

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

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December 6, 2019

**TO:** Budget and Finance Committee  
**FROM:** Budget and Legislative Analyst   
**SUBJECT:** December 11, 2019 Budget and Finance Committee Meeting

**TABLE OF CONTENTS**

<b>Item</b>	<b>File</b>		<b>Page</b>
1	19-1099	Updated Emergency Declaration - Repair Southeast Treatment Plant Final Effluent Force Main - Total Estimated Cost Not to Exceed \$6,250,000.....	1
2	19-1182	Lease Agreement - TZK Broadway, LLC - Seawall Lots 323 and 324 - Teatro ZinZanni - \$1,000,000 Annual Minimum Base Rent.....	4
4	19-1227	Hearing - Release of Reserved Funds - Art Commission - Arts Education, Space, and Support for Organizations and Individual Artists - \$2,613,000 .....	15

<b>Item 1</b> <b>File 19-1099</b>	<b>Department:</b> Public Utilities Commission (PUC)
<b>EXECUTIVE SUMMARY</b>	
<p style="text-align: center;"><b>Legislative Objectives</b></p> <ul style="list-style-type: none"> <li>• The proposed resolution would approve an updated emergency declaration to repair the Southeast Treatment Plant, increasing the total not to exceed by amount authorized under the previous emergency declaration by \$1,338,000 from \$4,912,000 to \$6,250,000. The additional amount includes additional contingencies which were estimated during construction due to change orders resulting from unforeseen field conditions, such as unknown buried debris, site security, and site access.</li> </ul> <p style="text-align: center;"><b>Key Points</b></p> <ul style="list-style-type: none"> <li>• The Board of Supervisors previously approved an emergency declaration due to the deterioration and leaking of a pipeline crossing Islais Creek, which conveys treated effluent from the Southeast Treatment Plant to the deep-water outfall located in the San Francisco Bay. During construction to install the new bypass pipeline crossing Islais Creek, poor soil conditions at the site were revealed, necessitating the construction of watertight cofferdams (an enclosure system within a body of water to allow water to be pumped out, creating a dry work environment) rather than portable cofferdams, which had been included in the original construction budget. The cofferdam construction required specialized crane and barge configuration and the construction of a temporary seawall. The requested increase in the amount of the emergency declaration is to cover the costs for these new construction requirements.</li> </ul> <p style="text-align: center;"><b>Fiscal Impact</b></p> <ul style="list-style-type: none"> <li>• The budget for the installation of a new bypass pipeline crossing Islais Creek is \$5,500,000 or an increase of \$588,000 over the current not to exceed amount of \$4,912,000. The increase largely accounts for site access and the installation of the watertight cofferdams.</li> </ul> <p style="text-align: center;"><b>Recommendations</b></p> <ul style="list-style-type: none"> <li>• Amend the proposed resolution to reduce the not-to-exceed amount by \$750,000, from \$6,250,000 to \$5,500,000.</li> <li>• Approve the proposed resolution as amended.</li> </ul>	

## MANDATE STATEMENT

Administrative Code Section 6.60(d) states that contracts entered into for emergency work that are more than \$250,000 are subject to Board of Supervisors approval. Prior to the commencement of emergency work above the \$250,000 threshold, the Department must also secure approval in writing from the Mayor, the President of the Board, or the Commission. If the emergency does not permit the required approvals of the emergency determination to be obtained before work begins, the Department head must submit a resolution approving the emergency determination to the Board of Supervisors within 60 days.

Administrative Code Section 21.15 provides for the Board of Supervisors to declare an emergency when it becomes immediately necessary to procure commodities or services to make repairs, safeguard lives or property, or respond to the breakdown of any plant equipment, structure, street, or public work.

## BACKGROUND

On February 15, 2019 the Board of Supervisors approved an Emergency Declaration for the repairs on the Southeast Treatment Plant, authorizing a not to exceed amount of \$4,912,000 (File 19-0011).

On November 5, 2019, the SFPUC submitted a resolution to the Board of Supervisors requesting an increase in the Emergency Declaration's not to exceed amount to \$6,250,000, in compliance with the Administrative Code 6.60(d) requirement that such notifications occur within 60 days of beginning construction.

## DETAILS OF PROPOSED LEGISLATION

The proposed resolution would approve an updated emergency declaration to repair the Southeast Treatment Plant, increasing the total not to exceed by \$1,338,000 from \$4,912,000 to \$6,250,000. The additional amount includes additional contingencies which were estimated during construction due to change orders resulting from unforeseen field conditions, such as unknown buried debris, site security, and site access.

The original emergency construction work consisted of installing a new bypass pipeline to abandon one of the pair of existing pipelines that cross Islais Creek, conveying treated effluent from the Southeast Treatment Plant to the deep-water outfall located in the San Francisco Bay. During construction to install the new bypass pipeline crossing Islais Creek, poor soil conditions at the site were revealed, necessitating the construction of water-tight cofferdams.<sup>1</sup> Initial designs planned to use a type of portable cofferdam, but this was not possible because the depth of the work was greater than is possible when using the portable cofferdam. The cofferdam construction required specialized crane and barge configuration and the construction of a temporary seawall. The requested increase in the amount of the emergency declaration is to cover the costs for these new construction requirements. According to Mr.

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<sup>1</sup> A cofferdam is an enclosure built within or in pairs across a body of water to allow the enclosed area to be pumped out, creating a dry work environment.

Michael Tran, SFPUC Project Manager, the project could not be completed prior to the 2019-2020 wet weather season beginning on October 15, 2019 without water-tight cofferdams.

Construction began on June 8th, 2019 and was substantially complete on October 8th, 2019, with demobilization complete on November 15, 2019. Although the original emergency was declared in December 2018, final engineering design was revised and finalized in May 2019 due to finding of a larger than expected depression in the middle of Islais Creek. In addition, final permits were issued by Bay Conservation Development Commission on June 5, 2019, and the encroachment permit was issued by the Port on May 28, 2019, both following completion of final engineering design. National Marine Fisheries Service finalized informal consultation on May 31, 2019 to determine any type of in-water work restrictions. There are minor activities remaining, such as site clean-up, minor sidewalk restoration, and permit close out, and construction is expected to be complete in December 2019.

## FISCAL IMPACT

The updated budget for completion of construction and installation of the bypass pipeline crossing Islais Creek is \$5.5 million as shown in Table 1 below, which is \$750,000 less than the amount specified in the proposed resolution.<sup>2</sup>

**Table 1: Total Project Budget**

<b>Item</b>	<b>Budget</b>
Design costs	\$422,215
Construction Management costs	347,793
Construction costs, excluding change orders	3,993,956
Change order costs	736,036
<b>TOTAL</b>	<b>\$5,500,000</b>

Source: SFPUC

The original project budget included a contingency of approximately \$1.2 million of which \$1 million was applied during construction because of deteriorated concrete and metal pipes and \$200,000 was spent on site access and initial construction costs for the water tight cofferdams.

Because the project budget of \$5,500,000 is approximately \$750,000 less than the resolution requested not-to-exceed amount of \$6,250,000, the proposed resolution should be amended to reflect the actual project budget, based on final contractor estimate after construction substantial completion.

## RECOMMENDATIONS

1. Amend the proposed resolution to reduce the not-to-exceed amount by \$750,000, from \$6,250,000 to \$5,500,00.
2. Approve the resolution as amended.

<sup>2</sup> According to Mr. Tran, the higher amount of \$6,250,000 was based on budget estimates during active construction in August 2019.

<b>Item 2</b> <b>File 19-1182</b>	<b>Department</b> Port
<b>EXECUTIVE SUMMARY</b>	
<p style="text-align: center;"><b>Legislative Objectives</b></p> <ul style="list-style-type: none"> <li>• The proposed resolution would approve the Port’s Ground Lease with TZK Broadway, LLC at Seawall Lots 323 and 324. The proposed lease would have an initial 50 year term with one 16 year option to extend, for a total term of 66 years.</li> </ul> <p style="text-align: center;"><b>Key Points</b></p> <ul style="list-style-type: none"> <li>• The proposed Ground Lease is for a project that would replace the existing parking lot with a development that will consist of Teatro ZinZanni, a restaurant-theatre venue, a 4 floor hotel with 192 rooms and with a restaurant and bar, and a public park.</li> </ul> <p style="text-align: center;"><b>Fiscal Impact</b></p> <ul style="list-style-type: none"> <li>• Under the proposed Ground Lease, annual rent to the Port during the construction period is \$1,000,000. Once the hotel and theater are in operation, rent consists (A) of the higher of the annual minimum rent or the percentage rent and (B) a participation rent from refinancing or sale of the hotel. Annual minimum rent is \$1,007,000 in the first two years of operation and \$1,471,000 beginning in the third year and increasing by the Consumer Price Index in the following years, and percentage rent is equal to 3.5 percent of gross hotel revenues escalating to 6.5 percent of gross hotel revenues over time, and 3.5 percent of Teatro ZinZanni revenues.</li> <li>• The Port would also receive 20 percent of the project profits after the developer has achieved an internal rate of return of 20 percent on equity or 50 percent of project profits once the developer has achieved 25 percent internal return on equity.</li> <li>• The proposed Ground Lease requires TZK Broadway to develop and operate 14,000 square feet of open space and a public park.</li> <li>• In addition, the proposed development is expected to generate \$8 million in development impact fees and \$4.1 million in ongoing General Fund revenues.</li> </ul> <p style="text-align: center;"><b>Policy Consideration</b></p> <ul style="list-style-type: none"> <li>• Administrative Code Section 23.30 requires the Port to determine the market rate leases that require Board of Supervisors approval. The Port did not obtain a more recent appraisal than the April 2015 appraisal because that appraisal was the basis for the 2016 Term Sheet, which was endorsed by the Board of Supervisors (File 16-0541), and the Port worked with an economic consultant to ensure that the percentage and participation rent rates were consistent with other hotel leases.</li> <li>• On May 5, 2015 the Board of Supervisors approved a resolution exempting the Port from pursuing a competitive solicitation for this project (File 15-0331). In doing so, the resolution stated relocating Teatro ZinZanni to Port property was consistent with City policy to “foster, promote, and sustain music and culture in San Francisco.”</li> <li>• We find that the Port’s determination that the rent rates in the proposed Ground Lease are market rate is reasonable and there recommend approval of the proposed resolution.</li> </ul> <p style="text-align: center;"><b>Recommendation</b></p> <ul style="list-style-type: none"> <li>• Approve the proposed resolution.</li> </ul>	

## MANDATE STATEMENT

City Charter Section 9.118(a) states that contracts entered into by a department, board, or commission that (i) have anticipated revenues of \$1 million or more, or (ii) have anticipated revenues of \$1 million or more and require modifications, are subject to Board of Supervisors approval.

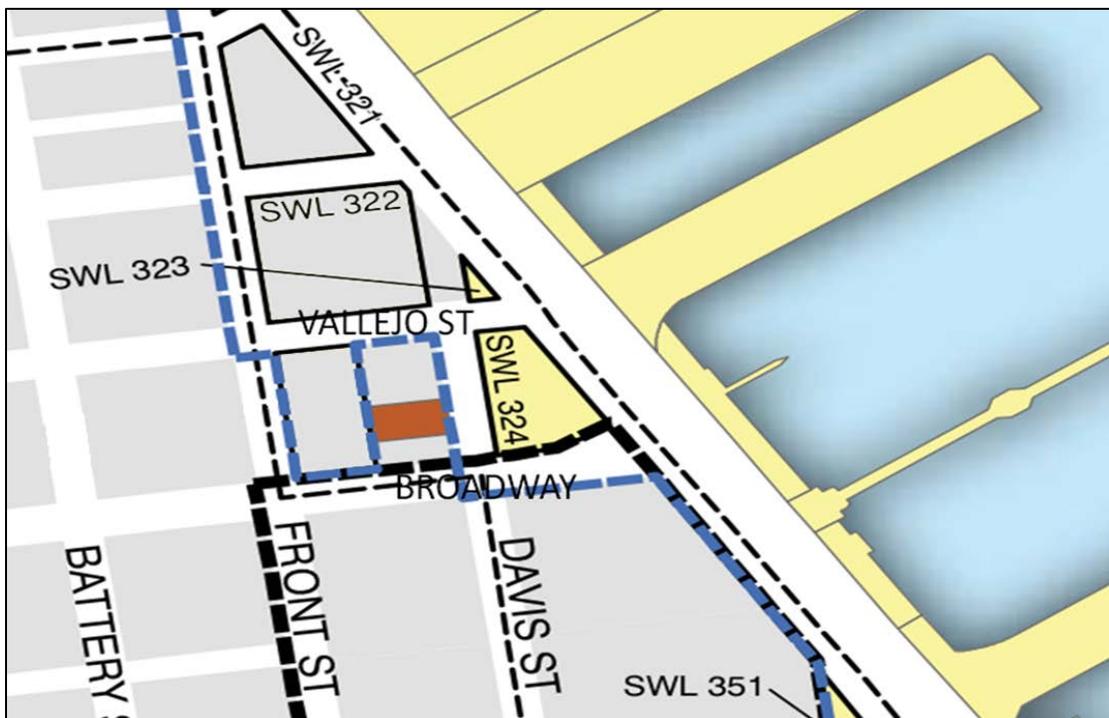
## BACKGROUND

### Overview of the Proposed Development

Prior to 2011, Teatro ZinZanni, a theatre venue and restaurant, operated on Port property. That lease with the Port was terminated to accommodate the America's Cup competition. Since that time, Teatro ZinZanni has partnered with Kenwood Investments and formed TZK Broadway, LLC, proposing to develop Seawall Lots 323 and 324. TZK has admitted PresidioCo Holdings, LLC, as a member to increase its hotel development capacity. The site, which is under Port jurisdiction, is currently being used as a parking lot and is shown in Exhibit 1 below.

On July 12, 2016 the Board of Supervisors approved a resolution endorsing the Port's Term Sheet with TZK Broadway, LLC (File 16-0541). Attachment 1 provides a summary of the changes to the project that are included in the proposed Ground Lease since the Term Sheet was approved by the Board of Supervisors in 2016.

### Exhibit 1: Map of Seawall Lots 323 & 324



Source: Port

The proposed project would replace the existing parking lot with a development that will consist of a restaurant-theatre venue, a 4 floor hotel with 192 rooms and with a restaurant and bar, and a public park. Teatro ZinZanni will operate the theatre-restaurant venue under a sublease with TZK Broadway. TZK Broadway will contract with a hotel management company, Interstate Hotels and Resorts, to operate the hotel under a Marriot franchise.

No vehicle parking is proposed at the site; 63 bicycle parking spaces will be constructed. Construction is expected to take approximately 22 months (October 2020 – August 2022) and is expected to cost \$143 million, all of which would be paid by private funds. The Planning Commission has determined that the proposed project would not have significant environmental impact, required certain mitigation measures, and has granted a Conditional Use Authorization to TZK Broadway.

### **DETAILS OF PROPOSED LEGISLATION**

The proposed resolution would approve the Port's Ground Lease with TZK Broadway, LLC at Seawall Lots 323 and 324. The proposed lease would have an initial 50 year term with one 16 year option to extend, for a total term of up to 66 years, and have a minimum base rent beginning at \$1 million per year.

The proposed resolution would also adopting findings of consistency with the City's General Plan, authorize the Port Executive Director to take necessary actions to finalize the proposed lease, and affirm the Planning Department's determination under the California Environmental Quality Act.

The Port Commission approved the Lease Disposition and Development Agreement, governing the development of the proposed hotel and theater project, and the proposed Ground Lease with TZK Broadway, LLC in September 2019. TZK Broadway must close escrow and take possession of the site within 12 months,<sup>1</sup> or approximately October 2020, at which time the Ground Lease goes into effect. Construction of the proposed hotel and theater project must be completed within 24 months after the proposed Ground Lease goes into effect. The proposed Ground Lease is subject to the terms of the Lease Disposition and Development Agreement prior to completion of construction of the proposed hotel and theater project, as discussed further below.

#### **Ground Lease Terms**

Exhibit 2 below summarizes the key terms of the proposed Ground Lease.

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<sup>1</sup> TXK Broadway has four three-month options to extend this term, subject to a fee of \$25,000 for each extension.

**Exhibit 2: Key Terms of Proposed Ground Lease**

Effective Date	Expected October 2020 (expected start of construction).
Term	Initial term: 50 years; One option to extend: 16 years. Up to 66 years in total
Construction Period	The construction period must not exceed 24 months; the developer has four options to extend this period in 3 month increments at a cost of \$25,000 for each.
Minimum Annual Rent	\$1,000,000 during construction. \$1,007,000 years 1 and 2 of operations. If hotel occupancy exceeds 80%, the hotel would pay the Port the 90% of hotel Percentage Rent and 100% of Theatre Percentage Rent. \$1,471,000 year 3 of operations and escalating by Bay Area CPI annually after. Every ten years beginning in year 11 of operations, minimum rent would be reset to maximum of that year's CPI increase or 65% of 5 year average of percentage rent.
Percentage Rent	3.5% of gross hotel revenues, escalating to 6.5% of gross hotel revenues. 3.5% of Teatro ZinZanni gross revenues.
Participation Rent with TZK as the First Tenant or Owner.	20% of project profits after developer's 20% return on actual equity and 50% of project profits after developer's 25% return on actual equity for (a) project operations, (b) project refinancing, and (c) sale of the project
Participation Rent with Subsequent Tenants or Owners.	20% of project profits after developer's 16% return on actual equity and 50% of project profits after developer's 18% return on actual equity for (a) project operations, (b) project refinancing, and (c) sale of the project
Park Maintenance	Paid by TZK Broadway.
Local Hire Requirements	30% Local Hire Program Expected. Compliance with First Source Hiring program expected.
Local Business Enterprise Requirements	17% LBE participation expected.
First Source Hiring	50% of open entry level positions
Permitted Uses	The project site must have hotel and dinner-restaurant venue in operation as well as a public park.

Source: Proposed Ground Lease between the Port and TZK Broadway

*Public Park*

The proposed Ground Lease requires TZK Broadway to develop and operate 14,000 square feet of open space and a public park. TZK is responsible for maintenance of the park, including trash removal and recycling systems, and security to keep the park clean and safe.

**Lease Disposition and Development Agreement**

The proposed Ground Lease between the Port and TZK Broadway is subject to the terms of the Lease Disposition and Development Agreement until the construction of the proposed hotel and theater project is completed and the Certificate of Completion is issued by the Port, as noted above. Exhibit 3 below summarizes the key terms of the Lease Disposition and Development Agreement.

**Exhibit 3: Key Terms of Lease Disposition and Development Agreement**

Effective Date	Upon approval of the proposed resolution <sup>2</sup>
Term	Through completion of construction of the proposed hotel and theater development and issuance of the Certificate of Completion
Project Plan	The final financing plan for the proposed development must be approved by the Port.
Payments to Port	Initial payment of \$37,500. Developer will also pay for the Port's transaction costs, capped at \$300,000.
Local Hire	Developer expected to achieve 30% local hire for construction work (per Chapter 82 of the Administrative Code) and to comply with the City's First Source Hiring program in (per Chapter 83 of the Administrative Code). Final values will be included in proposed Ground Lease.
Local Business Enterprise	17% of total project costs expected. Final value will be included in proposed Ground Lease.

Source: Lease Disposition and Development Agreement: Port/TZK Broadway

The final Local Hire and Local Business Enterprise commitments for the proposed development must still be finalized with Port and the Office of Economic and Workforce Development and Office of Contract Administration. According to Mr. Ricky Tijani, Development Project Manager at the Port, that is expected to occur at the execution of the Lease Disposition and Development Agreement. TZK Broadway is expected to comply with the requirements of the City's First Source Hiring program, administered by the Office of Economic and Workforce Development, which requires that City contractors and developers to make efforts to hire disadvantaged San Francisco residents.

<sup>2</sup> The proposed resolution does not approve the Lease Disposition and Development Agreement, but approval of the proposed ground lease for the hotel and theater project is necessary for TZK Broadway LLC to obtain financing, close escrow, and secure the site.

**FISCAL IMPACT****Ground Lease Rent**

Under the proposed Ground Lease, annual rent to the Port during the construction period is \$1,000,000. Once the hotel and theater are in operation, rent consists (a) of the higher of the annual minimum rent or the percentage rent and (b) participation rent from refinancing or sale of the hotel. Annual minimum rent is \$1,007,000 in the first two years of operation and \$1,471,000 beginning in the third year and increasing by the Consumer Price Index (CPI) in the following years, and percentage rent is equal to 3.5 percent of gross hotel revenues escalating to 6.5 percent of gross hotel revenues over time, and 3.5 percent of Teatro ZinZanni revenues, as shown in Exhibit 2 above. According to Mr. Tijani, the minimum annual rent is based on a 2015 appraisal that was used to negotiate the Term Sheet that the Board of Supervisors endorsed in 2016 (File 16-0541). The annual minimum rent has been escalated from \$890,000 in the 2016 Term Sheet to \$1,000,000 in 2019, as shown in Attachment 1. The percentage rent has not changed since the 2016 Term Sheet. According to a 2016 Feasibility Study prepared by HVS Consulting and Valuation Services for the Port,<sup>3</sup> the percentage rent values are consistent with other percentage rent ranges in similar Ground Leases for hotels in San Francisco, considering the inclusion of the participation rent and the zoning limits on the site area.

**Participation Rent**

The Port would also receive 20 percent of the project profits after the developer has achieved an internal rate of return of 20 percent on equity or 50 percent of project profits once the developer has achieved 25 percent return on equity.<sup>4</sup> According to the 2016 Feasibility Study, the estimated internal rate of return on the developer's equity ranges from 15 percent to 19 percent, based on the study's assumptions of the developer's equity contribution, debt service, and refinancing of the debt. Therefore, the Port may or may not receive participation rent depending on how the hotel and theater project appreciate in value when refinanced or sold as well as capital market conditions.

The 2016 Term Sheet did not address the participation rent of subsequent tenants to TZK Broadway. Under the proposed Ground Lease, The Port would receive 20 percent of the project profits after a subsequent tenant has achieved an internal rate of return of 16 percent on equity or 50 percent of project profits once a subsequent tenant has achieved 18 percent return on equity.

**Estimated Rent to the Port**

According to the 2016 Feasibility Study, the Port will receive percentage rent that exceeds the annual minimum rent specified in the proposed Ground Lease beginning in the first year of operation. Exhibit 4 below summarizes the expected rent to the Port through CY 2026. The values do not include participation rent from the first tenant's sale of the lease because the

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<sup>3</sup> Report to Port from HVS Consulting and Valuation Services dated May 6, 2016.

<sup>4</sup> Internal rate of return on developer equity is calculated by dividing present value project's cash flows after debt payments by the developer's equity contribution.

Port's Feasibility Study<sup>5</sup> concluded that the Port would not receive any participation rent through 2026 if assumptions about the amount of actual equity funded and appreciation rate do not change.

**Exhibit 4: Expected Rent Paid by TZK Broadway to the Port Through 2026**

Year	Construction		Initial Operations		Full Operations		
	2020	2021	2022	2023	2024	2025	2026
Minimum Annual Rent	\$1,000	\$1,000	\$1,007	\$1,007	\$1,471	\$1,515	\$1,561
Percentage Rent	n/a	n/a	\$1,364	\$1,487	\$1,577	\$1,623	\$1,661
<b>Expected Rent Payment to Port</b>	<b>\$1,000</b>	<b>\$1,000</b>	<b>\$1,364</b>	<b>\$1,487</b>	<b>\$1,577</b>	<b>\$1,623</b>	<b>\$1,661</b>

Source: Port

As shown above, the percentage rent from the project is expected to exceed the minimum base rent beginning in 2022.

*Risk Mitigation*

To mitigate risks to the project's financial success, the proposed Ground Lease requires Port approval for any sublease between TZK Broadway and the hotel operator, which, as noted above, is expected to be Interstate Hotels and Resorts. The Port will rely, among other due diligent considerations, on the underwriting standards of private lenders who will provide \$82 million of debt financing or approximately 57.7 percent of the project's total expected cost of \$142 million. The remaining 42.3 percent of the project's total cost is expected to be financed by a combination of mezzanine financing,<sup>6</sup> and equity contributions from Interstate Hotels and Resorts and from TZK Broadway. If the hotel project fails, the proposed Ground Lease requires that minimum rent continue to be paid. If the theater-restaurant business fails, the sublease with Teatro ZinZanni would be terminated and TZK Broadway would be responsible for finding a suitable replacement tenant, with approval by the Port. Under the proposed Ground Lease, if the hotel project fails, TZK Broadway would be responsible for clearing the project site for another use, which must be approved by the Port.

**Revenues Generated by the Proposed Development**

The proposed development will generate one-time and ongoing revenues for the City, summarized in Exhibits 5 and 6 below. As shown below, the proposed development is expected to generate \$8 million in development impact fees and \$4.1 million in ongoing General Fund revenues.

<sup>5</sup> Report to Port from HVS Consulting and Valuation Services dated September 11, 2019.

<sup>6</sup> Mezzanine financing is a type of investment that is subordinate to debt but senior to equity.

**Exhibit 5: Expected Revenue to the City from Development Impact Fees**

<b>Fee</b>	<b>Est. Amount</b>
Jobs-Housing Linkage Fee	\$3,333,400
Transportation Sustainability Fee	3,132,900
Public Art Requirement	711,600
Water & Wastewater Capacity Fees	500,000
Child Care Fee	258,200
Schools Fee	55,800
Bike Parking Fee	13,000
<b>Total</b>	<b>\$8,004,900</b>

Source: Economic Planning & Systems report to Port dated April 12, 2019

**Table 6: Expected Ongoing General Fund Revenues**

<b>Ongoing General Fund Revenues</b>	
Transient Occupancy Tax	\$3,070,700
Possessory Interest Tax	809,700
Property Tax in Lieu of VLF	184,200
Sales Tax	84,900
Gross Receipt Tax	Not Estimated
<b>Total</b>	<b>\$4,149,500</b>

Source: BLA analysis of HVS Consulting & Valuation report to Port dated September 11, 2019

Possessory Interest Tax refers to property taxes, based on improvements to the land owned by the Port and the value of the lease.

Property Tax in Lieu of VLF refers the State's Vehicle License Fee revenues distributed to the City as property tax revenues.

The HVS report also assumes that the ownership of the project changes every twenty years, which would generate Property Transfer Tax at the time of sale. HVS estimated that the annualized revenue from those transactions to be \$277,500.

According to the Port, the present value of the revenues to the Port expected from the parking lot currently operating at the proposed project site over the next 20 years is \$13.95 million. By comparison, the proposed project's minimum rent to the Port over the same period is expected to be \$17.8 million and actual rent to the Port, which includes the expected percentage rent, is projected to be \$26.5 million.

**POLICY CONSIDERATION****Fair Market Rent Determination**

Administrative Code Section 23.30 requires the Port to determine the market rate for its leases that require Board of Supervisors approval. The Board of Supervisors' approval of the proposed project's Term Sheet in 2016 included a minimum annual rent beginning at \$1,366,000 in the

third year of operation, based on a April 2015 appraisal,<sup>7</sup> which the Port has escalated to \$1,471,000 in the proposed Ground Lease to account for the passage of time. The negotiated construction period annual rent of \$1 million takes into account that there is no project revenue during this period.

According to Mr. Tijani, the Port did not obtain a more recent appraisal than the April 2015 appraisal because that appraisal was the basis for the rent negotiations with the developer in the 2016 Term Sheet, which was endorsed by the Board of Supervisors (File 16-0541), and the Port worked with its economic consultant, HVS Consulting and Valuation Services, throughout negotiations to ensure that the percentage and participation rent rates were consistent with other hotel leases.

On May 5, 2015 the Board of Supervisors approved a resolution exempting the Port from pursuing a competitive solicitation to develop Seawall Lots 323 and 324 (File 15-0331). In doing so, the resolution waiving these requirements stated relocating Teatro ZinZanni to Port property was consistent with Chapter 90A of the Administrative Code, which states that the policy of the City is to “foster, promote, and sustain music and culture in San Francisco.”

The resolution waiving the competitive solicitation requirements for this project requested that the Port work with a third party real estate consultant during negotiations to ensure the Port receive fair market value for the lease. According to the May 2016 Feasibility Study prepared for the Port by HVS Valuation and Consulting, the proposed Ground Lease terms for the proposed hotel and theater project are competitive when compared to similar hotel ground leases in light of the other terms of the lease such as the possibility of participation in profits from refinancing and/or sale of the hotel. According to Mr. Tijani, the proposed Ground Lease’s annual minimum rent and annual percentage rent are based on negotiations and set are competitive with recent leases in the San Francisco Bay Area, particularly for small or boutique hotels. Port staff ordered a hotel ground rent survey and reviewed the comparable rent structures. The comparable rent structures indicated that the base rent and percentage rent are at market rate given the economic profile for the project: (a) a site with limited development density, the height limit of 40 feet, required street vacation to make the project feasible (File 19-1181), required space for Teatro ZinZanni, and developing and maintaining a public park with no Port funding or rent credits for the park; and (b) comparable hotel ground leases typically do not have a landlord’s participation in tenant’s profits from refinancing or sale or transfer of the underlying project or hotel. According to Mr. Tijani, the hotel is expected to “change hands” multiple times during the term of the proposed Ground Lease. Under the proposed Ground Lease, the Port could participate in a share of each sale’s proceeds.

Because the Port’s determination that the rent rates in the proposed Ground Lease are market rate is reasonable, we recommend approval of the proposed resolution.

## RECOMMENDATION

Approve the proposed resolution.

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<sup>7</sup> The April 2015 appraisal found that the market rate rent for this site would be \$1.1 million per year.

	<b>2016 Term Sheet (File 16-0541)</b>	<b>Proposed Terms (File 19-1182)</b>
Site Area	57,180 sf	59,750 sf
Building	One 4-story building 182,932 gsf	One 4-story building 147,880 gsf
Hotel, Number of Floors	4 above-grade floors, one below-grade floor	4 above-grade Floors, no below grade floors
Hotel Rooms	180-200 Hotel Rooms 10 rooms for artists 146,591 sf	192 Rooms No artist rooms 118,000 sf
Theater	28,301 sf	29,570 sf
Public Park	7,500 sf	14,000 sf
Estimated Development Cost	\$124 million	\$142 million
LDDA Fees	\$37,500 fee \$50,000 fee to terminate. Port is reimbursed for transactions costs.	\$37,500 fee \$50,000 fee to terminate. Port is reimbursed for transaction costs, capped at \$300,000 during LDDA normal period; no limit during extended LDDA period.
LDDA Term	12 months to close escrow from Effective Date. Two six month extensions to close escrow at \$50,000 each.	12 months to close escrow from Effective Date. Four 3-month extensions to close escrow at \$25,000 each.
Ground Lease Minimum Rent During Construction	\$890,000	\$1,000,000
Ground Lease Minimum Rent, Initial 2 Years of Operations	\$915,000 Or 90% of Hotel Percentage Rent if hotel has >80 occupancy.	\$1,000,700 Or Theatre Percentage Rent and 90% of Percentage Rent if hotel has >80% occupancy.
Ground Lease Minimum Rent, Year 3 of Operations and on	\$1,366,000, increasing by CPI annually. Resets every 10 years to greater of 65% of Percentage Rent or that year's CPI increase.	\$1,471,000, increasing by CPI annually. Resets every 10 years to greater of 65% of Percentage Rent or that year's CPI increase but no less than previous year minimum rent.
Ground Lease Percentage Rent	3.5% of hotel gross revenues, escalating to 6.5% over twenty years 3.5% of theatre revenues.	No Change

	<b>2016 Term Sheet (File 16-0541)</b>	<b>Proposed Terms (File 19-1182)</b>
Ground Lease Participant Rent TZK, the First Tenant	Port receives 30% of profits, sale proceeds, or savings from refinancing after developer achieves 18% return on equity.	Port receives 20% of profits, savings from refinance, or sale after developer achieves 20% return on equity.
	Port receives 40% of profits, savings from refinance, or sale after developer achieves 25% return on equity.	Port receives 50% of profits, savings from refinance, or sale after developer achieves 25% return on equity.
Ground Lease Participant Rent, Subsequent Tenant	Not in 2016 Term Sheet	Port receives 20% of profits, savings from refinance, or sale after new owner achieves 16% return on equity.
		Port receives 50% of profits, savings from refinance, or sale after new owner achieves 18% return on equity.
Assignment	Prior to completion of the Project and during the first 7 years of the Lease, Tenant may not assign its interest in the LDDA or Lease without the prior written consent of the Port Commission	No Change
Sublease	All subleases are subject to the prior written consent of Port	No Change
Hotel Management	Tenant’s final selection of a hotel management company and the approval of the hotel management agreement are both subject to prior review, acceptance and approval by Port	No Change
Parking	Tenant has the responsibility to provide an off-site parking plan to accommodate the Project.	No offsite parking but required to submit a Transportation Demand Management Plan.
Public Park	Tenant is responsible for funding the costs of construction, operation and maintenance of the proposed public park and during the Lease Term at its sole cost and expense.	No Change

<b>Item 4</b> <b>File 19-1227</b>	<b>Department</b> Arts Commission
<b>EXECUTIVE SUMMARY</b>	
<p style="text-align: center;"><b>Legislative Objectives</b></p> <ul style="list-style-type: none"> <li>• The proposed hearing would release \$2,613,000 from Budget &amp; Finance Committee reserve.</li> </ul> <p style="text-align: center;"><b>Key Points</b></p> <ul style="list-style-type: none"> <li>• In November 2018, the voters approved Proposition E, which amended the Business and Tax Regulations Code to set aside 1.5 percent of the of the City’s hotel tax for arts and cultural purposes. The set aside amount for FY 2019-20 included \$2,613,000 allocated to the Arts Commission. Per Proposition E, this money must be spent according to the Cultural Services Allocation Plan jointly prepared by the Arts Commission and by the Grants for the Arts.</li> <li>• At the Budget and Legislative Analyst’s recommendation for the Arts Commission FY 2019-20 budget, the Board of Supervisors placed the \$2,613,000 on Budget and Finance Committee reserve pending the release of the 2019-24 Cultural Services Allocation Plan and recommendations from the Community Working Group.</li> </ul> <p style="text-align: center;"><b>Fiscal Impact</b></p> <ul style="list-style-type: none"> <li>• The proposed budget for the \$2,613,000 in Proposition E funds is comprised of 22 percent or \$572,000 for administrative costs and 78 percent or \$2.03 million for grants. The 2019-24 Cultural Service Allocation Plan recommends grants in the following four areas: 1) arts education; 2) affordable space for artists; 3) arts organizations support; and 4) individual artists support.</li> <li>• Actual spending on these four grant areas will be informed by recommendations developed by a Community Working Group, which convened in May. The Arts Commission and Grants for Arts will disburse the funds through a grant application and review process.</li> <li>• Future Proposition E appropriations are subject to Board of Supervisors’ approval.</li> </ul> <p style="text-align: center;"><b>Recommendation</b></p> <ul style="list-style-type: none"> <li>• Approve the release of reserves.</li> </ul>	

**MANDATE STATEMENT**

Administrative Code Section 3.3(e) states that the Budget and Finance Committee of the Board of Supervisors has jurisdiction over the City’s budget and may reserve proposed expenditures to be released at a later date subject to Board of Supervisors approval.

**BACKGROUND**

In November 2018, the voters approved Proposition E, which amended the Business and Tax Regulations Code to set aside 1.5 percent of the of the City’s hotel tax for arts and cultural purposes. The set aside amount for FY 2019-20 included \$2,613,000 allocated to the Arts Commission. Per Proposition E, this money must be spent according to the Cultural Services Allocation Plan jointly prepared by the Arts Commission and by the Grants for the Arts. At the Budget and Legislative Analyst’s recommendation for the Arts Commission FY 2019-20 budget, the Board of Supervisors placed the \$2,613,000 on Budget and Finance Committee reserve pending the release of the 2019-24 Cultural Services Allocation Plan and recommendations from the Community Working Group.

**DETAILS OF PROPOSED LEGISLATION**

The proposed hearing would release \$2,613,000 from Budget & Finance Committee reserve.

**FISCAL IMPACT**

The proposed budget for the \$2,613,000 in Proposition E funds is shown in Exhibit 1 below. The proposed budget was determined following a community input process in developing in 2019-24 Cultural Services Allocation Plan.

**Exhibit 1: Proposed Budget for Release of Proposition E Funds**

	%	FY 2019-20 Amount
<b>Administration</b>		
Reserve Fund	5.0%	\$130,000
Personnel	15.0%	\$390,000
Research and Evaluation	2.0%	\$52,000
<i>Subtotal, Administration</i>	<i>22.0%</i>	<i>\$572,000</i>
<b>Grant Areas</b>		
Arts Education	31.2%	\$811,200
Space & Capital	23.4%	\$608,400
Arts Organization Support	15.6%	\$405,600
Individual Artists Support	7.8%	\$202,800
<i>Subtotal, Grants</i>	<i>78.0%</i>	<i>\$2,028,000</i>
<b>Total</b>	<b>100%</b>	<b>\$2,600,000</b>

Source: 2019-2024 Cultural Services Allocation Plan

As shown above, \$130,000 or approximately 5 percent of the Proposition E funds for FY 2019-20 will be placed in a reserve account for future unexpected costs, subject to approval by the Arts Commission and the City Administrator. According to Ms. Rebekah Krell, Interim Deputy Director of Finance & Administration at the Arts Commission, the \$390,000 in costs will fund approximately 25% of salaries and mandatory fringe benefits for the Community Investments team, which is responsible for grant making. In addition, \$52,000 is expected to be used for a contract monitoring and evaluation consultant to measure the impact of the grants. According to Ms. Krell, the request for proposals (RFP) will be drafted in January 2020.

The 2019-24 Cultural Service Allocation Plan recommends grants in the following four areas:

1. Arts Education: *Intergenerational Learning*, where master teachers work to transfer knowledge to students of all ages; expanding the *Teaching Artist Residency*, to support additional genres outside of the literary arts; and *Creative Pathways*, providing paid internships for youth up to age 24 in arts administration, creation, and production.
2. Spaces & Capital: Supporting pathways for individual ownership of live/work spaces; fostering partnerships and developing innovative approaches for shared cultural spaces; providing technical assistance in needs assessment and financial planning, negotiating long-term leases, purchase agreements, and developing capital campaigns.
3. Arts Organization Support: multi-year general core operating support, and capacity-building opportunities to ensure stability and sustainability of art organizations.
4. Individual Artists Support: create an entrepreneurial art market program to support artists to earn a living through production of their work; and develop a *Learning Institute* to offer training opportunities for individuals in the arts sector.

Actual spending on these four grant areas will be informed by recommendations developed by a Community Working Group, which convened in May. The Arts Commission and Grants for Arts will disburse the funds through a grant application and review process.

The recommended allocations from the 2019-24 Cultural Services Allocation Plan shown in Exhibit 1 above account for \$2,600,000 of the \$2,613,000 in Proposition E funds on Budget and Finance Committee reserve. According to Ms. Krell, the remaining \$13,000 will be used to enhance the established grant categories detailed above.

Future Proposition E appropriations are subject to Board of Supervisors' approval.

## RECOMMENDATION

Approve the release of reserves.