




MEMORANDUM

November 5, 2021

TO: MEMBERS, PORT COMMISSION
Hon. Kimberly Brandon, President
Hon. Willie Adams, Vice President
Hon. John Burton
Hon. Gail Gilman
Hon. Doreen Woo Ho

FROM: Elaine Forbes
Executive Director 

SUBJECT: Portwide Delinquency Challenges Due to COVID19 Pandemic and Discussion of Potential Solutions

DIRECTOR'S RECOMMENDATION: Information Only – No Action Required

EXECUTIVE SUMMARY

As a self-supporting enterprise agency, the Port's revenue from its property funds operation, maintenance, and capital costs for its renowned open spaces, maritime commerce facilities, and historic resources. Port staff recognize the many businesses (small and large) that call the Port home and paid the Port \$78.4 million between July 2020 and June 2021, through several waves of the pandemic. The Port Commission discussed the continuing difficult revenue projections at numerous public meetings during the pandemic. Likely significant revenue declines not only threaten the Port's ability to maintain the San Francisco harbor, but also create an intolerable portfolio management issue, as hundreds of lease agreements are delinquent.

The unpaid balance of rent owed to the Port is almost *seven times* the typical pre-pandemic level, totaling \$24.5 million (compared with \$3 to 4 million pre-pandemic).

Our standard tools for collecting delinquent rent such as progressive informal communication, written communication, and late payment notices letters have thus far been unsuccessful in decreasing the overall delinquent balance. Port staff believe our efforts are falling short primarily because COVID is still affecting revenue for many tenant types but also because some tenants with significant balances are reluctant to

pay both outstanding and current rent as they weigh the likelihood of eviction or lease nonrenewal whether or not they pay.

The Port Commission has a significant role in directing staff on the management of delinquencies because it holds authority to concede rent owed of \$25,000 or more on any lease (the Commission has delegated amounts below \$25,000 to the Executive Director for negotiation and settlement).

To efficiently use the Port Commission's and staff's time on clearing delinquencies, collecting back rent, and then devoting more focus to economic recovery, staff propose the steps below (and further summarized in this memorandum) for Port Commission consideration.

- **Prioritize pursuit of delinquencies** beginning with:
 - largest outstanding balances;
 - leaseholds suspected of being abandoned; and
 - tenants coming forward with viable proposals to settle delinquencies.

- **Apply a checklist** to categorize tenants into those with whom the Port should pursue a Settlement Agreement (to maintain the lease) or those more appropriate for termination (mutual or otherwise). Considerations favoring the pursuit of a Settlement Agreement include:
 - Public Trust and mission-driven tenants, including maritime and visitor-serving
 - Tenants that have applied for available rent deferral, grant, forgiveness, and loan programs (including City and Port programs) to sustain their businesses
 - Tenants who have remained open
 - Tenants with a record of paying (all or partial) rent
 - Re-leasability of space, should the Port or the tenant pursue termination

- **Maintain transparency and treat similarly situated tenants alike**

This memorandum also describes efforts to prevent continued growth in delinquencies, recognizing that recovery is a long path, particularly in businesses tied to tourism, and is anticipated to last three to four more years. Staff are monitoring market conditions and considering whether reductions in rent for select lease types, tied to tourism or other market indicators, are appropriate recommendations to the Port Commission and, as applicable, the Board of Supervisors.

Finally, the memorandum describes a key accounting issue associated with these portfolio management activities: what to do with outstanding balances when the tenant has abandoned the lease and has otherwise demonstrated that further efforts at collection will not be cost-effective for the Port. As described below, Port staff anticipates proposing a policy for Port Commission consideration regarding uncollectable balances to clarify staff's authority, with City Attorney and Controller concurrence, to write off uncollectable balances for tenants who have left Port property.

STRATEGIC OBJECTIVE

A successful strategy for delinquency challenges will support the Strategic Plan 2021-2025 Economic Recovery goal and associated strategies.

Economic Recovery - Goal: Develop and implement strategies to stabilize the Port's financial position from the COVID-19 Pandemic economic impacts.

- *Tenant Recovery.* Work with tenants to recover from the COVID-19 Pandemic.
 - Portfolio Management. Analyze policies, consider market conditions, and pursue needed Port Commission authorizations by 2021
 - Space Management. Carry-out policies to address tenant settlement needs and develop policies and/or incentives to fill vacancies in 2021

BACKGROUND

COVID-Related Tenant Rent Relief & Portfolio Management

In response to the economic impacts of COVID-19, the Port deployed several relief measures to support our tenants along the waterfront since shelter in place orders were mandated in San Francisco beginning March 16, 2020.

The list below notes the array of programs adopted and implemented during the pandemic to support tenants and manage the real estate and maritime tenant portfolio. Port's tenant relief programs supported 137 tenants through rent deferral, rent forgiveness, forgivable loans, or fee waivers. In April 2021, the Port Commission provided staff additional authority to enter mutual terminations, under certain circumstances, and to offer tenants incentives for new leases. Since that time, Port staff have used the leasing incentives in marketing new leases and lease renewals, with approximately eight leases under negotiation between May and October.

Tenant Relief¹
<ul style="list-style-type: none"> • Rent Deferral and Opt-In Rent Deferral • Rent Relief for Maritime, LBE, Percentage Rent, and Civic Impact Tenants • Repayment Plans • LBE Loan Program • Shared Spaces licenses
Portfolio Management²
<ul style="list-style-type: none"> • Mutual Lease Terminations • Strategic Leasing Tactics

Relief Ends, Delta Surges

The longest-lasting Port-relief programs expired in April 2021, shortly before the COVID Delta variant – a more contagious and severe COVID-19 virus - spread across the U.S. The Delta surge, along with the slow path back to higher tourism levels and halting return to office plans,³ have contributed to continued difficult economic conditions for several types of Port tenants.

Travel, Office and Other Indicators, and Port’s Retail Tenants Gross Sales

Travel

While San Francisco’s vaccination rate and public health management prevented a more serious Delta surge, continued concern over COVID spread and travel restrictions stymied recovery in the travel sector. Recently published airline arrivals data from the US National Travel and Tourism Office shows tourism from Asia and Western Europe has all but halted completely. In 2020, international arrivals to the United States totaled 19.4M, which is a 75.5% decline from the 79.4M arrivals in 2019. This was the smallest number of arrivals to the United States in 43 years (18.4 million in 1977). At San Francisco Airport, travel is similarly reduced, with 1.3M passengers landing (227K of

¹ Authority for these programs is provided by Pot Commission Resolution 20-18, 20-27,nd 20-30; Resolutions 20-41 and 20-55, Resolution 20-56, Resolutions 20-33, 20-55, and Board of Supervisors Ordinance number 244-20. Relief for certain shared spaces licensees is authorized by Resolutions 20-50 and 21-26.

² Authority for these programs is provided by Por Commission Resolution 21-15 and Resolution 21-16.

³ See October 3, 2021 article on return to office plans: <https://www.bloomberg.com/graphics/2021-return-to-office/>

whom were from outside the U.S.) in August 2021, compared with 2.9M passengers landing as SFO in August 2019 (787K of whom were international travelers).⁴

Office and Other Economic Indicators

Other real estate indicators, while improving over the last quarter, continue to be poor. For example, the San Francisco office vacancy rate is currently 15%, higher than during the 2009-2011 financial crises, and vacant office sublease space is nearly 9 million square feet, five times the square footage available during that same period 2009-2011.⁵ As indicators of San Francisco workers return to work, key transit agencies report in late summer 2021 that ridership is between 24% and 45% of pre-pandemic levels (e.g., SFMTA reports about 45%,⁶ BART reports about 24%,⁷ and WETA reports about 35% of pre-pandemic ridership).⁸

Port Retail Tenants' Gross Sales

Figures 1 and 2 below show the Port's percentage rent tenants gross sales over a three-year period. As shown (and unsurprisingly), Fisherman's Wharf and Northwest Waterfront sales experienced about 70% sales revenue declines in 2021 compared to 2019. Sales for tenants south of the Ferry Building experienced a decline in of approximately 20% compared to 2019 sales.

In positive news for tourist-serving businesses, many international travel restrictions ended November 8, 2021 for vaccinated travelers from 33 countries (including China, India, Brazil, and most of Europe). While this is a positive step for recovery, SF Travel forecasts a return to 2019 visitation levels to San Francisco to not occur until 2025.⁹ During this period, some tenants will likely need income from sources other than sales (such as from government programs) to maintain their business as the recovery continues.

⁴ See SFO statistics: <https://www.flysfo.com/media/facts-statistics/air-traffic-statistics/2019>

⁵ See Avison Young Q3 2021 office market report: <https://www.avisonyoung.us/documents/92610/94959874/AY+Q3+2021+Office+Market+Report/6cdc191f-453c-4aa7-8895-fbda483b398a>

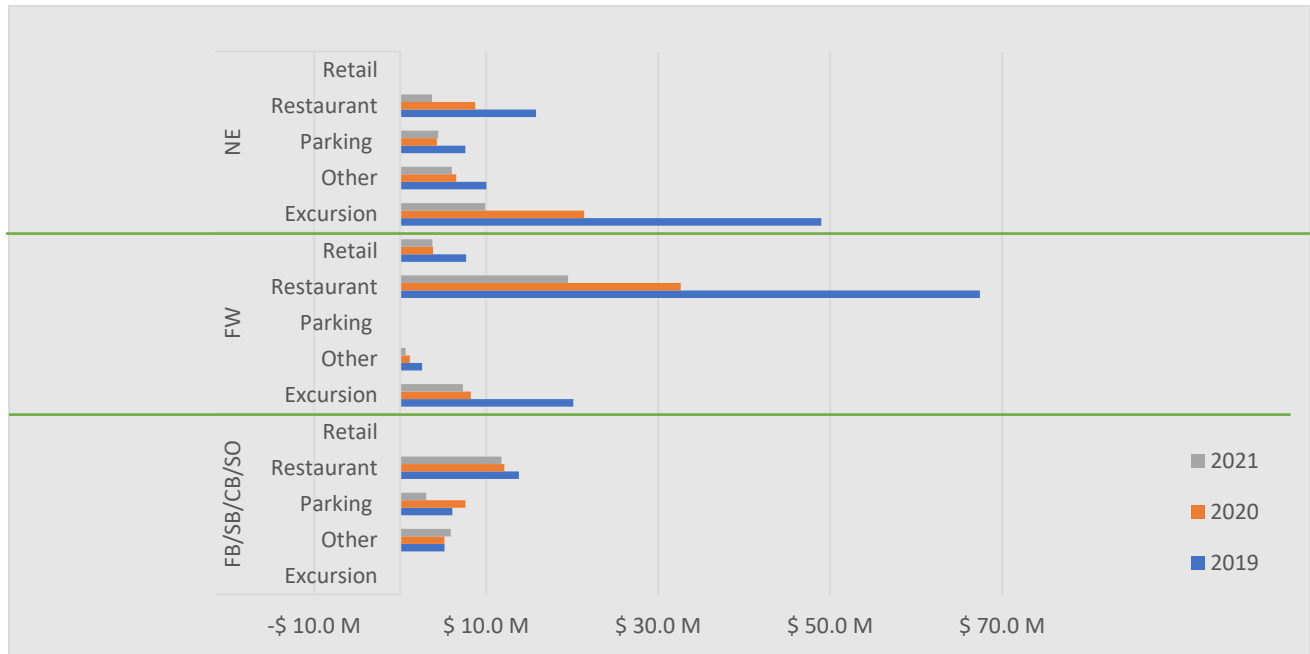
⁶ See: <https://sanfrancisco.cbslocal.com/2021/09/21/muni-rider-survey-pre-pandemic-service-levels/>

⁷ See: <https://www.bart.gov/sites/default/files/docs/202108%20Monthly%20Ridership%20Report.pdf>

⁸ See: <https://www.sfexaminer.com/news/ferry-expansion-planned-despite-pandemics-toll-on-ridership/>

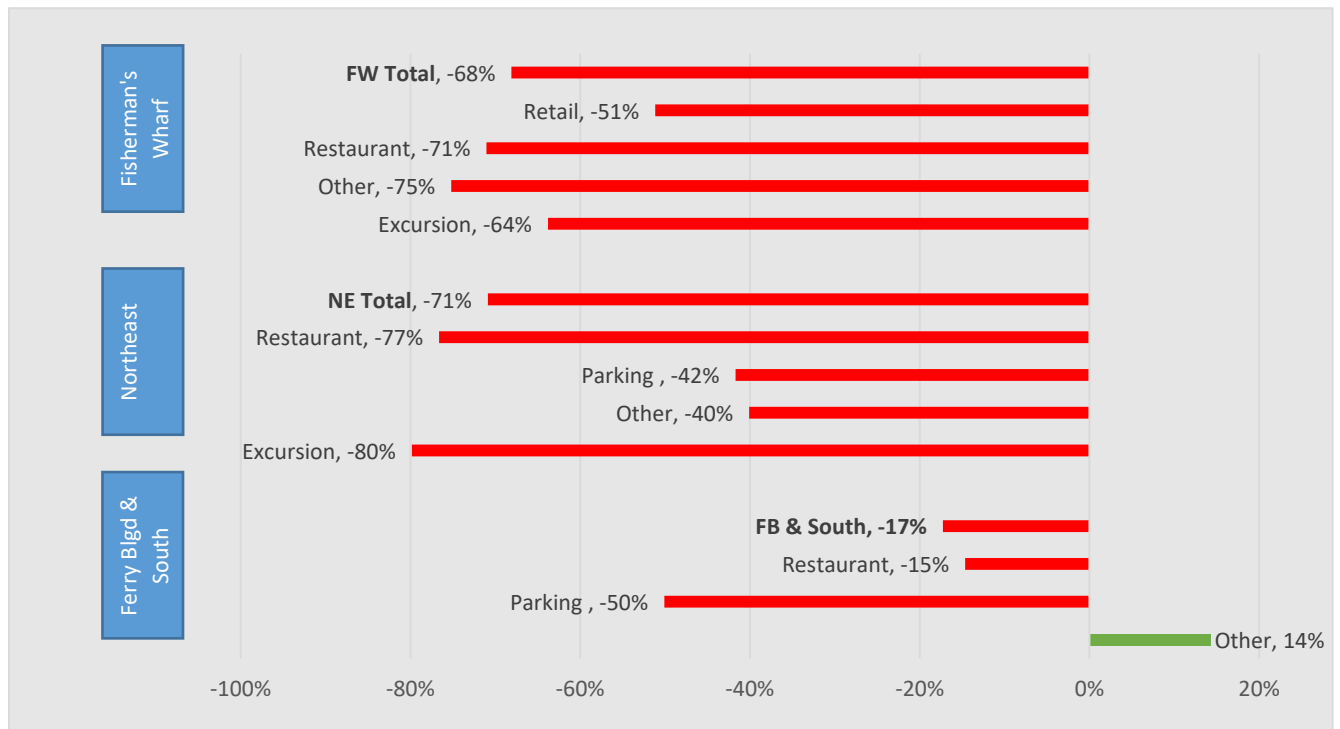
⁹ See October 15, 2021 ABC news article: <https://abc7news.com/travel-ban-nov-8-international-white-house/11132008/>

Figure 1. Port's Percentage Rent Tenant Sales, by Type & Portfolio, 2019-2021



*Timeframes for data are 12-month periods between September 1 and August 31 for the year shown, meaning that "2019" refers to September 1, 2018 to August 31 2019.

Figure 2. Percentage Change, Sales 2019 to 2021



DELINQUENCY CHALLENGES

Scale of Delinquent Accounts

Moving forward, the unfortunate reality is that a number of Port tenants will need to either downsize or vacate leasehold premises as their revenues fail to rebound. The Port’s accounts-receivable ledger was \$20.7 million in outstanding rent in December 2020, has grown to \$24.5 million as of August 2021. Pre-pandemic, the same metric was \$3.7 million.

The Portwide total unpaid balance has increased over 7-fold since before the pandemic (see Table 1). This delinquency has been an incredible workload challenge, with fewer staff handling the typical property management priorities of property upkeep, lease renewals, and new leases as well as attending to tenants in serious financial trouble. Staff have spent numerous hours reviewing tenant financial information, working with consultants and the City Attorney, and fielding tenant proposals for forgiveness, extensions, and other settlement or lease amendments beyond staff’s authority. The size of this delinquency challenge is daunting for a team fatigued by the pandemic workload.

Many tenants continue to struggle meeting their lease’s rental obligations as the economic effects of COVID-19 continue to be felt and economic activity swings with each COVID surge. Monthly, staff review the accounts receivable balance tenant by tenant and estimate how much of a tenant’s balance is likely to be paid – based on tenant communications and staff experience with the tenant. **Table 1** reports these balances which have grown significantly.

Table 1. Accounts Receivables and Collectability

Year	Number of Agreements	Unpaid Balance*	Staff’s Estimated Collectable Amount	Percentage Uncollectable
2021	453	\$24.5	\$11.9	51%
2020	439	\$13.6	\$12.2	10%
2019	328	\$3.3	\$2.9	10%

* Unpaid balance is reduced by overpayments, advance payments, and credits.

Delinquent Accounts by Size, Geography, and Revenue Type

Size

Of the \$24.5M in outstanding balances, almost half of the total is owed by 10 tenants. Port staff has been in frequent contact with this group of ‘high-balance’ tenants, and has

discussed some of these in closed session. Staff are working with each tenant to vet tenants' financial condition, business planning and viability of each respective operating business. Staff anticipates settlements that will require a lump sum payment (representing a percentage of back rent, related to each tenant's ability to pay) with the remainder to be paid over time (with an interest rate schedule).

Table 2 below breaks down the receivable balances by tenant business type. The key takeaway from this chart is that the uncollectable percentage of restaurant and retail (percentage rent tenants) is lower than that of other businesses. That is likely due to the application of relief programs that have already been implemented and applied. The unpaid balance is higher for this category than the other business types, which is indicative of how hard the restaurants and retail shops along the waterfront have been hit economically.

It is also noteworthy that the commercial delinquencies are high. This row includes both office delinquencies and shed and open land delinquencies. Shed space includes storage and operations supporting tourism-related businesses such as excursion operations, transportation companies, and restaurant and retail support. See **Attachment 1** for another geographic representation of the outstanding balance.

Table 2. Outstanding Balance, by Tenant Type

Tenant Type	Number of Agreements	Unpaid Balance
Participation Rent (restaurants, retail, excursion operators)	39	\$8.7 M
Commercial, Industrial, & Land (maritime and industrial shed, office, and open land tenants)	132	\$7.2M
Parking	9	\$3.2M
Miscellaneous (cargo, cruise, fishing, permitting, licenses, other maritime, among others)	273	\$5.4M
Total	453	\$24.5

Staff has also grouped tenants by amounts owed. **Table 3** below highlights the number of tenants and total outstanding balance represented by the size of the balance, grouped into: \$5k to \$25k balances, \$25k to \$250k balances, and balances above

\$250k. As noted above, the top ten tenants by balance by outstanding balance owed make up nearly 50% of the total collectable balance (\$9.8M).¹⁰

Table 3. Tenant Counts, by Size of Balance

Amount	Agreements	Total
Above \$250K	24	\$17.1M
Between \$25k to \$250K	77	\$6.4M
Between \$5k to \$25K	66	\$770K

Delinquency Strategies and Feedback Requested from Port Commission

With unprecedented economic tumult, portfolio managers nationwide have been working with tenants on lease workouts. Whereas nongovernmental property managers negotiate and execute lease amendments or concessions privately, the Port’s lease amendments or settlement agreements are public record. While Port staff have been working diligently to reduce delinquencies, the data show no appreciable decline in the portfolio-wide outstanding balance, despite the implementation of the 3-, 6-, and 14-month rent forgiveness program for select tenant types. Port staff have been using commercial real estate tools available – that is, communications, noticing, and negotiations – but have only pursued formal default and evictions sparingly, thus far.¹¹

As shown in **Table 3**, more than 95% of tenant outstanding balance’s exceed staff’s \$25,000 settlement authority. Port staff wish to gain concurrence from the Port Commission on the steps and approach to significantly reducing the delinquency balance.

Proposed Delinquency Management

During the previous 5+ years, the Port Commission has invested a significant amount of time to individual tenant settlements, typically allowing for extensive negotiations and devoting several closed sessions for a settlement agreement. Now, in this unprecedented and difficult economic period, with \$20+ million in back rent to settle (or terminate and write-off or pursue in court), a more streamlined, yet transparent, approach to individual settlements is necessary.

¹⁰ These high-balance tenants include restaurant, transportation, office, excursion, and parking tenants. Some would be eligible for rent forgiveness which would reduce much of their balances, however, we have not been able to grant relief under the existing program since they have unresolved pre-existing lease disputes (e.g., failure to pay pre-pandemic rent or to complete required improvements).

¹¹ This is partially due to the high cost of litigation. A recent unlawful detainer action to regain control of Port property cost about \$35,000 in unrecoverable legal costs for the Port.

To streamline the process for the anticipated nearly 100 agreements (and 40 to 50 tenants) requiring Port Commission attention, staff proposes these steps for consideration.

1. **Confirm goal of delinquency effort.** Staff's proposed goal is to negotiate with tenants to collect as much delinquent/past-due rent owed as is possible, in an efficient manner, recognizing the opportunity cost of devoting staff and Port Commission time to these collection matters.
2. **Prioritize pursuit of delinquencies** beginning with:
 - a. largest outstanding balances;
 - b. leaseholds suspected of being abandoned; and
 - c. tenants coming forward with viable proposals to settle delinquencies.
3. **Apply a checklist** to categorize tenants into: (i) those with whom the Port should pursue a Settlement Agreement (to maintain the lease) or (ii) those more appropriate for termination (mutual or otherwise). Key tenant characteristics to consider for inclusion in category (i) are:
 - a. Public Trust and mission-driven tenants, including maritime and visitor-serving
 - b. Small or socially impactful tenants, such as tenants previously allowed in LBE and Civic Impact rent forgiveness programs
 - c. Have successfully pursued available deferrals, grants, rent forgiveness, and loan programs to sustain their businesses
 - d. Have remained responsive to Port communications
 - e. Have stayed open and in operations
 - f. Have maintained leased premises as required in lease
 - g. Have record of paying (all or partial) rent and can continue to pay all or partial rent
 - h. Demonstrate economic harm from COVID (e.g., significant revenue loss, after considering grants, loans, and other support received)
 - i. Have viable path to recovery and regaining good standing with Port
 - j. Re-leasability of space, should the Port or tenant pursue termination
4. **Prepare Settlement Agreement with tenants meeting most or all of the above characteristics.**
 - a. Assess tenant's ability to pay through review of documents like audited (or certified) financial statements and year-to-date financials (income statement, cash flow statement, balance sheet), and tax returns
 - b. Negotiate for substantial repayment of rent owed
 - i. If tenant cannot repay a substantial portion of back rent, but meet most of the characteristics in 3 above, staff will flag these Settlement Agreements for the Port Commission in 5 below.

- c. Include a settlement (forgiveness) of a portion of the tenant's outstanding balance on a one-time basis and to be given by the Port only once tenant has repaid the agreed-upon back rent

5. Bring Settlement Agreements to Port Commission in a streamlined manner.

- a. Staff will go through the above process to propose Settlement Agreements containing standardized terms and conditions, to the Port Commission. Staff reports will include a summary of the tenant's performance on the checklist set forth in Section 3 above for ease of reference.
- b. Staff will work with the City Attorney's Office to group tenants for Port Commission consideration and calendar the items as determined by the Commission officers.

By applying this list of considerations (with input from the Port Commission), Port staff aim to implement a delinquency reduction effort which is transparent and treats similarly situated tenants alike.

UNCOLLECTIBLE BALANCES WRITE OFF POLICY

For real estate balances, City Departments "write off" uncollectable balances when a lease is terminated, a tenant has vacated without full payment of rent, and the cost of pursuing the balance will be outweighed by any potential recovery. The City Attorney's Office (Charter §6.102) and the City Controller (SF Admin. Code §10.41-1) must recommend or approve (respectively) all write-offs.

The Port does not have a clear policy on writing off bad debt and staff desires to make this procedure clear, as the high outstanding balance may mean a relatively high amount of balances may be determined by staff to be uncollectible. Port staff are developing a policy to include administrative policies and procedures including criterion for determining un-collectability of delinquent debt and procedure and process for writing-off such debts.

This policy and procedure will pertain to all outstanding debt owed to the Port as a result of non-payment of rent, fees or other amounts due for all property agreements where a tenant is no longer in possession. This policy will not affect the Port's policies regarding settlements; any settlement agreement with monies at issue of \$25,000 or more is subject to the approval of the Port Commission. Staff will bring this item back for action once the policy is fully developed.

LEASE STRATEGIES

The Ports current vacancy rate is approximately 11% representing 3.0M square feet available space for lease. Port staff's leasing efforts include:

- 1) New signage that identifies the site as a lease opportunity and directs prospective tenants to the new Port website.

- 2) In October 2021, Port's communications team led the launch of the new website which features a more user-friendly page for prospective tenants, with improved searches for space by type and location and includes featured properties with area maps and photos of the available space. The website also has a leasing inquiry page where Staff can receive lease inquiries from prospective tenants in real time.
- 3) Staff is looking into the possibility of a LoopNet subscription (or similar), to complement other efforts. LoopNet allows prospective tenants to search Port properties on a site where commercial brokers post their available properties.

SUMMARY AND NEXT STEPS

The purpose of this informational memorandum is to:

- 1) Share with the Port Commission the status of delinquencies which were largely caused by the negative economic impacts related to the pandemic.
- 2) Provide information on those receivables, broken down by categories of tenants.
- 3) Detail Port's strategy in managing collections among categories of balances, consistent with a shared prosperity model in terms of sharing the economic pain with our tenants.
- 4) Seek efficiencies in the process of the Port Commission's consideration and approval of Settlement Agreements, by clearly setting out Port staff's checklist for the process and seeking Port Commission feedback and concurrence on the importance of these factors.

The road to recovery is a long one and Port staff continue to seek the Port Commission's guidance and partnership in portfolio management, including solutions for streamlining delinquency solutions and Settlement Agreement consideration and approvals. As staff continue delinquency management, we anticipate future discussions on preventing future delinquencies by considering lease amendments, if appropriate, and adopting a write-off policy

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Attachment 1: Map of Outstanding Balances

