

MEMORANDUM

March 5, 2020

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

FROM: Elaine Forbes
Executive Director

SUBJECT: Request approval of a Settlement Agreement and Lease No. L-16653 with the Pilara Family Foundation (“PFF”) under which: (i) Port’s claims for rent due and PFF’s claims for rent credits due under current Lease No. L-14414 for the Pier 24 Annex will be resolved; (ii) Port and PFF will enter into a new lease for the Pier 24 Annex for a term of approximately four (4) years; (iii) the new lease will allow storage, curation and display of a photographic collection and require PFF to continue to provide free public access to view the collection and will allow for rent credits of up to \$5.5 million; (iv) the new lease is subject to approval by the Board of Supervisors; (v) the parties will release each other from potential claims in connection with the Settlement Agreement; and (vi) the Settlement Agreement and new lease include other terms and conditions as set forth in the documents on file with the Port Commission secretary

DIRECTOR’S RECOMMENDATION: Approve the Attached Resolution

Executive Summary

Lease No. L-14414 with the Pilara Family Foundation (“PFF”) for Pier 24 Annex expired on November 30, 2017. In December 2019, after two years of negotiations regarding a new lease and payment of delinquent rent, Port staff issued a notice of termination for the expired lease. The parties agreed to make an additional effort at bridging the divide and Port staff have negotiated a settlement approach that achieves the following goals:

1. Agreement by the Tenant to continue the public-oriented operations at the Premises for the benefit of visitors and residents of San Francisco as a required use of the premises;

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2. Improved reporting of visitor attendance and special event activities, to assist the Port in understanding the value of the space under its current occupancy constraints;
3. A lease term keyed to the amortization of remaining capital expenditures according to the current parameter rental rate of the facility;
4. Establishment of a path by which PFF may elect to prepare an assessment of further repair needs and potential seismic improvements that would form the basis of a negotiation for subject a further lease extension in exchange for capital improvements; and
5. Resolution of the parties' claims while avoiding costly and time-consuming litigation.

The proposed settlement achieves these goals through two methods: settlement of outstanding delinquent rent due and entry of a new lease, all as further described below. Port staff recommends approval of the settlement to set the parties on a path towards continuing and improving the public's ability to access PFF's unique photographic collection and restored shed space.

Strategic Objective

The proposed settlement supports the Strategic Plan goal of Equity by continuing a tenant relationship that attracts a diversity of people to the waterfront.

Background

In 2007, at the time when the Port initially entered the current PFF lease, Pier 24 Annex had been condemned with rotting and missing pilings, sections of collapsed floor, severe water and termite damage to several of the major exterior columns and inadequate utility services. The building had been vacant since the 1980s. In 1998, the Port issued a "Request for Proposals" for retail or entertainment uses. The RFP was awarded to a developer but lease negotiations did not result in a final executed lease due to the small footprint of the building and the extraordinary large amount of investment necessary to activate the building. In light of this deteriorated condition, the Port had approved a capital budget item in the amount of \$3 million for the demolition and removal of the entire pier shed.

Instead, the Port entered into Lease No. L-14414 on January 2007 with the PFF for 27,311 square feet of Pier 24 (the "Current Lease"). Under the Current Lease PFF performed a significant capital improvement to remedy the conditions noted above and make the building safe for storage of PFF's photography collection. The building is very unique; even though PFF improved the space it is still classified as a S2 Occupancy warehouse use with a limited occupancy load of 93 persons.

Over time PFF worked within the occupancy restrictions to operate the premises as a museum-like space for the public to enjoy the space and view the collection. PFF provides a unique opportunity for the public to enjoy the waterfront by engaging the community through exhibitions, publications, and public and school programs. PFF welcomes members of the public, academic institutions, museum groups, and scholars for self-guided tours through the space at no cost. Under the Current Lease, PFF bears

the costs of all building maintenance including the substructure improvements it installed plus all utilities, staffing, program and operational costs.

The Current Lease as previously amended was for a term of ten years with monthly rent and an amortized rent credit in the amount of \$3.0 million for base building core and shell improvements only. The Lease expired November 30, 2017 and the rent credit was exhausted. Per the Tenant, the amount of the project was \$14.0 million with a total of \$9.2 million invested into base building core and shell improvements (including \$1.0 million of substructure work). The Port has reviewed and validated \$8.5 million in base building core and shell improvements, leaving \$5.5 million in unamortized capital improvements as of the expiration date of the Current Lease. The Current Lease has continued on a holdover basis and will be finally terminated upon commencement of the new lease subject to the approvals described in this Staff Report.

In the months leading up to and following the expiration date of the Current Lease, the parties engaged in negotiations for a mutually agreeable extension of the term while PFF continued to pay rent in an amount reflecting the deduction of rent credits. When the best and final offers of the two sides remained appreciably apart after two years of such discussions, Port staff issued a 30-day notice of termination on December 22, 2019.

In the wake of that notice, representatives of the Port and PFF indicated a willingness to revisit the Port's last offer. Upon confirmation of the general agreement to the structure summarized below, Port staff issued a letter agreeing to forbear from taking legal action to enforce the notice of termination while the full agreement could be negotiated. Those discussions were successful and Port staff is recommending approval of these agreements to reframe and refresh the parties' relationship.

Settlement Summary

As noted above, the proposed settlement Port staff achieves these goals through two methods: settlement of outstanding delinquent rent due and entry of a new lease (Lease No. 16653, the "New Lease").

Delinquent Rent under Prior Lease. In terms of the outstanding rent, as of the time of the termination notice PFF had incurred approximately \$1,325,648.76 in delinquent rent charges, with \$873,776.72 attributable to the listed \$1.18/sf rate in the expired lease (the "Base Portion") and \$451,872.04 attributable to the 50% increase in such rate required under Section 26.1 of the expired lease (the "Holdover Provision Portion"). The proposed Settlement Agreement would address these amounts as follows:

- The Port would credit the Base Portion against the \$5.5 million of the unamortized costs noted above, with a true-up of amounts accrued up until the date the new lease commences.
- The Holdover Provision Portion would be waived.
- The unamortized rent credits remaining after addressing the delinquent rent charges would be eligible for use under the New Lease.

Entry of a New Lease. The Settlement Agreement's crediting of delinquent rent is further conditioned on the parties' agreement to enter the New Lease of the premises with the following rent terms:

- Monthly rent is equal to the current parameter rental rate adopted by the Port Commission (\$3.40/sf per month for 27,311 sf, or \$92,857.40 with no indexing increases);
- To defray that amount, Port will authorize PFF to take rent credits of \$3.19/sf per month, leaving a payment of \$0.21/sf per month or \$5,735.31; and
- The total authorized amount of rent credits is equal to the amount remaining after the true-up and crediting of delinquent rent as described above.

The base New Lease term would expire upon full amortization of the unamortized rent credit. This will vary according to the date the New Lease commences; for example, if the New Lease commences on May 1, 2020 then the remaining term will be 4 years and 3.7 months. There will be no provision that provides PFF the right to holdover.

As noted above, PFF would be required to continue the public-oriented operations at the Premises for the benefit of visitors and residents of San Francisco with free entry and will provide Port with improved reporting on its visitors. The New Lease will be non-transferable without Port's consent in its sole discretion. Except as otherwise described below, the New Lease will be on the Port's boilerplate form and will include standard as-is provisions, security deposit, the Seawall project, Port participation in sale of the lease, hazardous materials, indemnity, insurance requirements and all required City provisions. As was the case with the Current Lease, the New Lease does not include the Port's usual termination right for a Port program or project. In light of the short duration of the New Lease staff believes that this deletion is appropriate. In addition, the New Lease also includes an elective termination right for PFF with one year's prior written notice, and a termination right for PFF with 90 days written notice in the event that maintenance and repair obligations exceed what is reasonable in light of the remaining term of the New Lease. The parties have also negotiated an approach that carries over the security deposit from the Current Lease to the New Lease, rather than requiring further deposits in light of the increased underlying rental rate.

Both parties are also interested in exploring whether there are beneficial improvements that can be made to the premises that would justify further extension of the term under the Port's leasing policies. Accordingly, the New Lease provides that Port will consider a proposal by Tenant, made before the first anniversary of the Commencement Date of this Lease, to extend the Term of the Lease on terms and conditions consistent with City and Port policies and practices and which are mutually beneficial to the Parties. The Port's review of such a proposal will be predicated in significant part on the proposed improvements to Port property. Accordingly, any such proposal must be accompanied by a facilities condition report (the "Facilities Condition Report") prepared by a qualified team of construction professionals including a structural and mechanical engineer acceptable to both Parties. The Facilities Condition Report must, at a minimum, describe the condition and integrity of the Facility and improvements, the Seawall, substructure, and all plumbing, electrical, fire protection, life safety, security and other mechanical electrical, and communications systems serving the Premises; and the repair and investment needs and schedule and the estimated costs for such needs. Tenant's proposal must address all necessary repair and investment needs described in the submitted Facilities Condition Report anticipated over the proposed extension term and must also include a feasibility study of seismic upgrades that would eliminate the

current occupancy limitation and/or allow for public assembly. Any extension will be subject to approval by the Port Commission and the City's Board of Supervisors in the sole discretion of each.

Port Staff Policy Analysis

As noted above, Port staff negotiated the proposed settlement terms to provide more certainty for the continuation of the ability of the public to enjoy PFF's collection which in turn further fulfills PFF's stated mission as a nonprofit. In addition, PFF and Port staff expressed a shared desire to explore whether an agreement for additional lease term in exchange for additional improvements will allow PFF to continue its operations; the New Lease specifically lays out a process by which the parties can engage in the further technical review and negotiations needed to achieve such an arrangement.

Port Staff Recommendation

Port staff recommends that the Port Commission approve the attached resolution at the March 10, 2020 meeting authorizing execution of the Settlement Agreement and approving form of New Lease. If approved by the Port Commission, the New Lease would also require further approval by the Board of Supervisors per Charter Section 9.118. Upon such approval, the Port would execute both the Settlement Agreement and New Lease.

Prepared by: Michael Martin
Deputy Director
Real Estate and Development

**PORT COMMISSION
CITY & COUNTY OF SAN FRANCISCO**

RESOLUTION NO. 20-14

- 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 Port entered into Lease No. L-14414 in January 2007 with the Pilara Family Foundation, a nonprofit corporation (“PFF”) for 27,311 square feet of Pier 24 Annex (the “Lease”); and
- WHEREAS, The Lease, as subsequently amended, was for a term of ten years with monthly rent and an amortized rent credit in the amount of \$3.0 million for base building core and shell improvements only; and
- WHEREAS, The Port reviewed and validated \$8.5 million in base building core and shell improvements performed by PFF, leaving \$5.5 million in unamortized capital improvements; and
- WHEREAS, The Lease expired November 30, 2017 and the rent credit was exhausted; the Lease has been on holdover status since its expiration; and
- WHEREAS, The parties were unable to resolve their disputes regarding Port’s claims for rent due and PFF’s claims for rent credits due and after two years of such discussions, Port staff issued a 30-day notice of termination on December 22, 2019; and
- WHEREAS, After the issuance of that notice, the parties revisited their final offers and reached agreement on a draft Settlement Agreement (the “Settlement Agreement”) which requires the parties to enter into a new lease for the premises (the “New Lease”); and
- WHEREAS, Under the proposed Settlement Agreement, (i) Port’s claims for rent due and PFF’s claims for rent credits due under current Lease No. L-14414 will be resolved; (ii) Port and PFF will terminate the Lease and enter into a New Lease for the Pier 24 Annex for a term of approximately four (4) years equivalent to the time needed to apply the unamortized rent credits; (iii) the New Lease will allow storage, curation and display of a photographic collection and require PFF to continue to provide free public access to view the collection and will allow for rent credits of up to \$5.5 million; (iv) the parties will release each other from potential claims in connection with the Settlement Agreement; and (v) the Settlement Agreement and the New Lease

include other terms and conditions as set forth in the documents on file with the Port Commission secretary and as described in more detail in the Memorandum to the Port Commission dated March 5, 2020; and

WHEREAS, The parties now wish to settle their dispute in a manner that allows PFF to continue offering free access to its collection to interested members of the public and with the intention of avoiding protracted disputes, uncertainties, and litigation with their attendant inconveniences and expenses; and now therefor be it

RESOLVED, that, subject to Board of Supervisors' approval of the New Lease, the Port Commission hereby approves the execution of the Settlement Agreement and the New Lease, each in substantially the same form on file with the Port Commission Secretary; and be it further

RESOLVED, that the Port Commission authorizes the Executive Director to enter into any additions, amendments or other modifications to the Settlement Agreement and New Lease that the Executive Director, in consultation with the City Attorney, determines, when taken as a whole, are in the best interest of the Port, do not materially increase the obligations or liabilities of the City or the Port, and are necessary or advisable to complete the transactions which this Resolution contemplates and effectuate the purpose and intent of this Resolution, such determination to be conclusively evidenced by the execution and delivery by the Executive Director of such documents.

I hereby certify that the foregoing resolution was adopted by the Port Commission at its meeting of March 10, 2020.

Secretary