MEMORANDUM

August 7, 2020

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

FROM: Elaine Forbes
Executive Director

SUBJECT: Informational presentation on the status of the Pier 70 Mixed-Use District Project, roughly bounded by 20th Street to the north, San Francisco Bay to the east, 22nd Street to the south, and Illinois Street to the west.

DIRECTOR'S RECOMMENDATION: Information Only – No Action Required

EXECUTIVE SUMMARY

This memorandum provides an update to the Port Commission on the status of the Pier 70 Mixed-Use District Project. The project area is comprised of the 28-Acre Site, the Illinois Street parcels and the Hoedown Yard. This memorandum is for informational purposes only, to provide the Port Commission an update on construction progress and current financial projections. The economic uncertainly due to the COVID-19 health pandemic, and related slowdown on the vertical portions of the Project, prompted this update memorandum.

The Port's development partner for the 28-Acre Site, FC Pier 70, LLC, now an affiliate of Brookfield Properties ("Brookfield" or "Developer"), commenced site preparation and demolition in August 2018 and construction of Phase 1 horizontal improvements in March 2019. Infrastructure, aside from parks, is now approximately 75% complete. Brookfield will time construction of parks to coincide with the delivery of adjacent vertical development. As to vertical development, Brookfield is currently rehabilitating historic Building 12 but is not exercising its options for Parcels A (office) and E2 (apartment) at this time due to a concern that the appraised values do not reflect current market conditions, as a result of impacts of the unprecedented COVID-19 pandemic on real

estate markets. Port staff and Brookfield are embarking on a reappraisal process for both parcels with the hope of being able to transact early next year.
To date, costs for the 28-Acre Site project, including entitlement costs, Phase 1 horizontal costs, and Developer returns, total approximately $164.8 million. An estimated $91.4 million of additional capital costs are expected to complete Phase I improvements. Developer capital has been the primary source of project funding aside from the Port capital contribution of $6.5 million in December 2018 and the $24.2 million of land proceeds from the sale of Parcel K North in February 2019. Currently, the balance owed to the Developer is $134 million. The exclusive sources to repay the Developer are project-generated tax increment, special taxes, and land proceeds; neither the Port Harbor Fund nor the City General Fund are sources.

Here are the key takeaways from Port staff's update to the project's financial model:

1. **The Port estimates the overall internal rate of return for the Developer's horizontal cashflow may drop from the 19.0% projected at project approvals in 2017 to between 17.5% and 18.7% under current estimates.**
    a. Phase 1 costs have been higher than anticipated due in part to Bay Area-wide construction cost increases.
    b. Phase 1 revenues are later to come in and possibly lower than expected, creating a lower internal rate of return outcome than was projected at project approvals in 2017.

2. **Despite this drop, Port revenues in net present value (NPV) terms are estimated to sum to between $208 and $265 million over the Project buildout, compared with $259 million estimated in 2017.**
    a. Under the terms of the transaction documents, the Port receives several revenue streams which are not dependent on the project achieving a particular internal rate of return. They include:
        i. Transfer fees from condominium sales and lease transfers;
        ii. The land value from a parcel in Phase 3 (flex parcel C1A);
        iii. Special taxes for shoreline protection; and
        iv. Tax increment ear-marked for Pier 70 historic preservation.

3. **The range in financial outcomes reflect different assumptions for revenue and timing of revenue.**
    a. Variables which drive the range in internal rate of return in item 1 and the NPVs in item 2 above include:
        i. Appraised land values;
        ii. Timing of lease execution;
        iii. Timing of bond issuances; and
        iv. Amount of bond issuances.

General Overview of Pier 70 Special Use District

In 2017, the City approved the Pier 70 Special Use District ("SUD"), a 35-acre redevelopment area located at Pier 70 generally bound by 20th Street to the north, 22nd Street to the south, Illinois Street to the west, and the San Francisco Bay to the east. The SUD includes (1) an approximately 28-acre Port-owned site ("28-Acre Site"); (2) the 20th/Illinois Street parcels known as Parcel K North and Parcel K South; and (3) approximately 3 acres owned by PG&E known as the Hoedown Yard. The SUD provides for a mixed-use project comprised of up to 4.2 million square feet of development including 200,000 square feet of rehabilitated historic buildings (Historic Buildings 2, 12, and 21), 1,500 to 3,000 residential units with 30% provided at below market rates, office, retail, and production, design and repair uses, a new arts facility, mitigations to protect against future sea level rise, and 9-acres of new parks that will create public access to the San Francisco Bay where it has never previously existed.

28-Acre Site

The 28-Acre Site project, which will be built out in three phases, is governed by a Disposition and Development Agreement dated as of May 2, 2018 ("DDA") and related agreements between the Port and the Developer. Under the DDA, the Developer is responsible for subdividing and improving the 28-Acre Site and Parcel K South with horizontal improvements to serve vertical development. The Developer also has the option to lease or purchase designated parcels to develop vertical improvements. In May 2018, the Port approved the Phase Submittal for Phase 1 of the project, which includes the development of three acres of parks and backbone infrastructure to support an anticipated 588 residential units, more than 100,000 square feet of maker/PDR/retail space, and up to 460,000 square feet of office.

Illinois Street Parcels

In February 2019, the Port sold Parcel K North to 64 PKN Owner, LLC ("PKN Developer") for residential development pursuant to a Vertical Disposition and Development Agreement ("VDDA"). In addition to setting parameters for development of the vertical project, the VDDA obligates the PKN Developer to reconstruct the adjacent Port-owned segment of Michigan Street and build the future Port-owned 20th Street Plaza, subject to reimbursement from public financing sources. In November 2019, the City's Planning Department approved a schematic design for a seven-story, 65-foot tall, 377,506 square foot mixed-used building containing 245 for-sale dwelling units over ground floor amenity and retail spaces. Currently, the PKN Developer is working with the Port on designs for Michigan Street and the 20th Street Plaza. The second Illinois Street Parcel, Parcel K South, is a 100% affordable housing project that will be constructed by the Mayor's Office of Housing and Community Development in Phase 2 of the 28-Acre Site project.

Hoedown Yard

The City has a transferable option to purchase the three-acre Hoedown Yard from PG&E for $8,315,302, subject to PG&E's ability to find a replacement site for its current utility operations (temporary soil storage) at the yard. The option expires in June 2021. Port and City staff have been working with PG&E to locate potential replacement sites, including two acres of the Port's Western Pacific Property. This effort was underway in earnest in 2018 but has been stalled for the last 18 months while PG&E was in bankruptcy. PG&E has recently reengaged with the City and Port staff have been working with staff from the Office of Workforce and Development and Mayor's Office of Housing and Community Development on a workplan to exercise the option. This relocation will enable the City to enter an agreement with a developer to redevelop the Hoedown Yard consistent with the SUD.[1]

Status of Phase I Implementation

Horizontal Improvements

In preparation for construction of Phase 1 horizontal improvements, Brookfield began site preparation and demolition in August 2018. The substantial start of construction commenced in March of 2019 upon issuance of a Street Improvement Permit by the City. The horizontal scope of work includes installation of utilities, including auxiliary water supply main, low pressure water main, combined sewer main, combined sewer storage, and non-potable water main along 20th Street, Maryland Street, Louisiana Street, 21st Street, and 22nd Street. Surface improvements are also underway along 20th Street, Louisiana Street, and 21st Street. Approximately 75% of Phase 1 horizontal improvements have been completed to date, excluding parks which will be constructed on a schedule that coincides with delivery of adjacent vertical development.

Brookfield also obtained approvals from the Port and City for the Final Transfer Map, the Tentative Subdivision Map, and Master Utility Plans, as well as Design Review approval for the Phase 1 parks. The Final Subdivision map for Phase I is anticipated for approval by the Board of Supervisors in September.

Phase I Vertical Improvements

Building 12. Under the DDA, Brookfield is obligated to renovate historic Building 21 and historic Building 12, which is in Phase I of the project. In January, the Port entered a 66-year lease with a Brookfield affiliate for Building 12 and construction is currently underway. To date, numerous construction activities have been completed, including demolition, abatement, structural excavation, construction of foundations and the first stages of the building lift to account for future sea level rise. Upon completion, expected in December 2021, Building 12 will be a celebration of local making and manufacturing that engages the public in the process of manufacturing while providing retail opportunities and event space for public and private events. The first-floor market hall is envisioned to be a hub for local manufacturers and artisans to create their products onsite and to have an exciting public space to showcase their wares. The new second level will house artisan and maker studios and the upper floor will be designed for office uses.

[1] Click here for August 5, 2017 informational memo to Port Commission on proposed transaction.

Option Parcels. Under the DDA, the Developer has an option to purchase or lease all development parcels within the 28-Acre Site except the 100% affordable housing parcels (Parcels C1B and C2A), Parcel C1A, historic buildings 12 and 21, and the arts building parcel (Parcel E4). Subject to excusable delay, the Developer must close escrow on all Phase I option parcels no later than three years after completion of horizontal improvements within Phase I (excluding parks); otherwise, the Port has the right to offer the parcels through a public offering.

To date, Brookfield has received design review and administrative approval for two option parcels:

1. Parcel E2, containing 281 rental dwelling units, of which 56 units (20%) will be affordable at an average of 80% of area median income; and
2. Parcel A, a 353,459 square foot office building.

In addition, Brookfield initiated the joint appraisal process set forth in the DDA for Parcels E2 and A in mid- and late-2019, respectively. Under Resolution 20-07, adopted by the Port Commission in February, the Port agreed to offer Parcel E2 at an appraised value lower than the threshold value set in the DDA in exchange for Brookfield agreeing to shorten the timeframe for closing on Parcel A. Under that agreement, Brookfield had 120 days (until June 17, 2020) to exercise its options and enter binding contracts to lease each site. If Brookfield were to decide not to exercise its options, both the Port and Developer would revert to existing rights under the DDA, which include disputing parcel values through a reappraisal process and extending performance timeframes, among other rights. On June 17, Brookfield declined to exercise its options for both parcels. Due to impacts of the unprecedented COVID-19 pandemic on real estate markets, Brookfield does not believe the appraised values reflect current market conditions or support feasible vertical development at this time. As permitted under the DDA, Brookfield will be disputing the Parcel A appraisal and the Port will be disputing the Parcel E2 appraisal. The goal of both parties is to be able to transact on these parcels early next year.

Local Business Enterprise Participation

The 28-Acre Site project led by Brookfield has a 17.0% Local Business Enterprise ("LBE") participation goal. Contracts awarded during the first quarter of 2020 (end of March) were comprised primarily of Phase 1 horizontal improvement construction work, early phase construction work on historic Building 12 and design consultants for upcoming vertical projects. Brookfield also expanded the role of RDJ Enterprises, an LBE-Minority Business Enterprise ("MBE") firm, to tailor LBE engagement efforts and provide technical assistance to LBEs with barriers to entry in order to maximize LBE participation on available trade packages.

The main contract awarded in the first quarter of 2020 was the construction of Pier 70's first vertical building, historic Building 12, to general contractor Plant Construction. Plant and its subcontractors are still in the process of subcontracting out all the dollars targeted for LBEs under the general contract. As a result, the current percentage of contracted dollars to LBEs is lower than it will ultimately be once Plant and its subcontractors finish subcontracting. Through the end of the first quarter 2020, Plant has only awarded approximately 45% of the subcontracts under the Building 12 general contract, including work for site preparation, abatement, structural steel and work associated with lifting the historic structure. There is another approximately $6M dollars under the Building 12 general contract that Plant is targeting for LBE subcontracts. As a result, the statistics in the following paragraph do not capture all the LBEs that are anticipated to work on the Building 12 project. Upon award of all remaining subcontractors at Building 12, Brookfield anticipates the overall project will award over $50M or 26% in contracts to all LBEs.

Through the end of the first quarter of 2020, the Developer has awarded $187.9 million in contracts, of which $44.3 million or 23.6% has been awarded either directly or through subcontracts to LBE firms, including Small Business Administration-LBEs. $40.1 million or 21.3% has been awarded to small and micro-LBE firms. $22.4 million or 11.2% of total contract dollars have been awarded to small and micro-LBE firms located in the three zip codes (94107, 94124 & 94134) located next to the project area.

Vertical construction, in particular the “super structure” component of the projects, typically have more difficulty achieving higher LBEs participation rates in San Francisco compared to horizontal projects, which require fewer specialty trades that may not include as wide a range of LBE companies. As a result, Brookfield has taken advantage of its horizontal work to significantly exceed its LBE goal and will continue to target higher LBE levels on the infrastructure, parks and other horizontal work scopes of the project going forward. In addition, in advance of the project entering into the vertical building phase, RDJ undertook a “deep dive” analysis to identify LBEs that are well positioned to bid on upcoming vertical construction and/or will benefit from increased coordination efforts for construction scope matching within interior trades with good availability of LBE firms. RDJ has also focused on directing LBEs to COVID-19 business supports to ensure stability and certainty that they will still be available for these forthcoming LBE opportunities. While the Developer will continue to focus its efforts on maximizing opportunities for LBEs on all aspects of the projects to continue to meet or exceed the 17% LBE goal, given the coming shift of scope to vertical construction opportunities, Brookfield anticipates seeing a lower LBE participation rate in subsequent LBE participation reports than has been previously reported for primarily horizontal work.

Brookfield has been proactively working to increase the diversity of its team. In the first quarter of 2020 (with commencement of work on Building 12), Brookfield awarded $15.6 million in contracts to MBEs, including $5.2 million to LBE-MBE firms. Contractors that have commenced work on Building 12 include Eagle Environmental (LBE-MBE) performing abatement work, Hercules Builders (LBE-MBE) performing carpentry work on the building’s new roof, Marinship Development (LBE-MBE) performing work on the building’s shoring, Ground Control (LBE-MBE) and On-the-Level Concrete (LBE-MBE) performing concrete demolition and foundation work, respectively, as well as Kwan Wo, a non LBE-MBE, who is performing working on the structural steel, metal deck, and miscellaneous metals components of the project.

Project Performance

Overview of Financing Strategy

Under the Financing Plan, an exhibit to the DDA, project costs are funded by Developer capital, Community Facilities District ("CFD") special taxes, tax increment (and bond proceeds paid by special taxes and tax increment), land proceeds, and Port capital (at a 10% return, in Port's sole discretion). While all of these sources may be deployed to directly fund project costs, Developer capital is the primary early source of project funding because the other sources are available in relatively limited quantities prior to vertical construction (but will grow over project buildout). Because the Developer's capital is at the greatest risk and the Developer is obligated to fund all horizontal improvements if no other sources are available, Developer capital earns a market rate, risk-adjusted return of 18 percent annually ("Developer Return"). If the Project achieves an 18 percent Developer Return, land revenues will be split 55% to the Port and 45% to Developer. It is important to note that no City General Funds or Port Harbor Funds (except for project-generated land revenues) are pledged for the project in the event project sources are insufficient to repay Developer capital and Developer Return.

Status of Public Financing Districts

The project utilizes two tax sources to ultimately reimburse the Developer, Port capital contributions, land proceeds, and relevant returns. The first tax source is CFDs. CFDs, authorized by the state's Mello-Roos Act, create additional special tax assessments on certain buildings or uses within the District. At Pier 70, there are two CFDs: one encompassing the leased properties ("Pier 70 Leased Properties CFD") and the second encompassing condominium sites ("Pier 70 Condo CFD"). These two CFDs combine to provide funding for the horizontal infrastructure on the site, a community arts space, shoreline protection facilities, and ongoing maintenance of the area. The Board of Supervisors approved the formation of both CFDs in January 2020, and the Mayor signed the legislation on January 24, 2020.

The second tax source comes from the Port's Infrastructure Financing District ("IFD"). The IFD captures tax increment, the property taxes generated in an area above a baseline amount, as a funding source for the project. Tax increment from the IFD partially offsets the special taxes assessed by the Pier 70 Leased Properties CFD. The Board of Supervisors approved, and the Mayor signed, legislation authorizing the IFD in September 2018. The Port anticipates using both the CFD special taxes and IFD tax increment to leverage bonds to reimburse project costs.

Project Internal Rate of Return Performance

To date, Developer project costs with return total approximately $164.8 million. Of that amount, $35.1 million is entitlement costs, $78.6 million is Phase 1 horizontal costs, and $51.0 million is Developer Return. An estimated $91.4 million of additional capital costs are expected to complete Phase I improvements. As anticipated, Developer capital has been the primary early source of project funding aside from the Port capital contribution of $6.5 million made in December 2018 and the $24.2 million of land proceeds from the sale of Parcel K North in February 2019. Currently, the balance owed to the Developer is approximately $134.0 million.

Phase 1 costs are higher than anticipated due in part to Bay-Area wide construction cost increases. Meanwhile, Phase 1 revenues are coming in later and possibly lower than expected, creating a lower Developer Return than was projected at project approvals in 2017. Port staff and their consultant, Century Urban, have updated the project's financial model with current cost information and, given the current market uncertainties, a range of assumptions regarding land values, the timing of vertical transactions and bond issuances, and the start of future phases. With these updates, the overall Developer Return generated in the model has dropped from 19.0% at project approvals to between 17.5% and 18.7%, depending on the assumptions used. Aside from land values, the variables that make the biggest impact on model results are earlier parcel transactions and bond issuances. To that end, Port staff and the Developer are exploring with their financial consultants the possibility of issuing land bonds (prior to the start of vertical development).

Port Revenue Streams Not Contingent on Developer Return

As noted above, the Port's receipt of 55% of land proceeds is contingent upon the Developer achieving an 18% return, as is the Port's ability to collect annual rent on leased parcels as opposed to entering prepaid leases. However, the project will generate several revenue streams for the Port that are not contingent upon the Developer achieving its 18% return and provide long-term income stream for the Port. In the updated model results, these Port-specific revenue streams changes from $259.6 million at project approvals to between $208.4 million and $265.3 million, net present value terms.

These revenue streams include:

- **Parcel C1A Land Proceeds**: The Port will receive 100% of the proceeds of the sale or lease of Parcel C1A in Phase 3 for office use or market rate condominiums.

- **Percentage Rent:** On leased parcels except historic buildings 21 and 12 and the new arts facility, the Port will receive 1.5% of modified gross income generated from ground-leased premises for years 30 through 59 of each lease and 2.5% of modified gross income for years 60 to 99 of each lease.

- **Participation in Proceeds from Lease Transfers / Refinancings:** On leased parcels, the Port will participate in 1.5% of net sales proceeds upon the transfer of a lease as well as 1.5% of net proceeds upon the refinancing or recapitalization of a lease.

- **Condominium Transfer Fee:** On condominium parcels, the Port will receive 1.5% of the purchase price of each condominium unit after the initial sale.

- **Port Tax increment:** Approximately 8.9% of every dollar of tax increment will be Port Tax Increment available to fund a portion of historic Building 12 and 21 rehabilitation costs, Irish Hill Park (if needed) and then to fund other historic rehabilitation costs at Pier 70 (outside of the 28-Acre Site).

- **Services Special Tax:** A special tax in perpetuity on development parcels will fund the operations and maintenance of parks, streets, and open space within the project.

- **Arts Building Special Tax:** A special tax on development parcels will generate approximately $20 million of funding for replacement space for Noonan building artists.

- **Shoreline Special Taxes (25% share):** A special tax on development parcels in the Lease Properties CFD will provide a dedicated funding source for (i) shoreline improvements along San Francisco Bay to protect the City from seismic and flood risk, (ii) planning and adaption investments for sea level rise, including the Port's Seawall Project, and (iii) any further improvements that may be needed in the future to protect the project site.[2]

<u>Next Steps</u>

As noted above, Port staff and the Developer are exploring different ways to improve project performance, including the possibility of issuing land bonds, which will require Port Commission approval. In addition, Port staff and Developer are beginning the appraisal dispute process for Parcel E2 and Parcel A, with the goal of being able to transact on these two parcels early next year.

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[2] Initially, 25% of the Shoreline Tax is kept in a Shoreline Account for shoreline improvement projects while 75% is kept in a Project Reserve Account. The Project Reserve Account reimburses the Developer if they do not achieve an 18% IRR with other sources, but all funds in the account are transferred to the Port for shoreline improvements if the 18% Developer Return is realized.

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