MEMORANDUM

August 10, 2018

TO: MEMBERS, PORT COMMISSION
Hon. Kimberly Brandon, President
Hon. Willie Adams, Vice President
Hon. Gail Gilman
Hon. Victor Makras
Hon. Doreen Woo Ho

FROM: Elaine Forbes
Executive Director

SUBJECT: Informational presentation regarding the proposed development under the Exclusive Negotiation Agreement with TZK Broadway, LLC, for the lease and development of a 180-200 room hotel, a dinner-theater, a 14,000-square-foot public open space, and ancillary uses at Seawall Lots 323/324 and portions of unimproved Vallejo and Davis Street right-of-ways on the west side of The Embarcadero at Vallejo Street

DIRECTOR'S RECOMMENDATION: Informational Only; No Action Required

EXECUTIVE SUMMARY

This staff report provides an update on the Exclusive Negotiation Agreement ("ENA") with TZK Broadway, LLC, a California limited liability company ("TZK") for the development of a 180-200 room hotel, a dinner-theater, a 14,000-square-foot public open space, and ancillary uses (the "Development" or "Project") through a lease of Seawall Lots 323/324 and portions of unimproved Vallejo and Davis Street right-of-ways on the west side of The Embarcadero at Vallejo (collectively, the "Site," shown on **Exhibit "A," Site Map**). The Site is currently used for surface parking. On September 8, 2015, the Port Commission adopted Resolution No. 15-31[1] authorizing Port staff to enter into the ENA for a one-year term with four six-month extension options, among other terms, to complete certain tasks and negotiate terms and conditions for leasing the Site. On April 26, 2016, the Port Commission adopted Resolution No. 16-18[2],

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[1] https://sfport.com/sites/default/files/FileCenter/Documents/10429-Item%2014B-Teatro%20ZinZanni%20ENA%20FINAL%209-2.pdf

[2] https://sfport.com/sites/default/files/Commission/Documents/Commission%20Meeting%20Staff%20Reports/2016%20Commission%20Meeting%20Items/APR26/Item%2012A%20SWL%20324%20Action%20Memo%20for%20042616%20PC%20Meeting.pdf

endorsing a non-binding term sheet ("Term Sheet") summarizing the conceptual terms and conditions proposed for the land disposition and development agreement (the "LDDA") and a lease (the "Lease") for implementing the development. On July 12, 2016, the Board of Supervisors adopted Resolution No. 277-16[3] and endorsed the Term Sheet as well. TZK is making progress to complete most of the key tasks it is required to complete under the ENA.

Tasks completed about to be completed include:

- obtained endorsement of the Term Sheet
- continuing its review of the Site suitability for its proposal
- communicating with stakeholders to gather input and keep community members informed
- substantial progress to complete design review by the applicable City departments
- substantial progress in working to complete the project's California Environmental Quality Act ("CEQA") evaluation
- substantial progress in finding financing for the Development
- Substantial progress in negotiating final terms for the LDDA and the Lease to seek Port Commission approval in February 2019.

Tasks remaining to be completed include:

- complete CEQA review,
- Obtain all required land use approvals, including s Certificate of Appropriateness from Historic Preservation Commission
- Obtain equity and debt financing commitments, and
- Obtain approval of LDDA and Lease from the Port Commission and Board of Supervisors

On-Going Efforts to make the Development a reality

To strengthen and improve its hotel development and capital raising capacity, TZK has admitted PresidioCo Holdings, LLC ("Presidio") into its membership. Port staff reviewed TZK-provided information on Presidio's financial wherewithal and experience and concluded that Presidio has the experience and financial standing to assist TZK in achieving the ultimate goal of a new home for Teatro ZinZanni in San Francisco and a successful hotel on the Site. Port staff will review updated Developer's ownership structure and business registration information in recommending approval of the LDDA and Lease to the Port Commission.

To improve the Development's financeability, TZK, with Presidio on board, has updated its development profile: (1) TZK, as the project sponsor, now includes (a) Kenwood, (b) Teatro, and (c) Presidio; and (2) the development has been further vetted but remains essentially as initially proposed: a single, four-story building with a 180-200 room hotel, restaurant/bar, an approximate 280-seat theater featuring Teatro's historic "Spiegeltent", and an approximate 14,000-square-foot privately financed public park. Changes to the Project since it was presented to the Port Commission on April 26, 2016 include:

[3] https://www.sfbos.org/ftp/uploadedfiles/bdsupvrs/resolutions16/r0277-16.pdf

basement level elimination (moved the few back-of-house uses in basement to the ground level) to reduce excavation and waterproofing costs, minor above-grade interior layout modifications to accommodate uses moved from the basement and to increase the 'proforma' (i.e., most likely number to be built) hotel room count from 180 to 192 rooms, and re-measurement of park land area confirming it is 14,000 square feet (not 7,500 square feet) in area. It is important to note that these revisions affect only the building interior and that the building footprint, site design, and exterior architectural and urban design features remain essentially unchanged.

To remove the basement and increase hotel room count, TZK has had to produce more interior design iterations than had been anticipated in its initial project timeline. These changes minimized expected increase in project costs and improved the potential for additional revenues. TZK has had to request that the ENA term be extended by exercising the extension options provided in the ENA for the maximum time allowed. As such, the Port's Executive Director has granted TZK's request and extended the ENA's Expiration Date through four six-month extensions from November 5, 2015 to November 4, 2018.

Port staff acknowledges that TZK will need additional time beyond the current ENA Expiration Date for it to complete CEQA review, its financing plan, and LDDA and Lease negotiations. Port staff plans to seek Port Commission consideration and approval of an amendment to the ENA to extend its term to allow TZK to complete its remaining tasks and continuance of the Project. September 25, 2018 is the target date for Port Commission consideration of an ENA extension beyond November 4, 2018. Port staff will seek approval of the LDDA and Lease from Port Commission and the Board of Supervisors in by March 2019. Thereafter, TZK will seek building permits, close escrow, and commence construction. A summary of the updated development is presented on Table 1.

The key goals of this Development for the Port are: (a) to lease the Site, which is no longer needed for trust purposes, for its *Highest and Best Use* to generate higher revenue and provide benefits to the Port, the community, and the City (these benefits include a privately-funded new public park, activation of the Site, and contributes to the integrity of Northeast Waterfront Historic District; and (b) to redevelop the Site with uses that (i) are open to all Californians, (ii) draw people to the Waterfront, and (iii) include a venue to retain the Port's previous tenant, Teatro ZinZanni, in San Francisco. The retention of Teatro ZinZanni is also supportive of the City's policy of "supporting and encouraging the use of City and County property, for indoor and outdoor music and other cultural events" (the City's music and culture sustainability policy, as articulated in Chapter 90A of the Administrative Code) and preserving and enhancing San Francisco's music and performance venues from displacement.

DEVELOPMENT SUMMARY

The Development is summarized in the table below:

Table 1 - Development Summary

Site Area	59,750 Square Feet
Proposed Building	
Building Height	40 Feet (4 stories) - 55 feet with elevator penthouse
Teatro ZinZanni - Entertainment Venue including Back of House, Circulation and the Spiegeltent:	29,570 Gross Square Feet
Hotel, including Back of House and Circulation:	192 Rooms on three levels, Floors 2, 3, and 4 118,130 Gross Square Feet
Restaurant Food and Beverage:	4,420 Gross Square Feet
Overall Building Gross Floor Area:	147,880 Gross Square Feet
Open Space:	Public Park – 14,000 Square Feet Common – Open Roof Terrace – 3,970 Square Feet
Bicycle Parking Spaces:	20 Class I 15 Class II
Loading Spaces:	2
Projected Total Development Cost:	$135,000,000
Funding Sources:	Debt: $ 72,000,000 Equity: $ 63,000,000 Total: $135,000,000

TZK is nearing completion of entitlement procurement, financing plan, and lease negotiations that will clear the way toward achieving the above goals. First, Port staff will return to the Port Commission during its September 25, 2018 meeting to seek consideration and approval of an extension of the ENA term; and second, once the three preceding main tasks are completed, Port staff intends to seek Port Commission consideration and approval of the two **key transaction documents** to implement the Development in February 2019.

Expected **ENA amendment** and **two Transaction Documents** and their **Key Terms** are as follow:

First Amendment to the ENA (the "First ENA Amendment") between the Port and TZK. Its purpose is to provide TZK six to twelve months to complete all required regulatory approvals, including approval of the proposed LDDA and the Lease. This amendment will provide, among other things: (a) an extension of the ENA Term by six months from November 5, 2018 to May 4, 2019, (b) one six-month extension option to extend the Term from May 5 to November 4, 2019 if the Developer is diligently pursuing Project approvals and the Executive Director wishes to grant the extension; (c) set the fee for ENA term extension from November 4, 2018 to May 4, 2019 at $25,000; (d) set the fee for ENA term extension from May 5, 2019 to November 4, 2019 at $50,000; and (e) revise the ENA Performance Schedule, including the date by which TZK must entered into the proposed LDDA to replace the ENA.

Land Disposition and Development Agreement or LDDA, between the Port and TZK. The LDDA's primary purpose is set the list of conditions TZK must satisfy before the Port will allow escrow to close and Site possession to transfer to TZK. These conditions include such things as: achievement of all regulatory approvals to begin construction; demonstration of sufficient financial resources to commence and complete construction; and posting of construction bonds, among other conditions. Other key terms of the LDDA include: **(a)** a 12-month term (with two six-month extensions options with fees), **(b)** requirement that TZK complete construction within 24 months after lease commencement subject to two six-month extension options with a $50,000 fee per extension, **(c)** description of LDDA fees payable to the Port, **(d)** requirement for payment of Port transaction costs, **(e)** Port's standard provisions, including liquidated damages for failure to complete on construction on time, insurance, and indemnification, and **(f)** prior consent for transfers and assignments, among other terms. The LDDA, which terminates once construction is completed, is subject to Port Commission approval only.

Ground Lease (the "Lease"), between the Port and TZK. The Lease's purpose is to convey property rights subject to the negotiated terms and conditions under which the Site is being leased to TZK. Proposed key terms include: **(a)** a 50-year initial term with a 16-year extension option; **(b)** rent to include **(i)** annual **Minimum Base Rent** per year for both construction and operation periods; **(ii)** annual **Percentage Rent** during the operation period and subject to escalations as further detailed in the analysis section of this staff report; **(iii) Participation Rent** during operation phase, and refinancing and sale events; **(c)** Port's standard lease provisions, including insurance, indemnity, sea level rise and flooding provisions; and **(d)** prior consent for transfers and assignments, among others. The lease is subject to approval by the Port Commission and the Board of Supervisors.

The remainder of this staff report provides background information and discusses the Site, accomplishments to date, and key terms being proposed for the ENA amendment, LDDA and the Lease. At the September 25 Port Commission meeting, Port staff intends to request the Port Commission's consideration and approval of an amendment to the ENA. In February 2019, Port staff will seek Port Commission's consideration and approval of the LDDA, the Lease, and the Development's schematic design, findings that the Project is consistent with applicable regulations, and authorization for the Executive Director to seek necessary approvals for the proposed LDDA and Lease from the Board of Supervisors.

STRATEGIC OBJECTIVE

The Development, if approved and implemented, is expected to contribute in a substantial way to meeting the *livability, sustainability, and economic vitality objectives* of the Port's Strategic Plan.

- *Livability Objectives*: The Development will create living wage jobs and provide business opportunities for local businesses. Under the City's music and culture sustainability policy, as articulated in Chapter 90A of the Administrative Code, the City "is committed to supporting and encouraging the use of City and County property, including Port property, for indoor and outdoor music and other cultural events" and is committed to preserving and enhancing San Francisco's music and performance venues from displacement due to development.

- *Sustainability Objectives*: The Development is expected to incorporate a variety of sustainable practices including environmentally sensitive demolition techniques, recycling of demolition and construction waste, use of recycled construction materials, installation of high-efficiency building systems and appliances, storm water management, zero waste operations, green building standards.

- *Economic Vitality Objectives*: Adding revenues from a hotel and dinner-theater operations diversifies the Port's asset portfolio and supports the durability of the Port's lease revenue. Changing the Site from its current use as a surface parking lot to its highest and best use[4] will maximize asset value and increase the income stream to the Port from the Site.

BACKGROUND

Site Description and Permitted Uses: Seawall Lots ("SWLs") 323 and 324 are two nearly triangular land parcels with a combined surface area of approximately 42,719 square feet with frontages on The Embarcadero, Broadway, Davis and Vallejo Streets. They are to be developed with the two abutting right-of-way parcels ("Paper Streets") that form the terminus of Vallejo Street and Davis Street as they intersect The Embarcadero. The four parcels, SWLs 323 and 324 and the two Paper Streets, have a combined land area of 57,170 square feet and these four parcels form the Site. The Site is currently paved with asphalt, striped for 227 self-parked stalls, and leased on an interim basis to a parking operator, SP Plus-Hide Parking Joint Venture (the "SP+Hide"), for surface parking lot operation. This parking operation generated approximately $850,000 in 2014-2015, $739,309 in 2015-2016, and $667,172 in 2016-2017 in net fiscal year revenues to the Port. This decline is due to (a) transition period learning curve as the lot transitioned from one operator to two other operators between 2015 and 2017, and (b) impact of new transit options from Uber, Lift, Chariot, electric scooters, etc. SP+Hide, the new operator, has made new improvements to the lot, improved

[4] Highest and best use is defined as the use allowed under current zoning which returns the highest land value.

signage and increased marketing efforts to increase revenue to meet the $960,000 minimum annual base rent set in the new lease for the lot.

Hotel, entertainment, theater, retail, and public open space, among others, are listed as acceptable uses for SWLs 323 and 324 in the Port's Waterfront Land Use Plan, the City Planning Department's Northeastern Waterfront Subarea Plan, and the Planning Department's Northeast Embarcadero Study. The Site is located in the Northeast Waterfront Historic District and within a C-2 (Community Business) zoning district and a 40-X Height and Bulk district. These lots are subject to the common law public trust doctrine, as well as to the terms and conditions of the Burton Act, which is the trust grant from the State of California to the City (sometimes referred to collectively as the "public trust").

Teatro ZinZanni and Relocation Plan: Teatro is a popular dinner theater performed in a historic Spiegel tent, which provides a big top setting for live music, comedy, and acrobatic entertainment. It is a unique hybrid of comedy, theater, music and dining that is part circus and part cabaret. It combines improvisational comedy, vaudeville revue, music, dance, and cirque into an engaging performance. It operates a venue in Seattle, Washington and operated a venue in San Francisco until 2011.

Teatro and the Port entered into a lease in 1999 for Teatro to use a portion of Piers of 27 and 29 for its dinner theater and cabaret operations (the "Theater Lease"). The Theater Lease was amended a number of times; it expired in 2005, and continued on a holdover month-to-month basis until 2011. To accommodate the 34th America's Cup and the construction of the new James R. Herman Cruise Terminal at Pier 27, the Port and Teatro mutually agreed to terminate the Theater Lease and identified a portion of SWL 324 as a potential relocation site. If Teatro satisfied certain pre-conditions (such as project design compatible with the Northeast Waterfront Historic District, completion of environmental review, etc., the parties would enter into a new lease for a portion of SWL 324.

Project Sponsor: Teatro and Kenwood Investments formed TZK to undertake the Development. At approval of ENA in 2015, TZK was comprised of two-member companies: Kenwood Investments No. 6, LLC, a California limited liability company ("KWI #6") established by Kenwood Investments, and TZZ, LLC, a Washington limited liability company ("TZZ") established by Teatro ZinZanni. Recently, one of the founding members of TZK informed Port staff that PresidioCo Holdings, LLC ("Presidio") has been admitted into TZK's membership. This admission does not constitute a "Transfer" under the ENA that required Port's prior consent. TZK shared with Port staff that it sought to admit Presidio to increase TZK's hotel development capacity and ability to raise additional capital. In particular, the partnership is focused on successfully raising capital for the somewhat unusual combination hotel and dinner theater operating model and securing affiliation with one of the major hospitality brands, reservation systems, and management operation standards to meet capital requirements.

TZK provided Port staff information on Presidio's financial wherewithal and experience, particularly with hotel development capitalization, management, and operation. Presidio is reported to have owned and operated independent boutique properties, full-service conference center hotels, full-service resort hotels as well as select- and limited-service hospitality properties at different locations across the United States. Upon review, Port staff agrees that Presidio has both the experience and financial standing to assist TZK in achieving the ultimate goal of a new home for Teatro ZinZanni in San Francisco and a successful hotel on the Site.

PROJECT COMPONENTS

The Proposed Development: The Development was originally planned to include between 180-200 hotel rooms, a dinner-theater operated by TZZ's Teatro ZinZanni, 10 short-stay guestrooms for visiting artists, and ancillary space built to conform to the district's height and bulk limits (40X) along with an approximately 7,500 square-foot public open space. A single building with approximately 174,892 square feet of gross floor area was proposed to contain the hotel, short-stay guestrooms, and the dinner-theater. The hotel was planned to occupy approximately 146,591 square feet of the gross floor area with the remaining 28,301 square feet for the dinner-theater. The Development was projected then to cost $124 million funded with $64 million equity and $60 million debt.

With Presidio on board, the development has been further vetted but remains essentially as initially proposed - a single building with a 180-200 room hotel, an approximate 280-seat theater, entertainment, arts, restaurant/bar and cultural facility (collectively, the "Entertainment Venue") that will serve as the permanent home for Teatro's historic "Spiegeltent", and an approximate 14,000-square-foot privately financed public park. The building will have four above-grade floors (a ground floor and three upper floors) and the below-grade or basement level included in the initial proposal has been removed to reduce excavation and waterproofing costs. The back-of-the-house uses located in basement are moved to the first floor. The building footprint, site design, and exterior architectural and urban design features remain unchanged as all revisions are limited to the building interior and the proforma hotel room count has increased from 180 to 192 and re-measurement of park land area confirms that it is 14,000 (not 7,500) square feet. Throughout the process all parties have acknowledged that no Port or public funding is anticipated for the Development.

Table 2 below provides a summary comparing the initial proposal to the current proposal:

Table 2 – Comparison of the Initial and the Current Proposals		
	Initial Proposal-2015	**Current Proposal-2018**
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Site Area	59,750 sf	59,750 sf
Building	One 4-story building & roof top deck 182,932 gsf Included 17' basement for foundation system and back of house features	One 4-story building & roof top deck 147,880 gsf Removed 17' basement and replaced with a 6' foundation system; back of house features now on first and second floors
Number of Floors	4 above-grade floors – Levels 1 to 4 and one below-grade basement floor Levels 2-4 are for guest rooms Level 1 for common guest amenities and theater & Back-of-the house Basement for more back-of-house space and meeting spaces	4 above-grade – Levels 1 to 4 and no below-grade basement floor Levels 2-4 are for guest rooms Level 1 is common guest amenities, restaurant and bar, theater, back of house space and reduced meeting space
Hotel Rooms	146,591 sf hotel 180	118,000 sf hotel 192
Theater with Spiegeltent and Back of House Features	Attached and integrated in project 28,301 sf	Attached and integrated in project 29,570 sf
Public Park	7,500 sf	14,000 sf
Estimated Total Cost	$124 million	$135 million

Key development components are as follow:

The Entertainment Venue

The entertainment venue is proposed to include approximately 29,570 gross square feet to house the historic Spiegeltent and seating for the venue, kitchen, bar, bathrooms, welcoming areas, ticket booth, merchandise area, shared indoor public space, and back-of-house activities. This venue would be located inside a clear gazebo-like structure, constructed of glass and metal with steel or metal supports, at the northern end of the site adjacent to the public park. The glass gazebo-like structure would be clear to allow pedestrians walking past the structure to view the historic Spiegeltent and see through the backstage area during daylight hours. The structure's roofline would be glass with metal. This venue is expected to accommodate up to a maximum of 285 patrons and would operate from 8 a.m. to 2 a.m. Monday through Sunday.

This entertainment venue is planned to include a small outdoor raised stage area located at the south end of the public park, attached to the back-of-house portion of the entertainment venue. Operable doors on the northern side of the entertainment venue structure would open up onto the outdoor stage area. The operable doors would remain closed during regularly scheduled performances. The outdoor raised stage that would be located in the public park could be programmed and used for small-scale community and neighborhood events; small-scale theater performances by local schools and community groups; and other neighborhood events, such as weekly exercise classes or a children's dance or singing performance. The public park is only 14,000 square feet and has limited capacity because of its size, which would restrict the size of events that could take place. Activities that would occur in the public park would allow for passage of pedestrian traffic through the site.

The Hotel

The hotel component is proposed to include a total of approximately 118,000 gross square feet, of which 14,560 gross square feet would be at ground level for entry and drop-off areas for guests, the front desk, a concierge, gathering space, retail, restaurant and café uses, back-of-house uses, and elevator and stairwell access. The hotel would also include a restaurant and bar. Operating hours for the restaurant would be approximately 6 a.m. to midnight, 7 days a week. The bar portion of the hotel would be permitted to remain open until 2 a.m., although it is anticipated to close earlier on weekdays. The restaurant and bar are proposed to include an outdoor patio along the eastern side of the building, along The Embarcadero. Above the ground-level floor, the proposed project would include approximately three floors of hotel uses totaling 95,560 gross square feet and 192 hotel guest rooms. The hotel would also include an approximately 3,970-gross-square-foot rooftop deck, serving food and beverages from the hotel's bar and restaurant services, for use by hotel guests only. The roof would include screens for screening rooftop mechanical devices from the street and surrounding areas, as well as low-impact-design stormwater facilities and wind-protected outdoor spaces for hotel guests. The roof would be designed to accommodate a small array of solar panels.

The Public Park

The proposed Development would construct an approximately 14,000-gsf public park in the northern portion of the site parallel to The Embarcadero, as depicted in Exhibit "B," Proposed Project Drawings. The park would consist of both landscaping and hardscape, with benches and lighting in and around the park. The park would include pathways for pedestrian access from The Embarcadero through to Vallejo and Davis streets. The public park would provide space for a variety of informal activities, such as family and community picnics, and gatherings, neighborhood yoga and tai chi classes, programming for toddlers and young children, educational events for elementary school students, and pedestrian strolling, and sitting. The park would also include view mounds to allow visitors to "get up to see the bay," as well as moveable and permanent seating and tables, wayfaring, lighting, historic signage, and public art features. Additionally, the park would include iconic statuary art at the intersection of Davis and Vallejo streets, marking the park as an important destination across from the waterfront.

The public park would be used for informal passive activities on weekdays and weekends during normal business hours, subject to lease provision on compliance with the Port's Good Neighbor Standards. The park may also include temporary events, approximately one time per week, under the supervision of the project sponsor, in accordance with the terms and lease with the Port[5] and the City's event policies. Activities could involve hosting a food truck gathering, lunchtime music or lecture session, or activities related to local festivals or events in the vicinity or other parts of San Francisco, such as Sunday Streets. The public park may also be used for a pre-show activity related to the theater or hotel. For example, if a wedding were held at the hotel, guests could enjoy drinks outside before going inside for the celebration. Sound would be amplified only with the appropriate approvals, obtained in advance from the applicable City department(s).

TZK is responsible for maintenance of the public park, including trash removal and recycling systems, and security to keep the park clean and safe. The public park would be open 24 hours a day and would be supervised by private security hired by the project sponsor, unless actual usage or public safety concerns require less frequent late-night use. The Lease will include the negotiated roles the Port and TZK would have in setting the usage of park in light of demand and operation, maintenance and security costs.

The public park area is planned to provide San Francisco Fire Department (SFFD) with access to the site from The Embarcadero or Davis Street through Vallejo Street right-of-way. This access will also serve as the emergency-vehicle access point between The Embarcadero and Vallejo Street which will be protected by new movable bollards where none exist today.

Vehicle Parking/Loading/Bicycle Parking

The Development is proposed to not include off-street vehicle parking on the project site. Instead, parking is proposed to be provided through offsite parking and valet services. The proposed valet service would park hotel guests' vehicles at nearby off-street parking facilities. Several existing parking lots and parking structures are located near the Site. TZK is planning to send early and regular communication to patrons to encourage taking public transit, cabs, or ridesharing services to hotel and entertainment venue and would inform them of the many off-site, self-parking locations close to the theater, such as parking at 847 Front Street, Pier 19, 1000 Front Street, and One Maritime Plaza.

A new 80-foot-long curbside passenger loading space ("white curb") along the northern side of Broadway is being proposed to provide ingress and egress into the site for hotel guests, theater guests, and other patrons. The passenger loading space would be located adjacent to the hotel lobby entrance into the building and would be used in a curbside valet operation for hotel guests, theater guests, and other patrons and ride sharing drop-off.

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[5] The Guidelines & Application for Special Events, https://sfport.com/special-events-port, set forth the applicable regulations governing special events at Port property.

A loading zone for deliveries and services is proposed along the project frontage on the eastern side of Davis Street. The loading dock and service area would be used exclusively for deliveries, service providers including waste collection, and recycling and will include an audible and visual signal to alert pedestrians to truck movement at the dock.

Approximately 59 bicycle parking spaces, consisting of 20 *class I* bicycle parking spaces and 43 *class II* bicycle parking spaces are proposed for the Development. Access to the class I bicycle parking spaces would be via a secured door into the building along Davis Street and are reserved for use by hotel and other employees only. The 43 class II bicycle parking spaces would be located on the sidewalk in front of the project site (14 new spaces along Davis Street and 10 new spaces along The Embarcadero, in addition to 15 existing spaces along The Embarcadero). The location of bicycle parking spaces within the public ROW is subject to further review and approval by the San Francisco Municipal Transportation Agency (SFMTA), the Port, and San Francisco Public Works (SFPW).

Updated Development diagrams are attached as **Exhibit "B," Proposed Project Drawings**.

Current Status of the ENA

ENA Key Requirements and Performance Schedule: TZK has completed most of the key tasks it is required to complete under the ENA: it obtained endorsement of Term Sheet, reviewed the Site suitability for its proposal, conducted community outreach to stakeholders to gather input and keep community members informed, completed a majority of architectural and urban design review by the Planning Department, the Architectural Review Committee of the City Historic Preservation Commission, and the Waterfront Design Advisory Committee, and solicited and continued to solicit input from the applicable City departments to address City approval requirements. TZK is working to complete CEQA evaluation, procure all required land use entitlements for the Development, and complete negotiation of final terms and conditions to include the LDDA and the Lease.

The ENA will expire on November 4, 2018 unless the ENA is amended to extend its term. TZK needs additional time beyond the ENA expiration date to complete CEQA review, its financing plan, and LDDA and Lease negotiations. Port staff plans to seek Port Commission consideration and approval of an amendment to the ENA to extend its term.

Endorsement of the Term Sheet in 2016 does not commit the Port Commission to approve the Development, enter into the proposed LDDA, the Lease, or any other transaction document with TZK or take any other action. The Port will not take any discretionary actions in connection with the Development until it has reviewed and considered environmental documentation prepared in compliance with CEQA.

SUMMARY OF THE ENDORSED TERM SHEET

The purpose of the endorsed Term Sheet is to set forth the basic terms and conditions on which the Port and TZK agree to further negotiate and that will be refined and set forth in more detail in the proposed LDDA, the Lease, and related transaction documents. The Term Sheet was negotiated and endorsed in April 2016, approximately 28 months ago, and as such, Port staff and TZK representatives anticipate updating some of the terms and conditions to address the current project circumstances and the current market conditions.

Attached as **Exhibit "C,"** is the **Term Sheet** that Port Commission and Board of Supervisors endorsed in April and July 2016, respectively. Its key terms and conditions include:

1. **The Premises or Site:** Comprised of four parcels, SWLs 323 and 324, and the two Paper Streets, for a combined land area of 57,170 square feet. It will be leased in "As Is" condition.

2. **Development Program:** This is as described earlier in this Staff Report. *TZK has further vetted and updated the Development as of July 2018 as provided in this staff report. Please refer to Table 2 for more detail.*

3. **Total Development Cost and Sources of Funding**: TZK is responsible for funding the Development estimated to cost approximately $124 million, subject to escalations over time. TZK is responsible for paying all of the Port's transaction costs and for providing performance and payment bonds for the Development. *TZK has updated the total development cost to be $134 million as of July 2018.*

4. **LDDA term**: TZK is required to close escrow on a construction loan, among other things, within 12 months of the LDDA's effective date (subject to two 6-month extension options to close escrow, with fees).

5. **Complete Construction**: TZK must complete construction within 24 months after lease commencement, subject to two six-month extension options at a $50,000 fee for each extension.

6. **Liquidated Damages for Failure to Timely Complete Construction:** If TZK fails to complete construction within the 36-month period (24-month construction period plus the two 6-month extension periods), it must pay the Port $1,150 for each day it has yet to complete construction. This $1,150 per day is based on the average rent per day the Port will lose for the development failing to start operations on schedule.

7. **Lease Term:** 50 years initial term, plus one 16-year extension option. The 16-year extension is subject to TZK remaining as a "tenant in good standing" and having exercised the extension option within two years prior to the end of the initial term. This term is based on the Developer's need to attract required capital

investments, amortize the capital investment, and the Port's need to review the lease and development 48 years from now based on the then-existing conditions including sea level rise.

8. **Construction Period Rent:** The Minimum Base Rent of <u>$890,000</u> is set for Lease Years 1 and 2, when the development's improvements are being constructed. The rental amount is based on maintaining the current stream of income the Port is receiving from the Site while also recognizing that the Developer is not earning any revenue from the development.

9. **Operation Period Rent**: **Minimum Base Rent** <u>plus</u> **Percentage Rent** as defined below**.** The Developer will pay the Port the greater of the Minimum Base Rent or the Percentage Rent. The exact amount of percentage rent due to the Port will be confirmed at the end of the hotel operation's fiscal year when the required supporting financial reports are prepared.

10. **Minimum Base Rent for the first two years of the Operation Period**: The Minimum base Rent for Lease years 3 and 4 is set at **$915,000 per year** to allow the operation to address (a) unexpected or greater than expected start-up costs, (b) greater than expected operational expenses, and (c) lower-than-projected revenues because the new hotel has yet to establish a robust customer base. If the hotel operations do well by attaining 80% occupancy in either of these two years, TZK will pay the Port 90% of the applicable Percentage Rent, currently estimated at between $1,387 million and $1,788 million.

11. **Minimum Base Rent from third through fifth years of Operation Period**: Lease Years 5 through 7 *(Operation Period Years 3 through 5):* The Minimum Based Rent starts at **$1.366 million** and escalates annually by the annual increase in the Consumer Price Index for the Bay Area ("CPI"), with a minimum increase of 2.5% and a maximum increase of 3.5% annually until reset in the 11th year of the Operation Period. This arrangement sets a floor to protect the minimum base rent the Port will earn from the Site regardless of how the development is performing financially. It also provides protection for the Developer from larger than budgeted rental spikes. *[This last sentence means TZK can plan its operation budget knowing that the Minimum Base Rent will not crease beyond the 3.5% escalation.]*

12. **Minimum Base Rent Reset:** At the end of every 10-year interval of the Lease Term Operation Period, (beginning in the 13th Lease Year, Hotel Operation Period Year 11), the Minimum Base Rent will be reset to <u>**the greater**</u> of **(a)** then existing CPI-adjusted Minimum Base Rent <u>or</u> **(b)** 65% of the average of the five prior years percentage rents actually paid to the Port. This market reset recognizes the cyclical rental amounts the development is able to support while ensuring that the minimum base rent stays above the prior year minimum base rent to protect the Port against inflation.

13. **Percentage Rent:** <u>During Lease Years 3 to 7:</u> ***(Operation Period Years 1 to 5)***

The amount by which 3.5% of the Annual Gross Revenue from all of the Hotel operations plus 3.5% of the Annual Gross Revenue from all of the Dinner-Theater Operations (Teatro ZinZanni's Operations on the Site) exceeds Minimum Base Rent.

During Lease Years 8 to 12 **(Operation Period Years 6 to 10)**
The amount by which 4.5% of the Annual Gross Revenue from all of the Hotel operations plus 3.5% of the Annual Gross Revenue from all of the Dinner-Theater Operations exceeds Minimum Base Rent.

During Lease Years 13 to 22: **(Operation Period Years 11 through 20)**
The amount by which 5.5% of the Annual Gross Revenue from all of the Hotel operations plus 3.5% of the Annual Gross Revenue from all of the Dinner-Theater Operations exceeds Minimum Base Rent.

During Lease Years 23 to 50: **(Operation Period Years 21 through 48)**
The amount by which 6.5% of the Annual Gross Revenue from all of the Hotel operations plus 3.5% of the Annual Gross Revenue from all of the Dinner-Theater Operations exceeds Minimum Base Rent.

During Lease Years 51 to 66: **(Extension Period Years 49 to 64)**
The amount by which 6.5% of the Annual Gross Revenue from all of the Hotel operations plus 3.5% of the Annual Gross Revenue from all of the Dinner-Theater Operations exceeds Minimum Base Rent.

14. **TZK Equity Repayment and Return of Equity**: TZK is limited to earning 18% IRR on the actual amount of equity invested and after earning the 18% IRR, surplus cash flow will be shared at (i) 70%/30% (TZK/Port) until TZK receives a 25% IRR and then (ii) 60%/40% (TZK/Port): (a) During Period of No Refinance or Sale: After TZK has earned 18% IRR, surplus cash flow shall be shared at (i) 70%/30% (TZK/Port) until TZK receives a 25% IRR and then (ii) 60%/40% (TZK/Port) *and (b)* During Period of Refinance, Assignment, or Sale: After TZK has earned 18% IRR, surplus cash flow shall be shared at (i) 70%/30% (TZK/Port) until TZK receives a 25% IRR and then (ii) 60%/40% (TZK/Port).

15. **Competent Hotel Management Required:** TZK's final selection of a hotel management company or operator is subject to prior review, acceptance and approval by the Port Executive Director which will not be unreasonably withheld, delayed, or denied. The management agreement will be required to include a number of provisions, including the minimum number of years of hotel management experience, operation standards to maintain, Port's ability to require TZK to replace the hotel operator, etc.

16. **Sublease**: All subleases are subject to Port's prior consent and Port's percentage rent requirements, most of which may require negotiations.

17. **Leasehold Financing**: TZK will have the right to obtain project financing from bona fide institutional lenders secured by its leasehold interest.

18. **No Subordination of Port's Lease Interest:** TZK is not allowed to place any lien on Port's ownership of the Site.

19. **Public Open Space**: TZK is responsible for funding the construction, operation, and maintenance of the proposed public open space during the lease term.

20. **Sea Level Rise**: The relevant transactions documents will include the recommended provisions addressing seal level rise. TZK has express interest in working with the Port on addressing this issue.

21. **City and Other Standard Lease Requirements**: The relevant transactions documents will respond to all of the applicable Port and City requirements. These requirements are usually provided under the General Terms and Conditions of Port and City leases. They cover such topics as insurance requirements, non-discrimination requirements, hiring policies, etc.

ANALYSIS OF PROPOSED PROJECT - AS OF APRIL 2016

The following analysis is an excerpt from the April 21, 2016 staff report, and it is provided in this report to recall the economic expectation of the development as of April 2016. Market conditions have since changed and continue to change due to a number of factors, including escalating construction costs, tightening capital market underwriting requirements, ongoing interest rate hikes, and new trends in the hospitality market. Currently, lease negotiation is ongoing between TZK representatives and Port staff and will not be concluded until TZK has made further progress on procuring land use entitlements and its financing plan. Thereafter, Port staff expects TZK to submit updated proforma for review and analysis by Port and HVS, the economic and hospitality consultant assisting Port staff in comparing the proposed lease terms to similar terms in comparable leases and other market metrics. HVS stands for Hospitality Valuation and Services and it is a division of TS Worldwide. Any impact on the terms and conditions listed in the Term Sheet will be analyzed. Port staff will then update the below analysis section of this report to apprise the Port Commission of the impact of any proposed changes to the terms before seeking its consideration and approval of the final deal terms.

An Excerpt from April 21, 2016 Staff Report – Request for Term Sheet Endorsement.
This mixed-use Development that includes a boutique hotel (defined as such due to its scale and style); dinner-theater component that will be operated by Teatro ZinZanni; and a waterfront public open space that will be adjacent to The Embarcadero, collectively, is a creative proposal that leverages the Site's many attributes. It represents the highest and best use of the Site, based on the City's appraisal of the Site. The underlying fundamentals of San Francisco's hotel marketplace - e.g., strong demand driven by the city's status as one of the world's most favored travel

destinations, high-hotel occupancy (currently averaging 80% which exceeds the national average of 62%), and constrained supply of hotel rooms – combined with the Site's waterfront location, all clearly provide support for the proposal.

Preliminarily, the Development is deemed feasible barring any significant revisions to the current development concept and the related development assumptions. These assumptions include that the current estimated construction costs will remain within or near to the costs plus estimated contingency, that there will not be significant entitlement delays, that the real estate capital market will remain stable with no spikes in interest rates or dramatic change in commercial loan underwriting, and that the economy in general will remain stable.

The lease payment terms in the draft Term Sheet were set to ensure that the minimum base rent to the Port would not dip below the current revenues generated by the surface parking lot. ***Figures 1*** *and* ***2*** *illustrate a 20-year projection of lease revenues to the Port from:*

- ***Existing use.*** *Surface parking operations (based on the last four years of operations and five-year revenue projections from Real Estate staff).*
- ***Proposed hotel development, base rent.*** *TZK minimum base rent in draft Term Sheet (assuming no market resets, as described in (12), above).*
- ***Proposed hotel development, projected rent.*** *TZK projected rent to the Port (based on hotel revenue projections).*

As shown, the existing use is projected to generate $14.2 million over 20 years (in net present terms) compared to the guaranteed base rent in the TZK draft Term Sheet of $17.1 million and the projected rent to the Port in the TZK draft Term Sheet of $29.0 million. Note that a longer projection (e.g., through years 50 or 66) would show an even greater divide between the financial outcomes to the Port from the continued use of the land as a surface parking lot compared to the proposed hotel development.

Figure 1. Lease Revenues to the Port
Net Present Value Projections (20 years, 6% discount rate)
Surface Parking Lot, TZK Base Rent, TZK Projected Rent

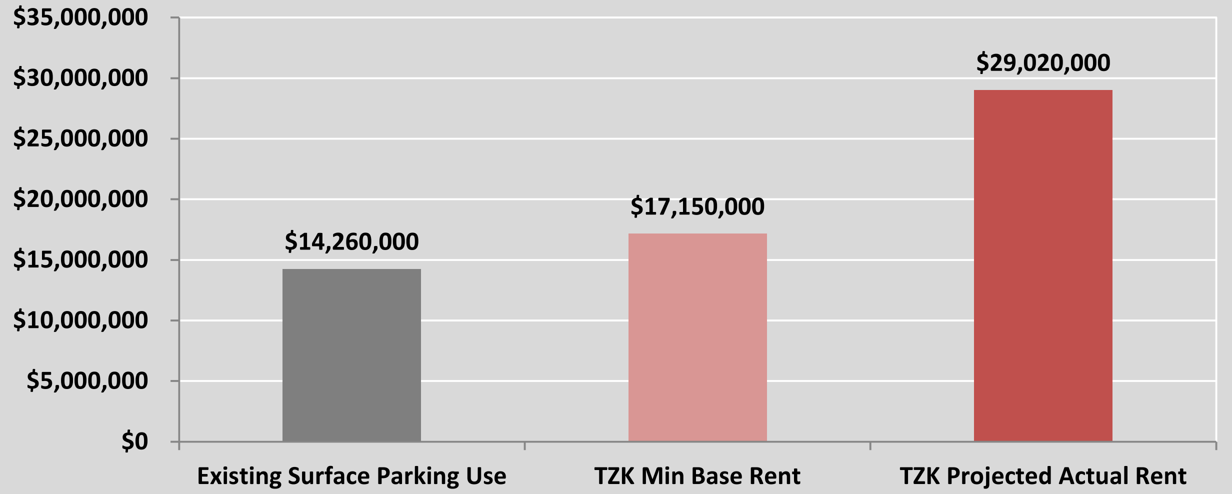

Figure 2. Lease Revenues tothe Port
Surface Parking Lot, TZK Base Rent, TZK Projected Rent

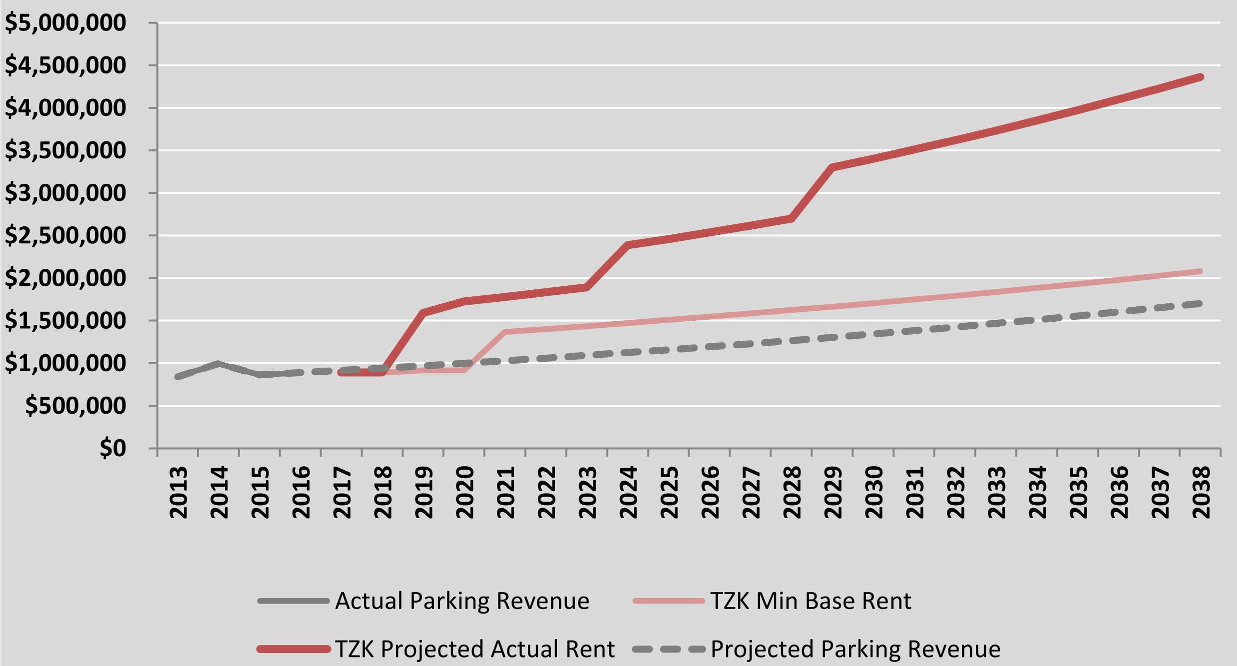

Table 3 *presents projected gross revenues for the hotel operations (from lodging, food and beverages and miscellaneous operations), projected gross revenues for Teatro's dinner-theater operations (from ticket sales, food and beverages and miscellaneous*

*operations), minimum base rents to the Port with annual escalations, percentage rent, and the expected high and low annual net rent to the Port under the lease based on the Term Sheet. Row 13 in **Table 3** presents net projected annual rent to the Port starting from construction period at $890,000 per year and gradually increasing to $2.692 million in Operational Year 10 and $4.352 million in Operational Year 20.*

Focusing only on minimum base rents, projected (minimum base) rent starts from $890,000 (row 3) and increases through annual escalations and markets reset to approximately $2.079 million per year in the 20th year of the development operation phase (row 21). Percentage rent is projected to generate $1.778 million per year from Operational Year 3 (row 12) and rises through a series of preset percentage rate increase, from 3.5% against all gross revenues to 4.5% and 5.5% against hotel gross revenue plus 3.5% against the dinner-theater gross revenue to approximately $4.352 million per year in the 20th year of the development operation. Percentage rent increases once more during the lease term, to 6.5% against hotel gross revenue plus the 3.5% against the diner-theater gross revenue, in the 21st year of the development operation phase.

Projected gross revenue for the hotel and dinner-theater is forecasted at $45 million for the first year of operations, increasing to $61 million by the 10th year of operations, and continued increases to approximately $74 million by the 20th year of operations. These projections have been verified and confirmed by the Hotel Feasibility Study[6] that Port staff procured as part of Port's due diligence. The forecasted revenues support the estimated $64 million of equity and $60 million of debt proposed to fund the $124 million of estimated total development cost.

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[6] http://sfport.com/sites/default/files/HVS%20Market%20Study%20-%20Proposed%20Waterfront%20Development%20-%20FINAL.011516.pdf

Table 3 – Projected Revenues on the Term Sheet for Lease Years 1 to 22
Projected Lease revenues for the Port ($000s)

Row	Base Year	Factor	2015	2016	2017	2018	Year 1 2019	Year 2 2020	Year 3 2021	Year 4 2022	Year 5 2023	Year 6 2024	Year 7 2025	Year 8 2026	Year 9 2027	Year 10 2028	
			Construction Period				Operation Period										
							Stabilization Period		Full Operation Period								
1	**Base Rent**																
2	Baseline Rent, Assumed Escalation/yr:	2.50%	$1,100	$1,128	$1,156	$1,185	$1,185	$1,214	$1,245	$1,276	$1,308	$1,340	$1,374	$1,408	$1,443	$1,479	
3	**TZK Project: Negotiated Minimum Base Rent**				**$890**	**$890**	**$915**	**$915**	**$1,366**	**$1,400**	**$1,435**	**$1,471**	**$1,508**	**$1,546**	**$1,584**	**$1,624**	
4	Compare: Baseline Row 2| TKZ Negotiated Min. Base Rent Row 3				77%	75%	77%	75%	110%	110%	110%	110%	110%	110%	110%	110%	
5	**Negotiated Percentage Rent**																
6	Gross Hotel Revenue, Assumed Escalation/yr:	3.33%					$34,693	$38,350	$39,627	$40,947	$42,310	$43,719	$45,175	$46,679	$48,234	$49,840	
7	Gross Theater Revenue, Assumed Escalation/yr:	2.00%					$10,745	$10,959	$11,179	$11,403	$11,631	$11,863	$12,101	$12,343	$12,589	$12,841	
8	Projected Percentage Rent to the Port:																
9	From Hotel Operations Years 1 though 5	3.50%					$1,093	$1,208	$1,387	$1,433	$1,481						
10	From Hotel Operations Years 6 though 10	4.50%										$1,967	$2,033	$2,101	$2,171	$2,243	
11	From Theater Operations	3.50%					$376	$384	$391	$399	$407	$415	$424	$432	$441	$449	
12	**Total Percentage Rent**						**$1,469**	**$1,592**	**$1,778**	**$1,832**	**$1,888**	**$2,383**	**$2,456**	**$2,533**	**$2,611**	**$2,692**	
13	**Scheduled Lease Payment to Port**				**$890**	**$890**	**$915**	**$915**	**$1,778**	**$1,832**	**$1,888**	**$2,383**	**$2,456**	**$2,533**	**$2,611**	**$2,692**	
14	**Minimum Base Rent Adjustment at end of Operation Year 10**																
15	65% of the average of the 5 prior years , OR	65%															$1,648
16	Minimum Base Rent Inflated																$1,664
17	**Estimated Minimum Base Rent to start Operational Year 11**																**$1,664**

Row	Base Year	Factor	11 2029	12 2030	13 2031	14 2032	15 2033	16 2034	17 2035	18 2036	19 2037	20 2038	
			Operation Period										
			Full Operation Period										
18	**Base Year**	Factor											
19	**Base Rent**												
20	Baseline Rent, Assumed Escalation/yr:	2.50%	$1,516	$1,554	$1,593	$1,633	$1,674	$1,716	$1,759	$1,802	$1,848	$1,894	
21	**TZK Project: Negotiated Minimum Base Rent**		**$1,664**	**$1,706**	**$1,749**	**$1,792**	**$1,837**	**$1,883**	**$1,930**	**$1,978**	**$2,028**	**$2,079**	
22	Compare: Baseline Row 20| TKZ Negotiated Min. Base Rent Rown 21		110%	110%	110%	110%	110%	110%	110%	110%	110%	110%	
23	**Negotiated Percentage Rent**												
24	Gross Hotel Revenue, Assumed Escalation/yr:	3.33%	$51,500	$53,214	$54,987	$56,818	$58,710	$60,665	$62,685	$64,772	$66,929	$69,158	
25	Gross Theater Revenue, Assumed Escalation/yr:	2.00%	$13,098	$13,360	$13,627	$13,900	$14,178	$14,461	$14,750	$15,045	$15,346	$15,653	
26	Projected Percentage Rent to the Port:												
27	From Hotel Operations Years 11 though 20	5.50%	$2,832	$2,927	$3,024	$3,125	$3,229	$3,337	$3,448	$3,562	$3,681	$3,804	
28	From Theater Operations	3.50%	$458	$468	$477	$486	$496	$506	$516	$527	$537	$548	
29	**Total Percentage Rent**		**$3,291**	**$3,394**	**$3,501**	**$3,611**	**$3,725**	**$3,843**	**$3,964**	**$4,089**	**$4,218**	**$4,352**	
30	**Scheduled Lease Payment to Port**		**$3,291**	**$3,394**	**$3,501**	**$3,611**	**$3,725**	**$3,843**	**$3,964**	**$4,089**	**$4,218**	**$4,352**	
31	**Minimum Base Rent Adjustment at end of Operation Year 10**												
32	65% of the average of the 5 prior years , OR	65%											$2,661
33	Minimum Base Rent Inflated												$2,130
34	**Estimated Minimum Base Rent to start Operational Year 11**												**$2,661**

FURTHER PROJECT REVIEW

After TZK has submitted updated proforma for Port staff and HVS review and analysis, a new analysis of the updated terms and conditions will be provided to the Port Commission before seeking its consideration and approval of the final deal terms in the LDDA and Lease.

Community Outreach

Representatives of TZK and Teatro ZinZanni remain committed to thorough public involvement in the review of the proposed development. They have continued to conduct engaging outreach to stakeholders, including meeting with the Barbary Coast Neighborhood Association, Golden Gateway Tenants Association and Gateway Commons Board of Directors. With assistance from Port staff, they have presented the proposed development concept to the Northeast Waterfront Advisory Group ("NEWAG"). Members of NEWAG continue to express support for the proposals. Both Port staff and the TZK and Teatro representatives will continue to apprise NEWAG of key project developments.

Approval Process

TZK has completed most of the key tasks it is required to complete under the ENA as reported earlier in this staff report. TZK is working to complete CEQA evaluation, procure all required land use entitlements for the Development and complete negotiation of final terms and conditions of the LDDA and the Lease, and seek Port Commission approval in February 2019.

Timeline/Next Steps

Port Commission approval of an amendment to the ENA	September 2018
TZK to complete CEQA review and evaluation	November 2018
Historic Preservation Commission	December 2018
Planning Commission approval	January 2019
Complete lease negotiations	January 2019
Port Commission approval of the LDDA and Lease	February 2019
Board of Supervisors' approval of the Lease	March 2019

Prepared by: Ricky Tijani
Development Project Manager

Through: Rebecca Benassini, Assistant Deputy Director
Waterfront Development

For: Michael Martin, Deputy Director
Real Estate & Development

Exhibits:
"A," Site Map
"B," Proposed Project Drawings
"C," Endorsed Term Sheet

Exhibit “A”
Site Map

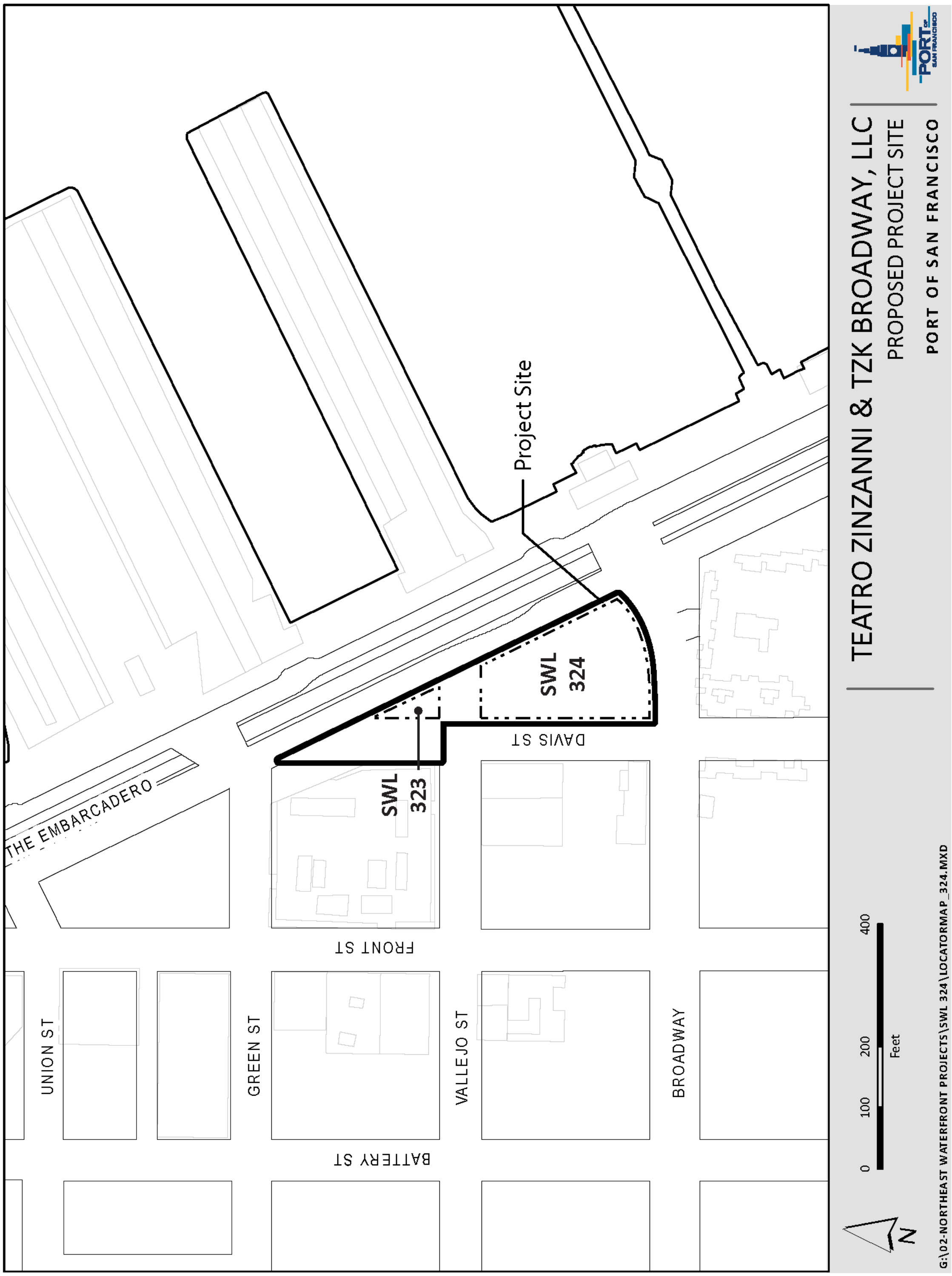

Exhibit "C"

Endorsed Port-TZK TERM SHEET

(April 4, 2016)

As required in the Exclusive Negotiating Agreement (ENA) executed September 10, 2015, this Term Sheet sets forth the basic terms and conditions on which the parties agree to further negotiate and that will be refined and set forth in more detail in the lease disposition and development agreement ("**LDDA**"), the lease (the "**Lease**"), and related transaction documents between Port and TZK Broadway, LLC. ("**TZK**" or "Developer" or "Tenant").

This Term Sheet is not intended to be, and will not become, contractually binding unless and until environmental review has been completed in compliance with the California Environmental Quality Act and the parties are able and willing to execute and deliver a mutually acceptable LDDA, Lease and related transaction documents regarding the Project. In addition, under San Francisco Charter, no officer or employee of the City and County of San Francisco (the "**City**") has authority to commit the City to the transaction contemplated herein unless and until the San Francisco Port Commission has approved the transaction documents and the San Francisco Board of Supervisors has approved the form of Lease.

1.	Parties:	Developer/Tenant: TZK Broadway LLC, a California limited liability company ("TZK" or "Developer" or "Tenant") which is comprised of two member companies: Kenwood Investments No. 6, LLC, a California limited liability company ("KWI #6") and TZZ, LLC, a Washington limited liability company ("TZZ") established by Teatro ZinZanni. Landlord: City and County of San Francisco (the "**City**"), acting by and through the San Francisco Port Commission (the "**Port**")
2.	Key Party:	KWI #6 may not transfer more than 50% of its legal and beneficial interest in TZK without the Port's prior consent which shall not be unreasonably withheld, conditioned or delayed. TZZ may not transfer any of its legal and beneficial interest in Tenant without the Port's prior consent which may be withheld in its sole discretion prior to issuance of a certificate of completion, and which shall not be unreasonably withheld, conditioned or delayed after issuance of a certificate of completion. It shall be reasonable for Port to withhold its consent if any transfer of interest would result in the suspension or closure, whether permanent or temporary, of the dinner theater component of the Project during the minimum number of lease years the dinner-theater is required to serve its marquee and catalyst role on the waterfront pursuant to

the City's music and culture sustainability policy (City Admin Code Chapter 90A).

3. <u>Premises or Site:</u> Approximately 57,180 square feet of Seawall Lots 323 and 324 ("SWLs"), and portions of the unimproved Vallejo Street right-of-way on the west side of the Embarcadero at Vallejo Street ("ROWs"), as depicted on the attached **Exhibit "A,"** Site Map, subject to Board of Supervisors' approval of any jurisdictional transfer of the ROWs to Port at no cost to Port or any other approval required from any other City agency for use of the ROWs for the proposed Project.

4. <u>Proposed Development Program:</u> A mixed-use development including a theater and hotel built to conform to the district's height and bulk limits (40X) with allowed rooftop appurtenances, rooftop hotel open space, and new public open space in the northern most part of the Premises. The mixed-use development includes:

a. 180-200 room boutique hotel,

b. approximately 28,301 square feet of dinner-theater-performance space which will be operated by TZZ's Teatro ZinZanni,

c. subject to State Lands approval, no more than 10 hotel rooms at any given time for use by artists from outside the Bay Area performing at the theater on a short-term basis, and

d. approximately 7,500 square-foot public park (collectively, the "**Project**"), all to be built on the Premises at Tenant's sole cost and subject to all required approvals.

A single building with approximately 174,892 square-foot of gross floor area will contain the hotel, short-stay guestrooms, and the dinner-theater. The hotel will occupy approximately 146,591 square-foot of the gross floor area with remaining 28,301 square-feet for the dinner-theater-performance space. A more complete description of the Project is attached as **Exhibit "B," Preliminary Project Description**."

5. <u>Total Development Cost and Sources of Funding:</u>

Tenant is solely responsible for the funding of the proposed Project estimated to cost approximately $124 million as of March 2016, subject to escalations over time. Tenant has indicated that it will fund the development with approximately $60 million of debt and $64 million in equity subject to the IRR hurdle rates set forth in Number 18 below.

6. <u>LDDA Effective Date and Period to Close Escrow:</u>

The LDDA Effective Date shall begin on the date the Parties fully execute the LDDA (which shall be not more than three (3) months after the Board of Supervisors' approval of the proposed LDDA, if applicable, with the form of Lease attached to the LDDA) and the LDDA shall terminate at the earlier of the date a Certificate of Completion is issued for the Project or the termination of the LDDA Term, subject to two six-month extensions.

Tenant must close escrow ("COE") within 12 months of LDDA Effective Date subject to two six-month extension options so long as Tenant is not then in default under the LDDA, upon payment of an extension fee described in item **Error! Reference source not found.** below. The LDDA terminates if COE does not occur within such time period, subject to force majeure events.

7. <u>LDDA Key Issues to Address:</u>

Specifically, among other matters:

a. The conditions to the Close of Escrow

b. The Delivery of the Site under the Lease,

c. The scope of the Developer's obligations to construct the Project,

d. The Schedule of Performance for various obligations and performance benchmarks, including provisions for defined force majeure events,

e. Certain First Source Hiring Program, LBEs, Local Hire, and Prevailing Wage Provisions, and

f. The required financing for construction of the proposed improvements.

8.	LDDA Fee:	Tenant shall pay the Port an LDDA fee in the amount of \$37,500 for the initial 12-month period before COE and \$50,000 for each 6-month extension period, as consideration for having exclusivity over the Premises during the LDDA Term, (the "L**DDA Fee**"). The LDDA fee will not be prorated.
9.	LDDA Termination Fee and Assignment of Project Materials:	If the LDDA terminates before the Close of Escrow, due solely to a Tenant Event of Default, then Tenant agrees to pay to Port as liquidated damages a termination fee (the "L**DDA Termination Fee**") in the amount of \$50,000 and assign to Port all of its consultant's work products, including entitlements received to date. If a third-party seeks to obtain and use the work product assigned to the Port, the third-party will be required to negotiate appropriate compensation for the incremental value of the work product.
10.	Period to Complete Construction; Extension Fee; Liquidated Damages for Failure to Timely Complete:	Tenant must complete construction within the 24-months after lease commencement subject to two six-month extension options at a \$50,000 fee for each extension. **Liquidated Damages for Failure to Timely Complete Construction**: If Tenant fails to complete the construction of the Project within the 36-month period the (24-month construction period plus the two 6-month extension periods and extensions for force majeure events) Tenant shall pay Port \$1,150 for each day after the 36-month period has been exhausted and Tenant has yet to complete construction.
11.	Reimbursement of Port's Transaction Costs:	Developer will reimburse Port for all of Port's actual direct transaction costs incurred during the term of the LDDA, including any extension periods based on the actual direct costs incurred by the Port as demonstrated by a written invoice provided by the Port. The Developer will deposit quarterly a \$45,000 Payment Advance to be applied towards Port's transaction cost. Underpayment and overpayment shall be subject the provisions similar to those under the ENA Section 4.2. There is no cap on the total amount of reimbursable Port's transaction costs. Accrual of new reimbursable transaction costs shall cease upon issuance of the Certificate of Completion. Developer's obligation to reimburse the Port for accrued

unpaid transaction costs shall survive the expiration, termination or issuance of the Certificate of Completion.

12.	Performance and Payment Bond:	Tenant or its General Contractor(s) will provide the Port with Performance and Payment Bonds or other forms of acceptable credit enhancements, guaranteeing completion of construction of the proposed improvements to the Premises, including timely payment of all construction materials and labor, and all applicable fees.
13.	Lease Term:	50 years, plus one 16-year extension option. The 16-year extension option shall be at Tenant's sole and exclusive option, subject to Tenant not being in default under the lease, Tenant having exercised the option to extend no later than two years prior to the end of the Initial Term and Port's review of then-existing conditions including sea level rise.
14.	Lease Commencement Date:	Close of Escrow under the LDDA.
15.	Construction Period Rent:	**Lease Years 1 and 2:** For the period commencing as of the close of escrow and ending upon the earlier of issuance of the final certificate of occupancy for the hotel or 24 months after Lease Commencement Date. Construction Period Rent is set at **$890,000 per year**. Rents to be paid monthly in advance.
16.	Minimum Rent Commencement Date:	Commencing from the earlier of issuance of the final certificate of occupancy for the hotel or 24 months after Lease Commencement Date.
17.	*Minimum Base Rent and Percentage Rent:	**Lease Years 3 and 4**: **(Project Operation Years 1 and 2)**: The Greater of: • Minimum Base Rent: The Greater of: **$915,000 per year** Or • 90% of the percentage rent (i.e. 3.5% of Hotel

Gross Revenues) if the hotel has 80% occupancy on an annual basis during the prior year

Lease Years 5-7: (Project Operation Years 3, 4 and 5):

Greater of:
Minimum Base Rent: $1,366,000 escalated annually by the annual increase of the Consumer Price Index ("CPI") for the Bay Area subject to a minimum increase of 2.5% and the maximum increase of 3.5% annually.
Or

- Percentage Rent: 3.5% of Hotel Gross Revenues plus 3.5%** of Gross Revenue from Dinner-Theater operations

Lease Years 8 through 12:

(Project Operation Years 5 through 10):

The Greater of:

- **Minimum Rent:** The then existing minimum base rent escalated annually by the annual increase of the CPI subject to a minimum increase of 2.5% and a maximum increase of 3.5% annually

Or

- Percentage Rent: 4.5% of Hotel Gross Revenues plus 3.5%* of Gross Revenue from Dinner-Theater operations

Lease Years 13 through 22:

(Project Operation Years 11 through 20):

The Greater of:
- Minimum Base Rent: The then existing minimum base rent reset in Lease Year 13 at greater of Lease Year 12 Minimum Base Rent escalated annually by the annual increase of the CPI subject to a minimum increase of 2.5% increase and a maximum 3.5% increase or 65% of the average of the prior 5-year percentage rent.

Or

- Percentage Rent: 5.5% of Hotel Gross Revenues plus 3.5% of Gross Revenue from Dinner-Theater operations;

- **<u>Years 23 through 50</u>**:
(Project Operation Years 21 through 48):

The Greater of:

- Minimum Base Rent: The then existing minimum base rent reset in Lease Year 23 escalated annually by the annual increase of the CPI subject to a minimum increase of 2.5% increase and a maximum 3.5% increase or 65% of the average of the prior 5-year percentage rent. Minimum base rent reset at Lease Years 33 and 43 at greater of Lease Years 32 and 42 Minimum Base Rent escalated at between 2.5% to 3.5% annually based on CPI, respectively, or 65% of the average of the prior 5-year percentage rent. Minimum Base Rent escalates annually at between 2.5% to 3.5% annually based on CPI

Or:

- Percentage Rent: 6.5% of Hotel Gross Revenues plus 3.5% of Gross Revenue from Dinner-Theater operations.

- **<u>The 16-year Extension Period</u>**:

- **<u>Years 51 through 66</u>**
(Project Operation Years 49 through 64):

The Greater of:

- Minimum Base Rent: Lease Year 53 Minimum Base Rent greater of Year 52 Minimum Base Rent escalated annually by the annual increase of the CPI subject to a minimum increase of 2.5% and a maximum of 3.5% annually or 65% of the average of the prior 5-year percentage rent. Minimum Base Rent Reset Lease Year 63 at 65% of the average of the prior 5-year percentage rent and shall be no less than the prior year Minimum Based Rent escalated at between 2.5% to 3.5% annually based on CPI

Or:

- Percentage Rent: 6.5% of Hotel Gross Revenues plus 3.5% of Gross Revenue from Dinner-Theater operations.

*The above Minimum Base Rent are projections based on the assumption that the Tenant Project Timeline will be met; however, if there is any delay that results in a longer time for entitlement and construction, then the Minimum Base Rent will be escalated for the time lapsed to reflect the time-adjustment Minimum Base Rent.

**If the existing space for the dinner theater operations is no longer used for dinner theater operations, then the 3.5% percentage rent will be subject to negotiation between the parties such that the percentage rent for the use on such space is in line with other Port retail leases.

A table of the projected Minimum Base Rent during the Term shall be attached to the Lease.

18. <u>Equity Repayment and Return on Equity:</u>

Tenant is limited to earn 18% IRR on actual equity capital invested ("Actual Equity Capital Invested") in the Project and after earning the 18% IRR, surplus cash flow shall be shared at (i) 70/30 (Tenant/Port) until Tenant receives a 25% IRR and then (ii) 60/40 (Tenant/Port) (collectively, the "IRR Hurdle Rates"). With respect to Tenant only, Actual Equity Capital Invested is defined as the actual amount of money Tenant invests in the Project as "Total Project Costs" through project completion, less tax credit equity, debt, and Port capital contributions made to the Project, if any. The Total Project Cost includes Tenant's costs directly related to the development and construction of the Project incurred from and after the effective date of the ENA until and including opening of the hotel to the public as follows: (i) Tenant's hard and soft fees and costs for design, government relations, development, permit processing, impact fees, insurance, and general and administration costs; (ii) all construction costs and fees, including all materials costs and fees, and contractor and subcontractor overhead costs and fees, insurance and performance and payment bonds and costs, and general and administrative costs and fees; (iv) all legal and other professional costs and fees, (v) all financing costs and fees that are capitalized, (vi) all project-related expenses of Tenant, including reasonable costs incurred in opening the hotel and dinner theater and a proportionate share of Tenant's overhead such as salaries paid by Tenant for employees below the level of manager working directly on the Project, and (vii) a development fee of 5% of hard costs during the development phase of the Project.

The above definition of "Actual Equity Capital Invested" does not apply to subsequent Tenants."

Subject to Port's prior consent, which shall not be unreasonably conditioned, withheld, delayed or denied, future equity invested in the Project shall be entitled to receive the approved IRR Hurdle Rate on its invested equity based only on those amounts of equity that are actually invested into the acquisition, maintenance and operation of the Project, and not for a future equity investor's employment costs or management fees.

19. Port's Share of Excess Cash Flow:

After Tenant has earned 18% IRR, Tenant, surplus cash flow shall be shared at (i) 70/30 (Tenant/Port) until TZK receives a 25% IRR and then (ii) 60/40 (Tenant/Port).

20. Port Share of Transfer and Refinance Proceeds:

After Tenant has earned 18% IRR, net transfer and refinance proceeds shall be shared at (i) 70/30 (Tenant/Port) until Tenant receives a 25% IRR and then (ii) 60/40 (Tenant/Port).

Net transfer proceeds mean all consideration received by or for the account of Tenant in connection with a Transfer less costs incurred in connection with the Transfer, such as legal and broker fees, and transfer proceeds applied so that Tenant can hit either the initial minimum IRR or subsequent IRR so that Port may share in the remaining net transfer proceeds, as further defined in the lease

Net Refinancing proceeds means all funds disbursed by a lender, less (i) funds used (a) to take out any existing loans secured by the leasehold estate, if any, (b) directly for the maintenance and repair of the project, (ii) legal fees associated with the financing, (iii) funds applied so that Tenant can hit either the initial minimum IRR or subsequent IRR so that Port may share in the remaining net refinancing proceeds, all as further refined in the lease.

21. <u>Security Deposit:</u> Within 30 days prior to the applicable period, Tenant shall provide the Port with a Security Deposit in the following amounts:

a Two months of Construction Period Rent prior to the commencement of the Construction Period,

b Tenant shall increase its Security Deposit every year prior to annual increase of Minimum Base Rent such that the security deposit always equals no less than 2 months of the then Minimum Base Rent.

22. <u>Environmental Oversight Deposit:</u> No later than 60 days prior to estimated opening date of the hotel, Tenant shall provide the Port with its operations plan related to use, storage and disposal of hazardous materials in the Project, which plan will include a list of hazardous materials and their quantities, in the Project. After Port's review of the operations plan, Port may require tenant to deposit an Environmental Oversight Deposit which can be provided through a cash deposit, a letter of credit or other mutually acceptable form of credit enhancement.

23. <u>Payment of Impositions</u> Tenant shall pay when due all impositions, such as possessory tax, license fee, or periodic permits, as applicable.

24. <u>Uses:</u> Approximately 180-200 room hotel, retail/commercial on the ground floor, dinner theater, and privately financed public park. Any change in use of the dinner-theater-performance space will be subject to Port's prior written consent, which consent will not be unreasonably withheld, conditioned or delayed.

25. <u>As-Is Condition:</u> Premises will be delivered in its as-is condition. Port will provide to Tenant all prior studies and reports in its possession pertaining to the Premises in advance of executing the LDDA.

26. <u>Assignment:</u>

<u>Prior to completion of the Project and during the first seven (7) years of the Lease</u>

Tenant may not assign its interest in the LDDA or Lease, as applicable, without the prior written consent of the Port Commission subject to the following: Developer acknowledges that Port is entering into the LDDA and/or Lease on the basis of Developer's special skills, capabilities, and experience. This LDDA and the Lease are personal to Developer and neither may not be Transferred without the Port Commission's prior consent, which consent may not be unreasonably withheld, conditioned or delayed; provided, however, it will be reasonable for Port to withhold its consent to any assignment or transfer (i) that would result in a change in use of the dinner-theater operations and location and provided Port approves of the change in use, the percentage rent owed to Port from the gross revenues from such new use is less than the percentage rent received by Port for similar uses, or (ii) the initial and subsequent IRR thresholds are not reduced to account for the assignee's or transferee's reduced risk on its investment in the Project.

Under the LDDA and/or Lease, "**Transfer**" means: (1) dissolution, merger, consolidation, or other reorganization; (2) any cumulative or aggregate sale, assignment, encumbrance, or other transfer of (i) fifty (50) percent or more of, as applicable, Kenwood's or Tenant's legal or beneficial interests in Developer, or (ii) any percentage of TZZ's legal or beneficial interests in Developer, if applicable; (3) the withdrawal or substitution (whether voluntary, involuntary, or by operation of law and whether occurring at one time or over a period of time) of any member of Developer owning ten (10) percent or more of the interests in Developer or rights to its capital or profits; (4) the occurrence of any of the events described in (1), (2), or (3) with respect to either Kenwood Investments, LLC No. 6 or TZZ, LLC, or such other entity related to any subsequent assignee or transferee Port requires in connection with the applicable assignment or transfer; or (5) Darius Anderson or Norman Langill are no longer actively involved in the day-to-day operations of the Project.

No Transfer made with Port's consent, or as herein otherwise permitted, will be effective unless and until Port receives within thirty (30) days after the applicable transferor has entered into a transfer agreement with the transferee, an executed counterpart of such transfer agreement and any changes or amendments of any operating agreement in connection with such Transfer.

27. <u>Sublease:</u> All subleases are subject to the prior written consent of Port, which consent will not be unreasonably withheld, conditioned or delay; provided, however, it will be reasonable for Port to withhold its consent to any sublease that would result in a change in use of the dinner/theater operations and location and provided Port approves of the change in use, the percentage rent owed to Port from the gross revenues from such new use is less than the percentage rent received by Port for similar uses any change in use. All subleases are subject to Port Percentage and Participation Rents.

28. <u>Leasehold Financing:</u> Tenant has the right to obtain construction financing, mezzanine financing, other interim financings, and permanent take-out financing from bona fide institutional lenders for the development of the Project that will be secured by Tenant's leasehold interest.

29. <u>Maintenance and Repair of all components of the Project, including the Park:</u> Sole responsibility of Tenant.

30. <u>Utilities:</u> Port makes no representation regarding existing utilities (including water and sewer) or need to construct new utilities (including water and sewer) or relocate existing utilities (including water and sewer) for development of the Project. Sole responsibility of Tenant.

31. <u>Hazardous Materials:</u> Sole responsibility of Tenant, provided Tenant will not be responsible for any pre-existing hazardous materials so long as they are not released or exacerbated by Tenant or its agents or invitees.

32. <u>The development must be self-supporting:</u> Tenant is responsible for providing the Port with a balanced development pro forma that considers reasonable sources and uses, feasible financial projects and assumptions, the Equity IRR and Equity Return, all

Port Rent of any kind and ample reserves for debt service, maintenance and operation reserves. Hotel operator and management selection are also the responsibility of Tenant subject to Port consent as described below.

33.	Competent Hotel Management and Approval of Management Agreement Required; Approved Operating Standard:	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, which review and acceptance shall not be unreasonably withheld, conditioned or delayed. Except as may otherwise determine by the Port Commission, at a minimum, any hotel management company must have no less than 10 years' of reputable experience operating no less than 3 boutique hotels, in a manner similar to Generally Accepted Operating Standards for downtown locations of major cities in the United States or if the operator does not meet the foregoing minimum qualifications, as may be otherwise determined by the Port in its sole discretion, which determination shall not be unreasonably withheld, conditioned or delayed. The hotel management company must operate the hotel in a commercially reasonable manner that seeks to maximizes hotel gross revenues After notice to Tenant, and good faith discussions between Tenant and Port, the Port may require Tenant to remove the then current hotel management company if the hotel is operated in a manner that is less than the manner for Generally Accepted Operating Standards for downtown locations in major cities in the United States and is not maximizing hotel gross revenues. "Generally Accepted Operating Standard" shall be further defined in the Lease, but at a minimum, shall mean operation and maintenance of a hotel (including the public park) at a level that (i) meets hospitality and service standards at other comparably sized boutique hotels in San Francisco of the highest quality, and (ii) attains from and after the 2nd anniversary of hotel operations, an overall rating of at least 3 diamonds from the American Automobile Association ("AAA") at least 3 years out of each and every consecutive 4 year period during the lease

term, (iii) incorporates 4 diamond standards, as established by AAA, into the design, furniture, fixtures, equipment, utilities, finishes and ambiance of the lobby and guest room areas, and (iv) complies with Port's good neighbor policy.

"**Boutique Hotel**" means a public, lodging establishment having approximately 180-200 separately keyed guest rooms that provides superior services, facilities and amenities for its guests at no less than the Generally Accepted Operating Standards, but which do not necessarily provide all of the services of a full-service hotel, such as a full-service conference, meeting, food and beverage or catering facilities, a full-service health club and spa, or other full-service recreational facilities.

34. No Subordination of Fee Interest or Rent: Under no circumstance will Tenant place or suffer to be placed any lien or encumbrance on Port's fee interest in the Premises. Port will not subordinate its interest in the Premises nor its right to receive rent to any mortgagee.

35. Parking: Tenant has the responsibility to provide an off-site parking plan to accommodate the Project. The Port agrees to consider providing Tenant with off-site parking options that may become available on Port properties on the same terms and conditions that the Port provides to any other parking tenants or licensees.

36. Trust Consistency: Port requires Tenant to submit its Trust Consistency plan to the Port for review and comments. If appropriate or necessary, Port will work with Tenant to obtain trust consistency letter from State Lands Commission staff or approval of the proposed project, including rooms in the hotel for short-term use by artists from outside the Bay Area.

37. Regulatory Approval: Tenant is responsible for obtaining all regulatory approvals, at its sole cost and expense.

38. Public Park and Open Space: 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.

39.	Use Program and Conceptual Design:	Tenant is responsible for providing the floor area square footages and schematic design diagrams for all major and minor categories of uses of the proposed Project as part of its efforts to entitle the Project.
40.	Development Management Plan:	Developer/Tenant is responsible for the legal, financial, and operation management plans for all phases of the proposed Development.
41.	Initial Comprehensive Financial Plan Demonstrating Development Feasibility:	Tenant is responsible for providing a preliminary comprehensive financial plan that supports the feasibility of the constituent elements of the proposed development, and the feasibility must be mutually agreed upon by the Port and Tenant, which agreement shall not be unreasonably withheld, conditioned or delayed.
42.	List and Analysis of Public Benefits:	Tenant is responsible for providing a list of the expected public benefits of the Development along with quantitative characterization of the benefits. The benefit list and its characterization are subject to the mutual determination of the Port and Tenant and Port shall not unreasonably withhold condition or delay its approval.
43.	Standard Lease Terms	The Lease will include other standard lease terms customary for a Port lease, including but not limited to force majeure event provisions.

Attached Exhibits:

Exhibit "A," Site Map
Exhibit "B," Preliminary Project Description
Exhibit "C," Performance Schedule

Exhibit “A”
Project Description

Exhibit "B"
Preliminary Project Description

Exhibit “C,”
Performance Schedule