STAFF REPORT FOR CALENDAR ITEM NO.: 17
FOR THE MEETING OF: September 13, 2018

TRANSBAY JOINT POWERS AUTHORITY

BRIEF DESCRIPTION:

Presentation informing the TJPA Board of Directors on the execution of a lease agreement with Venga, Inc, a California corporation (d/b/a Venga Empandas) for about 691 square feet of commercial/retail space on the ground level of the new transit center (space number 123) for a 10 year term, consistent with the Board's Retail Leasing Policy.

EXPLANATION:

<u>Commercial/Retail Leasing Background</u>

As Phase I of the Transbay Program (Program) progresses toward completion, the TJPA is planning to activate one of the elements of the Program—approximately 100,000 square feet of commercial/retail areas located on the ground, second, and park levels. Activating the commercial/retail areas entails completing lease agreements with commercial, retail, and service businesses.

In March 2017 the TJPA Board authorized an Asset Management Agreement (AMA) with a team led by Lincoln Property Company (Lincoln) for the transit center. Lincoln is overseeing the management of the transit center and, with its team member, Colliers International (Colliers), who is also managing the commercial/retail leasing of the transit center. One factor that contributed to the TJPA's selection of the Lincoln team for the AMA was the Lincoln team's revenue and expense projections. Specifically, the Lincoln team projected stabilized retail revenues of $5.51 million annually, excluding percentage rent. The Lincoln team projected an initial capital expenditure for tenant improvements of $27.10 million.

In May 2017 the Lincoln team presented to the TJPA Board a draft Retail Vision for the new transit center. The draft Retail Vision introduced, among other things, a proposed mission statement, an assessment of customer draw to the transit center, proposed programming based on expected day of the week and time of day of customer use, an explanation of potential tenant categories, a proposed merchandising logic based on location within the transit center, and a proposed commercial/retail space plan.

In July 2017 the TJPA Board approved the Retail Merchandising Plan (Plan) with the categories of dry goods, food/entertainment, market/food hall, and services. The Board authorized the Lincoln team to begin marketing and negotiations for commercial/retail leasing consistent with the Plan for approximately 100,000 square feet of space comprised of approximately 35 leases. In general, the Plan contemplates a mix of food retailers on the ground floor characterized as either short stay (impulse quick service food) or extended stay (table service restaurants). On the second floor, the Plan anticipates uses including office, services, fitness, beauty, food hall/cooking school/farmers market, and traditional grocer. At the park level, there are spaces for a full service restaurant and a café. The Plan anticipates leasing to a mix of businesses that offer goods and services at all price points to ensure that the transit center is accessible and appealing to a diverse population. The Plan anticipates certain demand from consumers and users of the transit center for local merchants.

In October 2017 the TJPA Board adopted a Retail Leasing Policy (Policy) that, among other things, authorizes the Executive Director to execute certain leases consistent with the Policy. The parameters within which the Executive Director can execute a lease under the Policy are: (a) initial term of 10 years or less (with no more than two options to extend at no more than five years each); (b) $1.8 million or less in stated base rent in the aggregate over the initial term (exclusive of any participation rent or other revenue); (c) tenant improvement allowance of not more than $150 per square foot; (d) lease agreement in substantially the form of the lease agreement template attached to the Policy; (e) lease generally consistent with the most recent Plan approved by the Board; and (f) lease consistent with the applicable Board-approved budget. Leases that fall outside of these parameters are presented to the Board for approval.

For FY18-19, the Board-approved budget for capital expenditures is $27,918,300. This assumes about 98,000 square feet of commercial/retail space construction would be funded in this fiscal year, with an average contribution from the TJPA of $113 per square foot in tenant improvement allowance ranging from $50 per square foot to $300 per square foot depending on the type of space from personal service business to full service restaurant (note that the TJPA does not expect that each tenant would be entitled to the budgeted level of contribution; the TJPA team intends to vigorously negotiate the agency's contribution, if any, toward a tenant's improvements and would expect greater rent as a result of any contribution the TJPA makes to the cost of tenant improvements). The average base building budget is $171 per square foot. Base building work includes topping slab, mechanical, electrical, plumbing and fire life safety installations. This amount will fluctuate on a per space basis. However, the expectation is that the overall budget is managed and is not exceeded in total.

Also, for FY18-19, Colliers developed a multi-year projected schedule for each space -- in other words, a projection (proforma) that outlines the targeted or market rent, the percentage increases for each year, the number of years in the term and the tenant improvement allowance. The proforma is individualized for each space because the proforma is influenced by the type of space and its location within the center. Under the schedule, stabilized first year rents total approximately $6.40 million annually which compares favorably with Lincoln's initial projected, stabilized rents of about $5.51 million annually.

As such, each proposed deal takes into consideration the approved budget for capital expenditures, the projected rent schedule, and adherence to the Plan as key factors in determining whether to proceed with a proposed tenant.

Commercial/Retail Leasing Transaction – Venga, Inc., a California Corporation

The following summarizes the key business terms of a the commercial/retail lease with Venga, Inc., a California Corporation (d/b/a Venga Empanadas).

Tenant Name	Suite #	Premises Area (sq ft)	Category	Stated Base Rent (over Initial Term)[1, 2, 3]	Initial Term (years)[4]	TI Allowance
Venga, Inc.	123	691	Food	$752,546.36 (avg ~$109 psf per year)	10	$58,735 ($85 psf)
Notes: 1. Exclusive of percentage rent. 2. Market conditions call for rent to be on a "gross" basis which means that common area expenses are embedded in the rent rate. 3. Reflects annual rent increases at 3% per year 4. One five-year options to renew at full market value						

The business terms are within the proforma for the premises as follows. Lincoln did a net present value (NPV) analysis using a market discount rate of 8%. The NPV of the 10-year deal is $404,521.04 based on a $85 psf tenant improvement allowance and a starting rent of $95.00 psf increased at 3% each year. The NPV of the proforma 10-year deal is $410,929.19 based on a $75 psf tenant improvement allowance with a starting rent of $95.00 per square foot increased at 3% each year. Square footage is 691. As such, NPV revenue is slightly unfavorable by $6,398.15. Base building improvements are estimated to be $234,984 compared to a budget of $267,620; a positive difference of $32,636 offsetting the slightly negative revenue NPV and making the overall business terms generally consistent with the pro forma.

Proforma		
Base Rent Over Initial Term	**Initial Term**	**TI Allowance**
$752,546.36 (avg ~$109 psf per year)	10	$51,825 ($75 psf)
Assumed 3% annual increases.		

Venga is currently in business at 433 Valencia Street, operating since 2011. And, they also have a location in Redwood City. The transit center location would be further expansion. This is a quintessential San Francisco, small business owned and operated by Pablo Romano and Paula Capovilla, both originally from Argentina. The Mission District location has been in business for ten years and offers accessibly priced selections from $3.95 for empandas to $6.25 for salad.

As such, a lease with Venga, Inc. is a favorable transaction for the transit center. It adheres to the Plan's expectation that the ground level would incorporate diverse restaurants at all price points consistent with the FY18-19 proforma. Also, the proprietors of Venga, Inc. are an established, financially sound business.

The terms of the lease are within the scope of the Executive Director's authority under the Retail Leasing Policy. The lease (a) is for an initial term of 10 years (with one option to extend at five years); (b) has a stated based rent of under $753,000 in stated base rent in the aggregate over the initial term (exclusive of any participation rent or other revenue); (c) the tenant improvement allowance is $85 per square foot; (d) the lease is in substantially the form of the lease agreement template attached to the Policy; (e) the lease is generally consistent with the most recent Plan approved by the Board; and (f) the lease is consistent with the applicable Board-approved budget. As such, the lease was executed on August 23.

Construction is expected to be completed in approximately six to seven months taking into consideration design and permitting. So, this timeframe will be earlier than the originally planned occupancy of Q2 and Q3 2019 for this particular space and, as such, ahead of schedule.

RECOMMENDATION:

Information only.

ENCLOSURES:

1. Venga, Inc. Lease