

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

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TO: Budget and Finance Sub-Committee

FROM: Budget and Legislative Analyst



SUBJECT: April 24, 2019 Budget and Finance Sub-Committee Meeting

TABLE OF CONTENTS

| Item | File | | Page |
|-------------|-------------|---|-------------|
| 2 | 19-0330 | Lease Agreement - Brookstone SFO T-2, LLC - Terminal 2 Specialty Retail Concession Lease No. 1 - Lease No. 18-0071 - \$325,000 Minimum Annual Guarantee | 1 |
| 3 | 19-0347 | Memorandum of Agreement - United States Department of the Interior, National Park Service - Management of Watersheds Supplying San Francisco Regional Water System - Not to Exceed \$33,257,629 | 4 |
| 4 | 19-0333 | Real Property Lease Extension Option - Choo Laguna, LLC - 258-A Laguna Honda Boulevard - \$51,192 Annual Base Rent..... | 7 |

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| Item 2 File 19-0330 | Department: San Francisco International Airport (Airport) |
| EXECUTIVE SUMMARY | |
| <p style="text-align: center;">Legislative Objectives</p> <ul style="list-style-type: none"> • The proposed resolution would approve a retail concession lease in Terminal 2 between San Francisco International Airport (Airport) as landlord and Brookstone SFO T-2, LLC as tenant for a term of seven years and Minimum Annual Guaranteed (MAG) rent of \$325,000. <p style="text-align: center;">Key Points</p> <ul style="list-style-type: none"> • In August 2017, the Airport Commission authorized Airport staff to conduct a Request for Proposals (RFP) for six concession leases in Terminal 2, including an electronics and travel retail concession lease. The Airport received two proposals, and an evaluation panel determined Brookstone SFO T-2, LLC to be the highest scoring responsive and responsible proposer. In March 2018, the Airport Commission approved a lease with Brookstone. • In August 2018, Brookstone filed for Chapter 11 bankruptcy, announcing that it would close its 101 shopping mall stores, while keeping its 35 Airport stores and online business open. Airport staff decided to not move forward with the lease at that time, as it awaited bankruptcy court proceedings to conclude. After receiving assurances from Brookstone that it still wishes to pursue the lease and keeping its existing International Terminal location open, Airport staff has decided to proceed with the lease. • The proposed resolution would approve a lease with Brookstone for a term of seven years and initial MAG rent of \$325,000, with no options to extend. <p style="text-align: center;">Fiscal Impact</p> <ul style="list-style-type: none"> • Over the seven-year term of the lease, the Airport would receive at least \$2,275,000 in MAG rent. The Airport expects to receive percentage rent, which would exceed the MAG. <p style="text-align: center;">Recommendation</p> <ul style="list-style-type: none"> • Approve the proposed resolution. | |

MANDATE STATEMENT

City Charter Section 9.118(c) states that any modification, amendment or termination of a lease that had an initial term of ten years or more, including options to extend, or that had anticipated revenues of \$1 million or more is subject to Board of Supervisors approval.

BACKGROUND

In August 2017, the San Francisco International Airport (Airport) Commission authorized Airport staff to conduct a Request for Proposals (RFP) for six concession leases in Terminal 2,¹ including an electronics and travel retail concession lease. After conducting an informational meeting with interested parties, staff gathered feedback and modified business terms. In December 2017, the Airport Commission approved the minimum requirements and lease specifications and authorized Airport staff to accept proposals. In January 2018, the Airport received two proposals for the electronics and travel retail concession lease. A five-member panel reviewed the proposals and scored them as shown in Table 1 below.

Table 1: Proposals and Scores for Electronics and Travel Retail RFP

| Proposer | Concept Name | Score |
|-----------------------------------|--------------|-------|
| Brookstone SFO T-2, LLC | Brookstone | 80.32 |
| InMotion Entertainment Group, LLC | InMotion | 79.64 |

Brookstone SFO T-2, LLC was determined to be the highest scoring responsive and responsible proposer and was awarded a lease. In March 2018, the Airport Commission approved the lease.

In August 2018, Brookstone filed for Chapter 11 bankruptcy, announcing that it would close its 101 shopping mall stores, while keeping its 35 airport stores and online business open. According to Mr. John Reeb, Airport Senior Principal Property Manager, Airport staff decided not to move forward with the lease at that time, as it awaited bankruptcy court proceedings to conclude. After receiving assurances from Brookstone that it still wishes to pursue the lease and keep its existing International Terminal location open, Airport staff has decided to proceed with the lease.

¹ The RFP was for six lease sites; the proposed resolution would approve one of the six lease sites. In October 2018, the Board of Supervisors approved leases with Canonica New York, LLC (Candy/Confections Retail, File 18-0599) and SSP America, Inc. (Casual Dining Restaurant, File 18-0602). A fourth lease with Avila Retail Development and Management, LLC (Regional Gifts Retail) was approved by the Airport Commission and submitted to the Board of Supervisors (File 18-0601). Avila’s principal owners have since decided to retire from the industry, and the Airport Commission rescinded the lease in August 2018. Airport staff has awarded the lease to MRG San Francisco, LLC, which is awaiting Board of Supervisors approval. According to Mr. Reeb, the Airport did not receive any proposals for Specialty Retail Lease No. 4 (Museum Store). The concept was changed to Sunglasses and Cosmetics and the Airport awarded the lease to Air Sun JV dba Sunglass Hut, which did not meet the criteria to require Board of Supervisors approval. The concept for Specialty Retail Lease No. 5 was changed from Sunglasses and Cosmetics to a Wellness Center. A lease was awarded to XpresSpa SF International, LLC, which was approved by the Board of Supervisors in November 2018 (File 18-0824).

DETAILS OF PROPOSED LEGISLATION

The proposed resolution would approve a retail concession lease in Terminal 2 between the Airport as landlord and Brookstone SFO T-2, LLC as tenant. Under the lease, Brookstone would pay the greater of the Minimum Annual Guaranteed (MAG) rent or percentage rent based on gross revenues. The key provisions of the lease are shown in Table 2 below.

Table 2: Key Provisions of Lease

| Tenant | Brookstone SFO T-2, LLC |
|--|--|
| Square Footage | 928 square feet |
| Term | 7 years |
| Options to Extend | None |
| Initial MAG Rent² | \$325,000 |
| MAG Adjustment | Annually based on Consumer Price Index (CPI) |
| Percentage Rent (of Gross Revenues) | 12% up to \$500,000; 14% from \$500,000 to \$1,000,000; 16% over \$1,000,000 |
| Minimum Investment | \$700 per square foot |
| Interim Rent During Construction | 16% of gross revenues |
| Deposit | Equal to one-half of initial MAG (subject to mid-term adjustment) |
| Promotional Charge | \$1 per square foot per year |

According to Mr. Reeb, the concession is expected to open in late October 2019.

FISCAL IMPACT

The Airport would receive at least \$325,000 annually in MAG rent, for total revenue of at least \$2,275,000 in MAG rent over the seven-year term of the lease. According to Mr. Reeb, the Airport expects to receive percentage rent, which would exceed the MAG.

RECOMMENDATION

Approve the proposed resolution.

² The Airport sets MAG rents for retail lease sites at approximately 75 percent of projected percentage rent.

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| <p>Item 3 File 19-0347</p> | <p>Department: Public Utilities Commission (PUC)</p> |
| <p>EXECUTIVE SUMMARY</p> | |
| <p style="text-align: center;">Legislative Objectives</p> <ul style="list-style-type: none"> • The proposed resolution would authorize a Memorandum of Understanding (MOA) between San Francisco Public Utilities Commission (SFPUC) and the National Park Service (NPS) for comprehensive management of watersheds supplying the San Francisco Regional Water System, for a term of four years, from July 2020 through June 2024, and an amount not to exceed \$33,257,629. <p style="text-align: center;">Key Points</p> <ul style="list-style-type: none"> • The Hetch Hetchy Reservoir and watershed is located in Yosemite National Park, which is operated by the U.S. Department of the Interior’s NPS. Water from Hetch Hetchy currently provides approximately 85 percent of the Regional System’s water supply. • Under the Raker Act, SFPUC is required to reimburse NPS for the cost of the inspection necessary to insure compliance with the sanitary regulations, the costs of road and trail maintenance, and expenses incurred by NPS in making investigations or decisions with respect to SFPUC’s rights, benefits, and obligations under the Raker Act. According to state and federal law, SFPUC must demonstrate control over watershed activities like stock management and wastewater treatment to allow the water to remain untreated. Since the watershed above Hetch Hetchy is controlled by NPS, the MOA uses SFPUC funding to protect and enhance water quality. The current MOA expires June 30, 2020. <p style="text-align: center;">Fiscal Impact</p> <ul style="list-style-type: none"> • The MOA authorized by the proposed resolution would not exceed \$33,257,629 over the four year term. Expenditures of \$7,203,582 in FY 2020-21 under the proposed MOA for core tasks are an increase of four percent compared to the FY 2019-20 budget in the existing MOA; expenditures for core tasks increase by four percent annually through the remainder of the four-year MOA term. • The FY 2020-21 budget includes an additional \$600,000 for special projects, increasing by four percent per year through the remainder of the four-year MOA term. Special projects may be performed based on the shared needs of both SFPUC and NPS to supplement core tasks to address new or changed conditions. Special projects have limited time and duration and may include, but are not limited to, studies, infrastructure improvements, contingency reserve funds, or funding for equipment • The MOA would be funded by the SFPUC Hetch Hetchy Water Enterprise operating budget, as appropriated through the Board of Supervisors two-year budget process. <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

The Hetch Hetchy Reservoir and watershed is located in Yosemite National Park, which is operated by the U.S. Department of the Interior's National Park Service (NPS). The 1913 Raker Act authorized the City and County of San Francisco to construct the O'Shaughnessy Dam at Hetch Hetchy and other water and power facilities to supply water to the San Francisco Regional Water System. Water from Hetch Hetchy currently provides 85 percent of the Regional System's water supply.

Under the Raker Act, the San Francisco Public Utilities Commission is required to reimburse NPS for the cost of the inspection necessary to secure compliance with the sanitary regulations, the costs of road and trail maintenance, and expenses incurred by NPS in making investigations or decisions with respect to SFPUC's rights, benefits, and obligations under the Raker Act.

Water delivered by the SFPUC to San Francisco from Hetch Hetchy is exempt from filtration under federal and state law. To maintain this exemption, the SFPUC must demonstrate control over watershed activities like stock management and wastewater treatment. Since the watershed above Hetch Hetchy is part of Yosemite National Park, managed and controlled by NPS, the Memorandum of Agreement (MOA) uses SFPUC funding to protect and enhance water quality in addition to expenses that are SFPUC's responsibility under the Raker Act.

In July 2016, the Board of Supervisors approved a new MOA between SFPUC and NPS, for a term of two years, from July 2016 through June 2018, and an amount not to exceed \$12,326,507 (File 16-0538, Resolution 276-16). In June 2018, the Board of Supervisors approved an amendment to the MOA, extending the term through June 2020 and increasing the not-to-exceed amount to \$26,904,364 (File 18-0496, Resolution 192-18). According to Ms. Cheryl Sperry, Hetch Hetchy Water and Power Administrative Services Manager, SFPUC is seeking a new MOA now to avoid competing deadlines for both SFPUC and NPS, which have created challenges in completing previous MOAs.

DETAILS OF PROPOSED LEGISLATION

The proposed resolution would approve a new MOA between SFPUC and NPS for comprehensive management of watersheds supplying San Francisco Regional Water System, for a term of four years, from July 2020 through June 2024, and an amount not to exceed \$33,257,629. According to Ms. Sperry, the scope of services would not change from the current MOA.

FISCAL IMPACT

The MOA authorized by the proposed resolution would have an amount not to exceed \$33,257,629 over the four-year term. Expenditures for core tasks increase in FY 2020-21 by four percent compared to the FY 2019-20 budget in the existing MOA, and increase four percent annually through the remainder of the four-year MOA term. The cost breakdown is shown in Table 1 below.

Table 1: MOA Program Costs

| Program | FY 2020-21 | FY 2021-22 | FY 2022-23 | FY 2023-24 | Total |
|---------------------------|--------------------|--------------------|--------------------|--------------------|---------------------|
| Source Water Protection | \$5,511,438 | \$5,731,896 | \$5,961,172 | \$6,199,619 | \$23,404,125 |
| Environmental Stewardship | 316,753 | 329,423 | 342,600 | 356,304 | 1,345,079 |
| Security | 833,068 | 866,390 | 901,046 | 937,088 | 3,537,592 |
| Program Manager | 182,144 | 189,429 | 197,007 | 204,887 | 773,467 |
| Administrative Support | 360,179 | 374,586 | 389,570 | 405,152 | 1,529,488 |
| <i>Core Task Subtotal</i> | <i>\$7,203,582</i> | <i>\$7,491,725</i> | <i>\$7,791,394</i> | <i>\$8,103,050</i> | <i>\$30,589,751</i> |
| Raker Act Fee | 30,000 | 30,000 | 30,000 | 30,000 | 120,000 |
| Special Projects | 600,000 | 624,000 | 648,960 | 674,918 | 2,547,878 |
| Total | \$7,833,582 | \$8,145,725 | \$8,470,354 | \$8,807,968 | \$33,257,629 |

The special projects budget is \$600,000 in FY 2020-21, and increases by four percent per year. According to Ms. Sperry, special projects may be performed based on the shared needs of both SFPUC and NPS to supplement core tasks to address new or changed conditions. Special projects have limited time and duration and may include, but are not limited to, studies, infrastructure improvements, contingency reserve funds, or funding for equipment. They are jointly developed and funded through the normal budget process.

According to Ms. Sperry, the MOA would be funded by the SFPUC Hetch Hetchy Water Enterprise operating budget, as appropriated through the Board of Supervisors two-year budget process.

RECOMMENDATION

Approve the proposed resolution.

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| <p>Item 4 File 19-0333</p> | <p>Department: Office of the Public Defender (OPD)</p> |
| <p>EXECUTIVE SUMMARY</p> | |
| <p style="text-align: center;">Legislative Objectives</p> <ul style="list-style-type: none"> • The proposed resolution authorizes the Director of Real Estate to exercise the one lease extension option for the real property located at 258-A Laguna Honda Boulevard with Choo Laguna, LLC, as landlord, for use by the Public Defender, as tenant, for a five-year term to commence on July 1, 2019 through June 30, 2024. The initial monthly base rent for the 1,800 square feet of office space at 258-A Laguna Honda Boulevard will be \$4,266 for a total annual base rent of \$51,192. <p style="text-align: center;">Key Points</p> <ul style="list-style-type: none"> • The Public Defender has had office space at 258-A Laguna Honda Boulevard since 2004. In July 2014, the Board of Supervisors approved a resolution retroactively authorizing a five-year lease from July 1, 2014 through June 30, 2019, with one five-year option to extend through June 30, 2024. Under the terms of the lease, rent would increase to 95 percent of fair market value on exercise of the extension option. • The existing lease uses the office space at 258A Laguna Honda Boulevard for seven to eight Public Defender staff members and two interns to meet with clients and to prepare client defenses at the Juvenile Court. The number of staff members using the space is not expected to change. <p style="text-align: center;">Fiscal Impact</p> <ul style="list-style-type: none"> • The Public Defender’s current annual rent for 258-A Laguna Honda Boulevard in FY 2018-19 is \$47,268 equal to approximately \$26.26 per square foot per year for 1,800 square feet. Under the proposed lease extension, the rent would increase by 8.2 percent to an annual base rent rate of \$28.44 per square foot per year with an annual base rent of \$51,192. The proposed annual base rent rate of \$28.44 per square foot represents 95 percent of the prevailing fair market rent as determined by the Real Estate Division. • Over the five-year term of the lease extension from July 1, 2019 through June 30, 2024, total rent to be paid by the Public Defender is \$271,785 and the total cost for utilities and operating expenses is estimated at \$56,361, resulting in a total cost of \$328,147 for the proposed five-year lease extension. <p style="text-align: center;">Policy Consideration</p> <ul style="list-style-type: none"> • On April 9, 2019, a proposed ordinance was introduced to the Board of Supervisors amending the Administrative Code to require the City to close Juvenile Hall by December 31, 2021 (File 19-0392). According to the Public Defender, the proposed ordinance only closes down the lock up/detention center for youth and not the main administration building of the Juvenile Justice Center. There is no provision in the proposed ordinance to close down the administration building where the courts are located. Public Defender staff will still have to represent youth in the courthouse located at the Juvenile Justice Center. <p style="text-align: center;">Recommendation</p> <ul style="list-style-type: none"> • Approve the proposed resolution. | |

MANDATE STATEMENT

Administrative Code Section 23.27 requires that leases in which the City is a tenant must be approved by resolution of the Board of Supervisors.

BACKGROUND

On February 11, 2004, the Public Defender's Office (Public Defender), as tenant, began leasing 1,800 square feet of office space from Laguna Honda Properties, as landlord, located at 258A Laguna Honda Boulevard for a period of approximately 11 months, expiring on December 31, 2004. Since the end of the lease on December 31, 2004, the Public Defender continued to occupy the office space at 258A Laguna Honda Boulevard through annual extensions approved by the Director of Real Estate through December 31, 2013. Under Administrative Code Section 23.26, the Director of Real Estate has the authority to enter into leases, in which the City is a tenant, on a year-to-year or shorter tenancy in which the rent is less than \$5,000 per month.

On March 6, 2013, Choo Laguna LLC purchased the property at 258-A Laguna Honda Boulevard. The Public Defender continued to lease the office space from Choo Laguna LLC on month-to-month leases while a longer term lease was negotiated. The monthly rent from January 1, 2014 through June 30, 2014 was \$3,950 per month or approximately \$2.19 per square foot, plus \$625 monthly janitorial costs, for a total of \$4,575 per month paid to Choo Laguna LLC. In July 2014, the Board of Supervisors approved a resolution retroactively authorizing the lease of office space at 258-A Laguna Honda Boulevard between the Public Defender and Choo Laguna LLC for a period of five years beginning on July 1, 2014 through June 30, 2019. The initial rent was \$3,500 per month or \$1.94 per square foot. The lease includes an option to extend the term of the lease for an additional five years on the same terms and conditions, adjusting rent to equal 95 percent of the prevailing fair market value.

According to Ms. Patricia Lee, Managing Attorney at the Public Defender's Office, the existing lease uses the office space at 258A Laguna Honda Boulevard for seven to eight Public Defender staff members and two interns to meet with clients and to prepare client defenses at the Juvenile Court. The number of staff members using the space is not expected to change.

DETAILS OF PROPOSED LEGISLATION

The proposed resolution authorizes the Director of Real Estate to exercise the one lease extension option for the real property located at 258-A Laguna Honda Boulevard with Choo Laguna, LLC, as landlord, for use by the Public Defender, as tenant, for a five-year term to commence on July 1, 2019 through June 30, 2024. The initial monthly base rent for the 1,800 square feet of office space at 258-A Laguna Honda Boulevard will be \$4,266 for a total annual base rent of \$51,192. Table 1 below summarizes the terms and conditions of the proposed lease extension.

Table 1. Summary of Proposed Lease Details

| | Proposed Lease |
|------------------------------|---|
| Premises | 1,800 square feet plus a parking lot for 3 vehicles |
| Base Rent (monthly) | \$4,266 (Annual \$51,192) |
| Operating Expenses (monthly) | Estimated first year cost of \$850 per month (Annual \$10,200) with an estimated increase of 5% annually for utilities, property taxes and operating costs |
| Base Rent Increase Date | Annually on July 1 |
| Base Rent Increase Amount | 3% (annually) |
| Term of five year extension | July 1, 2019 to June 30, 2024 |

Source: Real Estate Division

FISCAL IMPACT

The Public Defender's existing annual rent for 258-A Laguna Honda Boulevard in FY 2018-19 is \$47,268, equal to approximately \$26.26 per square foot per year for 1,800 square feet. Under the proposed lease extension, the rent would increase by 8.2 percent to an annual base rent rate of \$28.44 per square foot per year with an annual base rent of \$51,192.

The proposed annual base rent rate of \$28.44 per square foot represents 95 percent of the prevailing fair market rent as determined by the Real Estate Division¹. According to Mr. Joshua Keene, Special Projects and Transactions Manager at the Real Estate Division, comparable properties provided a rental range of value from \$28 to \$36 per square foot (per year). The Real Estate Division negotiated a prevailing fair market rental rate of \$30 per square foot; per Section 4.2 of the existing lease agreement, the base rent was adjusted to 95 percent of the prevailing fair market rental rate², which equals \$28.44 per square foot per year.

According to Mr. Keene, the annual rent increase of 3 percent per year reflects the current rent increase percentage in the existing lease agreement. Mr. Keene also states that the annual operating costs increase of 5 percent per year reflects inflation, market increases and actual current expenditures under the existing lease.

As shown in Table 2 below, over the five-year term of the lease extension from July 1, 2019 through June 30, 2024, total rent to be paid by the Public Defender is \$271,785 and the total cost for utilities and operating expenses is estimated at \$56,361, resulting in a total cost of \$328,147 for the proposed five-year lease extension. This total cost, including utilities and

¹ No third-party appraisal was obtained as the fair market rent is below the appraisal threshold requirement of \$45 per square feet per year pursuant to City Charter Section 23.27: "If the consideration to be paid by the City for the lease as base rent is more than \$45 per square foot per year, the Director of Property, on behalf of the department concerned shall obtain an appraisal for the market rent of the Lease."

² \$2.50 per square foot (per month) x 95% = \$2.37 per square foot (per month) which equals \$28.44 per square foot (per year). \$28.44 per square foot (per year) x 1800 square feet = \$51,192 annual base rent or \$4266 monthly base rent for the proposed lease extension.

operating expenses, would be paid from the City's General Fund, subject to Board of Supervisors appropriation approval in the Public Defender's annual budget.

Table 2: Total Costs by Year under Proposed Lease Extension

| Lease Year | Base Rent (per sq. ft. per year) | Annual Rent ³ | Annual Operating Costs ⁴ | Total Cost |
|--------------|-------------------------------------|--------------------------|-------------------------------------|------------------|
| FY 2019-20 | \$28.44 | \$51,192 | \$10,200 | \$61,392 |
| FY 2020-21 | \$29.29 | \$52,727 | \$10,710 | \$63,438 |
| FY 2021-22 | \$30.17 | \$54,310 | \$11,246 | \$65,555 |
| FY 2022-23 | \$31.08 | \$55,939 | \$11,808 | \$67,747 |
| FY 2023-24 | \$32.01 | \$57,617 | \$12,398 | \$70,015 |
| Total | | \$271,785 | \$56,361 | \$328,147 |

Source: Real Estate Division

According to Ms. Lee, the location of the proposed lease is advantageous because it is close to the main juvenile office in the administrative building of the San Francisco Juvenile Justice Center, which is less than a mile away and allows for staff to make court appearances for their clients, file motions, pick up daily court calendars, petitions and filings. Ms. Lee states that currently the Public Defender has staff housed at the main administration building at the Juvenile Justice Center, but the office space is at capacity thus necessitating the need to have a supplemental office in close proximity to the courts to house other Public Defender juvenile unit staff. Additionally, the existing office of the proposed lease agreement (258-A Laguna Honda Boulevard) is physically separated from the courts, juvenile probation, and district attorney's offices, which may help in maintaining attorney/client confidentiality and ensuring that youth clients feel comfortable in visiting the Public Defender's staff for client interviews and crisis intervention.

According to Mr. Keene, if approved, the proposed lease agreement will be evaluated by the Real Estate Division approximately 1 to 2 years prior to the lease expiration. If the best option is for the Public Defender to remain at 258-A Laguna Honda Boulevard, the Real Estate Division will renegotiate an extension for the lease. The Real Estate Division will analyze and review the availability of alternative lease opportunities if the Public Defender's needs have changed, if a better opportunity (such as available City-owned space) is available, or if the landlord is unwilling to extend the lease.

POLICY CONSIDERATION

On April 9, 2019, a proposed ordinance was introduced to the Board of Supervisors amending the Administrative Code to require the City to close Juvenile Hall by December 31, 2021 (File 19-0392). According to Ms. Lee, the proposed ordinance only closes down the lock

³ Assumes annual increase of 3 percent.

⁴ Assumes annual increase of 5 percent. The current year operating cost estimates equal \$810 per month (\$625 per month for janitorial services and \$185 for utilities and garbage services).

up/detention center for youth and not the main administration building of the Juvenile Justice Center at 375 Woodside Ave. Consequently, the proposed ordinance should not impact the proposed lease extension for the Public Defender's office space at 258-A Laguna Honda Boulevard because the San Francisco Superior Courts will still be operating at the Juvenile Justice Center, and there is no provision in the proposed ordinance to close down the administration building where the courts are located. Ms. Lee states that Public Defender staff will still have to represent youth in the courthouse located at the Juvenile Justice Center.

RECOMMENDATION

Approve the proposed resolution.