KEYSER MARSTON ASSOCIATES™
ADVISORS IN PUBLIC/PRIVATE REAL ESTATE DEVELOPMENT

MEMORANDUM

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To: Rebecca Benassini, Deputy Director, Real Estate and Development
Port of San Francisco

From: Keyser Marston Associates, Inc.

Date: July 7, 2022

Subject: Draft Assessment of Market Conditions and Recommendations for Monthly Rental Rate Schedule for FY 2022/23

In accordance with your request, the consulting team of Keyser Marston Associates, Inc. and Maven Properties (KMA Team) have undertaken an in-depth review of market conditions, the Port's current Monthly Rental Rate Schedule, and leasing incentives/ concessions that are being offered in the marketplace. The purpose of the review is to provide recommendations for rental rates to be incorporated in the Monthly Rate Schedule for FY 2022/23 and a program of leasing concessions to enhance leasing efforts. As further described in this memorandum, the KMA team has recommended the following for the FY 2022/23 Monthly Rate Schedule and leasing incentive program:

- Maintaining the existing rent schedules for most office, shed, and parking properties;
- Increasing the rent schedules for nineteen properties and reducing the rent schedules for nine properties;
- Modifying the leasing incentives that are currently being offered to office, shed, and restaurant tenants.

The KMA team engaged in the following efforts to formulate recommendations:

- Obtained and analyzed relevant market data on office, industrial, cell tower and parking land uses in San Francisco;
- Toured several Port shed, office, and restaurant buildings;
- Obtained and analyzed relevant market transactions relative to the rental rate, escalation terms, concessions, and improvement requirements;

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- Reviewed the Port Commission staff reports for FY 2021/20 and FY 2019/20 and the adopted FY 2019/20 Rental Rate Schedule and supporting materials
- Discussed the Port's recent leasing activity with Port staff, as well as the market research that both the KMA team and the Port staff have collected
- Obtained and analyzed Port data on lease terms, rent roll and vacancy trends

A. Purpose of the Port's Monthly Rental Rate Schedule

The Port of San Francisco owns and leases a diverse array of properties, many of which are located on piers along the waterfront. The Port directly leases space for office, industrial, warehouse, maritime, parking, special events, and film uses. In addition, the Port has executed long-term ground leases with master lessees who have redeveloped Port properties, and these master lessees handle the leasing for these buildings, which include the Ferry Building, Pier 1, Piers 1½-3-5, and the 20th Street Historic Core at Pier 70. There are also free-standing restaurant properties for which the lease terms are negotiated and not governed by the Monthly Rate Schedule.

The purpose of the annual Rental Rate Schedule is to establish minimum parameter rents for Port properties that will be directly leased to most effectively administer the leasing process. Each year Port staff performs an analysis to assure that the minimum rents in the Rental Rate Schedule are consistent with market rates for similar properties. Given the challenges that the Covid-19 pandemic have created relative to supporting existing tenants and leasing new space, the Port retained the KMA team to assist Port staff in setting parameter rent recommendations and leasing concessions to enhance the leasing of properties.

Once the Rental Rate Schedule is approved by the Port Commission, Port staff may enter into new leases or lease renewals that equal or exceed the minimum parameters contained in the Rental Rate Schedule upon approval by the Port's Executive Director. The Port Commission must approve all leases that fall outside the parameters of the Rental Rate Schedule.

This process provides clarity and certainty to the Port Commission, tenants and staff. It also furthers the Port's goals to execute a holistic and balanced real estate strategy to effectively maximize the value of its assets and income while retaining affordable business space for certain maritime uses, non-profit entities and single proprietorships, consistent with the public trust regarding waterfront land. The Monthly Rental Rate Schedule and the Port's leasing policies take into account these key Port's goals.

The Rental Rate Schedule establishes as a minimum rent floor for each property. Port staff may lease properties at the highest rate achievable from a new lease or lease renewal. Based on discussions with staff and review of rent schedules for recently leased properties, we understand that Port staff has been able to continue to lease properties at rates consistent with the Rental Rate Schedule. Given the challenges created by the Covid pandemic, the Port has offered concession and rent abatement programs to support struggling existing tenants and secure new tenants.

B. Market Assessment

The San Francisco real estate market has been and continues to be significantly impacted by the Covid-19 pandemic. Tourism and in-office work are sectors that have been particularly impacted by the pandemic, which are key components of demand for many businesses that operate on Port properties, including ferry excursions, cruises, restaurants, retail shops, and entertainment venues. The industrial sector has been the least negatively impacted by the pandemic. There are signs that conditions are improving. Hotel occupancy rates now exceed 70%, cruises are operating, and entertainment venues and sports facilities are fully open and well-attended. The most critical lagging metric is the return of office workers to San Francisco office space. Weekly office attendance in San Francisco is currently at 30% and lags behind other metro areas, including Los Angeles, New York, and Austin Texas. The slow return to office means a significantly lower daytime population in the City each day, which leads to reduced spending in area restaurant, retail, and attractions businesses. While in-office metrics are anticipated to slowly improve, it is expected that a portion of remote work will continue indefinitely. The combination of remote work and the trend of firms relocating to lower-cost areas will continue to constrain the office market and, indirectly, the sales volumes of restaurant, retail, and entertainment businesses, which ultimately reduce participation rents to the Port.

As shown on Exhibit 1 at the end of this memo, we reviewed market data for office and industrial properties from seven real estate companies actively engaged in leasing and selling real estate in San Francisco. In addition, we provided case studies of lease transactions that were brokered by Maven Properties to highlight current rent and concession trends. We have gathered current parking, cell-tower, and maritime fee data through our own independent research. The findings from our research regarding the three major uses that are included in the Rental Rate Schedule and are summarized below.

1. Office Market Conditions

As shown in the following chart, office market conditions have continued to decline since the start of the pandemic, but the rate of decline has lessened since Q4 2020 and some metrics have started an upward path. The overall vacancy rate has quadrupled from 5.2% to 21.9%, reflecting a total vacancy of 18 million square feet in the market area. Asking rents have declined by approximately 15%. Despite these declines, there is evidence that the market has reached the bottom and conditions are improving. Absorption was positive during the Q1 2022, which reversed the trend since the start of the pandemic. The construction pipeline totaled 1.4 million square feet in Q1 2022, continuing a downward trend since 2017.

Table 1: San Francisco Office Market Trends, All Properties

	Q4 2019	**Q4 2020**	**Q1 2022**
Total Vacancy Rate	5.2%	13.6%	21.9%
QTR Net Absorption	374,000 sf	-2 million sf	205,000
Direct Monthly Asking Rent, FSG	$7.77/sf	$7.16/sf	$6.65/sf
Vacant Space	4 million sf	11 million sf	18 million sf

Source: Jones Lang Lasalle IP, Inc.

Sublease space continues to decline. Tenants continue to seek the best lease and rent packages and, accordingly subleases now make up 38.5% of all office leases. Demand for high-end office space continues to increase as businesses push for nicer space to attract employees back to the office and to take advantage of the soft marketplace. High quality office space offering private offices is currently more desirable than industrialized spaces featuring open floor plans. Landlords continue to upgrade and add amenities to older buildings to enable the properties to be competitive in the marketplace. Large transactions in early 2022 have included CBS's 90,000 square foot sublease at 680 Folsom Street and Sephora's sublease of 286,000 square feet from Salesforce at 350 Mission Street.

The Port directly manages approximately 150,000 square feet of Class B office space and 180,000 square feet of class C space. Class B and C office space has lower quality building finishes and building systems than Class A space, which are reflective of their older building conditions.[1]

[1] The Building Owners and Managers Association (BOMA) classifies office space into three categories: Class A, Class B, and Class C. BOMA states that Class A facilities have "high quality standard finishes, state of the art systems, exceptional accessibility and a definite market presence." For Class B, "building finishes are fair to good for the area and systems are adequate." Class C buildings attract "tenants requiring functional space at rents below the average for the area.

While the Port's inventory consists of Class B and C space, many of the Port's properties along the Embarcadero offer beautiful water views and proximity to parking and downtown amenities, which should enhance the desirability of these spaces.

Market data for Class B and C buildings indicate that market demand for these classes have declined in a similar pattern as for all office space in San Francisco. The vacancy rates for these properties exceed the vacancy rate for Class A properties and Class C market conditions have declined somewhat more than market conditions for Class B space.

Table 2: San Francisco Office Market Trends, Class B and C Properties

	Q4 2019	Q4 2020	Q1 2022
Class B Properties			
Total Vacancy Rate	5.6%	19.1%	27%
QTR Net Absorption	-130,00 sf	-1 million sf	15,300 sf
Direct Monthly Asking Rent, FSG	$6.80/sf $5.05/sf NNN	$6.29/sf $4.54/sf NNN	$5.98/sf $4.23/sf NNN
Vacant Space	1 million sf	4 million sf	5 million sf
Class C Properties			
Total Vacancy Rate	7%	16.6%	27.2%
QTR Net Absorption	49,000 sf	-62,000 sf	-24,000 sf
Direct Monthly Asking Rent, FSG	$6.05/sf $4.30/sf NNN	$5.66/sf $3.91/sf NNN	$4.85/sf $3.10/sf NNN
Vacant Space	130,000 sf	308,000 sf	557,000 sf

Source: Jones Lang Lasalle IP, Inc.

The strength of hiring in office-based industries coupled with the continued flow of venture capital and return to in-office work are expected to translate into continued improvement in the demand for office space. As the number of office workers increase, the performance of many Port properties will also improve, including the many restaurants and entertainment businesses that serve office workers. The demand for Port office space will also be positively impacted by the general rebound of the office market.

2. Recommendations for Office Rental Rate Schedule

The current parameter rents for office properties are generally somewhat less than current general market conditions. We believe that this is appropriate given the age and condition of the Port's buildings and the significant decline in market conditions since the rates were set in 2019. Given these considerations, we are recommending that the parameter office rent schedule remain unchanged for 14 of the 26 office properties. We have suggested rent increases for 7 properties and decreases for 5 properties based on discussions with Port staff regarding the unique qualities of the space and leasing experiences, as follows:

Table 3: Proposed Changes to Office Rents

	Current Monthly Rental Rate	*Proposed Rate for FY 2022/23*
Proposed Rent Increases		
Ferry Plaza, Ag. Bldg. Interior	$1.60 to $1.84	$1.75 to $2.00
Ferry Plaza, Ag. Bldg. Window	$3.50 to $4.03	$3.75 to $4.05
China Basin, 401 Terry Francois	$3.50 to $4.03	$3.60 to $4.05
China Basin, Pier 54 Office	$1.50 to $1.84	$1.95 to $2.50
China Basin, Pier 70, Bldg. 11	$1.10 to $1.27	$1.20 to $1.50
Southern Waterfront, 501 Cesar Chavez	$1.30 to $1.50	$1.60 to $2.00
Port-wide, Office Storage	$1.70 to $1.96	$2.00 to $2.55
Proposed Rent Decreases		
Fisherman’s Wharf, 490 Jefferson	$3.50 to $4.03	$3.00 to $3.50
NE Waterfront Pier 29 1/2	$2.25 to $2.59	$2.00 to $2.75
NE Waterfront, Pier 29 Annex “beltline” bldg.	$3.15 to $3.62	$2.25 to $2.75
NE Waterfront, Pier 35 Interior	$2.50 to $2.88	$2.25 to $2.75
Southern Waterfront, 601 Cesar Chavez	$1.80 to $2.07	$1.30 to $1.50

3. Industrial and Warehouse Market Conditions

The industrial market has remained relatively strong during the pandemic. Inventory in San Francisco has declined since 2020, resulting in tight market conditions. Vacancy rates have dropped since the first quarter of 2020 and currently stand at 3.9%, but rates have increased for smaller dated warehouses that do not easily tie into e-commerce distribution. Rents throughout the broader San Francisco/San Mateo County region have steadily risen during the pandemic due to the strength of the biotech market. The key driver of demand in San Francisco has been last-mile services due to the growth of e-commerce. The other active industry in San Francisco is advanced mobility firms. The outlook for the industry is strong due to the continued strength of e-commerce and limited opportunities for new development. Rental rates and absorption are anticipated to rise, while vacancy rates and concessions are anticipated to decline.

Table 4: San Francisco Industrial Market Trends

	Q1 2020	**Q4 2020**	**Q1 2022**
All Industrial in San Francisco			
Total Vacancy Rate	5.0%	4.8%	3.9%
QTR Net Absorption	--320,000 sf	28,000	7,135
Direct Monthly Asking Rent, IG	$2.39	$1.99	$1.92
Inventory	15,870,000	15,801,000	15,777,000
Warehouse & Distribution			
Total Vacancy Rate	5%	4.7%	3.7%
QTR Net Absorption	-300,000 sf	23,000	10,000
Direct Monthly Asking Rent, IG	$2.44	$2.12	$2.02
Inventory	14,102,000	14,026,000	14,001,000

There is approximately 14.7 million square feet of space in the submarket areas that span the Embarcadero, from the Northern waterfront to Bayview Hunters Point. Logistics space represents the largest component of space at 9.1 million square feet. Rents for logistic space range from allow of $2.50 per square foot in the Northern Waterfront area to a high of $3.30 per square foot in China Basin. Vacancy rates range from a low of .4% in the Northern Waterfront to 6.9% in Bayview Hunter's Point. Market demand is strong in the area and rents are expected to increase by 6% to 7% over the next 12 month.

The majority of the Port's industrial and warehouse space is located in Pier sheds that are categorized as Class C space. These properties have various levels of building improvements, ranging from large open shed spaces that may or may not include interior walls, partitions, fencing and utilities. Many of the Port's properties lack loading docks, attached office space and non-permeable concrete floors, and many share a common drive aisle, some adjacent to busy streets.

Despite these conditions, the Port has been able to negotiate favorable rental rate terms for much of its industrial and warehouse space given the scarcity of industrial property in San Francisco and the location of a substantial amount of the Port's shed space along the Embarcadero, which has great access to the Bay Bridge, the Downtown, and Fisherman's Wharf.

According to Port staff, demand for industrial and warehouse space varies from building to building based on its location and building condition. The Port directly manages approximately 1,600,000 square feet of industrial and warehouse shed space and represents approximately 6.5% of the industrial market in San Francisco. The majority of Port warehousing and shed space is categorized as Class C. The average rent for industrial space in San Francisco is about $2.06 per square foot per month.

The Port's industrial properties have various levels of improvements including partitions, fencing, electrical service, plumbing, etc. Private industrial warehousing shed spaces are typically leased under NET leases with space defined as "gross leasable area." The majority of these spaces lack modern loading docks, attached office space, non-permeable concrete floors, and share a common drive aisle. Despite the limited infrastructure, the demand in the marketplace is such that the Port will likely see an increase in negotiated rental rates this fiscal year. This is due in large part to demand in the marketplace and the general scarcity of industrial land in San Francisco. The Port's current industrial and warehouse shed vacancy rate higher than the City average at 25%.

4. Recommendations for Industrial Pier and Shed Rental Rate Schedule

Based on market conditions, we are recommending that the rental rates on Northeast Waterfront properties remain as is. Demand is stronger in the Fisherman's Wharf area, so we are proposing modest rent increases to the two properties in Fisherman's' Wharf. Similarly, we are proposing rent increases for properties in China Basin and a portion of the properties in the Southern Waterfront. Several of the buildings in South Beach are in relatively poor condition and we are recommending rent decreases for those buildings. There is strong demand for paved and unpaved land to provide for construction staging and storage. Given the demand, we are recommending rent increases for the Port's paved and unpaved land properties.

Table 5: Proposed Changes to Industrial Rates (Pier and Shed and Land)

	Current Monthly Rental Rate	*Proposed Rate for FY 2022/23*
Proposed Rate Increases		
Fisherman's Wharf, Pier 47	$1.60 to $1.76	$1.65 to $1.85
Fisherman's Wharf, Pier 45	$1.60 to $1.76	$1.65 to $1.85
China Basin, Pier 54 Shed	$0.70 to $0.77	$0.75 to $1.25
China Basin, SWL 343 and 345	$1.25 to $1.38	$1.30 to $1.45
Southern Waterfront, SWL 349	$1.10 to $1.21	$1.20 to $1.40
Southern Waterfront, SWL 352 and 344	$1.10 to $1.21	$1.25 to $1.40
Southern Waterfront, Pier 96	$1.25 to $1.38	$1.30 to $1.40
Open Land, Pedicab	$20 per pedicab	$30 per pedicab
Open Land, Paved Land	$0.45 to $0.50	$0.55 to $0.75
Open Land, Unpaved Land	$0.35 to $0.39	$0.40 to $0.50
Proposed Rent Decreases		
South Beach, Piers 26 and 28	$1.75 to $1.93	$1.70 to $1.80
South Beach, Pier 40	$1.75 to $1.93	$1.65 to $1.85
South Beach, Pier 40 Maritime Tenants	$1.75 to $1.93	$1.10 to 1.50
Proposed New Property Categories		
Open Land – Subterranean Land with Industrial Power Capacity	NA	$0.39 to $0.61
Open Land & Pier Air Space	NA	$0.40 to $0.50
China Basin, Pier 54 Apron	NA	$0.15 to $0.25

5. Parking Market Conditions

While BART ridership is less than 30% of 2019 levels, traffic on the Bay Bridge and Golden Gate Bridge are 80% to 90% of pre pandemic levels due to a shift from public transportation to private cars. This shift in demand has helped off-set the impact of the loss of tourism.

The Port owns and operates a diverse set of parking facilities along the waterfront, with most parking spaces leased to Port tenants.

We are recommending that monthly stall rates be increased for each parking facility as follows.

Table 6: Proposed Changes to Parking Rates

	Currently Monthly Stall Rent	*Proposed Rent for FY 2022/23*
Agriculture Building – Building Tenant	$ 425.00	$ 437.50
Pier 9 – Shed Tenant	$ 425.00	$ 437.50
SWL 302 – Commercial Tenant	$ 400.00	$ 412.50
SWL 302 – Restaurant Tenant	$ 275.00	$ 287.50
SWL 303 – Commercial Tenant	$ 400.00	$ 410.00
SWL 303 – Restaurant Tenant	$ 275.00	$ 290.00
Pier 26 – Shed Tenant	$ 250.00	$ 275.00
Pier 40 – Berthholder	$ 125.00	$ 150.00
601 Cesar Chavez – Building Tenant	$ 187.50	$ 215.00
Pier 80 – Industrial Trucking	$ 200.00	$ 275.00
Pier 90 – Industrial Trucking	$ 250.00	$ 275.00
Pier 94 – Industrial Trucking	$ 250.00	$ 275.00
Pier 96 – Industrial Trucking	$ 250.00	$ 275.00

C. Leasing Incentives and Concessions

Maven Properties assessment of market trends relative to incentives and recommendations for Port properties is provided as Attachment 2 to this memorandum.

D. Conclusions

Market conditions and trends indicate that the San Francisco economy is recovering from the pandemic. While office workers have been slow to return to their offices and it is anticipated that the level of in-office work will be permanently diminished relative to 2019, tourism, the residential market, and in-office work are rebounding. During this recovery period, the demand for Port assets varies based on location and the linkages of the businesses that are occupying space to tourism and in-office work. As the portfolio adjusts to changing market conditions, we are recommending a range of adjustments to the parameter rent schedule. For most properties, we are recommending that the rate schedule remain unchanged. However, based on market conditions and Port staff experiences, we are recommending that rental rates for 32 properties be increased and that rents for nine properties be decreased.

ATTACHMENT 1:

List of Reviewed Brokerage Information

1. Office Market Reports

- Jones Lang Lasalle, San Francisco Office Insight, Q4 2019, Q4 2020; Q1 2022
- CoStar San Francisco Office Market Report, May 2022
- CBRE Marketview, San Francisco Office, Q4 2020, and Q4 2021
- Colliers International, San Francisco Office Market, Q4 2020 and Q4 2021
- Cushman & Wakefield Marketbeat, San Francisco Office, Q4 2020 and Q4 2022
- Kidder Mathews, Real Estate Market Review, San Francisco Office, Q4 2020 and Q4 2022
- Newmark Knight Frank, San Francisco Office Market, Q4 2020 and Q4 2021

2. Industrial Market Reports

- Jones Lang Lasalle, San Francisco Industrial Insight, Q1 2020, Q4 2020, and Q1 2022
- CoStar San Francisco Industrial Market Report, May 2022
- Cushman & Wakefield, San Francisco Industrial Market, Q4 2020 and Q4 2021
- Kidder Mathews, Real Estate Market Review, SF Peninsula Industrial, Q1 2020
- LoopNet.com parking searches

ATTACHMENT 2

Leasing Strategy and Concession Recommendations

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OFFICE SECTOR

As of Q4 2020, the San Francisco office market has surpassed a 15% vacancy rate and 20% availability rate. As a result, the San Francisco office market is experiencing a decrease in minimum rental rates and an overall change in leasing strategy. As was the case during the Great Recession (2007-2009), the vacancy rates in Class A buildings are relatively lower than the vacancy rate in Class B and C office buildings. This trend is caused by the slight reduction in Class A office rates, the less competitive environment for Class A office, and the natural tenant shift to quality office buildings, a result of the ability to seek better quality office space for their dollar.

<u>Trends & Leasing Strategy</u>

Office	
Tenant Incentives	Trends & Leasing Strategies
Extended rent abatement period	Tiered Rent Structure
Reduced Year 1 & 2 Rent	Increased Procuring Broker Commissions ($3.00 PSF)
Shorter Lease Terms	Shorter Lease Terms
Favorable terms in exchange for Lease Extensions	Rent Abatement
	More Abated Rent/ Less TI Allowance
	Softer approval process on as-is deals
	Blend & Extend (Rent Adjustment in exchange for Lease Extensions)
	Active submarket - Large discounts on sublease deals
	Emphasis of Private Offices / Private Entrances / Outdoor Areas
	Quoting Pre-Covid Rents coupled with "Make an Offer"
	Smaller, neighborhood office spaces are more active

As office vacancy continues to surge throughout San Francisco, turnkey spaces are inundating the market in all office classes. Tenant improvement allowances, previously reaching more than $100/PSF, are now substantially lower and often non-existent as tenants absorb spaces that had been renovated within the last few years. In certain cases (and more so in Class B and C office buildings), landlords are offering extended periods of rent abatement to offset the tenant’s improvement costs. Maven is also finding that landlords across many asset classes (including office) are relaxing their credit standards, often seeking enough security to cover their transactional costs.

As landlords seek out new tenants to fill their vacancies, they are simultaneously seeking out “blend and extend” opportunities with existing tenants, where tenants exchange an extension of lease for more favorable and immediate lease terms (lower rental rate, additional capital improvements, etc). Short term leases have also become more popular on vacant space as tenants seek flexibility while landlords strive to position themselves for a market rebound.

Tiered rent structures are becoming more prominent in the market, providing tenants with a significantly reduced Year 1 minimum rental rate, but making larger adjustments in the later years of the initial term to achieve a blended rate closer to landlord's pre-Covid rate. Brokers are quoting minimal rental rates coupled with a "make an offer" note in effort to initiate tours and proposals. As seen in the Great Recession, landlords are increasing procuring leasing commissions to as much as $3.00/PSF/Year to incentivize brokers.

San Francisco continues to experience a very active submarket with 5.9% of the market inventory available for sublease. With almost 11 million square feet of available sublease space, tenants are able to secure office space at large discounts, leaving the master tenants to pick up rent shortfalls. This surplus of space will pressure asking rents, and landlords will need to continue to be aggressive in securing tenants for years to come.

Lastly, directly due to the pandemic, Maven has determined that tenants in today's market have shifted their focus from open floor plans to spaces with more individual offices and conference rooms. They are also seeking space with outside areas, private entrances, and spaces that are near parking.

<u>Recommendations</u>
The Port inventory contains office properties with a significant amount of outside area. The Port should work on retaining existing office tenants and assess existing vacancies and asking rents; extend rent abatement schedules and/or offer shorter term leases to compete with comparable spaces.

INDUSTRIAL

Although the pandemic delivered a jolt to San Francisco's industrial market, the industrial sector is expected to outperform all other asset types. The San Francisco industrial market consists of three major submarkets in addition to the Port: SOMA, 3rd Street/Potrero Hill and Bayview/India Basin. While the rental rates softened in 2020, the lack of new developments and overall supply limitations in San Francisco have created a relatively stable environment in comparison to other property types.

<u>Trends & Leasing Strategy</u>

Industrial	
Tenant Incentives	Trends & Leasing Strategies
Free Rent	Reduced Rent, but shorter lease term
Soft approval process on 'as-is' deals	More Abated Rent/ Less TI Allowance
	Shorter Lease Terms
	As-is / Less Landlord Work

Flex space has experienced the biggest setback with over 10% of San Francisco's flex space sitting vacant. The larger San Francisco industrial sector is experiencing a 6.7% vacancy factor, considerably higher than 2019 and above the national average. Landlords are using tools such as extended rent abatement, short term leases, and tiered rent schedules to lure tenants into spaces. We are also seeing more "as-is" transactions with little or no landlord work contribution, but rather an offset of tenant's improvement costs against minimum rent. Landlords are finding that offering short term leases are getting their spaces filled sooner and are also providing landlords with the ability to reset the rents in what should be a better market.

<u>Recommendation for Port Inventory</u>
Although the overall industrial vacancy has increased over the last year, we have not seen enough of a dip in the market rents to recommend any reduction in asking rates and would therefore recommend that

asking rents remain unchanged. However, the Port should consider increasing rent abatements in lieu of tenant improvement allowances to compete with the marketplace.

MARITIME

With exception to passenger and tourist business, maritime operations continue to be impacted at a far lower rate than that of office, retail and restaurant – perhaps a direct reflection of its "essential nature" and its overall necessity to commerce. The Port of Oakland reported only a 6% profit loss at the start of Q4 2020 with expectations that it will continue through most of 2021. Unlike Oakland, however, San Francisco is highly dependent on tourism and passenger business, which has experienced a tremendous decline since the start of the pandemic.

Trends & Leasing Strategy

Maritime	
Tenant Incentives	Trends & Leasing Strategies
Rent relief packages in the form of deferred rent	Right to relocate or downsize tenant footprints throughout lease term
No rent increases on short-term extension	Provide substantial TI allowance in the form of amortized rent abatement to off-set necessary improvements.
TI Allowance in form of Rent Abatement	Keep tenants at their current locations or relocate elsewhere in the Port inventory

The Ports of Oakland and Richmond are providing incentives to existing tenants to sign short-term extensions by either not increasing annual rent or by providing tenants with larger-than-normal tenant improvement allowances in the form of rent abatement at the start of the lease extension. This contribution allows the respective tenant to make necessary improvements to their facilities. In many cases, these tenant improvement allowances are being utilized by tenants to upgrade unimproved land by means of fencing, and utility upgrades and installations.

In addition, both the Port of Oakland and San Diego have provided relief to tenants in the form of rent deferment, especially for industries that have been hit hardest by the pandemic.

Recommendation for Port Inventory
We recommend that the Port keep rents at current levels and place emphasis on retaining tenants by offering rent relief packages and extending lease terms. The Port should consider offering additional rent abatement to offset the cost of necessary tenant improvements in exchange for lease extensions.

RETAIL

According to Yelp data, thousands of businesses temporarily closed in the last year and a startling number of those businesses permanently closed. As a result, vacancy rates across San Francisco have experienced a sharp increase and market rents have softened, even in the most desirable retail areas. Although retailers are limited in general, Maven is seeing certain national tenants enter the market for new space (or for supplementary locations) and smaller retailers looking for opportunities in Hayes Valley and Fillmore Street that have not existed for years. We are seeing opportunities on prime corners and many spaces have hit the market that have not been available in decades.

Trends & Leasing Strategy

Although this may be an opportune time for retailers to negotiate the best terms for the top spaces, many remain on the sidelines until they see signs of economic improvement. Many are finding the middle ground, sparking trends such as pop-up concepts or short-term leases with longer option periods. More sophisticated retailers are signing long term leases to lock in a gentler rent but including early termination rights, whether unilateral or triggered by low sales volumes.

With tourists and foot traffic down over 80% in the downtown areas, retailers have found solace in the neighborhoods. Although Hayes Valley, Chestnut Street, Fillmore Street, and Noe Valley have had their share of turnover, many of the vacant spaces have already been leased, albeit at slightly lower rents. Landlords have recognized the delays in permitting and have agreed to take on more of the base building work and/or add extended permit contingency periods. And as the pandemic continues, Landlords have also added Covid-related language to their leases to predetermine the base rent during any partial or full government-mandated shutdown. Landlords have also delayed lease and rent commencement dates to fall in line with the summer months when most believe the pandemic will be better under control.

<u>Recommendation for Port Inventory</u>

Retail	
Tenant Incentives	Trends & Leasing Strategies
Tiered rent years 1-3	Percentage Rent (often coupled with the lesser of base rent or % rent, etc)
Extended rent abatement period	Pop-Ups
Limited personal guarantees	Short term leases with longer options
COVID clauses to protect against shutdowns	Extended permitting contingency periods
Delayed lease/rent start dates	Current focus is on neighborhoods / close to home
Bonus Commissions for Brokers	Landlords performing more base building work (ADA, vanilla shell)
	Early termination clauses / often based on sale performance
	COVID Clauses / Often based on allowable occupancy
	As-is delivery condition (with or without TI Allowance)
	Offsetting TI allowance with abated rent
	Longer permit contingency periods due to City delays
	Softer approval process on as-is deals
	Gross leases in short term deals
	CAM/NNN Caps

RESTAURANTS

The heartbreaking pain that the pandemic has caused the San Francisco restaurant industry is widely acknowledged. At one point in May 2020, The Golden Gate Restaurant Association reported that they expected 50% of restaurants in San Francisco to permanently close. However, while we have seen many restaurants close, including some that are iconic San Francisco businesses, the restaurant industry – although incredibly volatile – has been incredibly active over the last 12 months. Since the start of the pandemic, 48.6% of Maven lease transactions were restaurant-related transactions.

Restaurant	
Tenant Incentives	Trends & Leasing Strategies
Percentage Rent-Only / Years 1-3	Percentage Rent (often coupled with the lesser of base rent or % rent, etc)
Tiered rent years 1-3	Extended permitting contingency periods
Extended rent abatement period	Landlords performing more base building work (ADA, Hoods, etc)
Limited personal guarantees	Emphasis on outdoor seating areas

COVID clauses to protect against shutdowns	COVID Clauses / Often based on allowable occupancy
10-15 year leases to lock in rent	As-is delivery condition (with or without TI Allowance)
Delayed lease/rent start dates	Offsetting TI allowance with abated rent
	Longer permit contingency periods due to City delays
	Softer approval process on as-is deals
	Early termination clauses
	Current focus is on neighborhoods / close to home
	Preference for second generation space
	CAM/NNN Caps

Trends & Leasing Strategy

Historically, many of San Francisco's renowned restaurants were in the downtown areas, near the office towers and hotels. Since the pandemic, the emphasis has been on neighborhoods, outdoor areas, and convenience. With the introduction of the Shared Spaces program, San Francisco restaurants have been able to move closer to their maximum occupancy numbers, despite being limited to a 25% capacity indoors. With the potential for the Shared Spaces program (and older Parklets program) to continue in the future, outdoor areas have become increasingly popular.

Furthermore, with extraordinary delays in City permitting, restauranteurs are seeking second generation space that needs little or no work. Landlords, once only offering minimal abated rent and tenant improvement allowances, are now offering more contribution in the form of base building work in effort to help tenants avoid permitting delays and get open sooner. Landlords continue to offer abated rent in lieu of tenant improvement allowance and are agreeing to limited or no personal guarantees for experienced operators.

Landlords have also adjusted their rent structures to provide tenants with a sense of comfort during the pandemic. The tiered rent structure, which has become more prevalent, provides the tenant with a lower starting rent during the first year or two while business is slow and gradually increasing throughout the term. Percentage rents, which have historically been linked to more sophisticated and shopping center leases, have surfaced as one of the landlord's best tools to accommodate the tenant while protecting themselves against any upside. Landlords have also resorted to percentage rent structures (often with a minimum base rent) to modify existing leases. Lastly, tenants have been successful in obtaining caps on operating expense reimbursements to landlords.

Landlords have also added Covid-related language to their leases to predetermine the base rent during any partial or full government-mandated shutdown. The Covid language is often pinned to the allowable occupancy in the premises.

Recommendation for Port Inventory

Many of the restaurants within the Port's inventory contain outdoor areas that are considered vital to today's restaurants. Survey which spaces have potential for outdoor seating and create attractive marketing to showcase the same. Analyze the existing Port restaurant leases to see how the percentage rent structure compares to market and make efforts through rent relief or otherwise to retain existing tenants. Offer extended periods of rent abatement, perhaps amortized over a period of time, in lieu of a tenant improvement allowance. Allow for longer leases to accommodate the opportunists and split bonus rent 50/50 in the event of a sublease or assignment. Also allow for short term leases on the smaller spaces to allow for new and exciting concepts that will bring excitement and freshness to the piers.

PARKING

Parking	
Tenant Incentives	Trends & Leasing Strategies
Tiered Rent Schedules	Tiered Rent Schedules
Percentage Rent Deals (Net of Parking Tax)	Percentage Rent Deals (Net of Parking Tax)
Short term leases	Short term leases
	Reduced management fee on management contracts
	Guaranteed minimum rent structures with percentage rent on top

Maven interviewed two parking companies that operate a combined 28 locations in San Francisco. Both of these operators have experienced a sharp decrease in sales, generally around 60% less than 2019. In 2019, 70% of their revenue was made up of daily parking and 30% of revenue was generated from monthly parking. In 2020, the numbers were opposite - 70% of their revenue was made up of monthly parking and 30% was generated from daily parking. With the lack of tourists, office workers, and shoppers, this sector has suffered a severe hit to their business operations.

Trends

Parking lot operators have generally been successful in modifications of their leases. In most cases, a tiered structure was implemented where rent was reduced to 25% of the total rent due during the first few months of the pandemic, then to 50% of the total rent due during the following 3-4 months, followed by a few months of 75% of the total rent due. Maven has also learned that several parking lot landlords have converted to a percentage rent structure, in which the tenant pays to landlord 60% of any gross collections after deducting the City parking taxes.

Unlike many other property types, parking lots are occasionally operated under a management agreement with a hired parking lot operator. The operator passes through all income and expenses to the landlord, less a monthly management fee and potential share of revenue. Many parking lot operators have reduced their management fees to the particular landlord in effort to build rapport come lease renewal time.

New parking transactions are few and far between, but due to the supply limitations of parking lots throughout the City, most operators are continuously on the hunt for additional space.