

**STAFF REPORT FOR CALENDAR ITEM NO.: 10
FOR THE MEETING OF: November 8, 2018**

TRANSBAY JOINT POWERS AUTHORITY

BRIEF DESCRIPTION:

Authorizing the Executive Director to execute a lease agreement with Ugochukwu and Carlynn Ihenacho (d/b/a Charleys Philly Steaks) for about 971 square feet of commercial/retail space on the ground level of the new transit center (space number 139) for a 15 year term.

EXPLANATION:

Commercial/Retail Leasing Background

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.

Proposed Commercial/Retail Leasing Transaction – Ugochukwu and Carlynn Ihenacho.

The following summarizes the key business terms of a proposed commercial/retail leasing deal with Ugochukwu and Carlynn Ihenacho (d/b/a Charleys Philly Steaks).

Prospective Tenant Name	Suite #	Premises Area (sq ft)	Category	Stated Base Rent (over Initial Term)^{1, 2, 3}	Initial Term (years)⁴	TI Allowance
Ugochukwu and Carlynn Ihenacho	139	971	Food	\$2,212,207 (avg ~\$152 psf per year)	15	\$97,100 (\$100 psf) plus \$399,624 landlord contribution for additional interior improvements

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 just under the proforma for the premises as follows. For a like comparison between the 10 year proforma deal and the proposed 15 year deal, Lincoln did a net present value (NPV) analysis using a market discount rate of 8%. The NPV of the 15 year deal is \$912,588 based on a \$100 psf tenant improvement allowance, \$399,624 in landlord contribution for additional interior improvements, \$312,260 for base building improvements and a starting rent of \$150.00 psf increased at 3% each year. The NPV of the 10 year proforma deal is \$928,312 based on a \$100 psf tenant improvement allowance, base building improvements of \$312,260 with a starting rent of \$150.00 increased at 3% each year. Square footage is 971. As such, NPV revenue for the proposed lease is slightly under NPV revenue of the proforma (\$15,724) or (\$1,048) over a 15 year term.

Extending the term from 10 years to 15 years garners additional revenue of \$542,493 to offset the cost of additional interior improvements above the \$97,100 allowance. Above-allowance improvements are estimated to be \$399,624. These funds will be applied to additional interior work as follows: electrical, grease duct and hood work, plumbing drains, flooring, ceiling, walls, cabinets and a restroom.

Proforma		
Base Rent Over Initial Term	Initial Term	TI Allowance
\$1,669,714 (avg ~\$172 psf per year)	10	\$97,100 (\$100 psf)
Assumed 3% annual increases.		

The proprietors currently have a location in Brentwood, California operating since 2007. The transit center location would be an expansion. Although Charleys is a franchise, as noted, it is a local, minority-owned, small business who have a track record of operating an established, financially sound business.

As such a lease with the Ihenachos would be a favorable transaction for the transit center. It adheres to the Plan's expectation that the ground level would incorporate reasonably priced and diverse offerings.

Upon full execution of the lease, 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 Q3 and Q4 2019 for this particular space and, as such, ahead of schedule.

As of the date of this report, the tenant is fully committed to moving forward by having signed a lease agreement wherein all the material terms and conditions have been negotiated and agreed to. The signed lease is attached. It is consistent with the TJPA Board approved template.

In that the initial term is in excess of 10 years and the stated base rent over the initial term is in excess of the \$1.8 million cap on the Executive Director's authority under the Policy, the proposed lease transaction is being submitted to the TJPA Board for its approval.

RECOMMENDATION:

Authorizing the Executive Director to execute a lease agreement with Ugochukwu and Carlynn Ihenacho (d/b/a Charleys Philly Steaks) in the form attached to this report.

ENCLOSURES:

1. Resolution
2. Ugochukwu and Carlynn Ihenacho lease

**TRANSBAY JOINT POWERS AUTHORITY
BOARD OF DIRECTORS**

Resolution No. _____

WHEREAS, The Transbay Joint Powers Authority (TJPA) is a joint powers agency organized and existing under the laws of the State of California to design, build, and operate the Transbay Transit Center Program (Transbay Program); and

WHEREAS, The TJPA's construction of the new transit center is nearing completion and the TJPA is actively planning for operational readiness of the facility, including negotiation of lease and use agreements with transportation operators; and

WHEREAS, 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 and its team member Colliers International (Colliers) are managing the commercial/retail leasing of the transit center; and

WHEREAS, In July 2017, the TJPA Board approved a Retail Merchandising Plan (Plan), and authorized the team to begin marketing and negotiations for retail leasing generally consistent with the Plan; and

WHEREAS, In October 2017, the TJPA Board approved a Retail Leasing Policy (Policy) authorizing the Executive Director to execute leases that meet certain criteria; and

WHEREAS, On TJPA's behalf, the Lincoln team has been negotiating lease terms with Ugochukwu and Carlynn Ihenacho (d/b/a Charleys Philly Steaks) for commercial/retail space on the ground floor of the transit center (Lease), and the Ihenachos have executed the Lease; and

WHEREAS, The Lease terms are consistent with the Plan, but the initial term and aggregate base rent over the initial term exceed the parameters of the Policy; and

WHEREAS, A lease with the Ihenachos would be a favorable transaction for the transit center. It adheres to the Plan's expectation that this portion of the ground floor would focus on food service businesses; it is near to the Fiscal Year 2018-19 proforma for net rental revenues at the premises; the Ihenachos run an established, financially sound business; and the business implements the Plan's goal to offer a variety of reasonably priced and diverse choices; now, therefore, be it

RESOLVED, That the TJPA Board authorizes the Executive Director to execute the Lease with the Ihenachos for certain commercial space in the transit center in the form presented; and, be it

FURTHER RESOLVED, That the TJPA Board authorizes the Executive Director to take all actions and execute all documents as he deems reasonably necessary to implement and effectuate the above approval.

I hereby certify that the foregoing resolution was adopted by the Transbay Joint Powers Authority Board of Directors at its meeting of November 8, 2018.

Secretary, Transbay Joint Powers Authority