Lot 337 and Parcel P20, rehabilitation and re-use of Pier 48, and construction of approximately 5.4 acres of net new open space, for a total of approximately 8 acres of open space on the project site. The project would include up to 2.7 to 2.8 million gross square feet (GSF) of mixed uses on 11 proposed development blocks. The mixed-use development would comprise approximately 1.1 to 1.6 million GSF of residential uses (estimated at 1,000 to 1,950 units, 40 percent of which would be designated as below market rate), approximately 972,000 to 1.4 million GSF of commercial/office uses, and 241,000 to 244,800 GSF of active/retail and production uses on the lower floors of each block. Additionally, the project would include up to approximately 10 million GSF of above and below ground parking (approximately 3,000 spaces) in one or two centralized garages. 100 additional parking spaces would be allowed throughout the remaining parcels on the site. As part of the project, 242,500 GSF at Pier 48 would be rehabilitated for industrial, restaurant, active/retail, tour, exhibition, and meeting space use. The 11 blocks on Seawall Lot 337 would be developed with building heights ranging from 90 feet to a maximum of 240 feet for the tallest building, excluding the mechanical and other accessory penthouse roof enclosures and unoccupied building tops, subject to specified standards.

### Prior Resolutions of Intention for the Port IFD

On March 27, 2012, the Board of Supervisors approved a Resolution of Intention<sup>2</sup>, which initiated the State statutory requirements, to establish the City and County of San Francisco Infrastructure Financing District No. 2 on Port property (Port IFD). The Port IFD encompasses

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<sup>1</sup> China Basin Ballpark, LLC is a subsidiary of San Francisco Baseball Associates, LLC (San Francisco Giants). Seawall Lot 337 Associates, the developer of the Mission Rock project, is also a subsidiary of the San Francisco Giants.

<sup>2</sup> This resolution was adopted as part of the Host and Venue Agreement and Disposition Development Agreement for the 34<sup>th</sup> America's Cup held in San Francisco (File 12-0128; Resolution No. 110-12).

the entire 7-mile contiguous Port property and includes various specific project areas<sup>3</sup>. On June 12, 2012, the Board of Supervisors approved a resolution to amend the earlier Resolution of Intention to add Seawall Lot 351 as another project area in the Port IFD (Resolution No. 227-12).

### Term Sheet

In May 2013, the Board of Supervisors found that the proposed Seawall Lot 337 and Pier 48 (Mission Rock) project is fiscally feasible under Administrative Code, Chapter 29<sup>4</sup> and endorsed the term sheet between Seawall Lot 337 Associates, LLC and the Port Commission (File 13-0286).

### Intent to Establish Project Area I (Mission Rock) and Issue Bonds

In November 2017, the Board of Supervisors approved a resolution establishing the City's intent to establish Project Area I (Mission Rock) and 13 subproject areas - Subproject Area I-1 through Subproject Area I-13 - in Port Infrastructure Financing District No. 2 (File 17-1117). In November 2017, the Board of Supervisors also approved a resolution stating the City's intent to issue bonds, paid by incremental property tax revenue allocated to the City and generated within each of the subproject areas, in one or more series in the maximum aggregate principal amount of not to exceed \$1,378,000,000 (17-1118)<sup>5</sup>.

## DETAILS OF PROPOSED LEGISLATION

**File 17-1314:** The proposed ordinance would (1) establish Project Area I (Mission Rock), and Sub-Project Areas I-1 through I-13, of City and County of San Francisco Infrastructure Financing District No. 2 (Port of San Francisco), and (2) affirm the Planning Department's determination and making findings under the California Environmental Quality Act. The proposed ordinance would approve the Infrastructure Financing Plan for Port IFD Project Area I (and all of the subproject areas). The public facilities to be financed by Port IFD Project Area I incremental property tax revenues are identified in Appendix I of the Infrastructure Financing Plan, which is subject to approval. At the January 23, 2018 Board of Supervisors meeting, the Board, sitting as the Committee of the Whole, continued this ordinance to the Board of Supervisors meeting of February 13, 2018.

**File 17-1315:** The proposed resolution would (1) approve the City's issuance of bonds, paid by incremental property tax revenue allocated to the City and generated within each of the

<sup>3</sup> These resolutions designated the following project areas within the Port IFD, with the caveat that the City intended to establish additional project areas in compliance with State law: Project Area A: Seawall Lot 330; Project Area B: Piers 30-32; Project Area C: Pier 28; Project Area D: Pier 26; Project Area E: Seawall Lot 351; Project Area F: Pier 48; Project Area G: Pier 70; and Project Area H: Rincon Point-South Point Project Area.

<sup>4</sup> Chapter 29 of the City's Administrative Code requires Board of Supervisors' approval of certain projects to determine the project's fiscal feasibility prior to submitting the project to the Planning Department for environmental review if (a) the project is subject to environmental review under the California Environmental Quality Act (CEQA), (b) total project costs are estimated to exceed \$25,000,000, and (c) public monies which may be invested in the project exceed \$1,000,000.

<sup>5</sup> Files 17-1117 and 17-1118 are resolutions of intent, and do not obligate the Board of Supervisors to establish the IFD or issue bonds.

subproject areas, in an amount not to exceed \$1,378,000,000 for Project Area I (Mission Rock) and Sub-Project Areas I-1 through I-13 of City and County of San Francisco Infrastructure Financing District No. 2 (Port of San Francisco), and (2) approve the Indenture of Trust and Pledge Agreement. At the January 23, 2018 Board of Supervisors meeting, the Board, sitting as the Committee of the Whole, continued this resolution to the Board of Supervisors meeting of February 13, 2018.

In general, the public facilities will be built by the developer of the Mission Rock Project, Seawall Lot 337 Associates, LLC, and the bonds will be used to reimburse the developer for some of those costs. In addition, the bonds may reimburse the Port for funds advanced to pay for the public facilities before tax increment is available.

**File 18-0092:** The proposed resolution would (1) approve a Disposition and Development Agreement (DDA) between the Port and Seawall Lot 337 Associates, LLC, for 28 acres of real property known as Seawall Lot 337, located east of Third Street between China Basin Channel and Mission Rock Street, China Basin Park, and the portion of Terry A. Francois Boulevard abutting the park, Pier 48, the marginal wharf between Pier 48 and Pier 50, and Parcel P20; (2) adopt findings under the California Environmental Quality Act; (3) adopt findings of consistency with the General Plan, and the eight priority policies of Planning Code, Section 101.1(b); and (4) adopt public trust consistency findings.

The proposed resolution authorizes the Port Executive Director to execute the Master Lease between Seawall Lot 337 Associates and the Port, and the ground (parcel) leases and vertical DDAs with vertical developers without further Board of Supervisors approval if these leases and agreements conform to the subject DDA between Seawall Lot 337 Associates and the Port. The proposed resolution also authorizes the Port Executive Director to enter into amendments to the DDA between Seawall Lot 337 Associates and the Port without further Board of Supervisors approval if the amendments do not materially decrease the benefits or increase the obligations to the Port.

The proposed DDA between the Port and Seawall Lot 337 Associates is for a maximum of 30 years<sup>6</sup>, during which Seawall Lot 337 Associates will plan, design, entitle, and construct street, utility, site grading, and other infrastructure improvements to the Mission Rock Project Site. The proposed DDA sets the terms of the Mission Rock Project, including project scope and financing. The proposed Master Lease will have a maximum term of 30 years, subject to extension of the DDA<sup>7</sup>. The proposed Parcel Lease will have a term of 75 years.

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<sup>6</sup> Under the proposed DDA, the term is earlier of 30 years or upon Port's issuance of Final Certificate of Occupancy for the Project and acceptance of the Final Audit but for rights and obligations which survive the DDA termination contained in any or all project transaction documents.

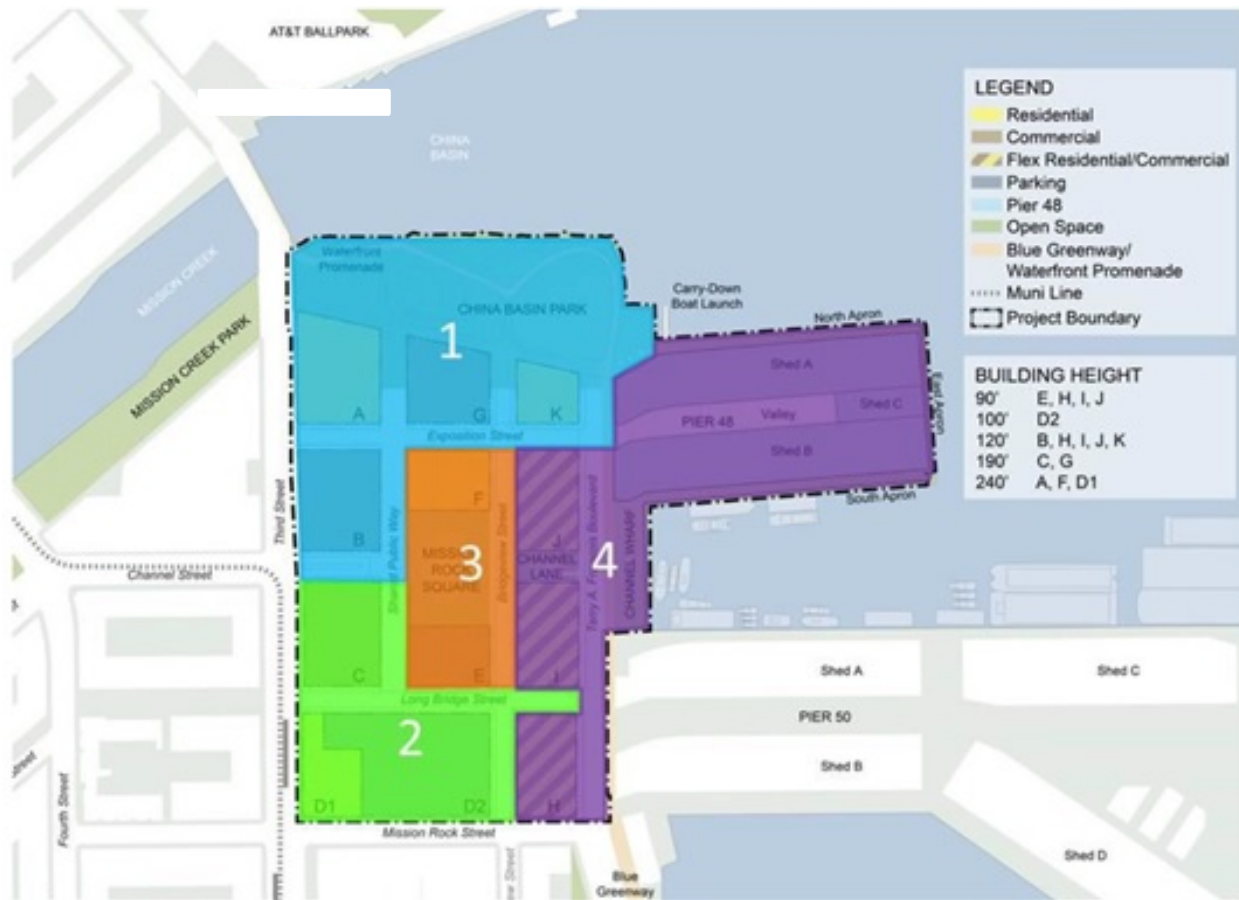
<sup>7</sup> The Master Lease is a form that sets forth the terms and conditions under which the Port will lease most of the Site, other than Pier 48, to the developer when it is ready to begin constructing horizontal improvements, including parks, streets and utilities in accordance with the DDA, and, in the interim, for parking, special events and ancillary uses. Term is a maximum of 30 years, subject to extension of the DDA. Port has early termination option if DDA is terminated and developer has been repaid Entitlement Costs and Phase 1 Alternative Rent Credit.

**Mission Rock Project Description**

*Subproject Areas*

IFD Subproject Area I-1 through Subproject Area I-13 encompass the 28.1-acre Mission Rock project comprising the Seawall Lot 337 and Pier 48, bounded by Third Street on the west, the Bay and Pier 50 on the east, the Bay on the north, and Mission Rock Street on the south, as shown in Exhibit 1 below.

**Exhibit 1: Proposed Mission Rock Project**



The project is divided into four phases.

- Subproject Areas I-1, I-2, I-7, and I-11 incorporate phase 1 development. Phase 1 extends from approximately 2018 to 2025.
- Subproject Areas I-3 and I-4 incorporate phase 2 development from approximately 2019 to 2025.
- Subproject Areas I-5, I-6, and I-13 incorporate phase 3 development from approximately 2019 to 2026.
- Subproject Areas I-8, I-9, I-10, and I-12 incorporate phase 4 development from 2023 to 2029.

*Proposed Public Improvements and Facilities to be Funded by the IFD Subproject Areas*

Seawall Lot 337 Associates is responsible to develop (or cause to be developed) horizontal infrastructure for the Mission Rock project, subject to reimbursement with IFD tax increment, IFD bond proceeds, special taxes levied in one or more proposed Community Facilities Districts (CFD) and CFD bonds. Proposed horizontal infrastructure elements include:

**Exhibit 2. Description of Infrastructure Elements for Mission Rock Project**

<b>Infrastructure Plan Element</b>	<b>Summary Description</b>
Environmental Management	Environmental management of soils under the Port's adopted Risk Management Plan.
Demolition and Abatement	Demolition or abandonment of utility infrastructure; re-use of recycled materials on-site where feasible.
Geotechnical Improvements	Geotechnical improvements to improve seismic stability.
Site Grading and Drainage, including Sea Level Rise	Grading plans designed to remove new development areas from existing FEMA flood plain designation and provide future flood protection from sea level rise.
Street and Transportation Systems	Efficient site layout provides a dense, transit-oriented development that encourages bicycling and walking. Streets to be built over a structural support system to mitigate geotechnical challenges.
Open Space and Parks	Improvements and/or establishment of China Basin Park, Mission Rock Square, Channel Wharf, Channel Street, Channel Lane, and Pier 48 Apron.
Low Pressure Water System	New reliable and efficient potable water system based upon reduced demands due to water conservation measures.
Non-Potable Recycled Water System	A District-scale system will collect graywater from 3 buildings to be reused for site-wide toilet and urinal flushing, irrigation, and cooling tower makeup.
Sewer System	Construction of a new Pump Station to accommodate existing and proposed flows from Mission Rock site; A new wastewater collection system; new stormwater management features
Auxiliary Water Supply System ("AWSS")	Baseline scenario consists of a loop of 12-inch high-pressure pipes with four new hydrants, connecting to the existing AWSS distribution system in 3rd Street.
District Utility Infrastructure	Eco-District infrastructure to be built centrally within Block A allowing for heating, cooling, and greywater treatment in a plant, and distributed throughout Mission Rock.
Dry Utility Systems	Replace overhead electrical distribution with a joint trench distribution system following the roadways. New power, gas and communication systems to serve the development.



*Proposition D*

On November 3, 2015, San Francisco voters approved the Mission Rock Affordable Housing, Parks, Jobs and Historic Preservation Initiative (Proposition D), which authorized increased height limits on the Project Site (subject to environmental review) and established a City policy to encourage development of the Project Site with the following features:

- 1,000 to 1,950 new residential units, most of which are expected to be rental and 40 percent would be below market rate and affordable to middle- and low-income households;
- Creation of approximately 8 acres of new and expanded parks, pedestrian plazas and rehabilitated public piers and wharves, as well as space for retail uses and commercial/office and light industrial space
- Sustainability and resilient design strategies to address projected Sea Level Rise and provide leadership in long-term sustainability planning and design; and
- Creation of new temporary and permanent jobs.

*Residential Development*

The Mission Rock Project development provides flexibility between development of commercial and residential uses on some of the parcels within the Site. The number of residential units on the Mission Rock Project Site ranges from 1,000 to 1,950, depending on whether the development maximizes commercial or residential development on these parcels.

The DDA's Affordable Housing Plan requires at least 40 percent of all residential units in the Project to be below market rate.

- Vertical developers of commercial and retail space will pay a Mission Rock Inclusionary Housing Fee, similar to the City's jobs/housing linkage program, to support the development of the affordable inclusionary units at the Project Site.
- 24 affordable inclusionary units will be set aside for youth transitioning out of foster care or other public systems.
- Affordable inclusionary units will be delivered in each phase and on each residential parcel.

*Transportation Plan*

The Mission Rock Project Environmental Impact Report (EIR) requires the implementation of a Transportation Demand Management (TDM) Program, which is attached to the proposed DDA. Key provisions of the Transportation Plan and TDM Program include the following:

- Vertical developers must pay transportation impact fees that SFMTA will use and allocate for transportation improvements to transit, bicycle, and pedestrian improvements, including improvements in the vicinity of the Mission Rock Project Site.

- The developer, building owners, and tenants must implement the TDM Program designed to reduce Project-related vehicle miles traveled (VMT) by 20 percent.

#### *Office Development*

The Mission Rock Project will provide approximately 1 to 1.4 million square feet of new commercial/office space. New office development at the Mission Rock Project Site will count against the City's annual limit on new office space as provided in the City's Planning Code. The DDA provides a process in which the developer's timeframe for developing new office space is balanced against other large office developments in the City.

#### *Retail Uses*

The Mission Rock Project will provide 250,000 square feet of ground floor, retail and production space intended to include a range of space for shops, restaurants and neighborhood-serving retail uses

#### *Parks*

The Mission Rock Project will provide over 8 acres of new and expanded open space for a variety of activities, including a regional-sized, 4.4 acre China Basin Park on the north side of the Site fronting on San Francisco Bay, a 1.1 acre neighborhood central gathering place called Mission Rock Square, and a 0.5 acre hardscaped plaza at Channel Wharf.

#### *Workforce Development Program*

The DDA's Workforce Development Plan sets the employment and contracting requirements for construction and operation of the Mission Rock Project Site. Workforce plan obligations include the following:

- 30 percent local hiring goals and apprenticeship goals applicable to certain construction work for Local Residents and Disadvantaged Workers established for both the developer and vertical developers.
- Employers must enter a First Source Hiring Agreement that will require participation in the City's Workforce System, including good faith efforts to meet hiring goals in entry-level positions as specified in the Workforce plan. The developer and vertical developers must work with the Mayor's Office of Economic and Workforce Development (OEWD) to make good faith efforts to hire entry level positions for specified pre-construction architectural and engineering services, janitorial, security, landscape and maintenance activities.
- Providing a total of \$1,000,000 in funding for OEWD job readiness and training programs and community based organizations (Workforce Funding). The cost of the Workforce Funding will be shared among the vertical developers on a per parcel basis, excepting the vertical developers of the Parking Structure(s).
- The developer and vertical developers must comply with the Local Business Enterprise (LBE) Utilization Plan to make good faith efforts to meet the outreach goals applicable to design and construction work.

### *Shoreline/Sea Level Rise Protection*

The Project Site's waterfront edge will be designed to protect buildings against the projected 2100 sea-level-rise estimates established by the state, and the grade of the entire site will be raised to elevate buildings and ensure that utilities function properly. In addition, a special tax will be placed on all newly-developed parcels to provide an ongoing revenue stream to protect Port property from sea level rise.

### **Pier 48 (File 18-0093)**

The Mission Rock Project will include the re-use and rehabilitation of Pier 48<sup>8</sup> in support of the Embarcadero National Historic District. Because the developer and the Port have not yet identified a long-term use for Pier 48 that would result in rehabilitating the facility, the Port and China Basin Ballpark Company, LLC (CBBC) have negotiated an interim lease to allow the continued current uses of Pier 48, which include parking and special events (File 18-0093), pending before the Board of Supervisors). The Port Commission approved the lease on January 30, 2018. Under the proposed lease, the Port will lease approximately 212,000 square feet of Pier 48 to CBBC for a term of 10 years.

According to the Port, the term of the proposed lease is 10 years to accommodate potential parking needs during the period between Phase 1 and prior to the construction of the Parcel D2 parking garage. As noted in Exhibit 1 above, the re-use and rehabilitation of Pier 48 is part of phase 4 development from approximately 2023 to 2029. The Port can terminate the lease after commencement to facilitate long-term investment and use of the Site if: (1) termination is required in order to deliver possession to a developer/long-term user for rehabilitation and occupancy of the Pier, and (2) alternate parking resources in comparable locations have been secured.<sup>9</sup> According to the Port, the intention is to rehabilitate Pier 48 to accommodate new commercial/light industrial uses while maintaining the existing maritime operations surrounding the pier, and preserving Pier 48's historic integrity.

### **Project Approach**

The Mission Rock Project consists of (1) horizontal development, such as streets and utilities, and (2) vertical development, including office and residential buildings. Horizontal and vertical development is divided into four phases. Seawall Lot 337 Associates is the master developer for the Mission Rock Project, and is responsible for ensuring the horizontal development is coordinated with vertical development.

Seawall Lot 337 Associates is obligated to complete construction of the horizontal improvements for all phases of the project. Seawall Lot 337 Associates may transfer its development rights and obligations to another developer meeting net worth and experience

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<sup>8</sup> Pier 48 is located east of Terry A. Francois Blvd., south of China Basin Channel and north of Pier 50

<sup>9</sup> According to the Port, both parties plan to work in good faith to determine whether a long-term use can be accommodated in Pier 48. In the event feasible alternatives are identified, the Port and the Master Developer will negotiate to reach agreement on the terms of a lease for the Master Developer to rehabilitate Pier 48, with improvements to accommodate the long term use. If no agreement is reached, the Port has the right to issue an RFP or similar solicitation, provided Master Developer, at its option, has the right to respond to the RFP or forgo the right to respond and collaborate with the Port on the solicitation.

requirements in Phase 1, subject to Port approval in its sole discretion, and in Phase 2 and subsequent phases, subject to Port approval in its reasonable discretion.

*Master Lease, Vertical DDAs, and Ground Leases*

The Master Lease sets the terms and conditions under which Seawall Lot 337 Associates, LLC, or an affiliated successor entity, will lease the Mission Rock Project Site from the Port for the purposes of constructing Horizontal Infrastructure like parks, roads and utilities in accordance with the DDA, and, in the interim, for parking, special events and related ancillary uses. Individual development parcels will be removed from the Master Lease and will subsequently be governed by a Vertical DDA (VDDA) and a Parcel (Ground) Lease.

*Infrastructure Plan*

An Interagency Cooperation Agreement, defining the obligations of various City agencies to the Mission Rock Project, is pending before the Board of Supervisors (File 18-0094). The Interagency Cooperation Agreement describes how the City agencies will coordinate their review and approvals in relation to the Mission Rock Infrastructure Plan, which details the infrastructure (horizontal improvements) requirements of the 28.1-acre Mission Rock Project Site.

**Project Approvals**

Exhibit 3 shows the following legislation related to the Mission Rock Site Project that requires Board of Supervisors approval:

**Exhibit 3: Pending Legislation to Approve Actions Related to the Mission Rock Site Project**

<b>File Number</b>	<b>Action</b>
File No. 171286	CEQA and Mitigation Monitoring Report Program Resolution
File No. 170940	Planning Code and Zoning Map Amendment Ordinance
File No. 171313	Development Agreement Ordinance
	Disposition and Development Agreement
	<ul style="list-style-type: none"> <li>• Financing Plan</li> <li>• Form of Vertical DDA and Parcel Lease</li> <li>• Form of Master Lease</li> <li>• Phasing Plan</li> <li>• Schedule of Performance</li> <li>• Infrastructure Plan</li> <li>• Affordable Housing Plan</li> <li>• Workforce Development Plan</li> <li>• Transportation Program (including TDM Plan)</li> </ul>
File No. 180092 (Subject of this report)	
File No. 180093	Pier 48 Lease Resolution
File No. 180094	MOU re Interagency Cooperation Resolution
File No. 180095	MOU re Tax Allocation Resolution
	<b>Infrastructure Financing District No. 2 (Mission Rock Project Site)</b>
File No. 171117 (Approved)	Resolution of Intention - Establish Project Area I
File No. 171118 (Approved)	Resolution of Intention - Issue Bonds for Project Area I
File No. 171247	Hearing to Consider Legislation to Establish Project Area I
File No. 171314 (Subject of this report)	Ordinance Establishing Sub-Project Areas G-2, G-3, and G-4
File No. 171315 (Subject of this report)	Resolution Authorizing Issuance of Bonds for Project Area I
	<b>Mission Bay Parcel 20 Amendments</b>
File No. 171280	Mission Bay South Redevelopment Plan Amendment Ordinance, continued to the February 13, 2018 Board of Supervisors meeting, sitting as a Committee of the Whole
File No. 171293 (Approved)	Motion to sit as Committee of the Whole to consider Mission Bay South Redevelopment Plan Amendments
File No. 171312	Hearing - Committee of the Whole - Amendments to the Mission Bay South Redevelopment, continued to the February 13, 2018 Board of Supervisors meeting, sitting as a Committee of the Whole

**Planning Approval**

The Planning Commission at its October 5, 2017 meeting took the following actions regarding the Mission Rock Project: (a) certified the Final Environmental Impact Report, (b) adopted CEQA findings and the Mitigation Monitoring and Reporting Program (MMRP), (c) adopted findings of consistency with the General Plan, and the eight priority policies of Planning Codes, Section 101.1(b) (d) recommended approval of Planning Code text amendments and amendments to the Zoning Maps to establish the Mission Rock Mixed-Use District and the Mission Rock Special Use District; (e) recommended approval of the Development Agreement; and (f) approved the Design for Development.

**Community Facilities District (CFD)**

The Board of Supervisors will need to approve land use and financial transactions, including the DDA between the Port and Seawall Lot 337 Associates and the Infrastructure Financing Plan for Port IFD Project Area I before the proposed Mission Rock development can move forward. If the Board of Supervisors approves the DDA and Infrastructure Financing Plan, the project would establish a CFD to levy special taxes in perpetuity to fund ongoing maintenance of public facilities within the CFD. The special tax would cover expenses ranging from the maintenance and repair of streets and parks to security and janitorial services. The Port and Seawall Lot 337 Associates will establish maintenance expense assumptions to document the basis for establishing special tax rates to be levied on contributing parcels.

**Shoreline Special Tax**

According to the Port, the project will be constructed to accommodate an estimated 66 inches of sea level rise. In addition, the CFD formation documents will establish a special tax, called the “Shoreline Special Tax” that would be levied on new development at Mission Rock to finance shoreline improvements. According to the Port, all of the Shoreline Special Taxes from Phase 1 are anticipated to be reinvested in the project for site improvements to protect the project site from sea level rise.

**FISCAL IMPACT**

The Mission Rock Project consists of public and private development costs. Public development costs consist of horizontal infrastructure (utilities, streets, site grading, other), parks and open space, and affordable housing.

Sources of funds to pay for public infrastructure and facility costs include sale and lease of public land, assessment of affordable housing and transportation fees on private development, incremental property tax revenues generated by new development and proceeds from tax increment bonds in the proposed Port Infrastructure Financing District (IFD) Project Area I, and special property assessments through the formation of a proposed community facilities district (CFD).

Estimated sources and uses of funds (excluding bond debt service revenues and expenses) are approximately \$697.6 million (2017 dollars), as shown in Exhibit 4 below.

**Exhibit 4: Estimated Sources and Uses of Funds (in Millions of Dollars)**

	2017 Dollars	Nominal <sup>10</sup>
<b>Sources</b>		
Developer Capital	\$193.3	\$217.6
Advances of Land Proceeds	63.1	67
<u>CFD</u>		
Net Bond Proceeds	61.2	73.7
CFD Pay Go <sup>11</sup>	<u>84.0</u>	<u>257.2</u>
<i>Subtotal, CFD</i>	<i>145.2</i>	<i>330.9</i>
<u>Tax Increment</u>		
Net IFD Bond Proceeds	109.3	143.2
IFD Pay Go	<u>186.7</u>	<u>563.7</u>
<i>Subtotal, IFD</i>	<i>286.0</i>	<i>706.9</i>
<b>Total Sources</b>	<b>\$697.6</b>	<b>\$1322.4</b>
<b>Uses</b>		
Preferred Return to Developer	\$88.3	\$111.4
Developer Capital Distribution <sup>12</sup>	<u>180.0</u>	<u>217.6</u>
<i>Payments to Developer</i>	<i>268.3</i>	<i>329.0</i>
Entitlement <sup>13</sup>	25.0	25.0
Hard and Soft IFD Facility Costs <sup>14</sup>	203.3	300.6
Tax Increment Repayment of Land Proceeds <sup>15</sup>	71.9	171.1
Sea Level Rise Protection/Resiliency Improvements <sup>16</sup>	129.2	496.7
<b>Total Uses</b>	<b>\$697.6</b>	<b>\$1322.4</b>

Source: Infrastructure Financing Plan

<sup>10</sup> According to Ms. Benassini, nominal amounts are forecasted cash flows between 2012 and 2072 with any numbers prior to 2018 as actual spending. Constant 2017 dollars reflect the sum of actual spending and future projected cash flows, discounted at 3 percent a year.

<sup>11</sup> Revenue stream categories have various magnitudes over time, affecting the difference between the nominal and 2017 dollar totals. The "CFD Pay Go" source category reflects the revenue stream from CFD Special Taxes not committed to debt service in the "Net Bonds" categories of sources. This "Pay Go" revenue stream is small in the early part of the projection, reflecting a 2 percent growth in the tax rate. Then, once bonds are fully repaid, there is a large increase in this revenue stream. This difference – small revenue stream in the early part of the cash flow and large stream in the latter part – drives the difference between the nominal and 2017 dollar totals.

<sup>12</sup> Cash flow from the Project to reimburse the developer for the equity contribution.

<sup>13</sup> Equity spent by the developer to create the entitlement prior to any revenue generated by the Project.

<sup>14</sup> Spending on backbone infrastructure required to create finished pads to be sold to vertical builders to support construction of buildings.

<sup>15</sup> Repayment for the Port's land value investment into the Project, funded by tax increment generated from the Project after debt service needed to service the CFD and IFD bonds. This repayment includes a 4.5 percent interest.

<sup>16</sup> Port's waterfront improvements that will be funded by a special tax ranging from \$0.18 to \$1.00 per square foot per year to address sea level rise and resiliency protection issues.

### Horizontal Infrastructure

Under the proposed DDA, Seawall Lot 337 Associates is obligated to obtain entitlements and complete construction of horizontal infrastructure development. Estimated horizontal infrastructure costs are approximately \$190 million<sup>17</sup>, as shown in Exhibit 5 below.

#### Exhibit 5: Estimated Horizontal Infrastructure Costs (2017 Dollars)

Type of Improvement	Estimated Cost (2017 Dollars, millions)				
	Phase 1 (including entitlements)	Phase 2	Phase 3	Phase 4	Total
Demo, Grading, Compaction, Piles and Building Pad Preparation	\$6.07	\$8.16	\$0.64	\$0.46	\$15.33
Streets, Utilities, Streetscape, and Stone Columns	\$31.38	\$17.06	\$5.70	\$10.84	\$64.98
Parks and Open Space	\$14.01	\$0.00	\$7.26	\$3.20	\$24.47
Entitlements, Soft Costs, and Contingency	<u>\$53.33</u>	<u>\$15.08</u>	<u>\$7.90</u>	<u>\$8.80</u>	<u>\$85.11</u>
<b>Total Infrastructure Budget</b>	\$104.79	\$40.30	\$21.50	\$23.30	<b>\$189.89</b>

A third party review of the hard costs<sup>18</sup> (approximately \$104.78 million) by Hathaway Dinwiddie found the hard costs to be reasonable. The review did not assess the costs for entitlements, soft costs, and contingency. According to the proposed DDA, contingency costs are limited to 15 percent or less unless the competitive process demonstrates that the market terms for contingency are higher. In addition, soft costs (e.g., construction management fees, project management costs, and asset management costs) are limited in the aggregate to 15 percent of hard costs. In developing the soft costs and contingency amount thresholds, the Port relied on the third party review of horizontal infrastructure costs for the Forest City project at Pier 70 (File 17-0986) completed by Parsons-Lotus Water Joint Venture Partnership (Parsons) because the Mission Rock Project is in a similar location and includes similar type of work. The Parsons report found that an aggregate 15 percent of hard costs allocation to construction management, project management and asset management costs are reasonable.

<sup>17</sup> According to the Port, a cost difference exists between the approximately \$190 million in horizontal infrastructure costs and \$203.3 in Hard and Soft IFD Facility costs (Exhibit 4) because of costs which occur late in the cashflow for selected Pier 48 improvements. Pier 48 historic structure rehabilitation costs are eligible expenditures under the IFP but are not primarily captured in horizontal infrastructure costs.

<sup>18</sup> This includes costs for (1) Demo, Grading, Compaction, Piles and Building Pad Preparation; (2) Streets, Utilities, Streetscape, and Stone Columns; and (3) parks and open space.



### *Entitlement Costs*

Since 2010, the developer has incurred costs of approximately \$27.4 million for entitlements and is projected to spend approximately \$29 million through project approvals.<sup>19</sup> The Port retained JHS, CPAs, an accounting firm, in 2017 to review the Mission Rock Project's preliminary Entitlement Cost Statement. According to the Port, the firm has conducted much of the work required to analyze and validate the entitlement costs and, thus far, has not identified significant issues with the preliminary Entitlement Cost Statement. The firm will present its final conclusions in February or March 2018.<sup>20</sup>

### **Sources of Funds for Horizontal Infrastructure**

Project costs will be funded by developer capital, bond proceeds, development rights payments, annual special taxes and tax increment, and Port capital (funds the Port Commission elects, in its sole discretion to invest in the Project). According to the Port, while all of these sources may be deployed to directly fund project costs under the deal structure, developer capital is projected to be relied upon as the primary early source of project funding because development rights payments, bond proceeds, and annual special taxes and tax increment revenues are anticipated to be available at project outset in relatively limited quantities and to grow over project buildout (i.e. these sources will repay developer capital contribution).

The DDA's Financing Plan provides for the following sources of funds to pay for horizontal infrastructure costs and repay the developer's capital contribution, beginning in 2019:

- Four Port land parcels (Parcels A, B, F, and K) will be conveyed in 75-year ground leases to developers (see Exhibit 6 below) and the ground lease payments will be prepaid in 2019 and 2020. The Port will advance proceeds of the prepaid ground leases beginning in 2019 as a source of funds to pay horizontal infrastructure costs and to begin repaying the developer capital contribution (developer equity) and return on investment discussed further below. The DDA Financing Plan provides for repayment of the Port's advance of prepaid ground lease proceeds from project revenues, beginning in 2024 and extending through 2057.

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<sup>19</sup> According to the Port, the Port and Seawall Lot 337 Associates completed modeling for project approvals in late 2017, with a project schedule that anticipated City hearings in 2017 and State Lands hearings in early 2018. The estimated entitlement costs were \$25 million at that time and are thus listed as such in the Infrastructure Financing Plan. In part because of the longer time period in preparing for and getting to approvals, entitlement expenditures are currently estimated to be \$29 million. While this is a roughly 16 percent increase for entitlement costs, the overall difference in the context of the full set of Project Uses (summing to \$697 million) is less than 1 percent.

<sup>20</sup> Within 90 days following Project Approval, the developer will provide a supplemental Entitlement Cost Statement that includes expenses and accrued developer return through the date of Project Approval. The Port is obligated to pay the amount of the Entitlement Sum reflected in the final, reviewed, and approved Entitlement Cost Statement.

- Proceeds from CFD bonds, secured by special taxes on properties in the CFD, beginning in 2020.<sup>21</sup>
- Property tax increment generated by new development in Mission Rock, beginning in 2019, with bonds secured by property tax increment to be issued in 2024.<sup>22, 23</sup>

### *Prepaid Ground Leases*

The Financing Plan timeline assumes that project revenues will become available in 2019, or approximately one year from the time of project approvals. While under the DDA the developer will contribute capital to fund entitlement and initial horizontal infrastructure costs, the project will owe the developer a return on the capital contribution (or return on investment, discussed below), calculated as a percentage of the unreimbursed capital contribution balance. Delay in the conveyance of the pre-paid ground leases, establishment of the CFD, or generation of property tax increment will delay repayment of the developer's capital contribution. As a result, the developer's return on investment would continue to accrue on the unreimbursed capital contribution balance, increasing payments to the developer from project revenues and decreasing the availability of these revenues for direct project costs. The Port plans to advance proceeds from prepaid ground leases to the horizontal infrastructure to expedite the pay down of the developer's capital and return on investment, particularly in Phase 1.

The developer has the option to enter into ground leases for the parcels at fair market value established by appraisal, as discussed below.<sup>24</sup> According to the Ms. Rebecca Benassini, Port Assistant Deputy Director for Waterfront Development Projects, the developer is obligated to exercise its options to enter into ground leases the first two parcels at the appraised fair market value for which the ground lease revenues will be a source of funds to pay down the developer's capital contribution toward project entitlement costs and the associated return on the capital contribution (or "return on investment").

### *IFD Property Tax Increment, CFD Special Taxes, and Bonds*

According to the Port, the first CFD bond is projected to be sold in 2019 concurrent with Phase 1 infrastructure approvals. It will be secured by the entitled land value of the site and the planned Phase 1 value of the infrastructure (a "land secured CFD bond"). The debt service will be paid by the horizontal developer until leases are transferred and vertical builders are in place to support the tax payments. According to the Port, the first vertical buildings are expected to be completed in 2021. This is a projection based upon the expected time required to complete approvals, mapping, and the City's infrastructure review and approvals. According

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<sup>21</sup> According to the Port, the CFD will be formed in 2018 and will include all of the parcels at Mission Rock and Pier 48, specifically, parcels A, B, C, D1, D2, E, F, G, H, I, J,K, and Pier 48.

<sup>22</sup> According to the Port, the leases for parcels A, B, G, and K are anticipated to transact in 2019 and will start generating relatively small amounts of tax increment based on construction value. A year after building completion in 2021 and 2022, it is assumed that the parcels will be reassessed based on the value of the improvements.

<sup>23</sup> As noted below, State law limits the use of IFD property tax increment to pay the developer's return on investment. Therefore, the Port plans to use land sale proceeds and CFD special tax proceeds, when available, to pay the developer's return on investment.

<sup>24</sup> If the developer declines to exercise its option for a parcel, the Port will publicly offer the parcel to select a vertical developer, as discussed below.

to the Port, the Port and Seawall Lot 337 Associates are prepared to implement this schedule. Except for soil compaction to prepare the site for development, the developer must obtain Port approval of Phase 1 before spending capital on hard costs. This restriction on spending limits the Port's exposure to outstanding developer capital earning a return without revenue sources to pay the account.<sup>25</sup> The Port expects to issue CFD bonds before the properties are completed and have been working closely with a public financing team (Office of Public Finance, Port Finance and economic consultants) that has determined the viability of the land-secured CFD to be positive.

The IFD tax increment assumes properties will be completed and generating property taxes in 2019-2020. According to the Port, the first vertical buildings – Parcels A, B, G, and K – are expected to be completed in 2021 and 2022. According to Port staff, the Port is aware that the time to get onto the tax rolls may delay the availability of tax increment. During the period while the Office of the Assessor-Recorder is working to bring properties onto the tax rolls, the CFD Special Tax intended to approximate the tax increment can be assessed, making that tax revenue available to service CFD debt. Additionally, all parcels are assumed to be generating tax increment during construction.

#### *Developer Equity and Return on Investment*

As noted above, the developer has financed the costs of entitlements of approximately \$27.4 million since 2010 for a total of approximately \$29 million through the project approvals process and will finance the costs of horizontal infrastructure, for total estimated developer contribution of \$193.3 million in 2017 dollars (\$217.6 million in nominal dollars) shown in Exhibit 4 above.

To date, Seawall Lot 337 Associates has accrued approximately \$15.5 million in return on investment. The Port estimates that the developer's return on investment will be approximately \$111.4 million over the life of the project.

Under the Term Sheet approved in May 2013 (File 13-0286), Seawall Lot 337 Associates would receive a return on equity for horizontal development equal to the greater of (1) 20 percent of their unreimbursed equity investment, or (2) 1.5 times the highest balance of their unreimbursed equity investment. Under the May 2013 Term Sheet, Seawall Lot 337 Associates would also receive 20 percent of rent exceeding \$4.5 million per year for 45 years, beginning in the year in which total rent first exceeds \$4.5 million<sup>26</sup>. Under the proposed DDA, the Port and Seawall Lot 337 Associates have agreed to a lower developer return of 18 percent<sup>27</sup> on outstanding capital in exchange for a greater share of annual rent. In exchange for the lower

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<sup>25</sup> The Port's consultant, Economic & Planning Systems, has tested several "timing" sensitivities related to delays and has found that delays in beginning a phase may result in a minor reduction in land value and associated ground rent to the Port, because the spending during the delay is limited.

<sup>26</sup> The \$4.5 million threshold does not increase during the 45-year term.

<sup>27</sup> The 18 percent return applies to both entitlement (until the entitlement is completed) and infrastructure costs over four phases of buildout. Dollars invested early in the project, e.g., Entitlement Costs from 2010 through 2017 are exposed to a greater risk of loss (and thus, require a higher return) than dollars invested in, for example, Phase 3, after much of the infrastructure and vertical buildings have been built. Investors will require higher returns on spending to achieve entitlements and lower returns towards the end of the Project.

developer return of 18 percent, Seawall Lot 337 Associates will receive a share of ground rent revenue above \$2.5 million as follows:

- 45 percent for years 1 to 25;
- 35 percent for years 26-50; and
- 25 percent for years 51 to 75.

According to the Port, Seawall Lot 337 Associates and the Port agreed to reduce Seawall Lot 337 Associates' upfront return in exchange for more backend sharing and a cost containment mechanism for Phase 1<sup>28</sup>. The Port states that this trade improves several aspects of project performance including: (1) better aligning the parties' interests in preserving annual revenue from the site, by reducing costs and advancing public financing of infrastructure costs and (2) providing for a much lower return on Phase 1 developer equity, if Phase 1 costs exceed the Phase 1 approved budget.

The Port estimates that the developer's return on investment on horizontal equity will be an 18 percent annual return, with quarterly compounding, for each project area, prior to considering backend participation. As noted above, in order to limit costs to the project for the developer's return on investment, the Port plans to advance proceeds from land sales to the horizontal infrastructure to expedite the pay down of the developer's equity and return on investment. Port IFD subproject area property tax increment and bond proceeds, when available after servicing debt, and reimbursing developer funded horizontal costs, will be used to reimburse the Port for the advance of land sale proceeds. State law limits the use of IFD property tax increment to pay the developer's return on investment. Therefore, the Port plans to use land sale proceeds and CFD special tax proceeds, when available, to pay the developer's return on investment.

Under the proposed DDA, developer capital for the project will be repaid with a return equal to the greater of: (1) 1.5 times the highest unreimbursed equity in a given phase ("peak equity" by phase) and (2) an interest rate of 18 percent per year, compounded quarterly, and must sum to at least \$40.5 million over the course of the four Project phases. The only exception to this is return on developer capital on entitlement spending, which accrues interest until entitlements are achieved and then interest and return are frozen.

#### *Pre-Paid Ground Leases and Development Rights Payments*

Under the proposed DDA, proceeds from the Port's conveyance of the two Lead Parcels will be the primary source to pay the developer's entitlement expenditure and return. Lead Parcels will

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<sup>28</sup> Phase 1 Cost Containment (Section 2.6 of the Financing Plan) states the following: If the Parties are unable to identify measures to eliminate the Phase 1 Overage or to agree on measures that could be taken, the Port, in its approval of a revision to the Phase Budget to provide for payment of the Phase 1 Overage, may, in its sole discretion, elect one of the following approaches to fund the Phase 1 Overage: (i) The Port may elect to fund the Phase 1 Overage by a Port Capital Advance, which will bear Alternative Return. (ii) The Port may elect to require that the developer fund the Phase 1 Overage with Developer Capital. Up to \$10 million of Developer Capital used for the Phase 1 Overage will bear Alternative Return. Developer Capital above \$10 million used to pay the Phase 1 Overage will bear developer return. (iii) The Port may elect to fund part of the Phase 1 Overage and require developer to fund the balance, subject to the limitations of clause (ii) of this Subsection.

be conveyed as fully prepaid 75-year leases. Exhibit 6 below notes the fully prepaid ground leases and development rights payments (meaning, partially prepaid ground leases) anticipated by parcel. Phase 1 parcels include A, B, G, and K. Two of these parcels will be designated as Lead Parcels through the Phase 1 approval process and used to repay the entitlement costs and return.

Exhibit 6 below shows the estimated upfront payments expected when the Port signs leases on the below parcels. \$0 for a parcel means that no upfront payment is expected, rather, the parcel will pay rent annually.

**Exhibit 6: Estimated Upfront Payments for Parcel Leases**

<b>Project Sources (Nominal Dollars)</b>		
<b>Parcel</b>	<b>Pre-Paid Ground Lease</b>	<b>Development Rights Payments</b>
A	\$13,000,000	\$0
B	\$25,125,000	\$0
C	\$0	\$9,500,000
D	\$0	\$0
D1	\$0	\$0
D2	\$0	\$750,000
E	\$0	\$0
F	\$26,750,000	\$0
G	\$0	\$0
H	\$0	\$5,100,000
I	\$0	\$0
J	\$0	\$0
K	\$8,100,000	\$0
<b>Total</b>	<b>\$72,975,000</b>	<b>\$15,350,000</b>

Proceeds from the Port's conveyance of the Lead Parcels will be the primary source to pay the entitlement sum (the developer's entitlement costs and the developer's return on investment accrued through the effective date of the DDA). The entitlement sum does not accrue the developer's return on investment following the effective date. According to the Port, Lead Parcels will be conveyed as fully prepaid 75-year leases, against which the developer will be entitled to credit bid the lease value.

**Master Lease Between the Port and Seawall Lot 337 Associates**

Under the proposed DDA, the entitlement sum will stop accruing a return after project approvals are achieved. In exchange for the "freezing" of the return on entitlement costs, the Port has agreed to discounted Base Rent and discounted Percentage Rent on the Master Lease. Specifically, Base Rent and Percentage Rent will be \$2.04 million and 56 percent prior to Lead Parcels' conveyance to the developer, then will increase to \$2.4 million (reduced on a pro rata

share relative to how much land remains in the Lease and increased by 3 percent per year from lease execution) and 66 percent after conveyance of the Lease Parcels.

### **Parcel Leases Between the Port and Seawall Lot 337 Associates or Seawall Lot 337 Associates' Affiliates**

#### *Reserve and Base Rent*

Under the Term Sheet approved in May 2013 (File 13-0286), the reserve rent<sup>29</sup> was set at \$3.5 million. Under the proposed DDA, the Port has reduced the reserve rent from \$3.5 million to \$3.25 million<sup>30</sup>. According to the Port, this reduction would make it more difficult for the developer to delay the Schedule of Performance due to poor market conditions. It also requires the Port to enter parcel leases at potentially lower rents. However, the Port states that parcel rents will be set by appraisal or third-party bid, thus the parcel disposition process assures that the Port will receive fair market rent, regardless of the reserve rent threshold.

Under the proposed DDA, monthly base rent for hybrid leases will be determined by converting fair market fee value to an annual rent according to a formula applied by the appraiser engaged through the DDA conveyance procedures or through the public offering process. Some Parcel Leases will be prepaid in full. Where rent is not fully pre-paid, monthly base rent amount will be fixed in the Parcel Lease and adjusted every 10th year based on 85 percent of the average of the previous 3 years of rent.

#### **Parking Garage Financing Update**

Under the Term Sheet approved in May 2013 (File 13-0286), SFMTA considered developing the major parking garage on Parcel D2 of the Project Site. SFMTA ultimately chose not to do so. Under the proposed DDA, the parking garage would be privately financed and developed by a vertical developer affiliated with the developer. The developer has analyzed the feasibility of the parking garage and has concluded that the private financing and development of the garage is feasible as part of the overall Mission Rock Project.

The parking garage is proposed to be developed in Phase 2. If the other vertical development in Phase 2 is proceeding, the Port has the right to require the developer to cause its affiliate to enter into a VDDA for the lease and development of the parking garage, and the failure to do so would be a material breach of the DDA.<sup>31</sup>

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<sup>29</sup> The reserve rent serves two purposes: (1) it defines the parcel ground rent below which the Port may decline to enter a lease and (2) it also defines the rent below which the developer may delay its Schedule of Performance on the Project, due to poor market conditions.

<sup>30</sup> Reserve Rent will be set Site-wide (excluding Lead Parcels, parking structure Parcel D, and Pier 48) to be \$3.25 million, which will be allocated proportionally to parcels at the time of the first Phase Submittal.

<sup>31</sup> The parking structure parcel will be conveyed under a parcel lease. The lease provisions provide no public subsidy or public financing mechanism; the garage will be privately financed. The rent for the parcel will begin upon lease execution and is equal to the Office Special Tax rate in effect at the time of lease execution multiplied by the number of square feet of the garage. The Port will also share in 50 percent of the revenue stream, once the annual net revenues from the garage exceed 8.5 percent of the total construction costs.

**Transportation Improvements**

The Mission Rock Transportation Plan requires vertical developers to pay Transportation Fees<sup>32</sup> that SFMTA will use and allocate for transportation improvements to transit, bicycle, and pedestrian improvements, including improvements in the vicinity of the Project Site. According to SFMTA, unlike the standard practice of withholding transportation fees for citywide purposes, SFMTA agreed to apply the fees, or the equivalent level of funding (equal to the Transportation Sustainability Fee (TSF) as provided in the DDA Exhibit B7) toward a representative list of transit, bicycle, and pedestrian improvements in the neighborhoods surrounding the Project Site. Per the entitlements for Mission Rock and Pier 70, the SFMTA will combine the estimated \$43 million in Transportation Fees paid by the project at full buildout with the estimated \$45 million in total Transportation Fees paid by the Pier 70 project to fund projects such as increased capacity and reliability on the T-Third line, closure of gaps in the bicycle and pedestrian networks and complete additional improvements to bus service and/or water transit. Transportation Fees are paid at the time of building permits, and therefore will be generated over the 10 years of the projects’ phases. According to SFMTA, the agency is committed to seeking other funds to advance the neighborhood investments, and then get repaid with the Transportation Fees as they come in.

**Affordable Housing**

The Affordable Housing Plan provides for 40 percent of all residential units on the Mission Rock Project Site to be inclusionary units and developed at the following affordability levels shown in Exhibit 7 below.

**Exhibit 7: Levels of Affordability for Mission Rock Project**

<b>Percent of Total Affordable Housing Units</b>	<b>Area Median Income (AMI) Levels</b>
2%	45%
10%	55%
4%	90%
17%	120%
7%	150%
<b>Total: 40%</b>	<b>AMI Range: 45% to 150%</b>

<sup>32</sup> The Transportation Fee will be equal to the Transportation Sustainability Fee listed on the current San Francisco Citywide Development Impact Fee Register for the same land use category with annual escalation in accordance with the methodology currently provided in Section 409 to the date that the Port issues the first construction permit for each Vertical Improvement. For example, the Transportation Sustainability Fee in 2017 for residential buildings with up to 99 units is \$8.13/gsf, and \$9.18/gsf of residential use in all dwelling units at and above the 100th unit in the building.

The Mission Rock Project's Housing Plan includes 24 inclusionary units that will be set aside to house persons transitioning out of public systems, such as the foster system, or homelessness (TAY units). It is anticipated that the vertical developer developing the TAY units will partner with a qualified non-profit services provider and, in consultation with such provider and the Port and other city agencies, will establish requirements to govern TAY units and any associated service space.

Residential inclusionary units at Mission Rock will be delivered over four phases. Each phase will contain private market-rate residential developments. Within each market-rate residential development, a portion of the residential units will be dedicated as below market rate units affordable to low and moderate income households. As such, the affordable units will be delivered concurrently with market-rate residential units. The affordable units will make up no less than 40 percent of the overall number of residential units within the Project Site.

As noted above, vertical developers of commercial and retail space will pay a Mission Rock Inclusionary Housing Fee, similar to the City's jobs/housing linkage program<sup>33</sup>, to support the development of the affordable inclusionary units at the Project Site. Revenues collected from the Inclusionary Housing Fees are estimated to be approximately \$39.3 million over the course of the project.

#### **Pier 48**

According to the Port, parking and rental revenue for Pier 48 have not been specifically projected because the lease structure envisions the Port and the tenant investing in capital repairs for the facility over time to continue the parking and special events uses. The repairs have not yet been identified. The Port received approximately \$850,000 from the current Pier 48 license in calendar year 2017.

#### **Revenue to the Port**

The Port received \$4.3 million in rental revenues under the five existing leases at Seawall Lot 337 and Pier 48 in calendar year 2017. Under the DDA, the Port will receive base rent and percentage rent from ground leases for the eleven land parcels and one parking facility in Seawall Lot 337 and Pier 48. According to the Port, the project Proforma estimates that the Port would receive \$642 million in rent over the 75-year terms of the new ground leases and \$1.8 billion in revenue from all Project based sources (including tax increment and special taxes which can be used on eligible capital projects).

#### Port's Participation in Capital Events

Under the parcel leases between the Port and Seawall Lot 337 Associates or Seawall Lot 337 Associates' Affiliates, the Port would participate in revenue from the transfer of leases as follows:

- If Seawall Lot 337 Associates' affiliates transfer any of the eleven (A, B, C, D1, E, F, G, H, I, J, K) parcels to a new leaseholder, the Port would receive all net lease transfer

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<sup>33</sup> Jobs/Housing Equivalency Impact Fees



proceeds to be used exclusively for the costs of horizontal infrastructure development if the building permits have not yet been issued, and 1.5 percent of net proceeds which is exclusively a benefit to the Port, if building permits have been issued (except for the two lead parcels which are not subject to the 1.5 percent participation). The Port would also receive 1.5 percent of net proceeds from refinancing of the lease. If a parcel lease is executed through a public bid, the Port would receive 1.5 percent of net proceeds.

### **Timing of Sources and Uses**

The developer, Seawall Lot 337 Associates, will contribute capital to pay for project costs, prior to property tax increment and other project funds becoming available. The proposed Infrastructure Financing Plan assumes that the developer will contribute \$193.3 million (in 2017 dollar equity) or \$217.6 million (in nominal dollar equity) through 2029.

According to Ms. Benassini, proceeds from the sale of land or prepayment of ground leases are assumed one month prior to construction of each parcel and are available to pay for project costs immediately.

As noted above, the Port also anticipates issuing the first bond in 2019 and subsequent bonds as vertical leases are signed and construction begins on buildings. Because the IFD Project Area I will not generate property tax increment in 2019, the bonds will be secured by CFD special tax assessments, subject to future Board of Supervisors approval of the CFD. The Port anticipates introducing legislation to approve formation of the CFD atop the 13 subproject areas after the developer has obtained approval of the tentative subdivision map for Seawall Lot 337, which is anticipated to occur in mid-2018. The Port anticipates moving forward with the CFD formation shortly thereafter, by the end of FY 2018-19.

### **Estimates of Annual Property Tax Increment Generated by Subproject Area I-1 through Subproject Area I-13**

Incremental property taxes generated by development of Subproject Area I-1 through Subproject Area I-13 depend on the assessed value of this development.

According to the Infrastructure Financing Plan, property tax increment above \$100,000 is forecasted to begin in FY 2020-21.

The project's assessed value has been estimated based on the anticipated value of the leasehold interest as parcels with horizontal improvements are transferred to vertical builders and the estimated cost of vertical improvements. According to Ms. Benassini, a report prepared by Keyser Marston Associates, Inc. estimates that the development of the Mission Rock Project will have an overall value of approximately \$500 (in 2017 dollar equity) per gross square foot of building and parking area. The projection assumes that construction costs increase at 3 percent per year and that the value of built-out parcels increase at 2 percent per year. Based on these assumptions, the report estimates that the Project's assessed value will stabilize in FY 2028-29 at which time its value will approximate \$2.6 billion, and it will generate approximately \$25.7 million of annual property tax/possessory tax increment. Allocating the City's share of property tax (64.59 percent of annual property tax increment), results in an estimated allocation of \$16.6 million property tax increment to the IFD. The proposed Infrastructure Financing Plan for

Project Area I's subproject areas estimates that approximately \$1.09 billion of cumulative tax increment will be allocated to the IFD over the life of the IFD.

The estimated cumulative<sup>34</sup> and maximum tax increment allocation amounts from each subproject area are shown in Exhibit 8 below.

**Exhibit 8. Estimated Cumulative and Maximum Tax Increment Allocation by Subproject Area**

<b>Sub- Project Area</b>	<b>Estimate of Projected Cumulative Tax Increment Allocated over 45-year Term (Nominal)</b>	<b>Maximum Limit on Cumulative Tax Increment Allocated over 45-year Term (Nominal)</b>
I-1	\$125 million	\$370 million
I-2	\$80 million	\$236 million
I-3	\$110 million	\$384 million
I-4	\$253 million	\$829 million
I-5	\$47 million	\$170 million
I-6	\$108 million	\$411 million
I-7	\$89 million	\$266 million
I-8	\$51 million	\$182 million
I-9	\$72 million	\$280 million
I-10	\$53 million	\$204 million
I-11	\$42 million	\$130 million
I-12	\$57 million	\$240 million
I-13	\$0 million	\$143 million
<b>Project Area I Total</b>	<b>\$1.09 billion (nominal); \$446,000 (2017 dollars)</b>	<b>\$3.85 billion (nominal); \$1.40 billion (2017 dollars)</b>

According to the Infrastructure Financing Plan, the total limit on the property tax increment that can be allocated to the IFD from the Sub-Project Areas over their 45-year terms is \$3.85 billion. These limits reflect projected total property tax increment plus a contingency factor of approximately 200 percent to account for variables such as higher assessed values of taxable property, more frequent reassessments due to resales, and the time it takes to buildout the project. According to Ms. Benassini, the property tax increment cap does not determine the actual amount of property tax increment allocated to the project through pay-as-you-go or issuance of bonds secured by the property tax increment, which is subject to Board of Supervisors approval.

<sup>34</sup> According to Ms. Benassini, pursuant to the IFD Law, the cumulative amount of tax increment to be allocated to each subproject area is subject to a maximum cap. An estimate of the cap has been established based on the assumption that assessed values increase at an average annual rate of 5 percent per year and that construction costs increase at 12 percent per year. For context, the citywide assessment roll has increased at an average annual rate of 6 percent since FY 2004-05.

### Waterfront Set-Aside Requirement

According to the Infrastructure Financing Plan, 20 percent of the property tax increment generated in the subproject areas must be set-aside for shoreline restoration, removal of bay fill, public access to the waterfront, and/or environmental remediation of the waterfront in accordance with the requirements for “waterfront districts” as stipulated in California Government Code Section 53395.8(g)(3)(C)(ii). The 20 percent allocation requirement applies to IFD Project Area I as a whole.

### **Bond Issuance (File 17-1315)**

The proposed resolution (File 17-1315) provides for the approval of the issuance of bonds, secured by property tax increment. The bond authorization would be for up to \$1.378 billion<sup>35</sup> for the project.

The Port anticipates issuing a combination of (1) CFD bonds backed by special taxes and IFD tax increment; (2) CFD bonds backed only by special taxes; and (3) IFD bonds backed by tax increment.

The proposed Infrastructure Financing Plan’s assumptions for the bond authorization include an interest rate of 6 percent, a term of 30 years, issuance cost of 4 percent, reserves of 8 percent, and an annual debt service coverage ratio of 1.1. The Port anticipates issuing a CFD bond in FY 2018-19.

## **POLICY CONSIDERATIONS**

### **Project Risks to the City**

The proposed DDA between Seawall Lot 337 Associates and the Port provides a complex financing scheme to develop public projects. Revenues generated by the Mission Rock Project are intended to cover most public project costs. Seawall Lot 337 Associates invested its own equity for entitlements and will invest its own equity for horizontal infrastructure development, which will be reimbursed from available project-generated taxes. The DDA states that the developer cannot compel the City to use General Fund or Harbor Fund monies (except for lease revenues generated in the project site and Port capital committed to the Project in a Port Commission approval of a Phase Budget)<sup>36</sup> to reimburse the developer for its costs to develop the horizontal infrastructure or other developer obligations under the DDA.

Changes to the project’s financing assumptions, especially in Phase I, could delay completion of the project and potentially reduce the amount of public funding for the horizontal infrastructure and future projects. For example, the DDA Financing Plan includes an initial project Proforma, which contains key revenue and expenditure assumptions for the Mission Rock project site. The Proforma incorporates certain assumptions that informed the drafting of

<sup>35</sup> According to the Port, the maximum bond authorization is estimated by discounting the maximum projected tax increment by 3 percent to simulate a favorable bond environment.

<sup>36</sup> No City General Funds or Port Harbor Funds are pledged for the Project, other than lease revenues from the site (in certain circumstances). The Port Commission will have the option in its sole discretion to invest Port Capital in the Project and to earn a 10 percent cumulative annual return, compounded quarterly, on this investment.

the Financing Plan, including that the developer's entitlement costs would be reimbursed by prepaid lease revenues from two "Lead Parcels" in Phase 1. A significant decrease in the value of those two Lead Parcels would potentially impede the developer's and the Port's ability to move forward with Phase 1, as it is currently envisioned.

According to the Port, the only way to issue debt based on CFD revenues early in the Project will be to form a CFD over the Mission Rock project site and seek Board of Supervisors authorization to sell a CFD bond repaid by a special tax levy on undeveloped property at the site for which the entitled land serves as collateral.

To begin a phase, the developer must submit a phase application and a phase budget. The developer has the option to enter into ground leases for the parcels at fair market value established by appraisal. If the developer declines to exercise its option for a parcel, the Port will publicly offer the parcel to select a vertical developer. According to the Port, Proforma modeling indicates that the first three to four leases will need to be fully prepaid fair market rent at the close of escrow to finance Phase horizontal costs while nearly all of the remaining leases are anticipated to have annualized lease structures, meaning the fair market rent will be paid each year, with no upfront payment due at closing.

Rent on all ground leases must meet two financial tests for the Port to be required to enter into a lease: (1) the sum of prepaid rent from all parcels within a phase must be sufficient, when combined with existing and projected public financing sources, to repay all horizontal development costs for the phase (including accrued interest) and (2) the annual ongoing ground rent from the parcel must meet the reserve rent, which is the site wide minimum annual guaranteed rent from the Project.

Because the developer's return on investment continues to accrue, delays in funding to reimburse Seawall Lot 337 Associates for its equity investment and return on investment will increase the developer return on project equity, potentially reducing funding for other uses.

#### *Risks of Insufficient CFD and IFD Revenues*

The Port estimates that the CFD Special Taxes and CFD Maintenance Taxes are likely to total about \$3.50 per gross office square foot per year and about \$2.12 per net residential square foot per year (proportionally less for Below Market Rate square footage). IFD tax increment will depend on the assessed value of properties on the tax roll, which could be lower than projected if (1) fewer square feet than assumed are developed, and/or (2) property values are lower than assumed due to market conditions when certificates of occupancy are issued.

#### *Potential Changing Market for Financial Investors for IFD and CFD Bonds*

While the investment market for CFD bonds is established, IFD bonds are a new debt instrument. The extent to which investors will be interested in purchasing these bonds is not known, although the IFD bonds, which are secured by property tax increment, are similar to bonds issued by former redevelopment agencies, which were an established market. The proposed Infrastructure Financing Plan's assumptions for CFD bonds include an interest rate of 6 percent, a term of 30 years, issuance cost of 4 percent, reserves of 8 percent, and an annual debt service coverage ratio of 1.1. The proposed Infrastructure Financing Plan does not include

assumptions for IFD bonds since the Port has not modeled IFD bonds yet. IFD bond sales may occur when developed properties are added to the tax roll, which could take until 2027 or 2028.

### **Summary**

The Mission Rock Project is a complex project, subject to financing risks, as noted above, and other development risks. The Project plan under the proposed DDA generally conforms to the 2013 Term Sheet endorsed by the Board of Supervisors and the conditions set by Proposition D. For the Mission Rock Project to be implemented, the Board of Supervisors needs to authorize pending legislation, outlined in Exhibit 3 above, as well as future legislation for the approval of the formation of the CFD atop the 13 subproject areas. Because this legislation has not yet been considered by the Board of Supervisors, approval of the proposed resolution is a policy matter for the Board of Supervisors.

### **RECOMMENDATIONS**

1. Amend the proposed resolution (File 18-0092) to request the Port Executive Director to report to the Board of Supervisors annually in May of each year on the status of the project and project financing.
2. Approval of the proposed resolution, as amended, is a policy matter for the Board of Supervisors.