MEMORANDUM

April 7, 2016

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

FROM: Elaine Forbes
Interim Executive Director

SUBJECT: Informational presentation of the proposed Term Sheet between the Port and TZK Broadway, LLC whose members include Teatro ZinZanni and its financial partner, Kenwood Investments No. 6, LLC, for the lease and development of a hotel with approximately 180-200 rooms, a dinner-theater, a 7,500 square feet of 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 presents the non-binding Term Sheet Port staff has negotiated with TZK Broadway, LLC, a California limited liability company ("TZK") for its proposed hotel, dinner-theater, open space, and ancillary uses (the "Development" or "Project") on Port's Seawall Lots 323/324 and the two unimproved adjacent street stubs (collectively, the "Site," shown on **Exhibit "A," Site Map**), which is currently used for surface parking. This negotiation proceeded under the Exclusive Negotiation Agreement dated September 10, 2015, between Port and TZK ("ENA"), which the Port Commission authorized pursuant to Resolution 15-31 on September 8, 2015 for the Site. The Term Sheet represents the conceptual agreement on the terms and conditions proposed for anticipated transaction documents for implementing the development.

Port staff intends to present the content of the Term Sheet before the Port Commission on April 12, 2016 and to seek the Port Commission's endorsement of the Term Sheet at

THIS PRINT COVERS CALENDAR ITEM NO. 12A

its subsequent hearing on April 26, 2016. The staff report for the April 26 hearing will provide additional Project analyses, including updated evaluation of the proposed rental payments to the Port, and projected benefits to the Port, the community and the City. If the Port Commission endorses the Term Sheet, then the item will be put before the Board of Supervisors for endorsement. Obtaining the endorsements of the proposed Term Sheet from both the Port Commission and Board of Supervisors is a key ENA requirement for continuing to move the Development forward.

STRATEGIC OBJECTIVE

The proposed Term Sheet 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[1] 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 they 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, Priority Parking CA, for surface parking lot operation that generated approximately $850,000 in net annual revenue to the Port in fiscal year 2014-2015.

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

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 evolving form. It operates a venue in Seattle, Washington and operated a venue in San Francisco.

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.

The Proposed Development: Teatro and Kenwood Investments formed TZK to undertake the Development. TZK is 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. As a mixed-use project, the Development, is planned to include between 180-200 hotel rooms, 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 conceptual diagram of the Development is attached as **Exhibit "B," Proposed Project Concept**.

A single building with approximately 174,892 square feet of gross floor area is proposed to contain the hotel, short-stay guestrooms, and the dinner-theater. The hotel will occupy approximately 146,591 square feet of the gross floor area with the remaining 28,301 square feet for the dinner-theater. The Development is projected to cost $124 million funded with $64 million equity and $60 million debt. No Port or public funding is anticipated for the Development.

Between October 28, 2014 and September 8, 2015, the Port Commission and the Board of Supervisors took a number of actions that culminated in authorization to enter into the Port/TZK ENA. The staff reports and the resolutions related to the actions[2] [3] [& 4] can be reviewed at the internet links provided in the footnotes below.

<u>ENA Key Requirements and Performance Schedule:</u> TZK is required under the ENA to pursue its due diligence review of the Site suitability for its proposal, conduct community outreach to stakeholders, negotiate a term sheet for Port Commission and Board of Supervisors' endorsements, complete preliminary architectural and engineering designs, pursue all required entitlements, finalize its financial plans for construction completion and operation of the Development, and negotiate all require transaction documents, include the lease.

TZK is in compliance with the ENA requirements and has requested the Port Commission's endorsement of the proposed Term Sheet to allow TZK to continue to make progress on the Development. TZK's next milestones to attain under the ENA are: obtain Board of Supervisors' endorsement of the Term Sheet; continue with environmental review process in compliance with CEQA (California Environmental Quality Act); complete negotiation of transaction documents; and pursue required entitlements and regulatory approvals.

While the Port will support the environmental review and entitlements process, the responsibility and cost of obtaining these approvals will be borne by TZK. Upon completion of any required environmental review and finalization of negotiations by Port Staff, the Port Commission will be requested to consider the transaction documents including the lease disposition and development agreement and the lease for approval. The lease will also be subject to approval by the Board of Supervisors.

Endorsement of the Term Sheet does not commit the Port Commission to approve the Development, enter into any lease disposition and development agreement, 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.

<u>SUMMARY OF TERM SHEET</u>

The purpose of the 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 lease disposition and development agreement ("**LDDA**"), the lease (the "**Lease**"), and related transaction documents. This Term Sheet is subject to the review

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[2] http://sfport.com/ftp/meetingarchive/commission/38.106.4.220/modules/Item%2010B%20SWL%20324%20Teatro%20Action%2010-28-14-documentid=9020.pdf.

[3] http://www.sfbos.org/ftp/uploadedfiles/bdsupvrs/resolutions15/r0170-15.pdf.

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

and endorsement by the Board of Supervisors. If the Developer clears CEQA review, then the LDDA, the Lease, and related documents can be brought to the Port Commission and the Board of Supervisors for their respective considerations for approval.

Attached as Exhibit "C," is the Term Sheet. 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.

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.

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 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** plus **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.

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 **the greater** of **(a)** then existing CPI-adjusted Minimum Base Rent or **(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:** During Lease Years 3 to 7: ***(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).

15. **Participation Rent:** 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).

16. **Participation Rent:** 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).

17. **Competent Hotel Management Required:** TZK's final selection of a hotel management company or operator is subject to prior review, acceptance and approval by Port 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.

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

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

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

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

22. **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.

23. **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

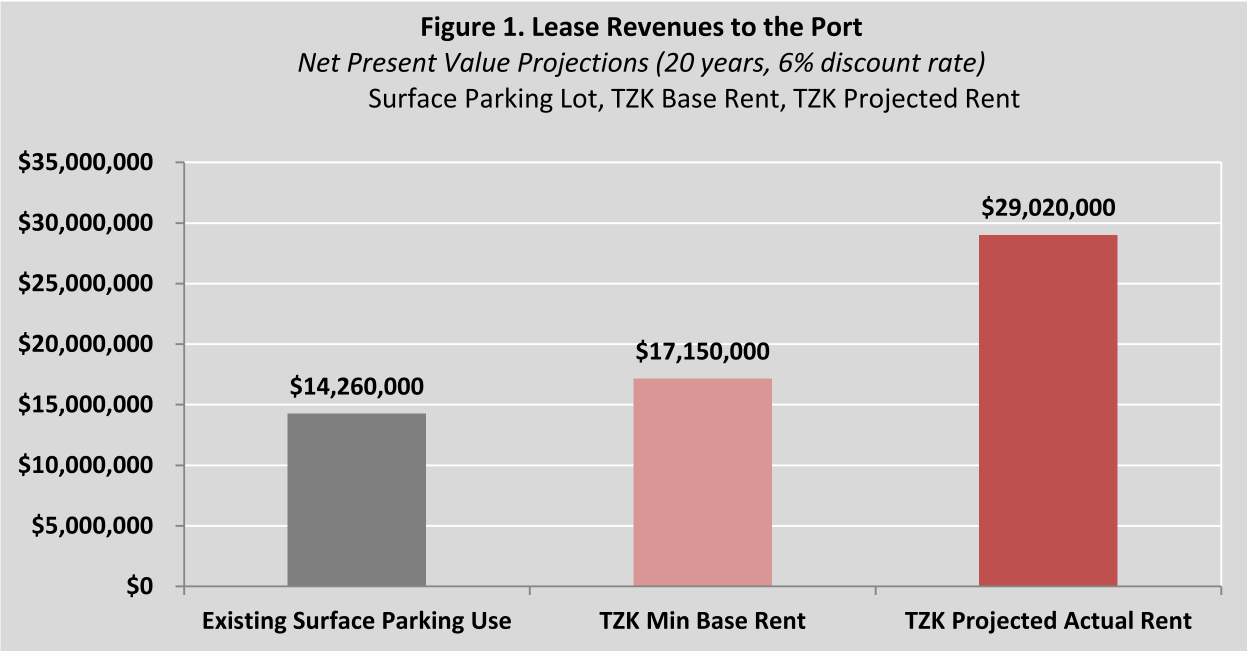
This mixed-use Development that includes a boutique hotel (defined as such due to its scale and style); dinner-theater component that will be operated by Teatro ZinZanni; and a waterfront public open space that will be adjacent to The Embarcadero, collectively, is a creative proposal that leverages the 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.



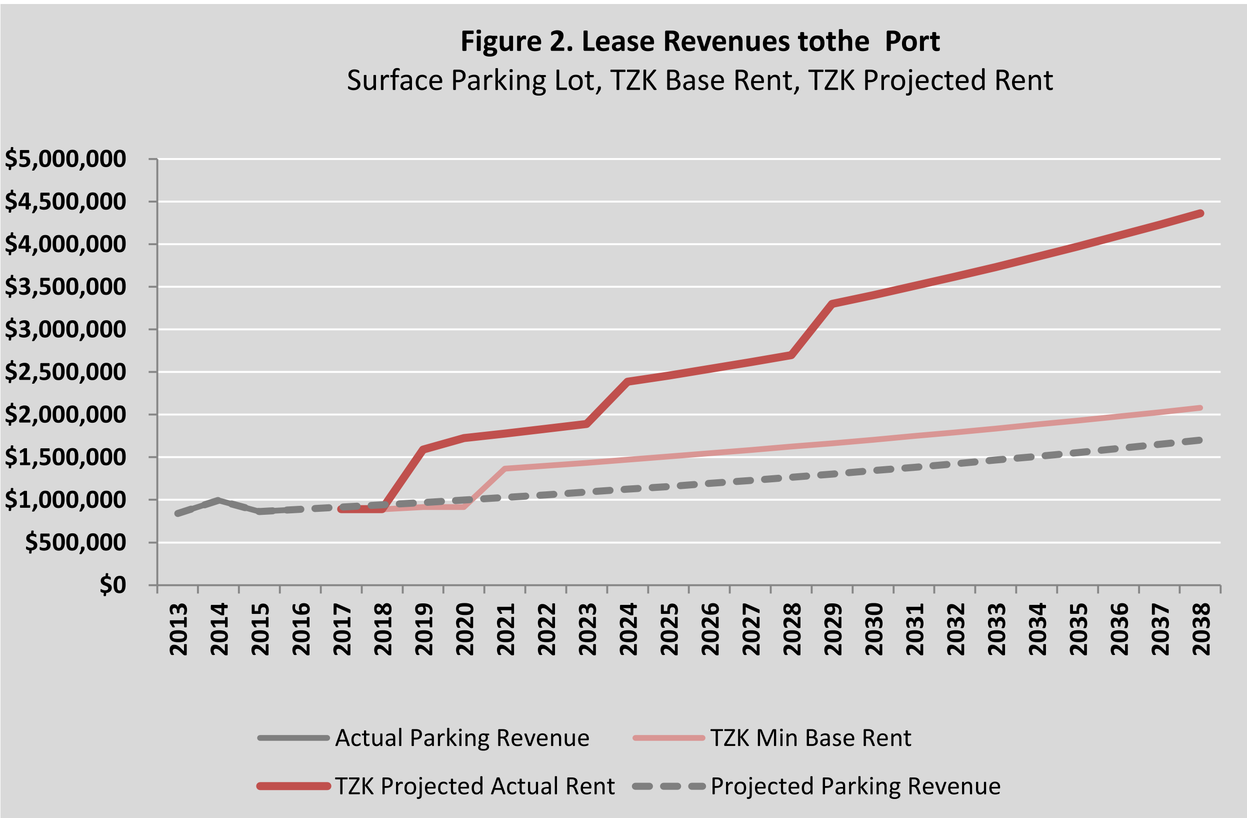


Table 1 presents projected gross revenues for the hotel operations (from lodging, food and beverages and miscellaneous operations), projected gross revenues for Teatro's dinner-theater operations (from ticket sales, food and beverages and miscellaneous operations), minimum base rents to the Port with 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 1** 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[5] 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.

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

Table 1 - 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**												
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**

ANALYSIS OF THE PROPOSED TERMS AND CONDITIONS

Based on real estate consultant reports and market comparables, Port staff analysis of the proposed Term Sheet resulted in the following conclusions:

1. The rent structure is on par or higher than comparable recent leases in the San Francisco Bay Area, particularly for small or boutique hotels. Port staff ordered a hotel ground rent survey and reviewed the pertinent comparables and their related rental rates. The comparables indicated that the base rent and percentage rent proposed for the Term Sheet are competitive and at market rate given the economic profile for the Site and the development.

Most hotel ground leases do not provide for the landlord to participate in the development upside other than through percentage rent against gross revenue. The proposed deal provides for the Port to participate in all development upsides, including profits from refinancing, assignments and sales. In return, the Port is allowing TZK to earn a hurdle rate on equity limited to an 18% internal rate of return or IRR prior to additional revenue sharing with the Port. Once the developer earns an 18% IRR, surplus cash flow is required to be shared with the Port at 70%/30% to TZK/Port until TZK attains a 25% IRR at which time the share of further profit is 60%/40% to TZK/Port.

2. The proposed terms will allow TZK to induce the necessary capital investment for the development. While the minimum base rent and percentage rent increase as the term left on the lease decreases, the lease terms/conditions provided in the proposed deal structure combined with the potential high upside in San Francisco's hotel market provides sufficient incentives to induce fresh investment capital to maintain the competitiveness of this facility.

3. There is no Port funding for any part of the Development and all costs incurred by the Port in the transaction connected to the development are to be paid by the TZK. These costs include Port staff costs, Port consultant costs, and Port attorney costs.

4. Expected benefits of the proposed development include, among other things, an architecturally-fitting, urban edge to the eastern boundary of the Northeast Waterfront Historic District and a welcoming and an activating gateway to North Beach and Chinatown.

5. The proposed Development will help sustain culture and arts in the City. Specifically, it will reinforce the City's commitment pursuant to City Administrative Code Chapter 90A, encouraging support for accommodating cultural venues on available City properties to prevent displacement for such venues.

6. The Term Sheet includes provisions addressing or limiting potential exposure of Port to risks including development, cost, and market risks, among others (described further below).

Development Risks
The Port owns the Site which is currently generating about $850,000 per year as of 2015 in net revenue to the Port and it is not encumbered. The current parking operation is an interim use not representing the Site's highest and best use. The proposed development does pose some risks to the Port most of which can be mitigated through the LDDA requirements and construction and base rent provisions. The development project represents the Site's highest and best use with greater economic benefit for the Port and the City (relative to its current use) and includes a major investment of private capital into Port property which will revert to the Port at the end of the lease.

Hotel Development Risk
Considered high-risk/high-reward investments, hotels usually pose challenges in asset valuation. As with all hotel developments, the proposed hotel will combine real estate with an operating business, and it will have high operating leverage and some economic sensitivity. It also will be management, marketing, energy and capital intensive. Despite all these, this hotel is expected to generate favorable long-term yields as a quality real estate investment given its many favorable attributes. It is in San Francisco at a premium location on the waterfront and it is of a scale that will sustain desirable occupancy over the long term. To mitigate the operating risk, the Port will insist on the hotel manager meeting certain prerequisites and that the manager-selection be subjected to Port's prior consent. Port's exposure to risk is limited to not receiving percentage rent and that can be addressed through the proposed hotel management agreement.

Entitlement Risk
The developer is already taking proactive steps to mitigate entitlement risks through its project timeline and budget assumptions, and its engagement of stakeholders to gain public support and regulatory approvals. Port's exposure to this risk is considered minimal both under its proprietary role as a landowner and as a regulator.

Financing Risk
Given the current low-interest rate environment, and the desirable quality of this hotel located in a high-tourist and business travelers area with limited supply of hotels, the availability, and cost of, funds are expected to be supportive of the proposed development. The Port's exposure to this risk is minimal since the Port is not providing any capital funding for the project and the site will not be encumbered until escrow is closed.

Cost Risk
The project is subject to the expected increases of construction costs as well as entitlement costs, if project approvals take longer than the developer had planned. Measures to mitigate this risk include cost projections that provide ample construction contingency, using guaranteed maximum pricing for the construction contract, providing for performance and payment bonds, and using competent project managers. Port's exposure to this risk is considered minimal since the Port is not providing any capital funding for the project. If there are cost overruns and the developer has to invest more

money into the project, it may take longer for the Port to share in the development's profits through percentage and participation rents.

<u>Market Risk</u>
Market or business cycle risk for the proposed development is considered minimal given the supply and demand conditions of the hotel market. Through competent hotel management with proactive stance on marketing, this risk can be mitigated. Port's exposure to this risk is considered minimal and it is limited to the percentage rent] and further mitigated through guaranteed minimum base rent.

<u>Counterparty Risk</u>
This risk usually arises from poor project oversight brought on by lack of requisite development expertise and financial capacity. *TZK members have the qualifications and financial capacity to perform as a developer and project managers.* In June 2015, Kenwood Investments provided the Port a description of its qualifications and financial capacity. BAE Urban Economics, a Port-hired third-party real estate consultant ("BAE"), and Port staff reviewed the qualifications and financial capacity information. BAE issued a report confirming that Kenwood Investments is qualified to develop the Project. Port staff filed the report with the Clerk of the Board of Supervisors on August 18, 2015. Port's exposure to this risk is considered minimal and it is mitigated by requiring the developer to reimburse all Port costs related to this transaction and further mitigated by not closing escrow until all preconditions to escrow closing are met.

<u>Operating Risk</u>
This risk usually arises from inadequate budgeting, planning and project management. This risk is being mitigated by requiring competent project manager and hotel operator who can maintain high occupancy and meet pro-forma expectations. The Port's percentage rent income is dependent on the hotel management. Port's exposure to this risk, however, is considered minimal and mitigated through guaranteed minimum base rent.

<u>FURTHER PROJECT REVIEW</u>

After endorsement of the Term Sheet by the Port Commission and the Board of Supervisors , the **Proposed Project Concept** presented in the attached **Exhibit B** will be refined and subject to a historic resources evaluation and review by the Port and Planning Department as part of the entitlement process.

Community Outreach

Representatives of TZK and Teatro ZinZanni remain committed to early and 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"), and plan to make further presentations to NEWAG as the development evolves. 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

Under the ENA, TZK is expected to complete the following by September 2016: obtain Port Commission endorsement of the Term Sheet, then seek Board of Supervisors' endorsement of the Term Sheet and continue its due diligence, complete environmental evaluation, complete negotiation of transaction documents, and seek Port Commission adoption of CEQA findings and Public Trust Consistency findings and approval of transaction documents. Thereafter, TZK is to seek the Board of Supervisors' adoption of CEQA findings and approval of the lease. There are four 6-month extension provisions in the ENA subject to extension fees that TZK can exercise if more time beyond the initial term is required to accomplish the above tasks.

Endorsement of the proposed Term Sheet does not commit the Port Commission to approve any project, enter into a lease with TZK or take any other action. The Port will not take any discretionary actions in connection with this project until it has reviewed and considered environmental documentation prepared in compliance with the California Environmental Quality Act (CEQA).

Timeline/Next Steps

Pending direction and input from the Port Commission, endorsement of the proposed Term Sheet will be presented for the Port Commission's consideration on April 26, 2016. Port Commission endorsement of the proposed Term Sheet will allow TZK, with Port staff assistance, to seek the required Board of Supervisors' endorsement.

Prepared by: Ricky Tijani
Development Project Manager

Through: Rebecca Benassini, Assistant Deputy Director
Waterfront Development

For: Byron Rhett, Deputy Director
Planning & Development

Exhibits:
A. Site Map
B. Proposed Project Concept
C. Draft Term Sheet

Exhibit A
Site Map

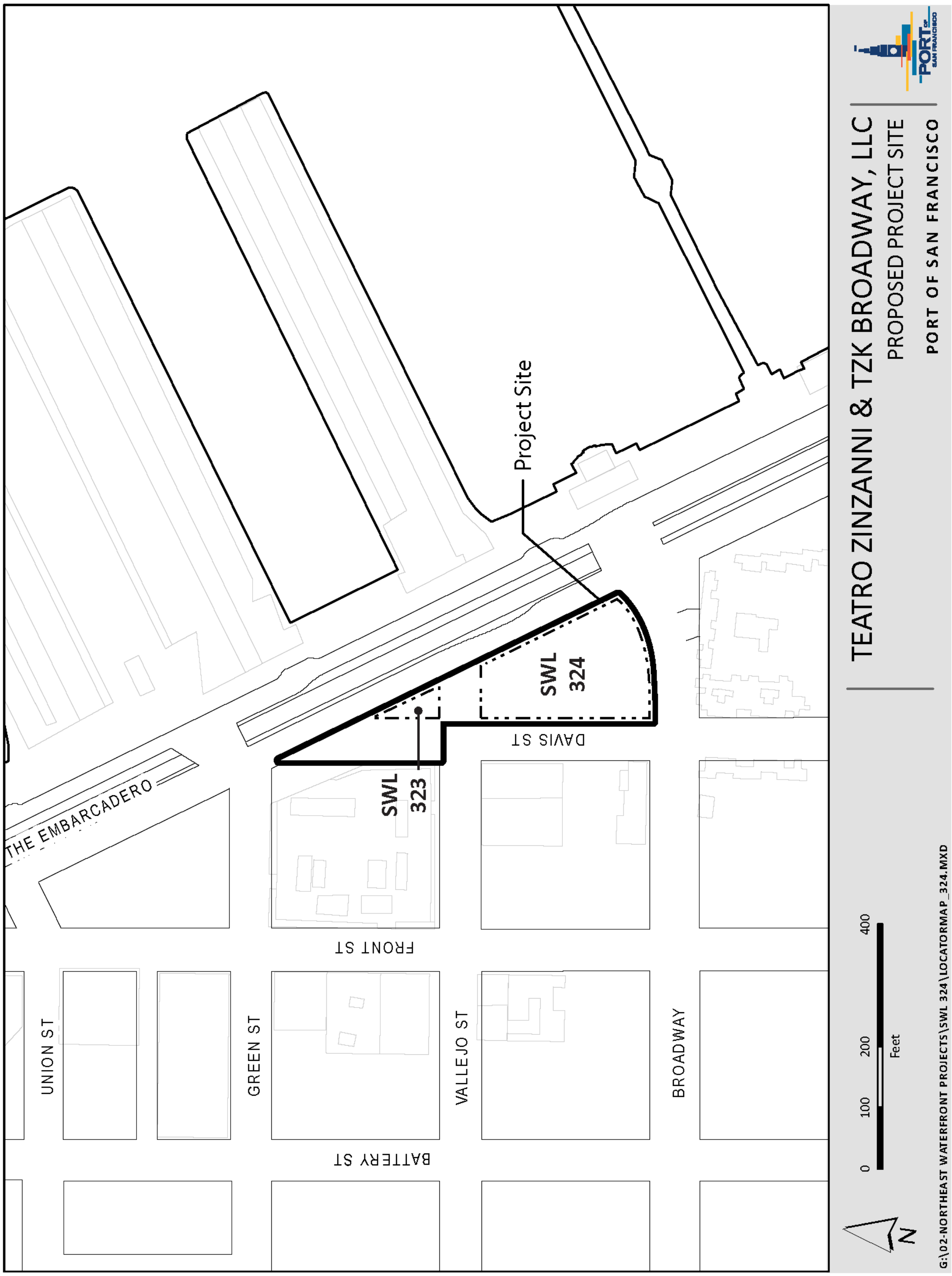
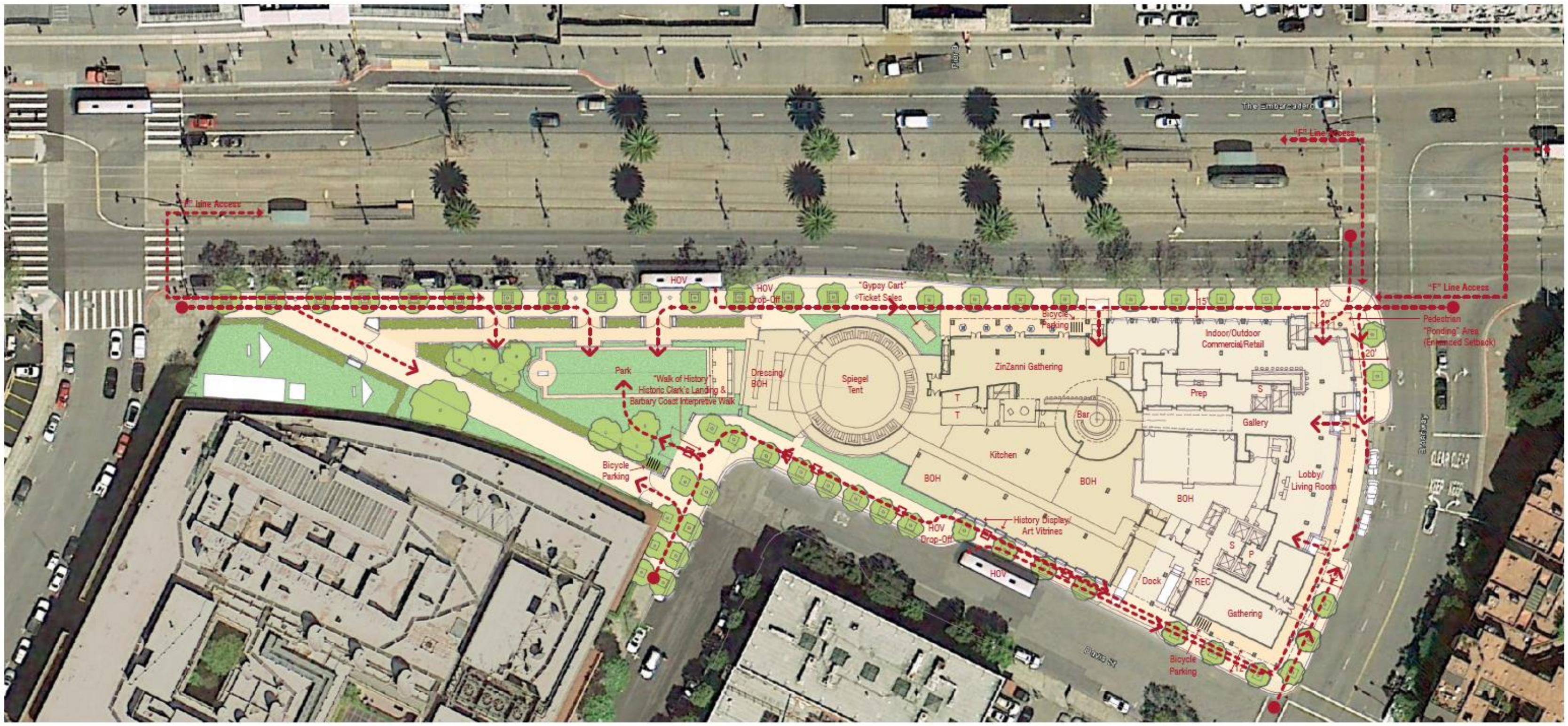


Exhibit B
Proposed Project Concept



Ground Level - Pedestrian, Circulation and Access Diagram

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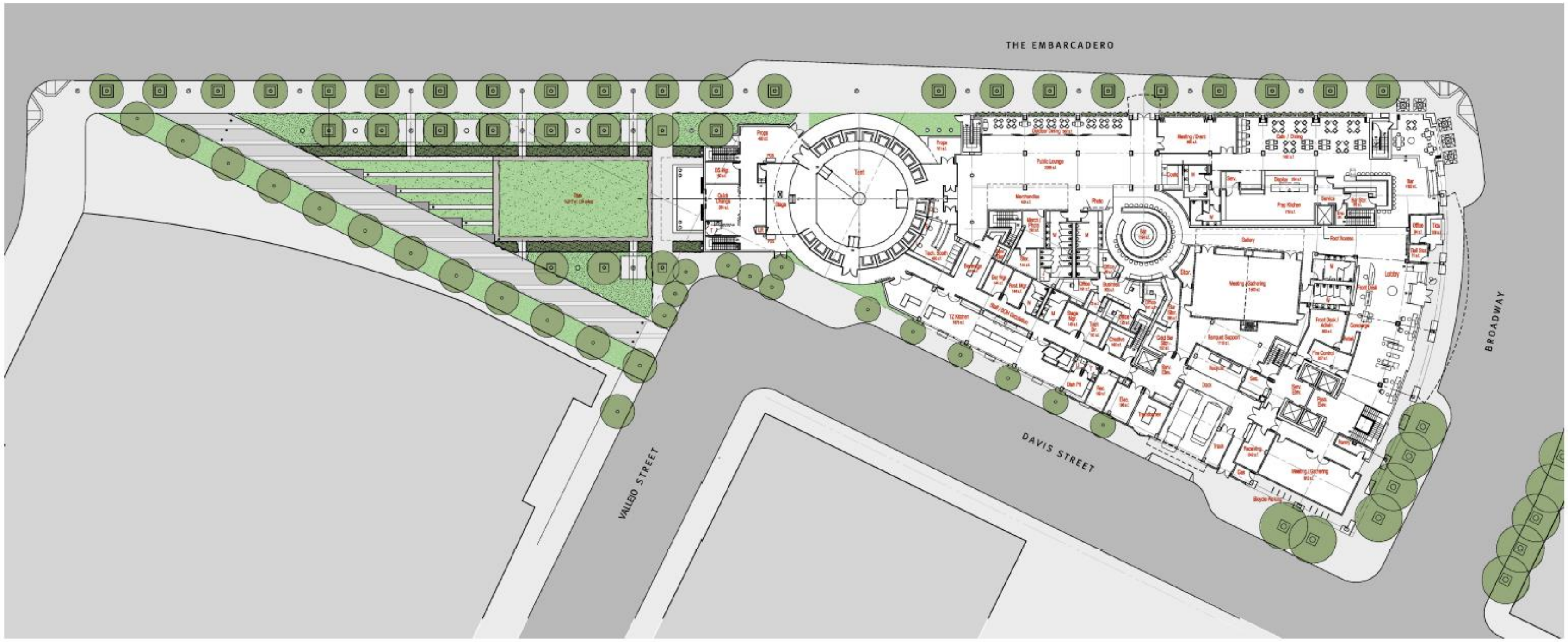
Teatro ZinZanni
KENWOOD INVESTMENTS

ZinZanni / Kenwood - The Theater & Hotel @ Broadway | San Francisco, California
A Teatro ZinZanni & Kenwood Investments Project

Hornberger + Worstell Architects



Site Plan | **New Theater and Hotel**

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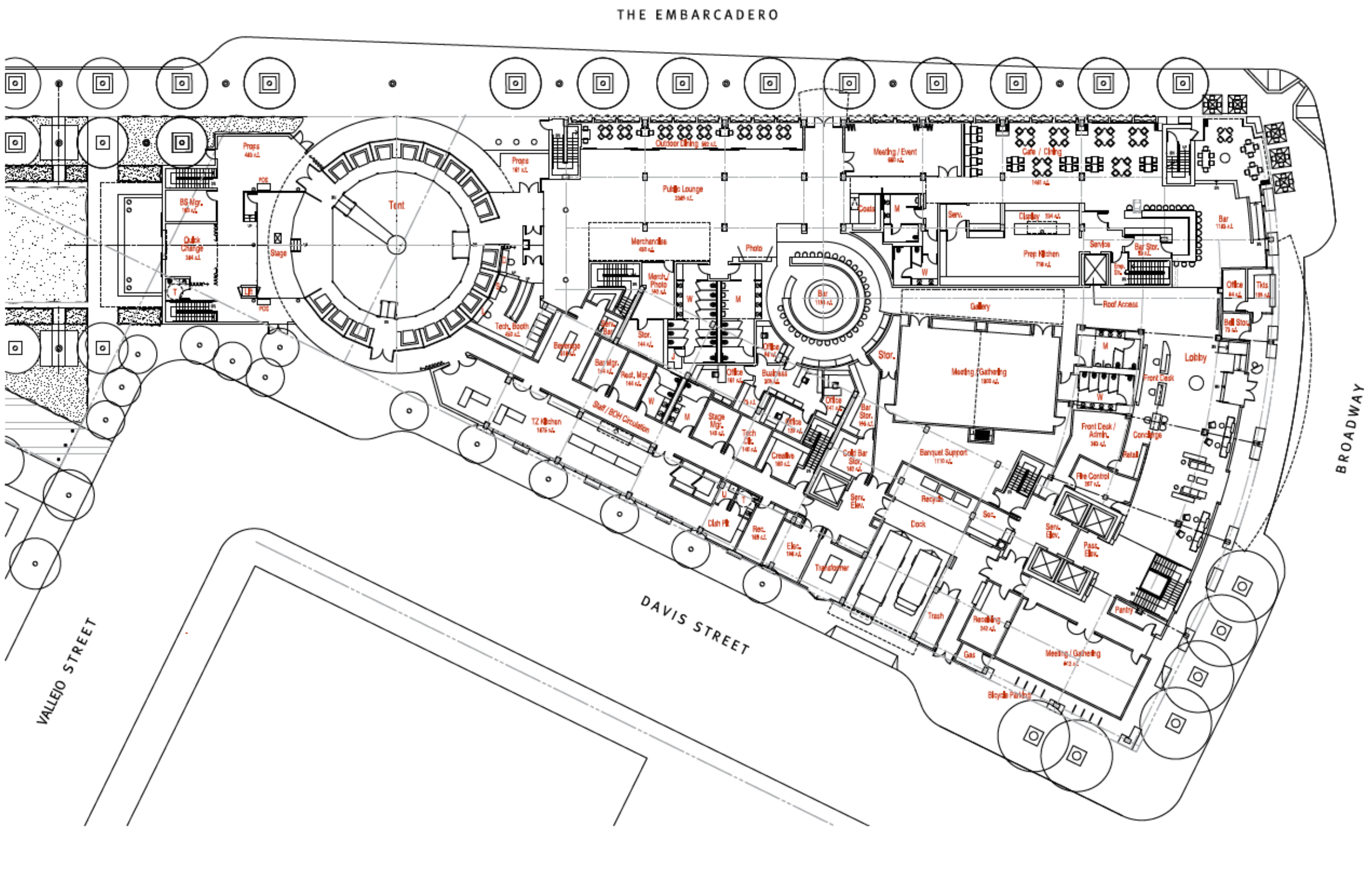
Teatro ZinZanni
KENWOOD INVESTMENTS

ZinZanni / Kenwood - The Theater & Hotel @ Broadway | San Francisco, California
A Teatro ZinZanni & Kenwood Investments Project

Hornberger + Worstell Architects

Hornberger Worstell



Floor Plan | **Ground Level**

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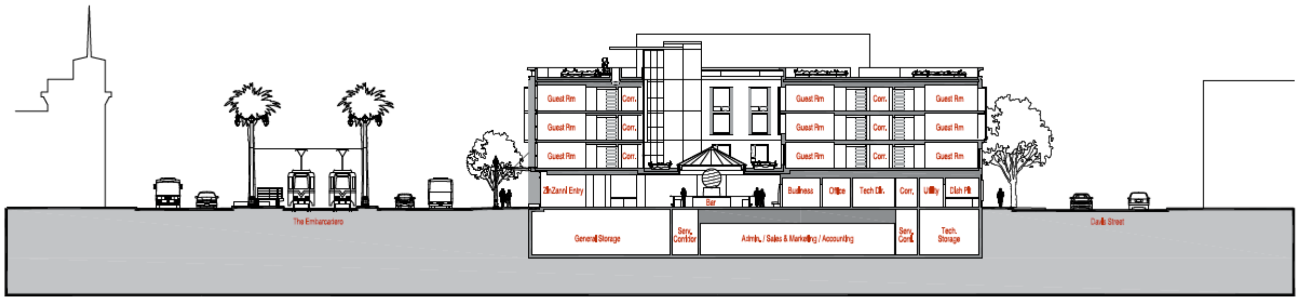
Teatro ZinZanni
KENWOOD INVESTMENTS

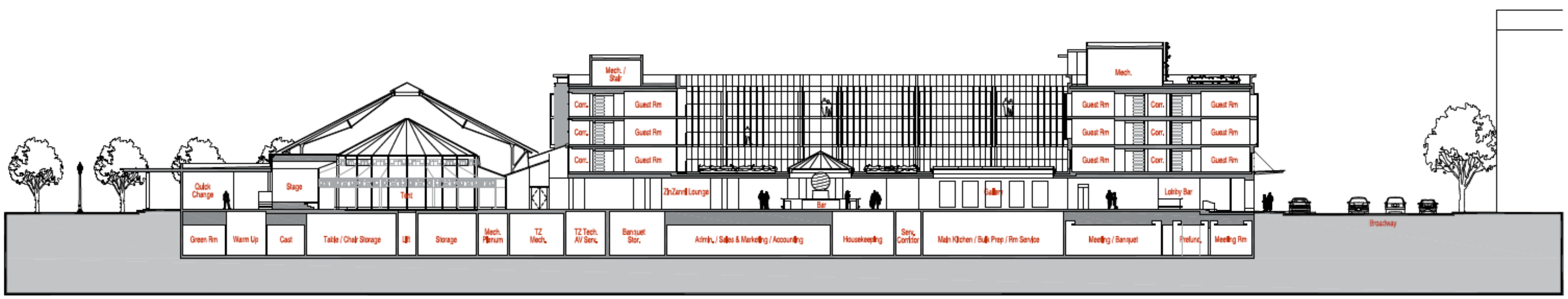
ZinZanni / Kenwood - The Theater & Hotel @ Broadway | San Francisco, California
A Teatro ZinZanni & Kenwood Investments Project

Hornberger + Worstell Architects

Hornberger + Worstell



Transverse



Longitudinal

Building Section | **Transverse and Longitudinal**

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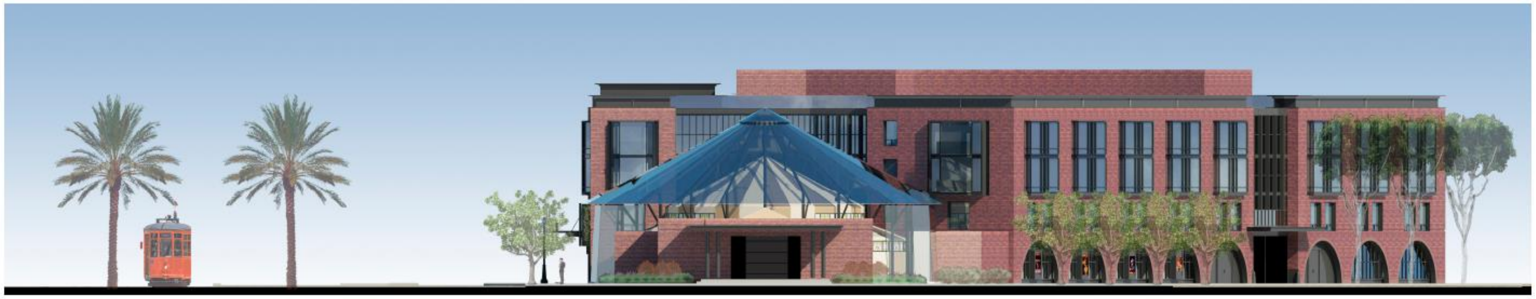
Teatro ZinZanni
KENWOOD INVESTMENTS

ZinZanni / Kenwood - The Theater & Hotel @ Broadway | San Francisco, California

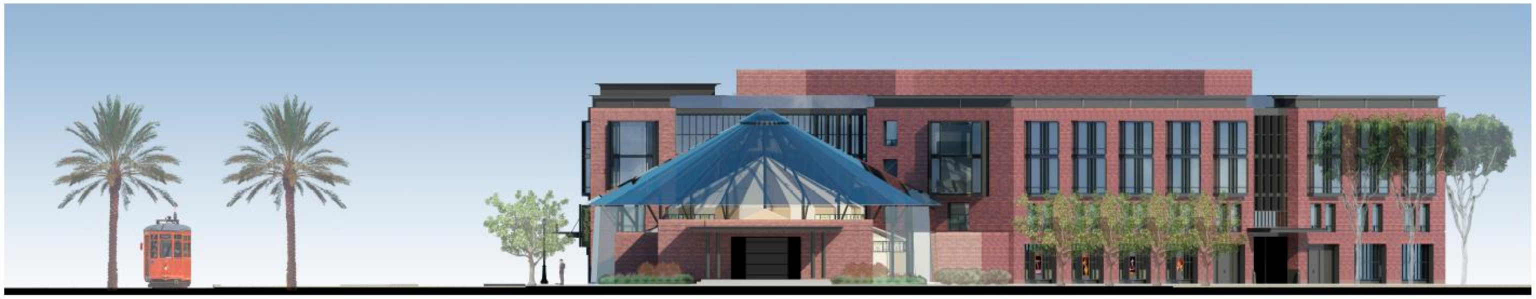
A Teatro ZinZanni & Kenwood Investments Project

Hornberger + Worstell Architects

Hornberger Worstell



Arch



Rectangular

Elevation Options - Color Scheme 1 | **Park Side**

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Teatro ZinZanni
KENWOOD INVESTMENTS

ZinZanni / Kenwood - The Theater & Hotel @ Broadway | San Francisco, California
A Teatro ZinZanni & Kenwood Investments Project

Hornberger + Worstell Architects

Hornberger + Worstell

Arch

Rectangular

Elevation Options - Color Scheme 2 | **Embarcadero**

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Teatro ZinZanni

KENWOOD INVESTMENTS

ZinZanni / Kenwood - The Theater & Hotel @ Broadway | San Francisco, California

A Teatro ZinZanni & Kenwood Investments Project

Hornberger + Worstell Architects

Hornberger + Worstell

Arch

Rectangular

Elevation Options - Color Scheme 2 | **Davis Street**

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TEATRO ZINZANNI
KENWOOD INVESTMENTS

ZinZanni / Kenwood - The Theater & Hotel @ Broadway | San Francisco, California

A Teatro ZinZanni & Kenwood Investments Project

Hornberger + Worstell Architects

Hornberger + Worstell

Existing

Proposed

Visual Analysis | **View 4 - Looking North Along The Embarcadero**

Exhibit C
DRAFT 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 of Supervisors has approved the form of Lease.

1.	<u>Parties:</u>	<u>Developer/Tenant</u>: 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. <u>Landlord</u>: City and County of San Francisco (the "**City**"), acting by and through the San Francisco Port Commission (the "**Port**")
2.	<u>Key Party:</u>	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.	Premises or Site:	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.	Proposed Development Program:	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.	Total Development Cost and Sources of Funding:	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.	LDDA Effective Date and Period to Close Escrow:	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.	LDDA Key Issues to Address:	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.	<u>LDDA Fee:</u>	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.	<u>LDDA Termination Fee and Assignment of Project Materials:</u>	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 consultants 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.	<u>Period to Complete Construction; Extension Fee; Liquidated Damages for Failure to Timely Complete:</u>	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. **<u>Liquidated Damages for Failure to Timely Complete Construction</u>**: 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.	<u>Reimbursement of Port's Transaction Costs:</u>	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;

- **Years 23 through 50**:
(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.

- **The 16-year Extension Period**:

- **Years 51 through 66**
(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. Equity Repayment and Return on Equity:

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 means 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.	Security Deposit:	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.	Environmental Oversight Deposit:	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.	Payment of Impositions	Tenant shall pay when due all impositions, such as possessory tax, license fee, or periodic permits, as applicable.
24.	Uses:	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.	As-Is Condition:	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. Assignment:

Prior to completion of the Project and during the first seven (7) years of the Lease

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.	Sublease:	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.	Leasehold Financing:	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.	Maintenance and Repair of all components of the Project, including the Park:	Sole responsibility of Tenant.
30.	Utilities:	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.	Hazardous Materials:	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.	The development must be self-supporting:	Tenant is responsible for providing the Port with a balanced development pro forma that takes into account 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 determined 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.	<u>Use Program and Conceptual Design:</u>	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.	<u>Development Management Plan:</u>	Developer/Tenant is responsible for the legal, financial, and operation management plans for all phases of the proposed Development.
41.	<u>Initial Comprehensive Financial Plan Demonstrating Development Feasibility:</u>	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.	<u>List and Analysis of Public Benefits:</u>	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.	<u>Standard Lease Terms</u>	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