

MEMORANDUM

October 18, 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 on Current Vacancies at Port Facilities and Proposed Interim Leasing Strategies

DIRECTOR'S RECOMMENDATION: Information Only- No Action Required

Executive Summary

Pursuant to statute, the Port is required to charge market rates for its commercial properties and deposit such revenues into the Harbor Fund for use in operating and maintaining the Port. In furtherance of this objective, Port staff annually seeks a delegation from the Port Commission to enter leases for Port property without further Commission action under certain conditions, most notably including market rental rates established for various leasable spaces on Port property based on market research. In addition, Port staff maintains a report detailing vacant space on Port property that is used as a management tool to identify existing leasing opportunities and to track leasing performance over time.

At the Port Commission's request, Port staff is returning to the Port Commission to provide an updated status of its vacant properties. There are a number of bulkhead office and shed spaces that are potentially available to lease, subject to completion of associated improvement work as well as considerations around longer-term plans for the facility in question. This staff report details these vacancies and the reasons behind them, and offers staff proposals for leasing strategies that will generate revenues for the Port while limiting any unnecessary costs or obstacles to longer-term Port initiatives and objectives.

Lastly, this staff report also details the steps Port staff is taking to more systematically refine the process by which it develops the vacancy report, reducing the multi-division staff involvement and the hours required to manually assemble the report, and thus make it more useful as a tracking and strategy tool.

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Strategic Objective

The management of the vacancy report as a communications and management tool in support of the Port’s leasing efforts furthers the goals of the Port’s Strategic Plan as follows:

Engagement:

By continuing to proactively communicate with the Port Commission in setting vision, strategy, policy and fiscal goals for the Port.

Economic Vitality:

By planning and executing a holistic and balanced strategy to the real estate portfolio and asset management to more effectively maximize asset value and income to the Port.

Stability:

By continuing to expand ongoing revenue sources to address Port operational and maintenance needs while not impeding other long-term development and renewal goals.

Current Vacancies

The Port currently has a vacancy rate of 7.65% of its leasable space, comprised of the following sectors:

Vacancy Rate By Category	
Office	2.8%
Industrial Warehouse / Shed	8.6%
Restaurant & Retail	5.3%

For an office market comparison, Port staff notes that the Port’s office space has a lower vacancy rate than that reported for San Francisco as of September 30, 2018 by Kidder Mathews (5.3%) and JLL (7.5%).

For an industrial market comparison, Port staff observes the relative lack of non-Port industrial assets in the City and generally looks to the combined SF-Peninsula market for a benchmark. The Kidder Mathews report for the area bounded by San Francisco in the north and San Carlos in the south reflects a 2.2% vacancy rate as of September 30, 2018, slightly higher than that reported for the San Francisco submarket alone (2.1%).

For a retail market comparison, Kidder Mathews reports a 3.5% vacancy rate in San Francisco as of September 30, 2018. (Port staff notes the vacancy rate above will decrease below this benchmark once the Per 33.5 restaurant opportunity awarded to Anchor Hospitality at the September 25 Port Commission hearing results in an executed lease.)

A detailed chart showing key information regarding currently vacant leasable spaces on Port property is attached as Exhibit A; this chart includes all spaces contributing the vacancy rates noted here. For additional background, the following is a set of narrative notes regarding the vacancies at a number of key facilities:

1. Pier 19: Port capital projects underway, expected to be completed in mid-2019. Certain types of leasing may continue during completion of final scope of work (standpipe). Pier is included in RFI request for public-oriented concepts; see “Staff Analysis and Proposed Strategies” below.
2. Pier 23: Port capital projects underway, expected to be completed in mid-2019. Certain types of leasing may continue during completion of final scopes of work (restroom facility, standpipe). Pier is included in RFI request for public-oriented concepts; see “Staff Analysis and Proposed Strategies” below.
3. Pier 28: Pier is included in RFI request for public-oriented concepts; see “Staff Analysis and Proposed Strategies” below.
4. Pier 29: bulkhead substructure improvements are underway. Shed is licensed to Pacific Cruise Terminals LLC for short-term special events. Pier is included in RFI request for public-oriented concepts; see “Staff Analysis and Proposed Strategies” below.
5. Pier 29.5: new ADA-compliant restroom has been recently completed to serve office space, rendering the space more attractive for further leasing efforts. Pier is included in RFI request for public-oriented concepts.
6. Pier 31: Golden Gate National Parks Conservancy will lease a portion of the bulkhead to construct and operate a café in connection with the Alcatraz Embarkation project. Upon completion of Port improvement projects, Department of Elections will lease the remainder of the space under an MOU with the Port.
7. Pier 33: vacant space is anticipated to be used for Alcatraz Embarkation Point construction laydown activities once the National Park Service has selected its ferry concessioner and that entity has entered into the Ferry Concession lease approved by the Port Commission and the Board of Supervisors.
8. Pier 33.5: vacant space to be leased per Anchor Hospitality restaurant proposal, which was awarded at the September 25 Port Commission hearing.
9. Pier 35: Pier is included in RFI request for public-oriented concepts; see “Staff Analysis and Proposed Strategies” below.
10. Piers 38 and 38.5: Pier is included in RFI request for public-oriented concepts; see “Staff Analysis and Proposed Strategies” below.
11. Pier 40: Pier is included in RFI request for public-oriented concepts; see “Staff Analysis and Proposed Strategies” below.
12. Pier 54: the most recent rapid structural evaluation of the pier indicated areas of deterioration, including certain red-tagged areas. Port staff is pursuing near term safety improvements such as a height restrictor to keep large vehicles from entering the pier and is in communication with the current tenants about their operations in

light of these findings. Longer term strategy of improvements to the pier and further leasing is under review.

13. 501 Cesar Chavez Street: these are limited-amenity offices often used by contractors or television or movie filming operations for short- or medium-length terms.
14. SWL 303: Recently vacated building at 490 Jefferson Street, space was previously used as an office but is located on a busy retail corridor. Staff is developing strategies for a use that complements existing tenancies.
15. SWL 318: ongoing capital work at Roundhouse II includes elevator upgrades plus envelope, security and common area enhancements. Further unfunded work includes HVAC replacement; staff analyzing funding and delivery methods for such improvements. Security work is critical to attracting new tenants and retaining the existing ones.

The remainder of this report focuses on staff's plans for entering leases to fill vacant space, starting with a review of the recent leasing recommendations adopted by the Port Commission in connection with the update of the Waterfront Land Use Plan (the Waterfront Plan Update).

Staff Analysis and Proposed Leasing Strategies

There are external and internal factors that influence Port staff's outlook regarding these vacancies and the strategy for managing further leasing activities.

General Market Trends

From the larger leasing market perspective, while economic and leasing activity in the larger market remains strong, there are indications that uncertainty about the further longevity of the current economic expansion may be limiting prospective tenants' appetites for spaces with high tenant improvement requirements (as is the case with many Port facilities listed on Exhibit A). To that point it is notable that the Port's leasing pipeline has been decreasing, from 34 pending proposals under staff review in March 2018 to 23 pending proposals under staff review in September 2018.

Similarly, media reports note an expanding field of tenants in the City seeking short term "pop-up" spaces that allow for revenue generation while limiting costs of improvement and long-term lease rates. This runs in parallel to Waterfront Plan Update recommendation 33 noted above. These proposals are somewhat opportunistic and depend greatly on factors that are often outside of the landlord's control, like location in proximity to anticipated customers or complementary activities. Port staff is tracking these trends and is looking at potential strategies to accelerate capital work in order to make facilities more easily occupiable for these types of short-term opportunities.

Waterfront Land Use Plan Recommendations for Historic Pier Leasing

At its August 14, 2018 meeting the Port Commission endorsed a series of recommendations for the Waterfront Plan Update. These recommendations were advanced unanimously from a multiyear public working group process which included community and regulatory stakeholders.

The recommendations approved by the Port Commission included a number of strategies for the leasing of historic piers, including:

29. Establish a new framework to support Port leases for short-term (0-10 years), intermediate-term (11-49 years) and long-term (50-66 years) periods, and criteria for pier repairs, uses and public trust benefits to provide feasible asset management strategies needed to maintain the integrity of the Embarcadero Historic District and support the waterfront's evolving needs.

30. Allow intermediate-term (11-49 years) leases to amortize capital repair costs of Embarcadero Historic District facilities, prioritize bulkhead buildings for public-oriented uses to enhance the pedestrian environment along The Embarcadero, and generate Port rental revenue. Intermediate-term leases may occur as a master lease for an entire/most of pier, which may allow seismic improvement to support higher occupancy in limited parts of the facility; Intermediate-term leases managed by the Port within multi-tenant piers are needed to finance repairs but would not likely support seismic improvements. Consistent with Port Building Code standards, allow intermediate-term leases for high revenue, higher occupancy uses (e.g. Production/Distribution/Repair (PDR) or office) in limited areas to finance pier repairs and improvements, without changing the overall industrial, maritime or low/limited occupancy of the pier facility.

31. Allow long-term (50-66 year) leases to support full seismic and structural rehabilitation of the historic piers, sea level rise adaptation, public-oriented uses in bulkhead buildings, maritime and/or public access on pier aprons. Long-term leases require high-revenue generating uses (e.g. public/visitor serving retail, general office/PDR) to finance seismic upgrade and facility improvements and generate Port rental revenue. Promote development of piers for public-oriented uses but recognize that this will likely require new sources of revenue and/or investment including private fundraising, targeted public investment, or other financially feasible uses to ensure financial feasibility.

32. Support intermediate-term leases which meet revenue needs, support businesses and job opportunities, and support public-oriented uses that front on The Embarcadero Promenade. Piers that offer limited public-oriented uses should be distributed among other developments and attractions and, if feasible, provide areas that may be made available for community or public use as a public benefit.

33. Encourage pilot and pop-up public-oriented uses that promote a dynamic waterfront and small business opportunities.

The full report summarizing the recommendations developed during Phase 2 of the Waterfront Plan Update process can be found here:

<https://sfport.com/sites/default/files/Planning/WLUP%20Documents/9.11.17%20Waterfront%20Update%20Part%202%20Summary%20Report.pdf>

Port staff is utilizing these recommendations as the basis of its strategy for managing certain leasing activities, as further summarized below.

Piers Included in the Port's Request for Interest

The Port is subject to the common law public trust for commerce, navigation and fisheries and the Burton Act statutory trust (collectively, the "Trust"). The Trust requires that the Port generate revenues from its properties to support its Trust mission. The Burton Act includes specific provisions that allow the Port to pursue leasing that is not trust-consistent, so long as the term is for ten years or less and the rent is not less than fair market value. This flexibility greatly elevates the importance of these leases to the Port's revenues and overall enterprise: 79% of the Port's leases have terms of ten years or less, and these leases represent just under half of the total base rent revenues budgeted for the current fiscal year.

On the other end of the lease term spectrum are the long-term historic pier rehabilitation projects summarized in Waterfront Plan recommendation 31 that are the intended objective for the Port's Request for Interest (the RFI). The RFI seeks interest from operators of public-oriented businesses and organizations in leasing space in certain of the Port's historic piers and structures of the Embarcadero National Historic District (the RFI): Piers 19, 19.5, 23, 26, 28, 29, 29.5, 31, 33, 35, 38 and 40 plus the Agriculture Building. (Pier 48 is also included but that is under contract with Seawall Lot 337 Associates LLC as part of the Mission Rock project.)

The objective of the RFI is to set the stage for further competitive solicitation in order to enter a lease that provides for the historic rehabilitation of some number of these facilities. While Port staff hopes to move quickly to execution of leases for these ambitious projects, staff also remains realistic that the timelines for approval and entitlement of past Port projects have all exceeded initial projections. Therefore, Port staff must balance the preparations for such competitive solicitations with the need to generate revenues from those same facilities in the interim.

With those factors in mind, and in view of the Waterfront Plan Update recommendations noted above, staff is planning to pursue the following strategies at the RFI locations in order to generate needed revenues while limiting risk of any impacts on the RFI and related subsequent competitive solicitations:

1. Continue parking operations where currently authorized. These parking operations serve an existing need and generate significant revenues for the Port. They are generally operated on a license with a parking operator and are more readily terminated as a new project reaches entitlements as compared to more traditional leases.

2. Where feasible, continue to activate sheds with nonexclusive special event and “pop-up” opportunities per the Pier 29 model. As with parking operations these opportunities provide a revenue stream while avoiding any ongoing contractual obligations that would complicate a future rehabilitation project.
3. For those locations without parking or special event opportunities, target city agencies, small storage tenants or contractor spaces relating to time-limited needs such as a specific job or project. For storage/contractors, develop demising fences for small (3000-5000 sq. ft.) spaces for ease of administration. Work with an outreach consultant and Port’s existing information channels to advertise vacancies to the non-City opportunities noted here.
4. After review of RFI responses Port staff will present a set of recommendations for follow-on competitive processes for Port Commission approval. For those facilities that are not included in the initial set of further solicitations, Port staff will evaluate the leasing opportunities for that specific pier. This evaluation will include the interim leasing opportunities described above but also the potential for intermediate leasing as described in Waterfront Plan recommendations 30 and 32 above. Such intermediate leasing would allow for some component of the public-oriented uses desired by the community stakeholders for trust consistency while hopefully achieving project feasibility by targeting costly seismic repairs only to those areas with high public occupancy.

Improvements to Vacancy Report Management

In the past producing a vacancy report has been a time-intensive effort requiring staff time from a range of divisions. It has also at times created a set of slightly conflicting approaches depending on the purpose for which the data is used (e.g. leasing strategy versus bondholder or insurance disclosures). In connection with the preparation of this item, Real Estate and Development division staff has initiated the process of standardizing and systematically integrating the vacancy data and linking together the Port’s rent roll reports and new information technology platforms (MS Power BI) to develop a more easily produced and consistent set of reports for the organization. Staff is also looking to enhance our current data systems with the implementation of GIS mapping capabilities and a detailed space inventory module to the Port’s Property Management System. With assistance from the Engineering and Finance and Accounting divisions these efforts will result in a more consistent and accessible vacancy tracking tool for evaluating and implementing leasing strategies in the future.

Conclusion

The Real Estate and Development division appreciates this opportunity to share the current status of the portfolio and the key issues that are driving further efforts to lease up the Port's space. We welcome the Commission's feedback as to how best to manage these efforts, both at this hearing and going forward.

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Exhibit A Vacancy Matrix
Exhibit B Vacancy Report Facility Category Definitions