

MEMORANDUM

March 22, 2019

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 policy considerations regarding potential extension of Fisherman's Wharf retail leases beyond expiration of their initial 66-year terms

DIRECTOR'S RECOMMENDATION: Informational Only; No Action Required

Executive Summary

A number of Fisherman's Wharf restaurant leases are set to expire in 2036, 66 years after they were originally issued in 1970. In the wake of recent lease extensions for restaurant operations elsewhere on Port property, certain of these tenants inquired about the potential to extend their own leases. In an effort to share information consistently across similarly-situated tenants, Port staff invited all of these tenants to meet and discuss the business strategies that were successful in those prior lease extension approvals and the policy issues common to the Fisherman's Wharf area. After convening this series of meetings, Port staff noted that the considerations surrounding these long term leases are different from those affecting other types of long term leases (office buildings, for example). Today's presentation provides a summary of Port staff's analysis of these discussions in order to receive the Port Commission's feedback and direction on how to approach these negotiations in the future.

Strategic Objective

If approved, these potential policies would advance the Stability objective of the Port's Strategic Plan by maintaining the Port's financial strength by (a) structuring lease extensions to continue high-performing tenancies that will perform through economic cycles and (b) encouraging investment in Port-owned properties.

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Background

Around the time the State transferred the Port properties to the City in 1970, a number of Fisherman's Wharf restaurant leases were issued for the full 66-year term allowed by law. These include the following:

CONTRACT #	COMPANY NAME	RESTAURANT NAME	EXPIRATION DATE
L-7491	Alioto Fish Company, Ltd.	Alioto's No. 8	4/30/2036
L-7493	Castagnola's Restaurant	Castagnola's Restaurant	4/30/2036
L-7494	Chu, Frances Y. and Hwang, Jyi Jeng	The Crab Station	4/30/2036
L-7498	Herringbone Tavern, Inc.	Fisherman's Grotto	4/30/2036
L-7500	Herringbone Tavern, Inc.	Tarantino's	4/30/2036
L-8993	Mama Franceschi, L.P.	Capurro's	4/30/2036
L-7492	Pollack Group, Ltd.	Nick's Lighthouse	4/30/2036
L-7496	SFS39, Inc.	The Franciscan	4/30/2036
L-7499	Sabella & La Torre	Sabella & La Torre	4/30/2036
L-8996	Scoma's Restaurant, Inc.	Scoma's Restaurant, Inc.	4/30/2036

On May 22, 2018, the Port Commission improved amendments to the Boudin Properties Inc. restaurant lease at 160 Jefferson Street that provided two ten-year options to extend the term of the lease past its initial expiration in 2045, along with certain related changes to business terms. Tenant's exercise of each respective option was conditioned on the performance of \$2 million of capital improvements approved by the Port, with an additional \$1 million of improvements required during the extension term itself. While Boudin's lease was not one of the 66 year leases, this approval prompted other operators to inquire about prospects of negotiating similar amendments for Port Commission consideration. Because the leases noted above are roughly coterminous, Port staff convened meetings with each operator to hear their objectives and to outline some of the key considerations from the Port's perspective so that all parties could understand the dynamics involved.

Staff Analysis

Based on the external and internal dialogues noted above, Port staff has assembled the following list of issues that it would recommend for the Port Commission to consider in any proposed extension of a Fisherman's Wharf restaurant or retail lease.

1. **Retail Leasing Policy.** Port staff would expect any proposed extension to satisfy the terms of the direct negotiation exception to the retail leasing policy. Most notably, this requires satisfaction of the Tenant in Good Standing Policy, performance metrics showing above-average rents per square foot as compared

to similarly situated operators, and the submission a written business plan to determine the cost and value of the capital improvements to Port property and viability of future revenue projections.

2. Timing. The Port's recent practice is not to offer extensions before they are needed. Typically, this would result in consideration close in time to the scheduled expiration of the lease, but in the Boudin case it was recognized that as lease term dwindles the incentive for the operator to maintain or improve the facility also decreases, which potentially could devalue the Port's asset. In that case the Port Commission acknowledged that the need to obtain financing for needed improvements would be an appropriate rationale to approve an extension option with some years left before lease expiration. Another potential reason for the Port Commission to consider an early extension of a lease could be an operator's proposed redevelopment of its site to significantly enhance revenue by adding new lines of business or diversifying its existing operations.
3. Capital Requirements and Extension Term. As detailed in both the retail leasing policy and the Boudin example, Port policy is to require capital improvements that extend the life of the facility or improve its ability to generate revenues (or both) and serve a public purpose. The cost and scope of those improvements would in turn determine the length of the extension term to the period needed for the business to amortize the required capital improvements through its operations. Accordingly, based on recent experience, staff would not expect to propose a term approaching 66 years for any of these extensions. Tenants would not be entitled to rent credits for any capital improvements that serve as a basis for an extended lease term.
4. Participation in Sale or Refinancing Proceeds. The extension of a lease term creates additional value in the lease, and per the Retail Leasing Policy Port staff would expect any extension to include a provision allowing the Port to participate in the net proceeds of sales or refinancings (to the extent the refinancing proceeds are not reinvested in the property).
5. Substructure Maintenance. Many of these restaurants are supported by piles over water. As a general matter, these leases require the tenants to maintain their own substructure. While the Port would like to retain this general allocation of responsibility, the discussions with the operators and Port Engineering Division staff did note the fact that these are interrelated pile systems and the failure by one operator to fulfill its maintenance requirements could cause negative outcomes for others. Port staff will continue to evaluate whether there may be alternative approaches for collectively funding and performing improvements and will report back to the Port Commission prior to any extension proposal.
6. Sea Level Rise and Flooding. As sea levels have risen, the increase in episodic flooding has driven the Port to develop lease provisions that protect the Port's interest. These include comprehensive disclosures regarding flood risks as well

as provisions requiring the tenant to obtain permits for, construct and implement measures to protect the premises from damage resulting from flooding or sea level rise, as such measures are determined by the Chief Harbor Engineer in his or her regulatory capacity. Port staff expects to include these provisions in any lease extensions or amendments of these long term leases.

7. Bay Conservation and Development Commission (BCDC) "50% Rule" Policy. As part of its policies for limiting Bay fill, BCDC's current Replacement Fill policy, also known as the 50% Rule, requires that major seismic upgrades or structural improvements of existing pile-supported structures used for restaurants and commercial recreation businesses must reduce the footprint of the business to 50% of the site. The policy requires that treatment of the remaining 50% of the site address BCDC bay fill and public access objectives by removing the structure, converting the pile-supported platform to public access, or a combination of the two, in order to secure a BCDC permit. In coordination with the Waterfront Plan Update, Port Planning and Environment Division staff have been working with BCDC to take an area-wide approach to meet the objectives in the 50% Rule instead of imposing these requirements on individual businesses. The removal of the Pier 43 parking lot has already been banked to address the fill removal element of the 50% Rule requirement, and other major public access improvements have been completed to deliver a meaningful collection of replacement public access benefits for the area, including: the Pier 43 pedestrian promenade and public plaza at Pier 45 for enjoyment of Bay views along the length of the new open water basin, and public access improvements on Jefferson and Taylor Streets. Port staff will continue to evaluate this rule in light of the potential extensions and will look for ways for the Port and its tenants to collectively satisfy BCDC requirements in the most cost-effective and beneficial manner for the Fisherman's Wharf area.

Conclusion

Port staff sees today's presentation as an opportunity to lay out the common considerations that are unique to this location and land use on Port property. Port staff welcomes feedback from the Port Commission on the list of items above and any other criteria or negotiation points that would be useful to include as staff continues its dialogue with the tenants in advance of any lease extension proposal being presented to the Port Commission for approval.

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