



Waterfront Plan Working Group

Meeting: May 11, 2016

Real Estate and Development Meeting Notes

Members Present: Grant Ballard, Kirk Bennett, Reid Boggiano, Kevin Carroll, Chris Christensen, Jane Connors, Jon Golinger, Carolyn Horgan, Earl James, Ellen Johnck, Janice Li, Ron Miguel, Rudy Nothenberg, Alice Rogers, Jasper Rubin, Cristina Rubke, Peter Summerville, John Tobias, Dilip Trivedi, Anne Turner, Corinne Woods, Dee Dee Workman

Absent: Mike Buhler, Jeffrey Congdon, Linda Fadeke Richardson, Stephanie Greenberg, Aaron Hyland, Ken Kelton, Stewart Morton, Jacquelyn Omotalade, Karen Pierce, Tom Radulovich, Frank Rescino

1. Welcome & Acceptance of April 27 Working Group Meeting Notes (6:00-6:10)
 - Welcomed attendees; reviewed the remaining Part 1 orientation meetings of the Working Group on June 1 (Urban Design & Open Space) and July 6 (Transportation). Co-Chair Rudy Nothenberg suggested that --a further meeting might be necessary if the group felt that any issues needed to be revisited at the conclusion of the scheduled Phase 1 meetings
 - Working Group accepted April 27, 2016 Meeting Notes
 - Link to Working Group documents: <http://sfport.com/waterfront-plan-archives>
 - Link to SFGovTV meeting video: http://sanfrancisco.granicus.com/ViewPublisher.php?view_id=183

2. Port Real Estate and Development (6:15-7:15)

Link to presentation: <http://sfport.com/sites/default/files/2016-5-11%20Real%20Estate.pdf>

Introduction to the Port's Real Estate and Development: Diane Oshima, Assistant Deputy Director, Planning & Development

- Port has an ongoing real estate asset management program that supports a unique blend of maritime, commercial and industrial uses, and historic assets. The distinctions between real estate leasing and process for long-term Port development projects are not always understood by the public. This meeting -will address both programs..
- Mark Lozovoy, Assistant Deputy Director of Asset Management, Leasing and Special Projects, will discuss Port leasing practices and ongoing efforts to keep Port facilities occupied and maintained.
- Rebecca Benassini, Assistant Deputy Director of Development, will discuss Port development objectives, process and issues moving forward

- Briefing handouts were emailed and posted containing excerpts -from the Waterfront Land Use Plan for interim lease policies, and long-term development policies and community review process. In addition, excerpts from the Waterfront Plan, 1997-2014 report on lease and development projects are provided.
- Most Port real estate leases are for shorter-terms of 10 years or less. However, due to increased and new repair and improvement costs that require longer amortization, some leases are requiring longer than 10 years. For such longer-term leases, the Waterfront Plan policies call for more community review, similar to that for long-term development projects.

Presentation on Port Leasing: Mark Lozovoy, Assistant Deputy Director

- The Port is one of the largest landlords in San Francisco, especially in the realm of production, distribution, and repair (PDR) and light industrial facilities.
- There are over 500 Port leases including nonprofits, industrial, and retail tenants for small and large entities. Port shed space can be rented in small increments, which - support- many small incubator and family businesses.
- Leases - that generate more than \$1m in revenue requires Board of Supervisors approval
- -
- Port utilizes an annual fair market rent survey and third party consultant services to confirm that Port rents are market rents. The Port Commission approves parameter rents rates on an annual basis.
- Interim leases in the northern waterfront average 5-10 years and up to 25 years in the southern waterfront, which hosts industrial businesses –that require substantial capital improvements. The determination of lease term in large part is driven by the type and cost of improvements to the lease premise.
- Interim leases provide significant revenues that are fundamental to the Port operating and capital budgets.
- All tenants are required to comply with all applicable environmental and regulatory review and approval requirements, including CEQA environmental review, historic preservation standards and BCDC permitting and public access requirements.
- Port leases generally fall into one of three categories, beginning with shorter-term, “bread and butter” leases. These leases typically include shed storage space for small PDR and light industrial businesses.
- The second type of lease is a restaurant/retail lease. These lease opportunities go through a competitive bid process to ensure the Port receives fair market rents. Retail and restaurants typically involve higher costs for tenant improvements and equipment.
- The third type of lease provides longer terms for tenants in buildings that require extensive capital improvements, particularly on un/under-improved properties in the Southern Waterfront. CEMEX and Bode concrete batch plants in the Pier 90-94 Backlands are examples.

Boudin's restaurant in Fisherman's Wharf is another example. Boudin's worked very closely with the Fisherman's Wharf Waterfront Advisory Group during its entitlement process and actually is more like a development project.

- Port efforts to re-tenant Pier 29 bulkhead went through substantial review by Northeast Waterfront Advisory Group (NEWAG) to define offering in an RFP process. The Port sought a public-oriented tenancy rather than the standard "bread and butter" type of industrial and parking leases. A NEWAG member sat on the review panel and recommended the Jamestown proposal. The Port Commission authorized selection of Jamestown, which has proposed a 15 year lease term based on the proposed improvements.
- Rising and newly determined improvement costs are leading to longer lease terms, particularly in the northern waterfront. The cost to operate and renovate aging facilities is a major challenge for the Port and its tenants. Term flexibility allows tenants the amortization period required to invest in facilities.

Presentation on Port Development: Rebecca Benassini, Assistant Deputy Director

- In comparison to Port interim leases, development projects are larger in scale and achieve greater public benefit improvements
- The Port utilizes public private partnerships to harness private financing resources to improve facilities that the Port cannot finance on its own
- Rehabilitation projects have activated the waterfront and preserve assets for the long-term
- Port development costs are high, a reflection of seismic and historic rehabilitation requirements, public access and development program mix to meet public trust requirements; lengthy entitlement process requirements also add to project costs
- The Port acknowledges that its property—including substructure, piers and buildings—typically requires substantial improvement to be leasable

- Once development projects are completed, oversight and responsibility for lease and property management shifts to the Port's Real Estate Division
- The Waterfront Plan promotes a diversity of maritime and mixed use developments; there is no cookie-cutter formula. Development projects require well-committed development partners to sustain investment during lengthy entitlement process
- Construction costs are rising, entitlement processes are longer, and sea level rise and seawall improvements are adding to the existing challenges. To obtain historic tax credits, the lease terms must be 39-47 years long. New realities are causing Port to consider new tools and approaches to development.

Responses to Questions:

- Is there a public process for interim leasing? Per the Port's standard leasing policy, short term leases that are within parameter rent rates are –undertaken administratively although rent activity is reported to the Port Commission. These leases include storage and small offices. All leases are subject to California Environmental Quality Act review. Port staff engages Port advisory groups and neighborhood stakeholders for retail or other leases with longer terms.
- Do you have a pie chart breakdown of trust versus non-trust uses? No. Tonight's presentation includes a pie chart illustrating revenues generated by use.
- In tonight's packet, there is information about interim leases north of China Basin. What is the Port policy regarding interim leasing in this area? The Waterfront Plan interim use policies recognize terms for most interim leases for 5-10 years; for longer terms, the Waterfront Plan calls for community engagement with the Port advisory group(s) for the given project site to discuss and provide information on lease concept and details prior to selecting a tenant (described in handout booklet).
- Office use is not listed in the Waterfront Plan's list of acceptable uses for Pier 38, is it an allowed interim use? How does the Port decide whether a project such as the Pier 38 rehabilitation is a development project or an interim lease? Will the Port address the term length of 25 years? The Waterfront Plan Acceptable Use charts in Chapter 4 (see handout booklet) apply to long-term development projects. Port interim leases allow broader range of uses, including non-trust uses, as long as they comply with zoning. As discussed in the April 27th Working Group meeting, Pier 38 was offered in an RFP as an interim lease opportunity. The site had been closed due to poor condition and permit violations by the former tenant. The RFP was to bring the bulkhead into compliance with Port Building Code consistent with historic preservation standards, and reopen the office, restaurant and public dock facility. The tenant, TMG, found that the condition of facility was worse than was originally understood and required more capital improvements and longer amortization period than expected. This is the slippery slope issue, where amortization requirements drove need for a 25 year lease term, much longer than typical Port interim leases. The Port consulted with State Lands and secured support for the balance of trust and non-trust uses and public benefits prior to Port Commission approval of the lease. This case study was shared with the Working Group to highlight the policy question for the Waterfront Plan Update about whether and how leases and development projects should be distinguished from each other.
- Where does the Port go from here? There are not that many development sites left, and thus limited opportunities to secure develop partnerships to help finance long-term waterfront

improvements. In the absence now of defined options or solutions about sea level rise and financing seawall seismic improvement, it is difficult to address long-term outcomes. The Working Group discussions should talk about what may be needed to help the Port manage through the short-term until more information becomes available, and to provide direction about what kinds of regulatory, land use changes should be considered.

- Is BCDC review required for lease renewals and new leases? It depends on type of lease and whether facility is within BCDC jurisdiction. Simple re-tenanting of existing facilities with no change in use does not require BCDC permits. Changes in use or substantial capital investments are subject to BCDC review to determine permitting requirements.
- Are there long term leases at Pier 9? Yes, the maritime lease for the San Francisco Bar Pilots is long-term while most of the other uses at Pier 9 are 1-5 year leases. Autodesk lease is for 10-years because the tenant made significant repairs and improvements to the shed structure.
- Do the uses in the pie chart have overlap between office and maritime categories? Yes. The revenues pie chart has overlap pertaining to specific uses.
- What types of tenants are at Pier 26 annex and Pier 24? IDEO is an industrial designer in Pier 26, makes unique products. The Pilara Foundation in Pier 24 is a photography museum with a collection of rare photographs that is open to the public for pre-scheduled tours.
- Are tenants responsible for all improvement costs including seawall repair? A shorter term lease generally covers tenant improvements but not substructure or seawall repairs.
- Are interim leases—such as 10 year leases—renewable? Are there extension options? Tenants can reapply to renew their leases just as anywhere else, but this does not mean that they will get it. Options to extend are offered in certain cases. Port options are more stringent than those in the private sector, requiring tenants to be in good standing and meet certain benchmarks, and reset rents to prevailing market levels.
- Did leases for Boudin's and Pier 38 have a public process? Yes, substantial outreach to Fisherman's Wharf community (for Boudin's) and South Beach community and through Port Commission hearings (for Pier 38).
- What was the reason for the difficulty with removing the Sinbad's restaurant? Sinbad's was a restaurant use, and its removal was required as a condition of the America's Cup BCDC plan amendment and permit approvals. The restaurant demolition was delayed due to litigation by the tenant.

- How does the Port calculate per square footage investment and how does the condition of the building affect these rates? Through its annual rent survey, the Port establishes market-rate rent parameters that take into account the condition of its facilities.
- Is it possible that tenant improvements may make a property less appealing to new tenants? Port takes it into account unique improvement needs with an interest to improve the asset's leasing value. Office-styled improvements are generally accepted that can be easily re-leased if the tenant defaults.
- Piers 19-27 have had diverse mix of small businesses and tenants before the America's Cup. What happened to them? Are all interim tenants when the Port decides to do long-term development? During improvements for America's Cup, all existing tenants were offered replacement space on other Port property. For those tenants that desired to remain at the Port, they relocated to other facilities. The Waterfront Plan interim use policies are in place to balance the Port Commission desire to avail sites for long-term improvements.
- Besides lease term length, what type of flexibility does the Port seek? The Port does seek more tools to achieve its public purpose. Longer terms help to amortize investments and realize trust consistent uses, because the concept of five years does not work in every case. Accommodation of office and other higher revenue-generating uses are needed finance development and historic rehabilitation costs. Private investment helps to finance these improvements. Without the ability to attract these investments, the public will have to subsidize costly improvements. Streamlining the regulatory entitlement process also suggested as another type of approach to assist implementability of projects.
- What is net present worth of \$7 per sf/per month of rental income? Approximately \$900 sf, though the estimation depends on various assumptions such as operating expenses, lease term, capitalization rate, and other site specific factors.
- We heard an estimate that by 2065, many Port piers will become difficult to maintain. Can the Port model scenarios that can estimate the remaining useful life of piers? Can this model include seismic risk and other risks? The Port has modeling capability. To determine General Obligation bond ratings, the Port has modelled useful life of piers. Specifically, we have modeled our estimated \$2 billion deferred maintenance backlog as well as how the Port would perform without certain piers. We can definitely model some scenarios for future Working Group meetings.

- Is there a financial metric (i.e. ROI by land use) that the Port uses to determine investment allocation? Are we getting enough for the land uses? (Example: in Sacramento, the Kings stadium transferred a parking site to a developer and this turned out to be a successful revenue generator. Chicago obtained \$1 billion from doing something similar.) Port studies its portfolio and analyzes alternative uses. Port has the capacity to do financial modeling and can provide this as a resource as questions come up throughout the Waterfront Plan Update process. It is important to use this process to identify the public amenities and values that should be prioritized in this planning process, to support financial modeling analysis.
- The revenue generated over the last 10 years is great; if Port staff did this, they can do more. What other tools can we use—what about maintenance assessment districts and infrastructure financing districts? What in addition to GO Bonds? Port staff provided the Working Group with a long term financing reference guide which lists some of these existing public finance tools. Byron Rhett and Brad Benson (Port staff) recently visited Washington, D.C. to see if there are federal funding opportunities to address infrastructure repairs and sea level rise. The Port acknowledges that additional outside sources are necessary to fund the outstanding backlog and growing needs.
- Are there union requirements or prevailing wage requirements? There are prevailing wage requirements, but the City cannot impose union employment requirements.

Closing Comments from Members of the Working Group, Advisory Committee members or members of the public:

- This is the right time to address these policy questions in light of sea level rise and other challenges, and think creatively about solutions.
- There appear to be distinctions between lease terms and uses permitted. It would be helpful to have discernable rules.

There appears to be an underlying issue that where interim uses that are not listed as acceptable uses in the Waterfront Plan are perpetuated for a longer timeframe . . .

- Response: staff hears this concern. As land trustee, the Port actively searches for maritime and public trust tenants to lease property Interim leases contain provisions to support maritime uses. . . To the extent that we cannot find maritime tenants. Recognize that this is the public purpose, but interim leases are very important for the Port's financial requirements.
- This is recognized by the Working Group, although there is desire for the process to clarify definition and distinctions between interim leases and long term development .

-

- Port PowerPoint presentation should use white backgrounds, not black background, which would be more legible and require less ink to print (This change will be made before posting on the Port's website.)
- The Plan Update is well-timed, as the Port is on the the cusp of changing conditions, facing new realities.
- State Lands Commission is struggling with how to address interim uses and ways to prevent Port assets from becoming dormant. When we get into 30 year terms and discussion of maximizing revenues, this does not fit the definition of "interim"
- Would like to see more recreation as recommended in the Waterfront Plan, including new ideas for art and culture on the piers. Port has done good job providing passive recreation; would like to see more active recreation options besides professional teams.
- Interested in seeing feasibility analyses on failed small and large projects. We know some are due to politics and some due to cost. More project dissection would be useful to avoid making same mistakes.. The cost of doing business for tenants (e.g. Ferry Building) is very high due to a high cost of living, loss of wait staff and support, the new \$15 minimum wage law, and union contractors as required by Port. There is a pass-through fee of \$34 per square foot which Ferry Building tenants must pay to be able to maintain and operate the public areas around the Ferry Building. Substantial expenses often cannot be supported in five year leases.
- With a limited amount of remaining property to develop, where does the Port go to generate revenue? This is one of the overarching questions for this process. Short term leases are not going to be the solution to repair the seawall.
- Agree with need to address long term sea level rise. Past funding solutions will prove to be more difficult. In the absence of knowing everything we have to recognize that long term development projects have substantial seismic and sea level rise needs. The Working Group has a role in helping to strategize some solutions. The Waterfront Plan Update process can help in the short term, but will be harder in the long term.
- Working Group must rethink the policy of development on piers and how it relates with interim leases. Successful and failed projects can teach us lessons. Challenges include cost of substructure repairs, complex and unpredictable results of entitlement process, and political interference to create legacy projects.
- There are limited sites left to develop. The large sites were a focus of the 1997 Waterfront Plan so that these projects could fund open space. In the 1990s large mixed use projects were in vogue, and now there are fewer developers willing to take these large endeavors because of long process and infrastructure needs.
- The probability of sea level rise limits the Port's ability to offer 50-60 year leases on piers. Yet these leases are essential to undertake large utilities, public access, and substructure improvements. We must have a greater acknowledgement of cost escalation. Also, an increased appreciation of the significance of historic resources by public and agencies.

- Some lessons to conclude from development is that without major public private partnerships with long term leases, the Port or other agencies will need to fund substructure improvements and sea level rise mitigations. The Port has an impressive pile driving crew to improve substructure. Port should shift to smaller leases and make interim uses work within Waterfront Plan Update goals.
- Consider these ideas: Focus on leases longer than 5-10 years but shorter than 50 years. Move towards use goals that maximize the Public Trust objectives of the Port, rather than a grid of acceptable uses, to sustain maritime uses, historic resources, and financial ability to maintain the Port. The Port is achieving public trust goals and this process does not fit into a clean table.
- Maritime use contributes 20% of revenues and its presence is what makes the Port a port. Maritime preservation is important and the Port Commission should continue to ensure this.
- Be mindful of scheduling future meetings during summer vacation season
- Working Group members have any questions from the Part 1 meeting discussions, new issues or unaddressed questions prior to starting Part 2 of the planning process, including questions from the public, email to Diane Oshima at diane.oshima@sfport.com
- Try to avoid too many meetings over the summer vacation season.

3. Next Working Group meeting will be on June 1, 2016 on Open Space and Urban Design.