




MEMORANDUM

February 10, 2023

TO: MEMBERS, PORT COMMISSION
Hon. Kimberly Brandon, President
Hon. Willie Adams, Vice President
Hon. Gail Gilman
Hon. Steven Lee

FROM: Elaine Forbes
Executive Director 

SUBJECT: Authorization to offer tenant improvement allowances and request that the Board of Supervisors waive Administrative Code Chapter 6 for certain Port leases to facilitate Port's use of up to \$20 million on tenant improvements to spur economic recovery and revenue generation.

DIRECTOR'S RECOMMENDATION: Approve Attached Resolution No. 23-08

EXECUTIVE SUMMARY

After multiple years focusing on tenant forgiveness and lease amendments due to the COVID pandemic, the Port is working to tackle business closures and increased vacancies. With increasing vacancy – there are currently six storefronts that have closed since COVID (and two others that were closed pre-COVID) – we want to move faster in finding tenants and providing support to make our aging facilities operational. With our success in securing outside dollars, the Port has funds for tenant improvements and economic recovery activities.

In reviewing our tools for filling spaces, Port has typically used rent credits to assist tenants in preparing a space for operations. When a Port and tenant agree on rent credits, the tenant funds and performs the work and receives a negotiated rent credit. While a good tool, rent credits exclude potential bidders without access to upfront capital. This barrier can be difficult for BIPOC and other small businesses to complete. With funding specifically for tenant improvements and other funding, the Port is in a position to use a tool common in the

THIS PRINT COVERS CALENDAR ITEM NO. 11A

marketplace – offering tenants a tenant improvement allowance to sign a lease with strong rents (and no rent credits). This tool puts Port’s money to work, earning a return.

To ensure streamlined use of potential tenant improvement allowances, Port staff recommend waiving City contracting rules for “public works” (Chapter 6 of Administrative Codes). Chapter 6 public works contracting rules require advertising, bid requirements, bid protest provisions, and requirements for contract provisions, among other items. We need to cause improvements to our property for economic recovery and having our tenants perform the work is a way to achieve more equitable and resilient economic recovery. The rules of Chapter 6 make this tool less effective because they are unique to public contracting and it would be costly and inefficient for a private business to attempt to conform.

A tenant improvement allowance and the Chapter 6 waiver are proposed to apply only to:

1. Leases or lease amendments subject to Port Commission and Board of Supervisors approval;
2. Property improvements that spur economic recovery and generate additional rents to the Port; and
3. Total amount no more than \$20 million cumulatively.

It is important to note that a Chapter 6 waiver would not impact other key construction-related requirements in City leases including: prevailing wage requirements for construction projects; local hiring requirements for projects over the threshold amount (currently \$1,000,000 per building permit); and all other standard City and Port leasing requirements.

Approval of the attached resolution will support a waiver ordinance by the Board of Supervisors. If enacted, Port staff will consider prospective tenants’ proposals with tenant improvement allowances and bring potential leases or amendments forward to the Port Commission and then the Board of Supervisors for consideration.

STRATEGIC OBJECTIVE

The strategies recommended in this memorandum support the Port’s Economic Recovery objectives regarding increasing rental revenues and filling vacancies. In addition, the action supports Equity objectives by facilitating the use of tenant improvement allowances, thereby reducing the need for tenants to attain significant upfront capital in order to upgrade and lease Port property, a key financial barrier to those seeking Port leases.

BACKGROUND

Need for Investment in Aging Assets, Amid Economic Downtown

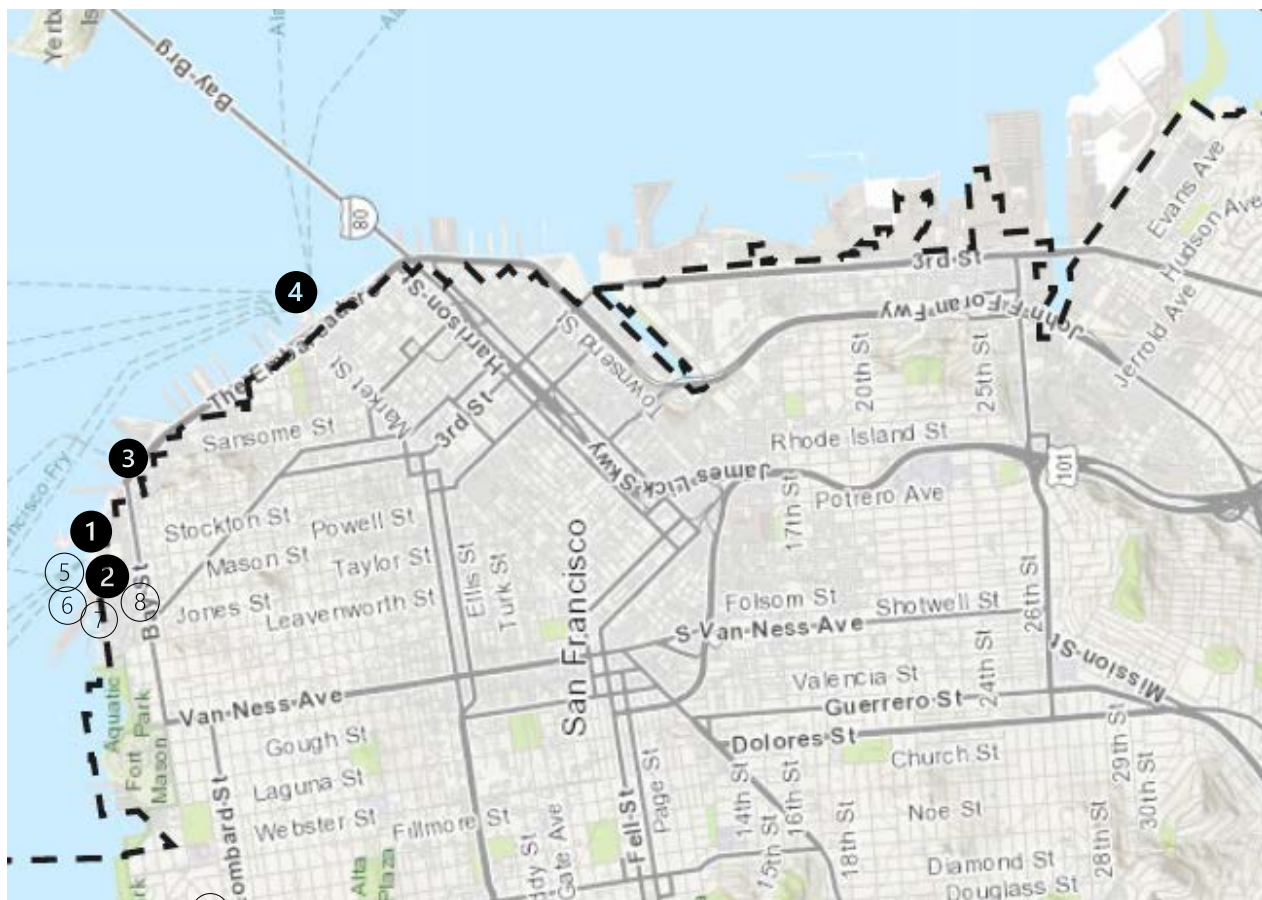
As custodian of two nationally-registered historic districts and many other facilities built 75 to 100+ years ago, much of the property that the Port maintains has significant maintenance and capital investment needs. In the current 10-Year Capital Plan, the Port estimates properties require approximately \$2.0 billion over the next 10 years to bring assets up to a “state of good repair” and keep them maintained. While these estimated

capital costs dwarf the Port's budget, the Port has been opportunistic and successful in leveraging outside dollars (federal and State grants and private investment, through long-term leases) to transform many of our buildings into beloved spaces for the public to use and enjoy.

During recent strong economic times, the Port's typical tool for securing investment in facilities included competitive solicitations which led to leases wherein the Port's tenants invested significant dollars to improve outdated facilities up to building code and modern uses, in exchange for rent credits, long-term leases, or both. The economic downturn in the wake of the COVID-19 pandemic has both weakened the pool of potential tenants for the Port's facilities and has significantly increased the number of closed businesses and vacancies at the Port. Specifically, Port has eight closed or vacant retail or restaurant locations, about 65,000 square feet of shed space available, and staff are beginning to see office tenants reduce space or use space for storage rather than employee space.

Figure 1 illustrates the locations of recent closures or vacated buildings that require competitive processes to re-tenant.

Figure 1. Items 1-8 on Map Show Spaces Vacant or Closed that were Tenanted and Activated Pre-COVID



- ① Style means location has a tenant but is closed.
- ① Style means Port controls property.

- 1. Alioto's, 2. 490 Jefferson, 3. Pier 33½, 4. Ferry Plaza East Building,
- 5. Tarantino's 6. Castagnola's, 7. Lou's Blues, 8. Pompeii's Grotto

Success in Securing Funds for Economic Recovery

The Port has been successful in securing outside public funds, specifically, securing a total of \$117 million for expenditure in the broadly defined eligibility categories including maintaining and restoring jobs, generating economic growth, restoring efforts delayed or deferred by COVID, and helping communities disproportionately impacted by COVID through the ARPA stimulus bill.

To generate economic growth, in the Port's last budget, we have initially allocated \$8 million for tenant attraction and retention, including improvements to our property in order to secure and increase revenue. Due to the flexibility of eligible uses in this stimulus-funded program, investment could increase to a total of \$18 million.¹ In addition to the stimulus funding, the Port may be successful in achieving other grant funding for new businesses. For example, through the City's budget process, the City provided \$1 million in funding for tenant improvements for new businesses along the waterfront. Between stimulus funding and other grants, Port staff believe it is possible that the Port could have up to \$20 million available for tenant improvements to activate vacant or underutilized spaces with a financial return to the Port.

Investments in the Port's revenue-generating, physical assets are critical to the Port's financial security as they create a virtuous cycle because increases in the Port's revenues (beyond operating costs) may be used for more capital improvements along the waterfront.

The stimulus program parameters allow the Port to use certain funds to prepare, market, and improve spaces for tenants to retain or generate higher revenues. As an economic recovery funding source, the Port must demonstrate to funding administrators that the Port reasonably projects that spending the tenant improvement funding for a particular project will result in retained or higher lease revenues to the Port than would otherwise be achieved without the expenditure.

Contracting Rules for "Public Works"

Projects defined as "public works" are subject to various State and City requirements. Chapter 6 of the Administrative Code (Chapter 6) provides the local requirements for public works contracts and includes competitive bidding requirements and specifications around all phases of the bidding and contracting process.² Improvements to Port buildings that are paid for with City funds, even when performed by the tenant, may be subject to the provisions of Chapter 6 of the Administrative Code.

¹ To provide a sense of scale of these dollars and as an example calculation, if the Port successfully secures tenants with tenant improvement allowances of \$200 per square foot, \$8 million "tenant improvement" dollars could improve 40,000 square feet (5 to 10 spaces, depending on which spaces are leased). Depending on opportunities, the Port is also likely to spend some stimulus funding on Port-delivered capital projects to improve other space types for leasing (office, shed, parking lots).

² Chapter 6 defines "public works" as: "*Any erection, construction, renovation, alteration, improvement, demolition, excavation, installation, or repair of any public building, structure, infrastructure, bridge, road, street, park, dam, tunnel, utility or similar public facility performed by or for the City, the cost of which is to be paid wholly or partially out of moneys deposited in the Treasury of the City. A Public Work or Improvement may include Integrated Furniture, Fixtures, and Equipment.*"

https://codelibrary.amlegal.com/codes/san_francisco/latest/sf_admin/0-0-0-64902

PROPOSED WAIVER OF CHAPTER 6 RULES FOR TENANT-CONTRACTED IMPROVEMENTS

Rationale for Waiver in Certain Circumstances

Port staff anticipate spending a good portion of the economic recovery budget on improving vacant spaces. Under current distressed market conditions, Port staff believe that attracting and retaining tenants with tenant improvement allowances will be a critical way to compete in the marketplace. Specifically, Port staff anticipate negotiating with prospective tenants and potentially current tenants as to lease amendments to provide funds at negotiated milestones or at lease or lease amendment commencement for agreed-upon tenant improvements under a lease.

A tenant improvement allowance would only be used when:

1. Leases or lease amendments are subject to Port Commission and Board of Supervisors approval;
2. Property improvements spur economic recovery and generate additional rents to the Port; and
3. Total amount no more than \$20 million cumulatively.

Proposed Waiver of Chapter 6 Rules For Tenant-Contracted Improvements

In order to effectively and efficiently deploy tenant allowance funding, staff recommends seeking an ordinance waiving the applicability of Chapter 6 to tenant improvements when funded with a tenant improvement allowance in a lease.³ It is important to note that a Chapter 6 waiver would not impact other key construction-related requirements in City leases including the below:

- All tenants will be subject to the prevailing wage requirements for construction projects.
- All tenants will be subject to local hiring requirements for projects over the threshold amount (currently \$1,000,000 per building permit).
- All other standard City and Port leasing requirements will be adhered to, including Civil Service approvals where needed.

Staff propose a waiver of Chapter 6 in these certain cases because this streamlining vehicle:

- Is competitive as landlords of comparable restaurant spaces are offering \$150-\$200 per square foot for existing restaurant space and \$500 to \$750 per square foot for new restaurant space in tenant improvement allowances.
- Reduces barriers for small businesses leasing with the Port. The Port, typically does not have funding to support a tenant improvement budget and therefore offers

³ See link to municipal code here: https://codelibrary.amlegal.com/codes/san_francisco/latest/sf_admin/0-0-0-64902

businesses rent credits and sufficient term for amortization for agreed upon improvements. Rent credits – while a good financial tool for the Port given our balance sheet limitations - places a financial burden on tenants as they must assemble upfront financing for the project and get repaid over time through rent credits. The upfront need for capital makes is difficult for small tenants with less access to credit.

- Is efficient because the tenant can contract for and direct improvements to the space that suits their operational needs.
- Allows the Port to have regular ongoing payments of fair market rent.
- Will be subject to reporting, accountability and enforcement measures to ensure that the promised improvements are delivered.
- Increases the number of improvement projects on Port property over the next few years. With the Port's constrained number of construction project management staff, this tool leverages a tenant's resources to deliver more improvements to the Port's property than the Port could accomplish on its own.

Port staff recognize that tenant improvement allowances shift a level of risk of non-completion to the Port, relative to the rent credit tool – that is, a Port tenant may receive the tenant allowance, not complete the project, and be defaulted out of the lease. To help mitigate this risk, Port leases typically require financial security instruments prior to the start of an improvement project to ensure the project will be completed once started.

Need for Programmatic Chapter 6 Waiver

In order to effectively and efficiently deploy stimulus funding to increase Port's revenues through a tenant improvement allowance, staff recommends seeking an ordinance waiving Administrative Code Chapter 6 for tenant-contracted projects to activate spaces, generate revenue, and support a resilient economic recovery.⁴ Tenants, however, skilled at running a business and managing a tenant improvement project, are not equipped to follow specialized City codes for public works projects. Being clear that these public works contracting rules are waived in these cases would allow the Port to efficiently use stimulus funding and other funds to increase the Port's revenues, improve Port property, activate vacant spaces, and spur economic recovery.

While the Port could include the relevant tenant improvement allowance provisions and seek the Chapter 6 waiver in any specific lease brought to the Port Commission and Board of Supervisors for approval, the Port seeks Port Commission authority to use tenant improvement allowances and needs the Chapter 6 programmatic waiver in advance so that the Port can be clear about potential tenant improvement allowance requirements during the solicitation process. It is important for potential tenants to understand the value of any

⁴ See link to municipal code here: https://codelibrary.amlegal.com/codes/san_francisco/latest/sf_admin/0-0-0-64902

offered tenant improvement allowances in order to take the stimulus-funded contribution into account in their proposals. As a key term in a lease, any negotiated tenant improvement allowance will be presented to the Port Commission and the Board of Supervisors at the time of lease award and/or lease approval. **Figures 2 and 3** provide an illustration of the typical (rent credit) and proposed additional tool (tenant improvement allowance).

Figure 2. Typical Process when Tenant Receives a Rent Credit

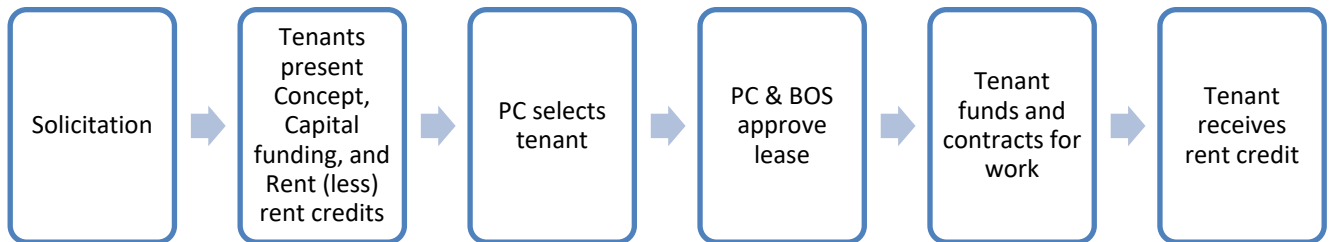
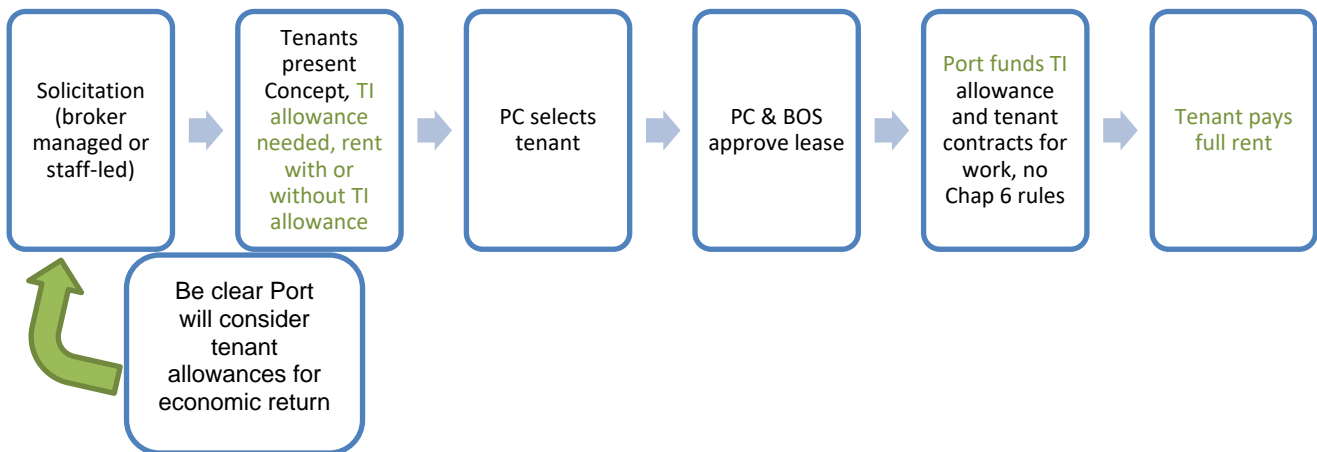


Figure 3. Proposed Process with Tenant Improvement Allowance in Place of Rent Credit



RECOMMENDATION

Port staff recommend approval of the attached resolution authorizing the use of tenant improvement allowances and authorizing staff to seek a programmatic Board of Supervisors’ waiver of Chapter 6 for the leases as described in this Memorandum. Port staff recommend this action to provide certainty and facilitate efficient deployment of stimulus and grant dollars aimed at economic recovery for all.

Prepared by: Rebecca Benassini
Deputy Director Real Estate and Development

PORT COMMISSION
CITY AND COUNTY OF SAN FRANCISCO
RESOLUTION NO. 23-08

- WHEREAS, Charter Section B3.581 empowers the Port Commission with the power and duty to use, conduct, operate, maintain, manage, regulate and control the Port area of the City and County of San Francisco; and
- WHEREAS, The economic downturn as a result of the COVID-19 pandemic has had an outsized impact on the Port's leasing revenue due to loss of tourism, empty offices, and a sharp reduction of visitors to the waterfront; and
- WHEREAS, President Biden signed the American Rescue Plan Act into law in March of 2021, providing billions in federal stimulus to state and local governments, including \$27 billion for California, \$250 million of which California allocated to ports to offset pandemic-related economic losses including, over three application cycles, \$117 million awarded to the Port of San Francisco for expenditure by 2026 in broadly defined eligible categories including tenant improvements; and
- WHEREAS, By Board of Supervisors Resolution 278-22, the Port was authorized to accept and expend up to \$115,887,377 in relief funds from the State's General Fund (originally sourced from American Rescue Plan Act) including approximately \$8,000,00 to be used for "tenant improvements to attract and retain tenants" and \$10,000,000 placed on reserve for economic recovery projects; and
- WHEREAS, The Port has determined that providing a portion of stimulus funds, other grant funds (subject to applicable accept and expend approvals), or other Harbor Funds for tenant improvements directly to tenants through a tenant improvement allowance in new or amended leases is a commercially reasonable and efficient method to achieve economic recovery and revenue generation; and
- WHEREAS, In instances where the Port pays for tenant improvements through a tenant improvement allowance, a tenant maybe subject to the provisions of Chapter 6 of the Administrative Code; and
- WHEREAS, Compliance with Administrative Code Chapter 6 (Chapter 6) contracting requirements could increase potential costs to Port and its tenants that could outweigh the benefits of the granted monies; and now therefore be it

RESOLVED, The Port Commission authorizes Port staff to offer the use of tenant improvement allowances in the following limited circumstances (i) lease or lease amendment subject to Port Commission and Board of Supervisors approvals; (ii) property improvements spur economic recovery and generate additional rents to the Port; and (iii) not more than \$20 million in tenant improvement allowance funds may be committed cumulatively across all such leases; and be it further

RESOLVED, To the extent Chapter 6 would otherwise be applicable, the Port Commission supports a waiver of Chapter 6 by the Board of Supervisors in the limited circumstances listed above and urges adoption of an ordinance to implement such a waiver on a programmatic basis.

I hereby certify that the foregoing resolution was adopted by the Port Commission at its meeting of February 14, 2023.

Secretary