MEMORANDUM

October 4, 2012

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

FROM: Monique Moyer
      Executive Director

SUBJECT: Request approval of term sheet for Pier 70 20th Street Historic Buildings development opportunity with Orton Development Inc. (“ODI”)

DIRECTOR’S RECOMMENDATION: Approve Attached Resolution

EXECUTIVE SUMMARY

Port Staff seeks approval of a term sheet for the lease and rehabilitation of the 20th Street Historic Buildings at Pier 70. The Term Sheet presents a conceptual agreement by the parties of the terms of a transaction to achieve the objectives specified in the Port’s October 4, 2011 Request for Proposals (“RFP”)¹.

On December 2, 2011, ODI submitted a proposal to create a “New American Workplace” through thoughtful rehabilitation of these historic office and industrial buildings. ODI proposed a participation structure for the transaction economics: ODI would provide the capital, design, redevelop, and operate the project. The Port would share in proceeds from the project after ODI had recovered its equity investment. On February 28, 2012, the Port Commission awarded ODI an exclusive negotiating right for the 20th Street Historic Buildings.

After negotiations with ODI and project due diligence, Port Staff is now presenting for approval a refined project concept (Exhibit B) and term sheet (Exhibit C). As proposed, ODI will rehabilitate the buildings securing the required funding including up to $14 million of its own equity investment. The Port will contribute $1.5 million capital funds,

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¹The RFP, ODI’s proposal, and background information is available on the Port’s website at: http://www.sfport.com/index.aspx?page=1559
already budgeted for these buildings. ODI will receive a 14% percent return (on a simple interest basis) on its investment after specified expenses and debt service. ODI and the Port will share equally in net cash flow after ODI’s equity is repaid. An annual guaranteed base rent of $200,000 (escalated to reflect inflation) is due 20 years after commencement of the lease.

Based on current cost and revenue estimates and assuming lease approval in early 2013, Staff projects that the Orton equity investment will be repaid by 2021 and the Port will subsequently receive $600,000 a year in participation rent. The transaction structure guarantees revenue to the Port starting 20 years after the lease execution (expected to be 2033), even if the maximum ODI investment is required.

Historic rehabilitation is inherently complex and laden with risks. Following the approval of the Term Sheet, ODI will continue to refine its project cost estimates including engineering analyses, code assessment, and historic preservation review. Concurrence of the Port Commission, and later the Board of Supervisors, on this transaction framework allows ODI to undertake the work needed to design the project, commence project review, secure capital partners, and attract tenants. More details on all aspects of the Project will be presented to the Port Commission, prior to approval of the lease (anticipated in January 2013), including an in-depth financial analysis.

ODI has agreed to work with the Port, BAE Systems, the Port’s ship repair tenant, and Forest City, the developer for the 25 acre, Waterfront Site. ODI will collaborate to integrate its project into the physical infrastructure of Pier 70 as well as the “place-making” needed to reconnect Pier 70 with the Dogpatch and the rest of San Francisco.

Staff recommends approval of this term sheet to achieve the following Port objectives:

- Saving an extraordinary collection of historic buildings from potential collapse. The Port’s Capital plan has approximately $110 million of unfunded costs for these structures. Transferring responsibility for these buildings to ODI, who has the capability and access to capital to rehabilitate them, will reduce the Port’s unfunded capital requirements and positively affect the Port’s credit outlook.
- Adding to the value of Port Property. This effort would create about $50 to $60 million of new assessed value that could be bonded to provide $4 to $5 million of future infrastructure financing district funding for Pier 70.
- Improving the Port’s operating cash flow. In the near-term, reducing security costs and repair costs due to vandalism.
- Providing Port revenue, in the longer-term.

**BACKGROUND**

In April 2010, the Port published its Preferred Master Plan ("Master Plan") for the 65-acre Pier 70 area after an extensive community planning and technical feasibility analysis effort. The Pier 70 Master Plan provides a vision balancing sustained ship
repair, historic preservation, new waterfront parks, and new development. On May 11, 2010, the Port Commission authorized two efforts to attract development partners for Pier 70 (Resolution 10-27). In July 2011, following a competitive solicitation process, the Port entered into an exclusive negotiating agreement with Forest City California for the “Waterfront Site”, the southeast 25 acres of Pier 70 with capacity for significant new development and over 250,000 square feet of historic buildings.

In this context, on October 4, 2011, the Port issued a RFP for the 20th Street Historic Buildings to ten parties. Four parties responded to the RFP as presented to the Port Commission on January 20, 2012. On February 28, 2012, the Port Commission awarded the opportunity to ODI and directed staff to negotiate an Exclusive Negotiating Agreement (“ENA”) for the project. On April 24, 2012, the Port Commission approved the ENA terms. This Term Sheet approval is one of the critical milestones in the ENA.

These buildings are in poor condition at the present with two red-tagged and none currently leased. It is important to note that the RFP did not set a minimum rent or any other floor financial requirements. In fact, it acknowledged the urgency and import of saving these buildings and that public funding sources could be required for this effort.

TERM SHEET

Project Proposal

On July 10, 2012, ODI presented its project concept to the Port Commission and received supportive feedback on its approach to this site. The uses proposed – light industrial, education, recreation, office, and commercial – are, with the addition of potential education and recreation components, the same as the proposal that the Port Commission considered when it selected ODI on February 28, 2012.

The purpose of this project is to rehabilitate the 20th street Historic Buildings and make them once again a vibrant, integral part of the surrounding community. ODI will return the buildings to profitable use while maintaining their historic fabric. The proposed work includes repair and maintenance, seismic and structural upgrades, security measures to combat an atmosphere of neglect and criminal opportunity, and abatement of hazardous environmental conditions.

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2 Item 10B on this agenda: http://www.sfport.com/index.aspx?page=1412
6 Item 9B on this agenda: http://www.sfport.com/index.aspx?page=2063
7 Item 9B on this agenda: http://www.sfport.com/index.aspx?page=2088
Proposed uses by building are as follows:

- Building 101 and 104, as former Bethlehem Steel and Union Ironworks office buildings will return to office use with the technological capabilities required for modern businesses.
- The former Bethlehem steel cafeteria (in Building 101) will remain food production, while the former powerhouse (Building 102) will become a restaurant.
- The Union Ironworks Machine shop (Building 113) and surrounding warehouses (Buildings 114/115/116 and Building 14) will return to industrial and educational use as food, technology and arts production centers, mirroring the high-quality “maker” type businesses currently thriving in the Dogpatch neighborhood, with ancillary office and retail.
- A limited number of caretaker residential units may be included in the project.

New floor area construction is limited to that required for seismic stability or life-safety systems, for example, if a structural mezzanine is required to create a seismic diaphragm. All work will be consistent with the Secretary of the Interior’s Standards for the Treatment of Historic Properties (“Secretary's Standards”). ODI’s efforts will include repairing or replacing existing roofing, repairing existing masonry surfaces, repairing deteriorated windows, making existing toilet rooms operational and constructing accessible toilet rooms. The work also includes installing a new concrete slab floor to the industrial buildings, creating accessible entries to each space, and stubbing in new electrical, fire safety, phone, data, water, sewer and gas utilities that will be upgraded to meet applicable code requirements.

Working with the Port, 20th Street will be improved to accommodate safe pedestrian thoroughfare with links to Crane Cove Park, and the Machine Shop courtyard can be programmed with activities and events open to the public. The result will be a beautiful historic core that will foster successful businesses, provide jobs, and enhance the local neighborhood.

Proposed Transaction Terms

Attached as Exhibit C is the Term Sheet proposed for approval. The key business terms are as follows:

- ODI will rehabilitate the buildings to meet the Secretary's Standards. Given the age and dilapidation of the structures, this involves extensive repair and replacement of building systems, structural upgrades, and life safety improvements. ODI estimates the project cost at $58 million.
The Port will redeploy the $1.5 million of capital funding budgeted in FY2011/12 for interim shoring of the Union Ironworks Machine Shop as a contribution to the full seismic retrofit for this structure.8

ODI will invest up to $14 million of equity in the project and secure project debt and tax credit investors for the remaining funds.

Net revenue from the project after debt service will first pay ODI a 14% return (on a simple interest basis), then repay ODI’s investment, and finally be split equally with the Port.

Port participation through equal sharing of any refinancing proceeds and a 10% participation in the net proceeds from a sale or assignment of the lease.

A guaranteed annual minimum rent of $200,000 escalated to reflect inflation after 20 years, even if ODI has not yet recovered its equity investment.

Parking for the project will be provided as part of an area parking strategy on sites to be determined and the Port, not ODI, will receive the parking income.

Recognizing the difficult state of the buildings, a provision to allow ODI to undertake limited early work and to be reimbursed up to $75,000, before lease execution, on the project to address security or other immediate needs.

In addition, the Term Sheet provides for mechanisms to further the evaluation of the project including:

- Requiring a full project underwriting package to be submitted to inform the transaction documents negotiation.
- Working closely with BAE Systems and the Port to identify a plan to remove the existing electrical systems from Building 102 to allow its re-use.
- Committing to minimizing the cost of capital for the project.
- Risk sharing measures to address the risks of unknown base building conditions.

**Pier 70 Wide Coordination**

ODI will collaborate with Forest City, the Port, the City, the shipyard tenant, and the community to revitalize Pier 70.9 This collaboration will start with defining site-wide infrastructure requirements. It will also include shared parking resources, transportation demand management efforts, and other needed activities to fully invigorate Pier 70. For example, as some of these buildings frame the planned “Machine Shop Courtyard”, project concepts and uses must foster the success of that plaza. Similarly, for ODI to reuse Building 102, the Power House, the existing electrical systems serving the

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8 This capital project was put on hold after selection of ODI so the Port could evaluate whether this interim measure was still prudent if a full seismic repair could be achieved soon. The shoring work, while addressing life-safety concerns regarding collapse, is an interim measure.

9 On September 25, 2012, the Port Commission received an overview presentation on how the Office of Workforce and Economic Development and the Port are managing the Pier 70 initiatives.
shipyard must be relocated. In the Term Sheet, ODI agrees to assess the electrical systems, recommend a strategy, and then negotiate with the Port how to best address electrical system separation.

**ANALYSIS OF PROPOSED PROJECT**

Rehabilitation of these buildings has been a goal of the Port since the adoption of the Waterfront Land Use Plan which acknowledged, “the cost of renovating these buildings would be prohibitive for maritime businesses and most public uses” and allowed flexibility in uses. As part of the Pier 70 Master Plan process, the financial feasibility analyses for these six buildings estimated $150 million of capital costs. With a typical real estate development structure, the revenues forecasted supported private investment of $100 million, leaving a feasibility gap on the order of $50 million. This estimate was revisited in late 2011 to incorporate new information on environmental conditions and uses for the buildings to show a total cost of $106 million and a feasibility gap of $13 million. Several different real estate developer assessments, including other recent proposals, found that major public investment would be required to save these buildings.

Given the earlier evaluations of the economic challenge of this project, it is exciting that the ODI project offers the ability to address these buildings in the near term. ODI’s vision and expertise brings the following factors to accelerate this project:

- A lower project capital cost estimate of $58 million due to:
  - A less extensive rehabilitation – largely leaving the buildings in their existing form.
  - Building to cold shell and having tenants fund their use-specific improvements and rents appropriate for that building standard.
  - ODI's expertise in rehabilitation projects in particular in addressing hazardous materials and designing cost-effective solutions to address structural and other code issues.
- Strong market interest in authentic space and in the Dogpatch neighborhood.
- ODI's access to capital given its track record and assets. Between historic tax credit investors and bank debt, ODI anticipates a capital structure for the project that has a 5% annual average weighted average cost of capital. If the maximum equity is required, this increases to 7%.
- ODI's willingness to commit its equity to the project.

In addition to these factors, the Port's contribution of the $1.5 million and the participating rent structure mitigates certain risks of the project, allowing ODI to secure

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needed third party capital. The terms proposed provide the Port a means to share in the upside of the project yet catalyze the project by deferring guaranteed base rent for 20 years.

**ANALYSIS OF THE FINANCIAL TERMS**

Based on current information, Staff prepared three projections of Port rent income under this deal structure:

- **A Base Case** with current estimates of capital costs, revenues, and capital structure.
- **A Low Rents Case** where rents are 30% lower and ODI would be required to invest $14 million to realize the project.
- **A High Costs Case** with a total capital cost of $70 million that, with other factors held constant, would also require ODI to invest $14 million.

In the base case, ODI’s investment is repaid in 2021 triggering the start of participation rent. In the other two cases, although the guaranteed minimum base rent begins in 20 years, participation rent is delayed due to the length of time needed to repay the ODI equity. In the High Costs Case, ODI’s equity is repaid in 2045; for the Low Rent Case repayment takes until 2051.

**FURTHER PROJECT REVIEW**

After endorsement of the Term Sheet by the Port Commission and the Board of Supervisors, the Project Concept presented in Exhibit B will be refined and subject to a historic resources evaluation. The repair and construction improvements will require review by the Port and Planning Department to determine their consistency with the Secretary Standards. The proposed repairs and use of the buildings are subject to review under the California Environmental Quality Act (“CEQA”). The Eastern Neighborhoods Final Environmental Impact Report (“EIR”)\(^{11}\), certified August 8, 2008, evaluated the environmental effects of General Plan amendments, rezoning and projected new development in the Eastern Neighborhoods, which includes the Central Waterfront and Pier 70. The review of environmental effects of ODI’s proposed repairs and use of the 20th Street historic buildings will be conducted by the Planning Department to determine the CEQA review needed, in the context of the analysis in the Eastern Neighborhoods FEIR.

ODI will be seeking Federal Historic Rehabilitation Tax Credits for this project. Eligibility for tax credits requires the Port to list the Pier 70 Historic District on the National Register of Historic Places. The tax credit process includes an additional level of project design review by both the California State Office of Historic Preservation and the U.S. National Park Service.

\(^{11}\)Available at this link: [http://www.sf-planning.org/Modules/ShowDocument.aspx?documentid=3991](http://www.sf-planning.org/Modules/ShowDocument.aspx?documentid=3991)
COMMUNITY BENEFITS

Rehabilitation of these historic structures and allowing their reuse and public enjoyment is both the primary outcome of the project and the primary community benefit. The challenging nature of the Pier 70 project as a whole, with a particular focus on the historic resources, was well understood by the public and policymakers in November 2008 when 68 percent of voters supported Proposition D amending San Francisco’s Charter to facilitate the Pier 70 project. As discussed above, ODI’s project will include a public plaza and spaces to foster the community’s enjoyment of Pier 70’s heritage.

These buildings will provide 400-500 jobs when the project is complete and leased. Construction of the project, over a two year period, will employ an estimated 250 workers (full time equivalents). In both the construction of the project and in its long-run operation, ODI is committed to working closely with the City to employ San Franciscans and use local businesses.

CENTRAL WATERFRONT ADVISORY GROUP COMMENT

ODI has presented its project concepts to the Central Waterfront Advisory Group (“CWAG”) twice, July 25, 2012 and September 26, 2012. CWAG expressed support for the uses and project concept. Exhibit D summarizes the discussions. CWAG asked that the ODI project be very well coordinated with the overall plans for Pier 70 on issues like transportation, parking and public realm. OEWD and Port staff discussed how this coordination will occur and committed to continuing to work closely with the CWAG and the community as all the Pier 70 initiatives progress.

NEXT STEPS

If the Port Commission endorses it, the Term Sheet will be submitted to the Board of Supervisors (“Board”) for endorsement and finding that the project is fiscally feasible and that it is prudent to commence environmental review as required under Administrative Code Chapter 29. The Board action will include public hearings and opportunities for public comment. The Board review of the Term Sheet is consistent with the recommendations of the 2004 Management Audit of the Port by the Board of Supervisor’s Budget Analyst as a means of providing the Board with an “early read” on Port development projects.

If the Port Commission and the Board endorse the Term Sheet, Port staff will move forward with project review and negotiation of transaction documents for the project. Throughout this process, there will be numerous opportunities for public comment and review of the proposed project.
RECOMMENDATION

Port staff recommends that the Port Commission approve the attached resolution endorsing the Term Sheet shown in Exhibit C.

Prepared by: Kathleen Diohep, Manager
Public/Private Development Projects

Through: Jonathan Stern, Assistant Deputy Director
Waterfront Development

For: Byron Rhett, Deputy Director
Planning & Development

Exhibits
A. Pier 70 Area Map
B. Project Proposal
C. Term Sheet
D. Central Waterfront Advisory Group Review
WHEREAS, Charter Section B3.581 empowers the Port Commission with the authority and duty to use, conduct, operate, maintain, manage, regulate, and control the lands within Port jurisdiction; and

WHEREAS, The Port owns, in trust, a cluster of several historic buildings in need of substantial rehabilitation (the “20th Street Historic Buildings”), located on or near 20th Street, east of Illinois Street, and identified as the “Historic Core (Orton)” on Exhibit A to the staff report accompanying this resolution; and

WHEREAS, On February 28, 2012, by Resolution 12-18, the Port Commission awarded Orton Development Inc. (“ODI”) an exclusive right to negotiate with the Port for the development, rehabilitation, and lease of the 20th Street Historic Buildings (“the Project”); and

WHEREAS, On April 24, 2012, by Resolution 12-36, the Port Commission authorized the Executive Director or her designee to execute an Exclusive Negotiating Agreement (“ENA”) between the Port and ODI for the Project and the Port and ODI entered into the ENA effective May 17, 2012, which ENA required, among other things, for the Port and ODI to negotiate a Term Sheet to describe the fundamental deal terms for the Project; and

WHEREAS, ODI and Port staff have negotiated the Term Sheet attached as Exhibit C to the staff report accompanying this resolution (the “Term Sheet”), which sets forth the essential terms upon which the Port and ODI will negotiate in good faith to reach agreement on the final transaction documents; and

WHEREAS, Prior financial analyses conducted by Port to develop and rehabilitate the 20th Street Historic Buildings of this Project found that the projected income would not be insufficient to support the projected capital costs of over $100 million, thus requiring such that a significant subsidy would be required; and

WHEREAS, The proposed financial terms between Port and Orton for the Project are structured as a participating rent deal in which the Port contributes $1.5 million to the capital costs and defers minimum rent for a certain period, ODI contributes up to $14 million in equity, and both parties share equally in the long-term net revenues of the Project, creating a structure that maximizes the ability to secure third-party capital for the Project; and
WHEREAS The parties acknowledge that the Term Sheet is not itself a binding agreement that commits the Port or ODI to proceed with the approval or implementation of the Project and that the Project will first undergo environmental review under CEQA and will be subject to public review in accordance with the processes of the Port Commission, other City departments and offices, and other government agencies with approval over the proposed Project before any entitlements and other regulatory approvals required for the Project will be considered; now, therefore be it

RESOLVED, That the Port Commission hereby endorses the Term Sheet and authorizes and directs the Executive Director of the Port, or her designee, to execute the Term Sheet and present the Term Sheet to the Board of Supervisors for their endorsement and for consideration of a finding that the Project is fiscally feasible and responsible under San Francisco Administrative Code Chapter 29 (the “Fiscal Feasibility Finding”), and in the event the Board of Supervisors fails to make a Fiscal Feasibility Finding for the Project, to either terminate the ENA or revise the Term Sheet; and be it further

RESOLVED, That provided the Board of Supervisors endorses the Term Sheet and makes a Fiscal Feasibility Finding for the Project, the Port Commission authorizes that directs the Executive Director of the Port, or her designee, to work with ODI to undertake project review and negotiate the terms and conditions of any development agreement, lease, and related documents (“Transaction Documents”), with the understanding that the final terms and conditions of the Transaction Documents negotiated between Port staff and ODI during the exclusive negotiation period will be subject to the approval of the Port Commission and as applicable, the Board of Supervisors and the Mayor; and, be it further

RESOLVED, That approval of the Term Sheet and direction to Port staff does not commit the Port Commission or the City to approval of final Transaction Documents or implementation of the Project or grant any entitlements to ODI, nor does the Term Sheet foreclose the possibility of considering alternatives to the proposal, mitigation measures or deciding not to grant entitlement or approve or implement the Project, after conducting appropriate environmental review under CEQA, and while the Term Sheet identifies certain essential terms of a proposed transaction with the Port, it does not necessarily set forth all of the material terms and conditions of any final transaction documents; and, be it further
RESOLVED, That the Port Commission will not take any discretionary actions committing the Port to implement the Project, and the provisions of the Term Sheet are not intended and will not become contractually binding on the Port unless and until the Port Commission has reviewed and considered environmental documentation prepared in compliance with the CEQA for the Project and the Port Commission, and as applicable, the Board of Supervisors and the Mayor, have approved final Transaction Documents for the Project.

I hereby certify that the foregoing resolution was adopted by the San Francisco Port Commission at its meeting of October 9, 2012.

__________________________________________
Secretary
EXHIBIT A
PIER 70 AREA MAP
EXHIBIT D
Central Waterfront Advisory Group Review of ODI project

July 25, 2012

The ODI team presented their project concepts and discussed four alternative proposals for the industrial buildings on the south side of 20th Street – in particular the iconic Union Ironworks Machine Shop (Building 113).

1. Arts production and education
2. Makers/light manufacturing/ likely food focus
3. Cirque du Soleil, a permanent facility, that would need a 300 room hotel elsewhere at Pier 70
4. Tech Office Campus

CWAG's discussion supported the arts and light industrial uses in Scenarios 1 and 2. CWAG members expressed significant concerns about Cirque and the required hotel. A tech office complex raised additional concerns about being too private of a use.

The Machine Shop, Building 113, with its 90,000 square feet of high volume space, has been suggested as an event venue or other predominately public use like a market hall or museum. ODI has programmed an atrium of 11,000 square feet in the building and suggests events for the courtyard behind; however, most of the building would be tenanted. At this time, an event space is not an economically feasible use without subsidy.

September 26, 2012.

ODI returned to CWAG on September 25, 2012 and discussed the rehabilitation efforts by building and the uses for each. ODI explained they have eliminated Scenarios 3 and 4 discussed in July. CWAG expressed support for the narrowed set of uses. Discussions with CWAG identified issues that will need careful attention as the design of the ODI project moves forward, which include:

Seismic Retrofit: how the details will impact the historic buildings
Public Access: Allowing the public to view and enjoy these buildings through the atrium, public lobbies, or other measures.
Public Realm: Upgrades to the streetscape and plazas to support returning these buildings to use, for example adding and repairing sidewalks as needed.
Transportation and Parking: As discussed above, locations for near-term parking will be refined as the transaction documents are negotiated and the parking requirements of the 20th Street businesses will be incorporated in the overall Pier 70 parking plan.