

MEMORANDUM

April 6, 2018

TO: MEMBERS, PORT COMMISSION
Hon. Kimberly Brandon, President
Hon. Willie Adams, Vice President
Hon. Leslie Katz
Hon. Doreen Woo Ho

FROM: Elaine Forbes
Executive Director

SUBJECT: Informational presentation on Boudin Properties, Inc. 160 Jefferson Street, regarding an amendment to the lease to provide for two (2) extension options of ten (10) years each, up to June 30, 2065, subject to Board of Supervisors' approval.

DIRECTOR'S RECOMMENDATION: Informational Presentation Only

EXECUTIVE SUMMARY

Boudin Properties ("Boudin") has been an exceptional steward of its leased Port property and has privately financed over \$30 million in capital improvements on its flagship location over the last 10 years. This investment has helped increase the facility's revenues and rent payments to the Port. In addition to being a high performing tenant, Boudin intends to continue to invest in its flagship location. Accordingly, Port staff has negotiated terms to amend the lease to provide Boudin with two 10-year extension options, each subject to specific performance and capital improvement conditions on extensions for retail leases, as called for under the Port Commission's Retail Leasing Policy (Resolution 11-15).

As a condition precedent to exercising its 1st Extension Term, Boudin will invest a minimum of \$2 million cumulatively in the premises prior to June 30, 2025. As a condition precedent to exercising its 2nd Extension Term, Boudin will invest an additional minimum of \$2 million cumulatively in the premises prior to June 30, 2035. The investments shall be in verifiable capital improvements to the premises that will improve the financial performance and /or extend the asset useful life as determined by the Port.

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During each Extension Term, Boudin shall invest an additional minimum of \$1 million cumulatively within the initial five (5) years of each extension term. The investment shall also be in verifiable capital improvements to premises that will improve the financial performance and/or extend the asset useful life as determined by the Port. The current lease includes participation rights for the Port regarding transfers of the lease by Boudin. As further consideration for the amendments described above, Boudin has agreed to increase the Port's participation rate from 10% of seller profit (as calculated under the lease provision) to 12%.

In view of the significant financial benefits projected from the capital improvements called for in relation to the extension options, and the increase in the Port's transfer participation rights, Port staff supports the request.

BACKGROUND

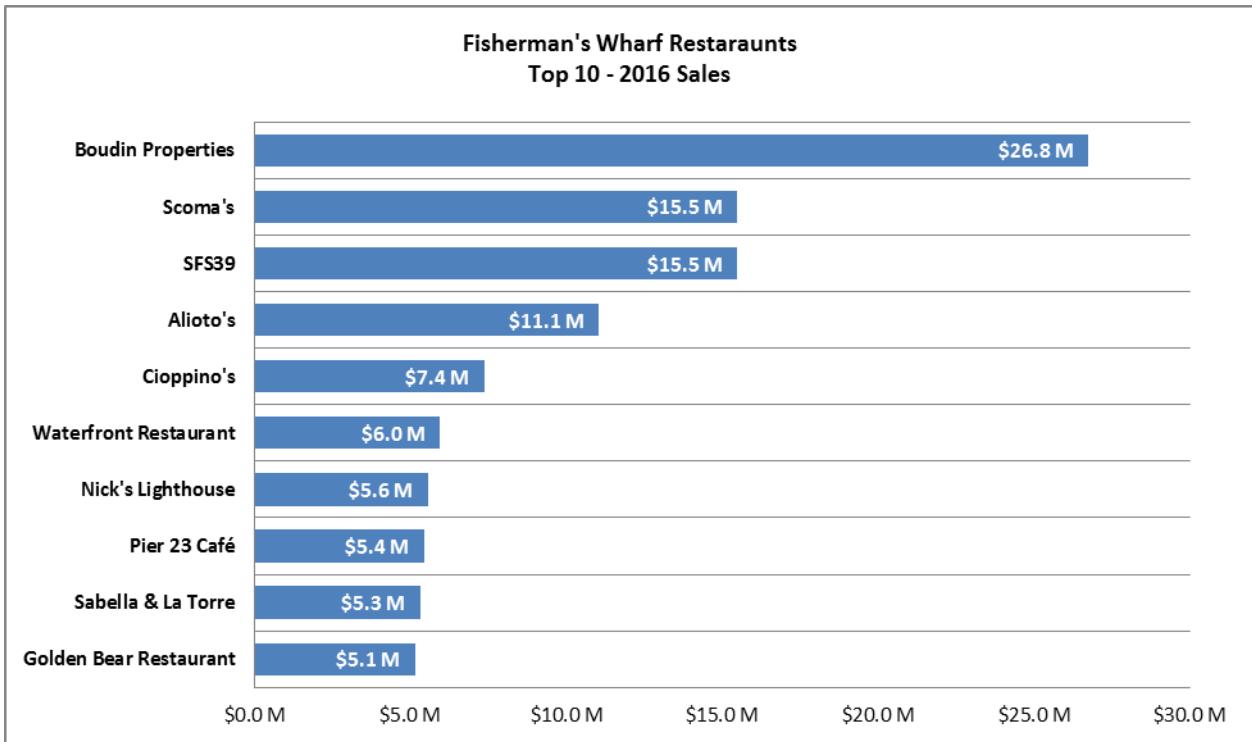
Boudin Bakery is the oldest continuous operating business in San Francisco and the producer of the Original San Francisco Sourdough French Bread™. The Boudin brand is synonymous with San Francisco. Having the flagship restaurant and bakery facility on Port property is in the best interest of the Port, the City, and the Fisherman's Wharf community because Boudin's is an anchor tenant that draws people to Fisherman's Wharf and provides cohesion and excitement to the Fisherman's Wharf experience.

In 2003, Boudin entered into a Lease (the "Ground Lease") at 160 Jefferson Street and constructed a 27,000 square foot flagship location known as "Boudin at the Wharf." Since its opening in July 2005, the flagship has been generally regarded as one of the most significant privately financed retail improvement projects on Fisherman's Wharf, and is a premier destination on Fisherman's Wharf for locals and tourists. The term of the Ground Lease currently expires on June 30, 2045 and there are no renewal options.

Boudin's flagship includes a Boudin café, retail store, sourdough bread shop, wholesale bakery, museum and Bistro Boudin, a full service restaurant located on the second floor, complete with oyster bar, private dining room and banquet facility. The flagship employs approximately 250 full time and 75 seasonal employees.

Boudin approached the Port in 2015 to request a twenty-year extension to its lease in order to continue to access the financial markets for financing of its debt and provide for an appropriate time to amortize significant capital improvements essential to continue to grow its revenues. More broadly, Port staff continues to study strategies to address negative rent trends as tenants close out the waning years of their lease terms with no incentive for renewal investment. Therefore the parties interests in this discussion have been strongly aligned.

Since its opening in 2005, Boudin has seen its annual sales at its flagship grow from approximately \$13 million to \$26.8 million in 2016 and is the highest grossing restaurants on the Wharf. Total Rent paid to the Port for 2016 is approximately \$1,654,000 comprised of \$1,154,000 in percentage rent and \$500,000 in base rent. Per the chart below, Boudin is the leading Fisherman's Wharf restaurant in terms of sales and rent paid to the Port by a significant margin.



RETAIL LEASING POLICY

The Port Commission adopted the Retail Leasing Policy for existing retail tenants which calls for Port staff to evaluate renewals and extension requests on a case-by-case basis based on proposed improvements, capital costs, the Port's future plans for the site and tenant history. Port staff may negotiate with an existing tenant where a tenant proposes to make capital improvements; in such cases a lease extension may include the term required to amortize the planned improvements.

Port staff then seeks a Direct Negotiation Exception from competitive solicitation by determining the following criteria:

- Determine Tenant is in compliance with the Tenant in Good Standing Policy;
- Evaluate whether the tenant is the most suitable economic tenant based on reasonably projected sales and revenues to the Port, using comparable retail rents on a per square foot basis; and
- Request a written business plan and evaluate the plan to determine the cost and value of the capital improvements to Port property and viability of revenue projections.

Port staff has determined that Boudin meets all of the criteria of the policy as it is a Tenant in Good Standing, Port staff has evaluated the projected sales and revenues projections as viable and has determined the proposed capital improvements will likely generate additional revenue that the Port would not otherwise receive. Boudin is an anchor tenant at

Fisherman’s Wharf and it is in the Port’s interest to offer extension terms that incentives continued investment into the facility that drive continued successful performance.

PROPOSED BUSINESS TERMS

Proposed Lease Extension:	Tenant shall have two Options to Extend the Lease for an additional ten (10) years each (“Extension Term”). There shall be no additional options to extend the term.
Extension Terms:	Ten (10) years each.
Extension Commencement Date:	The 1 st Extension Term shall commence on July 1, 2045 and expire on June 30, 2055. The 2 nd Extension Term shall commence July 1, 2055 and expire on June 30, 2065.
Extension Rent Exercise Period	Subject to performing the conditions as outlined, Tenant shall provide written notice of its intent to exercise its 1st Extension Term within 24 to 48 months prior to June 30, 2025. Subject to performing the conditions as outlined, Tenant shall provide written notice of its intent to exercise its 2 nd Extension Term within 24 to 48 months prior to June 30, 2035.
Performance conditions to option terms:	Each of the option(s) are subject to Port discretion if sales per square foot over preceding 12 months is less than 90% of same metric leading up to execution of lease amendments (i.e. current sales).
Minimum Rent:	Same as current: Upon commencement of each Extension Term, the Minimum Rent shall be adjusted as described in Section 2.3 (d) (i) and (ii) of the Lease, to the greater of (a) 70% of the average annual aggregate total rent for preceding 3 years, or (b) the Minimum Rent prior to the Rent Adjustment Date multiplied by the increase in the SF/San Jose CPI over the 5 years since the prior Rent Adjustment Date. If the adjusted rent is less than the current minimum rent it shall remain unchanged. The Minimum Rent shall be adjusted on each 5-year anniversary per the same formula.
Percentage Rent through existing lease:	Same as current: Percentage Rent for Food & Beverage and Off-Premises Bakery Sales shall remain at 6.5% of gross sales that exceed monthly minimum rent. Percentage Rent for Retail and Consumer product package sales shall remain at 8.50% of gross sales that exceed monthly minimum rent.
Percentage Rent during extension	Upon commencement of the Extension Term, the Percentage Rent shall be reset to fair market value from the current 6.50% of

terms:	<p>gross sales to the following:</p> <ol style="list-style-type: none"> 1) During the 1st Extension Term Percentage Rent shall be reset at beginning of each extension term to fair market value however in no event below 6% and not above 7% on Food and Beverage and Off-Premises Bakery Sales that exceed minimum rent. Percentage Rent for Retail and Consumer product package sales shall remain at 8.50% of gross sales that exceed minimum rent. 2) During the 2nd Extension Term Percentage Rent shall be reset at beginning of each extension term to fair market value; however, in no event below 6% and not above 7% on Food and Beverage and Off-Premises Bakery Sales that exceed minimum rent. Percentage Rent for Retail and Consumer product package sales shall remain at 8.50% of gross sales that exceed minimum rent.
Improvements:	<p>As a condition prior to exercising its 1st Extension Term, Tenant will invest a minimum of \$2 million cumulatively in the premises prior to June 30, 2025. The investment shall be in verifiable capital improvements to premises that will improve the financial performance and /or extend the asset useful life as determined by the Port.</p> <p>As a condition prior to exercising its 2nd Extension Term, Tenant will invest an additional minimum of \$2 million cumulatively in the premises prior to June 30, 2035. The investment shall be in verifiable capital improvements to the premises that will improve the financial performance and /or extend the asset useful life as determined by the Port.</p> <p>During each Extension Term, Tenant shall invest an additional minimum of \$1 million cumulatively within the initial five (5) years of each extension term. The investment shall be in verifiable capital improvements to premises that will improve the financial performance and /or extend the asset useful life as determined by the Port.</p> <p>The improvements would be separate and in addition to any required Repair and Maintenance per Section 8 or Damage and Destruction per Section 12 of the Lease. As part of the proposed capital improvements, Boudin will be responsible for obtaining all necessary permits and approvals as necessary.</p>
Transfer Participation	<p>The Port's transfer participation in Net Proceeds from defined capital transactions will increase from the current 10% to 12%.</p>
City Requirements	<p>The amended lease shall be updated to include all current City ordinances and requirements as required.</p>

FINANCIAL ANALYSIS

The Port retained Seifel Consulting and its subcontractor C. H. Elliott & Associates to analyze the potential effects of the proposed lease extension terms as compared to the base case of either Boudin extending its lease without any additional capital improvement investment or vacating the premises. The consultants pursued interviews with the tenant and analyzed financial performance and lease terms to provide the analysis summarized below.

Table 1
Projected Capital Improvements and Associated Sales Revenues by 2025
Scenario 2 Proposed Lease Extension
Boudin Flagship Property

Year of Capital Improvement	Proposed Improvement	Capital Investment	Projected Sales (in Subsequent Year)
2020	Capital Phase I	\$1,000,000	\$800,000
2021	Capital Phase II	\$200,000	\$350,000
2022	Capital Phase III	\$400,000	\$450,000
2024	Capital Phase IV	\$400,000	\$150,000
	Total	\$2,000,000	\$1,750,000

Based on an analysis of each individual capital project, the consultants evaluated and projected how the proposed improvements to the bakery, seating areas and retail would likely increase Boudin’s revenue base. The effects of these investments were then combined to provide an estimate of the Port’s revenue performance if the full lease extension proposal were realized on the current terms. Chart 1 below compares the revenue effects of this capital improvement analysis (Scenario 2) to the base case assuming the continuation of current revenue trends (Scenario 1) to the extent the tenant extends the lease without the capital improvement requirement.

**Chart 1
Comparison of Projected Rent to the Port under Each Scenario
Boudin Flagship Property**

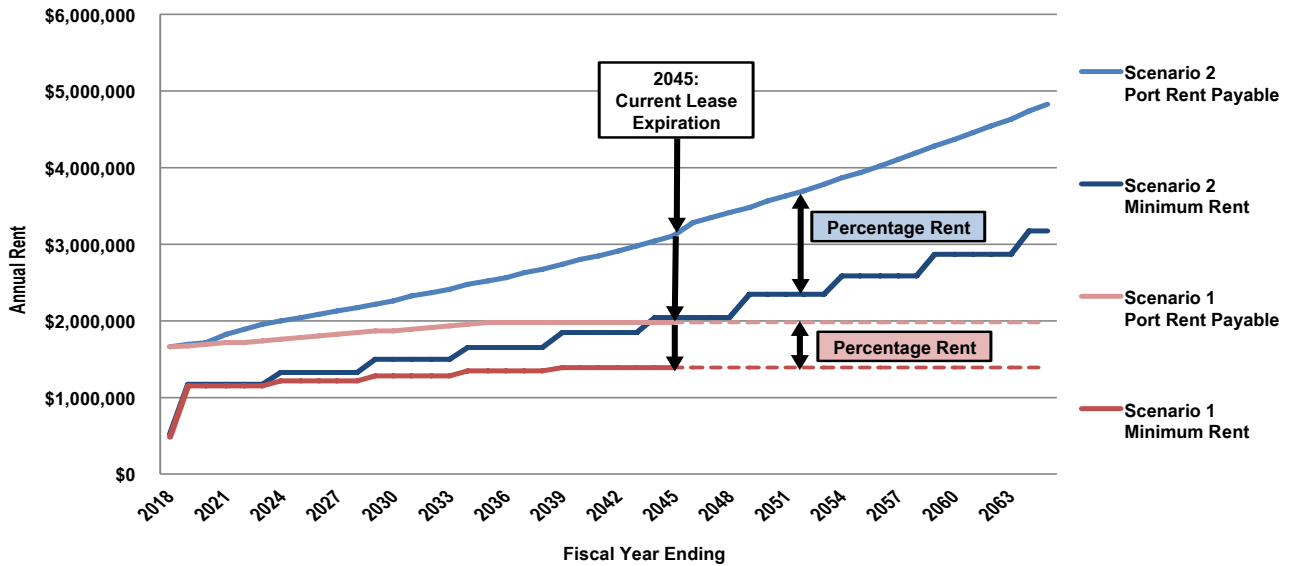
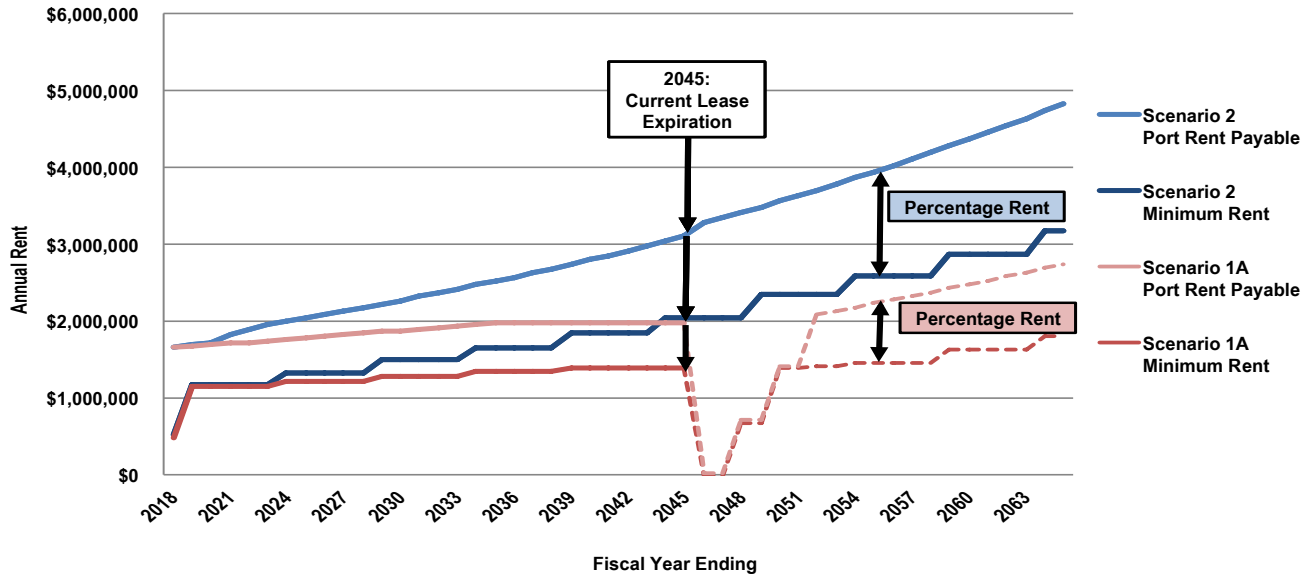


Chart 2 compares Scenario 2 to the potential of the space being vacated at the expiration of the original term and subsequently re-leased to a new tenant (or tenants). Scenario 1A assumes 2 years of no rent to the Port due to the time required securing a new tenant and then an adequate construction time. In addition, once the tenant is operational, the financial analysis assumes there would be a 3 year ramp up period to bring the sales revenue back to existing levels at the time of expiration. While not the assumption in this analysis, given Boudin’s extraordinary performance, it is reasonable to assume that sales numbers from a new tenant would not reach prior levels.

**Chart 2
Comparison of Projected Rent to the Port under Each Scenario
Boudin Flagship Property**



The consultants provided the following two comparisons of the Port’s revenues on a net present value basis. Scenario 1 is the continuation of the current lease into a month-to-month scenario (retaining the goodwill benefits of the current operation) and Scenario 1A reflects the closing out of the Boudin lease term and the competitive selection and installation of a new operator. Scenario 1A shows a significant decrease in the net present value received during the first extension from 2046 through 2055 as compared to Scenario 1.

Table 2
Summary of Value Analysis
Comparing Projected Performance under Alternative Lease Scenarios
Showing Nominal Value and Net Present Value (NPV) at Six Percent (2018\$)

Port Value Analysis	Scenario 1- Existing Lease Scenario		Scenario 2- Proposed Lease Extension		Percent Increase	
	Nominal Value	NPV	Nominal Value	NPV	Nominal Value	NPV
Existing Lease Through 2045	\$52.4 M	\$25.9 M	\$66.0 M	\$30.8 M	26%	19%
Lease Extension (2046-2055)	\$19.8 M	\$3.0 M	\$36.0 M	\$5.4 M		
Lease Extension (2056-2065)	\$19.8 M	\$1.7 M	\$44.2 M	\$3.7 M		
Total Value (2018 \$)	\$92.0 M	\$30.6 M	\$146.1 M	\$40.0 M	59%	31%
Port Value Analysis	Scenario 1A- No Boudin Lease Renewal		Scenario 2- Proposed Lease Extension		Percent Increase	
	Nominal Value	NPV	Nominal Value	NPV	Nominal Value	NPV
Existing Lease	\$52.4 M	\$25.9 M	\$66.0 M	\$30.8 M	26%	19%
Lease Extension (2046-2055)	\$12.8 M	\$1.8 M	\$36.0 M	\$5.4 M		
Lease Extension (2056-2065)	\$25.0 M	\$2.1 M	\$44.1 M	\$3.7 M		
Total Value (2018 \$)	\$90.3 M	\$29.7 M	\$146.1 M	\$40.0 M	62%	35%

Note: Numbers may not add precisely due to rounding

As shown above, the Port is projected to receive additional value from the Boudin lease extension (Scenario 2) when compared to either Scenario 1 or 1A. Through the existing lease term, the value to the Port is projected to increase by approximately \$4.9 million or 19% (based on the net present value of lease revenues discounted at 6%). Over the entire term, inclusive of the potential lease extension term, the value to the Port is projected to increase between 31% and 35% depending on the scenario.

RECOMMENDATION:

Port staff seeks comment, input and guidance from the Port Commission on Boudin's proposed lease extension, capital reinvestment plan, and the other negotiated terms. Based on that input, it is anticipated a term sheet will be finalized in April and a lease amendment will be prepared for Port Commission review in June 2018.

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