

**CITY AND COUNTY OF SAN FRANCISCO**

**BOARD OF SUPERVISORS**

**BUDGET AND LEGISLATIVE ANALYST**

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**TO:** Government Audit and Oversight Committee

**FROM:** Budget and Legislative Analyst



**SUBJECT:** June 3, 2021 Government Audit and Oversight Committee Meeting

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<p><b>Item 2</b> <b>Files 21-0391</b></p>	<p><b>Department:</b> Department of Public Health; Real Estate Division</p>
<p><b>EXECUTIVE SUMMARY</b></p>	
<p style="text-align: center;"><b>Legislative Objectives</b></p> <ul style="list-style-type: none"> <li>• The proposed resolution approves a new lease between the City as tenant and 1076 Howard St. LLC, a Delaware limited liability company, as landlord to lease real property located at 1076 Howard Street for general office use and social services, including a sobering center. The initial lease term is 8.5 years with one 5-year option to extend, subject to Board of Supervisors’ approval (for a total possible lease term of 13.5 years) at a base rent of \$854,235 per year with 3 percent annual increases.</li> </ul> <p style="text-align: center;"><b>Key Points</b></p> <ul style="list-style-type: none"> <li>• Mental Health SF is the City’s strategic framework for improving the behavioral health response to people experiencing homelessness. The proposed use of the site at 1076 Howard Street is for implementation of two key components of Mental Health SF, the Drug Sobering Center and the Street Crisis Response Team.</li> <li>• 1076 Howard Street was selected due to geographic proximity to other behavioral health and supportive service facilities and building size.</li> <li>• The lease term is anticipated to begin in November 2021 after completion of tenant improvements to be made by both the landlord (who will contribute \$916,740) and the City, which will fund the remaining estimated \$1.9 million.</li> <li>• For the first six years of the lease, the City will not have to pay base rent for the month of July, which results in \$460,454 in rent reduction over the initial 8.5-year term.</li> <li>• The lease provides for the right of first refusal if the landlord wants to sell the property. As the term approaches its end, the City will consider purchasing the building if it becomes available, acquiring a different property or relocating to a City-owned building.</li> </ul> <p style="text-align: center;"><b>Fiscal Impact</b></p> <ul style="list-style-type: none"> <li>• The first year rent of \$854,235 (\$51.25 per square foot) is higher than the appraised value of \$820,000 (\$49.20 per square foot). Projected rent under the proposed lease, including annual 3 percent rent increases and six months’ rent abatement, is \$7,676,697 over the entire 8.5 year term, which is less than the total appraised market rent of \$7,811,091.</li> <li>• The rent and proposed improvements for the Drug Sobering Center leased space will be paid from Proposition C “Our City Our Home” funding.</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**

In accordance with City Administrative Code Section 23.27, leases in which the City is the tenant require approval by the Board of Supervisors.

**BACKGROUND****Mental Health San Francisco**

Mental Health San Francisco is a new program that will provide mental health services, substance use treatment, and psychiatric medications to all adult San Francisco residents with mental illness and/or substance abuse disorder who are homeless, uninsured, or enrolled in Medi-Cal or Healthy San Francisco. Mental Health SF is the City's strategic framework for improving the behavioral health response to people experiencing homelessness. An ordinance amending the Administrative Code to establish Mental Health SF was approved by the Board in December 2019 (Fil3 19-1148). Two key components of Mental Health SF are the Drug Sobering Center and the Street Crisis Response Teams, both administered through the Department of Public Health (DPH) in collaboration with other City departments.

**The Drug Sobering Center**

The Drug Sobering Center is a non-clinical model focused on harm reduction, safety, and engagement and will serve as a place for individuals who are experiencing the effects of fentanyl, methamphetamine, and other substances to move safely through intoxication, then have an opportunity to engage in conversation about recovery options available to them. The Street Crisis Response Team, launched in November 2020, is a collaboration between the Department of Public Health (DPH), the San Francisco Fire Department (SFFD) and the Department of Emergency Management (DEM) to provide rapid, trauma-informed response and care coordination for people experiencing behavioral health crises in public spaces in San Francisco. Clients for the Drug Sobering Center may self-refer or walk-in, and will also be referred through the City's Street Crisis Response Teams (DPH), Street Medicine Teams (DPH), Homeless Outreach Teams (HSH) and/or the Fire Department's Emergency Medical Response team (EMS-6), a specialized emergency paramedic team. A goal of both programs is to reduce law enforcement encounters and unnecessary emergency room use.

The center was initially slated for operation in 2020. According to Mr. Josh Keene, Special Projects and Transactions Manager at the Real Estate Division, the City originally considered using City-owned property at 180 Jones for the center, which was also going to utilize tent space to house clients. However, 180 Jones is currently being used as a safe sleeping site. According to Mr. Keene, DPH has also determined that for this program, a more permanent brick and mortar facility (such as 1076 Howard) is appropriate. The proposed use of the site is for implementation of two key components of Mental Health SF, the Drug Sobering Center and the Street Crisis Response Team.

### **Selection of 1076 Howard Street**

According to Mr. Keene, the site was determined to be the best site for housing the Drug Sobering Center due to geographic proximity to other behavioral health and supportive service facilities and building size. The site has sufficient space to provide care for an estimated 15-40 clients per day.

### **DETAILS OF PROPOSED LEGISLATION**

The proposed resolution would (1) approve the lease between the City, as tenant, and 1076 Howard St. LLC, as landlord to lease real property located at 1076 Howard Street for general office use and social services, including a sobering center, for a term of 8.5 years with one 5-year option to extend, subject to Board of Supervisors' approval (for a total possible lease term of 13.5 years) at a base rent of \$854,235 per year with 3 percent annual increases and anticipated commencement date of November 1, 2021, (2) authorize the Director of Property to execute documents, make certain modifications and take certain actions to finalize the lease; (3) find the proposed transaction is in conformance with the General Plan, the eight priority policies of Planning Code, Section 101.1; (4) adopt findings that the lease is not a project under the California Environmental Quality Act; (5) authorize the City to request the landlord perform completion of improvements on behalf of the City, with City's cost not to exceed \$1,888,990; and (6) indemnify the landlord for any claims and costs related to the City's use of the site.

#### **The 1076 Howard Street Site**

The property at 1076 Howard St. includes 16,668 square feet of office space over two floors. The building is currently owned by 1076 Howard Street LLC, a Delaware limited liability company, and is currently uninhabited.

The first floor will house the Drug Sobering Center, and includes restroom facilities for staff and clients, shower facilities, client consultation space, a medical exam room, sleeping areas for clients, quiet client activity space, and staff working spaces. According to the Department of Public Health, the site is anticipated to initially serve between 15-20 clients per day, and then likely increase to 30-40 per day.

The second floor will serve as a collaboration and administration space for the Street Crisis Response Team and other DPH staff that are predominantly field-based. According to the Department of Public Health, the site has sufficient space for the approximately 105 staff needed to run the program.

Table 1 below lists the terms of the proposed lease.

**Table 1. Terms of Proposed Lease**

Landlord	1076 Howard Street LLC
Tenant	City
Building	1076 Howard St, San Francisco CA
Area	16,668 rentable square feet
Monthly Rent	\$71,186
Annual Rent	\$854,235 (\$51.25 per square foot)
Rent adjustments	3% annual increase for initial 8.5-year term
Anticipated Lease Commencement Date	Upon substantial completion of tenant improvements, estimated November 1, 2021
Anticipated Rent Commencement Date	November 1, 2021
Term	Initial term of 8.5 years
Options to extend	One 5-year option to extend
Rent during extension	Rent resets at 98% of the then prevailing market rate, not to be reduced below 103% of the base rent for the 12-months prior <sup>1</sup>
Services and Operations	City will pay for electricity, and Landlord will provide heating, ventilation, air conditioning, elevators and water at City's expense
Taxes and Insurance	City will pay real estate taxes and landlord's insurance
Tenant Improvements	Landlord to perform capital and tenant improvements estimating \$916,740 at landlord's expense. City will pay up to \$1,888,990 in additional tenant improvements

Source: Proposed Lease

### Tenant Improvements

As part of the proposed lease, the landlord will perform and pay up to \$916,740 (\$55 per square foot, and approximately 34 percent of the total cost) towards needed tenant improvements including telecommunications infrastructure work, fire safety, plumbing and electrical upgrades, minor demolition and office space construction and the City will fund the remaining estimated \$1.9 million (approximately 66 percent of the total). The current estimated cost of tenant improvements is \$2,673,171, however according to Mr. Keene, the actual costs may change once final drawings are detailed and priced.

Additionally, the landlord will also complete construction of a gender-neutral restroom on the second floor. Construction of the second-floor bathroom is a base building improvement that is not included in the tenant improvements budget and will be paid for entirely by the landlord.

<sup>1</sup> No less than 103% of the Base Rent for the 12-month period before the extended term

The estimated cost of the second-floor restroom is \$75,000. The tenant upgrades are estimated to begin in early July 2021 and reach completion by November 1, 2021. The City is not required to pay rent until substantial completion of tenant upgrades. DPH staff, including the Street Crisis Response Team, will move in upon substantial completion of tenant improvements.

### **Option to Purchase**

The lease provides for the right of first refusal if the landlord wants to sell the property. According to Mr. Keene, as the term approaches its end, the City will consider purchasing the building if it becomes available, acquiring a different property or relocating to a City-owned building.

### **Early Termination Option**

If the tenant improvements are not completed by the estimated commencement date, which is currently November 1, 2021, then the City will not have to pay rent until the improvements are completed and the landlord is able to deliver possession of the building. The lease also allows the City to terminate the lease if the landlord is unable to deliver possession of the building to the City with the leasehold improvements substantially completed within 180 days after Landlord receives permits necessary for construction.

### **Abated Base Rent**

For the first six years of the lease, the City will not have to pay base rent for the month of July, which results in \$460,454 in rent reduction over the initial 8.5-year term. If the City chooses to extend, there will be no rent abatement.<sup>2</sup>

### **City Obligations to Pay Additional Charges**

The lease requires that the City pay the landlord's insurance, property taxes, and all operating expenses including utilities, maintenance, and repair costs. According to Mr. Keene, this will result in an estimated additional \$14,483 per month (\$173,796 per year). This amount is not included in the base rent. These additional charges are included in the program budget and will be funded by DPH.

## **FISCAL IMPACT**

Under the proposed lease, the City would pay an initial annual rent of \$854,235, escalating by 3 percent per year over the 8.5-year term, with rent abated every July for the first six years of the term. Total rental costs for the initial 8.5-year term for 1076 Howard Street are estimated at \$7,676,697 (including six non-consecutive months of rent abatement, approximately \$460,454 total). Under the proposed lease, one additional five-year extension option exists with rent at 98 percent of the then-prevailing market rate, not to be reduced below 103 percent of the base rent for the 12-month period prior to the extended term (equivalent to \$65.90 per square foot). Table 2 shows total rental costs under proposed lease for 1076 Howard Street compared to the estimated fair market rent value.

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<sup>2</sup> In the event the landlord wishes to sell the building, the lease allows the landlord to "buy back" \$460,454 worth of rent credits to the City, rather than have the new buyer continue providing free rent.

**Table 2. Rental Costs Under Proposed Lease for 1076 Howard Street**

Year	Square Feet	Annual Rent per Square Foot	Annual Rental Costs in Proposed Lease
1	16,668	\$51.25	\$854,235
2	16,668	52.79	879,904
3	16,668	54.37	906,239
4	16,668	56.00	933,408
5	16,668	57.68	961,410
6	16,668	59.41	990,246
7	16,668	61.20	1,020,082
8	16,668	63.03	1,050,584
8.5	16,668	64.92	541,043
Base Rent Total (excluding 6 months' rent abatement in Years 1-6)			8,137,151
<i>Rent Abatement</i>			<i>(460,454)</i>
<b>Total</b>			<b>\$7,676,697</b>

Source: BLA Review of Proposed Lease

In April 2021, an appraisal conducted by R.Blum & Associates indicated the market rental rate of the property to be \$820,000 for the first year, and total rent over the 8.5 year of \$7,811,091 over the 8.5 year term.<sup>3 4</sup> Projected rent under the proposed lease, including annual 3 percent rent increases and six-months' rent abatement is \$7,676,697, which is less than the appraised market rent.

### Source of Funding

The rent and proposed improvements for the Drug Sobering Center leased space will be paid from Proposition C "Our City Our Home" funding.

### RECOMMENDATION

Approve the proposed resolution.

<sup>3</sup> The first year rent of \$51.25 is over the \$45 square foot that would require an appraisal in accordance with Administrative Code Section 23.27. Per City Administrative Code Section 23.27, the Director of Property shall determine the Market Rent of such lease based on a review of available and relevant data. If the Market Rent of the lease is more than \$45 per square foot per year as base rent, the Director of Property shall obtain an appraisal for such Lease.

<sup>4</sup> According to Mr. Keene, fair market rent assumes an increase of 3 percent each year starting on the first anniversary of the lease.