

CITY AND COUNTY OF SAN FRANCISCO
BOARD OF SUPERVISORS
BUDGET AND LEGISLATIVE ANALYST

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March 10, 2011

Honorable Ross Mirkarimi
and Members of the Board of Supervisors
Room 244, City Hall
1 Dr. Carlton B. Goodlett Place
San Francisco, CA 94102-4689

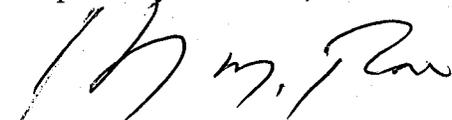
Dear Supervisor Mirkarimi and Members of the Board of Supervisors:

Pursuant to your request, transmitted is the Budget and Legislative Analyst's report of the review of the modifications made by the Mayor's Office and other City officials to the 34th America's Cup Host and Venue Agreement subsequent to the Agreement having been approved by the Board of Supervisors on December 14, 2010.

The Host and Venue Agreement (HVA), as previously approved by the Board of Supervisors on December 14, 2010, contains numerous changes made by the Mayor's Office and other City officials, including some minor clarifications to the Agreement.

This report focuses on the more significant changes made to the Agreement by the Mayor's Office, and other City officials, subsequent to the Agreement having been previously approved by the Board of Supervisors. The significant changes are largely in the areas of infrastructure improvement work to be performed by the Event Authority and in the long-term development rights to be transferred from the City to the Event Authority (Sections 6 and 7 of the HVA).

Respectfully submitted,



Harvey M. Rose
Budget and Legislative Analyst

cc: President Chiu	Supervisor Weiner
Supervisor Avalos	Clerk of the Board
Supervisor Campos	Mayor
Supervisor Chu	Cheryl Adams
Supervisor Cohen	Controller
Supervisor Elsbernd	Greg Wagner
Supervisor Farrell	Jennifer Matz
Supervisor Kim	Monique Moyer
Supervisor Mar	

Executive Summary

Background

The Board of Supervisors previously adopted a resolution (585-10) approving the 34th America's Cup Host and Venue Agreement between the City, the San Francisco America's Cup Organizing Committee and the America's Cup Event Authority¹ on December 14, 2010 for purposes of having the City and County of San Francisco host the 34th America's Cup.

The resolution, approved by the Board of Supervisors on December 14, 2010, authorized and urged the Mayor, the Director of the Office of Economic and Workforce Development and other City officials, including the Port's Executive Director, to take the necessary steps and enter into any additions, amendments or other modifications to the Host and Venue Agreement, in consultation with the City Attorney, as determined to be in the best interests of the City, if such modifications did not materially increase the obligations or liabilities of the City and if such modifications were necessary or advisable to bring the 34th America's Cup to San Francisco Bay.

While City staff have concluded that such changes to the Agreement, as modified by the Mayor's Office and other City officials, did not materially increase the obligations or liabilities of the City, and that such modifications are consistent with the terms of Resolution 585-10, the Budget and Legislative Analyst does not concur with that assessment in all instances.

In the professional judgment of the Budget and Legislative Analyst, some of the modifications represent material changes in process from what was approved under the Board of Supervisors resolution of December 14, 2010 and other modifications made by the Mayor's Office and other City officials, could have a material impact on Port revenues and costs, as detailed below.

Key Changes in Agreement

- The Agreement, as modified by the Mayor's Office and other City officials, provides a broader definition of reimbursable infrastructure improvement work that can be performed by the Event Authority, subject to approval by the City. The Agreement continues to require that certain work be performed by the Event Authority and that the Event Authority expend a minimum of \$55 million on improvements, although the funds can now be expended on a broader variety of improvements.
- The Agreement, as modified by the Mayor's Office and other City officials, specifies that any Additional Work, which could be performed by the Event Authority, and which would entitle the Event Authority to long-term development rights on Piers 26 and 28, must be in addition to work performed by the Event Authority as part of its

¹ The Event Authority is a limited liability company appointed by the Golden Gate Yacht Club and the Club Nautico di Roma (the challenger for the America's Cup) to organize and manage the 34th America's Cup

\$55 million obligation to the City. The Agreement, as previously approved by the Board of Supervisors on December 14, 2010, did not make such a distinction.

- Depending on the Event Authority's level of expenditures on infrastructure improvements, the Agreement, as modified by the Mayor's Office and other City officials, allows for the Port and the Event Authority to potentially enter into additional long-term leases and provides for the transfer of long-term development rights to the Event Authority of up to five Port properties including Piers 19, 23, 27, 29 and 80, in addition to the four Port properties- Piers 30-32, Seawall Lot 330 and Piers 26 and 28 previously authorized under the December 14, 2010 Agreement approved by the Board of Supervisors. The City has the right to approve which properties long-term leases will be entered into with the Event Authority, except for Pier 29, for which the Event Authority has the unilateral right to establish a long-term lease for Pier 29. No City approval of the Event Authority's selection of Pier 29 for a long-term lease is required in the Agreement, as modified by the Mayor's Office and other City officials. This entire provision, as described above, was not included in the Agreement of December 14, 2010 as previously approved by the Board of Supervisors.
- The Agreement, as modified by the Mayor's Office and other City officials, more explicitly establishes financial terms for the long-term development rights and leases than the Agreement previously approved by the Board of Supervisors on December 14, 2010. Such modifications are as follows:
 - **Base rent:** Under the terms of December 14, 2010 Agreement previously approved by the Board of Supervisors, base rent, payable by the Event Authority to the Port, was to be set at a fair market rent established through an appraisal process. Under the Agreement, as modified by the Mayor's Office and other City officials, this requirement has been removed and replaced by set base rents of \$4 per gross square foot of building area for Piers 30-32 and \$6 per gross square foot of building area for all other long-term development sites, excluding Seawall Lot 330 (see below). These per square foot rental rates were established through negotiation between the Mayor's Office and other City officials and the Event Authority. Contrary to the Agreement previously approved by the Board of Supervisors, wherein such rents were to be established through an appraisal process, no such appraisal process has taken place. While the results of any independent appraisal cannot be predicted, the change in process for establishing base rents under the modified Agreement does not provide the same level of guarantee to the City that fair market rents would establish for the 66 year term of the subject leases. Although Port staff acknowledge that these rates were not determined through an appraisal process, the Port states that such rates are reflective of current market conditions for the properties.

The Budget and Legislative Analyst notes that such negotiation of the rental rates were not specifically authorized by the Board of Supervisors under its approved Agreement of December 14, 2010 and rather, the Board of Supervisors had authorized that such rental rates be established through an

appraisal process.

- **Interim rent:** For the periods between the conclusion of America's Cup events and commencement of long term uses, "interim rents" are set in the Agreement as modified by the Mayor's Office and other City officials, for Piers 30-32, Seawall Lot 330 and Piers 26 and 28. The December 14, 2010 Agreement, as previously approved by the Board of Supervisors, did not include a separate provision for interim rent. The Board of Supervisors previously approved Agreement provided for the establishment of base rent for these properties through an appraisal process. The modified Agreement now establishes the current annual rents to be paid by the Event Authority to the Port as the amounts to be paid as interim rents.
- **Seawall Lot 330 rent:** Both the December 14, 2010 Agreement, as previously approved by the Board of Supervisors, and the Agreement, as modified by the Mayor's Office and other City officials, include provisions to transfer possession of Seawall Lot 330 to the Event Authority. Under the modified Agreement, rent would no longer be charged by the Port to the Event Authority for Seawall Lot 330, although the appraised value of Seawall Lot 330 would be used as an offset to reduce the Event Authority's rent credits for the Event Authority's expenditures on infrastructure improvements. The transfer of ownership of Seawall Lot 330 to the Event Authority is predicated on the City obtaining approval by the State to remove current Public Trust limitations on developing the property. If the City is not successful in removing those Public Trust requirements, the new modified Agreement provides for the establishment of a 75-year lease on the property, with rent set at the same amount as the Port is currently receiving from the parking lot operations on Seawall Lot 330, or approximately \$565,000 per year, to be adjusted annually by changes in the consumer price index.

This provision in the modified Agreement significantly differs from the December 14, 2010 Agreement, as previously approved by the Board of Supervisors, which provided that the rent to be charged to the Event Authority for Seawall Lot 330 should be set at fair market value rent based on an appraised value of the property.

While the results of a future appraisal cannot be predicted, the proposed 75 year rental amount in the modified Agreement is less even if the proposed base rent amount of \$6 per gross square foot rent, as required for other long-term development sites in the modified Agreement, is used. Applying the \$6 per gross square foot rate to 103,329 square feet at Seawall Lot 330 would produce \$619,974 in rental revenue per year, or \$55,053 more per year than the approximately \$565,000 required under the Agreement as modified by the Mayor's Office and other City officials.

- **Participation rent:** Participation rent requirements in the December 14, 2010 Host and Venue Agreement, as previously approved by the Board of Supervisors, in which the Port would receive a percentage of the value of

certain financial transactions from the long-term development properties, have been entirely removed in the Agreement as modified by the Mayor's Office and other City officials. No participation, or percentage, rent of any kind is included in the modified Agreement. The December 14, 2010 Agreement, as previously approved by the Board of Supervisors, required payment to the Port equal to 1 percent of the sales price of each condominium sale from the expected development on Seawall Lot 330 and 15 percent of the net proceeds of each transfer or sublease of long-term leases from the Event Authority to other parties. Such required payments by the Event Authority to the Port have been entirely removed from the Agreement as modified by the Mayor's Office and other City officials.

Assuming 10 condominiums per year are sold at a prices of \$700,000 each, the Port would forgo revenues of \$70,000 per year. This lost Port revenue would change over time, commensurate with changes in the sales value of the condominiums. While the net proceeds of transfers or subleases of the Event Authority's long-term leases cannot be predicted, the Budget and Legislative Analyst concludes that such transfers or subleases will occur over the 66 year life of the leases and that the deleted provision, which would have resulted in a 15 percent fee payable to the Port, would be significant.

- Rent credits are a key mechanism for reimbursing the Event Authority for the Event Authority's infrastructure improvement expenditures both in the Host and Venue Agreement, as modified by the Mayor's Office and other City officials, as well as in the Agreement previously approved by the Board of Supervisors. However, in the Agreement as modified by the Mayor's Office and other City officials, the Event Authority would not pay any base rent whatsoever to the Port for Piers 30-32 for the 66-year term of the lease for that property, based on the assumption that all rent payments will need to be used to reimburse the Event Authority for its infrastructure improvement costs. Current estimates and proposed base rent amounts indicate that the rent credits to reimburse the Event Authority for its \$55 million in infrastructure expenditures would eliminate the payment of any rent by the Event Authority to the Port for Piers 30-32 for the 66-year term of the lease. However, current assumptions, such as the assessed value of Seawall Lot 330, which will be used as a rent credit offset, could prove incorrect, resulting in the possibility of requiring the Event Authority to pay the Port some rent for Piers 30-32 after the Event Authority is fully reimbursed for the Event Authority's investment of \$55 million. In contrast to the Agreement as previously approved by the Board of Supervisors on December 14, 2010, under the Agreement, as modified by the Mayor's Office and other City officials, the payment of such rent by the Event Authority to the Port is entirely precluded.

In present dollars, base rent, under the Agreement as modified by the Mayor's Office and other City officials, for Piers 30-32 at \$4 per gross square foot, and assuming 565,000 square feet of building space is developed on the site, would be \$2.2 million per year, which would be lost to the Port under the Agreement, as modified by the Mayor's Office and other City officials, since, as noted above, such rent is now not

required.

- The Agreement, as modified by the Mayor's Office and other City officials, includes a new provision allowing the City to pay directly or purchase any Event Authority Infrastructure Work in excess of the \$55 million expenditure amount required of the Event Authority. This provision provides the City with potential flexibility in controlling what is owed by the City to the Event Authority in exchange for the Event Authority's infrastructure improvement expenditures.
- The Agreement, as modified by the Mayor's Office and other City officials, includes a new provision allowing the Event Authority, at its discretion, to transfer the properties for which the Port is granting the Event Authority long-term development rights, back to the Port for periods of up to 10 years between the end of the America's Cup events and commencement of the Event Authority's long-term uses on the properties (e.g., after new condominiums, office, retail, etc. development projects on the properties are constructed and occupied).

While the Port would be able to lease the properties and be paid rent from tenants during this time, the Budget and Legislative Analyst concludes that the rent to be realized by the Port would very likely be less than what the Port would be entitled to be paid in rent from the Event Authority if the Event Authority kept possession of the properties during this "interim" period. consistent with what was required in the December 14, 2010 Agreement, as previously approved by the Board of Supervisors.

Under this provision, as modified by the Mayor's Office and other City officials, the Port would incur: a) property management and maintenance costs if the properties were transferred back; and b) lost rent during the transition periods when it would have to market the properties and attract new tenants, all of which would lower the Port's net revenues. Since the interim rents payable by the Event Authority to the Port, for the four primary properties, Piers 30-32, Seawall Lot 330 and Piers 26 and 28, for which long-term development rights could be transferred to the Event Authority, would be an estimated \$2.3 million annually, the Port could incur an estimated net loss (combination of additional property management and maintenance costs and gaps in rent payments) of 10 percent, as a result of the Event Authority transferring back the properties to the Port. This would result in lost Port revenues of an estimated \$230,000 per year.

- The Agreement, as modified by the Mayor's Office and other City officials, now allows for Infrastructure Financing District bond proceeds to be used by the Port for a broader range of improvements to Port properties.

Transaction Structure and Timeline

The Host and Venue Agreement establishes a process by which various Port properties will be prepared and transferred to the Event Authority for use in the 34th America's Cup and subsequent to that for long term development purposes. Both the City and the Event Authority are required by the Agreement to cover the costs of certain improvements to Port properties prior to their use for America's Cup events and for other improvements needed for the Event Authority's subsequent long-term development of the properties. The Event Authority's costs are to be reimbursed through rent credits on its leased long-term development properties and incremental property tax generated by the properties.

Subsequent to the final Match in September 2013, long-term development rights will be conveyed to the Event Authority for certain Port properties with leases of 66 to 75 years or, in the case of one property, Seawall Lot 330, permanent ownership will be transferred to the Event Authority, if certain conditions are met.

The properties will be transferred to the Event Authority through various instruments to be developed over the time period covered by the Agreement:

Venue Leases: These will cover the terms and conditions for Port properties transferred to the Event Authority for the period prior to and including the Final Match in September 2013, and, potentially, for up to six months after the Final Match for certain venues. Those same Venue Leases could possibly be extended even beyond that if the Golden Gate Yacht Club is successful in defending the America's Cup and the City and Event Authority negotiate a new host agreement for future America's Cup events.

Long-term Leases ("Legacy Leases" and "Legacy Option Leases"): In exchange for the Event Authority providing required up-front funding for certain infrastructure and site preparation work on various Port properties in advance of and after the 34th America's Cup events, long-term development rights will be transferred from the Port to the Event Authority for various Port properties through long-term leases and in one case, Seawall Lot 330, transfer of ownership if certain conditions are met. The long-term leases and transfer will provide the Event Authority, or its nominees, with development rights on these properties for periods of up to 75 years. The terms and conditions in these long-term leases will be governed by yet to be developed Disposition and Development Agreements (DDAs) that will be subject to approval by the Board of Supervisors.

Transfer Agreement: This agreement will provide the terms and conditions for permanent conveyance of one Port property, Seawall Lot 330², to the Event Authority. This permanent transfer will only occur if the City is able to have the Public Trust designation of the property, which restricts use of the property to maritime uses and other uses that attract visitors to the waterfront, permanently removed. Currently the property is exempt from those restrictions due to State legislation³ waiving Public Trust

² Seawall Lot 330 is a Port-owned lot at the corner of The Embarcadero and Bryant Street. It is presently used as a parking lot but current zoning of the property allows for development of a residential tower on the property.

³ California Senate Bill 815

requirements on that property until 2094. If the City is not successful in getting the Public Trust designation removed from the property, long-term development rights for the property will instead be transferred to the Event Authority through a 75 year long-term lease.

Venues

(Host and Venue Agreement Section 5)

The Port properties to be used as event venues have not changed from the Agreement approved by the Board of Supervisors on December 14, 2010 though there are some slight changes in the terms and conditions related to the venues.

Long-term venues (to be delivered to the Event Authority in sufficient time for improvement work to be completed prior to events):

- Piers 26
- Pier 28
- Piers 30-32, and
- Seawall Lot 330.

The Venue Leases for these properties can continue for up to six months after the Final Match.

Short-term venues (to be used intermittently or for shorter periods through September 2013):

- Pier 19
- Pier 23
- Pier 27
- Pier 29
- Pier 80 (portions)
- The Brannan Street Wharf, and
- Certain water areas

The Agreement as modified allows for the Port's planned construction of a cruise ship terminal on Pier 27 to take place simultaneous with the use of the pier for America's Cup activities.

Infrastructure and Site Preparation Work to be Performed by the City

(Host and Venue Agreement Section 6.1)

The Host and Venue Agreement calls for infrastructure improvements on Port properties to be performed by the City and the Event Authority. There are no changes in the City's infrastructure improvement requirements in the current modified version of the Agreement compared to the Agreement approved by the Board of Supervisors December

14, 2010. The City's obligations remain⁴:

- 1) Causing the U.S. Army Corps of Engineers to demolish and remove Pier 36 by not later than January 1, 2013
- 2) Completing the Brannan Street Wharf by no later than June 30, 2013
- 3) Ensuring that the People Plan that the City is required to prepare for the events allows for safe and efficient crossing of the Embarcadero roadway near Piers 30-32 whether by temporary traffic controls or permanent pedestrian overcrossing
- 4) Relocating and/or storing the shoreside power installation for Pier 27 as required to accommodate the Event Authority's use of the Pier 27 for America's Cup events. (Funding for this obligation up to \$2 million is to be provided by the Event Authority.)

Infrastructure and Site Preparation Work to be Performed by the Event Authority ("Authority Infrastructure Work")

(Host and Venue Agreement Sections 6.2 – 6.6)

The Agreement approved December 14, 2010 required that the Event Authority perform the following infrastructure improvements and site preparation work, referred to as Authority Infrastructure Work in the Agreement:

- 1) Pile replacements and strengthening on Piers 30-32, as required by applicable law and to make them ready for the Event
- 2) Demolition of portions of Piers 27 and 29 for the Event and for the Port's cruise ship terminal.
- 3) Payment of the lesser of the actual cost of relocating and/or storing the shoreside power installation for Pier 27 or \$2 million.⁵
- 4) At the Event Authority's discretion, pile replacements, substructure strengthening, deck repairs or substructure strengthening on any short-term venue and any cash contribution to the City to complete the Pier 27 cruise terminal or the adjacent Northeast Wharf Plaza.

The modified Agreement still contains the four requirements above and adds the following:

- 5) At the Event Authority's discretion, any improvements to prepare the waterfront for the Event on any short-term venue or other Port property, subject to approval by the City.⁶
- 6) Any dredging, construction of wave attenuation projects, or any other repairs and improvements to other venues deemed necessary by the Event Authority for the regattas, subject to approval by the City.⁷

⁴ Section 6.1 (a) – (d).

⁵ Added on December 14, 2010.

⁶ Section 6.2 (d).

⁷ Section 6.3.

The new provisions in the modified Agreement allow more flexibility in the work to be performed by the Event Authority through the Agreement, as modified, still requires that the first four obligations be met by the Event Authority and that the Event Authority expend \$55 million on improvements. The December 14, 2010 version of the Agreement had a more narrow definition of Authority Infrastructure Work, limited to the first four obligations listed above.

Classification of new work paid for by the Event Authority as Authority Infrastructure Work in the modified Agreement is significant because the Event Authority's costs for such approved work will be subject to reimbursement through rent credits, incremental property tax revenues and value "balancing", as discussed further below.

➤ **Consistency between Agreements: *Authority Infrastructure Work***

Dredging, wave attenuation project construction and other repairs were allowed in the Agreement approved December 14, 2010 by the Board of Supervisors but they were not classified as Authority Infrastructure Work and thus were not subject to reimbursement. Now the Event Authority's costs for such work is subject to reimbursement and no longer represent additional value beyond the \$55 million in expenditures provided by the Event Authority to the City, as they did in the December 14, 2010 Agreement. Such work was previously considered to be of value only to the Event Authority and was not eligible for reimbursement in the December 14, 2010 Agreement. It is now considered to possibly be of value to the Port as well, though any such work would have to be pre-approved by the Port before reimbursement is authorized.

The modified Agreement retains the requirement, also in the Agreement approved December 14, 2010 by the Board of Supervisors, that the City and Event Authority identify a minimum scope of work for the Authority Infrastructure Work at the time the Venue Leases are negotiated.⁸ However, the version of the Agreement approved by the Board of Supervisors December 14, 2010 required that the scope of work satisfy the "pile replacement, strengthening requirements, shed demolition and shoreside power relocation" expectations of the City. These specific requirements have been removed from the minimum scope of work in the modified Agreement. The only requirement now is that the estimated cost of the improvements be \$55 million, to be expended before the Final Match in September 2013. The nature of the work to be performed as Authority Infrastructure Work is no longer specified.

The modified Agreement requires that any of the newly allowable work and improvements can only be included as Authority Infrastructure Work if both parties agree that the work is necessary for America's Cup events (as compared to improvements for long-term development purposes). However, the modified Agreement allows for the required pile replacements, substructure strengthening and deck repairs on Piers 30-32 (Obligation #1 on the list above) to be deferred for up to five years following the expiration of the Venue Lease for that property, or well after the Final Match⁹. This allowance for deferred work on Piers 30-32 appears inconsistent with the requirement

⁸ Section 6.5

⁹ Section 6.4.

that the other reimbursable Authority Infrastructure Work must be needed for the America's Cup events.

Additional Work that may be performed by the Event Authority, at its discretion

(Host and Venue Agreement Section 6.7)

In addition to the Authority Infrastructure Work, both the December 14, 2010 and the now modified Host and Venue Agreement provide the Event Authority with the option of performing additional site preparation and improvement work, collectively known as "Additional Work", including work on Piers 26 and 28. The nature of the work on the two piers would include pile replacements, substructure strengthening and deck repairs, estimated to cost \$15 million on Pier 26 and \$10 million on Pier 28, according to provisions in the December 14, 2010 and modified versions of the Agreement.

If the Event Authority elects to perform the improvements on Piers 26 and 28, it would be entitled to receive long-term development rights for those two properties. All of the costs incurred as part of the Additional Work are subject to reimbursement through rent credits, incremental property tax revenues and value "balancing", discussed further below.

➤ Consistency between Agreements: *Additional Work*

The primary change in the Agreement pertaining to Additional Work is to specify that any improvement work performed and paid for by the Event Authority on Piers 26 and/or 28 and claimed as part of their required \$55 million pre-Match expenditure will not count as allowable expenditures for the purposes of transferring long-term development rights to the Event Authority for these two properties. Qualifying work for that purpose would instead have to be made in addition to any pre-Match amounts spent on the two properties.

Long-term development sites

(Host and Venue Agreement Sections 7.3 (a) – (b))

The modified Agreement allows for transfer of long-term development rights for certain Port properties to the Event Authority, as did the Agreement approved by the Board of Supervisors December 14, 2010. The Agreement, as modified, continues to allow for transfer of the following Port properties to the Event Authority in exchange for infrastructure improvement expenditures by the Event Authority:

- ◆ Piers 30-32
- ◆ Seawall Lot 330
- ◆ Pier 26 (if the Event Authority performs certain infrastructure improvement work, referred to as Additional Work in the Agreement and discussed above)
- ◆ Pier 28 (if the Event Authority performs certain infrastructure improvement work, referred to as Additional Work in the Agreement and discussed above)

In addition to these properties, the modified Agreement allows for transfer of long-term development rights to the Event Authority for the following additional Port properties, all of which the Event Authority is also entitled to use as short-term venues for America's Cup events, according to the modified Agreement:

- ◆ Pier 19
- ◆ Pier 23
- ◆ Pier 27 (with limitations to allow for the Port's planned construction of a cruise ship terminal on this pier)
- ◆ Pier 29
- ◆ Pier 80 (with limitations to allow the Port to continue breakbulk cargo operations along the east face of this pier)

According to the modified Agreement, long-term development rights to these additional properties would be added through a process referred to as value "balancing", explained further below but, generally, this would provide the Event Authority with additional compensation if their expenditures on infrastructure work and site improvements are greater than the value of the properties for which they are to receive long-term development rights. Conveyance of long-term development rights for any of these additional properties is subject to approval by the City, except for conveyance of long-term development rights to Pier 29, which could be selected by the Event Authority, without approval of the City.

Consistent with the Agreement approved December 14, 2010, the terms and conditions of the long-term development rights for all of the properties listed above will be defined in detailed terms sheets and Disposition and Development Agreements (DDAs), to be approved by the Board of Supervisors. After they are approved, the Port shall ground lease the selected properties, except for Seawall Lot 330, to the Event Authority for periods of up to 66 years. Seawall Lot 330 is to be permanently conveyed to the Event Authority through a Transfer Agreement, discussed below, assuming the City can cause the Common Law Public Trust requirement now governing the property to be permanently removed either through an exchange with another City owned property or by agreement with the State Lands Commission or State legislative action. If the Public Trust designation is not removed, long-term development rights for Seawall Lot 330 would be conveyed to the Event Authority through a 75 year lease.

The long-term leases, to be executed after the Venue Leases expire, will cover terms and conditions for: (a) interim uses by the Event Authority for periods of up to ten years following expiration of the Venue Leases; (b) rent during construction on the sites; and (c) long-term uses for the balances of up to 66 years per lease for all properties, except Seawall Lot 330, for which the term would be 75 years (but only if the Common Law Public Trust requirement now governing the property is not permanently removed).

➤ **Consistency between Agreements: *Long-term development rights***

One major difference between the December 14, 2010 and the modified versions of the

Agreement is the addition of five additional short-term venues for which the Event Authority may now receive long-term development rights. This could potentially affect the City's liabilities and obligations if the Event Authority elects to obtain long-term development rights to these additional properties in that the Port would no longer be able to lease these properties to other tenants and collect market-rate rent. Further, with rent credits that are to be provided to fully reimburse the Event Authority for their expenditures on Authority Infrastructure Work and Additional Work, it is possible that the Port would not collect any rent at all for some or all of these additional sites. Offsetting any change in rental rates would be the additional value of infrastructure improvement work performed by the Event Authority required for long-term development rights to be transferred to the Event Authority for these properties.

The other major difference in the modified version of the Agreement is that the Event Authority can alone select Pier 29 for a long-term development lease if certain conditions are met. The City does not have the right in the modified Agreement to approve the Event Authority's choice of Pier 29, as it does for the other properties for which the Event Authority could now obtain long-term leases.¹⁰

Rent for long-term leases

(Host and Venue Agreement Section 7.3 (c)(i), (e), (f))

The modified Agreement now includes more details on the financial and other terms and conditions governing the long-term development rights and leases. The modified Agreement covers three components of long-term rents to be paid by the Event Authority:

- A.) rent for interim uses;
- B.) rent during the construction phase before long-term uses commence; and
- C.) rent for long-term uses.

The modified version of the Agreement also removes a source of Port rent revenue included in the December 14, 2010 version:

- D.) Participation rent.

Base rent amounts are established for all three components in the modified Agreement. As was also the case in the Agreement approved December 14, 2010, the Event Authority would not be obligated at any time to pay any participation, or percentage, rent to the Port for uses on its long-term development sites.

A.) Interim use rent (Sections 7.3 (c)(i) (A) – (C))

For Piers 30-32 and Seawall Lot 330, interim uses, defined as either existing uses or any other uses allowable by applicable laws and Public Trust restrictions, are allowed for up to ten years upon expiration of the Venue Leases. After that, any development for long-term uses on the properties is to be complete and the new uses in place, according to the

¹⁰ Section 7.6(h)(iv)

modified Agreement.

Regardless of the Event Authority's actual use of Piers 30-32 and Seawall Lot 330 during the interim period, the modified Agreement calls for base rents to be paid to the City by the Event Authority equal to the annual rent received by the Port prior to the Effective Date of the Agreement¹¹. For the optional long-term development rights on Piers 26 and 28, interim use rent would be the Port's then-effective parameter rental rates for pier warehouse sheds¹².

Interim rents for any of the other short-term venues for which long-term development rights will be transferred to the Event Authority under the modified Agreement (Piers 19, 23, 27 and 80) are not specifically defined in the modified Agreement, but new language is included that the terms of all other long-term leases will be "commercially reasonable" and, consistent with language in the December 14, 2010 version of the Agreement, comparable to terms in other long-term ground leases which the Port has entered in to with "highly sought-after tenants" who have made capital improvements to their leased Port property and receive rent credits based on the value of those improvements¹³. The term "commercially reasonable" is not defined in the Agreement.

All interim use rents would be subject to annual consumer price index adjustments.

➤ **Consistency between Agreements: *Interim use rent***

Setting rents for interim periods of up to 10 years as the same amount as the Port has been receiving prior to the Effective Date precludes the Port from collecting greater amounts that might have been paid under the December 14, 2010 version of the Agreement which called for long-term rents to be set based on the appraised value of the properties. Since at least some of the Port properties should be improved prior to the America's Cup events and/or should be of greater value for leasing after the Final Match, the Port's revenue during the interim period is potentially lower or higher as a result of setting interim rents in the Agreement now at the same level as currently received from the unimproved properties.

B.) Construction period rent (Section 7.3(c)(i)(D))

After the interim rent period, and while the Event Authority performs construction on the long-term sites, no rent would be paid to the City, according to the modified Agreement. This no-rent period would extend from the time any building permits are issued for development on the sites through issuance of certificates of occupancy. The December 14, 2010 version of the Agreement did not preclude the Event Authority from paying rent during this period so this change represents lost revenue to the Port of an amount that cannot be determined. It is not unusual for the Port to discount rent during construction.

¹¹ The "Effective Date" is defined in the Agreement as the date upon which all three of the following conditions have been met: (1) the Agreement has been executed by all parties; (2) the Board of Supervisors has approved the Agreement; and (3) the Agreement has been approved by the Port Commission.

¹² "Parameter rental rates" are rents charged by the Port for sheds on its properties.

¹³ Section 7.3(e).

C.) Long-term rent (Section 7.3(f))

The modified Agreement states that after certificates of occupancy for Event Authority development on the long-term sites are issued, base rent would be imposed. The Agreement approved December 14, 2010 stated that base rents would be “fair market rent”, to be initially based on appraisals that the Port regularly conducts to establish fair market rents for its properties. Such appraisals were to be conducted before the City and Event Authority entered into DDAs for the properties.

The modified Agreement removes the requirement in the December 14, 2010 version that appraisals be conducted to establish fair market rent for the Port properties for which long-term development rights are transferred to the Event Authority. Instead, the Agreement establishes negotiated base rent rates of \$4 per gross square foot of building area per year for Piers 30-32 and \$6 per gross square foot per year of building area for all other long-term leases, to begin on the first day of the first full month after the Event Authority has received a certificate of occupancy for each site. No participation, or percentage, rent would be charged for any of the sites.

These long-term base rent amounts are to be adjusted every five years based on changes in the consumer price index and reset after all allowable rent credits, discussed below, are fully applied, and every ten years thereafter. The December 14, 2010 version of the Agreement called for annual consumer price index adjustments and “periodic” resets to fair market rental rates every 10 years, with appraisals performed for every market reset. The modified version of the Agreement removes the requirement for appraisals and, instead, calls for any adjustments to be made by the City, then subject to arbitration in the event of disagreement between the City and the Event Authority over the fair market rental rate.

D) Participation Rent (Section 7.3(i))

The modified version of the Agreement explicitly states that the Event Authority will not be obligated to pay rent on any revenues from uses at the long-term development sites, such as percentage of sales or participation in gross rental revenues or net operating income. The Agreement approved December 14, 2010 also precluded participation rent except for the following:

- 1% of the sale price of every condominium sold constructed on Seawall Lot 330, excluding the initial sale of each condominium
- 15% of the net proceeds of each transfer or sublease of long-term leases from the Event Authority to other parties, excluding the first such transfer.

➤ Consistency between Agreements: *long-term rent and participation rent*

The negotiated permanent base rent amounts of \$4 – 6 per gross square foot of building area are established in the modified Agreement whereas the version approved December 14, 2010 called for appraisals to be performed to determine fair market rents before the City and Event Authority enter into any DDAs. By establishing the rates through negotiation now, without incorporating the value of the planned improvements to the sites and the impact of the passage of time between now and execution of the DDAs,

these amounts may be lower or higher than fair market rent that could otherwise be charged for the properties. Most Port tenants currently pay rates higher than \$4 – 6 per square foot per year though Port representatives point out that the lower rates in the modified Agreement, particularly for Piers 30-32, reflect the development costs the Event Authority would have to incur to prepare the sites for long-term development and use.

The removal of the participation rent requirements in the December 14, 2010 version of the Agreement will potentially reduce the Port's income by an unknown amount since it will no longer be entitled to a fee every time a condominium is sold (assuming a residential condominium building is constructed by the Event Authority on Seawall Lot 330) and will not receive a 15% fee for any assignments or subleasing of the Event Authority's long-term leases. It is possible that such assignments or subleases will not occur, in which case the Port would not receive any of these fees anyway. But the modified Agreement rules out this possibility, whereas the December 14, 2010 version allowed for potential Port revenue through this mechanism.

Assuming 10 condominiums per year are sold at a prices of \$700,000 each, the Port will forgo revenues of \$70,000 per year. This lost Port revenue would change over time commensurate with changes in the sales value of the condominiums. While the net proceeds of transfers or subleases of the Event Authority's long-term leases cannot be predicted, it is likely that such transfers or subleases will occur over the 66 year life of the leases and that the removed 15 percent interest for the Port would likely be substantial.

Transferring long-term sites back to City

(Host and Venue Agreement Section 7.3(c)(i))

The modified version of the Host and Venue Agreement adds a new provision allowing the Event Authority, at its discretion, to transfer some or all of its long-term development sites back to the City, after the Venue Leases expire, for interim periods of up to ten years before long-term uses commence. During that time, the City would be allowed to collect any rent generated on the properties but would also be responsible for all maintenance, repair and operations costs for these sites during that time. The Event Authority would not be responsible for paying any rent to the City during that time but would retain the right to take possession of the properties again within six months of notice to that effect submitted to the City. The City would then be responsible for delivering the properties back to the Event Authority in the same condition received from the Authority.

➤ Consistency between Agreements: *transferring long-term sites back to City*

This new allowance in the modified version of the Agreement would result in previously unanticipated costs to the Port and a likely loss of base rent revenue (or drawing down rent credits owed to the Event Authority in the case of Piers 30-32 since rent from that property would be offset entirely by rent credits under the terms of the modified Agreement). Specifically, after the Venue Leases expire, the Port would have to attract new tenants to the properties transferred back from the Event Authority to the City for an uncertain amount of time, cover maintenance costs on the properties during that period and cause the tenants to be moved off the properties again upon request of the Event

Authority.

It is highly unlikely that the Port would be able to collect rent during this time period equal to what would have been paid under the December 14, 2010 version of the Agreement, which did not allow for the Event Authority to transfer back any of the long-term sites to the City and potentially lose rental revenues related to such transitions. The Port's net revenues would also be less than if the properties remained with the Event Authority for the interim period since rent paid by the Event Authority during the interim period would be uninterrupted and fixed at the amount paid to the Port by its tenants as of the Effective Date of this Agreement and the Event Authority would be responsible for all maintenance costs for the properties. Since the interim rents for the four primary properties for which long-term development rights are being transferred to the Event Authority would be approximately \$2.3 million annually, a net loss (combination of additional property management and maintenance costs and gaps in rent payments) of 10 percent resulting from the transfer back would translate into lost Port revenues of approximately \$230,000 per year.

Reimbursement of Event Authority for infrastructure improvement work

(Host and Venue Agreement Sections 7.3 (g), (k) and 7.6)

In addition to obtaining long-term development rights for various Port properties, both the modified and December 14, 2010 versions of the Host and Venue Agreements include mechanisms to reimburse the Event Authority for their costs for infrastructure improvements and related work performed on Port properties before and after the America's Cup events. The mechanisms to be used in both Agreements are: (1) rent credits on the base rents paid by the Event Authority for its long-term development sites; and (2) incremental property tax revenues generated by the long-term development sites after development is completed on the sites; and (3) value "balancing" of the Event Authority expenditures with other items to ensure that the Event Authority provides at least \$55 million worth of value to the City and receives full reimbursement for that amount or the actual amount expended, if higher or lower than \$55 million. All three of these reimbursement mechanisms were also included in the December 14, 2010 version of the Agreement.

The costs to be reimbursed for Authority Infrastructure Work detailed above are anticipated in both Agreements to be at least \$55 million. The Event Authority costs of the optional Additional Work on Piers 26 and 28 are anticipated to be \$10 million and \$15 million, respectively, or a total of \$25 million. However, both versions of the Agreement acknowledge that the actual expenditures might be more or less than these estimated amounts.

As with the December 14, 2010 version, the modified Agreement states that reimbursement of Authority Infrastructure Work will be paid with interest at the rate of 11 percent per year. On this basis, payment for this work by the City would save a considerable amount since the 11 percent interest rate would not be included. However, it would require that the City have a sum of cash on hand to cover such costs. The modified version of the Agreement includes a new provision that allows the City, at its discretion,

to pay directly for, or purchase, Authority Infrastructure Work in excess of the expected \$55 million in Event Authority expenditures¹⁴.

➤ **Consistency between agreements: *Reimbursement of Event Authority***

The two versions of the Agreement are comparable in terms of Event Authority reimbursement provisions. The only significant difference is the new provision allowing the City, at its discretion, to pay directly for Authority Infrastructure Work above the \$55 million expenditure expected of the Event Authority. If the City elects to do this, the amount to be reimbursed to the Event Authority through rent credits, incremental property tax and value balancing would be reduced.

Rent credits

(Host and Venue Agreement Section 7.3 (g))

As with the December 14, 2010 version of the Agreement, rent credits in the modified version of the Agreement are anticipated to offset any base rent payments until the Event Authority's eligible Authority Infrastructure Work and Additional Work costs are amortized. The modified version adds a new provision that rent credits "will offset in full all base rent over the term of the Legacy Lease for Piers 30-32, if the Authority makes a pre-Match investment of at least \$55 million".¹⁵ In other words, the Agreement now provides for no rent to be paid for Piers 30-32. Consistent with the December 14, 2010 version of the Agreement, the modified version of the Agreement allows for annual interest on the rent credit balance of 11% per year¹⁶.

The Agreement approved by the Board of Supervisors December 14, 2010 included a formula for determining rent credits that first considered the value of the Event Authority's expenditures (referred to as "investment value"), then deducted any reimbursement to the Event Authority from public funds such as Infrastructure Financing District bond proceeds (discussed further below) to arrive at the amount of rent credits to be issued. The modified Agreement removes that formula and no longer requires that reimbursement from public funds, including Infrastructure Financing District bond proceeds, be counted before determining rent credit amounts. The modified Agreement of the Agreement now defines investment value as Authority Infrastructure Work + Additional Work + public improvements to the long-term development sites that are part of an approved Infrastructure Facilities District.

➤ **Consistency between agreements: *Rent credits***

The major difference between the December 14, 2010 and modified Agreement is the explicit provision that the Event Authority will not pay base rent on Piers 30-32 for the full 66 term of the lease for that property. While current estimates and proposed base rent amounts indicate that rent credits sufficient to reimburse the Event Authority for its \$55

¹⁴ Section 7.7.

¹⁵ Section 7.3 (g).

¹⁶ The 11 percent interest rate was added to the Agreement in the version presented to the Board of Supervisors on December 14, 2010 and was not included in the Budget and Legislative Analyst's last report on the Host and Venue Agreement delivered to the Budget and Finance Committee on December 13, 2010.

million infrastructure work would eliminate the payment of any rent for Piers 30-32 for the 66 year term of the lease, current assumptions, such as the assessed value of Seawall Lot 330 which will be used as a rent credit offset, could prove wrong, resulting in the possibility of the Port collecting some rent from Piers 30-32 after the Event Authority is fully reimbursed. However, the modified Agreement precludes collection of such rent by the Port.

Property tax increment

(Host and Venue Agreement Section 7.3(k))

The modified Agreement requires that the City create an Infrastructure Financing District (IFD) comprising the long-term development sites to enable the City to issue debt and use the proceeds to reimburse the Event Authority for its expenditures improving the Port venues used for America's Cup events and for long-term development purposes (Authority Infrastructure Work and Additional Work). The December 14, 2010 version of the Agreement allowed for IFD debt proceeds to be used for the following purposes, in this priority order:

1. Any Authority Infrastructure Work not previously reimbursed through rent credits
2. Any Pier 26 and Pier 28 Additional Work not previously reimbursed through rent credits
3. Public improvements such as environmental remediations, shoreline improvements, public access improvements, etc. on or adjacent to the long-term development sites
4. Other public improvements benefitting Port property allowable under the Infrastructure Financing District State law

The modified Agreement continues to allow IFD debt proceeds to be used for the four purposes above and now adds a fifth allowable expense:

5. Any substructure improvements made to the long-term development sites and other structural improvements to historic piers, with the Port's approval and not previously reimbursed through rent credits.

The Agreement, as modified, now allows for inclusion of the Event Authority's deferred Additional Work subject to the Board of Supervisors amending the IFD financing plan when the Legacy Leases are presented to the Board of Supervisors for approval.

➤ Consistency between agreements: *Property tax increment*

The modified version of the Agreement expands the reimbursement potential for improvement work performed by the Event Authority to its long-term development sites and other Port properties as compared to the focus in the December 14, 2010 version on improvement work performed in preparation for America's Cup events.

Transfer Agreement for Seawall Lot 330

(Host and Venue Agreement Section 7.3(m))

The modified and December 14, 2010 versions of the Agreement require that the City cause the Tideland Trust provision (also known as the Public Trust provision) governing Seawall Lot 330 to be permanently removed so that the property will no longer be subject to State-imposed restrictions that limit the use of most Port properties to maritime purposes and/or purposes that increase visitors to Port properties. The current restrictions would preclude construction of a condominium building on the site, the highest and best use of that parcel from a financial perspective, according to an analysis conducted for the Port in 2010.¹⁷

Once the restriction is removed, both versions of the Agreement require that the City convey fee simple title to the property to the Event Authority at no cost to the Event Authority. At that point, an appraisal is to be conducted of the land and the appraised value included in the “Legacy Value” amount that will be used to determine the extent of rent credits for which the Event Authority will be eligible.

If the City is not successful in having the Public Trust provision removed, the property would be conveyed to the Event Authority through a long-term lease and could be developed for a variety of purposes, including non-condominium residential uses (i.e., apartments) or commercial uses. Regardless of the use on the land after development under the modified version of the Agreement, the Event Authority would only be required to pay base rent equal to the amount received by the Port prior to the Effective Date of the Agreement, approximately \$565,000 per year, or \$5.47 per square foot per year. This is below the \$6 per gross square foot per year base rent amount in the Agreement for all other long-term leases (except Piers 30-32) and substantially below fair market rent given the property’s development potential.

➤ Consistency between agreements: *Transfer Agreement*

As discussed above, the December 14, 2010 version of the Agreement called for fair market rents to be charged for all long-term development sites based on appraised value of the land. The rent to be charged for Seawall Lot 330 if the City is not successful in having the Public Trust provisions permanently removed from this property would not be subject to that standard under the modified version of the Agreement.

While the results of a future appraisal cannot be predicted, the proposed 75 year rental amount in the modified Agreement is less than if the proposed base rent amount of \$6 per gross square foot rent, as required for other long-term development sites in the modified

¹⁷ The Tideland Trust restrictions require all Port property developments to be of maritime use or to cause increased visitors to Port property. Office or residential uses are not allowed on such properties. California Senate Bill 815 temporarily removed the Tidelands Trust restrictions on Seawall Lot 330 but only through 2094. However, in order to build and sell condominiums on the land, the Tidelands Trust restriction would have to be fully and permanently removed because condominiums cannot be sold on leased land. Commercial developments and rental residential uses would be allowed on the property even if the Tideland Trust restrictions are not permanently removed.

Agreement, was used. Applying the \$6 per gross square foot rate to 103,329 square feet at Seawall Lot 330 would produce \$619,974 in rental revenue per year, or \$55,053 more per year than the approximately \$565,000 required under the modified version of the Agreement.

Balancing investment vs. property value

(Host and Venue Agreement Section 7.6)

As with the December 14, 2010 version of the Agreement, the modified version calls for an accounting of the Event Authority's expenditures on Port property improvements (referred to an "Investment Value") against the value of the properties for which the Event Authority will have received long-term development rights (referred to as "Legacy Value"). The purpose of this exercise is to ensure that the Event Authority is repaid in full for its expenditures on Port property improvements, even if that amount is greater than the minimum required \$55 million. Similarly, if the Event Authority ends up expending less than the \$55 million, this accounting, or balancing, would provide a mechanism for the City to obtain at least \$55 million in value from the Event Authority.

There are some slight changes in the value balancing formulae between the December 14, 2010 version of the Agreement and the modified version but the concepts are largely unchanged. The "Legacy Value" in the modified Agreement is determined based on the fair market value of the Legacy Option Leases (long-term development leases for Piers 26 and 28), the amount of funding available to the Event Authority through the Infrastructure Financing District and the sale price of historic tax credits to which the Event Authority would be entitled in exchange for its improvement work on Piers 26 and 28.¹⁸ This value would be compared to "Investment Value" which would account for Authority Infrastructure Work and Additional Work expenditures by the Event Authority and the actual costs of public improvements to the long-term development sites that are part of the Infrastructure Financing District. If the Investment Value is greater than the Legacy Value, or vice versa, the following remedies are spelled out in the Agreement.

Under the modified version of the Agreement, if Investment Value is greater than Legacy Value:

- ◆ The Event Authority can reduce the scope of its Authority Infrastructure Work or Additional Work.
- ◆ The City could increase the value of rent credits provided to the Event Authority on its long-term leases.
- ◆ The terms of the long-term leases could be amended.
- ◆ Long term development rights and leases could be awarded to the Event Authority for any of the short-term venues as identified above (Piers Piers 19, 23 and 27).
- ◆ Long-term development rights and leases could be awarded to the Event Authority for Piers 26 or 28 without the Event Authority fulfilling the Additional

¹⁸ See Section 7.6 (b)

Work requirement that otherwise applies to long-term development rights for these two properties.

Under the modified version of the Agreement, if Legacy Value is greater than Investment Value:

- ◆ The Event Authority can perform more improvement work on Port properties.
- ◆ The financial terms could be changed on the long-term leases.
- ◆ The Event Authority could pay the difference to the City.

The modified Agreement also spells out a detailed process for determining the fair market value of Seawall Lot 330¹⁹. The value identified through that appraisal will be deducted from rent credits awarded to the Event Authority.

➤ **Consistency between agreements: *Balancing investment vs. property values***

One of the primary differences between the December 14, 2010 and modified versions of the Agreement regarding value balancing is the basis of the Legacy Value is now lower than it was before, with the value of Piers 30-32 removed from the calculation, thus increasing the possibility that the Event Authority will be entitled to reduce the scope of its improvement work, increase its rent credits, or obtain additional long-term leases on other Port properties. The other key difference is that the December 14, 2010 version of the Agreement called for an independent review of Event Authority's cost estimates for their Authority Infrastructure Work and Additional Work which would be used as the basis for the Investment Value amount used for Balancing purposes. The modified version of the Agreement no longer makes this requirement but instead allows for the City to approve the Event Authority's actual allowable costs for balancing purposes.

¹⁹ See Section 7.3(m)(i).