CONSIDER APPROVAL OF DETERMINATIONS PURSUANT TO CHAPTER 529, STATUTES OF 2016 (AB 2797) REGARDING THE PROPOSED DEVELOPMENT OF SEAWALL LOT 337 AND PIER 48, KNOWN AS MISSION ROCK DEVELOPMENT, LOCATED ALONG 3RD STREET BETWEEN TERRY FRANCOIS BOULEVARD AND MISSION ROCK STREET ON LEGISLATIVELY GRANTED LANDS IN THE CITY OF SAN FRANCISCO, CITY AND COUNTY OF SAN FRANCISCO

TRUSTEE:
City and County of San Francisco, acting by and through the San Francisco Port Commission

BACKGROUND:
In 2007 the Legislature enacted Chapter 660, Statutes of 2007 (SB 815) involving the management of state public trust lands by the City and County of San Francisco, acting by and through the San Francisco Port Commission (Port). A primary purpose of SB 815 was to temporarily lift the Public Trust use restrictions over the Port’s seawall lots south of Market Street (former tidelands that were filled after the construction of the seawall) to enable development to generate revenue for Port historic rehabilitation, open space, and public plazas. The Legislature’s lifting of these trust use restrictions required findings that the seawall lots were cut off from the water, represented a relatively small part of Port land, and were no longer needed for trust purposes except to generate funding for the rehabilitation of historic piers and structures and the construction of waterfront plazas and open space.

As a result of SB 815, the Port initiated a planning process for the Mission Rock Project (Project) located within Seawall Lot 337 (SWL 337). Following a multiyear community process, Seawall Lot 337 Associates (Developer) was selected as the Port’s development partner for the master development of the Project. The Developer is a wholly-owned special purpose vehicle of Giants Development Services, LLC, which is a subsidiary of San Francisco Baseball Associates, LLC, owners of the San Francisco Giants baseball franchise. The Project proposes construction of approximately 1,600 units of new rental housing and 1.4 million square feet of new commercial and office space, as well as space for small-scale manufacturing, retail, and neighborhood services, waterfront parks, and public
infrastructure, and sets forth a process aimed at the rehabilitation of historic Pier 48.

The Project will be developed in four phases subject to the approval process outlined in the Disposition and Development Agreement (DDA). The cost to deliver the infrastructure improvements, including soft costs and mitigation measures, is estimated at $166 million. SB 815 was enacted before Port staff understood the complexity of developing Seawall Lot 337, including the need to finance new infrastructure to support development. The Project requires substantial investment in public infrastructure, including new streets, sidewalks, utility infrastructure, and elevation increases to address sea-level rise.

SB 815 limited the use of the Port’s nontrust lease revenue and did not address how to finance infrastructure improvements for SWL 337. Under SB 815, all Port revenue from the leasing and development of the seawall lots was reserved for rehabilitation of the Port’s historic piers and structures and the development of waterfront plazas and open space. Chapter 529, Statutes of 2016 (AB 2797) amended SB 815, creating a new strategy to finance development. AB 2797 allows the Port to use its nontrust lease revenues from the Project to make port advances to finance the costs of the SWL 337 infrastructure, including water, sewer, storm water management, streets, roadways, sidewalks, parks, public access, open space areas, shoreline improvements, and other public facilities. AB 2797 requires the Port to ensure repayment of port advances with interest within 25 years of each port advance, although the repayment period may extend beyond 25 years with Commission approval.

LEGAL REQUIREMENTS:
AB 2797 added Section 4.5 to SB 815 to allow the Port to use its nontrust lease revenues from the Project development parcels to make port advances to fund Seawall Lot 337 infrastructure if the Commission approves the following findings required under paragraph (3) of subdivision (a) of Section 4.5:

Within 75 days after approval of the Project by the City and County Board of Supervisors and receipt of all required documentation from the Port, the Commission shall either approve or disapprove the following items:

1. Procedures for establishing fair market value of development parcels.
2. The form of ground lease.
3. The Port’s use of port advances of nontrust lease revenues to pay for SWL 337 infrastructure costs. The Commission shall not
approve port advances unless documentation submitted by the Port shows that the use of port advances:

a. Is in the best interests of the State
b. Will benefit the Public Trust
c. Is consistent with Port fiduciary duties
d. Contains sufficient assurances that the Trust will be made whole

In addition to the above approvals, SB 815 provides that SWL 337 remain subject to the trust use requirements until certain conditions are met, including that the Commission approve a Port study analyzing the need to retain trust uses within SWL 337.

ANALYSIS AND STAFF RECOMMENDATION:

Approval of Port Advances

AB 2797 enables the Port to use its nontrust lease revenues from development parcels in SWL 337 to make port advances to fund SWL 337 infrastructure, provided the Commission has approved the port advances. Under Section 4.5, subdivision (a), paragraph 3 of SB 815, as added by AB 2797, the Commission may only approve port advances if it has “evidence of financial assurances acceptable to the Commission that the trust will be made whole.” The Commission cannot approve use of port advances unless it determines that doing so is “in the best interests of the State, will benefit the public trust, and is on terms and conditions consistent with the port’s fiduciary duties as trustee.”

Over the last 2 years, the Developer’s consultant team, the Port, and the Port’s financial consultant, Economic & Planning Systems (EPS), have worked extensively on the financial architecture of the Project. The Port believes the resulting agreement is optimized to balance the objectives of the Port and the Developer.

The Port provided the Commission staff a copy of the DDA, including the Project’s Financing Plan. The DDA describes the process for how the Developer will initially finance and be repaid for construction of horizontal infrastructure improvements and the process for how City agencies will inspect and acquire the public infrastructure in the Project. The DDA is the principal agreement governing development of the Project. The DDA and its exhibits provide the overall program and projected timing for development of the Project, including both "horizontal" and "vertical" development of the Project, delivery of public benefits, and the financial structure for the transaction.

The funding for the entitlement and infrastructure costs associated with the Project will be the responsibility of the Developer. The Developer will be
reimbursed for the entitlement and infrastructure costs through Mello-Roos Special Taxes, tax increment, and bonds secured by these revenues. AB 2797 allows the Port to advance a portion of prepaid ground lease rents from the Port’s nontrust leases to acquire this infrastructure on behalf of either the City or the Port. Special Taxes from Mello-Roos Community Financing Districts (CFDs) and Infrastructure Financing Districts (IFDs) will repay the port advances. This arrangement is based on the premise that port advances of ground rent will allow the Port to stem the compounding of Developer returns and repay Developer’s equity and return more quickly, substantially reducing financing costs, while also preserving the Port’s underlying land value.

Reflective of numerous financial studies conducted by the Port, EPS, and the Developer, the existing agreement structure calls for a balance of port advances of ground rent, Developer equity, and Special Taxes and tax increment. The Project’s financial pro forma assumes that roughly 60 percent of the Port’s land value to be loaned to the Project for infrastructure improvements. This land value contribution has been identified as the optimal scenario that maximizes the Project’s performance and the Port’s ability to generate long-term revenue. The Project’s Financing Plan submitted by the Port specifies mechanisms to ensure Port advances and any return on such advances are properly authorized and recorded.

The Project’s Financing Plan, an exhibit of the DDA, establishes the contractual framework for financing the infrastructure improvements for the Project and for distributing net proceeds from the Development Project. To provide public sources of financing to fund infrastructure costs and to repay Port and Developer Capital, the Financing Plan establishes two public financing mechanisms: property tax increment estimated to be generated by IFDs covering the Project site; and special taxes from one or more to-be-formed Mello-Roos CFDs over the Project site.

Commission staff contracted with Sperry Capital, Inc., to analyze the Port’s financial documents, determine the risks associated with the port advances, and determine whether there are financial assurances in place to confirm that the Port and Public Trust will be made whole.

Sperry Capital reviewed documents the Port provided to Commission staff and participated in several conversations with Port representatives and Port consultants. Their Risk Assessment found that many of the qualitative risks related to the Project, such as real estate risk, seismic risk, and sea-level rise, are general in nature and would be consistent with many real estate development transactions in San Francisco. The qualitative risks identified are mitigated by clauses within the transaction documents and plans for the Project.
Certain quantitative risks unique to the Project are more difficult to assess. IFD bonds will likely only be issued if CFD special taxes and CFD bonds are insufficient to cover the Project’s infrastructure costs. Thus, CFD revenue and bond proceeds will be predominantly used to repay Developer capital and port advances. The City plans to form one or more Mello-Roos CFDs over the Mission Rock Special Use District and establish annual tax rates for CFD special taxes. Taxable parcels for the Project, however, have not yet been created. Goodwin Consulting, the Port’s special tax consultant for the Mission Rock CFDs, is under contract to prepare the documentation required to form the CFDs and will be able to do so once taxable parcels are created at the start of Phase 1 of the Project. Forecasts for the CFDs, therefore, are unavailable. Without formed CFDs, Sperry Capital was unable to analyze the annual cashflow projections for special tax revenues to determine whether there are enough financial assurances in place to ensure that the Port will be fully repaid or that the trust will be made whole.

Nonetheless, Sperry Capital concluded that it is reasonable to assume that the City will establish CFD special tax rates that provide sufficient funding for the infrastructure costs, consistent with the Project’s Financing Plan. The formation of a CFD requires a special tax election with a two-thirds affirmative vote of residents living in the proposed boundaries. If there are fewer than twelve residents, the vote is instead conducted of current landowners. Because the Port is the single owner of SWL 337, no other parties will vote in a CFD formation election. The Port and the Developer have agreed to a CFD Term Sheet on tax levels the Port intends to seek through CFD formation. The Port plans to pursue the formation of the CFDs once taxable parcels have been created within the Mission Rock Special Use District, which is expected to occur in early to mid-2018. The structure of the Project’s transaction documents gives the Port significant control over the process of budgeting and the formation of the CFD.

Additionally, as mentioned above, the use of port advances is an essential financing component of the Project, enabling the Port to pay down Developer equity more quickly, increasing the Port’s return on the Project. Authorizing the use of nontrust lease revenues as an additional source of early infrastructure funding will likely reduce infrastructure financing costs and is projected to increase the underlying land value accruing to the Port’s harbor fund. Port advances also allow the Project to deliver China Basin Park, a large park planned along the north waterfront, during the first phase of the Project, years earlier than otherwise anticipated.

Although there is risk associated with the repayment of port advances, staff believes the benefits to the trust outweigh the risks. Assuming the City and Port
proceed with the formation of CFD(s) and establish a special tax rate to provide sufficient funding for infrastructure costs, staff recommends the Commission find that there are sufficient assurances that the trust will be made whole and that the use of port advances, as described in the Port’s documents, is in the best interests of the State, will benefit the Public Trust, and is on terms consistent with the Port’s fiduciary duties as Trustee.

Commission staff requests that following the formation of the CFD, the Port provide the CFD cash flow projections prepared by an independent, CFD-specialized consultant so staff can review these projections.

Approval of the form of ground lease and procedures for establishing fair market value:
AB 2797 requires the Commission to approve the procedures for establishing fair market value of the Project’s development parcels and approval of the form of the ground lease. In addition to the DDA and Finance Plan, the Port submitted the Project’s form of Vertical Disposition and Development Agreement (Vertical DDA), form of Parcel Lease, and the Joint Appraisal Instructions for Commission approval.

The Vertical DDA, a form attached to the DDA, sets forth the conditions to a Vertical Developer’s acquisition of the parcel lease of each Development Parcel within the Project site of Mission Rock. The Parcel Lease is a form attached to the Vertical DDA and serves as the template by which the Vertical Developers will acquire rights to the development parcels. The Vertical DDA terminates upon completion of the development project and any deferred infrastructure. Before entering into a parcel lease, the Developer and the Port will mutually engage an appraiser to determine the fair market value of the leasehold in accordance with the form appraisal instructions included in the DDA. The Port will then lease the parcels for 75 years, subject to rights and obligations set forth in SB 815, AB 2797, and the applicable transaction documents.

Staff has reviewed the form of Vertical DDA, the form of the Parcel Lease, and the form of the Joint Appraisal Instructions and recommends Commission approve the documents.

Public Trust Study
Prior to the lease of SWL 337 for nontrust uses, SB 815 requires the Port to submit for Commission approval a study analyzing the need to retain trust-consistent uses on the site and to determine land uses and the location of those uses within Seawall Lot 337 and the adjacent Piers 48 and 50. The Study provided by the Port provides analysis and conclusions addressing public outreach, Public Trust needs at the site, and planned uses. As required by SB
815, the Study also addresses the transportation needs of AT&T Park and other trust uses on Port property in the vicinity. Over the past three decades, the City, the former San Francisco Redevelopment Agency, and the Port have engaged in extensive public outreach efforts regarding the development of Mission Bay, SWL 337, and Pier 48. From the early planning processes for Mission Bay, community input shaped the location of parks and public uses in the neighborhood and the Port's development planning for SWL 337 and Pier 48.

The Developer’s Project proposal for SWL 337 envisions public parks, walkways, publicly accessible open space, and pedestrian and bicycle rights-of-way totaling about 12.3 acres. Approximately one-third of the area within the Project site will be dedicated to parks and open space. Other proposed Public Trust uses include environmental habitat and restoration, including about a half-acre of wetland and habitat restoration at the northern end of the Project site; maritime sales and rentals; restaurants; visitor- and waterfront-serving retail; entertainment and assembly facilities; and programs that promote appreciation and enjoyment of the waterfront.

In addition to the ground floor retail space in the buildings, park-serving retail is envisioned in two specific locations within China Basin Park and Mission Rock Square. The park-serving retail will draw visitors onto the waterfront and will enhance the safety and enjoyment of Public Trust spaces. These limited retail locations will also generate diversified revenue streams to benefit the maintenance and operations of the Public Trust parkland. The Developer’s Project proposal is consistent with the conclusion of the Port Study.

Staff has reviewed the Study and recommends that the Commission approve the conclusions of the Study.

OTHER PERTINENT INFORMATION:
1. The proposed action is consistent with Strategy 1.2 of the Commission’s Strategic Plan to provide that the current and future management of ungranted sovereign lands and resources and granted lands, including through strategic partnerships with trustee ports and harbor districts, is consistent with evolving Public Trust principles and values, particularly amid challenges relating to climate change, sea-level rise, public access, and complex land use planning and marine freight transportation systems; Key Action 1.2.1 to provide guidance to grantees on the elements of the Public Trust Doctrine, fiduciary duties, and use of trust lands and assets, generally and specifically in the context of sea-level rise and climate change; Key Action 1.2.2 to develop strategic partnerships with trustee ports to facilitate opportunities for responsibly enhancing California’s economy, including California’s “blue economy,” consistent with the Public
Trust Doctrine; and Key Action 1.2.3 to promote Public Trust consistent waterfront development and revitalization, addressing sea-level risk and climate change in the planning process.

2. The City and County of San Francisco Board of Supervisors approved the DDA through BOS Resolution No. 42-18, adopted by the Board of Supervisors on February 13, 2018. The Port approved this Agreement through Resolution No 18-03, adopted by the San Francisco Port Commission on January 30, 2018. The Commission was not a party to the agreements.

3. Staff recommends that the Commission find that the approval of the use of port advances, the form of Vertical Disposition and Development Agreement, the form of Parcel Lease, the form of the Joint Appraisal Instructions, and the Public Trust Study does not have a potential for resulting in either a direct or a reasonably foreseeable indirect physical change in the environment, and is, therefore, not a project in accordance with the California Environmental Quality Act (CEQA).

Authority: Public Resources Code section 21065 and California Code of Regulations, title 14, sections 15060, subdivision (c)(3), and 15378.

EXHIBIT:
A. Location and Site Map

RECOMMENDED ACTION:
It is recommended that the Commission:

CEQA FINDINGS:
Find that the approval of the use of port advances, form of Vertical Disposition and Development Agreement, the form of Parcel Lease, the form of the Joint Appraisal Instructions, and the Public Trust Study is not subject to the requirements of CEQA pursuant to California Code of Regulations, title 14, section 15060, subdivision (c)(3), because the subject activity is not a project as defined by Public Resources Code section 21065 and California Code of Regulations, title 14, section 15378.

AUTHORIZATION:
1. Find that the use of port advances, as described in documentation submitted by the Port, is in the best interests of the State, will benefit the Public Trust, and is on terms and conditions consistent with the Port’s fiduciary duty as trustee.
2. Find that, predicated on the City and Port forming CFD(s) and establishing a special tax rate that provides adequate funding for infrastructure costs, there are sufficient assurances that the trust will be made whole.

3. Approve the Port of San Francisco’s procedures for establishing fair market value of the development parcels.

4. Approve the form of the Vertical Disposition and Development Agreement, the form of the Parcel Lease, and the Joint Appraisal Instructions in substantially the form on file with the Commission.

5. Approve the Port’s use of port advances to pay for Seawall Lot 337 infrastructure costs.

6. Approve the conclusions of the Port’s Public Trust Study.
This Exhibit is solely for purposes of generally defining the lease premises, is based on unverified information provided by the Lessee or other parties and is not intended to be, nor shall it be construed as, a waiver or limitation of any State interest in the subject or any other property.