M e m o r a n d u m

To: CHAIR AND COMMISSIONERS
CALIFORNIA TRANSPORTATION COMMISSION

CTC Meeting: October 24, 2012

Reference No.: 2.4c.(2)
Action Item

From: NORMA ORTEGA
Chief Financial Officer

Prepared by: Brent Green
Chief
Division of Right of Way
and Land Surveys

Subject: **AIRSPACE LEASE – REQUEST TO DIRECTLY NEGOTIATE WITH 888 BRANNAN LP**

RECOMMENDATION:

The California Department of Transportation (Department) recommends that the California Transportation Commission (Commission) approve a request to directly negotiate a 15-year lease with 888 Brannan, LP (Brannan) for a freeway lease area (FLA) that Brannan is currently leasing from the Department. The lease would include an annual escalation as well as lease rate re-evaluations every five years. The initial lease rate will be at fair market value as determined by an appraisal performed by the Department's District staff.

BACKGROUND:

Brannan currently leases FLA SF-80-02 under State Route 80 an elevated freeway structure in downtown San Francisco (City) at 8th Street between Brannan and Division Streets. FLA SF-80-02 is a 73,700 square foot (s.f.) lot used by Brannan for employee and customer parking for the business tenants of the 888 Brannan building as shown in Exhibit B. The existing two-year lease was established via an oral bid public auction in January 2010. Brannan possesses this FLA on a holdover basis pending the long-term lease proposal.

850-888 Brannan St. Property History

In 2011, 888 Brannan, LP, representing the partnership of SKS Investments and Vantage Property Investors, purchased the property located at 850-888 Brannan Street in San Francisco. The historic two-building complex was originally home to a division of National Carbon Company. In 1983, it was converted into a wholesale jewelry and gift exchange building, which thrived for more than 20 years known as the Giftcenter. In recent years, however, vacancy rates increased as gift and jewelry tenants closed their businesses due to the downturn in the economy. Currently, the property is leased by approximately 100 small gift and jewelry business tenants with 350 employees, and the overall property has a 70 percent vacancy rate.

850-888 Brannan Street Property Renovation

The Brannan has started a $25 million historic restoration of the buildings. The space occupied by the remaining jewelry and gift businesses is being renovated and expanded to 125,000 s.f., while 170,000 s.f. of tech/office space renovations will accommodate the building's new major tenant AirBnB (www.airbnb.com), which currently employs 300 people, and plans to hire an additional 700 employees over the next few years, all to be housed within the newly renovated property. An additional 130,000 s.f. of renovated space will be leased to another as yet undisclosed major tenant. After renovations are completed and the building fully leased, the property will house over 2,000 employees.

888 Brannan LP Requires Employee Parking

In order to attract major tenants, Brannan must secure and provide nearby parking for its tenants' employees. The Department's FLA SF-80-02 is located across the street from the Brannan building and can accommodate over 300 vehicles. Brannan currently holds an auction based short-term lease, but desires to secure the site for a longer term for employee parking.

SF-80-02 Lease History

Historically, the FLA has been leased via short-term agreements to various public-parking businesses that would then sublease spaces to either the neighboring Euromotors San Francisco Mercedes Benz dealership for new vehicle inventory parking or to employees and customers of the Giftcenter and Jewelry Mart. However, such short term public parking leasing in this corridor is no longer in the best interest of the Department due to revisions in the local public parking tax and permitting ordinances which reduce the profitability of public parking operations and therefore the operators' ability to pay top dollar rent. Tenants whose use is for private no-fee employee and customer parking are not as aggressively regulated by the City and therefore command higher values for State properties.

SF-80-02 Property Condition

These FLAs require certain grading and drainage work to correct standing water issues, new paving, new and updated fencing, and required lighting for safety. Additionally, the City is implementing a new landscape plan for this neighborhood, and Brannan will be re-landscaping the sidewalk area of the FLAs. Brannan will be removing several old eucalyptus trees that have caused property damage and will be planting City and Department approved landscaping that will better suit the neighborhood and be in compliance with the City's new landscape plan. Brannan is prepared, at its own cost, to perform all the necessary maintenance for this FLA. These improvements will be coordinated with Brannan's neighbors, Euromotors San Francisco Mercedes Benz, which leases Department FLA SF-80-04 across the street, and Jewelry Square Associates which leases FLA SF-101-43, within this same corridor. Brannan has requested a longer lease term in order to amortize the costs over a longer period of time.

Directly Negotiated Long Term Lease Benefits to the State

- The Department has no budget to maintain or improve its airspace properties. Entering into a directly negotiated long-term lease is the most beneficial method for the Department to implement necessary but expensive long-term maintenance repairs, ensure quality improvements, and guarantee tenant motivation to maintain the improvements in first class condition, which benefit not only the Department, the tenant, and the surrounding neighborhood.
- Recent changes in the City's public parking regulation have substantially increased the costs of obtaining annual public parking permits, and require a six to eight week processing and formal hearing period during which Department properties must remain vacant. Private no-fee parking uses do not require public parking permits. Directly negotiating a long-term lease with a tenant that will be using the airspace site for private no fee parking decreases the risk that the airspace site will remain vacant for months due to annual permitting related issues.
- In addition to the value of the necessary long term maintenance repairs and the value-added improvements received on the airspace properties, the Department would receive rent based on the properties' highest and best use as parking and storage extensions of the dealership's showroom and service facility instead of the typical general public parking use, which necessarily supports a lower rental rate due to the added expense of the City's 25 percent parking tax ordinance. Private free parking or storage uses are not subject to the City's high parking tax; therefore, tenants such as Brannan could afford to pay a higher rent since they are not burdened by the additional tax.
- The Department has the opportunity to assist in improving neighborhood safety by enabling the installation of lighting within its airspace properties that currently are dark after sunset.
- Brannan will make all the necessary maintenance repairs, which will improve the neighborhood aesthetic with a uniform theme. The 888 Brannan building is a landmark property whose owners are motivated to improve this increasingly technology-centered neighborhood. Directly negotiating with such community "anchors" best serves the State's interests of guaranteeing a long-term fair market rent stream while also partnering with an entity that is motivated to make positive changes in the neighborhood.
- The Department will assist in the creation of hundreds of high-tech jobs in the northern South of Market neighborhood. By directly negotiating with an owner of office space, much needed employee parking is guaranteed, which ensures that outdated buildings such as this 888 Brannan building can be remodeled to attract growing tech companies that provide new high paying jobs into the State, and more specifically into the city of San Francisco.
- In addition to the value of the necessary long term maintenance and the value-added improvements received on the airspace properties, the Department would receive rent based on the properties' highest and best use as employee/customer parking instead of the typical general public parking use, which necessarily supports a lower rental rate due to the "middle-man" parking operator profit and the added expense of the City's 25 percent public parking tax and costly permitting requirements.

SUMMARY

The ability to directly negotiate with Brannan is in the best interest of the Department for the reasons stated above. Brannan is committed to restoring a failing high-vacancy landmark building into a modern high-tech office space. Brannan has been a reliable and conscientious Department tenant, is a solid supporter of the local community, and has already contributed in excess of $1.3 million towards local transit, jobs, and neighborhood funds. The FLA requires certain expensive repairs and the Department does not have the budget to make these necessary repairs. Brannan is prepared to make the required repairs and also construct a number of aesthetic and safety improvements that will benefit both the Department and the surrounding neighborhood. Such repairs and improvements are not financially feasible without the tenant's ability to amortize the costs over a longer term. A long term lease would allow the Department to receive fair market rent for an extended period of time with the ability to increase rent as the market changes, and would allow for the required repairs. This directly negotiated long term lease with Brannan is supported by the Mayor of San Francisco, who has provided a letter of support requesting that the Department execute a long-term lease for the subject airspace properties so to secure for a long term the substantial jobs and site-specific improvements that will benefit this Brannan Street neighborhood and all of the parties involved.

Attachments
Exhibit A: SF-80 Bryant Street – Division Street Corridor
Exhibit B: SF-80-02 location maps and photos
Exhibit C: Sample of required repairs

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Exhibit A

SF-80/101 Bryant Street to Alameda Street Corridor

RED
Euromotors SF Benz
Dealership and
3 Airspace Sites
SF-80-04
SF-80-05
SF-80-06

BLUE
888 Brannan LP
Building and
Airspace Site
SF-80-02

GREEN
Jewelry Mart Building
and Airspace Site
SF-101-43

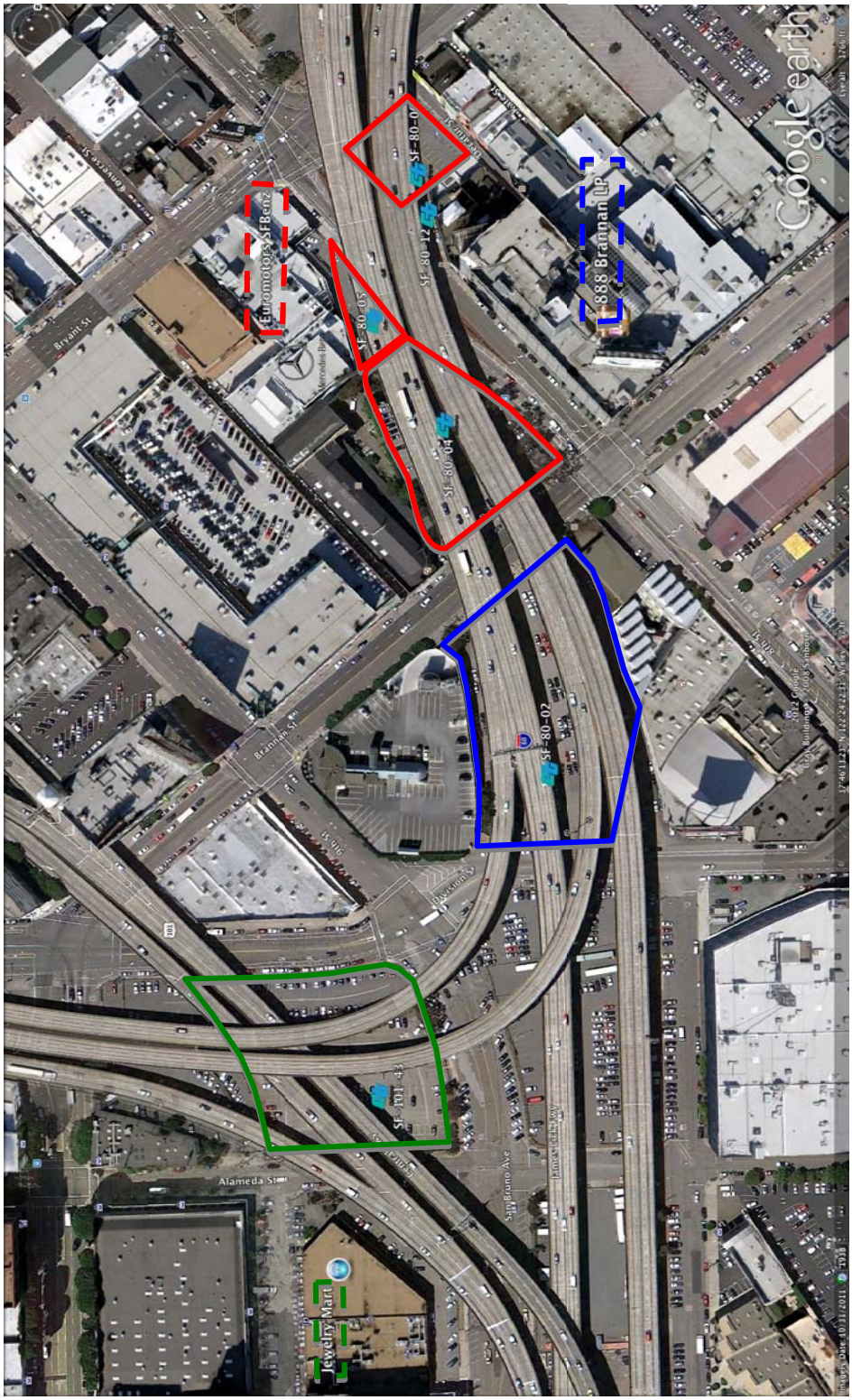

EXHIBIT A

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Exhibit B

SF-80-02 at 8th Street & Brannan Street

Looking southeast from Brannan Street

EXHIBIT B

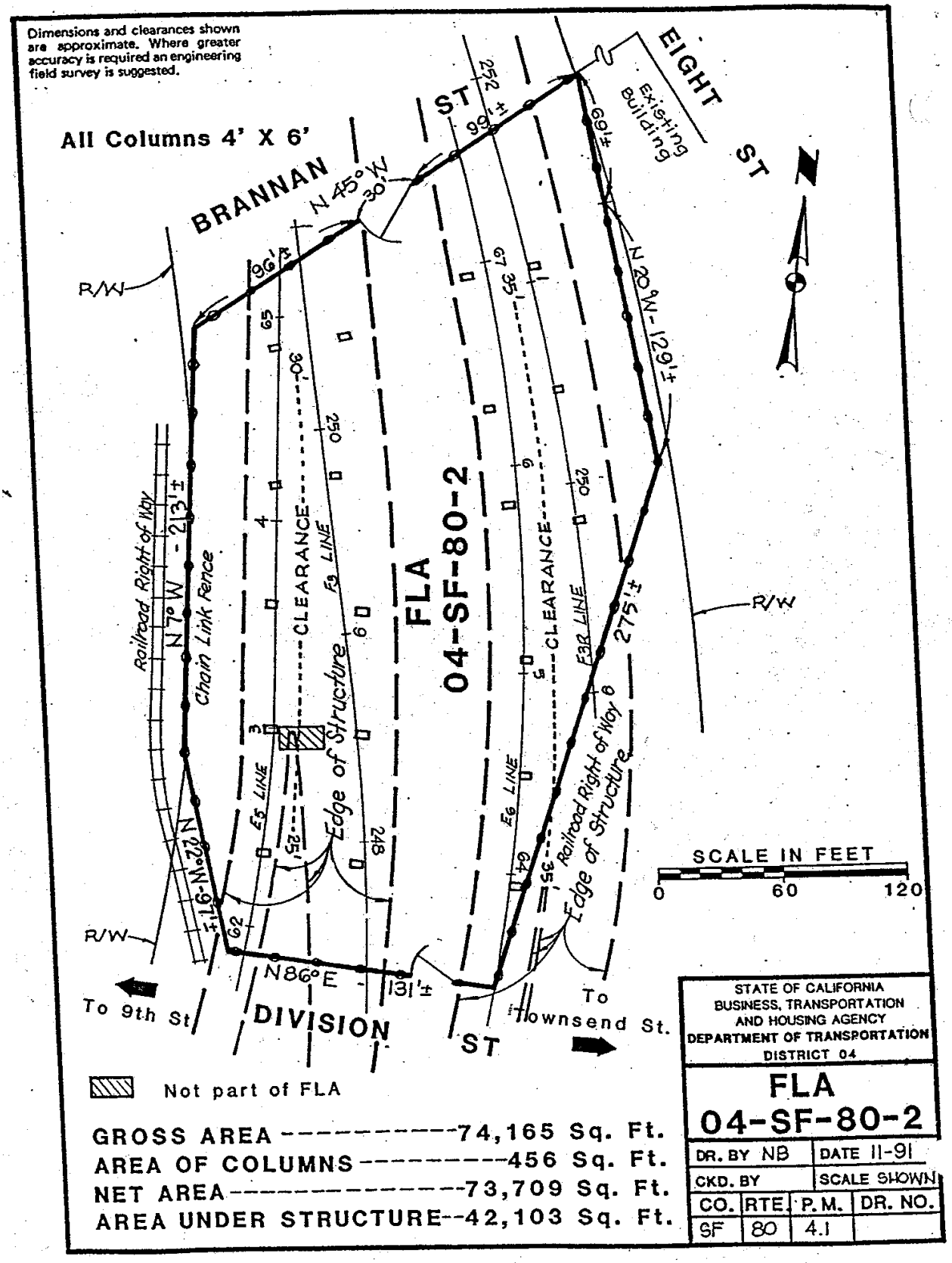
Dimensions and clearances shown are approximate. Where greater accuracy is required an engineering field survey is suggested.
All Columns 4' X 6'
BRANNAN
ST
EIGHT
ST
Existing Building
N 45° W
30'
R/W
N 29° W - 129'±
N 7° W - 213'±
Railroad Right of Way
Chain Link Fence
CLEARANCE
Edge of Structure
E5 LINE
E3R LINE
E6 LINE
FLA
04-SF-80-2
Railroad Right of Way
Edge of Structure
275'±
N 22° W - 91'±
N 86° E - 131'±
R/W
R/W
To 9th St
DIVISION
ST
To Townsend St.
SCALE IN FEET
0
60
120
Not part of FLA
GROSS AREA ----------74,165 Sq. Ft.
AREA OF COLUMNS ----------456 Sq. Ft.
NET AREA ----------73,709 Sq. Ft.
AREA UNDER STRUCTURE--42,103 Sq. Ft.
STATE OF CALIFORNIA
BUSINESS, TRANSPORTATION AND HOUSING AGENCY
DEPARTMENT OF TRANSPORTATION
DISTRICT 04
FLA
04-SF-80-2
DR. BY NB
DATE 11-91
CKD. BY
SCALE SHOWN
CO. RTE. P.M. DR. NO.
SF 80 4.1

EXHIBIT B

Sample of Required Repairs

Eucalyptus tree damaging fence and growing onto neighboring building

Sample paving crumbling and depression causing water runoff pooling

EXHIBIT C