INFORMATIONAL MEMORANDUM

TO: Agency Commissioners  
FROM: Fred Blackwell, Executive Director  
SUBJECT: To update the Commission on staff’s disposition strategy for the Agency-owned public parking garage at the Fillmore Heritage Center at 1300 Fillmore Street in the Western Addition neighborhood

PURPOSE OF INFORMATION

The purpose of this informational memorandum is to update the Commission on staff’s disposition strategy for the Agency-owned public parking garage at the Fillmore Heritage Center at 1300 Fillmore Street in the Western Addition neighborhood (the “Garage”). The Commission was last updated on this issue on August 4, 2009 in a separate informational memorandum (see Attachment 1). At that time, staff intended to transfer the management, and eventually the ownership, of the Garage to the City and County of San Francisco (the “City”). But, for reasons that are explained later in this memorandum, that transfer has not occurred, and staff is now recommending an alternative disposition strategy. This informational memorandum (1) presents staff’s recommended alternative disposition strategy, (2) describes the status of ongoing negotiations with the City to manage and own the Garage, and (3) presents historic performance data for the Garage. As part of the recommended alternative disposition strategy, staff intends to issue a Request for Proposals (“RFP”) for a garage operator, which will be discussed in a separate informational memorandum for the Commission’s October 5, 2010 meeting.

DISCUSSION

The Garage was completed in June 2007 at a cost of $5.7 million in Agency grant funds. It was built primarily to serve the two commercial tenants at the Fillmore Heritage Center: Yoshi’s jazz club and restaurant, and 1300 on Fillmore, another restaurant. It has 112 spaces but can increase its capacity to 160 spaces using valet and tandem parking. DAJA International Inc. (“DAJA”) has been managing the Garage for the Agency since late October 2007 (DAJA’s contract converted to a month-to-month contract in late October 2009.).

The Agency never intended to be the long-term owner of the Garage. The plan has always been to transfer the Garage to the City which manages several public parking garages through the City’s Municipal Transportation Agency (“MTA”). However, for a variety of reasons (discussed later in this memorandum and in Attachment 1), this transfer has not happened yet and it may not happen for some time. Staff intends to continue to work with MTA officials to effect such a transfer, but in the meantime staff is proposing an alternative disposition strategy: improve the Garage’s cash flow as much as possible and then sell it on the open market. Staff believes this plan has the greatest likelihood of success and could be accomplished within the shortest timeframe.
Recommended Disposition Strategy

Staff believes the Agency should do everything it can to enhance the value of the Garage before it is offered for sale. Since it opened, the Garage has operated at a deficit, which now runs at about $8,000 a month. To improve the Garage’s financial position, and thereby enhance its value to potential buyers, staff is proposing the following:

1. **Require performance-based financial incentives for the garage operator.** Staff proposes to issue an RFP for a garage operator (discussed in a separate informational memorandum for the Commission’s October 5, 2010 meeting) who will operate the Garage under a performance-based fee structure. Typically, this structure involves a low base fee, which the operator would receive regardless of the garage’s performance, and an incentive fee based on a percentage of net operating income, which the operator only receives if the garage performs at a high level. Staff believes this kind of tiered fee structure will motivate the operator to improve the Garage’s performance as much as possible. The Agency’s current agreement with DAJA does not include an incentive-based fee structure. Under the RFP, the Agency will be looking for an operator who can more aggressively and creatively increase revenues (i.e., more aggressive marketing and promotional opportunities, more aggressive solicitation of daytime monthly parkers) and more aggressively and creatively cut expenses (i.e., lower payroll costs, lower base management fee, tiered performance-based incentive fees). More information about the Garage’s historical and current performance is discussed later in this memorandum.

2. **Continue supporting efforts to expand the customer base at Yoshi’s.** The Garage’s performance is highly dependent on Yoshi’s performance. More than 80% of the Garage’s revenues come from events at Yoshi’s. Since it opened in November 2007, Yoshi’s has struggled financially due to operational inefficiencies and a lingering economic recession, both of which have limited the number of patrons at the jazz club and restaurant. For more than a year, Agency staff has been working very closely with the management team at Yoshi’s to improve the performance of the jazz club and restaurant. Toward that end, the Agency hired the Puccini Group, a restaurant operations and marketing consultant, to assess where improvements could be made and to recommend management and operations changes. Key recommended changes that have subsequently been implemented include: (1) cutting costs and streamlining the management team, including hiring a new general manager (who just started in August), (2) diversifying the menu offerings at the restaurant and lowering the price points, (3) diversifying the entertainment offered in the jazz club (i.e., blues, world music, comedy), and (4) more focused and targeted marketing efforts. Agency staff expects these changes to increase the number of people frequenting Yoshi’s and also parking at the Garage over the next several months.

3. **Continue efforts to reduce the Garage’s common area maintenance charges.** Unlike most garages, the Agency’s Garage is responsible for paying a portion of common area maintenance charges (“CAM Charges”) associated with managing the common areas at the Fillmore Heritage Center. These CAM Charges include shared utilities, security, insurance, and maintenance, among other things. The Garage shares these costs on a pro-rata basis with the owner of the commercial space and the condominium owners, who are represented by a homeowner’s association (“HOA”). These costs are significant and
represent more than 40% of the Garage’s total expenses. Over the last year, Agency staff has been working very closely with the HOA’s board of directors to open the lines of communication, improve relationships, and scrutinize the CAM Charges, line by line, to make sure they are as fair and frugal as possible. CAM Charges for all parties, including the Garage, were increased by 20% in May 2009 to more accurately reflect the actual shared costs of the building after more than a year of operations. This fiscal year, the CAM Charges for the Garage have remained basically flat, and now total $14,410 a month. While Agency staff will continue to work with the HOA board to try and lower this number, it is unlikely it will decrease dramatically in the foreseeable future, given the building’s present costs and reserve requirements.

Staff remains hopeful that these moves, along with an overall improvement in the economy, will improve the Garage’s financial position, and enhance its value to potential buyers. One complicating factor of a potential sale is that, under Section 33445 of California Community Redevelopment Law, the Garage would have to remain publicly owned until August 1, 2018, which is the estimated payoff date of the bond funds used to finance the construction of the Garage. However, this doesn’t mean that the Agency couldn’t sell the Garage to a private entity. It could, but the transaction would have to be on a lease-to-own basis until August 1, 2018.

The efforts mentioned above, however, are going to take some time to have an effect. Staff proposes assessing the situation in nine to 12 months to see if the changes noted above have made a difference in the Garage’s performance. At that time, staff will likely recommend to the Commission either (1) selling the Garage on the open market, even if the cash flow is still negative, or (2) moving forward with an agreement with the City for the management, and eventual ownership, of the Garage, assuming negotiations with MTA officials progress accordingly. The details of what has transpired on the City front over the last year are contained in the next section.

**Ongoing Negotiations with the City**

As discussed in the August 2009 informational memorandum to the Commission (see Attachment 1), staff were expecting to enter into a Memorandum of Understanding (“MOU”) with the MTA in late 2009 to manage and eventually own the Garage. Agency staff expected to join a previously released request for proposals issued by the MTA in April 2009 that was soliciting garage operators to manage several City-owned garages. Once these operators were selected, Agency staff expected the MTA to enter into a contract with the selected operator for the Garage in early 2010. However, there was a problem with the MTA’s request for proposals that significantly delayed the entire process and the solicitation document had to be reissued. This did not happen until April 2010. The MTA now plans to select the operators by February 2011 at the earliest, which means that the Agency would not be able to enter into the MOU with the MTA until June 2011 at the earliest.

**Garage Performance**

Since it opened, the Garage has operated at a deficit, which now runs at about $8,000 a month. Occupancy at the Garage is averaging only a little more than 50%, or about 2,218 cars per month. To break even, the Garage would need to handle about 613 more cars every month, or about 150 more cars a week (which translates into an occupancy rate of approximately 67%).
A summary of the actual and projected Garage operating budgets from January 2008 through December 2010 is presented below in three tables. The numbers, which are based on staff’s analysis of DAJA’s monthly profit and loss statements, show how the Garage is performing with and without CAM Charges. As shown, the “operating profit/loss” line excludes the CAM Charges and the “net income/loss” line includes the CAM Charges.

### Table No. 1
2008 Operating Summary – Fillmore Heritage Garage

<table>
<thead>
<tr>
<th></th>
<th>First Quarter 2008</th>
<th>Second Quarter 2008</th>
<th>Third Quarter 2008</th>
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<tbody>
<tr>
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<td>Net Income/Loss</td>
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### Table No. 2
2009 Operating Summary – Fillmore Heritage Garage

<table>
<thead>
<tr>
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<td>Revenues (Less Parking Tax)</td>
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### Table No. 3
2010 Operating Summary – Fillmore Heritage Garage

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<tr>
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<th>First Quarter 2010</th>
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<th>Third Quarter 2010 * (Projections)</th>
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<td>($96,268)</td>
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* The Third and Fourth Quarter 2010 projections are from DAJA.
The Garage’s basic problem is shown in these tables. Expenses have been trimmed over the last 2.5 years, but flat revenues over the same period have not been enough to cover the additional burden of the monthly CAM Charges. The primary driver of demand in the evenings is Yoshi’s. For most garages, the primary driver of demand during the daytime is office workers. Unfortunately, the Agency’s Garage is not located in an area with a large pool of office workers. There are very few office users in the neighborhood or large daytime draws, such as tourist attractions or concentrations of lunch spots. In early 2009, a lease with California Pacific Medical Center ("CPMC") for 50 to 100 parking spaces at $100/stall/month temporarily helped the Garage’s cash flow, but that lease was terminated by CPMC in August 2009. The current operator has not been able to secure a similar daytime lease, or find other ways to significantly increase daytime revenues.

In total, the Agency has paid about $440,000 in ongoing monthly operating subsidies for the Garage over the last 3.5 years (a subsidy of about $11,000 a month on average). This money was paid out of a property/asset management reserve in the Western Addition A-2 budget, which currently stands at about $343,500. This means that, assuming no change in the Garage’s performance, the Agency could only cover the Garage’s operating deficit for another 3.5 years.

NEXT STEPS

Staff is interested in getting the Commission’s feedback on the proposed disposition strategy presented above. As mentioned earlier, staff intends to inform the Commission of an RFP for a garage operator in an informational memorandum for the October 5, 2010 meeting.

*Originated by Tracie Reynolds, Manager, Real Estate and Development Services*

Fred Blackwell
Executive Director

Attachments:
Attachment 1: Informational Memorandum dated August 4, 2009 (w/o attachment)
INFORMATIONAL MEMORANDUM

TO: Agency Commissioners
FROM: Fred Blackwell, Executive Director
SUBJECT: To update the Commission on staff’s proposed long-term management/ownership plan for the Agency-owned public parking garage located in the Fillmore Heritage Center on Agency Parcel 732-A; Former Western Addition Redevelopment Project Area A-2

PURPOSE OF INFORMATION

The purpose of this Informational Memorandum is to update the Commission on staff’s proposed long-term management/ownership plan for the Agency-owned public parking garage (the “Garage”) located in the Fillmore Heritage Center on Agency Parcel 732-A in the former Western Addition Redevelopment Project Area A-2. The Agency’s agreement with the current garage operator expires in October 2009.

DISCUSSION

Garage Overview

The Garage has 112 parking stalls and was completed in June 2007 at a cost of $5.7 million in Agency grant funds. It was built primarily to serve the commercial tenants in the Fillmore Heritage Center (i.e., “Yoshi’s” jazz club/restaurant and the “1300 on Fillmore” restaurant). The Garage was financed with Agency grant funds because revenue bonds were not feasible. The Agency owns the Garage and has an agreement with EJI-HSM Property Management Company (the “Manager”) to manage the Garage. The Manager then in turn has an agreement with DAJA International Inc. (“DAJA”) which manages the day-to-day operations at the Garage. Both agreements, which are discussed in greater detail below, are set to expire on October 24, 2009.

Existing Garage Management Agreements

Before the Garage was completed, the Agency had anticipated that the Parking Authority of the City and County of San Francisco (the “Parking Authority”) would purchase or lease the Garage from the Agency and hire an operator to manage it upon its completion. Over several months in late 2006 and early 2007, Agency staff discussed a number of management/ownership alternatives with the Parking Authority and the Municipal Transportation Agency (“MTA”). However, the Agency was unable to effect this expected transfer to the Parking Authority at that time because of changes in the way the MTA owns and manages public garages and MTA’s concerns about the economic feasibility of the garage and its revenue-generating potential.
After negotiations with MTA failed to produce results, staff examined other alternatives to ensure that the Garage would be open in November 2007 when Yoshi’s and 1300 on Fillmore were set to open for business. Because there was not enough time for the Agency to issue a competitive solicitation through a standard Request for Proposals process, Agency staff proposed a non-competitively negotiated agreement with the Manager to manage and operate the Garage. The Commission, by Resolution No. 121-2007, approved a two-year agreement with the Manager and the Manager’s two-year agreement with DAJA. Both agreements are set to expire on October 24, 2009.

Actual and Projected Garage Operating Budgets

A summary of the actual and projected Garage operating budgets from January 2008 through December 2009 is presented below in Table Nos. 1 and 2. The numbers, which are based on staff’s analysis of DAJA’s monthly profit and loss statements, show how the Garage is performing with and without the common area maintenance charges (“CAM Charges”). As shown, the “operating profit/loss” line excludes the CAM Charges and the “net income/loss” line includes the CAM Charges.

### Table No. 1: Fillmore Heritage Garage - 2008 Operating Statement

<table>
<thead>
<tr>
<th></th>
<th>First Quarter 2008</th>
<th>Second Quarter 2008</th>
<th>Third Quarter 2008</th>
<th>Fourth Quarter 2008</th>
<th>Total</th>
</tr>
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<tbody>
<tr>
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<tr>
<td>Net Income/Loss</td>
<td>($55,881)</td>
<td>($37,447)</td>
<td>($30,889)</td>
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### Table No. 2: Fillmore Heritage Garage - 2009 Operating Statement

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<tr>
<th></th>
<th>First Quarter 2009</th>
<th>Second Quarter 2009</th>
<th>Third Quarter 2009 * (Projections)</th>
<th>Fourth Quarter 2009 * (Projections)</th>
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<tr>
<td>Revenues</td>
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<td>($70,453)</td>
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* The Third and Fourth Quarter 2009 projections are from DAJA and assume slight rate changes to be more competitive.

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1 CAM Charges are the operating costs (i.e., management, maintenance, repair, and insurance) associated with managing the common areas at the Fillmore Heritage Center building. The Garage shares these costs on a pro-rata basis with the owner of the commercial space and the condominium owners represented by the HOA.
As shown, the Garage initially ran an operating deficit but by the Third Quarter 2008 the Garage began making an operating profit, which is expected to reach about $25,000 by the Fourth Quarter of 2009. Revenues more or less hold steady during this period, while expenses have been reduced by about 35%. However, this operating profit is not enough to cover the CAM Charges, which were increased by 20% in May 2009 by the project’s Homeowners’ Association (“HOA”). As shown, the Garage’s net income (which includes the CAM Charges) is negative throughout this period, although the deficit is expected to decline by nearly 70% by the end of this year.

In total, the Agency has paid about $332,000 to cover the Garage’s operating deficits to date, of which $308,000 has gone to cover the CAM Charges and $24,000 has gone to cover other operating expenses. Over the last two years, staff has worked diligently with the Manager and DAJA to improve the performance of the Garage in an effort to eliminate the deficit. Some of these efforts include:

- Consolidating the two valet operations to increase the Garage’s utilization and reduce its operating expenses.
- Reducing the valet operations from seven days a week to four days a week (Thursday, Friday, Saturday and Sunday) to further reduce operating expenses.
- Reducing the number of Garage staff in the daytime to match the level of parking demand.
- Securing a monthly lease with California Pacific Medical Center (“CPMC”) for 50 to 100 parking spaces at $100/stall to generate much-needed daytime revenue. This two-year lease was projected to generate $5,000 to $10,000 per month beginning in January 2009. Unfortunately, due to low participation, CPMC decided to cancel this lease as of August 1, 2009. DAJA is now marketing the Garage to other firms in an effort to lease the bulk of the daytime parking spaces.

The Garage continues to face a number of challenges that are causing reoccurring deficits, most notably the CAM Charges and the current economic downturn. One key element of staff’s long-term management/ownership plan for the Garage is to generate positive net income. This plan is more fully explored in the next section of this Informational Memorandum.

Proposed Long-term Management/Ownership Plan

In November 2007, when the agreements with the Manager and DAJA were approved, staff indicated to the Commission that it would continue to explore long-term management/ownership alternatives and apprise the Commission of its findings. However, staff’s efforts have been hampered over the last two years by economic circumstances. While the Garage’s operating results had slowly improved in mid-2008/early-2009, the severe current economic downturn has negatively affected revenues. Due to declining revenues and the additional burden of the CAM Charges, the Garage does not break even, as discussed above. Therefore, staff believes it would not have been possible to discuss any kind of long-term management/ownership plan with outside parties. Staff believes that it is essential to first take the necessary steps to generate
positive net income before disposition is possible. With that in mind, the following summarizes staff’s proposed plan for the Garage over the next two to three years.

**Proposed Management Plan**

1. **Enter into a Memorandum of Understanding with the MTA to manage the Garage.**
   
   Agency staff has spoken with the MTA about the MTA managing the Garage for the Agency, and the MTA has agreed to explore a Memorandum of Understanding (“MOU”) (See Attachment 1). The Agency still would be responsible for any deficits, since the Agency would still own the Garage, but the Agency would get the benefit of the MTA’s garage management expertise and full-time garage management staff. This MOU would be similar to other MOUs MTA has with other City agencies, including one currently being developed for the Recreation and Park Department, which has hired the MTA to manage some of its garages. Under this proposed MOU, the Agency would join a recent Request for Proposals (“RFP”) issued by the MTA that is soliciting garage operators to manage several City-owned garages. MTA would then select a garage operator for the Garage and enter into a contract with an incentive-based fee structure with the selected operator (the Agency’s current agreement with DAJA does not include an incentive-based fee structure that sufficiently motivates the operator to improve the Garage’s performance). The MTA and the Agency will be looking for an operator who can more aggressively and creatively increase revenues (i.e., more aggressive marketing and promotional opportunities, more aggressive solicitation of daytime monthly parkers) and cut expenses (i.e., lower payroll costs, lower base management fee, tiered incentive fee).

   Agency staff believe MTA management of the Garage makes sense for a number of reasons: (1) the MTA’s expertise in managing and operating garages is more likely to result in profitability for the Garage, (2) economies of scale are achieved when one operator is managing several garages, which can help reduce operating expenses, and (3) the Agency would have to expend significant human resources to issue its own RFP in an area of very limited staff expertise. Under this proposed plan, the MTA’s management of the Garage would begin sometime in early 2010 when the garage operators are selected under MTA’s RFP. Until then, the Agency’s agreement with DAJA can continue on a month-to-month basis. Staff intends to bring this MOU before the Commission for its consideration as soon as possible. Agency staff also hopes to include in the MOU provisions allowing for good-faith negotiations with the MTA over the terms and conditions of an eventual transfer of the Garage to the MTA (which is discussed below).

2. **Work with the HOA to lower the Garage’s CAM charges.**
   
   The Reciprocal Easement Agreement (the "REA") governs the relationship and obligations between the Agency (as the owner of the Garage), Fillmore Development Commercial, LLC (as the owner of the project’s commercial space), and the HOA, which represents the residential condominium owners. The REA includes procedures and controls for assessing CAM Charges, and allows all three parties to provide input into the process for calculating and billing CAM Charges. This process allows the Agency to form an “Advisory Committee” with the owner of the commercial space. This Advisory Committee can then “meet and confer” with the HOA over issues related to the common areas, such as the CAM Charges. The Advisory Committee plans to meet with the HOA in coming days to discuss the recent 20% increase in CAM Charges from $11,985 to $14,382, the allocation of CAM Charges among the three
uses, and the line-item charges billed to each use, among other things. Agency staff hopes to reach an amicable solution with the HOA without having to go to binding arbitration as provided in the REA.

**Proposed Ownership Plan**

Assuming the CAM charges are reduced and an operator under an incentive-based fee structure is managing the Garage, and assuming the economy improves over the next 12-18 months, Agency staff believes the Garage will generate positive net income and become attractive to outside parties, including the MTA. The following outlines the proposed next steps toward disposition.

1. **Explore a possible transfer of the Garage to the MTA.** As mentioned above, Agency staff hopes to include in the MOU provisions allowing for good-faith negotiations with the MTA over the terms and conditions of an eventual transfer of the Garage to the MTA. Transferring ownership of the Garage to the City makes sense for a number of reasons: the Garage would remain publicly owned, the City is in the business of owning and operating garages, and the City already owns the nearby garage in Japantown, opening up the possibility for a more synergistic relationship with that garage. Although the Agency explored this idea with City officials more than two years ago, staff believes it is appropriate to open discussions again. Agency staff intends to negotiate as many community benefits as possible. Staff will keep the Commission apprised of how these discussions progress. On a side note, the project’s developer, Fillmore Development Associates, expressed no interest in owning the Garage.

2. **If transfer to the MTA doesn’t occur, consider selling the garage within two to three years when economy improves.** If the Agency and the MTA are not able to reach agreement on transferring the Garage, then the Agency will remain the owner and the MTA will continue to manage the Garage for the Agency. Once the economy improves, and the Garage generates positive net income, Agency staff could then sell the Garage on the open market. The Garage would still have to remain public until 2018 since the Garage was financed with tax increment dollars.

Agency staff is interested in getting the Commission’s feedback on the proposed approach discussed above.

*Originated by Ricky Tijani, Senior Development Specialist, and Tracie Reynolds, Manager, Real Estate and Development Services Division*

Fred Blackwell
Executive Director

Attachment:

Attachment 1: Letter dated July 28, 2009 from the Municipal Transportation Agency (“MTA”)