

MEMORANDUM

November 14, 2014

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

FROM: Monique Moyer
Executive Director

SUBJECT: Informational Presentation on a Lease No. L-15892 between the Port of San Francisco and TMG Pier 38 Partners, a California Limited Liability company for premise located at Pier 38 in the Central Waterfront on The Embarcadero at Delancey Street with an initial term of 25 years plus two (2) five (5) year extension options granted at the sole discretion of the Port

DIRECTOR'S RECOMMENDATION: No Action. Informational Only

Summary

Following a Pier 38 developer solicitation process that resulted in the selection of TMG Pier 38 Partners, LLC (TMG), Port staff and TMG have developed a proposed site plan and business terms for the Pier 38 bulkhead project. This presentation is to provide an overview of the proposed project and will allow the Port Commission to provide input and direction to staff. Port staff intend to bring back this proposal, subject to regulatory approval, to the Commission when the lease is fully negotiated and documented.

Background

On September 25, 2012, the Port Commission authorized staff to issue a Request for Proposals (RFP) with the objective to restore and re-tenant the Pier 38 bulkhead, bring it back into economic use and provide on-going revenue to the Port.

THIS PRINT COVERS CALENDAR ITEM NO. 12B

The Port issued the RFP on November 16, 2012.¹ In March 2013, the Port received proposals from two developer teams: 1) San Francisco Waterfront Partners, LLC and 2) TMG. The development teams presented their qualifications and proposals to the Port Commission on June 11 and August 13, 2013.

On December 12, 2013, the Port Commission awarded the Pier 38 bulkhead rehabilitation opportunity to TMG and directed Port staff to negotiate a lease on terms and conditions that reflect the Port's goals, as described in the RFP.²

This project is limited only to the bulkhead and a portion of the shed as described in the development solicitation and does not extend to the total rehabilitation of Pier 38.

Pier 38 consists of two structures. The Pier 38 bulkhead structure is a two-story wood framed concrete building which resides along the Embarcadero. It was built in 1936 and consists of approximately 13,000 square feet previously used as office and retail space. The pier shed is a single story, high ceiling warehouse building consisting of approximately 97,000 square feet. A portion of the pier shed which includes a mezzanine area had been used for office use consisting of approximately 10,000 square feet. The RFP defined the bulkhead rehabilitation project as consisting of the bulkhead and the office portion of the pier shed (also referred to below as the west pier shed).

The Port sought a developer that has demonstrated the ability to renovate, manage and operate a comparable mixed-use project that includes the existing bulkhead space and that can upgrade the life safety and other code improvements needed for occupancy. The improvements consist of base building core and shell improvements and tenant improvements, including repairs to the building façade, roof and windows, mechanical systems, seismic bracing, interior tenant improvements, Americans with Disabilities Act (ADA) upgrades such as an elevator, accessible bathrooms, and paths of travel and energy efficiency upgrades.

The Port selected TMG which is a joint venture partnership with TMG Partners and Premier Structures, a certified Local Business Enterprise (LBE). TMG will make necessary repairs to the floating dock and gangway, enhance public access improvements on the north apron, and repairs to the substructure, including piles, beam and girders beneath the bulkhead and, if necessary, a portion beneath the west pier shed.

TMG proposes to invest approximately \$7,200,000 at a scale commensurate with the surrounding areas and primarily limited to the bulkhead. The developer has calculated a use program that will not trigger a seismic upgrade of the entire pier. Undertaking such

¹ <http://www.sf-port.org/modules/showdocument.aspx?documentid=4934>

² <http://sfport.com/modules/showdocument.aspx?documentid=7078>

seismic upgrade would render the project financially infeasible. However, an inherent concern to the Port and TMG is the on-going condition of the substructure during the lease term.

Proposed Uses

Parcel A--Bulkhead

As shown on Exhibit A, the bulkhead will continue to be used primarily for office space on the first and second floors for a total of approximately 11,000 square feet. The northern portion of the first floor bulkhead will be used as a full service restaurant consisting of approximately 2,200 square feet.

The office space will be targeted to creative- and technology-oriented users. TMG believes that they can attract such users because of Pier 38's unparalleled waterfront location, the unique character of the bulkhead and the attractiveness to an open floor plan with minimal interior divisions.

The 2,200 square foot space is targeted for restaurant use which would activate the northern portion of the pier apron and the adjacent Brannan Street Wharf. This dining area would be a distinctive use along the Embarcadero and the waterfront and would represent a public amenity.

In the area of the main Pier 38 arch, the center drive aisle will remain to serve both vehicular and pedestrian access.

Parcel B--West Pier Shed

This portion of the shed will contain a mixture of uses. On the south side of the center drive aisle, there will be approximately 1,000 square feet of office space and an office lobby. Restrooms for office and restaurant employees and restaurant patrons will be located in this area. The north side of the first floor will consist of approximately 1,300 square feet of restaurant space.

The second floor of the pier shed area will be used for approximately 9,000 square feet of office space.

Parcel C—Pier Shed

Approximately 40 parking spaces will be used solely by tenants of the refurbished office space. The parking amenity will allow TMG to command higher rental rates. There will be no public parking.

A portion of the pier shed, or approximately 45,000 square feet, will be used intermittently (i.e., 1 to 2 events per month) for temporary public assembly/special events. Events will be staged on an "as-is" basis. Occupancy will be determined through

the permitting process, but it is likely that the maximum number of users would be less than 500 per event. Events will be permitted individually by the Port through a “Temporary Public Assembly Permit”. Events will likely include corporate events, private parties, trade shows and other private invitation only events.

Parcel D—Public Access

A portion of the north apron will be refurbished to allow approximately 6,500 square feet of new public access from the Embarcadero to the portion that TMG will occupy.

TMG proposes to continue use of the gangway and floating dock on the north side of Pier 38. These will need to be repaired and made usable in order for water taxi operation. Short term guest berthing will also be permitted. The refurbished gangway and floating dock will also be used as public access areas during the daytime.

Proposed Business Terms

Term

The initial lease term is 25 years, unless otherwise extended as noted below.

Port Rent

Base rent starts at \$25,000 a month (\$300,000 a year), escalated every five years based on a Consumer Price Index, but not less than 10% or more than 20% increase every five years. The lease provides for a 12 month construction period in which no rent is paid. The lease also provides a 12 month extension of the rent abatement period at the sole discretion of the Port Commission.

The rent is the greater amount of either the base rent or 15% of effective gross income (i.e., gross income less Common Area Maintenance (CAM) reimbursements to TMG by subtenants and other agreed-upon security deposits and tenant improvement reimbursements).

Port Participation on Sale

The lease provides for a 15% of net proceeds to the Port from sale or transfer of the lease above a 12% return on invested equity. The Port does not participate in any refinancing proceeds.

Port staff believes that this a reasonable change to the Port standard interim lease boilerplate and should not serve as a precedent to other lease negotiations because TMG will accept the Port’s right of early termination in Year 10 in the event that, as noted below, the Port Commission does select TMG as the developer for a full development of Pier 38. The standard lease does not envision such right of termination.

In addition, Port staff acknowledges that the proposed Pier 38 lease term is shorter and the leasable area of improvements is smaller than other waterfront projects, such as the Piers 1 ½ - 5 project. These limitations create difficulty for TMG to raise necessary investment capital and to attract high quality tenants that would be willing to invest into tenant improvements. As such, staff believes the proposed sale and refinancing provisions allow TMG to overcome these limitations.

Construction of Improvements

TMG is required to construct initial improvements as noted above as Proposed Uses.

The improvements budget is estimated at a minimum of \$7,200,000 and shown on Exhibit B. These improvements must be completed within 12 months of Lease Commencement, defined as within 12 months of Port Commission approval. One 12 month extension is allowed.

Port will provide a draft of the completion guarantee in the lease.

Rent Credits for Improvements and Substructure Repairs

Improvement rent credit is capped at 50% of total annual base and percentage rent (i.e., \$300,000 less rent credit of \$150,000 would equal a net annual base rent to the Port of \$150,000). Rent credits may be taken for base building core and shell improvements only.

TMG will be granted an additional rent credit that is intended as a substructure reserve fund. This is calculated as an additional 25% of total annual rent (i.e., \$300,000 less \$150,000 rent credit for improvements plus \$75,000 substructure rent credit, if necessary, would equal a net annual base rent of \$75,000). Although the mechanics of this fund still need to be negotiated, this rent credit would provide a pool of money to fund specific substructure repairs prior to the expiration or termination of the lease. TMG is obligated to perform a Rapid Condition Assessment of the pier's substructure every three years (or another schedule as mutually agreed) and will provide such report to the Port.

Neither party is obligated to perform additional substructure work. However, if both parties agree that during the lease, additional substructure repairs are needed, then TMG may use these funds to undertake repairs. Use of these funds is subject to the Port's approval which must be granted for Parcels A and B so long as the investment is commercially reasonable for TMG, but the Port may exercise sole discretion for Parcel C.

If the amount of money accumulated for this purpose is insufficient, then TMG can choose to invest additional monies. In this scenario, TMG can continue to set aside these monies from rent payable without making additional deposits into a reserve fund until such additional investment is repaid.

Prior to the end of the 20th year of the lease, if both parties reasonably agree that further substructure work is required to maintain the usability of the pier and that there is an insufficient amount of monies to fund these repairs, then the lease will be extended at that time to allow reimbursement of these repair costs for either one period of 5 years or two successive periods of 5 years each, but in no event would the total term exceed 35 years.

If neither party elects to perform additional substructure repairs and the Port determines to “red-tag” or condemn the pier, then the lease will terminate.

At the end of the lease or upon termination by either party, any balance remaining in the reserve for substructure repairs will be returned to the Port.

Termination for Full Development of Pier 38

While this proposed project only includes the bulkhead portion of Pier 38, the Port Commission has the ability to direct Port staff at some point to initiate a planning process for the Full Development of Pier 38 which would include: 1) engaging regulatory agencies to determine feasibility, 2) creating a local community advisory group to provide input and guidance, and 3) determining how it intends to select a developer for this separate project.

If the Port Commission eventually approves the lease with TMG, subsequently directs staff for a planning process for the Full Development of Pier 38, and that project is deemed financially and regulatorily feasible, the Port Commission would have to determine the process to select a developer for this Full Development. If through that process, TMG is not selected to be that developer, then the Port may terminate the TMG lease to allow for a Full Development of Pier 38 by another developer.

In this scenario, the Port may terminate the lease after Year 10 (after lease commencement). Such termination should require 3 years notice. If notice is given, then the Port would pay a termination payment based on the year of termination that calculates an average of actual net operating income for agreed upon lease years with a 5% increase, and discounts this amount for the remaining term at a 6% annual rate. For example, if a termination notice is given in Year 7 for a lease termination in Year 10, then the calculated terminal payment has been projected to be approximately \$13.3 million, as illustrated in Exhibit D.

In the event that TMG enters into an agreement with the Port for Full Development, then there is no termination payment due.

Local Business Enterprises

The Port encourages the participation of local business enterprises (LBEs) in TMG’s operations. As noted above, Premier Structures is an LBE. In consultation with the

City's Contract Monitoring Division, TMG agrees to implement good faith outreach efforts to solicit further LBE participation in its operations and provide annual reporting of its efforts to the Port. TMG has identified areas where LBE participation may be implemented: 1) suppliers of goods and equipment, janitorial services, valet parking, printing and some design services for interior signage, etc.; and 2) events: marketing design, website and social media services, suppliers of goods and equipment, janitorial, printing, etc.

Climate Change

Repair and re-tenanting of the Pier 38 bulkhead may result in these improvements being placed at risk as sea levels rise over the next decades. Given the term of the proposed lease, it is unlikely that these improvements or increased commercial and pedestrian traffic will create more property or safety risks at Pier 38. During the term of the proposed lease, there is some risk that the maintenance of the substructure of this facility will be more difficult and expensive to maintain.

Update on Permitting and Regulatory Approvals

California Environmental Quality Act (CEQA)

An Environmental Evaluation application was filed in July 2014. The City Planning Department is in the process of preparing the CEQA determination for the project. Most of the questions from the Planning Department staff have pertained to historic preservation. The renovation and repair work will be done in a manner that is consistent with the Secretary of the Interior Standards for Historic Preservation.

Bay Conservation and Development Commission (BCDC)

Port staff and TMG have met with BCDC staff several times to review and discuss the BCDC permitting requirements of the project. Following these meetings, TMG prepared a proposed Public Access Plan (see Exhibit C) and presented it to BCDC and Port staff. The project includes additional dedicated public access areas on the north apron and floating dock as well as improvements to this area and additional amenities to the existing Embarcadero Promenade.

The Pier 38 bulkhead and shed are considered to be within BCDC's "shoreline band" jurisdiction. The major requirements within this area are the provision of maximum feasible public access consistent with the project, and visual and physical access to the Bay.

Next Steps

Pending direction and input from the Port Commission and the public, approval of the Pier 38 bulkhead lease agreement may be presented for Port Commission consideration as early as December 16, 2014. This is dependent on a determination of

environmental review and trust consistency and completion of lease negotiation and documentation. Following Port Commission consideration of the lease, the Board of Supervisors will need to approve the lease and the BCDC will need to issue a permit for Pier 38.

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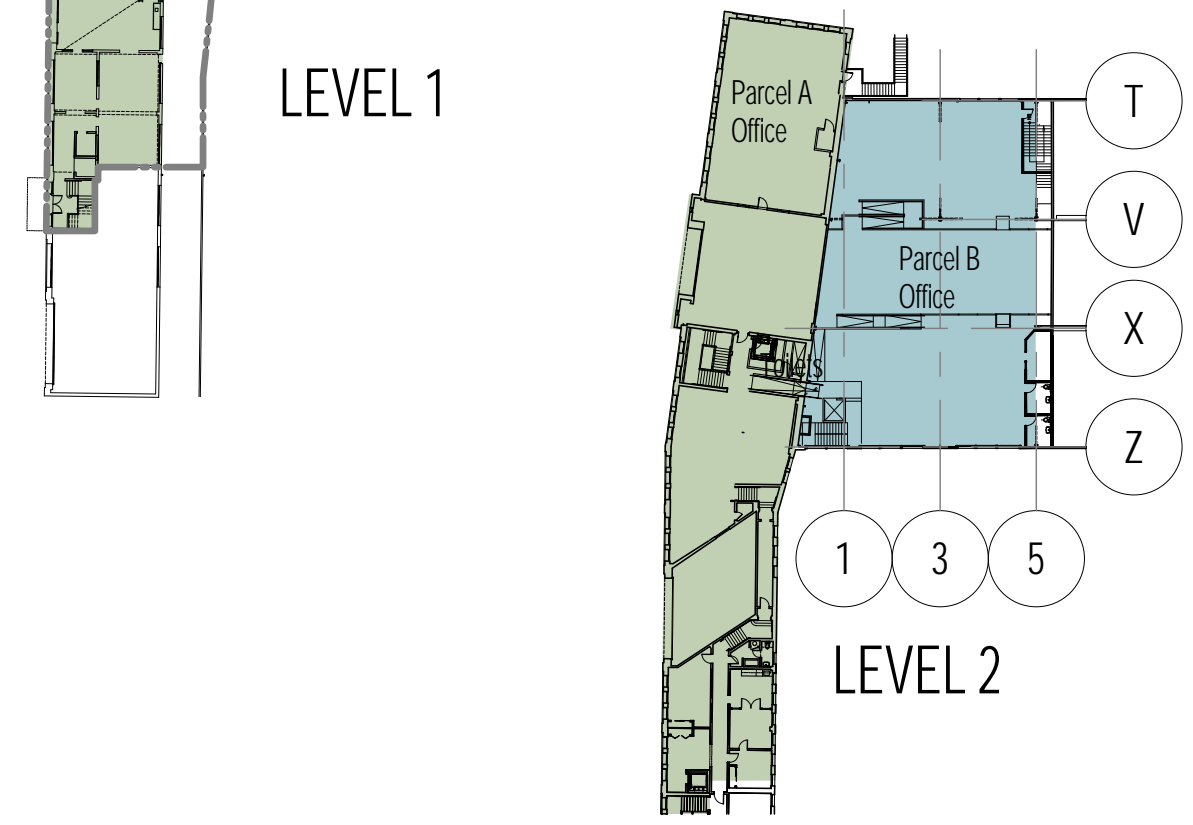
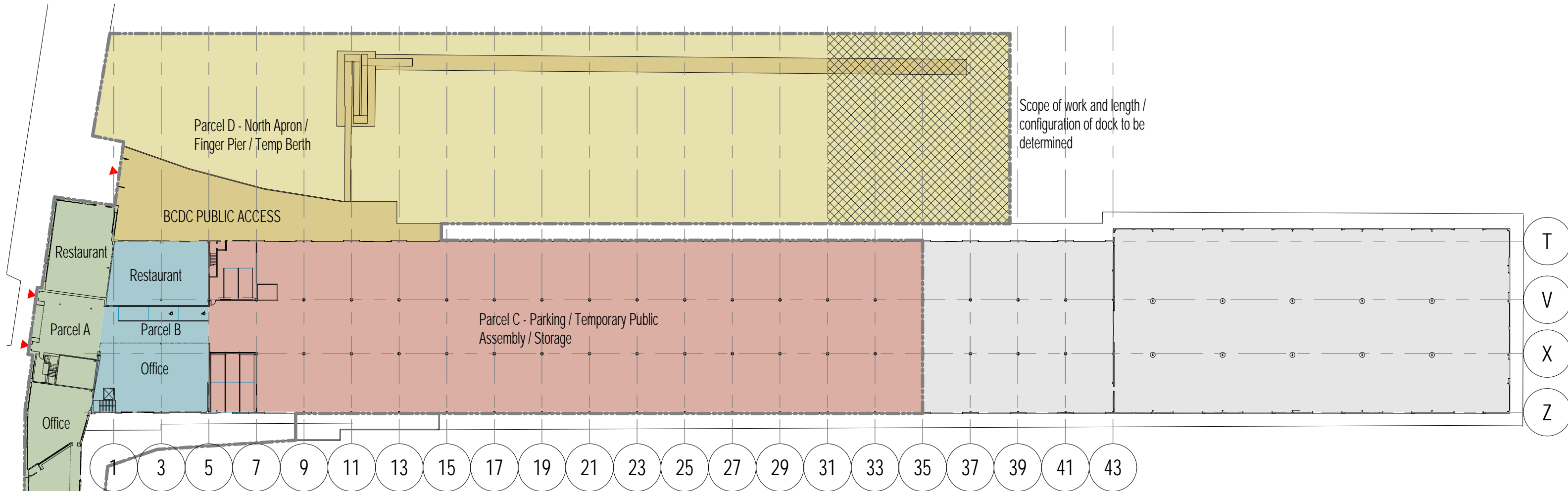
Exhibits:

Exhibit A – Site Plan

Exhibit B -- Project Budget

Exhibit C -- Public Access Plan

Exhibit D – Sample Calculation of Lease Termination Payment



----- INDICATES PROJECT BOUNDARY

PIER 38 - SITE PLAN - AREA SUMMARY

	APPROX. (SQ FT)	USE	LOAD FACTOR	OCCUPANTS
PARCEL A				
RESTAURANT	2,200	A-2	15	147
OFFICE	11,000	B	100	110
SUBTOTAL	13,200			
PARCEL B				
RESTAURANT	1,300	A-2	15	87
OFFICE	10,000	B	100	100
SUBTOTAL	11,300			
PARCEL C				
PARKING + TEMPORARY EVENTS	45,000	S-2	250	180
PARCEL D				
TOTAL	69,500			623

Exhibit B – Project Budget

Pier 38 Development Budget

4-Nov-14

Design & Development Soft Costs

Due Diligence Costs	\$ 75,000
Architecture & Engineering	230,000
Testing & Inspection	100,000
Legal-entitlements, leasing & contracts	200,000
Other consultants	50,000
Outreach	10,000
Environmental & permit fees	113,839
Marketing	30,000
Property Taxes	10,000
Insurance-during construction	51,177
Miscellaneous Soft Costs	33,500
Project Management	150,000
Contingency on Design & Entitlement costs	82,852
Development Fee	328,648
Subtotal Design & Development Soft Costs	\$1,465,016

Construction Hard Costs

Core & Shell Improvements	\$ 4,994,348
Building & Permit Fees	109,887
Escalation	117,713
Contingency	510,423
Subtotal Construction Hard Costs	\$5,732,371

Grand Total Costs	\$7,197,387
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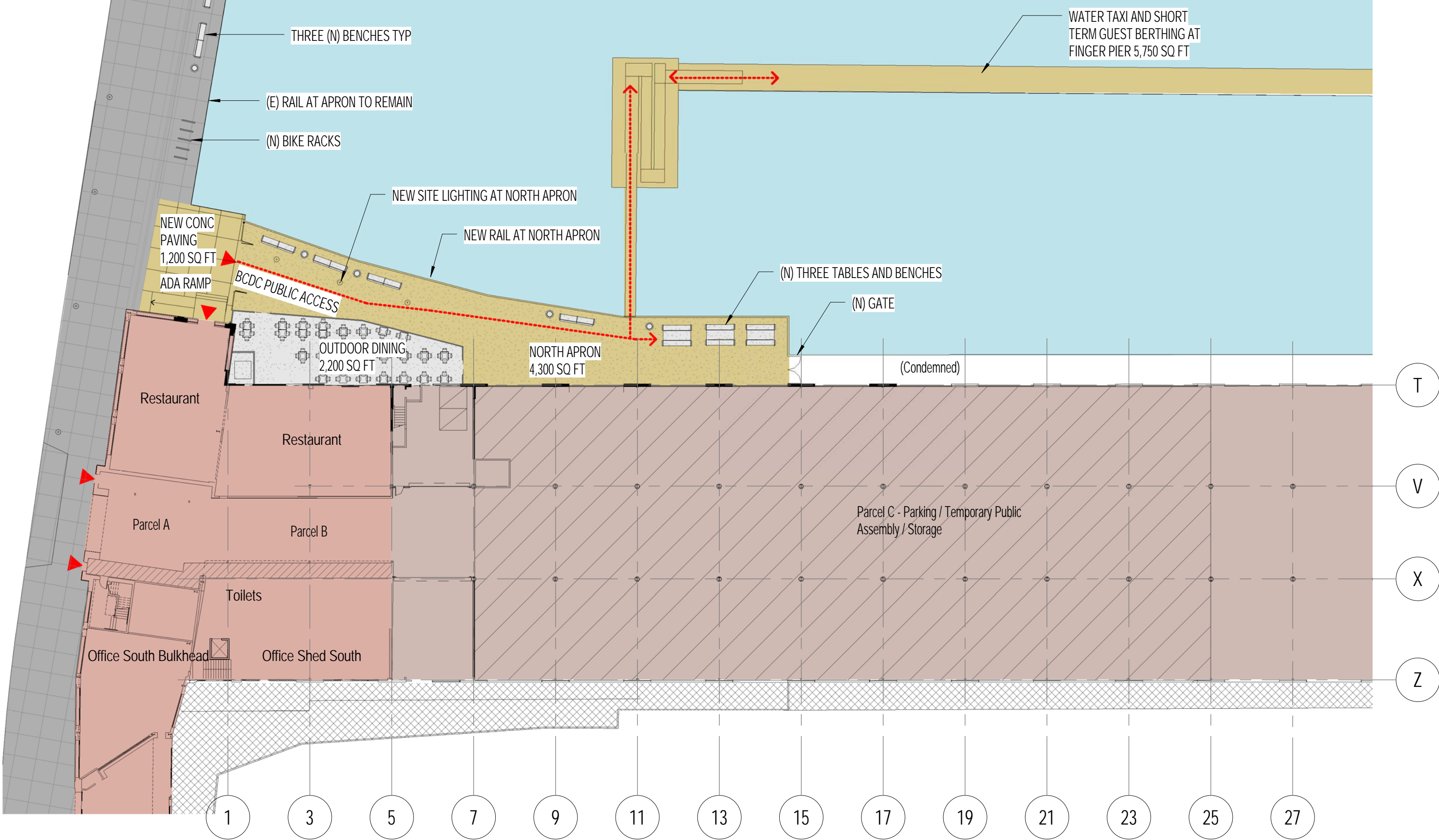


Exhibit D – Calculation of Lease Termination Payment

- The Port shall pay a Termination Payment calculated as follows:
 - For Termination in Year- 10: an amount equal to the average of the actual Net Operating Income (NOI) for Lease Years 6 and 7, + 5%, shall be forecast (with no additional increase) to each year from the year following the Termination (Year 11) to the end of the Lease Term, and discounted at a 6% annual rate.
 - For Terminations from Years 11 through 18: an amount equal to the greater of (a) the average of the actual NOI for Lease Years 6 and 7, or (b) the average of the actual NOI for the two Lease years prior to the Termination Notice, with either amount, +5%, be forecast (with no additional increase) to each year from the year following the Termination to the end of the Lease Term, and discounted at a 6% annual rate.
 - For Terminations from Year 19 onward: an amount equal to the average of the actual NOI for the two Lease years prior to the Termination Notice, +5%, shall be forecast (with no additional increase) to each year from the year following the Termination to the end of the Lease Term, and discounted at a 6% annual rate.
 - In addition, the Termination Payment shall include amounts expended by TMG on substructure repairs in excess of amounts available in the Substructure Reserve Fund which have not been recouped through Substructure Rent Credits, unless the term of the Existing Lease has been previously extended (in which case the Lease Term for the NOI projections described above shall include such extensions).

- The Port may elect, to make the Termination Payment in one of the following ways:
 - In a single lump sum payment on the Termination Date.
 - In two payments: 35% on the Termination Date, and 65% one year later, with the unpaid balance carrying a 6% interest rate.
 - In 5 annual level self-amortizing payments, at 6% interest, with the first payment on the Termination Date and annually for the subsequent 4 years.
 - The inclusion in the Lease of the last two options (i.e., making the Termination Payment over time) is subject to agreement on securing the obligation to Tenant's satisfaction.

- In the event that Tenant or an affiliate or related party enters into an agreement with the Port for "full" development of Pier 38, no Termination Payment shall be due under this Lease.

**Example of Termination Payment calculation for termination after Year 10
(Termination Notice delivered after Year 7)**

Year 6 NOI	\$ 1,304,487
Year 7 NOI	\$ 1,318,535

Note that actual results would be used in place of above figures

Average of Year 6 and 7 NOI	\$ 1,311,511
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Escalated 5%	\$ 1,377,087
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Projected NOI Post-Termination

Year 11	\$ 1,377,087
Year 12	\$ 1,377,087
Year 13	\$ 1,377,087
Year 14	\$ 1,377,087
Year 15	\$ 1,377,087
Year 16	\$ 1,377,087
Year 17	\$ 1,377,087
Year 18	\$ 1,377,087
Year 19	\$ 1,377,087
Year 20	\$ 1,377,087
Year 21	\$ 1,377,087
Year 22	\$ 1,377,087
Year 23	\$ 1,377,087
Year 24	\$ 1,377,087
Year 25	\$ 1,377,087

PV at 6% = TERMINATION PAYMENT	<u>\$ 13,374,607</u>
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