

MEMORANDUM

September 23, 2010

TO: MEMBERS, PORT COMMISSION
Hon. Rodney Fong, President
Hon. Kimberly Brandon, Vice President
Hon. Ann Lazarus

FROM: Monique Moyer
Executive Director

SUBJECT: Request approval of term sheet for Seawall Lot 351(at Embarcadero and Washington Street) with San Francisco Waterfront Partners II, LLC as part of the 8 Washington Project

DIRECTOR'S RECOMMENDATION: Approve Attached Resolution

SUMMARY

This staff report presents the Term Sheet Port Staff has negotiated for disposition of Seawall Lot 351 (SWL 351), currently a surface parking lot, located on The Embarcadero at Washington Street, in conjunction with the Golden Gateway Tennis and Swim Club site located at 8 Washington Street (GGTSC Site) the adjacent property to the east and north (shown in Exhibit A). San Francisco Waterfront Partners II, LLC (SFWP) was awarded the SWL 351 development opportunity on February 24, 2009 (Resolution 09-12) following a request for proposal process. The Term Sheet presents a conceptual agreement by the parties of the terms of a transaction, based on policy direction by the Port Commission and responding to the Northeast Embarcadero Study (NES) published by the San Francisco Planning Department in May 2010.

SFWP has revised the project it proposed in December 2008 to respond to the NES. The revisions adjust the height and massing of buildings but, generally, result in a project of similar scale.

Staff asks for authority to move forward to negotiate a development agreement with SFWP to include SWL 351 with the adjacent GGTSC Site as part of a single project on the 3.2 acre combined site area (as proposed, the Project). The transaction would result in a land transfer, guaranteed payments of no less than \$5 million dollars to the Port of San Francisco, and a land lease with annual payments of \$120,000 per year. In addition, the transaction includes provision for future payments to the Port triggered by

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resale of condominiums created by the Project. SFWP agrees to include the entire site in a to-be-established Infrastructure Financing District (IFD) that will allow a portion of growth in property taxes to be reinvested in public facilities. The IFD funding from the project is estimated starting at \$2.5 million annually. No more than \$5 million of these funds will be used for project-related public realm improvements recommended in the NES. Port staff has estimated that the tax increment from this project could generate more than \$24 million in bonding capacity for other Port projects such as the Pier 27 cruise terminal. Port staff will bring a proposed plan for IFD funding for waterfront improvements to the Port Commission upon consideration of the IFD district expected later this year.

BACKGROUND

On February 24, 2009, by Resolution 09-12, the Port Commission authorized Staff to negotiate and enter into an Exclusive Negotiating Agreement (ENA) with SFWP for development rights for SWL 351 following a competitive request for proposals process. In addition to the standard terms of a Port development project, the Port Commission direction included the following milestones for project review:

1. Engage in a **planning process** [for the combined site] to respond to continuing community concerns about height and massing.
2. Development of a **term sheet** for review and approval by the Port Commission. That term sheet will include at a minimum the following terms:
 - Guaranteed minimum rent (\$500,000 per year), annual increases, percentage rent and Port participation in sale and financing proceeds must be set at fair market value and must comply with the terms indicated in the RFP.
 - The developer will be responsible for all development and operating costs of the project and any land exchange or lease agreement will include provisions to ensure the Port has no ongoing costs from this project in perpetuity.
 - Port interest in the land will not be subordinated to any debt or claim.
 - The transaction documents should include specific requirements for creating and retaining public parks, open space, active recreation and public parking as permanent conditions of the project.

The City's Planning Department led the NES planning process that included the 3.2 acre site under consideration as well as other Port properties and the public realm on the land side of The Embarcadero from Washington Street to North Point. The NES was a year-long process which concluded with presentations to the Planning Commission on July 1, 2010 and the Port Commission on July 13, 2010. By resolution on July 8, 2010, the Planning Commission "urge[d] the Port of San Francisco to consider the principles and recommendations proposed in the Northeast Embarcadero Study when considering proposals for new development in the study area and when considering public infrastructure improvements in the study area."

A coalition of neighborhood organizations filed a lawsuit challenging the Planning Commission's July 8, 2010 action on the grounds that it occurred prior to a comprehensive analysis of the NES under the California Environmental Quality Act.

DEVELOPMENT CONCEPT FOR THE PROJECT

The Project is a mixed use project with 165 residential condominiums, a visitor-serving, below grade, parking garage, a re-built private, tennis and swim club, restaurants and retail uses, and new public parks and open spaces.

A new public park is proposed for the portion of the site north of Pacific Avenue, and the 48 foot-wide portion of the site along the Jackson Street right-of-way (Jackson Commons) will become public open space. In exchange for the lands becoming public passageways or parks, portions of SWL 351 would be transferred to SFWP for development of the mixed use project.

Exhibit B includes the revised design. The 3.2 acre site will be bisected by reopening Jackson Street and Pacific Avenue as public passageways, effectively creating three blocks bounded by these new public, pedestrian walkways and the existing Embarcadero, Washington, and Drumm Streets. The uses proposed on these three new blocks are described below:

Washington/Drumm/Jackson/ Embarcadero: This block will include two condominium buildings containing approximately 165 condominiums, ground floor retail and restaurant use and a 3-level underground parking garage. The eastern building, along the Embarcadero, will be between 48 and 70 feet high and will contain approximately 54 residential condominiums, with ground floor retail and restaurant uses. The western building will be between 84 and 136 feet high and will contain approximately 111 residential condominiums, with ground floor retail and restaurant uses.

A three level underground parking garage will be built below this block. The garage will contain up to 255, but no less than 90, public parking spaces available for waterfront visitors and 165 residential condominium parking spaces, for a total of up to 420 parking spaces.

Jackson/Drumm/Pacific/ Embarcadero: The rebuilt Golden Gateway Tennis and Swim Club containing four outdoor ground level tennis courts, a 12,800 square foot fitness center and two outdoor rooftop swimming pools will occupy this block.

Pacific Avenue/Embarcadero/Drumm: The third block, Pacific Avenue Park, will contain approximately 11,000 square feet of public open space and a 4,000 square foot restaurant.

SWL 351 TERM SHEET

The Term Sheet (Exhibit C) sets forth the basic elements of SFWP's proposed development concept and uses for the Project, and the economic parameters and other fundamental terms that will serve as the basis for negotiating a detailed disposition and

development agreement, a purchase and sale agreement, a ground lease, and related transaction documents between the Port and Tenant (the "Transaction Documents"), with the understanding that the Project will continue to evolve throughout the public review process. It is subject to completion of environmental review of the Project, including a full range of appropriate alternatives and mitigation measures for the Project in its entirety under the California Environmental Quality Act ("CEQA"). The Term Sheet may be subject to further changes in the course of public review of the Project during the extensive approval processes that will follow CEQA review and in response to other City, Port, and public concerns that may arise, and is limited to the uses currently proposed by SFWP, and does not cover all potential uses for Seawall Lot 351, which the Port may consider in the course of the approval processes. The Term Sheet may be amended, along with the ENA, to reflect any subsequent proposal to change the uses, the mix of uses, the intensity of development, or other fundamental terms, subject to Port Commission review and additional CEQA review, if the changes have not already been analyzed. Along with any underlying documents such as pro forma, the Term Sheet is not intended to be, and will not become, contractually binding until the parties execute and deliver the Transaction Documents.

Transaction Structure

In the RFP the Port contemplated a long term lease of SWL 351 with minimum annual lease payments of \$500,000. SFWP in its December 2008 submittal proposed a structure that included an internal swap within the combined SWL 351/GGTSC Site and sale of portions of SWL 351. Under the proposed Term Sheet the Port, SFWP and the State Lands Commission would enter into an exchange agreement for portions of SWL 351 and portions of the GGTSC Site. The exchange agreement would result in the removal of the public trust designation on the majority of SWL 351 in exchange for imposing the public trust designation on a portion of the GGTSC Site (as shown in Exhibit B). The trust swap effectuated by the exchange agreement would allow for the sale of portions of SWL 351 for residential development, in exchange for development of public trust open space and restaurant uses on portions of the GGTSC Site that are not currently encumbered by the public trust.

Upon implementation of this trust exchange, SFWP would purchase the majority of SWL 351 from the Port and lease Jackson Commons and Pacific Avenue Park parcel from the Port for 66 years. A 4,000 square foot restaurant sublease parcel would be identified within the Pacific Avenue Park lease.

The residential condominiums would be sold. The developer would lease the retail and restaurant portions of the project to private operators. The developer or future transferee would own the private recreation club. The developer would operate the visitor serving parking garage and be responsible for all operating costs of the site, including the parks and public areas.

Financial Terms

For the sale of the majority of SWL 351 the Port will receive a \$3 million guaranteed payment upon stabilization (defined as one year following receipt of a temporary

certificate of occupancy) of the Project. Additionally SFWP must record covenants committing all owners to transfer payments to the Port of ½ percent of sale value for all sales of the residential condominiums and all sales of commercial condominiums except the first sale. The Golden Gate Tennis and Swim Club as a recreational amenity is excluded from the transfer payment structure. SFWP will guarantee a minimum of \$2 million from the initial transfer payments from the residential condominiums created by the Project.

SFWP will lease the remainder of SWL 351(a portion of the Jackson Commons) and the exchange parcels (Pacific Avenue Park) for use as publicly accessible open space. SFWP will complete public improvements and then lease these parcels for 66 years, paying \$120,000 per year upon completion. Rent will be adjusted every 5 years by the CPI with a minimum increase of 2% and a maximum of 4% per annum. The Project will be responsible for all operations and maintenance of this open space in perpetuity. SFWP proposes restaurant, café and other concession uses in the park parcels. The Port will receive 15% of gross rent from any restaurant or other concession use income generated within these areas.

During the construction period SFWP will pay the Port \$60,000 per year.

Public Finance

SFWP will be required to include the GGTSC Site in an Infrastructure Financing District (IFD) as a requirement of acquiring SWL 351. Following Board approval of the IFD (that includes GGTSC Site) formation, up to \$5 million of certain project related off-site public improvement costs (to be defined) will be funded with IFD tax increment funds. These improvements on publicly-owned or dedicated property will implement the public realm improvements (including sidewalk widening, street furnishings, etc.) recommended in the Northeast Embarcadero Study.

The Port agrees to use best efforts to cooperate with SFWP to include SWL 351 in a Mello-Roos Community Facilities District (CFD). CFD assessments would be applied to property within the Project site, and CFD funds will only be used for capital and maintenance costs for public components of the Project. If engineering and cost analyses deem additional funding is needed to finance agreed upon public improvements, the Port agrees to designate some or all of the \$120,000 per year park rent to augment CFD financing of these public improvements.

Analysis of Financial Terms

As outlined above the Port will receive multiple payment streams in consideration for entering into this transaction with SFWP. The Port will receive \$5 million in land payments (including guaranteed transfer payments from the first sales of the residential condominium units) at or near stabilization of the Project. After the initial sales during the stabilization period, all subsequent commercial and residential condominium sales are subject to transfer payments to the Port. These are conservatively projected to total \$25.3 million over 66 years with an estimated net present value (NPV) of \$3.1 million.

The Port would also receive lease revenue from short term construction rent and the long term park lease. Expected construction lease revenue is \$180,000, and park lease revenue is projected at \$22,781,676 over the 66 year life of the park lease. These lease revenues are projected to have an NPV of approximately \$2.4 million. Additionally the Port could receive percentage rents from any commercial uses in the parks area, projected at \$4.8 million over the life of the lease with an estimated NPV of \$400,000.

Project Port Revenue

Source	Total	Net Present Value
Land Payments	\$3,000,000	\$2,448,894
Transfer Payments		
First Transfer	\$2,000,000	\$1,632,596
Subsequent Transfers	\$25,307,464	\$3,160,912
Construction Period Rent	\$180,000	\$157,459
Long-term Park Lease	\$22,781,676	\$2,277,641
Restaurant Lease	\$4,780,586	\$412,732
Total	\$58,049,726	\$10,090,234

In total it is expected that the NPV of the Port's compensation would be approximately \$10.1 million. This compares favorably to the \$9.6 million NPV of \$500,000 annual rent proposed in SFWP's RFP submittal and represents fair market compensation for the sale of Seawall Lot 351. Given the development constraints of SWL 351 this value exceeds the value of stand alone development on SWL 351. Over half of this value is in the form of short term guaranteed payments providing the Port Commission monies to contemplate investing in other needed waterfront improvements. Additionally, long term transfer payments from sales and resales of condominiums represents a new revenue source for the Port.

The Project is expected to generate approximately \$400 million on new assessed value on the combined Project site. By agreeing to include both SWL 351 and the GGTSC site in a new Port IFD (subject to the approval of the Board of Supervisors) the Port can expect over \$2.5 million of tax increment to flow to the Port annually. This revenue will flow to the Port for up to 40 years and will likely increase over time. Port staff has estimated that the tax increment from this project could generate more than \$24 million in bonding capacity for other Port projects such as the Pier 27 cruise terminal.

This transaction guarantees short term payments, enhances long term lease revenue and provides the Port with a new mechanism to participate in the long term appreciation of this real estate asset. Given the current state of the real estate and financing markets the finance structure allows the Port to unlock the value of the site by accepting payments at stabilization and receiving long term participation in the financial upside of the Project.

PUBLIC COMMENT/CONCERNS

As evidenced by the extensive comments on the NES study throughout its duration and when presented at both Port and Planning Commissions, there is substantial public sentiment both in support of and in opposition to this Project. The Port Commission has

held 7 public hearings on this project concept since May 2006 and 2 on the NES. Additionally, the NES effort included 5 community meetings and 2 Planning Commission presentations.

It is worth noting that the proposed Project includes a re-built tennis and swim club and the Port expects that the final Project approvals will include agreements by SFWP granting rights to current tennis and swim club members for future use. Similarly, the proposed Project replaces, and expands, the amount of public parking for waterfront visitors. The final transaction documents will address provision of parking during the construction period.

NEXT STEPS

If the Port Commission endorses it, the Term Sheet will be submitted to the Board of Supervisors ("Board") for endorsement. 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. It should be noted that, under the financial structure proposed in the Term Sheet, the Port will not seek the Board's determination of financial feasibility under Administrative Code Chapter 29 because tax increment funds and Mello-Roos special taxes are not public funds for the purpose of the ordinance.

If the Port Commission and the Board endorse the Term Sheet, Port staff will move forward with environmental review, project design review, public trust analysis, 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. A draft environmental Impact report is expected to be published in late 2010 or early 2011. Further Port Commission consideration will occur after that report is certified by the Planning Commission.

RECOMMENDATION

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

Prepared by: Kathleen Diohep, Project Manager
Jonathan Stern, Assistant Deputy Director
Waterfront Development

For: Byron Rhett, Deputy Director
Planning & Development

Exhibits

- A. Site Map
- B. Project Proposal
- C. Term Sheet

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

RESOLUTION NO. 10-66

- 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 Seawall Lot 351 (“SWL 351”), located at Washington and The Embarcadero as shown on the map attached as Exhibit A; and
- WHEREAS, By Resolution 09-12, the Port Commission awarded to San Francisco Waterfront Partners II, LLC (“SFWP”) an exclusive right to negotiate with the Port to develop SWL 351 in combination with 8 Washington Street; and
- WHEREAS, SFWP entered into an Exclusive Negotiating Agreement, effective August 26, 2009 (the “ENA”), setting forth the process, terms, and conditions upon which the Port and SFWP agreed to negotiate certain transaction documents for the disposition and development of SWL 351 and requiring the Port and SFWP to negotiate a Term Sheet to describe the basic elements of the proposed project, site plan, use program, economic parameters, and other fundamental terms that will serve as the basis for defining the proposed project for the purpose of undertaking environmental review under the California Environmental Quality Act and negotiating transaction documents; and
- WHEREAS, Resolution 09-12 also directed SFWP and Port staff to participate in the Northeast Embarcadero Study, (the “NES”) a community planning process led by the San Francisco Planning Department, as recommended in the February 19, 2009 letter to the Port Commission from Supervisor David Chiu; and
- WHEREAS, The Planning Department presented the NES recommendations on July 8, 2010 to the Planning Commission and on July 13, 2010 to the Port Commission; and
- WHEREAS, SFWP has submitted an updated building proposal for the Site in combination with 8 Washington Street (the “Project”), responding to the recommendations of the NES, attached as Exhibit A, describing the proposed Project; and
- WHEREAS, SFWP and Port staff have negotiated the Term Sheet attached as Exhibit B, which sets forth the essential terms upon which the Port and Developer will negotiate in good faith to reach agreement on the final transaction documents; and

WHEREAS The parties acknowledge that the Term Sheet is not itself a binding agreement that commits the Port or Developer 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; and

WHEREAS Consistent with the terms of the RFP, the Term Sheet specifies that, if the proposed Project is approved and developed, the Port would receive land payments representing fair market value for the portions of SWL 351 proposed to be conveyed to SFWP; 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 work with the Developer to undertake environmental review and to initiate any regulatory actions needed for the Project, with the understanding that the final terms and conditions of any development agreement, lease, and related documents negotiated between Port staff and SFWP during the exclusive negotiation period will be subject to the approval of the Port Commission; and, be it further

RESOLVED, That the Port Commission authorizes and directs the Executive Director of the Port, or her designee, to present the Term Sheet to the Board of Supervisors for its review and endorsement, and if the Board of Supervisors fails to endorse the Term Sheet, to either terminate the ENA or negotiate for a revised Term Sheet for the Port Commission's consideration in accordance with Section 3.3(b) of the ENA; and be it further

RESOLVED, That approval of the Term Sheet and direction to Port staff do not commit the Port Commission to approval of final Transaction Documents or implementation of the Project or grant any entitlements to Developer, 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 California Environmental Quality Act ("CEQA") for the Project and negotiated and approved final agreements for the Project.

I hereby certify that the foregoing resolution was adopted by the San Francisco Port Commission at its meeting of September 28, 2010.

Secretary