

MEMORANDUM

July 3, 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: Request approval of Amendment and Restatement of Port Lease No. L-14100, which includes an option to extend the term for 10 years, with Frankie's Java House, LLC, located at Pier 40½ at the Embarcadero and Townsend Street. (This action constitutes the approval action for the project for the purposes of CEQA, pursuant to Section 31.04(h) of the San Francisco Administrative Code).

DIRECTOR'S RECOMMENDATION: Approve Resolution

Executive Summary

Java House is a longstanding restaurant operation at Pier 40½. In the latest phase of an ongoing dialogue with the Port regarding coming into compliance with lease requirements for capital improvements, and in an overall desire to improve operational performance, the tenant has approached the Port with a proposal to restructure ownership and bring in a new investor.

Under this proposal, the reconstituted entity would complete the previously required capital improvements, plus construct an addition to the restaurant to allow outdoor dining and alcohol sales, subject to amendments to the lease that would improve the Port's financial metrics and provide the tenant with additional lease term, all as further described below. Port staff has commissioned a third-party financial analysis of the proposed terms in relation to fair market value and the likely benefits to the Port. Relevant portions of that analysis are included in this report.

Port staff sees potential benefits to the Port of this tenant restructure and workout arrangement as fully summarized below, but also observes that the lease amendment

THIS PRINT COVERS CALENDAR ITEM NO. 11C

proposal does not qualify for direct negotiation under the Port Commission's adopted Retail Leasing Policy. Because there is approximately 4 years of term remaining on the current lease, the Port could not bid out this opportunity without pursuing a default remedy against the current owner. Factoring the time and expense that such a strategy would require and the uncertainty of the market interest in an opportunity requiring a significant investment, staff believes that approval of the subject proposal would yield a more timely, certain and more beneficial financial outcome to the Port as compared to other options.

This proposal was the subject of an informational presentation to the Port Commission at its February 12, 2019 meeting at which time the Port Commission directed staff to finalize negotiations and prepare a lease for further Port Commission consideration.

Strategic Objective

The proposed amendment and restatement of lease is expected to contribute in a substantial way to meeting the Stability Objective of the Port's Strategic Plan by managing the real estate portfolio to maximize value and income to the Port and to foster a tenant that would be better able to perform through economic cycles.

Background

The Java House, under various owners, has operated at Pier 40½ since 1912. Along with Red's Java House at Pier 30 and the Pier 23 Café at Pier 23, it is one of the last "working person's" cafes that once dotted the San Francisco waterfront when the Port's finger piers were working cargo and passenger terminals employing tens of thousands of longshoremen, stevedores, clerks, warehousemen and teamsters. These restaurants also served the crews and passengers of the cargo and passenger ships calling at the Port of San Francisco.

While the economic and maritime landscape of the San Francisco Waterfront has changed dramatically from those bygone days, the current owners of the Java House, LLC (Java House) have maintained the tradition of providing affordable dining for San Franciscans and others visiting or enjoying a baseball game at Oracle Park or a boating excursion out of South Beach Harbor. The Papadopoulos family has operated the Java House at Pier 40½ for over 33 years. First, under the stewardship of Phillip and Sotiria Papadopoulos, and then in 2006, the senior Papadopoulos family members passed forward this stewardship to a new family generation led by their daughter Maria Papadopoulos-Moustakis.

Lease Summary

The Java House currently operates under Port Lease No. L-14100 (the "Original Lease"), which commenced on September 1, 2008, as approved by the Port Commission by Resolution No. 06-36 and Board of Supervisors Resolution No. 555-07. The term of the Original Lease is for fifteen (15) years and will expire on August 31, 2023. The Original Lease covers approximately 1,490 square feet of existing building space housing the Java House restaurant. The Java House is allowed under the Original Lease to operate as a casual food restaurant with bar service.

The Original Lease provides for the Port to receive the greater of guaranteed monthly base rent or percentage rent. Current monthly Base Rent is \$3,314.39, which equates to \$39,772.68 per year. Percentage rent is set at 7.5% of Gross Sales for food, beverage and retail sales. For the 12 month period ending in May 2019, Java House reported average monthly Gross Sales of \$17,703.09, which resulted in no Percentage Rent being paid to the Port. Moreover, Percentage Rent has not exceeded Base Rent since the commencement of the Original Lease in 2008. The Port is also entitled to a 10% participation in the proceeds of a transfer of the Original Lease.

Pursuant to the Lease, Java House was required to make capital improvements of at least \$346,120.00 to the facility by September 1, 2010. Java House has not completed the required capital improvements and is thus currently not in compliance with the Original Lease.

Proposed Transaction

The owners of the Java House have been engaged in negotiations to sell the Original Lease to a new entity in which the current owners will retain a 15% interest. The transfer of the Original Lease is subject to Port consent by the Executive Director, which cannot be unreasonably withheld. The proposed purchaser entity is Shareheffholder LLC Series E, dba: Frankie's Java House, LLC (Frankie's), with the majority owner being Michael Heffernan, a well know businessman in San Francisco associated with the insurance industry.

Staff of the Port's Finance and Administration division has reviewed Mr. Heffernan's financial information and verified his financial capacity for the proposed investment and ability to complete the capital improvements. Mr. Heffernan has also committed to hiring a manager from one of his existing restaurant operations to manage the operation under the new entity, rather than utilizing current Java House management or staff. Mr. Heffernan's staff attended the February 12, 2019 meeting to further detail their business plan for the restructured and improved restaurant and bar operation.

The Frankie's proposal seeks to resolve the current outstanding issues related to completion of the required capital improvements and make an additional investment in order to reposition the restaurant into a viable business enterprise. Mr. Heffernan has indicated that he is willing to (i) condition any extension of lease term on the successful completion of the site improvements and (ii) provide a personal guarantee for the cost of construction. The proposed Amendment and Restatement of Lease (the "Amended Lease") would require Frankie's to make a capital investment of no less than \$737,000.00 into the facility, which also includes the improvement requirements not completed as required by the Original Lease. Upon 100% completion of the capital improvements, which must be completed within one (1) year of the commencement of the Amended Lease, Frankie's will have the right to exercise an option to extend the term of the amended lease for ten (10) years. A summary of the negotiated lease terms for the proposed Amendment and Restatement of Lease are outlined beginning on the following page.

<p><i>Tenant:</i></p>	<p>Frankie’s Java House LLC, a California limited liability company</p>
<p><i>Background; Amended and Restated Lease:</i></p>	<p>Port and Java House, LLC entered into Lease No. L-14100, dated October 19, 2007 for reference purposes, as approved by the Port Commission by Resolution No. 06-36 and Board of Supervisors Resolution No. 555-07 (the “Original Lease”). The Original Lease was effective on September 1, 2008 and expires on August 31, 2023.</p> <p>Java House LLC is proposing to sell substantially all of its assets and assign all of Java’s House LLC’s interest in the Original Lease to Frankie’s Java House, LLC (the “2019 Sale”). The 2019 Sale is subject to Port’s consent by the Executive Director and the payment to Port of a percentage of the net sale proceeds as provided for in the Original Lease. In connection with and conditioned upon the successful closing of the proposed 2019 Sale, Port and Java House LLC negotiated the following new and amended terms to the Original Lease:</p> <ul style="list-style-type: none"> (i) Base Rent would be increased to \$4,000.00 per month escalated by three percent (3%) annually; (ii) Port would be paid twelve (12%) of the net sale proceeds from the 2019 Sale and all future Transfers; (iii) Java House, LLC will pay the Port \$51,000 due to its failure to complete the tenant improvements required by the Original Lease; (iv) Tenant would expend not less than \$737,000 in improvements to the premises including construction of a new outdoor patio in an expanded premises footprint; such improvements to be guaranteed by a personal guaranty by the principal owner of Tenant equal to one hundred percent (100%) of the construction costs of the improvements; (v) in consideration of the above terms and other valuable consideration, Port would consent to the 2019 Sale; and (vi) the above terms would be documented in an Amended and Restated Lease to become effective after the successful closing of the 2019 Sale and receipt of Port’s portion of the sale proceeds. <p>Port is not obligated to execute the Amended and Restated Lease until and unless the 2019 Sale is completed and Port receives payment of Port's Sale Participation.</p>
<p><i>Premises:</i></p>	<p>Parcel A – Approximately 1,146 square feet of free-standing building comprised of the restaurant located in the vicinity of South Beach Harbor; and</p>

	Parcel B – Approximately 1,090 square feet of exterior marginal wharf space located adjacent to the restaurant.
<i>Expiration Date:</i>	August 31, 2023
<i>Monthly Base Rent:</i>	\$4,000.00 per month.
<i>Base Rent Adjustments:</i>	On the commencement date of the Extension Term (if any), and on the fifth (5 th) Anniversary Date of the commencement date of the Extension Term (if any), Monthly Base Rent shall be adjusted to the higher of: (i) 85% of the average of 7.5% of the Gross Revenues for the previous thirty-six (36) month period divided by twelve (12); or (ii) the Monthly Base Rent for the previous month increased by three percent (3%). In all other years, Monthly Base Rent will increase by three percent (3%) on each Anniversary Date.
<i>Percentage Rent:</i>	Percentage Rent shall be seven and one-half percent (7.5%) of Gross Revenues. In addition to the monthly Base Rent specified above, Tenant shall pay monthly Percentage Rent in an amount equal to the difference between (i) the Percentage Rent for such calendar month; and (ii) the Base Rent for such calendar month in any month in which the Percentage Rent exceeds the Base Rent.
<i>Security Deposit:</i>	Ten Thousand Dollars and 00/100 (\$10,000.00).
<i>Permitted Use:</i>	<u>Parcel A</u> shall be operated as a casual dining restaurant and bar; and <u>Parcel B</u> shall be used as an outdoor patio seating area and for other uses directly related to the support of the restaurant and bar operation.
<i>Initial Tenant Improvements:</i>	Tenant must complete the following Initial Tenant Improvements; two ADA restrooms, accessible service counters, new FOG interceptor, remodeled kitchen and dining areas, create outdoor seating area, new paint, installation of a new sanitary sewer line, new kitchen equipment, a new bar, refrigeration, plumbing and other improvements. The Initial Tenant Improvements shall be constructed at Tenant's sole cost and expense. Tenant must Complete the Initial Tenant Improvements no later than one (1) after the Effective Date.
<i>Extension Option:</i>	If Tenant completes the Initial Tenant Improvements within one (1) year of the Effective Date, then Tenant shall have one (1) option to extend the term for ten (10) years. If the Initial Tenant

	Improvements are not timely completed, there is no extension option.
<i>Rent Abatement:</i>	No Base Rent shall be due for ninety (90) days during the construction of the Initial Tenant Improvements starting on the date the Port issues the building permit for the Initial Tenant Improvements and ending on the ninetieth (90 th) day thereafter. During this 90-day Base Rent abatement period, Percentage Rent will continue to be due.
<i>Initial Tenant Improvements Guaranty:</i>	Michael Heffernan, President/CEO of Tenant, shall provide a personal guaranty in an amount sufficient to guarantee Completion of the Initial Tenant Improvements. The executed Personal Guaranty shall satisfy the requirements in this Lease for a financial guaranty for the Initial Tenant Improvements.
<i>City Requirements:</i>	The amended and restated lease will be updated to include all current Port provisions as well as current City Ordinances and requirements.

Table 1. below compares two scenarios: (1) the operation of the Original Lease terms and no transfer with (2) the proposed amended terms for the Amended Lease if the transaction moves forward as described (though as noted Port staff intends to continue negotiations based on Port Commission direction and informed by third party analysis).

Table 1. Comparative Lease Scenarios		
Deal Term	Original Lease - Base Case	Proposed Transaction
Expiration Date	August 31, 2023	August 31, 2023, subject to an extension until August 31, 2033 (10 years) if improvements are complete and tenant is in good standing.
Base Rent	\$3,314.36 per month as of June 2019	\$4,000 per month upon approval and execution of the amended lease (a 20.7% increase). Base rent will be waived for three months during the construction of the required improvements, but percentage rent will still be payable on gross revenues from any operations without setoff of base rent.
Base Rent Adjustment		On the commencement date of the Extension Term (if any), and on the fifth (5 th) Anniversary Date of the

Table 1. Comparative Lease Scenarios		
Deal Term	Original Lease - Base Case	Proposed Transaction
		commencement date of the Extension Term (if any), Monthly Base Rent shall be adjusted to the higher of: (i) 85% of the average of 7.5% of the Gross Revenues for the previous thirty-six (36) month period divided by twelve (12); or (ii) the Monthly Base Rent for the previous month increased by three percent (3%). In all other years, Monthly Base Rent will increase by three percent (3%) on each Anniversary Date.
Percentage Rent	7.5%	7.5%
Capital Improvement requirements	<p>Tenant required by original Lease to remodel premises to include:</p> <ol style="list-style-type: none"> 1. ADA restrooms 2. ADA Service Counter 3. FOG interceptor 4. Remodel kitchen and dining area and furniture (cost not less than \$172,882) 5. New interior paint 6. New sewer line <p>Items above to be completed at a cost of not less than \$346,140 by September 1, 2010. Port could pursue default proceedings, but as noted in the Executive Summary above the removal of tenant and replacement with a new tenant could result in a long period of no revenue from the site.</p>	<p>Frankie's must cure lease default and complete all of the improvements required under the Original Lease. In addition, Frankie's must construct an enclosed outdoor seating area, which will increase seating capacity by 133%. The projected cost for these tenant improvements is approximately \$737,000. All improvements will be completed within one year of lease signing; estimated completion in Fall 2019. The term extension could not be exercised until and unless the tenant improvements are completed within one year. Funding for tenant improvement costs will be secured by personal guarantee from Michael Heffernan.</p> <p>Tenant will also pay \$51,000 for tenant's failure to complete capital improvements under the Original Lease.</p>

Table 1. Comparative Lease Scenarios		
Deal Term	Original Lease - Base Case	Proposed Transaction
Transfer Participation Metric	Port is entitled to 10% of the purchase price of the lease, net of costs of sale	Port is entitled to 12% of the \$525,800 Purchase Price of the Lease (and any future sale), net of "Costs of Sale" as defined in the Lease.
Transfer Participation Amount	\$0 if no transfer	Up to \$63,096, depending on the costs of the sale.

Project Description

Current Java House Site

The current site consists of a portion of the Pier 40½ marginal wharf located at the north end of the South Beach Harbor Promenade directly adjacent to and overlooking South Beach Harbor. The restaurant is just north of and across the promenade from the Harbor Boat House. The current leasehold area of the existing lease is approximately 1,490 sq. ft. consisting primarily of just the building footprint with no outdoor seating allowed. Per the Port’s Rapid Structural Assessment Report in August 2017 the substructure was rated Green - which is unrestricted use and generally in good condition.

Proposed Improvements to the Site

Frankie’s proposes to invest no less than \$737,000.00 in capital improvements. In terms of sales performance and revenue generation the most impactful portion of the proposed investment is the addition of an enclosed outdoor patio that will increase seating capacity and add more appealing views and atmosphere.

The proposed improvements include the following:

- Addition of ADA accessible restroom, and relocation of 2nd restroom
- Construction of an ADA accessible ramp from the sidewalk into the restaurant
- Construction of ADA accessible service counters
- Class 1 FOG interceptor
- Remodeled kitchen with new kitchen equipment, kitchen hood, cooking and prep surfaces
- Remodeled dining area (remove existing bathroom and closet in front kitchen area to add seating and sales counter)
- Add bar in current dining area
- Interior and exterior paint, window repairs, roof repairs and cosmetic improvements
- Installation of new sewer lateral connection, and other required utility modifications

- Railing to enclose patio café seating area to the north and west of the building
- Public access seating, bike racks and picnic tables to the south of the building
- Outdoor café seating in place of current garbage dumpsters on north end and west side of building
- Improve Refrigerated storage
- Repair and update exterior signage (consistent with Port Sign Guidelines)
- All work will be consistent with the Secretary of the Interior Standards for Historic Rehabilitation

Proposed New Management Team and Strategy

Michael Heffernan intends to build from his success at Vin Antico restaurant in San Rafael and to reposition Frankie's by pursuing successful strategies reflected at the Port's other waterfront casual dining locations. The project sponsor has provided the following information about its experience with related businesses:

Vin Antico opened in San Rafael in 2006 and was modestly successful until 2013 when it closed and was put up for sale. Michael Heffernan purchased the business in 2013 and brought in a new management team, transitioning to a more dinner and wine focus including a wine bar while the menu shifted from primarily Italian to a farm to table focus. After this transition 2014 sales revenues increased by 86% to \$887,482. Over the past five years Vin Antico has generated annual average sales of \$758,124.00 per year; the performance for 2018 fell to \$632,467 partly as a result of a remodeling of the second floor of the restaurant.

Kelly Phu is the General Manager of Vin Antico and will oversee the Java House business. David Donati, one of the founding partners of Frankie's Java House, LLC, is the Chief Operating Officer of Maxville Lake Winery in the Napa Valley. David spearheaded the development of a large (27,000 square feet) tasting room and event center at the winery. David is leading the design of the new kitchen and development of a new menu for Frankie's. Maxville Lake Winery opened in 2015 and by 2018 was generating sales over \$1 million domestically and another \$1.5 million internationally.

The proposed Frankie's restaurant will merge the strategy of the Vin Antico shift towards dinner and more lucrative beverage sales with the price points of other Port restaurants with outdoor dining.

Financial Analysis

As shown on the Annual Gross Sales and Percentage Rent Revenue Table 2. below, for the past five years Java House has not achieved annual gross sales that resulted percentage rent payable to the Port.

Table 2.

Annual Gross Sales and Percentage Rent Revenue

Java House Sales & Rent FY 14-18				
Year	Reported Gross Sales	Base Rent	% Rent	Total Rent Paid
2014	\$134,211.00	\$31,488.00	\$0	\$31,488.00
2015	\$131,220.00	\$31,488.00	\$0	\$31,488.00
2016	\$175,160.00	\$35,471.00	\$0	\$35,471.00
2017	\$166,924.00	\$38,316.00	\$0	\$38,316.00
2018	\$210,739.00	\$39,773.00	\$0	\$39,773.00
Total				\$176,536.00

Frankie's projects the generation of a significant increase of approximately \$235,169.00 in additional rent over the initial 5 years of the new amended and restated lease, as compared to 5 prior years of rent paid by Java House.

Frankie's Java House Five-Year Projected Sales & Rents				
Year	Projected Gross Sales	New Base Rent	% Rent	Projected Rent
1	\$789,400	\$36,000.00	\$59,205.00	\$59,205.00
2	\$900,000	\$49,440.00	\$67,500.00	\$67,500.00
3	\$1,100,000	\$50,923.20	\$82,500.00	\$82,500.00
4	\$1,300,000	\$52,450.92	\$97,500.00	\$97,500.00
5	\$1,400,000	\$54,024.48	\$105,000.00	\$105,000.00
Total				\$411,705.00

As noted above in "Executive Summary", Port staff has commissioned a third-party analysis to validate these projections. Seifel Consulting and its subcontractor C.H. Elliott & Associates (collectively "Seifel") have been retained to analyze the potential effects of the proposed lease amendment as compared to the base case of either not extending the lease or evicting the tenant. The Seifel team performed various financial analyses, including cash flow projections of future sales and Port lease revenues, with and without the proposed lease amendment terms, in order to determine the potential value of the lease amendment term to the Port.

Seifel's research indicates that Java House needs more seating in order to become a viable business and achieve a level of sales that will result in the Port receiving percentage rent. Seifel tested this observation by projecting what the sales would be if the current tenant completed just the required alterations per the Original Lease, and then the lease was extended for 10 years in 2023 on the current terms. The analysis indicates that even if the sales per square foot and per seat almost double as a result of the alterations, the annual sales volume would still not be enough for the tenant to pay percentage rent at any point in the next 14 years.

Seifel then analyzed what the sales could be if the lease were assigned to Frankie's, the required alterations and additional capital investment are undertaken, and the lease is extended for 10 years. Using a similar analysis to the one prepared by the prospective tenant, the projected sales on a per customer basis at different times in the season,

such as game days at Oracle Park and other events, weekends and weekdays. The projections following the renovations are shown below in Table 3.

**Table 3.
Projected Sales Revenues in 2020
Following Proposed Renovations by Frankie's**

	Number of Days	Average per Check	Customers per Day	Estimated Total Sales	Turns
Game Days	81	\$25	200	\$405,000	2.38
Event Days	10	\$25	175	\$43,750	2.08
Weekends	74	\$20	80	\$118,400	0.95
Weekdays	200	\$18	60	\$216,000	0.71
Total	365			\$783,150	

In addition, Seifel assumed that Frankie's would require a few years to attract customers and build its brand, which means that its revenues will build up over time. Accordingly, Seifel analyzed this dynamic by projecting how sales could grow to stabilized levels by 2023, as shown below in Table 4. While these projected sales are less than Frankie's management team provided to the Port, they represent a significant increase over current sales. The projected sales revenues of about \$1.3 million are approximately mid-point between the current sales of Red's Java House and Hi Dive (two high performing local restaurants that are directly comparable to Java House) on a per square foot and per seat basis, which Seifel deemed to be reasonable.

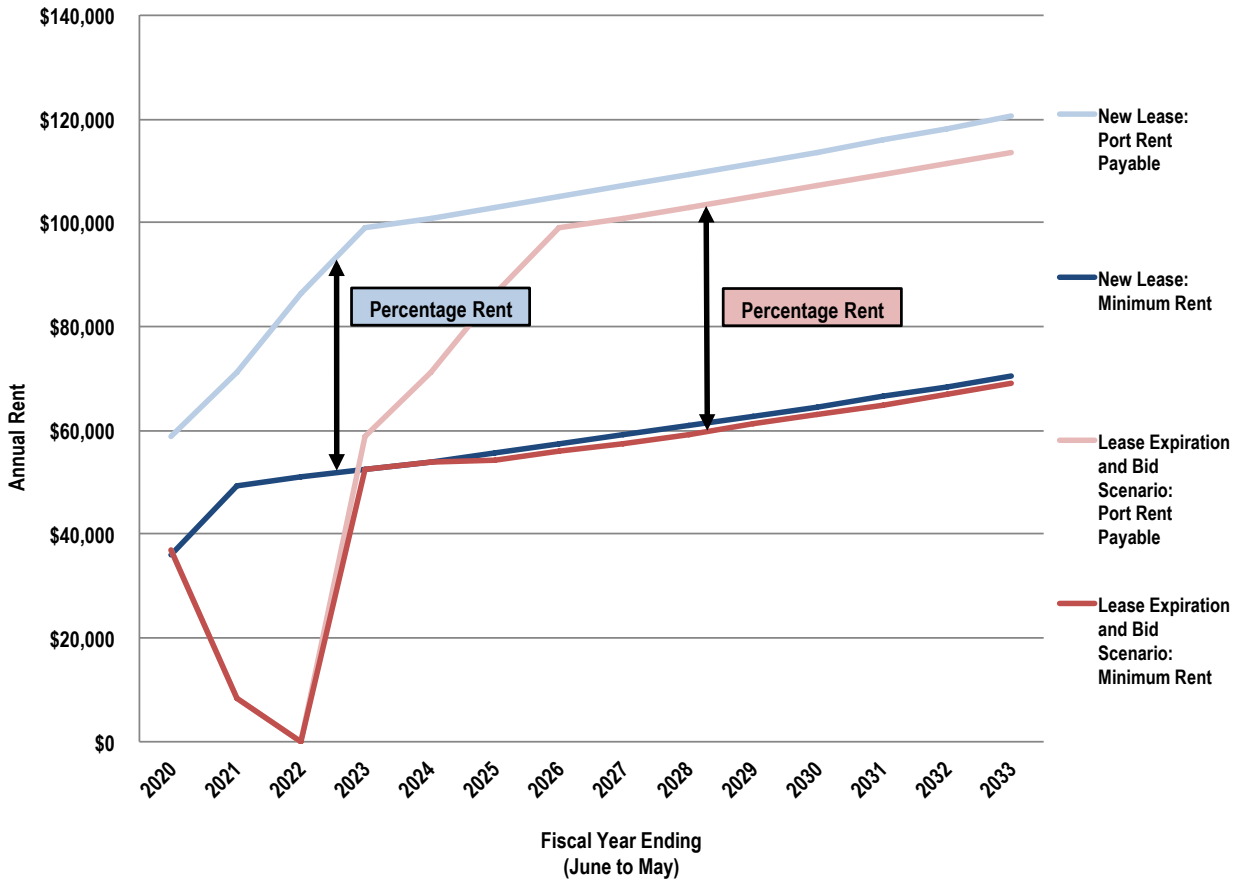
**Table 4.
Projected Stabilized Sales Revenues in 2023
Following Proposed Renovations by Frankie's**

	Number of Days	Average per Check	Customers per Day	Estimated Total Sales	Turns
Game Days	81	\$35	275	\$779,625	3.27
Event Days	10	\$30	225	\$67,500	2.68
Weekends	74	\$25	125	\$231,250	1.49
Weekdays	200	\$20	60	\$240,000	0.71
Total	365			\$1,318,375	

Chart 1. below compares the projected revenue to the Port under the following scenarios:

- New Lease (blue lines) – proposed terms and lease amendment with Frankie's lease assignment
- Lease Termination and Bid Scenario (red lines) – assumes that the Original Lease were to be terminated and the Port issues a request for bids for a new lessee.

**Chart 1.
Comparison of Projected Port Revenue
under Proposed Lease Amendment/Workout and Base Case Scenarios**



Value to Port from Lease Extension

The value to the Port is calculated based on the net present value of the future base rent and percentage rent that the Port is projected to receive as a result of increases in sales resulting from the proposed renovations and the Port’s 12% participation in net proceeds from the sale of the leasehold interest that occurs upon the lease assignment.

Table 5. below summarizes the results of the financial analysis, which compares the revenues to the Port under the proposed Amendment and Restatement of Lease with the Port’s potential revenues if the Original Lease were to terminated and the Port issues a request for bids for a new lease (Lease Expiration and Bid Scenario).

**Table 5.
Summary of Value Analysis
Comparing Projected Performance under Future Lease Scenarios
Showing Nominal Value and Net Present Value (NPV) at Six Percent (FY2019/20 \$)**

Port Value Analysis (Based on NPV of Lease Revenues)	Lease Expiration and Bid Scenario	New Lease	Value Increase	Percent Increase
Total Value (Nominal \$)	\$1,114,614	1,485,456	\$370,842	33%
Total Net Present Value (FY 2019/20 \$)	\$708,646	\$1,027,739	\$319,093	45%

As shown above, the Port is projected to receive additional value from the Frankie's renovations and lease extension when compared to the existing lease. Over the entire term, inclusive of the potential lease extension term, the value to the Port is projected to increase between 33% on a nominal basis and 45% on a Net Present Value basis.

The analysis indicates that the proposal represents fair market value as compared to competing restaurants in the area and is further evidence that a competitive bid process would not guaranty a more beneficial outcome for the Port.

Based on this analysis, and a comparison between the proposed capital investment in outdoor seating (and not the investment to correct the failure to construct the improvements required under the Original Lease) Seifel analyzes the proposed 10 year option to be an appropriate amount of term to amortize the investment.

Retail Leasing Policy

The Port Commission adopted the Retail Leasing Policy (Resolution 11-15) for existing retail tenants which calls for Port staff to evaluate renewals and extension requests on a case-by-case basis based on proposed improvements, capital costs, the Port's future plans for the site and tenant history. Port staff may negotiate with an existing tenant where a tenant proposes to make capital improvements; in such cases a lease extension may include the term required to amortize the planned improvements.

Under the policy, the Port Commission determines whether a Direct Negotiation Exception from competitive solicitation is granted based on the following criteria:

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

Port staff has determined that the proposed extension of the Java House lease term associated with the tenant ownership restructuring and lease amendments noted above meets two out of the three criteria of the policy. Java House does not meet the Tenant in Good Standing criteria due to its failure to complete the tenant improvements required under the Original Lease. However, as described above, with the assistance of Seifel, Port staff has evaluated the projected sales and revenues projections as viable and has determined the proposed capital improvements will likely generate additional revenue that the Port would not otherwise receive.

Port Staff Policy Analysis

As a basic business proposition, Port staff sees value in (a) the proposed restructuring of the tenant entity to bring in new capital to address the delinquent performance of infrastructure improvements and add new revenue-generating outdoor seating and (b) the amendment of the lease to improve the Port's revenue metrics. Based on the proposed management team's business improvement strategy and the success of similar strategies at other waterfront restaurants with casual dining and bar operations, Port staff believes the proposed transaction would reasonably be expected to improve the Port's revenues from this restaurant. This represents an opportunity to improve a Port-owned facility and operating revenue performance without investment of Port funds or incurring the costs and lost revenues of pursuing default remedies and seeking a new operator under a competitive solicitation. Normally, a competitive solicitation would be the usual path to take if there were no better solution at hand. And, since there is remaining term on the current lease, the Port could not pursue a competitive bid without first pursuing an eviction actions against the current tenant. This proposal presents an excellent opportunity to efficiently and effectively move forward to a more beneficial and certain outcome for the Port.

At the same time, Port staff observes that it is challenging at best to recommend that the Port Commission, in essence, reward the current tenant's failure to uphold the terms of its lease by facilitating a transaction that will result in that tenant's realization of a significant financial benefit. However, this is partially mitigated in the Amended Lease by the tenant's agreement to pay \$51,000 to the Port from the sale proceeds for its failure to complete the capital improvements, a payment penalty called for under the Original Lease.

In light of these challenges and with Port Commission direction, Port staff has continued to negotiate a transaction that reflects fair market value and maximizes benefits to the Port especially in light of the fact that this is a direct negotiation. Since staff's information presentation to the Port Commission on February 12, 2019, the negotiations have yielded a number of significant improvements to the business terms in favor of the Port, which include;

- 10-year extension option versus 11-years originally proposed, despite the fact that updated cost estimates reflect a total project cost of \$737,000 instead of the prior \$450,000 estimate,
- Tenant payment of \$51,000 out of sale proceeds to the Port in respect of tenant's failure to complete the tenant improvements under the Original Lease which payment is in addition to the previously negotiated 12% for participation of sale, and
- adjustment of Base Rent to reflect actual percentage rent performance in the fifth year of the extension period (if any).

In this case, the Port Commission is being asked to waive the "tenant in good standing" criteria of the Retail Leasing Policy in order to resolve this issue through a business work-out solution instead of incurring the costs and potential delays of legal action followed by the market risks and time requirements of a potentially lengthy solicitation

process. This proposal seeks to bring certainty to an uncertain situation by committing the tenant to a defined set of benchmarks and conditions that must be met prior to any benefits inuring to the tenant, while improvements to the Port's revenues commence more quickly (i.e. base rent, sale participation, completion of improvements within a year).

Port staff believe, as supported by the Seifel analysis, that the benefits of a directly negotiated agreement far outweigh the risk and costs associated with a possible default/eviction proceeding, and the loss of time and revenues and the uncertainty associated with a competitive solicitation. The prospect of a prolonged eviction solution is further exacerbated when considering the added market risk involved in light of the currently challenging restaurant business environment. Accordingly, for all of the reasons mentioned above, staff recommends a finding that competitive bidding is impractical and/or impossible and would not guaranty a more beneficial outcome for the Port; and the proposed rent under the Amendment and Restatement of Lease, along with the other negotiated terms, is not less than Market Rent (defined to mean the most probable rent that real property should bring in a competitive and open market reflecting all conditions and restrictions of the property agreement in Administrative Code Section 23.2).

California Environmental Quality Act (CEQA)

On June 26, 2019, the City Planning Department issued a Class 1 Categorical Exemption 2019-006140ENVproject. This exemption concludes the environmental review of the project and allows the Port Commission to take action on the lease amendment.

If the Port Commission approves the proposed Amendment and Restatement of Lease through the attached Resolution based on the categorical exemption, its action constitutes the "Approval Action" (as defined in S.F. Administrative Code Chapter 31, as amended, Board of Supervisors Ordinance Number 161-13). As such, the CEQA decision prepared in support of this Approval Action will be subject to appeal within the time frame specified in S.F. Administrative Code Section 31.16. Typically, an appeal must be filed within 30 calendar days of the Approval Action.

Recommendation

Port Staff recommends that the Port Commission adopt Resolution No. [] approving the Amendment and Restatement of Lease No. L-14100 with Frankie's Java House, LLC for Premises located at Pier 40½. If the Port Commission approves, the Amendment and Restatement of Lease would be subject to approval by the Board of Supervisors.

Prepared by: Mark Lozovoy
Assistant Deputy Director for
Real Estate

Prepared for: Michael Martin
Deputy Director, Real Estate and
Development

Exhibit A: Site Plan

**PORT COMMISSION
CITY & COUNTY OF SAN FRANCISCO**

RESOLUTION NO. 19-26

- WHEREAS, Charter Section B3.581 empowers the Port Commission with the power and duty to use, conduct, operate, maintain, manage, regulate and control the Port area of the City and County of San Francisco; and
- WHEREAS, on May 9, 2006, through Resolution 06-36, the Port Commission approved Lease No. L-14100 (“Lease”) with Java House, LLC (“Java House”), subsequently approved by the Board of Supervisors (Resolution 555-07) for approximately 1,490 square feet of restaurant space located at Pier 40½; and
- WHEREAS, the initial term of the Lease was for fifteen (15) years and required the tenant to make \$346,140.00 in capital improvements to the premises; and
- WHEREAS, Java House has proposed to sell substantially all of its assets and assign all of Java House’s interest in the Lease to Frankie’s Java Houses, LLC (“Frankie’s”), and
- WHEREAS, As a condition to completing the purchase of Java House, Port staff and Frankie’s have negotiated an Amendment and Restatement of the Lease which, among other negotiated terms; (i) increases the monthly rent to \$4,000.00, (ii) provides the Port a payment of 12% of the net sale proceeds from the sale of the Lease, (iii) requires a \$51,000.00 payment to the Port for Java House’s failure to complete capital improvements required under the Lease, (iv) commits Frankie’s to making no less than \$737,000.00 of capital improvements to the premises in exchange for an option to extend the term by 10 years (including those improvements that should have been completed under the current Lease), and (v) requires a personal guaranty by the principal owner of Frankie’s equal to 100% of the construction costs of the improvements, and
- WHEREAS, pursuant to Section 23.33 of the Administrative Code, it is City policy that leases be awarded in accordance with competitive bidding procedures (“Competitive Bidding Procedures”), unless such Competitive Bidding Procedures are impractical or impossible. It shall also be City policy that any and all Leases awarded without following the Competitive Bidding Procedures shall be in an amount not less than the fair market value of the leased property.

- WHEREAS, the Port staff has determined that in this circumstance the Competitive Bid Procedures are impractical and/or impossible; and
- WHEREAS, the proposed rent under the amended lease, along with the other negotiated terms, is not less than Market Rent (defined to mean the most probable rent that real property should bring in a competitive and open market reflecting all conditions and restrictions of the property agreement in Administrative Code Section 23.2); and
- WHEREAS, the Amendment and Restatement of Lease includes the terms and conditions as described in the Memorandum to the Port Commission dated July 3, 2019 for the remaining term of the Lease to August 31, 2013 and one 10-year option to extend the term of the Lease to improve and operate a casual dining restaurant at Pier 40½; and
- WHEREAS, the Planning Commission issued a Categorical Exemption 2019-006140ENV(State CEQA Guidelines Section 15332) for the project; and now therefor be it
- RESOLVED, that the Port Commission finds that in this case: (i) the Competitive Bid Procedures are impractical and/or impossible, and (ii) the terms and conditions included in the Amendment and Restatement of Lease are not less than “Market Rent” as defined in Section 23.2 of the SF Administrative Code; and be it further
- RESOLVED, that, subject to Board of Supervisors’ approval, the Port Commission approves the Amendment and Restatement of Lease No. L-14100 and authorizes the Executive Director or her designee to execute such Amendment and Restatement of Lease in substantially the same form on file with the Port Commission Secretary; and, be if further
- RESOLVED, that the Port Commission authorizes the Executive Director to enter into any additions, amendments or other modifications to the Amendment and Restatement of Lease that the Executive Director, in consultation with the City Attorney, determines, when taken as a whole, to be in the best interest of the Port, do not materially increase the obligations or liabilities of the City or the Port, and are necessary or advisable to complete the transactions which this Resolution contemplates and effectuate the purpose and intent of this Resolution, such determination to be conclusively evidenced by the execution and delivery by the Executive Director of such documents.

I hereby certify that the foregoing resolution was adopted by the Port Commission at its meeting of July 9, 2019.

Secretary