



MEMORANDUM

September 8, 2023

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

FROM: Elaine Forbes
Executive Director 

SUBJECT: Informational presentation on (1) Phase 1 Revised Budget; (2) Contribution of Port Capital; (3) Preview of Final Budget and Misc. items, for the Mission Rock Project at Seawall Lot 337, bounded by China Basin Channel, Third Street, Mission Rock Street and San Francisco Bay.

DIRECTOR'S RECOMMENDATION: Informational Only – No Action Required

EXECUTIVE SUMMARY

The Mission Rock Project's development is governed by the Disposition and Development Agreement ("DDA") and related agreements between the Port and the Developer, which were executed in August 2018. On September 24, 2019, by Resolution No. 19-39, the Port Commission approved the \$145 million Mission Rock Phase 1 budget. Subsequently, despite significant constraints due to the COVID-19 pandemic, the project team successfully obtained the Phase 1 Street Improvement Permit ("SIP"), Phase 1 Final Map, and Phase 1 Notice to Proceed. On August 10, 2021, by Resolution No. 21-33, the Port Commission approved the revised Phase 1 budget reflecting increased cost for construction and regulatory oversight, and cost-saving measures to ensure Phase 1 feasibility, including a revised schedule for the construction of China Basin Park inland and shoreline components.

Despite numerous design, environmental, and economic challenges, the Mission Rock project team is nearing completion of a successful Phase 1. Phase 1 vertical construction includes four buildings: 2 primarily residential (totaling 537 units) and 2 commercial office/life science. Three of the four Phase 1 buildings have received a Temporary Certificate of Occupancy (TCO), an important milestone for the completion of the base buildings. The first residential building, The Canyon, received its first residents on June 1, 2023.

The utilities, streets, and sidewalks supporting the Phase 1 buildings have been substantially completed to support the achievement of the TCO and the waterfront park construction is ongoing, with construction completion anticipated in Q1 2024. While the project teams are proud of the progress made to date, there are anticipated budget increases required to complete Phase 1 Horizontal Improvements.

The project team has been expecting that due to several factors, the project budget would eventually need to be increased to account for the underestimated cost of City, Port, and consultant costs associated with such a large-scale, complex, and uniquely designed project. Specific to these City costs, through Phase 1 completion in 2024, including contingency to account for any carryover work in 2025, the project budget will need to increase by \$16.5 million to account for this work. Port staff has reviewed, approved, and subsequently projected the remaining balance of this scope as necessary and accurate. Port staff is proposing to exercise its option to fund this budget increase as a Port Capital contribution, which earns the Port a return on its investment once repaid.

Although not detailed in this report, in addition to the increased City and Port costs mentioned above and, in order to eventually finalize the Phase 1 budget and complete construction, the Developer notified Port staff this past July of the other remaining cost increases it expects needed to complete Phase 1. The DDA sets forth an approval process for increases to horizontal development costs provided that the costs are reasonable to fulfill the obligations of the DDA, and sufficient funding sources are anticipated to repay the Developer for these costs. These other remaining budget costs are being reviewed and will be presented in detail to the Port Commission at a subsequent meeting. The Developer estimates these additional costs are expected to increase the budget by an additional \$13.4 - \$17.8 million. The funding of these other project costs is proposed to be covered through incremental developer capital, not Port Capital. Consistent with the August 2021 Phase 1 budget approval, this budget increase will rely on future phase repayment sources to repay both the Developer Capital and the proposed Port Capital.

In total, the Port staff expects the budget will need to be increased by \$30.0 million - \$34.4 million to complete the Horizontal Phase 1 Improvements. This would result in a total Phase 1 Budget of \$214.1 million - \$218.5 million as shown in **Table 1** below.

Table 1 – Expected Final Budget

Cost Item	2019 Port Approved Budget	2021 Port Approved Budget	Revised Budget (low)	Revised Budget (high)
Hard Costs				
Hard Costs	\$52,659,913	\$69,385,516	\$77,240,266	\$78,198,463
Inland CBP	27,397,300	33,395,979	39,184,050	40,657,253
Owner Costs ¹	9,688,437	5,292,826	2,587,204	2,587,204
Total Hard Costs	89,745,650	108,074,322	119,011,520	121,442,920
Soft Costs				
General	\$33,583,205	\$48,476,902	\$49,463,907	\$50,158,218
City Costs ²	\$5,000,000	5,000,000	19,577,000	19,577,000
Developer Items	\$13,461,848	\$18,907,674	23,774,409	23,787,637
Open Space	\$1,652,500	\$1,652,500	1,004,580	1,004,580
Soft Cost Contingency	\$1,984,086	\$1,984,086	1,250,000	2,500,000
Total Soft Costs	\$55,681,639	\$76,021,161	95,069,896	97,027,435
Totals	145,427,289	184,095,483	214,081,416	218,470,355

1. Owner Costs include contingency funds for hard costs. As the project progressed, these funds were reallocated to the Hard Costs and Inland CBP line items, which is why Owner Costs decreased over time.

2. In the 2019 Approved Budget, City costs were included in the General Soft Costs line item.

Both the increased City/Port costs of \$16.5 million and the other estimated project costs increases are primarily attributable to 1) sequencing complexity and project time extensions, impacting both hard and soft costs; 2) unforeseen conditions related to soils, dewatering and underground utilities; 3) enhanced security improvements and reinforcing of concrete in China Basin Park; 4) inflation and cost increases of labor and resources; and 5) increased Developer, City, and Port staff costs required to implement the project, including coordination of unique design features.

Vertical development has progressed faster than obligated through the Vertical Disposition and Development agreements. This has had a positive impact on the repayment sources available to the project, helping to partially offset the impact of the higher Phase 1 Budget. The in-place vertical development value has served as collateral for the issuance of \$108.2 million in CFD / IFD bonds issued to date, a future bond issuance of up to \$60M planned for fall 2023, and the earlier availability of tax increment to serve as repayment sources. The timing of the upcoming bond issuance is a key driver of project economics - for example, assuming an issuance with ~\$40 million in available bond proceeds, each month after issuance saves nearly \$500K of developer return accrual (and, conversely, each month of delay to a bond issuance would cause the project to incur \$500K of additional accrued return).

In addition to the focus on completing Phase 1, the Port and the Developer continue to evaluate the conditions for commencing the project's second phase. While acknowledging the current market creates challenges to a feasible Phase 2, important initial steps have been taken in pursuit of future development and the team is considering all available options that increase feasibility. These steps include the development of a Basis of Design for the infrastructure required to support the Phase, the preparation of a Garage Report defining the parameters of the Phase 2 parking garage, and the Vertical Developer

investment in preliminary massing studies. These initial steps ensure the team is prepared to take swift advantage of forward momentum once key economic indicators again point to a rebounding market or upon the identification of unique demand drivers such as pre-leasing. The remainder of the staff report includes the following sections:

- Project Overview and Status
- Phase 1 Increased City Costs and Budget Increase
- Port Capital Contribution
- Parcel Lease Technical Amendments
- Phase 2 Update
- Next Steps

PROJECT OVERVIEW AND STATUS

Project Overview

At full build-out, the Mission Rock Project will include up to 1,200 units of new, rental housing, 1.4 million square feet of new commercial and office space, and rehabilitation of historic Pier 48, as well as space for small-scale manufacturing, retail, and neighborhood services, eight acres of parks and open spaces, and public infrastructure. Forty percent (40%) of the residential units in Mission Rock will be below market rate.

Phase 1 of the Project includes four buildings: two primarily residential apartment buildings (Parcel A, “The Canyon”, and Parcel F) totaling 537 units, and two commercial office/life science buildings (Parcel B and Parcel G) totaling approximately 620,000 square feet. Parcel G will serve as Visa’s global headquarters. Phase 1 also features nearly five acres of parks and open spaces, including pedestrian paseos and China Basin Park. The Project’s district-scale private utility systems – a blackwater recycling system and a thermal energy system – have also been constructed in Phase 1.

Project Status

Phase 1 horizontal and vertical improvements are nearing completion. **Table 2** below illustrates the construction progress milestones (Temporary Certificate of Occupancy) and expected occupancy dates of the four Phase 1 vertical buildings and the open space elements within the Phase.

Table 2 - Construction Status

Parcel	TCO Date	Occupancy Date	Comments
Parcel G	Jan-23	1Q24	VISA TI Work ongoing.
Parcel A	May-23	2Q23	Market rate and BMR leasing ongoing. BMR lottery occurred on 6/20/23.
Parcel B	Jun-23	TBD	Leasing ongoing.
Parcel F	Projected Jun-24	3Q24	The building is on schedule for delivery in 2Q 2024.
Horizontal - SIP	NOC: Projected Q2 2024	N/A	Improvements nearing completion and supported TCO of 3 vertical buildings.
Horizontal - CBP	NOC: Projected Q2 2024	1Q24	Park landscaping and flatwork progressing toward park opening in early 2024.

Following Port Commission approval of the Phase 1 budget in September 2019, as amended in 2021, the Project team has accomplished the following milestones:

1. Issuance of the SFPW Director's Order authorizing the use of lightweight cellular concrete (LCC) in the project's streets
2. Approval of project-wide Tentative Map and Phase 1 Final Map
3. Approval of China Basin Park Schematic Design
4. Issuance of Phase 1 Street Improvement Permit (SIP)
5. Issuance of Port Building Permit for China Basin Park
6. Issuance of Notice to Proceed with the installation of horizontal infrastructure
7. Secured Bond Financing for District Utilities
8. Closed on all four Phase 1 Parcel Leases
9. Approval of new street names honoring Dr. Maya Angelou and Toni Stone
10. Successful preparation, marketing, and sale of \$108.2 million CFD/IFD bonds through two (2) separate issuances
11. Awarded more than \$163 million in contracts to LBE partners on the project as of June 2023
12. Commenced construction of Phase 1 horizontal infrastructure, including streets, paseos, and the inland portion of China Basin Park
13. Commenced construction of all four Phase 1 vertical buildings
14. Successfully recruited, trained, and hired a diverse group for the first all women's cohort of building trade apprentices
15. Submitted Phase 2 Basis of Design to City Departments
16. Submitted Phase 2 Application to Port, including a Garage Report establishing the parameters for the Phase 2 garage structure
17. Received TCO for Buildings A, B, and G
18. Topped out structural elements of Building F and on track to receive TCO in June 2024
19. Commissioned district-scale thermal energy plant and blackwater recycling plant
20. Began market rate and BMR leasing, and welcomed first residents to The Canyon (Parcel A)
21. Signed first 5 Mission Rock retail leases

The significant progress that has been made during the last four years has not come easily. The approval process for the use of lightweight cellular concrete to mitigate the settlement of the streets delayed the commencement of the horizontal infrastructure. The impacts of this delay continue to be felt today as horizontal and vertical construction has overlapped and created significant coordination challenges on the space-constrained Phase 1 site. The complexity of the ongoing public-private partnership and the infrastructure design and construction has contributed to schedule and cost impacts beyond what was originally anticipated by the project team. The site conditions, which are the product of the site's industrial history on land constructed by filling in the Bay, have also been more challenging than anticipated with soils, groundwater, and unknown underground utilities complicating construction. Most notably, construction continued throughout the entire COVID-19 pandemic, with impacts on labor and supply chains that have disrupted the construction of the project. The impacts of the pandemic have also been shocking to the real estate and capital markets, bringing commercial and residential development in San Francisco to a standstill.

Despite these conditions, the project team has outperformed the market and other comparable projects in the region. The infrastructure design and construction team has minimized design changes to the extent possible. The Port and Developer have efficiently managed park permitting and construction and were successful in cost-effectively mitigating significant groundwater impacts during the excavation of the park. The project team also started construction on Parcel F in March 2022 due to the unique financial structure of the project, including the payment of Jobs Housing Equivalency Fees by the office projects to subsidize the below-market rate housing.

Port staff and the Developer team are proud of the progress in delivering Phase 1 despite numerous headwinds and continue to work together on ways to support a successful commercial outcome in Phase 1. The success of Phase 1 directly impacts the ability to progress Phase 2 in the future. The team is actively working towards the successful occupancy and operation of the Phase and is excited for the anticipated opening of the public realm of the project - the park and paseos, streets and street rooms, and initial retailers by mid-2024.

Contracting

The Mission Rock project was one of the City's first development projects to commit to a Local Business Enterprise ("LBE") participation goal. Throughout Phase 1, the project team has worked collaboratively with the different General Contractors, City agencies, Community leaders, and businesses, to both address and implement various barrier mitigation strategies to help identify and assist local and historically underrepresented businesses to be competitive during the bid and awarding process. The recent LBE report includes \$35,387,174.84 (21.6% of total LBE awards) in contracts awarded to women-owned small businesses based in San Francisco and \$71,306,252.64 (43.6% of total LBE awards) in contracts awarded to minority-owned small businesses based in San Francisco. In total, \$163,482,494.69 (18.3% of total awards) of contract dollars were awarded to LBE businesses. The project has awarded contracts to one of the first certified LGBTQ-certified LBE partners, Anco Iron and Construction, in addition to minority-owned partners: AJS Painting (Interior Painting), Min Design (Street room design), Montez Group Inc. (Engineering), Micro-LBE Southeast Electric (Electrical). The project team continues to invest in the LBE partners at Mission Rock beyond these contracts. There are micro-LBEs that have worked closely with the team and grown, and Mission Rock Partners continues to offer additional support through sponsorship of technical training and business consulting support.

PHASE 1 INCREASED CITY COSTS AND BUDGET INCREASE

Phase 1 Increased City Costs

Throughout the Mission Rock project from the entitlement process continuing through today, the Port and Mission Rock Partners team has collaborated with the City agencies to help plan, review, and implement the project, particularly concerning the Project as follows:

San Francisco Public Works ("SFPW")

City Attorney's Office ("CAO")

"Other" includes:

- San Francisco Public Utilities Commission ("SFPUC")

- San Francisco Municipal Transportation Agency (“SFMTA”)
- Misc. City Agencies

The Phase 1 Budget revision approved in 2021 included \$5M for costs from City agencies for their role in reviewing and approving project infrastructure design and related documents and agreements. Since 2021, as construction on Phase 1 progressed but as the delivery schedule and acceptance schedule were extended, the project team worked through numerous technical issues with City agencies, several of which were unanticipated, including the following:

- Unique project design and materials to address projected sea level rise including the use of Lightweight Cellular Concrete (“LCC”) in the project’s streets
- Infrastructure design modifications
- Unforeseen subsurface conditions
- Complex contract documents requiring extensive legal review, such as the Recycled Water Purchase Agreement and the forthcoming Park Lease
- Staffing and legal support for multiple bond issuances
- Coordination and agreements to allow for utility services and opening of streets prior to acceptance
- Additional staff review of unique project conditions and specifications
- Coordination and documentation for Notice of Completion and Acceptance of City and Port improvements
- Impact of Covid-19 (specifically, supply chain and labor issues)

This broad scope of technical challenges resulted in a significant increase in City and Port staff, including their consultants and legal resources, which are involved in the review and approval of Phase 1 infrastructure. The following tables show the cost impact of this additional required staffing and resources.

Table 3A – City Agency Budgeted Amounts through Phase 1 Completion

CITY / PORT COSTS								<i>Total</i>
City Agency	2019	2020	2021	2022	2023	2024	2025	Phase 1
SFPW	241,457	865,845	1,141,191	1,052,610	998,561	1,007,315	300,563	5,607,541
Port Staff	78,664	373,518	480,966	622,154	858,292	785,267	806,925	4,005,787
Consultants	276,323	668,254	559,909	513,473	1,052,271	626,977	236,320	3,933,527
City Attorney	666,304	262,979	1,222,911	367,420	199,976	341,463	282,961	3,344,014
Other	172,846	384,291	443,027	505,952	449,439	497,371	232,138	2,685,064
Annual Total	1,435,594	2,554,888	3,848,005	3,061,609	3,558,540	3,258,392	1,858,906	19,575,933

Note: FY' 23 is 3/4th actual vs. projected; FY' 24 & 25 is 100% projected

As shown in **Table 3A** above, through the completion of Phase 1 in 2024, City costs are now estimated to be \$19.6M, which is nearly four times greater than estimated in the 2021 project budget. The allocation by department/type is shown in **Table 3B**:

Table 3B – Expense Allocation

CITY AGENCY	PHASE 1 TOTAL	%
-------------	---------------	---

SFPW	5,607,541	29%
Port Staff	4,005,787	20%
Consultants	3,933,527	20%
City Attorney	3,344,014	17%
Other	2,685,064	14%
Total	19,575,933	

The project DDA contemplated Phase 1 costs potentially exceeding Phase 1 sources of funds. This is because Phase 1 is burdened with much more than its share of the project's overall horizontal costs. Phase 1 includes 4 of the 12 vertical parcels, but nearly 40% of the project's horizontal improvement areas, including the inland portion of the project's signature waterfront park. Phase 1 must also support sitewide entitlement costs, a sitewide infrastructure basis of design, a project-wide Tentative Map, approval of lightweight cellular concrete, and significant precedential documentation.

Phase 1 Budget Increase

Since the Port Commission approved the updated Phase 1 budget nearly two years ago, costs anticipated to complete and close out the Phase 1 construction work have exceeded the previously approved contingency amount for the above reasons. The immediate budget increase request of \$16.5 million represents an increase of approximately nine percent (9%) above the prior approved budget.

As mentioned above, the Port expects the final budget request to require an increase of \$30.0 million - \$34.4 million (inclusive of the \$16.5 million for City costs). The specifics of the balance of the remaining \$13.4 million - \$17.8 million will be presented in detail once finally reviewed and confirmed by Port staff and its consultants, which is actively underway.

For both City costs and the other remaining project costs, the Developer team and Port staff are committed to continuing to manage the remaining construction activities efficiently and improving budget confidence over the months ahead.

PORT CAPITAL CONTRIBUTION

Under the terms of the DDA, both the Developer and the Port may invest at-risk capital to fund project costs. While the Port may elect to make this investment, the Developer must fund horizontal costs with Developer equity if public financing or land proceeds are not available.

Port staff is proposing to fund up to \$16.5 million of City Costs through investment of Port Capital. This will fully fund the necessary budget increase associated with the City Costs. The remaining proposed budget increase of up to \$17.8 million will be funded by Developer Capital. Each of these Port Capital Advances receives up to 10 percent interest from the effective date.

Staff is currently working with its third-party consultant to project a potential repayment schedule alongside other Phase 2 scenarios and will present that at the Port Commission meeting on October 10, 2023.

PARCEL LEASE TECHNICAL AMENDMENTS

At the time the Parcel Lease was executed in 2020, the Port and Developer acknowledged the need to modify the Parcel Lease form in the future with respect to the Port Participation calculation. The revision to the Port Participation calculation requires approval by both the Port Commission and the Board of Supervisors, and there was no time for that process before Parcel Lease execution to occur in 2020. The current timing of this requested revision is tied to the ability of the Developer to seek permanent financing for completed Phase 1 Vertical Parcels, a process which is anticipated to begin in late 2023 in a challenging commercial real estate financing market. The Port intends to seek approval to revise the language to clarify that proceeds used to pay off the prior financing are not included in the definition of "Net Financing Proceeds". The Port will already participate alongside the Developer and thus, this technical correction is appropriate.

In addition to this modification, throughout development and initial leasing, the Developer identified a few other recommended changes to provide clarity requested by commercial, retail, and residential subtenants and lenders. The Port is considering these requests and to the extent any require Port Commission approval, Port staff will present those in detail along with the technical correction at a future Port Commission meeting and seek approval, which could be as soon as this October.

PHASE 2 UPDATE

As required pursuant to the Port Commission's 2021 approval of the revised Phase 1 budget, on December 28, 2022, Developer sent the Port its Phase 2 Submittal. Since Phase 2 will include the parking garage, the Developer also submitted the Garage Report on October 14, 2022. This report was reviewed and signed off by SFMTA and Planning, for inclusion in the Phase 2 Submittal.

Regarding the Phase 2 budget and preparation of Phase 2 Fair Market Valuation appraisals, the Developer has previewed with Port Staff that current market conditions (the current combination of high-interest rates, high construction costs, and high commercial vacancy) do not support the minimum land values required for a viable Phase 2 budget and as such, the Developer has indicated that this element of the submittal will be deferred pending improving real estate market conditions.

Likewise, a full analysis and detailed financial model for Phase 2 is deferred and the details for Port's Ground Rent, the potential for prepaid leases as Project Sources, and other financial feasibility data, will be presented once the Fair Market Valuation process has been completed and there is increased certainty around the timing of the Phase. Prior to a Phase 2 budget, costs incurred by the Developer for Phase 2 will continue to be at the

Developer's risk. Additionally, the Developer team has incurred vertical costs to support the refinement of building massing to position Phase 2 once it is financially feasible.

In addition to the Phase 2 Submittal, on November 18, 2022, the Developer submitted a Basis of Design (BOD) for Phase 2 infrastructure that leveraged the engineering and construction experience from Phase 1. It is intended that critical design assumptions will be approved by the relevant city agencies as part of the BOD submittal. The Developer has met with relevant City agencies to facilitate the City's review of the Phase 2 BOD. As many aspects of the Phase 2 BOD were reviewed and approved for Phase 1, the review process for Phase 2 and future phases is anticipated to be more efficient.

The Port Staff and Developer have been in continued communication regarding the path to Phase 2 feasibility. The Developer team has committed to monitoring the market environment that influences the timing of Phase 2, including the following macro factors influencing development:

- Construction Cost Environment: Construction cost escalation has far outpaced rent growth over the last 5 years in San Francisco and has put downward pressure on land values and project viability. The developer team has continued to engage with contractor teams on both the vertical and horizontal scopes to monitor changes in the environment.
- Commercial Office Leasing: The commercial office market in San Francisco continues to face significant headwinds from the pandemic-related work-from-home policies which have influenced the recent demand for office space, leading to higher vacancy rates, stagnant rents, and increased capital outlay related to leasing. Recent leasing and momentum around AI and the continued return to work shifts have the potential to improve market sentiment quite rapidly.
- Interest Rates and Financing Environment: The drastic increase in interest rates over the past 18 months has impacted the cost and availability of capital to support real estate development. The higher interest rate environment has also reduced the bond proceeds supported in future issuances, reducing the available repayment sources.

Port staff have engaged a third-party consultant for this purpose. This will be presented in more detail to the Port Commission at a subsequent meeting and will be formally advanced during the future Phase 2 budget approval process.

NEXT STEPS

Staff will return to the Port Commission to seek approval of the Port Capital contribution and the initial \$16.5 million budget increase. As Port staff continues to analyze the revised budget estimates the Developer needs to complete the Phase, it will also review the proposed technical amendments to the Parcel Lease before returning to the Port Commission with a recommendation on those items, which is expected to occur as soon as October 10, 2023.

Prepared by: Phil Williamson, Senior Project Manager

Through: Josh Keene, Waterfront Development Manager

For: Michael Martin, Assistant Port Director